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Debt Ridden and Deficit Afflicted Economic Turmoil of Pakistan

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***Abstract*: Pakistan economy lost out steam during pandemic turbulence. The total external debt burden of Pakistan reached excessive high. As per IMF data of February 2022, current account deficit of Pakistan increased substantially, inflation remained stubbornly high and local currency rupee weakened significantly. As export prospect dimmed in 2020, current account deficit aggrandized in the wake of strong import demand. Import bill went spiraling high amidst hike in global commodity prices although export growth remained meagre for the south Asian nation. Annual growth rate of Pakistan was on declining trend since 2018 and aggravated further during COVID inflicted period when economy registered negative growth rate. Unemployment level remained intractably high and poverty became pervasive. Pakistan appealed IMF since 2019 to provide much needed funds which would be 22nd assistance from the same institution to bail out dwindling economy. Indebtedness to China on account of financing infrastructural project and Afghanistan refugee influx after Taliban reoccupation further added worry and stress to beleaguered nation.**

***Keywords*: Currency depreciation, Debt burden, Dwindling foreign reserve, Economic downturn, Inflationary pressure, Policy failure, Soaring deficit.**

1. Introduction

Pakistan is one of the prominent nations of south Asia. Pakistan, a Muslim-majority country that arose from the partition of the Indian subcontinent in 1947, witnessed both domestic and regional political upheavals. The location of Pakistan was regarded as Indus valley civilization in prehistoric time. The main religion, Islam, was adopted around 711. The country was annexed by the Mogul Empire in 1526, which governed the Indian subcontinent from the 16th to the mid-18th centuries. Around 1857, the British had established themselves as the region's domineering force. The Muslim minority's discontent rose as Hindus gained the majority of economic, social, and political benefits, culminating to Mohammed Ali Jinnah's founding of the nationalist Muslim League in 1906. While Hindu nationalist leaders Nehru and Gandhi refused to assist Britain during WWII, the league did. Jinnah expected British assistance for Muslim autonomy in exchange for the league's support for Britain. In August 1947, Britain consented to the creation of Pakistan as a distinct Commonwealth dominion, a sad setback to India's goal of an undivided subcontinent. Jinnah rose to the position of governor-general. The religious separation of Pakistan and India led in the biggest exodus in human history, with 17 million people fleeing across the borders in both directions to avoid sectarian bloodshed. First war broke out in 1948 against India over territorial dispute of Kashmir region. Pakistan battled for political stability and long-term socioeconomic development throughout its history. Its capital, Islamabad, is located in the northern slopes of the Himalayas, while its largest city, Karachi, is located in the south on the Arabian Sea coast. East Pakistan which was huge delta of the Ganges-Brahmaputra river system stretched more than 1,000 miles to the east. East Pakistan was declared the independent county and christened as Bangladesh in 1971 as a result of serious internal political difficulties that culminated in civil war in which India supported Bangladesh Liberation Movement strategically and with military force. In 1947-48, 1965, and 1999, India and Pakistan clashed two wars and a short combat over the disputed Kashmir area. Bilateral relations between India and Pakistan eased in the mid-2000s, but have been turbulent since the Mumbai attacks in November 2008, and have been deteriorated further by strikes in India by insurgents alleged of being based in Pakistan. Pakistan has suffered from decades of internal political strife and low levels of international investment, resulting in economic stagnation. There is a sizable English-speaking community in Pakistan. Investors have been discouraged by a unfavourable security situation, electrical shortages, and a taxing investment atmosphere. Agriculture generates one-fifth of total production and employs two-fifths of the workforce. Pakistan's export revenues are dominated by textiles and clothing, and the country's incapacity to diversify its exports has left it exposed to global demand fluctuations.

2. Historical Background of Current Economic Depression

Pakistan economy went through several restructuring since nation was formed. Pakistan sustained as mixed economy, with state-owned firms accounted for a major share of the country's GDP. Nation dealt several experimentations of economic modelling. The significant part of Pakistan economy was privately run till nationalization drive started in early 1970s and sectors like manufacturing, financial services and transportation

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got nationalised. In the 1980s, during Zia ul- Haq's military regime, more modifications were enacted. In particular, an "Islamic" economy was established, which prohibited behaviours disallowed by Shariah (Muslim law), such as collecting interest on loans (rib), and imposed traditional religious obligations like as zakt (tithe) and ushr (sacrifice) (land tax). Though certain aspects of the Islamic economy continued to exist, the state commenced privatising substantial areas of the nationalised economy in the 1990s, in whole or in part. The economy, which was mostly agrarian when the country gained independence, tried to diversify to some extent. Agriculture, which is no longer the major sector, accounts for around a fifth of GDP, while manufacturing accounts for about a sixth. Trade and services, which together make up the major part of the economy, had expanded significantly. In terms of economic structure, Pakistan is more like the middle-income nations of East and Southeast Asia than the impoverished Indian subcontinent countries. Pakistan's economic performance remained superior than that of many other developing countries; since independence, the country maintained a consistent yearly growth rate. At the same time, the population had been rising rapidly, therefore despite real economic development, production per capita had only increased slightly. However, Pakistan's modest increase in per capita income had not associated with a high prevalence of absolute poverty, which is far lower than in other South Asian nations. Despite this, a large section of the population lives in destitute, and the relative wealth of the industrialised districts surrounding Karachi and Lahore contrasts strongly with the poverty of the Punjab's barani areas, semiarid Balochistan, and Khyber Pakhtunkhwa. Pakistan has a rather well-developed financial services system. The State Bank of Pakistan, commenced in 1948, implements official monetary and credit policies, including exchange restrictions, and works as a banker to the national and provincial governments. It is the exclusive issuer of currency (the Pakistani rupee), as well as the protector of the country's gold and foreign exchange reserves.

