The Business

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LSM growth

According to the provisional Quantum Index numbers, theLarge Scale Manufacturing (LSM) grew by 7.65 percent in September 2020 as compared to September 2019 and 10.9 percent against August 2020. That is really very impressive, especially when the downward drag of the pandemic is taken into consideration. This bit of news even helped the stock market stay in green for the day after a number of erratic sessions and the numbers seem to suggest that fiscal as well as monetary measures to stimulate the economy, to take advantage of the country's lead in handling the first wave of the pandemic, are working. The federal ministry for planning did not help clarify matters at all when it indicated that LSM had grown seven percent from July to September and 10 percent y-o-y this September.Maybe in the excitement and hurry to win points for the government, even though there was really no need for such a thing especially from the planning ministry, they mixed the numbers or maybe they know something that the Pakistan Bureau of Statistics (PBS) doesn't. Either way the uninvited comments didn't exactly help explain what is really happening in the manufacturing sector. Just as recently as August, the month before September, LSM growth had slowed down to 1.2 percent as eight out of 15 major industries recorded negative growth.

The government would right now be reconciling with the fact that any hopes of a fast recovery from the slowdown were simply misplaced. So somebody should take the trouble to explain just what miracle happened in that one month. Yet even the August slowdown would look impressive if you just take a look at LSM performance in the last fiscal, when it contracted by more than 10 percent. Now, even though the government is breathing a sigh of relief, a fair bit of skepticism seems to be justified considering how wildly growth in this sector can swing between positive and negative numbers.Until the government explains the sudden growth in LSM in a more detailed manner, especially when its own senior ministers are adding to the confusion, it is only natural for people to draw their own conclusions.

The government must explain which industries are leading the charge and exactly what to expect and when. Such things will clarify more than the expected performance of one very important sector for the rest of this fiscal. They will also shed light on the likely GDP growth figure at the end of it. And if the growth is really as impressive as all the headlines and tweets are suggesting, then every effort must be made to protect and nurture it because the second wave of the coronavirus has finally reached Pakistan in full

China, Japan and the RCEP - Part II

DR NAAZIR MAHMOOD

While the countries of the Far East and South East Asia have signed the RCEP, where does Pakistan stand? According to the IMF's estimates, Nepal and Pakistan will be among the lowest performing countries. Not only Bangladesh but even Bhutan, Maldives, and Sri Lanka are performing better than Nepal and Pakistan.

After signing the RCEP, how is China expected to fare? First, due to the corona pandemic nearly all economies of the world are going through a recession, sparing China which is prospering. Just one month's statistics of September 2020 show a remarkable rise of nearly 10 percent in Chinese exports with nearly 13 percent growth in imports. It is imperative to note that with the onset of the coronavirus, China imposed a strict lockdown for nearly three months facing tremendous losses to its economy before July 2020 when it started its rebound which is likely to accelerate after the signing of the RCEP.

Both America and India will deprive themselves of any possible benefits from the RCEP, whereas Japan will show a much better performance led by its able PM Suga who has already shown his mettle. He has already tried to capitalize off the soaring international demands of Japanese electronic and medical equipment that are considered among the best in the world. Even China is also catching up with Japan in this field. In August 2020, Japan had faced a reduced economic activity as a result of declining exports but now it is expected to bounce back.

ASEAN is a major trading partner of China and Japan followed by America and the EU, but after the initiation of the RCEP, it is going to play a leading role. Here we need to talk about the role of Pakistan because we have seen Arab countries and Israel sign agreements to change the regional economy. On the other side, partnerships such as the RCEP are bringing the countries of the Far East and South East Asian even closer. And here we are in South Asia stuck with a 70-year-old thought pattern that prevents any better relationships with neighbouring countries.

Be it with Afghanistan and Iran or Bangladesh and India, or trade relations within the South Asian Association for Regional Cooperation (Saarc), we have failed to alter our thinking at nearly all levels. We see in the Far East and in the Middle East that from Bahrain, Emirates, and Israel to Australia, China, and Japan all move forward by keeping their economic interest supreme. First, they improve their trade relations that result in better political relations. Bahrain, Emirates, and Israel have signed agreements to improve trade relations by removing impediments to business cooperation.

