PAKISTAN

PERSISTENT ECONOMIC CRISES

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INTRODUCTION

In September 2024, the International Monetary Fund (IMF) granted final approval for the loan to Pakistan. The international financial body has approved a 37-month extended arrangement under the Extended Fund Facility (EFF) for (around) US$7 billion.[1] The Pakistan government has approached the IMF for the 25th time and is its fifth largest debtor. Turning to the IMF has been inevitable for Pakistan due to its unresolved balance of payments crisis. Under the new EFF-supported programme, the key priorities include:

> (i) rebuilding policy-making credibility and entrenching macro-economic sustainability through consistent implementation of sound macro policies and a broadening of the tax base; (ii) advancing reforms to strengthen competition, and raise productivity and

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1. International Monetary Fund, "IMF Executive Board Concludes 2024 Article IV Consultation for Pakistan and Approves 37-Month Extended Arrangement," September 27, 2024, https://www.imf.org/en/News/Articles/2024/09/27/pr-24343-pakistan-imf-concludes-2024-aiv-consultation-pakistan-approves-37-mo-extended-arr. Accessed on October 1, 2024.

> competitiveness; (iii) reforming SOEs (State-Owned Enterprises) and improving public service provision and energy sector viability; and (iv) building climate resilience.[2]

In an unusual move, the IMF held unscheduled talks with Pakistan in the second week of November, ahead of the stipulated time, and issued a press release, with recommendations for Pakistan:

> ...the need to continue prudent fiscal and monetary policies, revenue mobilization from untapped tax bases, while transferring greater social and development responsibilities to provinces. In addition, structural energy reforms and constructive efforts are critical to restore the sector's viability, and Pakistan should take steps to decrease state intervention in the economy and enhance competition, which will help foster the development of a dynamic private sector.[3]

Pakistan's revenue shortfall stood at Rs 190 billion in the first four months (July to October) of the current fiscal year, and according to the financial body, Pakistan has time till February next year (2025) to recover the shortfall.[4]

Perhaps the most critical challenge for the Shehbaz Sharif government has been to address the country's economic crisis. The government has indicated that it would want this to be the last loan from the financial institution. In the last two years, Pakistan has experienced compounding financial challenges, including an alarming decline in foreign reserves at the Central Bank, which dropped to as low as US$2.9 billion in February 2023—just enough to cover three weeks of imports. The country faced a high debt burden, hard-hitting inflation that peaked at almost 30 per cent, and a desperate need for external assistance from the IMF and Pakistan's

2. Ibid.
3. International Monetary Fund, "IMF Staff Concludes Visit to Pakistan," Press Release 24/423, November 15, 2024, https:// www.imf.org/en/News/Articles/2024/11/15/ pr-24423-pakistan-imf-staff-concludes-visit-to-pakistan. Accessed on November 17, 2024.
4 Khaleeq Kiani, "Govt, IMF Wrap up Talks after Rare revision of fiscal data," *DAWN*, November 16, 2024, https://www.dawn.com/news/1872730. Accessed on November 17, 2024.

traditional donors, who have stepped in to provide relief in the past. Without delving into the details of Pakistan's history of economic mismanagement, it would not be incorrect to state that the persistent economic crisis in the country are the result of a mix of factors: frequent phases of political uncertainty, the military's expanding stakes in the economy, economic mismanagement, unattended fiscal deficit, excessive reliance on debt, lack of focus on investment in the social sector, and, very importantly, consistent high investment in the conventional military and nuclear build-up.

After the exit of Imran Khan and the controversial general elections in February 2024, there have been some positive shifts in the figures of foreign reserves and inflation, but the critical question is whether these shifts indicate changes in the economic dynamics or are a fallout of foreign assistance which Pakistan managed to receive from the IMF and its 'friends in need'.

ECONOMIC INDICATORS

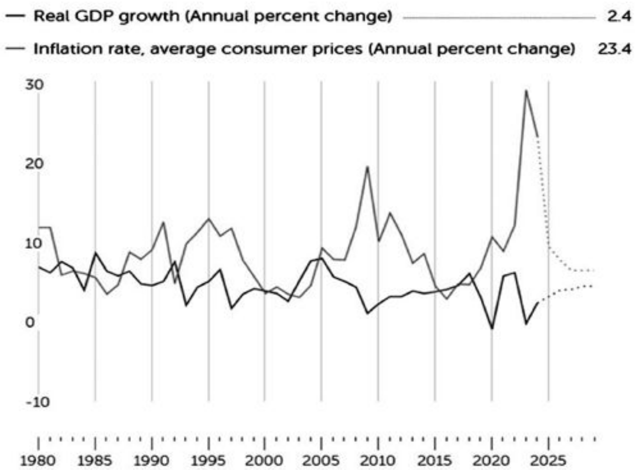
According to the *Pakistan Economic Survey*, in Financial Year (FY) 2023-24, "the government confronted four critical challenges that threatened Pakistan's socioeconomic growth: achieving sustainable macroeconomic stability, reducing poverty, ensuring fiscal consolidation, and addressing external account vulnerabilities."[5]

