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# The Outlook for Pakistan

Carnegie Endowment for International Peace

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# Key Messages

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- Pakistan has abundant potential
- Non-economic factors have hurt economic performance (political, security, and natural catastrophes)
- So have inappropriate economic policies
- Risks and vulnerabilities have grown, and the external environment has deteriorated
- Measures are needed now to contain vulnerabilities and move the economy to high and inclusive growth





# My presentation today

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- Key Features of the Economy
- Economic Outcomes
- Outlook
- Policies
- Key Messages





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# I. Key Features of the Pakistan Economy and Policy Framework



# Pakistan's potential



Key Features of the Pakistan Economy and Policy Framework

# An economy vulnerable to shocks

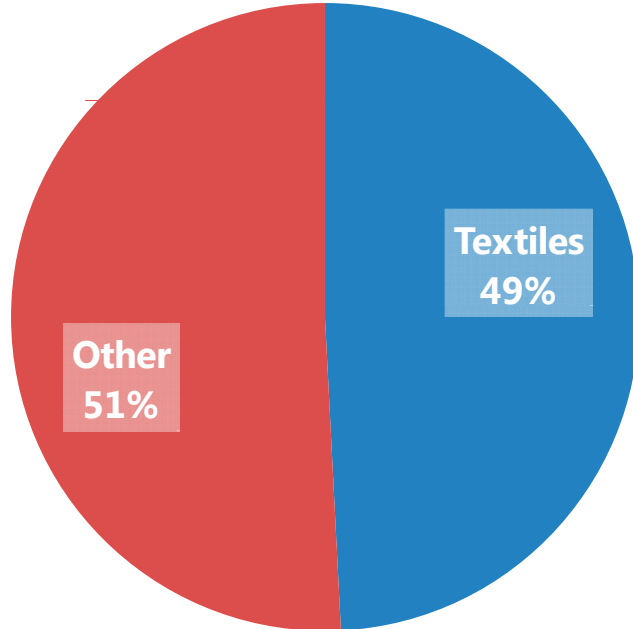




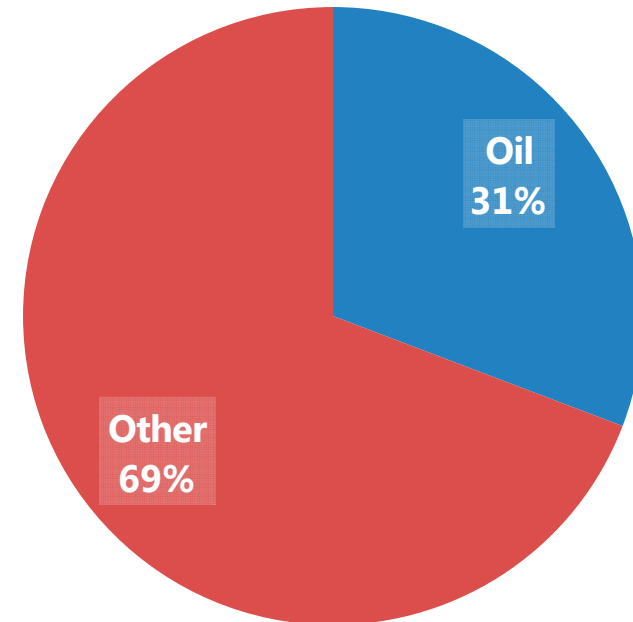
# An economy vulnerable to external shocks

