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Scenario **F**orecasting **f**or **P**akistan **E**conomy 2010-2015

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THE CURRENT SITUATION

This is an enormously critical moment in Pakistan's troubled economic and political history. Most economic indicators are pointing downwards. The rate of growth in national product is on a declining trend. Today Pakistan's presumed GDP rate of growth is one half that likely for Bangladesh and one-third that expected for India. Stalling GDP growth means increasing incidence of poverty, widening income disparities, growing unemployment, increasing gap in average incomes of the relatively better performing areas in the country and those that are more backward. This is clearly not a sustainable situation. Unless arrested with the adoption of right sets of public policies, economic troubles will also produce those that are political and social in nature.

Also, the country is getting increasingly isolated, unable to take advantage of the enormous changes in the global economy. One indication of the country's failure to integrate or link the economy with the international production system, is its declining share in world trade that originates in the developing parts of the world. More successful emerging economies have taken advantage of the rapidly changing and growing systems of international commerce and industrial production. Pakistan has fallen behind.

The people are becoming increasingly restive. As political economists have been suggesting for several years, the feeling of "relative deprivation" not only deepens resentment among those who are concerned that they have been left behind, their discontent also manifests itself in the form of a challenge to the authority of the state. That is what the world has seen in the political explosion on the Arab streets. It is this discontent that has fed, to a considerable extent, domestic terrorism in Pakistan. Continuing problems with domestic security have taken a heavy economic toll that may well last into the future.

The institutional structures, that together make up the Pakistani state, have become progressively weak since the founding of the country 64 years ago. There are several reasons for this. Perhaps, the most important among them is the failure of a societal consensus on how people should be governed, resulting in constant experimentation that has gone on for six and a half decades as to the most appropriate structure of government. The country has alternated between civilian and military rule; the military was allowed to govern for 33 out of 64 years since the country gained independence. Three different constitutional arrangements were put in place, and half a dozen systems of local governments were experimented with. Constitutional provisions were not fully observed even when the civilians were in charge. In fact, the Constitution of 1973 was subverted soon after it was promulgated.

Overall, there is a "perfect storm" through which the economy has to navigate. It is affecting simultaneously the country's economy, its political system and the national psyche. That metaphor seems even more befitting since the dangers in recent months have increased exponentially and policymakers as well as the citizenry are faced with tremendous amounts of uncertainty. The most important task before the country's policymakers, therefore, is to create a degree of confidence among the citizenry. This has to be done by moving simultaneously on a number of different fronts. Islamabad and the provincial capitals need to be actively involved in improving the economic situation and following the 18th Amendment to carefully devolve to the provinces a number of functions that were hitherto performed by the federal government.

What is likely to happen in the foreseeable future? This paper seeks to find an answer to this question which is important not only for Pakistan but also for the international community. But before we do that, we review first in some detail the current economic situation.

As mentioned earlier, Pakistan today is in the grips of an economic slowdown, with the GDP growth rate down close to the population growth rate and with high double-digit inflation, which is showing a persistent and rising tendency. The recent devastating floods have no doubt contributed to a loss of production, especially in agriculture. The loss of growth momentum is also due to a number of structural factors like a large energy shortage and the war on terror, which has dislocated economic activity and led to a loss of investor confidence.

Following the crises of 2008, the Standby Agreement (SBA) with the IMF had helped greatly in stabilizing the situation. Pakistan was able, subsequently, to complete four reviews successfully in this programme and receive assistance worth $8.7 billion. However, from 2009-10 onwards, economic conditions have begun to deteriorate. The root cause is the major worsening in the fiscal position, due to lack of achievement of revenue targets, big increase in security spending, grants to cover large losses of state enterprises, etc. Consequently, as compared to the original fiscal deficit target of 4.9 percent of the GDP in the SBA, the actual deficit approached 6.3 percent of the GDP in 2009-10.

During the first nine months of 2010-11, there is evidence of growing difficulties. The Finance Minister has warned that in the absence of strong policy actions the fiscal deficit could approach the peak level of 8 percent of the GDP. This has meant large bank borrowings to finance the deficit. Currently, these borrowings stand at Rs 400 billion, which is almost 33 percent above the level attained during the corresponding period of the previous year. This has not only fuelled monetary expansion and led to persistence in the rate of inflation, but high interest rates are also leading to a 'crowding out' of the private sector.

The rise in the fiscal deficit is due to a number of major policy reversals in recent months, arising primarily from failure of a relatively weak coalition government to implement the reform agenda agreed with the IMF. The reformed GST, involving removal of exemptions on goods and broad-basing to services, was to be implemented by October 1, 2010. But this did not happen due to strong political opposition and pressures from vested interests. Similarly, the policies of raising power tariffs and of adjusting POL prices in line with the increase in the international oil price have been partially abandoned leading to a loss of significant revenues and rise in subsidies. Earlier, the decision to raise government salaries and allowances by 50 percent at budget time has added substantially to current expenditures of both federal and provincial governments. Due to slippages on the policy front, the Fund programme has effectively remained suspended since May 2010. Following a recent IMF mission, belatedly a Presidential Ordinance has been promulgated with additional taxation, expected to yield Rs 53 billion of revenue during the rest of the year, alongwith some cutbacks in expenditure.

There is a common perception that the fiscal situation is unlikely to improve due to postponement of structural reforms on the taxation and expenditures fronts as the political process moves into an 'election cycle', with a focus on populism. Elections are due in 2013 but may now be earlier. As opposed to these concerns, there is a degree of complacency arising from the present record level of foreign exchange reserves of over $ 17.5 billion and buoyancy in exports and remittances, which have led to a quantum reduction in the deficit in the current account of the balance of payments. There is need, therefore, for undertaking economic scenario analysis for the next few years linked to the types of political developments that are likely to take place and which will largely determine the extent to which major structural reforms are undertaken.

There are basically five types of political and economic scenarios possible. One the current coalition government stays in office, with three possible outcomes with regard to implementation of reforms, that is, business as usual, the reform situation worsens, or reform situation improves. The fourth scenario is early elections, followed possibly by induction of a government with a majority, the fifth a national government unity with technocrats. We discount the possibility of a military take over for reasons given below.

We give below a detailed narrative outlining the political developments and economic consequences at both the Federal and where appropriate provincial level. The economic forecasting includes estimates from 2010-11 to 2014-15.

SCENARIO 1: CONTINUATION OF COALITION GOVERNMENT WITH DETERIORATION IN THE REFORM SITUATION

Political Developments

In this scenario, the coalition government stays in office. The National Assembly of Pakistan has a total membership of 342. For a majority 172 members are required. The current breakup of the party strength is :PPP,126; PML N,92; PML Q,50; MQM,25; ANP,14; MMAP, 8; PML F, 5; PPP S, 1; BNP A, 1; NPP,1; FATA,11, and ; IND,5. There are 3 vacant seats.

