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Causes and Consequences of Pakistan's Economic Crisis

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Abstract - Pakistan is currently facing one of the worst economic crises in its history. A combination of rising debt levels, persistent trade deficits, political instability, and a lack of investment has created a 'perfect storm' for the Pakistani economy. This paper examines the various factors behind Pakistan's economic crisis and analyzes its devastating consequences for the country's population. Pakistan's debt-to-GDP ratio has risen above 80%, making it difficult for the government to fulfill its loan obligations. The country has also run persistent trade deficits due to high imports of oil and other goods. At the same time, political instability has prevented the implementation of reforms needed to rebalance the economy. These issues have been compounded by a large informal sector that does not contribute taxes and a substantial decline in investments necessary for growth. The crisis has led to a sharp devaluation of the Pakistani rupee and very high inflation, further eroding purchasing power and living standards. Unemployment has risen and millions have been pushed into poverty. The government has been forced to make cuts in public spending, further straining an already inadequate healthcare and education system. In an attempt to stabilize the economy, Pakistan has entered into reform programs and bailout packages with the IMF. However, these require painful austerity measures including tax hikes, spending cuts, and tighter monetary policy. While necessary, these will further burden ordinary Pakistanis. Promoting exports, foreign direct investment, and public-private partnerships are critical for recovery. Initial reform efforts have calmed markets, but long-term solutions remain elusive given political uncertainties. This paper recommends sustained measures to expand the tax base, reduce corruption, streamline bureaucracy, and restructure public enterprises. Political will to implement politically difficult reforms is essential to avoid a humanitarian crisis. In conclusion, the conjunction of rising debt, trade deficits, lack of investment, and instability has created a perfect storm from which Pakistan must emerge through concerted reform. Given its large, young population, Pakistan has the potential to recover. But leaders must act decisively to address structural weaknesses in the economy and lay the foundations for sustainable growth.

Keywords: Balance of payments crisis, Debt sustainability, Fiscal deficit, Current account deficit, Foreign reserves depletion, Currency devaluation, IMF bailout, Import compression, High inflation, Structural reforms.

1. INTRODUCTION

1.1 Brief Background on Pakistan's Economy and Current Economic Crisis

Pakistan is currently in the midst of a severe economic crisis characterized by high inflation, declining growth rates, rising fiscal and current account deficits, and depleting foreign exchange reserves. This precarious economic situation threatens recent gains in macroeconomic stabilization and development. Pakistan has a population of over 220 million people, making it the world's 5th most populous country. It has consistently registered high population growth rates of over 2% annually. Pakistan's economy has seen periods of impressive growth as well as relative stagnation over the decades. In the 1960s, Pakistan was

seen as a model of economic development and averaged growth of 6% annually. However, nationalization policies in the 1970s led to slower growth. Structural reforms and liberalization in the 1980s and 1990s helped restore growth to over 6%. However, growth decelerated in the 2000s as Pakistan faced challenges of political instability, energy shortages, natural disasters, and a difficult external environment. The economy proved resilient after the global financial crisis, with growth rebounding to average around 5% between 2010-2018. Poverty levels declined significantly from 64% in 2002 to 24% in 2015. However, the gains have proved inadequate given the persistently high population growth rate.

Pakistan's economy is currently in crisis. GDP growth slowed to just 1.9% in FY19 and contracted by 0.4% in FY20 due to the Covid-19 pandemic. The IMF projects just 1% growth in FY21. Inflation peaked at 17% in 2020 before moderating to around 8% recently. The fiscal deficit has risen to over 8% of GDP due to shortfalls in revenues and increased spending related to the pandemic. The current account deficit rose to $20 billion or 4% of GDP in FY22. Foreign exchange reserves dipped below $10 billion in early 2022, covering less than 2 months of imports. Several factors have contributed to Pakistan's recurring macroeconomic vulnerabilities. Fiscal mismanagement and an overvalued exchange rate led to the balance of payments crisis in the late 1990s requiring an IMF bailout. The 2000s saw unsustainable consumer booms financed by short-term borrowing. Institutional weaknesses hampered development of an export-oriented economy. Consequently, Pakistan has experienced recurrent boom-bust cycles and has required frequent IMF assistance.

The latest crisis stems from the legacy of expansionary fiscal and monetary policies since 2018. Despite weakening fundamentals, policymakers wanted to boost growth in an election year. This led to a sharp rise in fiscal and current account deficits. The situation was exacerbated by exogenous shocks. Rising global commodity prices increased import costs. Meanwhile, remittances and exports lost momentum due to the pandemic and global recession. Debt sustainability concerns and credit rating downgrades exacerbated capital outflows. To arrest the latest crisis, the new government that assumed power in April 2022 has embarked on stabilization reforms under a $6 billion IMF program. Key elements include market-determined exchange rates, increasing energy prices, raising taxes, tightening monetary policy, and structural reforms to strengthen institutions. However, these measures risk slowing growth further and triggering social discontent. Pakistan faces an uphill battle to overcome its latest economic crisis against the backdrop of rising global uncertainties. The Russia-Ukraine war has fueled inflation and weakened the external outlook. Climate change poses risks to agriculture. Long-standing structural issues in competitiveness, energy, and governance must also be tackled. With prudent policies and robust implementation, Pakistan can place its economy back on a sustainable growth trajectory. But the path ahead will require deft political management and global support.

2. CAUSES OF THE ECONOMIC CRISIS

2.1 Rising Debt Levels

Pakistan's rising public debt, particularly its domestic debt, is a critical factor behind the current economic crisis. Total public debt stands at around Rs53 trillion ($250 billion), having grown at a compound annual growth rate of 18% over the past 5 years. Domestic debt makes up four-fifths of the total debt stock. This heavy debt burden is crowding out private investment and has become unaffordable given low revenue generation. Pakistan's total public debt as a percentage of GDP has risen sharply from around 70% in 2018 to well over 90% presently. External debt as a share of GDP has remained relatively stable at around one-third, but domestic debt has soared from around 40% to over 60% of GDP. The government has increasingly

relied on short-term domestic borrowing to finance persistent fiscal deficits. Domestic debt with maturities of less than 1 year makes up nearly 50% of total domestic public debt compared to just 10% a decade ago.

Rising debt levels have been driven by the government's heavy reliance on deficit financing to fund populist policy measures, subsidies, and loss-making state-owned enterprises. Tax revenues as a share of GDP have stagnated at around 10-12%, among the lowest globally. Debt service costs consumed nearly 40% of total revenues in FY2021, constraining resources for development and social spending. Consequently, Pakistan must rollover or issue new debt just to meet obligations falling due. With a relatively small tax base, high incidence of tax evasion, and inflexible expenditures, the fiscal deficit has topped 7-8% of GDP since 2018. Budget deficits have been primarily financed through domestic borrowing from commercial banks. This has crowded out the private sector and triggered a sharp build-up in short-term debt at higher interest rates. The maturity profile of domestic debt worsened significantly between 2018-2022. The share of short-term debt (under 12 months maturity) in total domestic debt jumped from 30% to over 45% over this period. The share maturing within 1-5 years also rose from 25% to 35%. This shift toward short-term debt has increased rollover and interest rate risks for the government. Over 40% of domestic debt must be refinanced each year, exposing public finances to suddenly shifting market sentiments.

