Economic Performance of Three Governments

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Pakistan Economy

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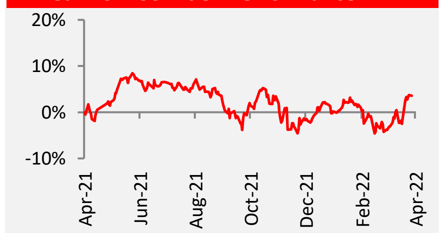
Key Data

KSE100 Index	46,073
KSE-All Share Value (PKRmn)	9,663
KSE-All Share Value (USDmn)	51.8
KSE-All Share Volume (Shmn)	368.8
Market Capitalization (PKRtn)	7.7
Market Capitalization (USDbn)	41.1
1Year High	48,726
1 Year Low	42,780

Source: PSX, Next Research

1 Year KSE100 Index Performance



Source: PSX, Next Research

Next Capital Limited has asked for an objective and unbiased comparison of the economic performance the governments from 2008-09 to the recently ousted PTI government. Analysis is undertaken of the change in key macroeconomic indicators during the tenure of three governments. The first government is the PPP government which was in power from 2008-09 to 2012-13. The second government is that of the PML(N) which held office in Islamabad from 2013-14 to 2017-18. The third government is of the PTI which has been in the federal government since 2018-19. The assessment of economic performance is a complex and difficult exercise. There is need first to recognize the role of exogenous factors like trends in the world economy and global trade which impact on individual economies. In particular, the role of international commodity prices, especially of oil, must be fully allowed for. There are also several domestic factors which affect performance during the tenure of a particular government. In the Pakistani context, this particularly includes the impact of power loadshedding, acts of terrorism and natural disasters. Also, Pakistan has witnessed major constitutional changes like the 18th Amendment and the 7th NFC Award after 2010 which have changed the roles and distribution of resources between federal and provincial governments. Consequently, the report is organized as follows. Section 1 focuses on trends in the world economy from 2007-08 to 2020-21. Section 2 highlights the change during these years in domestic factors like the incidence of acts of terrorism, power outages and natural disasters. Section 3 onwards focus respectively on economic growth, investment, employment, inflation, public finances, balance of payments and the international rankings of Pakistan. The analysis has been undertaken with the help of a Macro econometric Model of Pakistan developed by the author with 60 equations.

1. TRENDS IN THE WORLD ECONOMY

The trends in the world economy during the tenures of the three governments are presented in Table 1. The conditions in the global economy appear to have been somewhat more favorable from 2013-14 to 2017-18, during the tenure of the PML(N) government. At the time of assumption to power by the PPP government, the oil price had reached the peak level of $140 per barrel, after a period of boom in the world economy. It fell to $46 per barrel in 2016-17.

Table 1: Trends in the World Economy

	Growth Rate of World Economy	Growth Rate of Volume of World Trade	Growth Rate of the International Commodity Price Index	Growth Rate of Crude Oil Price (%)
2008-09 to 2012-13	3.3	3.1	0.7	2.1
2013-14 to 2017-18	3.5	3.5	-5.5	-8.4
2018-19 to 2020-21	1.9	2.1	6.3	-2.0

Source: IMF

The pandemic, COVID-19, spread globally in early 2020. The year, 2019-20, saw negative growth in the global economy of 3 percent and fall in volume of world trade of over 5 percent. Clearly, this impacted negatively on the domestic economy in the second year of the PTI government. Fortunately, there has been a relatively strong recovery in 2021.

2. NEGATIVE FACTORS IN THE DOMESTIC ECONOMY

The big negative impact on Pakistan's economy has been the big upsurge in acts of terrorism in the country after the US invasion of Afghanistan following 9/11 and Pakistan's support to this operation. The incidence of acts of terrorism and lives lost due to the attacks are given in Table 2.

Table 2: Annual Number of Terrorism Attacks and Number of Persons Killed

	Terrorist Attacks	Average Annual g%	Number of Persons killed	Average annual g%
2005-06	675		907	
2007-08	2,577	67.0	7,997	α*
2010-11	2,985	4.9	7,107	-3.9
2012-13	1,717	-27.6	2,451	-53.2
2015-16	748	-27.7	1,956	-7.5
2017-18	497	-20.4	1,516	-12.7
2018-19	433	-12.9	1,030	-38.6
2020-21	207	-36.9	335	-56.1

Source: Institute of Peace Studies, Islamabad. * Very large

Table 2 reveals that the number of attacks grew rapidly and reached a peak in 2010-11. It was only after the attack on the Army Public School that a National Action Plan against terrorism was prepared during the tenure of the PML(N) Government in 2015-16. This led to the launch of Zarb-e-Azb operation by the armed forces, especially in FATA. Thereafter, there has been a big decline in the incidence of terrorism. The rampant acts of terrorism imposed both direct and indirect costs on the economy of a large magnitude. The direct costs include the damage to property and loss of lives. The indirect costs consist of fall in investment due to heightened risk perceptions, negative movement in share prices, increase in expenditure of the armed forces, and in higher costs for maintaining law and order. The Ministry of Finance has estimated in the Pakistan Economic Survey of 2013-14 that the total cost cumulatively of the war on terror from 2001-02 to 2013-14 was as high as $102.5 billion. The peak of these costs was in 2008-09 and 2009-10 of $13.6 billion and $23.8 billion respectively. The path of acts of terror and the resulting costs indicate that the largest burden of these costs has been during the tenure of the PPP government. Costs were also high in the initial three years of the PML(N) government, but much lower thereafter following the successful anti-terrorism operation by the military. Fortunately, the PTI government has largely not been hampered by terrorism. However, there are more attacks now, especially in Baluchistan. The magnitude of this negative factor must be kept in mind when evaluating the performance of different governments. The other big constraining factor impacting on the economy has been the incidence of power loadshedding. Table 3 indicates the growth rate in the level of installed capacity and in the quantum of generation of electricity.

Table 3: Growth in Installed Capacity and Generation of Electricity

	Average Annual Growth Rate (%)	
	Installed Capacity	Generation
2003-04 to 2007-08	0.1	4.2
2008-09 to 2012-13	3.2	0.1
2013-14 to 2017-18	7.7	6.2
2018-19 to 2020-21	7.0	1.3

Source: Pakistan Economic Survey.

