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Pakistan Economy 2019: Prospects for Investment
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As an economist, I have been asked to say a few words on the situation of the country's economy and prospects. I had the good fortune to work on and in the country and might see developments more in perspective. I am not a business person and would concentrate more the macro-economic framework and the political economy of development.

In order to give my presentation some structure, I want to answer the following question:
- What is the present economic situation of the country?
- What will be the main drivers of growth?
- How are the chances of a new IMF bail out?
- What does this mean for investors?

The situation of the economy at the end 2019

Going by the latest figures presented by the Economist, gross domestic product (GDP) is rising presently at a rate of 3.3 per cent, faster than the USA (2.3%) or Saudi Arabia (2.4%), but less than India (5.0%) or China (6.2%). Inflation has risen to 11.4 per cent, higher than in most countries. The official unemployment rate stands at 5.8 per cent, lower than in the Euro Area (7.4%) or India (7.2%). The current account balance is negative and has risen to -3,7 per cent, almost as bad as that of the United Kingdom (-4.0%). More of concern is the budget deficit (-8.9%), the worst among the 44 countries listed by the Economist. The government's problems to raise funds is reflected by a record high rate for 10-years dollar denominated government bonds at 11.6 per cent that increased by almost one half (+44%) over the last year. The Pakistan Rupee lost a sixth of its value (-16.4%) over the last year and stands at 156 per US-dollar.[1]

The International Monetary Fund (IMF) presently is reviewing Pakistan's economic performance. By the end of this month a group of IMF experts will visit Pakistan and prepare a report, the basis for IMF's conditions for any new support. In July, the Resident Representative in Islamabad, Ms. Teresa Daban Sanchez, decried that measures taken up so far 'fell short of the comprehensive policy actions and reforms needed to ensure macroeconomic stability.'[2] The policies envisaged under the IMF-supported programme would be: 'First, a revenue-based fiscal consolidation; Second, a market-determined and flexible exchange rate, and [...] price stability, third the strengthening of [the] safety net.[3]

The Government of Pakistan is no stranger to this procedure: Since 1958 there have been 18 lending arrangements. Only one, the Extended Economic Facility (EEF) 2013-16 was fully disbursed. She writes 'The stability gains achieved since late 2016 eroded. Pakistan [is] again in a challenging situation.'[4]

[1] The Economist. 12 Oct 2019, p. 84.
[2] Teresa Daban SANCHEZ: IMF Extended Fund Facility arrangement for Pakistan. Chartered Financial Analysts Society of Pakistan, July 22, 2019, p. 12. https://www.imf.org/en/Countries/PAK
[3] Ibid., p. 13.
[4] Ibid., p.4.

Most of you are familiar with these facts. It is not so much a crisis of the economy, but a never-ending story of government overreach. Government expenses tend to exceed tax revenue, the gap is filled by lending internally and externally. While debt servicing of Rupee denominated loans can be eased by printing money, this is not an option for dollar-denominated loans. Consequences are inflation and a crowding-out effect: Capital becomes more expensive for private investors.

Traditionally, public deficits come with its twin, i.e. a lack of foreign capital. Following the logic of the two-gap-theory, foreign exchange loans provide the government with financial funds and foreign exchange at the same time. In theory, both would be needed to build-up production capacities through investment.

Although Pakistan lost much of international clout as an exporter of merchandise goods, it became a major exporter of manpower. Home remittances of Pakistani working abroad have been saving Pakistan's balance of payments.

Pakistan used to be the most open country[5] in South Asia. As recently as 2013 the rate of trade to GDP was 33 per cent, now it has fallen to 28 per cent, much less than in China (38%) or India (43%). Lack of openness is accompanied by a high deficit in the balance of trade: Imports of goods and services are twice as high as exports (2018: 19.4% of GDP vs. 8.5%).