Some of the critical economic indicators which project some stability are as follows:

- Compared to 2023, Pakistan has shown some stability with general elections (February 2024) and stable external factors in 2024 and this reflected in the Gross Domestic Product (GDP) growth. The IMF standby agreement was approved in 2023, and weather conditions have been more favourable. The GDP growth rate has shown a slow improvement, with FY 2024 projected at 2.4 per cent, compared to -0.2 per cent in FY 2023. Inflation, which stood at 29.2 per cent in 2023, has reduced to 23.4 per cent in 2024 (Fig 1).

5. Government of Pakistan, "Pakistan Economic Survey 2023-24"; p. 3, https://www.finance.gov.pk/survey/chapter_24/overview%202023-24.pdf. Accessed on October 2, 2024.

Fig 1: Pakistan's GDP and Inflation



Source: International Monetary Fund, Pakistan, https://www.imf.org/en/Countries/PAK. Accessed on October 21, 2024.

- Robust growth in the agriculture sector was the key driver of the GDP growth in FY 2024.[6] The growth of the agriculture sector was estimated at 6.25 per cent in FY 2024. The main crops contributing to growth include wheat, rice and cotton.[7]
- The GDP at current market prices is projected to grow by 26.4 per cent over last year's US$302 billion, increasing to US$382 billion in FY 2024.[8]
- The industrial and service sectors witnessed a positive growth of 1.21 per cent in FY 2024.[9]

The growth figures are a temporary relief, but unfortunately, do not represent a shift in economic mismanagement. Even though the economic indicators have shown some positive growth, the high debt numbers and the persistent dependence on borrowing remain prime challenges for Pakistan. The economy has always remained

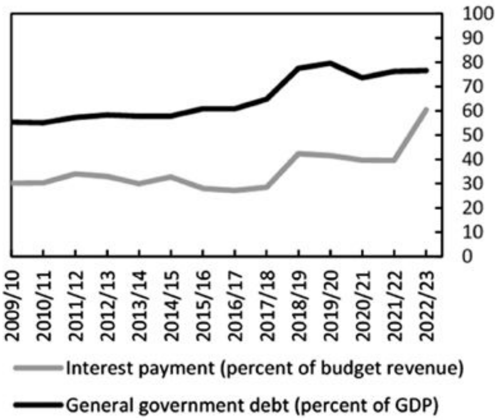
6. Ibid., p. 3.
7. Ibid., p. 4.
8. Ibid., p. 3.
9. Ibid., p. 4.

aid-dependent, and for decades, the nation has been in a vicious cycle of taking new loans to repay the old ones.

THE FISCAL CRISIS

Pakistan does face an acute fiscal crisis. The ratio of public debt-to-GDP has increased significantly in recent years (Fig 2), growing by approximately 16 percentage points of GDP between FY 2017 and FY 2023.[10] The debt stands at about 74 per cent of the GDP at present. The IMF report outlines multiple factors contributing to the fiscal deficit, including sluggish GDP growth, depreciation of the Rupee, under-performing SOEs, natural disasters, and lack of planned fiscal consolidation.[11] To deal with the fiscal deficit, Pakistan needs to increase the revenue base, increase the taxation, cut down on unproductive expenditure and invest in social and development sectors.[12] Along with the chronic issues which need to be addressed, phases of prolonged political uncertainty have not allowed the economy to settle down.

Fig 2: Debt and Debt Service



Source: Fazeer Rahim, Richard Allen, Sybi Hida, and Soren Langhoff, *Technical Assistance Report: Pakistan Improving Budget Practices*, International Monetary Fund, August 2024, p.11.

10. Fazeer Rahim, Richard Allen, Sybi Hida, and Soren Langhoff, *Technical Assistance Report: Pakistan Improving Budget Practices*, August 2024, p. 11, file:///Users/shalinichawla/Downloads/3005-4575-019.2024.issue-099-en%20(2).pdf. Accessed on October 20, 2024.
11. Ibid.
12. Ibid.

Fig 3: General Government Gross Debt

Source: International Monetary Fund, Pakistan, https://www.imf.org/en/Countries/PAK. Accessed on October 21, 2024.

