CHARTING PAKISTAN'S FUTURE: A STRATEGIC BLUEPRINT FOR ECONOMIC TRANSFORMATION

Pakistan's economic landscape presents a multifaceted challenge[12] for the newly appointed government, which inherited the reins from a caretaker administration that showcased a semblance of stabilization.

At the surface, indicators such as a reduced current account deficit, attributable to a narrowing trade gap, along with a marginal surplus in tax collection targets and a dip in inflation from the previous year's zenith, paint a picture of economic recovery. These developments were buoyed by a Stand-by Arrangement (SBA) with the International Monetary Fund (IMF), secured by the preceding government, alongside additional financial support from Saudi Arabia and the UAE.

Finance Minister Muhammad Aurangzeb's commitment to persist with the caretaker's policies underscores a recognition of their temporary success in curbing the current account deficit through measures like import suppression and reduced public sector expenditure. However, this approach has been criticized for inducing a state of fragile and superficial stability, primarily because adherence to the IMF's stringent requirements has inadvertently stifled economic growth and development.

The resultant economic situation is far from rosy, there has been a spike in poverty rates to 37.2% and significant job losses[13]. This scenario vividly illustrates the limitations of short-term fixes over sustainable economic policies, emphasizing the persistence of critical structural problems within the economy.

Pakistan's economic malaise is deep-rooted, characterized by excessive debt, inefficient tax collection, a pronounced import-export disparity, energy sector shortcomings, loss-making State Owned Enterprises (SOEs), and a burgeoning population. These chronic issues have precipitated repeated financial crises, severely constraining fiscal capacity and foreign exchange reserves, thus limiting the government's ability to foster growth or make meaningful investments.

The practice of deficit monetization, which essentially involves printing money to cover expenses, has exacerbated these challenges, leading to the rupee's devaluation, rampant inflation, and persistently high prices. The reliance on rescue lending from multilateral lenders and allies, coupled

[12] Abid Hussain, "Pakistan's election: Can the next government bring economic stability?," *Al Jazeera,* February 07, 2024, https://www.aljazeera.com/economy/2024/2/7/pakistans-election-can-the-incoming-government-bring-economic-stability.

[13] Amin Ahmed, "Rising food, energy prices drive surge in poverty across Pakistan: World Bank," *Dawn,* October 20, 2023, https://www.dawn.com/news/1782269.

with a tendency towards short-term financial remedies, continues to undermine economic stability.

In this context, the new government faces the daunting task of steering the economy towards stabilization, structural reform, and managing public expectations. With limited fiscal leeway, the ability to stimulate growth or fulfill electoral promises is severely restricted. Engaging in negotiations for a successor program with the IMF seems inevitable, which will likely entail stringent targets and conditions, further limiting economic policy options. The anticipated increase in energy prices, resulting from such arrangements, will exert additional pressure on households and industries, leaving the government with scant room to maneuver.

Addressing these challenges necessitates a pragmatic approach from the new leadership. Managing public expectations and preparing the people for the impending tough measures are crucial. The government's immediate focus must be on restoring financial health, which may, unfortunately, sideline initiatives aimed at enhancing the common citizen's welfare in the short term. However, these painful adjustments are indispensable for setting Pakistan on a path to sustainable growth and stability.

Pakistan's economic recovery and stabilization require a comprehensive strategy that addresses the structural deficiencies[14] plaguing its economy. While the journey ahead is fraught with challenges, it presents an opportunity for the new government to implement reforms that could lay the groundwork for long-term prosperity. The effectiveness of these measures, however, will hinge on their ability to balance immediate economic pressures with the imperative for structural transformation.

What Needs To Be Done?

Subsidies:

State subsidies, particularly in energy and agriculture, are inadvertently fostering unsustainable consumption patterns and exacerbating economic imbalances. These subsidies, often designed to alleviate costs for consumers, inadvertently encourage overconsumption. This heightened demand for energy results in increased imports, placing a significant strain on foreign exchange reserves.