In the mid 2010s Pakistan managed to have an almost even balance of payments. It quickly deteriorated, but recovered in the last year (2018/19). Accordingly, foreign exchange reserves that had reached a maximum of US$19bn in 2016, have almost halved. Besides exports of goods and services, home remittances are the main source of foreign exchange (2018/19: US$21.4bn, all transfers: US$24.2bn). To be deducted is the balance of 'primary income', i.e. debt servicing. Still, there is a gap of US$4.8bn in the balance of current accounts.[6] Theoretically, Pakistan could be free of foreign debt since years, as remittances provided a tool to get rid of foreign debt.[7] But self-reliance was no longer a goal of development policy, once foreign assistance was flowing freely again. The public reacts by sending almost half of all home remittances not through official (banking), but though unofficial, unaccounted channels (*hundi* or *hawala*).[8]

Industry did not live up to expectations: It never became the leading sector. Manufacturing only has a share of (2017) 12 per cent in GDP, half of that of agriculture (22,9%).[9] The services sector already in the 1960s became the leading sector.

Drivers of Growth

Foreign direct investment is welcomed as a panacea for economic growth in the Global South, expecting a wider range of quality products, earning and/or saving foreign exchange, employment,

[5] Openness is usually measured by the proportion of trade (imports and exports of trade in merchandise goods and servicces) and (GDP). For systematic reasons, smaller economies tend to be more 'open'.
[6] 2 per cent according to the State Bank of Pakistan. Summary balance of payments as per BPM6 - August 2019. http://www.sbp.org.pk/ecodata/Balancepayment_BPM6.pdf
[7] Towards reducing the dependence on capital imports: a planning model for Pakistan's policy of self-reliance / by Heinz Ahrens and Wolfgang-Peter Zingel. With a contribution by Syed Nawab Haider Naqvi. - Wiesbaden: Steiner, 1982.
[8] 'Over 15b being remitted through illegal channel.' In: The Express Tribune. Karachi, December 11th, 2018. https://tribune.com.pk/story/1864038/2-15b-remitted-illegal-channel/ (2.10.2019).
[9] Word development indicators. Washington, D.C.: World Bank. www.worldbank.org.

tax revenue. Economic growth, however, is only an indicator of progress, not a goal itself. Foreign investors, however, are rather driven by different interests, especially new captive markets for their products or competitive production sites.

Pakistan certainly promises opportunities. With over 210 million people it is the fifth most populous country.[10] With a GDP of US$282bn it ranks 44th internationally, just above the Czech republic. There is a tremendous demand of almost everything, starting with food items for the rapidly growing population (at 2.2 per cent) and agricultural inputs. Almost all crops in Pakistan are grown under irrigation. Already a water scarce country, Pakistan urgently needs improvement of the water economy. The irrigation network is the largest in the world. It will not be sufficient to build more dams, reservoirs and canals, but to use water saving techniques and have the necessary installations. There is substantial, but not unlimited, hydro-electric generation potential. Major dams are under construction. When the largest earth-filled dam in the world was constructed at Tarbela, German firms made major contributions.

Pakistan suffered power-cuts, because of lack of power plants, transmission lines and efficient distributions systems. Finally, the large coal reserves have been tapped. Pakistan is home of one of the largest solar power parks, but expectations have not been met so far. High hopes also had been set in nuclear power. Pakistan has a net of gas pipelines. With own reserves no longer sufficient, Pakistan depends more and more on imported gas. Construction on TAPI, the Turkmenistan-Afghanistan-Pakistan-India pipeline, have started. IPI, the Iranian-Pakistan-India pipeline, has reached the border; the project has been stalled because of the Iran embargo. LNG, i.e. liquidated natural gas, has to be brought in by tankers; two terminals are working already, more are under construction or planned.

Transport is another bottle neck. Major highways have been built or constructed. Railways have been neglected for decades and only now get attention again. The country sees an unprecedented urbanization. Karachi already is one of the largest cities in the world. Mass transport systems have been started, just a beginning. Not to speak of necessities like housing, education and health. Here major contributions have been made by the private sector.