The coalition government in the centre notionally comprises the following parties: PPP 126 members, MQM 25, ANP 14, PML F 5, FATA 11, IND 5, and 3 other members. In the latest negotiations between the PPP and the PML Q, an understanding has been arrived at where Q league would support the coalition government. It has 50 members in the NA which should bring the total members of the coalition to 239; a formidable majority in a house of 342. The problem is that these figures do not reveal the fragility of the coalition. The Q league is divided into many factions. By general consent, the Chaudries, leaders of the party only have support of about 20 members but it is difficult to be exact because loyalties of the members keep shifting but if 20 is counted as a firm figure it reduces the total coalition membership to 209.

The relationship of PPP with another coalition partner, the MQM, is always on the verge of breaking down with the PPP. It is only with great difficulty that the latest truce has been arrived at. Both the parties have conflicting interests in Karachi and it is quite possible that MQM may quit sometime. Also, the two parties have different constituencies. PPP's is largely rural and MQM's almost totally urban. Therefore, there are serious differences on policy matters too such as any taxation or increase in prices. MQM greatly objected to petroleum prices increase that largely has an urban impact. PPP is averse to taxing agriculture income that MQM supports. It is certain that sooner or later, both have to part. If this happens and its 25 members are removed from the equation, the present PPP led coalition is left with 164, effectively a minority.

ANP's support to the PPP is firm but the two other components are exceedingly fragile. The 11 FATA members and 5 independents can shift their loyalties anytime depending on which way the wind is blowing. If the support of these 16 is lost then the PPP support in the NA comes further. The PML F is Pir Pagara's party and he has no love lost for the PPP. If it appears certain that PPP majority is wafer thin, his 5 members would jump ship too.

To summarise, the firm support that the PPP has is 126 of its own members and 14 of ANP plus a possible 20 from the Q league who might stand with it, although knowing their track record they will also abandon a sinking ship. Thus, purely in a numbers game this is a very fragile coalition. Is it likely to tip over?

The answer is a cautious no. For a long time the tipping point had been the MQM as its 25 members were critical to the survival of the government. PPP leadership has tried to balance this by seeking support from PML Q. Considering the help that its leadership needs from the PPP government to sort out its legal issues, this support may last. Thus, the ability of the MQM to blackmail the coalition has gone down somewhat.

Secondly, coalitions break up when something advantageous to the breaking parties is visible. In the event that the coalition collapses a midterm election could become a possibility. Many of the coalition parties do not necessarily want this. PML Q could lose many of its members in Punjab and MQM would have a harder time getting the same number of seats in Karachi. Thus, the prospect of a midterm election would not be very palatable to them. This is an important reason why the coalition is likely to last politically.

Besides the numbers game in the national assembly, there are other ways in which the coalition government could have a problem. There are a number of issues on which serious disagreements are erupting between judiciary and the executive. Some of these relate to civil service, judicial and statutory appointments, such as Chairman National Accountability Bureau but the one case that has a serious possibility of upsetting the government is the non implementation of the NRO decision and the eligibility of Asif Ali Zardari to hold the Presidential office. Both these cases are potential minefields. If decided against the government they could create circumstances which may lead to fall of the government.

In the NRO case, the court could hold the Prime Minister in contempt. This would amount to conviction and attract article 63 of the constitution, which forbids convicted people from being members of the National Assembly. If Gilani loses office, it may set a chain of events where a new leader may be difficult to find and lead to a hung parliament. If this decision is coupled with disqualification of the President, it would be a double body blow.

These are just possibilities but are they likely to happen? This cannot be ruled out but unlikely unless the tussle between the government and the court becomes acute and, critically, the Supreme Court is sure of support from the military. The reason for this is simple. The government could choose to defy court orders as it has done in many other cases. In such an eventuality, the court can, under article 190 of the Constitution, ask for assistance from the army. If the army is ready to do it, it would be the end of the game for the PPP. If it declines, the Supreme Court would become largely ineffective.

For the moment, both sides are trying not to take matters to this pass. Supreme Court is not passing final orders on some of these critical applications and the government is paying lip service to court decisions. Both are conscious of the dangers of going too far. However, while the survival of the coalition has a high probability, its dialectic with the Supreme Court is a wild card as filing of a reference recently by the President on the conviction of Mr. Zulfiqar Ali Bhutto 34 years ago.

If the coalition government continues in office what kind of policies will it pursue? The reform agenda is presented in Box 1. This is the comprehensive set of policy measures and reforms required to remove the structural problems that have emerged in the economy and lead to a revival of the process of growth. It covers the required changes in fiscal, monetary and trade/balance of payments policies. The ability of the government to comprehensively and faithfully implement these reforms will determine the future state of the economy. Forecasts of key macroeconomic variables in the different scenarios are generated through the IPP Macroeconomic Model (described in Box 2).

Implementation of Reforms

In the scenario where the coalition government continues and the reform situation worsens, efforts at raising the tax-to-GDP ratio, especially through reforms like the RGST, continue to be effectively blocked by a coalition of political parties and vested interests. Provincial governments remain reluctant to develop their own revenue sources, especially in the period leading up to the elections and in lieu of larger transfers following the 7^{th} NFC Award. The overall tax-to-GDP ratio further slides down from 10 percent of the GDP to 9.5 percent over the five year period.

Given the existing problems of governance, including mismanagement and corruption, state enterprises continue to bleed heavily and require large and growing subventions from the exchequer. No conscious efforts are made to restrain current expenditure, and the burden of adjustment continues to be in the form of draconian cuts in development expenditure. The circular debt problem festers, and the power sector places large claims on the budget. The PSDP is increasingly exposed to ‘pork barrelling’, especially before the elections. The consequence is that total expenditure remains, more or less, at the same level, however, the composition tilts towards recurrent and away from development spendings, with its negative concomitant implications for growth and development.