The growing role of commercial banks in financing fiscal deficits has also been problematic. Bank investments in government securities as a share of total assets rose from under 30% in 2017 to over 50% in 2022. This reflects regulatory relaxations and the lack of other fixed income instruments. While bank lending to the private sector has stagnated, credit to the government and public enterprises has grown rapidly. Rising indebtedness has substantially increased Pakistan's external vulnerability. By FY2021, external debt servicing amounted to over $13 billion annually, consuming nearly 60% of export earnings. Default risks increase when export growth lags. Debt sustainability analysis shows public debt levels are dangerously high. Urgent steps are needed to expand the tax base, cut wasteful spending, improve efficiency of state-owned enterprises, and curtail debt accumulation to avoid a debt trap. Debt restructuring may also be required to restore sustainability. In conclusion, Pakistan's heavy reliance on short-term domestic borrowing to finance large fiscal deficits has significantly increased rollover, interest rate and default risks. Reversing debt dynamics should be the foremost priority to avoid loss of macroeconomic stability. This requires fundamental fiscal reforms and erosion of unwarranted privileges enjoyed by the elite to mobilize revenues for investment and social spending.

2.3 Persistent Trade Deficit

Pakistan has run persistent trade deficits for decades, which has emerged as a major weakness in its external account. The trade deficit rose to an alarming $48 billion in FY2022, putting extreme pressure on foreign exchange reserves. Structural weaknesses have prevented Pakistan from making the transition to a competitive, export-oriented economy. Pakistan's exports have grown slowly due to narrow export base, lack of product diversification and weak competitiveness. Exports amounted to only $32 billion in FY2022, equal to just 10% of GDP. Textiles and clothing account for over 60% of total exports. This is troubling given the phase-out of quotas under WTO that opened these products to global competition. Exports remain concentrated in low value-added, labor intensive segments like basic textiles. Meanwhile, imports have grown rapidly driven by high oil prices, rising consumer demand, and capital goods imports. Over the past five years, import growth of 10% annually has far outpaced export growth of around 3%. Imports amounted to $80 billion in FY2022, dominated by petroleum, machinery, chemicals, and metals. The resulting trade deficit has continuously contributed to current account deficits.

Pakistan's current account deficit has averaged around 4-5% in recent years due to the large trade deficit. Rising global commodity prices, subdued textile demand post-Covid, and the economic slowdown widened the current account deficit to $17 billion (4.6% of GDP) in FY2022. Historically, even small current account deficits of 2-3% have proven unsustainable. The recent deficit drove rapid depletion of foreign exchange reserves to just 1.5 months of imports. Several factors explain Pakistan's lack of export competitiveness and expanding imports. The overvalued exchange rate has hurt exports' pricing power. Energy shortages, inefficient logistics and red tape have undermined exporters. High effective import tariffs on raw materials have raised costs. Low integration in global and regional value chains limits industrial upgrading. The narrow direct tax base restricts funds for infrastructure, R&D, and human capital critical for industrial development. Delays in tax refunds hamper firms' liquidity. Meanwhile, substantial tax concessions and loopholes allow the influential elite to accumulate wealth overseas. The resulting lack of investment in manufacturing has prevented structural transformation of the economy.

On the imports side, Pakistan failed to diversify its energy sources and remains dependent on imported oil. Tax incentives and leakages facilitated a surge of consumer goods imports. Lopsided free trade agreements further widened the trade deficit without reciprocal market access for exports. Pakistan must implement deep structural reforms to address the high trade deficit. The exchange rate should be aligned to fundamentals to boost exports. Trade policy should aim at export diversification into higher value-added products. SEZs can be leveraged to attract FDI in export-oriented manufacturing. Technical assistance programs are needed to help firms meet international standards and join GVCs. Energy and logistics infrastructure must be upgraded to reduce business costs. The ease of trading across borders can be improved through trade facilitation reforms. Tax and power sector reforms are essential to eliminate anti-export bias. Concurrently, Pakistan should seek favorable access for exports in key markets. In summary, addressing Pakistan's persistent trade deficit requires concerted policy efforts and political commitment. The export competitiveness gap can be bridged through exchange rate adjustments, trade policy reforms, upgrading industrial capabilities, and improving the business environment. These steps coupled with import rationalization are imperative to avoid recurring balance of payments crises.

2.4 Overreliance on Imports Such as Oil

Pakistan's heavy dependence on imported oil has emerged as an acute vulnerability contributing to its balance of payments crises. Petroleum imports amounted to over $17 billion in FY2022, accounting for a quarter of Pakistan's total import bill. Rising global oil prices amplified pressures on the external account. The oil import dependence reflects Pakistan's lack of progress in expanding indigenous energy sources. Oil constitutes nearly 25% of Pakistan's total primary energy supply. However, domestic crude oil production meets just 15-20% of total requirements. Pakistan has to import over 80% of its crude oil needs, making it highly vulnerable to global price shocks. Petroleum imports surged to over $21 billion in FY2022 as oil prices crossed $100 per barrel after the Ukraine war. The oil import dependence has repeatedly contributed to Pakistan's external crises. The first major crisis in the late 1990s stemmed from rising oil import costs following the Gulf war. During 2008-2013, widening current account deficits were tied to surging oil prices crossing $100 per barrel. The present crisis also owes significantly to the spike in oil import spending.

Successive governments have failed to reduce Pakistan's oil dependency despite clear energy security risks. Energy policies focused on cheaper imported fuels rather than indigenous resources like hydropower and renewables. Oil-based power generation continues to account for over 30% of installed capacity in Pakistan though oil prices have soared. Expensive furnace oil power plants were irresponsibly installed

under power sector deals with IPPs. Pakistan's stagnant oil production is another facet of flawed energy policies. Domestic crude output peaked at 90,000 barrels per day in 2006 but subsequently declined to just 60,000 bpd. Lack of investment in exploration limited new discoveries. Delays in project approvals and contract disputes compounded matters. Roughly just 15% of Pakistan's sedimentary area has been explored for hydrocarbons. The missed opportunities are underscored by major new oil and gas finds in neighboring countries with similar geological conditions like India, Iran, and Afghanistan. For instance, the TAPI gas pipeline from Turkmenistan and Galkynysh gas field in Afghanistan hold tremendous potential for Pakistan. But progress remains stalled due to regional tensions.

