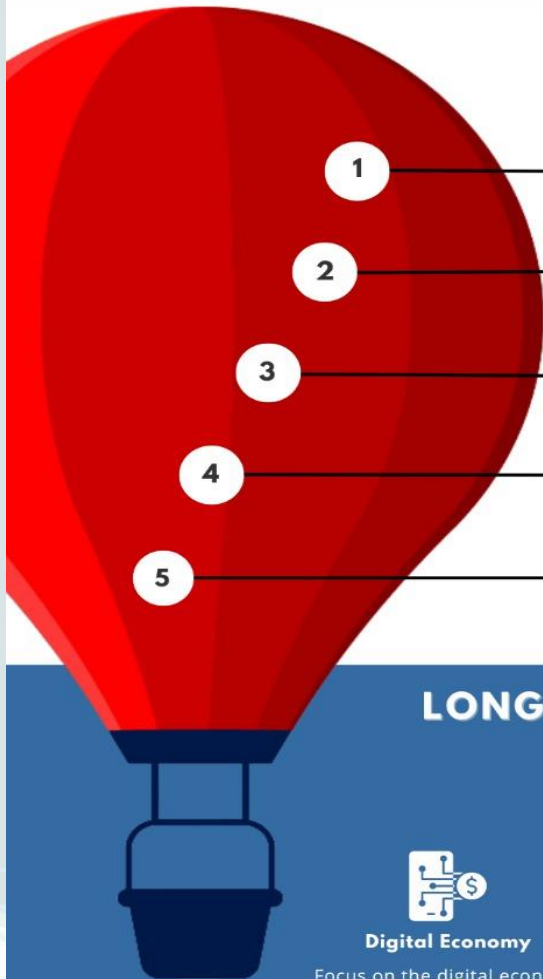


Long-term Policy Options for Reducing Dependence and Improving Core of National Economy

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(June, 2023)

EXECUTIVE SUMMARY

LONG-TERM POLICY OPTIONS FOR REDUCING DEPENDENCE AND IMPROVING CORE OF NATIONAL ECONOMY



KEY CHALLENGES



Growing Population

Strain on resources & infrastructure. Population expected to reach 350 million by 2050.



Weak Economy

High debt-to-GDP ratio, low foreign exchange reserves, high inflation & unemployment rates.



Political Instability

Hinders economic planning, slows growth, and leads to bad policy decisions.



Lack of Investment

Low investment-to-GDP ratio, resource depletion, and reliance on borrowing.



Reliance on Foreign Aid

Impedes economic independence and domestic revenue generation.

LONG TERM POLICY OPTIONS

Diversifying the Economy



Digital Economy

Focus on the digital economy for growth, innovation, and job creation



Investment Policy & Climate

Improve investment policy and climate to attract foreign direct investment



Human Capital

Invest in human capital to enhance education, health, and workforce skills

Governance



Economic Governance

Modernize economic governance for efficiency and swiftness



Political Governance

Establish clear separation between parliament and cabinet for effective political governance



Increase Engagement

Increase engagement and dialogue with regional and global organizations



Cultural Exchanges

Promote cultural exchanges and contribute to international peace and security

OVERVIEW

Pakistan's economy is paralyzed, with every indication falling. State budget deficits range from 2.95% to 12.2% of GDP due to persistent income-expenditure mismatch. Our tax-to-GDP ratio is one of the lowest in the world because of an anti-growth exploitative tax system, sectoral imbalances, and inadequate province revenue production. Successive administrations have taxed just the salaried elite and manufacturing sector, leaving 50% of the economy untaxed. It has lowered middle- and lower-middle-class buying power and raised export manufacturing costs.

Public expenditures are dominated by defence and debt servicing, leaving little for other services. Since education and health get a pittance, there is little room for cuts. Overdependence on imports, stagnating exports, poor foreign direct investment, and shrinking remittances cause external imbalances. Fiscal deficits caused by prolonged revenue-expenditure mismatches contribute to external imbalances.