The same is happening with the RCEP in the Far East. Now trade routes are shrinking and to facilitate intercontinental and intracontinental trade, intelligent leadership is playing its role. While we are still repeating the mantra of 'eternal enemies'. We have been reluctant to open land routes from Central Asia to South East Asia for which we need to give an open corridor.

Such a corridor would bring in hefty economic benefits and also help us resolve the military and political issues at hand. With the trade between the UAE and Israel, both countries will reap rewards worth billions of dollars and create thousands of new jobs. The same is expected in the RCEP countries; but we are nowhere to be seen in this game from the Middle East to the Far East, nor even in South Asia. All our hopes are pinned with CPEC, of which five years have already passed but our economy is still headed to the abyss. The only remedy is wider trade agreements. From Bahrain, Israel and the UAE to Australia, China and Japan – all have compromised by a give and take process. And here we are trying to take all resulting in meagre gains. We have not been able to reform our foreign policy nor have we altered our military and political priorities. The way to modify these we can find through trade to which General Musharraf did take some major steps by opening bilateral trade via entry points in Kashmir. But then extremist lobbies on both sides thwarted such attempts. When Benazir Bhutto met Rajiv Gandhi and Vajpayee and Modi visited Nawaz Sharif in Pakistan, again all hell broke loose.

We have been coming back to square one time and again, or rather we have gone further back. We need to remember that while signing the RCEP document all ten member countries of ASEAN welcomed it and no one tried to spoil the deal. In ASEAN, from Brunei, Cambodia, and Indonesia to Laos, Malaysia, and Myanmar (Burma) all were unanimous in welcoming the five new non-ASEAN countries – Australia, China, Japan, New Zealand, and South Korea – to the new partnership. Australia and Japan did not try to invoke old enmities with China and South Korea, nor did the Philippines bring in the maritime dispute with China.

It shows remarkable sagacity to keep your military and political differences aside so that your economic and trade relations can flourish. What if the RCEP and Saarc countries try to sign a similar agreement? Ideally, for this region and for Asia at large the best option is to connect the RCEP with the SCO through Saarc, creating a trade bloc stretching from New Zealand to Russia. For this proposal, the CARs and Russia will be more than willing to join but the intractable problem lies with the Saarc countries and especially with India and Pakistan.

At the moment, both India and Pakistan have worsened their relationship to squander their resources on arms and bombs while neglecting the basic needs of their people. Just take India, for instance, which has strained relations not only with Pakistan but also with China. India objects to the Chinese railway project connecting Tibet with the rest of the country because the railway line is not far from Arunachal Pradesh, a state of India, which China still considers as part of South Tibet. So, China is also not above board in this matter.

China is building this nearly 50-billion-dollar project proving China's superior economy and expertise that India cannot match. India is also trying to improve its infrastructure in this region but China is far ahead. India is consumed by worries that after the completion of the railway project China will be able to transport huge missiles closer to the border with India, reducing China's reliance on nuclear weapons in case of a full-blown war. The BJP government in India – rather than trying to improve relations with China or RCEP – has been fanning Hindu chauvinism within India.

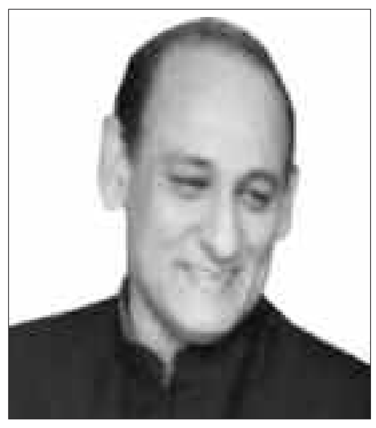
Whenever some governments fail to perform better economically, they try to use religion as a deflection from people's problems. With the recent victory of the BJP alliance in Bihar, it has consolidated its position domestically and bullies the neighbouring countries. We also see countries such as China and Vietnam that have fought wars in the past – the 1979 war lasted for a whole month – but still they have managed to forget the bitter war memories and moved forward to extend hands of cooperation and friendship to each other. That is the spirit we need.

Or look at Cambodia and Vietnam which were in a state of war for nearly a decade from 1978, but now they are close friends. This spirit has facilitated first ASEAN and now RCEP, which has kept its doors open for other countries. Will we ever learn?

