**ECONOMIC STABILITY AND GROWTH IN PAKISTAN[[1]](#footnote-1)**

This lecture is divided into four parts. I would begin by narrating the pre-requisites for economic stability and growth at a generalized level drawing on the experience of the last six decades. Then I would dwell upon the positive factors in Pakistan that can influence the rate of economic growth. Next I take up the negative domestic factors that are impeding the path of economic growth followed by the external shocks that have worsened the situation.

**Pre-requisites for Economic Stability and Growth**

There are at least four essential pre-requisites for a stable economy to grow on a sustainable path over time. First is a long term vision provided by the country’s leadership that sets the direction in which the economy would be moving, the goals that will be aimed at and the execution strategy through which this vision can be translated into reality. As the environment in which every country is operating is rapidly changing due to the factors beyond their control and uncertainty is besetting all the nations of the world, continuous adjustment and fine tuning is required by the policy makers. China laid down its 25 year plan in 1980 under the visionary leadership of Deng Xiaoping. But every succeeding leader followed that plan after fine tuning and modification to suit the given circumstances. One of the explanations for China’s stellar achievements in infrastructure and energy is the disciplined pursuit of this long term plan. Second, political stability is sine quo non for economic growth. If the investors – domestic and foreign – face unstable political conditions where they are told that the government of the day is going to be removed or toppled any day naturally you won’t expect them to put their money at risk. They are not sure about the returns they will get on their investments. As investment remains shy growth will not take place. Unemployment rises and incidence of poverty becomes high. An orderly predictable transition of power at regular intervals of time is the only way that political stability can be assured. Premature and abrupt dismissal of elected governments before they complete their terms of office is highly inimical for sustained economic growth. Third, if an incoming government reverses the policies, suspends the programs and abandons the projects initiated by the previous government without any cogent reason simply based on partisanship the private investors would again hesitate to commit their money in that country. Broad political consensus exists in Pakistan on the direction of economic policies but the tendency of every government to score points against their predecessors and condemn whatever they had done during their regime irrespective of its merit causes serious handicaps. Markets are based on sentiments and do not like abrupt turns and twists. Continuity, consistency and predictability are what they like. Fourth, even if we have a long term vision, political stability and broad political consensus on the contours of policy the capacity to implement those policies is the critical success factor. The overall governance structure and the strength of institutions determine whether we can achieve the goals we have set for ourselves. If the implementing agencies are saddled with corruption, incompetence, indifference and ineptness there will be a lot of leakages and waste. The same rupee if properly invested can bring 10 percent returns but if only half rupee is invested and the other half is pocketed for personal use then we may end up with negative returns and a loss to the economy.

Having set out the framework essential for economic stability and growth let us turn to the case of our own country – Pakistan. I would leave it to form your own judgment whether these pre-requisites exist in Pakistan today or not. I would only spell out the various positive and negative factors affecting Pakistan’s economy.

**Positive Factors Influencing Pakistan’s Growth**

In my view there are at least six factors that are quite favorable for the present and future prospects of the economy. First is the size of the domestic market. With a population of 170 million people Pakistan offers an attractive market for goods and services. A growing middle class that constitutes almost one quarter of the population with its rising purchasing power creates demand for goods and services. Expansion of this demand helps the industry to achieve economies of scale and lowers unit cost of production. Backward and forward linkages to the industry generate new employment opportunities that add further impetus to demand and reduction in the incidence of poverty. Second is the favorable demographics. While the rest of the world particularly the advanced countries of Japan and Europe would have rising dependence ratios due to increase in ageing population Pakistan, India and Bangladesh would have relatively younger population. 63 percent of Pakistan’s population is below the age of 25 and 50 percent is below the age of 19. If properly educated and skilled this youth can become the work force for the labor deficient countries. In case we do not concentrate on their education and training the younger population can prove to be a source of social tension and explosion. Third Pakistan enjoys a highly favorable geostrategic location. Two giant economies of the world – India and China – are its neighbors. Peaceful relationship with India can spawn benefits to Pakistan’s economy through trade, economic cooperation and scientific and investment collaboration. Linking western China with Gwadar Port through railways, highways, pipelines, etc. can be mutually profitable for both the countries. Central Asian Republics and Afghanistan are land locked countries. The most economical transit route for their exports and imports is through Gwadar. Hydropower and gas resources of these Republics can ease the energy shortages in Pakistan. Fourth, one of the largest and well developed irrigation system in the world is the Indus Basin that has boosted Pakistan’s agricultural productivity over time. The country is not only able to feed its burgeoning population but is the third largest exporter of rice, generates exportable surplus of wheat from time to time and is one of the major cotton producer and textile exporter in the global market. Although both the share of labor force employed in agriculture sector and the share of agriculture in the GDP have declined over time the physical output has multiplied eight to ten times. Fifth, Pakistan’s enterprising Diaspora which has ventured out to almost all parts of the world accounts for almost 3 million people. This migration has not only eased the unemployment situation domestically but has been a consistent and upward inclining source of foreign exchange in form of remittances. Demand for Pakistani food products, fruits and vegetables have also risen in the markets where the Diaspora are located. In many instances investment has flown into Pakistan from the relatively well off overseas Pakistanis. Sixth, we should remember that there are very few developing countries who have achieved 5 percent annual average GDP growth rate over a sixty year period. Per capita incomes have gone up from $100 in 1950 to $1,000 today. This historical track record has been uneven and fluctuated widely with higher growth recorded in the 1960s, 1980s and 2001-07. But the point that I wish to make is that the country is capable of performing well if the economy is managed properly. However, the record is not too good compared to other countries in Asia Region which have overtaken us and have done much better than us.

