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Thirteenth International Conference on the Management of the Pakistan Economy

Igniting Technology Led Growth in Pakistan: Role of Monetary, Fiscal and Investment Policies (29th-30th March, 2017)

The Pakistani economy currently stands at a crossroads; while it has stabilized over the last few years, the focus has turned towards restarting economic growth. This is a challenging task because of structural problems faced by the economy as well as the global economic slowdown. While the economy has avoided a major downturn since the IMF's package in 2013, economic growth has been sporadic due to a variety of causes, including fiscal deficit, and financial vulnerabilities.

The fact remains that Pakistan's economy has experienced a tepid growth rate in the 3-4 percent range over the last decade and has struggled in the management of budget deficits, trade deficits, capital inflows and outflows, "circular debt" plaguing the energy sector, and the handling of domestic and external debt. Currently, the national economy faces two major challenges. The first is to reverse its falling growth of productivity, especially total factor productivity, and through it regain competitiveness in both the global and domestic market. The second is to create more and better jobs for a fast growing, young and increasingly educated labor force. The first is necessary to put the economy on a higher and sustained growth path. The second is the most effective means of ensuring equitable growth and overcoming rising inequalities which have been accentuated in recent years. Yet there can be an apparent tradeoff between the two. Higher productivity can result in lower job generation. But low productivity jobs are neither sustainable nor well paying. The need then is to adopt policies which can realize both objectives at the same time. This requires generating much higher economic growth so as to compensate for a lower employment elasticity of this growth.

This year's Annual Conference on the Management of the Pakistan Economy focused on a range of both macroeconomic and microeconomic issues facing the Pakistan economy. The reason for this dual focus was the recognition that behind many of the macroeconomic problems confronting Pakistan are a series of microeconomic issues, like low productivity or institutional weaknesses, that need to be addressed. Additionally, many of the macroeconomic problems that Pakistan has faced over the last few decades have resulted in poor developmental outcomes, such as inequality or unemployment, that are best analyzed at a microeconomic level. It is for this reason that the papers vary across themes, though when looked at as a whole they present a series of policy recommendations aimed at promoting sustainable, long-term economic growth.

The papers that focused on macroeconomic issues looked at recent trends in key macroeconomic indicators (GDP growth, fiscal deficit, exchange rate, external debt and monetary policy), their determinants and future outlook in addition to papers that examined the impacts of government policies (trade and innovation) on one of the most important drivers of growth, firm productivity.

Chaudhry, Jamil, and Chaudhry focus on a pressing macroeconomic issue facing the country: trade and the impact of trade policies. They focus on an important trade agreement and find that exports and imports have both risen as a result of the Pak-China Free Trade Agreement 2006/07, but that firm level productivity and value-added have fallen, both in the sectors made more vulnerable (by reductions in Pakistan's tariff rates) as well as in the sectors that China has given greater access (by reductions in China's tariffs). In subsequent trade negotiations, the authors conclude that Pakistan should insist that it get the same access to China as the ASEAN countries and reductions from Pakistan's side should focus on high-quality intermediate inputs to feed its industries rather than importing cheap final goods from China.

Another major concern for the Pakistan economy is the management of the external debt. Because of the lackluster performance of the economy due to severe internal and external pressures, there has been a sharp increase in its external debt and there is a constant debate about whether this debt is sustainable and when Pakistan will face a debt crisis (while some commentators saying that the country is already facing such a crisis). Uppal based his analysis on the marginal costs of external debt as indicated by the yields on the country's Eurobonds and the spreads on the Credit Default Swaps (CDS) traded in the international markets. The author finds a sharp decline in the yields on the Pakistani Eurobonds from their peak reached during the Global Financial Crisis (GFC) period. Since then this declining trend has continued. He concludes that in the initial post-GFC period, the decline was largely driven by quantitative easing and the resultant low interest rates in international debt markets while the continued decline in the yields in the more recent period, 2013-2017, is due to strengthening of the county's borrowing capacity over the period. The author also finds that Pakistani yields seem to be converging to those for other Asian countries, even though the yield-spreads between Pakistan and other countries are still substantial. The author concludes that the decrease in bond yields and CDS spreads may signal that the country's external debt is currently at sustainable levels. But as the author points out, this positive development has to be tempered with the recognition that Pakistan's continued reliance on external borrowing carries inherent risks.

Unmanageable fiscal deficits are also a problem plaguing Pakistan. Iqbal, Din, and Ghani look at this issue by analyzing the relationship between the fiscal deficit and economic growth, finding that the latter is compromised when the deficit exceeds a threshold of about 5.6 percent. For much of the last 45 years, however, government spending has exceeded that level. Recent trends, that have included increasing government revenues and constraining current expenditures, have been encouraging for the country's fiscal future.

In addition to fiscal problems, the country has faced balance of payments crises with alarming regularity, a problem that has resulted in the need for multiple structural adjustment programs. A often asked question in the context of the balance of payments is whether the Pakistani rupee is overvalued. Hamid and Mir attempt to analyze this question by looking at the degree of currency overvaluation in Pakistan and exchange rate management across different government tenures. The authors find that that prior to

March 2013, the policy target of exchange rate management was the stability of the real effective exchange rate while the current government's policy target has been the stability of the nominal exchange rate against the US dollar. The authors also find that as the currencies of Pakistan's major trading partners (UK, Europe and China) have depreciated against the dollar, the real effective exchange rate has appreciated by over 20 percent since 2013. They conclude with a discussion of how overvaluation in general and the recent reversal in the exchange rate management policy in particular have had an adverse impact on exports and the manufacturing sector and how these may also present a risk to long term growth as well as short-term balance of payments stability.

