

Report

# **Growth and Sustainability: Hand in Hand or Poles Apart?**

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# **Growth and Sustainability: Hand in Hand or Poles Apart?**

## **Introduction**

Pakistan's economic policy managers face myriad of challenges, which hinder the transfer of economic benefits to the common masses. Both civilian and military governments have contributed to the perpetuation of the "elite capture" because of which the immense economic potential of the country has remained untapped, while putting the common man at a disadvantage. The government's failure to tackle the issue of burgeoning population has hampered economic growth, which has already been contracting in the wake of inconsistent economic policies and prolonged political instability. The trickle-down growth model implemented by the previous governments strangled the flow of economic welfare to the lower strata of the society, thus widening the gap of inequality between the rich and the poor. The poor taxation system, a slowed GDP growth rate, and lack of export-led growth further aggravated the dwindling economy of Pakistan. Depleting water resources continue to undermine the potential of agriculture sector which is considered as a backbone of Pakistan's economy. Lack of investment in public sector and availability of limited alternatives to direct funds have been undermining sustainable growth and development of the country.

## **Professor Sajjad Bokhari**

### **Executive Director IPI**

- When we entered the new millennium, Pakistan's GDP per capita was higher than our regional neighbors - India and Bangladesh. But, now Pakistan has fallen behind its regional peers. Myriad internal and external challenges, volatile political and security situations, and a fraught regional environment are generally blamed for this decline. It is, however, the absence of policy consistency and endemic political instability, which continue to stymie efforts for building strong foundations for sustainable economic growth and development.
- When the PTI government took office, Pakistan was faced with twin deficits – the current account deficit and fiscal deficit. Government first secured bilateral financial support from China, Saudi Arabia, and the UAE, but still return to an IMF program was inevitable. When Pakistan reluctantly signed up to an austerity-focused IMF program in the summer of 2019, it led to a decline in economic growth on the back of heavy devaluation of the rupee, double-digit inflation, and unprecedented interest rates of over 13 percent.
- While the economy was reeling under a tough IMF program, less than a year later COVID-19 pandemic emerged and exacerbated economic pain for millions of Pakistanis as lockdowns were imposed, and economic growth turned negative for the first time in decades. Khan government suspended the IMF program in emergency intervention and to seek debt relief it rolled out a 1.2 trillion rupees stimulus package. Cash transfers program were expanded to safeguard the most vulnerable sections of the society and State Bank cut down policy rates sharply to boost economic activity.

- Gradually, the state response to coronavirus picked up, federal and provincial governments cooperated and collaborated through the National Command and Operations Centre to effectively slow down the spread of the virus. Slowly business confidence returned and the economy picked pace. Early signs of recovery are indicative of a stabilizing economy that grew by 1.9 percent in 2019 and contracted by 0.4 percent in 2020. This year government claims the economy expanded by about 3 percent. Granted that the economy has stabilized, Pakistan is far away from achieving sustainable growth.
- Recently adopted 2021-22 budget focuses on supporting economic growth and expands public spending by the government. Meanwhile, inflation particularly, food inflation remains high. At the same time, despite growth in exports during the last year, the trade deficit has ballooned to nearly USD 30 billion. Some of this has been absorbed through rising remittances from Pakistan's overseas workers. Yet, the economy's core problem remains the inability to earn enough foreign income to pay for rising imports and servicing debt remains.
- For the next 12 months, Pakistan would have to figure out a way to address the fiscal deficit. Revenue targets have been increased. Though tax collection has been enhanced, the government needs to keep its spending in check and avoid massive borrowing from the banking sector to pay for debt servicing, defence, and pension needs.
- For Pakistan's leaders – civil or military, government or opposition– the focus needs to be meeting the ambitions and aspirations of the youth. Creating an enabling environment for generating millions of well-paying jobs that expand the purchasing power of the citizenry and improve quality of life should be the ultimate goal. Pakistanis have suffered a sustained decline in their purchasing power and job losses have increased in the past couple of years. Borrowing by successive governments has reduced the productivity of the economy and now the focus is on making the ends meet. This is not sustainable in the long run.
- The absence of new jobs and boom-bust cycles of economic growth and contraction create conditions that foster lingering instability. In this comes the focus of today's webinar: growth and sustainability. How to achieve growth and make it sustainable? The short and easy answer is to reform. We have heard of reforms in the past. Our political leaders have said many times that Pakistan needs economic reforms on an urgent basis. But the question is: why have not reforms been successful? Are our leaders capable of undertaking deep-rooted reforms that stir the political economy of this country?