**Challenges Facing the Economy**

1. **Domestic Factors** Next, I would like to present seven negative factors that are pulling Pakistani economy down. All of these factors are very much in our own control and can be rectified.

First Our domestic savings rates of 15 percent of GDP is dismally low which means that we have to depend on foreign savings to boost our investment rate. To grow by 6 percent per annum, a country needs at least 24-25 percent of GDP. Thus the effect of low domestic savings rate is either we have inadequate investment rate and consequently a much lower growth rate or we have to seek assistance from foreign sources to fill in this gap. By contrast India’s saving rate has risen to 35 percent of GDP which has enabled them to attain 38 percent investment rate and 8 to 9 percent annual growth rate. Some of you may be surprised that China’s domestic savings rate is 50 percent of GDP. Unless we augment our domestic savings and curtail conspicuous consumption the chances of sustained high growth are bleak.

Second Pakistan’s fiscal imbalances, i.e. the difference between government revenues and government expenditure are a source of macroeconomic stress. Financing fiscal deficit by heavy borrowings from the Central Bank and rising public debt have created inflationary pressures, giving rise to high interest rates and crowded out private sector credit. Public debt servicing now pre-empts one third of government budgetary expenditure and leaves very little degree of maneuverability in fiscal management. It is simply impossible to balance the books when out of every one rupee of income generated in private hands only nine paisas are collected as tax revenues. How can the government meet the debt servicing, defense, development, social services law and order and running of civil administration expenditures with such paltry amount? Unless tax evasion is curbed, tax net is widened and tax collection machinery is improved fiscal imbalances are likely to persist.

Third Public sector enterprises and corporations have become a major burden on the country’s exchequer. The enormous waste, corruption, leakages and losses are not only adding pressures on the budget but the goods and services provided by them are unreliable and do not satisfy the customer demand. The Government has no business in running the businesses because the incentives of the functionaries are not aligned with those of the enterprise. Government should have a strong regulatory framework and an enabling environment to facilitate private sector to run these businesses. By paying taxes to the exchequer the private sector will contribute to the government’s finances and losses incurred by the government corporations at present will disappear after privatization.

Fourth Weak social indicators and lack of attention to human capital formation over last six decades has done more damage to suppress the country’s economic potential than any other single factor. 54 percent of the population is literate and only 4 percent of the age group is enrolled in higher education. Net enrolment rate in primary schools is 53 percent and only one half of them complete primary schooling. Similarly, health indicators such as Maternal mortality, infant mortality, child malnutrition, access to drinking water and sanitation are at the bottom of the rung compared to other countries in the region. Technical and vocational education, so critical for imparting skills to our younger population, covers only 1 percent of the relevant age groups. Investment in social services and human capital formation does not impose a great burden on the finances but requires improvement in the organization and delivery of services.

Fifth, in the recent years the energy shortages both power as well as gas have created a havoc for the economy. The benefits of rupee depreciation could not be availed by our exporters as they were not able to deliver the orders on time due to load shedding and gas shut downs. The whole issue of circular debt in the energy sector has arisen due to mismanagement and weak institutional capacity of the Power Companies. Overdue reforms in the energy sector as well as new investment in non fossil oil energy sources are urgently needed to overcome these problems that are badly hurting the economy. The fragmentation among various agencies of the government in energy sector has to be replaced by a more cohesive, result oriented single agency.