Despite the many challenges facing the economy, it seems that inflation has been brought under control by the monetary authorities over the last few years. Mangla and Hyder investigate the monetary policy effectiveness of Pakistan amid weak economic growth of developed economies and international oil price movements. They estimate a model in which the impact of international oil prices and global demand is analyzed on the key macroeconomic variables of Pakistan. Their findings suggest that monetary policy is quite effective in controlling inflation in Pakistan and that supply shocks due to increases in oil prices result in increases in the real policy (interest) rate, real exchange rate depreciation, economic growth slowdown and a rise in inflation. At the same time, they find that global demand surges cause the real policy rate to increase, the real exchange rate to appreciate, and economic growth and inflation to increase. Generally, they find that real policy rates adjust upward in response to shocks to inflation and the real exchange rate depreciates if inflation increases. Their results indicate that monetary authorities in Pakistan are fairly effective in stabilizing consumer prices and the real exchange rate in the economy.

While many Pakistani economists tend to focus their attention on monetary and fiscal issues, international experience shows the critical role of financial markets in generating growth and investment. With this in mind, Khalid focuses on the relationship between macroeconomic growth and financial development. He begins with a review of the microeconomic literature that analyzes how financial deepening could lead to changes in the behavior of economic agents and then looks at the macroeconomic literature which analyzes the literature on the relationship between financial development, financial integration and economic growth. The author then presents empirical evidence on the link between financial and trade integration and growth using data from a sample of countries from Asia Pacific region.

Another lesson from international experience is the role of the state in fostering innovation and technology-led growth, especially in the East Asian economies. Rasiah uses this as a backdrop to analyze the impact of policy frameworks on economic performance for a sample of East Asian economies. The author motivates his discussion by pointing out that while this literature recognizes that capital accumulation and macroeconomic management were critical in accelerating economic growth in East Asia, few analyses have systematically and comparatively addressed how policy frameworks spearheaded through selective interventions stimulated technical progress, and the different performance outcomes achieved by these countries. The author attempts to fill the void by systematically analyzing the investment regimes, sources of finance, technological upgrading and the policy frameworks to explain the economic growth performance of Indonesia, Malaysia, Philippines, South Korea and Thailand.

A fundamental question that many people fail to ask is whether certain countries are trapped in low growth and low development equilibria over the longer term because of structural weaknesses that may be extremely difficult to overcome. McCartney looks at the case of Bangladesh as an example of a country that is at risk of falling into the "middle income trap" or the risk that middle income countries fail to become fully developed countries. The paper uses the theory of Unequal Exchange from the Dependency School to understand why Bangladesh may be caught in this trap and further argues that the ideas of productivity, competitiveness and technological change may not useful in understanding growth prospects and policy responses in contemporary middle income countries. The paper then focuses on the role of structural change as a means of potentially sustaining growth in middle income countries.

The papers that focused on microeconomic issues looked at how individuals and households are affected by macroeconomic movements and how they adapt to Pakistan's increased economic integration with the global economy.

While looking at macroeconomic issues, many times economists tend to forgot the actual consequences of slow economic growth on individual households. In their analysis, Ejaz and Hyder use multiple rounds of the PSLM (2006 – 2015) to examine the vulnerability of demographic groups in Pakistan to business cycle fluctuations. Breaking down the labor force by gender, province, education level, age, and status (employer/employee/self-employed), they are able to provide a nuanced view of how the real wages of these groups evolve over the business cycle. Some results come out as one would expect: older and younger are more vulnerable than middle-aged workers, and women and employers also tend to be more vulnerable. Other results were surprising, for instance that education was not always protective against business cycle fluctuations.

One way in which many households try and reduce the impact of economic shocks is by trying to find diverse sources of income. Hussain and Said look at the role of income diversification strategies amongst rural households in Pakistan in raising living standards. Unlike Sub-Saharan Africa where only around half of households have multiple income sources, 85 percent of rural households in Pakistan tend to diversify away from a single income source. They find that households that diversify have higher income and spending as compared to households that specialize in a single occupation, using the Pakistan Panel Household Survey 2001-2010. Further, households with diversified occupations also tend to plant a larger number of crop types. Their results suggest that there are synergies between on-farm and off-farm activities that policymakers should take into account.

Another factor that is often overlooked when looking at development in Pakistan is the role of technology in mobilizing financial resources which in turn can impact savings and investment. Rizvi, Naqvi, and Tanveer look at the relatively recent history of mobile banking in Pakistan. Recognizing that the government and private sector have lately taken multiple steps to improve access to financial services such as credit, savings, remittances and insurance, the authors discuss how the introduction of mobile banking platforms is the one of the most prevalent methods of improving access. The authors begin by studying the various models of mobile banking and assess its current state using available data to understand how the segment has been evolving over time and transforming the conventional banking structure in the country. The authors then touch upon the ecosystem that needs to be built in Pakistan to utilize the full potential of mobile technology and makes some recommendations on how to move forward in that direction.

Individually, each paper presents a critical issue that needs to be taken into account by academics, policy makers and stakeholders in Pakistan, while as a whole this special issue presents a picture of an economy that is still in the process of transition. What the history of economic management in Pakistan has shown is that policy makers tend to focus on a small subset of short-run issues while ignoring the bigger picture. This in turn has led to certain problems that are only addressed when they become crises (like the cyclical balance of payments crises the country has faced) or other problems that are perpetually ignored (like the vulnerability of certain income groups to the regular economic shocks). The aim of this issue is to motivate policy makers to move beyond a narrow scope of short-run economic policies towards coordinated strategies that focus on long-run inclusive growth.