COVID-19 AND PAKISTAN'S ECONOMY CHALLENGES AND WAY FORWARD

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Abstract

Pakistan's economy is currently facing multi-dimensional economic challenges that include slower economic growth, rising unemployment and poverty; large fiscal deficit, growing public and external debt. These challenges are not the making of the last three years, but these have grown over the last thirteen years (2008-21). All the three previous governments sought balance of payments support from the International Monetary Fund (IMF) and implemented its four decades old policy prescription. The outcomes of the policy prescription included slower growth, rising unemployment and poverty, persistence of large fiscal deficit and the attendant rise in public and external debt. Various suggestion and recommendation have been made as to how to revive economic growth, reduce budget deficit, protect the hard-earned and costly improvement in external balance of payments and bring debt situation under control. It should be the resolve of the government to not to seek any more balance of payment support from the IMF. Pakistan must learn to live without the IMF Program.

Keywords: Economic Growth, Unemployment, Poverty, Budget Deficit, Current Account Deficit, Public and External Debt, IMF Program, Coronavirus, Economic Recovery.

Introduction

Pakistan's economy is currently passing through one of the most difficult and challenging phases of its economic history. The economic landscape of Pakistan has changed dramatically since 2007-08 owing to the unprecedented surge in oil and commodity prices, resulting in global economic meltdown of 2007-08 and to over a decade of managing the economy by successive

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governments with weak and frivolous economic team, causing serious damage to the economy on the one hand and weakening the institutions, especially the key economic institutions on the other. While the decade of the 1990s was described as the lost decade for Pakistan, the decade of 2008-18 was also termed as the second lost decade in Pakistan's economic history.[1]

During the second lost decade (2008-18), Pakistan witnessed its economic growth slowing at the back of declining public and private sector investment, the pace of job creation slowing, fiscal deficit rising and public and external debt ballooning. During this decade, the country also witnessed massive deterioration of institutions, particularly institutions dealing with economic policy making, thereby the role of "Consultants" continued to rise in government. Weakening of the institutions also wakened policy making ability of the governments, resulting in excessive reliance on donors for policy formulation.

Against the backdrop of the second lost decade (2008-18), the new government took charge of the state affairs in August 2018. They inherited an economy which was in shambles. Both fiscal and current account deficits were high, economic growth was slowing, unemployment was rising and both public and external debt was shooting up. The new leadership, while in opposition, had raised expectations of the people that once they would be in the government, they would have the capacity to address these multidimensional challenges. There is a general consensus among the independent economists within and outside the country that instead of addressing the challenges that they had inherited, the economic team in fact further compounded the difficulties.

The economic team, like the teams in previous governments, was weak and had little or no capacity to deliver. The Prime Minister, under pressure to deliver, kept on changing the key members of its economic team. Within 32 months in the government, the prime Minister changed four finance Ministers, six Chairmen of the Federal Board of Revenue (FBR), four Chairmen of the Board of Investment, four Secretaries Commerce, three Finance Secretaries, and the three Chairmen of the Securities and Exchange Commission of Pakistan. With such a high degree of instability in economic team, should we expect stability in the economy? The government either had no option or was "forced" to go to the IMF for a balance of payment support within the first 100 days of the government. The government continued to implement prior actions for the IMF Program. These actions were front loaded to test the resolve of the government in implementing the formal program from July 2019. These prior actions included market-based exchange rate regime or in other words, massive devaluation of the currency, quickly raising discount rate as part of the tight monetary policy and raising utility prices (gas and electricity) with unprecedented pace. All these prior actions were implemented simultaneously which suffocated the economy on the one hand and raised the cost of production on the other. These measures totally devastated the economy and created uproar in the print and electronic media.[2]

While Pakistan's economy was already facing serious challenges owing to the implementation of the IMF Program, the COVID-19 struck Pakistan in early March 2020 which further compounded its economic difficulties. The Pandemic not only created huge uncertainty but also brought colossal human suffering on the one hand and major economic disruption around the world, and Pakistan on the other. While the Pandemic adversely affected domestic real economic activity, it benefited Pakistan immensely in many ways.[3] Notwithstanding benefits that accrued to Pakistan financially, it continued to lurch from one crisis to other. The government, reeling under the pressure to perform, kept on changing cabinet Ministers including the secretaries, the governors of the central bank, and the captains of the economic team. Is it safe to expect stability in the economy with such a frequent changes in the members of the economic team?

The purpose of this paper is many folds. The state of the economy as it prevails today is not the making of the last few years. Rather it is the continuation of the second lost decade. How the economy performed during 2008-18 is the subject matter of Section-I. The present government inherited a shattered economy in August 2018. How the economy was managed during the Pre-COVID-19 period is discussed in Section-II. The impact of COVID-19, both positive and negative, is presented in Section-III. Possible way forward is the subject matter of Section-IV while the conclusions are documented in the final section.

SECTION – I

Pakistan's Economy During 2008-18

At the back of robust macroeconomic performance from the early 2000s to mid-2007 when Pakistan's economic growth was accelerating, investment reaching all-time high, both unemployment and poverty were declining, external and public debt were also declining, foreign investment was rising rapidly, and the country's foreign exchange reserves were reaching at comfortable level, Pakistan entered into the second lost decade (2008-18).[4] The government that took charge of the state affairs during 2008-13 began its journey in the aftermath of global financial turmoil and the unprecedented rise in oil and commodity prices in 2007-08. At a time when both political and economic sagacity were required the most, the country was lurching from one crisis to another. For a protracted period, there were no finance, commerce, petroleum and health ministers in the country. The government lost six months in finding its feet on the ground and hence gave the impression of having little sense of direction and purpose.[5] The style of governance created a crisis of confidence which adversely affected the country's economic environment. This gave the impression that the government was building a case for going back to the IMF for a balance of payment support. Foreign investors started to walk away, the stock market nosedived, foreign exchange reserves plummeted and Pakistani rupee slumped in value by a third. The case was fully ripe for seeking balance of payment support from the IMF. Pakistan entered into a $ 7.6 billion Standby Arrangement with the IMF in November 2008 for a duration of seven quarters, ending in June 2010. It may be noted that Pakistan returned to the IMF after its exit from the Program, ahead of time, during November / December 2004.

The landscape of Pakistan's economy changed dramatically during 2008-13. Five years of managing the economy with weak and frivolous economic team had not only damaged the economy but also weakened the key economic institutions.[6] Table 1 presents the comparative picture of the economy during the first half of the second lost decade (2008-13) viz the period (2003-07) when economy was performing robustly.

