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Trade deficit - an equitable analysis

Trade deficit is good if it generates the required value addition within an economy, and results in a good exploitation of trade through productive investments that enhance the industrial sector's capacity for future consumption and productivity. As a result of highly contractionary fiscal and monetary policies, the competitiveness of Pakistan's economy, has been severely dented, as the country is dependent on certain imports, including capital goods and raw materials. A higher trade deficit can be both good, or, bad for an economy, just like at times the contraction of trade deficit transpires into a problematic scenario for domestic industries for the long-run. If a country remits qualitative imports from another country, it can generate higher benefits in future. Resultantly, a major cut-down in imports to influence trade deficit, is not always healthy for an economy, as it can force a country to miss out on future potential gains for the industrial sector which will lead to an eventual slowdown in the economy.

Capital goods such as; power generating machinery, office machinery, construction-related raw material, mining machinery, automotive, iron and steel, among other things, create a large impact on the industrial development and economy, that is relative to their production capacity. Similarly, raw materials such as cotton, yarn and textile fiber are the prerequisites needed to produce final goods within an economy.

The table above depicts an interesting relationship between capital goods imports, trade deficit, industrial sector and GDP growth. Across the following five years; FY2013-14 to FY2017-18, despite a large trade deficit Pakistan, has had higher industrial and GDP growth. This was due to mega infrastructure and CPEC-related machinery which later contributed to the surge in the demand of capital goods import of transport, textile, iron and steel etc. In absolute terms, imports of capital goods including machinery, transport, textile, iron, and steel scrap, among other things were recorded at a peak $19.936 billion during FY2017-18. On an average, $15 billion capital goods were imported per year during the abovementioned time span. This 'injection of capital goods' had a multiplier effect on the manufacturing sector, which in turn accelerated the industrial sector, created jobs and furthered the expansion of the economy. On account of an overall positive sentiment in the economy, coupled with the revival of the industrial sectors, the gross fixed investment as a percentage of the GDP (private and public) grew from 13% in FY2013-14 to around 15.1% in FY2017-18.

With higher imports of capital goods, the industrial sector within Pakistan's economy grew consistently from 4.53% in FY2013-14 to maximum levels of 5.69% in FY2015-16. By the end of FY2017-18 which was the last year of the previous government, industrial sector growth of the country had increased by 4.92%. Although, the imports had also grown significantly, the quantum impact of capital-goods imports had a larger impact on the growth of the aggregate investment in the country. The share of capital goods imports during the same period showed an upward trajectory, and grew from 25.51% FY2012-13 to 35.23% FY2017-18. Moreover, on one hand, the country recorded a GDP growth of more than 5.5%, while on the other, it also attracted substantial financial and capital inflows of worth $44 billion from FY2013-14 to FY2017-18.?

Furthermore, Pakistan had also initiated three LNG-based power projects with a total incremental capacity of 3,561 MW. Moreover, two coal-fired projects with a total capacity of 2,563 MW also started contributing to the national grid in FY2017-18. Hence, the contribution of gas and coal in the country's power generation witnessed a significant surge to 35% in FY 2017-18, as against the 10% recorded last year. It may be noted that around 60% of imported LNG later consumed by the power sector increased the overall energy imports bill by 30% to $14.43 billion in FY2017-18 vs. $10.92 billion in FY2016-17. However, it had a tremendous impact on our industrial development, as massive building-up strategic assets not only significantly added value to the same. It is pertinent to note that it was due to the abovementioned positive impact that Pakistan's jumped 8 places, from 36th to 28th, in the list of the largest steel producers in the world. Pakistan's manufacturing sector growth was recorded by a revised figure of 4.92%, on account of a strong performance of the LSM, a private sector offtake, and higher capital goods imports including a surge in steel import scraps by 24%, and a 20% growth in domestic steel production.

Under such a booming scenario, the price of capital-goods imported within the country becomes 'cheaper' in the long-run, considering its role with regards to its aggregate contribution in boosting demand, productivity and economic growth of the country. Hence, every incremental stock of imported capital goods acts as a catalyst to multiply domestic value production significantly if the respective political government provides a conducive environment to the private sector and businesses.