*Heavy dependence on oil and textile price.*

**Share of Textiles and Cotton in Total Exports**  
(Average 2008/09 - 2010/11)

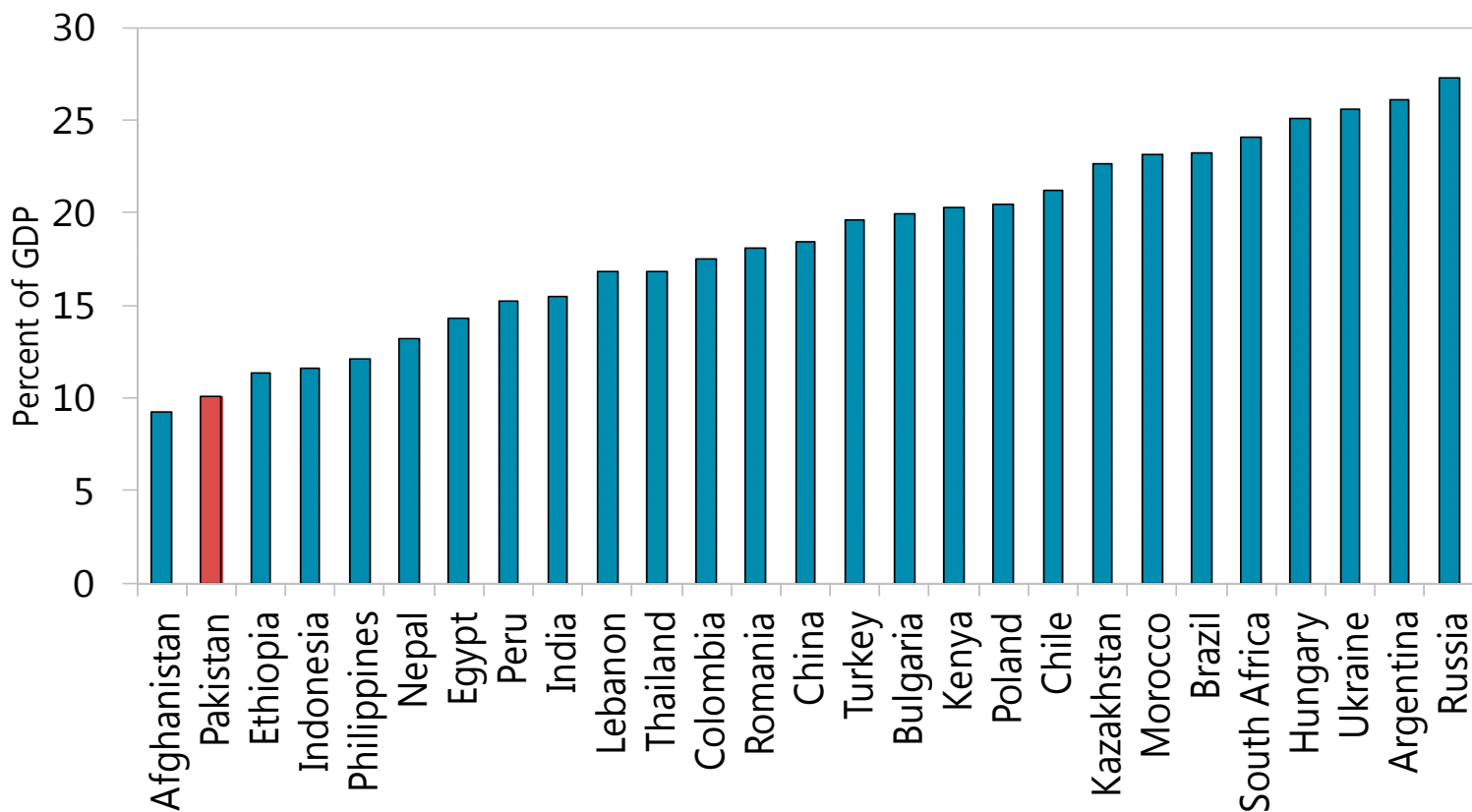


**Share of Petroleum Products in Total Imports**  
(Average 2008/09 - 2010/11)



# Limited buffers - Weak fiscal structure

## General Government Tax Revenue, 2010



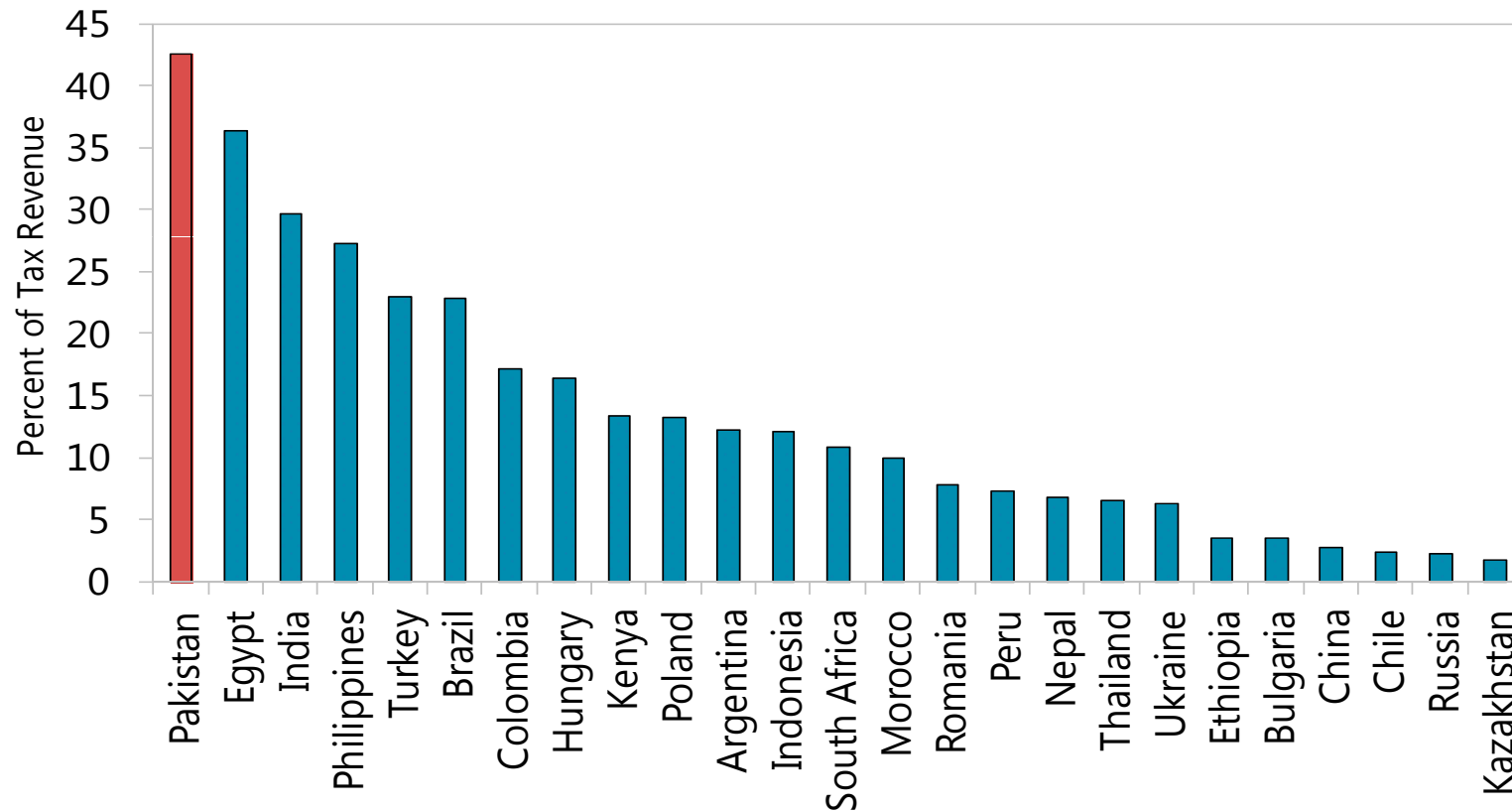
Source: IMF Fiscal Monitor Database.





# Weak fiscal structure

## Interest Expenditure, 2010



Source: IMF Fiscal Monitor Database.





# Weak fiscal structure: Public enterprises

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- Large public enterprises operate in energy, transportation, food and other sectors
- Many run large losses that end up on budget
- Services provided by these enterprises are poor in quality, e.g., there are widespread electricity shortages and power cuts





## Weak fiscal structure: Fiscal decentralization

- Increased share of revenue allocated to expenditure responsibilities devolved to provinces
- But rules of the game need strengthening
  - Little incentive for provinces to raise own revenue
  - No binding mechanism in place to coordinate federal and provincial fiscal targets





# Constrained energy supply

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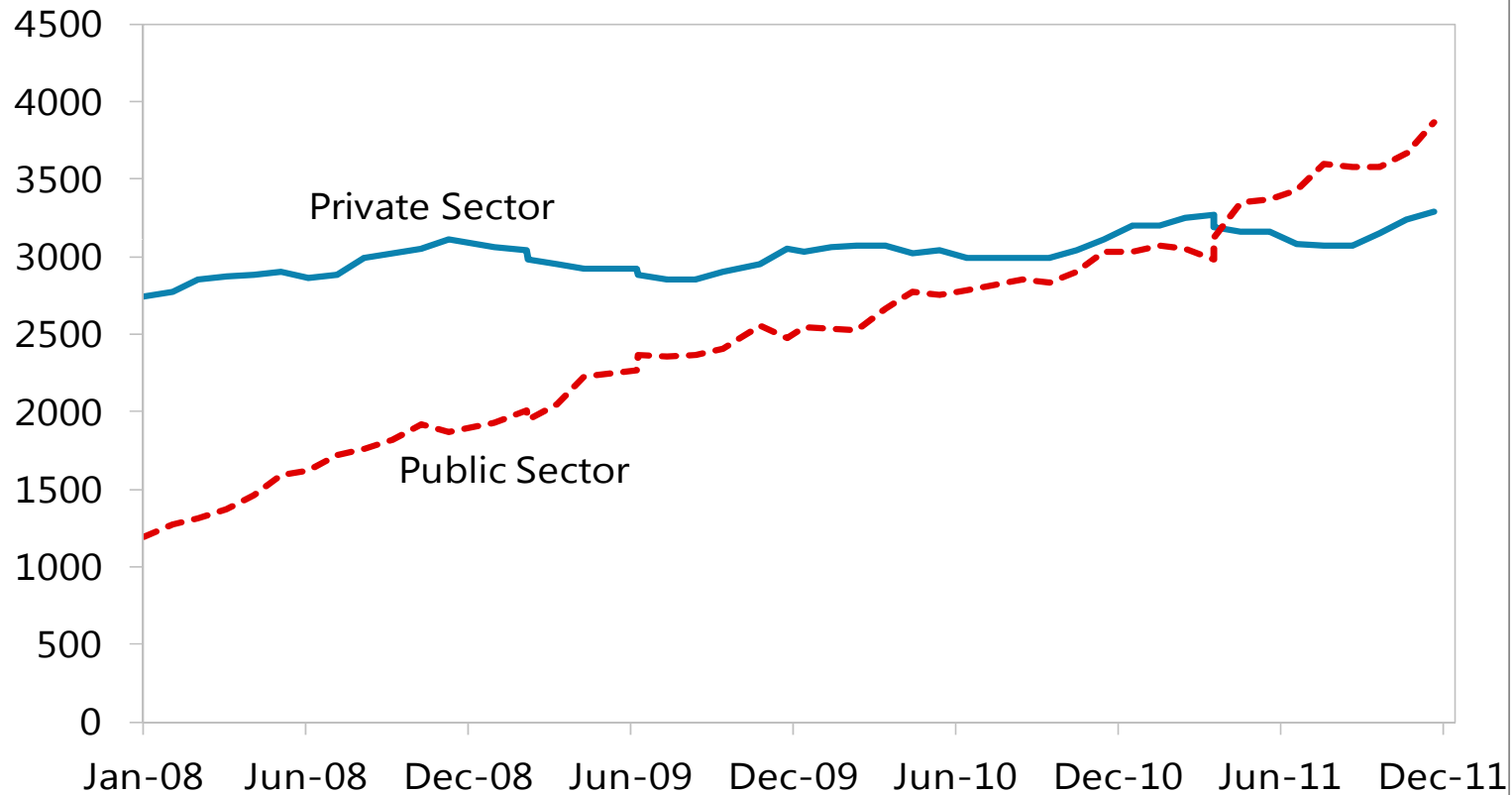
- Energy shortages a longstanding issue
- Reform plans not implemented
- Widespread outages that hurt growth
- Large budgetary subsidies that hurt public finances



