Journal of Social & Organizational Matters

Vol 3 No 4 (2024): 331-357

Macroeconomic Problems of Pakistan: Impacts and Way Forward

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Keywords: *Macroeconomic Problems, Stagflation, Fiscal Deficit, Debt Burden, Currency Depreciation, Balance of Payment Crisis*

DOI No:

https://doi.org/10.56976/jsom.v3i4.143

This paper assesses the significant macroeconomic challenges faced by Pakistan amidst its ongoing economic crisis. It identifies major issues that have contributed to the economic meltdown. These issues encompass high inflation/stagflation, low foreign exchange reserves, a substantial fiscal deficit, and mounting public debt. Additionally, Pakistan has experienced sluggish economic growth, marked by low productivity and declining exports. The study further delves into the underlying causes of these problems, attributing them to factors such as poor governance, corruption, and political instability. The study sheds light on the current economic turmoil by employing a descriptive approach with a mix of quantitative and qualitative data analysis. To address these pressing challenges, the paper proposes a comprehensive reform agenda encompassing some vital measures. The article also provides policy recommendations that will help policymakers tackle the economic challenges in theory and practice.

1. Introduction

Pakistan's economy has undergone multiple restructuring phases since its inception, transitioning from a mixed economy with significant state-owned firms to a nationalization drive by Zulfiqar Ali Bhutto in the 1970s. The 1980s introduced an "Islamic" economy, incorporating Shariah principles, and subsequent privatization efforts began in the 1990s (Asian Development Bank, 2008). Agriculture and manufacturing play significant roles in these regimes, while trade and services dominate the economy. Despite consistent economic growth, population growth has limited the per capita income improvements. Pakistan experiences a notable wealth disparity between industrialized regions and poverty-stricken areas. The country possesses a well-developed financial services system overseen by the State Bank of Pakistan, which implements monetary policies and manages currency and reserves (Anjum & Sgro, 2017).

The initial economic policies pursued by Pakistan, such as import substitution (aimed to promote domestic industries by reducing reliance on imported goods) and state-led industrialization (sought to accelerate industrial growth through government intervention), have contributed to imbalances, inefficiencies and a lack of competitiveness in Pakistan's economy, leading to challenges such as a heavy reliance on imports, trade deficits, and limited export diversification (Guisinger & Irfan, 1980; Krueger et al., 2017). The influence of political factors on economic decision-making and the role of elites in shaping policies resulted in the challenges of governance, corruption, and political instability that have affected Pakistan's economic development (Khan, 2009).

External factors, such as foreign aid and geopolitical dynamics, have significantly shaped Pakistan's economic trajectory. Foreign aid has been crucial in financing development projects and addressing balance of payments issues. For instance, between 1960 and 2021, Pakistan received approximately 1.84 billion USD in foreign aid (World Bank, 2022). Geopolitical dynamics, including the impact of regional conflicts, such as the war in Afghanistan, have strained Pakistan's economy through increased security spending and refugee influxes.(Zaidi, 2015) Now, the Russo-Ukraine war has impacted the global markets. In the short term, the battle is expected to result in lower economic growth and increased inflation due to disruptions in energy and food markets. Long-term consequences hinge on policy responses, with a potential clash between energy security and green goals and disruptions in commodity markets impacting the transition to a low-carbon economy, possibly leading to a global recession.(Izzeldin et al., 2023) As a result, the developing economies, including Pakistan, bore the brunt of these external factors, adding to the complexities and challenges faced by Pakistan's economy.

A comprehensive understanding of Pakistan's economic state requires several crucial factors to be examined, such as Gross Domestic Product (GDP) and Economic Growth, Employment and Labor Market, Inflation and Price Stability, Trade and Balance of Payments (BOP), Fiscal Policy and Government Debt, Income Distribution and Poverty, Monetary Policy and Financial Sector Stability, Infrastructure and Human Capital, Political and Policy Environment, and External Factors and Global Economy.

The existing literature identified the relationships among these macroeconomic variables and their impacts during various conditions but lacked the whole picture of the stagnant economy of Pakistan. The current economic situation of Pakistan needs a thorough study of both Micro and Macro-Economic indicators to design effective policies. This paper aims to examine the current status of Pakistan's economic crisis and the major macroeconomic problems responsible for its decline, explore potential strategies for addressing these challenges, and get the struggling economy back on track.

