Article

Pakistan Economy: Past Trends, Current Situation and Future Prospects

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Part I : Introduction

Pakistan is beset with many problems. One third of the population is below poverty line. Its main industry is agriculture, but the country now has to rely partly on imported food due to population pressure. It suffers from low literacy, structural unemployment, chronic inflation, poor human resources, deficits in the government budget and deficits in the balance of payments. Its economic policies change frequently without consistency, being characterized by adhocism. These problems have long history and are therefore deep rooted. The present study intends to analyze the major problems facing the Pakistan economy and review the literature directly concerned. Based upon the

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analysis, economic prospects will be presented. Policy guidelines for sustainable growth will also be suggested.

Part Ⅱ: Past Trends and Current Economic Situation

Economic Growth—Unstable and Difficult to Sustain

Pakistan recorded an average annual growth of 6 % per annum during the last three decades. The average rate in the 1960s and 1980s was 5.8% and 6.5% respectively, although in the 1970s it was down to 4.8%. So unstable has been the economic growth. Pakistan now ends up with deep recession in the 1990s. Inflation persists over a decade or so. Poverty is widespread, and unemployment threatens the country's future. High illiteracy, poor human resources, perennial deficits both in the balance of payment and in the government budget also hinder economic growth. The current plight thus makes Pakistani growth prospects far from being bright. Economic planning has not paid constant attention to the need of a long-term sustainable development. Economic policies have turned out to be ineffective, with adhocism included as part of economic policy. Pakistan faces hardships to meet international obligations like debt servicing. More than two-thirds of the government budget are washed away by defense expenditures as well as debt servicing. As a result, only meager resources are left behind, being insufficient to further promote economic growth.

Population—Poor and Unevenly Distributed

The current population of Pakistan is about 140 million, spreading over the area of 796,095 square kilometers. About two-thirds of the population live in rural areas. The population density per square kilometer, according to the 1981 census, was 230, 135, 148 and 13 persons for Punjab, Sindh, NWFP and Baluchistan[1], respectively. Current estimates indicate that the density increased to 382, 224, 246 and 22 persons in 1997, respectively. The increase in population density was over 66% during the above period (1981–1997). The increase in Baluchistan was particularly high, about 69%. Baluchistan is the most underdeveloped province, but has the largest area with only 4 % of the total population. Thus the population is not evenly distributed across the country. The population was increasing at an average rate of over 3 % per annum in the recent decades, which has recently come down to 2.78%. The per capita income of Pakistan is now $460 and Purchasing Power Parity (PPP) income is $2230 according to the World Development Report 1997. The growth of real per capita income has become negative.

More than one-third of population is below poverty line. The decrease in growth and squeeze in development expenditures have added to increase poverty. The high population growth is increasing demand for public services and basic human needs.

Agriculture—Backbone of Economy

Agriculture sector continues to be the main stay for the bulk of population. It is the backbone of the economy, contributing to the 24%

1) These are four provinces of Pakistan. Punjab has the largest population and Baluchistan has the largest area. Punjab and Sindh are relatively developed provinces.

of the GDP. It makes more than 70% of the foreign exchange earnings. Half of the total labour force is engaged in agriculture. The agricultural growth rate was over 5 % during the 1960s and 1980s. It was down to 2.4% per annum during the 1970s. During the early 1990s, it grew to 5.5% per annum. Recently, its growth has been one of the lowest. In 1996-7, it grew by only 0.06% (Annex I). The industrial sector is dependent upon this sector, since major inputs for the industrial sector are drawn from agriculture. The rise and fall of the agricultural sector affects that of the industrial sector and hence the overall growth of the economy. Therefore, it is considered the backbone of the economy.

Out of the country's total area of 79.61 million hectares, 24.39 million hectares are not available for cultivation. Only 21.6 million hectares are cultivated, but still about 9 million hectares remain as cultivable waste land. Alone in Baluchistan more than one million hectares of virgin land lies unused. For the last decade or so there is hardly any increase in the new arable land.

Pakistan used to be an exporter of food but, presently, it has become an importer of such food items as wheat, lentils and powdered milk. This is caused by the increasing population pressure, slow agricultural growth and low investment in agriculture[2].

Industrial Sector—Still Far From Take-Off

The industrial sector of Pakistan has not expanded much over time.

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2) Quantitative figures are provided in the next sections. For more details also see Chaudhary (1989) and Economic Survey, of Pakistan, 1997-8.

Pakistan is still far from take-off stage. The share of manufacturing sector in the GDP increased from 16% in the 1960s to 19% in the 1990s. It grew about 10% per annum in the 1960s, slowing down to 5.4% both during the 1970s and the 1990s. During the 1980s, its growth was up to around 8% per annum. Its growth was as low as 1.2% during 1996-7. It may be noted that the small industries which employed over 70% of the industrial labor force as a whole were scarcely a major concern of the policy makers. Policy makers are seldom aware of the actual performance of the small industries. Its poor growth performance, according to a survey carried out several years ago, is repeated every year, which is not linked with overall economic growth. A policy to encourage large industries was encouraged, which did not generate many jobs since such investments were capital intensive[3]. As a result, industrial growth could not absorb increasing labor.

Services Sector——Producing Half of the GDP

The services sector is the largest sector, which contributes about 49% of the GDP[4]. Its growth rate remains constant around 6% per annum during the last two decades. It was, however, down to 4.6% in the 1990s. The above survey indicated that the structural change was slow. Recently all sectors have turned to show low growth rate. During the 1990s the economy suffers from overall depression.

3) For details of all sectors' employment elasticities see Chaudhary and Hamid, (1999).

4) For detailed analysis of the structural change see Chaudhary (1989).

Inter–linked Economic Problems

As already mentioned above, the economy grew at an accelerated rate during the 1960's and the performance was respectable again during the 1980s. During the 1960s, public policies were focused on export–led growth. The country experienced stable political environment too. The international flow of resources was also substantial. Such a healthy trend did not continue long. Political situation became so unstable. There was military rule for more than 10 years. Market–friendly environment was not available. The prolonged war in Afghanistan directly affected the economy of Pakistan. About one million refugees crossed the border for shelter. Thus a policy to manage day–to–day economic problems surfaced. The lack of resource mobilization added to its economic instability. Over time, it has ended up with accumulated debts, foreign and domestic, which pose a serious threat to growth potential.

