

# ECONOMY OF PAKISTAN – CHALLENGES AND PROSPECTS

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## **OVERVIEW**

Lets have a brief overview in simple terms as to what the structure of this economy is? In 1947, Pakistan had 30 million people with per capita income of 100\$. Agriculture accounted for almost 50% of economic output with hardly any manufacturing, as all industries were located in India. Therefore, it was unable to feed 30 million people and was dependent on PL-480 imports from the USA. From thereon, Pakistan has come a long way. Today with 170 million people, our per capita income in 2008 was 1000\$ which was ten times more. Pakistan is the third largest exporter of rice in the world and producing enough food grains to feed its people. 3 million tons of rice is exported every year by Pakistan which is surplus to our requirements. Pakistan is also one of the five major textile producing countries in the world. So if we measure in relation to where we were vis-à-vis structure of economy, agriculture has come down from 50% to 20%. Therefore, out of total national income, agriculture's contribution is just 20%, but instead of being deficient in food production, we are actually surplus and that is what productivity means i.e. by using the same land you produce more from the same inputs, that is how economic growth takes place. Agriculture is not only crops, within agriculture there has been a significant change. Livestock, dairy, mutton, beef, poultry and similar other products is 50% of agriculture output in Pakistan. Pakistan also produces third largest quantity of milk in the world. So within agriculture sector, there is a change i.e. major crops are only 36% of agriculture value added and 14% are minor crops, fisheries, orchards, fruits and vegetables. Thus, we are moving in a direction where the same land and same resources are being used more efficiently in order to produce more. As a contrast, agriculture is only 2.5% in the US having a population of 300 million, out of which they not only feed the entire population, but also export to the rest of the world. Therefore, it is important to understand that when it is said that agriculture is producing/contributing more, it is the productivity of agriculture rather than the share of agriculture in GDP. Manufacturing and industry now account for 25% of the income; when we recall there was not even a single industry worth its name at the time of partition. So if we look where we were and where we are, I think the justification for Pakistan in terms of betterment of economic conditions of Muslims in this

part is very strong. But where we have failed is that we have not lived up to our potential. In 1969, Pakistan exports of manufactured goods were higher than the combined exports of Indonesia, Malaysia, Philippines and Thailand. In 1960's Korea emulated Pakistan in its five years planning process. The tragedy is that even a country such as Vietnam which was completely devastated by the war has now overtaken Pakistan. Ten years ago, India which was way behind Pakistan (till 1990's) is now way ahead. As an economist and student of globalization, the biggest challenge is: how can we organize ourselves to reach that position where at least we can be running not at the nine second a mile but at least ten second a mile 3 race which is going on in the global economy. Ten more important challenges facing Pakistan's economy are deliberated in the succeeding paragraphs.

### **CHALLENGES TO PAKISTAN'S ECONOMY**

a. We Consume More and Save Less: Out of every hundred rupees of our national income, we consume 85 rupees and save only 15 rupees, which means that the amount of money which is available to invest for economic growth and advancement is too little. Because to grow by 6%, you need at least 24-25% investment rate - and if you want to rely on domestic savings, your saving rate should be 25%. India's saving rate was about the same, but last year they recorded 34% saving rates. China's saving rate is 50%, so this is the contrast as to why we are in serious difficulty because as a nation this is a problem which we have to recognize. We have to at least double on savings rate otherwise we will remain dependent on foreign sources.

b. We Import More and Export Less: Till 2007-2008, 80% of our imports were financed by our export earnings. This ratio has come down to only 50%, it may go up to 60% but a gap of 40% of financing needs in order to keep with the import level still exists. As a nation we prefer to use even the basic commodities of foreign countries rather than locally manufactured goods. Unless we do not change this attitude of preferring the imported goods we have to keep on relying on outsiders to fill in this gap b/w our imports and exports. Relying on outsiders' means that there are cycles, ups, and downs i.e. when things are good, one gets financing, and when things are bad one starves for financing. No nation which 4 strives to preserve its honour must go through this particular route. The lower is this gap between our export earnings and expenditure on imports - and that can be

achieved only by expending our exports; our reliance on external sources would be reduced.

