PAKISTAN'S ECONOMIC CRISIS

CHALLENGES & THE WAY FORWARD

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Report of the National Seminar

on

Pakistan's Economic Crisis

Challenges and the Way Forward

NUST Institute of Policy Studies (NIPS)

NUST | Islamabad

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- Dr. Ashfaque Hasan Khan, Director General, NIPS.
- Mr. Sakib Sherani, Founder and Chief Executive, Macro Economic Insights & Former Member of Prime Minister's Economic Advisory Council.
- Dr. Ather Maqsood Ahmed, Professor, Department of Economics at School of Social Sciences and Humanities.
- Dr. Muhammad Khan, Chairman, Department of Politics and International Relations, International Islamic University, Islamabad.

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- Mr. Iftikhar Ullah Babar, Former Secretary, Senate of Pakistan.
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NATIONAL SEMINAR – 2024

Pakistan's Economic Crisis Challenges and the Way Forward

NUST Institute of Policy Studies (NIPS)

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About the Speakers

Dr. Shamshad Akhtar

Dr. Shamshad Akhtar is currently serving as the Caretaker Federal Minister of Finance and Economic Revenue Affairs. Prior to her current position she served as the Under-Secretary-General of the United Nations and as the tenth Executive Secretary of the Economic and Social Commission for Asia and the Pacific from 2014 to 2018. She also served as the United Nations Sherpa for the G20. Formerly, as the UN Secretary-General's Senior Advisor on Economics and Finance, and Assistant Secretary-General for Economic Development at the Department of Economic and Social Affairs, she led the UN-wide coordination of the post-2015 development agenda and related policy and normative work, including supporting work on the Sustainable Financing Strategy.

Dr. Akhtar served as the Governor of the State Bank of Pakistan, and Vice President of the Middle East and North Africa Region of the World Bank. In her capacity as Governor, Dr. Akhtar was also the Chairperson of the Central Bank Board and its affiliates, as well as a Governor of the IMF. During her term of office, she was recognized for the success of the Bank and won two consecutive awards as Asia's Best Central Bank Governor from Emerging Markets and from the Banker's Trust. In 2008, The Wall Street Journal Asia also recognized her as one of the top ten professional women of Asia. Dr. Akhtar has had a long-standing career with the Multilateral Development Banks (MDBs). She served in the Asian Development Bank (ADB) for almost 15 years, rising through the ranks from Senior Economist, to attaining the highest professional positions, including as Special Senior Advisor to the President of ADB, and as the Bank's Director-General of the South-East Asia region. During the Asian financial crisis, she also served as the ADB Coordinator to the APEC Finance Ministers, providing analytical support in a number of economic and social areas for crisis prevention and mitigation, while also leading engagement with the Bank for International Settlement and other standardsetting bodies. She has also served as a member of the Pakistan Economic Advisory Committee and of the Governing Council of the Pakistan Statistics Bureau.

Mr. Muhammad Ali

Mr. Muhammad Ali is currently serving as the Caretaker Federal Minister at Ministry of Energy (Power Division). He has thirty years of domestic and international work experience in the public and private sectors, including as Chairman of the Securities and Exchange Commission of Pakistan. He also Chaired the Committee on Power Sector Audit, Circular Debt Resolution and Future Roadmap which prepared a detailed report for reforming Pakistan's power sector and was member of the negotiation team which successfully negotiated revised power tariff and signed the MoUs with private power producers.

Mr. Ali revamped the capital market and corporate governance landscape of Pakistan by ensuring successful passage and implementation of the Demutualization Act, 2012, and developing a revised capital gains tax regime. He served on Boards of leading Pakistani corporates, stock exchange, credit rating agency, Capital Market Advisory Council, Federal Board of Revenues' Tax Advisory Group and Government of Pakistan's Economic Coordination Committee of the Cabinet. Moreover, he led the team advising the Government of Pakistan on IPOs of the largest Commercial bank and one of the largest E&P companies in the country.

Dr. Ashfaque Hasan Khan

Dr. Ashfaque Hasan Khan is currently serving as the Director General, NUST Institute of Policy Studies (NIPS). Prior to his current position, he served as Principal, School of Social Sciences and Humanities, NUST. He is currently the Member of the Advisory Committee of the Asian Development Bank Institute (ADBI), Tokyo appointed by the President of the Asian Development Bank and recently been invited by the International Finance Forum (IFF), Beijing to become Member of the Academic Committee of the IFF. He is the first Pakistani ever to be nominated to these prestigious Institutions. He has been the Special Secretary Finance/Director General, Debt Office and Economic Adviser, Ministry of Finance, Islamabad, and the Spokesperson of the Government of Pakistan on Economic Issues (1998-2009).

Dr. Khan holds a PhD degree in Economics from The Johns Hopkins University, USA. He has published 11 books and more than 170 articles in national and international journals of economic science. In recognition of his outstanding contribution to the field of economics and public policy, the President of the Islamic Republic of Pakistan has conferred the award of Sitar-i-Imtiaz to Dr. Khan in 2005. The Economic Cooperation Organization (ECO) has conferred on him the ECO Excellence Award 2010 for his outstanding contribution in the field of economics. Dr. Khan is the frequent speaker at the National Defence University, National School of Public Policy, Pakistan Foreign Service Academy, PAF Air War College, Karachi etc. He is the author and editor of the two recently published books, *Russia – Ukraine War: Dawn of a New World Order?* and *Living Under Hybrid War*.

Mr. Sakib Sherani

Mr. Sherani has wide ranging experience in public policy, the financial sector, international capital markets, at the corporate board-level, and in the development sector as well as with not-for-profit organisations and initiatives. Mr. Sherani is the founder and Chief Executive of Pakistan's first independent research house, Macro Economic Insights that provides risk advisory to clients on Pakistan's economy.

He has served on the Prime Minister's Economic Advisory Council (EAC) and its variants on several occasions under different governments, first between 2004 and 2007, then from 2008 to 2010, from 2013 to 2017, and again in 2018-19. He has also served as the Principal Economic Advisor to the Ministry of Finance, Government of Pakistan between 2009 and 2010, and was a member of the Panel of Economists of the Planning Commission, Government of Pakistan during this period. He was also member, Revenue Advisory Council of FBR. Mr. Sherani is a noted commentator on the economy and has been an Op-ed columnist for Pakistan's largest circulation English-language newspaper daily Dawn since 2011.

Dr. Ather Maqsood Ahmed

Dr. Ather Maqsood Ahmed is currently serving as Professor, Department of Economics at School of Social Sciences and Humanities. He is one of Pakistan's eminent economists. He is the founder of the renowned Department of Economics at NUST. Prior to joining NUST, Professor Ahmed worked as Member, Tax Policy at the Federal Board of Revenue (FBR) for five years. In his capacity as Member, Tax Policy testified before the Standing Committees of the Senate of Pakistan and National Assembly and held extensive deliberations with representatives of international donor agencies on matters of interest for Government of Pakistan. He also served as researcher at PIDE and Kuwait Institute for Scientific Research (KISR). His extensive research has been published in the shape of various books, national and international journal articles, and research reports. He has supervised a large number of PhD and MPhil/MS dissertations. His research interests include macroeconomics, public finance, applied econometrics, monetary economics, and economic demography.

Dr. Muhammad Khan

Dr. Muhammad Khan holds a position of Chairman of the Department of Politics and International Relations at the International Islamic University Islamabad (IIUI). Additionally, he serves as the Director of Academics and Director of Examination at IIUI. Dr. Khan has served as the Head of the International Relations Department at the National Defence University (NDU) in Islamabad. Notably, he played a pivotal role in establishing the Faculty of Contemporary Studies (FCS) at NDU and founded the International

Relations Department. Dr. Khan's influence extends to the conceptualization and restructuring of the Institute of Strategic Studies Research and Analysis (ISSRA) at NDU. He has also been awarded the Fellowship of NDU-PLA in Beijing in 2011. Dr. Khan has over 100 research publications in Political Science and International Relations and authored more than 3000 articles published in various national and international newspapers, magazines, and journals. In recognition of his outstanding contributions, Dr. Khan received the prestigious "Best University Teacher Award" for the year 2011-2012 from the Higher Education Commission (HEC), underscoring his excellence in academia.

Foreword

I am pleased to share with you the comprehensive report of the proceedings of the national seminar on "Pakistan's Economic Crisis: Challenges and the Way Forward" organized by the NUST Institute of Policy Studies on Thursday, January 18, 2024.

The seminar brought together policymakers, economic experts, retired senior civil and military officials, principals and senior faculty of NUST schools, research professionals, and informed general public to discuss the causes, consequences, implications, and possible solutions to the prolonged economic crisis that has beleaguered the nation.

As we expected, the seminar occasioned frank, meaningful, and detailed discussion about a host of factors plaguing the economy, including, but not limited to, sluggish growth, low productivity, huge debt obligations, soaring inflation, chronic budget deficit, low rates of FDI, balance of payments crisis, chronic trade deficit, low rates of human capital formation, unenviable tax-to-GDP ratio, energy crisis, weak governance, political polarization, social instability, low industrial development, and other related issues.

At the same time, the speakers and participants identified the whys and the wherefores of these problems, they paid special attention to the critical task of putting forward recommendations that, it was hoped, would pass the four-fold criterion of viability, reliability, relevance, and responsibility underlying every sound policy and correct actions that it inspires.

Based on the seriousness with which the speakers covered their respective topics of which they had vast practical knowledge and the keen interest of the attendees as demonstrated by their questions and comments.

I would like to say that the seminar's deliberations did manage to pass muster in light of the above-mentioned four criteria. It is important to understand that resolving the domestic economic crisis requires deep multidimensional thinking, multidomain cooperation, and precise but flexible approach.

In other words, coming to grips with our economic problems calls for systems thinking and a strategic approach. This type of thinking and approach can only be the outcome of the unbiased collaborative inquiry of the diverse experts and informed citizens missing neither the forest for the trees nor the trees for the forest. I believe that the seminar, neither the first nor the last, was able to make some modest but solid contribution to the goal of articulating such an approach.

Dr. Ashfaque Hasan Khan

Director General

NUST Institute of Policy Studies

1. Executive Summary

The NUST Institute of Policy Studies (NIPS) organized the high-level national seminar on "Pakistan's Economic Crisis: Challenges and the Way Forward" on Thursday, January 18, 2024. Moderated by Dr. Ashfaque Hasan Khan, Director General, NIPS, the event attracted a diverse attendance of participants comprising ministers, high-level dignitaries, government officials, senior diplomats, development practitioners, esteemed economic experts, academics, think tank experts, scholars, and students.

The national seminar consisted of two sessions with renowned speakers, accompanied by keynote addresses by esteemed ministers, analyzing the economic dynamics of Pakistan.

In the first session, Dr. Ashfaque Hasan Khan, Director General, NIPS, presented a comprehensive overview of Pakistan's current economic challenges. In particular, he identified five critical challenges that Pakistan's economy is currently facing. These critical challenges include:

1. Persistence of large fiscal deficit.
2. Persistence of large current account deficit.
3. Unprecedented rise in public and external debt.
4. Slower economic growth.
5. Persistence of high double-digit inflation.

Dr. Khan not only highlighted the causes and consequences of these challenges for the economy but provided concrete solutions for addressing them.

Mr. Sakib Sherani, Founder & CEO of Macro Economic Insights (Pvt) Ltd, delved into the critical challenges surrounding contemporary economic condition of Pakistan. While discussing the issues of economy he said that the fault-line is structural and are primarily rooted in the Pakistan's heavy reliance on imports, the challenge of attracting Foreign Direct Investment

(FDI), a small and undiversified export base, a flawed growth model, and the impact of an overvalued exchange rate.

During the lecture Mr. Sherani's policy recommendations included, institutional reforms, improving the investment climate, addressing negative IMF program externalities, salvaging CPEC for regional value chain integration and Chinese investment, and recalibrating SEZs into export-oriented industrial clusters. These measures are crucial for enhancing Pakistan's economic outlook.

Dr. Shamshad Akhtar, Caretaker Federal Minister for Finance, Revenue & Economic Affairs, the Chief Guest of the national seminar, delivered a keynote address, focusing on Pakistan's economic challenges and the way forward. The honorable minister highlighted five key areas that have increased the vulnerability of Pakistan's economy to domestic and global shocks. First, the increase in public debt, with Pakistan in breach of the FRDL Act[1] since 2013. Secondly, climate shocks; the global warming model predicts that Pakistan's weather patterns will become even more volatile and extreme in the decades ahead, with an average increase in temperatures by 1.3 percent to 4.9 percent by 2090. Thirdly, the lack of innovation and diversity in the structure of the economy, and fourthly unsustainable fiscal policy due to revenue gaps and unproductive expenditures. Lastly, the failure to integrate Pakistan's economy with the rest of the world.

During the keynote, the minister further stressed on five critical areas of reforms essential to reducing Pakistan's vulnerabilities and fostering sustainable growth. Firstly, a comprehensive overhaul of the government's fiscal apparatus is necessary to lower the revenue-expenditure gap. Secondly, addressing structural weaknesses of SOEs and improving their efficiency and functioning. She also stressed the need to reduce the debt burden, enhance competitiveness and encourage new investments.

The minister highlighted that the bold reforms would lead to a new era of development and prosperity in the country and effective implementation

[1] Fiscal Responsibility and Debt Limitation Act.

of ambitious reforms will depend on addressing critical underlying institutional and governance constraints.

Dr. Muhammad Khan, Professor & Chairperson of the Department of Politics and International Relations at the International Islamic University Islamabad (IIUI), delved into the topic of political instability and its effects on the economy, during the second session. Conducting a comparative analysis, the esteemed speaker underscored the strengths and weaknesses of Pakistan's political landscape.

Dr. Khan further stressed that sustainable economic reforms should not be subject to fluctuations tied to electoral reforms. It is imperative, irrespective of changes in government, to maintain the continuity of economic progress plans. Highlighting the interdependence of political and economic stability, Dr. Khan observed this dynamic relationship in Pakistan's political economy, where economic crises have a direct impact on the political scenario. To address this, he stressed the equal importance of addressing political stability.

Distinguished speaker, Dr. Ather Maqsood Ahmed, a Professor of Economics at the NUST School of Social Sciences & Humanities, shared insights on fiscal and tax reforms. A key highlight from his address emphasized the imperative shift towards complete digitalization of the tax system and reassessment of the role of regulatory bodies. Dr. Ahmed stressed that tax collection should be seen as a by-product of the economy. A prosperous economy automatically generates enough resources, leading to a comfortable economic management.

Mr. Muhammad Ali, the Caretaker Federal Minister of Energy, Power & Petroleum, discussed the energy crisis and energy sector reforms in Pakistan. Recognizing the interlinked nature of the Pakistan’s power and energy challenges, the minister emphasized the need for comprehensive structural reforms as economic activity has collapsed due to import controls, creditworthiness downgrades, and ballooning interest payments. He said that a strategic approach is needed to meet the country's energy requirements as Pakistan relies heavily on gas and oil as main source of energy, while industries and transport consume the largest chunk of the energy produced.

The keynotes were followed by an extensive discussion session where participants articulated relevant points regarding the significance of the long-term policy plans and sticking to them. The discussion centered on the critical attention required for Pakistan's economy, acknowledging the formidable challenges it faces. However, with the right approach and a collective effort, there is optimism that Pakistan can surmount its economic challenges and pave way towards sustainable development and prosperity.

2. Recommendations[2]

Pakistan’s economy is currently passing through the most difficult and challenging time in its history. Both domestic and external factors have contributed to these challenges. This difficult situation has been caused in part by the suboptimal choices made by the fiscal and monetary leadership in the past. The urgent questions of the moment are: Can this economy be salvaged? Can this economy be revived? The answer is: Indeed, it can be salvaged, but doing so requires the following conditions, going forward:

1. A reasonably stable and credible government.

2. A credible expert economic team consisting of not more than five or six people; five to six competent civil servants to head Finance, Planning, FBR, Energy, and Commerce and Industry Ministries.

3. Close coordination between the Ministry of Finance and the State Bank of Pakistan (SBP) – the two strong pillars of the state’s economic policy making.

4. Role of friendly countries will be vital for our efforts to stabilize and then recover our economy. In this connection, the Ministries of Finance, Foreign Affairs, and the key institutions of the states will have to work in unison to achieve the goal. The assistance from the friendly and brotherly countries will be strictly temporary, not more than three years at the most.

5. Most importantly, there must be a desire and the will to improve the economy in civil and military leadership.

These prerequisites must be in place for taking the economy out of the current depressed conditions.

Current Economic Challenges

Pakistan is currently facing five critical economic challenges:

[2] These recommendations emerged from the expert deliberations during the seminar.

1. Persistence of large fiscal deficit (the gap between revenue and expenditure).
2. Persistence of large current account deficit (the gap between exports of goods and services and imports of goods and services).
3. Rising public and external debt.
4. Sluggish economic growth, which leads to extremely slow new job creation, increased unemployment, poverty, social unrest, and political polarization in the country).
5. Persistence of high double-digit inflation.

These challenges have been discussed in the report with relevant facts and figures. Here, only the key recommendations for solving these challenges are put forward.

Persistence of Large Fiscal Deficit

Fiscal deficit is the gap between revenue and expenditure. What measures should the government be taking to curtail expenditure and to increase revenue?

Curtailing Expenditures

- We have seen that the root cause of the persistence of large fiscal deficit during the last five to six years has been the ballooning expenditure. Why has the expenditure surged during the last five to six years? The main reason is the persistence of keeping the SBP's policy rate at an extraordinarily high level (22%) for a long period of time.
- Hence, reduction in SBP's policy rate is the need of the hour to restore fiscal balance. Empirical evidence suggests that one-percent reduction in the policy rate will reduce interest payment (the single largest budgetary expenditure) by over 350 billion rupees in one year. It has been shown empirically that this will also contribute to reducing inflation. It is proposed that SBP must start bringing its policy rate down in the manner prescribed here.

  - Current policy rate is at 22 percent.
  - Bring it down to 20 percent by June 2024 (2023-24)
  - Further reduce it to 16 percent by June 2025 (2024-25).
  - Make a further reduction of 12 percent by June 2026 (2025-26).
  - Further reduce it to 7-8 percent by June 2027 (2026-27).

- Pakistan will save over 2.5 trillion rupees in few years which will reduce fiscal deficit to that extent.

- Freeze Public Sector Development Program (PSDP) for at least two years. Money should be allocated only to the ongoing strategic projects.

- No new infrastructure projects to be undertaken in the next two years (2024-2026).

- Accelerate the pace of privatization of the loss-making public-sector enterprises (PSEs) such as Steel Mill, PIA, DISCOs, GENCOs, etc., to reduce pressure on budget. The operationalization of the Sovereign Wealth Fund (SWF) must urgently be translated into reality. This will accelerate the process of privatization of PSEs through G2G.

- Freeze the Benazir Income Support Program (BISP) at the current level of beneficiaries (9 million) and a budget of 460 billion rupees with no addition of new beneficiaries and no increase in allocation. A graduation plan of BISP's unconditional transfers must be made transparent and BISP administration must seriously implement the graduation plan. BISP's board of directors must monitor the performance of the graduation plan.

- The Public Investment Management Assessment (PIMA) Report prepared by the IMF must be implemented by the Planning Commission and the Ministry of Finance.

- Federal government should work with the provinces for expenditure–sharing on BISP. Furthermore, the cost of federal government's projects under PSDP (Public Sector Development Program), which falls under the provincial domain, must be shared by provinces as well.

- Large infrastructure projects must be shifted to public–private partnership (PPP) mode to reduce burden on the budget.
- All ministries that should have been devolved to Provinces after the 18th Amendment, must be devolved immediately to Provinces to reduce the size of the federal government. Institutional duplication and overlap results in waste of scarce resources as well as create governance issues.
- The board members of loss–making PSEs, attached to various ministries, resisting change, must be disciplined.
- Most importantly, there is an urgent need to revisit the current NFC Award. There are manufacturing defects in the current award. Without addressing these defects there will never be financial stability in the country.

Mobilizing More Revenue

- Aggressive expansion of point of sale (POS) must be ensured to minimize tax avoidance. Currently, the system is not working properly.
- Gradually bring untaxed sector within the tax net, starting from real estate and agricultural income tax at the federal level.
- Fixed tax for small businesses should be considered.
- Reduce tax rates, particularly the sales tax rate.
- Reform the tax administration. The current cabinet has already approved the restructuring plan of the tax administration. It must be ensured that the next government implements the decision of the current cabinet.
- There is an urgent need to address key structural concerns of the federal tax system, such as low corporate compliance, heavy reliance on withholding tax, use of additional custom duties (ADCs)/regularity

duties (RDs), pending of refunds, and huge frivolous litigation resulting in huge revenue being stuck up.

- Form a high-level expert committee to review tax exemptions. Currently, the tax expenditure is 4 trillion rupees, of which 86 percent exemption is company- specific. Criteria–based or rule-based exemption should be given rather than company-based exemption.

- Do not acquiesce in the distinction between filers and non-filers. Ensure that everyone is a filer by making progressively stringent rules to discourage non-filers.

- Make the lives of the taxpayers easier. FBR must facilitate those who want to pay taxes. In this connection, tax return form must be made simple and understandable.

- Taxpayers are filing multiple returns at the federal and provincial levels. Furthermore, taxpayers are facing multiple officers from different departments. It has made their lives difficult. Streamline the filing of tax returns.

- At the provincial level, the structural issues include: weak tax administration; narrow tax base owing to exemptions and concessions; low contribution to own provincial resources; and the heavy reliance of provinces on transfers from the federal government under the NFC Award. Provinces should be asked to address these structural issues.

Persistence of Large Current Account Deficit

Why does Pakistan go to the IMF for financial support? The answer is: Pakistan faces shortage of foreign exchange or a shortage of dollars. Hence, either Pakistan should earn more dollar or it should save more dollars, since a dollar saved is a dollar earned.

How to Earn More Dollars?

- Make the export industries competitive in the international market through the following measures:

- Reduce the cost of borrowing, which means interest rate should be reduced.
- Reduce the prices of utilities (electricity and gas). Energy sector issues are largely governance issues. By raising energy prices, we cannot resolve energy issues.
- Reduce the cost of imported inputs. Bring exchange rate gradually to Rs. 240-250 per US dollar. Ensure two-way movement of the exchange rate. This will bring rupee-dollar parity at Rs. 240-250 per dollar.
- Concentrate on IT exports, gemstones, electric fans, surgical instruments, etc. These goods have the enormous potential to increase exports in the short to medium term.
- Find new markets for exports in Africa and the Central Asian Republics.

