Chapter 2

MACROECONOMIC FRAMEWORK AND STRATEGY

The Plan is the first step towards attaining the long-term goals articulated in the Vision 2025, and the thrust is to achieve growth, while maintaining macroeconomic stability and distributional equity.

Growth with macro stability

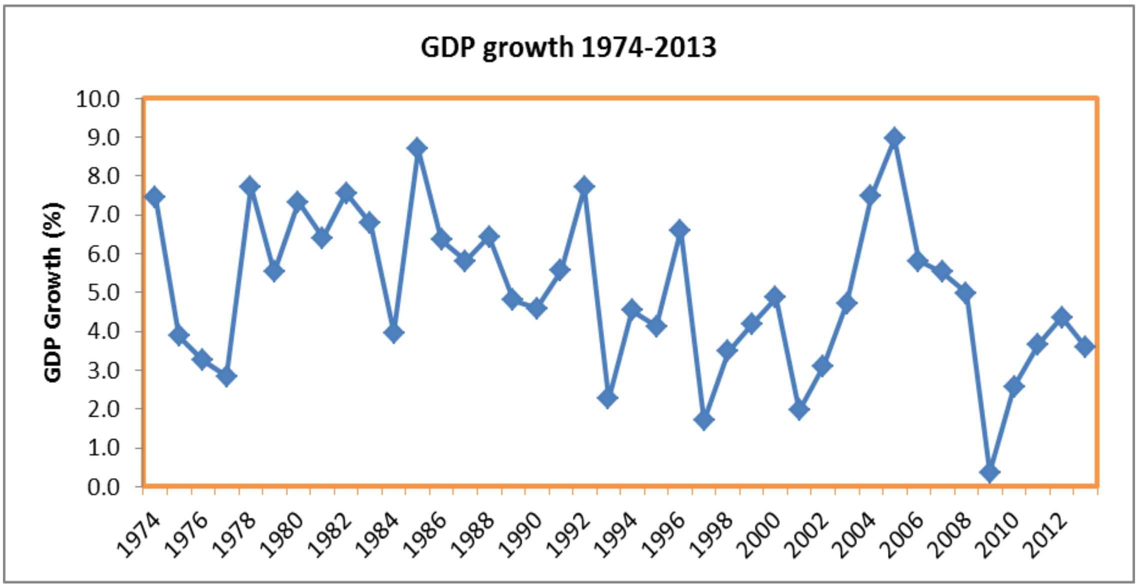
The macroeconomic stability is a fundamental prerequisite for sustained economic growth. The macroeconomic framework for the Plan has been designed to put Pakistan's economy on a robust growth trajectory through prudent macroeconomic management, which will ensure a stable macroeconomic environment with low inflation and sound internal and external balances. In the recent years, Pakistan has witnessed significant macroeconomic imbalances due to a combination of multiple factors like rising international commodity prices, global financial crisis and domestic supply constraints, such as acute energy outages and intensification of the War on Terror. The immediate aim, therefore, is to consolidate the emerging macroeconomic stability through appropriate monetary and fiscal measures, aimed at crowding-in the private investment, mobilising domestic savings and reviving the economic growth process.

Growth, investment and savings

Considering the period of 1974-2013 as a whole, Pakistan's average annual growth rate of 5.3 per cent would be regarded as reasonably satisfactory (Figure 1). However, three elements in the experience give cause for concern. First, in the most recent five-year period (2008-2013), the average growth dropped to 2.8 per cent. Second, too much of the growth has resulted from adding more units of capital and labour, and too little from increases in productivity. Thus, during the period of 1970-2005, increases in productivity provided about 20 per cent of the raise in the GDP; however, during 1998 to 2008, contribution of the Total Factor Productivity (TFP) accounted for only 11 per cent of the increase in the country's GDP. Third, Pakistan has consistently mobilised insufficient domestic savings, leaving much of the investment (and the resulting growth) to be financed by the external inflows, chiefly in the shape of foreign assistance. This reliance on the external resources, and the inevitable variability associated with these politically-determined resources, created several stop-go growth episodes in which high-growth periods were often quickly succeeded by bouts of low growth.

