



EXTERNAL IMBALANCES OF PAKISTAN: CAUSES, CONSEQUENCES AND REMEDIES

Initial Round Table Report
23 August 2022

Islamabad Policy Research Institute (IPRI) &
Karachi School of Business and Leadership (KSBL)

The only way that we can reduce our financial dependence on the inflow of funds from the rest of the world is to reduce our trade deficit.

The external imbalance is a result of a range of issues, including but not exclusively limited to high level of dependence on imported inputs in the manufacturing sector. Another reason is an inadequate export structure which is characterized by relatively low value-added commodities. The combination of these different factors has made exports more vulnerable to the external demand conditions. Therefore, the domestic economy is highly vulnerable to external factors. Due to rising international fuel prices and falling exports, the trade deficit has widened. Swelling import bills have strained the government's budget, as well as investors' confidence in the economy. Recent economic trends have placed Pakistan's currency in a state of crisis. Remittances sent by overseas Pakistanis have reduced substantially and Foreign Direct Investment (FDI) has slowed down. This combination has placed a strain on the economy, resulting in a higher current account deficit. The foreign exchange reserves are no longer sufficient to meet debt service obligations, which have reduced our capital account as well. The result is that our domestic currency has been devalued.

This roundtable is organized to discuss the external imbalances of Pakistan's economy, its gravity, and its impact on the people. Specifically, causes that are responsible for this imbalance were discussed, including market distortions, lack of competitiveness in key sectors due to weak institutions / regulations, lack of adequate infrastructure development, rising interest rates etc.

Scope of Discussion

- Identification of factors responsible for trade deficit in Pakistan.
- Barriers to FDI and strategies to improve investment environment in Pakistan.
- Role of remittances in reducing the current account deficit and ways to increase their inflow.
- Consequences of these external imbalances on economic growth of Pakistan.
- Ways to redress external imbalances.



The scope of this round table was to identify the factors responsible for trade deficit in Pakistan; barriers on the path of soliciting foreign direct investment (FDI); and last but not the least, as to how to tackle with a soaring current accounts deficit.







Discussants

Hussain Dawood

Chairman Engro Corporation and
Chairman KSBL
Closing Remarks

Dr. S Akbar Zaidi

Executive Director – IBA Karachi
External Imbalances

Dr. Farooq Pasha

Senior Economist - MENAP at Standard
Chartered Bank
*Role of Monetary Policy in External
Imbalance*

Dr. Ahmad Junaid

Associate Professor, Cluster Head
Finance and Accounting at KSBL
*Consequences of external imbalances on
economic growth and investment*

Dr. Aqdas Afzal

Professor at Habib University Karachi
*The new challenge of inflation and
external imbalance facing Pakistan*

Dr. Safia Minhaj

Professor at University of Karachi
Debt Austerity versus Leakages

Dr. Amir Hussain Saddique

Research Economist at Applied
Economics Research Center
Trade Agreements

Dr. Aadil Nakhoda

Professor at IBA Karachi
Trade

Mr. Moin ud Din Khan

Former Economist at SBP
Remittances

Mr. Salman Raza

Deputy Director at TDAP
Trade Imbalances

Ms. Afshan Uroos

Deputy Manager at TDAP
Balance of Trade

Mr. Ahsan Zafar

CEO Engro Fertilizer
*Role of Industrialization in promoting
exports*

Mubashar Hameed

Rector & CEO KSBL
Human Up scaling

Aijaz Haq

Head of Strategy and Chief of Staff, KSBL
Moderator

Participants from IPRI

Amb. Dr. Raza Muhammad

President

Dr. Aneel Salman

Chair, Economic Security
Moderator

Basit Ali

Research Assistant

Husnain Akram

Resident Researcher

“We need to move beyond gross domestic product as our main measure of progress, and fashion a sustainable development index that puts people first.”

– Ban Ki-moon, former UN Secretary General

Round Table Discussion



Amb. Dr. Raza Muhammad *President IPRI*
(Opening Remarks)

Foreign direct investment can play a major role in overcoming the current account deficit. The case in point is the economic progress of Asian Tigers, where foreign direct investment played an important role. Unfortunately, investors are reluctant to invest in Pakistan's economy due to policy inconsistency. Business-friendly environment should be harnessed to facilitate both domestic and foreign investments.



Dr. S Akbar Zaidi
External Imbalances

Historically, Pakistan's economy is the victim of its geostrategic position. Therefore, its economic comparison with the neighboring countries is not justified. One of the solutions to Pakistan's economic problems is to focus regional connectivity with a focus on trade with India. We have been underestimating remittances, but the fact is that they constitute a major share of our foreign reserves.



Dr. Farooq Pasha
Role of Monetary Policy in External Imbalance

Pakistan's monetary policy is a policy just to stabilize the short-term fluctuations in economy. Domestic monetary policy has certain limitations like it can't save the economy from external shocks like fluctuating oil prices. Therefore, we ought to ask ourselves if we need a short-term policy-oriented approach or long-term structural approach to solve our balance of payment crisis. Pakistan needs to have a structural approach to monetary policy.