At the back of robust and strong economic indicators, the period 2008-13 witnessed economic growth slowing to an average of 2.8 percent per annum, agriculture and large-scale manufacturing growth decelerating to an average of 2.4 percent and 0.3 percent per annum, respectively, and investment rate plummeting to 15.5 percent. Such a slowdown in economy was bound to have given rise to unemployment and poverty.

Table-1: Key Economic Indicators

Economic Indicators	**Unit**	**2003-07**	**2008-13**	**2013-18**
Real GDP Growth	Percent	6.8	2.8	4.7
Agricultural Growth	Percent	4.6	2.4	2.2
Large-scale Manufacturing	Percent	12.4	0.3	4.5
Services	Percent	6.7	3.6	5.5
Investment as % of GDP	Percent	22.5[a]	15.5*	15.9*
Budget Deficit as % of GDP	Percent	3.6	7.0	5.5
Public Debt	Billion Rs	4814[a]	14321[b]	25545[c]
Public Debt as % of GDP	Percent	52.5[a]	66.6[b]	73.8[c]
Foreign Direct Investment	Million $	5140[a]	1456[b]	2780[c]
Foreign Exchange Reserves	Billion $	14.3[a]	6.0[b]	9.8[c]
External Debt	Billion $	40.3[a]	60.9[b]	95.3[c]
Current Account Deficit	Billion $	6.9[a]	2.5[b]	

Note: a= 2006-07; b=2012-13; c=2017-18; *= definition of investment has been changed in 2012-13 therefore these numbers are not comparable with the past.

On fiscal side, a deterioration is observed on account of the developments in revenue and expenditure sides. Budget deficit surged to an average of 7 percent of the GDP with public debt reaching to 67 percent of the GDP and violating the Fiscal Responsibility and Debt Limitation Act 2005. Foreign direct investment declined to $ 1.45 billion in 2012-13 from an all-time high of $ 5.14 billion in 2006-07. The development on external sector resulted in external debt reaching as high as $ 60.9 billion in 2012-13 from as low of $ 40.3 billion in 2006-07. Foreign exchange reserves also witnessed a decline to $ 6 billion in 2012-13, thus building a case for going to the IMF for yet another program.

Based on the above, it is clear that a strong foundation was laid in the last five years for further deterioration of Pakistan's economy in the next five years (2013-18) so as to describe the decade (2008-18) as the second lost decade.

SECTION – II

Pakistan's Economy During 2013-18

The government that took charge of the state affairs in June 2013, inherited an extremely fragile economy. It inherited a nervous private sector, declining both domestic and foreign investment, low economic growth, rising unemployment and poverty, and growing income inequality. It also inherited a large fiscal deficit (over 8 percent of GDP) owing to faltering resource mobilization efforts and reckless spending with consequential rise in public and external debt, a rapidly looming debt payment crisis, declining foreign exchange reserves, rising circular debt and a power sector crisis.

These were indeed formidable challenges for the government but the government at the same time, received many God gifted opportunities which included:

- Significant improvement in the country's security environment,
- Significant improvement in law-and-order situation in Karachi;
- The China-Pakistan Economic Corridor (CPEC);
- Collapse of International price of oil;
- An extremely benign IMF simply doling out resources at a relatively cheaper rate; and
- A docile Parliament. All these opportunities were received by the then leadership in one go.[7]

As will be seen momentarily, the then government totally squandered these opportunities to strengthen the country's economy. It is also true that no government in the history of the country has ever received such bonanza in such a short period of time. In the presence of the above-mentioned bonanza, economic performance during 2013-18 has been dismal at best. Economic growth averaged 4.7 percent per annum. Performance of agriculture remained lacklustre at an average growth of 2.2 percent per annum, large-scale manufacturing performed reasonably well with an average growth of 4.5 percent and services sector maintained a robust growth of 5.5 percent during the second half of the second last decade (2008-18).[8] Investment as percentage of GDP has virtually remained stagnant at 15.5 percent. However, with the change of definition of investment in 2013-14, the average investment rate remained at 15.9 percent during 2013-18 (See Table 1).

Fiscal indiscipline has been the hallmark of the second lost decade. Unwillingness to mobilize resources on the one hand and reckless spending on the other, together with ill-thought-out 7th NFC award resulted in the persistence of large fiscal deficit averaging 5.5 percent of GDP during 2013-18.[9] The budget deficit numbers are grossly understated and therefore are not comparable with budget deficit numbers prior to 2013-14. It is indeed surprising that these understatements were carried out when Pakistan was implementing the IMF program. Hence, it is quite clear that the IMF program has always been a political program and the severity of the Program depended on the country's relationship with the IMF's major shareholders (See Barro and Lee (2005), Steinwand and Stone (2008)]. Independent economists estimated budget deficit in the range of 7.5-8.0 percent of GDP during 2013-18.[10]

The persistence of large fiscal deficit contributed to the surge in public debt, rising from Rs. 14321 billion or 66.6 percent of GDP in 2012-13 to Rs. 25545 billion or 73.8 percent of GDP by 2017-18 (See Table 1). In other words, public debt increased by Rs. 11224 billion in five years (2013-18) or Rs. 2245 billion per annum. This simply suggests that the budget deficit numbers are not at all consistent with the rise in public debt. How come public debt surges in the midst of a sharp decline in budget deficit during 2013-18? Isn't it the repeat of 1999 episode? Such increase was in line with the increase of Rs. 9507 billion during 2008-13. Almost Rs. 21 trillion public debt were added during the second lost decade (2008-18) which speaks volumes about the way the government managed their fiscal situation. It is fair to say that the country was drowned under the debt during the second lost decade (2008-18).

Pakistan's external balance of payment presents interesting picture during 2013-18. While Pakistan's export remained stagnant at $ 25 billion, imports after remaining stagnant during 2013-14 to 2015-16, surged suddenly to $ 48.7 billion in 2016-17 and then to $ 56.6 billion in 2017-18. International price of oil, which nosedived since June 2014 played a pivotal role in preventing serious balance of payment crisis during 2014-15 to 2016-17. As can be seen from Table 2, current account deficit remained at the comfortable level until the first three years of 2013-18 periods. All hell let loose during the last two years of the ill-fated decade (2008-18). The current account deficit witnessed extra-ordinary rise in 2016-17 and reached the unprecedented level of over $19 billion or 6.1 percent of GDP by 2017-18.