The Musharraf period witnessed hardly any expansion in electricity generation capacity, but the rate of utilization of available capacity reached a peak level by 2007-08. Consequently, there was little excess capacity in the initial years of the PPP government. In the last three years there was a modest expansion in capacity. The incidence of power loadshedding reached a peak in 2008-09. It is estimated that this resulted in a loss annually of almost 2 percent of the GDP. Credit must be given to the PML(N) government for cumulative expansion in capacity for power generation by almost 47 percent, equivalent to an additional 10,742 MW, in the latter part of its tenure, Chinese investment was attracted as part of CPEC. This has contributed further to additional capacity of over 5000 MW up to 2019-20. Today, Pakistan has significant excess capacity for power generation in winter months. Here again, the larger component of costs of power outages on the national economy have been borne during the tenure of the PPP government. These costs declined sharply in the last three years of the PML(N) government and have been, more or less, non-existent in the first three years of the PTI government.

3. RATE OF ECONOMIC GROWTH

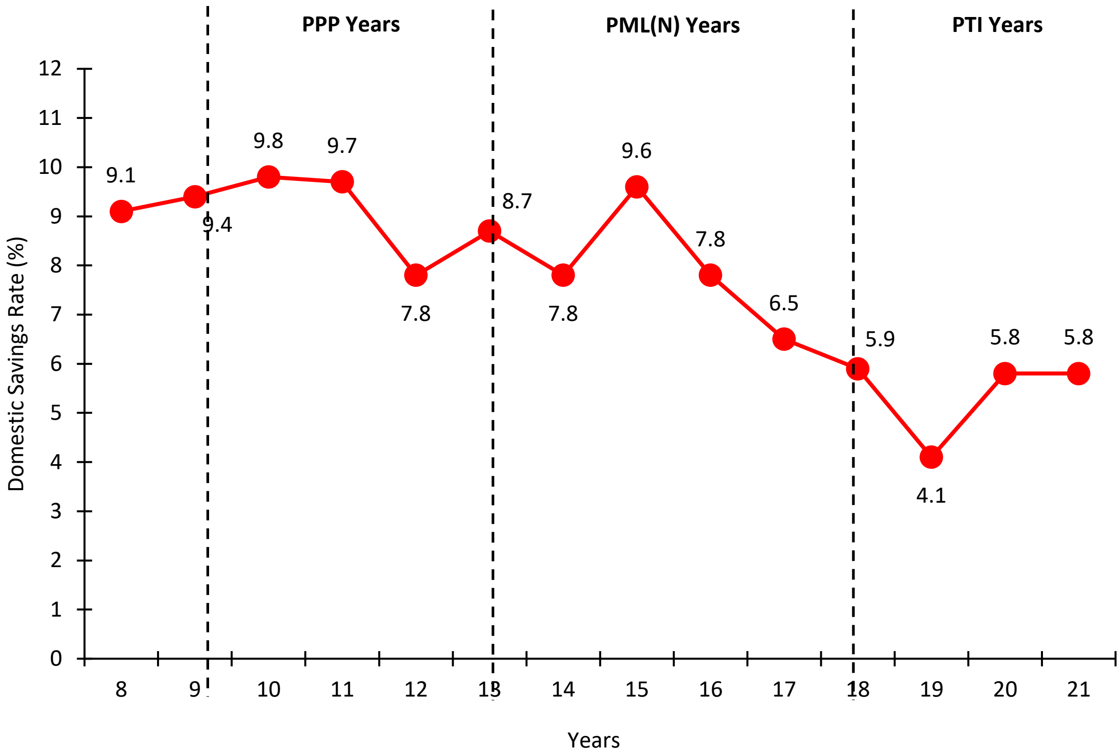
Following identification of the external environment and impact of different domestic negative factors in the three different regimes, assessment of the performance in key macroeconomic indicators is undertaken in this section and subsequent sections. The first performance indicator analyzed is the rate of economic growth. Table 4 gives an in-depth picture of the growth performance in the first and last years, as well as the average, for the PPP and PML(N) governments. This is shown for the first and the third years of the PTI government. The average annual GDP growth rate has been the highest during the tenure of the PML(N) government at 4.6 percent, as compared to 2.8 percent in the period of the PPP government and 1.8 percent in the PTI government tenure up to 2020-21. These growth rates are all low by historical standards. There has been a pattern in the annual GDP growth rates. The PPP and PML(N) governments have achieved a higher growth rate in the last year of their respective tenures. This is the consequence of the pursuit of expansionary fiscal and monetary policies prior to the elections. Among the productive sectors, a somewhat higher growth rate was achieved during the PPP tenure in agriculture, despite the damage due to floods in 2009-10. Industrial growth and expansion of services proceeded faster in the five years of the PML(N) Government. The contribution from the demand side of different expenditures has varied substantially. The fastest growth among different expenditures during the period of PPP government is observed in government consumption expenditure. This is attributable mostly to expansion in the employment of provincial governments following the 7th NFC Award and to liberal wage awards to federal employees. During the PML(N) tenure the fastest growth is observed in public investment of over 12 percent per annum. Also, household consumption expenditure showed relatively high growth rate of over 6 percent. One of the more redeeming features of the performance of the PTI government is the fastest growth rate among the three governments in exports of goods and services at over 7 percent.

Table 4: Growth Rate of the Economy in different Governments (%)

	2007-08	PPP			PML(N)			PTI		
		1st Year 2008-09	Average*	5th Year 2012-13	1st Year 2013-14	Average	5th Year 2017-18	1st Year 2018-19	Average	3rd Year 2020-21
GROWTH RATE OF ECONOMY**										
GDP at factor cost	5.0	0.4	**2.8**	3.7	4.0	**4.6**	5.5	2.1	**1.8**	3.9
GDP at market prices	1.7	2.8	**3.0**	4.4	4.7	**5.1**	5.8	1.1	**1.6**	4.7
GNI	1.7	3.3	**3.4**	4.4	5.2	**5.3**	5.6	2.5	**3.3**	7.1
BY SECTOR										
Agriculture	1.8	3.5	**2.4**	2.9	2.5	**2.1**	3.9	0.6	**2.2**	2.8
Industry	8.5	-5.2	**1.3**	1.4	4.5	**4.9**	4.9	-1.6	**-0.6**	3.6
Services	4.9	1.3	**3.5**	4.9	4.5	**5.3**	6.2	3.8	**2.5**	4.4
BY EXPENDITURE										
Household Consumption Expenditure	3.6	-0.5	**2.7**	2.5	5.6	**6.2**	6.8	3.0	**2.0**	7.4
Government Consumption Expenditure	-0.9	12.7	**5.6**	10.2	1.5	**6.1**	8.6	0.8	**3.8**	4.1
Private Investment	3.9	-3.6	**-2.8**	2.7	5.6	**5.5**	4.8	-2.7	**-0.2**	-1.3
Public Investment	6.4	-8.7	**-6.0**	-7.3	-7.1	**12.4**	12.7	-33.8	**-9.7**	33.6
Exports of Goods and Services	-4.6	-3.4	**2.0**	13.6	-1.5	**-0.1**	10.4	14.5	**7.3**	6.2
Imports of Goods and Services	5.9	-15.9	**-2.9**	1.6	0.3	**9.5**	15.8	4.3	**4.1**	17.5