Our export mix is low-valued items with low-income elasticity and strong price elasticity. Most imports are fossil fuels, which are affected by energy price shocks. Thus, our exports are uncompetitive and fail to generate foreign cash. Investment is minimal and goes to unproductive areas like real estate. Though remittances are expanding due to State Bank of Pakistan facilitation, they can be multiplied if the Pakistani government improves workforce skills. The economy's mainstays—agriculture and manufacturing—are also struggling. The elite benefit from this economy. Consumption-driven Pakistan may need budgetary tightening. Since the investment rate does not match development size, the growth trajectory is unsustainable.

There are several interrelated economic and political issues plaguing Pakistan's economy. The alternatives for long-term policy change to lessen reliance and strengthen the backbone of the national economy will be evaluated and recommended in this policy brief.

SOME KEY FACTORS CONTRIBUTING TO PAKISTAN'S DEPENDENCE

Growing Population: At the moment, Pakistan is home to more than 220 million people, and it is anticipated that this number will rise to over 350 million by the year 2050. This signifies a projected increase of 56% in the country's population, which is a cause for alarm due to the strain it will put on Pakistan's resources and infrastructure. Pakistan currently experiences a rapid population growth rate of nearly 2% per year, which is the highest among South Asian countries. If this trend continues, the population is estimated to reach 366 million people by 2050¹. The growing population poses many challenges such as food insecurity, water scarcity, employment and infrastructure.

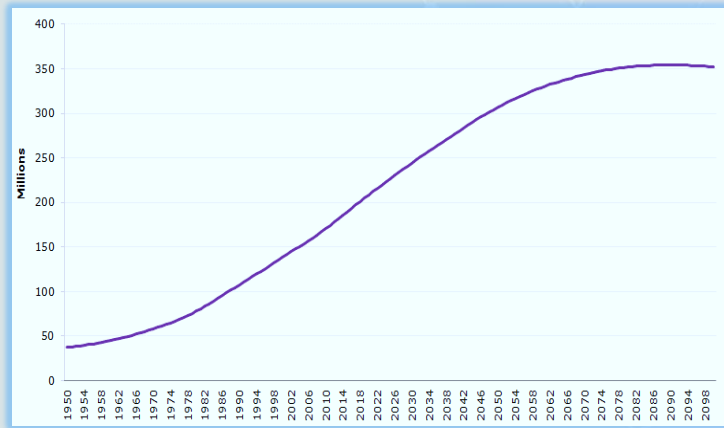


Figure 1. Pakistan – Total Population
Source: Population Statistics²

Weak Economy: Pakistan's economy has been struggling for many years. Pakistan's debt-to-GDP ratio is one of the highest in the world. In 2022, the country's debt was about 73.5% of its GDP³. This means that the government is spending more money on debt repayment than on other things, such as education, healthcare, and infrastructure. The foreign exchange reserve is very low. In 2022, the country reserves were less than \$10 billion which means that the country has limited resources to pay the import bill. High inflation is another core problem the economy is facing at the moment. Currently Pakistan has the highest inflation rate of 36.4% year on year basis which put extra pressure on economy. Similarly, unemployment rate is also high. In 2022, the unemployment rate was over 6%. This means that there are many people in the country who are unable to find work.

These challenges make it difficult for the government to invest in development and provide basic services to its citizens. The government needs to take steps to address these challenges in order to improve the economy and create a better future for near term.

¹ Tribune. (2022, October 23). Pakistan's population problem. The Express Tribune. <https://tribune.com.pk/story/2383016/pakistans-population-problem>

² Graph, G. (2019). Pakistan Population. The Global Graph. <https://worldpopulation.theglobalgraph.com/p/pakistan-population.html>

³ <https://www.sbp.org.pk/reports/annual/aarFY22/Chapter-05.pdf>

Political Instability/Uncertainty: Pakistan has a long history of political instability. The country has been ruled by a number of military dictatorships and civilian governments that have been unable to provide effective leadership. Political uncertainty can lead to economic uncertainty in a number of ways. For example, political instability can make it difficult for businesses to plan for the future, as they may not know what the political landscape will look like in a few months or years. This can lead to businesses investing less, which can slow economic growth. The overlap of political and economic uncertainty can make it difficult for governments to develop stable and sustainable economic policies. This is because governments need to be able to predict the future in order to make sound economic decisions. However, when there is a lot of uncertainty, it is difficult to make accurate predictions. This can lead to governments making bad economic decisions, which can further worsen the economic situation.