- Privatization of SOEs should be made to foreign or domestic investors, but payment must be made in foreign currency.
- Use non-resident Pakistanis to bail Pakistan out. Encourage overseas Pakistanis to invest in Pakistan.
- Set up the grievance cell at the Prime Minister's office for addressing the complaints of Pakistani diaspora. Their complaints of cheating, occupation of their land or fraud with their investment must be addressed immediately and firmly.
- Float Non-Resident Pakistani Deposit Scheme like Non-Resident Indian Deposit Scheme of the early 1990s. The structure of the deposit scheme can be made attractive for which a credible government in the country is a prerequisite.
- Remittances have the potential to increase to over $40-45 billion if *hundi* and *hawala* system can be curbed. SBP, in consultation with major foreign exchange companies, can streamline the flow of remittances. Foreign Exchange Association can be used to bring more dollars through official channels.

- Ministry of Foreign Affairs and the Establishment will have to play a crucial role along the following lines:
  - Enhance relations with China.
  - A strong government and a strong economic team will most probably attract help from Saudi Arabia, UAE, Qatar, Kuwait, and Turkey. Temporary financial support from these countries in terms of concessionary loans payable in 5 years will go a long way in reviving Pakistan's economy.
  - Operationalize the EXIM (Export-Import) Bank to facilitate exports of new products and new markets (Africa, Central Asia, etc.).

Sharing Our Economic Plan and Reform Agenda with Friendly Countries and Seeking Their Long-Term Funding

- China has the biggest dollar exposure to Pakistan in the shape of loans (bilateral loans, currency swaps, commercial loans, deposits, etc.) and foreign direct investment, especially in the power sector.
- It would be a great help to Pakistan's balance of payments position, if all loan repayments, interest expense, and dividends payable to Chinese institutions over the next 3 to 5 years are deposited on due dates in Special Convertible Rupee Accounts (SCRAs) of these institutions with the branches in Pakistan of Chinese Banks like the Industrial and Commercial Bank of China (ICBC) and the Bank of China (BOC).
- These deposits can be invested in government T-Bills and Pakistan Investment Bonds (PIBs) and the government should provide exchange cover at prevailing rates. These institutions will be able to repatriate their balances accumulated in their SCRAs in tranches after a period of 3 to 5 years.

How to Save Dollars?

- Selective but aggressive import-compression policy must continue for at least two years.

- Make the import of non-essential/luxury goods very expensive by using quota, exorbitantly high duty, and outright ban of some items in a time-bound and non-discriminatory fashion.

- Reduce energy import bill by concentrating on hydel, solar and other alternative sources of energy.

- Curb electricity generation through expensive fuel such as furnace oil and gas to 60% capacity. This will reduce fuel and gas import bill.

- Make travel very expensive to discourage people undertaking unnecessary travel abroad. Students and overseas Pakistani workers going abroad or coming home on leave should be exempt.

- Discourage the foreign visits of ministers and government functionaries unless this is absolutely necessary.

- The target should be reducing overall import bills by $5 billion through selective and yet aggressive import-compression policy in 2023-24 and keeping imports at that level in 2024-25 and 2025-26 as well.

- Strongly curb dollar smuggling to neighboring countries. The law enforcement agencies will have to play their critical role in this regard.

- How should people be encouraged to deposit their dollars in our own commercial banks? A declared or undeclared amnesty scheme can be offered to the people to deposit their dollars in their foreign currency accounts.

- Government may consider opening US dollar-denominated saving schemes in Pakistan where both local and overseas Pakistanis can invest. The duration of this scheme can be 3, 5, or 10 years with attractive rate of returns. No question should be asked from the investors in dollar-saving schemes about the sources of the funds.

Rising Public and External Debt

- How should debt situation be brought under control? Persistence of high interest rate policy does nothing but create a large fiscal deficit. Large fiscal deficit necessitates large borrowing to finance the fiscal deficit. More borrowing means more debt accumulation.

- In view of this situation, reduction in SBP's policy rate, as mentioned earlier, is the need of the hour. One-percent reduction in the policy rate will reduce budgetary expenditure by over Rs. 350 billion in one year. Imagine that if we reduce interest rate from 22% to 16% by June 2025, it will reduce budgetary expenditure by at least Rs. 2100 billion in just one and a half year. This will help reduce budget deficit resulting in less borrowing and less accumulation of public debt.

- For reducing the external debt, we must curb unnecessary imports, promote exports, attract more remittances, more FDI, and undertake privatization program aggressively. Recommendation on these items have already been listed above. Such policies will reduce our borrowing requirement and will slow down the pace of the accumulation of debt.

- To reduce the external debt burden, Pakistan may consider talking to bilateral creditors agencies for:
  - Debt to SDGs Swap.
  - Debt to Climate Change Swap.
  - Debt to Poverty Alleviation Swap.
  - Debt to Education Swap.
  - Debt to Environment Swap.

- Suggestions to deal with the Chinese debt have already been given above. If China agrees to this recommendation, it will solve Pakistan's debt problem to a large extent. We should not discuss China's debt publicly or through the print and electronic media. This issue must be handled at the diplomatic level. We can be confident that if we pursue our case with China professionally and technically, China will consider it favorably. This will alleviate our external debt problem significantly.

How to Bring Inflation Down?

- Pakistan's inflation is largely caused by the supply-side factors (food and energy prices). Frequent increase in the prices of gas and electricity is keeping inflation high. On the other hand, increasing the support price of various agricultural crops has kept food inflation high. The absence of the writ of the state has further emboldened the businesses/traders to charge the prices of their commodities at will. In such an environment, keeping interest rate high is not going to reduce inflation. Empirical evidence in the case of Pakistan suggests that one-percent increase in policy rate by the SBP increases inflation by 1.3 percent. Therefore, keeping interest rate high to bring inflation down is counterproductive in the case of developing countries like Pakistan. Interest rate is the right instrument if inflation is caused by excessive demand, that is, due to excessive monetary expansion.
- In view of this situation, Pakistan should do the following to bring inflation down:
  - Start reducing SBP's policy rate as discussed earlier.
  - Exercise extreme caution in raising utility prices (electricity, gas).
  - Improve the supply situation of food items by raising domestic production or by importing the items.
  - Exercise caution in raising the support price of various agricultural crops. Rather, priority should be given to raise per acre yield.
  - Maintain stability of the exchange rate by reducing pressure on external balance-of-payment accounts as discussed above.
  - Restore the writ of the state by giving exemplary punishment to hoarders/smugglers/currency manipulators.

Low Economic Growth

- Pakistan's economic growth has slowed in recent years to an average of less than 3 percent. Pakistan cannot achieve higher economic growth in 2-3 years because of the persistence of large budget and current account deficits. However, Pakistan must do the following things to improve economic environment with a view to promoting economic growth.

- Restore some degree of political stability in the country. Persistence of political instability is highly injurious to economic stability and development. A relatively stable and credible government is absolutely essential for promoting economic growth and development. In a politically unstable environment, neither local investors nor foreign investors would come forward to invest in the country. High investment is necessary for achieving higher economic growth. The SIFC can play a critical role in facilitating both local and foreign investment.
- Major growth drivers include agriculture, livestock and dairy sector, construction sector and SMEs. The government must give due emphasis to these sectors which do not require massive investment.
- Improve business climate through:
  - Low interest rate.
  - Stable exchange rate.
  - Competitive prices of utilities.
  - Relative political stability.
  - Constant interaction of the government with private sector and listening to their genuine grievances. SIFC can play a major role here.
  - Avoid imposing senseless taxation.
  - Maintain consistency and continuity in policies.
  - Massive investment in human capital through education and skill development is absolutely necessary for improving Pakistan's external competitiveness.
  - A 21st Century industrial policy based on science, technology, innovation, and skill development must be prepared by the Ministry of Industries and Production. This policy must be embedded in the country’s growth strategy and export promotion.

How to Address Energy Sector Issues?

The issues related to energy sector in Pakistan has become complex over the years. Availability of energy at affordable price is urgent for the country's overall economic progress. Some of the recommendations for energy sector are presented below:

- There is a need to reduce reliance on imported fossil fuels, diversify national energy mix, promote renewable energy and green transition, and strengthen policy, institutional, and societal support mechanisms for renewable energy development, production, and use. This will be a challenge in any case since Pakistan's energy mix till 2030 is expected to be dominated by imported LNG and oil as well as coal extraction from Thar. However, efforts should be made to work on energy mix diversification and green transition as much as possible.

- Pakistan relies heavily on gas and oil as main sources of energy, while industries and transport consume the largest chunk of the available energy. This necessitates special focus on taking urgent measures to shift transport and industry as much as possible to cleaner sources of energy. In this context, it is time to start thinking about the practical implementation of the 2019 National Electric Vehicles Policy (NEVP) so that its ambitious targets and goals could be translated into timely action.

- Considerable dependence on energy imports creates energy security crisis in addition to the rising energy demand that requires a global standard deep conversion refinery with a capacity of approximately 400 bbl/d. There is an urgent need to address the issue of low refining capacity at the same time that investment in greenfield refineries needs to be stimulated.

- Reliance on road-based infrastructure for 68 percent of total oil movement across the country means that upgradation of road infrastructure is an immediate priority, while the addition of pipeline mileage and rail transportation capacity enhancement should act as medium- and long-term priorities. While measures for facilitating national oil movement through infrastructure upgradation may remove transport bottlenecks, tighter border control should act to curb cross-border smuggling of more than 2.8 billion liters of petrol and diesel amounting to annual exchequer losses of 60 billion rupees. Further, exchange rate exposure, credit worthiness, country risks, and credit limitations are all factors that affect the domestic oil and gas sector requiring comprehensive and astute political and economic management at the national level.

- Special measures need to be undertaken for the development of gas exploration, production, and consumption infrastructure and strategies. Rapid decline in domestic resources will be increasingly met through costlier imports. There is a need to ratchet up E&P activities at the same time that there is a need to control and reduce demand for natural gas through investing in alternative as well as renewable sources of energy. So far, the policy incentives for Tight and Shale gas exploration are quite insufficient despite the tight and shale gas reservoirs in the country of up to 70 Tcf and 235 Tcf, respectively. Provision of attractive policy incentives in this regard should be prioritized. Moreover, high unaccounted-for-gas (UGFs), a persistent and pernicious form of gas loss, should be curbed through improved and well-controlled production, supply, and distribution systems to balance the gas tariff structure and prevent the passage of upstream inefficiencies downstream to consumers. Attention should be paid to the urgent task of rationalization of gas pricing, directing domestic gas resources to power plants, and the electrification of household demands, there is a scope for the reduction of short- to medium-term imports of expensive LNG.

- Overall energy sector governance and regulation should be consolidated. There is a need to develop energy financing capability. Electricity pricing and energy subsidies should be rationalized. Greater efficiency across the whole power generation, distribution, and supply chain should be the focus of power sector reforms. The use of indigenous resources for fast-track power generation should be optimized. Fuel cost imbalances need to be remedied to achieve maximal value from available resources. Human resource capacity building, technical capacity building, technological modernization, and infrastructure upgradation of GENCOS and DISCOS should be prioritized to cut inefficiencies. Low collection rates as well as high transmission and distribution losses should also be dealt with on urgent basis. Unbudgeted subsidies and cross subsidies should be the measure of last resort. Adoption of smart electric and gas metering systems should be pursued for the reduction of circular debt burden overall.

- There is a special need to learn from international best practices in power sector transmission and distribution. The policy of resource indigenization should guide the direction and momentum of power sector reforms through gas demand destruction, electrification promotion, tariff rationalization for both electrification drive and greater investment in the power sector, exploration and production sector reforms, especially in terms of coal-based power generation in a race against time. Policy frameworks for both greenfield and brownfield refineries should be formulated and implemented. Clear incentives should be articulated for exploration companies involved in exploring Tight and Shale gas reserves. Moreover, a comprehensive LNG roadmap should be spelled out.

- A budget-neutral circular debt settlement plan that is not mounted on the fiscal deficit or on the backs of the consumers must be the immediate strategic priority of the energy and power sector policymakers. It is essential to balance sustainability and affordability in energy sector, merging financial and sustainable needs seamlessly. It is critical to undertake multipronged natural gas pricing reforms aimed at implementing a new rationalized gas pricing structure as well as associated fertilizer sector reforms.

- In the gas sector, the implementation of WACOG (Weighted Average Cost of Gas) Law must be implemented to deal with the dilemma of RLNG (Re-Gasified Liquefied Natural Gas) diversion. This implementation is a crucial factor in terms of declining indigenous gas reserves, energy security challenges, economic stability requirements, and consumer welfare considerations.

- In the oil sector, disgruntled investors should be brought back and policy -level support should be offered to brownfield players. Oil Marketing Companies (OMCs) should be strictly monitored to control and discourage malpractices. Rationalization of OMCs and dealer margins should be carried out for sustainable operations. The myth of cheaper oil imports should be debunked decisively.
- In the power sector, solarization program should be sped up and scaled up. Power distribution companies should be handed over to the private sector by means of long-term concessions. Tariff rationalization should be enforced for power sector competitiveness. In addition, robust anti-theft and recovery powers by means of technological interventions, enforcement, smart metering rollout plan, transformer metering and increased enforcement density.

3. Keynote Address

Pakistan's Economic Challenges and the Way Forward

Dr. Shamshad Akhtar

Dr. Shamshad Akhtar highlighted that the bold reforms would lead to a new era of development and prosperity in the country but the effective implementation of ambitious reforms will depend on addressing critical underlying institutional and governance constraints.

Introduction

Let me start by sharing with you the good news. After months of hard work, the IMF Board has approved the first review of the $3 billion (Stand-By Arrangement). This is a very positive development for the economy and will support our efforts for macroeconomic stability.

The successful implementation of comprehensive stabilization measures helped to revitalize the Pakistani economy, placing it back on a positive growth trajectory. Economy is showing signs of recovery as 1QFY24 GDP has rebounded to 2.13% after two successive quarters of contraction in FY23. Growth in Agriculture and industrial sectors of 5.1% and 2.5% have led to the recovery in economic growth. Crops have posted healthy growth of 6.1% primarily due to double digit growth in important crops.

When the caretaker government took office in August 2023, Pakistan's economy was in a tailspin with a free-falling currency, runaway inflation, and markets in turmoil. According to the World Bank, the poverty rate increased to 40% in 2023 with 95 million people living below the poverty line. There has been an increase of 12.5 million poor people in the last year alone due to rising unemployment.

This crisis was driven by internal and external shocks including the devastating floods, global commodity super cycle, political uncertainty, and disruptions to the previous IMF EFF[3] program. However, the crisis has been exacerbated by the structural weaknesses in our economy and decades of negligence. The inability to collect taxes, rising dependence on energy imports, inability to liberalize trade and investment, and failure to privatize the loss-making SOEs have made the economy vulnerable to economic and climate shocks.

I want to highlight five key areas that have increased the vulnerability of the economy to domestic and global shocks such as the increase in international commodity prices and tighter liquidity conditions, with Pakistan effectively priced out of the international credit markets.

First, the vulnerability has increased due to the increase in public debt, with Pakistan in breach of the FRDL Act since 2013. Large fiscal and trade deficits over two decades have weakened the debt position, with the cost of servicing debt rising to three-fourths of FBR revenue in FY23.

Second, vulnerability has also increased to climate shocks. The global warming model predicts that Pakistan's weather patterns will become even more volatile and extreme in the decades ahead, with an average increase in temperatures by 1.3% to 4.9% by 2090. Consequently, climate disasters, in particular floods and droughts, are set to become even more frequent and severe.

[3] The Extended Fund Facility.

Third, the lack of innovation and diversity in the structure of the economy has meant that growth is not sustainable. The manufacturing base, the export base, and the agricultural basket are focused on a very narrow range of products and have failed to penetrate new markets.

Fourth, the fiscal policy is not sustainable due to the revenue gaps and unproductive expenditures, but it is also unsustainable due to the scale of the climate funding gap. To meet the targets set under the NDC 2021 of reducing emissions by 50% by 2030, Pakistan will have to scale up investments by 800% on a conservative basis to close the climate financing gap.

Fifth, we have failed to integrate our economy with the rest of the world. Growth should be driven by higher exports and higher investment flows. The sustainability of our trade and investment policy is critical to reduce the vulnerability of our economy to global shocks.

In my keynote, I want to highlight the critical areas for reforms and the measures taken by our government to stabilize the economy and initiate the reform process.

Where do we stand?

Pakistan has all the requisites of being a major economic player in the region and Asia. According to a World Bank report, our economy could reach $2 trillion by 2047, from $350 billion in FY23. However, this requires macroeconomic stability backed by structural reforms critical to the deep-rooted challenges shackling the productive sectors of the economy.

The inability to reform has caused huge losses to the economy and Pakistan has been left behind by our neighbors on all key indicators.

In terms of per capita income (PPP basis), Pakistan ($4,000) stood ahead of India ($2,800) and Bangladesh ($2,300) in 2003. However, two decades later, India ($7,500) and Bangladesh ($7,100) have raced ahead of Pakistan ($5,500).

In terms of the Human Development Index (HDI), Pakistan ranks in the least developed category and ranked a lowly 161 (out of 191), which is comparable to countries like Rwanda, Nigeria, and Ivory Coast, while India (132) and Bangladesh (129) are ranked significantly higher in terms of HDI and have graduated from the least developed countries list.

We have fallen behind because we do not invest enough resources in the people, infrastructure, industry, and natural resources. Pakistan's investment rate (15% of GDP) has remained constant over the last two decades and has lagged behind other countries Vietnam (35%), Bangladesh (30%) and India (28%).

Areas of Reforms

I want to highlight five areas of reforms that are critical to reduce Pakistan's vulnerabilities and help us achieve sustainable growth.

Fiscal Sustainability

First, we must completely overhaul the government's fiscal apparatus to lower the revenue-expenditure gap. Tax to GDP has remained low at 10% to 11% in the last 3 decades, with the government forced to finance large deficits through borrowing from domestic and external creditors.

Towards this end, the caretaker government has initiated the process of strengthening and modernizing Pakistan's tax administration. The digital transformation of tax administration is a crucial step in meeting the objectives of enhanced tax collection and improved compliance. Innovative digital technologies need to be implemented to minimize tax gaps, increase tax collection, and reduce the share of the shadow economy.

FBR restructuring plan to enhance revenue mobilization from 9.5% of GDP to a minimum 15% in the first phase and rationalizing tax regime to be pro-growth. Ambition should be to enhance tax to GDP of 20%, to match our public expenditures.

We are working towards the separation of the tax policy and tax administration functions, to remove the apparent conflict of interest in tax collection. Similarly, Customs is being reformed to increase vigilance against smuggling and under-invoicing and enhance trade facilitation.

Tax policy must be designed to be fair, equitable, and productive. The revenue and fairness objectives need to be pursued by expanding the tax base, reducing tax exemptions, and through a more efficient digital tax administration.

Simultaneously, there is a need to enhance the efficiency and effectiveness of public expenditure. There is an urgent need to improve coordination within the federal government and with provinces and reorient expenditure priorities towards social welfare. Towards this end, the government is working with the provinces to share expenditures on BISP and PSDP projects falling under the domain of provinces. A review is being conducted to devolve ministries and departments to the provinces.

Options are being explored to shift the large infrastructure projects under the PPP mode, providing sizeable savings on budgetary resources for both federal and provincial governments. We are looking at ways to enhance allocation to the Viability Gap Fund for undertaking Infrastructure projects in PPP mode. We can also potentially use credit guarantees from INFRAZAMIN to enhance private-sector investment in Infrastructure.

Restructuring Loss-Making SOEs

To address structural weaknesses of SOEs, improve their efficiency and functioning, and thereby reduce the drain on the budget, the government is focused on operationalizing the Centralized Monitoring Unit (CMU). The CMU will monitor the SOEs and publish regular reports on financial performance and contingent liabilities.

We are in the process of finalizing a SOE policy under the SOE law as agreed with IMF. The focus of the policy is on improving the governance and financial efficiency of the loss-making SOEs.

The Privatization program has been fast-tracked and Financial Advisors for PIA have been appointed. We are working with the IFC team on Concession and Management Contracts (Privatization) for DISCOs.

We are also working on the operationalization of the Sovereign Wealth Fund (SWF). This holding company will help us to fast-track the privatization of SOEs through G2G arrangements.

Reducing the Debt Burden

Pakistan's debt has increased sharply in the last ten years, and we have been in breach of our Fiscal Responsibility and Debt Limitation (FRDL) since 2013.

The debt structure presents numerous complexities to be worked out between Pakistan and its creditors. With limited buffers, even moderate shocks could increase debt distress.

Managing the public debt will require a multipronged strategy significant focus on reforms to enhance resource mobilization and contain unproductive expenditures including the SOE losses, with a particular focus on the energy sector.

The caretaker government has been successful in improving the maturity profile of existing debt. In December, more than 90% of all new borrowing was in longer term instruments (1Y and above). This has helped to reduce the cost of borrowing for the government to around 17%, from 25% earlier.

On the external side, the options are very limited. The bulk of our external debt 44% is to multilateral agencies (IMF, WB, ADB, IsDB) and cannot be reprofiled because of their preferred creditor status.

Commercial debt is 14% of our external debt and reprofiling this portion of debt is difficult because it involves many stakeholders and involves a cumbersome process.

Bilateral debt accounts for 35% of external debt and is an area where the government has benefitted from the G20 DSSI after COVID. Recently, we completed a debt re-arrangement with China for FY24 and FY25 amounting $2.4 billion in total (Public and Publicly Guaranteed).

We are also exploring avenues to complete Debt-for-nature/climate swaps with the bilateral agencies. Pakistan and Italy have recently extended the $100mn Debt Swap Agreement's (PIDSA) timeline until December 2024.

Enhancing Competitiveness

The export-import gap should be reduced through promoting exports. For this, the competitiveness of Pakistani exports must be improved and the impediments to exports be removed. The government believes in a market-based exchange rate regime that can avoid the persistent overvaluation of local currency.

The anti-export policies of the last 3 decades have led to the loss of competitiveness of our manufacturing base. Exports have failed to make a transition from low-technology to high-technology products as about 70 percent of the country's exports continue to be low-technology products. In addition, the country has failed to diversify its export commodities and export markets. Textiles and clothing sector, which contributes about 5% to world trade, dominates the country's exports, accounting for around 58% of total exports.