## **Syed Hussain Haider**

### **IPI Senior Research Fellow in Economic Policy**

- We need to closely examine whether the two important variables, growth and sustainability, are moving hand in hand or they are still poles apart.
- CPEC provides us with the opportunities which were once available to South Korea, Japan, and Mexico.
- The rising population is another challenge that has to be tackled to ensure sustainable growth.

## **Dr. Hafiz A. Pasha**

### **Former Federal Minister for Finance and Economic Affairs**

- The quality growth for any state should improve the living standard of its people at large, create a just distribution of wealth and income, and must not widen the inequality gap.
- Pakistan witnessed an increased growth rate during the authoritarian regimes of the 1960s, 1980s, and 2000s, which were rightly called ‘even decades’. But, the growth was transitory because the foreign policy was established on the model of receiving external support for offering the country as a client state. It is, however, laudable that the incumbent civilian Prime Minister has not emulated that model.
- During the Ayub era, the high growth rate resulted in pronounced inequality between the two wings to such an extent that Pakistan was dismembered in 1971. The Ayub era’s growth paved the way for the emergence of Pakistan’s 22 richest families, which later hijacked the financial system of Pakistan.
- The bottom-up growth approach pioneered by the current federal government portrays a paradigm shift from the traditional growth model which supported the trickle-down effect, where benefits are first reaped by the rich and later they are filter down to the poor. The bottom-up concept of growth is a laudable step. The primary instrument the government wants to use for succeeding in its bottom-up approach is through a horizontal massive expansion of small-scale credit to poor families, small farmers, and for housing purposes. Commercial banks should consider small borrowers as well.
- True growth comes from trading and the government should focus on export-led growth instead of making the construction sector a central pillar of its national growth policy.

## **Syed M. Shabbar Zaidi**

### **Former Chairman Federal Board of Revenue**

- Pakistan’s growth patterns have always fallen short of fulfilling the criterion of equal distribution of wealth. If two parameters, (i) tax collection, and (ii) government efficiency, are excluded from a capitalist state system, its progress comes to a standstill.
- Pakistan’s growth trajectory is floating and lacks depth. The government should invest heavily in growth-producing sectors instead of looking for investments from private sector.
- The housing schemes that the present government is introducing will provide opportunities to wealthy investors but will play a little role to alleviate poverty at the grassroots level. There is a dearth of any substantial initiative solely aimed at reducing the economic plight of the poor. There is an urgent need for a growth paradigm shift for equal distribution of wealth.

## **Dr. Hafiz A. Pasha**

### **Former Federal Minister for Finance and Economic Affairs**

- It is alarming that more than 6 million Pakistani youth are either sitting idle due to unemployment or are not attending any educational institution. The ‘idle youth’ becomes a

source of crime, violence, and extremism. An atmosphere like 'Arab Spring' can take shape in Pakistan if the issue remains unnoticed.

- A growth rate of 6-7% is critical to be achieved to absorb the youth into the labour markets. It can also mitigate unemployment and poverty. If per capita income increases by 3% and the prices of edible commodities remain sustainable, it will rapidly lower poverty.
- There were moments in our history, particularly from the FY2014-15 to FY2016-17, when we managed to grow the economy by 5%. That era sustained or even lowered prices of edible commodities and the percentage of the public living below the poverty line shrunk from 75 to 60 million. Unfortunately, the same figure has risen to 80-85 million now.
- As per the Fiscal Responsibility and Debt Limitation Act, the debt ratio of our government should not be above 60% or, in other words, 60% of our GDP. But we have reached 80% now. Because our GDP base is not expanding rapidly, and the budget loss has reached 8-9% of GDP, if the rupee's devaluation continues, it will reach 100% in the coming three to four years at the current pace. So, we need to accomplish the task of achieving 6-7% growth.
- The government should play a leading role in absorbing the idle youth, reduce poverty and manage the national debt ratio to achieve sustainable growth.
- The first solution would come through increasing saving and investment rates. One of the reasons for Pakistan's lagging behind India and Bangladesh in growth is the latter's high saving and investment rates, like 25-30% as compared to the former, where, even under favourable conditions, the investment rates rarely touch the figure of 16-17% and the saving rates hardly reach 13-14%.
- Second, the implementation of a sustained and fair taxation system would lower the existing inequality. Unfortunately, Pakistan's taxation system is a victim of elite capture.
- Export-led growth through the expansion of national exports can be a remedy for reducing poverty. The growth of imports is 1.4 times more than the expansion of exports in Pakistan. The rising imports are a result of the increasing wealth of the rich instead of translating benefits to the lower strata of society. Pakistan can come back on solid footing if its exports are increased by 2% at least.