BOX 1: THE REFORM AGENDA
Reforms
A. FISCAL POLICY
1. Development of Federal Taxes
1.1 Introduction of RDST
~ Withdrawals of Exemptions on Goods
~ Broadbasing of Sales Tax on Services
1.2 Introduction of Wealth Tax
1.3 Transition from Regime of Presumptive Direct Taxes to Minimum Withholding Taxes
2. Development of Provincial Taxes
2.1 Effective Levy of Agriculture Income Tax
2.2 Development of Taxes on Real Estate
3. Improvement in Federal Tax Administration
3.1 Campaign against Non-Filers and Under Filers
3.2 Strengthening of Audit Function
3.3 Checking smuggling from Afghan Transit Trade
3.4 Checking Under-Invoicing
4. Improvement in Provincial Tax Administration
4.1 Reform along Functional Lines
5. Reduction in Subsidies to Public Enterprises
5.1 Enhancement of Tariffs and Collection Efficiency in Power Sector
5.2 Reduction in Subsidies to Railways, PASMIC, PIA, etc.
6. Downsizing of Government and Reduction in Administration Costs
6.1 Reduction in Cabinet Size
6.2 Reduction in Non-Salary Costs
7. Policy on Administered Prices
7.1 Pass-through in POL prices of International Prices
8. Withdrawals of Subsidies on Agricultural Commodities
9. Rationalisation of PSDP
B. MONETARY POLICY
1. Granting of Full Autonomy to Central Bank
2. Limits to Borrowing from Central Bank
3. Enforcement of Overdraft Limits on Commodity Financing, Provincial Governments & PSEs
4. Strengthening of Provincial Regulations
5. Setting Policy Rate to counter inflation
C. BALANCEMENT OF PAYMENTS POLICY
1. Policy of no intervention in the FE Market
2. Avoiding Selective Fixation of Imports Tariffs
3. Withdrawal of Export Controls

The act granting greater autonomy to SBP remains stuck in the Parliament, and the central bank comes under pressure to finance a big part of the large and growing fiscal deficit, thereby fuelling inflation in the economy. The problem of NPLs spreads in the economy, leading to a further loss of growth potential and enhanced vulnerability of commercial banks, which may eventually require fiscal injections for a bail out.

BOX 2 FEATURES OF THE IPP MACROECONOMIC MODEL
• Short-Run/Medium-Run-Keynesian • Long-Run – Harrod - Domar • 42 Equation Model • Based on Consistent National Income Accounts from 1980-81 to 2009-10 • Models Consequences of • Fiscal Policy • Monetary Policy • Trade Policy • On Macroeconomic Imbalances, Inflation, Growth, Employment and Poverty • Models Impact of Changes in World Economy • Handy Tool for Policy Analysis and Scenario Building

On the external side, the IMF SBA remains suspended and comes to an end in September 2011. In the absence of the umbrella of a Fund programme, the international community becomes increasingly reluctant to make new pledges of support to Pakistan. Meanwhile, Pakistan has to continue honouring its debt servicing obligations, especially to the IMF and the multilateral development banks. In an environment of incipient crisis, the private sector becomes more shy and there is even the prospect of a flight of capital, triggered off by portfolio outflows from the stock market. As foreign exchange reserves decline, the exchange rate starts plummeting rapidly, thereby contributing to more imported inflation in the economy. Overall, the economy enters a period of low and declining growth with high and rising inflation; consequently, the level of unemployment and poverty are likely to worsen sharply.

Macroeconomic Forecast

In this scenario, as shown in Table 1, there is a real danger that the economy could plunge into a financial crisis by the second half of 2012-13, interestingly close to the time elections are to be held according to the normal schedule. This is caused by the haemorrhaging of foreign exchange reserves due to a rise in the current account deficit, unsuccessful completion of the IMF SBA implying no further release of funds, commencement of significant debt servicing obligations to the IMF from 2011-12 onwards, reduction in net inflows from donors and continuing fall in FDI. The exact timing of the crisis is, of course, difficult to predict. By the end of 2012-13, FE reserves could be down to about two months of imports. If business confidence starts falling before that happens, and there is a flight of capital then the crisis could hit the country in the earlier part of 2012-13.

Table 1: CONTINUATION OF COALITION GOVERNMENT
(Reform Situation Worsens)

OUTPUT

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Nominal GDP (Rs. Billion)	14,668	17,897	20,685	23,377	26,669	31,565
Nominal GDP Growth (%)	15.1	21.9	16.1	15.7	19.7	24.3
Real GDP Growth (%)	4.4	2.1	3.3	3.1	2.9	2.8
Investment* (Real Growth Rate) (%)	-2.0	-5.9	1.5	-2.8	-6.3	-7.5
Investment* (as % of GDP)	13.0	11.5	11.2	10.5	9.6	8.5

* Investment is the sum of Public and Private Investment.

GOVERNMENT FINANCES

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Consolidated Government Expenditure (As % of GDP)	20.5	20.4	20.3	20.6	20.5	20.5
Social Sector Expenditure (As % of GDP)	2.8	2.9	2.9	3.0	3.0	3.0
Subsidies (As % of GDP)	1.6	1.5	1.6	1.6	1.7	1.7
Consolidated Government Revenue (As % of GDP)	14.2	13.2	13.2	13.2	13.2	13.0
Tax Revenue (As % of GDP)	10.0	9.6	9.6	9.6	9.5	9.5
Non-Tax Revenue (As % of GDP)	4.1	3.7	3.6	3.6	3.4	3.1
Consolidated Government Balance (As % of GDP)	-6.3	-7.1	-7.2	-7.4	-7.5	-7.7

DEBT AND RESERVES

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Foreign Exchange Reserves with SBP ($ Millions)	12,958	11,527	7,950	3,072	799	4,695
Foreign Exchange Reserves with SBP (Months of Imports)	3.7	4.5	3.6	2.4	0.9	0.3
Stock of Government Debt (As % of GDP) (with IMF)						

Domestic	31.7	32.9	34.6	35.9	35.5	34.0
External	31.7	26.9	25.2	26.2	30.8	36.9
Total Debt	63.4	59.8	59.8	62.1	66.4	70.9
Stock of Government Debt (As % of GDP) (without IMF)						
Domestic	31.7	32.9	34.6	35.8	35.5	34.0
External	27.0	23.1	22.2	24.2	30.3	37.6
Total Debt	58.7	56.0	56.8	60.0	65.8	71.6
Debt Services Paid (As % of GDP)						
Domestic	3.94	4.06	4.00	4.14	4.64	4.95
External	0.44	0.48	0.43	0.41	0.41	0.45
Total Debt	4.38	4.54	4.44	4.55	5.04	5.40

PRICES AND FINANCIAL INDICATORS

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Rupee US$ Exchange Rate (Avg of the Period)	83.8	86.2	91.0	103.9	136.4	191.3
Rupee US$ Exchange Rate (End of the Period)	85.3	87.4	93.5	111.3	157.6	229.9
Interest Rate on Advances	13.6	16.8	14.4	14.3	18.2	22.6
Money Supply Growth (M2)	12.5	10.9	8.6	10.8	13.3	16.6
Inflation Rate (%)	11.7	14.3	11.9	11.8	15.7	20.1
Sensitive Price Rate (%)	13.3	16.0	13.2	13.1	17.5	22.4
Domestic Price Level (%)	214.4	245.1	274.2	306.5	354.7	425.9

EXTERNAL SECTOR (As % of GDP)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Imports	21.8	20.6	20.4	20.9	22.6	24.7
Exports	14.2	14.4	13.6	13.9	16.5	20.4
Trade Balance (Goods and Services)	-7.6	-6.3	-6.8	-7.1	-6.1	-4.3
Current Account Balance	-2.3	-1.7	-2.5	-2.7	-1.2	1.3

In an environment of incipient crises and following the crises, the growth rate of the economy is bound to suffer severely and to essentially remain at below 3 percent. The inflation rate is likely to rise sharply once again, especially due to the large depreciation of the rupee and exceed 20 percent by 2014-15. It is not surprising that the combination of low growth and high inflation is likely to lead to an explosion in poverty, with almost half the population falling below the poverty line in the next four years in this worst case scenario. The implications on the security and law and order situation are too horrendous to even begin to contemplate.