Lack of Investment: The fundamental factor in a country’s economic growth is the investment to GDP ratio. When there is population growth, there has to be investment. Contrarily, with no investment, there will be resource depletion. In case of Pakistan, the investment to GDP ratio remains below 15%. With no investment, the alternative policy adopted is borrowing. The borrowing needs to be repaid but so far neither the re-payment nor investment has been on the radar of political regimes for years. Due to the continuous borrowing over the years, Pakistan cannot borrow much anymore because it does not have repayment capability.

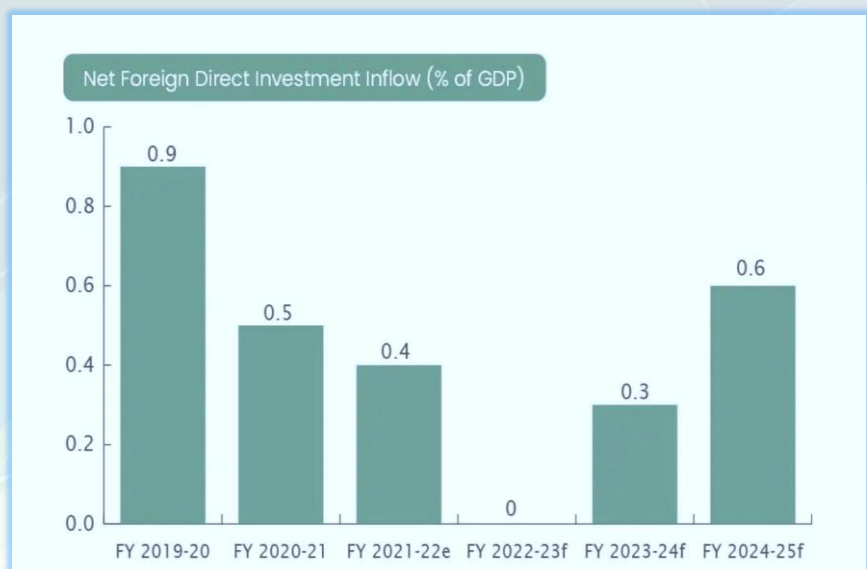


Figure 3. Net Foreign Investment Inflow

Source: Macro Pakistani

Reliance on Foreign Aid: Pakistan has been a significant recipient of foreign aid, receiving over \$16.974 billion in 2022.⁴ This assistance is essential for financing the government's budget and providing essential services to the public. Nonetheless, it poses obstacles to Pakistan's economic independence. The nation confronts structural challenges such as an informal economy, governance problems, corruption, and an energy crisis. Although aid comes with

⁴ Desk, W. (2022, December 29). Pakistan received \$16.974 billion foreign assistance in FY22: EAD. Pakistan Observer. <https://pakobserver.net/pakistan-received-16-974-billion-foreign-assistance-in-fy22-ead/>

conditions designed to promote good governance and sustainable development, it can be difficult to implement these reforms.

In addition, the instability and unpredictability of aid levels make it difficult for the government to effectively plan. Overreliance on foreign aid can impede the generation of domestic revenue, which is essential for long-term sustainability.