Table-2: Key Economic Indicators

Economic Indicators	Unit	2003-07	2008-13	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Real GDP Growth	%	6.8	2.8	3.7	4.1	4.1	4.6	5.2	**5.5**
Large–Scale Manufacturing	%	12.4	0.3	4.5	5.5	3.3	3.0	5.6	**5.1**
Agriculture	%	4.6	2.4	2.7	2.5	2.1	0.2	2.2	**4.0**
Services	%	6.7	3.8	5.1	4.5	4.4	5.7	6.5	**6.3**
Investment as % of GDP	%	22.5[b]	15.5	15.0	14.6[a]	15.7[a]	15.7	16.2	**17.3**
Budget Deficit as % of GDP	%	3.6	7.0	8.2	5.5	5.3	4.6	5.8	**6.5**
Public Debt	Billion Rs	4814[b]	14321[c]	14321	16389	17759	20054	21783	**25545**
Public Debt as % of GDP	%	52.5[b]	64.0[c]	64.0	65.1	64.7	68.9	68.2	**73.8**
Current Account Deficit	Billion $	6.9[b]	2.5[c]	2.5	3.1	2.8	5.0	12.3	**19.2**
External Debt	Billion $	40.3[b]	60.9[c]	60.9	65.4	65.2	73.1	83.1	**95.3**
Foreign Exch. Reserves	Billion $	14.3[b]	6.0[c]	6.0	9.1	13.5	18.1	16.1	**9.8**
Note: * grossly overstated; a. change of definition; b. 2006-07; c. 2012-13;									
Source: Pakistan Economic Survey, the SBP website and the IMF Review Document.									

The government continued to borrow with pride and pleasure to finance growing current account deficit, external debt payment, and build foreign exchange reserves with a view to preventing pressure on the exchange rate. Such a large borrowing led to the accumulation of over $ 34 billion in external debt and liabilities during 2013-18, despite saving $ 13 billion owing to the decline in international price of oil (See Table 2). By looking at the pace of borrowing on the one hand and the way the economy was managed, particularly, during the last two years of the lost decade, it was abundantly clear that the then government was making all-out effort to create serious balance of payment crisis so as to force the new government to go to the IMF for yet another financial support.[11]

It is indeed surprising that the government during 2013-18 while inheriting a shattered economy also received so many bonanzas that no government in the past was lucky enough to receive. But at the end of the day the government, during the last two years of its tenure, severely damaged the economy. The damage was widespread. It not only drowned the country into debt, but badly distorted key economic statistics also which became non-comparable with the history, slowed economic growth, created unemployment, particularly unemployment in educated youth, damaged key economic institutions by appointing weak and frivolous people, promoted cronyism and favouritism, private sector got disillusioned and resultantly the role of the IFIs in policy making deepened. What started during 2008-13, gained further traction during 2013-18 to make the decade (2008-18) truly a lost decade for Pakistan.

Pakistan's Economy during Pre-COVID – 19

By the end of the second lost decade (2008-18), Pakistan's economy had already reached in dire straits, owing to economic mismanagement and mis-governance during the decade. The second lost decade witnessed economic growth slowing to an average of 3.8 percent per annum at the back of low public and private sector investment (See Table 1). Economic growth in the range of 3.5-4.0 percent has become a new normal for Pakistan. Both agriculture and large–scale manufacturing slowed to an average of 2.3 percent and 2.4 percent per annum, respectively—growing more or less close to the country's population growth rate.

The decade also witnessed the perpetuation of fiscal indiscipline owing to stagnant revenue effort, rising expenditure (particularly interest payment on account of implementing IMF Program) and the pursuance of the 7th NFC Award. Budget deficit notwithstanding grossly understated, averaged 6.3 percent of the GDP during the decade, resulting in rapid accumulation of public and external debt. The decade also witnessed serious imbalances in external balance of payment owing to stagnant or slower growth in exports, surge in imports, stagnant flow of remittances, declining trend in the non-debt creating inflows and rapidly growing interest payment. Imbalances in external account resulted in the accumulation of external debt and liabilities at a threatening pace. While the decade of the 1990s (first lost decade) added $ 17.4 billion in external debts and liabilities, the second lost decade (2008-18) added over $ 55 billion to the same—more so during 2013-18. These two lost decades contributed $ 72.4 billion or 76 percent to the total external debt and liabilities till end–June 2018. One thing was common to these two lost decades—Pakistan remained under the IMF Program and implemented its four decades old policy prescription.

The second lost decade (2008-18) also witnessed massive deterioration of institutions, in particular, institutions dealing with economic policy making. The erosion of professional capacity resulted in the reliance on "Consultants" for deliverance and policy formulation.

Against the backdrop of the above-mentioned developments during the decade, came the present government at the helm of affairs in August 2018. The present leadership, while in opposition, raised expectations of the people of Pakistan. It is true that the present government inherited an economy which was in a bad shape. The scale and the depth of challenges that the government inherited warranted a team of experienced Ministers or Advisors. On the contrary, the team was weak and inexperienced and instead of addressing multidimensional challenges, further compounded the economic difficulties. The government decided to go to the IMF for a balance of payment support and on 54th day in the government officially requested the IMF for a bailout package.[12] An IMF delegation arrived in Pakistan on November 7, 2018 and started negotiation with Pakistani authorities for a bailout program. The IMF put forward a list of prior actions in the areas of exchange rate, interest rate, and utility prices. For eight months, the new government continued to implement prior actions which totally damaged the economy.[13] Both exchange rate and discount rate shot to the north. The prices of gas and electricity started rising at a pace never witnessed in recent history. All these prior actions or policies were implemented in one go which inflicted severe pain to economy and to its people. The government lost eight months in finding its feet on the ground. The crisis of confidence intensified, and investors preferred to wait at the side-line. Pakistani rupee was on a free fall and interest rates were racing up, as if it wanted to catch a train".

The government and the other stakeholders succeeded in mobilizing $ 12.4 billion - $ 9.2 billion in cash and the remaining $ 3.2 billion in deferred oil payment. These inflows failed to imbibe confidence in the economy because the bucket leaked. While foreign exchange kept flowing in on the one hand, import of non-essential items like cell phones, foreign chocolates, cheese, dogs and cats' meal and shampoo, fruits and automobiles kept on surging on the others. These actions generated high degree of uncertainty and by April 2019, Pakistan's macroeconomic vulnerability had grown unbearable. The Governor State Bank of Pakistan and then the Finance Minister were changed, and a new economic team descended on the scene to finalize the Program with the IMF. Accordingly, Pakistan started implementing the 1980s vintage of the 22nd IMF Stabilization Program from July 1, 2019. It is indeed strange that in the last four decades the world has witnessed sea change, but the prescription of the IMF Program or policies has remained unchanged. Prior to the present IMF Program, Pakistan had implemented 21 Programs with same policy prescriptions. The state of Pakistan's economy has not changed with 21 Programs. Should we expect a change in the health of the economy with 22nd IMF Program when the medicine remains the same?