2. Literature Review

2.1 Current Status of Pakistan's Economy

Pakistan is grappling with severe economic challenges rooted in long-standing structural weaknesses. Pakistan has made significant progress in poverty reduction in the last two decades. However, the country still faces serious issues related to human capital outcomes, such as high levels of impeding and learning poverty. According to World Bank data, the economic growth model has relied heavily on consumption, resulting in imbalances and frequent macroeconomic crises.(World Bank, 2023) The nation is currently dealing with economic stress marked by low foreign reserves, a depreciating currency, and high inflation rates. The situation was further aggravated by factors like catastrophic flooding in 2022 and global commodity price surges. The Post-Disaster Needs Assessment (PDNA) report by the Ministry of Planning Development & Special Initiatives estimated the regional and sectoral damages that depict economic activity decline across various sectors, such as agriculture, industry, services, and overall human development.

The recent floods in Pakistan are estimated to have caused significant infrastructural damage, amounting to around PKR 3.2 trillion (approximately USD 14.9 billion), equivalent to 4.8% of FY22 GDP (See Table 1 and 2). The agriculture, industry, and services sectors will each bear a portion of the losses. The disaster will have far-reaching effects on livelihoods, increasing poverty and multidimensional poverty rates. Around 8.4 to 9.1 million people may fall into poverty, with more profound impacts on households already in poverty (PDNA, 2022). Human capital losses and reduced land productivity could lead to longer-term declines in welfare. The floods are likely to exacerbate existing inequalities, affecting vulnerable groups disproportionately. Reversing the adverse effects will be a long-term process, requiring significant international support alongside domestic efforts to stabilize the economy and manage resources efficiently.

Table No 1: Flood Casualties by Region (million USD)

No.	Region	Damage	Loss	Need
1	Balochistan	1,625	2,516	2,286
2	Khyber Pakhtunkhwa	935	658	780
3	Punjab	515	566	746
4	Sindh	9068	11306	7860
5	Cross-Provincial	2,731	67	4,540
6	Special Regions	32	49	48
Grand Total		14,906	15,233	16,261

Source: Ministry of Planning Development & Special Initiatives, Author’s Compilation

Table No 2: Flood Casualties by Sector (million USD)

No.	Sector	Damage	Loss	Need
1	Social Sectors	6,261	896	3,872
2	Infrastructure Sectors	3,927	396	5,437
3	Productive Sectors	4,635	13,281	4,760
4	Cross-Cutting Sector	83	660	2,192
Grand Total		*14,906*	*15,233*	*16,261*

Source: Ministry of Planning Development & Special Initiatives, Author’s Compilation

In recent years, Pakistan's economy has seen significant challenges on both micro and macro levels. It heavily relies on trade and is struggling with persistent trade imbalances and a balance of payment crisis. The country's GDP growth rate has decreased while inflation and government debt have risen. Pakistan's economic freedom has declined, and it has relied on external borrowing. Various studies have highlighted the estimated decline of annual economic expansion from 5.8% in 2018 to 0.53% in 2020, resulting in a current account deficit. The country's current account balance has been under stress due to a higher value of imports than exports (Bhattacharya and Singh, 2022).

The overall status of Pakistan’s economy is examined through the rates of macroeconomic indicators such as GDP, Unemployment Rate, Inflation Rate, Interest Rates, Government Budget Deficit or Surplus, Exchange Rates, BOP, Consumption and Saving, and Investment.

Over the period from 2017 to 2023 (See Table 3), Pakistan's economic indicators have witnessed significant variations and fluctuations. The population grew steadily, increasing from 216.4 million in 2017 to 240.5 million in 2023. However, the GDP exhibited changes, rising to $376.4 billion in 2022 but projected to decrease to $341 billion by the end of 2023. Similarly, GDP per capita experienced fluctuations, dropping to $1322 in 2020 but expected to rise to $1474 in 2023. There is an excellent difference between nominal and real economic growth rates, as the higher the inflation rate, the more prominent the difference will be. The data in Table 3 displays.

