2020: NOW OR NEVER

SYED HUSSAIN HAIDER* & SYED ALI HASHIM ZAIDI**

Abstract

Year 2020 will witness the conclusion of the first year of an economic stabilization phase under the current International Monetary Fund (IMF) program. Hence, the mere improvement of macroeconomic indicators (the twin deficits, for instance) should ideally not be cause for celebration. What else can be expected of a heavily front-loaded IMF program? Either way, we had wandered down a dark road and have just started our journey to redemption.

Pakistan will turn 100 sooner than we'd like to think. Yet, it's history of unforgiving boom-bust cycles continues unabated. Argue all one may about the decision to go to the IMF, the fact is that the program has been chosen as a panacea to the country's immediate ailments and macroeconomic indicators should eventually fall into place as they always have. Would it not be prudent then to keep broader issues the centre of attention in gatherings related to the economy?

These issues and their solutions are not guarded secrets; libraries of credible literature are readily available. Why then, even with the abundance of such information, do our problems still linger? The simple fact of the matter remains that inability to solve a problem can arise for two broad reasons: either the absence of willingness or lack of ability. Hence, the intent and implementation capacity of those ultimately responsible should always be closely monitored. Nevertheless, if the impressions that are now being created actually materialize, Pakistan could finally embark on a path of sustainable growth, particularly considering its vast untapped potential.

To discuss the outlook for 2020, this article will pivot on the latest IMF Staff level report, released just recently, which provides a rather comprehensive numerical depiction of Pakistan. Whether or not one agrees with the report's forecasts, it cannot be argued that it does serve as a starting point. More importantly, this article will then discuss the broader issues at hand in light of the clues we are getting regarding the direction that the country is headed in.

IMF and the road ahead

The IMF has maintained Pakistan's Gross Domestic Product (GDP) growth forecast at 2.4% for FY20. This estimate seems closer to reality than the 3.5% put forth by local authorities, given the slowdown prevalent in large scale manufacturing and agriculture sectors in particular. On inflation, the IMF has revised its FY20 forecast from 13% to 11.8%, which falls in line with government estimates of 11-12%. Given that the recent hikes in power tariffs are being used to alleviate the circular debt in the immediate term, one should hope that they have been factored in in the inflation forecasts. Otherwise, one should brace for inflation shooting beyond these estimates. Moreover, higher oil prices remain another critical risk. In such cases, it should not be surprising if interest rate cuts do not materialize as is generally expected. However, such rates are unsustainable for an economy such as that of Pakistan, particularly considering the hikes of 2019. Broader market expectations with regards to policy rate cuts are around the 200bps mark during 2020.

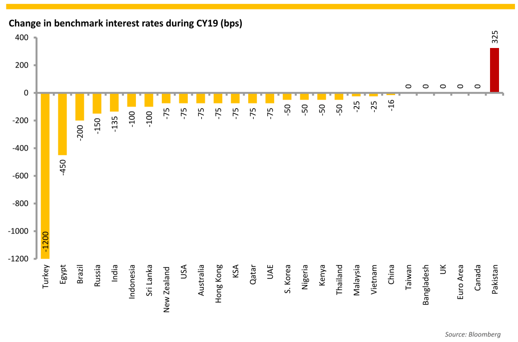
CHART 1

IMF Projections, Dec 2019		Actual		Estimate	Projected				
		2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Real GDP Growth	%	5.2	5.5	3.3	2.4	3.0	4.5	5.0	5.0
Inflation (period Avg)	%	4.1	3.9	7.3	11.8	8.3	6.0	5.0	5.0
Current Account Balance	US$ bn	-12.6	-19.9	-13.8	-6.6	-5.9	-5.9	-6.0	-6.8
Current Account Balance	% of GDP	-4.1	-6.3	-4.9	-2.4	-2.0	-1.8	-1.7	-1.8
Gross FX Reserves	US$ mn	16.1	9.8	7.3	11.2	14.8	20.7	27.1	30.5
Primary Balance	% of GDP	-1.6	-2.2	-3.5	-0.6	0.9	1.9	2.6	2.6
Budget Balance	% of GDP	-5.8	-6.5	-8.9	-7.6	-5.5	-4.0	-2.8	-2.6
Government Debt*	% of GDP	70.0	75.2	87.8	84.7	81.4	77.6	73.6	69.8

