Economy of Pakistan: Past and Future

ISHRAT HUSAIN[1]

PAST DEVELOPMENTS

At the time of the partition, Pakistan inherited an extremely weak and fragile economic base and infrastructure. LIFE magazine had predicted in its issue of January 1948 that Pakistan would collapse within six months as it would not be able to sustain itself economically. Many other experts had similar views. Pakistan not only inherited a shattered economic base but also had to face several serious adverse shocks in the first forty years of its existence. These were:

(i) Absorption and rehabilitation of 8 million refugees or one fourth of the population
(ii) The 1965 war against India
(iii) The breakup of the country in 1971
(iv) The nationalization of industries, banks and educational institutions
(v) The war in Afghanistan beginning in 1979

Despite the grave consequences arising from these shocks Pakistan not only survived economically but stunned its prophets of doom by ranking among the top ten performers in the developing countries. Its average annual growth rate of 6 percent between 1950-1990 could be matched by only a few countries. India was stuck in the same period with Hindu rate of growth of 3 percent annually. India's economy was only five times bigger while its population was eight times larger than Pakistan. Per capita incomes were higher in Pakistan and social indicators were better. Pakistan was able to spend up to 6 to 7 percent of GDP every year in building our defence capability as well as nuclear capacity for ensuring robust external security

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Since 1990's, Pakistan has lagged behind all other countries in the region such as India, Bangladesh, Viet Nam. Economic growth rate has come down to 4-4.5 percent annually between 1990-2015, If we exclude the period 2002-2007 when Pakistan growth was 7-7.5 percent the average would be below 4 percent. During this period of high economic growth a Special Fund of Rs 100 billion was established to meet the needs for equipment and capital goods required by the Armed Forces. The subsequent poor economic outcomes resulted in curtailment of our defence expenditure to around 3 percent of GDP and the Fund could not be replenished because of the paucity of financial resources. This happened at a time when the challenges of internal security also became overwhelming. The interplay between security and economy becomes quite obvious from this particular episode. When the economy was booming and growing, the beneficiaries were not only people of Pakistan but also the Armed Forces who are responsible for our security. In the mid 2000s, Pakistan had reached an investment ratio of 23 percent which led to 7 percent growth rate. Today investment ratio is down to 15 percent which has limited our growth to 4 percent average. Since 1990s the Indian economy has been growing at a rapid rate and has become eight times ours, and their per capita incomes exceed that of ours. Investment ratio in India is twice that of ours. Their billion dollars orders for defence equipment and insistence on location of defence manufacturing industries in India is a reflection of their economic strength. While we have lost our market share in global export markets, and thus our capacity to earn hard foreign exchange , India, Bangladesh and Viet Nam have increased their share significantly and accumulated sizeable foreign reserves to meet any future crises without the risk of destabilizing their economies. Bangladesh's exports which were a fraction of ours now amount to over $30 billion while ours have gone down from 25 billion to 21 billion.

The reasons for this decline are manifold

(i) Political instability
(ii) Lack of continuity in economic policies, programs and projects
(iii) Security issues

But the most predominant factor for this decine was the gradual decay of the institutions of democratic governance during the last twenty five years triggered by

- The growing Politicization of the Civil services and political interference in their postings, promotions and actions. . As   a consequence, the civil servants have lost professionalism, Competence and Capacity to perform. The selection to top positions is made on the basis of loyalty rather than merit. Responsibility is too diffused and therefore accountability cannot be pinned down. Corrupt officials are hardly taken to task while the honest officers are no longer prepared to take actions due to fear of NAB, FIA, the media etc.
- Processes and procedures have become cumbersome and complex. Decision making has become highly centralized and top down and therefore the limited ownership of decisions creates hurdles in implementation. Rules are bent and exceptions made to confer patronage to the supporters of the ruling parties thus tilting the level playing field against genuine businesses. Risk taking has been replaced by rent seeking .
- Access of basic services such as Education, Health, Law and order and justice is unavailable to those without financial means or political connections. Poor social indicators and growing income and regional inequality are manifestation of of this unequal access.
- Local Governments which are the main points of connection between the citizens and the government have been disempowered and deprived of the powers, authority and financial resources for delivering services to the citizens.
- Frequent judicial intervention in executive and policy matters such as declaring privatization of Steel Mills as illegal, rescinding agreements with foreign companies, disallowing contracts of LNG import when the country was facing severe energy shortages, suspending orders of promotion of civil servants

and protracted litigation with stay orders in tax collection , loan defaults etc.. has created many hurdles in the smooth and orderly management of the economy.