The worrying development during the tenure of the PML(N) government is the extreme widening in the trade gap. Exports of goods and services showed no growth in real terms, while the volume of imports grew annually on average by over 9 percent. In sharp contrast to this, especially in the three years of PTI, exports have shown a higher growth rate of over 7 percent as compared to 4 percent in imports. The pattern of growth in expenditure raises some doubts about the validity of the GDP growth rate estimate from 2013-14 to 2017-18. For a detailed analysis of consistency, reliability and size of the GDP of Pakistan, please refer to chapter 10 of the book titled "Growth and inequality in Pakistan" by this author. The very unexpected finding is that almost 92 percent of the increase in the size of the GDP is due to the increase in household consumption expenditure, as compared to 70 percent in the PPP period. Such a high marginal propensity to consume is very unusual. The same pattern is visible after 2017-18. It may be because household consumption expenditure is estimated as a residual and had to be overstated because other expenditures were inadequate in explaining the apparent increase in aggregate demand in the economy. The big increase in household consumption expenditure in the five years of the PML(N) Government also implies that the domestic saving rate was low in the economy during these years, as shown in Figure 1. The same pattern is observed in the initial three years of the PTI government.

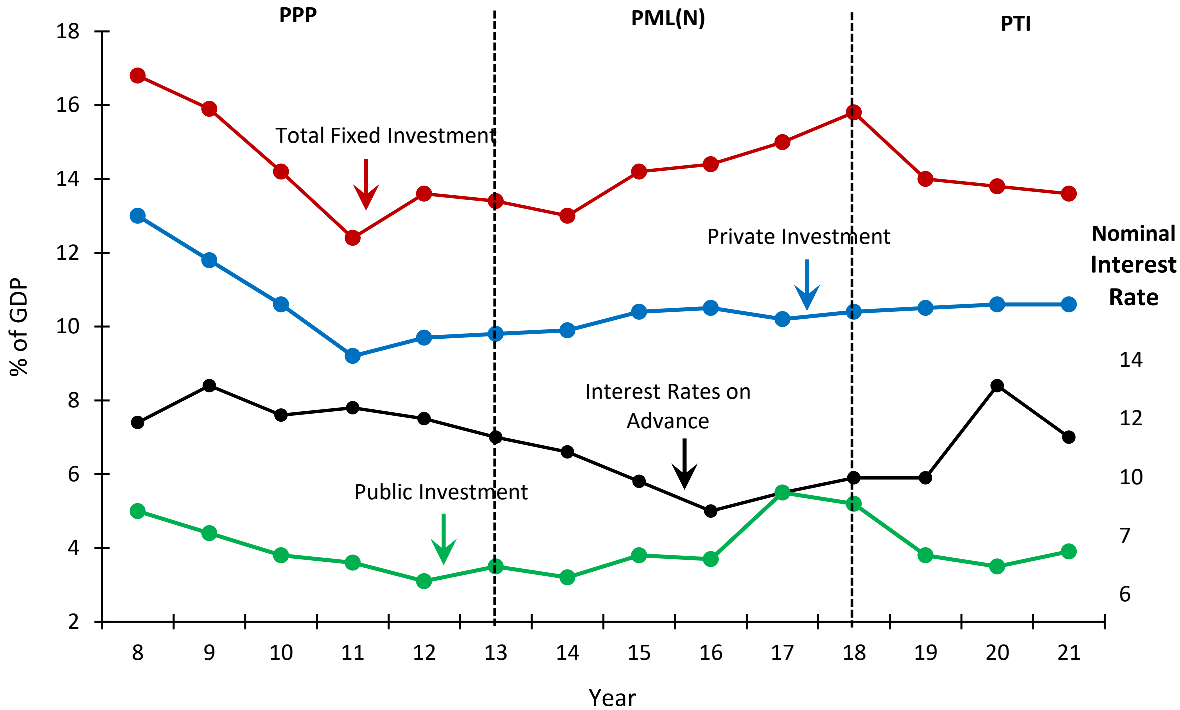
Figure 1: Domestic Saving Rate (derived from the Pakistan Economic Survey) (% of GDP)



4. INVESTMENT

Pakistan historically has had a relatively low level of investment as percentage of the GDP. It is close to half the level in other South Asian countries. However, the incremental capital-output is lower, and this has enabled an economic growth rate on average of 4 to 4.5 percent. The path of investment from 2007-08 to 2020-21 is shown in Figure 2. The high level of power loadshedding and incidence of acts of terrorism led to a big fall in the overall rate of investment during the PPP government from 18 percent of the GDP to only 12.5 percent of the GDP.

Figure 2: Trend in Total, Private and Public Investment and Interest Rate on Bank Advances



The negative factors ceased to pay a big role from 2015-16 onwards as highlighted in Section 2. Investment picked up and rose to above 15 percent of the GDP by 2017-18. After COVID-19, it has fallen again to below 14 percent of the GDP. The level of private investment plunged to below 10 percent of the GDP during the tenure of the PPP government from almost 13 percent of the GDP in 2007-08 and has since risen to almost 11 percent of the GDP. Perhaps surprisingly, there has been a cyclical pattern in public investment. It fell from 2007-08 to 2012-13, rose sharply up to 2017-18 and has since fallen once again. The peak attained during the PML(N) Government in public investment is partly attributable to the commencement of the CPEC. This led a big rise in development allocations especially for highway projects. Also, Chinese companies have invested heavily in coal and solar power generation during the last six years. The Macro econometric Model has been used to quantify the role of different factors in influencing the growth rate of real private investment in the country. The results are presented in Table 5.