The type of policies, commonly known as 'Washington Consensus', that Pakistan implemented under the IMF Program or as prior actions not only severely damaged Pakistan's economy but also have heavily dented the popularity of Pakistan's Prime Minister.[14] The impact of the IMF Program on Pakistan's economy has been far reaching. The standard 1980s vintage of the IMF Program as well as the prior actions that the government implemented since August 2018 have slowed both private and public sector investment (See Table 3). Consequently, real GDP growth first decelerated from 5.5 percent in 2017-18 to 1.9 percent in 2018-19, and added with Pandemic effects, economic growth turned negative in 2019-20 to 0.4 percent; large – scale manufacturing also witnessed sharp contraction both on account of the IMF Program and the adverse impact of COVID-19. Services sector growth decelerated to 3.8 percent in 2018-19 and then turned negative 0.6 percent in 2019-20. Agricultural growth slowed to an average of 1.7 percent during the last two years (See Table 3). Economic growth averaging 0.75 percent in the last two years has failed to create enough jobs, resulting in the rise of unemployment and poverty.

The IMF Program along with Pandemic severely impacted budgetary situation of Pakistan. The performance of tax collection was abysmally poor because of slower economic growth on the one hand and the hike in discount rate as part of the IMF Program from 6 percent to 13.25 percent on the other resulted in interest payment registering an increase of 75 percent in just two years. A surge in interest payment affected current and total expenditure, which played a pivotal role in widening the budgetary gap. Pakistan witnessed its budget deficit averaging 8.5 percent of GDP during the last two years. Rising budget deficit necessitated large borrowing on the one hand and IMF dictated massive devaluation on the other added to public debt. Public debt jumped to over 90 percent of GDP in 2018-19 from 73.8 percent a year ago and further to 91.2 percent in 2019-20.

Table-3: Key Economic Indicators: Post 2017-18

Economic Indicators	2017-18	2018-19	2019-20	2020-21 (Forecast)	Average (2018-21)
Real GDP Growth %	5.5	1.9	-0.4	3.0	**1.5**
Agriculture%	4.0	0.6	2.7	2.1	**1.8**
Large–Scale Manufacturing %	5.1	-2.6	-7.8	9.0	**-0.5**
Services %	6.4	3.8	-0.6	3.6	**2.3**
As % of GDP					
– **Total Investment**	17.3	15.6	15.4	15.6	**15.5**
– **Public Investment**	5.2	3.7	3.8	3.7	**3.7**
– **Private Investment**	10.5	10.3	10.0	10.3	**10.2**
As % of GDP					
Total Revenue	15.2	12.7	15.0	14.8	**14.2**
– **FBR Revenue**	11.1	10.1	9.6	9.4	**9.7**
Total Expenditure	21.8	21.6	23.1	23.0	**22.6**
– **Current Expenditure**	17.0	18.4	20.4	20.2	**19.7**
– **Interest Payment**	4.4	5.4	6.3	6.1	**5.9**
– **Development Expenditure**	4.4	3.2	2.9	2.8	**3.0**
Budget Deficit	6.6	8.9	8.1	8.2	**8.4**
Public Debt	73.8	90.6	91.2	92.0	**91.3**
Inflation (%)	4.7	6.8	10.7	9.0	**8.8**
– **Food Inflation (%)**	3.8	4.6	14.8	12.5	**10.6**
Exports (Billion $)	24.8	24.2	22.5	24.6	**23.8**
Imports (Billion $)	56.6	51.9	42.4	52.4	**48.9**
Trade Deficit (Billion $)	-31.8	-27.7	-19.9	-27.8	**-25.1**
Remittances (Billion $)	19.9	21.7	23.1	28.0	**24.3**
Current Account Deficit (Billion $)	-19.2	-13.4	-4.4	0.0	**5.9**
External Debt and Liabilities	95.2	106.3	112.8	119.0	
Foreign Exchange Reserves	9.8	7.3	12.1	16.0	

Source: Pakistan Economic Survey 2019-20 and Economic Data, State Bank of Pakistan

It is interesting to note that the two policies of the IMF, that is, raising discount rate from 6.0 percent to 13.25 percent and devaluing Pakistani rupee from Rs. 121.5 per US dollar in June 2018 to Rs. 166.4 per dollar in March 2020 alone added Rs. 6353 billion or $ 40 billion to the interest payment and public debt in 20 months' time. These two policies along with raising utility prices (gas and electricity) at unpresented pace have transformed Pakistan from a low cost to a high-cost economy. All the three policies substantially increased the cost of production which reduced output growth as well as eroded external competitiveness with serious consequences for exports growth.

External balance of payments improved during the last two years, primarily on account of the sharp contraction in imports, unexpected increase in remittances, substantial assistance from the IMF under the Rapid Financing Instrument to cope with COVID-19 crisis and $ 3.5 billion debt relief from the G-20 countries. Exports on the other hand declined substantially for three reasons. Firstly, the type of policies that Pakistan implemented under the IMF program made Pakistan's exports non-competitive in international market. Devaluation made the landed cost of all imported inputs to export – oriented industries expensive. Secondly, hike in discount rate made the cost of capital highly expensive. Thirdly, increase in utility prices (gas and electricity) with unprecedented pace further increased the cost of production. In other words, devaluation, hike in interest rates, and increase in utility prices simultaneously increased the cost of production which made Pakistani exports non-competitive in international market. Furthermore, COVID-19 also affected global demand as well as badly affected the supply chain and the cost of transportation of goods to the destination. Thus, a combination of the policies under the IMF Program and the impact of COVID-19 in global market badly affected Pakistan's exports which registered a decline from $ 24.8 billion in 2017-18 to $ 24.2 billion in 2018-19 and further to $ 22.5 billion in 2019-20.

On the import side, the implementation of the policies under the IMF Program suffocated the economic activity in the country, resulting in decline in imports.[15] Furthermore, Pakistan being a net importer of the oil, benefited immensely due to the unprecedented decline in international price of oil. The average international price of oil was $ 67.9 per barrel in 2008-19 but declined to an average of $ 53.6 per barrel in 2019-20 on account of COVID-19 – a decline of over 21 percent, thus saving $ 4.7 billion from oil imports. The combined effects of low level of domestic economic activity and the decline of oil prices resulted in the decline of $ 9.5 billion (or 18.3%) imports in 2019-20. Against all expectations, the strong growth in remittances has been the saving grace for Pakistan. It played an important role in reducing current account deficit thus far.