The Plan seeks to break this boom and bust cycle, and put the economy on the path of sustained long-term economic growth. In this context, the key areas of focus include: public-private partnership in the development process, improved productivity in agriculture and livestock sectors, enhanced industrial competitiveness, better service delivery systems, and upgraded human capital formation.

Figure 1: Annual GDP growth (1974–2013)



Source: *Economic Survey of Pakistan*

Evaluation of the economic performance (2002-13)

The growth experience of the last four decades is characterised by falling growth potential and occasional episodes of higher growth. Pakistan has become the only country in the region with a falling potential growth rate. All other countries have improved their potential growth during the last one decade or so. Output per worker has almost stagnated since 2005 (grew by just 0.6 per cent during 2005-2012), whereas it has increased almost among all peers[1] in this period. It is clear that critical structural reforms are needed in many sectors and activities if the economy is to attain the dynamism required by the country's demography and the need to prosper in an increasingly competitive global environment.

An overview of the sectoral performance, during the last five years, shows that the services sector was the major driver of growth, providing 63 per cent of the aggregate growth. Half of the growth of this sector comes from security-related services or public spending. It is worth noting that the growth of the services sector might have been higher than recorded in the national accounts since much of this sector remains undocumented.

Agriculture: During 2008-13, average annual growth was 2.4 per cent despite several price incentives and subsidies. The contribution towards growth was just 19 per cent, with the major part (15.2 per cent) coming from the livestock sector alone. The contribution of the crop sector to the economic growth was about 3.6 per cent. If the agriculture sector was to grow significantly higher than three per cent or so in the medium-term, it is likely to require extensive interventions in order to bridge the yield gap. This reinforces the need to support non-farm activity in the rural areas to make growth more inclusive and improve quality of life in the rural areas, where two-thirds of the population is estimated to live.

[1] Growth in output per worker during 2005-12: China (9.5%), India (6.9%), Sri Lanka (5.4%), Bangladesh (2.9%), Thailand (2.2%) and Nepal (1.3%) – **Source:** *Asian Productivity Database 2014*

Large Scale Manufacturing: The average contribution to the GDP growth was 11 per cent during 2008-13 (excluding negative contribution in 2008-09). The sector has been plagued by energy shortages and high-level of rent-seeking behaviour. The sector also suffers from a number of restrictive practices and other regulatory hurdles, which increase the cost of doing business, and raise barriers for investment and growth.

Consumption: For many years, the GDP growth was driven mainly by consumption, whereas investment growth has shown a declining trend. Investment as percentage of the GDP declined from 22 per cent in 2007-08 to 15 per cent in 2012-13; thereby showing a contraction of about two per cent of the GDP every year. For four out of five years, real fixed capital formation declined by 9.3 per cent per annum. Other outcomes related to the decline in investment were:

- During 2008-13, two major job-creating sectors, Large-Scale Manufacturing, and transport and communications, witnessed substantial erosion of their share in the total investment.
- Community services – mainly security-related investments – are growing largely because of the current law and order predicament.
- Investment is declining in all other sectors. As noted in the Framework for Economic Growth (FEG), construction and retail investment have remained very low throughout the period largely due to the adverse regulatory environment and inadequate moves to modify city-zoning.

Financial sector deepening: It is an important gauge of intermediation in an economy. The ratio of M2-to-GDP, a measurement of financial deepening, stood at 36 per cent of the GDP in 2012-13 (compared to 77 per cent of India). Access to finance and financial inclusion have become critical issues of Pakistan. The non-availability of competing instruments causes burdens on consumers, who are compelled to borrow from banks. The underdeveloped insurance sector and pension funds also impede financial intermediation and result in lower level of the domestic savings.