Breaking the oil addiction requires a comprehensive new energy policy centered on the theme of 'Strategic Petroleum Reserves'. A key pillar is actively seeking equity oil stakes overseas through bilateral deals. Partnerships with Gulf countries can provide supply cushions during global disruptions. Secondly, sufficient strategic reserves must be maintained domestically to cover 90 days of net imports. Expediting the Iran-Pakistan gas pipeline is critical given the 70 trillion cubic feet of gas reserves in Iran versus just 20 TCF in Pakistan. On renewables, the target for solar and wind power should be raised to at least 30% of installed capacity by 2030. Wasteful energy subsidies that burden the exchequer should be rationalized to encourage efficiency and self-sufficiency. In conclusion, profound policy and institutional reforms are urgently required to mitigate Pakistan's dangerous overreliance on imported oil. Developing strategic oil reserves overseas and domestically is vital to build energy security. Tapping regional hydrocarbon resources and expanding domestic renewables offer pathways to reduce the oil import dependence that has repeatedly strained Pakistan's external position.

2.5 Political Instability and Lack of Reforms

Pakistan's history of political instability and lack of continuity in economic policies has undermined development of strong institutions and reforms needed for stable growth. Frequent regime changes, tensions between military and civilian leaders, and vocal opposition groups have impeded consensus building on major reforms. Since independence in 1947, Pakistan has spent several decades under military rule interspersed with short periods of civilian democracy. The military has directly ruled the country for over 3 decades cumulatively. Political interference by the military even during civilian rule has constrained policy choices and weakened democratic norms and processes. This political instability has prevented effective reform implementation and continuity of policies. For instance, in the 1990s, privatization efforts lost steam after changes in government. Tax reforms in the mid-2000s were similarly reversed later. The FDI regime has remained restrictive despite government commitments to liberalize it. Even IMF programs have gone off track prematurely over two dozen times due to political upheavals.

Structural reforms needed to increase productivity and competitiveness have been hampered by ideological posturing and populist pressures around privatization, trade liberalization, tax policy, and public enterprise reforms. With no political party able to achieve a definitive mandate, coalition governments have struggled to build consensus on major reforms. The adverse impacts of political instability on economic management are clearly visible in Pakistan's boom-bust growth cycles. Periods of high growth fueled by debt accumulation and excessive spending are followed by balance of payments crises requiring sharp stabilization measures. This 'stop-go' economic trajectory reflects lack of political will for reforms during upcycles. For instance, the consumption bubble during 2003-2008 was fueled by unsustainably loose monetary and fiscal policies with no reforms to enhance productivity and exports. When the global crisis

hit, Pakistan was forced into an IMF program. The 2018 election year likewise saw imprudent policies to spur growth just before another crisis emerged.

Political interference has also systematically weakened key institutions like the tax administration, energy sector regulators, State Bank of Pakistan, and debt management offices. Governance challenges have worsened in power distribution companies, railways, and other public enterprises due to appointments based on patronage instead of merit. Elite groups in agriculture, real estate, retail and wholesale trade evade taxes and resist reforms that threaten their privileges. This distorts incentives and limits funds available for human development and public infrastructure. Deficit financing has increased due to lack of political will to implement progressive taxation and rationalize expenditures. To achieve lasting economic stability, deep-rooted institutional reforms are essential in areas like tax policy, debt management, public sector enterprises, and regulatory institutions to insulate them from political pressures. Credible long-term policy frameworks must transcend political transitions. Strengthening local governments can also foster accountability and development. In summary, reform efforts in Pakistan have repeatedly fallen prey to political instability and weak institutions. Development of consistent, merit-based economic policies and institutions backed by broad political consensus is crucial to avoid recurrent crises. Genuine democracy, rule of law and inclusive governance are prerequisites for difficult but inevitable economic reforms.

2.6 Large Informal Sector Evading Taxes

Pakistan has one of the largest informal economies in the world, estimated at around 30-40% of official GDP. The huge untaxed sector starves the government of revenues needed for development and social welfare. It also creates an uneven playing field that disadvantages formal firms. Bringing the informal sector into the tax net is pivotal for strengthening Pakistan's economy. Key domains with large informal activity include agriculture, retail trade, transportation, construction, domestic labor, services, and small manufacturing enterprises. Reasons for thriving informalization include cumbersome regulations on business formalization, inadequate tax facilitation, and lack of financial inclusion. The agriculture sector is particularly problematic, with under 1% of farmers paying income tax despite representing 20% of GDP.

The untaxed black economy comprises both criminal economic activities as well as legal production concealed to avoid taxes. Estimates suggest that just 1-2 million individuals file income tax returns in Pakistan, indicating rampant non-compliance. With less than 1% of the populace paying direct taxes, the tax-to-GDP ratio languishes at 9-10%, among the lowest globally. This hampers government's ability to provide infrastructure and social services. Tax exemptions granted to politically influential groups have expanded the untaxed economy. For instance, agricultural landlords and traders pay minimal turnover taxes instead of income tax on earnings. Exemptions on property income favor speculation in real estate. Leakages in the sales tax through fake invoices and smuggling are estimated at 50% of potential revenues. Elite capture thus deprives the economy of much-needed resources.

Informal activity also inflates the profitability of tax-evading sectors. Unregistered small enterprises in manufacturing and services can unfairly undercut compliant firms. This creates a culture of impunity and tax avoidance that even formal firms emulate, eroding the integrity of the tax system. Documentation drives have failed due to poor design and governance challenges. Pakistan must implement a well-planned "informal sector tax normalization program" focused on registering small enterprises, traders, professionals, and agriculture. For example, simplified taxation schemes for small businesses have succeeded in many countries. Taxpayer outreach and education campaigns can highlight benefits from joining the tax net like access to credit. A key pillar is digitization of processes, such as e-filing of taxes and

computerized risk-based audits to reduce contact points for corruption. Strengthening IT infrastructure and analytical capacity in revenue bodies is essential. The greater use of third-party information reports and data analytics can foster enforcement. Supportive policies like financial inclusion of informal firms will facilitate formalization. Tackling politically sensitive areas of tax evasion will require robust political commitment. Agricultural and property taxes need urgent reform. Policymakers must enact laws for offshore asset declarations. Anti-corruption agencies have a vital role in curbing collusion and elite capture in revenue bodies. Sustained multi-year efforts are needed to change societal attitudes toward taxation and rebuild trust in public institutions. In conclusion, the far-reaching reforms required to incorporate Pakistan's large untaxed informal economy into the mainstream will clearly not be easy. But they remain indispensable to boost the tax-to-GDP ratio, strengthen fiscal sustainability, promote inclusive growth and reduce inequality. This will be pivotal for avoiding recurrent economic crises driven by lack of public revenues, external imbalances and governance weaknesses.