# Private sector credit

## Banking Sector Credit, 2008–11

(In billions of Rupees)



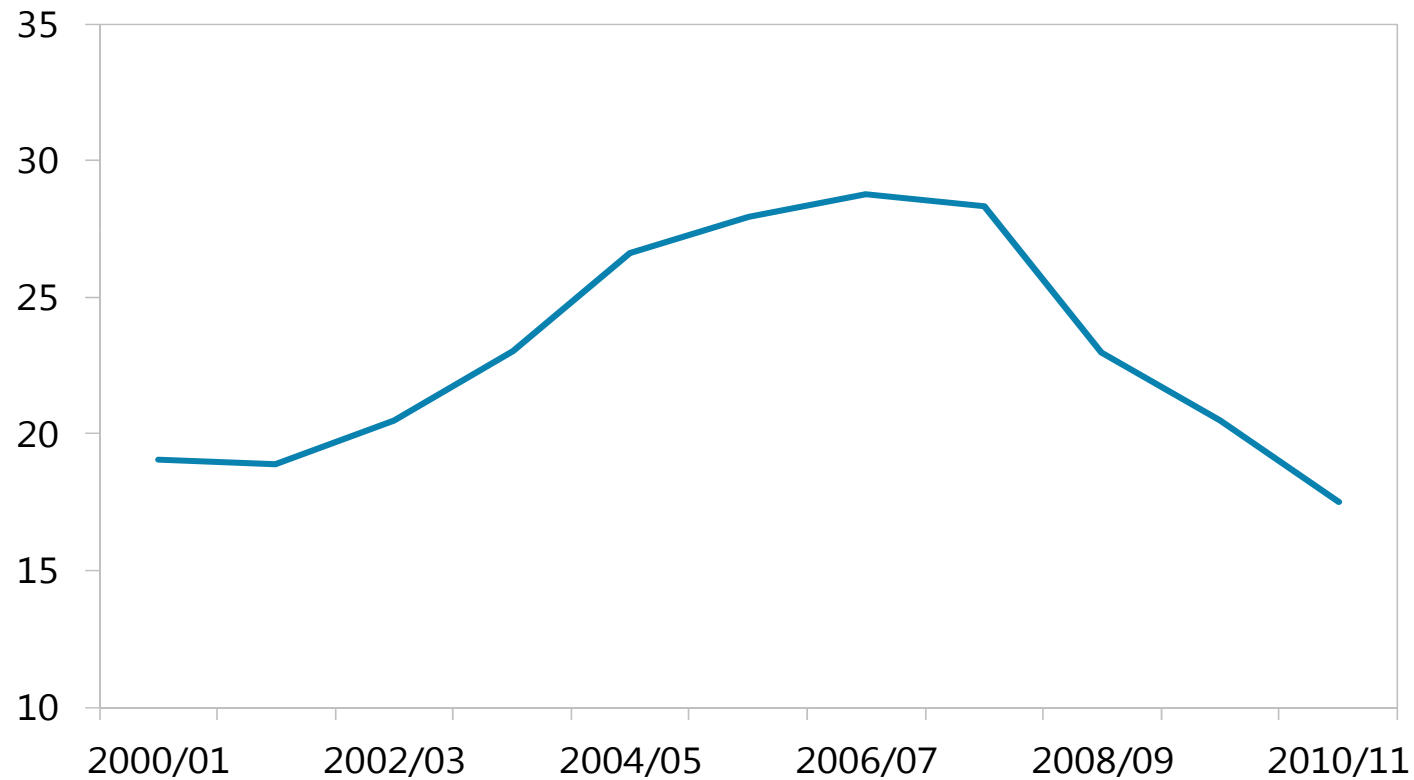
**Sources: Pakistani authorities; and IMF staff calculations.**



# Private sector credit

## Private Credit, 2001–11

(In percent of GDP)



Sources: Pakistani authorities; and IMF staff calculations.





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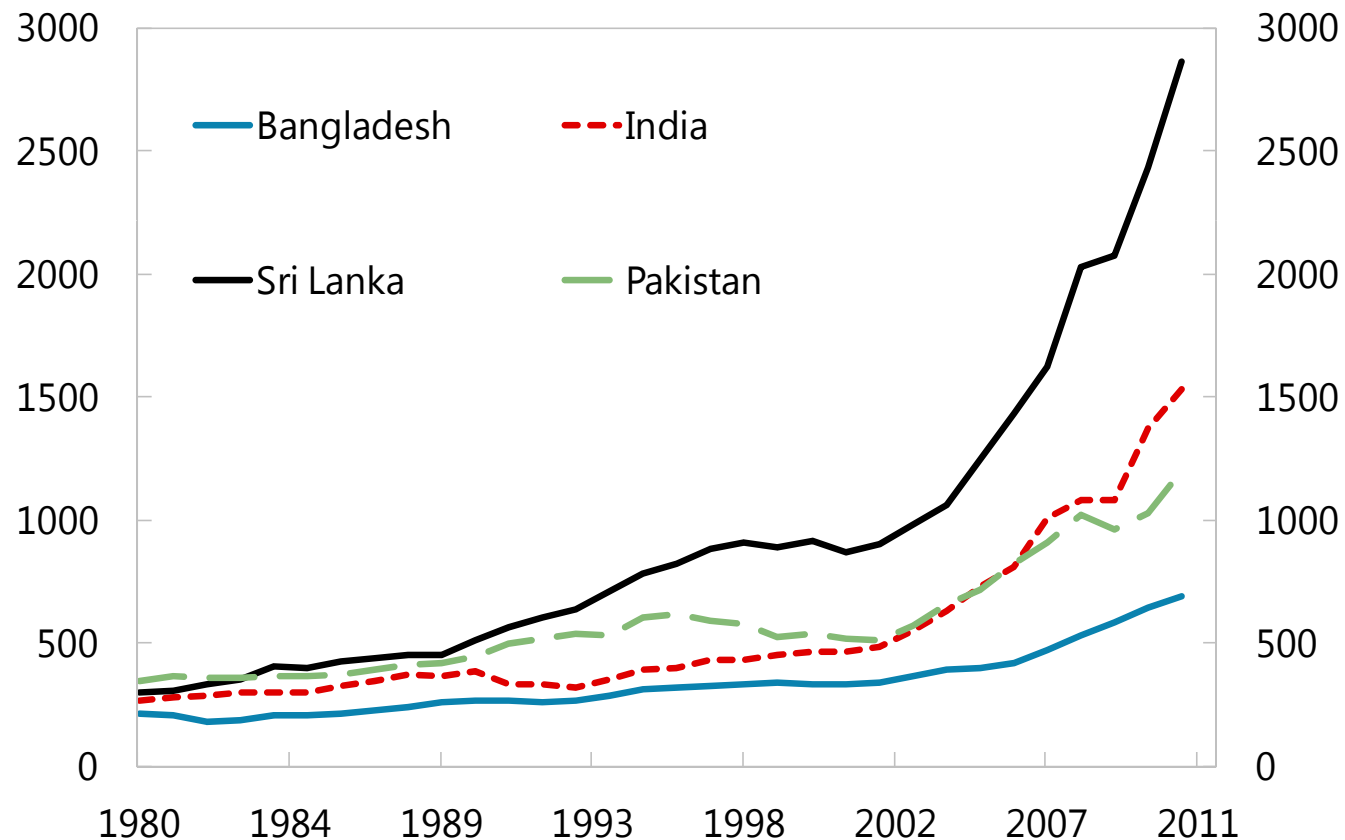
## II. Economic Outcomes



# Past economic outcomes - growth

## Real GDP per Capita

(In U.S. dollars)



Sources: Pakistani authorities; and IMF staff estimates.

