Thirteenth International Conference on
Management of the Pakistan Economy
Igniting Technology led Growth in Pakistan: Role of Monetary, Fiscal and Investment Policies
29 -30 March, 2017

The next Lahore School conference on management of the Pakistan economy, 29 – 30 March, 2017, will address the role of monetary, fiscal and investment policy in igniting growth in Pakistan. In reviewing past successes and failures and constraints on technology led growth, the goal would be to draw lessons and guidance on how macro and micro level policies can contribute to accelerating economic growth in Pakistan.

In 2016, Pakistan economy stands at a crossroad. Pakistan is in the middle of some profound economic, political, and social transformation. As the Pakistani economy has stabilized over the last few years, the focus has turned towards restarting economic growth. This is a challenging task because of the structural problems faced by the economy as well as the global economic slowdown. While the economy has avoided a major downturn after IMF's package of 2013, but outlook remains murky for economic growth due to various deficits, financial sustainability and capacity constraints.

The fact remains that Pakistan economy has experienced a tepid growth rate in 3-4% range in the last decade and has struggled in management of budget deficits, trade deficits, capital inflows-out flow in the external sector, circular debt and management of domestic and external debt. The dominant role of indirect taxes, improperly managed exchange rate and trade policy, falling exports and remittances, lack of FDI with an exception in the power sector etc., have hamstring the growth prospects.

The Pakistan 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 better educated labour 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 accentuated in recent years. Yet there can be an apparent trade-off 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 realise 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 was indeed the successful path followed by the East Asian countries.

This strategy of ensuring higher productivity and high employment growth requires a steep increase in the current low level of investment for new investment embodies new technology innovation and latest knowledge. A growth promoting fiscal and monetary stance is needed both to stimulate demand and ensure adequate credit to finance new investment. It requires on the supply side a more flexible and skilled work force including world class scientists, engineers and competent technicians. This may require attracting foreign investors who are prepared to make

local industry part of their global value chains and at the same time ensure technology transfer and up-gradation of skills so that local firms move to higher value-added activities.

The success of this strategy will also critically hinge on stimulating export growth to provide the foreign exchange to purchase new and latest machinery. Over the last twenty years recurring balance of payment crisis have led to a stop-go cycle of growth and repeatedly going to the IMF to bail out the economy. A productivity focused growth strategy will make the economy competitive and ensure not just sustainable but higher and more job generating equitable growth.

In case of FDI, Pakistan remains unsuccessful/much below in attracting capital relative to other economies in the region. However, the performance in attracting capital through FPI can be termed as somewhat promising. Debt instrument such as Euro Sukuk bond are the main contributor in FPI inflows, which are attracted by offering high return relative to other economies. It can be inferred that risk premium is relatively high in case of Pakistan due to internal situation. Simultaneously, Pakistan position is vulnerable to the global shocks. It seems that in Pakistan, exacerbating factors dominates in the cost benefit analysis of global recession. Thus, there is an acute need to address these issues by redesigning the fiscal, monetary, and investment policies.

A related question is Pakistan's reliance on external debt; is it sustainable way to keep reserves high? Another unique event of this decade is financial market have become more intertwined, the notion of a "global interest rate" becomes more persuasive. The global real interest rate is now negative, denoting that the capital-to-labor ratio has become so high in developed economies that central banks effectively pay to lend at the overnight rate. This may have its own spillover effects for Pakistan. Central bank policy is supposedly segregated by political jurisdiction, but it is clear over the last decade, monetary policy has become increasingly global in an increasingly integrated international economy. The case of steadily decreasing long-term rates become more of an issue as economies develop.

Economists have long recognized the limitations of the monetary and fiscal policies in promoting economic growth in the developing countries. Even in the developed countries, due to current near zero (or even negative) real rates of interest, the monetary policy seems to have lost any stimulant power in the face of persistent sluggish economies. Rise of new players like shadow banks microfinance, sovereign funds, evolution of ultra-capital and economic super-entities have created new structures in the global economy. The growing dominance of financial sector and markets over the traditional industrial and agricultural economies, poses new challenges for economies seeking to foster economic growth.

In addition to conventional policy tools that can promote growth, there is also a growing understanding that industrial policy has played a key role in the growth in modern economies. The presence of market failures in the developing country context typically leads to low levels of research and development, stunted innovation and obsolete technologies which in turn lead to low productivity traps. Thus successful industrial policy emphasizes the role of the government and focuses on the macroeconomic objective of higher total factor productivity as well as the microeconomic objective of higher firm level productivity through innovation and technology adoption. Countries that have broken out of these low productivity cycles have focused on creating

opportunities and incentives for researchers and institutions to innovate, for firms to innovate and adopt new technologies and for workers to gain the skills that lead to higher productivity.