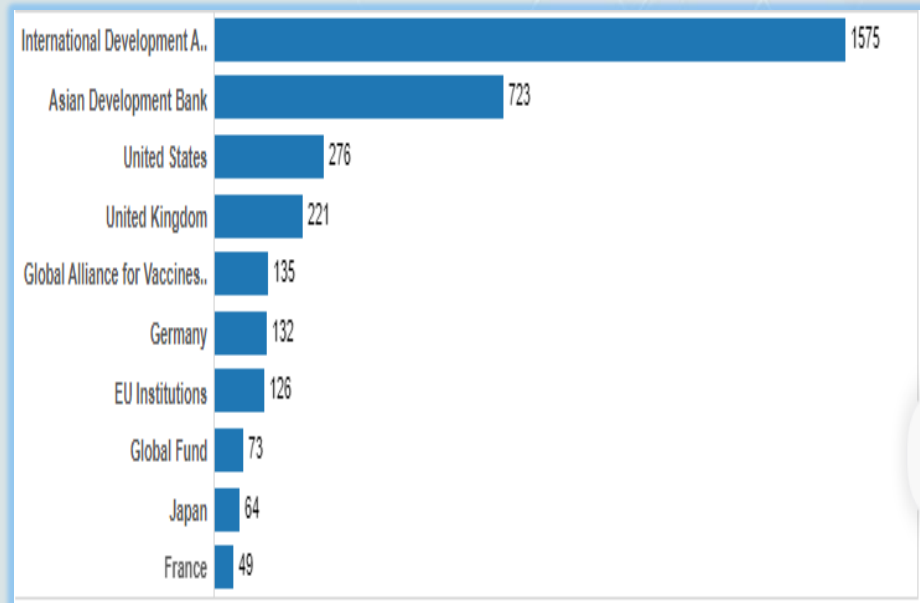


Figure 3. Top Ten Donors of Gross Official Development Assistance (ODA) for Pakistan, 2020-2021. (USD million).

Source: OECD⁵

LONG TERM POLICY OPTIONS

To reduce Pakistan's dependence on certain key factors in the long term, several options can be considered. These options may vary depending on the specific factor being targeted, but here are some general strategies.

1. Diversification of the Economy

Pakistan can work towards diversifying its economy by reducing its reliance on a few key sectors. This can be achieved by promoting the growth of other industries. Some key sectors may be focus such as;

○ Focus on Digital Economy

Pakistan should prioritize long-term investment in the digital economy, considering its immense potential to generate \$60 billion by 2030. Furthermore, by embracing the adoption of Web 3.0 technologies over the next 20 years, the country has an opportunity to unlock an estimated income of \$100 billion. Focusing on the digital economy can pave the way for economic growth, job creation, and technological innovation, positioning Pakistan as a leading player in the global digital landscape. To realize this potential, strategic initiatives such as developing digital

⁵ OECD-DAC: <https://www.oecd.org/dac/financing-sustainable-development/development-finance-data/aid-at-a-glance.htm>

infrastructure, promoting digital literacy, fostering innovation, and creating a conducive business environment will be key in harnessing the transformative power of the digital revolution.

- **Focus on Investment Policy and Climate**

Considering Pakistan's economic size, level of development, remoteness, and factor endowments, it is estimated that the country has an untapped potential for foreign direct investment (FDI) of approximately US\$2.8 billion annually. The regions offering the greatest prospects for FDI into Pakistan are North America and the European Union, accounting for a significant portion of the estimated US\$2.5 billion of potential FDI that remains unexplored.⁶ To tap into this potential, it is crucial to enhance the investment climate by improving regulatory frameworks at the federal, provincial, and local levels. This involves streamlining and simplifying business licensing and operational regulations while embracing digitalization to expedite processes. Furthermore, updating the legal framework for investment through the implementation of a new Investment Law that harmonizes and modernizes existing laws and policies is essential to attract and facilitate investment flows into the country.

