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Money Matters

The deficit antidote

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By **Rai Nasir Ali Khan**

Pakistan is pitted against a pile of challenges, cropping out of ever-yawning current account and fiscal deficits that have brought the economy to the brink of bankruptcy, necessitating a 'take the bull by the horns' approach to reforms instead of bogging itself down deeper and deeper into indebtedness.

Pakistan is pitted against a pile of challenges, cropping out of ever-yawning current account and fiscal deficits that have brought the economy to the brink of bankruptcy, necessitating a 'take the bull by the horns' approach to reforms instead of bogging itself down deeper and deeper into indebtedness.

If we look at the numbers, the current account deficit during FY2018 widened 42.6 percent to $17.99 billion compared to $12.62 billion in the previous year. On the other hand, during the period under review, the trade deficit swelled 16.5 percent to $31.1 billion compared to $26.7 billion during FY2017.

Our exports (free on board) during FY2018 bounced back to reach $24.8 billion, which is 12.6 percent higher compared to $22 billion during FY2017.

This rebound was a result of economic recovery of our major export destinations, which revived demand, and improving local economy that boosted supply side and exportable surplus. The various other factors like prime minister's exports facilitation package, an increase in the international prices of commodities like cotton and rice, depreciation of rupee, improved energy supply, and better law and order situation, also restored investors confidence and thus exports.

Imports during FY2018 hit a staggering $ 55.85 billion, up 14.7 percent compared to $48.68 billion registered in FY2017. The rising imports can be attributed to improving growth, China-Pakistan Economic Corridor (CPEC) and other developmental activities. The machinery group imports posted a growth of 20 percent, petroleum group 25 percent, metal group 30.3 percent, while transport group registered an increase of 21.3 percent in the period. Moreover during the last fiscal year, additional imports of over $7 billion were also recorded with food group contributing 1.1 percent, machinery group 20 percent, transport group 7.9 percent, petroleum group 37.1 percent, agriculture and other chemical group 16.6 percent, and metal group 15.5 percent.

Over the years workers' remittances have remained a mainstay of our external sector. During FY2018, remittances rebounded to hit $19.6 billion, showing a growth of 1.4 percent.

Foreign Direct Investment (FDI) is also an important source of non debt creating foreign inflows. However, it almost remained stagnant at $ 2.77 billion during the last two years. Amid a rising current account deficit and FDI stagnancy, the government floated bonds worth $2.5 billion during FY2018 and also borrowed $ 8.4 billion from other bilateral and multilateral agencies, while it repaid an amount of $4.1 billion in last fiscal year.

However, the widening current account deficit, amid insufficient financial inflows to finance it, mounted pressure on State Bank of Pakistan's (SBP) liquid foreign exchange reserves that declined by $6.4 billion, and rupee depreciated 11.9 percent against dollar on a year-on-year basis, whereas the real effective exchange rate (REER) depreciated 12.3 percent year-on-year.

In FY2017, Pakistan's exports as a percentage of GDP were 7.2 percent, while India's stood at 12.4 percent. Similarly, Pakistan's imports were 16 percent of the GDP and Indian's 17.3 percent. The trade deficit, during this period, for Pakistan and India was 8.7 percent and 4.9 percent of the GDP, respectively.

During FY2017, invisibles credits (services, workers' remittances and other income) as percentage of the GDP in India and Pakistan were 10.6 percent and 9.8 percent, while invisibles debits were recorded at 6.4 percent and 5.2 percent of the GDP, respectively.

Resultantly, India and Pakistan's current account deficit was 0.7 percent and 4.1 percent of the GDP, respectively. The foreign investment in India and Pakistan was 2.2 percent and 0.9 percent of the GDP, respectively.

It is evident that Pakistan needs to enhance its exports by 4-5 percent of the GDP and also encourage non debt creating inflows like FDIs to make its external account sustainable.

Pakistan is facing twin deficit challenge. The fiscal deficit affects the trade and current account deficit as the enhanced public expenses lead to higher domestic demand, which is partially met by additional imports. Our propensity to import is high and in case the increase in exports does not keep pace with the imports, which generally happens in Pakistan, the trade deficit goes up. Furthermore, fiscal expansion increases the demand for money that ultimately pushes upward the markup rate. In turn, it raises the cost of doing business and adversely affects competitiveness of the domestic industry.