Sixth the poor governance and dysfunctional civilian institutions, are in my view, the main culprit for most of the economic woes of the country. Civil Service, Police, Judiciary were all well functioning institutions but with the passage of time they have gone through a decay. Access to basic public services to a common citizen is no longer possible without connection or extra legal payments. Security of person and prosperity are no longer assured and dispensation of justice is expensive, time consuming and biased in favor of the well-off. The writ of the state has eroded and the capacity to implement projects and programs has weakened. Politicization of Civil Service and Police and the recent abolition of local government system have worsened the situation. Economic welfare is closely linked with good governance and sound institutions and the reforms for revamping them would make a huge difference to the lives of the ordinary citizens.

Seventh Unlike other countries in Asia region Pakistan is facing stagnating exports in a buoyant world market. We are struggling to cross $20 billion mark while a country devastated by war – Vietnam – attained $50 billion two years ago. Only a few years ago Vietnam was behind Pakistan in its exports. The reasons for the dismal performance of our exports lies in too narrow a commodity base and too much concentration on traditional markets. Sixty percent of our exports originate from textile sector that is not one of the dynamic sectors in the world markets. We have not yet penetrated the markets for electronics, semi-conductors, pharmaceuticals, industrial chemicals, health care products, etc. which are the rising sectors. At the same time we are shipping most of our goods to the U.S., Europe and Middle East while the fastest growing region in the world is Asia. Although we have a Free Trade Agreement with China we have not made any headway in that market. Pakistan has to diversity its exports both in terms of products and markets and focus its attention on the dynamic sectors and rapidly growing markets.

1. **External Shocks**

Pakistan has faced at least four major external shocks during the last decade:

The First was precipitated by Pakistan’s participation in the war against terror. Leaving aside the losses of human lives and a state of disorder and turbulence throughout Pakistan by the suicide bomb attacks it is estimated that Pakistan’s cumulative losses to the economy have so far exceeded $43 billion. The reimbursements received from the U.S. under the Coalition Support Fund have amounted to only $10 billion. A country in dire economic conditions like Pakistan can hardly afford to tolerate such a heavy financial burden. Part of the fiscal imbalance problem can be ascribed to the increased expenditures on paramilitary forces and defense. Export earnings, foreign investment, tourism receipts, diverted contracts and orders, increased insurance premiums, and cancellation of visits by buyers all have contributed to those losses.

The Second shock occurred in 2007-08 when the global food and fuel prices went through an abnormal and abrupt hike. Oil prices went up from $55 per barrel to $150 per barrel in a period of twelve months and so the prices of commodities such as palm oil imported by Pakistan. These price hikes put enormous pressures on the current account as the import bill jumped by almost 20-25 percent in one year. Fiscal deficit also widened as the government absorbed these price increases and did not pass on to the consumers. Resort to the Central Bank for financing the deficit and expansion of high powered money intensified the inflationary pressures.

The Third shock was the Global Financial Crisis of 2008-09 that resulted in a world wide recession of the magnitude not witnessed since 1930s. As the incomes slumped in the U.S. and Europe, the demand for Pakistani goods and services also slackened. Foreign commercial borrowings and access to bond market disappeared.

The Fourth and most severe shock was the floods that devastated a large chunk of arable lands, displaced 20 million people, destroyed or damaged 1 million houses, roads, bridges, power grids, embankments, spurs, railway tracks, etc. The World Bank and Asian Development Bank have prepared preliminary assessments of the damage and they estimate that about $10 billion will be required for rehabilitation. It would be difficult for the Government of Pakistan to raise such a large amount and therefore the international community has to come to our rescue. The economy may in that case, get a kick start by the stimulus provided by the additional expenditures on flood rehabilitation works to be financed by the donors. A one-time flood surcharge tax would have to be imposed on the propertied classes of Pakistan to fund some of these works.

To sum up, the challenges faced by Pakistan’s economy are quite formidable but the salvation lies in resumption of growth that will result in decline in both unemployment and the incidence of poverty and preserve the living standards of the middle class. The reprioritization of development expenditures, savings on recurrent expenditure, reduction in across-the-board subsidies to public sector enterprises and corporations, improvement in tax collection and levy of flood surcharge tax along with the grants and donations from the international community for flood rehabilitation works can provide the stimulus for growth. Governance reforms are the key to economic stability and growth in Pakistan and should be relentlessly pursued.

1. Lecture delivered at the Command and Staff College, Quetta on October 21, 2010 [↑](#footnote-ref-1)