Similarly, more than 50% of exports rely on only four markets - USA, EU, China, and Afghanistan. The country has been losing competitiveness in international markets and finds it harder to sell even within its traditional markets.

Pakistan's loss of competitiveness is evident from the fact that exports of goods and services have declined to 10% of GDP, compared to India (19%) and Bangladesh (15%).

To facilitate exports to new markets and encourage the export of new products, we have operationalized the EXIM bank. This will bring credit guarantees and insurance products for exporters, encouraging them to target new markets for exports.

The launch of the Export-Import Bank of Pakistan (EXIM) is a major milestone for the people of Pakistan and will transform the banking and trade finance landscape in the years ahead. As the institution matures it will shape the institutional framework for investment and trade finance, leading to stronger export performance and balance of payment stability.

Another factor is the tariff structure that has a significant anti-exports bias. Within the tariff policy space, a large number of SROs distorts the trade regime by modifying the notified import duties selectively without any economic justification.

This has resulted in low import content which in turn restricts our manufactured products to a narrow range of low value-added exports. This is also the reason why Pakistan is among countries with the lowest integration in the global value chains. Some progress has also been achieved in streamlining customs rules and procedures to expedite the clearance of both exports and imports through the Single Window operations, but more work is needed to achieve international best practices.

Encouraging New Investment

The investment-saving gap has grown more acute in the last 3 decades, greatly limiting the growth potential of the economy. In Pakistan, any acceleration in economic growth invariably leads to a balance of payment difficulties, reversing the gains of higher GDP growth.

The SIFC has been set up to materialize new investments in critical infrastructure and neglected productive sectors of the economy including agriculture, minerals, and IT services. SIFC is also facilitating G2G arrangements and has successfully executed the first transaction between Karachi Port Trust (KPT) and AD Ports, UAE for the Container terminal at Karachi. SIFC is also facilitating potential partnership of the Saudi Wealth Fund in the $7bn Reko Diq project. Under the SIFC a transaction pipeline has been developed to expedite investment in critical infrastructure, which includes $10bn Saudi Aramco Refinery project and the Agriculture Corporate farm lease of 85,000 acres of land to potential foreign investors.

Financial Inclusion Agenda

The Financial Inclusion strategy focuses on using digital platforms and non-banking channels to bring financial services to the masses. To tackle this challenge, the Pakistan authorities launched an ambitious National Financial Inclusion strategy in 2018.

An elaborate digital infrastructure is being developed that includes the launch of the RAAST payment gateway in 2021. This has enabled instant end-to-end digital payments between individuals, businesses, and government entities.

We have now integrated RAAST with Buna, the cross-border payment system launched by the Arab Monetary Fund (AMF) in 2020. This integration will create new opportunities for our entrepreneurs to tap the growing markets and reduce the cost of cross-border transactions.

We are working on developing the Pakistan Stack, the blueprint for a Digital Infrastructure for a connected ecosystem that enables a digital economy and drives efficiency for individuals, public and private sectors. This is being done in collaboration with the Bill and Melinda Gates Foundation and Karandaaz.

The creation of the NCGCL is a strategic move that aims to catalyze the positive transformation of the SME landscape in Pakistan through increased access to finance for SMEs by creating mechanisms for risk mitigation.

SBP has awarded in-principle approval (IPA) to five digital banks, as part of our commitment towards developing a vibrant digital ecosystem.

We have launched an ambitious capital markets agenda with a focus on launching new government instruments (short-term Ijara Sukuk and zero-coupon bonds) on the PSX and listing existing government securities on the PSX to mobilize a wider consumer base. Similarly, we are targeting listings of SOEs on the PSX through IPOs. We are also studying opportunities for SOEs to raise capital from the PSX through new debt issuances.

Conclusion

In conclusion, bold reforms will lead to a new era of development and prosperity in the country. We need to establish a fast-growing and efficient economy that is capable of creating more quality jobs to absorb its labor force, especially the youth of the country; an economy that is more self-reliant yet economically better integrated with economies in the region and beyond; an economy which is forward- and outward-looking, willing, and capable of competing for its rightful place in international trade and commerce.

Effective implementation of ambitious reforms will depend on addressing critical underlying institutional and governance constraints. We need to build stronger institutions to deal with the momentous challenges facing Pakistan today.

4. Overview of Pakistan's Economic Crisis: A Way Forward

Dr. Ashfaque Hasan Khan

Dr. Ashfaque Hasan Khan presented an extensive overview of Pakistan's economic crisis. He highlighted that the economic landscape of Pakistan is at a crossroads with enduring crisis encompassing fiscal and current account deficits, burgeoning debts, persistence of inflationary pressures, lower economic growth and structural impediments that demand a decisive approach and a deliberate response. Pakistan also faced significant devaluation of its currency and hike in the interest rate at a substantial cost. To address these challenges, there is a dire need of multifaceted reforms and policy initiatives across fiscal, monetary, trade, and investment domains.

Economic Challenges

Dr. Khan identified five critical challenges that Pakistan's economy is currently facing. These challenges include:

1. Persistence of large fiscal deficit (the gap between revenue and expenditure).
2. Persistence of large current account deficit (the gap between imports of goods and services and exports of goods and services).

3. The resultant unprecedented rise in public and external debt.
4. Slowdown in economic growth giving rise to unemployment and poverty.
5. Persistence of high double-digit inflation is detrimental to the well-being of people in general, and fixed and low-income groups in particular.

Persistence of Large Fiscal Deficit

From the perspective of Dr. Khan, the lack of fiscal discipline has been the hallmark of successive governments during the last one and a half decades. Failure to mobilize adequate resources on the one hand and reckless spending with wrong priorities on the other have been the economies Achilles heel during the period. On top of this, the 7th National Finance Commission Award (NFC) has further compounded Pakistan's fiscal challenges. Such a prolonged period of fiscal indiscipline resulted in a large fiscal deficit averaging 7.0 percent of the GDP and given rise to the public debt at a threatening pace.

Why has large fiscal deficit persisted for so long a period? Dr. Khan identified the reasons by pointing out narrow and punctured tax base as well as weak tax administration as one of the key factors responsible for inadequate revenue mobilization. Pakistan's tax system, according to Dr. Khan, is complex and tedious, which along with high tax rates, have encouraged tax evasion. Non-availability of reliable statistics from the businesses and the existence of large informal sector have made the task of the tax administration difficult to assess the potential taxes as well as emerged as major hindrance to domestic tax collection.

Concentrated economic and political powers among non-compliant individuals further strains the system. Besides, the political considerations also cause hindrance in equitable and efficient tax collection because they want to safeguard their vote bank, have contributed to inadequate tax collection.

Furthermore, the structure of the ongoing 7th NFC Award has taken away the incentives from both federal and provincial governments to mobilize more resources and hence compounded the difficulties for the government to maintain fiscal discipline. Dr. Khan emphasized the needs for reviewing the current NFC Award. He is of the opinion that without addressing the challenges that the ongoing NFC Award has created, Pakistan can never achieve financial stability in the country.

The following charts and tables illustrate Pakistan's deteriorating fiscal position.

Table 1 and Figure 1[4]

Table 1: Trends in Revenue (as % of GDP)

Years (Averages)	Total Revenue	Total Tax Revenue	Non – Tax Revenue
1990s	13.9	11.1	2.8
2001-07	13.9	10.5	3.4
2008-18	14.0	10.4	3.6
2018-19	12.7	11.6	1.1
2019-20	15.0	11.4	3.7
2020-21	14.5	11.1	3.4
2021-22	12.0	10.1	1.9
2022-23*	11.4	9.2	2.1

Source: Ministry of Finance, Government of Pakistan

Figure 1: Trends in Revenue (as % of GDP)

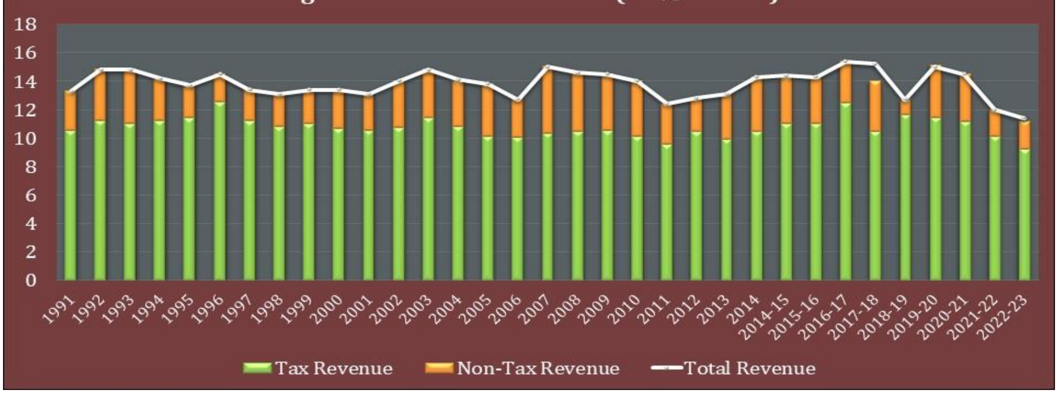


Figure 1 and 2 illustrate stagnant revenue efforts of Pakistan owning to the challenges in revenue collection as discussed above. Both total revenue and tax revenue as percentage of GDP have remained stagnant for over three decades despite the fact that a series of reforms has been undertaken by the successive governments. These reforms have failed to improve the

[4] The figure and tables in this section have been extracted from Dr. Ashfaque Hasan Khan's presentation during the seminar.

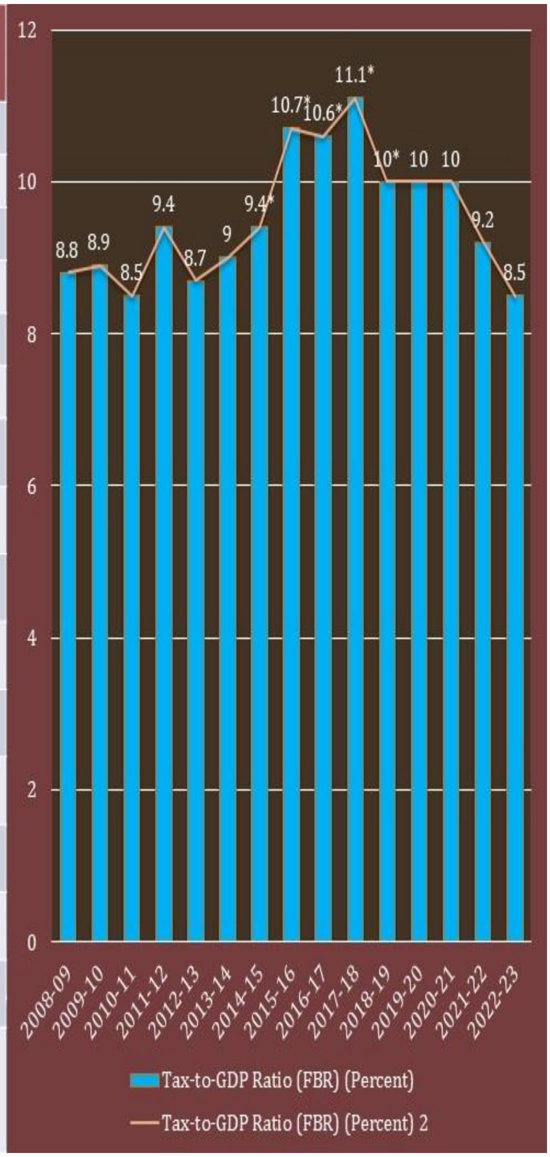
workings of the tax system and tax administration as if there has been no ownership of these reforms.

A cursory look at table 2 and figure 2 clearly reflects the stagnancy of the tax efforts by the Federal Board of Revenue (FBR). Over the last 15 years, the tax-to-GDP ratio has remained stagnant at 10 percent.

Table 2 and Figure 2

Years	Tax-to-GDP Ratio (FBR) *(Percent)*
2008-09	8.8
2009-10	8.9
2010-11	8.5
2011-12	9.4
2012-13	8.7
2013-14	9.0
2014-15	9.4*
2015-16	10.7*
2016-17	10.6*
2017-18	11.1*
2018-19	10.0*
2019-20	10.0*
2020-21	10.0*
2021-22	9.2*
2022-23	8.5*

Source: Pakistan Economic Survey 2021-22
* These numbers are not comparable with 2013-14 and earlier because of changes in the definition of tax revenue.



On the expenditure side, table 3 and figure 3 show that total expenditure as percentage of GDP averaged 20 percent during the last three decades.

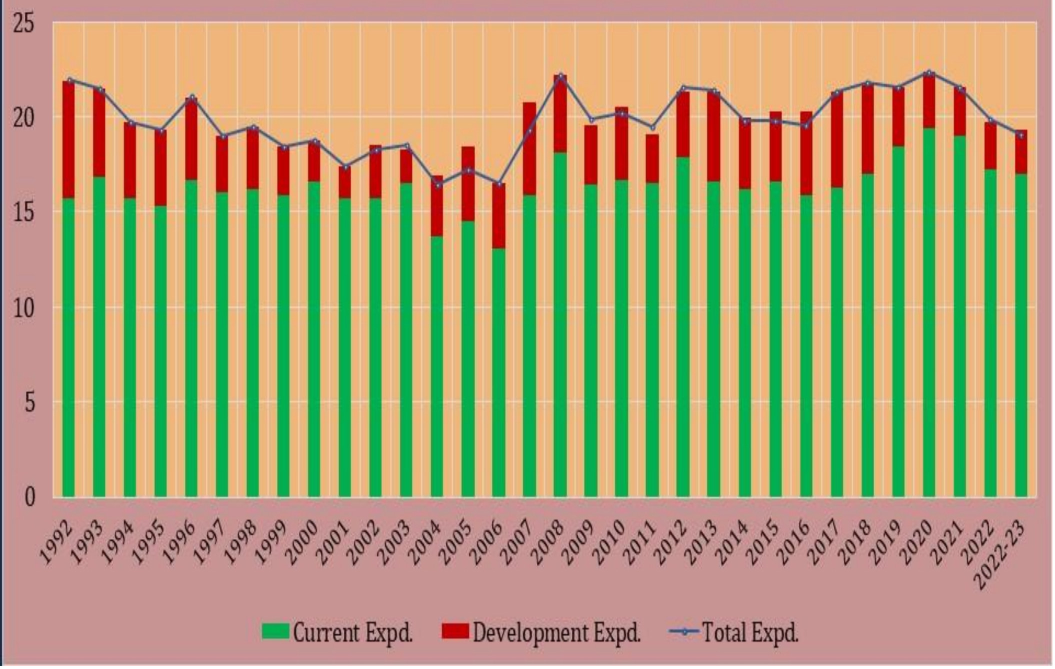
Current expenditure averaged 17.0 percent while development expenditure, averaged three percent of the GDP during the same period.

Table 3 and Figure 3

Table 3: Trends in Expenditure (as % of GDP)

Years (Averages)	Total Expenditure	Current Expenditure	Development Expenditure
1990s	20.0	16.1	3.9
2001-07	17.7	15.0	3.1
2008-18	20.4	16.3	4.3
2018-20	22.4	19.4	3.0
2020-21	21.6	19.0	2.6
2021-22	19.9	17.2	2.5
2022-23*	19.1	17.1	2.3

Figure 3: Trends in Expenditure (as % of GDP)



Within the current expenditure, interest payment has emerged as the single largest contributor. It averaged 5.2 percent of the GDP in the 1990s but accelerated to 6.7 percent in 2022-23 (See table 5 below). The persistence of high interest rate (the State Bank of Pakistan's (SBP) policy rate is 22 percent) causing interest payment (the largest expenditure item) to exceed net federal revenue has totally destroyed Pakistan's budget. In addition, the losses of public sector enterprises and subsidies, especially in power and gas have compounded Pakistan's fiscal difficulties.

Table 4

TRENDS IN DEFENSE SPENDING				
Years	Defense Spending (Billion Rs)	Defense Spending (Billion Rs)*	Defense Spending (Billion $)	Defense Spending (Billion $)**
2000-01	131	131	2.24	2.24
2001-02	149	141	2.43	2.36
2002-03	160	150	2.73	2.61
2003-04	185	166	3.21	3.08
2004-05	212	174	3.57	3.26
2005-06	241	183	4.03	3.55
2006-07	250	176	4.12	3.52
2007-08	277	174	4.43	3.68
2008-09	330	172	4.20	3.36
2009-10	375	175	4.47	3.59
2010-11	451	185	5.27	4.16
2011-12	507	187	5.68	4.12
2012-13	541	186	5.59	4.04
2013-14	630	199	6.03	4.33
2014-15	698	212	6.78	4.55
2015-16	758	223	7.26	4.70
2016-17	888	251	8.48	4.84
2017-18	1030	280	9.38	5.0
2018-19	1147	290	8.43	4.6
2019-20	1213	277	7.68	4.2
2020-21	1316	277	8.12	4.4
2021-22	1411	263	7.83	4.2
2022-23*	1586	260	7.00	4.0

Source: Pakistan Economic Survey 2013-14, 2012-13 and 2006-07 * at constant price of 2000-01
** at constant price of 2000 * Forecast

Defense budget in dollar terms has been $7 billion in 2022-23 but at constant price of 2000-01, it stood at $4 billion only (See tables 4 and 5).

Table 5

TRENDS IN CURRENT EXPENDITURE (% of GDP)				
Years (Averages)	Current Expenditure	Defense Expenditure	Interest Payments	Subsidies
1990s	16.1	4.7	5.2	0.7
2001-07	15.0	3.2	4.0	0.8
2008-18	16.3	2.6	4.5	2.1
2018-19	18.4	3.0	5.4	0.5
2019-20	20.4	2.9	6.3	0.4
2020-21	19.0	2.8	5.8	0.9
2021-22	17.2	2.1	4.8	2.3
2022-23*	17.1	1.9	6.7	1.3

Most importantly, defense spending accounted for 18.3 percent of the budget in 2000-01, gradually declined to 11 percent of the budget in 2022-

23 (See table 6 below). Furthermore, Pakistan's per capita defense spending stood at $29 in 2022-23 as against $51 of India --some 43 percent less than India.

Table 6

BURDEN OF DEFENSE BUDGET			
Years	Defense Spending		Per Capita Defense Spending ($)*
	as % of GDP	as % of Budget	
2000-01	3.2	18.3	16
2001-02	3.4	18.1	16.5
2002-03	3.3	17.8	17.8
2003-04	3.3	19.7	20.6
2004-05	3.3	19.0	21.4
2005-06	2.9	17.2	22.8
2006-07	2.7	13.9	22.3
2007-08	2.6	12.2	22.3
2008-09	2.5	13.0	20.0
2009-10	2.5	12.5	20.9
2010-11	2.5	13.1	23.8
2011-12	2.5	12.9	23.0
2012-13	2.4	11.2	22.1
2013-14	2.5	12.3	23.3
2014-15	2.5	12.7	23.0
2015-16	2.5	12.7	24.3
2016-17	2.8	13.0	23.7
2017-18	3.0	13.8	24.9
2018-19	3.0	13.8	22.5
2019-20	2.9	12.6	20.2
2020-21	2.8	12.8	20.8
2021-22	2.1	11.2	20.0
2022-23	1.9	11.0	19.0

Source: Pakistan Economic Survey 2006-07 and 2013-14, * at const. price of 2000

Interest payment has emerged as the single largest budgetary item in Pakistan- increasing from 28.4 percent of total revenue in 2006-7 to 59.1 percent in 2022-23.

As percentage of tax revenue, it increased from 41.5 percent to 72.8 percent during the same period. In other words, almost three-fourth of Pakistan's tax revenue is being consumed by interest payment.

Most horrifyingly, interest payment as percentage of net federal revenue increased from 44.2 percent in 2006-07 to 122.3 percent in 2022-23.

In other words, Pakistan's fiscal situation has deteriorated to an extent that the net federal revenue is not even sufficient to finance one budgetary item, that is, interest payment. Even the government had to borrow to pay for the interest (See table 7).

Table 7

IMPACT OF KEEPING INTEREST RATE HIGH ON BUDGET (%)

Year	Interest Payment as % of Total Revenue	Interest Payment as % of Tax Revenue	Interest Payment as % of Net Federal Revenue	Share of Interest Payment in Total Expenditure	Interest Payment as % of Development Expenditure	% Share of non-Interest Expenditure in Total Expenditure
2006-07	28.4	41.5	11.2	22.0	147.0	78.0
2007-08	32.7	46.6	52.0	21.5	108.4	78.5
2008-09	34.5	52.9	52.5	25.2	142.1	74.8
2009-10	30.9	43.6	47.9	21.4	104.7	78.6
2010-11	31.0	41.1	61.0	20.2	137.9	79.8
2011-12	34.6	43.3	66.6	22.6	121.4	77.4
2012-13	33.2	45.1	63.5	20.6	127.5	79.4
2013-14	31.6	44.8	57.2	22.8	101.0	77.2
2014-15	33.2	43.2	61.4	24.2	117.2	75.8
2015-16	28.4	34.5	57.0	21.8	96.2	78.2
2016-17	27.3	34.0	52.2	19.8	79.6	80.2
2017-18	28.7	33.6	60.5	20.0	94.7	80.0
2018-19	42.7	46.7	102.6	25.1	177.5	74.9
2019-20	41.8	55.2	79.9	27.2	217.6	72.8
2020-21	39.8	52.2	77.9	26.7	222.0	73.3
2021-22	39.6	47.1	85.1	23.9	196.8	76.1
2022-23	59.1	72.8	122.3	35.3	300.9	64.7

* Source: Fiscal Operations Tables: Ministry of Finance

Fiscal deficit means total expenditure exceeding total revenue. Which budgetary expenditure contributed most to the increase in total spending? Table 8 documents the percentage contribution of various expenditure to total expenditure. It can be seen that during the last five years more than 46% contribution to the increase in total spending came from the increase in interest payment as compared to the previous almost one decade more strikingly interest payment contributed almost 88% to the rise in total expenditure in 2022-23 resulting in further increase in fiscal deficit (See table 8).