Mr. Ahsan Zafar

Role of Industrialization in promoting exports

A stable economy is important for national security. The reason USSR could not stop its disintegration was because of its weak economy as compared to the US economy. The biggest issue of the economy is high population growth rate and consequently food insecurity. To reduce the trade deficit, we need to discourage imports by levying import duties and provide subsidies to export sector. Government of Pakistan needs to work on policies targeted at enhancing labour productivity. The economy is suffering from inefficiency. There is scope of heavy engineering, too, and we need think about it. The government needs to cooperate with businesses to invest more in the country.



Mr. Mubashar Hameed

Rector KSBL

All the modern economies have concentrated on developing their people, which have made all the difference. Therefore, Pakistan should invest more on developing its human resource, so that they can bring in more foreign remittances.



Dr. Safia Minhaj

Debt -Austerity versus Leakages

Government of Pakistan needs to cut back its expenditures, especially expenses on unnecessary government protocols in order to avoid deficits. Pakistan's monetary and fiscal policies are working in isolation. As a result, Pakistan is unable to effectively cater to its growing debt.



Dr. Amir Hussain Saddique

Trade Agreements

Dollarization is the biggest challenge before Pakistan's economy at the macro-level. Pakistan pays its import bill in dollars to all the trade partners. It increases the demand of dollars and consequently devalues the domestic currency. Pakistan needs to control dollarization. Entering into currency swap agreements followed by their effective implementation is one way to do about it.



Dr. Ahmad Junaid

Consequences of external imbalances on economic growth and investment

Pakistan's higher population growth rate is alarming, as it has outpaced the economic growth rate of the country. Pakistan has import-led growth model. Therefore, dependence on imports is increasing day by day and adding to trade deficit. Not only Pakistan has low investment but also whatever investment is made, it is directed towards the unproductive sectors like real estate. Investments ought to be steered towards productive sectors of economy, such as the manufacturing sector. It will help boost our exports and help Pakistan overcome balance of payment crisis.



Dr. Aqdas Afzal

The new challenge of inflation and external imbalance facing Pakistan

Monetary policy has distributional consequences. Businesses need lower interest rates as it reduces cost of borrowing for them. Citizens demand higher interest rates with the hope that it would bring inflation down. Government should not be trying price controls. In the short-term, interest rate needs to go up. It will slow down economy and will help both in reducing fiscal deficit and current account deficit. It will help bring forex. Government needs to move from imported energy resources to alternative sources of energy.



Mr. Moin ud Din Khan

Remittances

Remittances play a crucial role in Pakistan's economy, providing a much-needed inflow of dollars to boost foreign exchange reserves. One reason behind increase in the volume of remittances is the increase in number of Pakistani labourers in the Middle East markets in the recent years. SBP has launched schemes like TT Charges Scheme, Exchange Companies (ECs) Scheme, M Wallet and Sohni Dharti Remittance Program (SDRP) to facilitate remittances.



Dr. Aadil Nakhoda,

Trade

The biggest challenge Pakistan's economy is faced with is on the productivity side. Lower productivity affects the manufacturing sector and consequently exports. As a result, exports end up being less competitive. Rising East Asian economies are focusing on finished goods, while Pakistan is stuck with exports of raw goods only. Government needs to increase the productivity level by fostering competition among firms. Current policies favour large exporters by providing them handouts\subsidies. This doesn't incentivize them to add value to the goods they are exporting. Thus, our exports majorly comprise low-valued goods.



Ms. Afshan Uroos, Deputy Manager at TDAP

Balance of Trade

Pakistan has a limited basket of export goods. The textile exports include only the raw material or summer clothes. Majority of Pakistan's export destinations are European markets where the winter season lasts for eight months a year. But the textile sector doesn't export winter clothes despite having both the demand and capacity.



Mr. Salman Raza
Trade Imbalances

The reason Pakistan's trade policies are failing is because they are not integrated in a strategic manner. Despite having an agriculture base, yield per acre is very low. It needs to be increased by investing in Research and Development in the sector.



Amb. Dr. Raza Muhammad, President IPRI
(Closing remarks)

A business-friendly environment should be created to attract the investors, both the domestic and international ones. CPEC is being demonized by the Western block because of the global competition between China and the US. Pakistan's economy cannot progress without regional connectivity. India and Pakistan need to improve its relation to benefit from their trade potential.



Hussain Dawood, Chairman Engro Corporation
(Closing Remarks)

Pakistan's biggest problem is disunity because of which we don't have a direction. Without focusing on human development, our economy can't progress. Unfortunately, Pakistan is the lowest on Human Development indicators in the region. Government should harness the potential of private sector in overcoming the economic challenges. Pakistan was the 4th largest Asian economy in 1960s. But we lost our direction by changing the economic paradigm. To overcome economic challenges of today, private sector needs to be encouraged. We also need to shed away from the colonial thinking.