A closer examination reveals that these subsidies are regressive, benefiting the wealthier segments of society more than the broader population. Such practices are evident in the distribution of fertilizer subsidies, which primarily benefit a small cartel of producers rather than the intended farming community at large. Similar issues are observed in the sugar

[14] Syed Haris Ahmed, "Economy faces structural issues," *The Express Tribune,* March 22, 2021, https://tribune.com.pk/story/2290681/economy-faces-structural-issues.

industry, where subsidies favor a limited group of producers.

The disparity in subsidy benefits extends to fuel subsidies as well. While intended to assist all consumers, the actual consumption pattern shows that those with larger, fuel-intensive vehicles derive greater benefits than individuals using more economical modes of transport, such as motorcycles or small cars. This skewed distribution means that a larger portion of government subsidy expenditure benefits the wealthier, contrary to the aim of broad-based economic support.

Given the government's limited financial resources and the negative impact on consumption behavior, there is an urgent need to reform these subsidy programs. The goal should be to eliminate regressive subsidies that disproportionately favor the affluent and redirected towards most vulnerable through targeted cash transfers via BISP program.

Government Spending:

The intersection of government spending, deficits, and their broader implications on a country's economic health presents a complex scenario that requires careful analysis and strategic solutions. The crux of the problem lies in the imbalance between government revenues and expenditures. When a government spends more than it collects in revenues, it results in a fiscal deficit. This deficit, in turn, can contribute to a current account deficit, indicating a broader economic imbalance where the country relies on borrowing and injects more demand into the economy than it can sustain through its collections.

The paradox of feeling cash-strapped despite running a deficit underscores a deeper issue within fiscal management. The limited revenues collected are predominantly allocated to inflexible spending categories such as military expenses, pensions, wages, and, notably, interest payments on both domestic and external debt. These expenditures consume the bulk of revenues, leaving scant resources for investment in productive sectors like infrastructure, education, and health. Such a scenario traps the economy in a cycle where expenditures do not stimulate productive potential or contribute significantly to long-term growth.

Defense spending, while crucial for national security, does not inherently enhance productive capacity. Similarly, wages and pensions, although necessary for maintaining public services and social stability, do not directly contribute to economic productivity. The lion's share of revenue servicing debt interest further constricts the government's ability to invest in areas that could foster economic development and prosperity.

In this context, increasing public-private partnerships and advocating for privatization emerges as a potential remedy. The argument for privatization stems from the belief that the private sector tends to operate more efficiently due to the direct accountability and profit motives that drive corporate governance. The culture of free-riding observed in government-owned enterprises, where lack of accountability leads to inefficiency and resource depletion, supports the case for privatization. By transferring ownership and management of certain entities to the private sector, it is posited that efficiency gains can be realized, thereby enhancing the overall productivity and economic health of the country.

The concept of the "common pool problem" illustrates the challenge of collective resource management where individual incentives to consume outweigh the incentives to conserve or invest for the common good. Privatization, in this view, aligns personal stakes with resource management, potentially mitigating the free-for-all mentality that can plague public resources and enterprises.

Therefore, there is the need for a recalibration of government spending priorities, with a focus on minimizing deficits and reallocating resources towards sectors that promise long-term economic benefits. Coupled with strategic privatization, where appropriate, these measures could pave the way for a more sustainable and productive economic framework, ultimately fostering a healthier balance between consumption and investment, and between public needs and fiscal responsibility.

Fixing Tax Culture:

Pakistan's tax system faces a multifaceted challenge that requires a holistic and concerted effort to broaden its tax base and ensure equitable tax collection[15]. This endeavor not only demands structural reforms but also a strategic approach to include untapped sectors into the tax net. Among these, the retail sector, professional services, agriculture, and real estate stand out as critical areas that have historically evaded their fair share of taxation. Addressing these gaps could significantly enhance the country's revenue collection, thereby alleviating some of the fiscal pressures it currently faces.

The retail sector, particularly small shopkeepers, have been resisting imposition of Value-Added Tax (VAT). Previous attempts to bring this sector into the tax net have met with opposition, underscoring the political sensitivity of tax reforms. The notion that the Pakistan Muslim League-Nawaz (PML-N), with its pro-business community stance, could effectively implement such reforms suggests that leveraging political affiliations might ease the resistance. However, this strategy depends on the prevailing

[15] Adeel Malik, "How not taxing the rich got Pakistan into another fiscal crisis," *Al Jazeera,* October 30, 2018, https://www.aljazeera.com/opinions/2018/10/30/how-not-taxing-the-rich-got-pakistan-into-another-fiscal-crisis.

political will and the party's influence within the business community.

