

Pakistan's Economy: Challenges and Opportunities

**Discussion session led by Shahid Javed Burki
Center for Strategic and International Studies
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Shahid Javed Burki, Chairman of the Institute of Public Policy, discussed the current state of Pakistan's economy and its impact on the February 2008 elections in Pakistan at a discussion session at the Center for Strategic and International Studies (CSIS) on March 25, 2008. Mr. Burki's talk focused on two main topics relating to Pakistan's economy: 1) Pakistan's likelihood of sustaining the impressive 7% average growth rate it has enjoyed since 2001 and 2) the absence of the trickle down effect in Pakistan since the country's economy's performance has not been noteworthy at the micro level.

Role of Economic Factors in 2008 Elections

Mr. Burki began by pointing out that none of Pakistan's major political parties paid much attention to the economic conditions in the country when campaigning during election season in February 2008. The winning as well as losing political parties were taken by surprise when election results were later announced. Prior to the elections, political insiders had been convinced that issues surrounding the domestic political climate would play a decisive role in determining the election outcomes in Pakistan. Instead, Mr. Burki believes that economic factors turned out to be pivotal in influencing election results since the common man was more concerned with economic challenges such as unemployment, price of every day goods, electricity cuts, etc rather than the domestic political infighting in Pakistan. Mr. Burki noted that these election results reflect the ongoing disconnect between those who lead Pakistan and those who are being led.

Unsustainable Economic Growth Rate

Mr. Burki provided a few reasons that explain why Pakistan will not be able to sustain its present 7% growth rate. If you use the incremental capital output ratio (ICOR), which compares the rate of investment to the rate of GDP growth, Pakistan's current investment ratio would have to be around 28%-30% for the country's economy to sustain its current 7% growth rate. However, Pakistan's current investment ratio is only about 18%. According to Mr. Burki, Pakistan experienced a high growth rate during the last 7 years, despite this low investment ratio, because of the following sources of growth:

- **'Pent-Up' Growth Released during Musharraf Regime:**
There existed a considerable amount of 'pent-up' growth in Pakistan's economic system that had not been released due to political instability in the pre-Musharraf era. President Musharraf provided a stable environment where policy changes were not arbitrary, which resulted in a significant portion of 'pent-up' growth being released in the economy
- **Optimal Weather Conditions:**
Pakistan enjoyed unusually optimal weather conditions that allowed for good agricultural output. This was a significant factor since Pakistan's economy is dominated by its agricultural sector.
- **Influx of Foreign Investment:**
Investments have flowed into Pakistan from a variety of foreign sources, with a high portion of these investments being made by the Pakistani Diaspora living abroad.

Mr. Burki stated that none of the three aforementioned factors are reliable sources of investment that can sustain economic growth since 'pent-up' growth will always eventually be released into the economy, weather conditions are ever-changing, and no economy's growth can rely solely on foreign investments.

Foreign Direct Investments in Pakistan

Mr. Burki also pointed out that the sources of foreign investment in Pakistan have changed considerably in the last few years. The main sources of foreign direct investment (FDI) in Pakistan are no longer the United States and the World Bank. Today, Pakistan's largest source of FDI is the 5 to 7 million Pakistanis living

abroad, who have injected approximately \$6 billion into Pakistan via formal investment channels. The second largest source of investment in Pakistan's economy includes donors from the Middle East, especially in the form of Sovereign Wealth Funds (SWFs) from Dubai and Saudi Arabia. The United States has reduced its foreign investment in Pakistan and it is now only the third largest source of Pakistan's FDI income. Mr. Burki pointed out that this decreasing U.S. importance in terms of FDI may reflect the United States' diminishing political influence in Pakistan.

Imbalanced Benefit from Economic Growth

Mr. Burki then went on to discuss why Pakistan's impressive growth in the recent past has not benefited the poor in Pakistan. Shaukat Aziz, Pakistan's Finance Minister and later Prime Minister in the Musharraf government, has rightly placed privatization at the top of his economic agenda. However, this initiative is not sufficient by itself since Pakistan's regulatory sector remains very weak. The government has not placed sufficient constraints on the expansion of the private sector and has not regulated the emergence of monopolies. As a result, Pakistan has experienced a sharp increase in prices. This is especially the case for sectors such as telecommunications, real estate, and construction. It is true that cell phones have become increasingly affordable for the middle class in Pakistan and the landscapes of major cities like Lahore, Karachi, and Islamabad now boast large-scale construction of tall building structures. However, the deliberate concentration of FDI-driven resources in only a few sectors, and only in mainly urban areas, has resulted in several repercussions, including:

- There has been no long-term creation of jobs for the poor and uneducated rural population
- There has been an increase in inequality
- This has created a considerable contingent liability for the Pakistani government. These specific sectors generate income in Pakistani rupees. But, the returns must be made in foreign currencies, given that most of these sectors are FDI-driven.

Current Challenges

Mr. Burki pointed out that Pakistan's trade deficit is now between \$12 - \$13 billion. In addition, the Pakistani government had not managed the country's agricultural sector properly and has failed to invest in the power sector. For instance, the government maintains insufficient buffer stock and it has no fund to manage the import and export of agricultural commodities. The poor management of the agricultural sector is further compounded by the smuggling of wheat into Afghanistan. Additionally, the Pakistani government has not carried out a serious analysis of the impact of the country's economic growth on the increased demand for energy. Demand elasticity for power tends to be in the range 1.4 to 1.5. This means that there is a 1.4% increase in demand for electricity for every 1% increase in GDP growth. Since the government has not invested in improving power generation, parts of Pakistan experience up to 8 hours of load shedding.

'Next 100 Days' Recommendations

Mr. Burki ended his talk by recommending long-term policy options as well as short term considerations in the first 100 days for the new administration:

- Increase Pakistan's Domestic Savings Rate: Pakistan cannot maintain a strong economic growth rate without considerable improvement in domestic savings since these savings will lead to increased investments in the economy. Savings can be encouraged by implementing program loans and by adopting institutional reforms.
- Invest in Human Resource Capital: Mr. Burki pointed out that Pakistan has one of the youngest populations in the world. There needs to be focused investment in education, particularly at the primary and secondary school level and in technical schools.
- Decentralize Economic Decision-making in Pakistan: For instance, Punjab is a well-managed province and could easily achieve an economic growth rate of 10% if it is allowed to manage its own resources. Given that Punjab accounts for 60% of Pakistan's economy, high growth rates in Punjab would have a positive impact on the entire economy.
- Serve As a Regional Transit Route: Pakistan should be opened up as a transit route for the region, thereby creating tremendous opportunity for FDI.
- Address Shortages in Relevant Economic Sectors: Mr. Burki suggested that the government should address shortages that occur in certain economic sectors when any given economy begins to grow. Examples of such sectors are natural gas, cement, etc.