Policies——Unstable and Ineffective

Development policies are not very stable in Pakistan. Economic priorities keep on changing without fully achieving goals. Agricultural development was the top priority in the first and second development plans (1955–65). Thereafter, industrialization policy was emphasized. While the country did not reach an industrial take–off stage, the policy priorities were changed again. All heavy industries were nationalized, in the name of inequitable distribution of wealth. The policy change lessened the confidence of businessmen, affecting industrial growth so adversely. Basic Human Needs (BHN) approach, which was introduced during the 1980s, failed all over the world including

Pakistan. Recently, Social Action Plan (SAP) focuses on the development of five social sectors as discussed later. During the late 1980s, privatization, deregulation and denationalization policies were introduced. So far these policies have not shown much fruit. Prices keep on rising and double-digit inflation persists over a decade now. Unemployment is widespread and investment is not responding to economic policies. The public policies end up with adhocism. As pointed out above, long term real objectives for sustainable growth were not pursued. The country is beset with inter-linked economic problems. These major economic problems and their linkages are explained in terms of five major economic diseases, as shown in Figure 1.

Figure 1 indicates five major economic diseases of Pakistan. Among these diseases AIDs (foreign borrowings) and Cancer (inability to mobilize domestic resources) are serious. These diseases have deep roots and inter-linked. The neglect of one problem or its mishandling leads to the birth of another. These five major diseases are as follows[5).

i) *Inconsistent Policies*

ii) *Triangle of Deficit, Debt and Inflation*

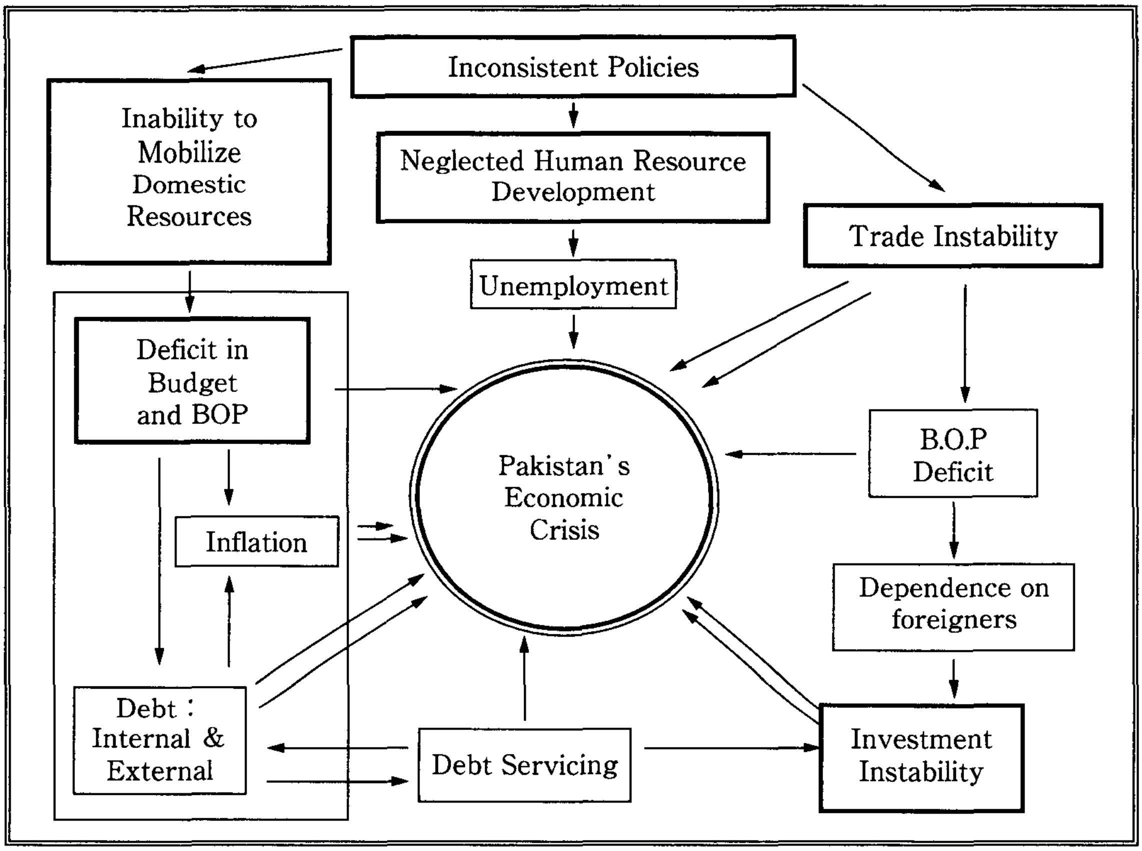
iii) *Trade Instability*

iv) *Neglected Human Resources and Unemployment*

v) *Difficult Domestic Resource Mobilization and Weak Public Sector*

5) For comprehensive and complete sources of these problems also see, Chauhary (1988), Chauhary and Hamid (1999), Chaudhary and Ahmed (1995), Chaudhary and Qaisrani (1996), Chaudhary and Altaf (1995), Chaudhary (1993), Chaudhary (1995), and Naqvi and Khan (1994).

Figure 1 : Linkages of Economic Problems



i) Inconsistent Policies and Planning Priorities

Shift of priority from agriculture to industry

Pakistan has followed economic planning since 1955. Five years plans were prepared and implemented. The first and second five-year plans (1955-60) gave priority to agriculture. More than 26% of the budget was allocated to this sector. Green Revolution was introduced and the sector performed well. Accelerated growth was observed during the 1960's (annex I). Thereafter, the planning priorities were changed, and agricultural development was no longer at the top of the development agenda. The surplus from agriculture was transferred to other sectors by pricing policies, causing adverse effect on agriculture (Chaudhary, 1989, 1985). Even today, the prices of agricultural produce are controlled. Planning priorities have certainly shifted to industrial sector. As a result, the agriculture was neglected in the third plan (1960–65) and onwards. The financial allocations for the agriculture sector keep on decreasing. Recently, hardly 4 % of the resources is allocated for this sector (1996–7). Thousands of hectares of virgin arable land remain unused. Inconsistency stays in agricultural policy.

