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# Restarting Pakistan's Economy: Focus on the People, not the Stats

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ASIA'S PATH FORWARD

By Dr. S. Akbar Zaidi

## INTRODUCTION

On June 25, Pakistan reduced its interest rates – for the fifth time in only 100 days – to 7%, almost half the rate of 13.25% just three months ago. The statement released by the Monetary Policy Committee of the State Bank of Pakistan (SBP) said that this most recent decision ‘should support growth and employment, while keeping inflation expectations anchored and maintaining financial stability.’<sup>1</sup> The business community, however, deemed this latest decision ‘too little too late,’ feeling that a one-time reduction to 4% is what the economy required in order to ‘trigger growth and accelerate economic activities.’<sup>2</sup> The business community felt that the ‘decision makers at the SBP and the governor do not have the perception of ground realities of Pakistan and the serious economic challenges the country will have to face in the near future if growth does not pick up soon.’<sup>3</sup> On the same day, June 25, the IMF issued its own analysis of Pakistan’s growth prospects, lowering Pakistan’s growth forecast by half, to one percent for the next fiscal year (FY21).<sup>4</sup> On April 14, when the coronavirus was still in its earlier stages and 5,837 cases had been reported<sup>5</sup> the IMF forecast the GDP rate for FY 21 at 2%. On 25 June, when the number of cases reached 193,000, the IMF reduced its target for the next year for the GDP to only 1%.<sup>6</sup>

The Government of Pakistan hailed the falling interest rates, ignoring the fact that this fiscal year, which concluded at the end of June 2020, ended up with an estimated negative 0.4% GDP growth rate, the lowest in seventy years. Some stock traders endorsed the Government’s move, saying that ‘[t]his step should bode well for the country’s growth prospects and stock market sentiments.’<sup>7</sup> Another economic statistic much-heralded by the government is the fact that Pakistani imports have fallen drastically over the last fiscal year: the Current Account Deficit (CAD) has declined from around 6.8% of GDP to 4.8%.<sup>8</sup> In

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<sup>1</sup> <https://www.dawn.com/news/1565154/sbp-cuts-policy-rate-by-100-bps-to-7pc>

<sup>2</sup> [https://www.thenews.com.pk/print/678257-businesses-want-big-rate-cut-in-one-go-to-rev-up-economy?\\_ga=2.83775890.563672569.1588245644-1430413245.1539598907](https://www.thenews.com.pk/print/678257-businesses-want-big-rate-cut-in-one-go-to-rev-up-economy?_ga=2.83775890.563672569.1588245644-1430413245.1539598907)

<sup>3</sup> Ibid.

<sup>4</sup> Pakistan’s fiscal year runs from 1 July to 30 June.

<sup>5</sup> <https://www.worldometers.info/coronavirus/country/pakistan/>

<sup>6</sup> <https://www.dawn.com/news/1565089/imf-lowers-countrys-growth-forecast-to-1pc>