## **Syed M. Shabbar Zaidi**

### **Former Chairman Federal Board of Revenue**

- GDP composition matters and the Pakistani GDP composition of the last 20-25 years draws our attention towards the fact that the contribution of services has increased with shares of industry, agriculture, and real estate remaining almost constant, not increasing more than 4-5%. We need to make progress in the industrial sector for endurable economic growth.
- Unfortunately, for the last 20 years, we did not pay adequate attention to agriculture and large-scale production.
- The looming crisis of the burgeoning population would be disastrous and should be addressed adequately by policymakers.

## **Dr. Hafiz A. Pasha**

### **Former Federal Minister for Finance and Economic Affairs**

- Pakistan's Human Development Index in South Asia is the lowest. Poor performance by education and health sectors is a major cause of Islamabad's lagging behind its regional peers, including Nepal, which is one of the least developed states in the world.
- More than 2% of Pakistan's GDP goes down the drains due to lengthy power outages. In the wake of the inauguration of CPEC, Islamabad's priority towards the construction of highways, mass transits, and roads, has sharpened manifold. The road-development approach adopted by successive governments is likely to take a heavy toll on the already dwindling economy of Pakistan. Unless the economic experts explore alternative ways to invest national wealth, Pakistan would continue to face difficulties in wading through the economic crisis.
- There is a blatant depletion of available water resources to keep the agriculture sector lucrative. The government must take immediate steps to manage the looming water crisis. The economic growth is likely to meet a failure if the crop sector is vanishing.
- The federal government can expedite the hitherto stagnant economic development if a better transmission and distribution system for power is introduced. This sector demands more than 50% of the public sector funds directed to it for its vigorous functioning. The PSDP, unfortunately, is again spending more than 50% on NHA, and the power sector is being placed on the back burner with only 20% of spending on it.
- Debt servicing is eating away more than 40% of the budget. Dispensation of salaries and pensions to federal and provincial employees, in addition to the excessive subsidies given out to the power sector, hinder Pakistan's economic growth. State-owned enterprises are reminiscent of a bottomless pit for money because they cost the federal government more than 950 billion rupees a year. All these developments going out of control can mark a bleak prospect for Pakistan's economic ordeals.
- The government's claim that it is all set to lower the budget deficit to 6.7% appears unrealistic given the present economic situation. Even if the federal government keeps it at 8%, it should deserve appreciation.
- The tax concession given to the elite costs more than 2400 billion rupees to the national exchequer. Such practices inflict harm on the national wealth.

## **Syed M. Shabbar Zaidi**

### **Former Chairman Federal Board of Revenue**

- The government lacks a concrete discourse on expenditures. Pakistan faces around 3000 billion rupees deficit between its revenues and expenditures.
- The government does not lack money, but it lacks the competence to make the work done. It lavishes the salaries on the employees who fail to deliver.
- A fiscal policy that dares tinker with the established status quo is sidelined. The political side fails to manage it. The absolute reluctance on the part of the legislators further reinforces the

phenomenon of ‘elite capture’. We cannot make a giant leap forward unless we discover the forces which can rein the mushrooming ‘elite capture’.

## **Syed Hussain Haider**

### **IPI Senior Research Fellow**

- There has been a lot of emphasis on export-led growth. We, therefore, have to ascertain the demand in various sectors and penetrate the areas having high demand. I would like to know how this export-led growth could be achieved.