Foreign Dependence on the Increase

Most of the development fund has been based upon foreign resources. Every policy plan was targeted on reducing foreign resource dependence. But in reality the result has been the opposite. Foreign dependence is steadily on the rise. It was once aimed to eliminate foreign dependence by the end of the third plan (1965). Two development plans (4th and 5th) were prepared in sequence, but scarcely implemented. The sixth plan (1983–88) was introduced with a new policy focused on rural development as well as the reduction of foreign dependence. Significant development was indeed achieved in the rural development, but there was almost no progress made in mobilizing domestic resources. The foreign borrowing was growing at the annual rate of 11%. Foreign dependence increased, not decreased, over time. Inconsistency stays in the strategic reduction of foreign dependence.

Inconsistent Industrial Policy

The industrial policy was also not consistent. In the early development plans, private sector was dominant, with the direct role of the public sector limited. During the 1970's, all heavy industries were nationalized in the name of better wealth distribution. Such action led to the halt of industrial growth. Thereafter, active role was played by the public sector in developing industries. This policy was also discontinued later, which was followed by the denationalization of industries and banks. Inconsistency in industrial policies is thus apparent.

BHN replaced by SAP

During the 1980s, Basic Human Needs Approach (BHN) was pursued (see Chaudhary, 1989, chapter 10). Such an approach was supported by international institutions and donor agencies. No significant improvement was achieved, however, by this approach. Therefore it was soon discontinued. A package of structural reforms was proposed by international donor institutions. The package did not have much impact on improving the economy. The country ended up with heavy foreign indebtedness, inflation and deficit.

Presently, SAP is in action. First SAP (1992-5) has been concluded and the second one is now in action. In reality, the SAP is a new name for BHN. The sectoral priorities remain the same. SAP is directed to developing social sectors such as primary education, basic health, population welfare, supply of potable water and sanitation facilities. About one-fourth of finance for the program stems from foreign aid. As already mentioned, through out this period, foreign borrowing continued to grow. The growth rate of foreign loans was as high as 11% per annum. Over time, the payments of these loans have started to wash away the whole growth. Foreign debt servicing alone constitutes over 3 % of GNP. Policy changes continue, amid the increasing foreign indebtedness. A wave of new reforms was introduced. Given the rigid economic structure and existence of monopolies, the reforms have not shown much result either; rather it has added to more problems. The policies keep on changing and economic instability continued. During this process of development, Human Resources Development (HRD) was neglected. On paper, long term goals were set but actually no serious efforts were made to achieve them[6). After thirty years of planned development, no sustainability of any sector was achieved. Lack of consistent long-term policy remains so detrimental.

Planning and Implementation Divorced

The development planning has been suffering from consistent mistakes. Inconsistency was also apparent in planned allocation, budgetary allocation and actual utilization. High financial and physical targets were set, to be hardy achieved. Initial promises and consequent action are so different. The same pattern is repeated time and again. High promises are followed by failed promises. Whatsoever was provided was not fully utilized (Shaheen, 1996). The resource shortage was evident in almost all later plans. Vicious plan targets were set. Even those targets were dependent upon foreign resources. Instability in the flow of foreign resources also contributed to the failed fund allocations and target attainment. The planning and the actual implementation remained divorced. These inconsistencies were repeated again and again. Development is a process to learn from experience and improve upon it. Such effort keeps on lacking in the economic planning of Pakistan. Most tragic is its failure to learn from its own past mis-

6) The issue is taken up in details later on. For comprehensive analysis see a complete book on the issue by Chaudhary & Hamid (1999).

takes.

ii) Triangle Disease: Deficit, Debt and Inflation

Pakistan is suffering from budget deficit ($G-T>0$, G=government expenditure, T=tax revenue), current-account deficit ($M-X>0$, M=imports, X=exports) and saving-investment gap ($S-I<0$, S=saving, I=Investment). The following macro-economic identity holds:

$$G-T=M-X+S-I$$

The resource gap exists in the shortage of the tax revenue relative to the government spending, which is matched by the shortage of the exports relative to imports as well as the shortage of saving relative to investment. The question is how to fill in the gap.

Tax Base

Tax base in Pakistan is very narrow and tax revenue is inelastic (Khan, 1996). Hardly one percent of population is taxpayer. A policy of easy tax revenue collection was adopted without considering its economic impacts. Taxes used to be raised from same taxpayers and same commodities. Such practices easily lead to the practice of tax evasion and corruption. Presently, at least 30% of the economy is underground, making it difficult to fill in tax loopholes.