c. Government Spends More than it Earns as Revenues: Fiscal deficit is the difference between the revenues which are collected in a year and the total expenditure incurred by the Government. Pakistan's government takes away 20% of national income as its own. 80% is left in the private sector and 20% in the hands of the government is spent on defence, debt servicing, development on education, health, general administration etc. The revenue generated is only 15% of the GDP at best, and in the worst days it is 12 to 13%. Out of the every rupee of income received by a Pakistani, on average, tax paid is only 9 paise and 91 paise remain with the individual. In 2007-2008, Pakistan's fiscal deficit was more than 7% which means its income or revenues were only 13% of GDP whereas, expenditures were 20%. Therefore, fiscal deficits have to be financed from somewhere, so how do you finance them; you either go again begging the external donors, or to the State bank of Pakistan. The financing provided by the State bank of Pakistan is dangerous because it creates high inflation in the economy, which is injurious to the middle class, those earning fixed wages and salaries, and the poor. Therefore, there is an uproar in the country if the inflation rate goes up. In 1999, our Debt to GDP ratio was 100%, which means that the entire national income was pledged as debt. Every single penny was pledged to the creditors. This ratio was reduced gradually over next six to seven years and brought down to 50%, an average for all the economies. However, the way the things are going for the last two years, it has moved from 50% in last two yrs to 58%, and with all the borrowings it may go to 60%, while the Fiscal Responsibility Law 2005 says, that the government should not exceed the debt GDP ratio more than 60% and is required to reduce it by 2.5%; and that is not happening. The reason the fiscal deficit is widening is low revenue collection. How can you expect that only nine paise out of every rupee of income generated by Pakistani population suffices to meet the requirements of defence, infrastructure, development, debt servicing etc. This is just not possible. In India, tax GDP ratio is 15% and still they have fiscal deficit. So Pakistan is way below the norm for developing countries. Many people say that defence takes away a lot of government expenditure. Whereas, the fact is that defence expenditure is only 20% of government expenditure. It is only 4% of GDP, and is not such a large expenditure as compared to debt

servicing which is 7-8% of GDP and almost 40% of government expenditure. Therefore, government has to contain its fiscal deficit by raising revenues. Agriculture incomes are exempt, professionals, retailers, wholesales, transport owners and many other service providers evade taxes by paying a small fraction of what is due. Continuing large fiscal deficits year after year may plunge the country into debt trap again.

d. Our Share in the World Trade is Shrinking: In 1990, Pakistan's share was 0.2% of the world trade. After 20 years it has come down to 0.12% in a very buoyant world economy. World trade has been growing faster as compared to the world output. India in the same period had doubled its share from 0.7% to 6 1.4%, while Pakistan is going the other way and that is the reason why exports/imports imbalance is increasing. We are not taking advantage of the opportunities which a buoyant world economy is providing. Pakistan is stuck with only a few commodities – textiles, leather, rice, sports, goods and the surgical goods. We have not entered the markets for more dynamic products. All our exports are to a few markets – the USA, EU and the Middle East. So this narrow export base and very limited geographical spread are not allowing us to expand our share. Unless we improve the quality of our products, go out and do the marketing abroad, invest in research and development, the prospects do not look promising. That is why we are lagging behind other countries which from way back are over taking Pakistan.

e. We Badly Lag in Social Indicators: One of the most glaring weaknesses is that a country like Pakistan that should have had best indicators in literacy, infant mortality, fertility rates, in access to water supply, in primary enrolment ratios has social indicators which are more comparable to Africa rather than to the countries of similar per capita income. Even Tajikistan, which is a very poor country, has better literacy rate and primary enrolment ratios than Pakistan. What does it mean? It means that if we had literacy rate of 100% instead of 55%, then in 2009-2010 our per capita income would have been 2000\$ rather than 1000\$. Instead of 30 million middle class in Pakistan we would have 60-70 million middle class people; we would have poverty reduced to 15-20%. We have committed to achieve the millennium development goals by 2015 i.e. we will be able to reach 80-85% literacy rate, but it is doubtful that this will happen. Why do we have 7 regional inequalities? Why Baluchistan is lagging behind other provinces? It is because of literacy

rates and primary enrolment ratios. There is a direct correlation between regional inequities and backwardness with the level of education.