The overall current account deficit witnessed a massive decline from $ 19.2 billion in 2017-18 to $ 13.4 billion in 2018-19 and further to $ 4.4 billion in 2019-20. With the improvement in current account deficit, the country's foreign exchange reserves increased from $ 9.8 billion to $ 11.2 billion in 2019-20 (See Table 3).

While the Pandemic has played havoc to the global economy and also took Pakistan's economic growth to a negative zone, it has significantly improved the country's balance of payments. The current account deficit shrank (from $ 19.2 billion to $ 4.4 billion), the country's foreign exchange reserves increased, Pakistan received $ 1.4 billion from the IMF's Rapid Financing Instrument, saved $ 4.7 billion in oil import bills, received $ 3.5 billion debt relief under the G-20 and most importantly, Pandemic caused the suspension of the IMF Program during February 2020 and until January 2021.

SECTION - III

Pakistan's Economy during Post – COVID – 19

As discussed in previous section, the impact of the IMF Program was already taking heavy toll on Pakistan's economy. The standard 1980s vintage of the IMF Program as well as its prior actions severely damaged Pakistan's economy. It is in the midst of the challenging economic time that the Coronavirus struck more than 210 countries and territories around the World. It was first diagnosed on December 31, 2019 in the Chinese city of Wuhan and spread like a wildfire around the world. The World Health Organization described the Coronavirus as "Pandemic" – the highest level of health emergency, on March 11, 2020 (WHO 2020).

The Pandemic has not only brought colossal human suffering but totally devastated the $ 133 trillion global economy with speed never witnessed in nearly a century (CRS Report 2020). According to the IMF's latest forecast, world economy contracted by 3.3 percent in 2020 but projected to grow by 6.0 percent in 2021 at the back of massive base effect. The shrinking of global economy in 2020 must have imperilled the progress made in reducing extreme poverty in developing countries (IMF 2021). The resurgence of Pandemic in many parts of the World in 2021 will make the economic situation more fluid and uncertain and will prevent strong economic recovery.

The Coronavirus first struck in Pakistan in late February 2020. Pakistan began to close down small and large businesses, transport, airlines, educational institutions, markets, industries, hotels and restaurants from March 22, 2020 with a view to stopping the spread of virus. The government took extra – ordinary fiscal and monetary measures to protect the poor and the vulnerable sections of the society on the one hand and businesses/ industries on the other. The State Bank of Pakistan (SBP) started reducing policy rate from 13.25 percent to 7.0 percent in a short span of time. These measures played a pivotal role in protecting the poor, ensuring the existence of sufficient demand, and preventing the collapse of businesses and industries in the country. In other words, these measures minimized the adverse effects of the Pandemic on the economy.

When seen at the back of the contraction of real GDP in different ports of the World, Pakistan's economic growth turned negative 0.4 percent in 2019-20 – first time since 1952 – 53. Without the Pandemic, Pakistan's economic growth under the ongoing IMF Program was projected to be close to 2.0 percent in 2019-20. Pandemic turned the growth to a negative 0.4 percent. When these numbers will be revised in May/June 2021, the last year's (2019-20) economic growth may turn out to be – 0.7 to – 0.8 percent. The base effect will play an important role in 2020-21 and it is expected that the growth would be 3.0 percent in 2020-21 as against the projection of 1.0 – 1.5 percent by the IFIs (See Table 3).

The Pandemic also affected Pakistan's fiscal situation. As a result of the slower level of economic activity, mainly on account of the IMF Program but partly as a result of the COVID-19, tax collection was severely affected during the lockdown period (April – June 2020). Expenditure on the other hand surged primarily due to the high interest rate and devaluation of Pakistani rupee under the IMF Program but also due to the relief measures taken by the government to protect the poor through the Ehsaas Program. Consequently, it was expected that the budget deficit would be above 9 percent of GDP in 2019-20. However, the extra-ordinary profit of the SBP which appeared as non-tax revenue in the budget, reduced the deficit to 8.1 percent of GDP.

During the current fiscal year (2020-21), the economic activity has remained subdued on account of the third wave of COVID-19, the total revenue as percentage of GDP is likely to decline to 14.8 percent as compared to 15.0 percent last year. Similarly, the FBR's tax collection is also projected to decline to 9.4 percent of GDP in 2020-21 as compared to 9.6 percent last year. Total expenditure is likely to remain at elevated level (23 % of GDP). Consequently, budget deficit as percentage of GDP is projected to be 8.2 percent – slightly higher than last year. Hence, the larger the gap between revenue and expenditure, the more will be borrowing to fill this gap. Accordingly, public debt will increase to 92 percent of GDP in 2020-21 (See Table 3).

Overall inflation in general and food inflation in particular remained at the elevated level during 2019-20 owing to the disruption of supply chain and overall lockdown to prevent the spread of COVID-19 on the one hand and massive devaluation of the Pakistani rupee under the IMF Program on the other. Food inflation in particular has had devastating impact on the poor and middle-income family. Food inflation has persisted in the range of 15-16 percent per annum since August 2019. Such a prolonged period of high food inflation has seldom been observed in Pakistan. The factors responsible for the persistence of high double digit food inflation include:

- Less production of wheat (24 million tons);
- Not releasing wheat to flour mills when flour prices kept on rising;
- Lack of capacity to take timely decision to import wheat;
- Lack of understanding of the economic team to handle the issue;
- Unprecedented increase in gas and electricity prices making grinding cost of wheat higher; and
- Finally the lack of seriousness on the part of the government to address these challenges.[16]

Overall inflation as well as food inflation are projected to be 9.0 percent and 12.5 percent respectively in 2020-21 owing to the improvement of supply situation of food items, stability in exchange rate (in fact exchange rate has appreciated), low overall interest rate and there is a realization on the part of the government to not to raise utility price further.[17]

The COVID-19 has contributed positively to improving Pakistan's balance of payments. It is likely to further improve Pakistan's external balance of payments situation in 2020-21. Exports are projected to rise by 9.3 percent to $ 24.6 billion mainly on account of price effect while imports are expected to surge to $ 52.4 billion, resulting in trade deficit to widen to $ 27.8 billion. Total exports are likely to increase by $ 2.0 billion in 2020-21. Because of the increase in international price of Pakistan's exportables Pakistan earned $ 4 billion additional but because of the decline in the quantity of Pakistani exports, Pakistan lost $ 2 billion. The net effect, therefore, has been $ 2 billion in 2020-21. In other words, increase in Pakistan's export resulted exclusively due to the rise in the international price of the commodity. Remittances are likely to be the greatest saving grace for Pakistan in 2020-21. Remittances are projected to increase by over 21.0 percent to $ 28 billion. The current account is expected to be balanced as opposed to a deficit of $ 4.4 billion a year ago. External debt and liabilities are expected to rise to $ 119 billion at end – June 2021 from $ 112.8 billion a year ago. The present government is likely to add approximately $ 24 billion in three years of its tenure. Foreign exchange reserves are projected to be $ 16 billion at end-June 2021 – an increase of approximately $ 4 billion from last year.