Pakistan struggles with a chronic debt problem (Fig 3), primarily due to a deficiency of resources. It has not managed to resolve the issue of expanding its revenue base. The country struggles with a low level of tax-to-GDP ratio. Despite being the sixth most populous country in South Asia, the tax-to-GDP ratio stood at 10.0 per cent in 2022, which was 9.3 percentage points below the Asia and Pacific average of 19.3 per cent.[13] This issue has been debated at length in the studies by the financial bodies, and a decade ago, a World Bank report outlined the key issues behind Pakistan's narrow tax base, which remain unchanged: "Pakistan's tax system underperforms because of a complicated and unfriendly taxpayer system, a narrow tax base, low compliance, weak and inefficient tax administration, and inadequate subnational taxation."[14]

The IMF has asked Pakistan to increase its tax base by bringing the real estate, agriculture and service sectors into the tax net. Some measures have been adopted and some are supposedly in the pipeline.

13. OECD, "Revenue Statistics in Asia and the Pacific 2024- Pakistan", https://www.oecd.org/content/dam/oecd/en/topics/policy- sub-issues/global-tax-revenues/revenue-statistics-asia-and-pacific-pakistan.pdf. Accessed on November 10, 2024.
14. Jose R Lopez-Calix and Irum Touqeer, "Pakistan Policy Note 16," June 2013, p. 3, https://documents1.worldbank.org/curated/ar/378401468074335833/pdf/795830BRI0SASE0Box0377381B00PUBLIC0.pdf. Accessed on September 16, 2024.

Pakistan's debt has grown at an alarming rate since 2010. Although it has been an aid-dependent economy for a long time, the nation borrowed significantly after 2010 to survive the impact of the global economic crisis. Pakistan's external debt stood at Pakistani Rupee (PKR) 4,756 billion in 2011 and increased to PKR 24,093 billion in 2024.[15] According to a think-tank report, in FY 2024, Pakistan will need to pay back around US$49.5 billion in debt maturities (30 per cent of which is interest).[16] The IMF recommendations and other inputs of the financial experts indicate debt restructuring as a solution. But, within the external debt, around 40 per cent comprises multilateral creditors, and this is not up for restructuring. Also, this component does not weigh too much in terms of interest cost. The bilateral component of the debt has grown significantly since 2010, and among the bilateral lenders, Pakistan owes the most significant component, around 58 per cent, to China.

Debt servicing in Pakistan surpasses the gross revenue and this has been a major issue. To control the deficit, Pakistan needs to increase the revenue base and cut costs. The most important sector, which consumes a large chunk of national resources, is defence. This has been a matter of discussion for decades within Pakistan and with the financial institutions. Although the *Pakistan Economic Survey* 2023-2024 indicates the defence spending at 1.2 per cent of the GDP in 2023, the actual spending, which includes pensions and defence acquisitions, is much more, and diverts resources from the development expenditure. Pakistan's defence modernisation has been maintained with the inflow of lavish Chinese equipment despite the acute economic crisis.

IS THE ECONOMY IMPROVING?

Pakistan had managed to dodge the risk of economic default in 2022 and 2023 with assistance from its friends and traditional donors. China, Saudi Arabia and the UAE extended approximately US$5 billion assistance through debt rollovers, which helped Pakistan stabilise its

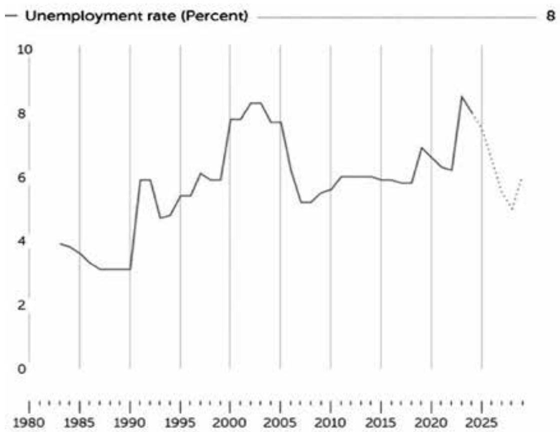
15. Government of Pakistan, Finance Division, "Pakistan Economic Survey 2023-24", Chapter 9, "Public Debt", p. 150, https://www.finance.gov.pk/survey_2024.html. Accessed on October 11, 2024.
16. Ammar Habib Khan and Zeeshan Salahuddin, "A Raging Fire: Pakistan's Debt Crisis," Tabadlab, February 18, 2024, https://tabadlab.com/a-raging-fire/. Accessed on October 18, 2024.

foreign reserves. Some positive signs in growth rate can be seen. The IMF loan, which the Sharif government is cherishing and projecting as a feather in its diplomatic cap, carries strict conditionalities, including a hike in taxation, high interest and an increase in energy prices. These measures further add to the financial burden on individuals already within the tax net, who are, as it is, struggling with high inflation and economic uncertainty in their day-to-day lives.

