INSTITUTE FOR POLICY REFORMS

REPORT

WHAT TO DO ABOUT PAKISTAN'S MOUNTAIN OF DEBT

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Executive Summary

External debt and current account deficit are not just the biggest economic issues, they are a national emergency. Solving them is critical for economic revival and security. If not done, there is every chance that the economy may default or face a Sri Lanka type situation. The Ukraine war with the ensuing supply problems and inflation, compound further an already intractable situation.

But so far government's only response is more loans from IMF, though it is known that the problem does not arise merely from a lack of access to foreign assistance. While IMF is needed, it is an insufficient response and one that ensures that before long we will have the same problem again.

It is critical to know why such a crisis keeps happening every few years, exacting a huge cost on the citizens. It also adds to the nation's gloom and despondency. Even a casual analysis convinces us that government must revisit its entire economic policy agenda. A plan to avoid future current account crises should lie at the centre of any substantial engagement with the IMF. To do so, we must set our own house in order and make some difficult and delicate political choices. Consequently, this report

- Analyzes what causes the current account's frequent breakdowns.
- Recommends near-term measures to manage the current account deficit
- Recommends medium term measures to put the current account on a sure footing to avoid future such emergencies

It does not recommend populist measures being discussed in the policy space, such as redistribution of land or cutting defence expenditure. Both would add to savings and investments and boost economic activity, and we don't disagree. But the report is conscious of what is possible.

Why is an IMF agreement insufficient response? IMF's mission is not growth and development. It helps with temporary balance of payment emergency. IMF looks at debt sustainability from a cash flow point of view. So, if Pakistan will receive enough loans to enable it to meet this and coming years' external payment obligations, including interest and amortization (to service past loans), IMF considers the situation sustainable. This is a short-term perspective emanating from the IMF's mission to help member countries meet emergency BoP challenges. As our over 20 visits to IMF testifies, Pakistan's case is more enduring in nature and entirely of its own making. The depth of reforms that our economy needs can only be set right by strong and committed political leadership engaged with the people of Pakistan and working for growth and development.

Behind the repeated crises are flawed policies. Resultantly, Pakistan has a constant trade deficit, which we have not come to terms with and which results from inability to invest and produce more. Figures 1 and 2 show that the economy's debt level grows by a higher margin in the years when the trade deficit is higher. When the economy grows by 2 to 3% Pakistan's export and remittances are enough to meet most imports. But when the economy grows by

about 5%, additional loans finance higher imports. That results in higher interest and amortization payments and a current account crisis. The same happens when price of essential imports such as energy and food suddenly increase.

The crisis results in a high cost to the economy from which it takes years to recover. It transfers resources out of Pakistan. And the ensuing devaluation, tight monetary policy, and cuts in public spending hurts the citizens and depresses economic activity. It is now a regular occurrence.

The sum of the economy's infrastructure, human resource, and institutional assets is good for the economy to grow by up to 3%. Trouble arises when it wishes to grow at a higher rate. In short, the economy has not accumulated enough capital for high growth. Clearly, a growth rate of 2 to 3% is not an acceptable goal for the economy.

For twenty years, our savings and investment are in decline, Figure 3. Our exports are at a perilous level of about 8% of GDP. They were at 19% in 1990. When savings fall, we invest and produce less, leading to high imports financed with imported capital. Manufacturing investment at about 1.5% of GDP is especially low, down from 4% of GDP in 2004. For the last ten years, Pakistan has mostly focused on managing debt with more debt. This debt-on-debt has led to our continuous impoverishment. Repayment and debt burden has depleted capital within and our ability to grow by more than 2-3%.

Manufacturing needs infrastructure, quality people and solid legal and governance support. Most rapidly growing economies set aside large sums of public money for the purpose reinforced with high level monitoring.

Public spending has not increased the country's productive capacity, see Figures 4 and 5. PSDP has been in terminal decline. It has never been enough to meet our needs. Our flawed political choice is evident from the trendlines. Fiscal deficit has been flat at about 6% of GDP, while PSDP has fallen rapidly. So where is the money going?

It is going to payment of interest for foreign and domestic debt, which is about 40% of government spending. And to subsidies led by IPPs and inefficient PSEs. When the government asks us to give more tax, 40% of that increase will pay interest and 19% will pay for subsidies and grants. (Though not all subsidy and grants are bad. The 19% does not include BISP).

There are other issues that dampen export-oriented manufacturing. Access to credit and especial incentives such as those offered for private power production, construction and duty protection for auto assembly (for about 30 years). These incentives divert investment while not contributing to exports directly. The power sector contributes to economic activity generally,

The pressure of continuous borrowing for consumption and debt servicing without developing the means to repay the loans makes the external account fragile. Tables 1 to 3 show rapid growth in external debt. There is also a trend of worsening sustainability ratios as well as a preference for shorter tenure and higher cost debt. Total foreign debt was less than $ 60 billion in 2015. In six years, it more than doubled to over $ 130 B in December 2021, and the borrowing continues, Table 3. But in those 6 years, exports of goods and services barely increased from $ 30.5 billion to $ 31.5 B in FY 21. Foreign debt grew by over 200% in six

years, exports grew by 3%. During the same period, debt servicing, principal plus interest, grew by about 250%. All sustainability indicators have worsened (Table 2).

Regarding debt tenor and cost, between 2010 and 2021 share of low cost mostly long-term Paris Club debt have fallen from 25% to 8.8%. Share of multilateral loans has fallen from 42.7% to 27.6%. As against this, the share of high-cost bonds/sukuks went up from 2.7% to 6.4%, commercial loans from zero to 8.4% and other bilateral loans from 3% to 16%. Table 1.

What should Pakistan do?

Enough is enough we must get serious and everyone must play their part:

- Each year, GoP must set targets for fiscal and current account deficits and cut its coat accordingly. Parliament must approve and monitor. The present ‘que sera, sera’ approach must stop.
- Do not just rely on indirect taxes: GoP has limited the discussion about raising taxes to indirect taxes such as higher petroleum levy, GST and import tariff. It serves the interest of decision makers and lobbies. Figure 7 shows that despite lip service to increase of direct taxes in every budget speech, and we will hear it again this year, its ratio is no better and has gone down lately.
- Ask IMF for debt relief, see Box 2: Go beyond the programme to seek debt relief from all lenders in the shape of reduction in interest rate, reduction in principal amount and extending repayment period (the last could add to indebtedness). To convince them, we must go with a sound plan for economic growth and correction of elite privilege. Pakistan has credible cause to make the appeal, as explained in Box 2.
- If debt relief is not forthcoming, rescheduling is another option, but from all creditors and no build-up of interest during rescheduled period.
- Increase exports: though production of exportable goods has not grown, make an item wise study of what export could increase quickly, possibly with incentives.
- Imports: Do away with all non-essential goods imports. Also, make an item wise review to find domestic substitutes for imports or bring some items quickly into production with incentives.
- Earmark remittances for repayment of external debt by limiting imports.
- Prevent re-entry of Afghan transit imports to help rebuild our industry.
- In addition to a Saudi facility for deferred payment for oil, we may request the same of Qatar.
- Restrict portfolio investment and end the volatility and transfer of resources that it causes
- Gradually we must start accessing external debt to only finance projects that create GDP growth and exports. If over 70% of new debt is consumed as is happening now, the crisis will never go away. This is a logic that even a village elder knows.

Medium term recommendations

- ➢ Reduce budget deficit through debt relief, debt restructuring, and reforming subsidies. Use the spared funds for development
- ➢ Make power sector financially sustainable to reduce burden on consumer and tax payers and more predictable payments to producers.
- ➢ Restructure domestic debt.
- ➢ Recast the PSDP and reorient project selection metrics so that it supports exports by raising private sector productivity
- ➢ Within SBP's monetary supply limits keep liquidity flowing, through specific measures:
  - Bring to fruition GoP's old plans of setting up an EXIM bank. Use EMDF.
  - SBP may ease regulatory requirements to increase credit for new manufacturing investment
  - Revive DFIs: Private sector needs fixed rate long-term financing for industrial growth

Increase productive capacity and self-reliance:

- ➢ Increase domestic sources of energy. Since 2012, government's focus has been on import of LNG. Need for a revised petroleum policy and especially a policy to begin shale gas exploration by helping access to finance and technology and by risk sharing.
- ➢ Same for mineral resources.
- ➢ SBP's recent effort for digitization of the economy will boost economic activity and productivity. Need to strengthen this area.
- ➢ Transparency: Submit all international agreements of economic nature to parliamentary review. If confidentiality is important, it may be a classified document with the relevant parliamentary committee. Secrecy hasn't worked. Examples are our high indebtedness and international contracts that lead to arbitration awards against us. When something goes wrong, as it frequently does, tax payers and consumers pay. Decision makers are never held to account.
- ➢ Keep an eye on flight of capital. This is a challenging and nuanced issue, see Box 3.

What to do about Pakistan's mountain of debt

Reducing the economy's external debt and current account deficit is not just the biggest economic issue faced by the country. It is now a national emergency. Addressing it is critical for economic revival as well as for economic security. If this is not done, there is every chance that the economy may default or face a Sri Lanka type situation when it does not have the means to import essential energy and food supplies.

Because the problem does not arise merely from a lack of access to foreign assistance, the needed response must be broad based and cover a range of areas. GoP's present focus is on getting more credit to solve immediate challenges. While that is needed, it is an insufficient response and one that ensures that before long we will have the same problem again. Our over twenty visits to the IMF are testimony.

The present situation is dire and can no longer continue. To address the problem sufficiently, it is critical to know why we keep coming to such a pass, so often. Even a casual analysis convinces us that government must revisit its entire economic policy agenda. To do so, it must make some difficult and delicate political choices. So far, there is no sign of that happening.

The external deficit is the outcome of many things that are wrong with our economic policy formulation, some of which would take years to address. Thus, this paper is in three parts, as follows:

- Part 1: Take stock of our current account weaknesses and what causes its frequent breakdowns.
- Part 2: Recommend measures to manage the current account deficit in the near term.
- Part 3: Analyze issues for medium term measures to put the current account on a sure footing to avoid future such emergencies and recommend measures for structural reforms

Even immediate measures would call upon the people of Pakistan to go through a period of unpleasant adjustment. It would take political dexterity on the government's part to assuage them. But short-term fixing, which seems to be the government's present approach, means that the economy forever stays in a low growth-high debt trap, with a current account crisis right around the corner.

The major point to consider is if there are any plans to put the current account on a sound footing to avoid future crises. That should lie at the centre of a substantial engagement with IMF. See Table 2, Sustainability Indicators. Each indicator in that Table has worsened in the last ten years, during most of which years we have been in an IMF programme. The IMF looks at debt sustainability from a cash flow point of view. So, if Pakistan will receive enough loans to enable it to meet this and coming years' interest and amortization obligations (to service past loans), it considers the situation sustainable. This is a short-term perspective emanating from the IMF's mission to help member countries meet emergency BoP challenges. Pakistan's case is more enduring in nature, see Box 1 for the difference in approach between meeting the short-term balance of payment challenge (the IMF approach) and what should be the country's long-term economic interest.

If government decides to take the more enduring route of reducing debt and moving to growth and development, top-level leadership must lead the effort. No single ministry can manage

the needed transition, especially not those ministries whose policies may have caused the problem to begin with and who are swayed easily by IFIs views. As we will see below, economic troubles arise from flawed political choices. Their solution cannot be outsourced to a single ministry. Politics matters more. The depth of reforms that our economy needs can only be set right by strong and committed political leadership engaged with the people of Pakistan. The problem that we see today has occurred because of a continuous disconnect between political and economic policy making. It is compounded by the influence of special interests on economic decision makers. We may handle it with short term measures and stay economically fragile, or take a long-term holistic approach.

A complex plan, such as the one needed now, calls for buy-in from all parts of the political spectrum. On the surface it may seem that decision making in a broad-based coalition government would pose a challenge. Yet representation in the Cabinet from all shades of political opinions, could also be a source of strength. This is one more chance for political leaders to rise to the challenge to take decisions in the long-term interest of the country, even at temporary political cost to them.

Box 1: Difference between sustainability indicators

Exhibits 1 and 2 below are IMF's estimate of Pakistan's gross foreign financing needs and external account sustainability for FYs 18 to 26. It estimates how much money Pakistan needs to stay afloat and how much of that amount it can finance itself. This way it estimates how much funding Pakistan needs from IMF. First half of Exhibit 1 is IMF's estimate of gross financing needs. For FY 2022-23, IMF estimates it to be US $ 35,068 million. In the second half, IMF gives its estimate of the financing that Pakistan has arranged already US $ 33,450 million. That part is titled 'Available Financing".

Of the $ 33,450 million 'available financing', estimated FDI is $ 3,063 million. The rest $ 30,259 million, or 91% is debt from private and official creditors. IMF estimates balance need to be US $ 1,618 million, most of which IMF would fund. The balance $ 533 million will be reserve depletion, Exhibit 1.