## **Dr. Hafiz A. Pasha**

### **Former Federal Minister for Finance and Economic Affairs**

- We had phases in which we had export-led growth – most recently 2000 -2010, when growth in exports was about 8-10% in real terms and at one time our exports had touched \$24-25 billion. We were then at par with India and Bangladesh in the global market, but then we fell behind. What was the change? What were those factors that pushed us back?
- Globally there was a lot of buoyancy in world trade till 2008 when the oil prices started going up. We too benefitted from it. But, behind that were the decisions taken in the 1990s. For instance, two major concessions given in the 1990s were the ‘Tax Credit for Modernization and Replacement’ and ‘Accelerated Initial Depreciation Allowance’. Moreover, the zero-rating plan was liberally applied to the exports sector. This created a hump in the investments in the textile sector and that produced the excess capacity, which we could use later.
- During the last fiscal year, growth in textile exports was noticed, but that was because of growth in prices and not the quantities. The reason was that there was space in the market because of the Covid-19 pandemic and we used it. But we do not have extra capacity. We do not have enough additional capacity that in next three years because of which our exports during the next 3 – 4 years could grow by 40 -50%. The problem is the lack of investment in recent years in the export sector.
- A couple of incentives given here has been withdrawn in the last budget because IMF says there should be no exemptions or concessions even on investments. The export sector, therefore, did not have the right incentives. India and Bangladesh ran cash incentive schemes. We could not even fix the tax refunds under which the exporters could be timely reimbursed.
- Pakistan was the ingenious country that came up with the most ingenious schemes for promoting exports in the 1960s commonly referred to as the bonus voucher scheme. India replicated it through its ‘duty script scheme’. We were way ahead in thinking but lost our way. FBR today causes inconvenience for the exporters.
- Second is our over-obsession with textile. APTMA once used to be a very strong lobby. How long are we going to rely on textiles that make up 58% of our exports? On the other hand, we have damaged the inputs used in the textile sector – cotton. It is a colossal mistake. The key input to export is virtually dying and the price of cotton has become hopelessly uncompetitive.



- Therefore, there is a need to diversify and go beyond the obsession with the six industries. There are at least 10 other items in the agriculture and manufacturing sectors, whose exports have increased to more than \$2.5 billion. These sectors need to be paid attention through granting them liberal incentives.
- SEZs should, moreover, be given a tax break for 10 years. The future has to be export-led growth.

## **Syed M. Shabbar Zaidi**

### **Former Chairman Federal Board of Revenue**

- Over time incentives for the export sector have ended. IMF, for instance, insisted on ending the depreciation allowance.
- Another issue that I'm seeing is that the second generation of our top exporters has lost the urge to invest in Pakistan because of the prevailing environment – political instability, accountability system, over-regulation, and the thinking that the rich are corrupt. Therefore, they do not see any incentive to invest in Pakistan.
- I introduced the Asset Declaration Law to give confidence to Pakistanis to invest in Pakistan. The positivity in business that we are seeing is related to Covid.
- Two areas could spur economic activity in Pakistan – the Faisalabad, Sialkot, Lahore, Gujranwala triangle, and one in Karachi. The Karachi side remains destabilized for decades and could not achieve the expected growth. There is no competition between the two areas, but they would have to be simultaneously developed without which positive results cannot be achieved.
- This time the government has taken a few steps on exports and services after ignoring them for a very long time.
- We could not get strategic results because of not focusing on emerging areas like IT.

## **Dr. Hafiz A. Pasha**

### **Former Federal Minister for Finance and Economic Affairs**

- The time has come when Pakistan needs a new social contract or a charter of the economy-based on just principles and reflecting our priorities.
- How will it happen? A consensus on a new social contract in which the 'elite culture' element diminishes, resource availability increases, and federal and provincial governments rationalize, but which power structure will allow it?
- After the 18th amendment, there were two lists in the constitution: Federal Legislative List I & II and if some subject is not in either list then it is assumed that it goes to the lower government (provincial government in such cases).
- But the problem is that the federal government is having 40 divisions. In the 1990s, I had sanctioned 12 divisions as the chair of the downsizing committee.
- There is a vested interest in the bureaucracy. For instance, higher education is on neither list, but HEC is running the higher education, and provinces are doing nothing.