Table 8

PERCENTAGE CONTRIBUTION TO TOTAL EXPENDITURE (%)				
Year	Interest Payment	Defense Expenditure	Development Expenditure	Other Expenditure
2017-18	22.1	20.7	- 8.6	68.8
2018-19*	*68.9	13.6	- 47.0	64.4
2019-20	40.6	5.1	- 1.2	55.4
2020-21	19.7	15.6	17.0	47.6
2021-22	14.5	3.2	11.4	70.9
2022-23	*87.9	6.1	10.3	- 4.3
Average 2008/09-2012/13	24.5	12.5	23.0	40.6
2013/14 – 2017/18	27.7	21.6	18.0	32.7
2018/19 - 2022/23	46.3	8.7	- 1.9	46.8

Hence, the root cause of fiscal deterioration over the last five years has been the unprecedented rise in interest payment, which in turn is due to keeping the policy rate of the SBP at an extraordinary high level (22 percent).

Not to mention that all other federal responsibilities including defense, development, salaries of the civil government, subsidies etc., have been financed through borrowed resources (See table 9).

Table 9

IMPACT OF KEEPING INTEREST RATE HIGH ON BUDGET (%)		
Year	Total Revenue as % of Total Expenditure	Total Revenue as % of Non-Interest Expenditure
2006-07	77.5	99.4
2007-08	65.8	83.9
2008-09	73.1	97..7
2009-10	69.1	87.9
2010-11	65.4	82.0
2011-12	65.2	84.2
2012-13	82.7	104.1
2013-14	72.4	93.8
2014-15	73.0	96.3
2015-16	76.7	98.1
2016-17	72.6	90.6
2017-18	69.8	87.3
2018-19	**58.7**	**78.4**
2019-20	**65.0**	**89.2**
2020-21	**67.0**	**91.3**
2021-22	**60.4**	**79.4**
2022-23	**59.6**	**92.1**
2023-24 (July – Sep)	73.6	118.4
Average (2018/19-2022/23)	**62.1**	**86.1**

As will be shown later, Pakistan maintained high interest rate to quell inflation. However, inflation remained stubbornly high at double-digit level, despite pursuance of the tight monetary policy for such a long period of time. By keeping interest rate at higher level, Pakistan failed to bring inflation down but totally destroyed its budget.

Table 10 shows that interest payment grew at average rate of 32.9 percent during the last five years as against 13.6 percent growth in total revenue.

Furthermore, while total expenditure grew by 11.1 percent and non-interest expenditure by 12.3 percent, interest payment grew at an average rate of almost 33 percent during the last five years. Hence, ballooning interest payment owning to the unprecedented high policy rate of the SBP has been the root cause of the deterioration in Pakistan's fiscal position. No amount of tax effort would match the growth in interest payment. Therefore, reduction in the SBP's policy rate is the key to restore fiscal balance.

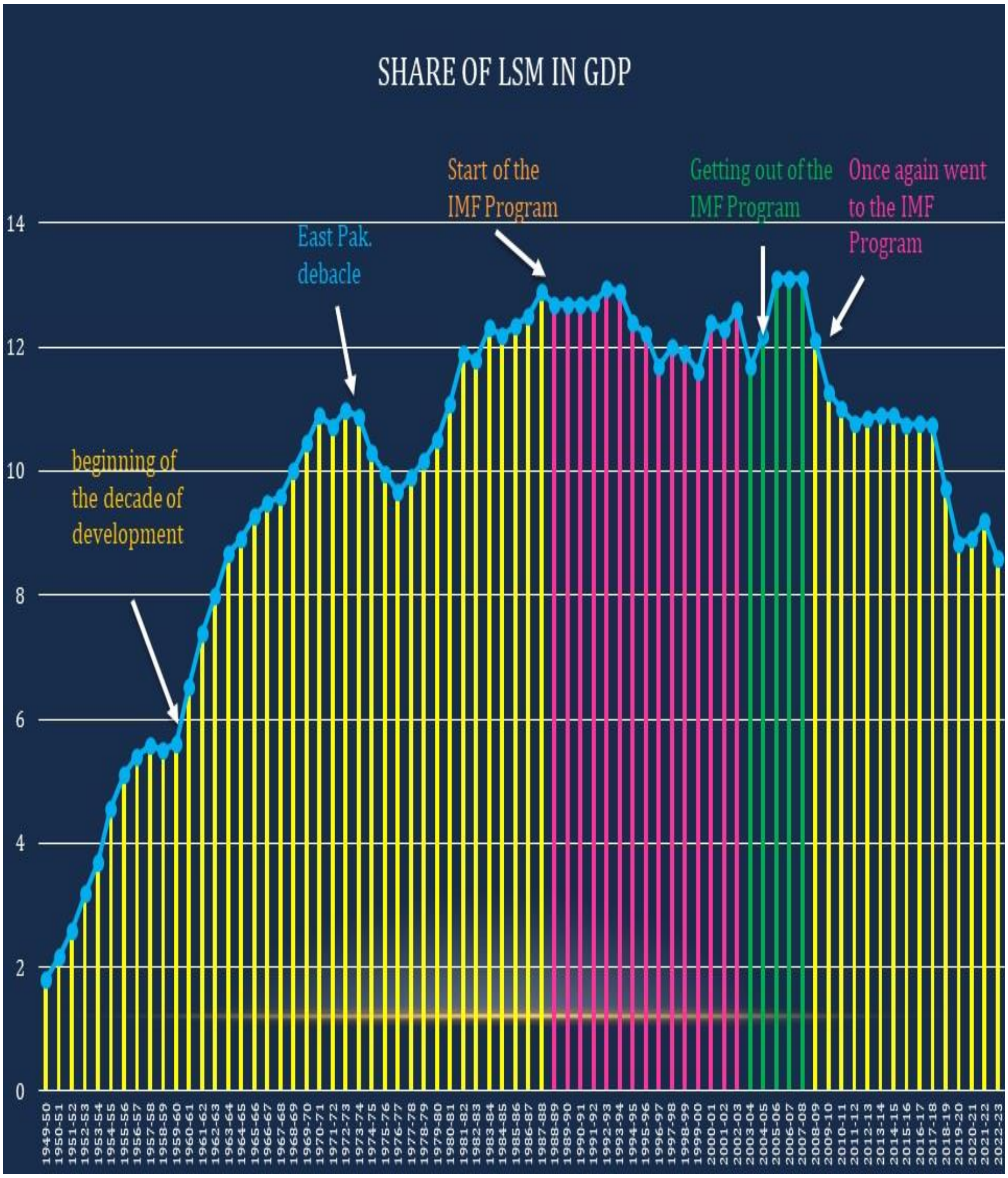
Table 10

GROWTH RATES OF INTEREST PAYMENTS, TOTAL REVENUE, AND NET FEDERAL REVENUE (%)					
Year	Interest Payment	Total Revenue	Net Federal Revenue	Non-Interest Expenditure	Total Expenditure
2018-19	39.4	- 6.3	- 17.8	4.4	11.4
2019-20	25.3	28.0	60.8	12.3	15.6
2020-21	5.0	10.1	7.6	7.5	6.8
2021-22	15.7	16.4	6.0	33.8	29.9
2022-23	79.0	19.9	24.5	3.4	21.5
Average	32.9	13.6	16.2	12.3	11.1

Persistence of Large Current Account Deficit

Dr. Khan highlighted the factors that have adversely affected the country's economic competitiveness. The escalation of production costs, driven by factors such as devaluation, high interest rates, frequent increases in utility prices, and inflation, has made industries less productive. This increase in the cost of capital, labor, raw materials and energy has undermined the competitiveness of export-oriented industries in the international market, leading to stagnant exports. The impact of devaluation and higher production costs has rendered industries of Pakistan, less competitive globally. Additionally, the country has experienced a rise in imports, including non-essential ones, a slower growth in remittances, and decline in non-debt creating inflows (such as foreign direct investment, portfolio investment, little or no privatization proceeds, and foreign grant assistance). These factors collectively contributed to the high current account deficit. Moreover, in contrast to global trends of increasing industrialization, Pakistan witnessed a decline in the share of industrial sector in GDP, starting from the early 1990s. This decline has further contributed to the challenges faced by the country in maintaining a competitive edge in the international market (See figure 4).

Figure 4



Balance of Payments Crisis

Despite the government's efforts to control imports and manage the current account deficit, Pakistan's export growth has been minimal, increasing from US$25.1 billion in 2013-14 to US$27.9 billion in 2022-23.

However, the current account deficit has experienced a significant decline, decreasing from US$17.5 billion in 2021-22 to US$2.2 billion in 2022-23. This reduction may be attributed to the import control measures and other economic strategies implemented by the government, lately. (See table 11 below)

Table 11

BALANCE OF PAYMENTS CRISIS (Billion $)

Years	Exports (Billion $)	Imports (Billion $)	Current Account Deficit (Billion $)	International Price of Oil ($/bbl)	Remittances (Billion $)
2012-13	24.8	40.2	2.5	109.1	13.9
2013-14	25.1	41.8	3.1	109.3	15.8
2014-15	24.1	41.4	2.7	73.5	18.7
2015-16	22.0	41.4	4.9	43.4	19.9
2016-17	22.0	48.7	12.6	50.1	19.4
2017-18	24.8	56.6	19.2	63.6	19.9
2018-19	24.2	51.9	13.4	67.9	21.7
2019-20	22.5	43.6	4.4	54.7	23.1
2020-21	25.6	54.3	2.8	47.3	29.4
2021-22	32.5	72.0	17.5	80.4	31.3
2022-23	27.9	51.8	2.2	84.0	27.3

Source: State Bank of Pakistan

Furthermore, in terms of foreign exchange reserves, we have witnessed a declining trend over the last one decade. In 2006-07, the reserves were US$14.3 billion, and by 2022-23, they had decreased to US$4.4 billion. The current reserves are noted at US$9.2 billion as of January 5, 2024, influenced by payments received from the IMF (See table 12).

Table 12

DECLINING TREND IN PAKISTAN'S FOREIGN EXCHANGE RESERVES (BILLION $)		
Years	**Foreign Exchange Reserves**	**(Months of Import Cover)**
2006-07	14.3	3.8
2009-10	12.9	3.6
2010-11	14.8	3.6
2011-12	10.8	2.7
2012-13	6.0	1.5
2013-14	9.1	2.2
2014-15	13.5	3.2
2015-16	18.1	3.7
2016-17	16.1	4.0
2017-18	9.8	2.1
2018-19	7.3	1.7
2019-20	11.2	3.2
2020-21	17.3	3.8
2021-22	9.8	1.5
2022-23	4.4	1.0
Jan 5, 2024	8.15	1.9

Source: State Bank of Pakistan

Factors Responsible for the Surge in Debt

Public and External Debt

Several factors contribute to the surge in debt, including the sharp depreciation of the exchange rate (devaluation), which results in a significant increase in public debt for every rupee devaluation. Additionally, the decline in non-debt creating inflows, such as foreign direct investment, portfolio investment, lack of privatization proceeds, and reduced grant assistance, has further fueled the reliance on debt to meet foreign exchange needs.

Moreover, the decision to keep interest rates high has led to an upward trajectory in interest payments, contributing to an increase in current expenditure, total expenditure, and ultimately resulting in a large budget deficit. This budget deficit necessitated more borrowing, adding to the overall public debt burden.

Dr. Khan enlightened that over the years, there has been a decline in non-debt creating inflows, compelling the country to depend more on debt-creating resources.

He said that Pakistan's external debt and liabilities, which stood at just US$145 million in 1959-60, have surged to US$128,091 million as of September 2023. Similarly, public debt has experienced rapid growth from Rs 155.4 billion in 1979-80 to Rs 67,939 billion as of September 2023 (See table 13 below).

Table 13

PAKISTAN'S DEBT PROFILE SINCE INDEPENDENCE		
Period	**External Debt & Liabilities (Million $)**	**Public Debt (Billion Rs)**
1947-48	0.0	-
1949-50	0.0	-
1959-60	145.0	-
1969-70	2959.0	-
1979-80	9458.0	155.4
1989-90	19207	801.2
1999-2000	36563	3018
2006-07	40324	4814
2009-10	61567	8911
2013-14	65365	16388
2014-15	65183	17819
2015-16	73063	20054
2016-17	83431	21783
2017-18	95,237	25574
2018-19	106,312	34418
2019-20	113,013	38061
2020-21	122,199	41236
2021-22	130,192	51518
2022-23	124.593	65983
Sept. 2023	128,091	67939
Source: State Bank of Pakistan and Debt Office, Ministry of Finance.		

This escalation has also led to an increase in debt servicing, reaching $20.8 billion in the fiscal year 2022-23 (See table 14 below).

Table 14

TRENDS IN EXTERNAL DEBT (AS PER THE IMF) (Billion $)				
Year	External Debt	Debt Servicing		
		Principal	Interest	Total
2004-05	35.4	1.92	0.87	2.79
2005-06	37.2	1.99	0.83	2.82
2006-07	40.3	1.79	0.98	2.77
2007-08	46.2	1.94	1.09	3.03
2008-09	52.3	3.59	1.03	4.62
2009-10	61.6	3.59	0.95	4.54
2010-11	66.4	2.87	1.00	3.87
2011-12	65.5	3.49	1.02	4.51
2012-13	60.9	5.55	0.93	6.48
2013-14	65.4	6.09	0.86	6.94
2014-15	65.2	-	-	7.0
2015-16	73.0	-	-	6.60
2016-17	83.4	6.52	1.63	8.15
2017-18	95.2	3.33	2.32	5.65
2018-19	106.3	8.64	2.95	11.59
2019-20	113.0	11.35	3.23	14.58
2020-21	122.2	11.19	2.24	13.43
2021-22	130.2	12.09	2.98	15.07
2022-23	124.6	16.39	4.42	20.8

Source: State Bank of Pakistan

Pakistan added $66.4 billion or 53.3 percent to its external debt and liabilities during the two lost decades (1990s, 2008-18).[5]

Table 15

ADDITION TO DEBT (BILLION $)			
Period	**No. of Years**	**Debt Added**	
1990s	10 years	17.4	
2008-13	5 years	14.7	
2014-18	5 years	34.3	
2008-18	10 years	49.0	Pakistan added $66.4 billion or 53.3% external debt and liabilities during the two lost decades (1990s & 2008-18).
Two Lost Decades		**66.4**	
2018-19	One year	11.1	
2019-20	One year	6.7	
2020-21	One year	9.2	
2021-22	One year	8.0	
2022-23	One year	-5.6	
2019-23	5 years	29.4	

[5] Dr. Ishrat Husain described the decade of the 1990s as the lost decade of Pakistan and Dr. Ashfaque Hasan Khan has termed the decade of 2008-2018 as the second lost decade.

The public debt of Pakistan also more than tripled in the last eight years as evident in the figure below.

Figure 5

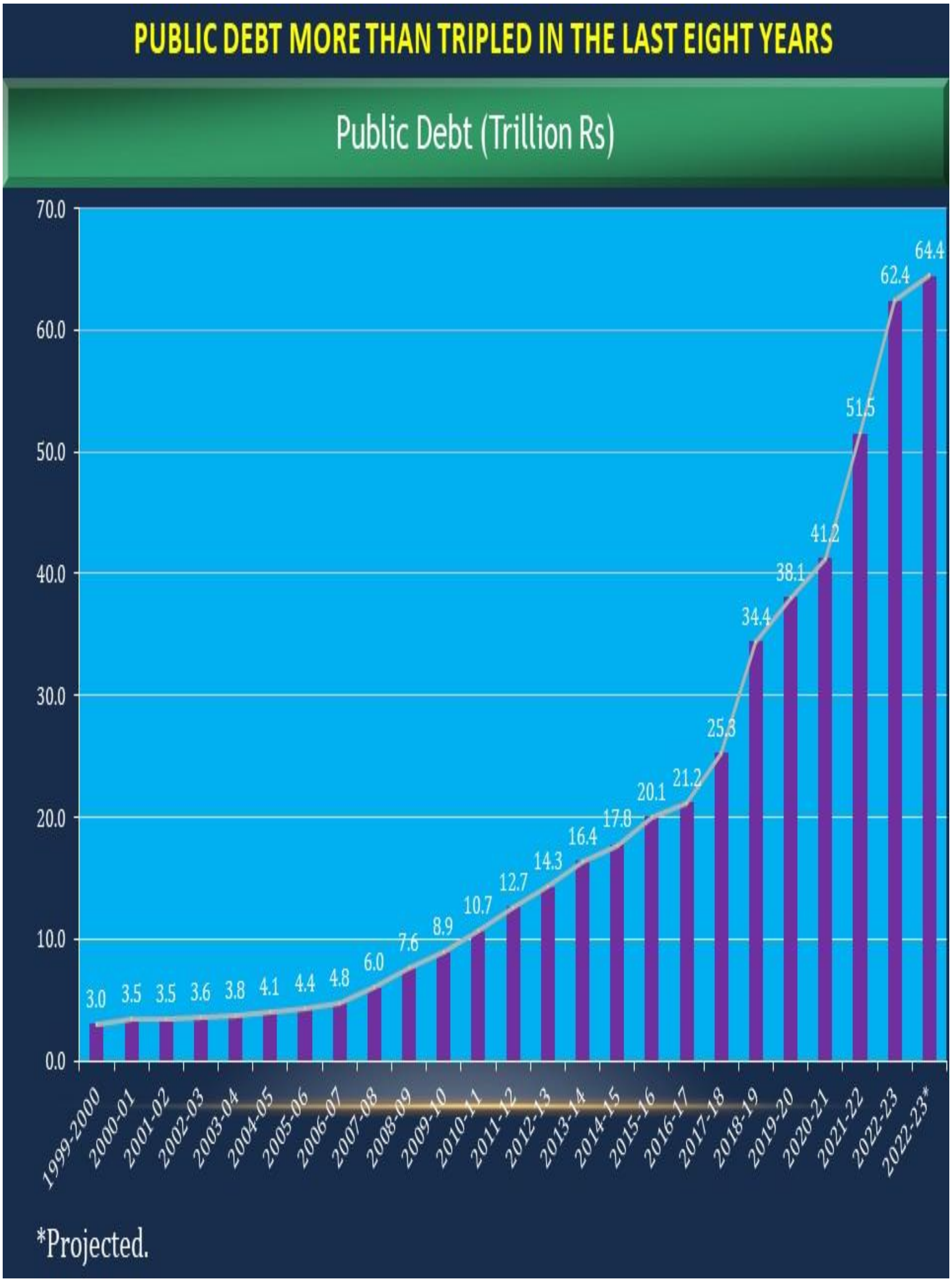
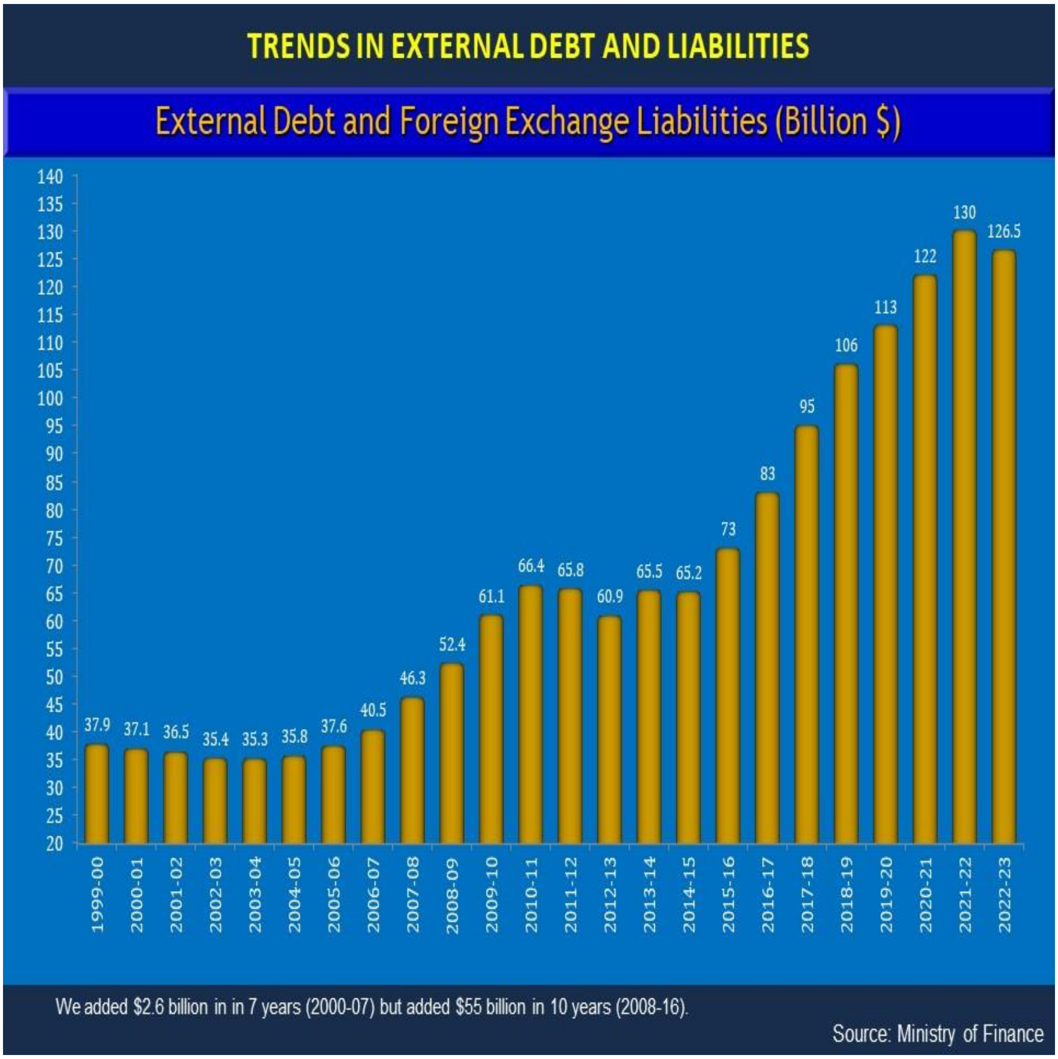


Figure 6 shows the trends in external debt and liabilities comprising the external debt and foreign exchange liabilities since 1999.