A few things are noteworthy. The major consideration for IMF in analyzing sustainability of Pakistan's BoP is the amount of external debt that Pakistan will receive. For FY 23, that amount is US $30,259. Even this debt amount is an estimate that Pakistan may or may not receive. Usually, under an IMF programme, debtors are forthcoming.

IMF bases our foreign financing needs on certain assumptions about the real and nominal GDP growth rates, interest and inflation rates, Exhibit 2. What happens in actual fact has a bearing on the sustainability outcomes even from IMF's cash flow perspective. When growth outcomes are worse, Pakistan must go back to IMF.

For Pakistan's economy, it is not enough to go with IMF's definition of sustainability. This is because our current account crisis is permanent. Pakistan must exercise a more robust watch on debt sustainability. Our debt levels and annual servicing must support the goals of economic stability, growth and development. IMF's rationale is to offer temporary short-term balance of payments help to meet with a crisis. It assumes that the recipient economy will undertake reforms to avoid such a crisis again.

But Pakistan has not made those fundamental reforms. Its especial crisis is of a permanent nature. That is mainly because special interests within and outside the government. Special interests are doing very well. The nation suffers.

The cash flow sustainability indicator also does not calculate the cost to the economy from outflows to creditors and the resulting instability. A situation of debt funded cash flow is sustainable for a year or two, but ultimately this new loan, the debt on debt, must be paid back. Pakistan must not look at the situation from the IMF's perspective of making sure the creditors get paid, but from what is good for the government's finances. The IMF deal is necessary without which we may default. Yet, how long we can pile debt on debt at a huge cost to citizen welfare is for the government to look deeply at.

In an earlier paper, this Institute has shown the absurd folly of this approach. Since FY 2001, Pakistan has paid an average of US $ 1.4 B annually in interest alone. Average interest paid in the last four years is US$ 2.7B annually for a total of US $ 10.7 B since FY 18. Since FY 2001, Pakistan has paid external creditors more than it has received from them. In 20 years, it has received $ 112.6 B and it has paid back $ 118 B in interest and principal. Yet its external debt has grown by 228% from $ 37.2 B in FY 01 to $ 122.2 B in FY 21. We may have paid back the original loan more than once and still owe it to the creditor. This is because often the purpose of new loans is to repay past loans with the result that over 70% of new debt is to meet balance of payments needs.

External debt must finance projects that create GDP growth and exports to enable the economy to repay. If over 70% of new debt is consumed, the economy does not have the means to repay. This is a simple metrics that most village elders understand well. Just the amount spent on interest on domestic and foreign debt (no repayment) is 38% of federal government's total expenditure. In the last three fiscal years, we have spent between 78% and 103% of net federal revenue on just interest payments. Most other expenditure is met from debt. We have piled debt on debt. This approach may serve elite interest, but the economy cannot go on like this.

Cont'd Box 1:

Exhibit 1. Pakistan: Gross Financing Requirements and Sources, 2017/18–2025/26
(In millions of U.S. dollars, unless otherwise indicated)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
				Est.			Principle		
Gross External Financing Requirements (A)	**30,005**	**25,552**	**23,430**	**21,551**	**30,417**	**35,068**	**41,882**	**39,123**	**36,600**
(In percent of GDP)	9.6	9.2	9.0	7.2	9.5	10.1	11.2	9.6	8.4
Current account deficit	19,195	13,434	4,449	1,916	12,994	12,163	12,363	12,230	11,789
(In percent of GDP)	6.1	4.9	1.7	0.6	4.1	3.5	3.3	3.0	2.7
Amortization	10,724	11,742	18,236	18,555	16,416	21,798	27,707	25,204	24,185
Public Sector	5,651	6,982	12,799	13,943	11,658	16,977	22,957	20,360	19,292
Short-term Borrowing	1,488	1,538	1,182	784	2,715	3,100	4,000	4,900	4,000
Long-term Borrowing (non-IMF)	4,163	4,444	10,617	13,159	7,942	12,877	17,957	15,460	13,492
Bonds	0	1,000	1,000	0	1,000	1,000	1,000	0	1,800
Private Sector 1/	5,073	4,760	5,437	4,612	4,758	4,821	4,750	4,844	4,893
Short-term Borrowing	4,094	3,474	3,610	3,365	3,514	3,381	3,414	3,471	3,520
Long-term Borrowing	979	1,286	1,827	1,247	1,244	1,440	1,336	1,373	1,373
IMF Repurchases	86	376	745	1,080	1,007	1,107	1,812	1,689	626
Available Financing (B)	**23,873**	**21,103**	**25,497**	**26,174**	**31,275**	**33,450**	**41,335**	**39,848**	**38,808**
Foreign Direct Investment (net) 2/	2,772	1,436	2,652	1,786	2,350	3,063	3,690	4,201	4,478
Disbursement	21,658	19,496	22,418	25,144	26,120	30,259	37,532	35,527	34,292
From private creditors	13,326	8,366	15,430	11,508	13,899	17,794	20,929	24,594	24,594
Disbursement to Private Sector 3/	8,110	4,268	12,052	4,221	5,317	8,394	10,329	8,912	10,303
Disbursement to Public Sector 4/	5,216	4,098	3,377	7,287	8,582	9,400	10,600	15,682	14,291
From official creditors (non-IMF)	8,332	11,130	6,989	13,636	12,222	12,465	16,603	10,934	9,697
o/w Project Loans	3,458	2,582	1,588	1,876	1,647	1,770	2,416	2,378	2,042
o/w China	1,811	1,574	487	204	63	100	127	127	0
o/w Program Loans	261	288	3,666	2,120	2,479	2,182	2,093	1,974	2,144
o/w WB	205	150	729	1,009	1,379	1,182	1,093	974	1,144
o/w ADB	50	87	2,347	858	738	1,000	1,000	1,000	1,000
o/w Rollover of short-term debt	5,344	8,244	12,631	8,945	10,567	10,014	10,043	10,395	9,703
o/w Public Sector	1,871	6,193	4,627	5,245	7,100	7,100	7,100	7,100	7,100
o/w Private Sector	3,474	2,051	8,004	3,700	3,467	2,914	2,943	3,295	2,603
Other Net Capital Inflows (net) 5/	-557	171	427	-756	38	127	113	120	39
IMF SDR allocation	0	0	0	0	2,767	0	0	0	0
Remaining Financing Needs (C=A-B)	**6,132**	**4,449**	**-2,067**	**-4,623**	**-858**	**1,618**	**546**	**-725**	**-2,208**
Borrowing from IMF (D)	**0**	**0**	**2,834**	**499**	**3,056**	**1,085**	**0**	**0**	**0**
Reserve Assets (decrease = +) (E=C-D)	**6,132**	**4,449**	**-4,901**	**-5,122**	**-3,914**	**533**	**546**	**-725**	**-2,208**
Memorandum items:									
Gross official reserves (stock, in US$ billions)	9.8	7.3	12.2	17.3	21.2	20.7	20.1	20.9	23.1
(In months of prospective imports)	1.9	1.7	2.4	2.7	3.2	3.0	2.8	2.8	2.8
(In percent of IMF ARA metric: assuming fixed ER)	37.1	32.3	35.4	46.4	52.1	47.1	42.9	42.0	46.0
(In percent of IMF ARA metric: assuming flexible ER)	48.3	35.0	55.2	73.8	81.2	72.3	65.9	64.4	72.0
Net FX derivative position (in US$ billions)	6.7	8.1	5.8	4.9	4.0	4.0	4.0	4.0	4.0

Sources: State Bank of Pakistan, and Fund staff estimates and projections.

1/ Includes banks and non-bank private sector.

2/ Includes privatization receipts.

3/ Includes equity and debt portfolio inflows, and borrowing by banks and other sectors.

4/ Includes syndicated loans and Euro bonds.

5/ Includes capital account, financial derivatives, errors and omissions.

Cont'd Box 1:

Exhibit 2. Pakistan: External Debt Sustainability Framework, 2016–26
(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2016	2017	2018	2019	2020	10-Year Historical Average	10-Year Standard Deviation	2021	2022	2023	2024	2025	2026	Debt-stabilizing non-interest current account 6/
Baseline: External debt	**26.1**	**27.0**	**30.0**	**37.4**	**41.6**			**39.1**	**40.6**	**40.1**	**39.1**	**37.7**	**35.2**	**-2.4**
Change in external debt	2.4	0.9	3.0	7.4	4.2			-2.5	1.5	-0.5	-1.0	-1.4	-2.5	
Identified external debt-creating flows (4+8+9)	0.3	1.0	4.5	8.2	2.9			-1.4	1.9	0.9	0.5	0.2	-0.1	
Current account deficit, excluding interest payments	1.0	3.2	5.2	3.5	0.3			-0.3	2.9	2.3	2.1	1.8	1.5	
Deficit in balance of goods and services	8.2	10.1	11.9	11.8	9.3			10.1	12.6	11.5	11.1	10.4	9.9	
Exports	9.9	9.2	9.8	10.9	10.7			10.5	11.4	11.1	11.0	10.9	10.8	
Imports	18.0	19.2	21.7	22.7	20.0			20.6	24.0	22.7	22.1	21.3	20.7	
Net non-debt creating capital inflows (negative)	-0.9	-0.8	-0.9	-0.5	-1.0			-0.6	-0.7	-0.9	-1.0	-1.0	-1.0	
Automatic debt dynamics 1/	0.1	-1.5	0.2	5.2	3.6			-0.5	-0.3	-0.5	-0.6	-0.6	-0.5	
Contribution from nominal interest rate	0.8	0.8	1.0	1.3	1.4			0.9	1.2	1.2	1.2	1.2	1.2	
Contribution from real GDP growth	-1.1	-1.2	-1.5	-0.7	0.2			-1.4	-1.4	-1.7	-1.9	-1.8	-1.8	
Contribution from price and exchange rate changes 2/	0.4	-1.0	0.7	4.6	2.0			...	...	...	.. .	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.1	-0.1	-1.5	-0.9	1.3			-1.1	-0.4	-1.5	-1.4	-1.6	-2.4	
External debt-to-exports ratio (in percent)	265.0	294.7	306.9	342.6	388.8			370.8	355.7	360.4	354.7	345.3	324.9	
Gross external financing need (in billions of US dollars) 4/	**11.6**	**22.0**	**28.5**	**26.6**	**19.8**			**21.6**	**30.4**	**35.1**	**41.9**	**39.1**	**36.6**	
in percent of GDP	4.2	7.2	9.1	9.6	7.6			7.2	9.5	10.1	11.2	9.6	8.4	
Scenario with key variables at their historical averages 5/								**39.1**	**40.2**	**40.5**	**40.5**	**40.6**	**39.2**	**-1.1**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	4.6	5.2	5.5	2.1	-0.5	3.6	1.7	3.9	4.0	4.5	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	-1.6	4.1	-2.6	-13.3	-5.1	0.7	7.8	9.9	2.7	3.7	2.7	3.6	2.6	
Nominal external interest rate (in percent)	3.4	3.3	3.7	3.9	3.7	3.0	0.6	2.5	3.1	3.3	3.3	3.4	3.5	
Growth of exports (US dollar terms, in percent)	-8.5	1.8	9.7	-1.3	-7.4	1.6	10.0	12.7	15.6	5.5	6.9	7.7	6.9	
Growth of imports (US dollar terms, in percent)	-0.2	16.9	16.0	-7.6	-16.6	3.8	11.0	17.7	24.4	2.2	5.1	4.8	5.0	
Current account balance, excluding interest payments	-1.0	-3.2	-5.2	-3.5	-0.3	-1.5	1.8	0.3	-2.9	-2.3	-2.1	-1.8	-1.5	
Net non-debt creating capital inflows	0.9	0.8	0.9	0.5	1.0	0.7	0.2	0.6	0.7	0.9	1.0	1.0	1.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

End of Box 1

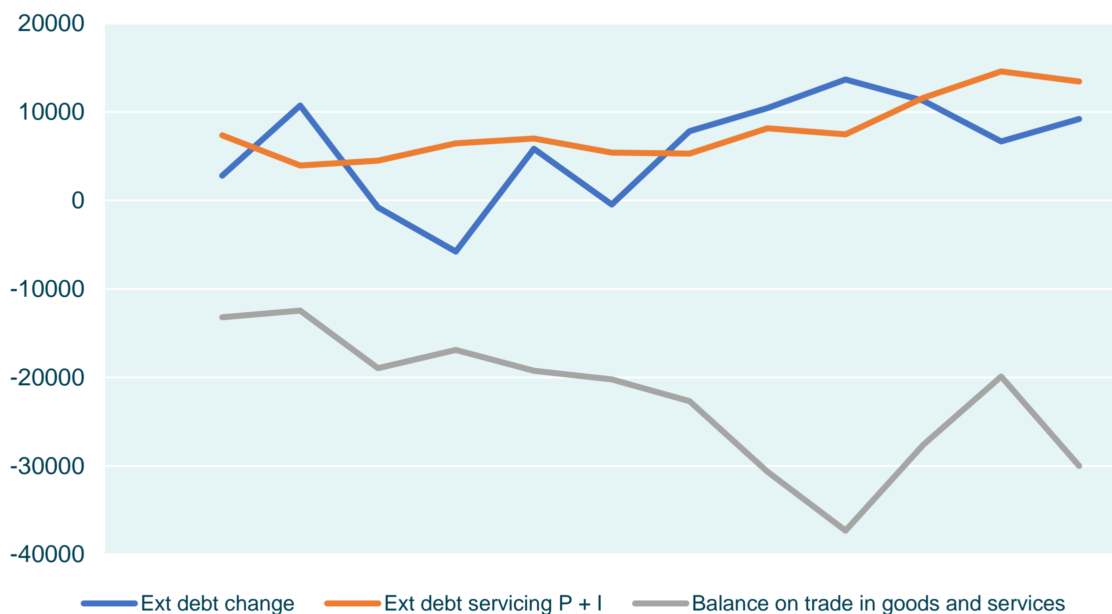
Part 1: Take stock of our current account weaknesses and what causes its frequent breakdowns.