- We need to have a rational allocation of functions respecting the constitution of Pakistan based on the principle of subsidiarity.
- Our biggest failure is that we have not gone to the third level i.e., local government.
- The district government system introduced by Musharraf was very successful. The progress achieved in the education and health sectors could not be achieved again. You have to devolve to the lowest level.
- There could be an element of participation by linking taxes with benefits.
- Article 40A of the 18th amendment has to be immediately implemented.
- There are two Constitutional bodies National Economic Council and the Council of Common Interest. They have the important role of guiding and monitoring the implementation of policies and reforms. CCI ensures that there is not too much friction between provinces or between provinces and the federal government. These two institutions have not worked. They occasionally meet. Make them effective bodies and Planning Commission the secretariat of these two bodies. Only then will we get the Planning Commission to play its role. Pakistan has a lot of potentials, give it a system, it will progress rapidly.

## **Syed M. Shabbar Zaidi**

### **Former Chairman Federal Board of Revenue**

We have to live with the existing policy structure. It can't be eliminated. The temperature of the political environment is running high. If not lowered, elite and bureaucracy may benefit, but the common man is most affected. The double standards on economic issues for political advantage must come to an end they are too dangerous for us.

It is important to see where our younger generation is seeing Pakistan in the next two decades.

Pakistan's economy is not in a critical care state right now but is afflicted by multiple diseases that are curable. However, if corrective measures are not taken through consensus among the stakeholders then the situation may become critical.

## **IPI Findings**

1. Pakistan lacks both policy consistency and political stability for achieving sustainable economic growth and development.
2. The population growth rate of Pakistan is so far the highest in the region. It poses a challenge to Pakistan's economic growth and slows down development.
3. The current government of PTI is luckily not emulating the past development models implemented by authoritarian regimes where foreign aid momentarily boosted economic growth but left grave repercussions in the long run by widening the gap of inequality.

4. The federal government's economic model of the bottom-up approach depicts a paradigm shift and is the right course of action towards reducing inequality.
5. The export-led growth is the only panacea for Pakistan's ailing economy. The government's focus on the construction sector for achieving sustainable economic growth will provide investment opportunities to wealthy businessmen with little benefits for the downtrodden.
6. If the policymakers do not find a lasting solution to engage the idle youth of Pakistan, it may give birth to multifarious social problems, and can also result in an 'Arab Spring' like political turmoil in the future.
7. The government needs to expedite the growth to 6-7% to meet the ballooning debt ratio, which currently stands at 80% and may further shoot up to 100% in the coming years.
8. The introduction of a sustained and fair taxation system, buoyed up by a marked rise in the saving and investment rates, can keep the withering economy of Pakistan afloat.
9. The share of the industrial sector in GDP composition should be enhanced for reaching the goal of sustainable growth. For decades, only the share of the services sector in GDP composition has raised, which is inadequate to meet economic challenges looming overhead. More attention should be devoted to agriculture and other large-production sectors.
10. There is a palpable absence of links between fiscal policies and economic targets set by the government. It is a flawed strategy to overcome economic challenges.
11. Poor performance of health and education sectors takes a heavy toll on the Human Development Index of the country.
12. Interminable power outages, excessive focus on the construction of roads and railway infrastructures and lack of investment in public sectors are a few causes hindering the economic growth of the country.
13. The depleting water resources are exacerbating the crop crisis of Pakistan. There is a sheer absence of a well-thought strategy to tackle the emanating water scarcity. It may pose an existential threat to Pakistan's existence if its agriculture sector perishes.
14. A better functioning transmission and distribution system of power is the need of the hour. The PSDP should enlarge the investment ratio to at least 50% to the power sector to uplift the economy.
15. The issue of debt-servicing consumes a larger chunk of the federal budget. State-owned enterprises have become futile assets to run the economy.
16. The tax concession given to the elite presents a gloom-ridden environment for the future of Pakistan.
17. There is a clear absence of a concrete analysis of expenditures. The gap between expenditures and revenues is expanding at a fast pace. The government's lack of competence and implement

out of the box strategies reinforces the ‘elite capture’ phenomenon, which further hinders economic growth.

18. The two Constitutional bodies National Economic Council and the Council of Common Interest should be made more functional and effective.
19. The legislators should make a unanimous effort to implement article 40A and the 18<sup>th</sup> amendment, the sooner the better, for resolving the impending issues.
20. A political charter that sets out functions, responsibilities, and mandates of federal and provincial institutions should be produced for smooth functioning.