Debt Cycle

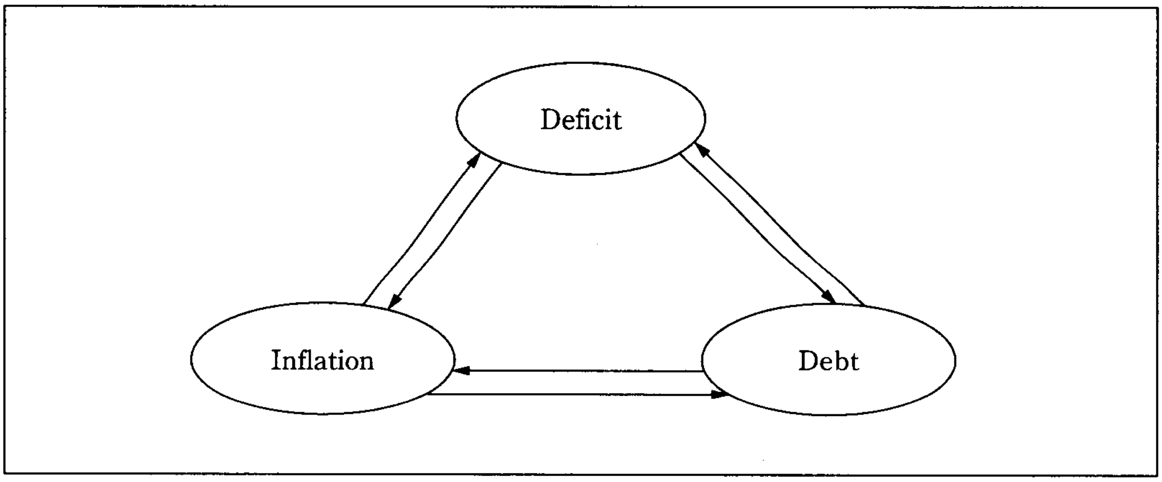
The resource gap was constantly met by borrowing. The resource gap and inefficiency led to continuos budget deficit. When the external borrowing position became tight, more internal borrowing was carried out by the government. This internal borrowing was done through nationalized banks at a low interest rate, destroying the banking system as a whole and squeezing the credit for the private sector. Credit crunch ensued. These national banks incurred losses by these policies. It was later decided to privatize the nationalized banks. More borrowing was done from public and private financial institutions. These new loans were obtained at a very high cost; for example, the public sector paid the interest of over 15% for the national saving loan. In the wake of the tightening up of international public loans, private lending was done at an even higher cost. As a result, debt burden kept on piling up. So did the debt servicing. Borrowing was increasingly done for the sake of repayment of debt services. Presently, about one-half of the new international borrowings are used for debt servicing. The debt cycle theory does seem to be working in Pakistan.

Deficit and Inflation

Pakistan is experiencing a double-digit inflation for a decade or so. Inflation has become a permanent feature of Pakistan economy. Its double-digit persistence has also added to economic crises. Uncertainty about prices may affect investment and decision making of the households and businessman, which affects economic growth too.

The budget deficit climbed up to 8 % of GDP in 1992-3. Chaudhary and Ahmed (1995) pointed out that the deficit was one of the major source of inflation in Pakistan. Thus, one disease is creating another disease. Negative repercussions stay. Besides, there are other sources of inflation like structural inflation, which emerges from ever growing non-development spending of the public sector. Rapid increase in the non-development expenditures (11%) also put squeeze on develop-

Figure 2 : Triangle Problem



ment expenditures. It also generates inflation, especially structural inflation. This linkage of deficit, debt and inflation is shown in Figure 2.

The inconsistent policies not only create the above triangle disease but also lead to unstable growth in the foreign sector. The deficit of the public sector is related to B.O.P. gap and saving- investment gap. During the 1960's, the foreign sector showed accelerated growth, mainly due to positive impact of public policies. Soon the concentration on trade disappeared and, therefore, exports did not grow much in the 1970s. As a result, the trade gap started to grow. The current account deficit reached as high as 7.1% of GDP, during 1996-7. Foreign borrowing was seen as remedy to fill in the increasing resource gap, since trade did not respond to improve balance of payments. Besides, Pakistan, being a small economy, is a price taker in the international market. The imports keep on increasing and so do the foreign debt. The increase in import prices further added to inflation (Chaudhary & Ahmed, 1995). Thus, another source of inflation was increasing import prices.

Saving–Investment Gap

In addition to above, saving–investment gap (S–I) continues to persist even after 50 years of Pakistan's independence. On average, Pakistan's saving rate has remained around 14% of its national income. (India, by contrast, has a saving rate of 22%.) Pakistan's investment was equivalent to around 19% of GNP. Thus, the resource gap of 5 % was met by borrowing, which is unstable. Investment is hence unstable. The resource gap and the inability to mobilize domestic resources was a source of borrowing and deficit. The deficit was a source of inflation.

The resource constraint was not only evident for the public sector but it appears that the nation became consumption–oriented rather than saving–oriented. Over time hardly any serious efforts have been made to diminish this gap. The situation has become even worse during the recent years. During 1996–7, the national saving was only 11.3% of GDP; while the total investment was 17.5%. The low savings relative to the investment lowers growth potential and makes dependence on foreign capital inevitable. The economic growth rate fell to 1.3% in 1996–7, one of the lowest in the recent history.

The above discussion leads us to conclude that deficit, debt and inflation are inter–linked. Present level of debt, deficit and inflation are not sustainable (Anjum, 1995) & (Farooq, 1996). Thus, it appears that the triangle economic disease is also linked with inefficient economic policies.

iii) Trade Instability

Foreign sector is one of the most volatile sectors. Pakistan's exports grew by more than 13% during the 1960s under very favorable circumstances. Export bonus scheme, foreign exchange concessions, export subsidies and tax holidays were effectively used. The result was an accelerated growth of exports. This, however, did not last long. The 1970s ended up with slow and unstable export growth.

Export instability index, based upon export fluctuations, is here calculated. Table 1 provides long-term export growth and its instability index. Just as the growth is volatile, so is the index. The index varies from 0.003 to 9.5. The growth rate of exports likewise fluctuates from negative (−6.4%) to positive growth (+25.1%). It implies instability in foreign exchange reserves. The current account deficit was as high as 3.6 billion dollars in 1992–3, being around 3.2 billion dollars during 1996–7. The deficit entails heavy borrowing. If Pakistan had been able to continue export-led growth effectively, the heavy debt problem would not have been so serious.

Regression analyses between export growth and economic growth are conducted. Correlation analyses are also done among capital instability, export instability, GDP growth rate, labor force, investment and real exports. The results are shown in Appendix 2. The instability in exports turns out to be positively related to GDP growth, although the correlation coefficient is as low as +0.019. The capital instability proves to be negatively correlated to the GDP growth, with the coefficient equal to −0.17. The investment growth is positively correlated with the instability of foreign exchange reserves, the coefficient being equal to 0.34. The income growth remains domestically caused, since export-led growth has not been materialized. The market responded only to local demand, with growth consequently limited.