Table No 3: Variation in Macroeconomic Indicators (2017-23)

Sr.	Indicators	2017	2018	2019	2020	2021	2022	2023
1	Population (million)	216.4	219.7	223.3	227.2	231.4	235.8	240.5
2	GDP (USD billion)	339	356.1	32.07	300.4	348.2	376.4	341
3	GDP per capita (USD)	1567	1621	1437	1322	1505	1597	1474
4	GDP (PKR billion)	35,553	39,190	43,798	47,540	55,836	66,624	84,658
5	Economic Growth (Nominal GDP ann. var. %)	8.6	10.2	11.8	8.5	17.5	19.3	27.1
6	Economic Growth (ann. var. %)	4.4	6.2	2.5	-1.3	6.5	6.2	0.3/0.5
7	Domestic Demand (ann. var. %)	6.8	7.4	2.5	-2.3	8.0	5.9	-1.3
8	Private Consumption (ann. var. %)	6.9	7.2	5.6	-2.9	9.5	6.8	1.7
9	Government Consumption (ann. var. %)	4.5	5.5	-1.6	8.5	1.8	-1.3	-7.2
10	Fixed Investment (ann. var. %)	7.7	10.3	-11.1	-6.7	3.7	5.7	-17.8
11	Exports (G&S, ann. var. %)	2.5	10.0	13.2	1.5	6.5	5.9	-8.6
12	Imports (G&S, ann. var. %)	19.0	15.7	7.6	-5.1	14.5	11	-17.8
13	Industrial Production (ann. var. %)	4.6	9.2	0.2	-5.7	7.8	7.2	-2.9
14	Unemployment (% of active population, aop)	5.8	5.8	6.9	6.6	6.3	--	--
15	Fiscal Balance (% of GDP)	-5.2	-5.8	-7.9	-7.1	-6.1	-7.9	--
16	Public Debt (% of GDP)	60.9	64.8	77.5	79.6	73.6	--	--
17	Inflation (CPI, ann. var. %, eop)	6.4	5.4	12.6	8.0	12.3	24.5	28.2
18	Inflation (CPI, ann. var. %, aop)	4.8	5.8	9.4	9.5	9.5	19.9	--
19	Policy Rate (%, eop)	5.75	10.00	13.25	7.00	9.75	16	--
20	Exchange Rate (PKR per USD, eop)	110	139	155	160	177	226	--
21	Exchange Rate (PKR per USD, aop)	105.4	121.6	149.8	161.8	162.8	204.6	--
22	Current Account Balance (USD billion)	-12	-19	-13	-4	-3	-17	-3
23	Current Account Balance (% of GDP)	-3.6	-5.4	-4.2	-1.5	-0.8	-4.7	-0.7
24	Merchandise Trade Balance (USD billion)	-26.0	-30.9	-27.6	-21.1	-28.6	-39.1	-24.1
25	Merchandise Exports (USD billion)	22	25	24	23	26	32	28
26	Merchandise Imports (USD billion)	48	56	52	44	54	72	52
27	Merchandise Exports (ann. var. %)	0.1	12.6	-2.1	-7.1	13.8	26.7	-14.1

28	Merchandise Imports (ann. var. %)	16.7	16.0	-6.8	-15.9	24.4	31.8	-27.3
29	Foreign Direct Investment (USD billion)	2	2	2	2	2	1	--
30	International Reserves (USD billion)	18	11	16	19	23	10	--
31	International Reserves (months of imports)	4.6	2.4	3.7	5.1	5.0	1.6	--
32	External Debt (USD billion)	83	95	106	113	122	130	--
33	External Debt (% of GDP)	24.6	26.7	33.0	37.6	35.1	34.7	--

Source: Focus Economics(Pakistan Economy: GDP, Inflation, CPI & Interest Rates - FocusEconomics, n.d.)- World Bank(GDP Growth (Annual %) | Data, n.d.)- World Population Review(Pakistan Population 2023 (Live), n.d.)- PBS - Statista(Pakistan - Gross Domestic Product (GDP) 2022 | Statista, n.d.)

volatility in economic growth rates; that is, the nominal growth rate has been raised from 8.0% in 2017 and is projected to be slowed down to 27.1% in 2023. At the same time, the actual growth rate has dropped from 4.4% in 2017 to 6.2 in 2022 and is projected to be lowered to 0.3/0.5 by the end of 2023. The fluctuation in inflation rates shows that in 2017, it was calculated as 6.4%, which was raised to 24.5% in 2022, and in the year 2023, it was estimated at 28.2% by the end of July.