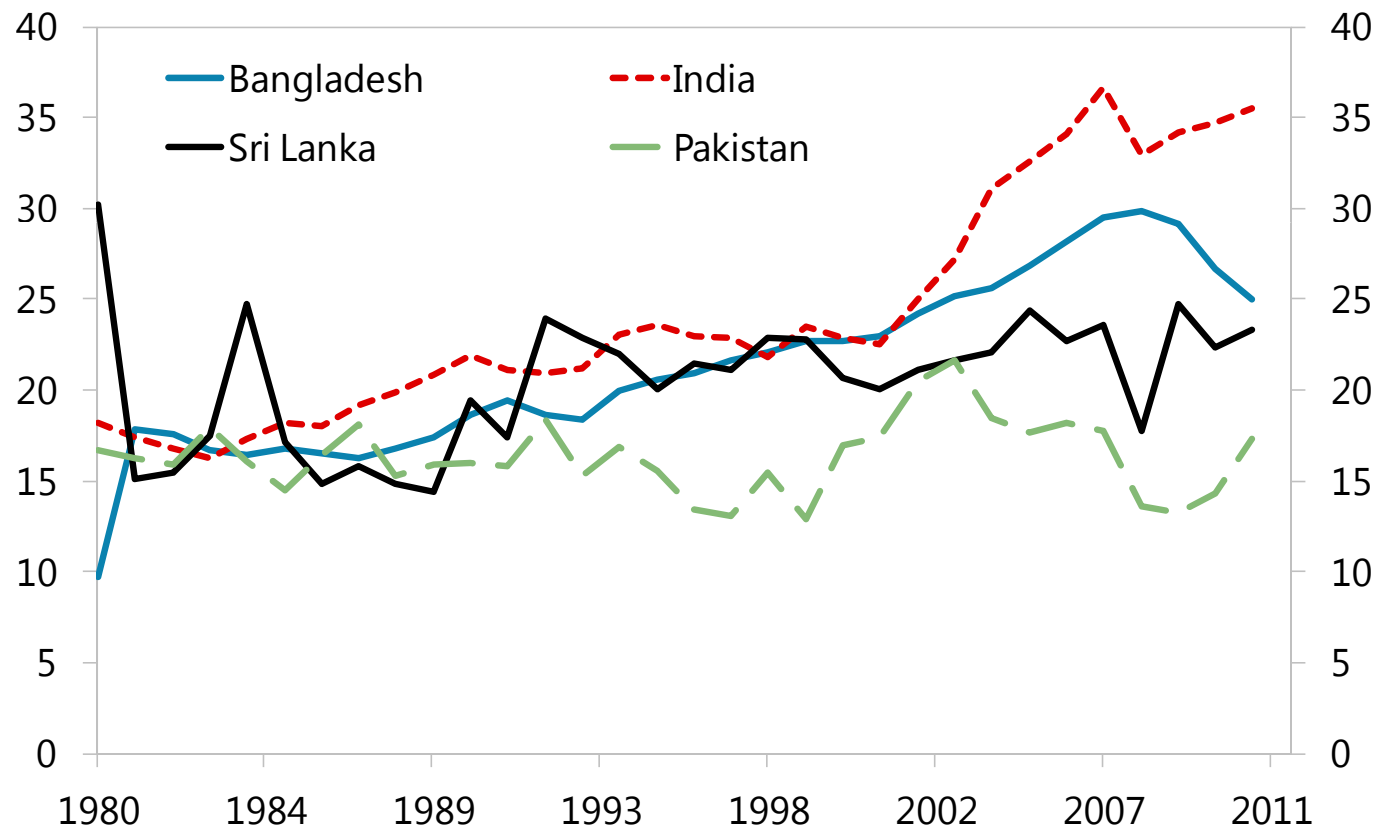




# Past economic outcomes - savings

## Gross National Savings

(In percent of GDP)



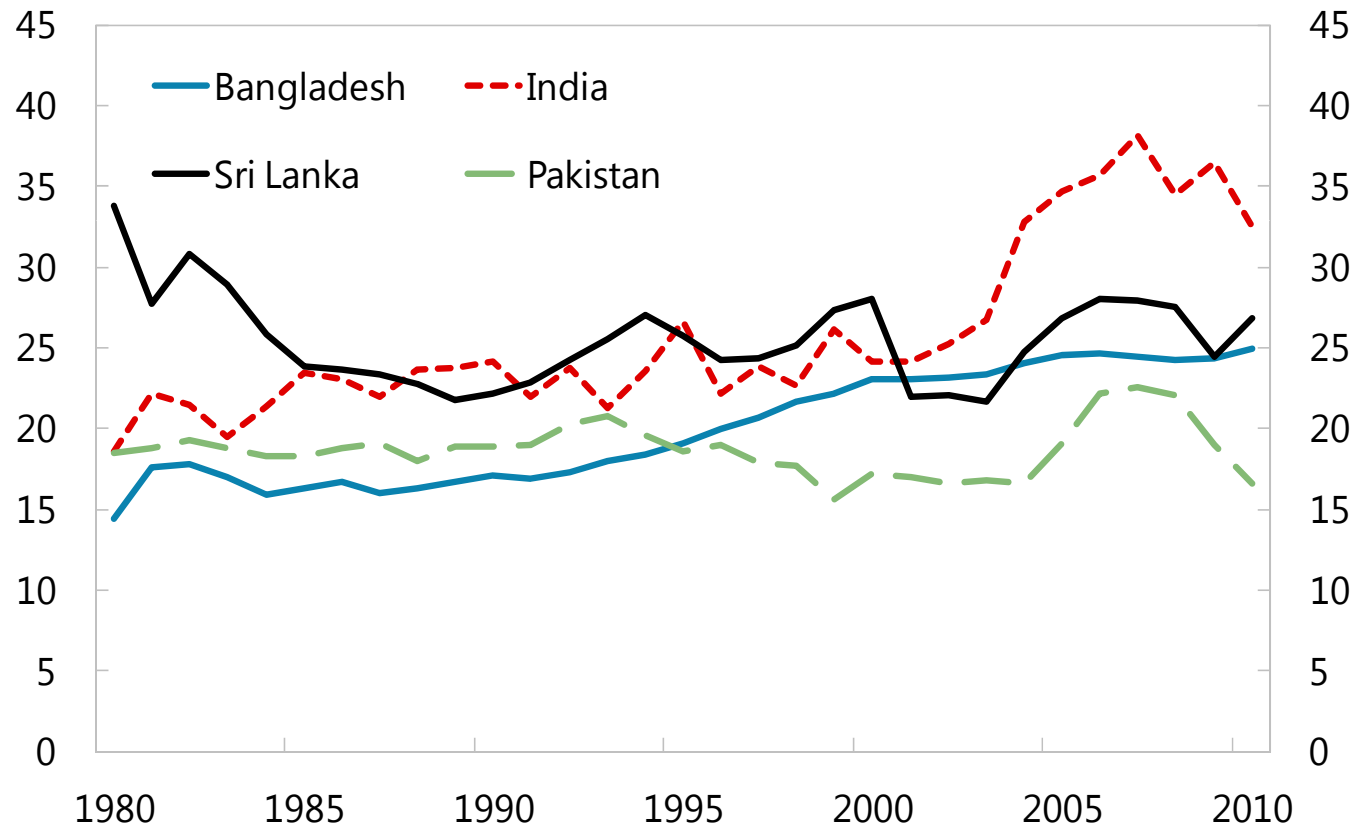
Sources: Pakistani authorities; and IMF staff estimates.



