Pakistan’s Macroeconomic Challenges[[1]](#footnote-1)

and the

Present Economic Framework

Theory and evidence tell us that Macroeconomic Management of a country at any point of time is driven by a combination of several factors. These are: (i) Initial Conditions; (ii) Resource Endowment; (iii) Policy Stance; (iv) Institutional Framework and (v) External Environment. There is no clear cut weighting that can be assigned a priori to each of these factors but they all impinge upon the outcomes in a variety of interactive and additive ways. Let us consider each of these factors individually in case of Pakistan and draw some inferences based upon our reading of the evidence.

**Initial Conditions**

Pakistan has recorded rapid economic growth, reduction in poverty and unemployment until 2007-08. Since then, a number of developments took place that changed the favorable conditions. The world food and fuel price increases spread over 2007 and 2008 were not adjusted in Pakistan and monetary expansion particularly borrowing from the Central Bank financed the corresponding fiscal deficit. Inflationary pressures were intensified and the beginning of the circular debt set in. Second, the transition from the previous government to the newly elected government was not smooth. The assassination of Mohtarma Benazir Bhutto in December 2007 created a crisis of confidence whose effects persisted over several months. The political uncertainty took a heavy toll on the economy and the resulting capital flight created severe pressures on macroeconomic management. Third, the newly elected government instead of continuing with sound policies of the past and altering those which were not desirable made public declarations that confounded the investors. This abrupt break and outright dismissal and rejection of the past policies accelerated the crisis of confidence. The foreign exchange reserves began depleting at the rate of $1 billion per month and exchange rate started depreciating at an alarming rate. Inflation in 2008 reached its peak level. Fiscal and current accounts reached record high. Foreign investments fell sharply, i.e. by 51 percent in FY09 on top of 35 percent in FY08 and the access to international capital market disappeared. The decline in capital receipts and a widening current account led to a further depletion of the foreign exchange reserves, severe reduction in domestic liquidity and a further impetus to domestic inflation. A vicious cycle set in. Fourth, at a time when the country was faced with serious economic crisis rapid turnover in the teams of economic managers was not helpful. It seemed to outside observers, that the economy was not a top priority and other pressing events engaged the attention of the government. On the contrary, the widening macroeconomic imbalances and deteriorating living conditions required strong hands on the steering wheel of the economy to get it out of the turbulent waters. It was only in November 2008 that after a macroeconomic stabilization agreement was signed with the IMF that things began to improve. To summarize, the initial conditions for macroeconomic in the 2008-2010 period management were not very favorable.

**Resource Endowment**

Pakistan’s resource endowment is better than many other developing countries in some respects while it is deficient in human resource development. The country possesses one of the largest irrigation system in the world that has helped to a great extent in boosting the productivity of agriculture. A country that could not feed 30 million people in 1950 and was dependent on PL-480 Food Aid from the U.S. is not only able to feed 170 million people but exports 3 million tons of rice and had accumulated an exportable surplus of 2 million tons of wheat this year. Cotton production has transformed Pakistan into one of the leading textile exporters in the world market. With almost a negligible manufacturing base the country produces a large variety of goods domestically and also exports others. But this progress has not been steady, smooth and continuous. The dependence on too narrow a commodity base and lack of diversification into dynamic sector with large buoyant demand has left Pakistan behind many other countries in the region.

The biggest setback has, however, been the lack of attention over the past sixty years to human resource development. All indicators of education, health, nutrition, access to drinking water, sanitation, etc. show a dismal picture. Only one half of the country’s population is literate. Net enrolment rate at 55 percent and the primary school completion rate at 47 percent are far below those achieved by the neighboring countries. Only 4 percent of population has degree level education. Public expenditure on education stands at bottom among South Asian peer group having lowest public expenditure that has remained below 2.5 percent of GDP. Health indicators are no better. Maternal mortality, infant mortality, child malnutrition are all relatively weak. Just like education, Pakistan stands at the bottom in terms of public expenditure on health – 0.55 percent of GDP. Only 35 percent of the population is using tap water for drinking while 25 percent uses pumps. 59 percent of the population has access to improved sanitation. Such poor indicators of human resource development place even stronger pressure on the capacity for equitable and sustainable development.

In addition to human resource development Pakistan’s recent economic down turn can also be partially ascribed to infrastructural deficiencies and partially to energy shortages. In this case, it is not only inadequate investment in physical infrastructure but also poor planning, flawed incentive structure and mismanagement of the generation, transmission and distribution companies in the power sector that has led to load shedding and unreliable supply to the industry. For example, Thar Coal, an indigenous and economical source of feedstock has not been utilized to augment power supply in the country. The reforms that have been overdue in the power sector for almost a decade have yet to be implemented despite many public commitments.