Table 5: Impact of different factors on Growth Rate of real Private Investment (%)

	2007-08 to 2012-13	2012-13 to 2017-18	2017-18 to 2020-21
Growth Rate of Real Private Investment (%)	**-2.8**	**7.3**	**-0.2**
Growth Rate of Real GDP (the 'accelerator')	2	6.4	1.1
Rise in Real Interest Rate on Bank Advances	-1.1	-1.3	0.2
Rise or Fall in the Relative Price of Imported Machinery	-2.1	1.3	-0.9
Rise or Fall in the Rate of Corporate Profitability	-0.3	1.4	-0.1
Impact of Negative Factors (Power loadshedding, terrorism COVID-19)	-1.3	-0.5	-0.5

During the period, 2007-08 to 2012-13, the 'accelerator' effort on private investment was more than neutralized by a rise in the real interest rate on bank advances, big jump in the rupee price of imported machinery, fall in corporate profitability, and the high incidence of power loadshedding and acts of terrorism. These were indeed difficult years for the private sector of Pakistan. In contrast, the years, 2012-13 to 2017-18, saw a growth rate of 7.3 percent annually in the level of real private investment. The accelerator effect was stronger, import prices of machinery in rupees did not rise much due to the less depreciation in the value of the rupee and corporate profitability rose significantly. The level of real private investment fell marginally from 2017-18 to 2020-21. Interest rates were brought sharply after COVID-19. The largest negative impact is due to the escalation in the cost of imported machinery due to the continuing process of devaluation of the rupee. Also, the spread of COVID-19 discouraged further expansion in capacity.

5. EMPLOYMENT

A critical measure of performance of governments is the creation of more employment opportunities for the people. The growth in employment hinges crucially on the rise in output in different sectors of the economy. This relationship is measured by the employment to output elasticity, which indicates the percentage increase in employment with a 1 percent increase in output. The Macro econometric Model has enabled the determination of the average elasticity, for the three productive sectors as Agriculture (0.601), Industry (0.545), and Services (0.721). These elasticities have been used to estimate employment in 2020-21. For earlier years, estimates are available from the Labor Force Surveys undertaken periodically by the PBS. Table 6 highlights the trends in employment in the three eras.

Table 6 Employment Trends (million)

	2007-08	2012-13	g %	2017-18	g %	2018-19	g %	2020-21*
Labor Force Participation Rate (%)	45.2	45.7	**0.2**	44.3	**-0.6**	44.8	**1.1**	43.2
Labor Force	51.78	59.74	**2.9**	65.5	**1.8**	68.75	**5.0**	71.06
Employed	49.09	55.01	**2.6**	61.71	**1.9**	64.03	**3.7**	64.33
Unemployment Rate	5.2	6.2	**3.5**	5.8	**-1.3**	6.9	**19.0**	9.4
INDUSTRY DISTRIBUTION								
Agriculture	21.89	24.49	**2.2**	23.76	**-0.6**	25.09	**5.6**	n.a**
Industry	9.47	12.02	**4.8**	14.62	**3.9**	14.73	**0.7**	
Services	17.73	19.5	**1.9**	23.33	**3.6**	24.21	**3.3**	
EMPLOYMENT STATUS								
Employers	0.44	0.73	**10.1**	0.36	**3.3**	0.96	**11.6**	
Self-Employed	16.78	18.81	**2.3**	21.47	**2.6**	22.92	**6.7**	
Unpaid Family Workers	14.19	14.73	**0.7**	13.21	**-2.2**	14.66	**11.0**	
Employees	17.68	21.74	**4.1**	26.17	**3.7**	25.49	**-2.6**	
FORMAL AND INFORMAL SECTOR*								
Formal	7.4	8.26	**2.2**	10.62	**5.0**	10.75	**1.2**	
Informal	19.8	23.19	**3.2**	27.33	**3.3**	28.19	**3.1**	

Source: Labour Force Surveys, PBS
* Projected ** Not available in rest of column

Employment trends from 2007-08 to 2020-21 are presented in Table 6. The labor force participation rate of population aged 10 years and above is relatively low in Pakistan at below 50 percent, due particularly to the low rate of entry of females into the labor market. It attained a peak of almost 46 percent in 2012-13 and has since fallen below 45 percent in 2018-19. The highest rate of annual increase was observed in the first three years of the PTI government. The labor force surveys also reveal that the growth rate of employment was higher in the PPP tenure then during the period of the PML(N) government, even though the economy grew at a faster rate in the latter period. This is partly attributable to the big increase in jobs in provincial governments after the 7th NFC Award. The only period when there was a fall in the unemployment rate was in the tenure of the PML(N) government, when it declined from 6.2 percent to 5.8 percent. Following the spread of COVID-19, there was a big loss of jobs. Despite the economic recovery in 2020-21, the unemployment rate remains at a historical high of 9.4 percent. This has been recently contradicted by the PBS which estimates the unemployment rate at only 5.4 percent in 2020-21. There is the likelihood that the growth in employment between 2018-19 and 2020-21 has been consciously overstated as the employment-to-output elasticities are much higher than has historically been the case. As development proceeds, the normal expectation is that the employment will shift from the traditional sector, agriculture, to the modern sectors of industry and services. However, the only period where this has been witnessed is from 2012-13 to 2017-18, when employment declined in agriculture. The fast growth of other sectors enabled absorption of an additional 6.4 million workers during these years. The positive development in the five years of the PPP government was an increase in the share of employees and a decline in the share of the self-employed. This provided for greater job security. Also, the share of jobs in the formal sector has been growing steadily in the three eras.

6. INFLATION

Another key indicator of the performance of a government is its success in restricting the rate of increase in prices, especially of food items. Table 7 gives the rate of inflation, overall and disaggregated, in the first and last years, as well as the average, during the tenure of a particular government.

