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**PAKISTAN IN 2011**

**Ishrat Husain**

Pakistan’s economy remained sluggish in 2011 due to domestic political instability, energy shortages, deteriorating Pakistan-U.S. relations, global climate change, and internal security concerns.

The latest estimates show that for fourth year in succession GDP growth in 2011-12 will again fall below its long term growth rate. With population rising around 2 percent per capita income will increase by around 2 percent. This outcome is in sharp contrast to the 2002-07 period when per capita incomes were recording around 5 percent growth annually. Investment rate dropped to 13.4 percent ---its lowest level in last four decades. Fiscal imbalances arising out of subsidies to loss making public enterprises, low tax mobilization efforts, inefficiency and waste in public expenditure resulted in excessive borrowing from the banking system. The government decided to terminate its ongoing arrangements with the IMF the flow of external resources for budgetary support from multilateral development banks was interrupted. The shortfalls in financing were made up by additional borrowing from domestic banking system.

Loss making public sector enterprises drained scarce fiscal resources and cost around 2 percent of GDP resulting in fiscal deficit of around 7 percent of GDP.Tax-GDP ratio declined further to below 9 percent and the new inter-governmental fiscal arrangements that favored the provincial governments in the allocation of divisible tax pool further exacerbated the fiscal situation. Most of inflexible large and growing expenditures on Defence, Debt Servicing, Internal Security, Energy fell within the domain of the Federal government while its share in the taxes has gradually receded and is now 42.5 percent of the total tax pool. This disconnect between the burden of expenditure and accrual of revenues has intensified fiscal imbalances as the Provincial governments have little incentive to raise additional revenues from their own sources while they can spend quite liberally as they do not face any constraints or controls. Inefficiency and waste in public expenditures have therefore become commonplace as the absorptive capacity of the Provincial governments has not kept pace with the growth in revenues allocated to them.

Inflation in 2011-12 is projected to remain around 12 percent which is beyond the acceptable threshold of Pakistani population and much higher than the single digit long term rate. Heavy reliance of government on borrowing from commercial banks to finance its deficit crowded out private sector credit and complicated the transmission of monetary policy signals in the allocation of credit. Private sector credit grew by only 4 percent while credit to government by commercial banks expanded by 74.5 percent. In an economy where private sector is the main driver of economic activity and generator of employment such a situation has naturally become a source of serious concern.

The spillover of fiscal imbalances into energy sector was another impediment to the revival of the economy. The circular debt between the buyers, suppliers, refiners, producers and consumers of electricity has disrupted the normal business cycle. While the peak load demand has increased substantially the constrained generation and distribution due to fuel shortage, gas shortfalls, liquidity crises have placed a heavy cost on the industry and exporters. Capacity utilization of public sector generation companies fell to 25 percent. Small and Medium industry is suffering the most as they do not have recourse to captive power supply like the large enterprises. Banking sector’s non-performing loans to SME sector have also risen because of the low capacity of these enterprises to service their debt.

Pakistan-U.S. relations suffered a serious setback after May 2 when Osama bin Laden was captured and killed by the U.S. Navy Seals in an operation that was not disclosed to Pakistani authorities. The NATO forces attack on Pakistan border posts in Mohmand Agency in November triggered strong reaction in Pakistan against the U.S. and NATO forces. The retaliatory actions taken by Pakistan to get the Shamsi Air base vacated and the stoppage of supply trucks for NATO forces to Afghanistan did not fit well with the U.S. public opinion. The freezing of $700 million in assistance to Pakistan by the U.S. Congress and non reimbursement of the Coalition Support Funds added fuel to the fire. The large trust deficit between the two countries can be gauged by the results of the public opinion surveys carried out in the two countries. Majority of the Americans have a negative view of Pakistan while over 85 percent of Pakistanis consider the U.S. in a similar negative way.

Pakistan’s floods for the second year in a row represent perhaps a shift in the rainfall pattern arising out of global climate change. This year’s floods were limited to the southern province of Sindh unlike the 2010 floods which devastated the whole country. The damage to the lives and property of those affected by the floods is estimated at $10 billion almost 5 percent of the GDP.

Internal security concerns in 2011 were not confined to the Taliban and jihadi attacks or suicide bombers. This year witnessed an eruption of urban violence in Karachi – business capital and the largest metropolitan area of the country. Target killings of workers of two rival political parties aided by criminals and mafia gangs disrupted the normal life of the city for several months. The Civil Armed Forces were called in aid of the local police and the situation was brought under control and the city has remained calm since then.

The year 2011 was tumultuous for Pakistan’s economy , society and politics. Election campaigning that will begin in 2012 will make the management of the economy even more difficult.