SCENARIO 2: CONTINUATION OF COALITION GOVERNMENT WITH BUSINESS AS USUAL

Political Developments

Same as described in Scenario 1.

Implementation of Reforms

On the taxation front, there is some withdrawal of exemptions on goods (as has been done recently in the Presidential Ordinance) but the introduction of a broad-based Provincial Sales on Services and a new RGST law are deferred. The Provincial governments fail to develop the AIT due to strong resistance from the feudal lobby, while some modest effort is made to develop the property tax. The campaign against non-filers and under-filers meets with only modest success. Smuggling through Afghan Transit Trade continues, more or less, unabated.

The power sector continues to be bedevilled by the problem of circular debt although subsidies are brought down somewhat by partial adjustments in tariffs. Reforms of other PSEs continue but with only limited success. There is no further reduction in cabinet size beyond that already achieved. Increases in the international oil prices are only partially transmitted through into domestic prices.

Monetary policies continue to have an expansionary stance accommodating, in particular, the borrowing needs of the government from the banking system. Efforts are made to maintain relative exchange rate stability through intervention in the foreign exchange market.

Macroeconomic Forecast

In this scenario, there is only a limited recovery in the growth process in the economy and the GDP growth rate remains below 4 percent. Similarly, there is little reduction in the size of the fiscal deficit. The inflation rate remains double-digit, with a tendency to rise after 2012-13 as the currency begins to depreciate rapidly. The economy remains vulnerable and there is the likelihood of a financial crisis in early 2013-14 as FE reserves get depleted. Therefore, as compared to the previous scenario, there is no quantum improvement in macroeconomic prospects.

SCENARIO 3: CONTINUATION OF COALITION GOVERNMENT WITH IMPROVEMENT IN THE REFORM SITUATION

Political Developments

Same as described in Scenario 1.

Table 2: CONTINUATION OF THE COALITION GOVERNMENT

(Business as Usual)

OUTPUT	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Nominal GDP (Rs. Billion)	14,668	17,151	19,690	22,511	26,525	32,406
Nominal GDP Growth (%)	15.1	16.9	14.8	14.3	17.8	22.2
Real GDP Growth (%)	4.4	2.2	3.6	3.7	3.8	3.9
Investment* (Real Growth Rate) (%)	-2.0	-0.8	5.3	2.2	-0.2	-0.3
Investment* (as % of GDP)	13.0	12.1	12.3	12.1	11.6	11.2

* Investment is the sum of Public and Private Investment.

GOVERNMENT FINANCES	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Consolidated Government Expenditure (As % of GDP)	20.5	20.1	20.0	20.1	19.9	19.8
Social Sector Expenditure (As % of GDP)	2.8	2.8	2.9	3.0	3.0	3.0
Subsidies (As % of GDP)	1.6	1.4	1.4	1.4	1.4	1.4
Consolidated Government Revenue (As % of GDP)	14.2	13.4	13.5	13.5	13.5	13.4
Tax Revenue (As % of GDP)	10.0	9.7	9.8	9.9	9.9	10.1
Non-Tax Revenue (As % of GDP)	4.1	3.7	3.6	3.6	3.4	3.1
Consolidated Government Balance (As % of GDP)	-6.3	-6.6	-6.5	-6.6	-6.5	-6.5

DEBT AND RESERVES	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Foreign Exchange Reserves with SBP ($ Millions)	12,958	11,822	8,975	4,323	1,509	4,521
Foreign Exchange Reserves with SBP (Months of Imports)	3.7	4.5	3.7	2.7	1.3	0.4
Stock of Government Debt (As % of GDP) (with IMF)						
Domestic	31.7	32.3	33.5	34.4	33.8	31.6

External	31.7	26.9	25.3	25.7	29.5	35.2
Total Debt	63.4	59.3	58.8	60.2	63.3	66.8
Stock of Government Debt (As % of GDP) (without IMF)						
Domestic	31.7	32.2	33.3	34.1	33.5	31.5
External	27.0	23.1	22.3	23.8	29.0	35.8
Total Debt	58.7	55.5	55.8	58.2	62.7	67.4
Debt Services Paid (As % of GDP)						
Domestic	3.94	4.04	3.81	3.84	4.25	4.53
External	0.44	0.48	0.44	0.42	0.41	0.44
Total Debt	4.38	4.52	4.24	4.26	4.66	4.97

PRICES AND FINANCIAL INDICATORS

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Rupee US$ Exchange Rate (Avg of the Period)	83.8	86.1	89.6	99.4	125.8	172.6
Rupee US$ Exchange Rate (End of the Period)	85.3	87.3	91.4	104.9	142.6	204.9
Interest Rate on Advances	13.6	16.9	13.4	13.0	16.4	20.6
Money Supply Growth (M2)	12.5	10.4	7.9	9.8	12.0	14.9
Inflation Rate (%)	11.7	14.4	10.8	10.3	13.5	17.6
Sensitive Price Rate (%)	13.3	16.1	12.0	11.4	15.1	19.6
Domestic Price Level (%)	214.4	245.3	271.8	299.7	340.2	400.1

EXTERNAL SECTOR (As % of GDP)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Imports	21.8	20.6	20.3	20.6	21.9	23.9
Exports	14.2	14.3	13.4	13.4	15.4	18.7
Trade Balance (Goods and Services)	-7.6	-6.3	-6.9	-7.2	-6.5	-5.2
Current Account Balance	-2.3	-1.7	-2.7	-3.0	-2.0	0.0

Implementation of Reforms

This is a scenario in which some reforms are undertaken but not enough to remove fully the structural problems faced by the economy. In this scenario there is a modest increase in the tax-to-GDP ratio of about 0.8 percent of the GDP, achieved primarily by the Federal Government through some significant improvements in tax administration and withdrawal of exemptions but the big move towards RGST does not take place. Provincial governments focus on development of property-related taxes and some services come under the sales tax net.

On the expenditure side there is reduction of subsidies to state enterprises and the problem of 'circular debt' is contained somewhat. In addition, the number of Ministries /Divisions is rationalized in the process of implementation of the 18th Amendment, leading eventually to some cost savings. The consequent scaling down of the fiscal deficit leads to some moderation in the growth of debt servicing liabilities. Spending on social sectors as a percentage of GDP, more or less, remain stagnant over the period.