* General govt. & govt. guaranteed debt (incl. IMF)

Source: IMF

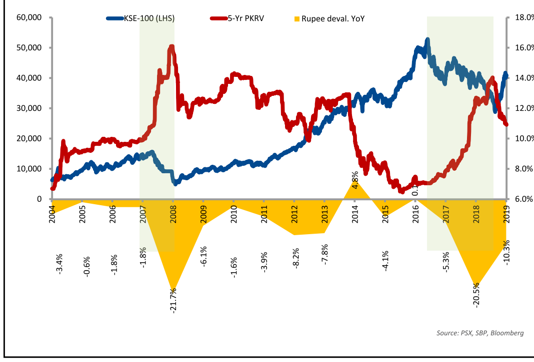
CHART 2



Beyond the stabilization phase of FY20, the IMF has forecasted that GDP growth will accelerate, the rate of inflation will slow down and macro imbalances such as the twin deficits will reach more manageable levels. But this is nothing new, rather a re-run of what has repeatedly happened in the past. Yet again, the stock market pre-empted the turnaround, reaping 42% gains from the lows in mid-August'2019 till end of CY19. At the same time, bond markets had been giving telling signs.

The external account situation has shown considerable improvement during 1HFY20. The current foreign exchange reserves levels have reached relatively safer levels. In fact, they currently stand near the IMF's year-end targets. The Current account deficit (CAD) is expected to comfortably beat the IMF target of US$6.6

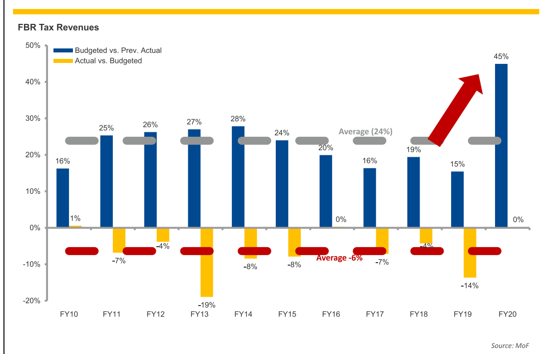
CHART 3



billion. And this reflects in the exchange rate which appreciated by nearly 3.6% during 1HFY20 as against general fears of a horrendous depreciation spell. Although the IMF does not specifically publish exchange rate forecasts, the implied rate using the latest Staff level report shows that the IMF expects the Rupee to depreciate by 3.7% per annum leading upto 2024 as against 4.8% implied in the previous report (July, 2019).

However, one summit that has remained insurmountable so far for the government is the high revenue collection target set by the IMF and that too right from the very onset of the program. The front-loading severity of revenue collection

CHART 4

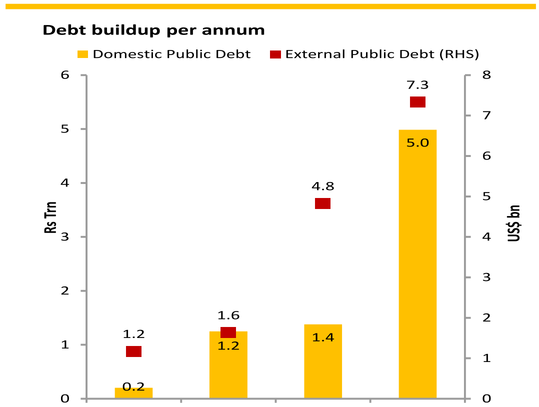


targets can be gauged from the fact that the IMF is aiming to lift the tax-to-GDP ratio from 12% in

FY19 to 14.2% in FY20 and then 15.9% in the following year. This is by no means an easy feat to achieve. So far, during 1HFY20, total revenue collection stands at Rs2.08 trillion. Such is the size of this target that despite collection being 17% higher YoY, there remains a shortfall of Rs287 billion. In this situation, conventional wisdom dictates that something has to give – in a more favourable scenario, a waiver would be granted while on the other end lies the cameo appearance of a mini budget (a real one this time). If all else fails, perhaps an option that has been ignored for far too long would eventually have to be considered, i.e. expenditure cuts. Here, one can be forgiven for confusing expenditure cuts with merely development expenditure cuts, given what has happened in the past. This will most likely not be the case anymore, as it could require a re-haul of the government apparatus that we have grown accustomed to.