Taking stock and what is wrong

➢ A look at the external account reveals a few characteristics:

- A huge trade deficit is behind our current account troubles. In Figure 1, notice the divergence between trade deficit (the gray line) and yearly change in external debt levels (blue line)[1]. Higher trade deficit brings higher increase in debt. The first obvious lesson to draw is that the economy must focus on export growth, as this Institute has emphasised many times before. Both macroeconomic stability and economic growth would follow.

Figure 1: Relationship between trade deficit and debt levels, FY 10 - FY 21



- Yet when we add remittances to it the current account deficit is not that high. In Figure 2, for the first few years the blue line is close to zero. That is, except when Pakistan wants to grow rapidly. Imports shoot up and the current account deficit becomes unsustainable. The current account is manageable when the economy grows at about 3%. It gets out of hand at a growth rate of 5% or so, especially with increased import of machinery to build production capacity. It is also unmanageable when energy costs suddenly rise, as is happening now. In Figure 2, the two worst years are 2018-19, when CPEC imports were high.

[1] Additional debt incurred each year

Figure 2: Current account balance as % of GDP
2010-21

- We finance the sudden rise in imports with high-cost debt. That causes the red line in Figure 1 to rise as loan amortization and interest payments increase quickly, red line. With imports in most years roughly equal to exports plus remittances, the economy does not have the capacity for high growth nor the resilience to withstand sudden external emergencies caused say by a hike in energy prices.
- The cost to the economy of this weakness is very high. It leads to transfer of resources out of Pakistan while getting nothing in return. And the ensuing devaluation, tight monetary policy, and cuts in public spending exact a high cost on the citizens and cause further loss in economic activity. This is now a regular occurrence and one that results entirely from political choice.

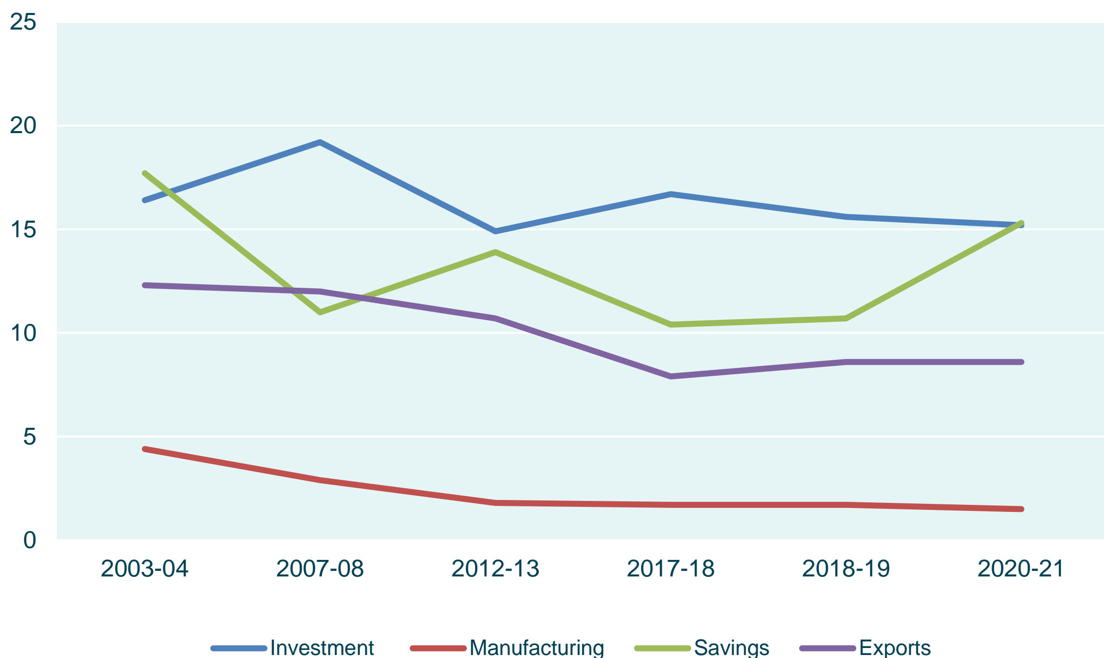
➢ Should we then stick to a growth rate of two or three percent annually? As that is close to the natural increase in population, it means just marginal improvement in living standards. However, that is better than the volatile periods of high-cost current account deficit when the nation goes through a demoralising turmoil.

➢ We need deeper consideration before being swayed by our belief in the ability for rapid economic growth.

➢ IPR research suggests that the present structure of our economy cannot support a growth rate higher than 2 to 3%. That means that the sum of our infrastructure, human resource, and institutional assets is good for the economy to grow by up to 3%. In short, the economy has not accumulated enough capital for high growth. Clearly, a growth rate of 2 to 3% is not an acceptable goal for the economy. Before we move forward about what to do, there are a few more trends to take note of below:

- Falling savings, investment, and exports, Figure 3. For twenty years, our savings and investment have declined, see the blue and olive lines. Along with them, our exports have taken a perilous hit, violet line. Export was 8.5% of GDP in FY 21. In 1991, exports were 17% of GDP. The red line in the chart tells us why. Exports have fallen because manufacturing investment has been especially low and in decline. It is barely one and a half percent of GDP. There aren't enough incentives for manufacturing to grow.

Figure 3: Trends in Savings, Investment, Manufacturing investment, and Exports
% of GDP



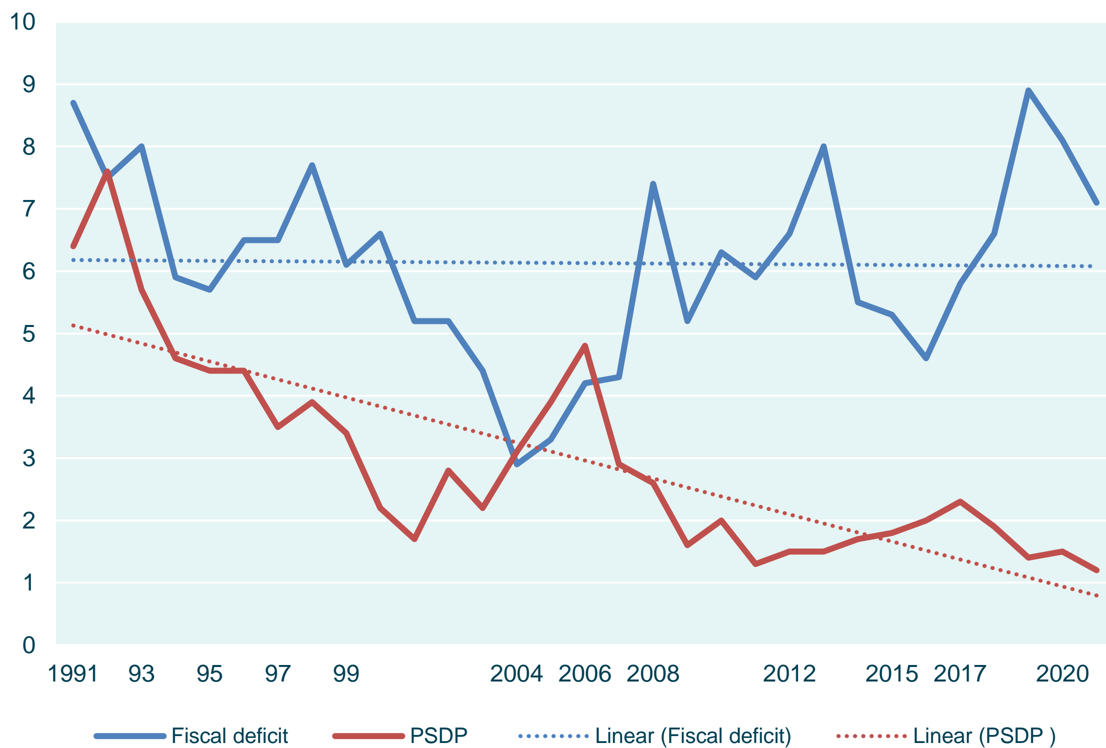
Source: Pakistan Economic Survey, relevant years

- Let's step back and see what is happening. We started with the economy's essential vulnerability, the current account deficit. We find that the current account is sustainable at a GDP growth rate of 2 to 3%, but not if we want to grow at a higher rate. That is exports helped by remittances are enough to pay for just that much import. If we grow, at a higher rate, imports grow for which we must borrow. The last chart above shows that for decades our savings and investment rates have fallen and with them exports. When savings fall, we invest and produce less, leading to high imports financed from imported capital.
- Also important is the gap between manufacturing investment and total investment. Prima facie, it is because of incentives and supporting activity. So, this chart takes us into the more important area of the links between what is happening in the domestic economy and their effect on exports and the current account. Exports will not rise just by wishing so. There are processes behind what causes manufacturing and exports to grow. We now review the processes that support manufacturing and exports. That takes us to government's fiscal operations and the budget deficit and its approach to policy:

- All business activity, especially manufacturing, need infrastructure, quality people and solid legal and governance support. Governments must supply power and other utilities as well as predictable and stress-free enforcement of laws. Most rapidly growing economies set aside considerable sums of public money to this end. This doesn't happen in Pakistan.
- Public spending has not helped increase the country's productive capacity, see Figures 4 and 5. Government builds infrastructure and human resource through allocations in the PSDP. But PSDP has been in terminal decline. It has never been enough to meet our needs.

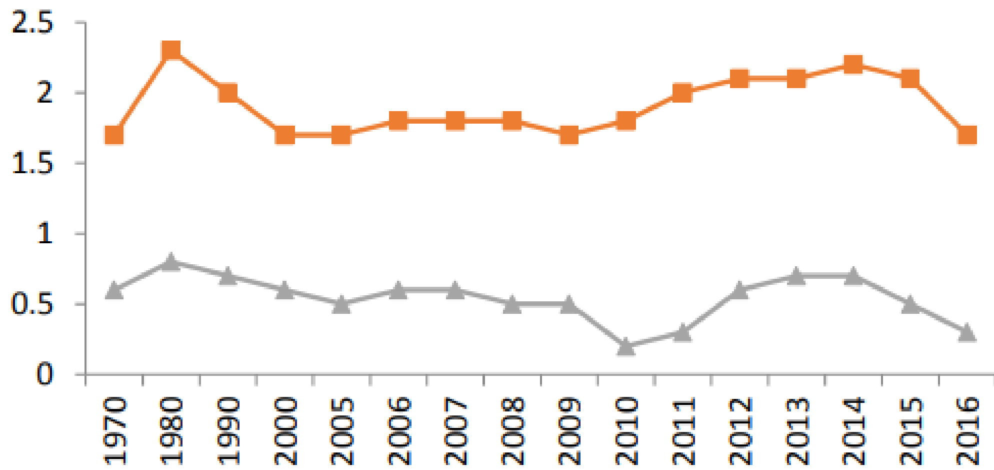
  The economy is under investing in key infrastructure areas that cause growth. Expenditure as % of GDP on health education has been flat throughout the years of high fiscal deficit. Our flawed political choice is evident from the trendlines added to the chart below. Fiscal deficit has been flat at about 6% of GDP, while PSDP has fallen rapidly.