Table 7: Trends in the Rate of Inflation (%)

Rate of Inflation in	PPP			PML(N)			PTI		
	1st Year 2008-09	Average	5th Year 2012-13	1st Year 2013-14	Average	5th Year 2017-18	1st Year 2018-19	Average	3rd Year 2020-21
CPI	**17.0**	**11.1**	**7.4**	**8.6**	**4.9**	**4.7**	**6.8**	**8.4**	**8.9**
Food Prices	23.1	**13.4**	7.1	9.0	**3.9**	1.8	4.8	**10.2**	12.8
Non-Food Prices	13.4	**9.7**	7.5	8.3	**5.2**	5.4	8.0	**7.3**	5.7
Implicit GDP Deflator	20.7	**11.9**	6.4	7.0	**3.6**	2.5	8.8	**9.1**	9.7
Core Inflation	11.4	**9.2**	9.5	6.6	**6.0**	5.8	7.2	**6.9**	6.0
SOME KEY PRICES									
Wheat Procurement Price	52.0	**13.0**	14.3	0.0	**1.6**	0.0	0.0	**10.8**	28.6
HSD Oil	3.6	**7.1**	-21.3	-4.1	**8.4**	46.6	6.2	**-1.1**	11.5
Motor Spirit	-23.4	**-1.6**	-22.5	7.9	**7.2**	36.6	13.2	**2.9**	8.3

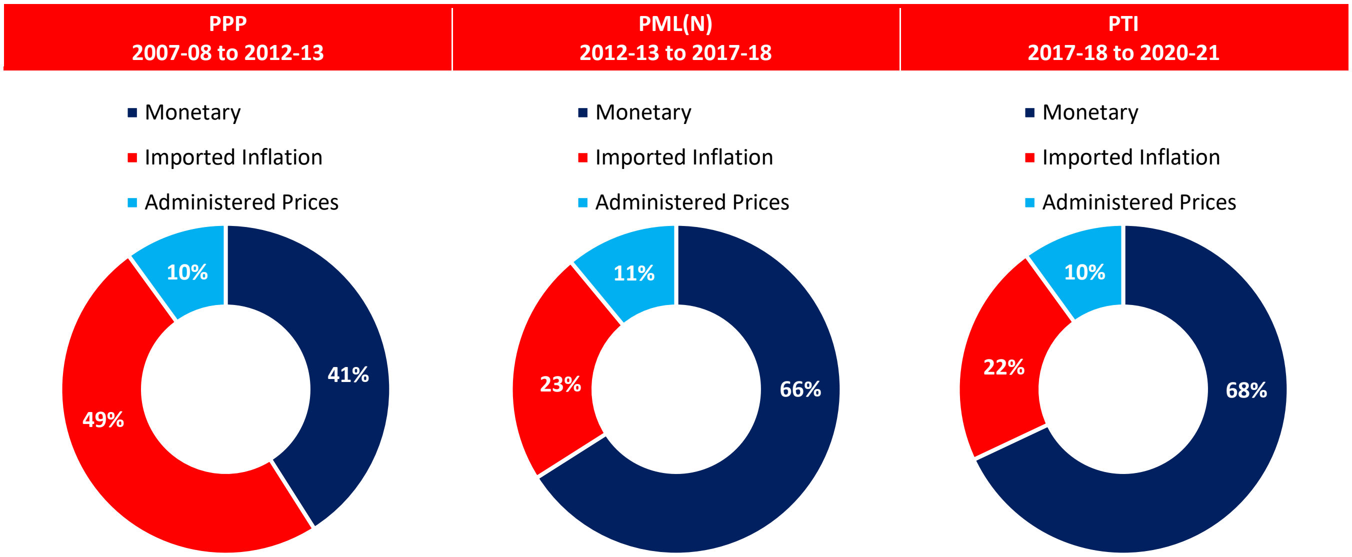
Source: PES

The highest average annual rate of increase in the overall consumer price index (CPI) was during the period in office of the PPP government. It was high by historical standards at 11 percent. The assumption to office by the PML(N) government saw a perceptible drop in the rate of inflation, especially in the last three years. Consequently, the five-year average was under 5 percent. The rate of inflation has accelerated during the tenure of the PTI government, from 6.8 percent in 2018-19 to over 12 percent currently. Throughout the period, 2008-09 to 2012-13, the rise in food prices significantly outpaced the increase in non-food prices. During its first year, the PPP government made a quantum jump in the procurement price of wheat by 52 percent to raise net incomes of farmers and boost production. As opposed to this, the PML(N) government maintained a tight lid on the wheat price. Overall, it had considerable success in keeping the increase in food prices over the five years to below 4 percent per annum. More recently, there has been a big escalation in the rate of increase in food prices to almost 13 percent in 2020-21. The key administered prices are the prices respectively of electricity, gas, motor spirit and HSD oil. They generally reflect the movement in import prices, but when these are unusually high, downward adjustments can be made in tax rates. Alternatively, when the global prices of petroleum products are low, the petroleum levy is enhanced. Table 7 reveals massive fluctuations in the price of motor spirit and HSD oil over the years. The 'core' rate of inflation focuses on the rate of increase in non-food and non-fuel prices. It is considered as a better reflection of the overall demand or cost-push pressures on prices. Historically, it has guided the posture of monetary policy. There are contrasting trends in the three periods. During the PPP years, the 'core' rate of inflation was below the overall rate of increase in the CPI. This pattern changed during the tenure of the PML(N). The core rate of inflation was higher at 6 percent. During the first three years of the PTI government, the 'core' rate of inflation is operating at a lower rate. The fundamental question is what have been the key factors affecting the rate of inflation in Pakistan? Research as part of construction of the Macro econometric Model of Pakistan reveals the following determinants in Pakistan of the overall rate of increase in CPI in a particular year:

- Rate of expansion in money supply (lagged by one year) minus the rate of increase in the real GDP
- Rate of increase in the unit value index of all imports (combined effect of change in US$ prices and depreciation of the rupee)
- Rate of increase in key administered prices (electricity, gas, petroleum products)

The estimation of the separate effects on the above three factors are given in Figure 3 below.

Figure 3: Contribution of Different Factors to Inflation in Pakistan



The results are striking. A significantly larger part of inflation in the PPP years was due to the escalation in import prices. The contribution was 44 percent as compared to 22 percent and 23 percent respectively in the case of the PTI and PML(N) governments. Therefore, the higher rate of inflation between 2007-08 and 2012-13 is attributable to bigger escalation in import prices. The PTI has also tended to highlight the imported component of inflation. However, this is valid only for part of 2020-21. After COVID-19, international commodity prices had, in fact, fallen sharply.

