PAKISTAN'S ECONOMY: FROM PERIL TO STABILITY

BY

Dr.Ashfaque Hasan Khan[*]

Pakistan's economy has made commendable progress over the last five years despite a series of domestic and external shocks of an unprecedented nature. A broad-based economic recovery has already gathered momentum, macroeconomic stability has been achieved and the external balance of payment is much stronger today than ever before. Pakistan's economy is now healthier and poised for a strong growth of 7 – 8 percent per annum over the next 3-4 years. The journey from Peril to stability has been an arduous one but the ingenuity, skills, determination and courage to take difficult decisions by the economic team on the one had and the dynamic leadership of President Pervez Musharraf on the other has helped achieved stability in Pakistan's economy. To appreciate the progress made by the current economic team under the stewardship of Mr.shaukat Aziz it is essential that we understand the gravity of situation that existed in 1999 - prior to the beginning of the reconstruction of the economy.

It is a well established fact that the decade of the 1990s was the lost decade for Pakistan. While many developing nations made substantial progress, Pakistan lurched from one economic crisis to another mainly of its own making. Weak macroeconomic management and the lack of commitment to undertake difficult structural reforms were typical of the quality of governance. Appalling economic decisions hyped on populist slogans were symbolic of the freewheeling decision-making that led to the incurring of huge public debt. Commercial banks and other financial institutions became the instruments of political patronage and profit for certain sub-sections of society. The gross mismanagement of public sector enterprises (PSEs) like WAPDA, KESC, the Railways, the Pakistan Steel Mills, PNSC and PIA, further added to the problems. The freezing of foreign currency accounts

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[*] The author is Director General, Debt Office and Economic Adviser, Ministry of Finance.

shattered the confidence of investors and expatriate Pakistanis vis-à-vis the management of the country.

The persistence of large fiscal and current account deficits *(7% and 5% of GDP, respectively)* and the associated build up of public and external debt *(over 100% of GDP and 335% of Foreign Exchange Earnings, respectively)* emerged as the major source of macroeconomic imbalances in the 1990s. Failure in enhancing revenues consistent with growing expenditure requirements, stagnation in exports *(stagnated at $ 8 billion for six years in the 1990s)* and in overall foreign exchange earnings *(stagnated at $ 11-12 billion range for six years in a row in the 1990s)* exacerbated these imbalances and vitiated a stable macroeconomic environment. Such a state of affairs had a far reaching impact on the country's economic well-being.

There was despondency among all, as many began to talk of Pakistan as a failed state. Indeed Pakistan witnessed economic growth slowing *(from an average of over 6% per annum in the 1980s to 4% by the end of the 1990s)*; investment rate decelerating *(from an average of over 19% of GDP to 15.6% by 1999);* the country's debt burden reaching alarming proportions *(public debt as a percent of GDP was over 100% of GDP and external debt and liabilities reaching $ 38 billion or 335% of Foreign Exchange Earnings – worse than many Highly Indebted Poor Countries (HIPCs)),* foreign exchange reserves plummeting to a level *($ 415 million on November 12, 1998)* hardly sufficient to finance two weeks of imports; poor governance beginning to be the norm; the country loosing its financial sovereignty; more and more people falling below the poverty line; and above all, the country was lurching from one crisis to another.

The massive cost of debt servicing *(almost two – thirds of the country's revenue were consumed by debt servicing alone)* rendered fiscal policy instruments ineffective and the country's physical and human infrastructure began to show signs of buckling under the combination of a fiscal crunch, rising poverty and poor governance. A weak and fragile economy became the cause as well as the effect of the poor law and order situation in the country. This was the background of the state of the economy that existed in 1999.

In this backdrop of a grave macroeconomic crisis, President General Pervez Musharraf invited Mr. Shaukat Aziz to take charge of the Ministry of Finance in

November, 1999. He very quickly assembled a team of highly trained economists and extremely talented civil servants. To address the issue of the severe macroeconomic crisis and place the economy on a path of sustained higher growth, financial stability, and improved external balance of payments, the economic team launched a comprehensive set of economic stabilization and structural reform measures. Stabilization policies were needed to stop the economic hemorrhage and dispel the gloom about Pakistan's future. The government believed that macroeconomic stability was vital for achieving higher and sustained economic growth, creating employment opportunities and preventing people from falling below the poverty-line.

While accepting this challenge, the government set forward four major policy objectives on economic front. First, to stabilize the country's debt situation with a view to restoring macroeconomic stability. Second, to revive economic growth and restore investor confidence. Third, to arrest the rising trends in poverty and fourth, to improve governance. These four-policy objectives were all interconnected. For example, a rising debt burden, which consumed almost two-thirds of government revenues on account of debt servicing forced public sector development programs to decline over the years. Being complementary in nature, private sector investment also declined. This decline in overall investment caused economic growth to decelerate with a corresponding rise in unemployment and poverty. Poor governance also contributed to the slowing of Pakistan's economic growth and the rising levels of unemployment and poverty. It is axiomatic that declining investment and economic growth in the 1990s was the mirror image of the prevalent political and macroeconomic environment at that time.