Alarmingly, government debt as a percentage of GDP has already reached record highs; yet the IMF has forecasted this ratio to fall gradually from current levels going forward (refer to IMF projections tabulated earlier).
One caveat is that the tacit assumption in this forecast is high growth in revenue collections. But in the unfortunate scenario that revenue collectiontakes longer than expected to match the desired pace, how will the authorities manage to bridge the shortfall? The answer is obviously expenditure cuts. Again, to emphasize, these cuts could reach proportions that have not been seen, at least in recent history.

CHART 5



Foundations of the state

Before moving on to the broader challenges at hand, it is imperative to highlight that speaking about them puts one at the risk of venturing beyond the limits of time. Such is their vastness. Regardless of perspective, there is tremendous amount of work that needs to be done in Pakistan's social and physical infrastructure. With the aim of covering maximum ground, the article adopts a 'to-the-point' strategy. Either way, there is no arguing that libraries of credible literature on the topic are anything but scarce. This article simply attempts to present the beating heart.

The three areas of focus should be:

1. Meritocracy
2. Planning
3. Education

Judiciary, Legislature and the Executive may be the three pillars of state, but meritocracy, planning and education form the foundation on which these pillars continue to stand. And these strong foundations have, for decades, allowed great nations to remain great and developing nations to prosper.

Interestingly, if one simply works on meritocracy, all else will fall into place. An effective workforce will automatically pave the path towards proper planning. And proper planning should prioritize education.

Meritocracy

First and foremost, meritocracy should be ensured at all levels. The term simply means that competent people should command areas that they excel in. In other words, the right people for the right jobs. All of them! It is quite similar to solving a puzzle; all the right pieces need to fall in the right place to get the desired result. For instance, the current Federal Board of Revenue (FBR) chairman was appointed to ensure revenue generation. One piece of the puzzle in place. So far, so good. But the appointment of just one individual is grossly insufficient to tend to Pakistan's myriad fiscal troubles; the expenditure side remains largely unattended to. For instance, while the FY20 budget did see salary cuts in the federal cabinet, one should ask whether the country really needs such a large cabinet, especially in times of fiscal austerity. Would Pakistan not be better off without the extra workforce and countless ministries that we see constantly arguing over jurisdiction? Since when did clutter become an integral part of governance? Can the country not survive on skeleton staff?

Planning

This thought leads us into the realm of planning, which needs no elaboration. As mentioned above, planning can be considered as a function of meritocracy. Hence, meritocracy in letter and spirit should help avoid major shortfalls in formulation of consistent and effective policy. At the risk of making it sound like a history lesson, past – and some very recent – hiccups are presented below.

- It has lately been quoted that data has surpassed oil to become the world's most valuable resource. And it is disheartening at the very least to say that in Pakistan, even a man-made resource as vital as this needs substantial nurturing. 72 years since independence, it remains a dream to see Pakistan Bureau of Statistics (PBS) become an autonomous body, free from conflicts of interest.
- Another interesting point can be found in the annual budget speeches. It is no less than a mystery how it is possible for individuals placed at ministerial positions to provide annual estimates of the country's account so far from the actual numbers so close to the year end. For instance, the estimated fiscal deficit (as percentage of GDP) for FY19 was announced at 7.1% in the FY20 budget speech while the actual number came to 8.9%. This 1.8% difference translates to roughly Rs700 billion!
- It could be the dense fog nowadays, but the current economic policy framework is not adequately clear. For instance, one may recall an Economic Advisory Council (EAC) that was established sometime in FY19 (which ended in a fiasco after members resigned for various reasons). More recently the Economic Development Council (EDC) was formed and, for a brief period, it seemed that this body would help formulate policies. Yet sometimes one gets the impression that the Prime Minister has taken it upon himself to make all policy decisions.
- On the other hand, we see the repeated reshuffling of senior

appointees. This simply tells that either there is a problem finding the right people or there is a lack of decisiveness.