There has been reduction in inflation but the cost of living has gone up, the unemployment rate has escalated (Figure 4), and the standard of living has been drastically challenged. Pakistan's popular daily reported:

> The pace of increase in prices may have come down but the cost of living remains steep. The nominal earnings of middle-income homes have not risen as much as prices in the last couple of years. They are worse off because their purchasing power or inflation-adjusted real income has fallen drastically, forcing most people to downgrade their standard of living.[17]

Fig 4: Unemployment Rate in Pakistan



Source: International Monetary Fund, Pakistan, https://www.imf.org/en/Countries/PAK. Accessed on October 2024. Accessed on October 21, 2024.

17. "Little Relief for Public", *Dawn*, November 29, 2024, https://www.dawn.com/news/1875475/little-relief-for-public. Accessed on November 30, 2024.

The World Bank report eloquently highlighted the risks of the Pakistan economy:[18]

1. In the absence of international capital market access, Pakistan has been heavily reliant on expensive domestic borrowing for fiscal financing, leading to an intensifying sovereign bank nexus.
2. In the absence of a strong national political consensus on an ambitious and credible economic reforms plan, policy slippages and delays in implementation of critical structural reforms (such as fiscal consolidation or energy reforms) are likely.
3. With limited fiscal space and foreign reserves amounting to only US$9.1 billion at end-February 2024 (equivalent to 1.7 months of FY 25 imports), any delays in the disbursement of planned external financing could pose substantial liquidity risks.
4. Global inflationary pressures,… amid potential extensions of production cuts by oil producing countries, continuation of export bans on food items by large global exporters, and the continued war in Ukraine. Any escalation of the conflict in the Middle East and the associated disruptions in the energy supply chain would pose additional risks.

The Foreign Direct Investments (FDIs) which need a push are now handled by the newly created Special Investment Facilitation Council (SIFC). The military's role in the economy has further expanded with the SIFC, and it remains to be seen this will serve the country's economic interests.

The IMF loan, debt rollovers from 'friends', and the rise in foreign reserves and inflation control have facilitated some indicators of economic stability. But the bigger question is: does this lead to economic growth for Pakistan? To stabilise economic indicators and achieve growth, Pakistan needs well-considered structural fiscal reforms, a reduction in non-developmental expenditure

18. The World Bank, "Pakistan Development Update," April 2024, p. 17, https://thedocs.worldbank.org/en/doc/140b30353b40dbb294cca42bcb86529a-0310062024/original/Pakistan-Development-Update-April-2024.pdf. Accessed on October 1, 2024.

and focussed investment in developmental expenditure. In the wake of the increasing population, Islamabad requires enhanced expenditure on health, education, climate change related disasters and green transition.[19] High defence spending certainly needs serious consideration. Pakistan needs policy reforms that ensure growth without depleting its foreign reserves or impacting inflation.

There has been an aggressive debate in Pakistan on the viability of the SOEs, the majority of which have been loss-making. A World Bank report (April 2024) offered recommendations for Pakistan to reform the SOEs and suggested that Pakistan needs:

> A performance improvement roadmap for SOEs, resizing and improving the SOE portfolio by closing insolvent SOEs and restructuring inefficient but economically viable SOEs, while assessing the potential for divestment, where possible…The Government should eliminate the longstanding practice of covering commercial SOE operating losses with transfers from the federal budget.[20]

The overall economic situation is alarming for Pakistan, and political uncertainty and serious security challenges raise questions about the sustenance of the ongoing economic efforts. Consistent political instability and uncertainty shrink the prospects of investments and collaborations. Pakistan is working aggressively to attract investments and the military is taking the lead in that direction.

There have been occasional talks about resuming trade ties with India, which were suspended completely by the former Prime Minister Imran Khan post abrogation of Article 370. Diplomatic relations between the two nuclear neighbours have been suspended since 2016, following the Pakistan-sponsored terror attack on the Indian air base at Pathankot. India's economic growth has been remarkable in the last decade, and its GDP growth is at more than 8 per cent, but Pakistan's continued reliance on proxy war as part of its India strategy does not provide any space for diplomatic or economic collaboration.

19. Khan, n. 16.
20. n. 18, p. 29.