

CSS-2023

Q: Critically discuss why Pakistan's economic growth continuous to be a "Balance of Payments" constraints which is one of the major causes of to keep the foreign exchange reserves under pressure. Do you think that Pakistan's export performance remains the most relevant long-term challenge to alleviate balance of payments constraints for sustained economic growth and explain radical structural reforms to improve export performance?

Introduction:

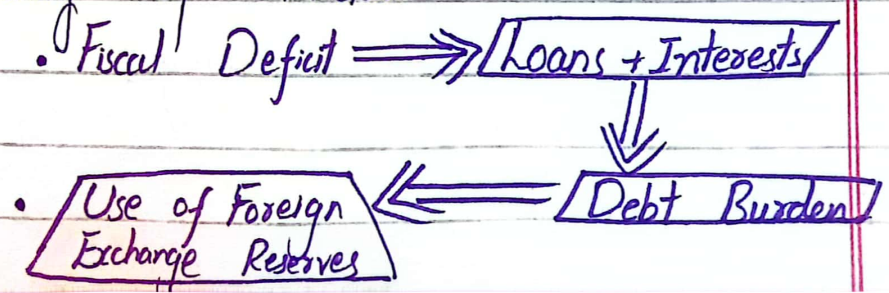
Pakistan was among the top ten fastest growing economies during 1960s to 1990s, known as Asian-tiger. Due to its geostrategic importance, presence of vast natural resources such as coal, natural gas, minerals, gold reserves and youth bulge it can reemerge as a strong economy on the map of the world. But, unfortunately the country is facing severe economic challenges such as fiscal deficit, balance of payment crises, incompetent governance, circular debts

along with many other factors. These challenges eventually led to a negative impact on FOREX reserves. Moreover, current account deficit because of import-export imbalance, narrow tax base, lack of foreign direct investment, high debt to GDP ratio are also long-term challenges for balance of payments. However, through structural reforms in taxation, SOEs "State Owned Enterprises", export performance can improve ~~export~~ ^{economic} performance.

• Causes keeping FOREX reserves under pressure:

i) Fiscal Deficit

When total expenditure of government exceeds the total revenue collection, it led to fiscal deficit. According to Economic Survey of Pakistan 2023-24, total tax collection by FBR is **8.12 Trillion** while expenditure stands at **18 Trillion** highlighting the grave fiscal deficit. This is a persistent challenge throughout the economic history of Pakistan.



ii) Balance of Payment Crisis

The BOP crisis is the main obstacle behind Pakistan's economic stagnation. It is also one of the major cause that keep FOREX reserves under pressure.



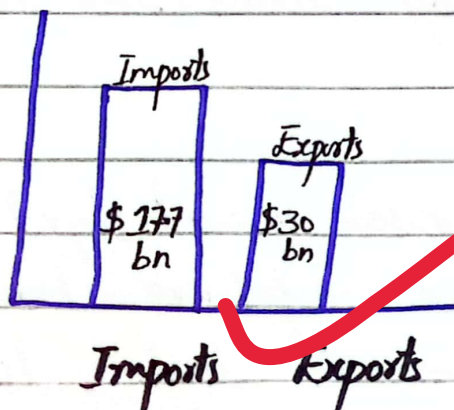
a) Capital account \approx Foreign exchange reserves
 \hookrightarrow Stabilize Dollar

b) Current account \approx Export - Import

\approx if Exports \uparrow , Imports \downarrow = Current account Deficit

\approx if Imports \uparrow , Exports \downarrow = Current account Surplus

c) Financial account \approx FDI, bonds



• Current Account Deficit

Reference: PIDE

Report 2022

- Current account deficit compels government to rely on borrowing. When a state gets loans, it has to repay that loan with interest, the same is the case with Pakistan.

According to State bank of Pakistan: In 2023-24 trade deficit account for 32%, while loans to be returned account for 13%. That short fall was 45%.

Although 30bn dollars were received in form of remittances but still there was deficit of 15 bn dollar which led to withdraw dollars from capital account.

A) Current account deficit

B) "Capital account deficit"

~ use of foreign exchange reserves to repay loans / Debt service

- c)
- Cause financial account deficit
 - Investor lose confidence, hence FDI decreased leading to dire economic situation

Keep the description of a single heading brief and increase the number of arguments instead.

iii) Narrow Tax Base keeping FOREX - exchange reserves under pressure.

- According to Institute of Policy Reform (IPR), almost 50-60% of economic activity in Pakistan is of informal economy, that is not registered. They don't comply with formal taxation.
- Tax Evaders like real-estate businesses, property dealers, builders, industries as well as retailers.
- Tax avoidance by small businesses like general stores, street vending, private local clinics etc.
- Agriculture sector enjoying tax exemption. It contribute 22% to the total GDP of the country but share in the tax is negligible.

According to World Bank, the tax to GDP ratio of any country should be above 13% for a better performance of economy but unfortunately Pakistan tax to GDP ratio is below 9%. Wherease,

India tax to GDP ratio is above 13%.

This narrow tax base led to decreased revenue tax-collection by FBR, which do not meet the burgeoning amount of expenditures. Eventually, government asks for loans as well as use foreign exchange reserves.

Pak at risk of default during 2023-24

due to very low foreign exchange reserves in capital as well as financial account.

• **Poor Export Performance ; Low Value-added exports :**

The stagnant economic performance of Pakistan, although has been caused by various factors like political instability, missed regional opportunities despite having geo-strategic importance, internal as well as external security challenge, issue of national integration (social stratification), inconsistent economic policies along with many other factors.

But, one of the main cause is BOP crisis which is highly driven by poor export performance.

“Almost 70% of Pakistan's export is low-tech” — “WB report”

“Textile and clothing contribute almost 58% of Pakistan's total export, which only account for 5 per cent of World Trade”
Dr. Qasim Bengali

* According to Rice Export Association of Pakistan (REAP), Pakistan's rice export have captured 25% of European market, surpassing India which contributed for 16%.

* Due to low value-added exports, technological and innovation gap, imports surpass the exports persistently leading to Balance of Payment Crisis.

• Structural Reforms to Improve Export Performance

i) Diversification of Exports

The government should made comprehensive strategies to diversify its exports beyond agriculture and textile. IT services related industries should be main priority to focus. Government should also encourage and invest in pharmaceutical industries and engineering goods.

“CPEC-2nd phase would focus on

Add more arguments in this part

collaborating in IT and agricultural sectors beyond infrastructure”-

ii) Trade Policy Reforms:-

According to WB, “Pakistan average tariffs account for 12.7 percent which is much higher than top-exporting countries i.e 2.7 percent.”

- Rationalize tariffs and reduce protectionism in order for better economic performance.

iii) Vocational Training:-

For High-Value added exports government must invest in education along with ~~also~~ vocational training for skill development. A skilled-worker can contribute to better performance.

iv) Export Financing to SMEs:-

Government of Pakistan has to spend a handsome amount on financing small and medium enterprises such as stitching, wooden industries etc which can contribute in better export-performance.

v) Strong export base by diversifying export market :

50% of Pakistan's export rely only on four to five markets ; USA, China, Afghanistan and UK.

"Pakistan exports could increase by 80% (25 billion dollars) , if trade with India reaches to its full potential" ~ WB estimate

Conclusion :

There is no doubt that Pakistan is facing persistent economic challenges in form of BOP crisis, fiscal deficits, high debt-services etc. But, by comprehensive and pragmatic policies of government can eliminate all the challenges. There is dire need of improvement in IT sector for better export performance, which is highly dependent on energy sector as well. So, government must focus on improving the economic situation by better and consistent trade policies and reforms.