On the external front, the Government is able to get some extension in the period of the on-going SBA with the IMF. However, external aid inflows remain limited and the exchange rate adjusts to the declining level of foreign exchange reserves. Government borrowings are increasingly financed by commercial banks rather than the Central Bank, thereby leading to less inflationary pressures.

Macroeconomic Forecast

In this scenario, there is a gradual recovery in the GDP growth rate from 4 percent in 2011-12 to almost 5 percent by 2014-15, as shown in Table 3. This is due primarily to some revival in the level of investment in the economy. Inflation declines initially to a single-digit level and then shows a tendency to rise once again as the exchange rate responds to the fall in FE reserves.

Table 3: CONTINUATION OF COALITION GOVERNMENT

(Reform Situation Improves)

OUTPUT

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Nominal GDP (Rs. Billion)	14,668	17,955	20,541	23,376	27,355	33,264
Nominal GDP Growth (%)	15.1	22.4	14.4	13.8	17.0	21.6
Real GDP Growth (%)	4.4	2.3	3.9	4.3	4.7	5.0
Investment* (Real Growth Rate) (%)	-2.0	4.4	9.1	7.3	5.9	6.8
Investment* (as % of GDP)	13.0	12.7	13.3	13.6	13.7	13.8

* Investment is the sum of Public and Private Investment.

GOVERNMENT FINANCES

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Consolidated Government Expenditure (As % of GDP)	20.5	19.7	19.7	19.6	19.4	19.1
Social Sector Expenditure (As % of GDP)	2.8	2.6	2.9	3.0	2.9	2.9
Subsidies (As % of GDP)	1.6	1.3	1.2	1.2	1.1	1.0
Consolidated Government Revenue (As % of GDP)	14.2	13.5	13.7	13.8	13.8	13.8
Tax Revenue (As % of GDP)	10.0	9.8	10.1	10.2	10.4	10.6
Non-Tax Revenue (As % of GDP)	4.1	3.7	3.6	3.6	3.4	3.1
Consolidated Government Balance (As % of GDP)	-6.3	-6.2	-5.9	-5.8	-5.6	-5.3

DEBT AND RESERVES

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Foreign Exchange Reserves with SBP ($ Millions)	12,958	12,118	9,999	5,575	2,218	4,346
Foreign Exchange Reserves with SBP (Months of Imports)	3.7	4.5	3.8	2.9	1.6	0.6
Stock of Government Debt (As % of GDP) (with IMF)						
Domestic	31.7	31.7	32.4	33.0	32.0	29.3
External	31.7	27.0	25.4	25.3	28.1	33.4
Total Debt	63.4	58.7	57.8	58.2	60.2	62.7
Stock of Government Debt (As % of GDP) (without IMF)						
Domestic	31.7	31.6	32.0	32.4	31.5	28.9
External	27.0	23.2	22.4	23.4	27.6	34.0
Total Debt	58.7	54.9	54.8	56.4	59.7	63.3
Debt Services Paid (As % of GDP)						
Domestic	3.94	4.02	3.61	3.54	3.86	4.10
External	0.44	0.48	0.44	0.42	0.41	0.43
Total Debt	4.38	4.50	4.05	3.97	4.27	4.53

PRICES AND FINANCIAL INDICATORS

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Rupee US$ Exchange Rate (Avg of the Period)	83.8	86.1	88.2	94.9	115.2	153.9
Rupee US$ Exchange Rate (End of the Period)	85.3	87.3	89.3	98.5	127.5	179.8
Interest Rate on Advances	13.6	17.0	12.5	11.8	14.6	18.6
Money Supply Growth (M2)	12.5	9.9	7.2	8.8	10.7	13.2
Inflation Rate (%)	11.7	14.5	9.7	8.8	11.3	15.1
Sensitive Price Rate (%)	13.3	16.2	10.9	9.8	12.6	16.8
Domestic Price Level (%)	214.4	245.5	269.4	293.0	326.2	375.4

EXTERNAL SECTOR (As % of GDP)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Imports	21.8	20.6	20.2	20.2	21.3	23.2
Exports	14.2	14.3	13.2	13.0	14.4	17.0
Trade Balance (Goods and Services)	-7.6	-6.3	-7.0	-7.3	-6.9	-6.1
Current Account Balance	-2.3	-1.7	-2.8	-3.2	-2.7	-1.4

On the fiscal side, there is a modest decline in the fiscal deficit of about 1 percent of the GDP by 2014-15. This is due partly to a rise in the tax-to-GDP ratio, although this is largely neutralized by a fall in the non-tax to GDP ratio. Public expenditure falls by about

0.6 percent of the GDP, with some decline in the level of subsidies. Debt servicing remains largely constant as a percentage of the GDP while there is some increase in the share of development expenditure.

On the external front, developments in the balance of payments lead to a decline in the reserve cover of imports from 4.5 months at the beginning of 2010-11 to less than two months by the start of 2013-14. This precipitates a fairly rapid decline in the value of the rupee.

Overall, in this scenario the economy essentially continues to ‘muddle along’ without enough policy action to lead to a major revival in economic growth. But the economy remains vulnerable to unanticipated negative shocks like a jump in commodity prices, especially, of oil, or bad harvests.

SCENARIO 4: EARLY ELECTIONS

Political Developments

Some talk of early elections has started ever since the PML (N) and PPP finally parted ways in the Punjab. This was further enhanced when the leader of the opposition in the National Assembly Ch. Nisar Ali Khan called for them in a speech from the floor of the house. The election to the current assembly was held in February 2008, which means its tenure runs to February 2013. Early elections can only be held in the following circumstances

1. The President on the advice of the PM dissolves the national assembly and calls for a new elections

2. The party in power loses majority in the National Assembly through a vote of no confidence and no other party or coalition is able to form a government. This would constitute a hung parliament and new elections would become inevitable.

There is no third possibility. There is little chance that PM Gilani would call for early elections. Elections for politicians are like war for the Generals. It is good to prepare for them but best to avoid them as long as possible. The only caveat to this is when the party in power feels that it has a surge in popularity and the chances of winning an election are fairly certain. The other is when it loses the majority in the assembly but is not too happy with the alternate government emerging within the house.

The eventuality by all accounts does not exist for the PPP. There are not too many reliable opinion surveys in Pakistan but the few that are do not show PPP to be very popular. An early election on its own volition would be a serious risk for the party. It is unlikely that it would take it. As for going for early election in case, it loses a vote of confidence, and the alternate is unpalatable there could be a possibility. But in this house, there is little possibility of an alternate coalition emerging.