f. We Face Energy and Water Shortages: Another challenge we face today is energy and water shortages, and that is not because we are not generating enough electricity or we are not having enough water. With the losses of KESC from the point it has generated to the point they realize the billing is 45%, so 55% people are paying for those who are stealing the electricity. Government of Pakistan out of its own limited resources is paying 200 billion rupees every year as subsidies for electricity. Our industry is at a disadvantage that they get the orders from foreign countries but they cannot execute the orders because there are electricity outages. In addition to economic losses it also creates inconvenience for pursuing normal life. We have silting of our dams, but no additional dams have been constructed since Tarbela in 1974. We have water course losses of about 20–25%. Even after these losses, the water is inequitably distributed. The influential land lords are able to take greater share of water from the canals as compared to poor farmers. Therefore, the productivity of poor farmer is only one ton per acre as compared to 3 tons by large holders. If we provide the water equitably to the small farmer, he would also be able to increase the productivity from one to at least two tons resulting into additional income, increase in exports of food grains, cotton and fruits and vegetables which will add to export earnings of Pakistan. With the climate change taking place with all the 8 glaciers in Himalayas which are going to melt, we are going to have difficulties in future due to global warming.

g. Cost of Doing Business is High: Pakistan is ranked among the bottom half of the rankings of the countries where cost of doing business is quite high. It is not high for any particular reason but because of our bureaucracy totally sitting on their seats without taking actions or decisions in time. Unless there is some pressure or incentive for them, the normal businesses particularly the small and medium businesses have serious problems at the hands of bureaucracy. Even if we have investors who are welcomed by the federal government, when it comes down to provincial and local governments there are given a run around – the land is not available, the water is not available, the gas is not available, electricity is not available, road is not available. Lack of coordination among various government agencies, innumerable laws and regulations that are antiquated and outdated

have proved to be serious impediments. Labour laws, inspections by multiple agencies, the delays in the court system, infringement of intellectual property rights and evasion of taxes by competing firms in the informal sector have rendered some of the well established firms unprofitable, or the feasibility of starting new ventures questionable.

h. Crisis of Governance and Implementation Weaknesses: If we glance on policy documents of various governments on education, agriculture, health, trade policy etc, and look at the same policy forty years ago and the problems, there is hardly any significant record of implementation of those policies or plans over this period. We produce five years plans and all kinds of medium term frameworks, but it is the poor governance and implementation that are the weak links in getting things done. Unless we strengthen civil services and bring about a merit based system of recruitment, promotion, performance evaluation, compensation, disciplinary action, etc, we will not be able to see any difference in the quality of governance. Orders are given by the higher ups but they are not carried out; summaries are approved, but they remain buried in the files and therefore; whether it is education, health, water supply, revenue or law and order, you can pin down the problem to the governance issues. Unless we fix the governance issue, the economy is not going to take off at the speed which is required.

i. Uncertainty and Unpredictability due to Lack of Continuity: Every government whether military or civilian starts with a clean slate, as if nothing happened before them and nothing will happen after them. This is not the way the real world works. You take the projects and programmes which were initiated by the previous governments, evaluate them as to what the strengths and weaknesses were, fix those weaknesses and carry them forward. It will take only few years to bring these inherited projects to completion and the country will benefit from new motor ways, new ports, highways, educational institutions etc. But the blame game of successive governments results into abrupt termination of all such projects and programs. When these are resumed the cost has escalated three times and it takes several additional years to complete them. In the meanwhile the people of Pakistan suffer because of this lack of continuity. When faced with such unpredictability about the future, the investors are pondering whether they should invest in this country as they are uncertain whether the new government when comes in would stop or alter

what the previous government was doing, or adhere to the commitments made to them. Take the example of Higher Education Commission, which was sending 1700 students for PhDs abroad but the new government comes in and suspends the funding of those programmes. This solved down the process of faculty development for our universities at a time when we should have been sending twice as many scholars.

j. Political Stability, Law and Order/Security: The overall arching theme is that for a robust economy we should have political stability, law and order and security. The Armed Forces of Pakistan deserve gratitude for what they have done in Malakand Division to bring about stability as far as the law and order situation is concerned. The sooner the country is gotten rid of this image of political instability, poor law and order situation and insecurity, whereby investors from all over the world hesitate in coming to Pakistan and invest, we will not be able to make any progress in this country. In 2007, Pakistan was one of the most favourite countries among the international investor community. A thirty year piece of paper was floated which was a bond for Pakistan to be paid in 2037 and Pakistan got four times over subscription at a price which was only 300 basis points above the US treasury. Very few countries can claim to have that kind of credibility with international fund managers. However, in two years time we have missed that boat. Therefore, it is imperative that we resume the journey which has been interrupted by nurturing a stable, secure and peaceful political environment.