Given the nature of the challenges, the government had two options. The first, was to implement the four objectives simultaneously, that is, stabilize the debt situation, promote investment and growth, reduce poverty and improve governance. The second option was to prioritize these objectives and address the core issues first. After extensive deliberations, the economic team opted for the second option for the following reasons: First, Pakistan did not have the capacity to address all these issues simultaneously. Second, to address all the issues simultaneously we had to use instruments whose outcomes were conflicting in nature. For example, the root cause of the rising debt burden had been the persistence of large fiscal and current account deficits, causing rapid accumulation of debt and consequent deterioration of macroeconomic environment. In such an unstable environment one could not expect the private sector to come forward and increase investment. A stable macroeconomic environment was an absolute pre-requisite for promoting private sector investment and spurring economic growth. Stabilizing the country's debt situation was considered to be the core issue and was addressed first with lot of vigour and ingenuity.

Wide-ranging structural reforms in almost all the key sectors of the economy were also needed to enhance economic incentives, improve resource allocation, and remove impediments to private sector development. The Finance Minister felt that Pakistan's economic problems were structural in nature and the objectives of sustaining high growth, low inflation; external payment viability and improving the lives of the common man could not be achieved without removing these structural bottlenecks. It is with this view that a series of structural reform measures were initiated in such areas as privatization and deregulation, trade liberalization, banking sector reform, capital market reform, tax system and tax administration reform, agriculture sector reform etc.

The fruits of the policies and reforms that were introduced by the government in early 2000 started yielding dividends. It has become a fashion among critiques to attribute all the successes on economic front to the events of 9/11 and that the economic team had no role in these successes. For them, dollars have been dropped from the helicopter and accordingly all economic indicators have improved thereafter. We Pakistanis have been so disillusioned by the governments and representatives of the past that, rightly or wrongly, we fail to realize success even if it is staring us in the face.

It is a fact that Pakistan's economy started showing signs of improvement by 2000-01 well before 9/11. Can any one dispute the facts that large-scale manufacturing grew by 11.0% in 2000-01 against 3.6% in 1998-99; inflation declined to 4.4% from 5.7%; revenue collection increased to Rs.396 billion against Rs.308 billion; debt servicing as a percentage of total revenue declined from 64% to 57%; exports increased from $ 7.8 billion to $ 9.2 billion; the current account deficit was reduced from $ 2429 million to $ 513 million; foreign exchange reserves increased from $ 1.7 billion to $ 3.27 billion and external debt and liabilities as a percentage of foreign exchange earnings declined from 335.4% to $ 259.5%? These are undeniable facts and well-documented in official publications. These improvements had taken place much before 9/11.

Almost three years have passed since the events of 9/11 but the pessimists remain mired in the past. In the meantime the economy continues to gain momentum and its growth trajectory is steepening at an ever increasing rate. Is 9/11 responsible for the acceleration of growth to over 6.4% and industrial growth to 18.1%? Can we attribute the additional tax collection of Rs.210 billion in 5 years to 9/11? Can any one deny the fact that it took 9 years *(1990-99)* to collect additional tax revenue of Rs.197.5 billion while in 5 years the present regime collected additional tax revenue of Rs.210 billion? Should not we attribute these increases to reform in tax system and tax administration? Is 9/11 responsible for maintaining an average inflation of less than 4% during the last 5 years against double-digit inflation in the 1990s? Should we attribute the reduction in the fiscal deficit to 3.3% of GDP from an average of 7.0% in the 1990s to 9/11? Or is this the result of prudent fiscal management? Is the sharp reduction in the country's debt burden due to 9/11? Or is this the result of prudent fiscal management on the one hand and efficient handling of the external sector on the other? Is the increase in exports to the tune of $4.5 billion during the last 5 years attributable to meager market access provided by the EU after 9/11? Or is it the outcome of the macroeconomic policies pursued over the last 5 years? Can any one deny the fact that it took 19 years *(1980-99)* to add $ 3.5 billion in exports but it took only 5 years *(1999-2004)* to add $ 4.5 billion? Is this unprecedented performance owed to 9/11? Can we attribute FDI of $ 949 million in 2003/04 as compared with $ 376 million in 1998/99 to 9/11? On the contrary, 9/11 has adversely affected the flow of FDI because of travel advisories issued frequently by Western countries. Could we attribute a five fold increase in the share index and market capitalization in the stock market to 9/11? Or is this the result of the strong economic fundamentals, prudent macroeconomic management and Shaukat Aziz being the country's Finance Minister?