A highly disturbing trend has affected public finances, economic productivity and social equity but has not been given any attention by successive governments whether elected or military . This has to do with the poor maintenance and inefficient operation of the existing capital assets built with huge investment of trillions of rupees made in the past decades. . It is more rewarding to build and inaugurate new projects to demonstrate your performance little realizing that an ordinary citizen feels satisfied if he is able to obtain basic services from the existing facilities. Today we are faced with annual losses of the exchequer of approximately 1 trillion rupees annually because of

- Water losses in the Irrigation system from river inflows to farm gate amounting to almost 50 percent of the total water inflows. These losses equal three times the capacity of the three big dams we have.
- Transmission and Distribution losses from the Power system and non recovery of dues coupled with generation plant inefficiency. At the same time we have to pay fixed charges for capacity whether we get any power from the IPPs or not.
- Unaccounted for losses of the gas system which have gone up from 4 percent to 15 percent in a short period of time. Because of these losses we have to import 400 million cubic feet of LNG every year.
- Road network outside the national highway and main trunk roads is in poor shape
- Operations of Railways and Airline result in losses of billions of rupees annually

It is estimated that 1 percent improvement in infrastructure services (at an aggregate level) can boost GDP growth by 1.25 percentage points .Water productivity which is one third that of India can go up if the tail enders are provided water which is being wasted by those at the head by applying 4 to

5 times water in relation to the actual requirement .Poor farmers at the end of the distributary end up with low yields per acre.

Another problem is the misallocation of resources under the Public Sector Development program (PSDP). Too many projects are included in the PSDP and token allocations are made to each of them without evaluating the inter-se priority and their possible contribution to the economy. The throw forward of all the ongoing projects included in the PSDP would take 20 years to be completed at the current level of allocation every year. The result is cost overruns and diminished benefit stream making a large number of projects economically unviable. If external borrowing is resorted to finance these, we are in worse of both the worlds—inability to repay the loans as income from these loans is negative and the shortages and congestion continue to persist.

FUTURE PROSPECTS

How do we assess the future course of Pakistan's economy? We have constructed three possible scenarios –optimistic, muddling though and Pessimistic

Optimistic (a) Pakistan is able to strengthen and reform its institutions of democratic governance, establish effective coordination mechanisms between the federal and provincial governments, the provincial and local government, Government and the private sector and pursue outward looking economic policies with continuity and stability. CPEC investments begin to generate positive outcomes that boost economic growth and overcome energy shortages.

Expected outcome: Per capita incomes are likely to grow by 4 to 5 percent annually

Muddling through (b) Reforms are implemented half-heartedly, there is no broadly shared consensus on the direction of economic policy, tension between the various tiers of government and government and private sector continues with ups and downs and economic management remains reactive but CPEC investment flows in at the envisaged level.

Expected outcome: Per capita incomes likely to rise between 2 to 3 percent annually

Pessimistic (c) The country suffers from Political instability. Macroeconomic pressures such as widening fiscal and current account deficits persist, exchange rate shows volatility and investors face uncertainty . Implementation of CPEC projects is slow and lacklustre. Poor economic management, overregulation and over taxation of organized private sector and lack of coordination between various tiers of government create unpredictability for investors and raises cost of doing business.

Expected outcome: Per capita income is likely to stagnate or rise very slowly.