Figure 4: Relationship between Fiscal Deficit and PSDP as % of GDP



Source: Pakistan Economic Survey

Figure 5: Expenditure as % of GDP on Education (brown line) and Health (gray line), 1970-2016



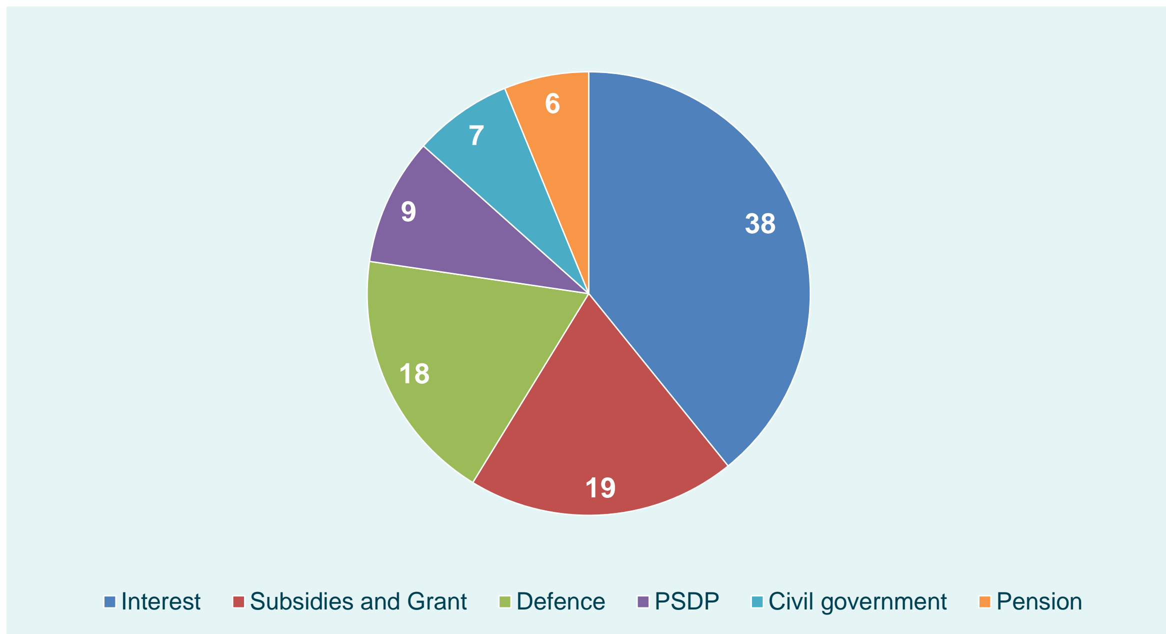
Source: Pakistan Journal of Humanities and Social Sciences, October – December 2018, Public Investment in Social Sector in Pakistan: Trends and Issues, Sadia Idrees, and Nor'Aznin, Abu Bakar

Yet, despite low public spending on such essentials, government's budget deficit is high.

If public investment is down, where is government money going? To subsidies led by IPPs and inefficient PSEs. But mostly to paying of interest to domestic and foreign creditors. When the government says that it will increase tax to GDP ratio, 40% of that increase will pay interest and 19% will pay for subsidies and grants. Not all subsidy and grants are inefficient spending. Some grants help the vulnerable population (BISP is not included here). Others help in supporting economic activity.

Largely, government does not spend the money judiciously and nowhere enough that would help build a solid manufacturing base in the country to boost exports. Its priorities are misplaced.

Figure 6: How government spends our tax money



[2]

- Let's go back to Figure 3, 'Trends in Savings, Investment, Manufacturing, and Exports, % of GDP'. We may spend a minute on what explains for the large difference between total investment and manufacturing investment. Total investment to GDP of about 15% goes to a lot of economic sectors. Agriculture usually has the biggest share, followed by housing and then manufacturing. Where the investment goes is a business decision, depending on demand for output and on the available technical and financial resources. In addition to a lack of infrastructure and human resource, investment in 'manufacturing for export' suffers from inadequate incentives. Especial incentives or duty protection available for preferred sectors, such as private power production, construction and auto assembly diverts a lot of investment towards these areas. These three areas increase imports, but do not contribute to exports directly. The power sector contributes to economic activity generally, including exports. To revive manufacturing and exports, government must offer credit and financial incentives to selected export industries. It offers incentives to some non-export manufacturing such as duty advantage for motor car assembly. (The auto industry produces products at a cost and quality that do not enable it to compete in the export market. There are suspicions of transfer pricing to avoid taxes[3], while customers suffer from late delivery and indifferent service).

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[2] MoF, Fiscal Operations FY 21, data

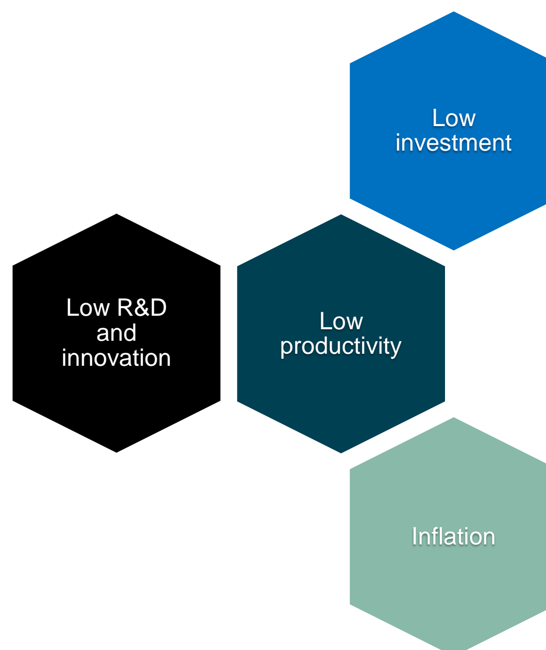
[3] A number of publications give a good account of such informal flows by MNCs globally: 1. UN University WIDER, Working Paper Are less developed countries more exposed to multinational tax avoidance? Niels Johannesen, Thomas Tørsløv, Ludvig Wier, 2017, 2. OECD, Measuring and Monitoring BEPS, Action 11 - 2015 Final Report, 3. Transfer Pricing and Tax Havens: Mending the LDC Revenue Net, Charles E. McLure, Jr. Hoover Institute, Stanford University, International Studies Program Public Finance Conference, The Challenges of Tax Reform in a Global Economy, https://www.issuelab.org/resources/5323/5323.pdf

- To sum up, export-oriented manufacturing investment suffers from a combination of insufficient public goods, weak governance, difficulties in access to credit, and lack of a host of other incentives that government makes available to other businesses that do not produce tradeable goods.

What we have seen here briefly are the many processes whose poor functioning causes the current account deficit and stagnant exports. They form the links between the external account and the rest of the economy. Fixing the current account is not just a matter of accessing more debt to fund the deficit as the Finance Ministry has done for decades, and is doing now. While that helps with the immediate emergency, it also makes the problem worse. Solid work to rebuild manufacturing is needed to put the current account on sound footing. Doing so is critical for economic development. There is not even a discussion on this issue.

Below is a summary of the structural issues in the Pakistan economy that cause a continuous current account balance:

Structural Issues that lead to persistent current account deficit



Some Risks

- The risks of not changing our priorities are very high. During 2003 to 2007 and in 2015-2018, Pakistan celebrated moderate to high GDP growth. But those were economic growth without exports or even jobs. As expected, the economy suffered soon after these booms with severe loss in welfare from devaluation, fall in GDP growth and massive borrowing. This led to a fall in per capita income. It is a perilous path to take. We have the example of Sri Lanka. Sri Lanka has been unable to pay for import of key goods for want of foreign exchange. Consequently, it suffers long hours of power cuts because the economy is unable to import fuel. Even medicines are in short supply. If this happens, we cannot rule out social unrest, especially in the context of current political uncertainty.

  The resultant debt problem

  The pressure of continuous borrowing for consumption and debt servicing has increased the fragility of the external account. Tables 1 to 3 below show that not only has our external debt grown rapidly. There is also a trend of worsening sustainability ratios as well as a preference for shorter tenure and higher cost debt.

  Total foreign debt was less than $ 60 billion in 2015. In six years, it has more than doubled to over $ 130 B in December 2021, and the borrowing continues, Table 3.

  On the other hand, in FY 2015, exports of goods and services was $ 30.4. It barely increased to $ 31.5 B in FY 21. So, while foreign debt grew by over 200% in six years, exports grew by a small 3%. During the same period, debt servicing grew by about 250%.

  When remittances are added to exports, foreign exchange earnings grew by 24% between FY 15 and 21, nowhere close to the growth of 250% in debt servicing. It seems that governments in Pakistan have kept borrowing without any thought about how they will repay.

  Similarly, debt profile has changed, Table 1. Average debt tenor has reduced and cost of borrowing have increased. Thus, we see that between 2010 and 2021 share of low cost mostly long-term Paris Club debt have gone down from 25% to 8.8%. Share of multilateral debt, another source of concessional loans, fell from 42.7% to 27.6%. As against this, the share of high-cost bonds/sukuks went up from 2.7% to 6.4%. Cost of the three bonds floated in FY 21 ranged between 6% and 8.9%. Share of commercial loans are up from zero in 2010 to 8.4% of total debt in 2021. Their cost is in the range of 5%. Share of 'Other bilateral' loans, mostly from China has grown from 3% to over 16%. Their cost is higher than Paris Club debt. So, from a share of 68% of total debt, loans from IFIs and Paris Club now have a share of 36.4%. While the total of bonds, commercial loans, and other bilateral loans have grown from 6% of total to 31%. Not only has debt grown, but the share of high-cost debt is now virtually at par with concessional credit. Government's frequent resort to market-based financing is especially a source of concern. No surprise that all sustainability indicators are worse than before, Table 2.

Table 1: Share by lending source [4]			%
	2010	2015	2021
Paris Club	25.1	17.9	8.8
Multilateral	42.7	37.3	27.6
Other bilateral	3.3	7.5	16
Bonds Euro/Sukuk	2.7	6.9	6.4
Commercial loans incl PSEs	0	0.4	8.4
Government FOREX Liabilities	2	5.7	7.2

Table 2: Debt Sustainability Indicators [5]			In percent
	FY 2010	FY 2015	FY 2021
Total Ext Debt/GDP	31.8	24.2	40.6[6]
Total Ext debt/Exports	183	117.1	384
Total Ext debt service P+I/GDP	3.2	2.0	3.8
Reserves/Short term debt	1800	385	304
Debt Servicing/Total revenue (fed + prov), interest on public debt, domestic and foreign	30.9	33.2	39.8
External debt servicing (P+I)/Exports	28.9	22.5	52.3
External debt servicing (P+I)/Exports + Remittances	16.7	18.4	22.0

[4] SBP data
[5] SBP debt, forex, and balance of payments data
[6] IMF calculation Table 1. Pakistan: External Debt Sustainability Framework, 2016–26

Table 3: Pakistan External Debt and Liabilities Billion USD						
	June 2007	June 2013	June 2018	June 2019	June 2020	June 2021
Public Debt (PSEs included)	**38.1**	**52.6**	**78.1**	**88.1**	**92.9**	**102.2**
Public and Guaranteed Debt	**38.1**	**50.2**	**75.4**	**83.9**	**87.9**	**95.2**
• Multilateral and Paris Club	31.4	37.7	39.7	39.0	41.8	44.6
• Other bilateral	1.0	2.9	8.7	12.7	13.4	14.8
• Bonds, Sukuks, commercial	2.9	1.6	14.1	14.8	13.6	17.5
• Short-term debt	0	0	1.6	1.3	1.5	0.9
• IMF	1.4	1.4	6.1	5.6	7.7	7.4
• Forex Liabilities guaranteed	1.4	2.4	5.1	10.5	9.9	8.8
• PSEs	**--**	**2.1**	**2.7**	**3.9**	**4.9**	**6.7**
Banks	**--**	**1.5**	**4.4**	**4.7**	**4.5**	**5.3**
Private debt, non-guaranteed	**2.0**	**3.1**	**9.2**	**10.5**	**11.1**	**10.9**
Intercompany debt	**--**	**2.8**	**3.6**	**3.3**	**4.4**	**4.1**
Total Ext Debt & Liabilities	**40.1**	**59.8**	**95.2**	**106.3**	**112.9**	**122.2**
Official liquid reserves	13.3	6.0	9.9	7.7	12.5	17.4
Ext Debt & Liabilities % of GDP	28	25	30	37	45[7]	35
GDP in Billion USD	144	237	313	279	264	347[8]

Source: SBP Annual State of the Economy Report

Looking at risks, another major development is the Ukraine war. We have seen its effect on energy prices. The war also has led to global inflation. In addition to energy, food prices are up while there is global slowdown in growth. Economies such as Pakistan that are net importers of food and fuel and dependent on foreign capital have been hit hard. Our policy framework, which does not focus on industrial development but mostly on managing public finance and the external account renders the economy unable to withstand such crises.

The possible help from Saudi Arabia for deferred payment for oil import would help. All those measures that can possibly insulate us from the harmful effect of Ukraine is necessary to consider. Whether getting by with the goodwill of others is acceptable policy for a nuclear weapons country is for the leadership to decide.

IPR's report "Foreign Aid and its Purpose" of April 2021 describes the folly of the policies we have pursued.

[7] Source for EDL/GDP is SBP's Annual State of the Economy Report FY 20, Pg 81, Table 5.7
[8] Rebased and revised GDP by government

Part 2: Recommend measures to manage the current account deficit in the near term.

What should Pakistan do?