3. The Gravity of Pakistan Economic Crisis

Pakistan’s economy went into in rough terrain before pandemic troubled the nation. Macroeconomic data doesn’t show any convincing progress. According to the World Bank, Pakistan's annual economic expansion in calendar year 2018 was 5.8%, but it decreased to 0.99 percent a year later and to 0.53 percent in 2020. This has resulted in a current account deficit over a specified period, which represents the difference between a country's import and export of goods and services, as well as net transfers such as foreign aid. Current account balance was under stress for last couple of years as value of import superseded value of export. Pakistan had been viewed as one of the least open economies of the world. Its current account deficit was -4.8% of GDP in 2019 and reached -1.7 percent in 2020. Due to trade imbalances and foreign exchange shortages, the government had been forced to impose import restrictions and give financial incentives to encourage export commerce. Machinery, chemicals and chemical products, crude oil, refined petroleum, food and edible oils, and motor cars are all major imports. The United States, the United Arab Emirates, Saudi Arabia, Afghanistan, and China are Pakistan's most major commercial partners. Trade developed to become one of the most important areas of the Pakistan’s economy, employing a large section of the workers. Despite a tendency toward more exports, the country maintained a chronic yearly trade imbalance, with imports frequently outpacing exports. The makeup of international commerce had changed intensely with passage of time. While the share of overall exports from primary commodities, such as raw cotton, had decreased, the share of manufactures climbed drastically. However, cotton commodities made up the majority of manufactured goods entering the export sector, implying that Pakistan remained reliant on its top cash crop as ever. The following diagrams would be able to decipher economic weakness precisely.

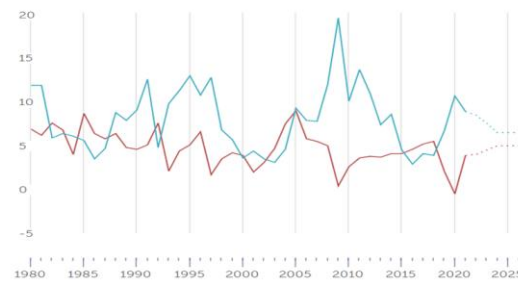

Fig. 1. Real GDP growth rate (Annual percent change) and inflation rate (Annual percent change)
Source: IMF Data Mapper, Country Data- Pakistan, October 2021

In the above diagram, real GDP growth rate is depicted in red line and annual percent change of inflation is graphed in blue. The real GDP growth rate in annual percentage term showed a downward trend during pandemic ridden year. Real GDP growth rate on annual percentage term reduced to 2.1 percent in 2020 from 5.2 percent in 2019. Inflation had been riding high in last couple of years. Persistent inflation weakened local currency and reduced purchasing power. It affected household budget adversely and incidence of poverty went higher during pandemic driven uncertainty.

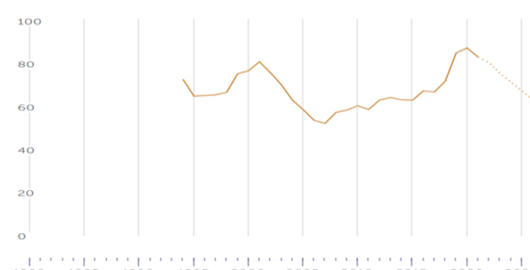

Fig. 2. General government gross debt (Percent of GDP)
Source: IMF Data Mapper, Country Data- Pakistan, October 2021

The above diagram illustrated rising gross government debt since 2007 which spiked high since 2015. General government gross debt was 63.3 percent of GDP in 2015 and escalated to 87.6 percent in 2020. Despite attempts to reduce the deficit, the deficit is expected to remain high in financial year 2022, at 7.0 percent of GDP, and predicted to increase to 7.1 percent in financial year 2023 as a result of pre-election expenditure. The top individual income tax rate remained 35%, while the top corporation tax rate had been lowered to 29%. The entire tax burden was 11.4 percent of gross domestic product. Over the last three years, government expenditure had averaged 22.3 percent of total production (GDP), with budget deficits averaging 7.8 percent of GDP. The implementation of essential revenue-enhancing changes, notably the harmonisation of the General Sales Tax, would help to reduce the budget deficit over time. In the medium run, Pakistan's public debt would remain high, so also its vulnerability to debt-related shocks. There had been delay in IMF- Extended Fund Facility programme in absence of convincing structural reform program. There are ten preferential trade agreements in place in Pakistan. There are 83 nontariff measures in place, with a trade-weighted average tariff rate of 9.6%. Economic dynamism continued to be hampered by the government's persistent intervention in sectors and an unproductive investment environment. Although private banks account for the bulk of commercial banks, the banking system remained subject to government intercession.