7. PUBLIC FINANCES

The trends in public finances are presented in Tables 8 to 10. They have been derived from the information on fiscal operations released quarterly by the federal Ministry of Finance. Sustainability of the growth process requires that fiscal deficits remain at a manageable level in terms of access to relatively low-cost financing and that the level of government debt is restricted. The Fiscal Responsibility and Debt Limitation Act of 2005 had set the limit on government debt at 60 percent of the GDP. This limit was breached for the first time in 2012-13. Table 8 presents the picture of public finances of the federal and provincial governments combined. Total revenues as percentage of the GDP have shown a variable trend. They attained a peak in the tenure of the PML(N) Government. This was achieved by enhancement of the tax-to-GDP ratio to 13 percent. However, during the first three years of the PTI Government it has fallen below 12 percent of the GDP. Total expenditure has remained at close to 22 percent of the GDP in the last five years. Earlier, it had shown a rising trend from under 20 percent of the GDP in the initial years of the PPP government. The lid on total expenditure as percentage of the GDP has implied a sharp cut in the level of development spending in the presence of a rising level of current expenditure with negative impact on the growth process. In particular, the cost of debt servicing has risen significantly as percentage of the GDP.

Table 8: Broad Trends in Public Finances (Consolidated Position of Federal and Provincial Governments) (% of GDP)

	PPP		PML(N)		PTI	
	First Year 2008-09	Terminal Year 2012-13	First Year 2013-14	Terminal Year 2017-18	First Year 2017-18	Third Year 2020-21
Total Revenue	**4.1**	**13.0**	**14.3**	**15.2**	**12.7**	**14.5**
Tax Revenue	9.2	9.6	10.1	13.0	11.6	11.9
Non-Tax Revenue	4.9	3.4	4.2	2.2	1.1	2.6
Total Expenditure	**19.3**	**21.0**	**19.8**	**21.8**	**21.6**	**21.6**
Current Expenditure	**15.6**	**16.0**	**15.8**	**17.0**	**18.4**	**19.0**
Debt Servicing	4.9	4.3	4.5	4.4	5.4	5.8
Defense Expenditure	2.5	2.4	2.5	3.0	3.0	2.8
Others	-	9.3	8.8	9.6	10.4	10.4
Development Expenditure and Net Lending	3.5	5.0	4.9	4.7	3.2	2.8
Budget Deficit	**-5.2**	**-8.0**	**-5.5**	**-6.6**	**-8.9**	**-7.1**
Primary Deficit	**-0.3**	**-3.7**	**-1.0**	**-2.2**	**-3.5**	**-1.3**
Level of Government Debt *(% of GDP)*	54.53	60.13	58.33	66.51	77.51	74.75

Table 9: Level and Composition of Government Expenditures (% of GDP)

	PPP		PML(N)		PTI	
	1st Year 2008-09	5th Year 2012-13	1st Year 2013-14	5th Year 2017-18	1st Year 2018-19	3rd Year 2020-21
A. FEDERAL	**13.5**	**14.6**	**14.4**	**13.2**	**14.3**	**14.3**
1. Current Expenditure	**11.6**	**11.2**	**11.2**	**11.0**	**12.4**	**13.1**
Debt Servicing	4.9	4.3	4.5	4.4	5.4	5.8
Defense* Expenditure	2.9	2.8	2.9	3.7	3.7	3.4
Grants & Subsidies	1.9	2.8	2.6	1.8	2.0	2.6
Others	1.9	1.3	1.2	1.1	1.3	1.3
2. Development Expenditure	**11.6**	**11.2**	**11.2**	**11.0**	**12.4**	**13.1**
B. PROVINCIAL	**5.8**	**6.4**	**6.3**	**8.5**	**7.3**	**7.5**
1. Current Expenditure	4.2	4.8	4.6	6.0	6.0	5.9
2. Development Expenditure	1.6	1.6	1.7	2.5	1.3	1.6
C. TOTAL	**19.3**	**21.0**	**19.8**	**21.8**	**21.6**	**21.8**
Share of Provincial Expenditure (%)	**30.0**	**30.5**	**31.8**	**39.0**	**33.8**	**34.4**
Share of Development Expenditure (%)	**18.1**	**23.8**	**26.3**	**21.6**	**14.8**	**12.8**

Budget deficits as percentage of the GDP have been relatively low during the tenure of the PML(N) government. However, the last year of both the PPP and PML(N) governments has witnessed the use of expansionary fiscal policies to improve election prospects. There has been a big increase in the government debt as percentage of the GDP, with the quantum of debt being measured according to the FRDL Act. As shown in Table 8, the ratio has risen during the tenure of all three governments. Perhaps surprisingly, the increase in the government debt to GDP ratio from the first year to the fifth year was larger in the PML(N) government tenure at 8.2 percent of the GDP as compared to 5.6 percent of the GDP in the five years of the PPP government. The big jump in the level of government debt of 11 percent of the GDP in the first year of the PTI government is attributable to a big fall in revenues to GDP due particularly to efforts at controlling the level of imports to reduce the extremely large current account deficit left by the PML(N) Government. However, by the third year, the level of debt has been brought down by 3 percent of the GDP.

Table 9 highlights the trends in the level and composition of public expenditure. As indicated earlier, the level of current expenditure has risen during the last few years, due primarily to the jump in debt servicing, following the hike in interest rates. Development expenditure at the federal level has consequently been cut back sharply. Provincial expenditure has shown a sharply rising trend, especially after 2009-10, following the big increase in transfers built into a favorable 7th NFC Award. One of the positive consequences has been the increase in social sector spending on education and health, which has risen from 2.3 percent of the GDP in 2007-08 to almost 3.4 percent off the GDP by 2020-21.

Table 10: Trend in Tax-to-GDP Ratio (%)

	PPP		PML(N)		PTI	
	1st Year 2008-09	5th Year 2012-13	1st Year 2013-14	5th Year 2017-18	1st Year 2018-19	3rd Year 2020-21
A. FEDERAL						
Direct Taxes	**3.4**	**3.2**	**3.5**	**4.5**	**3.8**	**3.6**
Income Tax	3.4	3.2	3.5	4.5	3.8	3.6
Indirect Taxes	**6.4**	**5.8**	**5.9**	**7.3**	**6.8**	**7.3**
Sales Tax	3.5	3.7	3.9	4.3	3.8	4.2
Customs Duty	1.1	1.0	0.9	1.8	1.8	1.6
Excise Duty	0.9	0.5	0.6	0.6	0.6	0.6
GIDC + Petroleum Levy	2.9	0.6	0.5	0.6	0.6	0.9
B. PROVINCIAL	**0.3**	**0.6**	**0.7**	**1.2**	**1.0**	**1.0**
C. TOTAL TAXES	**10.0**	**9.6**	**10.1**	**13**	**11.6**	**11.9**
Share of Direct Taxes	**34.0**	**33.3**	**34.6**	**34.6**	**32.8**	**30.3**

The trend in revenues from different taxes is shown in Table 10. The peak was attained during the tenure of the PML(N) Government of 13 percent of the GDP in 2012-13. A number of proposals were implemented to broaden the income tax base and raise the effective tax rates in indirect taxes. The tax-to-GDP ratio now stands at close to 12 percent of the GDP and the share of indirect taxes has increased somewhat.

