

Balance of Payments Constrained Growth in Pakistan

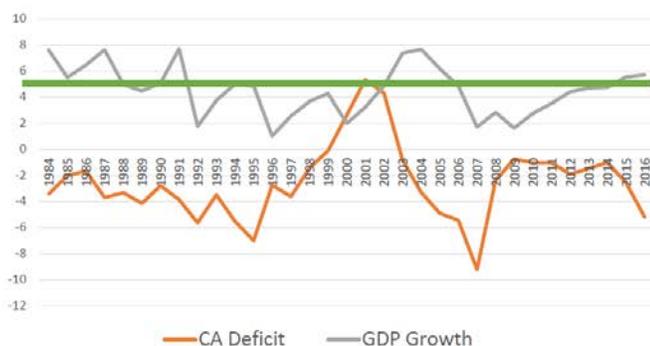
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Introduction:

- Once again, a BOP problem has arisen after a few years of higher growth.
- The problem may not simply be one of mismanagement but rather a structural issue.
- The argument presented here is that it is the higher growth that causes the BOP problem.
- If there exists a structural weakness in terms of the composition of Pakistani exports, higher growth (above 5%) is accompanied by significantly higher imports but only slightly higher exports (Felipe, McCombie and Naqvi, 2010).
- So there exists a **BOP-constrained maximum growth rate $\approx 5.1\%$**

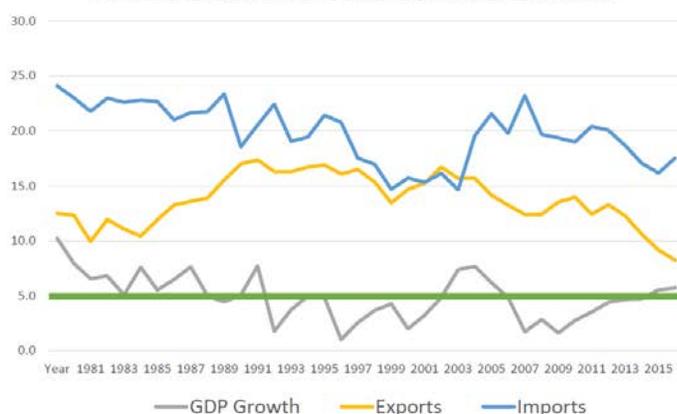
Results:

GDP Growth and the Current Account in Pakistan



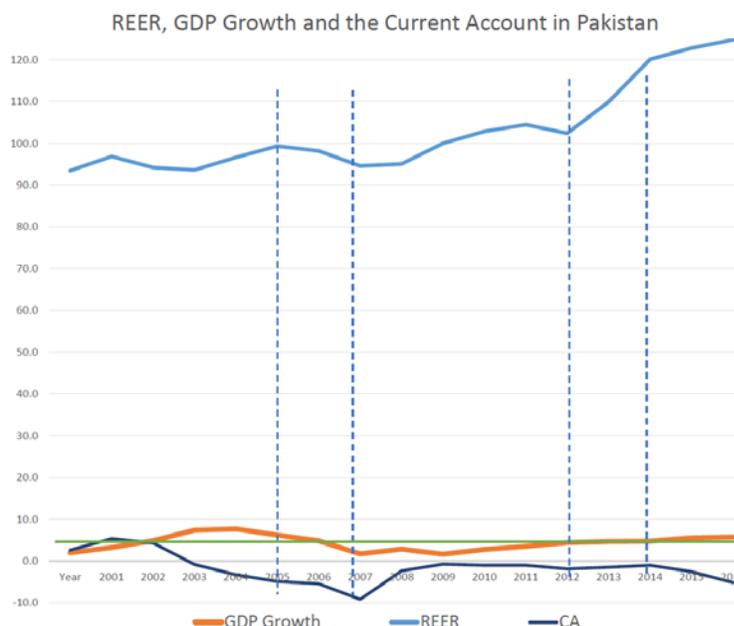
So every time the growth rate goes above 5%, the CA significantly deteriorates

GDP Growth, Exports and Imports in Pakistan



And the CA deterioration is caused by significantly higher imports when the growth rates goes above 5%

- A change in the real exchange rate is not having a significant impact on the current account.
- Impact only occurs when GDP growth exceeds 5%.
- Marshall-Lerner condition is not satisfied in the Pakistani case (Felipe, McCombie and Naqvi, 2010).
- So a real devaluation will not significantly reduce the current account deficit.
- Only way to get out of the current BOP crisis is to reduce the growth rate.



Policy Recommendations:

- With an effective devaluation of approximately 20% of the real exchange rate, the overvaluation of the rupee has now been resolved. So there is little need for further devaluation.
- Because of the inelasticity of imports and exports, the devaluation on its own will not solve the balance of payments problem.
- Only a sharp slowdown in the growth rate caused by a severe fiscal contraction will stabilize the current account.
- Tariff increases on consumer goods, in particular luxury goods, should be strongly considered.
- Despite the fact that poverty in Pakistan has fallen over the last decade, the impending fiscal contraction has the potential to lead to a significant increase in poverty.
- The previous IMF program included a substantial increase in social sector spending, focused on a sharp increase in spending on the Benazir Income Support program.
- BISP allocation is currently at 0.4% of GDP with coverage across all of the provinces:

Province	Beneficiaries millions	%age of Popluation
Punjab	14.88	13.53
Sindh	6.60	13.78
Khyber Pakhtunkhwa	3.64	10.24
Baluchistan	1.10	8.85

- Any external borrowing should in part should be used to focus on provision of social services.
- The Poverty Reduction and Growth Facility (PRGF) Program of the IMF aimed at reducing poverty is one option.