Figure 6

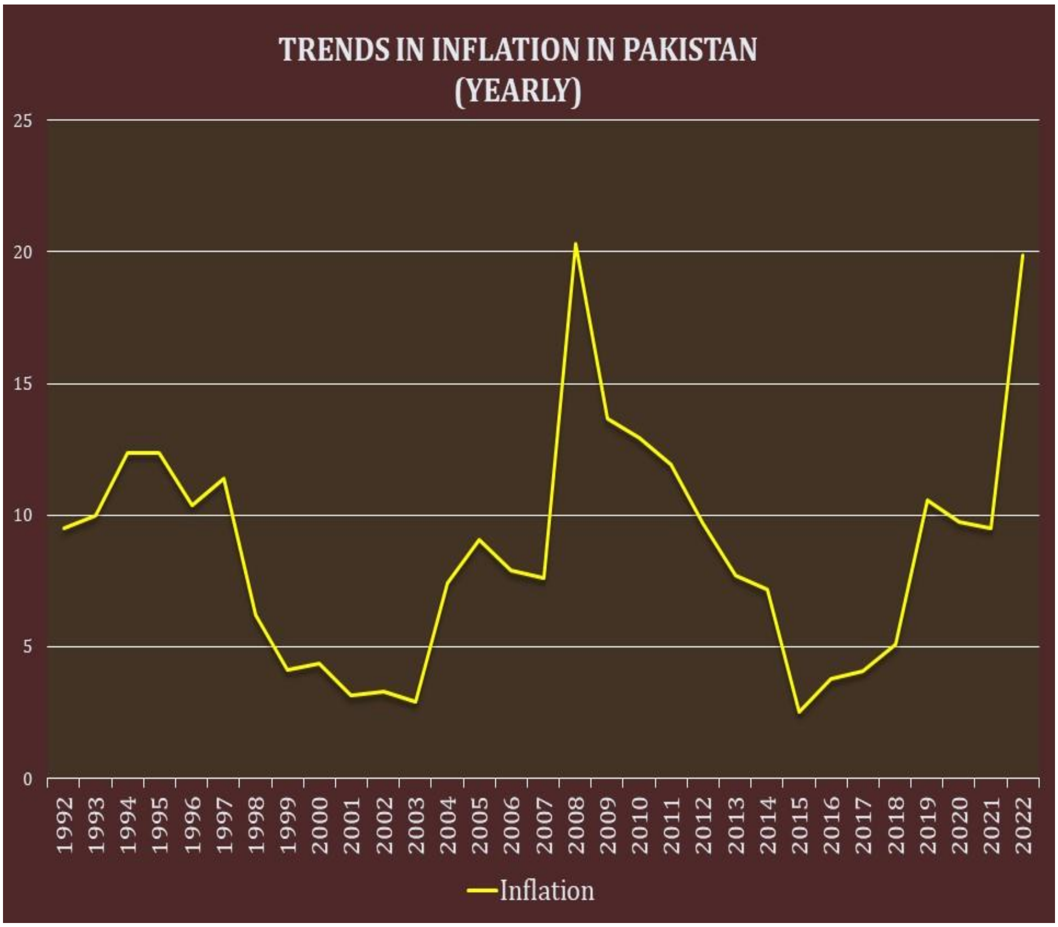


Persistence of Higher Double-Digit Inflation

The persistence of higher double-digit inflation in Pakistan, reaching approximately 30 percent, is unprecedented and poses significant challenges for various segments of the society. This prolonged period of high inflation, not witnessed before in the country's history, is particularly concerning for the poor, the fixed-income group (salaried class), and the middle-income group. It is evident through the empirical data that a one-percent increase in the State Bank of Pakistan's policy rate leads to a 1.3 percent increase in inflation within one year.[6]

Dr. Khan highlighted a number of factors, both domestic and external, contributing to the surge in inflation. The domestic factors include massive devaluation of currency, the persistence of high-interest rates, and the frequent upward adjustment of utility prices (electricity and gas). Additionally, there is a substantial increase in the support price of various agricultural crops, especially wheat and a weakening, almost non-existent writ of the state (See figure 7 below).

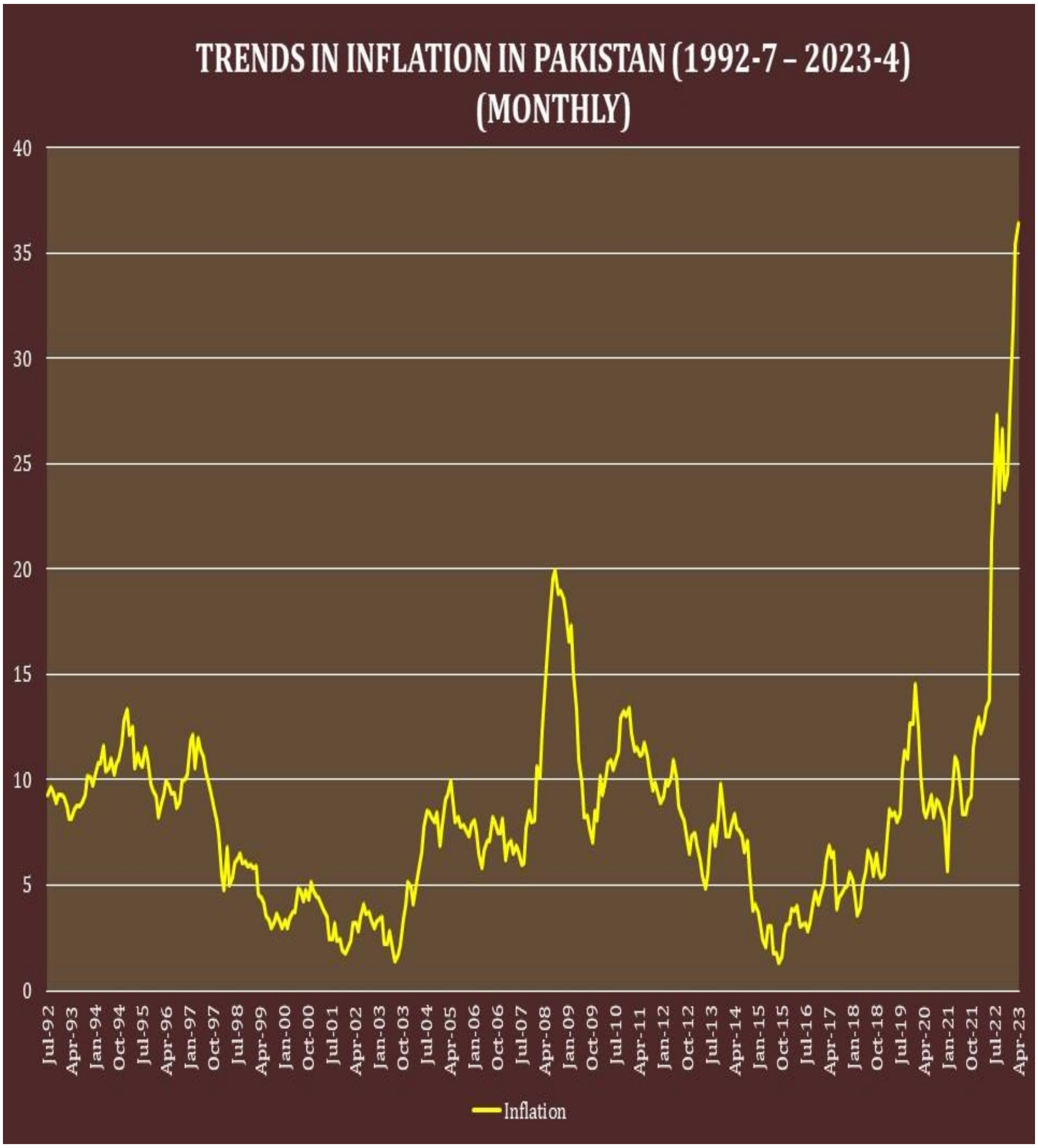
Figure 7



[6] M. Nizami and Abdus Samad, "Limitation of Monetary Policy in Developing Countries: A Case Study of Pakistan", Final Year Bachelor Project submitted to the Department of Economics, School of Social Sciences & Humanities, NUST, Islamabad.

Political instability further exacerbated the economic situation. Among the external factors, mainly there are disruptions in the supply chain due to the pandemic. The rise in shipping charges owing to the increase in the insurance charges during the pandemic further impacted the inflationary situation. Additionally, the Russia-Ukraine war has had a profound effect on global energy, food, and fertilizer prices, contributing to the rise in general price level.

Figure 8



The consequences of such inflation rates have created immense pressure on the affected groups, presenting a challenging scenario for any government in power. Addressing the root causes of inflation becomes crucial to alleviate the economic burden on the populace.

Pakistan's inflation is largely caused by the supply side factors (food & energy) complemented by the frequent increase in utility prices (gas & electricity) by the government.

Dr. Khan has raised a pertinent question about the effectiveness of keeping interest rate high.

Interest rate is a demand side instrument and well-suited to quell inflation if it is caused by excessive demand, which in turn, is caused by excessive monetary growth.

But if inflation is largely caused by the supply side factors coupled with the increase in government administrated prices (gas & electricity), is keeping interest rate high a right policy? Certainly not. Interest rate instrument is not effective in a situation where inflation is largely a supply side factors.

Empirical evidence in the case of Pakistan suggests that when inflation increases, the SBP increases the policy rate. The increase in the policy rate further increases inflation. Hence, there exists a bi-directional causation between inflation and policy rate.[7]

Lower Income Growth

The unprecedented scale of political instability, coupled with the high-interest rates, massive currency devaluation, continuous increases in utility prices, and unfavorable tax measures, has created a challenging environment for business activity and investment in Pakistan.

These factors collectively have resulted in a significant economic slowdown, with the country's growth averaging 3.5 percent per annum

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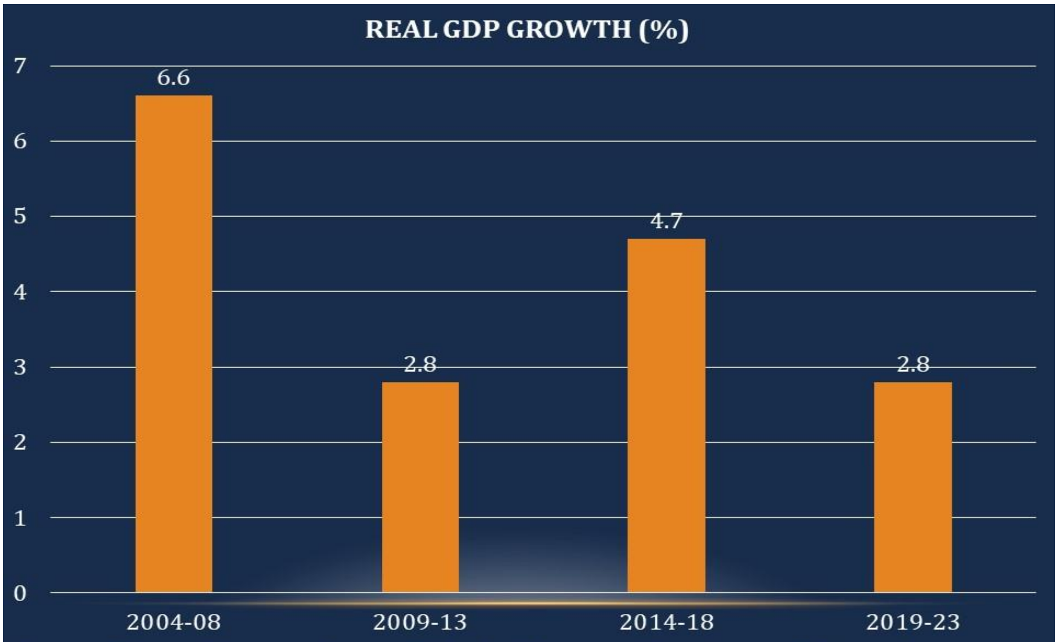
[7] See Ashfaque H. Khan and Tanweer ul Islam, "The Limits of Monetary Policy: A Trivariate Analysis of Inflation, Policy Rate, and Economic Growth in Pakistan," *NIPS Working Paper Series (WP-1),* December 2023.

over the last 15 years and further declining to an average of 2.8 percent over the last 5 years (See figure 9 below).

Figure 9



Source: Pakistan Economic Survey 2021-22 & Statistical Supplement, Pakistan Economic Survey, 2016-17.

The lower economic growth in Pakistan has not generated sufficient job opportunities, contributing to a rise in unemployment and social unrest. This challenging economic environment has led to despondency among the population and intensified political polarization within the country.

Way Forward

Dr. Khan presented some key recommendations to address the five critical challenges discussed above.

Fiscal Side

Addressing the root causes of the fiscal crisis in Pakistan requires a focus on expenditure management. The prolonged maintenance of the State Bank of Pakistan's (SBP) policy rate at an exceptionally high level has been identified as a major contributor to current fiscal challenges. Additionally, the current high interest rates are identified as a cause of increased production costs, leading to inflation, lowering it is expected to contribute to a decrease in inflation.

Dr. Khan also proposed a roadmap for gradually reducing the policy rate in Pakistan from the current level of 22.0 percent, is outlined as follows:

- 2023-24: Reduce to 20 percent during the second half of the fiscal year.
- 2024-25: Further reduction to 16 percent.
- 2025-26: Continue the gradual reduction to 12 percent.
- 2026-27: Finally, reduce the policy rate to 8 percent.

This roadmap suggests a step-by-step approach to bring down the policy rate over the next few years, aiming to alleviate fiscal challenges and contribute to economic stability. Empirical evidence suggests that 1 percent decline in the policy rate of the SBP will reduce interest payment by Rs 350 billion in one year.

There is a need to freeze Public Sector Development Program (PSDP) for at least two years and allocate more resources to the on-going strategic nature projects so as to complete the projects on time. The ongoing developmental projects require pruning as there are over 1200 projects amounting to approximately Rs. 10.5 trillion which is sufficient for 12-14 years of federal government PSDP. The projects on which 15-20 percent allocation has been made should be dropped to save money and the projects on which 80-85 percent work has been completed must be allocated more resources to complete them on time. For the next two years, no new infrastructure projects be undertaken.

Dr. Khan further stressed that in order to achieve financial stability in the country, it is recommended to expedite the privatization of loss-making public sector enterprises and Distribution and Generation Companies (DISCOs and GENCOs) to alleviate budgetary pressures. The budget for the Benazir Income Support Program (BISP) should be frozen at the existing level of over Rs. 450 billion annually, and a transparent graduation plan for BISP must be established. The implementation of the Public Investment Management Assessment (PIMA) Report, prepared by the IMF, is crucial for effective public investment. A paramount step is the urgent reassessment of the current National Finance Commission (NFC) Award, as addressing this issue is deemed essential for achieving financial stability in the country.

On the revenue side, to enhance tax compliance and streamline the tax system, several key recommendations were proposed by Dr. Khan. First, an aggressive expansion of Point of Sale (POS) to minimize tax avoidance and addressing existing operational issues pertaining to POS be undertaken. The untaxed sector, starting with real estate and agricultural income, should be gradually brought under the tax net at the federal level. Consideration may be given to implementing a fixed tax for small businesses. Tax rates, especially the sales tax rate, should be reduced to stimulate economic activity.

The speaker emphasized that reforming the tax administration is crucial, and the approved Restructuring Plan of the FBR should be diligently implemented by the new government. An expert committee should be formed to review tax exemptions, aiming to shift from company-specific exemptions to criteria-based or rule-based ones, as the current tax expenditure stands at Rs. 4 trillion, with 86 percent being company-specific exemptions.

Besides, the tax filer and non-filer concept should be eliminated, making it challenging for non-filers while facilitating taxpayers who willingly comply. The tax return form should be simplified to make it more understandable and user-friendly. Additionally, the issue of taxpayers filing tax returns in different provinces has different challenges and complexities within the institutions; approaching different departments for tax compliance purposes. The speaker stressed to address such issues to ease the burden on the tax filers.

External Sector

To strengthen Pakistan's economic conditions, a comprehensive dual strategy was emphasized by the speaker, focusing on both earning and conserving dollar. To enhance dollar earnings, efforts should concentrate on making export-oriented industries globally competitive by addressing issues such as reducing borrowing costs, stabilizing utility prices, and resolving governance problems in the energy sector. Diversification of exports in sectors like IT, gemstones, electric fans, and surgical instruments, along with exploring new markets in Africa and Central Asia, can increase foreign exchange earnings. Encouraging overseas Pakistanis to invest, optimizing remittances, and attracting Foreign Direct Investment through the initiatives like the Special Investment Facilitation Council (SIFC) are crucial steps.

On the conservation front, a strategic approach involves maintaining a selective and yet aggressive import compression policy for at least two years. Measures include making non-essential/luxury goods more expensive through quotas, higher taxes, tariffs, or even bans, reducing the energy import bill by transitioning to alternative sources, and discouraging unnecessary travel abroad.

To enhance trade and investment, several key strategies were recommended by the speaker including the strategy for trade and investment focusing on fostering a more open and efficient trading environment by removing barriers and promoting liberalization. A key aspect involved evaluating and adjusting tariff structures to ensure competitiveness and efficiency in the trade sector.

Emphasis was placed on enhancing trade relations with neighboring countries such as Afghanistan, Iran, and China. Careful preparation and negotiation based on competent groundwork is essential when contemplating trade with India. The recommendation extended to identifying and exploring new markets in regions like Africa and Central Asia, with a call to diversify products to broaden export opportunities.

Additionally, China-Pakistan Economic Corridor (CPEC) should be leveraged as a strategic vehicle to simultaneously promote trade and industrialization, creating synergies for overall economic growth. The SIFC may facilitate the CPEC related industrial projects with potential to export promotion.

How to Control Inflation?

Pakistan's Central Bank has been pursuing tight monetary policy for quite some time to quell unprecedented double-digit inflation. The textbook of economics suggests that when inflation is high, the Central Bank raises interest-rate to bring inflation down. Our Central Bank has been doing exactly the same and yet failed to bring the inflation down. This is what is known as 'Aspirin Approach to Monetary Policy' which the State Bank of Pakistan has been pursuing.

Our recommendation is that the SBP should first determine the root causes of inflation and then devise a policy accordingly. If inflation is largely caused by excessive demand, raising interest rates is the right policy instrument because interest rate is regarded as demand management instrument. However, if the inflation is largely caused by supply-side factors, raising interest rate is not the right instrument. In the case of Pakistan, the current inflationary buildup has been caused by rising food prices, energy prices and massive devaluation of Pakistani currency plus weak governance. Empirical evidence suggests that in the case of Pakistan, higher interest rate further exacerbates the inflationary pressure. Hence, the recommendations are:

1. Improve the supply of food items either by increasing production or importing food from outside.
2. The government must exercise restraint in frequently increasing the prices of electricity and gas, as well as increasing the support prices of various agricultural commodities.
3. Must maintain stability in the exchange rate by managing non-essential imports.
4. Keep a close eye on the unscrupulous elements in the forex market as well as in the commercial banks to keep foreign exchange market calm.
5. The writ of the state must be established by penalizing the hoarders/ smugglers/currency manipulators of essential commodities and foreign exchange market. Such people must be handled firmly.

5. Keynote Address

Energy Sector Crisis and Reforms

Mr. Muhammad Ali

Mr. Muhammad Ali stressed that strategic approach is needed to meet the Pakistan's energy requirements as Pakistan relies heavily on gas and oil as main source of energy, while industries and transport consume the largest chunk of the energy produced.

Mr. Mohammad Ali provided a comprehensive overview of the challenges and reforms in Pakistan's energy sector. The multifaceted approach, comprising domestic consumer charges, fertilizer sector reforms, green energy initiatives, and future strategies, reflects a concerted effort to establish a sustainable, affordable, and reliable energy landscape for the nation's growth.

While addressing the session, the minister highlighted that during the last 18 to 24 months, Pakistan has had economic difficulties encountered by political uncertainties, resulting in significant impacts on investor confidence. Additionally, import controls have been implemented, causing a rise in interest payments, particularly on the domestic front, resulting in a substantial increase in the debt burden. Therefore, the present economic conditions are characterized by deteriorating quality, inflation-induced wage disparities, and reduced overall purchasing power.

Mr. Ali stressed that the adverse economic conditions has led to a significant decrease in both levels of confidence and overall economic activity of the country.

The economic environment has become more difficult due to import control and significantly increased interest payments. The consequences affected the whole population, leading to a significant rise in poverty rates.

Due to this situation, the financially challenged population faced a significant drop in their income levels. Hence there is a decrease in employment quality, and an increase in inflation, which resulted in a reduction in the ability of local population to buy goods and services. This has further exacerbated socio-economic tensions during a time of economic instability.

Mr. Ali suggested measures to provide consumers a secure, economical, and sustainable energy. These include expanding indigenous production, optimizing energy imports, and encouraging investment.

He further emphasized the necessity of strengthening domestic energy sources for self-reliance and security. To efficiently fulfil demands, there is the need to streamline the energy imports.