2.7 Decline in Investments

The decline in private and public investments over the past decade is a key factor behind Pakistan's recurring growth crises. Gross fixed capital formation has fallen from over 15% of GDP a decade ago to just 13% presently. This drop in investment, both domestic and foreign, has constrained Pakistan's growth potential. Several factors are responsible for the fall in investment. Chronic energy shortages, infrastructure gaps, cumbersome regulations and high business costs have discouraged private investors. The sharp rise in political risks and policy uncertainty, especially around taxation, has created doubts over expected returns from large projects. At the same time, massive debt accumulation by the government has crowded out private credit. Rising fiscal deficits and sovereign borrowing have dominated bank lending, leaving little liquidity for private investors. High real interest rates above 10% have also hampered investments. Deficient public infrastructure in transport, water and skilled labor has raised business costs.

In addition, Pakistan has received low foreign direct investment due to its perception as a high risk economy given security challenges, macroeconomic instability and weak contract enforcement. Net FDI inflows have hovered around $2 billion annually, well below comparators. Overseas investors demand high returns to compensate for the elevated risks. On the public investment side, budgetary pressures and fiscal consolidation needs have squeezed development spending in recent years. Infrastructure investment as a share of GDP used to average over 3% but has now dropped closer to 2%. Public investment in human capital in areas like health, education and social protection has also lagged considerably. This decline in investment, both public and private, has lowered Pakistan's economic growth potential. Capital accumulation is essential to enhance labor productivity and adopt new technologies needed to move up the value chain. With the demographic dividend on its side, Pakistan must raise investment significantly to create jobs for its growing youth population.

To revive private investment, Government must address core bottlenecks around energy, taxation, credit access, infrastructure gaps and improving security. Public-Private Partnerships can help mobilize resources. SEZs and export-oriented sectors should be favored. SME financing and digitization initiatives can support entrepreneurship. Constructive engagement with overseas Pakistanis can attract more FDI. On public investment, the tax-to-GDP ratio must be enhanced by at least 3-4% of GDP over 3 years by broadening direct taxes, streamlining GST, and strengthening tax administration. This will generate fiscal space for public infrastructure and human capital spending. Public Financial Management reforms are also vital for efficiency and transparency. In summary, arresting the decline in investment is pivotal to boost

Pakistan's economic growth, modernize its industry, create jobs and improve competitiveness. This requires comprehensive policy actions and an improved business environment that address both immediate bottlenecks and the deeper institutional failures hampering investment. Sustained efforts over a decade will be needed to rebuild investor confidence.

3. CONSEQUENCES OF THE CRISIS

3.1 Currency Devaluation

Pakistan has witnessed sharp currency devaluations during the present crisis as well as past balance of payments crises. The rupee depreciated over 30% against the US dollar in 2022 alone, reflecting the precarious external position. Currency devaluations contribute to inflationary pressures and rising cost of imports. However, they are necessary to correct external imbalances. The State Bank of Pakistan has transitioned to a market-determined exchange rate regime since 2019. This resulted in the rupee depreciating cumulatively by over 50% against the dollar over the past four years compared to a relatively stable nominal value previously. The rupee fell from 115/$ in May 2018 to over 230/$ by July 2022. Rupee depreciation was inevitable given the large current account deficit driven by the rising trade gap and declining foreign reserves. Persistent deficits that exceeded the country's foreign exchange earnings necessitated adjustment in the rupee value to curb imports and correct the imbalance.

However, delayed adjustments in the past allowed the rupee to become substantially overvalued. This led to abrupt and disorderly devaluations during crisis periods to the extent of 30% in a single year. It also diminished the competitiveness of Pakistan's exports. Timely and incremental adjustments could have avoided the need for such dramatic corrections. The downside of abrupt currency devaluations is imported inflation, especially in oil and commodities. The recent 30% drop in rupee value fueled domestic inflation to reach 24% in 2022. Price pressures get transmitted to other sectors. Input costs rise for industry, squeezing profit margins. Debt service costs of government's external loans also increase in rupee terms. For the common citizen, currency depreciation translates into higher prices of petrol, utilities, cooking oil and other essentials, reducing real incomes. The State Bank has responded by tightening monetary policy, raising interest rates by over 625 basis points since September 2021 to contain second-round impacts.

While currency devaluations impose short-term adjustment costs, they are needed to restore competitiveness. The real effective exchange rate, adjusting for inflation differentials, is estimated to be still overvalued by 10-15%. Further gradual correction will be needed for sustainable growth. With global recession looming, exports offer the only viable growth engine. The government can mitigate the inflationary effects of currency depreciation through supply-side management. Removing barriers to imports of raw materials and machinery can ease pressures. Subsidies and tax relief on essentials items may be required temporarily for vulnerable groups. Tight monetary policy will also have to continue. In summary, sustained macroeconomic stability necessitates a competitive, market-driven exchange rate. While currency devaluation contributes to inflationary pressures, it remains unavoidable for correcting imbalances. Policymakers must weigh the short-term pains against long-run gains of export competitiveness and self-reliance. The focus should be on demand management and safety nets rather than resisting real exchange rate correction.

3.2 High Inflation

Pakistan is experiencing an inflation crisis, with the consumer price index rising to 27.3% year-on-year in August 2022, the highest level in nearly five decades. High inflation has severely reduced the purchasing power of the average Pakistani, further pushing millions below the poverty line. Multiple factors have caused this rapid inflationary surge. Currency depreciation of over 30% in 2022 has made imports more expensive, transmitting into higher domestic prices. Global commodity price shocks, especially in energy and food, have also fueled inflation. Floods have disrupted domestic supply chains, creating shortages. Moreover, expansionary monetary and fiscal policies over the past few years have overheated demand and drained foreign reserves. The resultant imbalance between aggregate demand and supply is manifesting in high inflation. Government borrowing from the central bank to finance deficits has pumped excess liquidity into the system.

The upshot is that Pakistan faces demand-pull, cost-push and imported inflation simultaneously. Food inflation reached 30% in August 2022, hammering the poor. Pakistan's GDP per capita has fallen from over $1600 in June 2022 to below $1500 in September 2022 in real terms after adjusting for inflation. For a country where 24% of the population lives below the poverty line, such high inflation is unleashing immense economic pain and social costs. It is estimated that over 8 million people could fall into poverty due to the current crisis. Rural households are especially vulnerable to food inflation. High inflation also risks macroeconomic stability. Rising prices induce demands for higher wages which can fuel cost-push inflation further. Inflation expectations start driving up current prices as people anticipate future price rises. To anchor expectations before they become unhinged, the State Bank has rapidly raised interest rates by over 600 basis points since September 2021.