The economy of Pakistan faced a roller-coaster ride during the years 2008-09 to 2012-13, due to external and internal shocks, including but not limited to, a crumbling energy crisis, a contraction in the manufacturing sector, bleeding within the public sector entities, severe economic mismanagement, security hazards, and a global economic slowdown. The power crisis alone trimmed 2% of the GDP annually, and negatively impacted the industrial growth of the country. According to the Economic Survey of 2012-13, the Pakistani economy grew at an average rate of 2.9% per annum during 2008-09 to 2012-13 as compared to the rate of 7% per annum during 2003-04 to 2007-08. The share of the import of capital goods remained stagnant, both in terms of percentage to total imports, and in terms of quantum. In the wake of import compression policies and high input costs, the manufacturing sector suffered a serious setback that slowed down the industrial sector, and along with it, economic growth.

Similarly, under the incumbent government, due to a tight monetary environment, a crowding-out private sector, and tough regulatory interventions from the Federal Government, the ministry of finance has cut down on imports of the following capital goods; machinery, transport, textile and iron and steel scrap. The imports of the aforementioned capital goods, have gone down from being $20 billion in FY2017-18, to $16 billion in FY2018-19. Moreover, the share of capital goods imports have also dropped from being 35.23% in FY2017-18, to 30.73% in 2018-19, in terms of percentage to total imports and in terms of quantum which is affecting industrial development of the country in a negative manner. Interest rate hikes, additional taxes, and power tariffs surge has restricted the growth of the private sector. Furthermore, a massive devaluation of the Rupee has further escalated cost of imported raw material and capital goods needed to run businesses. The acceptable 'economic theory' has turned upside-down in the wake of massive import-compression policies, which has led the country to one of the worst economic slowdowns, which is restricting future potential gains.

Following the prescriptions of the IMF, despite a shrinking trade deficit, the country's industrial growth and GDP growth have significantly dropped consequent to a massive cut in imports of capital goods and raw material; imports whereof are needed to spur growth. On account of a tight monetary regime, a drop in public sector spending, a curbing aggregate demand, and an overall slowdown in the economy, the gross fixed investment as a percentage of the GDP (private and public sector) has dropped from being 15.1% in FY2017-18, to around 13.8% in FY2018-19.

If the economy grows over 5.5% of the GDP, the rise in the domestic demand on account of strong economic growth will then bring in investments, relative stability, enhance productive capacity in industrial sector and much needed value addition, along with the surge in imports. Neither the developed, nor developing countries, can produce all the goods and services they need. In order to post growth a country has to incur deficit to create required a level of balance in the economy.

In pastimes, with relative stability in exchange rate and a better amount of foreign exchange reserves held with the SBP, the country has had a high GDP growth despite a growing trade deficit. Pakistan's real GDP grew consistently at an average rate of 7% during FY2003-07 with improved SBP reserves, a stable exchange rate and trade deficit. Similarly, during the previous two regimes, between 1990-1993 and 2013 to 2018, Pakistan experienced a relatively higher GDP growth, stability in the Rupee against the US dollar, and large foreign exchange reserves, even with a surge in trade deficit.

It is not necessary that Pakistan observes an economic growth only if the trade deficit comes down. If that was to be the case, then one may ask as to why has Pakistan been facing an economic slowdown due to the policies of the incumbent Government, despite a 30% contraction in the trade deficit? That has led to Pakistan has been facing stagflation, which has impacted citizens belonging to all social classes within our society. In this writer's view it is time to stop the 'repeated misleading' trade deficit rhetoric, and look at the economy as a whole. This country needs to trade¬off between consumer and capital goods which impact economic growth, contingent upon the choices being made, as every choice has a cost to deal with. A growing trade deficit is not always burdensome for the economy, or a sign of worry for that matter, as an allocation of higher resources to capital goods is likely to lead to higher industrial growth and GDP growth in the long run.

Majority of the contemporary Economists are of the view that policymakers must not be over-concerned with the growing trade deficit. The policymakers should, instead of only striving for reducing the trade deficit, pursue structural transformation for sustained industrialization at a national and international level to encourage the private sector for the GVC (global value chain) phenomenon by reforming the entire manufacturing sector. This dream of industrialization can only be materialized if there are favorable macroeconomic and trade policies introduced, and such a conducive environment is generated due to such policies. With that being said, infrastructure bottlenecks must also be addressed, and policy measures must be revisited to increase competitiveness. Nevertheless, the high cost of doing business must be curtailed or brought down, by gradually reducing interests' rates, fixing the circular debt syndrome, and improving the cheap credit availability for the private sector, along with an effective import-substitution strategy that creates an export led-growth in the economy.