**Policy Stance**

Pakistan’s policy stance particularly in terms of liberalization and integration with the world economy has been historically quite sound. With the exception of some intermittent episodes fiscal, monetary, trade and exchange rate policies were not far from equilibrium. But the structural policy reforms in the area of domestic savings, trade diversification, competitiveness and innovation have been lacking and therefore the opportunities that a dynamic global economy offers have not been fully availed. Continued dependence on foreign savings to finance domestic investment has eased the pressures for taking hard economic decisions. The frequent recourse to the international financial institutions, bilateral donors such as U.S., Japan, Saudi Arabia and China have enabled the policy makers to follow a path of least resistance and short term or instantaneous gratification. A country with an average domestic savings rate of 15 percent of GDP and a tax-GDP ratio of 9 percent would always remain severely constrained in pursuing a self propelling growth trajectory. The unfortunate negative view of the private sector, foreign investment, multinational corporations and privatization prevailing in the country would always keep us below our potential. China, with 1.2 billion people, could have relied upon its large domestic market but has emerged as the world’s number one exporting nation and the largest recipient of foreign investment. More than 8,000 multinational companies are actively engaged in various economic activities in China. Unless we change our world view, mobilize our own domestic resources, tax the rich and the affluent, subsidize only the poor the prospects for our growth would remain unattractive. The most urgent policy reform needed is in the area of fiscal policy – both revenues and expenditures rationalization. Public dissavings of 5 to 6 percent of GDP have become the main source of low domestic savings.

**Institutional Framework**

If you ask me as to which one of these factors is overwhelming in keeping Pakistan in its present economic predicament I would venture to say that it is the decay of the institutions.

After inheriting a sound system of governance and well functioning institutions such as the Civil Service, Judiciary, Police, Legislative, etc. we have gradually and slowly turned each one of these institutions either dysfunctional, limping or moribund. Democratic governance system with its in-built check and balances has been replaced with highly personalized, arbitrary and whimsical rule of an individual or a few individuals. Although the interruptions in the democratic process by the military rule or overthrow of the elected governments before completion of their term has done more harm than good but the elected governments themselves have not adhered to the standards of good governance in the larger interest of the citizens. Loyalty rather than competence, Personal allegiance rather than rule of law, preferential treatment rather than uniform application of rules, individual interests rather than collective interests have become the hallmark of the governance in the country. Access to delivery of basic public services to the citizens can only be secured through connections or money. Security of personal life and property and dispensation of justice are available to only a selective few. Trust deficit in the public institutions has reached at its peak nurturing a sense of cynicism, negativism and despondency. Some of them have turned towards extremism and terrorism in acts of despair and hopelessness. The growing institutional desertification in the country in my mind is also the main root cause for economic backwardness compared to other factors. Blueprints for comprehensive institutional reforms have been developed but the political will to implement them has been found lacking so far.

**External Environment**

Pakistan has also been unfortunate in being inflicted with one shock after another in the last decade. First, the participation in the war against terror imposed huge financial, economic, human and psychological costs on the country. In simple monetary terms, the inflows for the U.S. of about $10 billion are only one fourth of the $43 billion of the losses to the economy incurred so far. This money has also come in dribs and drabs with a lot of scrutiny, hesitation and with a sense as if charity was being provided. Second, the 2007 global price hike in oil and commodities inflicted a major blow to the economy. A three fold price hike in petroleum products from $55 per barrel to $150 over a period of 12 months proved devastating for the balance of payments situation of an oil importing country such as Pakistan. As if this was not enough the global economy went through a crisis and recession of the magnitude that has not been witnessed since the depression of 1930s. Weak global demand and suspension of capital flows did not help Pakistan in its external accounts.

The worst shock to the economy, however, came in July-August this year which has resulted in displacement of 20 million people, destruction or damage to 1 million houses, infrastructure, railways, bridges, roads, irrigation system, power grids. The World Bank – Asian Bank preliminary assessment show the damages due to the floods have cost approximately $10 billion – a burden that cannot be absorbed by a country of the resources that Pakistan has. Of course, the massive rehabilitation and reconstruction program, if partly financed by infusion of additional money from the international community can kick start the economy and provide a badly needed stimulus that will halt the erosion in the living standards, provide job oportunties to unemployed and help the internally displaced persons. How soon and effectively this can happen depends upon the response capacity of the government, private sector, civil society organizations and international community.

**Summing UP**

The above survey of the factors that impact macroeconomic situation of a country reveals that the biggest challenge for Pakistan today is the restoration and strengthening of the institutions of governance. This requires strong political will, a time horizon beyond the current term of office and a visionary leadership. In presence of the requisite institutional framework the policy formulation and execution will be the first to improve. Strong institutions will also lay down the foundation for investment in human resources, physical infrastructure, and domestic resource mobilization. Over time the effect of initial conditions will be neutralized. External environment does not remain adverse or benign all the time. Adverse circumstances can be managed and favorable conditions can be taken advantage of. This is the path many successful countries have taken and there is no reason that we in Pakistan cannot replicate it.

1. A paper presented to the participants of the National Security & War Course 2010/2011 at the National Defense University, Islamabad on October 18, 2010. [↑](#footnote-ref-1)