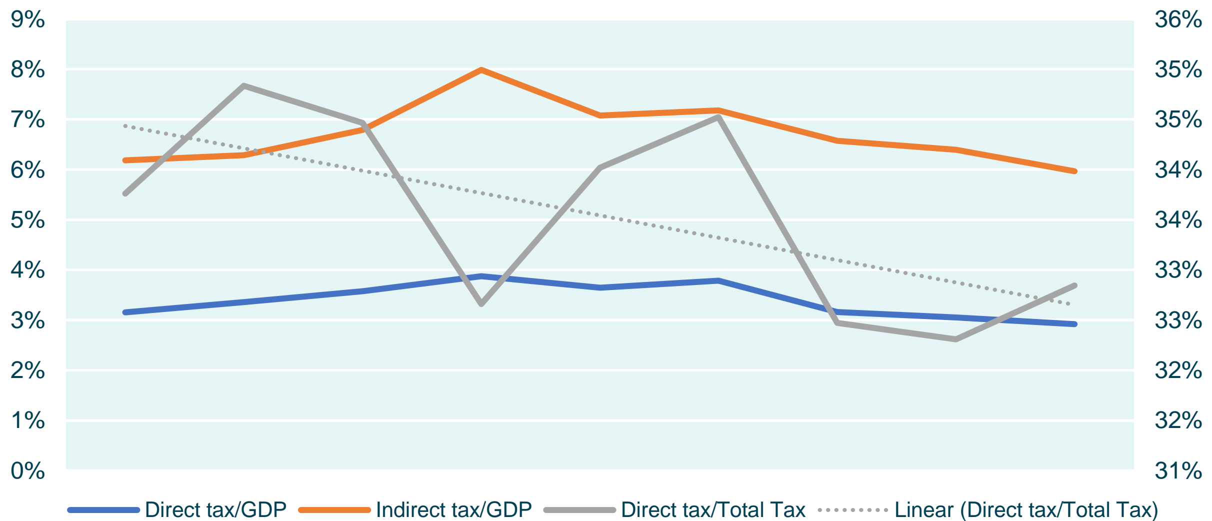
For this and coming four years, IMF's projected gross financing needs is between $ 30 and 40 billion[9]. With this year's current account deficit expected to reach $ 17.5 billion, our dollar gross financing need is about $ 35 billion. Reportedly, GoP needs another $ 9 to 12 billion in addition to what it has[10]. And there is not much time:

- GoP must set targets for fiscal and current account deficits. Parliament must approve. It must therefore customize its spending accordingly.
- While there is an in-principle agreement with the IMF, government must take politically unpopular decisions to conclude the arrangement. Yet, it must be done to stabilize the economy. In any case, the price freeze in February 2022 was for political reasons and had no economic logic.
- For decades, decision makers have framed the discussion about increasing tax to GDP ratio by referring only to indirect taxes and levy. So, higher petroleum levy, GST and import tariff find mention while discussing budget deficit. It entirely serves interest of decision makers and influential lobbies. In Figure 7 below, the blue line represents direct taxes. Despite lip service to its increase in every budget speech, and we will hear it again this year, the ratio of direct taxes to GDP has not improved. In fact, it has fallen in the last three years. Contribution of indirect taxes, red line, is about twice as much. The gray line measures the share of direct taxes to total tax collection, on the right vertical axis, Its share has fluctuated between 32.5% in FY 20 to 35% in FY 14. Repeated tax exemptions and favourable tax rates prevents increase in the share of direct taxes. The common person is expected to keep funding the large budget deficit which entirely arises from poor policies that serve elite interests (those of creditors, IPPs and other PSEs, untaxed agriculturists, and lower PSDP for all). This coupled with high inflation caused mostly by increase in administered prices is a huge burden on the common people.

[9] IMF, 2021 Article IV Consultation, Sixth Review Under the Extended Arrangement Under the Extended Fund Facility, Table 3b. Pakistan: Gross Financing Requirements and Sources, 2017/18–2025/26, page 41

[10] Dawn, Experts call for comprehensive economic reform strategy, Jamal Shahid, April 24, 2022

Figure 7: Low Direct Taxes
FYs 13 to 21



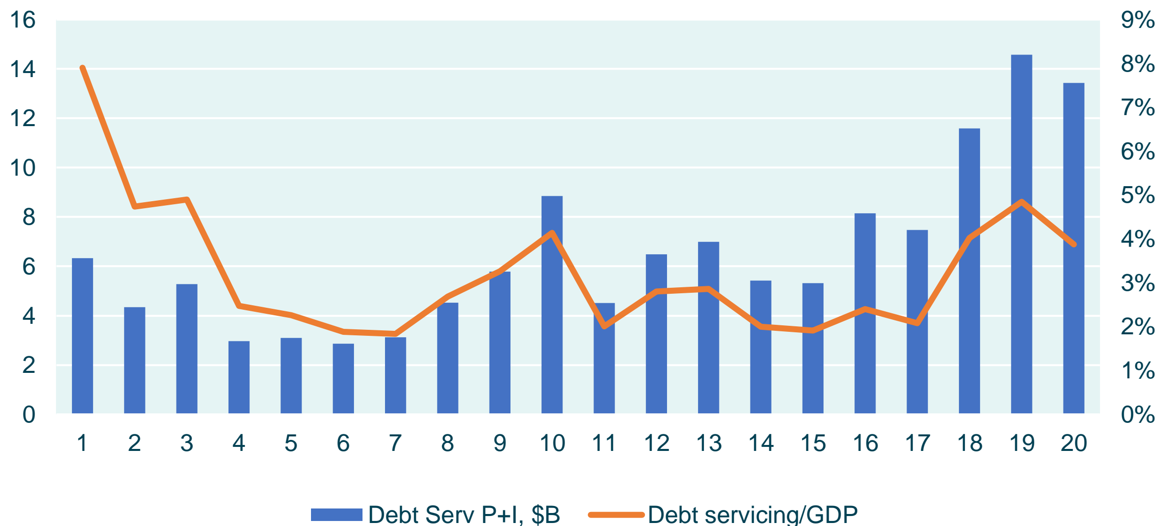
- Debt relief: Go beyond the programme to seek debt relief. Debt relief includes either reduction in interest rate on debt or a reduction in principle amount of the debt. It also means extending the repayment period. Or it could be a combination of the three.

  Pakistan has a credible basis to make the appeal, see Box 2. Still, it would need very able persuasion by Pakistan in world capitals for advocacy with the IMF. It has to be done if we are to avoid a Sri Lanka like situation.

  Debt relief is in the interest of Pakistan as well as the creditors. If we look at the debt structure and profile and the pace at which our external debt has grown, a substantial repayment in the coming years is not possible. Relief to bring down our obligations, so that they are in line with the economy's capacity to repay and service, is in the interest of both Pakistan and the creditors.

  In the last 20 years, Pakistan has paid 2% to 8% of GDP in debt servicing (principal plus interest), the red line on the right axis. Total amount that outflowed each year has ranged

Figure 8: Debt Servicing P+I



between US $ 3 billion and 14 billion annually. These are very large sums of money leaving the economy. The benefit to the economy is unclear.

IFIs agree to debt relief when an economy's debt structure is not sustainable. But as pointed out, IMF considers our debt sustainable by financing it with more debt. From the country's point of view that is a sub-optimal position and inherently not sustainable, other than for a short time. Thus, our repeated visits to IMF.

Because definitions of sustainability vary, we must persuade IMF via other major world capitals. The present IMF leadership has a holistic approach to debt and could be amenable if approached with a credible plan for avoiding to seek future concessions. 'A 2002 IMF report concurs: "restructuring can increase returns to all parties in cases where debt is unsustainable."[11]'

However, Pakistan has availed Paris Club rescheduling before. To convince them that we are serious about not knocking on their door again, we must share a robust growth plan that would put Pakistan on a sustainable path in terms of the balance of payment[12]. The economic growth plan must include measures to build private productivity and exports.

Our record is not impeccable. Pakistan has been less than judicious in using foreign loans. Lenders too though have funded low impact projects and programmes, whose ideas often originated with the IFIs[13]. This is clear from their own evaluation reports.

IMF levies a surcharge on the loans. While it sounds innocuous, it adds to the debt burden in a major way, According to Fortune magazine, "added burden from surcharges is no trivial amount … 16 countries are paying IMF surcharges, which increase their collective borrowing costs by over 64%.". The Center for Economic and Policy Research (CEPR)[14] estimates that surcharges make up close to half of all non-principal debt service owed to the Fund by its five largest borrowers[15]. Pakistan must make this request to the IMF and other IFIs and bilateral creditors.

- If debt relief is not forthcoming, rescheduling is another option. Two things are important. All creditors, not just Paris Club, must reschedule and they must not charge interest during the rescheduled period. Otherwise, rescheduling increases indebtedness. Nothing will be easy, but we must try to gain lenders' confidence and to make the exercise meaningful for us. Of late, China has become a major lender. Debt relief or rescheduling is not possible or meaningful without Chinese loans being part of the rescheduling exercise. Money is fungible and Western economies are deeply averse to using the money made available from rescheduling of their loans to service Chinese loans. Also, Paris Club loans are more concessional than non-Paris Club loans. A couple of examples below:

[11] Business Recorder, How to solve the debt crisis, Arshad Zaman 22 Apr, 2022. The writer gives a six-step how-to on domestic debt restructuring, italics added

[12] Project Syndicate, Desperately Seeking a Mechanism for Sovereign Debt Restructuring, Anne O. Krueger, 22 April 2022

[13] The News, The economy needs rapid improvement, Humayun Akhtar Khan, 14 April 2022, https://www.thenews.com.pk/print/950021-the-economy-needs-rapid-improvement

[14] Centre for Economic Policy Research (CEPR), based in London, is a distributed network of economists, who are affiliated with but not employed by CEPR, and who collaborate through the Centre on a wide range of policy-related research projects and dissemination activities.

[15] Fortune Commentary, Now would be a good time for the IMF to do away with unfair and unnecessary surcharges, Shereen Talaat and Dan Beeton, April 22, 2022

Table 4: Comparison of terms of debt from sources				
	Lender	**Amount**	**Amortization Years**	**Rate**
FY 2016-17	Japan	USD 23.8 M	30	Fixed 0.1 & LIBOR Yen 06 Months + 0.1, = **0.44%**
FY 2016-17	China	729.4 M	20	Fixed 2 & LIBOR 06 Months + 2.8, = **6.78%**
FY 2016-17	IDB, Short-term	700.0 M	1	LIBOR 12 Months + 2.22, = **4.72%**
FY 2016-17	World Bank IDA	761.2 M	25	Between **1.88 and 3.2** Fixed

Source: Pakistan Economic Survey FY 20, Table 9.5 of Statistical Supplement Japan and WB are concessional sources. IDB Islamic Development Bank, IDA is WB's concessional window.

As we borrow more with the soon to be renewed IMF arrangement, we must also find other ways to reduce the debt and debt servicing burden:

- Increase exports: given that the country's production base, especially of tradeable goods, has not grown much, there are few commodities available to rapidly increase exports by a large margin. Yet, GoP may make an item wise review of goods whose exports can increase quickly. GOP should incentivize manufacturers of such items. This would need special effort and may lead to a marginal increase. But even a $ 1 Billion annual increase is important in the current state the economy is in.
- Imports: Effort to limit imports may take two forms. Immediately, do away with non-essential goods imports. As luxury imports into Pakistan are limited already, this effort may include those goods whose substitutes are reasonably available in Pakistan. Here too GoP must make a line-by-line review.

  This may include also those imported goods whose substitutes can be easily brought back into production domestically. Food items come to mind, especially those in which the economy was surplus until recently. Two examples are wheat and raw cotton, which Pakistan now imports. Experts in government and academia may study what combination of policies would quickly increase production, such as change in support price, especial measures to improve and subsidize input supply such as fertilizer, pesticide, prioritized water, storage of produce, or prioritized farm credit for specific products.
- Government must make especial efforts to prevent re-entry of Afghan transit imports. These re-imports have done great damage to our manufacturing sector.
- Earmark remittances to pay back loan, rather than just borrow to repay. Of course, money is fungible, but earmarking sets a clear target in the government's mind to direct a certain amount towards debt repayment. Even 10% would mean a reduction in debt by $ 3 billion. Less foreign exchange available for import, would force government to curtail imports and find substitutes in Pakistan.

- In addition to a Saudi facility for deferred payment for oil, we may request the same of Qatar, if the government has revived the long-term LNG contract. Energy exporters are windfall beneficiaries of recent hike in prices. Government may request Qatar for partial interest free deferment of payments, or if possible, payment in Rupees.
- All this calls for especial efforts by appealing to the global leadership. This especial effort must be based on our diplomatic as well as strategic relations.
- Restrict portfolio investment into the country. Contrary to the widely held belief that portfolio investment lends forex exchange buffer, their unrestricted two-way flow is a source of volatility and uncertainty. They are speculative in nature and potentially a source of illicit flows, see Box 3. They do nothing to help with private project finance. They also hurt the interests of local investors. Restriction should be in the shape of higher capital gains tax and requirement for minimum holding period.