4. Discussion

As per world bank data of 2022, Pakistan economic Gross Domestic Product reached $262 billion. Pakistan’s GDP in nominal per capita ranked 48 as on January 2022 and GDP per capita in purchasing power parity held 24th rank at the same time. In pandemic ridden time inflation reached record high and registered 9.7 percent in January 2022. Foreign debt ballooned up and reached the $286 billion which exceeded GDP value of the economy. Foreign exchange reserve plummeted sharply to $14.4 billion which didn’t appear adequate to finance import bill and service burgeoning debt obligations. Due to an increase in the volume of energy and non-energy goods imported, the Current Account deficit for the July-December financial year 2021-22 was $ 9.1 billion (5.7 percent of GDP). Furthermore, growing worldwide commodity costs, particularly for oil, COVID-19 vaccines, food, and metals, exerted additional pressure on import bills. During July-December financial year 2021-22, exports on Free on Board (FOB) increased by 29.0% to $ 15.2 billion, while imports on FOB increased by 56.9% to $36.4 billion. Pakistan had no choice but to turn to IMF for billion-dollar loan tranche. IMF wanted assurance on loan repayment and structural reform before disbursement and rejected the plea in November 2021 as Pakistan had prior debt to repay. Presumptuous prime minister Imran Khan failed to realize gravity of the crisis and remained incompetent to roll out revival policy prescription. Pakistan remained indebted to neighbouring country China to the amount of $17 billion owing to its agreement on China Pakistan economic corridor. The economy of Pakistan stagnated in 2019 and decreased in 2020. In 2021, growth resumed but remained downbeat. Anaemic economic freedom had worsened in a five-year trend. Pakistan has lost 4.0 points in total economic freedom during 2017, due to reductions in ratings for business freedom, fiscal soundness, and rule of law, and moved from the "Mostly Unfree" to the "Repressed" category. Although monetary and trade freedoms showed potential, economic freedom remained jeopardised by a persistent lack of fairness in the rule of law. Since 2019, the business outlook had brightened to some extent, although state-owned enterprise privatisation had been gradual. Business rules were inconsistently applied and enforced throughout provinces, while labour laws were inconsistently administered and enforced. The IMF recommended eliminating subsidies on essential goods, energy, and gas in order to achieve fiscal discipline in 2021, however the budget for 2021–2022 boosted many of the same subsidies.

5. Conclusion

Pakistan, which was formed as a result of India's division in 1947, is a somewhat unstable pseudo-democracy that is imperilled by sectarian bloodshed and religious fanaticism. The military still has the upper hand over civilian administrations. Pakistan, empowered with nuclear weapons and a large number of religious fanatics, poses a threat to the rest of the world. Prime Minister Imran Khan was elected after his Pakistan Tehreek-e-Insaf (PTI) party won a landslide victory in the 2018 election, promising to create jobs, build new houses, and implement structural liberalization. Tensions between India and Pakistan remained at an all-time high. Economic progress was hampered by political and social instability. The majority of export revenues was managed from textiles and garments, although much of the sector functioned informal, and underemployment remained significant. China had promised more than $60 billion in infrastructure and energy development in the China–Pakistan Economic Corridor (CPEC), despite considerable delays and criticism. Organized crime, corruption, a weak regulatory environment, and judicial system subversion all eroded protection for the acquisition and disposition of property rights. Extremist organisations and high-ranking political figures had influenced and intimidated the court, making it politicised. Courts remained sluggish, inefficient, and archaic. In politics, government, and law enforcement, corruption had been rampant.

Pakistan economy is in dire strait in Imran Khan administration. It faced severe turmoil during COVID inflicted time. It had to feel pressure from China as it borrowed heavily for financing infrastructural projects. Taliban capturing of neighbouring Afghanistan in 2021 led to facing influx of Afghanistan refugees poised as a heavy burden for fragile economy. With the pandemic, government had prioritised managing COVID-19 infection waves, initiating a mass vaccination campaign, increasing its cash distribution programme, and providing supportive monetary conditions to support economic buoyancy. Faced with the fourth COVID-19 wave, the government established micro-lockdowns, which successfully reduced the spread of the virus while allowing economic activity to continue, reducing the economic impact. Vaccination rates gained traction, although they remained noticeably low. Only about 12% of the overall population had been properly vaccinated as of September 2021. As per Asian Development Bank guidance, there is greater need for rectifying economic anomalies by setting priorities such as amelioration of economic management, bolstering economic resilience, reinforcing market efficiency and competitiveness and encouragement of higher private sector engagement.

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