- **Focus on Human Capital**

Addressing the human capital deficit is of utmost importance for Pakistan's development. Significant investments are needed to address gaps in education and health outcomes, which currently limit Pakistan's progress and potential for growth. Enhancing human capital is vital for sustainable economic growth, preparing the workforce for future skilled jobs, and competing globally. It also builds resilience, adapts to climate change, fosters a green and inclusive economy, and reduces inequality. Pakistan can achieve substantial economic growth by controlling population growth, investing in healthcare and education, and increasing women's participation in the labor force. The Human Capital Index (HCI) of 0.41 reflects the current productivity gap in Pakistan, lower than the South Asian average. Additionally, low female labor force participation contributes to the human capital crisis.⁷ By nurturing a highly skilled workforce, Pakistan can enhance its capacity

⁶ World Bank Group. (2022). From Swimming in Sand to High and Sustainable Growth. <https://openknowledge.worldbank.org/entities/publication/414760a0-4a40-5311-acbb-c317379e73e6>

⁷ World Bank Group. (2023, May 4). The Silent, Deep Human Capital Crisis Facing Pakistan: The Country Needs to Substantially Increase its Investments in Human Development. World Bank. <https://www.worldbank.org/en/news/press-release/2023/05/02/the-silent-deep-human-capital-crisis-facing-pakistan-the-country-needs-to-substantially-increase-its-investments-in-huma>

for innovation and technological advancement, which can drive economic growth and reduce dependence on external factors.

2. Governance

Governance structure in Pakistan has not evolved past the 20th century. 21st century governance requires modernization through efficiency and swiftness assisted with digitalization of processes.

○ Economic Governance

To enhance economic governance, it is imperative to revamp the colonial bureaucratic structure by eliminating service hierarchies and inter-government transfers. Bureaucrats should receive monetized market competitive compensation and a fully-funded pension to attract and retain talent. Embracing lateral entry would inject fresh perspectives and expertise into the bureaucracy. Additionally, bureaucratic control over government institutions and agencies should cease, granting them operational autonomy and evaluating performance based on predefined goals and Key Performance Indicators (KPIs). Devolving Principal Accounting Officer powers to the concerned agencies themselves would enhance accountability. Competent local boards, free from potential conflicts of interest, should govern all public sector agencies, while minimizing bureaucratic involvement in their affairs. Leadership appointments for these agencies should empower the boards and local communities, reducing the reliance on senior-level government appointments. Such reforms would contribute to more efficient and effective economic governance.

○ Political Governance

For effective political governance, it is vital to establish a clear separation between the parliament and the cabinet, avoiding the perception of parliament as a direct pathway to the executive. Reducing the total number of cabinet members and limiting the representation from parliament would help maintain this separation. Electoral reforms are imperative, with the adoption of technology to ensure a swift and transparent electoral process. Introducing direct elections for the Senate would further enhance the democratic process. Local governments should be entrusted with the responsibility of public service delivery, and efforts must be made by the next government to empower and activate them early on. Unnecessary federal ministries should be devolved to the provinces as mandated in the 18th amendment, and similar ministries should be merged to improve performance and reduce expenditure. Additionally, stricter parliamentary scrutiny should be applied to the establishment of new government agencies. These reforms would contribute to more efficient and accountable political governance.

3. International Cooperation

In order to strengthen its regional standing, Pakistan should focus on increasing its economic, political, and cultural engagement, particularly within the framework of organizations such as Organization of Islamic Cooperation etc. Efforts should be made to intensify cultural exchanges with Arab nations and foster greater dialogue and understanding with nations worldwide. Pakistan can also play a significant role in promoting coexistence between different religions and cultures by actively sponsoring and supporting dialogue among civilizations. Additionally, Pakistan should contribute towards international peace and security by taking part in political initiatives and providing developmental and humanitarian assistance. By implementing these suggestions, Pakistan can enhance its regional influence and make meaningful contributions on the global stage.

CONCLUSION

Pakistan has several economic and political issues. The country's economic weaknesses stem from its overreliance on a few major factors: a rising population, a poor economy, political instability, lack of investment, and foreign help. However, long-term policies can diminish Pakistan's dependency and boost its economy. Diversifying the economy, focusing on the digital economy, boosting investment climate, and tackling the human capital shortfall are solutions. Restructuring the bureaucracy, improving economic and political governance, and promoting international collaboration are essential governance improvements. Pakistan may reduce its dependency on foreign forces and promote inclusive growth by following these steps.

About the Authors

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