Many studies have shown that Pakistan is capable of becoming one of the top 20 ranking economies in the world by 2025. This would require that the government, opposition parties, the private sector and the civil society work in unison and harmony to make this happen. But we have a mind set of negativity so deeply ingrained that many of our intellectuals and commentators dismiss this as a pipe dream. They consider this as a figment of imagination of the foreigners who do not comprehend the " ground realities" of Pakistan. To them, the country is at the brink of economic disaster and these doomsday pundits are unable to reconcile their view of the economy with the facts, evidence and analysis pointing in a direction contrary to theirs. There is another group which is continuously creating scare in the country about the CPEC projects and China becoming an East India company. Nothing can be far from truth but his tune is heard frequently. The change in this negative mind set is a prerequisite for attainment of rapid shared growth.

The above scenarios do not take into account the possible impact of the newly declared Trump policy for Afghanistan and South Asia. The consequences would depend upon our response capacity. If we set aside our differences, divisions and factions and work hard in unison to introduce austerity in our public expenditures, mobilize taxes from those outside the net and reduce waste and inefficiencies the adversity would be minimal. However, if we continue on the path of the business– as usual where the political atmosphere remains vitiated, the quality of economic management is unaltered and the mistrust and suspicion among various segments of the population remain ingrained we should be prepared for quite tough times.

Agenda for sustained economic and social development

What are the actions and measures that would help in translating the optimistic scenario into a reality? Of course, the journey forward would not be smooth but bumpy. External environment may turn out to be more harsh than envisaged. Other unanticipated shocks my create difficulties but a relentless pursuit of the agenda described below may lead to successful outcomes enhancing the resilience capacity to face these shocks. The agenda can be divided in two parts--- Short term and Medium to Long term.

Short Term

- As across – the – board institutional reform is not politically feasible, select a few key institutions critical to growth, security, equity and accountability and restructure and revitalize them.
- Devolve administrative powers and financial resources to local governments to deliver basic services such as Education, Health, Drinking water, Sanitation, Roads etc. to the common citizens.
- Reduce budgetary deficits by bringing in 2 million tax payers who are eligible but are outside the tax net , tax real estate and capital gains and privatize loss making public enterprises particularly in the power sector to stop the ever growing circular debt problem
- Unleash the entrepreneurial energies of the private sector by easing excessive regulatory requirements and reducing tax burden on the organized sector particularly manufacturing sector
- Revamp laws and institutions of accountability so that the honest and competent civil servants act fearlessly and the corrupt are taken to task. The present environment of Too much Accountability coexisting with Too little Accountability has to be replaced by a fair and judicious process

- Reduce trade imbalances by lowering the cost of production and logistics to make our exports competitive and encourage import substitution of goods based on emerging technologies
- Align closely with the Chinese value chain by supplying intermediate inputs to their industries . Renegotiate FTA with China to facilitate relocation of labour intensive export oriented industries in the Special Economic Zones in Pakistan

Medium to Long term

The major challenge facing us in the future would be : how to absorb 1-1.5 million youth in the labour force annually while moving up on the technology front to maintain our competitiveness in the world market. To strike this difficult balance, we have to

- Enhance the quality of exports by producing goods and services that are in heavy demand in the international markets particularly Asia by increasing efficiency and enhancing productivity thus improving competitiveness of Pakistani products
- Invest heavily in producing quality science, technology, engineering and mathematics graduates who can push Pakistan towards innovation, technology assimilation and sophistication.
- Promote vocational and technical skills training as the employment opportunities for general degree holders are receding and the demand for para-engineers, para-medics, technicians, para-scientists, mechanics etc. are rising rapidly
- Subsidize the research and development activities in the Defence, public and private sectors for developing new products and processes
- Take maximum advantage of the country's strategic location by becoming a hub of Regional Trade and transit. CPEC projects particularly pipelines, motorways and railways connecting Gwadar to Kashgar should be expeditiously completed.
- Improve the maintenance and operations of the existing capital assets—irrigation systems, railways, energy infrastructure that are causing huge financial losses to the exchequer; recover user charges for meeting this expenditure

- Introduce internationally accepted standards certification and tests such as FDA approved food and pharmaceutical products for our industries.

If this agenda is faithfully implemented by every successive government and policies, programs and projects are not altered every time there is a change in the government the chances of Pakistan regaining its lost space in the international league appear quite promising.