The current account balance improved from -3.6% of GDP in 2017 to -0.8% in 2021 and is projected to rise slightly to -0.7% in 2023. However, external debt as a percentage of GDP exhibited an upward trajectory, increasing from 24.6% in 2017 to 35.1% in 2021. Additionally, international reserves substantially dropped from $23 billion in 2022 to $10 billion in 2023. These variations and fluctuations underscore the importance of effective economic management and policy decisions to maintain stability and foster sustainable growth in Pakistan's economy.

On the other hand, Pakistan experienced some positive developments as well. Despite the fluctuation (-5.8 in 2019 and -4.2 in 2020), the reduction in the current account deficit from -3.6% of GDP in 2017 to -0.7% in 2023 indicates progress in external balance. Additionally, the economy rebounded in 2021, demonstrating resilience and growth potential.

3. Methodology

A mixed-methods approach has been adopted in pursuance of the research objectives. The data has been collected from authentic primary sources such as the State Bank of Pakistan (SBP), Pakistan Bureau of Statistics (PBS), Ministry of Finance (GoP), Focus Economics, Asian Development Bank (ADB), World Bank (World Bank), International Monetary Fund (IMF) reports, Economic Freedom, United States Institute of Peace (USIP), and WorldoMeter, as well as an in-depth study of literature from reliable secondary sources, including books, journal articles, working papers, policy papers, reports, etc., written by institutional and individual experts in the fields of economics and public policy.

4. Results

4.1 Macroeconomics and its Indicators

Macroeconomics examines variables such as Gross Domestic Product (GDP), Unemployment Rate, Inflation Rate, Interest Rates, Government Budget Deficit or Surplus, Exchange Rates, Balance of Payments (BOP), Consumption and Saving, and Investment. The top 11 macroeconomic indicators are divided into leading and lagging indicators. Leading indicators include the stock market, house prices, bond yields, production and manufacturing statistics, retail sales, and interest rates. Lagging indicators encompass GDP growth rates, the Consumer Price Index (CPI) and inflation, currency strength and stability, labor market statistics, and commodity prices (XTB, 2024). These variables have multidimensional and proportional (cause and effect) relationships. Additionally, these variables, among others, are used to analyze and model the dynamics of an economy, understand the relationships between different sectors, and formulate policies to achieve desirable economic outcomes.

For example, GDP is a measure of economic development. Still, factors such as inflation, trade imbalances, declining foreign investment, and currency crises can negatively impact a country's GDP. Foreign direct investment (FDI), exchange rates, and trade deficits significantly determine GDP. Global events and conflicts can affect commodity prices and inflation, affecting GDP growth forecasts. Currency shortages, like the shortage of dollars in Pakistan, can lead to scarcity of essential imports and capital flight.(Zaheer et al, 2022) Similarly, Fiscal policy plays a crucial role in Pakistan's economy, with government expenditure stimulating GDP and interest rates, while taxes have varying effects. Government actions influence private consumption and investment, and prices respond with a lag.(Munir and Riaz, 2019) Therefore, a thorough study of every variable that has any cause or effect on the performance of an economy is essential to analyze the performance critically.

4.2 Macroeconomic Problems of Pakistan

The major problems of Pakistan’s economic downfall include the defaulting state of the country, foreign reserves, currency depreciation, high inflation rates, increasing unemployment and poverty, fleeing population, etc., resulting in a large capacity of brain drain to the country. The discussion of this study will follow a cause-and-effect approach, which will better explain the inter-relationship of the variables and their causes.

4.3 Fiscal Challenges - High Fiscal Deficit and Growing Public Debt Burden

The major macroeconomic issues of Pakistan’s stagnant economy, which needs serious concerns, include the fiscal deficit and the growing public debt burden. The persistent fiscal deficit in Pakistan has strained public finances, limiting government spending on crucial sectors such as infrastructure, education, healthcare, etc. Pakistan’s fiscal policy always followed an expansionary pattern: the government's expenditure was higher than the revenue generated. Consequently, it has increased its fiscal deficit, leading her to accumulate more debt. The relationship between fiscal policy, fiscal deficit, and public debt burden is complex and influenced by various factors, including the state of the economy, interest rates, investor confidence, and government credibility.