These are small measures but together they may produce a substantial amount. Even small amounts of less debt are a valuable goal to have. Also, this way the external account emergency would be known and felt by decision makers and the people of Pakistan. Taking on more debt quietly and putting the country's future at risk may cause less ripples now, but hardly makes a desirable national goal.

Box 2: Pakistan has a very strong and credible case for debt relief

We may make a case on the following lines:

- Brief them on the amount of external debt incurred by the economy and how much Pakistan has paid back as interest and principal. Net resource transfer in 20 years is negative $ 5,221 million. Over 70% of new debt is for BoP support, data from a past IPR report[16].
- That despite large sums paid back, stock of debt has risen greatly by 228%, even as net transfer to Pakistan is negative in 20 years and in most years a small proportion of total disbursed amount.
- That whether concessional or other creditors, share of interest in total servicing is high. It ranges from 20% for multilateral creditors to 51% for Paris Club lenders.
- Where debt buildup and interest paid are concerned, concessional debt is a euphemism. There is not much difference in cost to GoP. Concessional debt merely adds to the myth of the usefulness of foreign debt.

The high level of debt has resulted in huge sums paid as interest to IFIs and bilateral lenders. This is flow of scarce resources from Pakistan to creditors in rich countries. In the last five years, Pakistan has paid annually US $ 2.3 Billion as interest, Table below. In the last 20 years, we have paid US $ 1.4 Billion annually. In all, we paid US $ 27.2 B as interest since 2001. Of this, US $ 12.9 Billion have been paid to 'concessional creditors, IFIs and bilateral. Add US $ 1.6 Billion paid to IMF in 20 years and we paid US $ 725 Million per year to 'concessional' lenders. Meanwhile, our foreign indebtedness has grown to US $ 113 Billion, Table.

Table 5: Disbursement and Servicing of Concessional Credit FY 01-20

Million USD

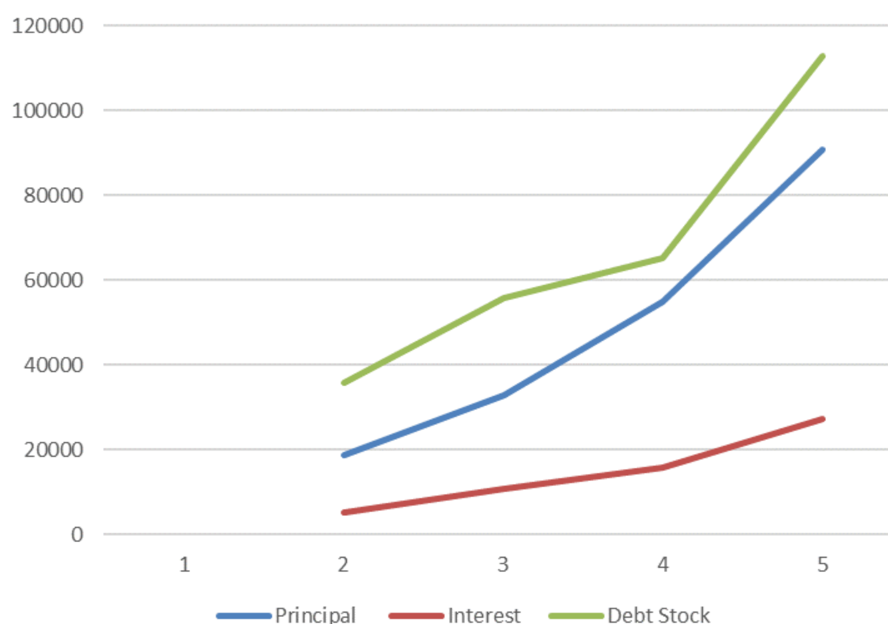
	Disbursed by lender FY 01-20	Serviced by Pakistan		Total	Net Transfer Col 2 - 5	Debt stock
		Principal	Interest			
Multilateral	36,946	23,313	5,694 20%	29,007	7,939	31,712 +18,402
Paris Club	2,871	5,297	5,475 51%	10,770	-7,951	10,924 -921
Other Bilateral	17,360	3,530	1,818 34%	5,348	12,012	13,428 +12,977
Total Above 3	57,177	32,140	12,987 29%	45,127	12,000	55,250 +30,458
Grand Total	112,644	90,652	27,213 23%	117,865	-5,221	112,858 +75,699

[16] IPR https://ipr.org.pk/wp-content/uploads/2021/04/Foreign-Aid-and-its-Purpose.pdf

Cont'd Box 2:

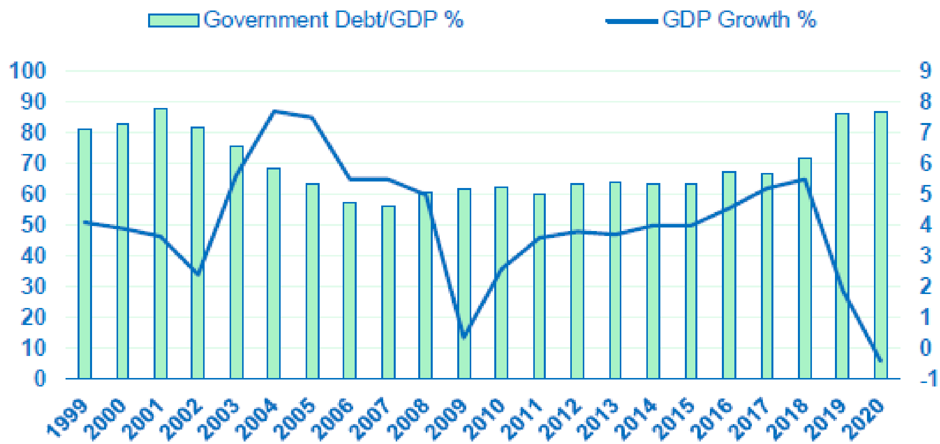
- That the fragility of the external account limits our ability to spend on infrastructure, invest in human capital, to acquire technology, leave alone spend on R&D or on technical skills development. Without these inputs the economy cannot grow. Pakistan will forever be a low growth and highly indebted economy. And it will always be an economy close to default, as it has been for about thirty years.
- The Ukraine war has added to the troubles of indebted low-income economies. Barely have we come out of challenges created by Covid when this second challenge not of our making has hit us. The cost of the invasion of Ukraine and the sanctions imposed on Russia by the West is borne by the whole word. This is in the shape of high energy costs, increase in food prices (Pakistan is a net food importer), global inflation and disturbance in supply of essentials. Already Pakistan it is difficult for Pakistan to meet the essential needs of our vulnerable population. The fallout of the Ukraine crisis has multiplied that challenge.
- The unsustainability of external debt is seen from Table 5 and Figure 2-1. Figure 2-1 shows that the economy has paid an ever-increasing amount of principal and debt, yet the stock of debt has risen with it. Figure 2-2 shows that high debt has not led to economic growth.

Figure Box 2-1



Cont'd Box 2:

Figure Box 2-2
Higher debt does not give high growth



- ➢ Rather than stimulate growth, high indebtedness has left us with almost permanent fiscal and current account deficits and lower growth potential for the economy, Figures 2-3 and 2-4.

Figure Box 2-3
Fiscal Deficit % GDP 2001-2020

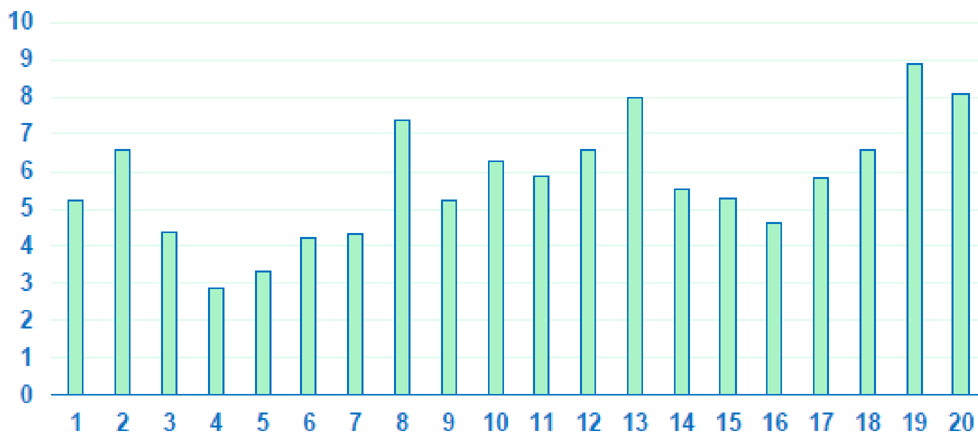


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Figure Box 2-4
Current Account Deficit in Million US$

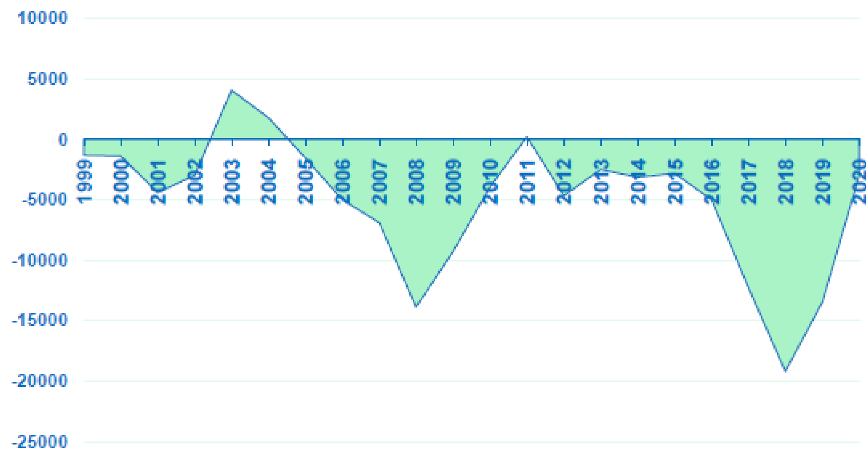
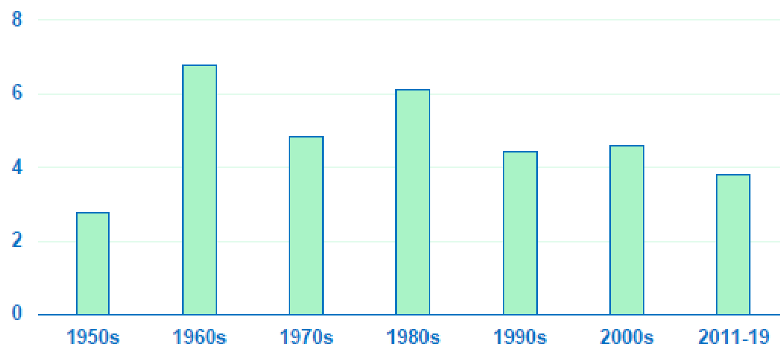


Figure Box 2-5
Growth Potential: Average annual growth by decades



The value of Rupee has fallen consistently. Rather than boost exports, which has declined sharply, the falling Rupee has made the cost of machinery and raw materials unaffordable. Our manufacturing and exports have suffered.