The professional sector, encompassing lawyers, doctors, and other private practitioners, represents another significant untapped revenue source. Despite earning substantial incomes, many professionals circumvent their tax obligations, often submitting misleading tax returns. To combat this, Pakistan could emulate international best practices for taxing professional services, utilizing indirect indicators such as travel records, vehicle registrations, and lifestyle proxies to identify potential taxpayers. The National Database and Registration Authority (NADRA) database offers a valuable resource for cross-referencing and validating individuals' financial activities against their declared tax contributions.

Agriculture, despite being a cornerstone of Pakistan's economy, remains lightly taxed, reflecting its political clout and the challenges of enforcing tax collection in rural areas. Similarly, the real estate sector enjoys leniency in taxation, particularly regarding property transfers and capital gains. The involvement of powerful interests, including the military's significant presence in real estate, complicates efforts to reform tax policies in this domain. Yet, the potential revenue gains from properly taxing these sectors are too significant to ignore.

A common thread underlying public resistance to tax reforms is the perception of misallocated government spending. Citizens are more likely to support tax initiatives if they believe their contributions are funding public services and infrastructure rather than serving the interests of government officials or servicing foreign debt. This sentiment highlights the necessity of transparency and accountability in government expenditure to foster taxpayer compliance.

Broadening Pakistan's tax base requires a multifaceted strategy that addresses not only the technical aspects of tax collection but also the political and social dimensions of tax reform. By focusing on untapped sectors and improving public trust in government spending, Pakistan can create a more equitable and efficient tax system. This, in turn, would provide the government with the fiscal space needed to invest in critical areas such as education, healthcare, and infrastructure, contributing to the country's overall development and prosperity.

Debt Problem:

Pakistan's debt dilemma is a multifaceted issue that beckons for a nuanced understanding and a bold, comprehensive approach to restructuring[16]. The common narrative surrounding debt obligations—that defaulting or failing to stay current on

[16] Ammar Habib Khan and Zeeshan Salahuddin, "Pakistan's Debt Crisis," *The Friday Times,* February 19, 2024, https://thefridaytimes.com/19-Feb-2024/pakistan-s-debt-crisis.

repayments heralds cataclysmic consequences—is often oversimplified and, to some extent, misleading. Experiences of countries that underwent debt restructurings have illuminated the reality that when foreign exchange reserves dwindle to critically low levels, prioritizing national interests and the well-being of one's own population becomes imperative. Allowing substantial foreign exchange resources to flow out to international creditors without considering the domestic economic ramifications is untenable.

The fear that failing to meet external debt obligations will halt imports is a misconception. History shows that countries can, and do, successfully restructure their debts without affecting trade credits, ensuring that essential imports continue unhindered. During a restructuring phase, while a country might temporarily lose access to international borrowing markets, such as issuing Eurobonds, this concern is somewhat moot for Pakistan, given the prohibitive borrowing costs it currently faces, which effectively sidelines it from these markets anyway.

Critically, restructuring does not imply a cessation of all financial inflows. Remittances, a significant source of income for Pakistan, would likely continue unaffected. Export proceeds, too, would remain stable, as trade transactions are generally exempt from the restructuring process. Moreover, multilateral loans from institutions like the IMF and the World Bank could still proceed. In fact, these institutions might favor a restructuring scenario, as it could improve Pakistan's ability to meet its obligations to them by alleviating the debt burden.

The distinction between viewing default as a policy choice rather than an inevitable outcome is crucial. Timely and comprehensive debt restructuring can prevent the kind of disorderly default that wreaks havoc on an economy, as illustrated by the unfortunate situation in Sri Lanka. Procrastination or piecemeal approaches only exacerbate the uncertainty and economic instability, deterring investment and eroding confidence in the country's financial management.

Pakistan finds itself in a precarious situation where much of the financial support it receives is funneled directly back to creditors, leaving nothing for domestic development or for addressing the needs of its people. A bold restructuring proposal, communicated transparently with creditors, could propose no payments for an extended period, allowing the country to reallocate resources towards sustainable development and immediate economic needs.