(Concluded)

Beware CPEC

HASSAN DAUD



As preparations for the 10th Joint Cooperation Committee (JCC) meeting of the CPEC get into full swing, this year the meeting will be held in an environment where production and distribution systems across the globe have been impacted by the COVID -19 virus and therefore, cooperation within regional partners and global markets is imperative. In this changing scenario, the meeting will be held in an increased atmosphere of cordiality, friendship, mutual trust and desire to explore new avenues for cooperation. But as we approach the meeting dates, the negative campaign by naysayers will commence maintaining proclivity as has been the pattern in the last seven years since China announced its Belt and Road Initiative (BRI) and Pakistan commenced CPEC. The most popular and frequently repeated false narrative is around the 'Debt trap' which I believe has outlived its life.

Under the nine completed projects and 13 ongoing projects, over 70,000 direct jobs have already been created under CPEC and another 450,000 direct jobs could be generated in the next 4 to 5 years which mainly depends on the commencement of the Special Economic Zones (SEZ's) and the Gwadar Free Trade Zone. Despite COVID -19, since the last JCC, significant progress has been made on projects under Gwadar with the port becoming operational for Afghan transit trade, the first fishing vessel with 200 tonnes of cargo arriving on November 20, IA/PPA for 300 MW power plant in the final stage of process, work on Gwadar airport and vocational centres is starting and that of connecting the port to the Coastal highway through the East Bay expressway is nearing its completion. More importantly, new investors registering in the free zone are creating new opportunities for local employment. Since the start of development work in Gwadar, its opponents have been critical of progress, as is now the case for ML-1 Project where the foes know that it is another game-changing project which will transform the way we travel and trade.

On the industrial cooperation front, the challenge will be to attract investment that brings the export-led industry with new technology and support import substitution at a time when economies are getting insulated as an immediate response to the pandemic and investors are becoming risk averse. Pakistan on its part, is working on policies favourable to market transactions, such as being open to foreign direct investment, protecting property rights to encourage entrepreneurship and promoting sustainable knowledge investment. With Rashakai, Dhabheji and Faisalabad SEZs all set for starting development work, efforts need to be made to remove bottlenecks in the banking processes, provision of utilities and crafting regionally competitive incentive packages spurring growth and employment under the vision of the PM Imran Khan. The industrial development is likely to take place in two stages as in the initial stage it is expected that the SEZs will be occupied by labour intensive industries followed by modern hitech industries that will demand workers possess a combination of high-tech skills.

On the socio-economic development front, both sides are keen to accelerate the progress as the recent natural calamities including the COVID-19 pandemic have made us realise that in order to combat the challenges, partnerships need to be strengthened to draw a new normal where harmony can be achieved through economic integration. In the coming years there will be burn-centres across major cities of Pakistan. Healthcare equipment including ambulances are also being provided through Chinese grants and some of the latest technology is coming in vocational training and HEC projects are also going in the same direction by providing virtual training to students.

As a developing country in transition, Pakistan faces numerous challenges and opportunities in the process of industrialisation. In this process to becoming "Gateway of Prosperity", CPEC will be confronted by a number of opponents who are aware that the initiative is not only linking Pakistan and China but is also creating new job opportunities, poverty reduction, and development to boost sustainable industrial growth. In response to this negative narrative, all we have to do is echo Mr Zhao li Jian Spokesman & DDG, Information Department, Foreign Ministry, China who recently stated that "any attempt to sabotage the China-Pakistan Economic Corridor (CPEC) project would not succeed".

IMF & Pakistan's inflationary conundrum

HASSAN MUJTABA

The economy of Pakistan is in hot waters once again. With the second wave of COVID-19 sweeping through the country, rising expenditure heads, and mounting debt obligations, it seems that the return to the International Monetary Fund's (IMF) is inevitable. Indeed, in a recent statement, Adviser to the PM on Finance & Revenue Dr. Abdul Hafeez Shaikh confirmed that the stalled talks with the IMF's Staff Mission are expected to resume soon, which will determine the future of Extended Fund Facility (EFF) and the release of the third tranche. If and when that happens, we can expect a second round of tight fiscal and monetary policies coupled with an increase in energy tariff, unrealistic tax targets, doing away with subsidies (that have artificially pumped the economy), and prolonged fiscal consolidation.