However, the policy rate at 15% is still below the inflation rate, implying negative real interest rates. Depositors are moving savings into physical assets like real estate. Further tightening will be imperative to make real interest rates positive. The government is also planning emergency measures like utility subsidies, tax cuts, price controls and reduced fuel levies to curb inflation. But an effective anti-inflation policy also requires correcting the root imbalance between demand and supply. Boosting productivity in agriculture and easing supply bottlenecks are vital. Agricultural modernization and removal of intermediaries can enhance food supply. Upgrading logistics infrastructure and ports will lower freight costs. Fiscal consolidation to prevent monetization of deficits is equally important. Widening the tax net and prudent expenditure policies are key. Currency flexibility and openness to imports will also facilitate price discovery and help cool inflation. Sustained efforts on multiple policy fronts will be essential to overcome the current inflation crisis. In summary, high inflation triggered by economic imbalances is severely impacting the lives and livelihoods of millions of Pakistanis. Urgent measures to tighten monetary policy, relieve supply pressures and curb demand are imperative to prevent compounding the country's economic hardship. Managing inflation should be the foremost priority for policymakers.

3.3 Unemployment

Pakistan's economic crisis has led to rising unemployment as economic growth has slowed, industries have closed, and new job creation has suffered. Unemployment has historically remained high in Pakistan but has worsened recent years. This has serious socio-economic costs including poverty, inequality, social unrest, and lost productivity. The latest labor force survey data shows the unemployment rate rose to 6.9% in 2021-22 compared to less than 6% before the crisis. Unemployment levels increased by around 2 million to over 4 million. The surge was particularly high in urban areas and among females and youth. Balochistan and Sindh have the highest provincial unemployment rates. The crisis has impacted both salaried jobs as

well as self-employment. Firms across manufacturing, services and trade have laid off contractual and temporary workers to cut costs amid reduced demand and losses. Many micro enterprises and vendors have also seen a fall in activity. With economic restructuring during downturns, layoffs rise as some firms close while others emerge.

The lack of job creation compounds matters. In good times, new entrants to the labor force could find work opportunities in the informal sector. But this absorption has declined as firms postpone expansion and recruitment plans. Consequently, youth have been the worst hit by joblessness during the crisis. The loss of livelihoods has pushed more households into poverty and vulnerability. The purchasing power of the unemployed reduces drastically. Families cut down on nutritional food, healthcare and education. They turn to casual work in the informal sector but that too remains subdued. Social safety nets are inadequate to provide income support to jobless households. Prolonged unemployment has psychological costs too on motivation and skills. For youth, the inability to get a first job prevents human capital accumulation on the job. Resulting discontent and idleness can foster social problems like substance abuse and crime. There are also economic costs from loss of production and income.

For a country like Pakistan where 65% of the population is under 30, high unemployment represents not just an economic challenge but a demographic time bomb. Lack of employment opportunities for the youth bulge risks social unrest. Providing adequate gainful work is pivotal for reaping the demographic dividend. The government must prioritize job creation in crisis response plans. Boosting construction activities and housing can generate immediate employment. Skill development programs are needed to employ youth productively. Supporting SMEs, startups and farms creates more inclusive job opportunities. Expanding social security nets is vital to protect the vulnerable unemployed. Restoring macroeconomic stability and growth are imperative to revive firm-level activity and demand for labor. Targeted subsidies may be required to avoid firm closures and job losses in the short run. In the longer run, improving human capital, business environment and competitiveness are essential to absorb the growing workforce productively. In summary, rising unemployment in the economic crisis underscores the urgency of countercyclical policies for job creation and skills development. Preserving employment must be a key goal along with macroeconomic stabilization policies. Employing Pakistan's youth bulging population gainfully remains the country's foremost economic challenge.

3.4 Poverty

Pakistan has made strides in reducing poverty over the past two decades, but the recent economic crisis risks reversing this progress significantly. High inflation, job losses and reduced incomes are pushing millions back below the poverty line. The crisis threatens to undo years of steady, though insufficient, poverty reduction. According to the latest official data, 24% of Pakistan's population was living below the national poverty line in 2020. This figure had declined from 35% a decade ago after years of sustained economic growth. However, the crisis has led to estimates that poverty may have risen substantially to touch 37-40% of the population now. The World Bank estimates that rising prices alone may have increased poverty by 6 percentage points in the past year. Floods could drive up poverty further by 2-4 percentage points due to loss of jobs, incomes and assets. Effectively, over 15 million more Pakistanis may have fallen into poverty since the crisis began.

The rise in poverty is being witnessed across regions but is particularly pronounced in Balochistan and Sindh. Rural areas have been hit harder than urban centers. Agriculture, daily wage earners and informal workers have suffered massively but job losses have also hurt the urban poor. With depleted savings and

no social security, the new poor are highly vulnerable. While the national poverty line measures absolute deprivation, broader measures of multidimensional poverty also reveal major deficits in healthcare, nutrition, housing, water and sanitation. The crises has compromised access to essential public services for the poor due to higher costs and budget cuts. About 44% of children under 5 suffer from stunting. In addition to short-term relief, efforts to revive growth and create jobs will be vital for durable poverty reduction. But economic growth alone will not suffice given Pakistan's income and wealth inequality. Structural reforms are essential to create equal opportunities and inclusive growth. These include land reforms, increased women's participation, and progressive taxes to fund social spending. The Benazir Income Support Program and Ehsaas program play a pivotal role in protecting the most vulnerable, especially women and children, through cash transfers and other poverty alleviation initiatives. Expanding their coverage and adequacy should be an urgent priority, along with one-dish poverty reduction programs. Alongside social safety nets, increasing access to micro-credit, skills training, basic education, and digital finance can boost the income generation potential of the poor. Programs aimed at the bottom 40% must be expanded during crisis periods to prevent irreversible human capital losses. In summary, Pakistan cannot afford to lose the hard-won gains made in poverty reduction over the past two decades. Quick and robust countercyclical policies are vital to provide income support to the vulnerable even while addressing larger issues of inequality, governance and human capital development. Poverty reduction must remain an unwavering focus of policymaking.

3.5 Cuts in Public Spending and Services

Pakistan's severe economic crisis has necessitated sharp cuts in public spending by the government to reduce the large fiscal deficit. Development expenditures and social services have faced major cuts, directly impacting the welfare of citizens. This risks reversing the hard-won human development gains made by Pakistan over the past two decades. Fiscal consolidation was an unavoidable demand of IMF and other creditors to restore macroeconomic stability in light of dangerously low foreign reserves. However, compressed expenditures have hurt education, health, social protection programs and infrastructure investments at a time when they are most needed.

For instance, the PSDP was budgeted at Rs800 billion for FY2022-23, a reduction of over 30% compared to the previous year in real terms. Infrastructure projects in roads, rail and dams have been impacted along with cuts in provision of basic amenities like water and electricity to rural areas. Cuts to higher education scholarships have been made as well. Development spending by provinces has also been curtailed by around 15% in Punjab and Khyber Pakhtunkhwa. These funds are vital for the provision of health, education and other necessities. Overall social sector spending fell from 4.2% to 2.3% of GDP between 2018 and 2022. Spending on flagship welfare initiatives like Ehsaas and BISP has been protected but fail to cover many vulnerable households. Sale of commodities at subsidized rates at utility stores has been scaled back. The Benazir Mazdoor Card providing health insurance has been discontinued. With inflation over 25%, welfare amounts stretch even less. On the health front, cuts have been made to the Sehat Sahulat program and anti-polio campaigns even as Pakistan witnesses an uptick in cases. Funds for improving nurse training and nutrition programs have been reduced. Very little is allocated for measures to combat climate change and natural disasters.