# Past economic outcomes - investment

## Gross Capital Formation, 1980-2010

(In percent of GDP)



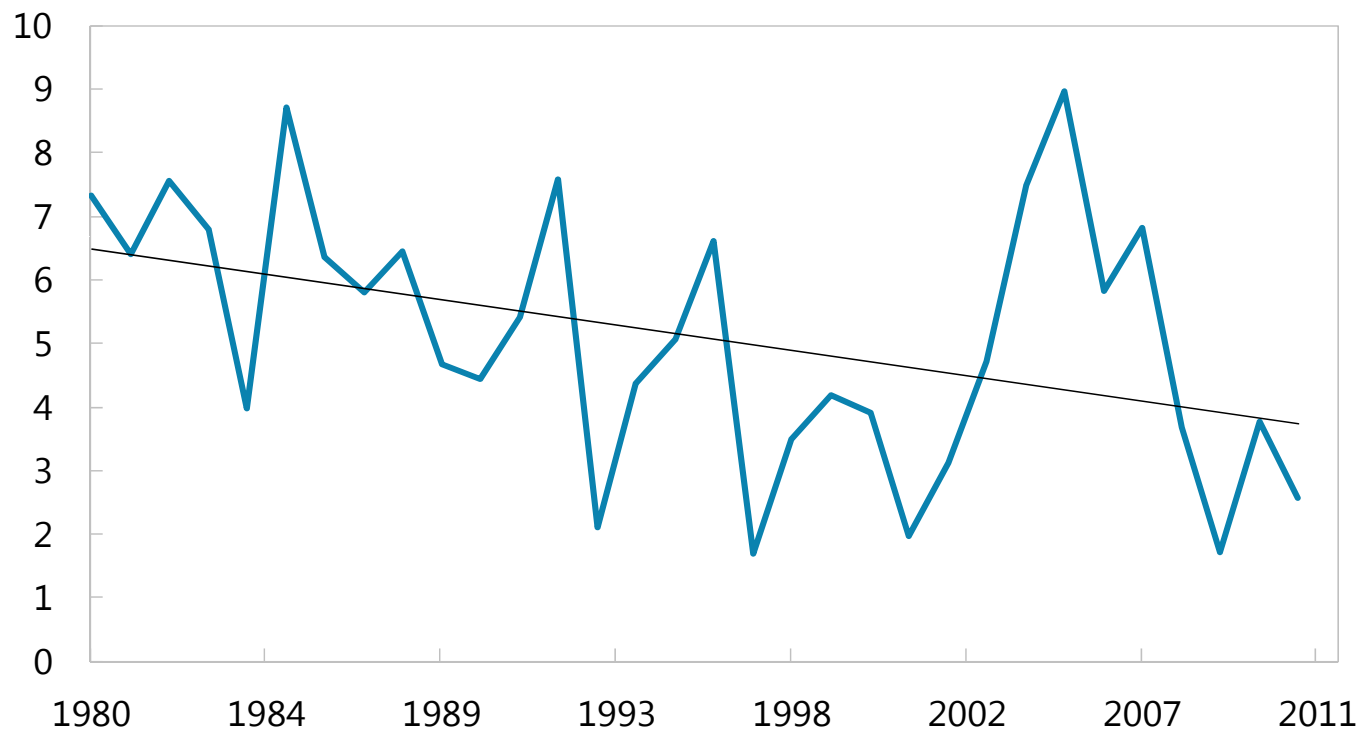
Sources: Pakistani authorities; and IMF staff calculations.



# Growth

## Real GDP, 1980–2011

(In y-y percent change)



Sources: Pakistani authorities; and IMF staff calculations.





# Growth

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## **Pakistan's New Growth Strategy**

- The government of Pakistan has formulated a new growth strategy (NGS)
- The NGS promotes sustained growth by addressing what it considers the two main constraints to growth:
  - Inadequate market development
  - Inefficient public sector management





# Employment

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- Official unemployment is low, but
- There is considerable underemployment and considerable unpaid employment and
- A young population; an average GDP growth of 7 percent per year is needed to absorb about 2 million new labor market entrants





# Inflation

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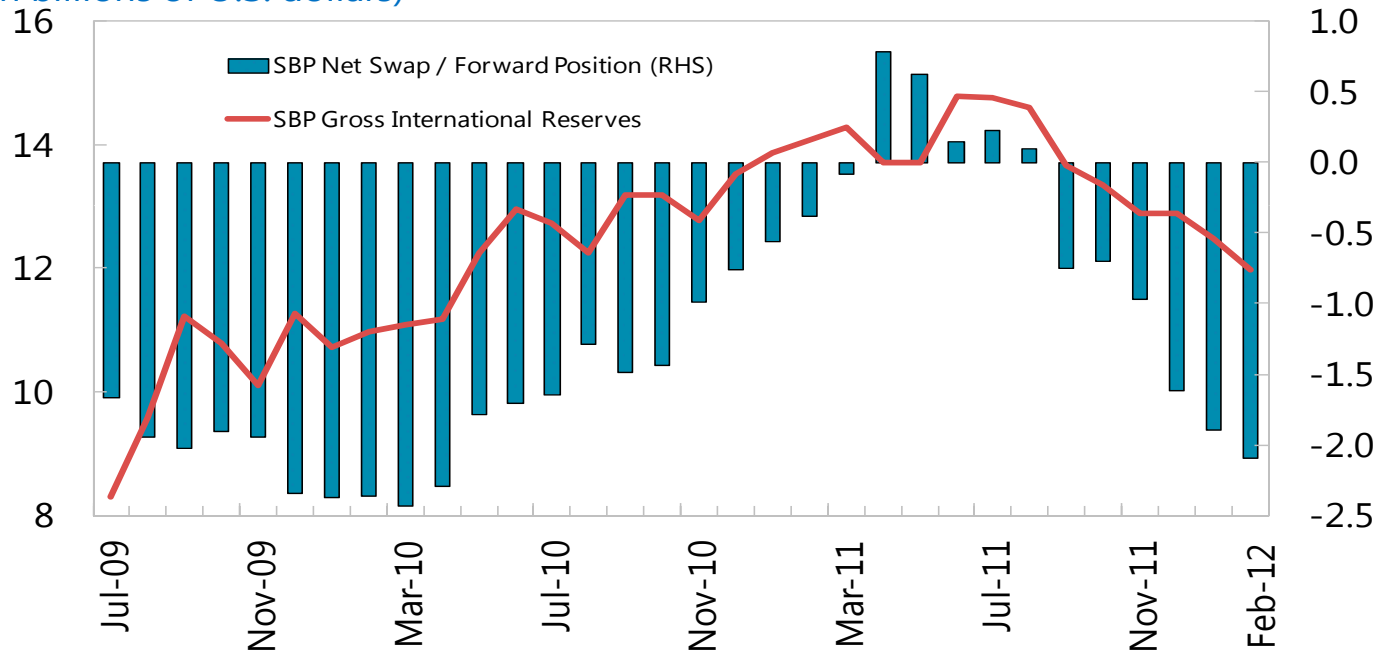
- Recent inflation performance has been poor
- High inflation is regressive and hurts the poor the most
- High inflation harms growth



# A weakening external position

## SBP Gross International Reserves and Net Swap/Forward Position, 2009–12

(In billions of U.S. dollars)



Sources: Pakistani authorities; and IMF staff calculations.

1/ Positive values indicate net purchases in the interbank foreign exchange market.