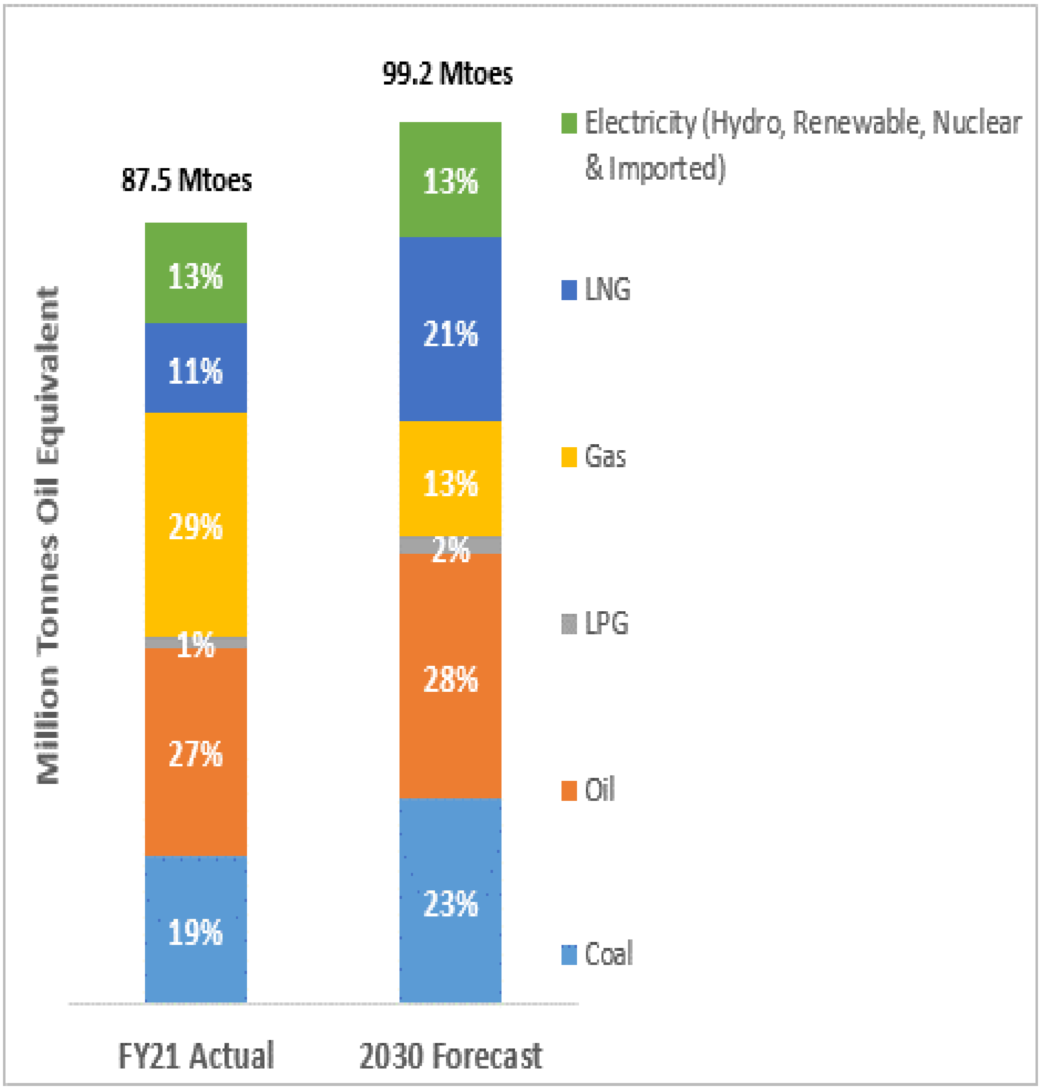
Additionally, to encourage local and foreign energy sector investments for long-term sustainability and growth, an investment-friendly environment should be promoted.

The minister delved into the vision of achieving sustainable, cost-effective, and dependable energy sources, stating that the total primary energy supplies in FY2022 were approximately 88 million tonnes of oil equivalent and those for 2030 were projected to be 99.2 million tonnes of oil equivalent.

Hence, Pakistan's future energy mix is forecasted to be dominated by imported LNG and Oil and Coal extraction from Thar coal.

The speaker highlighted the challenging situation of Pakistan's diminishing gas reserves, causing concern for the future composition of energy sources.

Figure 1[8]

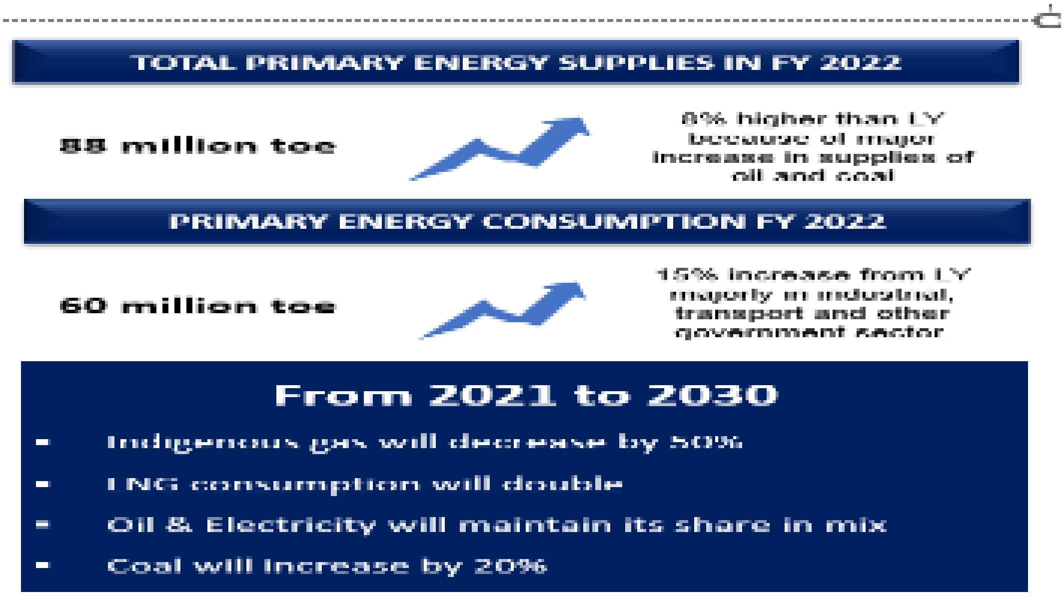


Source: Energy Yearbook 2020-21 by HDIP; Planning Commission's IEP Report 2020-2030 by Planning Commission

[8] The figures in this section have been extracted from Mr. Mohammad Ali's presentation during the National seminar.

Due to this the use of LNG is projected to double, leading to an increase in import expenses, and the utilization of coal is expected to increase by 20 percent. In addition to this, Pakistan's energy mix comprises natural gas, petroleum, electricity, coal, and liquefied petroleum gas (LPG).

Figure 2



Source: Energy Yearbook 2020-21 by HDIP; Planning Commission's IEP Report 2020-2030 by Planning Commission

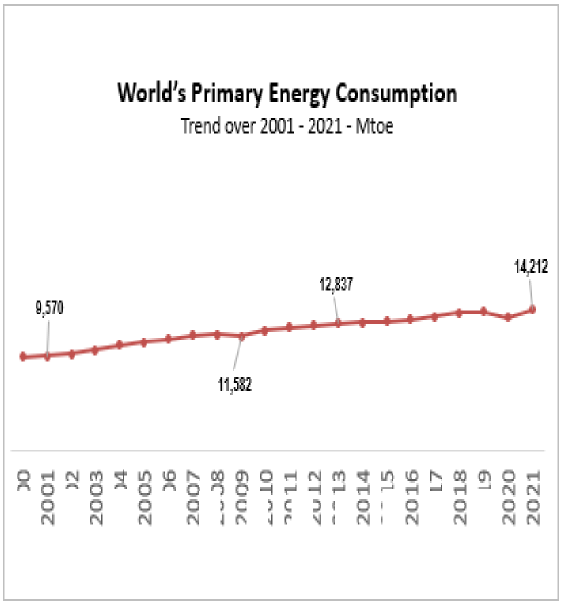
Out of these, 71 percent of the gas is locally generated, while the remaining 29 percent is imported in the form of liquefied natural gas (LNG). The speaker while analysing the consumption of coal and LPG pointed out their importance in the energy sector.

Additionally, the industrial sector comprises 44 percent of total energy consumption, while the transport sector constitutes with a share of 30 percent.

Pakistan, with a population representing 3 percent of the world, consumes only 0.6 percent of the global energy, as seen from a global viewpoint on primary energy consumption.

Although the country has a low per capita energy consumption, it can capitalize on this situation by implementing smart contracting and strategically expanding its energy supply to alleviate poverty.

Figure 3



Pakistan is 0.6% of World's Primary energy consumption while being 3% of total world population

ENERGY MIX FY22 PAK vs. World

Resource		
Gas	42%	24%
Oil	27%	31%
Coal	19%	27%
Hydro Electricity	9%	7%
Nuclear	3%	4%
Renewable	1%	7%
CAGR	3.5%	2.0%

Source: HDIP Energy Yearbook 2021; BP Statistical Review 2022

Mr. Ali while addressing concerns regarding specific energy sectors, stressed that the oil sector is facing a major challenge since it has a refining capacity of 14 million tons, which falls short of the projected demand of 25 million tons by 2034. Moreover, the reliance on imports shows a significant risk to the security of energy supply. Therefore, it is crucial to shift to alternative sources such as gas, oil, or coal to address these problems effectively. He further added that the challenges comprise of unstable international crude oil prices, reliance on the PSO (Pakistan State Oil), and the concerns arising from circular debt.

In the field of gas production, the diminishing domestic resources indicate a pressing requirement for immediate policy reforms. The inequalities between supply and demand, which are badly affected by the high cost of importing LNG, emphasize the significance of exploring new resources and managing the losses of unaccounted gas. Furthermore, it is imperative to rectify any irregularities in government payments to exploration companies to ensure long-term growth in the energy sector of Pakistan.

Mr. Ali delved into the existing cyclical debt cycle in the petroleum sector which has adversely affected E&P (Exploration and Production) companies in Pakistan, resulting in a decrease in international corporate participation. He suggested that it is imperative to tackle this issue to stabilize the petroleum industry. Unfortunately, in the last five years, there has been a significant increase of 22% in the cyclical debt associated with petroleum, emphasizing the need for effective strategies for settlement.

In power industry, the main difficulty resides in capacity payments, which currently is around 72 percent of the entire bill, while the energy components are declining. The change in the industry's dynamics is concerning since the government is having difficulty generating enough money to repay capacity payments, which increases the risk of defaulting on power plant tasks. Hence, the necessity for careful consideration and substantial investment in transmission lines is quite evident, considering the unequal distribution of energy consumption.

Furthermore, the circular debt in the power industry is worsened by a dependence on imported fuel and poor infrastructure, resulting in the increase of electricity bills. The speaker further stressed that such situations give rise to a complex network of problems that necessitates strategic reforms. In this regard, the caretaker government of Pakistan prioritized three essential factors to tackle the energy crisis: emphasizing the utilization of domestic resources, ensuring fair competition for investors, and striving for increased affordability of energy.

The strategy implemented involved a threefold approach. Initially, there should be an emphasis on utilizing local resources to decrease reliance on imported goods. Furthermore, emphasis is on implementing measures aiming to reduce gas consumption and electricity consumption, considering Pakistan's inadequate gas supply. Finally, reforms in the EMP sector are crucial for tackling the circular debt issue and maximizing the utilization of the country's gas resources.

The Strategic Pillars of Reforms—A Lean Approach Focused on Global Best Practices, Resource Indigenization, and Investor Confidence

Mr. Ali stressed on the reforms based on a simple and fundamental approach, taking inspiration from the most effective methods used globally. The speaker further added that the main objectives are to acquire knowledge from global experiences, adapting resources to local contexts, and establishing fair conditions to boost investor trust and guarantee affordability.

Also, while going through international comparisons of different countries there is a need to examine the worldwide management of power sector transmission and distribution, evaluate the global impact of liquefied natural gas (LNG), and further devise strategies to achieve Net Zero objectives. Mr. Ali also stressed on the implementation of regionally competitive pricing throughout all fuel industries, in accordance with worldwide norms of competitiveness which includes COP 28, future mineral development, and government-to-government actions to deal with and reduce obligations.

Moreover, the speaker delved into the need of countering energy challenges with the focused efforts to make resources more indigenous, highlighting the significance of utilizing current prospects rather than engaging in hypothetical results and risks. This includes initiatives such as reducing the demand for gas, encouraging the adoption of electric vehicles, and rationalizing tariffs. The speaker added that these measures target not only to promote the use of electric vehicles but also to stimulate industries of Pakistan and attract foreign investment. The reforms further include the E&P sector, with a focus on exploring internal resources and integrating coal-based power generation into the energy mix.

Pakistan must immediately improve its capacity to prepare for the global energy transition, due to its poor Energy Transition Index ranking of 107 out of 120. Pakistan scores only 34.5, significantly lower than the regional average of 51. Hence the country needs to prioritize stabilizing its political situation, decreasing carbon emissions, expanding renewable energy capacity, enhancing energy transportation, investing in digital infrastructure, increasing research and development in the energy sector, and optimizing the energy supply chain.

The minister emphasized that by focusing on these areas, Pakistan may enhance its energy resilience and establish itself as a more effective player in the global energy sector.

Mr. Ali highlighted another essential aspect of building investor trust to promote economic activity in Pakistan's energy sector, by facilitating through the formulation of greenfield and brownfield refinery policy frameworks. Additionally, the importance of enhancing the capabilities in the power sector, namely in the areas of power generation and transmission, were also emphasized.

Mr. Ali suggested that prolonging the duration of loan repayments can somehow alleviate financial burdens of the country, especially the energy sector and attract foreign investors. He also highlighted the need for innovative solutions, such as implementing a system of industry payment based on production.

The speaker further emphasized the significance of implementing regulatory reforms and shifting towards a market-based economy.

The strategy also focused on optimizing the sustainability and affordability balance. The speaker stressed on achieving equilibrium, resulting in inclusive measures on the expenses associated with sustainability.

The Collective Impact of Small Steps for Prosperous Pakistan

Gas Sector Reforms

The Gas Sector Reforms is not merely on addressing the Weighted Average Cost of Gas (WACOG) and avoid gas diversion, but also to direct undiscovered natural resources through comprehensive Exploration and Production (E&P) sector reforms.

The National Gas Pricing Reform package surpasses conventional modifications, with the objective of revitalizing sectors, promoting exports, and facilitating the transition to electrification.

Oil Sector Reforms

The focus of the Oil Sector Reforms is to restore investor confidence in refineries by offering policy-level assistance to existing players in the industry. The implementation of effective monitoring and regulation systems for Oil Marketing Companies (OMCs) is intended to effectively reduce fraudulent activities, while also prioritizing the adjustment of profit margins to ensure long-term sustainability.

Solarization Program

Incorporating the Solarization Program and the 1,320 MW Thar Coal Plant into the power sector reforms underscores the significance of diversification.

Implementation of anti-theft and recovery measures is important by the integration of technical interventions such as smart metering, transformer metering, and increasing enforcement density.

The effort to get long-term concessions for Distribution Companies (DISCOs) and the resolution of Circular Debt further demonstrates the sector’s dedication to achieving sustainable transformation.

Fertilizer Sector Reforms

The Fertilizer Sector Reforms aim to address the complex issues of standard pricing, encourage equitable competition, and guarantee farmers’ access to affordable fertilizers through targeted subsidies.

The focus must be on increasing domestic production demonstrates a dedication to decreasing budget shortfalls.

LNG/LPG Reforms

The reforms in the LNG/LPG sector are needed to effectively tackle the issue of managing winter load by implementing government-to-government initiatives and providing a detailed plan for meeting future gas demand.

The inclusion of Third-Party Access (TPA) provisions in free trade agreements further enhances the focus on transparency and efficiency.

Green Pakistan

The Green Pakistan Reforms were emphasized to prioritize addressing the issue of insufficient Foreign Direct Investment (FDI) in green and renewable initiatives. The emphasis on sustainable and innovative solutions is seen through the development of frameworks for green energy, particularly green hydrogen, and the establishment of laws for Electric Vehicle (EV) charging stations. Pakistan's focus on altering its energy landscape must be demonstrated by solarization initiatives.

6. Pakistan's External Account: Issues, Prospects, and Prescriptions

Mr. Sakib Sherani

Mr. Sakib Sherani presented a comprehensive critical analysis of Pakistan's economic challenges with a focus on the external balance of payments crisis.

He highlighted that for far too long, Pakistan's external account has been its Achilles heel, posing a persistent and unaddressed challenge.

Contrary to conventional wisdom and advice from the International Monetary Fund (IMF), the underlying issue is not purely fiscal but stems from structural faults.

The structural fault lines, including a small and undiversified export base, a flawed growth model, an over-valued exchange rate, inadequacies in tax policy, and IMF program design have exacerbated the predicament and increased Pakistan's reliance on imports, consequently constraining its capacity to attract foreign investment.

Therefore, Pakistan now stands at a critical juncture of mounting debt and persistent structural challenges that demand urgent attention and strategic interventions for a sustainable economy.

Pakistan's External Account Problem Rooted in Structural Issues

The speaker acknowledged that Pakistan's external account has always been a cause for concern, primarily due to the lack of an export-oriented growth strategy.

Unlike many developing countries, especially those that have successfully transitioned from low-income to middle-income status, Pakistan has not prioritized exports as a driver of economic growth.

Opposite to the "twin deficit" theory, which emphasizes the link between fiscal and external imbalances, Pakistan's external account problems are not primarily driven by fiscal deficits but rather stem from structural issues.

Three key structural factors that underpin Pakistan's external account challenges were identified by the speaker.

Firstly, a limited and undiversified export base makes the economy vulnerable to external shocks and hinders its ability to generate sufficient foreign exchange earnings.

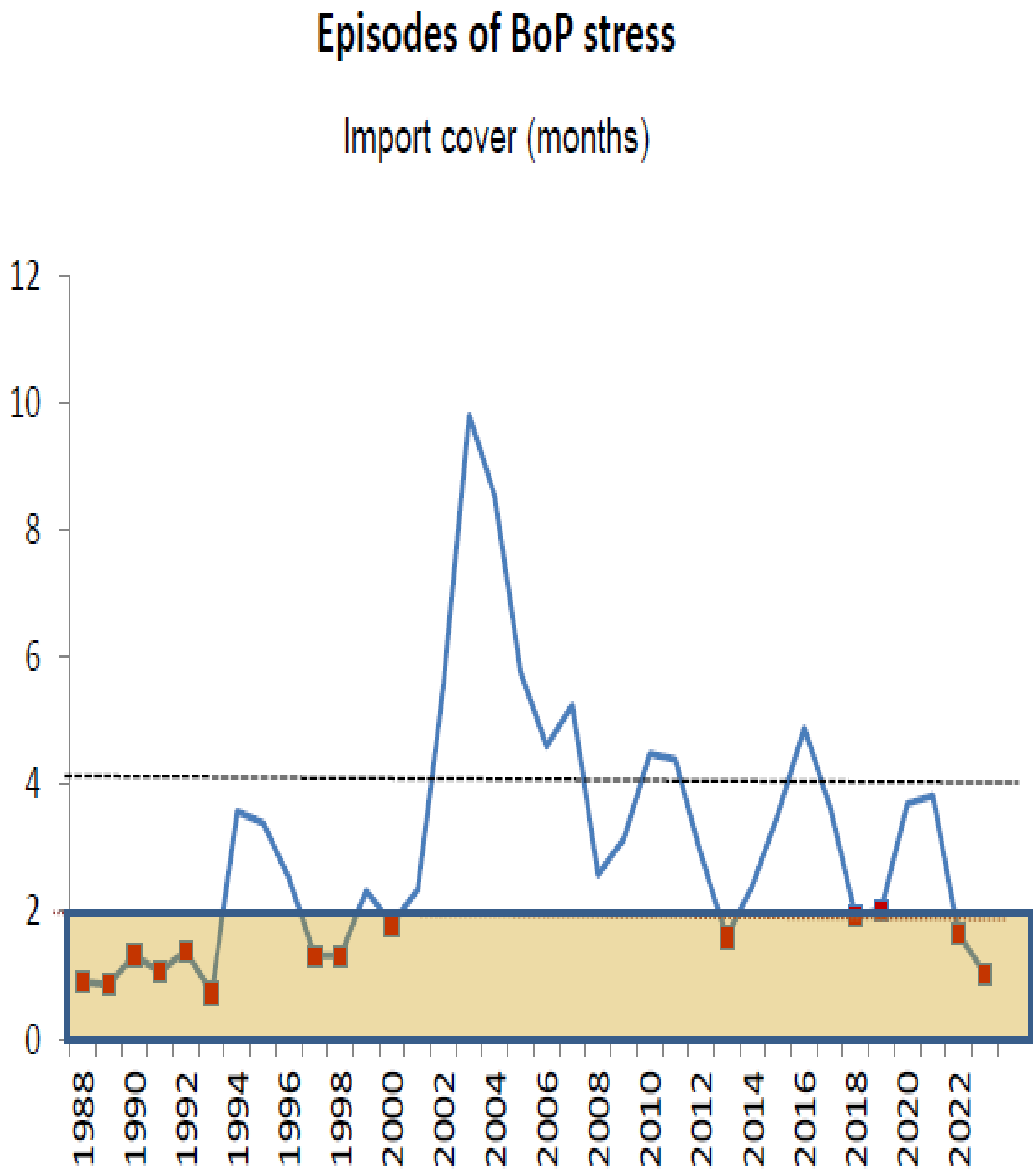
Secondly, the overvalued exchange rate policy has led to the misallocation of resources away from the tradable sector (exports) towards the non-tradable sector (domestic consumption) as this highly discourages exports and incentivizes imports.

Thirdly, structural dependence on imports owing to Pakistan's large and rapidly growing population, coupled with limited domestic energy and food production, creates dependence on imports and puts further pressure on the external account.

He underscored that these structural factors, combined with limited foreign direct investment (FDI), have contributed to the accumulation of external debt, pushing Pakistan towards a debt-trap situation.

Pakistan's Precarious Import Landscape and Lagging Export Growth

Figure 1[9]

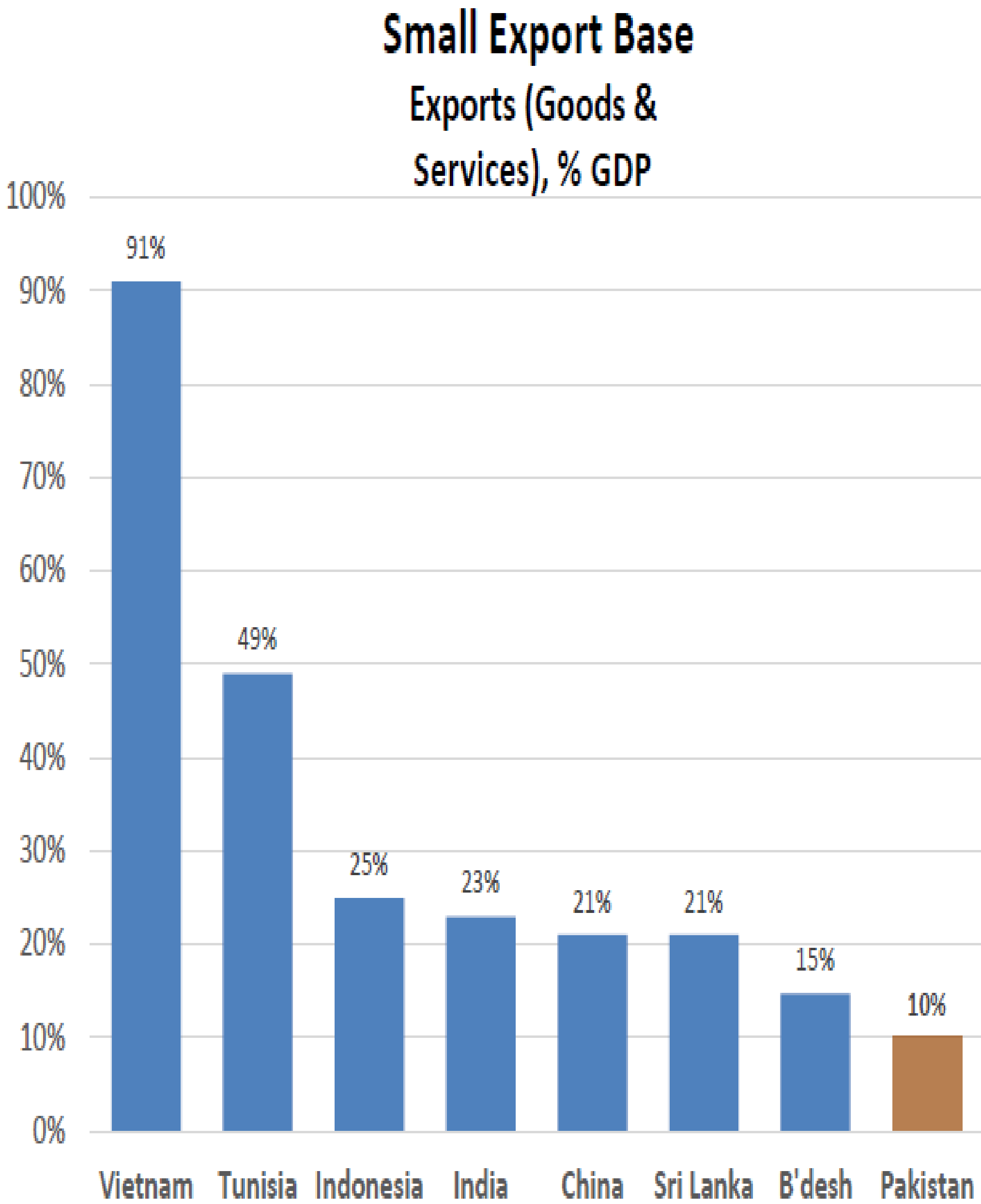


Source: SBP; Sakib Sherani

[9] The figures and tables in this section have been extracted from Mr. Sakib Sherani's presentation during the seminar.