Driven by ‘black money’ and home remittances, the housing sector – neglected by the government and most probably under-accounted – has been a safe bet for years.[11]

Funding and governance

Funding and governance are at the centre of attention. The government is especially interested in funds at their disposal. Much will depend on the outcome of the IMF mission. Economic interests and security always have been intertwined. The country received generous funding from abroad, when it was needed in the wars of the day, i.e. against Communism and terrorism. Relations with the USA appear to be better than commonly assumed. In September 2019, the State Department wrote: ‘In line with the South Asia strategy announced by the President in August 2017, the United

[10] After China, India, USA and Indonesia, after having overtaken Brazil. Results for 2018. www.worldbank.org/indicator

[11] Faizan Barai: Top reasons why Pakistan’s real estate market has been crashed. Karachi: Faizan Barai, 26 December 2018. https://www.faizanbarai.com/top-reasons-why-pakistans-real-estate-market-has-been-crashed/ (2.10.2019).

States continues to urge Pakistan to take decisive and irreversible action against these [terrorist] groups. Pending this action, the United States suspended security assistance to Pakistan in January 2018. The United States has been one of the largest sources of foreign direct investment in Pakistan and is Pakistan's largest export market. Trade relations between the United States and Pakistan continue to grow and the U.S. government supports this relationship by funding reverse trade delegations, business conferences, technical assistance, and business outreach. [...[Despite ongoing security and macroeconomic concerns, Pakistan remains an attractive market for U.S. companies due to favorable demographics, English language skills, low labor costs, and natural resources; however, there are real trade and investment barriers that limit the ability of U.S. companies to enter the market and grow their businesses in Pakistan. Overall U.S.-Pakistan trade in 2018 reached a record high of $6.6 billion, an increase of 4 percent from the previous year. U.S. exports to Pakistan increased 4 percent to reach an all-time high of $2.9 billion in 2018. While bilateral trade has remained strong in 2019, Pakistan will need to pursue economic reforms to promote future economic growth. Major U.S. investments are concentrated in fast-moving consumer goods, chemicals, energy, agriculture, out-sourcing, transportation, and communications.'[12]

Instead of the USA, China has become Pakistan's most trusted ally, mainly because of its no-strings-attached policy. The most visible proof is the Karakoram Highway that had been built with crucial support by China. At the end of the 1970s the road that links Pakistan with Xinjiang was opened. It is also the centre piece of the Chinese Pakistan Economic Corridor (CPEC), important, because it connects the western parts of China to the Indian Ocean. Not to forget that Western China is home to just a quarter of Pakistan's population, but to several times the GDP.[13] Improving road connectivity is a major ingredient of CPEC, as is the harbour at Gwadar. Other major projects are mainly in the energy sector. Easing transport and securing power supply are essential projects for any economic improvement in the country. Both are precondition for development and growth.

What to expect?

As for the future, much depends on internal and external security, not only in Pakistan, but in the whole region. The numbers of casualties, especially in the western regions, have fallen significantly.[14] This is most probably the most welcome news for investors. Pakistan sits at the thoroughfare from Southwest and Central to South and Southeast Asia. Neighbours Afghanistan, Iran and India could also benefit from the new transport route to China.

A few months ago, Pakistan has been listed among the top 20 reformers in doing business 2020. A final verdict is expected by the end of this month. However, as the World Bank writes, the list 'does not reflect fully an economy's attractiveness for business and is purely based on the improvement across ten different regulatory areas.'[15]

[12] U.S. Relations with Pakistan. Bilateral Relations Fact Sheet. Washington, D.C.: United States Department of State, Bureau of South and Central Asian Affairs. 21 June 2019. https://www.state.gov/u-s-relations-with-pakistan/

[13] See my: China's Pakistan option: Economic and social implications of an 'all-weather relationship'. In: IIC Quarterly. New Delhi: Indian International Center. 42(autumn 2015)2, pp. 14-24.

[14] Vide the weekly reports of the South Asia Terrorist Portal. New Delhi. www.satp.org

[15] Top-20 improvers in doing business 2020. www.doingbusiness.org/en/reforms (12.10.2019)