The second largest party is PML N but it is fairly isolated politically. It has had a serious war of words with MQM and has little truck with PML Q. Without their support, there is no chance that it can form an alternate government. Therefore, one can be certain that in case PPP loses the majority there would be no in house change.

Thus, one can be fairly certain that PPP on its own volition is unlikely to call for early elections. The second possibility discussed above is a vote of no confidence succeeding against the government. We have already considered this to be a difficult proposition. The one variant to this is that government is unable to get the budget passed. The difference between this and a vote of no confidence is that the government has to show its majority not the party moving a vote of no confidence. If the government is unable to get the money bills passed, this in a parliamentary democracy signals the end of a government. What are the chances of this happening?

Again, the wild card in this is MQM. If by the time the budget approaches, its relations with the PPP are once again strained, the government could have a problem. Not because MQM alone can ensure that PPP government is unable to pass the budget. But, because it might cause others to start thinking about ditching the coalition. Its actions could become the proverbial tipping point. It is therefore expected that till the passage of the budget the PPP would make every effort to keep the MQM appeased.

Still, all things considered, there do not appear to be circumstances for early election. Also, it must be remembered that whenever an election is called a caretaker government takes over according to the constitution. This cannot be something totally palatable to the sitting PPP government. Particularly because there is the possibility, that it may outlive its mandate. This we will discuss in detail in under the heading national government/technocratic government.

Implementation of Reforms

This hinges crucially on whether a government with a majority is sworn in after the elections. In this case reform situation could improve compared to the above scenarios if the new government decides to take difficult decisions early in its tenure and reap the benefits later on. Tax reforms in the shape of withdrawal of exemptions on goods taxable under RGST and improvement in the income tax regime are implemented along with partial development of provincial taxes. There is some success in reducing subsidies and streamlining the policy on administered prices along with exercise of austerity measures in current expenditures by the two levels of government. The PSDP is rationalized and throwforward of projects reduced in size. The above measures bring the expenditure down and contribute to curtailment of the budget deficit and to better management of the public debt.

Monetary policy is streamlined through granting of autonomy to the State Bank and limits placed on borrowings which is accompanied by setting of policy rate to counter inflation. There is also some success in managing the balance of payments by partially implementing reforms like avoiding selective fixation of import tariff and withdrawal of export controls.

Macroeconomic Forecast

Based on the adoption of a strong reform agenda, there is likely to be some return of investor confidence in the economy. Private investment starts picking up from 2012-13 onwards and the GDP growth rate begins to rise rapidly, approaching 6 percent by 2014-15.

The fiscal deficit position improves significantly, primarily on the back of a significant increase in the tax-to-GDP ratio and some containment of public expenditures. There are some changes in the composition of public expenditure with the share of subsidies and debt servicing falling somewhat while that of development expenditure and social expenditure rising.

The inflation moderates, at least upto 2013-14. The current account deficit remains manageable, although foreign exchange reserves could fall below safe levels by 2013-14. This, of course, depends upon the extent of support received from the international community by a newly elected government with an effective majority, which appears committed to a strong reform agenda.

The basic question is what will be the outcome of the elections? Will the incumbency factor damage the prospects for both PPP and PML-N, especially the former in terms of its perceived poor performance. But there is no other national party with chance of winning on its own or forming a winning coalition. A likely outcome is a split mandate once again with neither PPP or the PML-N having a majority and being forced to form the government with support from smaller regional parties. In this case, we are back to one of the earlier three scenarios of a coalition government.

SCENARIO 5: NATIONAL GOVERNMENT INCLUDING TECHNOCRATS

Political Developments

National government in general parliamentary parlance means a government that consists of all political parties. It generally happens during a major national emergency such as a war, when all parties decide to come together. Given the politics in this national assembly, there is little likelihood of that. PML N the second major party is not keen to have any association with what it considers an unpopular government. Its

Table 4: EARLY ELECTIONS (in 2011) FOLLOWED BY A MAJORITY GOVERNMENT

	OUTPUT					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Nominal GDP (Rs. Billion)	14,668	17,159	19,661	22,232	25,603	30,571
Nominal GDP Growth (%)	15.1	17.0	14.6	13.1	15.2	19.4
Real GDP Growth (%)	4.4	2.3	4.1	4.7	5.1	5.8
Investment* (Real Growth Rate) (%)	-2.0	3.4	9.7	8.8	8.3	9.5
Investment* (as % of GDP)	13.0	12.6	13.2	13.7	14.1	14.5

* Investment is the sum of Public and Private Investment.

	GOVERNMENT FINANCES					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Consolidated Government Expenditure (As % of GDP)	20.5	19.6	19.6	19.5	19.4	19.1
Social Sector Expenditure (As % of GDP)	2.8	2.6	2.9	3.0	2.9	3.0
Subsidies (As % of GDP)	1.6	1.1	1.1	1.0	0.9	0.8
Consolidated Government Revenue (As % of GDP)	14.2	13.6	13.9	14.0	14.2	14.3
Tax Revenue (As % of GDP)	10.0	9.9	10.3	10.5	10.9	11.2
Non-Tax Revenue (As % of GDP)	4.1	3.7	3.6	3.5	3.4	3.1
Consolidated Government Balance (As % of GDP)	-6.3	-6.0	-5.7	-5.5	-5.2	-4.8

	DEBT AND RESERVES					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Foreign Exchange Reserves with SBP ($ Millions)	12,958	12,920	11,889	8,502	5,543	7,821
Foreign Exchange Reserves with SBP (Months of Imports)	3.7	4.6	4.0	3.5	2.5	1.8
Stock of Government Debt (As % of GDP) (with IMF)						
Domestic	31.7	31.5	32.1	32.2	31.1	28.4

External	31.7	27.0	25.3	24.3	25.7	30.2
Total Debt	63.4	58.5	57.4	56.5	56.8	58.6
Stock of Government Debt (As % of GDP) (without IMF)						
Domestic	31.7	31.4	31.9	31.9	30.8	28.2
External	27.0	23.2	21.7	22.1	25.1	30.6
Total Debt	58.7	54.7	53.9	54.3	56.2	59.0
Debt Services Paid (As % of GDP)						
Domestic	3.94	4.03	3.66	3.51	3.68	3.84
External	0.44	0.48	0.44	0.41	0.40	0.41
Total Debt	4.38	4.52	4.10	3.93	4.08	4.26

PRICES AND FINANCIAL INDICATORS

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Rupee US$ Exchange Rate (Avg of the Period)	83.8	86.0	87.8	91.7	105.4	134.1
Rupee US$ Exchange Rate (End of the Period)	85.3	87.2	88.6	93.8	113.5	152.6
Interest Rate on Advances	13.6	16.9	12.9	11.3	13.2	16.8
Money Supply Growth (M2)	12.5	9.7	7.1	8.5	10.0	12.1
Inflation Rate (%)	11.7	14.4	10.0	8.0	9.6	12.8
Sensitive Price Rate (%)	13.3	16.0	11.2	9.0	10.7	14.3
Domestic Price Level (%)	214.4	245.2	269.8	291.5	319.4	360.3