# Past economic outcomes

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- Subpar growth
- Low savings and investment
- High inflation in recent years
- Considerable underemployment and unpaid employment
- Weakening external position







# III. Outlook





# Short-term outlook

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The outlook for 2011/12 is challenging, clouded by risks in the world economy:

- Real growth is recovering, but remains at a relatively low level
- Double digit Inflation expected to continue
- Balance of payments pressures
- Fiscal pressures





# Medium-term outlook

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Without policy changes

- Fiscal deficits could crowd out credit to the private sector
- Savings and investment would decline
- Growth would settle around 3½ percent per year
- External position could deteriorate
- Sizeable financing gaps could result





# Risks

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- There are several risks tilted to the downside
  - Gross fiscal financing requirements
  - Inflation
  - Spillovers from weak global economy
  - Financial stability risks





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## IV. Policies





# Policies

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- Policy objectives: to reduce short-term vulnerabilities and boost long-term growth
- Fiscal policies
- Financial sector policies
- Structural reforms





# Alternative scenario

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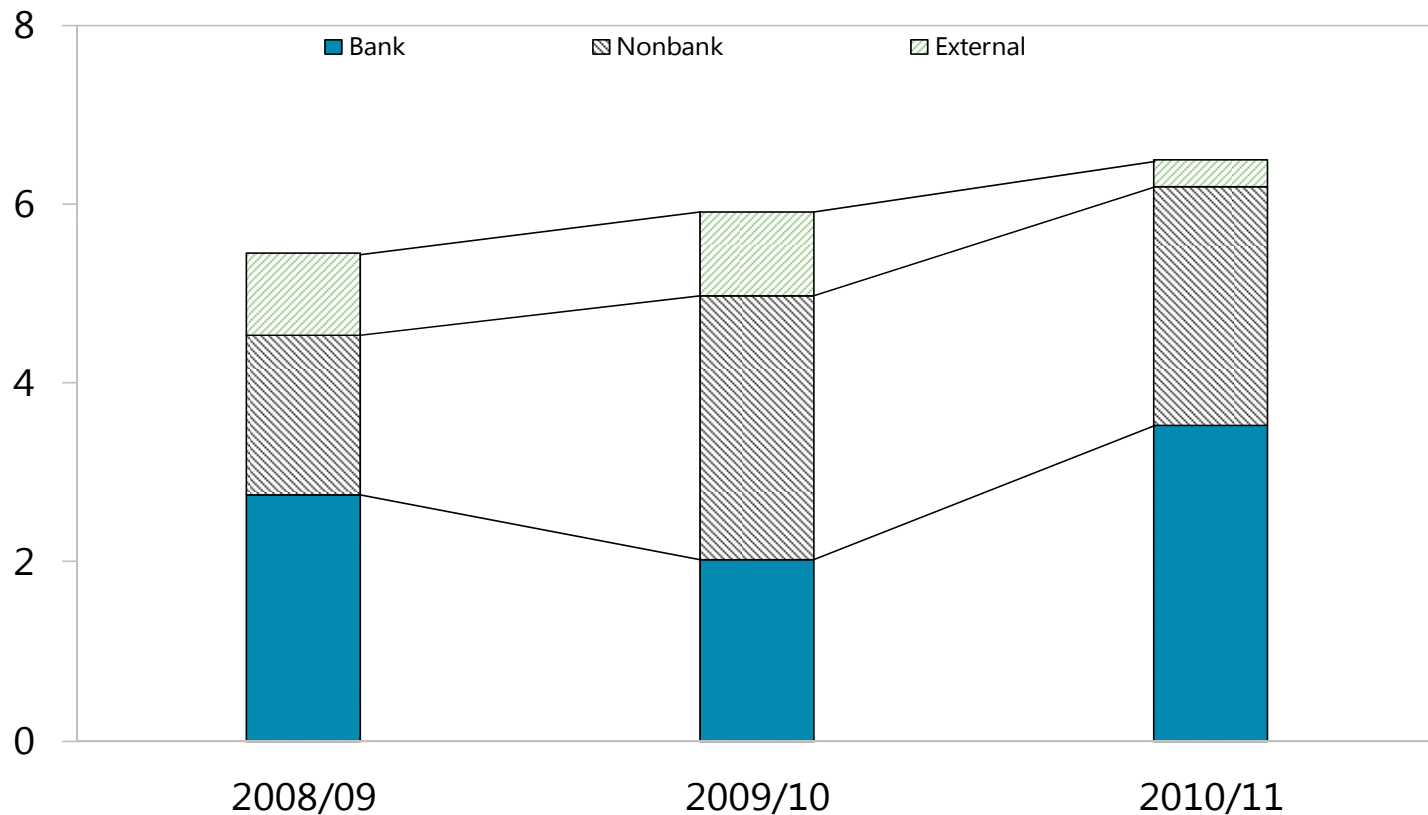
- To manage these risks and lift growth, an alternative set of policies is proposed.
- The scenario assumes prudent fiscal and monetary policies and structural reforms (tax policy, energy, business climate, and others) to enable further fiscal consolidation and higher productivity.
- These policies and reforms would produce higher growth, lower unemployment and inflation, and a more robust reserve cover.



# Fiscal policy

## Fiscal Deficit Financing, 2009–11

(In percent of GDP)



Sources: Pakistani authorities; and IMF staff calculations.







# Fiscal policy

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- In the near term, contain the deficit in 2011/12 through revenue and spending measures
  - Revenue measures
  - Limit power subsidies
  - Keep provincial budgets in surplus





# Fiscal policy

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- In the medium term
  - Revenue mobilization
  - Improving composition of spending by reducing untargeted subsidies, tightening other non-wage current spending and making space for higher spending on social protection, education and health
  - Improve cash and debt management
  - Strengthen fiscal decentralization framework





# Financial policies

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- Monetary and exchange rate policy
  - Cautious monetary policy needed
  - Allow more exchange rate flexibility
  - Strengthen central bank autonomy





# Financial policies

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- Safeguarding financial sector stability
- Safeguarding financial stability in the face of rising risks
  - Address NPLs
  - Limit regulatory forbearance and promptly restructure problem banks
  - Improve financial governance
  - Introduce deposit insurance
  - Establish commercial courts.
- Development of capital markets priority
  - Encourage the development of the managed funds industry, and
  - Greater transparency in company data





# Structural reforms

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## Improving Pakistan's competitiveness

- The key to Pakistan's external competitiveness is improving security conditions, the reliability of energy supply, and its business environment and governance.
- Out of 142 countries included in the World Economic Forum's *Global Competitiveness Report 2011–12*, Pakistan ranked 118.
- The World Bank *Doing Business Report 2011*, in which Pakistan ranked 83<sup>rd</sup> out of 183 countries.