- Then there is the matter of Gas Infrastructure Development Cess (GIDC) where a formal decision was made and then taken back, which has resulted in the case now pending in the courts of law.
- And what does fate have in store for state-owned enterprises (SOEs)? Will they be privatized or will they continue to remain under government ownership? If the former stands, then the question is "when"; In case of the latter, the question is "how".
- It seems that China-Pakistan Economic Corridor (CPEC), Pakistan's much-hyped 'Game Changer' has lost its place in the spotlight. The great debates that were in the limelight until just recently have now been rather overshadowed by other routine headlines.
- Then there were the rather aggressive talks about the dangers of Chinese involvement in Pakistan through CPEC. However, these voices died out soon after their sources became part of the governing mechanism of the country.
- The sudden sprouts of ideas that authorities go through are another cause for serious concern. Take the construction of dams and diaspora certificates for instance which came in like freight trains and disappeared like Houdini.

Apart from these hiccups, the state of planning in Pakistan can be seen in various sectors of the country such as Power, Petroleum refining, agriculture and technology to name a few. And if that wasn't enough, one just needs to look at the unique case of Pakistan's exports growth. Despite all efforts, the current growth figures suggest that the country's remittances will soon exceed exports. In terms of the export to GDP ratio, Pakistan not only finds a spot among the worst in the region but

CHART 6

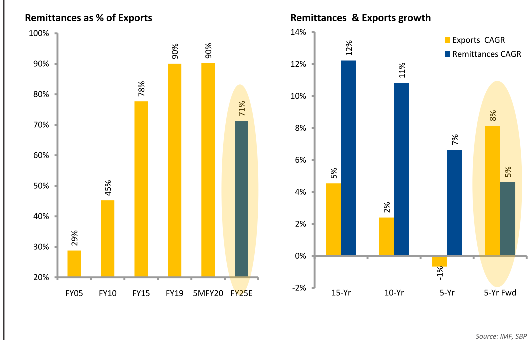
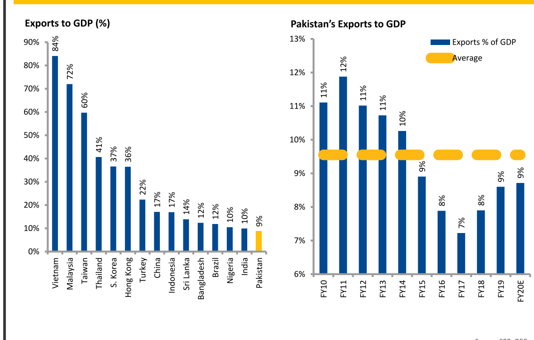


CHART 7



has, for the past few years, somehow found itself underperforming even its own historic average.

In a recently released report by the ADB[1] the authors have pointed out that "Periods of GDP growth rates that are higher than the BOP-constrained growth rate tend to result in foreign exchange reserve depletion, followed by periods of fiscal and monetary policy-led suppressed growth."

The report claims that the current Balance of

[1]Why Pakistan's economic growth continues to be balance-of-payments constrained. 2019. ADB Central and West Asia working paper series

Payments (BOP) situation (which has fundamentally remained unchanged for a considerably long time) only allows Pakistan's economy to grow sustainably up to a maximum rate of 3.77%. The only way to sustain a higher growth rate is to enhance exports. To this end, the report identifies avenues to redemption, some of which are quoted as follows:

- Identify the causes of lost export value in important industries (glass and stone, mineral products, plastics, and chemicals);
- Explore options for moving into new export products that require productive capabilities similar to those used for existing Pakistani exports, but have a higher level of sophistication within the product space;
- Establish a national single window for exporters; and
- Improve the availability of trade finance.

Rather amusingly, the China–Pakistan Free Trade Agreement-II (CPFTA-II) recently came online that gives duty-free access to over 6,000 Chinese items against allowing 313 Pakistani products to be exported to China on similar terms. Brilliant, isn't it?