Pakistan has made some progress in exporting manufactured goods. As stated earlier, most of the exports are based upon agriculture. About 70% of its foreign exchange earnings, directly or indirectly, come from agricultural exports. The share of primary, semi-manufactured and manufactured goods in Pakistan's total exports was 33%, 23% and 44%, respectively, during the 1960s, changing to 14%, 17% and 67% respectively in the 1997-8 period. Noteworthy is the increasing share of manufactured exports from 44 to 67%. The export base, however, is not very large and the majority of manufactured goods still consist of textile and textile-related products. The production of manufactured goods is not extensive. It suffers from quota restrictions on the international front. Such restrictions may be less in the future. It is a challenge to compete in quality in the export market. Limited growth of limited commodities will not generate much fruit. With the new WTO rules for free trade in existence, Pakistan economy faces both opportunity and challenge.

Trade instability remains to be a big problem for Pakistan. The foreign sector has not experienced stable growth, and it is not a large part of the economy. Pakistan has not benefited much from trade expansion so far. The foreign capital constraints have constituted serious bottlenecks for sound economic growth. Such trade instability results in accumulating debt burden as well as unstable economic growth.

iv) Neglect of Human Resources and Unemployment

Rising Unemployment

The development of human resources remained neglected in long-term plannings. Human Development Report (1997) ranks Pakistan as

Table : 1 Exports Instability Index

YEAR	INDEX	EXPORTS (ANNUAL % GROWTH)
1970-1	0.6	—
1971-2	6.9	25.6
1972-3	9.5	1.3
1974-5	0.2	0.4
1976-7	5.3	—
1979-80	1.7	25.1
1980-1	0.5	2.7
1983-4	3.5	—
1985-6	0.4	4.6
1988-9	0.003	23.8
1990-1	2.8	12.6
1991-2	4.7	−6.4
1993-4	1.6	7.1
1995-6	—	7.1
1996-7	—	−2.6

Source: Chaudhary & Qaisrani, (1996)
(Export instability index here is defined as

the 134th country in the world in view of its low level of human resources development. Over fifty years since Pakistan's independence, the literacy rate has been as low as 37%[7]. More than 25% of the children undergo no schooling. The existing schools remain deteriorated

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7) This rate is based upon the official strange definition of Unemployment. The effective literacy is hardly 20%.

in quality. The education system fails to match with escalating demands for skilled labor. The demand for skilled labor does exist, but remains unfilled. Traditionally educated youths remain unemployed, adding to the reservoir of surplus labor. The imbalance continues to stay in the labor market. Presently, the demand of over 30,000 skilled workers remains unfilled (Ghayur, 1997).

The public sector continues to underreport the unemployment rate by using naive definitions[8]. According to the official figure, the unemployment rate is just over 6 %. It means that only two million workers are unemployed. Hardly any experts believe in this low estimate. Chaudhary and Chaudhary (1996) have carried out a fresh survey and indicate that the unemployment rate really is as high as 20%.

During the last development plan, over 6 million jobs were planned to be created, whereas in practice not half of the plan was implemented. Thus, unemployment stays persistent and deep-rooted. Industrial policies beget capital-intensive investments, while the bulk of labor force remained unemployed, calling for labor-intensive investments.

The employment elasticity for the manufacturing sector is 0.35. The one for agriculture and the one for services are 0.3 and 0.55, respectively. The nation's overall employment elasticity is 0.33. Presently, the small-scale industries are also reported to become less labor-absorptive and inclined to be more capital-intensive (Chaudhary &

8) As per official definition of unemployment, if any one has not even worked for one hour, he will be unemployed. However if any one has worked for one hour, he will be considered employed. Given this definition, it may be difficult to find any one unemployed.

Hamid, 1999), although labor-intensive methods are needed to alleviate the unemployment issue[9]. Due to the low employment elasticities, actual employment generation remains insufficient to absorb the growing labour force. The inefficient policies, such as capital-intensive industries, have certainly caused such a mismatch in the labor market.

Declining Remittances

Pakistan used to live on remittances. The bulk of Pakistani workers used to migrate to Middle East in search of jobs. During the oil boom of the 1970s, over two million workers were working abroad, remitting over 3 billion dollars annually. This source of foreign exchange earning decreased over 50% in the 1980s, compared with that in the 1970s. The workers remittances declined from over 3 billion dollars in the 1970s to less than 1.5 billion dollars per annum, aggravating the balance-of-payments problems as well as domestic unemployment problem. In the beginning of the 1980s, these workers started to return home, adding to more domestic unemployment. Paper plans were prepared, but none of the plans were put into practice. No effective policy adjustment was, and could be, made, to absorb the returnees.

Low Priority put on Education

Training and education has never been a priority of development planning in Pakistan. Mass illiteracy persists. The kind of education

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9) It is being published in 1999 by Ferozsons, Lahore. The whole book contains a comprehensive analysis of the Human Resource neglect in Pakistan. Also see S. Ghayur (1996-7)

provided has indeed been a waste of human resources. In the early 1980s, the expenditure on education was equal to less than 1.5% of GNP. On average throughout the 1980s, it amounts to only 1.9% of GNP, the figure rising slightly to 2.3% in the 1990s (Appendix 1). It clearly indicates the low priority assigned to education. As the problem became severe, marginal policy changes were made in the financial allocation in favor of the education sector. The educational allocation for 1998 amounts still only to 2.3% of GNP. It may be noted that the primary education is one of the top priorities of the SAP. Chaudhary and Hamid (1999) carry out a detailed and comprehensive analysis of unemployment by education level and by sector. They point out that the unemployment will rise in future for educated segments and others in the society. The unemployment rate could increase to over 10%, if no effective policy measure were taken.

Mismatch

Inefficiency in education and training policy becomes evident, as even high skilled manpower like medical doctors and engineers end up with jobs like civil administrators and police officers. The education policy is not guided by market needs. Moreover, majority of peoples pursue arts education, not because they want but because they have no other choice. Such education system adds to the literate mass youth who are jobless in streets. The unemployment further aggravates poverty.