External sector: While both exports and imports grew between 1998-99 and 2007-08, the sluggish economy, structural and policy issues have kept the ratios of exports, imports and trade short of the GDP from any significant growth. These ratios show that the economy remains relatively closed, which is a factor constraining the economic growth. These factors will continue to affect economic activity in the medium-term; thus warranting policy reforms in the area for boosting the trading sector of the economy.

Proposed Plan

Macroeconomic targets

The objective is to increase real per capita income by about 20 per cent, based on an average GDP growth rate of 5.4 per cent and population growth rate of 1.9 per cent per annum during the Plan period. The following are some of the major projected outcomes:

- Opening of new avenues of economic growth in new sectors and harnessing potential of deprived regions of the country
- Keeping inflation rates in single digits during the Plan period

- Overcoming energy shortages and ensuring smooth and affordable energy supplies by the end of the Plan period
- Building modern infrastructure and extending the outreach of physical infrastructure to the remotest areas of Pakistan (for example, motorways, mass transit system, Gwadar Port, CPEC-related rail and road networks)
- Improving Pakistan's standing in international comparison of the cost of doing business and in the business environment for the private and foreign investors[2]
- Reducing the debt burden to a sustained level[3]
- Enhancing delivery, cost effectiveness and quality of output of the public sector investment programme through adoption of new development vehicles, like the public-private partnerships
- Active involvement of the private sector and civil society in formulation, monitoring and evaluation of the public sector projects

Drivers of the economic growth

The government will redefine its role as a facilitator and regulator rather than directly managing the production and distribution. However, it will continue to perform its decisive functions of the macroeconomic management, policy formulation and implementation of various laws. The private sector will be the main engine of economic growth and development. This will require a substantial revamping of the country's governance system, its incentive structure and the functioning of institutions. The industrial competitiveness will be increased, and cost of doing business reduced by major improvements in infrastructure, institutional reforms and policy paradigm.

New sectors will be identified and developed, while the existing sectors will be provided with information and support to modernise their production and distribution systems. Improved technology and information regarding best international practices will be disseminated throughout the agriculture sector in order to increase its value-addition. Agriculture and agro-business sector will be developed through vertical integration to reach high-end international markets.

The industrial development will be stimulated by making the Pakistani firms part of the global value chain through an enhanced competitiveness and reduction in the cost of doing business. Particular attention will be given to the Small and Medium Enterprise (SME) sector, which also generates sizeable proportion of employment. Measures, such as increasing number of the Common Facility Centres (CFCs), will be actualised to enable the SMEs improve quality and value-addition, and provide incentives to get formalised.

The services sector contributes more than 58 per cent to the GDP, and has emerged as major driver of the economic growth in the recent past. There is still unexplored potential in key services such as domestic commerce, transport, finance and insurance, communication,

[2] GCR rank among top 100 countries (Vision target: Top 75), Ease of Doing Business Rank (among Top 75), Double labour and capital productivity (Vision target: Triple), Knowledge Economy Index score from 2.2 to 3 (Vision target: 2.2 to 4)

[3] 60% of the GDP according to Fiscal Responsibility and Debt Limitation Act

housing, tourism, and social and community services. Appropriate measures will be designed to effectively harness the potential of this sector.

Sectoral growth projections

The projections are based on a reform programme and policy interventions to be undertaken during the next five years. The industrial sector has to play a crucial role, and it will benefit from an enhanced energy supply, administrative reforms, re-engineering of the business processes, opening up of the export market, and additional demand as a result of the rising incomes. The agriculture sector will receive major policy support in terms of quality inputs, better water management, enhanced credit lines and better-linked markets. The natural disasters and negative fallout of the climate change are major risks to the agriculture. The services sector will remain the mainstay of the economy and significantly contribute to the growth momentum. Important contributions are expected from the financial services, transport, communication and trade services. Table 1 shows projections of three sectors.

