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COVER STORY

# PAKISTAN'S ECONOMY UNDER MUSHARRAF

**In the era of General Pervez Musharraf, Pakistan's economic performance was impressive in terms of income per capita, employment generation and poverty alleviation.**

By **DR. ISHRAT HUSSAIN** | March 2023

**E**conomic achievements in most difficult

circumstances during President Musharraf's regime are dismissed outright, because of abhorrence of the military rule, imposition of the emergency in 2007, his decision to join the US in Afghanistan war, open tussle with the judiciary, withdrawal of corruption cases against the politicians, and his quest to get elected in uniform. This article is an attempt to provide a first-hand data-driven account of the economic record of the period 2000-2008. Pakistan suffered serious setbacks in the 1990s in terms of most economic and social indicators. Economic growth rates decelerated, inflation rose to peak rates, debt burden escalated substantially, macroeconomic imbalances widened and worst of all, the incidence of poverty almost doubled. Pakistan's credibility in the international financial community was at its lowest ebb as successive agreements concluded with the International Financial Institutions (IFIs) were not implemented. Foreign investors were unhappy as all the power

purchase agreements were being re-examined and criminal action was initiated against the Hub Power Company (HUBCO).

The situation exacerbated after the nuclear testing in 1998 when sanctions were imposed on Pakistan. External liquidity had dried up due to freezing of foreign currency deposits of \$11 billion held by resident and non-resident Pakistanis. The loss of confidence evaporated workers' remittances, foreign investment and foreign currency deposits. The assumption of power by the military government in October, 1999 led to fresh sanctions and bilateral and multilateral official flows were suspended. Credit rating agencies downgraded Sovereign Credit of Pakistan to Selective Default category and therefore the door for access to financial markets was shut down. The country faced a gap between external receipts and payments of \$2.5 to 3 billion annually for the next five years. The new cabinet had to face this crisis, i.e. how to meet its current obligations such as imports of goods and service, its debt service obligations and other payments with almost no reserves. To fill in this gap and keep the wheels of the economy moving, Pakistan had to get its debt service obligations rescheduled for which it was imperative to have an agreement with the IMF.

Pakistan entered a stand-by arrangement with the IMF in 2000 for a nine-month period followed by a three-year Poverty Reduction and Growth Facility (PRGF). For the first time in the history of Pakistan, the IMF was able to complete all the reviews successfully and released all the tranches on time. The credibility of Pakistan vis-à-vis international financial institutions was restored setting the stage for the re-profiling of Pakistan's external debt owed to Paris Club. This re-profiling of bilateral debt resulted in the reduction of external debt and liabilities as percentage of foreign exchange earnings from 224 percent to 125 percent and debt servicing from 26 percent to 9 percent saving \$ 1 billion annually for an extended period of time.

Pakistan's economic performance under Musharraf was impressive in terms of income per capita, employment generation and poverty alleviation. As a result of reasonably high GDP growth rate of about 6.3 percent a year, the per capita income in current dollar terms rose to about \$1,000. Headcount Poverty ratio fell from 34 percent to 15 percent. Unemployment rate fell also from 8.4 percent to 6.5 percent and about 11.8 million new jobs were created. Gross and net enrolment at primary level improved and health indicators such as children immunization, incidence of diarrhoea and infant mortality showed favourable changes.

There are at least five strands of criticisms of economic policies pursued under the Musharraf era. It is, therefore, necessary to address each one of them with the aid of hard published data.

