

*Invited Lecture: Key Takeaways***Is Pakistan Ready for the New Normal**

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Two important questions need to be addressed today—One, is there a new normal, and if yes, what it is? And two, if there is a new normal, is Pakistan ready for it?

Based on World Bank's research and experience in other countries, yes, there will be a new normal and the years ahead will be different from what we have experienced in the past. The answer to the second question is that Pakistan is not fully ready yet for that new normal. Yet, Pakistan has a great potential to benefit more from the new normal relative to the gains secured in the past.

It is noteworthy that the world was never the same again after every major global crisis. In fact, each crisis contributed to the development of new technologies, helping to make important changes to the world's economic power. Each time, new policies were framed and followed to address new problems or take seriously old problems paving the way for new solutions.

What we experience during a major crisis is that established firms suffer losses and sometimes shut down. This creates an opportunity for new firms to emerge, this is how creative destruction happens. When such changes occur in economic paradigms, economists come up with different kinds of models to address emerging issues.

For example, after the 1930's great depression, the world was never the same again. Before the 1930s, governments were spending roughly 6-7 percent of GDP, but afterward, the governments started to spend around 35 percent of GDP under the new normal. There was this new paradigm under Keynesian economics which realised that governments had a big role to play in stabilising the economy. As a result, such a great recession never happened again.

Similarly, another oil crisis during the 1970s and 1980s also led to a new normal – capital controls and inward-looking policies, being incapable to adjust to major relative price changes, were given up in favour of openness - Latin America gave up import substitution, Europe integrated into financial markets, and China opened up.

Then, in 2008, the global financial crisis occurred, and again the same happened. Following the crises, new developments occurred in the existing financial sector. Cryptocurrency like Bitcoin and Blockchain appeared just after the crisis. Similarly, the gig economy and digital platforms like Uber and Airbnb emerged. Next, digital technologies completely changed the way commerce is taking place now.

Now we have Covid-19, and it is reasonable to reflect on the questions such as what will be the next change. To answer this question, we must understand the problems that countries face and the emerging solutions. These changes will define the new economic structure, which will comprise the new normal.

One lesson from the Covid-19 pandemic is that countries, including Pakistan, were unprepared to absorb such a huge natural crisis. The social safety nets were not in place in all countries, especially for the population falling in the middle-income category. In many countries, the healthcare sector had no buffers, so the healthcare system collapsed. Even regarding macroeconomic policy, there was a lack of evidence on how to react to a sudden supply shock.

Pakistan did quite well under difficult circumstances to react to this shock, especially the interventions of the central bank deserve credit. There was an extension of social protection in Pakistan that put a limit to the shock. Nevertheless, it was something new that policymakers had to react to. Now building up resilience to external shocks will be part of the new normal.

There are some other risks, for example, climate change risks, having low probability but high impact. So far, many were inclined to dismiss the risk because of the low probability, but now we have seen the magnitude of such a shock on an economy and the people. So, we tend to take it much more seriously, and it will be part of the new normal.

A second lesson from this pandemic is that the impact of shocks in the face of inequality became much more apparent. Inequality has always been there, but it deepened during the crisis. The pandemic did not hit everybody in the same way. The middle-class people working in the formal sector were able to observe social distancing. They also often managed to work from home, thus enjoying income security. However, a large segment of the population was hit much harder than the formal sector.

About 80 to 90 percent of the people had no opportunity to observe social distancing, and they often did not have a reasonable opportunity to access healthcare and sanitation. They had no safety nets, and they lost their job. This segment of the population was hit harder. Furthermore, there was greater inequality in terms of gender, which we saw worsening. Now even when jobs are returning, evidence suggests that males manage to take up the returning jobs first, with women seen at the end of the line. These are certainly new issues that must be addressed, and countries are trying to address these. Hence, fighting inequality will be much more a part of the new normal than the old normal.

The third and last lesson of the crisis, and the most consequential one for future growth in Pakistan, is the emergence of new technologies - now we can work from home, and for this to happen at a greater magnitude, the internet and the communication systems are a necessity. In South Asia as well, there has been a huge shift towards e-commerce platforms because it is much safer to get the products delivered to your home than to go to the shops. Hence, the information system will be part of the new normal. In the new normal, there is a much more dominant role of services in the economy. World Bank has just published a report that argues that services-led development is now an option in South Asia and in Pakistan, and this is important for Pakistan.

Therefore, the new normal is inevitable, and the world will be different because new problems and new solutions have emerged from the governments, in the market sector, as well as in technologies. Now the question is Pakistan ready for the new normal? As far as the resilient part is concerned, it can be said that Pakistan is ready because the majority have a consensus that certain risks are intolerable and must be addressed. This is especially

true for the climate change debate, which everybody understands, can no longer be ignored. For Pakistan, macroeconomic instability is a major issue because, obviously, a country being dependent on fossil fuel imports is at risk. Therefore, policies that reduce the dependence on fossil fuels will also help in achieving macroeconomic stability. The same is true for the subsidy reforms that are never easy to do.

However, the inequality must be addressed in a sustainable way. The use of instruments such as subsidies or price controls though can help in the short run but at the same time, it distorts the economy and haunts it. The point is that just transfers, subsidies, and price control are not the ultimate solution. To reduce inequality, it is important to provide access to markets and finance to the large group of people in Pakistan that are not part of the formal sector. This would require a rethinking of economic policies.

Finally, the services sector is part of the new normal. The development in the IT sector has increased the productivity of the services sector. It also unleashes the potential, especially in the informal sector, by providing the home-based workers with the platforms to sell not only in the domestic market but also overseas for better prices. So, it is important to open up the informal sector because it has great potential for Pakistan.

To reflect upon more, Pakistan has a comparative advantage in services. Pakistan has never been successful in manufacturing, not to the extent that we can witness for other developing countries. The curve that indicates the relationship between income per capita and share of services has shifted upwards, meaning that at every level of development, the share of services is now higher than it used to be. If we plot the same curve for Pakistan, it is way the curves of other countries. Hence, Pakistan enjoys a comparative advantage in services; however the policies are geared towards the services sector.

Pakistan seems to be stuck in a bad equilibrium. There is a relatively small formal sector (industry) with relatively few big corporations, and they are well protected against competition. There are already many import restrictions, with even greater demands for more restrictions. Firms in the formal sector have almost exclusive access to commercial banks, they are well connected, and they feel comfortable in the space. Their exports and their production are not diversifying. On the other hand, countries like Vietnam not only are growing faster, but they are also much more transformative and moving up the value chain.

On the other hand, there are outsiders that do not have access to markets, those who do not have the kind of access that the big corporations have, and do not have access to financing and hence find it very difficult to be productive. Big corporations actually benefit a lot from the system because they not only use formal labour but they also employ even more informal labour because it is cheaper. This means that a dual system is a kind of equilibrium, and it tends to perpetuate itself. Pakistan has a great opportunity to start thinking about how productivity in the informal sector could be increased as part of the new normal.

To summarise, yes, there will be a new normal. The service sector of Pakistan is in its infancy with huge potential. Besides manufacturing, Pakistan needs to focus on this sector to unleash its true potential.