

## **The economy in 2020**

The prime minister is assuring people that 2020 will herald an era of growth and jobs. He has said that 2019 a difficult year for the country as it was facing a turbulent economy that needed to be stabilized.

The prime minister's desire to make 2020 a year of growth and employment is laudable. This is what he had promised to his voters but had been bogged down in stabilizing the economy and in selecting the method for this purpose. By the time he finally accepted an IMF programme, his economic team had already administered, together with the caretaker government, some heavy doses of increased interest rate and unprecedented devaluation to rein-in the excess aggregate demand.

However, the Fund demanded further tightening in both these variables. Added to that was the SBP's decision to further hike the interest rate in July to its present level of 13.25 percent. These two policy instruments were supplemented by a fiscal instrument – new taxes. A tax collection target of Rs5550 billion was set which represented a growth of 45 percent over the last year. For this purpose, new taxes amounting to Rs750 billion were imposed in the budget.

As a consequence, the economy has indeed been stabilized, reserves have seen healthy growth, reaching \$11.5 billion (highest in 22 months) compared to less than \$8 billion a few months ago. The exchange rate has also stabilized around Rs155 which was where it was set after the Fund programme.

However, what has been witnessed in its aftermath is nothing short of an over-kill. Imports are already down by \$11 billion since July 2018, with exports rising by a paltry \$300 million. The loss of imports has led to a massive slow-down in industrial production, with large-scale industry down by 6.5 percent during Jul-Oct 2018 on top of a decline of 3.65 percent during 2018-19.

Thus, stability was achieved at the cost of something that is akin to breaking the fever via an antibiotic which in the process has left no energy in the body. Everywhere, production is on the decline, imports have stopped without giving a significant boost to exports. At the current rate, imports would be down by \$15 billion from the high level of \$60 billion in June 2018, without any significant rise in exports.

Last year, the GDP was recorded at \$284 billion, down from \$315 billion a year earlier. This loss of dollar GDP is a consequence of massive devaluation. Imports decline of \$15 billion would mean that a quarter of our imports are lost. The value chain associated with imports is extensive and all-pervasive. Nearly all sectors have been affected – from food to petroleum, from agriculture to metals and from textiles to machinery. Whatever is left has been made hugely costly because of devaluation.

So everywhere we see prices rising, peoples' incomes declining and demand cut down significantly. The inflationary spiral is also unprecedented. Food inflation is the main driver despite some respite in several food prices. Sensitive price index continues to remain elevated to near 20 percent weak after weak since July 2019, hitting low-income groups the hardest.

The production scenario in agriculture is also depressing. The main cotton crop is facing a major decline. The data on cotton arrivals until January 3, 2020 is showing a decrease of 21 percent over the same period last year, which crop was also short. The textile industry cannot survive without resorting to significant imports but its economics is bad. The recent ECC decision to remove import duty on cotton is timely. Sugarcane is also said to be lagging behind the target. Rice, on the other hand, is reportedly seeing a strong crop which would help lift overall exports.

The tax collection performance (16 percent growth) is definitely better than last year but nowhere close to the target of 45 percent or even with the reduced target by the IMF. The department is lamenting that it has faced a nearly Rs500 billion shortfall in revenue because of loss of imports. But this is an outcome of a flawed policy where massive devaluation was also coupled with additional taxation using additional customs duty, valuation of imports at the retail prices for tax purposes and regulatory duty, leading to unprecedented rise in prices of imported products. The domestic prices of products using imports have suddenly risen to previously unprecedented levels. With declining incomes, demand has nosedived thereby engendering fears of recession.

The squeeze on domestic credit is too harsh. As against a flow of Rs1.1 trillion until Dec 28, 2018, the domestic credit was negative Rs202 billion until Dec 27, 2019. Even after excluding the inter SBP-Scheduled Banks adjustment of credit to government, there is a significant decline in available credit. The credit to private sector during the year was Rs117 billion compared to Rs504 billion last year. These numbers, which would not be relaxed in any significant measure during the programme period, are sufficient to realize how far the economy would remain in stabilization mode and talk of growth would be premature.

The fact that a small increase in petroleum prices on the eve of the new year was passed on to the consumers shows how steadfastly the government is committed to stabilization and how it will not consider an opportunity to pass on relief to the consumers by lowering the high rates of petroleum levy currently applicable.

Under the circumstances, the prime minister's desire is unlikely to be realized without a significant respite in the Fund programme, which focuses on stability and not on growth. The average growth in the three-year programme would be slightly less than 3 percent. After an anaemic growth rate of 3.3 percent year (which some economists estimate at less than 2 percent), this year it is projected at 2.4 percent – woefully inadequate for job creation.

In an environment of high interest rate, declining production, both in industry and agriculture, rising prices, declining credit to the private sector (a proxy for investment), muted growth in monetary assets and a general feeling of despair, the necessary elements that unleash growth are missing. The prime minister has to redraw the economic strategy if he wants to follow a path that would spur growth and create jobs. The present course is unfit to meet his desire.

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