Such a strategy would require an assertive stance with international creditors, advocating for a comprehensive restructuring plan that ensures long-term debt sustainability. The argument for restructuring is not only about alleviating immediate financial pressures but also about securing a more stable and prosperous future for Pakistan. Engaging with the IMF and other institutions not as alternatives to restructuring but as supportive partners in formulating and implementing a restructuring plan could pave the way forward.

In this complex landscape, the path to resolving Pakistan's debt problem is narrow and fraught with challenges. Success depends on the willingness to embrace a more nuanced view of debt management and on securing support from key international partners. Without decisive action, the risk of following in the footsteps of countries that have suffered under the weight of unsustainable debt is all too real. Restructuring offers a viable alternative, one that requires courage, strategic foresight, and a steadfast commitment to the nation's long-term economic health and sovereignty.

Energy Sector:

Pakistan's energy sector finds itself ensnared by past contractual commitments, which, while perhaps reasonable at the time of their inception, did not adequately factor in the potential for adverse scenarios, such as spikes in oil, gas, and coal prices. This oversight has resulted in an electricity cost structure that is notably higher than that of our regional counterparts and large exporters, thereby placing a considerable strain on our industry's ability to compete on the global stage. The repercussions of failing to address these energy costs are stark: without the ability to compete internationally and increase export proceeds, Pakistan's economic survival hangs in the balance.

Central to the challenge is the rampant theft of electricity across the country[17]. The phenomena of pilferage and non-technical losses in Pakistan are among the highest in the region, a situation exacerbated by a culture of illegal connections and misappropriated subsidized electricity. The implication here is clear: without a significant reduction in these losses, any attempt to simply hike electricity rates as a solution—potentially a measure the IMF might recommend to tackle the circular debt and deficit issues—would be untenable. Such an approach risks pushing the people towards civil disobedience, especially when considered against the backdrop of soaring inflation and a population already stretched to its financial limits.

A dual-pronged strategy is imperative for moving forward. Firstly, there must be zero tolerance for electricity theft, necessitating robust and immediate measures to curb pilferage. This is not merely a question of financial prudence

[17] Betsy Joles, "Pakistan Cracks Down on Power Theft to Rescue Debt-Laden Economy," *Bloomberg*, November 02, 2023, https://www.bloomberg.com/news/articles/2023-11-01/pakistan-cracks-down-on-power-theft-to-reform-debt-laden-economy.

but of preventing a potential breakdown of state functionality.

Secondly, Pakistan must pivot towards a sustainable and strategic partnership focusing on renewable energy sources[18], particularly with China, given its status as the leading producer of solar energy technology. The country is blessed with abundant natural resources, such as sunlight and water, yet has failed to capitalize on these for energy production. Investment in solar farms and hydropower, alongside initiatives like net metering that incentivize household-level solar electricity production, could revolutionize our energy sector.

This transition to renewable sources is not just an economic necessity but a strategic imperative to mitigate the volatility that comes with dependency on oil and gas. The fluctuating prices of these commodities have repeatedly placed Pakistan in precarious positions, underscoring the need for an energy strategy insulated from international price swings. While solar and renewable technologies might present an upfront cost, their long-term benefits and stability far outweigh the unpredictable and often exorbitant costs associated with fossil fuels.

Pakistan's path to energy sustainability and economic viability lies in aggressively tackling electricity theft and embracing a future powered by renewable resources. Such measures demand political will and strategic foresight but are essential for securing a stable, prosperous future for the nation. By reimagining our approach to energy, Pakistan can not only alleviate the immediate financial pressures on its industry and people but also lay the groundwork for a resilient and self-sufficient economic framework.

The Population Challenge

The trajectory of Pakistan's economic development is at a critical juncture, with the sustainability of its growth intimately tied to addressing two fundamental challenges: population control[19] and the enhancement of human resource quality. These issues are not isolated concerns but are deeply interwoven with the country's capacity to implement effective economic reforms and achieve long-term prosperity. The gravity of this situation is further underscored by Pakistan's current standing in the Human Development Index (HDI), where it finds itself classified within the 'low' human development category, having experienced a decline in its global ranking from 161 to 164 out of 192 countries between 2022 and 2023.