Cont'd Box 2:

Figure Box 2-6
Falling Rupee Value
PKR-US$ Rate 1995-2020

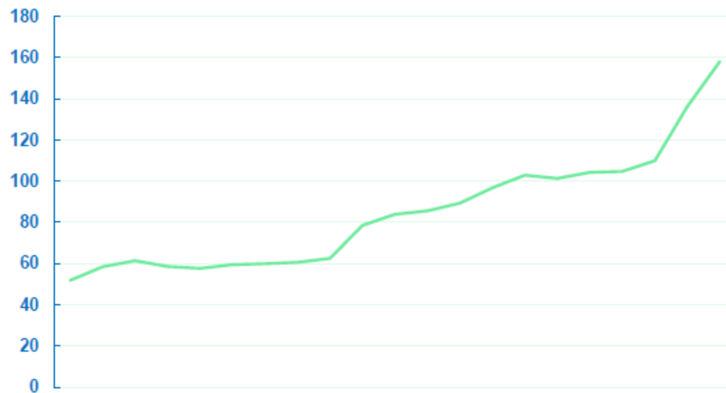
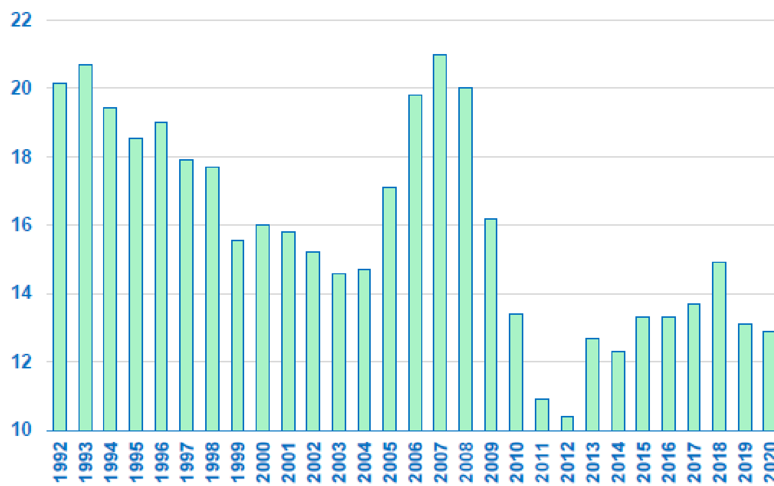


Figure Box 2-7
Pakistan's falling investment/GDP 1992-2020



All this has meant that our invest, exports and the economy's competitiveness has fallen rapidly. It is well below the average of similar economies in the region:

Cont'd Box 2:

Figure Box 2-8
Loss in competitiveness: Pakistan's declining export to GDP 1992-2020

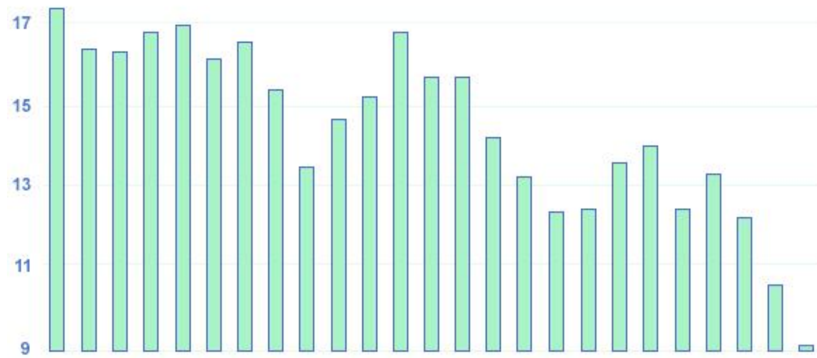
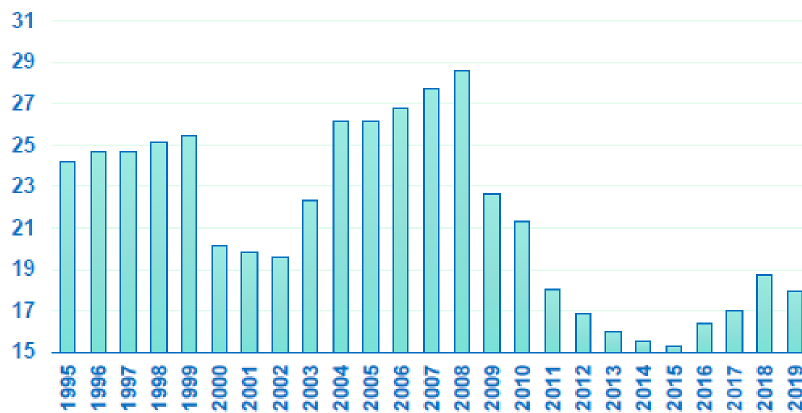


Figure Box 2-9
Bank credit to private sector %/GDP



The large outflows from the country have resulted in the decline of all growth inducing indicators. High interest payment contributes to high fiscal and current account deficits, leading to low investment in the economy's productive capacity, which reduces even further the economy's ability to service and repay its loans, which in turn encourages us to borrow more. It defies belief that policy makers cannot see this causal nexus which has sent us into an endless loop of dependence and impoverishment. For thirty years, we have dug ourselves into an ever deeper and we cannot figure it out?

The paragraphs below are from IPR's past report "Foreign Aid and its Purpose".
IFIs have been unhelpful with their advice. Firmly in the neo-liberal fold, in the 1990s they advised Pakistan to allow private sector in infrastructure development. The chaos it has brought to the

power sector is well known. Their other projects too have had low impact. According to World Bank evaluation, the Social Action Programme, the TARP (Tax Administration Reforms Project) and their structural assistance loans have had mixed results. So, has ADB's judicial reform project. Despite their own negative evaluation, IFIs continued to lend. For example, they funded SAP II "when SAP clearly was not working".

Regardless, Pakistani taxpayers must pay back the loans with interest. The creditors face no consequences.

The problem lies in the way we have used external debt. Foreign aid is used largely for BoP and budget support. And the problem has worsened incrementally. In recent years, loans for BOP were over 70% 0f total disbursements. The average for ten years is 61% of total, and over 20 years it is 59%. Use of foreign loans to pay back past debt is the norm. During 1989 to 1999, just 7.7% of borrowing was for BoP support. During nine years of the Musharraf government, foreign loans for BoP support jumped abruptly to 52% of the total. This is when IFIs began 'programme loans' such as DPL and PRSC i.e., Development Policy Loan and the Poverty Reduction Support Credit. These were quick disbursing loans not linked to any project. Despite their high-sounding goals, they had few measurable outcomes.

This happened despite very large sums of post 9/11 money received by Pakistan in the shape of grants, Coalition Support Fund, KSA's deferred payment for oil imports, and re-scheduling of Paris Club loans. Despite the world's largesse, we added few projects to leverage future growth. Since 2006, when energy prices suddenly hiked, they were used to fund oil import without passing cost of high energy prices to consumers. During the PML N years 2014-18, much of the borrowing was used to build Forex reserves and to keep the Rupee value high, a policy that defies logic.

So, the myth that borrowing creates growth is misplaced. In Pakistan's case, borrowing creates more borrowing with an external account crisis waiting to happen.

Moreover, project aid went to areas with severe flaws in project design. They resulted in weak project outcomes. Though program/project design are government owned, lenders and their assumed 'quality' inputs have more say in their design. During project implementation, lenders closely monitor progress. Disbursements are contingent on progress. Their own evaluations show weak to moderate impact. Despite this, disbursements continued. The loans are a burden on Pakistani tax-payers and service users and must be repaid with interest. The lenders who have a major say in project design take no responsibility.

Examples of weak economic impact are available in World Bank's "Independent Evaluation Report on its Pakistan programme for the 10-year period 1994-2003". The World Bank is a major source of credit for Pakistan. WB also has high level of technical and analytical sophistication. But below is what its own independent evaluation has to say:

The report recounts the four major themes of WB lending during the period 1994-2003: i. macro stability, ii poverty reduction and social sector uplift, iii sustainable growth, and iv governance. It says that "outcomes of Bank assistance were unsatisfactory in poverty reduction and social sector development, governance, agriculture and natural resource management, fixed infrastructure, and revenue mobilization and expenditure management. Therefore, overall outcomes of the Bank's assistance program are rated moderately unsatisfactory"[17]. Going into each programme and project, the report finds serious flaws in programme design and outcome measures. During this period, the World Bank's IDA and IBRD disbursements totaled US $ 3.7 Billion. Pakistan still

[17] World Bank, Independent Evaluation Report on its Pakistan programme for the 10-year period 1994-2003, 2006, quote taken from Page XV, discussion from many pages of document

must pay for these loans that had weak impact on economic growth or citizen welfare. In fact, their addition to the debt burden most likely had the opposite effect of what was intended.

The evaluations' comments on individual programme or project:

Private power: As part of the Bank's strategy to include private sector in infrastructure development, Pakistan was the pioneer of the Bank's energy policy. It soon had to "face the consequences of adopting an untested set of reforms"[18]. Before long "a number of problems emerged in implementation". The report says that the issues that had encumbered Pakistan's power sector such as line losses, recovery, and tariff rates were well known to the Bank. The Bank failed "to design projects that reflect the political economy and governance climate". The Bank's project design did not encourage competitive pricing. It could have designed the programme for 'lower cost more optimal set of generation investment". Also, "Bank management failed to recognize the considerable risks associated with the IPP program in Pakistan, particularly the excessive fiscal and external account risks placed on the country as a result of the government guarantees to the private power producers"[19]. The Pakistan firm and consumer has since paid a high cost of power with no improvement in supply quality. Resultantly, Pakistan firms further lost competitiveness.

Overall, "The Bank failed to develop realistic strategies in key areas such as poverty, rural development, power, and governance. Although the Bank knew that commitment, sustainability, and institutional capacity were limited and that vested interests often overruled good policy, project design failed to take those factors into account. The Bank also failed to stick to its own plans". The Bank also "was slow to acknowledge mistakes (following up with SAP II when SAP clearly was not working) and slow to address repeated problems"[20].

Similarly, TARP or Tax Administration Reforms Project of US $ 195 M and ADB's reform of the judiciary have had modest success. The structural assistance loans by the World Bank have been for macro stability. In Figures 5 to 8, this paper shows charts for macro stability.

Pakistan has also received much 'aid' in the form of loans. Between 1998 and 2005, the World Bank, Asian Development Bank and Japanese government lent over $500 million for a National Drainage Program. The project was supposed to improve Pakistan's irrigation system. However, following complaints by local people in the Sindh region, a World Bank Inspection Panel found that the project had led to widespread environmental harm and suffering among local communities, violating six of the World Bank's safeguard policies. In 2003, increased flooding, partially caused by the project, claimed more than 300 lives. Pakistan has paid back hundreds of million in interest and principal with hundreds of millions still to be paid.

As well as a large debt, Pakistan has huge development challenges, which are contributing to instability in the region. Since 2010, the country has been classified as 'middle income'. However, its national annual income per person is only $ 1,600. Pakistan fell short of most Millennium Development Goals and is way short of SDG targets. It is perhaps the only middle-income country whose rank has fallen in the HDI Index. Because it doesn't have the resources to invest in its people.

So, classifying Pakistan's debt as sustainable doesn't change on-ground realities. Pakistan has a very strong and credible case for debt relief.

End of Box 2

[18] Ibid Page 24
[19] Ibid Page 25
[20] Ibid Page 38

Part 3: Analyze structural issues for medium term recommendations to put the current account on a sure footing to avoid future such emergencies and recommend measures for structural reforms

Structural and Medium-term measures:

Measures to deal with the budget deficit, to set aside more funds for development. These are measures that would address key causes of the current account deficit by increasing investment and productivity:

- Make power sector financially sustainable: Doing so would reduce the budget deficit and make available funds for development.

  Power sector reforms of the 1990s, done on the advice of IFIs, have led to a collapse of power supply. Our economy could not support the cost of the 'reforms' that were put in place. Also, the sector is too complex to be solved by the simple idea of private participation in infrastructure. Having earned surplus profits, the original investors have mostly left. It is now clear that the consumer or the government cannot meet the cost of power along with the generous concessions that IPPs avail. In any case, because of long delays by the government in paying tariff differential subsidy, a part of IPP profits stay on the books for years without getting realized.

  This is an unsustainable situation. Power supply has hardly improved while cost of power has increased consistently. Government debt liability builds up and IPPs await realization of tariff differential due to them. Everyone suffers, producers, buyers, and government. Industrial production and exports have especially taken a hit. The previous government carried out a study to assess how the sector can be made sustainable. Despite claims, it fell short of opening up negotiations with IPPs.

  It is time to build on the study and begin exchange of ideas with IPPs and experts on how to make the power sector sustainable, including changes in agreements between IPPs and government. Those who have recently acquired interests in IPPs at a price that may have included expected profits would resist the most any change in agreement. Government may decide to give such cases one time compensation. But it is time to make power supply in Pakistan reliable and cost effective for business and individual consumers. That may also remove some of the governance problems from the DISCOs.

- Restructure domestic debt: With 38% of total federal expenditure going to interest payment (repayment is separate), government debt is now a huge burden on public finance. In the first nine months of FY 22, GoP spent 76% of net federal receipts on paying interest on debt. This is a massive cost on the people of Pakistan. Citizens pay for government's profligacy through taxes and poor services. We continue to borrow to pay past debts and interest expenditure keeps growing. There are recommendations in the policy discussion space to get debt relief by restructuring domestic debt. As proposed by an analyst, GoP may get debt relief by either reducing interest rates on domestic debt or through reduction in principle. 'IMF has recently provided a comprehensive guide to (its) execution, based on theory and experience. While the people of Pakistan have been driven to poverty and

destitution, the top 10 banks reportedly earned Rs 1,400 billion in interest income, during each of the last two calendar years'[21].

Pakistan's continued reliance on public debt may have led us to a stage where everyone knows that it cannot be returned, but does not admit it to protect their balance sheets. "This puts the continuation of mutually profitable creditor-debtor relations at risk …. Borrowing must be linked to returns"[22]. It takes away precious resources from public funds that is best invested in growth inducing projects.

- While IPR recommends increase in PSDP, there is a strong case to recast the PSDP into one that supports exports by raising private sector productivity. Planning Commission must develop a new metrics for selection of projects that support exports. The decline in exports from 19% of GDP in 1990 to about 8% in 2021 is a sad travesty and a major cause of present problems. All public investment must serve the goal of reversing this trend. Under top level supervision, all relevant parts of the federal and provincial governments must come together. In addition to the main players, they include HEC, science and technology, its affiliates such as PCSIR, the IT ministry, NAVTEC, FBR, and provincial departments[23].