The speaker noted that Pakistan's economic situation has been precarious for a long time, characterized by a concerningly low export base.

Figure 2



Source: World Bank

For decades, the country has functioned with import levels exceeding exports, teetering on the brink of default according to the two-month import cover rule.

Figure 3

Exports (Goods & Services)

	Exports (g&s) US$ bn:			Increase (x) from:	
Country	1990	2000	2022	1990	2000
Vietnam	2	17	384	165	23
China	51	257	3,714	73	14
India	23	61	779	34	13
Cambodia	...	2	20	...	11
Bangladesh	2	7	59	32	9
Turkey	20	53	350	17	7
Indonesia	28	68	323	11	5
Iran	17	24	111	7	5
Egypt	9	16	72	8	4
Pakistan	**6**	**10**	**40**	**6**	**4**
South Africa	27	37	136	5	4
Sri Lanka	2	6	16	7	3

Source: World Bank

The speaker drew a comparison of Pakistan’s limited export sector to more dynamic economies like Vietnam and India, whose export-to-GDP ratios have surged in recent years. Pakistan's export sector has fluctuated erratically, shrinking from a promising 11-12 percent of GDP to a meager 6 percent just a few years ago.

Even Bangladesh, once on par with Pakistan, has now doubled its export sector size, reaching 15 percent of GDP. The contrast becomes even starker when examining export growth across different countries.

Vietnam, the star performer, has skyrocketed its exports 23 times since 2000, while India and China follow closely behind. Pakistan, alongside Egypt, South Africa, and Sri Lanka, languishes at the bottom of the pack, showcasing stagnant export growth.

He further added, Pakistan's economic landscape shows extremely heavy reliance on a handful of products, primarily textiles.

This lack of diversification is evident in the "product space map," where green dots representing textiles dominate the low value-added zone.

This limited scope poses a significant challenge to Pakistan's industrialization and export aspirations. Getting stuck in this low value-added trap restricts the space for higher value-added products, hindering overall economic growth.

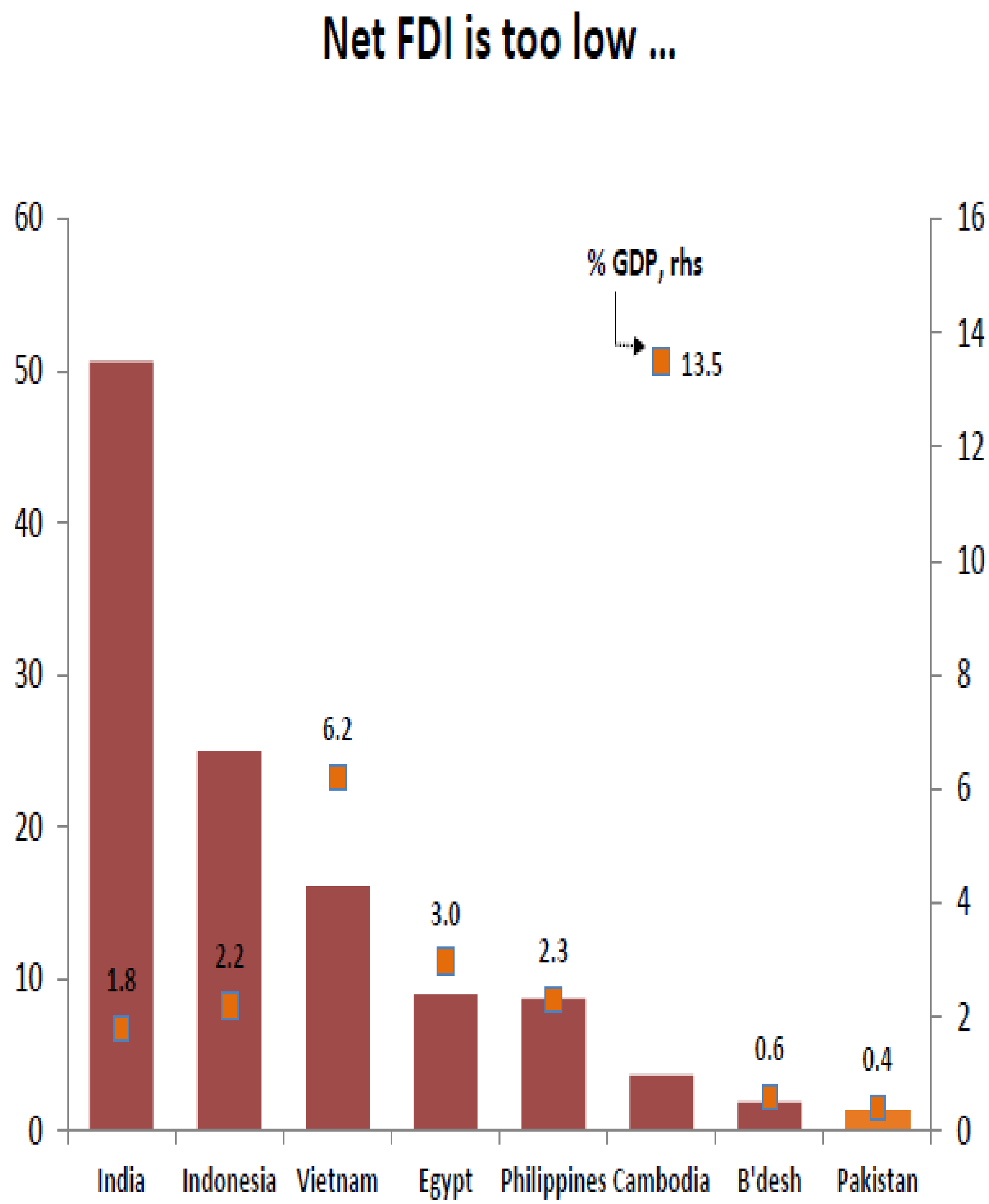
Further compounding the issue is Pakistan's high consumption levels coupled with a comparatively small production base. This imbalance results in significant import reliance, leading to low savings and consequently, low investment.

Mr. Sherani noted that financing this consumption-driven economy solely through exports or remittances proves insufficient.

Attracting foreign direct investment (FDI) becomes crucial, but here too, Pakistan is facing challenges.

Compared to Bangladesh, Pakistan receives only half the amount of FDI as a percentage of GDP, highlighting its struggle to tap into this vital source of external financing.

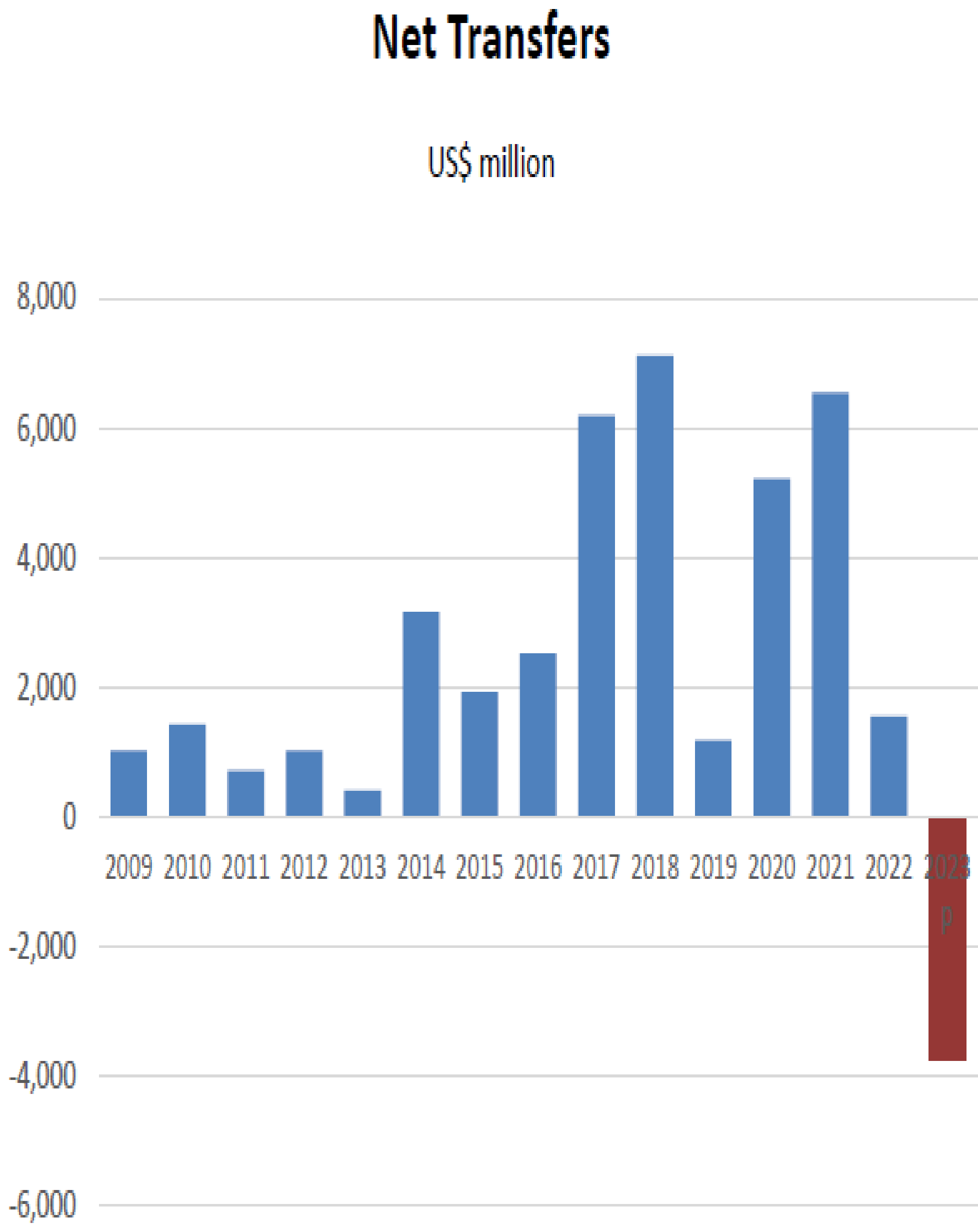
Figure 4



Source: World Bank; UNCTAD

The speaker expressed concerns about Pakistan's net transfers, another potential source of external funding which presents a dismal situation.

Figure 5



Source: Source: SBP

Historically, these transfers have fluctuated, occasionally turning positive, but as of 2023, the tide has turned negative.

Pakistan finds itself paying out more than it receives, adding to the strain on its currency and overall economic stability.

Figure 6

IMF Programs

Country	No. of IMF programs	Since (year)
India	7	1945
Bangladesh	12	1972
Sri Lanka	16	1950
Pakistan	**23**	**1958**

Source: IMF

This reliance on external support is further reflected in Pakistan's frequent visits to IMF.

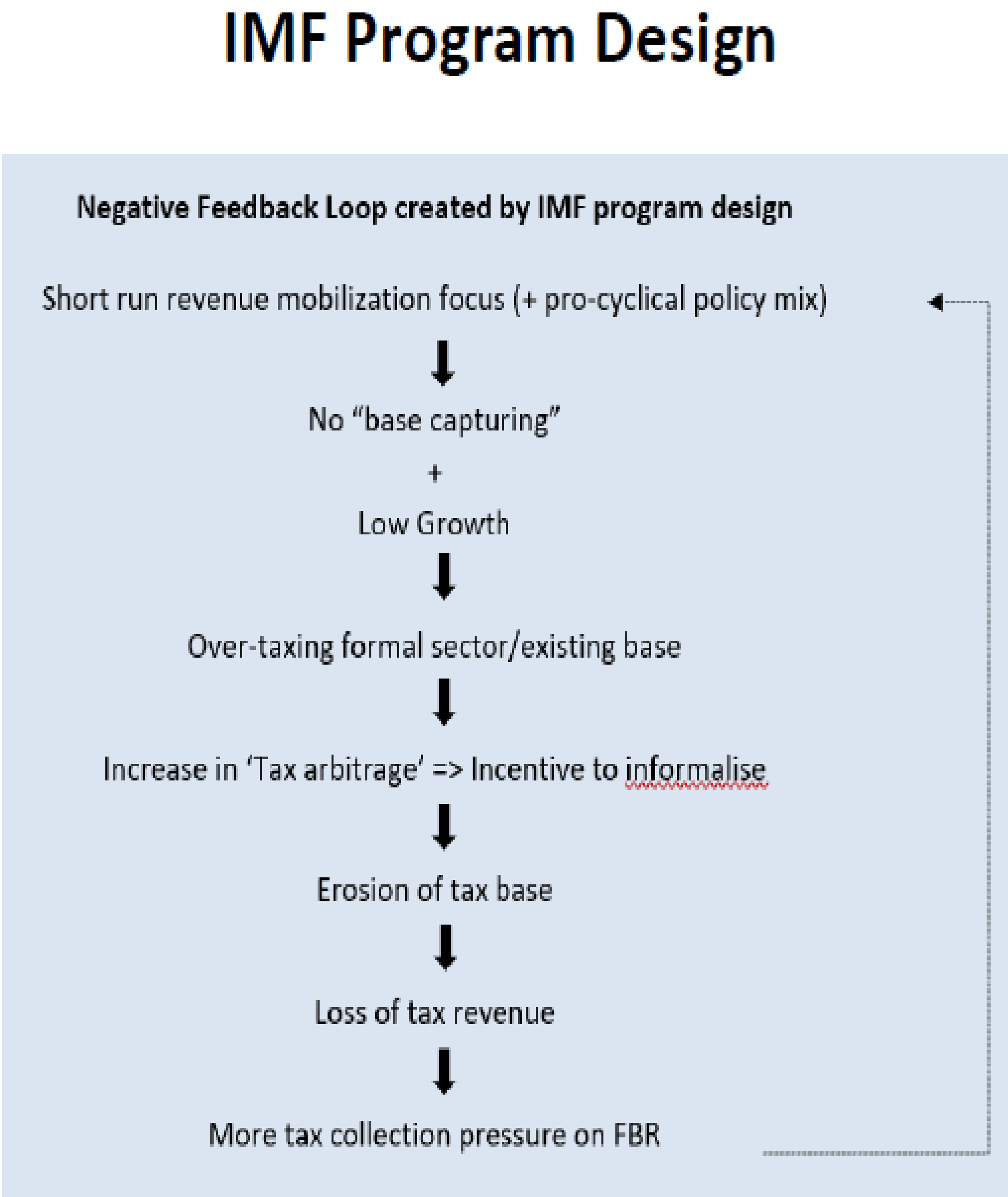
Only a handful of countries, namely Argentina and Egypt, share a similar track record of repeated IMF bailouts, showcasing the precariousness of Pakistan's external dependence.

IMF's Program Design and Stagnant Economic Growth

The speaker discussed the role of IMF program design and reminded the audience that the IMF operates within a complex landscape, often responding to urgent situations with readily available tools.

Figure 7

IMF Program Design



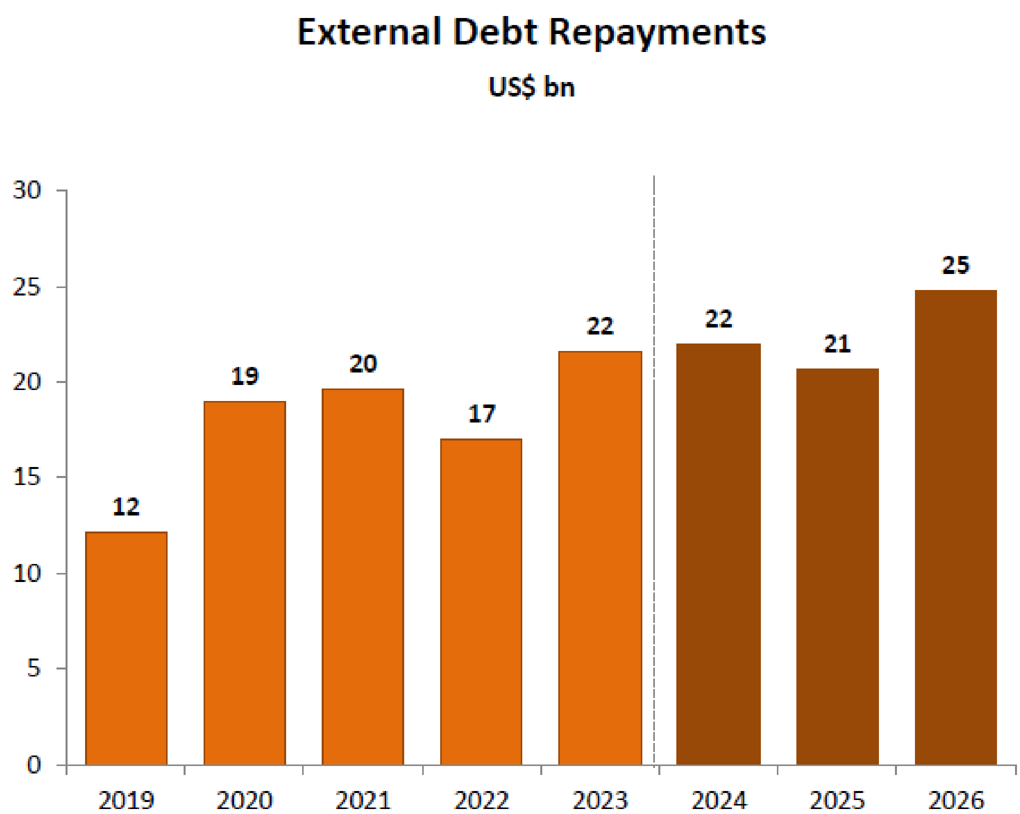
Source: Sakib Sherani

While these tools may bring temporary relief, the long-term impact on growth and development cannot be ignored. Pakistan's journey towards economic stability requires a nuanced approach that balances immediate needs with long-term aspirations.

The speaker accentuated the need for finding this balance, and potentially seeking alternative solutions that prioritize growth alongside stability, will be crucial for Pakistan to truly break free from the clutches of external dependence and chart its course towards economic prosperity.

IMF program is a vicious cycle- to raise revenue quickly, the IMF prescribes policies that reduce spending and raise taxes. It is a negative feedback loop, albeit an unintended one. The focus on austerity measures, primarily fiscal consolidation, can stifle investment and exports.

Figure 8



Source: IMF

Furthermore, the IMF's short-term focus on revenue mobilization can come at the expense of long-term development goals. Resources that could be directed towards expanding the tax base and strengthening institutions are instead used for immediate revenue generation.

This shortsighted approach leaves little room for crucial investments in infrastructure, education, and social safety nets, hindering Pakistan's potential for sustainable growth.

The speaker warned of dire consequences as stagnant growth, limited investment, and subdued exports, and its design inadvertently creates an environment that discourages risk-taking, innovation, and the very factors needed to break free from the cycle of dependence.

Pakistan's external financing needs are very significant for the foreseeable future. A pickup in foreign direct investment (FDI) inflows to cover the external financing gap is unlikely.

This means that Pakistan cannot rely on foreign investment to solve its financing problems. External debt re-profiling is required. This means that Pakistan may need to renegotiate the terms of its existing debts with its creditors.

While discussing the intricate challenges surrounding Pakistan’s tax collection system, the speaker emphasized that the burden of a depleted treasury does not fall on the elusive entities operating in the informal sector; rather, it disproportionately affects those who are already diligently adhering to tax regulations. In an economy grappling with sluggish growth, placing additional burdens on the formal sector only widens the divide between registered and unregistered entities.

At the heart of issues lies the ultimate tax battle: formal versus informal. The act of pressuring the compliant minority inadvertently creates a lucrative opportunity for the vast, untaxed majority. The allure of staying off the grid becomes irresistible, exacerbating the informal sector's growth and eroding the foundation of the formal economy.

The issue is compounded by a lack of effective communication. The divide between economic realities and policy decisions further strains the fragile trust between taxpayers and the authorities. When businesses feel penalized for their honesty, the appeal of informality becomes overwhelmingly attractive.

Strategies in External Financing for Debt Management

The speaker pinpointed the significance of External Financing (EF), he argued that EF needs are very significant in the coming years due to various reasons such as the need for investment in infrastructure, economic development, or to cover budgetary shortfalls. Additionally, debt rollovers, the process of refinancing existing debts, are crucial for maintaining the necessary financial support from external sources but EF is likely to face a high level of uncertainty and volatility due to global economic conditions, geopolitical factors, or other unpredictable events that may impact the availability or terms of external financing. Also, FDI is not expected to increase significantly to cover the external financing gap therefore, other sources of external financing will need to be explored, as FDI is not anticipated to be a major contributor. Debt re-profiling is required which involves renegotiating the terms of existing debt agreements, such as extending the maturity period, adjusting interest rates, or other modifications. This may be seen as a strategy to manage the external debt burden more effectively.