[18] Salman Siddiqui, "Pakistan's foray into renewable energy," *The Express Tribune,* December 28, 2022, https://tribune.com.pk/story/2393075/pakistans-foray-into-renewable-energy.

[19] Amin Valliani, "Rapid growth," *Dawn,* October 13, 2023, https://www.dawn.com/news/1780833.

Population Control: A Cornerstone for Sustainable Development

Pakistan's burgeoning population, which risks ballooning from 220 million to 320 million in the coming decades, presents a formidable challenge to its economic stability and growth prospects. This exponential population growth exerts unprecedented pressure on the country's finite resources, making it increasingly difficult to manage and undermining efforts to improve living standards. The experiences of countries such as Bangladesh, Iran, and Tunisia, which have successfully managed their population growth through comprehensive family planning and public health initiatives, offer valuable lessons for Pakistan. Addressing the population issue is not merely an option but a necessity for Pakistan to prevent the derailment of its economic reforms and ensure sustainable development. Immediate actions taken today will bear fruit in the coming years, helping to alleviate the strain on resources and providing a more stable foundation for economic progress.

Enhancing Human Capital Quality: Investing in the Future

The quality of human resources, evidenced by the health and education of the population, is another critical determinant of economic success. Pakistan currently faces significant challenges in this area, with widespread malnutrition, stunted growth among children, and insufficient access to quality education. These issues not only affect individual well-being but also have far-reaching implications for the country's productivity and economic potential. The Human Development Report's findings, highlighting Pakistan's low HDI value and declining global ranking[20], underscore the urgency of addressing these challenges. An emergency nutrition strategy, aimed at ensuring adequate and healthy food for children, is a pivotal step towards building a healthier, more capable generation. Furthermore, improving the education system and ensuring access to quality education for all are essential measures that will equip the population with the skills and knowledge necessary to contribute to the country's economic development.

The Role of Stability and Security

The imperatives of population control and human resource development cannot be effectively addressed in isolation from the broader socio-political context. Stability, security, and tolerance are foundational to the success of any economic reform effort. Pakistan's struggle with various forms of extremism[21], including political, sectarian, and radical ideologies, poses a significant threat to the country's peace

[20] Anwar Iqbal, "Pakistan's human development ranking declines," *Dawn,* March 14, 2024, https://www.dawn.com/news/1821355.

[21] "The Current Situation in Pakistan," *United States Institute of Peace,* January 23, 2023, https://www.usip.org/publications/2023/01/current-situation-pakistan.

and security. These challenges, if unaddressed, have the potential to undermine not only the immediate economic reforms but also the long-term developmental goals of the country. Creating an environment that fosters tolerance, inclusivity, and peace is therefore crucial for ensuring the successful implementation of economic policies and the sustainable development of human capital.

Conclusion

Pakistan faces a multitude of serious economic challenges that require bold and comprehensive solutions. The issues of unsustainable subsidies, imbalanced government spending, a narrow tax base, crippling debt burdens, an overdependence on imported energy, and a rapidly growing population have all contributed to the country's economic instability and hampered prospects for sustainable development.

Addressing these deep-rooted problems will necessitate a combination of fiscal discipline, structural reforms, and strategic long-term planning. Difficult choices lie ahead, such as phasing out regressive subsidies, prioritizing productive spending over debt servicing, broadening the tax base, pursuing comprehensive debt restructuring, and pivoting towards renewable energy sources. Perhaps most critically, curbing rapid population growth and investing in human capital through improved health, nutrition and education must become top priorities to secure Pakistan's future economic prospects.

The road ahead is undoubtedly challenging, but the costs of inaction are too severe to contemplate. By summoning the political will to implement these transformative measures, Pakistan can break free from the cycle of economic fragility and embark on a path towards sustainable growth, stability and prosperity for its people. The time to act is now, as further delays will only compound the difficulties and foreclose opportunities for meaningful reform. With determination and foresight, Pakistan can lay the foundations for an economic renaissance that upholds its sovereignty and secures a brighter future for generations to come.

This chapter was authored by the Islamabad Policy Institute research team, drawing upon consultations with distinguished economists.