In summary, while COVID-19 adversely affected Pakistan's economic growth, investment, unemployment, poverty, revenues, expenditure, budget deficit, and public debt; it has undoubtedly improved the country's external account. The Pandemic also suspended the IMF Program which helped in reviving economic activity and restoring private sectors confidence.

SECTION - IV

The Way Forward

There is an overwhelming consensus among independent economists within and outside the country that Pakistan's economy has never been in such a bad shape as it is in now. Over a decade of economic mismanagement through weak and frivolous economic team on the one hand and perpetually pursuing IMF driven demand management policy on the other have not only damaged short term growth prospects but even chocked the medium-to-long term economic recovery. In the words of the former Managing Director of the IMF, Ms. Christine Legarde "the longer demand weakness lasts, the more it threatens to harm long – term growth as firms reduce production capacity and unemployed workers are leaving the labour force and critical skills are eroding" (See Legarde 2016). Pakistan has been under the IMF Program during most of the last thirteen years (2008-21). Such a prolonged period of austerity or anti-growth policies has severely damaged Pakistan's growth prospects both in the short and in the medium term. As Joe Biden has recently said that "Trickle Down Economics Has Never Worked"[18]; in a similar vein the "Stabilization First and growth later" policy of the IMF has also never worked. Hence, growth is now a priority of the government. The country's fourth Finance Minister in 32 months has clearly stated that during the remaining tenure of the government, achieving 5 to 6 percent growth will be the government's priority.[19]

How to Revive Economic Activity?

How to revive economic activity or how to achieve 5 to 6 percent growth should be the priority of the government. Can this be achieved under the IMF Program? The answer is obviously no. What is the way forward? Pakistan has witnessed that with IMF Program remaining suspended since February 2020 and until January 2021, the usual IMF policies of raising utility prices (gas and electricity) also remained suspended. Such a suspension of the Program on account of COVID-19 brought tremendous positive to Pakistan's economy. It brought stability and transparency in policy which gave confidence to the private sector. Private sector moved forward, started investment, and the credit off take of the private sector increased. All these policies helped revive industrial activity, economic growth struggling to come out of the adverse effects of COVID-19, exports started gaining momentum and inflation stated slowing down.

The COVID-19 has once again resurrected and hurting economic activity. The government may ask the IMF to keep the Program suspended for yet another year and take this as an opportunity to revive the economy. Alternatively, Pakistan should renegotiate with the IMF and insist that there will be no more increase in the prices of utility. Instead, Pakistan should concentrate on reforms – a wide ranging reforms in power sector (raising electricity prices is no reform, it is tantamount to maintaining status quo), tax system and tax administration reform, and reforms in industries and agriculture. Reforms in the SBP in the name of giving more autonomy as proposed by the IMF, is like creating state within state, and therefore, must not be accepted.

Secondly, the government must hold hands of the businesses at all levels – small, medium and large. This is not the time to increase the cost of doing business by raising utility prices. Furthermore, the SBP must consider reducing policy rate to 5 percent from the current level of 7.0 percent in two/three monetary policy meetings.

Thirdly, agriculture has remained neglected for 13 years by the successive governments. Pakistan used to produce cotton in the range of 13-14 million bales until 2014-15. The production of cotton has nosedived to 6-7 million bales now.

What went wrong in cotton production? The government must find the answer and take necessary corrective measures.

Fourthly, wheat production in Pakistan is stagnating at 25 million tons since 2010-11 but its population has been growing each year. Resultantly, the per capita availability of wheat per annum has declined from 145 kg to 120kg in 2019-20. The country's wheat production has failed to maintain the pace of country's population growth rate. Pakistan is fast heading towards a permanent wheat importing country and accordingly creating itself a food security issue. What has gone wrong in wheat production should be the main policy agenda of the government. Pakistan has entered into the second phase of the China – Pakistan Economic Corridor (CPEC) in which agriculture is a priority area. Pakistan must learn to enhance wheat and cotton production from China under the CPEC.

Fifthly, the Small and Medium Enterprises (SME), construction, tourism and IT sectors have strong potential to revive economy and create enormous job opportunities.[20]

Sixthly, livestock and dairy sector accounts for 60.5 percent in agriculture and contributes 11.7 percent to GDP. This sector is almost equal to the large – scale manufacturing sector. Pakistan produces almost 62 million tons of milk in a year. More than 8 million rural population derive their livelihoods from this sector. This is a highly labour-intensive sector and has enormous potential to create jobs. The road to poverty alleviation in rural area passes through livestock and dairy sector but it has remained neglected in Pakistan. The government may involve private sector in the development of this sector for production of milk and dairy products to meet domestic as well as foreign requirements.

Seventhly, in the second phase of the CPEC besides agriculture, industrialization through the Special Economic Zones (SEZs) are yet another priority area where the progress is much to be desired. The government must use CPEC as a vehicle for reviving economic activity with a view to achieving 6 to 7 percent growth in the next four to five years.

Summing UP

In order to revive economic activity and to achieve a growth rate of 5-6 or even 7 percent in the next four to five years on a sustained basis, Pakistan needs to do the followings:

- Either suspend the IMF Program for a year or renegotiate the most cruel Program ever given to Pakistan,
- No more hike in utility prices (gas and electricity), in fact, there is a need to reduce the prices of electricity as Pakistan has excess capacity;
- Use both fiscal and monetary policy to achieve growth target;
- Reduce discount rate or policy rate to 5 percent in the next 2/3 Monetary Policy meeting;
- Major emphasis be given to agriculture and seeking Chinese assistance under the second phase of the CPEC;
- SMEs, livestock and dairy sector, construction, tourism and information technology sectors should form the priority areas along with agriculture; and
- Undertake wide-ranging reforms in agriculture, industry, energy, taxation, and governance.