Table 1: Sectoral growth projections

(Per cent)

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2013-18
	Final	Revised	Provisional	Projections			Averages
Agriculture	**2.7**	**2.7**	**2.9**	**3.9**	**4**	**4**	**3.5**
Important crops	0.2	8	0.3	3.2	3.3	3.3	3.6
Livestock	3.4	2.8	4.1	4.1	4.1	4.1	3.8
Industry	**0.6**	**4.5**	**3.6**	**6.4**	**8.2**	**9**	**6.3**
Large Scale Manufacturing	4.2	4	2.4	6	8.5	9.2	6
Services sector	**5.1**	**4.4**	**5**	**5.7**	**6.8**	**7.3**	**5.8**
GDP (bp)	**3.7**	**4**	**4.2**	**5.5**	**6.5**	**7**	**5.4**

Savings and investment

The macroeconomic policies, including monetary, fiscal and exchange rate, will be designed to reinforce each other and create incentives for saving mobilisation. The taxation policies will be redesigned to enhance allocative efficiency in the economy, and will also be a great deal of attention to an equitable sharing of the tax burden by all income earners. The entire list of the Statutory Regulatory Orders (SROs) will be examined with a view to reducing distortions since the current SROs are mainly person or company-specific, and to levelling the playing field for the economic agents.

Attaining and maintaining high growth trajectory, as projected in the Plan, will require substantial investments. These flows will primarily be financed by mobilising higher levels of the domestic savings. In order to channelise investment to priority sub-sectors, the entire public investment programme will be scrutinised with a view to lay emphasis on those projects and activities, which will be effective for crowding-in the private investment.

The public spending has to play an important role in boosting investment. The development expenditure – for improving the infrastructure, institutions, social capital and also to promote greater equity – is likely to average at about five per cent of the GDP during the Plan period.

The public-private partnerships will be encouraged to lessen the burden on the Public Sector Development Programme (PSDP).

Growth, investment and savings strategies

The Plan recognises the importance of not only steering the economic growth to a higher growth trajectory, but also of sustaining it for longer periods. The growth strategy is based on the underlying assumptions of effective measures to enhance economic growth, a private sector-led investment drive complemented by the public investment, and incentives for more saving mobilisation. The framework has also taken cognizance of risks to the projections from challenges posed by the domestic security environment, resistance to changing the status quo and difficult global situation. The following table 2 depicts the envisaged framework.

Table 2 Macroeconomic framework
(Current prices)

(Rs billion)

Items	2012-13 Actual	2017-18 Targets	AACGR (per cent) 2017-18/ 2012-13
GDP (bp)	21,497	37,129	11.5
Indirect taxes (Net)	882	2,390	22.1
GDP (mp)	22,379	39,518	12
Net Factor Income from abroad	1,162	2,198	13.6
GNP (mp)	23,541	41,717	12.1
External Resources Inflow (net)	241	612	20.4
Total resources and uses	23,782	42,328	12.2
Total consumption	20,434	33,318	10.3
Total investment	**3,348**	**9,010**	**21.9**
Fixed investment	**2,990**	**8,378**	**22.9**
Public including General Government	**788**	**1,792**	**17.9**
Private	2,202	6,586	24.5
Changes in stocks	358	632	12
National savings	3,107	8,398	22
	As per cent of the GDP (mp)		
Total investment	**15**	**22.8**	
Fixed investment	13.4	21.2	
Public including General Government	3.5	4.5	
Private	9.8	16.7	
National savings	13.9	21.3	
External Resources Inflow (net)	1.1	1.5	
Memo items			
GDP (bp) growth	3.7	7	
Inflation	7.1	6	
GNP (mp) per capita (Rs)	**128,968**	**207,650**	**10**

In order to achieve these targets, two crucial steps are: formalisation of the economy and proper quantification of the economic aggregates with credible data. The share of Pakistan's informal economy is estimated to be more than 50 per cent[4] and employment trends also show that the informal sector is the largest employer of the workforce, which provided employment to 73.6 per cent of the non-agricultural workforce[5] in 2012-13, and is trending upwards.

