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COMMENT: Short-term sacrifices, long-term gains

Ishrat Husain | Published March 14, 2024

THE newly elected government faces an immense challenge as it steps into office, with high expectations from citizens to curtail inflation, alleviate poverty, create jobs and deliver essential public services while consolidating its fiscal and external accounts in an ever-shrinking space.

The problems, their analysis and proposed reforms are well known, yet the implementation remains a stumbling block.

The new government's implementation strategy must follow a two-step approach in which the political and economic incentives are aligned.

In its initial three years, the administration must undertake stringent and potentially unpopular structural reforms aimed at macroeconomic stabilisation and boosting domestic productivity. This foundation is crucial to ensure sustained economic growth. The leadership must also communicate and appeal to the public to bear these short-term pains to set the economy's direction right.

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If the government manages to implement these structural reforms steadily and faithfully, the intended outcomes are expected to start becoming gradually visible in the fourth and fifth years.

Such progress would manifest as reduced fiscal imbalances, more manageable external financing needs, expanded agricultural and industrial capacities, and a decreased reliance on excessive borrowing.

The single major constraint at present is the lack of confidence by investors and businesses about the adequacy of foreign exchange. By the fifth year, the government should aim to have built a healthy level of foreign exchange reserves, mirroring India's success story with its $600 billion reserves.

Our target of four to five months of import cover is achievable through uninterrupted reform implementation and consensus among coalition partners on both content and phasing of reforms. This strategy necessitates minimising current account deficits and maximising non-debt financial inflows.

Benefits

The benefits of building up this financial buffer are manifold.

First, it instils confidence among the economic actors that the country would be able to cater to their foreign exchange requirements as and when these arise. Second, export earnings, remittances, portfolio investment, IT industry and freelancers' earnings would flow in full without large leakages.

Third, these would provide stability to the exchange rate and discourage the speculators. Fourth, a stable exchange rate would remove the urge to use dollars as a medium of precautionary savings. Fifth, the administrative restrictions on imports that disrupt the domestic supply chain would no longer be necessary. Sixth, the foreign investors would be assured that their dividends, interest payments, etc. would be remitted on time. Finally, these would act as a buffer against unanticipated domestic and external shocks.

Now, the question is: How can this virtuous circle be attained on a sustained basis?

There is a successful precedent for the 2000-07 period when the foreign exchange reserves escalated from less than $1bn to $13.5bn. The total foreign multilateral and bilateral flows to Pakistan during this period accounted for 8.5 per cent of the country's total foreign exchange receipts.

The remaining balance of 91.5pc resulted from export earnings (doubled), remittances (rose fivefold), foreign direct investment (reached $5bn), a reduction in external debt (almost by one half), and a stable exchange rate. Inflation was in single digits, GDP growth averaged 6pc, the current account was in surplus in three out of seven years, and the fiscal deficit was manageable as tax revenues doubled.

Building up the buffers

Keeping this precedent in mind and considering the present situation, it is possible to outline practicable and specific policy measures that can build up the buffer.

First, we must raise our export-to-GDP ratio, which has declined in the last decade. Pakistan's exports were $25bn a decade ago, and at an average modest growth rate of 7pc annually, this would have amounted to $50bn by now. Adding $30bn of remittances, the imports of $80bn would have been fully funded with no recourse to excessive borrowing.

In the next five years, policy, investment and institutional interventions can help raise the exports-to-GDP ratio. We can do this by promoting non-traditional exports for which the world demand is rising, penetrating into Asean countries, increasing our exports to China under the FTA, relocating some of the Chinese sunset industries in special economic zones, engaging aggressively in the global supply chain, augmenting services exports and raising the productivity of our exporting firms.

New export-processing zones in Karachi and Gwadar with provision of all the utilities and developed infrastructure in place should be set up. Realistic energy pricing, regulatory overburden, tax harassment, delays in decision-making and arbitrary and unnecessary government controls are the issues that the Special Investment Facilitation Council (SIFC) can and should take care of immediately.

Second, the three areas that can augment foreign exchange earnings significantly are a) Information and Communication Technology through exports, freelancing, business process outsourcing, consulting, and provision of value-added services; (b) mining sector — as the world demand for copper is rising, strenuous efforts should be made to auction other blocks adjoining Reko Diq with a greater share of profits accruing to the province; and (c) tourism sector, including ecotourism, heritage tourism, religious tourism. The coasts of Sindh and Balochistan offer tremendous opportunities if the accessibility, infrastructure, quality of services, training and attitude of service providers are improved.

Third, the trade deficit in agriculture can be turned into a surplus by intensifying efforts for raising small farmers productivity in crops, dairy and livestock through improved seeds, fertilisers, efficient water distribution, credit, and getting the government out of the price fixation and procurement of wheat and sugarcane.

Allocations for research and technology transfer have to be increased and made through competitive grants, and a systematic coordination mechanism between the federal and provincial governments has to be strengthened. Modern technology can help boost the national average yields. Meat and poultry, fisheries and marine products, fruits and vegetables can collectively bring $3bn of exports annually.

Fourth, industrial production for critical raw materials and inputs such as oil refineries, petrochemical value chains, plastics, steel, aluminium, automobile parts and expansion in pharmaceuticals, engineering goods and electronics industries have to be incentivised. Excessive taxation burden and overregulation must also be eased to make the industries competitive.

Fifth, energy costs for industries and exports must be made equal to those charged by the competing countries. Foreign and domestic companies should be given free hand for exploration and production through remunerative well heads pricing, observing the sanctity of concession agreements, unshackling them from too many permissions and NOCs. The refinery policy is a welcome step in substituting POL imports.

Electricity cross-subsidies from industrial and commercial sectors to domestic consumers must be replaced by targeted subsidies for the poor and low-income consumers. Retail electricity and gas marketing and sales should be opened up to the private sector to compete while the transmission companies recover wheeling charges. Low-cost domestic fuels such as Thar coal and renewables should gradually substitute the imported fuels, thus reducing the burden on the import bill.

Sixth, immediate steps must be taken to fill in the skills gap, not only in the country but also in countries such as Japan and South Korea, which are grappling with an ageing population.

Technical and vocational training, digital skills, continuous professional education, short-term certification and accreditation courses, Artificial Intelligence-driven tutoring, internships, attachments with industry, industry-academia collaboration in designing the curriculums, course contents and assessment methods would all help in upskilling and reskilling of our youthful population.

These training and skill enhancement institutes should be managed and operated by the private sector. The remittances from overseas workers could rise at least two times the present level.

The above phasing of reforms is likely to strike a balance between political imperatives and economic revival. The only precondition is that the government is assured of a full five-year tenure without any direct or indirect political engineering or extra-constitutional interventions. The leadership would then be in a position to take those tough reforms that would eventually remove structural weaknesses of the economy.

The writer is a former governor of the State Bank of Pakistan

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