EXTERNAL SECTOR (As % of GDP)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Imports	21.8	20.4	20.0	19.5	20.1	21.4
Exports	14.2	14.3	13.0	12.5	13.2	14.9
Trade Balance (Goods and Services)	-7.6	-6.1	-7.0	-7.0	-6.9	-6.5
Current Account Balance	-2.3	-1.5	-2.8	-3.0	-2.9	-2.2

determination to disassociate from the PPP can be seen from its recent decision to dismiss its Ministers in Punjab. This it did at the cost of negative fallout in the media wherein it was accused of encouraging party defections/floor crossing. PML N took that risk because it is convinced that PPP is so unpopular, any association with it would erode its vote bank. Without PML N there is no possibility of a national government within the current political dispensation.

Government of technocrats is a variant often discussed in the Pakistani media because something similar happened in Bangladesh. Briefly, the military took over the country but instead of ruling directly, installed a government of professionals. For the same thing to happen in Pakistan, the circumstances have to be similar, that is, a military take over however brief and through this mechanism the installation of a technocratic government.

This is not a very likely possibility because the military is not interested in taking over. After nine years of Musharraf's – and military's - rule, that ended in disarray there is no space for military to intervene again. Secondly, there is widespread recognition that military intervention would be very unpopular internationally and actually hurt the prospect of bilateral and multilateral assistance. The only caveat to this is a situation of grave national emergency, such as a financial and economic meltdown, than anything can happen. But, short of that, there is no possibility of a military taking over and putting in place a government of technocrats.

The only possibility of any such thing happening is if remaining within the ambit of the constitution, a caretaker government comes into place. According to the constitution whenever an election is announced, it has to be conducted under a caretaker government. If for any of the reasons discussed above, an early election becomes necessary, a caretaker government would have to be put in place. If provincial elections are happening simultaneously, these too would be under caretaker set up.

Once the caretakers are in place, someone is bound to move an application before the Supreme Court that circumstances do not exist for an election. The reason given would be disturbed situation in FATA, KPK and Balochistan. It is not beyond the realm of possibilities that the court may accept such an application. It could postpone the election until the right conditions exist or for a specified time period. This would mean that the caretaker government could remain in place for the specified duration. Only then, the possibility exists of technocrats being inducted into the government to run it.

Implementation of Reforms

This perhaps constitutes the best case scenario for policy reform and thereby the economy. In this scenario, the government implements major tax reforms whereby comprehensive RGST legislation is introduced by the federal government involving withdrawal of all remaining exemptions on goods and elimination of distortions that have crept into the GST act, along with substantial broad-basing of the Provincial Sales Tax on Services. This is accompanied by measures to raise tax compliance by improving public perceptions of the equity of the tax system, like reintroduction of the wealth tax and strong measures to curb evasion in the payment of direct taxes.

Beyond these big moves, the provincial governments proceed to develop taxes like the agricultural income tax, urban immoveable property tax and capital gains tax on property in line with the commitment made in the 7th NFC Award. The federal government focuses on measures to raise the quality of tax administration by strong campaigns against non-filers and under-filers, improvement of the audit process, introduction of mechanisms for curbing under invoicing of imports and leakages in Afghan transit trade. Simultaneously, provincial tax machinery is strengthened on a functional basis (see Box 1).

On the expenditure side, top priorities is given to improving the management and reduce losses of public enterprises/ utilities like the Railways, PIA, Pakistan Steel Mills, etc. Also, the problem of circular debt in the power sector is brought under control primarily through improvements in collection efficiency and rationalisation of power tariffs.

The Debt Management Policy is pursued effectively with the objective of reducing future debt servicing liabilities. Current expenditure of both levels of government is brought down by downsizing and practicing austerity wherever possible, including reduction in cabinet size. The policies on administrated/regulated prices are set in ways whereby domestic POL prices reflect fully the level of international prices and procurement/support prices of agricultural prices do not carry the weight of unsustainable subsidies. Finally, the PSDP is rationalised with allocations focused initially on completion of on-going priority projects and the size of the development programme increased subsequently as the fiscal situation improves. The consolidated government expenditure, through the above measures is curtailed, declining from 20.5% of the GDP in 2009-10 to about 19% of GDP. Expenditures on subsidies, in particular, declines from 1.6% of GDP to 0.6% during the five year framework and so does the spending of debt services.

Within the domain of monetary policy, the critical reform is the granting of greater autonomy to SBP under the new act, so as to limit the inflationary borrowing of the federal government from the central bank and to rigidly enforce the overdraft limits on the provincial governments and state enterprises. In the best case scenario, the SBP sets the policy rate primarily from the viewpoint of containing inflationary pressures. Given the enhanced vulnerability presently to NPLs, stronger prudential regulations are put in place to protect the financial sector.

On the external side, implementation of the above reforms enables a resumption or to a move to a new IMF programme. This has a salutary impact on the flow of funds from other multilateral and bilateral donors. Also, the improvements in governance and strong policy actions contribute to a major resurgence in business confidence. Private investment in general and foreign direct investment in particular start rising once again. Government of Pakistan begins to float bonds in the international capital markets. The

Central bank also adopts a policy of non-intervention in the foreign exchange market. The real effective exchange rate, consequently, more or less accurately reflects the state of the balance of payments. There is minimum resort to physical controls on exports (like food items, cotton yarn, etc), and private sector imports are allowed to the extent possible. Fiscal and other incentives are focused on achieving greater diversification of exports.

Other areas include, first, an upsurge in social sector expenditure, due especially to enhanced revenue transfers to provincial governments in the aftermath of the 7th NFC Award, which increases the share of provinces in national resources. Also, implementation of the 18th Amendment, which involves transfer of functions from the federal to provincial governments, if implemented properly, can result in improved service provision in the medium term time frame. Second, the resort to a more aggressive and better targeted social protection policy focusing not only on income supplements and food security but also on employment promotion. Coupled with higher growth, these policies lead to a fall in poverty once again after rising rapidly in recent years.

Macroeconomic Forecast

Decisive policy actions on the fronts of tax reforms and containment of current expenditure lead to a decline in the fiscal deficit from about 6 percent of the GDP in 2010-11 to below 4 percent of the GDP by 2014-15, as shown Table 5. The tax-to-GDP ratio rises by almost two percentage points while current expenditure falls by almost 1.5 percentage points of the GDP. Alongwith significant deficit reduction, this enables an increase in the level of development expenditure by almost 1.5 percentage points of the GDP.