Poor Education

The human resource development continues to be ignored, with poverty increasing over time. The highest income bracket, 20% of population, has more than 40% of national wealth: whereas the lowest income bracket, 10% of the population, has only 3.4% of national income. So uneven is the income distribution. The latest Economic Survey of Pakistan contains a title on income distribution, but the text contains not a single sentence on it (Economic Survey, 1997–8. pp–vii–8). It indicates, however, that 0.2% of GDP was spent on social safety network and anti–poverty measures. It also shows that the reduction in welfare expenditures over time has worsened poverty (Economic Survey, 1997–8, pp–vii–8). In developed countries, by contrast, such welfare expenditures exceed the 5 % level of GDP. The need for such welfare expenditures is even greater for developing countries where welfare facilities are critically deficient.

The latest findings of the survey conducted by the Statistics Division and Jaffri (1996) indicates that about 30% of the population live under poverty line. The poverty–line per–capita income is Rs 300, less than $10 per month. This segment of population can hardly afford schooling and two meals a day. Such a condition has led to the increase of child labor. The child labor has become a problem for the exporting sector, since the goods produced by using child labour will not be accepted in the world.

Poor human resource developments add to unemployment, poverty and child labor, affecting trade and growth adversely. Human resources remain underdeveloped in Pakistan. Literacy rate is still very low. Serious unemployment stays. Education polices remain inconsistent, with no focus on technological education. Unless appropriate educational policies are consistently adopted, the country will continue to suffer greatly from one problem after problem.

v) Resource Mobilization and the Inefficient Public Sector

Untapped Resources

The major source of economic crises in Pakistan seems to be the inability for the public sector to respond timely. The public sector finds it difficult to respond to changing economic situations and needs appropriate policies. Shortage of relevant resources is a continuing problem. The tax structure continues to be inelastic and stagnant (Khan, 1996). Taxpayers are mostly middle class and salaried persons with fixed income. The millionaire presidents, prime ministers and businessmen have paid taxes as low as Rs. 5000. The rich and influential class continues to evade tax payments. Agriculture, the largest sector in the economy, remained untaxable until very recently. The government was not able to tap the taxable resources of the rich businessmen and influential landlords. Instead, the government found an easy way out by borrowing from financial institutions, outside and inside. The government did postpone the needed tax burden, with the result that additional burden was placed again on the same taxpayers. Instead of searching for new sources of tax revenue, the same taxpayers continued to be the target of new taxations.

Indirect Taxation and Inflation

The public sector was unable to mobilize direct taxation. Indirect taxation, instead, was relied upon to meet fresh revenue needs. The increasing reliance on the indirect taxes not only put additional burden on the specific segment of the society but also creates other economic ills. Inflation increases in the consumer market and input prices go up. The indirect taxes increased by 12% from 1997 to 1998. The revenue from taxation constitutes about 13.5% of GDP. About 70% of the tax revenue consists of indirect taxes. The non-tax revenue amounts only for 2.6% of GDP[10]. The sum of the tax and non-tax revenue (T) amounts roughly to 16% of the GDP. The public expenditure (G) exceeds the 22% level of GDP. Thus, the gap of about 6 % (=G−T) is filled in either by borrowing or through monetization. As already pointed out, the borrowing from internal market leads to the shrinkage of the credit available to the private sector. The borrowing from the international financial sources imposes pressure on the BOP. The outcome is heavy burden of debt servicing, which means additional bottleneck of economic growth.

The budget deficit was as high as 8.7% of GDP during 1990-1. Presently, it is down to 6 % of GDP. Such a decrease is not necessarily a healthy adjustment, because major cuts on development expenditures, rather than non-development expenditures, were imposed every year. The current expenditures indeed keep on increasing at the annual rate of over 10%, but development-related expenditures were squeezed from 6.5% of GDP in 1990-1 to only 3 % of GDP in 1996-7. Such a negative adjustment adversely affects economic growth. Given the public budget, equivalent to about 22% of GDP, 17.6% of GDP was used for non-development purposes in the 1980s. During the 1990s, over 19% of GDP are used for non-development ex-

10) Khan (1995) contains detailed analysis of the tax and revenue structure of Pakistan.

penditures. However, the efficiency of the public sector has not risen over time in spite of the increasing current expenditures. A study by the Services Division indicates that the government staff is in surplus by 30%. Still, every year, more civil servants are given employment.

The reduction of the public sector will not decrease overall productivity but increase it. New government staff is added every year to get a kind of unemployment allowance. Such a welfare policy hinders their incorporation into productive sectors. Public sector continues to be a provider of unproductive jobs. It is a waste of educated manpower and capital. Such policies have caused heavy costs of inefficiency and waste of public resources.

Diminishing Foreign Exchange Reserves

Recently, the international economic sanctions on Pakistan have exerted a major impact on foreign exchange reserves, which keep on declining[11]. The foreign reserves now shrink to as low as 550 million dollars. Adhoc policy measures were again taken by freezing foreign exchange accounts. Such restriction resulted in the halt of remittances, and more hardships were imposed on foreign exchange transactions. Afterwards, the government realized that such a restrictive action was a mistake. A new policy was introduced. Now, deposits can be withdrawn in local currency at the exchange rate lower than that in markets. New foreign exchange accounts can be opened and foreign

11) The foreign reserves varied from over 3 billion dollars to half a billion dollars. The later is not sufficient for two weeks imports. Presently these reserves are maintained by more and more borrowing rather from trade.

exchange certificates can be purchased. However, it has not gained the trust of the public. Such policies brought Pakistan to the brink of default. The persistence of deficit, foreign dependence, and the inability to mobilize domestic resources are severe diseases, or a cancer and AIDS of Pakistan economy. The repayment of foreign loans has become a major obstacle to economic growth.

Part Ⅲ: Future Prospects

Default in Sight ?