8. BALANCE OF PAYMENTS

Perhaps the most critical area from the viewpoint of management of the national economy is the balance of payments in external transactions of the country. Table 11 presents the trends from 2007-08 onwards in different accounts of the balance of payments. These accounts are respectively the current account, the capital account, and the financial account.

Table 11: Trend in Balance of Payments (% of GDP)

	Current Account	Capital Account	Financial Account	Errors & Omissions	Balance of Payments	IMF	Reserves	∆* (Reserves)
2007-08	-13.9	0.1	8.1	0.3	-5.4	-0.1	9.7	-5.5
2008-09	-9.3	0.4	5.6	0.1	-3.1	3.7	10.3	0.6
2009-10	-3.9	0.2	5.1	-0.1	+1.3	+1.3	14.0	4.1
2010-11	0.2	0.1	2.1	0.0	2.4	2.4	15.6	2.1
2011-12	-4.7	0.2	1.3	-0.1	-3.3	-3.3	11.9	-4.4
2012-13	-2.5	0.3	0.5	-0.3	-2.0	-2.0	7.2	-4.5
2013-14	-3.1	1.9	5.6	-0.4	4.0	4.0	10.5	3.4
2014-15	-2.8	0.4	5.1	0.0	2.7	2.7	14.8	4.6
2015-16	-5.0	0.3	6.9	0.5	2.7	2.7	19.4	4.7
2016-17	-12.3	0.4	9.9	0.1	-1.9	-1.9	17.6	-2.8
2017-18	-19.2	0.4	13.6	-0.9	-6.1	-6.1	11.4	-6.2
2018-19	-13.4	0.2	1.8	-0.1	-1.5	-1.5	9.3	-1.9
2019-20	-4.4	0.3	9.3	0.2	5.3	5.3	13.7	4.6
2020-21	-1.9	0.2	8.2	-1.0	+5.5	+5.5	18.7	4.4

Source: SBP

The current account deficit was at a peak of almost $14 billion, due, in particular, to the extremely high oil price in 2007-08. Thereafter, it showed a sharply declining trend up to 2015-16. After 2015-16 the exponential growth in the deficit is largely attributable to the big rise in the real effective exchange rate implying that the rupee was kept substantially overvalued. The PML(N) government apparently chose this strategy to keep the inflation rate very low especially prior to the elections. However, this led a 30 percent jump in imports from 2015-16 to 2017-18. The bottom line in terms of the level and change of foreign exchange reserves reflects the size of the current account deficit and net inflows into the financial account. A clear cyclical pattern is visible in the level of reserves. From 2007-08 to 2010-11, they rose from $9.7 billion to $16.6 billion. They then fell to $7.2 billion in 2012-13. Between 2012-13 and 2015-16 they rose rapidly once again to reach the peak of $19.4 billion in 2015-16 and then declined sharply to $11.4 billion just before the exit of the PML(N) government. This was followed by another cycle and the year, 2020-21, closed with relatively high foreign exchange reserves of $18.7 billion. Table 12 highlights the trend in key ratios of external vulnerability from 2007-08 to 2020-21. The external debt to GDP ratio declined somewhat during the tenure of the PPP government and has risen thereafter, as per the SBP. The very critical ratio of external debt as percentage of exports has risen to an extremely high level, from 192 percent in 2007-08, with a doubling, to 388 percent in 2020-21. Fortunately, although low, reserves as percentage of external debt have shown a rising tendency since 2012-13. Overall, there are disparate trends in the key ratios.

Table 12: Key Ratios of External Vulnerability ($ billion)

Key Ratios	2007-08	2012-13	2017-18	2020-21
Current Account Deficit (% of GDP)	-8.5	-1.1	-6.0	-0.6
External Debt as % of GDP	28.2	27.0	29.5	34.6
Debt Servicing as % of External Debt	4.1	9.0	5.5	9.2
External Debt as % of Exports	192	193	310	388
Reserves as % of External Debt	18.8	9.8	10.4	14.2
Reserves Cover of Imports (months)	2.3	2.4	1.7	3.4
Reserves as % of (Current Account Deficit + Debt Servicing)	55.1	75.0	40.6	132.8

9. COMPARISON OF IMBALANCES IN TERMINAL YEAR

The tenure of the PTI government is likely to end shortly. The issue is the magnitude of imbalances left by this government and whether the task of stabilizing the economy will be more or less difficult for the successor government than what the PTI faced when it assumed power. A comparison is made in Table 13 below of the deficits in the terminal year of the PML(N) and PTI governments.

Table 13: Imbalances in the last year of the PML(N) and PTI Governments

	PML(N)	PTI	% Difference
A. EXTERNAL ($ Billion)			
Trade deficit *	-27.3	-35.4	29.6
Current account deficit**	-11.5	-12.1	5.0
Foreign exchange reserves*	14.0	12.0	-14.3
B. DOMESTIC (%of GDP)			
Budget Deficit ***	-2.2	-2.1	-4.5

*As of end March 2018 and March 2022

** As of end February 2018 and February 2022

*** AS of end December 2017 and December 2021

Sources: PBS, SBP and Ministry of Finance

Therefore, the balance of payments position is worse at the time of exit of the PTI government. However, the budgetary position is marginally better, but the higher expenditure due to the relief package could lead to a larger budget deficit by end June compared to the deficit in 2017-18. The fundamental question is what were the policies that contributed to the large deficits in the tenure of the PML(N) government? These are identified as follows:

i) The PML(N) government consistently maintained the policy of keeping the exchange rate overvalued to keep the rate of inflation low at below 5 percent. The result was that the Real Effective Exchange rate (REER) rose to the peak index value of 121.0 in June 2017, with the base year of 2016. This led to phenomenal growth in the volume of imports, while simultaneously reducing the profitability and volume of exports.

ii) The policy was also to keep the level of interest rates very low to stimulate private investment. The interest rate on bank advances was only 7 to 8 percent as compared to 13 to 14 percent during the tenure of the PPP government. There was success in raising the real private investment by 6 percent per annum, but it kept the cost of import financing very low. Import of machinery grew rapidly coupled with the peak in imports of power generation machinery. This put more pressure on the trade deficit.

iii) The growing external financing needs due to large current account deficits led to a big jump in external borrowing. Not only did the level of public external debt go up by 40 percent but there was increasing resort to high-cost medium-term commercial borrowing and flotation of bonds. This has implied exponential growth in external debt servicing during the tenure of the PTI government.

iv) The last and pre-election year of 2017-18 also witnessed the resort to expansionary fiscal policies. Numerous tax concessions in the budget for 2018-19, including a doubling of the exemption limit in the personal income tax, were granted. This put pressure on the budget deficit in the first year, 2018-19, of the PTI government and it reached an all-time peak of almost 9 percent of the GDP.