The relationship between macroeconomic policies, fiscal vulnerability, and financial stress in Pakistan from 1971 to 2020 depicted a long-run proportionate relationship. Bidirectional causality exists between fiscal vulnerability and macroeconomic policy, implying that they influence each other.(Chandia K. E., et al, 2022) Fiscal vulnerability causes stress in the financial sector, and the studies showed a weak causal relationship between macroeconomic policies and financial stress.

The Pakistan Economic Survey 2022-23 (See Table 4) reflects the government's fiscal performance over several years. The major trends observed a consistent rise in total expenditure from FY2016 to FY2020, driven by increases in both current and development expenditures, possibly indicative of government efforts to stimulate economic growth and address pressing needs. However, the fiscal deficit, while generally negative (indicating a surplus) in earlier years, has turned increasingly hostile since FY2019, suggesting a growing reliance on debt to cover expenditures. This is compounded by the persistent positive revenue deficits, revealing an imbalance between revenue generation and current spending. The budget estimation for FY2023 shows a slight improvement, with a smaller fiscal and revenue deficit, but still relies on borrowing.

However, the data underscores the need for careful fiscal management to ensure sustainable economic growth and avoid excessive debt accumulation.

Table No 4: Trends in Components of Expenditure (% of GDP) 2016-23

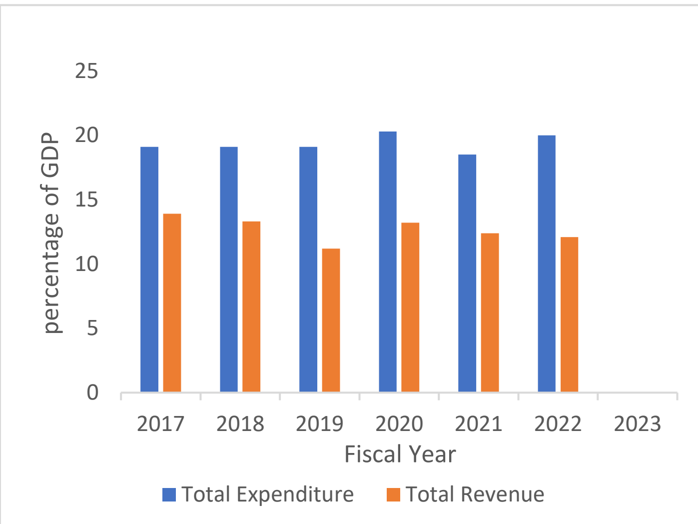
Year	Total Expe-diture	Current Expen-diture	Markup Pay-ments	Defense	Develop ment Expendit ure	Non-Interest Non-Defense Exp	Fiscal Deficit	Revenue Deficit
FY2016	17.7	14.3	3.9	2.3	4.0	11.5	4.1	-0.8
FY2017	19.1	14.6	3.8	2.5	4.8	12.8	5.2	-0.7
FY2018	19.1	14.9	3.8	2.6	4.0	12.7	5.8	-1.6
FY2019	19.1	16.2	4.8	2.6	2.7	11.7	7.9	-5.0
FY2020	20.3	17.9	5.5	2.6	2.4	12.2	7.1	-4.8
FY2021	18.5	16.3	4.9	2.4	2.2	11.2	6.1	-3.9
FY2022	20.0	17.3	4.8	2.1	2.4	13.1	7.9	-5.2
FY2023 (Budget Estimation)	18.1	15.6	5.1	2.0	2.4	11.1	4.9	-2.3

Markup Payment: This refers to payments made on loans or interest payments on government debt. It's the cost of servicing the debt.