In this regard, following initiatives are suggested to ease the pressure on external sector:

During the last five years, the GDP growth rate has started picking up. The higher economic growth increases the demand for imports. In the wake of low revenue and exports growth, the twin deficits continue to threaten the macroeconomic stability. There is a need to pursue a growth strategy which holistically addresses structural imbalances and improve overall investment climate. This will support economic growth and promote exports. At the moment the level of both private and government consumption is high in relation to the peers, whereas investment is very low.

Pakistan's major problem for growth in economy as well as exports traces its origin in inadequacy of investment in key areas. The investment in the past could not create incentive structure for exports-based industry in the country. The FDI inflows are not only low but they are not coming in export-oriented sectors. We need to enhance the FDI by improving image of Pakistan and key rankings in indices like Ease of Doing Business (EODB), Human Development Index (HDI), and Global Competitiveness Index (GCR).

Pakistan ranks at 115 in Global Competitiveness Report (GCR) 2017-18. In terms of institutions, infrastructure, macroeconomic environment and health and primary education, Pakistan is placed at 90, 110, 106 and 129, while India ranked at 29, 66, 80 and 91. Our position with other countries like Vietnam, China, and Sri Lanka is also not well. According to researchers, the competitiveness effect includes trade policy, changes in the real exchange rate, tariff structure and structural reforms. We need to improve our competiveness.

On EODB status Pakistan dropped to 147th rank from its previous 144th position. The World Bank's EODB report uses 11 indicators to measure aspects of business regulation that matter for entrepreneurship. We need to improve on these indicators to encourage investment in the country and reduce cost of doing business.

Trade integration and facilitation have positive and significant impact on economic growth. It helps to increase volume of trade. However, according to EODB 2017-18 report's indicator on Trading Across Borders Pakistan is ranked 171, while India, Vietnam, China, and Sri Lanka stand at 146, 94, 97, and 86, respectively.

Fiscal slippages amid slow growth in revenue compared to rising public sector spending demand put additional pressure on external sector. Pakistan is confronting with deteriorating twin deficits; current account and fiscal deficits have climbed from 1.7 percent and 4.6 percent of the GDP in FY2016 to 5.7 percent and over 6.5 percent of the GDP in FY2018. Thus, it requires concerted efforts to mobilise more resources through broadening the tax base and compliance, containing current expenditures through turning around loss-making public sector entities and maximising utility of development funds through effective appraisal, monitoring and evaluation of development projects.

During a recent seminar, Dr Pervez Tahir, former chief economist, emphasised upon drastic restructuring and revamping of tax machinery. It will help achieve tax-to-GDP ratio of 18 percent as envisaged in Vision 2025.

Fiscal dominance of monetary policy is adversely affecting credit to private sector. During FY2018, the government borrowed an amount of Rs1,367 billion from the SBP for budgetary support ,whereas credit to private intake was Rs 775.5 billion. The central bank should be given full autonomy in conduct of monetary policy.

Global supply chain has transformed the manufacturing world and revolutionised development options and standards of living. We need to encourage integration with global supply chains for higher and sustainable increase in economic growth.

The concessions granted under Free Trade Agreements (FTAs) to various countries may be appraised in terms of their impact on bilateral trade and, thereafter, reviewed/renegotiated.

Artificial overvaluation of exchange rate affects external competitiveness unfavorably because it leads to fewer jobs, small businesses can't compete with cheap imports and farmers do not get a fair price for their crops. So, we need to follow an exchange rate policy aimed at maintaining a competitive real exchange rate and make it more flexible.

Pakistani expatriates played a critical role in bringing resources, experience, technology, and providing access to markets. Pakistan is blessed with extremely gifted diaspora.

Pakistani diaspora is contributing in financing the balance of payments requirements through sending much needed foreign exchanges earnings. Over the years, workers' remittances have shown gradual increase however it is slowing down now.

Ministry of Human Resource Development and Overseas Pakistanis may address mismatch of demand of skilled manpower and assess the demand abroad in various sectors like health and information technology on regular basis and arrange skilled manpower.

Furthermore, it should also focus on new markets for manpower exports as well as convince our traditional destinations for awarding more work permits to our workers. Finance Division may also launch diaspora bonds/saving certificates to tap the savings of Pakistani Diaspora.

In addition, we also need to focus on diversification of exports in terms of products and markets. Efforts should be strengthened for exploiting full potential of GSP Plus status granted by EU in 2014 and adherence to conventions covered under the agreement. Improving quality and getting certification of our products. Promotion of exports of services also needs to be encouraged and incentivised.

The writer is chief economist at Planning Commission of Pakistan