The review of current economic situation so far shows clearly that Pakistan is trapped in deep-rooted economic diseases. A recovery would be neither easy nor fast. Most of the economic diseases are self-generated, a product of its own inefficient inconsistent policies. The economy has followed a path of dependent growth, relying on external finances. The country is caught in external debts and debt servicing plight. If the present trend of borrowing were to continue, the day would not be far away when it must default. Chaudhary (1988), Chaudhary & Ali (1993) and Sabahat (1997) have analyzed the impacts of further external borrowings. The analysis indicates that the debt servicing was 1.3% of GDP in 1971–72 but rose to 3 % of GDP in 1996–7. It will increase to over 6 % of GDP in the year 2010[12]. The whole economic growth will be washed away by foreign debt servic-

12) It is based upon the prediction of external debt. The same for the external debt is even higher. The external debt is over 42% of GDP. The internal and external debt will be over 100% of GDP in the first decade of 21st century.

ing alone. The servicing of internal debts will be additional burden, which will be far more serious than that of external debts. The borrowing, external or internal, must eventually be curtailed. This is needed in order to avoid default. Mobilization of domestic resources will eventually hold a clue.

Needed Improvement on Domestic Resources

The analysis so far indicates that the saving rate is very low in Pakistan, compared with that in other similar countries. If it were possible to raise domestic savings, a potential for accelerated growth would also arise. Economic policies must be improved, so that domestic resources may be mobilized. Ample room for improvement exists potentially. Intensive and extensive growth policies may be pursued to increase agricultural output. Diversity in crops needs to be introduced. Its exports can, and need to, be enhanced substantially. By doing so, industrial growth can, and must, be stabilized. It will certainly require incentives, initiatives and effective policies. These are attempting to solve severe economic problems. The attempts should not be postponed any further.

Tax Reform Needed

Budget deficit and inflation are inter-connected. Decreasing deficit as well as recovery of economic growth can help control inflation and mitigate unemployment (Farooq, 1996). Presently, under the pressure of international institutions, the government deficit has decreased. Further decrease is still needed. The deficit can be reduced by enhancing the efficiency of the public sector. Curtailment of current expenditures and improvement of tax collection methods, for instance, would raise the administrative efficiency. In order to mobilize resources, solid structural reforms are needed. These changes are not easy. Influential peer groups have to be brought under tax net. New taxes have to be introduced. Tax base has to be widened. The introduction of agricultural tax has not brought much revenue, needing further adjustment. No easy solution is in store. Commitment and sincere efforts are required.

Foreign Sector Improvement Needed

Foreign sector has been a source of economic instability. The growth of trade was unstable. The flow of international resources was also not stable. The trade and foreign exchange instability has contributed to economic problems. Pakistan has not placed priority on expanding exports. The new international economic order poses a set of new challenges for the Pakistan economy. Under new trade rules, there are opportunities to benefit from new free trade norms. The level of technological progress is low. Pakistani entrepreneurs are not very conscious of quality control. Appropriate policies are truly necessary to cope with the new challenge[13]. As stated earlier, Pakistan had been facing quota problems, which would hopefully be less in future. Textiles, the largest industry in Pakistan, are major export products. Improvement in textile products and increase in its exports could help

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13) A Japanese expert from JETRO indicated that Pakistan must focus on high value exports. It also needs to grow long content cotton to earn more foreign exchange.

improve foreign exchange earnings. Rice is also one of the major agricultural exports of Pakistan. Its export could also be enhanced to substantial level. Pakistan must, and can, diversify export base and find new export markets. All these changes indicate that potential does exist for improvement, if appropriate policies are introduced. But these will not be sufficient to fill in the foreign exchange gap. New sources of foreign exchange need to be explored and a breakthrough of inefficient policies must be made.

Unemployment Expected to Worsen

Unemployment is one of the deep-rooted problems of Pakistan. Its future prospects are not very bright, given the high population growth, low quality of human resources, slow economic growth and resource constraints. Several studies indicate the future scenarios. Hamid (1996), Chaudhary and Chaudhary (1994), Chaudhary (1998) and Chaudhary & Hamid (1999), for instance, indicate that if the present trend of slow job creation were to continue, the unemployment situation would become even worse. Future scenarios by Chaudhary & Hamid (1999) indicate that the absorption of surplus labour will be a major challenge. As stated earlier, presently, there are over two million workers who are jobless. Every year more than one million new workers are added and look for new jobs. Unemployment is already high and will grow more. The rate will exceed 10% (Chaudhary & Hamid, 1999), if no policy measure is initiated. However, if the population growth rate is brought down to a level lower than 2.5% and if the economy grows at the rate exceeding 6%, the unemployment rate may be reduced to around 5%. For a complete solution of the problem, improvement in human resources, improvement in labor-intensive employment and restoration of economic growth rate of over 6 % will be required.

Harder Future Challenge

Recently, the major international economic sanctions have been lifted. Some of the foreign aids have resumed. It implies that Pakistan will not default and current projects can be completed. More funds will hopefully be available for investment as well as for the repayment of debt services. The saving-investment gap will be filled in to some extent. The economic growth rate is therefore expected to recover to around 5 % or so by next year. However, it will not be a permanent solution. Still the economy will not perform to its full potential. Pakistan must deal squarely with the deep-rooted diseases and revise economic policies before achieving another accelerated growth. The future challenge will be harder than the past one. The world is squeezed into a global village where competitive survival dominates.

Short-run and Long-run Policies

Two types of policies are needed for sustainable growth.

(i) Short run policies, which focuses on economic recovery. Foreign aid must be utilized efficiently for some very essential purposes. The heavy debt burden does not permit unbounded borrowing. Attention must be paid to improve agricultural output which provides immediate returns. Small industries need to be encouraged to generate employment.