Overall, the PML(N) government in an attempt to show relatively high growth and low inflation greatly exacerbated the problem of large trade and current account deficits, leading to mushroom growth in external financing requirements and external debt. The PTI government inherited the largest ever current account deficit of over $19 billion in its first year in office. Reserves plummeted to $ 9 billion by December 2018. Clearly. The option was to go back to the IMF for balance of payments support. Instead, it preferred initially to borrow from bilateral lenders like China, Saudi Arabia, and the UAE. Strong measures were taken to stabilize the economy. The rupee was devalued by almost 34 percent. The current account improved somewhat but reserves remained low at $ 9.3 billion as of June 2019. Consequently, the decision was taken to seek IMF program funding through the Extended Fund Facility of $ 6 billion over three years. Following commencement of the IMF program the policy rate of the SBP was raised from 7 to 13.25 percent. The precipitous fall in commodity prices after COVID-19 greatly helped in curtailing the current account deficit which fell sharply to $ 4.4 billion in 2019-20 and to only $ 1.9 billion in 2020-21. Reserves increased to the healthy level of $ 18.7 billion by June 2021. The success in stabilizing the economy enabled the PTI government to launch an expansionary budget for 2021-22 aimed at raising the GDP growth rate to above 5 percent. Development spending was proposed to be increased by as much as 75 percent.

However, commodity prices started rising sharply from April 2021 onwards. They have since gone up by over 60 percent. Consequently, the current account deficit has risen once again to the very high level of $ 12 billion in the first eight months of 2021-22. The external debt servicing is likely to be $ 12 billion this year. Therefore, the annual financing requirement of Pakistan will reach the unprecedented level of almost $ 30 billion in 2021-22. If commodity prices do not start falling, then the inflow of funds required in 2022-23 will rise to $ 35 billion. The political situation had led to a de facto suspension of the Pakistan EFF program by the IMF. The rupee is floundering and has fallen below Rs 188 to the dollar. For the first time international credit rating agencies like Bloomberg are highlighting the growing risk of default that Pakistan faces in its external payment obligations.

10. INTERNATIONAL RANKINGS OF PAKISTAN

This last section of the report focuses on Pakistan's ranking in key international indices. This highlights not only external perceptions of the country but also can act as a measure of the performance of different governments. Four indices have been selected as shown in Table 14. The first is the human development index of the UNDP. Pakistan has had a relatively low ranking, even among South Asian countries. Unfortunately, the ranking has continued to worsen from 2008 to 2020. Pakistan was ranked 125th among 180 countries in 2008. It is ranked 154th in the latest ranking.

Table 14: Ranking of Pakistan in Different Indicators

Years	Human Development Index Ranking (UNDP	Global Competitiveness Ranking (World Economic Forum)	Corruption Perceptions Index (Transparency International)	CPIA Economic Management (World Bank)	CPIA Fiscal Management (World Bank)
2008	125	92	134	3.0	2.5
2013	146	112	127	2.8	2.5
2018	150	107	117	3.2	3.0
2020	154	110	140	3.2	2.5

The next is the Global Competitiveness Index of countries prepared by the World Economic Forum. The path of ranking is somewhat cyclical. It deteriorated significantly from 2008 to 2013; improved somewhat from 2013 to 2018 and has then worsened once again. The third index is the Corruption Perceptions Index. The good news here is that Pakistan's ranking improved substantially from 134th in 2008 to 117th in 2018. Unfortunately, it has fallen sharply to the 140th position in 2020. The World Bank undertakes Country Policy and Institutional Assessment (CPIA) of countries in the performance of different functions and assigns a score from a low of 1 to a high of 6. Table 13 gives Pakistan's score in the quality of economic management in different years. There is some fluctuation in the scores over the years. It fell somewhat during the PPP tenure. The highest score has been in 2020, which was the second year of the PTI government. This is perhaps a reflection of the stellar job of the Government in limiting the loss of lives and livelihood after the first COVID-19 attack.

11. CONCLUSION

The years 2008-09 to 2020-21 have not been exceptional years in the economic history of Pakistan. The average GDP growth rate has been relatively low while the rate of inflation has been relatively high. Very high levels of power loadshedding and acts of terrorism played a major role in restricting private investment and constraining productive activity up to 2015-16. The pandemic, COVID-19, then wreaked substantial damage on lives and livelihoods after March 2020. Each of the three governments have made efforts to sustain the economy in difficult conditions. The PPP government built political consensus around the comprehensive 18th Amendment to the Constitution and the 7th NFC award. Also, greater focus was placed on agricultural productivity, human development, employment creation and poverty alleviation. The PML-N government was able to revive private investment and accelerate growth. The constraint of limited power generation capacity was removed by the end of its tenure. Consensus was also built on the National Action Plan against terrorism, which was very effectively implemented by our Armed Forces. The CPEC program was launched in collaboration with China and envisaging investment of $60 billion in infrastructure projects. However, the current account deficit rose to a record level in 2017-18. The new PTI government first had to implement strong policies to bring down the current account deficit to a sustainable level, leading thereby to lower growth and higher inflation. The excellent job in managing the economy after the first COVID-19 attack in March 2020 has been internationally recognized, especially the various social safety nets put in place like the Ehsaas program. Pakistan is close to a financial crisis once again as shown in Table 13 due to the rise in international commodity prices after June 2021, following recovery of the world economy and more recently after the start of the Russia-Ukraine war, and the exponential in external debt repayments. The coalition government in power will have to implement very strong fiscal, monetary, and other policies to restore the ability of Pakistan to fully meet these large external debt repayment obligations and sustain the level of essential imports