Fiscal Challenges

Indiscipline fiscal policy has been the hallmark of every government since 2008 onward. Fiscal discipline is key to achieving growth target in the next four/ five years. What constitute fiscal discipline or how to achieve fiscal discipline going forward?

It is a well-known fact that Pakistan's economic activity has decelerated as it has sustained an average growth rate of 1.5 percent per annum in the last three years. Instead of bombarding the economy with heavy taxation and further chocking the economy, the government must concentrate in broadening the tax base and not raising the tax rates. Secondly, there is an issue of multiplicity of taxes with individual firm facing numerous types of taxes. There is a need to reduce number of taxes facing individual firm or business. Thirdly, the lack of coordination between the federal and provincial tax authorities have compounded the difficulties in terms of the issues of double taxation, higher tax burden and uncertainty for businesses. The government must look into this and improve coordination between federal and provincial tax authorities.

Fourthly, Pakistan's expenditure is also being influenced by the IMF Program. Raising discount rate and devaluation of the currency are the two critical elements of the IMF Program. While devaluation raises public debt in rupee, hike in discount rate raises the cost of borrowing of the government to finance fiscal deficit. These two policies have increased the interest payment – the single largest expenditure item in the budget, from Rs. 1500 billion in 2017-18 to Rs. 2619 billion in 2019-20 – an increase of 75 percent in just two years. During the current fiscal year (2020-21), interest payment may cross Rs. 3100 billion. It is in this context that the SBP must reduce discount rate to 5 percent by end-December 2021 to reduce interest payment.

Fifthly, the money saved from the interest payment may be diverted towards development expenditure. Within development expenditure, priority be given to physical infrastructure, education and health. Such expenditures are known as growth- propelling expenditure. Sixthly, Pakistan needs to improve its capacity to forecast revenue for the medium-term in general and for the next year in particular.[21] The government is facing serious capacity constraints in spending money prudently. Even if the development expenditure is increased in the Budget 2021-22, the government may not be able to spend money because of the serious capacity constraints as well as of the fear of the National Accountability Bureau (NAB), where officers are reluctant to sign on the project. The government needs to give confidence to the officer on the one hand and build capacity in the respective Ministries/Divisions on the other.

Sixthly, currently there are 1200 projects amounting approximately Rs. 6.5 trillion are under implementation by the Planning Commission. This is known as throw forward. By increasing the size of the development budget and hence adding more projects will be a futile exercise as this will simply increase throw forward. The government's money will be thinly distributed resulting in the delay of project completion and in cost escalation. It is proposed that the Planning Commission may formed a committee to clean-up these projects or reduce the number of projects or reduce the throw forward drastically. The projects on which 5 to 10 percent of the money have been allocated may be closed down and the amount may be treated as sunk cost. The Projects on which over 60 percent funds have been allocated may be given more money in the Budget 2021-22 so that they can be completed as soon as possible. Furthermore, no new projects may be added in the list of Projects. In other words, a moratorium may be imposed for new projects for at least two years.

Seventhly, there is a general agreement among professional economists, the IMF and the present government that the 7th NFC Award, instead of addressing Pakistan's Fiscal challenges, has in fact further compounded the country's financial difficulties. It has further been argued that with 7th NFC Award in operation, Pakistan can never achieve fiscal discipline, which is essential for achieving higher growth targets in four/ five years. It is absolutely essential to re-look the Award and make necessary improvement within the Constitution of the country. What are the challenges and how can it be improved upon are well-documented in [Khan (2021) (2020c) (2015)].

Balance of Payment Challenges

Pakistan's balance of payments situation has improved significantly over the last two years at a heavy cost to the economy and to the people. However, the recent trends in import are threatening to undo the improvement. Pakistan's imports are likely to cross $ 52 billion in 2020-21 and of late, imports were averaging over $ 5 billion per month. Within the overall imports, the imports of unnecessary or luxury items are surging with threatening pace. For example, the imports of cell phone have grown by 90 percent during the first nine months (July-March) of the current fiscal year. Similarly, the imports of cars in CKD condition have increased by 99 percent and overall import of road motor vehicles by 45 percent. Because of poor agricultural performance, Pakistan has imported wheat, sugar and raw cotton amounting $ 2.2 billion. There is a danger that the hard-earned improvement in balance of payment will be wiped out in 2021-22 and 2022-23 to build a case for 23rd IMF Program.

As a way forward, the government must pursue a selective and yet aggressive import compression policy to effectively discourage luxury or unnecessary import. Such policies must be seen in action in the 2021-22 Federal Budget. Furthermore, Pakistan must pursue import substitution policy in agriculture and manufacturing to save foreign exchange for which, a high-level Permanent Committee on Import Substitution (PCIS) may be established with active participation from private sector.

Given the all-time low interest rate environment in the world, this is an opportune time to float sovereign bonds to raise foreign exchange and build the country's foreign exchange reserves. Pakistan has very successfully floated three bonds in the current fiscal year and raised $ 2.5 billion (with no conditionality's attached). Pakistan must consider floating 5, 10 and 30-year maturity bond in 2021-22.

Debt Situation

Pakistan's debt situation has continued to deteriorate since 2008—rising from $ 40.3 billion in end-June 2007 to $ 119 billion by end-June 2021, an increase of almost $ 79 billion in just 14 years. While weak economic team and poor macroeconomic policies may be responsible for the surge in external debt and liabilities, the continuity of the IMF program has been the principal factor for such a rapid increase in Pakistan's indebtedness. How to bring debt situation under control or how to achieve debt sustainability is the real challenges for the government.

The first and foremost agenda of the government should be that there will be no more IMF program or no more 23rd IMF program. Let the country's Prime Minister commit to the nation that there will be no 23rd IMF program. Pakistan should learn to live without the IMF resources. Secondly, to achieve debt sustainability or to reduce public debt to GDP ratio, the Central Bank (SBP) must keep real policy rate (r) less than the real GDP growth rate (g).[22] If $r>g$, then the GDP will be growing at slower pace than the interest rate and the debt/ GDP will keep on rising over time. Eventually public debt will be larger than the size of the GDP. It has already reached 92 percent of GDP. Therefore, to bring debt situation under control, Pakistan must keep real interest rate less than the real GDP growth.