Budgets for higher education scholarships have also declined sharply in real terms. Recruitment of teachers has suffered, with adverse implications for learning outcomes. Cuts to vocational training initiatives hamper skilling of youth for jobs. Education already accounts for less than 3% of GDP compared

to 4-5% norms. Overcoming the economic crisis necessitates stabilizing public finances. However, cuts to human development and social spending risk further marginalizing vulnerable sections instead of protecting them from crisis impacts. Safeguarding pro-poor expenditures must be a priority within fiscal consolidation plans. Alongside spending cuts, mobilizing revenues through progressive taxation on wealth, real estate and agriculture is imperative. Reducing wastage, corruption and defense expenditures can create space for welfare spending for the disadvantaged. Protecting human development remains vital for Pakistan's future.

4. ATTEMPTS TO ADDRESS THE CRISIS

4.1 Reforms and Bailout Packages With the IMF

Faced with dangerously low foreign reserves, mounting public debt and a balance of payments crisis, Pakistan has repeatedly had to turn to the IMF for emergency financing. However, IMF bailouts have come with tough conditions mandating structural reforms and stabilization measures. Since the late 1980s, Pakistan has entered 13 different IMF programs, with the latest approved in July 2019. IMF loans help meet urgent external financing needs. But they also require the government to embark on painful fiscal adjustments and market reforms.

Under the ongoing $6 billion Extended Fund Facility, Pakistan has had to commit to reducing the fiscal deficit, increasing tax revenues, eliminating energy subsidies, allowing exchange rate flexibility, reducing public debt and rebuilding foreign reserves. Key revenue reforms include broadening the income tax base, increasing federal excise duties, market-determined gas and petrol prices, and a more abundant VAT regime. On expenditures, the IMF has demanded cuts to subsidies, social spending and development outlays along with privatization.

Tighter monetary policy is also an IMF priority to tackle inflation. Other reforms aim at strengthening central bank independence, consolidating the banking sector, improving regulatory frameworks for SOEs, expanding digital payments and developing capital markets. Such sweeping reforms come at major economic and political costs. Fiscal adjustments invariably impose hardship on the poor and middle class. Price hikes, job losses and reduced government welfare spending hurt the common citizen. The political backlash over such austerity can derail programs. However, Pakistan is left with little choice given its addiction to living beyond means and the failure to implement structural reforms that could have averted the crisis. IMF financing remains essential to buy time to correct the macroeconomic imbalances.

To ease the pain for citizens, social spending should be better targeted towards health, education and social security. Wasteful expenditures need to be curtailed. IMF programs must catalyze broader productivity-enhancing reforms to unlock growth potential. Sustained reforms are needed in tax policy, civil service, judicial and political governance, exports, education, power sector and SOEs to address underlying structural weaknesses rather than just short-term stabilization. Ultimately, political will is the key to successfully implementing painful yet unavoidable reforms mandated by the IMF. Governments must build public support through transparent communication. Credible reform implementation can restore macroeconomic stability and set the economy on a sustainable growth path. In summary, recurring IMF bailouts reflect Pakistan's failure to carry out major reforms during periods of stability. While IMF financing provides temporary relief, overcoming the boom-bust cycle requires the will for reforms that can lead to self-reliance.

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4.2 Government Austerity Measures

To stabilize the economy and meet IMF conditions, the government has undertaken sweeping austerity measures and spending cuts. These include tax increases, subsidy reductions, curtailed development spending, a hiring freeze, travel restrictions and other cost cutting steps in the face of a severe crisis. Key revenue mobilization measures include a 10% 'super tax' on large industries, higher federal excise duties on petroleum, electricity and services, and removal of sales tax exemptions. Direct tax measures include raising the maximum income tax rate to 35% and minimum Corporate Tax to 2%. These will help in fiscal consolidation. On expenditures, the government has drastically reduced current spending on operations, maintenance and non-salary items. The Prime Minister's Office budget was slashed from Rs1.15 billion to Rs0.81 billion. Purchase of vehicles, office equipment, foreign tours and unnecessary renovations have been banned. Utility consumption limits have been enforced. Cuts have also been made to development funds, health cards, power subsidies, LNG imports and allocation for Covid-related spending. Budgets for loss-making state enterprises like PIA and Pakistan Steel have been rationalized. All non-salary expenditures faced a 15% cut for achieving savings. The government imposed a complete ban on new hiring except for essential services like education and health to contain the ballooning wage bill. Luxury vacations of bureaucrats have been stopped. Government office timings have been increased for greater productivity. Numerous allowances and privileges for civil servants and state employees have been withdrawn as well.

Provincial governments are also following similar austerity drives, cutting non-development spending by Rs0.6 trillion. Punjab has returned surplus budgets and enforced efficient energy usage. Cost-saving targets have been set for departments. Ban on vehicles and foreign visits apply to provinces too. However, care has to be taken that vital current spending on health, education and social protection is not compromised. Cutting infrastructure investments will also have growth impacts. Targeted subsidies will be needed to protect the vulnerable from inflationary pressures due to fiscal consolidation. While the revenue measures are largely progressive, indirect taxation still forms the bulk of collections. Expanding the narrow direct tax base remains essential for equity and long-run sustainability. Non-tax revenues can also be boosted through PSE reforms and privatization. Good governance, transparency and reduced corruption is pivotal alongside austerity for achieving savings and better service delivery. Digitization of government payments and processes is important for efficiency gains. In summary, the difficult austerity drive was necessitated due to fiscal profligacy of the past. However, indiscriminate cuts risk slowing growth. Prudent spending rationalization combined with mobilization of progressive revenues can place public finances on a sustainable path without undermining socio-economic priorities.

4.3 Promoting Exports and FDI

Boosting exports and attracting foreign direct investment are pivotal for Pakistan to overcome the balance of payments crisis and embark on sustainable growth. The government has undertaken several initiatives on these fronts, but more policy reforms are needed for tangible results. On exports, the Rupee depreciation has helped bridge the competitiveness gap for Pakistani products. Duty drawbacks, tax refunds and subsidies have also been enhanced to support exporters. Cheaper energy has been ensured to export-oriented sectors along with improved liquidity through export finance schemes. Trade diplomats are engaging foreign partners for better market access. For instance, Pakistan secured GSP+ status in the EU which allows duty-free exports. Export potential in Africa, South Asia and the Middle East is also being tapped. Support programs help exporters meet international standards and join regional value chains.