It is an undeniable fact that Pakistan's economy has gained strength and its economic fundamentals have improved not because of 9/11 but because of prudent economic management on the one hand and the ingenuity, skills, determination and courage to take difficult decisions of the Ministry of Finance on the other.

The present economic team under the stewardship of Shaukat Aziz has not only salvaged a near bankrupt economy but has put it on a path of sustained high growth with financial stability and considerably improved external balance of payments. In so doing, the government has prevented many more millions from falling below the poverty line and suffering from lack of education, basic health facilities, safe drinking water, and shelter. Much has been done in the past five years. We are witnessing a decline in poverty and an improvement in social indicators. The recent up-gradation of Pakistan in the Human Development Index of the UNDP is a vindication of the policies pursued by the government in the last five years. Much more still needs to be done for which the Pakistani leadership is fully prepared.

No efforts to revive economy will complete unless the macroeconomic gains are transferred to the masses in terms of improved standards of living. The best way to improve the living conditions of the people is to provide them gainful employment, scaling up investment in human capital and maximizing the impact of existing public spending on education and health. Central to achieving the objective is the promotion of stronger economic growth. At the macro level, growth implies greater availability of government resources to improve the quantity and quality of education, health and other services. At the micro level, growth creates employment opportunities, increases income of the people and therefore reduces poverty.

It is a well-established fact that poverty in developing countries is largely a rural phenomenon and Pakistan is no exception. More than two-third of the country's population live in rural areas and overwhelming majority of them are dependent, directly or indirectly, on agriculture for their livelihood. Almost 44 percent of the country's workforces are employed in agriculture. The major constraint in Pakistan's agriculture has been the availability of irrigation water. The best way to help improve the living conditions of the people in rural areas is to improve agriculture by increasing the availability of irrigation water. It is in this connection that the government has launched over Rs.300 billion worth of water-related projects, most of which are likely to be completed during the next two to three years. The water-related projects include various dams, improvement in watercourses *(Rs.66 billion project to improve 87,000 watercourses has been launched on August 19, 2004)*, lining of canals, and revamping of irrigation and drainage systems. After the completion of these projects, 2.88 million acres of land will become available for cultivation thereby giving a quantum jump to agriculture growth, increasing the incomes of the farmers, providing more jobs to rural work force, and reducing poverty in rural areas.

Addressing the issue of educated unemployed youth in the country in general and urban areas in particular has always been central to the government's economic policies. Accordingly, the Information Technology and Telecommunication was identified as one of the major drivers of growth by my government because of its enormous potential to create jobs for this segment of society. This sector has witnessed unprecedented growth during the last four and a half years and has emerged as a major source of foreign investment – thanks to major reforms introduced in this sector. The sector is not only bridging the digital divide across the nations but within the country as well. It is playing an important role in the country's socio-economic development and improving the productivity of our economy. The extra-ordinary growth in IT and Telecom sector has created enormous employment opportunities, directly and indirectly, for educated unemployed youth in a wide-range of areas like call centres, telecom engineering, telecom sales person, customer services, finance and accounting etc. This is one of the fastest growing sectors of the economy and the pace is likely to accelerate even further in years to come, hence more job creation will be taking place.

While working towards improving the country's macro indicators and initiating wide-ranging structural reforms the government was never oblivion to the plight of the deserving segments of the society. It continued to pursue targeted intervention to address the problems of poverty, income and employment generation through public works program *(Khushal Pakistan Program)*, food support program, micro credit, zakat distribution and others. The improved macroeconomic conditions allowed the government to allocate substantially large resources for this purpose. The government spent Rs.114 billion on social sector and poverty related programs in 1999-2000 and this year the amount is raised to Rs.278 billion – an increase of over 100 percent in 5 years. Similarly, the strong macroeconomic gains allowed us to raise development spending from less than Rs. 100 billion to Rs. 202 billion in just 5 years. These resources are being utilized to create jobs, improve education and health services and strengthen the country's physical infrastructure.

Pakistan has lived through a difficult and testing period in the not too distant past. Its economy was fragile, the balance of payments was highly vulnerable to external shocks, the country's debt burden had reached alarming proportions, financial indiscipline was the order of the day and the country's foreign exchange reserves were at dangerously low levels. After five years of hard work Pakistan's economy is now resurgent and the balance of payments has never been as comfortable. Notwithstanding the impressive progress made so far the government must not be complacent, as the country has not yet realized its true potential. The 150 million people of this country have enormous potential to excel in many areas. The intelligence, the dynamism and the ability to learn are second to none. What is required is the unlocking of the creative energies of the people. If we stay the course, we are confidant that the desired results can and will be achieved. Let us together make Pakistan a better place to live and bequeath a stronger country to our current and future generation.