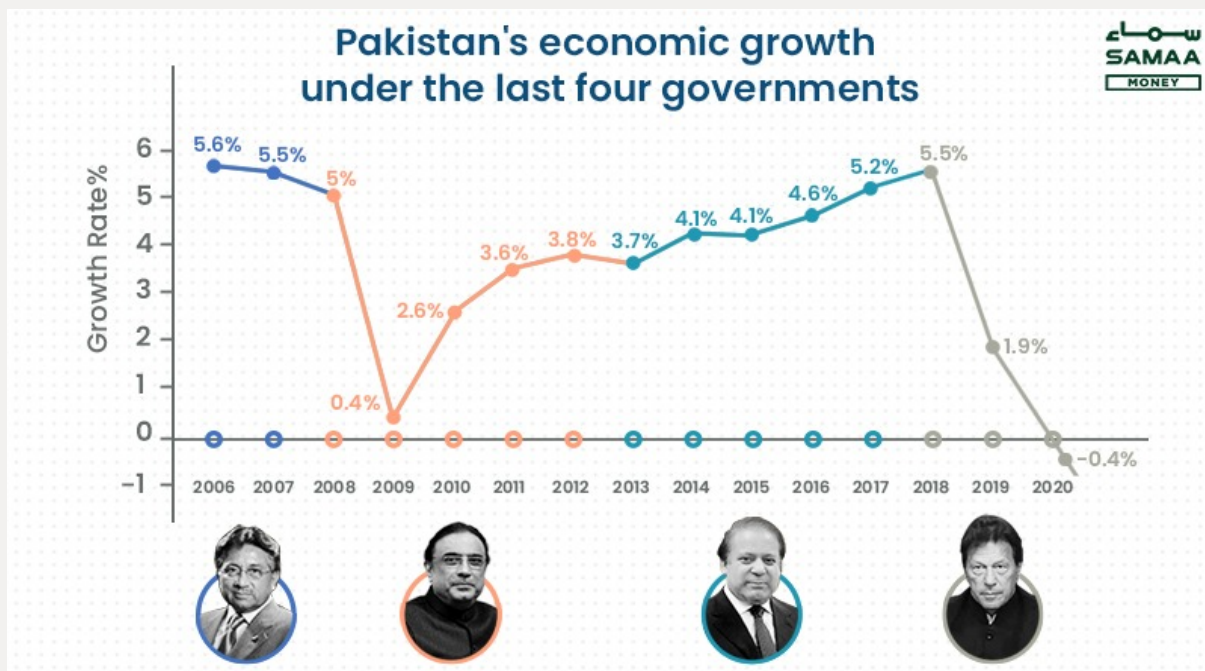
<sup>7</sup> [https://www.thenews.com.pk/print/678034-state-bank-interest-rate-cut-to-bid-well-for-country?\\_ga=2.51968429.563672569.1588245644-1430413245.1539598907](https://www.thenews.com.pk/print/678034-state-bank-interest-rate-cut-to-bid-well-for-country?_ga=2.51968429.563672569.1588245644-1430413245.1539598907)

<sup>8</sup> <https://tradingeconomics.com/pakistan/current-account-to-gdp>

May 2019, the Government of Pakistan took out its 13th structural adjustment loan from the IMF since 1980, worth \$6.4 million. The main reason for doing so was the high and rising balance of payments crisis affecting Pakistan. There was much jubilation in March 2020, when the pandemic was just beginning, as the Current Account Deficit fell to just \$6 million from \$823 million a year earlier.<sup>9</sup>

## Making Sense of Key Macro-indicators

Three critical sets of numbers emerge from the above. Firstly, Pakistan's economy crashed to a negative 0.4% GDP growth rate in FY19-20 and the projected GDP growth rate for the current fiscal year 2020-21 is a mere 1%. What must be pointed out here, as shown in the accompanying graph, is that Pakistan's GDP rate grew for ten years since 2009, increasing almost every year. but once the Imran Khan government took over in August 2018, the growth rate plunged, even before the outbreak of the pandemic. It has only gotten worse since March 2020.<sup>10</sup>



<sup>9</sup> <https://tribune.com.pk/story/2205383/2-pakistans-current-account-deficit-dips-99/>

<sup>10</sup> <https://www.thenews.com.pk/print/678759-faltering-economy>

The second dataset from above pertains to the interest rate. The assumption is that the lower the interest rate, the more the business community will borrow (at cheap rates) and invest in the economy. Standard economic theory stipulates that if the price of money is low, many will borrow, and in this case, use it to invest and that is 'good for the economy.' However, low and even negative interest rates have not always jump-started the economy – as in the case of Japan, where interest rates have been at zero for almost two decades. In the case of Pakistan, the significance of the interest rate as an instrument of economic revitalization does not necessarily follow textbook economics given the structure of the economy.