The State Bank has introduced an Export Facilitation Scheme allowing banks to obtain cheap financing to provide long-term loans for machinery purchases by exporters. Marketing subsidies have been provided for costs of product development and exhibition participation. Export-only bonds can raise funding privately. On FDI, regulations are being streamlined to reduce red tape and improve Pakistan's ease of doing business ranking. Investor roadshows are being held globally to change perceptions and project Pakistan's potential in digital, tourism, agriculture and minerals. SEZs are being developed to attract relocation of manufacturing units from China and East Asia, leveraging Pakistan's low-cost skilled labor. The Board of Investment has launched an online visa portal and grievance redressal mechanism to facilitate investors. Bilateral investment treaties are being implemented to encourage FDI. Fiscal incentives being offered include 10-year income tax holidays, exemptions from indirect taxes and tariff-free import of machinery. Uninterrupted supply of utilities to industries is being ensured. Infrastructure and connectivity corridors linking coastal areas with northwest regions seek to develop industrial clusters.

However, sustaining export growth requires deep-rooted structural reforms to enhance productivity and competitiveness. Energy costs must be lowered, logistics streamlined, and raw material imports facilitated. Liberalizing trade, improving ease of doing business and access to finance are vital for FDI. SEZ development needs acceleration. Strengthening certification systems, subsidized warehousing and cheaper trade finance can promote exports of perishables, halal products and services. Greater resource allocation and effective implementation of announced initiatives is crucial. Pakistan's overseas diaspora, technology sector and developing startups ecosystem can be leveraged for FDI promotion. Promoting linkages between foreign and local firms fosters integration into value chains. Focusing on competitive niches and penetrating new markets will diversify and increase exports. In summary, boosting exports and FDI is imperative for Pakistan to achieve sustainable growth, industrial upgrading and build reserves resilience. The reform momentum must continue to transform policies, institutions and equitably integrate into the global economy.

5. OUTLOOK AND RECOMMENDATIONS

5.1 Assessment of Reform Efforts So Far

Pakistan has embarked on a crucial IMF reform program to stabilize the economy and correct the deep-rooted imbalances that led to the balance of payments crisis. However, the implementation pace so far has been relatively slow. On the positive side, the government has taken several tough but necessary actions. Energy subsidies have been reduced, passing on higher fuel costs to consumers. The Rupee has been allowed to depreciate to a more market-based level. Interest rates have been hiked significantly to control demand and anchor inflation expectations. Fiscal adjustments have also begun through new tax measures, reduced development spending, a ban on non-essential government expenditures and imported items. Loss-making state-owned enterprises are being restructured. The FBR tax collection target has been increased substantially.

That said, the speed and depth of reforms has fallen short of requirements and the commitments made to the IMF. The restoration of the stalled program last August was a positive step. But prior actions agreed for fiscal consolidation, energy pricing and central bank autonomy remain incomplete. Power tariff increases have not kept pace with rising generation costs, causing circular debt to persist. The annual tax collection target of Rs7 trillion is unlikely to be achieved given historic trends. Non-tax revenues from privatization proceeds and telecom license renewal have not materialized. On the external side, bilateral financing from friendly nations has not come through to the extent expected. As a result, foreign exchange reserves with

the SBP remain distressingly low as external debt obligations continue mounting. Tough reforms mandated by the IMF like privatization, civil service right-sizing, resolving bleeding SOEs, and structural changes to the tax system have yet to be initiated in earnest. The frequent turnover of Finance Ministers has hampered continuity and coherence in economic management. Going forward, steadfast implementation of IMF reforms are vital to stabilize the precarious situation. Upfront actions to unlock financing tranches should not be delayed. The focus must remain on achieving fiscal sustainability, rebuilding reserves, and correcting imbalances through market pricing.

Mobilizing revenues is crucial. The tax net has to be broadened drastically by bringing wholesale, retail, agriculture and real estate into the tax net. Tax administration and compliance requires urgent reforms. Non-tax receipts need acceleration. Reducing public expenditures will necessitate reforms in pensions, pay and performance management of state enterprises. Tough decisions on loss-making PSEs through privatization or shutdowns are important. Strengthening regulatory institutions should continue. Furthermore, expanding social safety nets is vital to protect the vulnerable as crisis impacts intensify. Tight monetary policy will need persistence to ward off risks of runaway inflation. Careful sequencing of adjustments will be needed to manage trade-offs with growth and employment. In summary, the reform momentum must be sustained through difficult structural changes and removing elite capture to put the economy back on track. With prudent policies and implementation, Pakistan can navigate the turbulent crisis.

5.2 Recommendations for Promoting Stability and Growth

To break out of the recurring boom-bust cycles, Pakistan needs to implement deep-rooted reforms to achieve macroeconomic stability and lay the foundations for inclusive and sustainable growth. On the fiscal side, expanding the narrow tax base is imperative to enhance revenue mobilization. No more than 2 million individuals file income tax returns in a country of 220 million. Agriculture, wholesale, retail trade, services and real estate remain largely untaxed. Tax exemptions granted to politically influential groups need elimination. Strengthening tax administration through investments in IT infrastructure, data analytics and audit capacities is vital. Legal provisions should be enacted to impose wealth, inheritance and capital gains taxes. Provincial sales tax harmonization and integrated collection mechanisms with the FBR must be introduced. On expenditure, PSE reforms are critical given the heavy losses incurred. Around 200 public sector firms bleed over Rs 2 trillion annually, adding to the fiscal deficit. Loss-making firms should be privatized or shut down. For others, appointment of professional management on merit instead of political cronies is important.

Rationalizing energy subsidies, pensions and wasteful administrative expenditures is essential. Growth comes from public investments in infrastructure, health, education and social protection. Budget systems must be reformed for better service delivery. Strengthening public financial management and audit capacities will improve fiscal discipline. A competitive market-based exchange rate is needed to correct imbalances sustainably. Building foreign exchange reserves through exports, remittances and FDI should be the priority. Monetary policy must keep real interest rates positive to anchor inflation. The SBP's autonomy is crucial for maintaining price stability. An export-led growth strategy is imperative for job creation. Incentivizing value-added manufacturing and services exports requires affordable energy, trade facilitation, access to credit and quality infrastructure. SEZs, technology parks and industrial clusters can attract FDI. Moving up the value chain by integrating into GVCs is important. Financial inclusion must be rapidly expanded by supporting fintech innovations. Contract enforcement, ease of doing business and

governance reforms are essential to improve the investment climate. Across all sectors, merit-based recruitment and building capabilities is key. In summary, Pakistan must take bold decisions to undertake fundamental structural changes that remove elite capture, restore fiscal and external sustainability, and enable export-led growth. With continued engagement with the IMF and friendly countries, these reforms will put Pakistan on the path to prosperity.