Accurate and timely quantification of the economic activity is also of utmost importance because it guides the policy formulation and enables devising of appropriate strategies. Timely-revision of base of the national accounts and other economic indicators will facilitate the realisation of the Plan objectives.

Some sector-specific initiatives are given below.

Agriculture

To enhance productivity and efficiency of the sector, the government will

- overhaul marketing, advisory and extension services infrastructure with explicit targets for productivity and yield
- rationalise and monitor the mechanisms for setting the support price and procurement of wheat so as to maintain farming incentives
- increase the supply of quality seeds, including hybrid and high-yielding varieties
- ensure timely availability of the agriculture inputs by reforming the subsidies, imports policies, and marketing network
- improve water management through focus on increasing water reservoirs, for both irrigation and power generation, and
- eliminate subsidies largely benefitting interest groups rather than the poor farmers to align incentives and liberate resources from the federal and provincial budgets, and reallocate these resources for urgent public interventions, such as constructing farm-to-market roads, irrigation channels, refrigeration facilities and research centres.

Livestock

The livestock accounts for more than half of the value-addition of the agriculture sector, and imbalances between the supply and demand of the livestock products remained a major driver of inflation during the last five years.

During the Plan period, the strategy for the livestock sub-sector, among others, will consider the following initiatives:

- Formulate a milk augmentation programme by facilitating import of high milk-producing cows and buffalos from Australia and the Netherlands
- Incentivise corporate farming in order to expand meat supplies

[4] Planning Commission (2011)
[5] Labour force survey 2012-13

- Provide incentives to the poultry sector for production and exports, and enable it to exploit the potential of a large market in the Middle East

Industrial sector

Strengthening the industrial sector is a major plank in the framework of the Plan. The strategy for achieving the sectoral aims will include the following components:

- Improving the business environment by reviewing the regulatory framework governing the sector with a focus on the ease of doing business
- Provision of uninterrupted and affordable energy
- Promoting integrated supply chains and higher value-addition in the production sector
- Improving market information dissemination mechanism
- Revamping the vocational and technical education network to provide more skilled labour to the industry
- Encouraging small and medium industries through targeted loans, providing technical and extension facilities, and access to foreign markets with allowances for quality
- Establishing Special Economic Zones (SEZs) – where normal investment and trade restrictions do not apply – to help leverage further reforms

Services sector

The following steps will be taken.

- Technology upgradation
- Human resource development
- Skill development through technical and vocational trainings to enhance services exports
- Introducing export credit insurance
- Better financial regulations for improved and innovative financial instruments
- Rapid transit network in all major cities
- Improve and extend internet connectivity for penetration across Pakistan

Investment and savings

The following steps will be some of the major initiatives adopted to facilitate investment and savings.

Investment

- Making the Board of Investment (BOI) as a one-stop window for investors
- Simplifying procedures for licensing, approvals and land titles
- Creating a long-term and predictable investment and tax policy environment
- Modernisation of physical infrastructure and social networks

- Reducing entry and exit barriers for increasing competition and reducing the cost of doing business
- Forming clusters for priority industries
- Shifting of major commercial projects to the public-private partnership mode with adequate guarantees
- Designing strategies to increase venture capital

Savings

- Allowing government pension and benevolent funds to invest in stocks
- Improving and deepening corporate and government debt markets
- Increasing surveillance by the State Bank of Pakistan (SBP) to check malpractices in the financial sector
- Intensifying competition between commercial and foreign banks in the financial sector
- Limiting the spread between lending and deposit rates through an effective regulation by the SBP
- Deepening financial markets by providing incentives to increase availability of the competing financial products