(ii) Long term policies are needed for sustainable growth. Education and human resource development must be given top priority. A policy to convert small industries to medium and large export-oriented ones may be introduced in the long run. Spreading literacy and better education system will help achieve stable growth which can be sustained if domestic resources are mobilized. These changes could lead to political stability. The most important policy is to reduce resource gap and mobilize domestic resources[14]. The saving-investment position needs to be improved substantially. Pakistan used to achieve higher saving rate in the past. It could be achieved again if conditions were met. It must be done by compulsory saving policies and economic incentives. With improvement in resource availability, development expenditures for infrastructure need to be improved. The immediate attention must be paid to further develop the agriculture. It will help increase foreign exchange earnings, employment and savings on the basis of agricultural imports. For industrialization, export-led growth has to be followed, since domestic market is limited. Appropriate policies for this purpose may be introduced. A core for sustained growth is improvement in human resources. Old policies of the 1960s will not work in this new era of openness and competition. Market-orientated and efficiency-based strategies need to be followed. In spite of the poor economic situation of Pakistan, it could have a good potential for joining the new fast growing countries of Asia. Particularly, in the South Asia, it is one of the major countries, which has shown a high potential for rapid growth.

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14) For analysis of debt and its impacts and solution also see Ahmed, E. (1996).

Part Ⅳ: Conclusion and Policy Directions

The present economic analysis of the Pakistan economy reveals that there are five major economic diseases which badly affect its growth. Some of these problems result from inconsistent economic plannings and policies in the past. The triangle problem of deficit, debt and inflation is the result of inefficient economic policies. Trade instability and investment instability have caused the shrinkage of economic growth. International trade does not appear to be playing the role of a driving force for growth.

The long term policies of Pakistan never focused on developing human resources. It continuously suffers from illiteracy, unemployment and low productivity. Failure to mobilize domestic resources as well as foreign dependence appear to be the most serious problems. The government is easily concerned with reliance on external help, rather than internal help. It has unfortunately failed to learn from its own past mistakes. Its self-help attitude is not built in.

The international sanctions, which caused hardships for external sectors, are now lifted. With the resumption of foreign aid and foreign investments, the current depression hopefully will be over soon. The foreign exchange reserves, which had gone to a minimum, will hopefully recover.

In order for the economic growth to return to full potential, additional new steps will be needed. Lessons from past mistakes and improvement of economic policies could help the economy return to the right path.

Two types of policies, short-run and long-run, will be needed:

(1) Short run policies, which focuses on recovery, will help restore the confidence of international donors and local as well as international businessmen. The short run policies may focus on efficient use of resources, mobilization of domestic resources, improving agriculture and incentives for small industries.

(2) Long-term stable and consistent policies will be needed for sustained growth. The long-term policies may be geared to achieving sustained growth. These policies must focus on appropriate sectoral priorities. Human resource development should be at the top of the development agenda. One of the obstacles for international investment is illiterate labour. In the long run, small and medium industries need to be converted into large industries. There is also a need to improve upon technology and quality of exports. With the opening of new era for free trade, there are opportunities for Pakistan to increase its trade. Trade-led growth can accelerate economic growth, which should not be a short-run goal. In the long run, foreign dependence must be reduced, to stop the resource drain through debt servicing.

In the past the economy of Pakistan showed good response to development policies. It was able to achieve one of the highest growth rates in South Asia. The same pattern could occur again when good governance is established, domestic resources are mobilized and human resources are developed. Pakistan has good potential to catch up with rapidly growing countries in Asia. It all depends upon the political stability and efficiency of policies.

Appendix 1

Economic Indicators (% growth per annum)

INDICATORS	1960*s*	1970*s*	1980*s*	1990–91	1992–93	1995–6	1996–7
GNP	6.8	4.8	6.5	3.7	2.3	5.2	1.3
Agriculture	5.1	2.4	5.4	5.1	−5.3	5.8	0.06
Manufacturing	9.9	5.5	8.2	6.2	5.3	5.6	1.2
Services	6.7	6.3	6.7	6.8	4.6	4.8	2.1
Total. Investment (% of GNP)	—	17.4	17.5	19.9	20.6	18.3	17.5
Saving (% of GNP)	—	11.7	13.8	16.9	13.5	11.6	11.3
I–S (% of GNP)	—	5.7	3.7	3.0	7.1	6.7	6.2
Exports	—	13.5	8.5	19.8	0.3	7.1	−2.6
Imports		16.6	4.5	13.1	11.7	16.7	−6.4
Trade Deficit	—	20.5	0.9	−0.1	46.1	46	−15.1
Current A/C Deficit	—	—	21.2	38	174	84.2	15.9
CPI	3.8	12.3	7.3	12.7	9.8	10.8	11.8
Deficit (Overall Budget)	2.1	5.3	7.0	7.4	8.0	6.3	6.2
Development Expenditure.	—	—	7.2	7.5	5.7	4.3	3.5
Expenditure on Health (% GNP)	—	—	0.7	0.7	0.7	0.8	0.8

Source: Economic Survey 1994–5, 1997–8

Appendix 2

Table : 1 Correlation Coefficients among Exports, Foreign Exchange, Capital Instability and Other Variables

Variables	Instab. Capital.	Instab. Export.	Instab.Foreign. Exchange.
GDP growth	−0.17	0.019	−0.2
Growth of L. Force	0.124	0.147	−0.4
Growth of Invest.	−0.61	−0.293	0.34
Capital Instab.	—	0.51	−0.14
Export Instab.	—	—	−0.17
Instab. Foreign. Exchang.	—	—	−0.04

Chaudhary & Qaisrani (1996)

Table : 2 Export Instability, Capital Instability and Economic Growth (Regression Results)

Eq. \ Variable	C	GLF	GXN 2	GKPT	IPK	IX
1	7.5	0.09*	0.39	−0.0001	−722.23*	61.21
2	7.52*	0.1	0.039*	−0.0001	−682.07	—
3	5.29*	0.0297	0.029	−3E	—	−103.68

Chaudhary and Qaisrani (1996)

Eq (1, 2, 3) are equation. Dependent variable is GDP (growth of domestic output). Independent variables are GLF, GXN 2, GKPT, IPKPand IX, which are, respectively, growth of labour force, growth of real exports, growth rate of capital, instability of capital and instability of exports.

Sample Size=22 (1972–94)* Significant at 5 % or less. R–square varies from 0.14 to 0.35. DW statistics is close to 2.

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