One subject that has been ignored for too long by policy makers is population growth. Prime Minister Imran Khan, in his first address to the nation, expressed his desire to learn how China overcame its problems to become the powerhouse that it is now. A fundamental tool in China's success was managing population growth decades ahead of working on other areas such as infrastructure development. PM Khan has indeed publicly spoken about the challenge of a rising population. A small glimpse at Pakistan's historical population growth reveals that its population doubles every 25 years. At this rate, Pakistan will be home to over 400 million in the next 25 years and cross the 800 million mark in the subsequent round. An article in the Washington Post[2] suggests the same – that the population could double by the mid of this century. It further claims that Pakistan's population growth is among the highest (barring Africa) and the situation is 'a disaster in the making'. Reasons cited are 'religious taboos, political timidity and public ignorance … where only one-third of married women use any form of birth control.'

Pakistan's population problem has also been recognized in a World Bank Report[3] which recommends "reduction of fertility rates via awareness programs to encourage informed decisions on parenthood, including information on birth control, reproductive health, young women's health and child development…" as a reform measure to reduce population growth from 2.4% in 2017 to 1.2% by 2047. A policy note by the World Bank[4] suggested that one reason why investment and interventions in human capital have not borne fruit so far is the consistently high population growth rate, which has diluted the impact of reform. Moreover, health and population control are cited among key areas to ensure growth in incomes.

Education

Once meritocracy and an effective planning framework are in place, emergency focus on education should naturally flow in. Without investing on human capital, any quantum of public spending and infrastructure projects will be pointless. With regards to education, 'Pakistan@100: Shaping the Future' claims that Pakistan needs to spend twice the amount on education of what it currently does, keeping in

[2] 'A disaster in the making': Pakistan's population surges to 207.7 million, 2017.
[3] World Bank. 2019. Pakistan@100: Shaping the Future. © World Bank
[4] Pakistan@100 policy note on Human Capital. 2019.

view the regional average. The same report also highlights that: “Not only the quantity but also the quality of education is concerning in Pakistan. In rural areas 48 percent of class 5 students and 83 percent of class 3 students could not read a class 2 story in Urdu/Sindhi/Pashto; 54 percent of class 5 students and 85 percent of class 3 students could not read class 2 sentences in English; and 52 percent of class 5 children could not do two-digit division.”

However, there is also the view that there is sufficient spending on education and the problem lies in financial discipline[5]. “Ghost” schools and employees in the public sector continue to haunt enforcement of the policies in place. In such a scenario, where quality of education is also an issue in the few schools that do function, enrolment rates are unnaturally low as parents see low opportunity costs in not sending their children to school.

The problems in the education system are expected to worsen if quick but long term remedies are not worked out. Given the growing population, the student-teacher and student-school ratios could easily worsen from the levels that they have already dropped to.

Conclusion

The article mentioned that inability to perform either finds roots in absence of willingness or lack of ability. In the latter case, the former can still compensate and produce some result. However, when the tables are turned, there is no hope. Pakistan has a history of too frequent boom-bust cycles. It should be kept in mind that the mere improvement in macroeconomic indicators does not mean that economic growth will shoot anytime soon. It is high time that a now-or-never approach be taken for moving forward. Again, to quote 'Pakistan@100: Shaping the Future':

“Pakistan's future looks very different if it fails to achieve … reforms … Its consumption-based growth model, low tax revenue and inefficient resource use will have prevented crucial investments, and instead continued Pakistan's pattern of boom-and-bust growth cycles, and depleted the country's natural-resource base. In addition, its political system will remain influenced by elites that will continue to capture the majority of the economic benefits.”

***Syed Hussain Haider**

Syed Hussain Haider has vast experience in portfolio management and private banking in local and international capital markets. He is a CFA Charter holder, a CIPM Certificant and holds M.B.A. from IBA, Karachi.

****Syed Ali Hashim Zaidi**

Syed Ali Hashim Zaidi holds MSc in Financial Trading from Coventry University, UK and works in the capital market of Pakistan.

[5]Pakistan's Education Crisis: The Real Story, 2015 (Woodrow Wilson International Center for Scholars – Asia Program)