Way Forward

The speaker put forward the following recommendations:

1. External account will continue to face challenges in the medium term due to augmented debt repayments, precarious inflows, and geoeconomic fragmentation. For these and other related reasons, there are no quick fixes to economic recovery and stability. In fact, a back-to-basics approach should be adopted based on structural and institutional reform rather than unconventional structural and institutional experimentation.

2. The overall investment climate should be improved through concerted efforts for political and macroeconomic stability. Poor governance models that increase institutional sludge should be discarded. Normalizing good governance should be one of the highest priorities.

3. Negative externalities related to IMF program should be eliminated.

4. There is an urgent and a dire need to reinvigorate CPEC and focus on its comprehensive development as it has the potential to embed Pakistani exposed-based firms into regional and possibly global value chains and production networks. In addition, SEZs should be established and prioritized in the hierarchy of export-oriented industrial clusters. A 21st century industrial policy, characterized by regional science, technology, and innovation development and human capital formation centered on skill acquisition and learning design, needs to be embedded into the national export strategy.

7. Fiscal and Tax Reforms in Pakistan

Dr. Ather Maqsood Ahmed

Dr. Ather Maqsood Ahmed, while presenting a thoughtful analysis of fiscal and tax reforms in Pakistan, stressed upon achieving well-diversified high and sustained growth of more than 7 percent for ten years in commodity-producing sectors, namely agriculture and industrial, as well as in the services sectors to stabilize the economy of Pakistan. He also focused on ensuring macroeconomic and financial stability, with economic fundamentals remaining strong, including price and exchange rate stability and low unemployment along with the aim for the sustainability of macro imbalances, such as fiscal and trade deficits, and manage the debt burden effectively.

Broad Action Plan

Dr. Ahmed highlighted the objective of achieving sustainable growth that requires an improvement in productivity, can be attained through the accumulation of technologically advanced physical capital. This involves massive investments in human capital through education and skill development, coupled with efforts to enhance international competitiveness, ensuring institutional strength and better governance.

Moreover, the system's shock-absorbing capacity needs enhancement and extreme volatility needs to be minimized to guarantee stability. However, current macro indicators reflect concerning trends i.e., growth is slowing down, unemployment is rising, and inflation has reached double digits. Imports and exports are stagnant, resulting in a trade deficit, current account deficit, fiscal deficit, primary deficit, and an increasing burden of debt.

Dr. Ahmed, during his talk, compared Pakistan's growth rate with competitor states, encompassing Bangladesh, Sri Lanka, India, Indonesia, Malaysia, Philippines, Thailand, and Turkey, highlighting their average growth rate from the 1960s to 2017. In 1960, these states were growing at an average rate of 5.14 percent, whereas Pakistan's growth rate was 6.80 percent.

However, by 2017, they were growing at a rate of 5.68 percent, while Pakistan's growth rate had declined to 4.47 percent. This calls for a comprehensive action plan to address the economic challenges and enhance Pakistan's competitive position.

Fiscal Sector Management

Dr. Ahmed highlighted four key areas for fiscal sector management, each critical for the effective functioning of the financial apparatus.

He said that it involves resource mobilization through tax and non-tax receipts at both the federal and provincial levels. All activities in this domain are of a statutory nature, adhering to established legal frameworks.

It further encompasses the estimation, execution, and monitoring of both current and development expenditures across all levels of government, including federal, provincial, and local tiers aiming to ensure effective allocation and utilization of financial resources.

Besides, it focuses on maintaining fiscal and debt sustainability that intends to strike a balance between revenue generation and expenditure, preventing undue financial burdens on the economy and the development and adherence to a clear plan for reducing the overall debt burden.

Moreover, it encompasses the formulation of a well-defined exit strategy to gradually decrease reliance on borrowing and promote fiscal stability over time.

Nevertheless, a robust fiscal sector management framework is essential for the prudent and sustainable handling of financial resources, contributing to the overall economic health and stability of a nation.

Fiscal Policy Position

Dr. Ahmed compared government's stance and actual situation during his talk. According to the government's viewpoint, the essence of fiscal efforts is to sustain macroeconomic stability in the country while ensuring a conducive environment for economic growth along with an effort to reduce fiscal deficit through improvement in tax collection, reduction in debt servicing, and generating surpluses by provincial governments.

He added that the actual situation consists of inadequate resource mobilization at federal and provincial levels and inflexibility over expenditure heads (debt servicing, subsidies, security related expenses, salaries and perks of public sector employees), resulting in ballooning deficit leading to unsustainable domestic and external debt position with no apparent debt exit strategy.

Federal-Level Fiscal Issues

Structural concerns of Federal Taxation System

Dr. Ahmed underscored the structural concerns within the taxation system at federal level, including:

Corporate compliance is at only 45 percent, signifying that 55 percent of corporations registered with the Securities and Exchange Commission of Pakistan (SECP) do not file tax returns. Within this 45 percent, 60 percent declare zero income or business losses.

Among the remaining 40 percent, 80 percent report only marginal income, barely exceeding the basic threshold level. Notably, the income attributed to the CEO of the corporation, as per the tax files, is calculated to be no more than Rs 16,000, a figure deemed inaccurate and misleading.

Besides, there is a heavy reliance on withholding taxes, constituting 65 percent of indirect taxes. Withholding taxes are categorized into two types: one is adjustable and refundable, while the other is a final payment and falls under the classification of indirect tax.

The fact that 65 percent of withholding taxes are categorized as indirect taxes is noteworthy. Indirect taxes place a burden on the final consumers, predominantly affecting the poor. This design of taxation is inherently regressive, posing as anti-poor rather than pro-poor.

Moreover, the effective rate of GST is exceptionally low despite the statutory rate being 17 percent. A discriminatory practice exists in the tax system concerning filers and non-filers. Also, imposition of additional custom duties and regulatory duties lacks adherence to tariff rationalization principles.

The prevailing system imposes higher duties on fine goods, contrary to the ideal approach of levying higher duties on luxury items and lower duties on essential goods.

There is a need to counter the challenges and burden faced by FBR as it appears to solely focus on the revenue collection and is somehow lacking to calculate the impact faced by industries and small businesses.

Dr. Ahmed pointed out the disconnect between economy and taxation, evident in the mismatch between the composition of GDP and the sectoral contribution of taxes.

Notably, the largest textile sector in the country indicates negative income tax, essentially operating on subsidies. Similarly, in the sugar sector, with the presence of influential entities, only 1 percent tax contribution is observed, reflecting potential issues of tax evasion or irregularities within the sector.

Likewise, the system grapples with refund pendency, a plethora of frivolous litigation cases, and a primitive tax administration focused solely on meeting tax targets without research-based initiatives. The reversal of reforms and a discriminatory approach further undermine the principles of fairness, equity, and efficiency.

The technology arm, Pakistan Revenue Automation Limited (PRAL), is considered incompetent, adding to the challenges faced by the fiscal sector in Pakistan.

Addressing these multifaceted issues is crucial for achieving fiscal stability, fairness, and sustainable economic growth in the country.

Sub-National Fiscal Issues and Need for Reforms

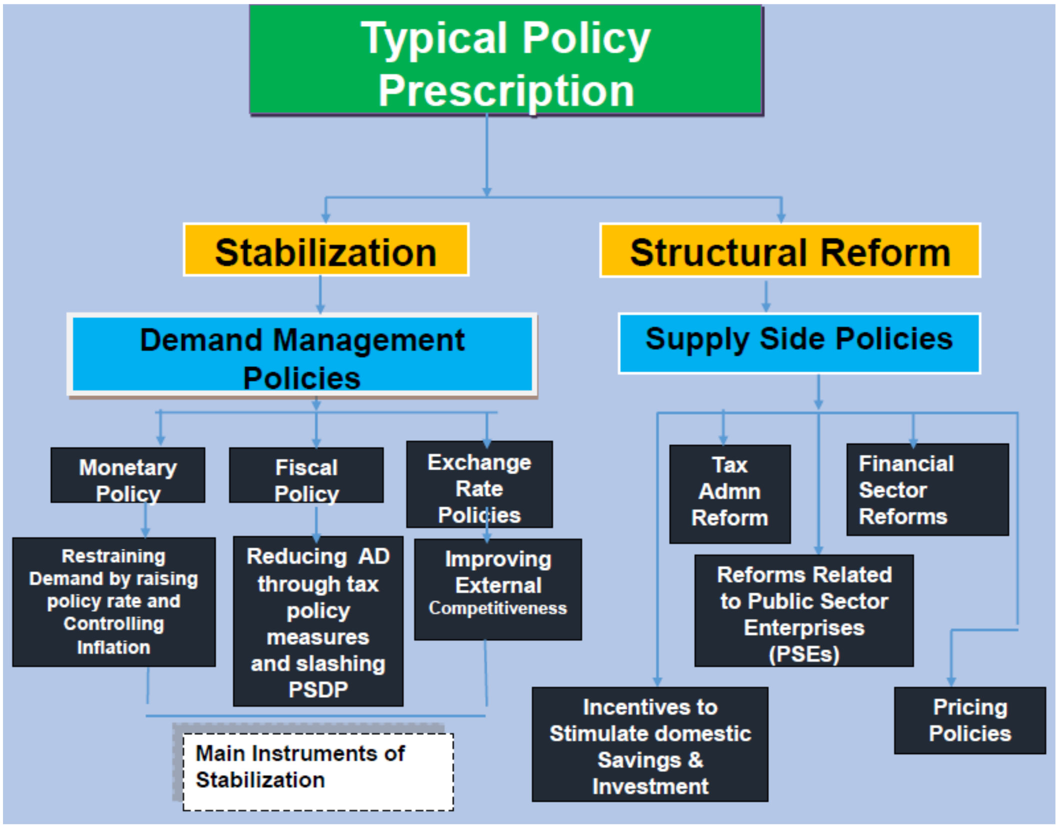
The provincial taxation structure in Pakistan encounters several challenges that necessitate reforms. These issues include the absence of capacity development at the local level, resulting in weak tax administration.

The tax base is narrow due to prevalent exemptions and concessions, compounded by political economy issues and encroachment on the tax base.

The provinces exhibit a high reliance on transfers through the National Finance Commission (NFC), with own-source revenues contributing inadequately. Additionally, the multiplicity of taxes and tax offices (Board of Revenue, Excise and Taxation Office, Revenue Authority) leads to high compliance costs. A leader-follower approach prevails due to capacity constraints.

Addressing these challenges requires both short- and long-term measures, implemented effectively, to ensure a more robust and efficient provincial fiscal system in Pakistan.

Figure 1[10]



Optimism versus Risks

The fiscal landscape in Pakistan presents a dual outlook of optimism and risks. On the risk side, the greatest concerns stem from a low tax base, where a substantial portion (25 percent) is derived from petroleum, and 80 percent of total tax receipts originate from only ten commodities, posing vulnerability to market fluctuations. The expansive government footprint, marked by 43 divisions, 400 attached departments, and a considerable workforce of 1,170 thousand employees, adds to the risks. Additionally, the country grapples with an escalating debt burden, accounting for 87 percent of the GDP, and an alarmingly high fiscal deficit nearing 10 percent of GDP. The unpredictability of price and exchange rates, susceptible to speculators' attacks, along with inadequate foreign exchange earning capacity, further

[10] This figure has been extracted from Dr. Ather Maqsood Ahmed's presentation during the seminar.

heightens the risks. De-industrialization and unemployment present additional challenges.

However, amidst these risks, a sense of optimism arises from recent economic performance indicators, including notable improvements in tax collection, currency stability, and other positive trends observed over the last few months. Despite this optimism, the sustainability of these positive developments remains a crucial consideration, warranting continued scrutiny and strategic planning for the fiscal future of Pakistan.

Way Forward

Dr. Ahmed stressed for a critical examination of past reforms in order to analyze further challenges; Tax Policy and Administration Reforms from 1988 to 2002, which started yielding dividends but were subsequently rolled back. He said that an honest review is imperative to understand the reasons behind this rollback and whether reinventing the wheel is a viable approach.

Furthermore, the devolution process initiated by the 18th Amendment needs to be fully implemented, with all ministries that should have been devolved adhering to this transition. Reducing duplicity of institutions and supra-institutions is crucial to streamline governance and minimize the federal government's footprint.

He stressed that the roles of regulatory bodies should be reassessed, particularly in terms of collaboration with rent-seekers, ensuring that their actions directly benefit consumers. The splitting of WAPDA into separate entities like GENCOs and DISCOs has raised efficiency concerns and added burdens on consumers, prompting a policy review.

Addressing inefficiencies in State-Owned Enterprises (SOEs) is essential, with a focus on removing board members from various ministries who hinder necessary changes due to conflicts of interest. Additionally, debt management offices must undergo reforms to ensure professionalism and prevent them from becoming debt stuffing organizations.

A fast-track digitization process for the financial and real sectors of the economy is crucial to address governance issues effectively. This forward-looking approach emphasizes the need for comprehensive reforms and critical evaluations to enhance efficiency and governance in Pakistan's economic landscape.

Dr. Ahmed emphasized that tax collection should be viewed as a by-product of a flourishing economy. In essence, a prosperous economy inherently generates sufficient resources, contributing to seamless economic management. The emphasis here is on fostering economic growth, as a robust and thriving economic landscape naturally results in increased tax revenue. Therefore, the strategic focus should be on promoting and sustaining economic growth, as it serves as the foundation for a self-sufficient and well-managed economy.

8. Political Instability and Its Effects on Economy

Dr. Muhammad Khan

Dr. Muhammad Khan highlighted the contours of political instability and its effects on the economy. He said that political stability is the precursor to economic stability and development in any country and the same holds true for Pakistan whereas political instability is the precursor to economic instability, abject poverty and social unrest which what is happening in the country.

Broad Contours of Political Instability

Dr. Khan, while presenting the contours of political instability, highlighted that the propensity for regime or government change has been a pervasive and enduring phenomenon, constituting a continuous process since the 1990s, characterized by a dynamic interplay of political, social, and economic factors. He said that the incidence of political upheaval and violence in society underscores the intricate nexus between various socio-political forces, reflecting a complex interplay of grievances, power dynamics, and historical contexts that contribute to the manifestation of unrest and conflict within the political landscape. He further added that the instabilities in the policies of governments manifest as a persistent challenge, marked by fluctuations and uncertainties that not only impact the effectiveness of governance but also have far-reaching implications for socio-economic development and the overall stability of the political system.

What Makes Up Political Instability?

Political instability is considered a significant malaise by economists, posing detrimental effects on economic performance. This phenomenon constrains policymakers' choices, resulting in the adoption of sub-optimal short-term macroeconomic policies. Moreover, it often engenders a heightened frequency of policy shifts, thereby introducing volatility into the political landscape, with adverse repercussions on macroeconomic performance. This frequent reliance on short-term policies, characterized by day-to-day decision-making, contrasts with the adoption of enduring long-term policies that have the potential to bestow political stability and foster economic prosperity within a nation.

Forms of Political Instability

Political instability takes various forms, each contributing to the challenges faced by nations:

1. Political Polarization among political parties has persisted for decades, creating divisions that hinder effective governance and constructive dialogue.
2. The polarization of the parliament contributes significantly to political instability, as a lack of consensus on issues of national interest and policy formulation impedes viable solutions for poverty and economic crises.
3. Coalition governments are often seen as a failed model, marked by inherent complexities that undermine the efficiency and stability of the political system.
4. The uncertainty of voters introduces unpredictability into political decision-making processes, complicating the overall political landscape.

5. Governance issues, including problems related to transparency, accountability, and effective administration, contribute to political instability by eroding public trust.
6. The frequency of government changes and frequent external interferences disrupt policy continuity, creating an environment of instability that hampers sustainable socio-economic development.

Features of Political Stability

Dr. Khan emphasized that the cornerstone for attaining sustained economic growth in a nation is a robust and unwavering political structure. A steadfast political authority plays a pivotal role in dispelling uncertainties within the state, paving the way for a conducive environment for economic stability. The symbiotic relationship between a stable political foundation and economic growth is evident, as a resolute policy framework provides the necessary support for fostering and sustaining economic stability. Conversely, an unstable political structure emerges as a detrimental factor, posing significant threats to economic stability, a reality that holds true not only globally but also within the specific context of Pakistan.

Factors Contributing towards Political Instability

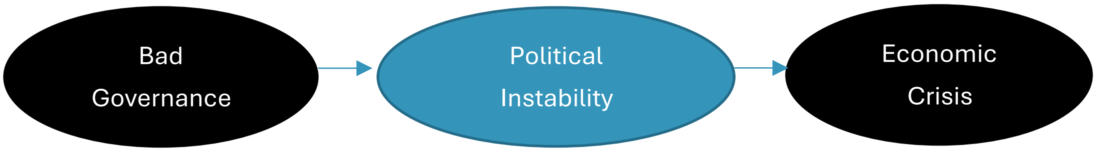
Political instability can be attributed to several contributing factors, including the precarious nature of governments marked by frequent changes or instability. The inefficacy and internal discord within political parties can hinder their ability to provide coherent and effective governance.

The fragility of political ethnicity, coupled with corruption, serves as a potent destabilizing force, eroding public trust and undermining the legitimacy of political processes. Inadequate governance practices, characterized by a lack of transparency, accountability, and responsiveness to the needs of the population, contribute to an environment of political instability.

Dr. Khan, after developing the linkage between governance, instability, and economic crises underlined that lack of good governance is the real issue contributing to political instability and the resultant impacts on the economy.

Figure 1[11]

Linkage between Governance, Instability, and Economic Crisis



Governance comprises all of the processes of governing undertaken by the government of a state through various means. Good governance is a way of measuring how public institutions conduct public affairs and manage public resources in an efficient manner. The concept of good governance emerges as a model to compare ineffective economies or political bodies with viable economies and political bodies. Good governance includes participation, consensus, orientation, accountability, transparency, responsiveness, effectiveness, efficiency, equitability, and the rule of law. On the other hand, bad governance is the unfavorable relationship between those who govern and the ones being governed. What makes governance of any society bad hangs on two-legged established beliefs: the government and/or laws rewarding practices that are unjust and unfair to all and lack of accountability of those breaking laws and causing unrest in the country.

Consequences of Political Instability

Consequences of these factors are even more dangerous for a multi-ethnic society like Pakistan. Political stability is indispensable for building a nation, whereas political instability can lead to chaos, civil unrest, and government collapse. It could result in conflicts and competition between political forces, leading to economic variables such as inflation, unemployment, low GDP, and low per capita growth interconnected factors that contribute to an adverse economic environment. The

[11] This figure has been extracted from Dr. Mohammad Khan's presentation during the seminar.

uncertainty associated with political instability tends to reduce investment, especially foreign direct investment, thereby impeding economic development.

Dr. Khan added that economic stagnation is strongly correlated with the political stability of a country, as political economists view instability as detrimental to the economic downfall of a state. Political instability necessitates changes in economic policies, often resulting in poor economic performance. The uncertainties in politics translate into economic uncertainties, prompting industrialists and the business class to avoid investing in politically unstable environments.

A strong political government can mitigate uncertainty through robust policies that support stable economic growth. The unstable political structure is undoubtedly the most critical factor affecting economic stability, as uncertainties in politics remain a primary concern for industrialists and businessmen who seek clarity and minimal future uncertainties for their investments.

Case Study of Nigeria

Dr. Khan, while examining the case study of Nigeria, stressed that despite having vast natural and hydrocarbon resources, Nigeria has grappled with severe political instability, coupled with high-level corruption, bad governance, and a recurring legitimacy crisis. Consequently, national development has been stunted, and the political environment remains uncertain. In addition to this, the leadership of the state has faced a legitimacy crisis, entangled in political intrigues within an ethnically differentiated polity. Political actors have consistently manipulated both the populace and political processes to further their self-serving agendas, leaving society pauperized, and the citizens mired in abject poverty.

Therefore, the loss of faith in political leaders and the political system has become evident among the populace. Presently, this hydrocarbon-rich state is confronted with serious economic crises, a direct consequence of the prevailing political chaos. The case of Nigeria serves as a poignant illustration of how political instability, corruption, and a legitimacy crisis can impede economic progress and adversely impact the well-being of a nation.

Where Do We Stand Today?

As a nation, we find ourselves at a critical juncture where introspection about our trajectory and destiny is imperative. Short-term measures, akin to patchwork, offer temporary relief but fall short as permanent solutions for restoring the economy.

The prevailing conditions paint a bleak picture. There is a storm of inflation and abject poverty, compounded by an unjust distribution of resources. These factors collectively push people toward despair and uncertainty, resulting in societal unrest. These further drive society towards intolerance and extremism while sowing the seeds of hatred, directly affecting the political environment of the state.

Dr. Khan stressed that there is a critical need to acknowledge that these challenges are due to bad governance, political instability, poor economic management, and widespread socio-economic and socio-political deprivations. The geostrategic location of Pakistan further amplifies its vulnerability to foreign interferences making the situation worse. In light of these circumstances, a collective and thoughtful approach is imperative to address the root causes and pave the way for sustainable development and stability.

The Way Forward

Dr. Khan stated that the way forward necessitates embracing a statesmanship approach in dealing with the political and economic affairs of Pakistan. Statesmanship calls for prioritizing the well-being and prosperity of the nation, state, and the masses above partisanship or ideological affiliations. The focus should shift towards ensuring long-term political stability and economic health through foresight and a strategically envisioned approach.

Besides, the political parties need to reconsider and reorient their preferences by developing strategies that nurture the political and economic strength of Pakistan. Alongside political consensus, the formulation of an Economic Charter with clear economic strategies for development is crucial. Moreover, there should be political and institutional consensus on issues of national interest without biases. A better governance system needs to be envisaged for efficient public service, creating better working conditions for investors and the masses. Peaceful settlements of political and social issues through consultation are essential.

Furthermore, Dr. Khan stressed on reforming the judicial system for the timely disbursement of justice is vital. Framing a better government system for functional and sustainable economic development is necessary. There is a dire need to build trust among state, society, political forces, and institutions is fundamental.

The speaker highlighted Pakistan, being a sovereign state, is not a battleground for proxies of any other country. Therefore, a sustainable economy in Pakistan will contribute to the decline of extremism, militancy, and extortion, fostering a more secure and stable environment.

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