5.3 Need for Political will to Implement Changes

Pakistan's recurring boom-bust cycles underscore the lack of political will for economic reforms during periods of stability that could have averted such crises. Tough reforms inevitably impose short-term adjustment costs and thus require resolute political commitment. However, the political leadership has repeatedly failed to undertake major reforms during upcycles that could have addressed structural weaknesses. Whether civilian or military governments, difficult decisions like tax reform, loss-making PSE privatization and civil service right-sizing have been postponed. Instead, short-term populist measures were adopted that provided temporary growth spurts but led to macro instability later on. This stop-go approach has prevented the continuity essential for positive outcomes from reforms. For instance, both the PML-N and PPP boosted subsidies and government spending in election years, causing fiscal blowouts and current account deficits that culminated in balance of payments crises after the polls. Similarly, reforms agreed with the IMF were frequently reversed midway due to political considerations.

This lack of political will has meant Pakistan failed to carry out key reforms in areas like expanding the direct tax net, liberalizing trade, restructuring public enterprises, and improving competitiveness - which could have avoided the present crisis. Debt dependence and external vulnerability kept rising in the absence of reforms. Political expediency and appeasement of vested interests like agricultural elites, traders and real estate tycoons have obstructed essential reforms. Weak civilian control ceded too much influence to non-elected institutions. Structural changes do not suit the privileged elite benefitting from the status quo. Hence generating the political will and public support for tough reforms requires strong political leadership that can communicate the costs of inaction and benefits of reviving growth. With the economy in turmoil, the time is opportune as people demand solutions. Undertaking deep-rooted governance reforms can enable the state to tax elites and reduce elite capture that distorts incentives. Merit-based institutions like the FBR and SECP must be urgently strengthened and protected from political interference. Parliamentary oversight on economic policies and PSE performance needs vast improvement. Engaging with stakeholders and using evidence to highlight reform impacts can build consensus. With better sequencing of adjustment policies, adverse effects can be mitigated. In summary, Pakistan can break out of the periodic crises cycle only if the political leadership summons the will to stare down vested interests, communicate the need for tough reforms and implement them competently. Reforming the economy is vital for Pakistan's survival.

6. CONCLUSION

6.1 Summary of How Various Factors Created a "Perfect Storm" for Pakistan's Economy

Pakistan finds itself in the midst of a dire balance of payments crisis as a result of multiple domestic imbalances and external shocks that have created a “perfect storm” for the economy. Imprudent economic policies, delayed reforms, and global pressures have precipitated the current economic turmoil. At the root, Pakistan’s growth model relied excessively on consumption and imports rather than exports, investment and productivity growth. Easy money and fiscal policies encouraged a credit boom for several

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years while competitiveness lagged. Consequently, import and debt dependence grew rapidly while reserves depleted. State capture by influential groups blocked essential reforms in taxation, energy pricing, and public enterprise governance. Tax exemptions and subsidies bloated fiscal deficits. Delays in needed adjustments led to boom-bust cycles ending in irreversible damage. Currency overvaluation for too long hurt exports.

The present crisis reflects the consequences of procrastinating key reforms. The tax-to-GDP ratio stagnated at 8-9% with only 1-2 million individuals filing returns. Agriculture, real estate and wholesale/retail sectors remain largely untaxed. Reforms to broaden direct taxes were constantly evaded. Loss-making state-owned firms like PIA and Discos imposed a heavy fiscal burden due to political appointments and lack of oversight. Circular debt kept mounting while energy subsidies constrained fiscal space. Privatization was limited despite large efficiency losses and deficits of public firms. Expenditures on defense also grew at the cost of human development spending. Skill gaps widened as education quality lagged. Health and social protection remained underfunded. Infrastructure gaps in energy, transport and water crippled competitiveness.

Externally, the economy came under immense pressure from ballooning imports especially of oil and commodities. But export competitiveness suffered from high costs and anti-export bias of policies. Remittances cushion provided only temporary relief. Consequently, high current account deficits led to external debt buildup. Multiple shocks in the past few years proved to be the last straw. The Covid pandemic disrupted global supply chains when Pakistan had negligible reserves buffers. The Russia-Ukraine war fueled imported inflation just as previous stimuli had run their course.

Tightening global financial conditions and rising geopolitical risk downgraded Pakistan's investment profile and access to financing. Flood devastation added to the economic losses. Together, these shocks exhausted foreign reserves and brought Pakistan to the brink despite repeated IMF bailouts. In conclusion, the present crisis symbolizes the costs of not undertaking essential reforms during stabilizing periods. Overcoming boom-bust cycles now hinges on whether requisite political will emerges for tough but needed economic reforms to restore macroeconomic stability and lay the foundations for sustainable growth.

6.2 Emphasis on the Urgency for Reforms to Avoid a Humanitarian Crisis

Pakistan today faces its worst economic crisis in decades. Foreign reserves are depleted, public debt is unsustainable, and the currency as well as inflation are spiraling out of control. The economy risks falling into a vicious debt trap unless urgent policy actions are taken. With inflation crossing 27% and growth slowing to less than 3%, ordinary citizens are bearing the brunt through job losses, poverty and reduced real incomes. The survey-based unemployment rate has already touched 6.9%, implying over 4 million people are jobless. An estimated 15-20 million could fall below the poverty line.

Rising prices of food and fuel have made basic necessities unaffordable for lower-middle income households. Utility costs have shot up with the withdrawal of subsidies. Given low social security coverage and limited social protection systems, vulnerable groups like daily wage earners face humanitarian challenges. The country's capacity to respond through increased social sector spending is severely constrained given the precarious fiscal situation. High government borrowing is already crowding out the private sector. This is reducing growth and employment generation. With provinces also forced to curtail expenditures, cuts have been made to development funds for health, education and infrastructure. Cuts to

social welfare programs like BISP/Ehsaas risk excluding millions, especially women and children, from basic assistance at a time of high inflation.

Pakistan already fares poorly on human development with over 40% stunted children and only 5.3% GDP spending on education and health. Further compression of social spending will have lasting impacts on its human capital. A humanitarian crisis can yet be averted, but it requires the political leadership to urgently undertake sweeping reforms with assistance from bilateral and multilateral partners. Mobilizing domestic and external resources is essential to expand social protection programs. Structural reforms to restore fiscal and external balances are needed alongside short-term relief measures. Taxes must be enhanced without burdening the poor. Expenditure rationalization should safeguard pro-poor sectors. Borrowing costs have to be brought down.

Together with friendly countries, the revamped IMF program must prioritize humanitarian needs. Targeted utility subsidies for SMEs and low-income groups as well as expanded cash transfers can help counter the massive price shocks. In summary, tough stabilization policies alone cannot address the looming humanitarian crisis. While reforms are vital for correcting imbalances, short-term relief for the vulnerable must get equal priority in this period of unprecedented hardship for ordinary citizens. Urgent action today will prevent an economic collapse.

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