For example, only 23% of Pakistanis have any sort of bank account,<sup>11</sup> which indicates that financial inclusion is limited in Pakistan and the interest rate does not affect most Pakistanis directly. While the corporate sector can (and does) borrow from banks, the formal sector accounts only for a fraction of those who interact in the (formal) economy. As much as 70% of Pakistan's economy is supposed to be 'informal' and most enterprises and individuals working in the informal sector probably do not have a bank account or much direct relationship with the interest rate.<sup>12</sup> Even those who do, such as those in the corporate and formal sectors, employ a small proportion of the labor force. With at least 75% of Pakistan's labor force considered to be in the informal sector and not directly related to corporate capitalism or the formal sector, the lowering of the interest rate fails to benefit a huge majority of Pakistanis and a major component of the economy.<sup>13</sup>

The third macroeconomic indicator mentioned above is the CAD, which has fallen very substantially, easing Pakistan's perennial balance of payments problem, one of the key demands of any IMF assistance program. While the government claims major success in achieving this IMF goal, it is worth emphasizing that imports were bound to fall when economic activity had already contracted so severely pre-COVID. Overall economic activity is linked to imports, and as income and GDP fall, for a country which imports a large part of its goods, imports would fall as well. This trend has been further exacerbated by physical and economic lockdowns over the last quarter since March. With no economic activity, as evidenced by a crash in the GDP indicators above, with people forced to stay at home, the improved balance of payments is a side benefit. However, since the coronavirus pandemic is a global event that has affected all countries and economic systems, Pakistan's exports have also

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<sup>11</sup> <https://karandaaz.com.pk/blog/unbanked-hundred-million-question/>

<sup>12</sup> <https://nation.com.pk/06-Feb-2019/70-pc-of-pakistan-s-economy-is-informal-which-is-of-high-concern-pbif>

<sup>13</sup> <https://www.ilo.org/islamabad/areasofwork/informal-economy/lang--en/index.htm>

suffered, as has Pakistan's main foreign exchange earner, its human capital exports. The Pakistani economy earns almost \$22 billion each year in remittances from Pakistanis working abroad. As the economy comes to a halt in the US, Europe and in the Middle East, Pakistan's projected foreign exchange earnings will continue to fall.

## Focus on People and SMEs

While it is possible that some macro-level measures will help some small sections of the economy, mainly corporate Pakistan, and perhaps others in the large scale enterprise sector, much more creative thinking and measures are needed to support the 'real' economy – comprised of the informal, small and medium scale economic activities. When the finance ministry announces that as many as 3 million jobs are likely to be lost due to the pandemic, that the proportion of those below the poverty line will increase from 24.3 to 33.5%,<sup>14</sup> and that the unemployment rate is expected to surge to near 10 %,one knows that this is a serious crisis affecting millions of lives.<sup>15</sup> Added to this is apprehension about growing inequality, as well as lack of access to health and medical facilities. The poor are the most affected and vulnerable section of the population.

Clearly, the best strategy is one which focuses on the working poor, the low-income, the self-employed, and those who do not have access to resources, such as finance. What should the government do?

The Government's response to the covid-19 crisis has been highly criticized for its flip-flopping, from giving mixed signals, to changing strategy and reversing decisions mid-track, partial 'smart lockdowns', to complete lockdowns, even to no lockdowns, and refusing to ban religious festivals and gatherings unlike many Muslim countries in the Middle East.<sup>16</sup> The consequence of this has been the admission by a senior government minister that Pakistan's COVID-19 cases might reach 1.2 million by end July.<sup>17</sup> The first step that the government must take is to have a clear cut policy, one which is consistent and can be implemented. This is imperative before any economic program can be advocated.

Due to partial openings, smart lockdowns, and other confusing and contradictory signals, policies which could affect and improve the lives of people, have not been able to do so. For example, the

<sup>14</sup> <https://www.dawn.com/news/1561492>

<sup>15</sup> <https://www.thenews.com.pk/print/668284-unemployment-rate-to-surge-to-9-56pc-in-2020-21>

<sup>16</sup> <https://time.com/5856416/what-happens-next-as-pakistan-lurches-from-crisis-to-crisis/>

<sup>17</sup> <https://www.dawn.com/news/1563477>

They were 250,000 on 28 June, so an almost five-fold increase in one month.

government announced a financial incentive package to the construction industry which, given its extensive linkages with numerous other industries and because of its focus on unskilled and poor workers and laborers, may have been a means to provide income and jobs to the needy. However, with migrant workers sent home and with no public transport, such measures have failed.