This will keep Pakistan in a low-growth equilibrium—notwithstanding the exogenous COVID-19 shock—for a long time to come and which is confirmed by the gloomy growth projections of the multilaterals as well.

The main objective of the IMF's Structural Adjustment Program (SAP) is to make a recipient country self-reliant by promoting economic growth and arresting inflation. But does their policy program achieve the desired results? Unfortunately, it does not! In fact, in most cases, it leads to outcomes that contradict the Fund's stated objectives vis-à-vis growth, poverty alleviation, inflation and economic modernization.

One wonders at this apparent discrepancy between the Fund's goals and its policy outcomes. Is it because of the ineptitude of the Fund's staff? Or are there other structural and ideological factors underpinning the Fund's agenda that tends to nullify macroeconomic stabilization? In my opinion, it's the latter, as the Fund is manned by world-class economists and policy analysts.

The truth is that IMF—like other multilateral institutions—is an apostle of neoliberalism with an unstated mission to promote free-market capitalism, deregulation, trade-liberalization, labor market flexibility, and free-float currency policies. While some of these policies may work for the developed world, their efficacy for the Least Developed Countries (LDCs) is far more questionable. Take the case of inflation targeting as an example. The IMF subscribes to the 'monetarist hypothesis' which states that inflation is— always and everywhere —a monetary phenomenon. Translation: An increase in the disposable incomes of the common people causes a price hike irrespective of the country or region of the world. In LDCs like Pakistan, this theoretical construct (aka Quantity Theory of Money or QTM) is questionable as 98 percent of the country's population does not have a bank account, which is an essential feature of M2, i.e., broad money supply. In addition, a plethora of studies conducted in the context of Pakistan have demonstrated that the one-on-one proportional relationship between M2 and Consumer Price Index—which is a necessary condition of the QTM—simply does not exist.

Conversely, Pakistan's inflationary conundrum is resolved by applying the Structuralist Hypothesis, which views the supply side or cost-push factors as primary determinants of inflation. Indeed, supply-side variables such as oil prices, the unit value of imports, and wheat support (procurement) prices have played a larger role in inflation than the M2 in the monetary history of Pakistan. This is further confirmed by the fact that during civilian rule in Pakistan, inflation averaged 11 percent, while the M2 growth hovered around 13 percent. On the other hand, during the military regimes, inflation averaged 6 percent, while the M2 grew at a much higher 14 percent. The fact that the growth in money supply and inflation move in the opposite direction is sufficient empirical proof for the validity of the Structural Hypothesis in the case of Pakistan. In addition, the 'structuralists' case is further consolidated by a State Bank study which shows that a 1 percent increase in the discount rates (i.e., central bank's interest rates) leads to a price hike by 0.7 percent. This means that any attempt to choke the aggregate demand fuels inflation in Pakistan's context, which is contrary to the monetarists' assertions, who contend that increases in the interest rates are a legitimate way to defuse inflationary pressures.

Little wonder then that policies of the IMF as part of its SAPs has fueled inflation in Pakistan—rather than arresting it—leading the Fund to nullify its structural macroeconomic objectives. Indeed, a study by Chaudhry and Choudhary (2006) concludes that Pakistani policymakers should not target inflation as part of monetary policy as it leads to severe economic downturns and inflationary pressures within the country. We saw a practical demonstration of this fact in the wake of the recent IMF SAP agreed upon by the incumbent government, which has led to high inflation, high unemployment, and dismal economic growth.

The Fund's objective for low inflation is better achieved, by targeting supply-side factors, in particular food and agricultural commodities. This is because Pakistan is primarily an agrarian country where food items account for a substantial weightage (close to 41 percent) in the basket of goods used for calculating Consumer Price Index (CPI). Of this 41 percent, 6 percent of the weight is accounted for by wheat and wheat items. Small wonder then that any exogenous shock to wheat and other crops spiral food inflation which hits working poor the most. Thus, to control inflation, Pakistani policymakers need to smoothen the wheat & agricultural supplies by ensuring adequate stocks and by raising the productivity of the agriculture sector. This will also lead to a partial vindication of the monetarists' arguments that inflationary expectations can lead to inflation, and thus, are necessary for its management.

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