First and foremost, it is the post 2001 massive capital flows of official aid from the US, other bilateral and multilateral sources that is responsible for the exceptional growth recorded during this period. The annual gross flows from all official bilateral and multilateral sources received between 2002 and 2008 accounted for 8.5 percent of Pakistan's total foreign exchange receipts (U.S. provided 4.5 percent of this total). The remaining 91.2 percent of foreign exchange receipts were generated by exports, remittances, and foreign direct investment. Thus the impact of these capital flows is highly exaggerated as the amounts received are no different from historical record of foreign assistance or subsequent acceleration of the US assistance under Kerry Lugar bill. The annual net official assistance

between 2009-2014 was \$2.8 billion, compared to \$1.6 billion between 2002-2008. A British researcher found that “the statistical evidence failed to relate these US aid capital inflows with savings and investment, expenditure, imports, domestic and external debt, corporate profitability and boost in public investment. The episode of growth was better explained by a stronger government able to mobilize domestic resources, ensure that they were utilized productively and create institutions that were able to overcome the conflicts associated with economic development”.

The second popular perception is that Pakistan’s debt re-profiling was made possible by the U.S. because of September 11, 2001 events. As a matter of record, the broad contours of this arrangement were agreed with the IMF and Paris Club long before September 11 as Pakistan had successfully implemented the standby agreement with the Fund establishing its credibility and becoming eligible for their medium term facility. It is true that the formal agreement was signed in December 2001 but the lead time because of extensive preparation, negotiations and building consensus of 20 members of Paris Club had taken almost a year.

Third, there are those who argue vociferously that Musharraf did not take advantage of debt relief and did not focus on any structural reforms, oversaw Pakistan spending beyond its means and the growth was fuelled by consumption .What does the evidence show? Investment/GDP ratio touched 23 percent which was the highest in Pakistan’s economic history and has since then revolved around 15 percent. The structural reforms consisted of fiscal consolidation by raising tax revenues, reducing expenditures, cutting down subsidies and containing the losses of public enterprises. Tax reforms were undertaken to widen tax base, remove direct contact between tax payers and tax collectors, introduce value-added tax as the major source of revenue, simplify tax administration and strengthen the capacity of the Central Board of Revenue. The adoption of universal self-assessment followed by random audit of selected tax returns, automation and reorganization of the tax machinery helped tax collection to double in five years.

### **Tariq Kirmani**

*Former Chairman PIA and PSO*

**A**s the head of two largest companies in Pakistan I would personally remember General *Musharraf’s days of rule as a great leader who gave Pakistan one of the best days in terms of economic development, led by his two economic tsars Shaukat Aziz and Dr Ishrat Husain, and governance in the country. I must also admit that during my tenure as the head of Pakistan State Oil (PSO) and as the Chairman of Pakistan International Airlines (PIA), he never ever asked me to favour anyone.*

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To tackle external account weaknesses, trade policy reforms and liberalization helped the country in earning foreign exchange through non-debt creating flows. Exports of goods almost tripled from \$7.8 billion to \$21.2 billion and along with a six-fold increase in the workers' remittances (\$1 billion to \$6.5 billion), the foreign exchange earnings almost tripled from \$16.8 billion to \$46.0 billion. Tariffs on imports were rationalized and brought down to average 7.6 percent. FDI inflows touched \$5 billion in each of the last two years and foreign exchange reserves rose from 991 million dollars to US \$14 billion covering six months' imports.

An aggressive privatization plan of state-owned enterprises in oil and gas, banking, telecommunications and energy yielded \$3 billion. The privatization of Habib Bank, United Bank, and Allied Bank - three large nationalized commercial banks of the country - transformed the banking sector into an efficient, privately owned and managed sector. Private sector credit grew at an average rate of 25% annually. At the same time the Central Bank was granted autonomy and its capacity strengthened. Banks became profitable, non-performing loans were reduced substantially and interest rates fell significantly. Capital market capitalization rose eight times and 60 new IPOs were listed and 48 corporate debt bonds issued.