The economy cannot be opened up if cases are to increase five-fold in a period of one month. A strict lockdown will be required, and this would mean a smart focus on providing food and means to those who are less privileged, the working poor (who have no work at the moment) and those who might be self-employed. Once the case numbers start to fall, one can think about opening the economy. Once we reach that stage, in addition to stabilizing the economy and taking steps which would help the macroeconomy, the government can take a number of measures:

One consequence of the adjustment program with the IMF has been a substantial 'rationalization' (increase) of utility prices which disproportionately affect the poor and the low-income. In this time of economic crisis, this government should put a halt to the entire IMF program, or at minimum halt such rationalizing measures which impose a heavy burden on the poor. Since the poor and low-income and those in the SME sector, for the most part, do not pay direct (income) taxes and pay almost exclusively indirect taxes on utilities, fuel, and other costs, lowering the incidence of all taxation on the SME sector would be a first step, albeit, not an easy-to-manage one and with the risk of free riders.<sup>18</sup> Specific incentives will have to be given to the SME and low-skilled sectors, such as cheap electricity, a waiver of any sort of tax they pay, and even extensive loans to the sectors.

This is also perhaps the best time for Pakistan's struggling microfinance sector to get support from the government; for the most part, the microfinance sector has been derided by the government for charging very high interest rates and has not received support which could help expand its reach. The current reach of around 6 million clients (60% of whom are women) is believed to represent only half of the potential of the sector.<sup>19</sup> Similarly, as the fourth largest milk producer in the world, the Pakistani dairy sector, which involves much of the rural economy, especially women, should be given direct rebates and financial incentives.<sup>20</sup>

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<sup>18</sup> Only 1 % of Pakistanis pay direct income tax and estimates suggest that only 20 % of Pakistan's tax is actually collected by the government.

<sup>19</sup> <https://www.accaglobal.com/in/en/member/member/accounting-business/2018/03/insights/microfinance-pakistan.html>

<sup>20</sup> <https://ideas.repec.org/a/pid/journl/v43y2004i2p149-174.html>

A GDP growth of -0.4%, with per capita GDP falling, a high and growing debt burden, with the foreign remittances which have been the mainstay of Pakistan's economy expected to fall, would be a particularly daunting task under normal global circumstances. Add to that a pandemic as well as IMF stringency and austerity, there is little room to maneuver. Yet, solutions must be found to restart the economy - not only broad macroeconomic measures, but direct rebates and incentives to SMEs and the informal sector.

The first step towards restarting Pakistan's economy is to understand problem, identify those most urgently in need of relief, and then follow up on their specific needs. Even this first step requires some clear thinking and a consensus amongst various actors, institutions and individuals in power. Given the handling of the Covid-19 crisis in Pakistan thus, this is mere wishful thinking.

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## AUTHOR

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Professor Dr. S Akbar Zaidi is a Political Economist who has had nearly four decades of teaching and research experience in Pakistan and abroad. He has been a Professor at Columbia University, New York, since 2010 and has held a joint position at SIPA (the School of International and Public Affairs), and at MESAAS (the Department of Middle Eastern, South Asian, and African Studies). He is currently the Executive Director/Vice Chancellor at the IBA, Karachi. He is a political economist with interests in political economy, development, the social sciences more generally, and increasingly, History. He has taught at Karachi University and at Johns Hopkins and has written over 80 academic articles in international journals and as chapters in books, as well as numerous books and monographs. Amongst his books, are: *Military, Civil Society and Democratization in Pakistan* (2011), *The New Development Paradigm: Papers on Institutions, NGOs, Gender and Local Government* (1999), and *Pakistan's Economic and Social Development: The Domestic, Regional and Global Context* (2004). His recent books include *Issues in Pakistan's Economy: A Political Economy Perspective* published by Oxford University Press in 2015, and a co-edited volume entitled *New Perspectives on Pakistan's Political Economy: State, Class and Social Change*, published by Cambridge University Press in April 2019. His history manuscript *Making Muslims: Reading Publics and Contesting Identities in 19th Century North India* is to be published by Cambridge University Press later this year.





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