

WAQAR MASOOD KHAN

Import compression

A major aim of economic policy announced by the new government was to put a break on imports as they were the primary source of unprecedentedly high trade deficit of \$37.6 billion in 2017-18. The current account deficit, at nearly \$20 billion, was the highest in dollar terms in country's history though it was 8% of GDP in 2008. In this article we would examine how far the import compression policy has succeeded and what challenges continue to remain on the horizon for the current year. The analysis is based on shipment data as compiled by PBS.

At the outset, we note that the overall imports declined from \$60.8 billion to \$54.8 billion, a difference of \$6 billion or about 10%. On the other hand, exports declined by one percent from \$23.212 billion in 2017-18 to \$22.979 billion. Thus exports have not helped to narrow the trade deficit, which declined from \$37.6 billion to \$31.8 billion, which essentially is the decline in imports.

Before we analyze the structure of imports and sources of reduced demand, it is important that we also understand that imports are not necessarily bad for a growing economy. The structure of our imports is conditioned on some critical factors. First, we are dependent on imports for meeting our energy needs. Petroleum products and electricity are the prime examples. Of late, gas has been added to the list of imported energy products. Second, we needed machinery for capital investments which is critical for growth. Third, there is a large quantity of industrial raw materials such as chemicals, accessories, paper & board, raw cotton, basic raw materials for medicines and CKD kits to manufacture transport vehicles, and so on.

Fourth, there are certain food items which are needed for essential consumption such as milk powder and edible oil. These four categories of imports constitute a dependence that can be reduced significantly if we follow a policy of import substitution, which is a medium term proposition if not a long term one. In the short-run, unless there is a foreign exchange constraint that requires otherwise, limiting imports would lead to curtailment of economic growth as the foreign savings implicit in the current account would be reduced and consequently the overall investment resources would be reduced by the same size.

Now we examine the imports. Imports are divided into eight major groups namely the food group, machinery group, transport group, petroleum group, textile group, agriculture and other chemicals group, metal group, miscellaneous group and the rest are grouped in "all other". In 2017-18, the top five groups in terms of value of imports were petroleum (23.74%), machinery (19.03%), agriculture & other chemicals (14.67%), food (10.17%) and metals (8.81%). These add up to 76.42% of total import. Barring food items, everything else is needed to push the wheels of the economy. Any reduction in these imports would surely lead to a reduced output in the country as it would lead to a cut-back on investment (machinery) or domestic production (with few inputs available).

In this background, let us identify the top five groups of imports which have suffered decline. These include transport (30%), machinery (23%), miscellaneous (21%), textiles (12%) and food (8%). Notice that all the leading groups represent productive imports, except food, but as we noted earlier, some food products are essential such as edible oil and milk powder etc. It looks curious that the top five groups have shown fairly large declines yet the overall decline was limited to 10%. We would discuss this in a short while.

The declines in two leading groups, transport and machinery, are most significant. This was evident in the local production of automobiles, which declined by 11% during the period Jul-May last fiscal year. The next group is machinery which, as we said earlier, is indicative of the slowing investment. Within this group, it is the power machinery that was down by 53%, which was largest item in the group. This is also due to completion of power sector projects within the CPEC and the LNG-based power projects in the public sector. However, it must be realized that there are enormous investments needed to remove the bottlenecks in transmission and distribution. Therefore, such a precipitous fall in this sector needs special attention.

The fall in textiles imports is also significant and consistent with both the decline in exports as well as local production. These imports are mostly needed for manufacture of exports. The most significant import in this group is raw cotton of special variety which is not locally produced and used basically in high value added exports. This has declined by 29% in value and 31% in quantity.

Quite significantly, petroleum group is missing from the list of top declines. The reason is that it has shown a small increase of 0.08%. But when we look at the quantities of petroleum products and crude oil, the two have declined by 31% and 13%. This is consistent with the data of OCAC which showed a 25% decline in the consumption of petroleum products. In terms of dollar value, petroleum products have declined by 15% while crude oil imports have increased by 8%.

Thus we also have this new development where despite lower consumption we haven't saved equivalent amount in dollars. On the other hand, LNG is the major component of the petroleum group and its value has increased from \$2.5 billion to \$3.3 billion, showing a phenomenal increase of 36%. Even though the data on quantities of LNG is not available, the significant rise in value is due to higher price of Brent which remained elevated last year compared to 2017-18. Thus the higher value again represents the adverse price effect.

An inevitable conclusion is that the quantity effects of import decline are significantly higher than its value, which is indicative of adverse terms of trade the country faced last year. Accordingly, it is not surprising that the growth rate was steeply dropped from 5.5% to 3.3%. Even this rate has been over-estimated as we have argued on several occasions based on the data released since April 2019 when the revised growth rate was announced.

The upshot of the above discussion is that the economy has been slowed beyond the need of stabilization. Although the trade data for the month of July is not yet out, the government has announced the overall export and import figures. It is stated that the exports have increased by 14% while imports have declined by 18%. As for exports, this is a highly encouraging development. However, with respect to imports, it is continuation of the compression process that has already stifled growth last year and clearly it seems that the year is beginning with the same contractionary policies.

There is an urgent need to pursue a different set of policies that would help revive economic growth. The first signal in this regard has to be the interest rate which is excessively high and is contributing to uninterrupted decline of the stock market, where already the values have fallen to five-year low.

(The writer is former finance secretary) waqarmkn@gmail.com