### **Engr. Hidayat Khaishgi**

**P**resident Musharraf came in at a time when Pakistanis were feeling dispirited and had low morale. With his team's dynamism and forward thinking, he was able to revive a feeling of pride amongst Pakistanis at home and abroad. His liberalization of the media and allowing them to develop without interference led to a boom of creativity and availability of information. His idea of 'Enlightened Moderation' showed the world a true face of Islam than that shown by religious extremists. He revived and strengthened Pakistan's international relations, often through the good personal relationships he developed with world leaders, including leaders of neighbouring countries. His famous handshake with Prime Minister Vajpayee and visit to Bangladesh bear witness to this.

Oil and gas, telecommunication, media and civil aviation sectors were deregulated. New gas fields operated by private sector companies added new capacity to meet the growing energy needs of the country. Power generation exceeded the demand and relied predominantly on domestic fuel, i.e. the natural gas, thus saving foreign exchange. Telecommunication witnessed a boom since the private sector companies were allowed

licenses to operate cellular phones. Telephone penetration rate reached 50 percent with about 70 million subscribers.

The cornerstone of the governance agenda was the devolution plan which transferred powers, responsibilities and financial resources from the federal and provincial governments to local governments headed by elected representatives. A new Police Order replacing the 19th century law was passed to modernize the force. The National Accountability Bureau (NAB) was established under a new legal framework as the main anti-corruption agency.

**Lt. Gen. (R) Tariq Khan**

*Former Chairman PIA and PSO*

**G**en. Pervez Musharraf was truly head and shoulders above the kind of leadership we have on display today - his achievements were outstanding and unparalleled in almost every field - a true Pakistani, who believed that Pakistan as a country must always be put first before any other consideration. I saw General Musharraf as a true leader, a man who was brilliant in crisis and whenever under pressure, a patriot of the first order, someone who served this country and its people selflessly, with honour and dignity.

Fourth, some economists are of the view that the loose monetary policy stance of the State Bank of Pakistan (SBP) resulted in overheating of the economy and led to inflationary pressures. It is true that the monetary policy in initial years was managed to kick-start the economy when it was trapped in low growth-low inflation equilibrium. Until FY 2005 inflation remained subdued (the average rate for first five years was slightly below 4 percent) but subsequently the inflation target slipped due to the uptrend in the global commodity prices as well as inefficiencies of wholesale and retail markets. As soon as there were signs of upsurge in inflationary pressures, interest rates were raised and monetary policy tightened. Other macroeconomic indicators also did not provide any signs of overheating as fiscal deficit was contained between 3 to 4 percent and current account was in surplus for consecutive three years and in negligible deficit in the next two years. Domestic productive capacity in agriculture and manufacturing had been expanding and thus supply shocks were not imminent. Excess demand, therefore, did not spill over into higher imports, which were in any case financed mainly by non-debt creating flows. How can in the weight of this overwhelming evidence one read overheating of the economy?

Finally, it has been surmised by some economists that Exchange Rate was artificially fixed for over six years. The data on Real Effective Exchange rate for this entire period does not show any such indication as it hovered around 100 deviating from the mean by 5 percentage points. Exchange rate can be defended by the SBP only if it is burning its reserves. In this period the situation was quite the opposite. Foreign exchange reserves were accumulating at a rapid pace because of huge inflows of export earnings, remittances and FDI, official grants and relief on account of debt servicing rising from \$0.9 billion to \$14

billion. The SBP had the difficult task of avoiding appreciation of exchange rate and thus hurting exporters and had to sterilize these foreign inflows.

It is, however, true that the policies pursued in 2007/08 did leave the economy in a parlous state. The momentum of growth slowed down due to derailment from the past track. Fiscal and current account deficits did widen leading to excessive borrowing resulting in expansion in money supply, foreign capital inflows shrank, inflationary pressures intensified reaching double digits, exchange rate came under pressure as foreign reserves depleted. Both agriculture and large scale manufacturing performed poorly. International prices of food and fuel were not passed on to the consumers because of political considerations in an election year. This expediency cost the country another round of IMF programme which the new government had to enter in 2008. The lesson is that delayed and postponed decisions bring with them avoidable grief to the economy. 