# Structural reforms

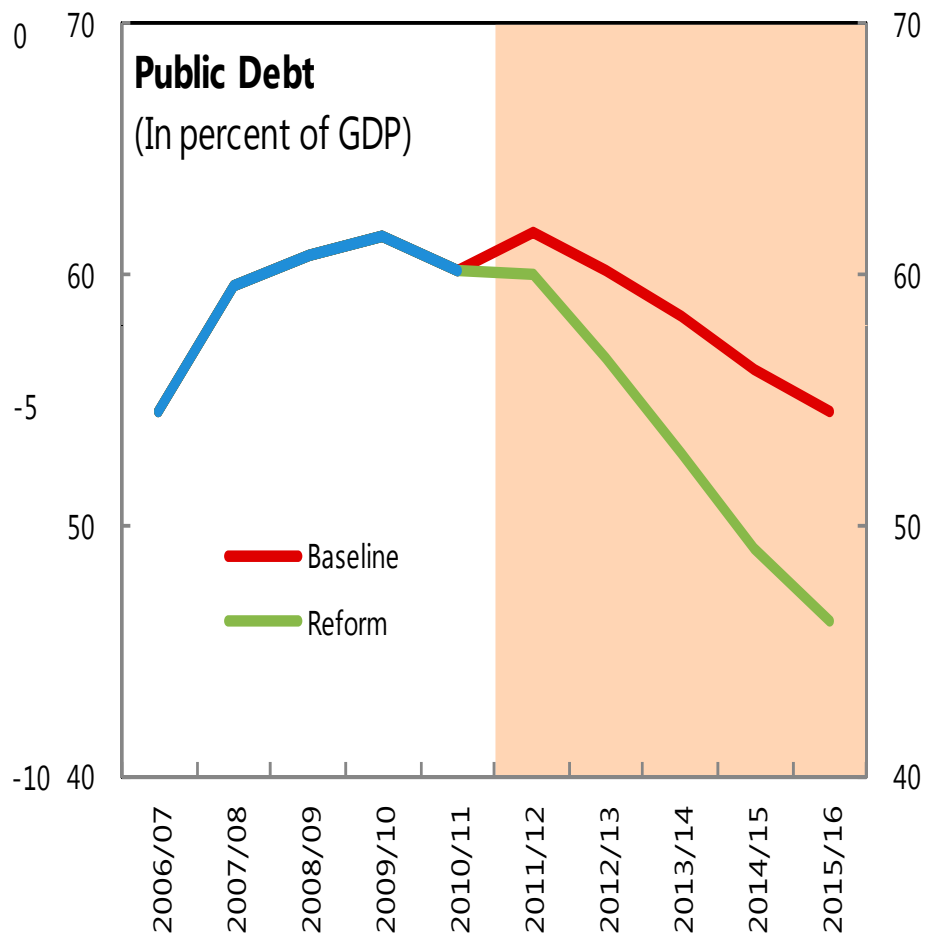
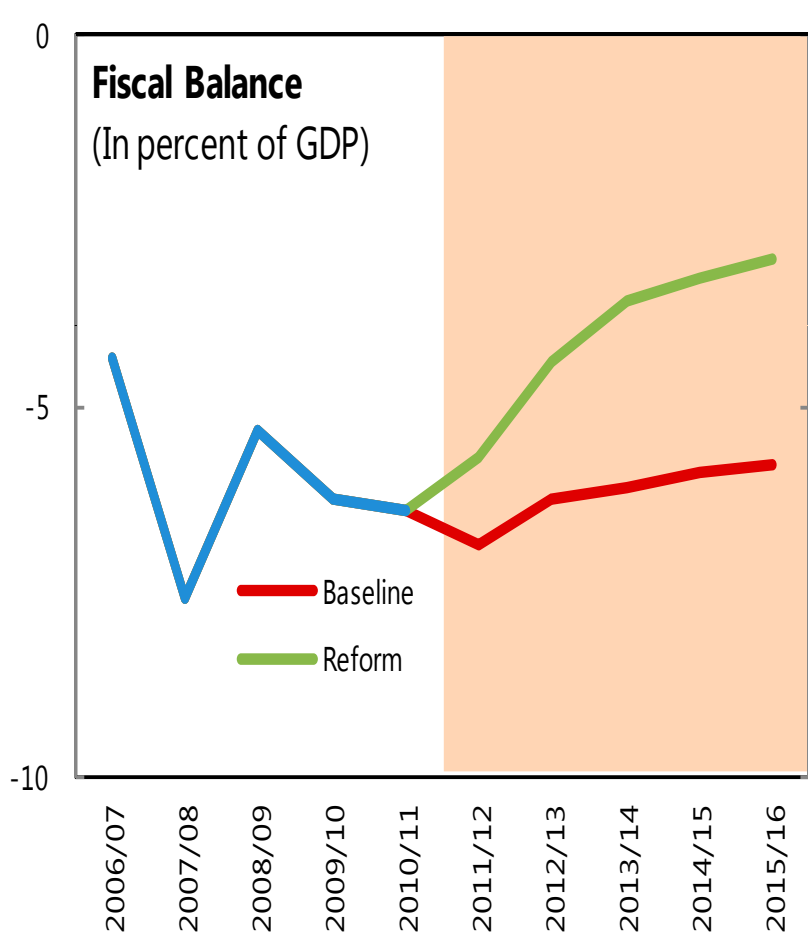
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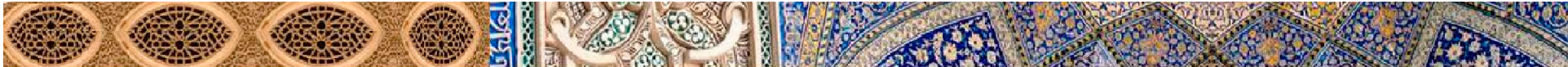
## **Sustained and inclusive growth requires a number of structural reforms**

- Improve reliability and efficiency of Pakistan's energy supply
- A strategy to restructure the large public enterprises
- A program to further reduce the state's footprint in the economy
- Improve the investment climate, by promoting better regulation and governance and facilitating the entry and exit of firms
- Civil service reform
- Improve the functioning of the financial sector
- Further strengthening of the social safety net
- Continue trade liberalization

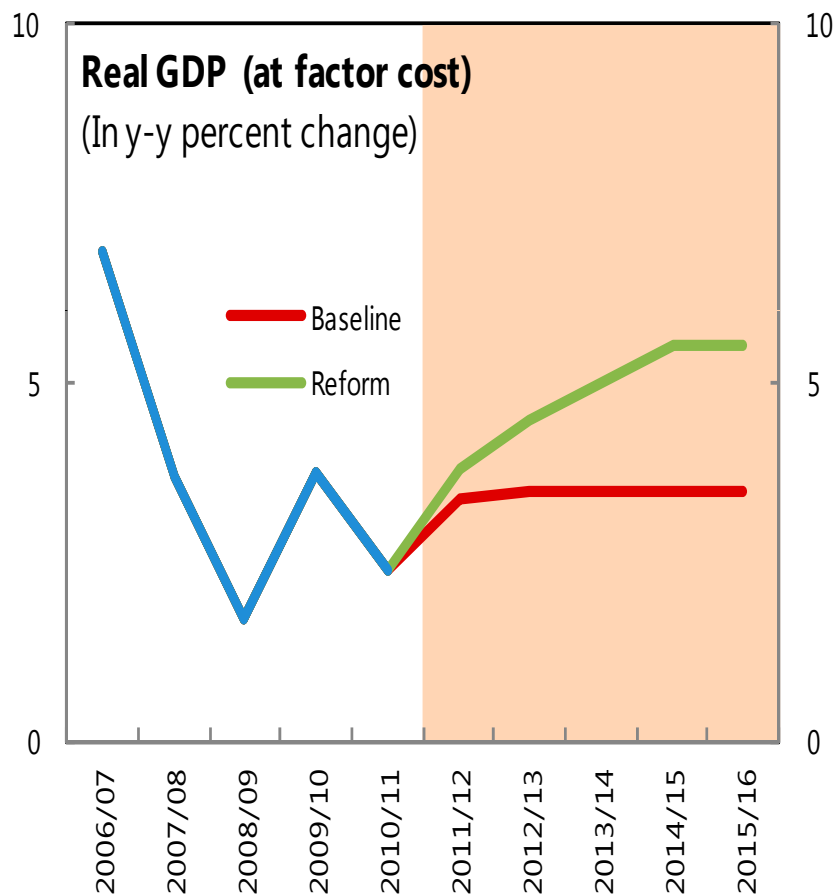
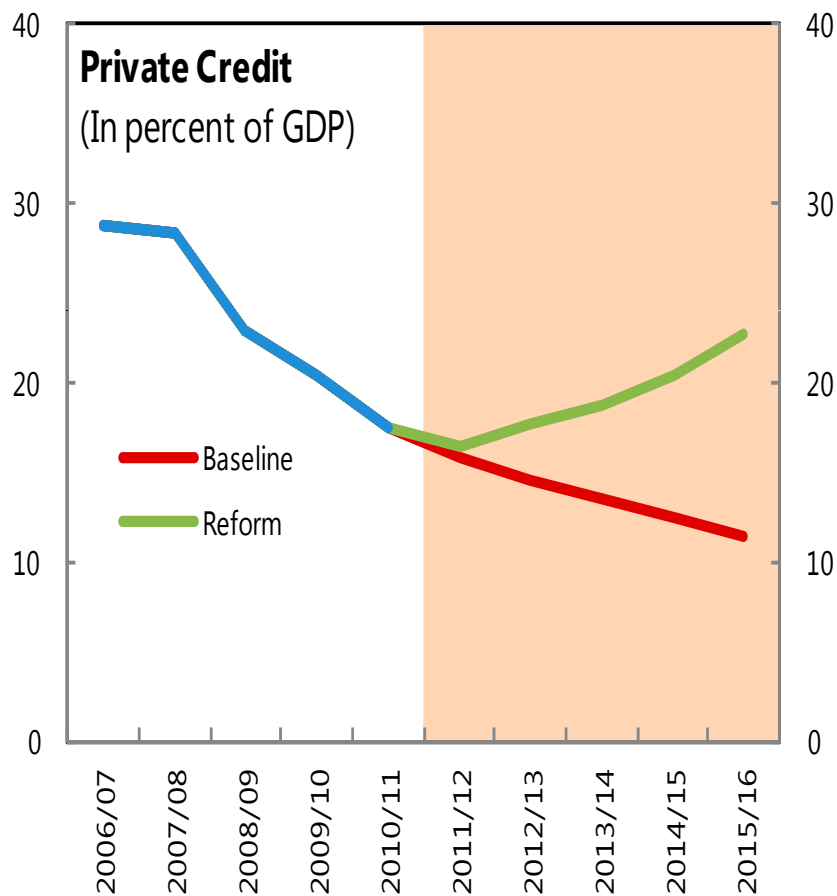