The rise in public investment coupled with a recovery in private investment leads to an overall increase in the investment to GDP ratio by over 2.5 percentage points. There is a visible revival in the process or economic growth after the damage inflicted by the floods. From a GDP growth rate close to 2 percent in 2010-11, the growth rate rises to 5 percent by 2012-13 and reaches 6.5 percent by 2014-15, implying that the economy gets back after a gap of eight years to a trajectory of high growth. The growth response could be even more rapid if there is a reduction in the intensity of the war on terror and relative peace returns to the major cities of Pakistan.

Foreign exchange reserves are bolstered by the receipt of the last two tranches from the IMF SBA of over $3 billion. Alongwith the presently high level of FE reserves, this enables the economy to sustain the balance of payments in the presence of higher debt servicing obligations, particularly to the IMF. The exchange rate remains stable and could even appreciate somewhat in real terms. Very importantly, the rate of inflation is expected to come down to single-digit by 2012-13, due to a low rate of monetary expansion and limited imported inflation. The Model indicates that after 2012-13, the incidence of poverty starts falling in the country.

Table 5: NATIONAL GOVERNMENT (WITH TECHNOCRATS)

	OUTPUT					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Nominal GDP (Rs. Billion)	14,668	17,897	20,685	23,377	26,669	31,565
Nominal GDP Growth (%)	15.1	22.0	15.6	13.0	14.1	18.4
Real GDP Growth (%)	4.4	2.2	4.4	5.0	5.5	6.7
Investment* (Real Growth Rate) (%)	-2.0	2.3	10.3	10.3	10.8	12.1
Investment* (as % of GDP)	13.0	12.5	13.1	13.7	14.4	15.1
* Investment is the sum of Public and Private Investment.						
	GOVERNMENT FINANCES					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Consolidated Government Expenditure (As % of GDP)	20.5	19.5	19.5	19.5	19.4	19.2
Social Sector Expenditure (As % of GDP)	2.8	2.6	2.9	3.0	3.0	3.0
Subsidies (As % of GDP)	1.6	1.0	0.9	0.8	0.7	0.6
Consolidated Government Revenue (As % of GDP)	14.2	13.6	14.0	14.3	14.6	14.9
Tax Revenue (As % of GDP)	10.0	9.9	10.5	10.9	11.3	11.8
Non-Tax Revenue (As % of GDP)	4.1	3.7	3.6	3.4	3.3	3.1
Consolidated Government Balance (As % of GDP)	-6.3	-5.9	-5.6	-5.2	-4.7	-4.3
	DEBT AND RESERVES					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Foreign Exchange Reserves with SBP ($ Millions)	12,958	13,723	13,780	11,430	8,867	11,295
Foreign Exchange Reserves with SBP (Months of Imports)	3.7	4.6	4.3	4.0	3.5	3.0
Stock of Government Debt (As % of GDP) (with IMF)						
Domestic	31.7	31.2	31.9	31.4	30.2	27.5
External	31.7	27.0	25.2	23.4	23.3	27.0
Total Debt	63.4	58.3	57.1	54.7	53.4	54.5
Stock of Government Debt (As % of GDP) (without IMF)						
Domestic	31.7	31.2	31.9	31.4	30.2	27.5

External	27.0	23.2	21.1	20.9	22.5	27.2
Total Debt	58.7	54.5	52.9	52.2	52.7	54.8
Debt Services Paid (As % of GDP)						
Domestic	3.94	4.04	3.71	3.48	3.50	3.59
External	0.44	0.48	0.44	0.41	0.40	0.39
Total Debt	4.38	4.53	4.14	3.89	3.89	3.98

PRICES AND FINANCIAL INDICATORS

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Rupee US$ Exchange Rate (Avg of the Period)	83.8	85.9	87.3	88.5	95.7	114.3
Rupee US$ Exchange Rate (End of the Period)	85.3	87.0	88.0	89.1	99.5	125.4
Interest Rate on Advances	13.6	16.7	13.3	10.8	11.8	15.0
Money Supply Growth (M2)	12.5	9.6	7.0	8.1	9.3	11.0
Inflation Rate (%)	11.7	14.2	10.3	7.3	7.8	10.5
Sensitive Price Rate (%)	13.3	15.9	11.5	8.2	8.8	11.7
Domestic Price Level (%)	214.4	244.9	270.1	289.9	312.7	345.6

EXTERNAL SECTOR (As % of GDP)

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Imports	21.8	20.2	19.8	18.8	18.9	19.7
Exports	14.2	14.3	12.8	12.0	12.0	12.8
Trade Balance (Goods and Services)	-7.6	-5.9	-6.9	-6.8	-6.9	-6.8
Current Account Balance	-2.3	-1.2	-2.7	-2.8	-3.1	-3.0

SCENARIO 6: MILITARY TAKE OVER

As mentioned earlier, there is a remote possibility of this scenario in Pakistan because of one: the military is not interested in taking over. After nine years of Musharraf's – and military's - rule, that ended in disarray there is no space for military to intervene again. Two, there is widespread recognition that military intervention would be very unpopular internationally and actually hurt the prospect of bilateral and multilateral assistance. The only caveat to this is a situation of grave national emergency, such as a financial and economic meltdown, than anything can happen. But, short of that, there is no possibility of a military taking over and putting in place a government. Given the low probability of this event, no macroeconomic forecast is generated for this scenario.

CONCLUSIONS

In the preceding paragraphs a number of emerging scenarios have been discussed. What exactly will happen is, of course, a judgement call. The most likely scenario is that the current coalition government will muddle along with occasional crisis among the partners. The real tipping point for political change, as mentioned above, is a financial or economic meltdown. If that happens, a technocratic government engineered by the main stakeholders could become a possibility. Short of this, the current alignment of political forces is such that no radical change is possible in way the country is governed. The next election is not due until February 2013. The only change that could result will need to come from outside the established political order. There are two possible catalysts: the military and the judiciary. The former is not likely to act overtly given the history of the past involvement in politics. The latter may make a move in response to an escalation in its dispute with the current executive. It may decide on a number of cases which could force charge by putting pressure on the president and the prime minister. This may result in dissolution of the national assembly and the appointment of a caretaker administration whose life could be extended by judicial action beyond the 90 day period permitted by the constitution. Such an approach would disrupt the course of political development that is underway.

The bottomline to the macroeconomic forecast is the implementation of a strong and wide-ranging reform agenda. The political context within which this could happen is either induction of the government of a party with majority in the Parliament after the next election that demonstrates a higher standard of governance or most probably following an economic crisis, the agreement on the formation of a national government including technocrats with consensus on the economic reform agenda. We hope and pray that the democratic process continues uninterrupted and the country is able to emerge from the ‘perfect storm’ it faces without too much cost to the lives of the people.