With lower real interest rates, interest payment will be reduced, current expenditure will be reduced, total expenditure will be reduced and given the revenue, the overall fiscal deficit will be reduced which will lead to less borrowing and slower accumulation debt. Furthermore, Pakistan needs to prepare a borrowing strategy, particularly to know how much Pakistan should be borrowing in a given year. Pakistan has been borrowing with pride and pleasure for quite some time, resulting in accumulation of external debt to $ 119 billion by end June 2021.

Concluding Remarks

Pakistan's Economy is currently facing multi-dimensional economic challenges. These challenges are not the making of the last three years, but these challenges are perpetuating since 2008. This is the third government in the last 13 years but sadly, no government gave importance to economy. Every government since 2008 managed the economy with weak and frivolous economic team. Economy never remained at the radar of the political leadership. They thought it right to take the easy route and decided to go to the IMF for their financial support. In so doing, they handed over the economic policy making to the IMF staff members. The IMF at the driving seat, continued to use 1980 version of the stabilization program with four policy instruments: tight monetary policy (raising discount rate), tight fiscal policy (austerity on the one hand and bombardment of taxes on the other without taking the conditions of the economy into consideration), market-based exchange rate (devaluation), and raising utility prices (gas and electricity).

Pakistan is implementing its third IMF Program since 2008 and 22nd in its history. Same medicines for different kinds of ailments have been the hallmark of the IMF Program, the outcomes of which included slower economic growth, declining investment, both public and private, rising unemployment and poverty, persistence of large fiscal deficit and the attendant rise in public debt. In its over seven decades of existence, Pakistan accumulated three-fourth (76%) of its external debt during the two decades only – the decades of the 1990s and the decade of 2008-18. One thing has remained common during these two decades – Pakistan remained under the IMF Program. Pakistan is currently under the IMF Program starting 2019. Could we afford yet another lost decade (2018-2028)?

The present government must announce that there will be no 23rd IMF Program. The entire efforts of the government should be geared towards bringing budget and current account deficits under control for which suggestions were given in the previous section. Pakistan is a nuclear and missile power, and no nuclear and missile power seeks financial support from the IMF. These countries have managed their economies and have become the superpower. Pakistan has the capacity to manage its economy. What is required is to find the right people for the right job which are available in plenty in this country. People land by helicopter to run Pakistan's economy have little or no understanding of the structure and composition of the economy, the ground reality and the awareness about data, particularly how these are collected, compiled and disseminated.

While the IMF Program was taking heavy toll on the economy, the COVID-19 struck Pakistan as well as the entire world. The virus has inflicted serious blow to the global economy and caused human sufferings of unprecedented proportion. Pakistan's economy has also been affected by the COVID-19. The government took several measures to protect the poorer segment of the society as well as took measures to protect businesses and industries. The government has successfully minimized the adverse effects of the COVID-19 on the economy. The COVID-19 has caused the suspension of the IMF Program which boosted the confidence of the private sector.

The economy is gradually recovering from the COVID-19 and moving in a right direction, the government, learning from its failures, has rightly made growth as its primary objective. Several suggestions have been made in the previous section regarding how to revive the economy, reduce budget deficit, protect the hard-earned improvement in external balance of payments and to bring debt situation under control. It is hoped that the government will take these recommendations seriously.

References

[1] Ishrat Husain has described the decade of the 1990s as lost decade for Pakistan but Khan (2020b) termed the decade of 2008-18 as the second lost decade for Pakistan.

[2] For a detailed discussion on this issue see khan (2020b,2020f)

[3] More on this, later in the paper

[4] For a detailed discussion on the performance of Pakistan's Economy during the early 2000s to mid-2007, see IMF (2008) and (2005)

[5] See Khan (2009) for a detailed discussion on this issue.

[6] In five years (2008-13) the government changed seven finance secretaries, eight chairman of the Federal Board of Revenue (FBR), and four governors of the Country's Central Bank.

[7] For a detailed discussion on these opportunities, see Khan (2017)

[8] Growth numbers are highly contested. For detailed discussion on this issue, see Khan (2017) and Khan (2016)

[9] Budget deficit number is grossly understated. For a detailed discussion on this issue see Khan (2016)

[10] See Khan (2016)

[11] In fact, Khan (2017) could foresee Pakistan going to the IMF for yet another bailout program sometime in March/April 2018. It got delayed because of the general election in the country. True to their strategy, the newly elected government was "forced" to go the IMF right after taking charge of the state affairs.

[12] For detailed discussion on this issue, See Khan (2020f)

[13] See Khan (2020b)

[14] Washington Consensus was developed in the early 1980s among the World Bank, IMF and the US Treasury on the set of policies that include tight monetary policy, tight fiscal policy, devaluation of the currency under the garb of market based exchange rate system and hike in utility prices (the prices of gas and electricity). More on this see Khan (2020e), Khan (2019) and Khan (2020g)

[15] Economic activity in a developing country like Pakistan is dependent on imported raw materials, imported capital goods, imported machinery and equipment and most importantly on imported energy.

[16] For a detailed discussion on this issue, see Khan (2020c))

[17] Empirical evidence in Pakistan suggests that there is a positive association between the SBP policy rate and overall inflation. A one percent increase in policy rate increases inflation by 1.3 percent. See Nazami and Samad (2021).

[18] US President Joe Biden has said this during his Presidential Address to a joint session of congress on April28, 2021 at the US Capitol in Washington, D.C.

[19] See Finance Minister's Press Conference on May 5, 2021 in Islamabad.

[20] All these sectors are highly labour – intensive with high employment elasticity.

[21] Failure to forecast revenue or setting unrealistic revenue target has serious consequences for fiscal discipline. More on this, see Khan (2014), Khan (2020a) and Khan (2021)

[22] The government budget constraint can be written as $\Delta B_t = B_t - B_{t-1} = r\ B_{t-1} + (G - T)$ - - - - - - - (1), that is budget deficit is equal to interest payment plus primary deficit. Here B_t is public debt in year t, B_{t-1} is public debt in year t-1 (last year); r is the interest rate and (G-T) is primary deficit (Total revenue minus non-interest expenditure). Equation (1) can be written as

$B_t = (1+r)\ B_{t-1} + D_t$ --------(2) where $D_t = (G\text{-}T)$. After doing some calculation and rearranging term, we get $b_t = \frac{1+r}{1+g} b_{t-1} + d_t$ ....(3)

If $d_t = 0$ or primary deficit is zero then $b_t = \frac{1+r}{1+g} b_{t-1}$

If $r<g$ or $g>r$ then b_t (public debt to GDP ratio) will not increase and public debt will achieve sustainability. See D'Souza (2008), page 329-330.