# Alternative scenario - Public finances



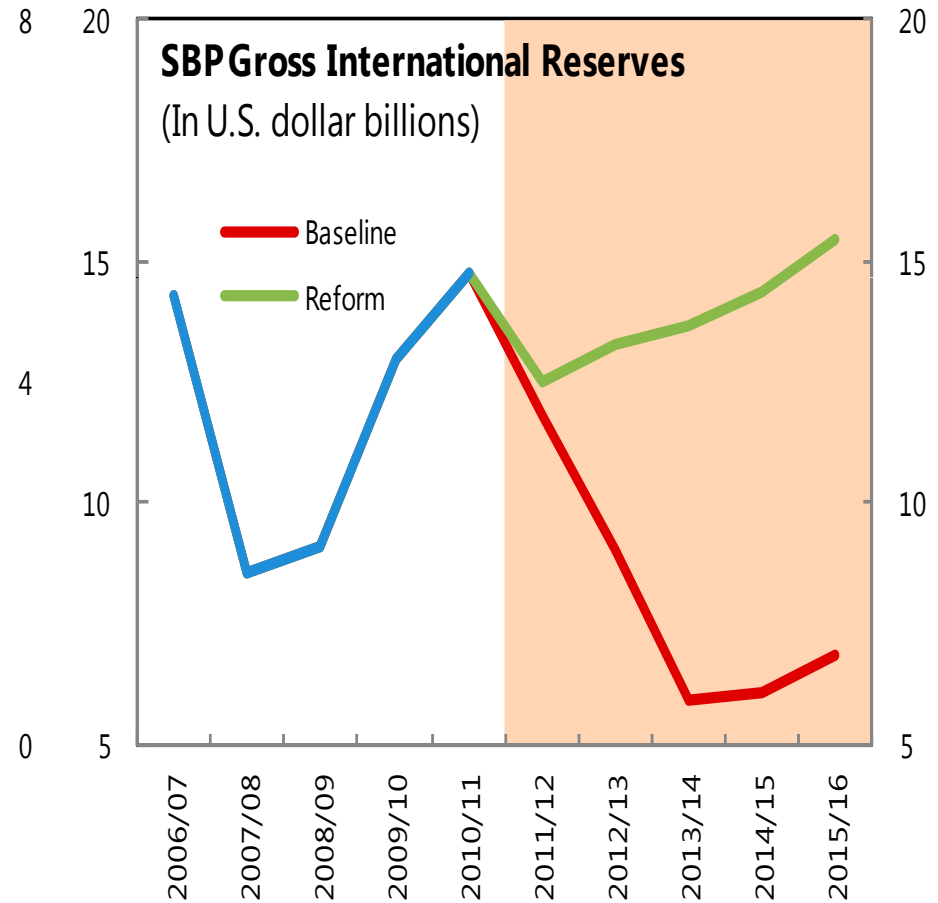
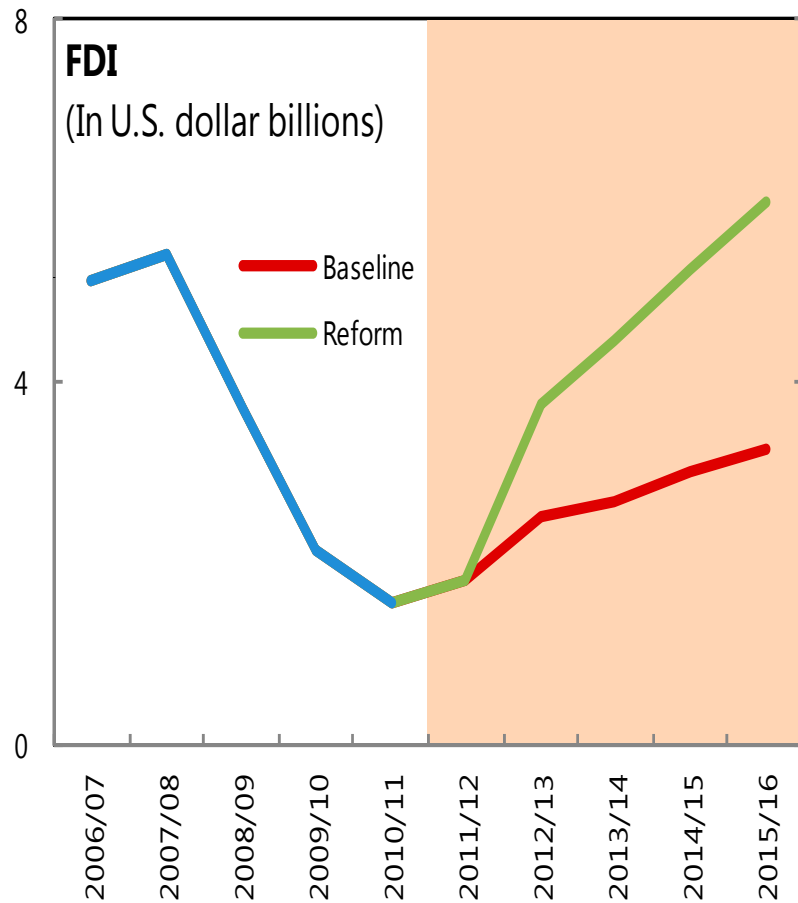


# Alternative scenario - Credit and GDP growth





# Alternative scenario—FDI and reserves



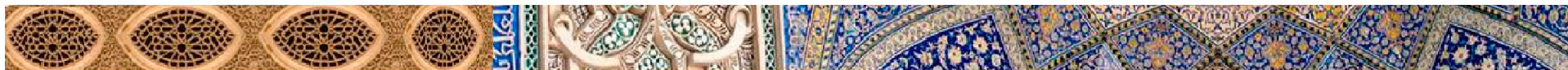


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Thank you

For further information, please see

<http://www.imf.org/external/pubs/cat/longres.aspx?sk=25714.0>