Monetary and other measures

- Keep liquidity flowing: While the present tight monetary policy is understandable, State Bank must find ways to keep credit flowing within its overall money supply target. This could help stall the slowdown in GDP growth. Credit is very important for growth. Done right, it could spur exports. There are a few measures to consider to enhance private sector investment and productivity:
  - Government may consider making available short- and long-term fixed rate financing for export industry. Also, Export Refinance Facility is too restricted by its ceiling limits. SBP may enhance ERF limits in line with devaluation of the Rupee.
  - Changes in exchange rate of the Rupee has made it necessary that SBP enhance the ceilings for Long-term financing facility.
  - Similarly, SBP's TERF became an important source of financing for industry. SBP may restore this facility.

Credit for export and industrial growth:

- For decades, government has considered setting up an EXIM bank with preferential rates for export finance and to extend concessional credit for preferred export industry. It is time for government to establish the EXIM Bank. It may set aside a part of the Export Development Fund to contribute to the EXIM Bank's equity.
- Ease regulatory requirements to allow banks to lend more to businesses. Pakistan's private investment is just 11% of GDP, about half the average for South Asia. This cannot yield meaningful industrialization in Pakistan.
- Find ways of increasing further credit for SMEs, though SBP has made efforts their outcome is unclear. They currently have a share of 6.3% in total private sector credit.

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[21] Business Recorder, How to solve the debt crisis, Arshad Zaman 22 Apr, 2022. The writer gives a six-step how-to on domestic debt restructuring

[22] Ibid

[23] The News, The economy needs rapid improvement, Humayun Akhtar Khan, 14 April 2022, https://www.thenews.com.pk/print/950021-the-economy-needs-rapid-improvement

- To strengthen industrial growth, government must revive DFIs. Fixed cost long-term project financing was key to industrial growth of the 1960s. DFIs have been done away with on IFI advice. That has not served us well. The private sector needs predictable and fixed cost project finance[24].

Increases productive capacity and self-reliance

- Increase domestic sources of energy: The last major policy update to enhance petroleum supply was in 2012. The last tight gas policy was in 2011[25]. Since 2012, government's focus has been on import of LNG. While that is good to tide over immediate needs, Pakistan needs a more sustainable arrangement. The Energy Information Administration of USA which is an office under the US Department of Energy has identified Pakistan as one of the top shale gas sources. Shale gas exploration needs complex technology with high cost and greater risk. Pakistan must have a separate policy for shale gas cost recovery, access to technology and risk sharing. Without such a policy, shale gas would forever be a potential that stays unrealized. Increased production would directly help with the current account deficit and make the supply more reliable.
- Similar effort is needed for other mineral resources.
- SBP's recent effort for digitization of the economy will help productivity. This must continue and other key areas must complement, especially the FBR, where refund delays often increase cost for business. These organisations must digitize their interface with citizens for efficient operation to reduce firm level cost of doing business. To encourage e-Commerce, it is important to increase the de minimus limit. Meaningful e-Commerce cannot take place within the present low limit. Also, there should be rules to encourage Venture Capital Funds for FINTECHs.
- Transparency:
    - No international agreements, except those related to security, should be secret from parliament or the public. International agreements, other than security, should be reviewed by the relevant parliamentary committee and if needed be kept classified. Yet, they cannot stay in the corridors of the executive. There is no check on loan agreements, including those sourced from the market. The cost of repayments is borne by the people of Pakistan as tax payers and as consumers of goods and service. There is no consequence or accountability of decision makers. Similarly, contracts such as mineral exploration or large infrastructure projects remain classified. The constitution provides for parliamentary review over finances. That has not happened.

      Clearly, secrecy has not worked. It has caused much grief to the people of Pakistan in the shape of frequent economic crises, high debt repayments, increase in cost of essentials, high indirect taxes, poor services for the people, and unemployment. Secrecy strengthens the negotiating hand of the other party not of Pakistan. There should be a decision by the National Assembly that henceforth all international agreements would be open to committee review and where possible be made open to the public.

[24] The News, The economy needs rapid improvement, Humayun Akhtar Khan, 14 April 2022, https://www.thenews.com.pk/print/950021-the-economy-needs-rapid-improvement
[25] Gas that is hard to drill for as it is locked in pockets of impermeable rock, sandstone, or limestone formations

- The above recommendation also extends for the relevant parliamentary committee to review all new international loans before government signs them. Parliament must also lay guidelines for incurring loans in the future. This is entirely in line with the essence of democracy.
- National Assembly may under its auspices commence a classified study to analyze where all past loans went. This should be done by the Auditor General of Pakistan. The study should not lead to a witch hunt of anyone. Its purpose should be to learn lessons from the past in order to avoid similar pitfalls in future.

➢ Especial effort to check flight of capital, see Box 3 [26]: In times of uncertainty and fear of loss in value of assets from devaluation, new taxes and inflation, capital leaves for more secure destinations. Resources earned from corruption is another source. There are also some measures that parliament must take: See Box 3

Above is a comprehensive plan to revive the economy. The purpose of this study is to move beyond the usual self-created boundary framing it as a discussion for incurring more debt. This study goes to the causes of the structural current account deficit to highlight the gaps in economic policy making of the last many years and to address these flaws.

There are a few requirements to execute such a comprehensive plan. First, political instability must end in the interest of the country. Another matter to keep an eye on is to not let the progress on Covid slip. And it is very important for government to deal with the supply side measures to tackle inflation. This step is critical for citizen welfare.

This is a long list of things to do by the government and regulators. They will happen if the government is serious in putting behind years of uncertainty and setbacks caused by weak financial management. And if it uncompromising in correcting the many flawed policies that together have brought us to this pass. There will be no progress, if GoP continues with policies that serve the interest of decision makers and cronies, as successive governments have done so far. In that case, any public statement about dealing with the debt crisis or reviving the economy should be discounted immediately.

[26] There are varied definitions of capital. This paper refers to assets held by Pakistan residents not recorded as investment or intercorporate transfer of fund by say transfer pricing.

Box 3: Capital flight [27]

In times of uncertainty and fear of loss in value of assets from devaluation, taxes and inflation, capital leaves for more secure destinations. Resources earned from corruption is another source of informal transfer. The best way to reduce the flight is for the country to have sound economic policies and improved enforcement. That hasn't happened in decades.

Besides this would not take care of transfer of money gained through corruption or MNC transfer pricing and profit shifting, a major source of leakage, No one has a handle on the scale of the problem in Pakistan. It is safe to assume that it is rife.

An IMF report estimated capital flight from a group of debt-ridden developing economies during the years 1978 and 1988. The report estimates that during those ten years, the stock of undeclared capital held by residents of the selected group of countries ranged between 38% and 51% of total stock of external debt[28]. For many reasons, that ratio seems high in the case of Pakistan. Yet given the total external debt stock of S 122 billion, even half of the lower estimate amounts to over $ 20 billion undeclared capital held outside.

IMF and the Centre for Applied Research, Norwegian School of Economics, and the Global Financial Integrity in two separate studies have detailed the harmful effects of illicit transfers that drain resources of poor countries. By redirecting resources from potentially productive uses, such transfers diminish developing country's capacity for growth. Their effect is more severe than what happens when outflows are recorded[29]. IMF estimates that between 2001 and 2010 illicit flows from developing countries totaled $ 5.9 trillion. Against this total ODA received by developing economies during this period was $ 670 billion, about 11.5% of the illicit outflows[30]. In fact, developing countries are net creditors for the rest of the world. GFI finds that in the 32 years between 1980 and 2012, developing economies lost $ 10.6 trillion or $ 405 billion annually, not including China[31].

Also, there is 'evidence that tax havens undermine national and international regulation. Tax havens have a detrimental effect on growth in poor countries[32].' They take away resources and encourage rent seeking activities.

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[27] There are varied definitions of capital. This paper refers to assets held by Pakistan residents not recorded as investment or intercorporate transfer of fund by say transfer pricing.

[28] IMF, Risk and Capital Flight in Developing Countries, Liliana Rojas-Suarez, July 1990, Page 5

[29] Financial Flows and Tax Havens: Combining to Limit the Lives of Billions of People, Centre for Applied Research, Norwegian School of Economics, Global Financial Integrity, Jawaharlal Nehru University, Instituto de Estudos Socioeconômicos, Nigerian Institute of Social and Economic Research, December 2015

[30] Finance & Development September 2013, Capital Flight Risk, Rabah Arezki, Senior Economist IMF's Research
Department, Gregoire Rota-Graziosi is a Senior Economist in the IMF's Fiscal Affairs Department, and Lemma W. Senbet, Executive Director of the African Economic Research Consortium and University of Maryland, based on IMF Working Paper, "Abnormal Capital Outflows, Natural Resources, and Financial Development." https://www.imf.org/external/pubs/ft/fandd/2013/09/Arezki.htm

[31] Op.cit 3, Table 4, page 12

[32] Op Cit 3, page XIII

Cont'd Box 3:

A large part of capital flight is by MNCs. A UN University study cites credible "evidence that multinational firms reduce their tax bills considerably by shifting profits from countries with high corporate taxes to countries with low taxes" or to tax havens. The "techniques are fairly well understood"[33]. Developing countries lose valuable taxable income with adverse effect on performance of institutions. According to IMF, globalization has made MNCs very powerful at the expense of common citizens as they pick between regulations and tax bases.

The IMF study lists another MNC tactic that deprives developing economies of tax revenue. 'Thin capitalization is when a company chooses to be more indebted than similar independent entities." It recommends having tax rules for 'thin capital', that limits the amount of deductible interest[34]. The productive investment that this may cause would outweigh the measure's deterrent effect on FDI. MNC's informal transfers are especially prevalent among exporters of minerals. With Reqo Diq to come into operation soon, Pakistan must exercise care.

Also, in an environment of high tax leakage, the corporate sector is important as a source of revenue. Therefore, losses from MNC's informal transfers have significant effect.

There are no easy solutions. IMF and GFI recommend vigilance by tax authority and regulators. They must keep an eye also on inflows to countries especially as portfolio investments. "High net worth individuals and private corporations may initiate illicit flows into a developing country"[35]. In Pakistan we have seen frequent examples of this with the in and out of portfolio investment, most glaringly in 2018-19 when the SBP offered interest rates of up to 13.25% on debt flows at a time when LIBOR was about 1%.

The OECD Common Reporting System is a useful platform for exchange of information about cross-border bank account holdings. It enables governments to see bank account details for their own taxpayers with wealth holdings in other countries. About 100 countries are signatories. There are glaring exceptions. USA has placed itself in the happy position of obtaining information from other countries through its FATCA[36], but not sharing information about residents of other countries with assets in USA. Switzerland creates difficulty for developing countries to access information. Loopholes in CRS that allows for fake residency is another challenge, whereby information goes to jurisdictions that are not the real place of residence of holders of assets. Shell companies make it difficult to know real ownership of assets[37].

A UNCTAD report states that by 2030 limits on informal outflows from Africa could generate enough funds to meet "50% of the $2.4 trillion needed by sub-Saharan African countries for much-needed climate change adaptation and mitigation measures"[38].

[33] WIDER Working Paper 2016/10, revised version May 2017, Are Less Developed Countries More Exposed to
Multinational Tax Avoidance? Method and evidence from micro-data, Niels Johannesen, Thomas Tørsløv, and Ludvig Wier*

[34] Op Cit 4, page 27

[35] Op Cit 3, XII

[36] The Foreign Account Tax Compliance Act (FATCA), which was passed as part of the HIRE Act, generally requires that foreign financial Institutions and certain other non-financial foreign entities report on the foreign assets held by their U.S. account holders or be subject to withholding on with-holdable payments. The HIRE Act also contained legislation requiring U.S. persons to report, depending on the value, their foreign financial accounts and foreign assets.

[37] This para based on Tax Justice Network's 'It's time for countries to start publishing the data they're collecting under OECD's Common Reporting Standard', Andres Knobel, 2018

[38] Africa loses $89 billion a year to illicit capital flight, UN report finds, Benjamin Fox | EURACTIV.com

Two things are important. That capital flight in various forms is a serious enough problem for Pakistani regulators to be concerned about. And that given the lack of transparency and the hurdles built in to the system, it requires a high level of expertise, constant vigilance, and persistence to capture the income to make them taxable. There must be especial institutional arrangements to monitor and enforce.

So far, governments in Pakistan have not been serious.

End Box 3

Board of Directors

Mr. Humayun Akhtar Khan, Chairman & CEO

Mr. Akbar Khan

Haroon Akhtar Khan

Mr. Ghazi Akhtar Khan

Mr. Ashraf M. Hayat, Executive Director, Company Secretary

Board of Advisors

Dr. Atta-ur-Rehman

Mr. Abdullah Yousaf

Lt. Gen (R) Sikander Afzal

Mr. Syed Yawar Ali

Mr. Tasneem Noorani

Mr. Tariq Parvez

Dr. Manzoor Ahmad

Mr. Tariq Malik

Dr. Iqrar Ahmad Khan

Mr. Salman Raja

Mr. Ashfaq Yousuf Tola

Ms. Roshan Bharucha

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