## **PROSPECTS/SOLUTIONS TO IMPROVE ECONOMY**

How can we overcome these challenges and problems and improve our economy? A lot has been written and talked about it, but let's focus on only a few action points.

a. Change in National Psyche and Mindset: We as a nation are too much negative oriented and too much cynical where we find everything wrong in this country. Unless we change our mindset and unless everybody who is doing what he is supposed to do, carries out his or her task with sincerity and honesty, we are not going to go anywhere. We should not expect any Messiah to come and fix our problems we have to do it ourselves individually and collectively. There are no short cuts available. Media is muddying the water by their sensational stories and inviting so called experts who contribute in projecting negative thinking and negative national psyche. Unless we have a positive "can do" mentality, it will

be difficult to progress. Unless each one of us changes our mindset rather than blame the government and the system, we are not going to go anywhere in this race for global economic survival. This is easier said than done. But I expect our younger generation to be more responsive and responsible.

b. Building up of Human Capital: There is no substitute to building up human capital. Private sector, public sector, NGOs, local communities, philanthropists etc, all here to put their hands on deck and participate in making sure that every child goes to school. Every high school graduate has some technical and vocational skill or goes for higher education. Unless we build up human capital, we are just going to be left behind because the world economy is going to be a knowledge based economy. It is not an economy where you memorize material or reproduce that in the exam and forget about it – that is no longer the case. One has to acquire the knowledge and use it in order to apply to problem solving. This is a new paradigm where human capital is as important as machinery and equipment. Pakistan lags behind other countries in the institutions, infrastructure and incentives for human capital formation. We have no choice but to accelerate the pace to catch up with others.

c. Use of Technology: The technology is spreading like a wild fire. How many people five years ago could have thought that even in a small towns and villages of Pakistan, one would access to mobile telephones. 95 million Pakistanis have mobile phones today. You can use this technology in order to provide them banking services, information on climate/weather, agriculture extension, health, education etc. It is a powerful tool which can leapfrog a lot of time which we have wasted. Using technology particularly the information/communication technology for the betterment of social and economic problems of Pakistan is something which needs to be done but it cannot be done the way we have compartmentalized this into different ministries. A more holistic and comprehensive approach that deploys technology for poverty reduction has to be put in place.

d. Young Labour Force: Pakistan is one of the few countries which has a young labour force which can be harnessed for its own and global economy. Japan, Europe, USA and after 2050 China are going to have aging population where the 13 ratio of old to young people

is going to increase. India and Pakistan are two countries where the ratio of younger people to the older ones is going to increase. If we tool these young men and women properly, we increase the female labour force participation, give them skills and knowledge, they can become the labour force for the rest of the world. This will give a big boost to Pakistan's own economy. In 2001, worker remittances were less than a billion dollars; today we have almost 7-8 billion dollars. Now this can be multiplied by three or four times if we have educated labour force i.e. skilled labour force going for overseas employment. This is also a way to create employment opportunities because if you have large number of younger people coming to labour force and you don't have job opportunities for them you can have social upheaval. Therefore, it is imperative to create employment opportunities for them and one of the avenues is to train them in the kind of the skills which are needed not only by the national economy but also by the international economy.

e. Governance, Devolution and Decentralization: As the population is increasing, one cannot govern Pakistan sitting in Islamabad, Karachi, Lahore, Peshawar or Quetta. One has to devolve powers, decentralize and delegate authority, provide resources to the local/district governments so that they can take decisions at their own. Those decisions would be very much in accordance with the requirements and the needs of those communities. Sitting in Islamabad one cannot visualize what is needed in Chaghi or Loralai, but the people in Loralai and Chaghi know exactly whether they need water, fertilizers or fruit processing industry. Let us devolve powers to the people at the grassroots level 14 and there would be much better allocation and utilization of resources. There must, however, be accountability of the local governments by the provincial governments and of provincial governments by the federal government but not interference or usurpation of powers. If we do that, then a lot more can happen with same amount of resources which are being wasted today, and the economic growth rate can be raised from 6-7 percent average to 8-9 percent annually.