Source: Budget Wing, Finance Division and EA Wing's Calculations(Wasti, 2021), Author’s Compilation

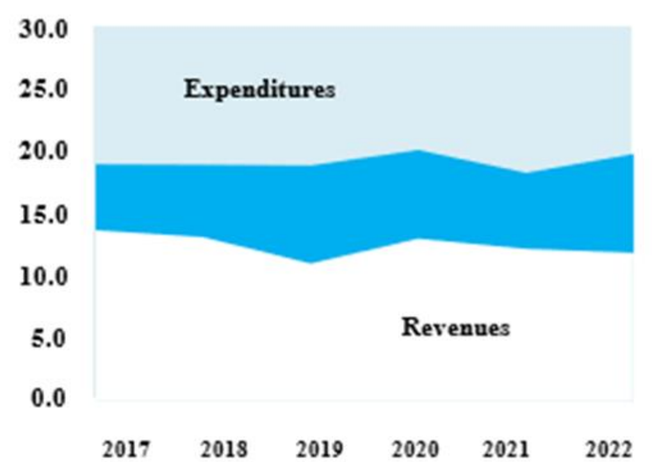
In FY2022 (Figures 1 and 2), government expenditures experienced an exceptional surge that surpassed revenue growth, placing significant pressure on the fiscal sector. This expanded the gap between revenue and spending, leading to a marked deterioration in fiscal performance indicators. This scenario underscores the importance of prudent fiscal management, emphasizing the necessity of aligning expenditures with revenue streams to uphold fiscal stability and sustainability. Addressing this challenge is paramount to prevent further degradation of the government's financial standing and to promote enduring economic resilience.

Figure No 1: Expenditure-Revenue Percentage of GDP



Source: Ministry of Finance Government of Pakistan(Wasti, 2021)

Figure No 2: Revenue-Expenditure Gap (Percentage of GDP)



Source: Ministry of Finance Government of Pakistan

The high debt burden poses risks to macroeconomic stability and reduces fiscal space for development initiatives.(Bhattacharya and Singh, 2022) On the other hand, public debt impacted the country's economic growth. Various studies identified a negative relationship between public external debt and per capita GDP and investment, indicating "Debt Overhang effects." Debt servicing hurts short-term per capita GDP, but its impact on investment is inconclusive (Akram, 2011). Debt financing is crucial for governments to bridge fiscal gaps, but high reliance on external debt has hindered Pakistan's growth, with significant revenue allocated to debt servicing. Domestic debt is linked to increased consumption and reduced investment, while external debt negatively affects consumption and investment but positively influences exports. Interest rate dynamics play a role in the relationship between debt and investment, while high external debt leads to increased interest rates and reduced consumption.(Rais, 2012).

According to the Fiscal Responsibility and Debt Limitation (FRDL) Act 2005, the “Total Public Debt” is debt that the Government owes (both Federal and Provincial) and is serviced out of consolidated funds and debts owed to the International Monetary Fund. The trend of the total debt burden of Pakistan from FY2013 till FY2023 is presented (See Tables 5 and 6). Apart from financing the fiscal deficit, the depreciation of the Pak-Rupee vis-a`-vis the US Dollarby around 39 per cent led to a significant increase in the stock of external public debt when converted into Pak-Rupee. The main factors behind the rise in total public debt during the first nine months of the ongoing fiscal year vis-à-vis the corresponding period of last year.

Table No 5: Total Public Debt 2013-23 (Billion Rs)

	Jun-13	Jun-18	Jun-19	Jun-20	Jun-21	Jun-22	Mar-23
Domestic Debt	9,520	16,416	20,732	23,283	26,265	31,085	35,076
External Debt	4,771	8,537	11,976	13,116	13,601	18,157	24,171
Total Public Debt	14,292	24,953	32,708	36,399	39,866	49,242	59,247
Total Debt of the Government	13,457	23,024	29,521	33,235	35,669	44,361	54,392
(Memorandum Items)							
GDP (current market price)	25,042	39,190	43,798	47,540	55,836	66,624	84,658
US Dollar (end of period av.)	99.1	121.5	163.1	168.2	157.3	204.4	283.8

Source: Budget Wing and Debt Management Office, Ministry of Finance(Division, 2023)

Table No 6: Trend in Total Public Debt (Billion Rs)

Year	Domestic Debt	External Debt	Public Debt
2007	2,601	2,201	4,802
2008	3,274	2,853	6,127
2009	3,860	3,871	7,731
2010	4,653	4,357	9,010
2011	6,014	4,756	10,771
2012	7,638	5,059	12,697
2013	9,520	4,771	14,292
2014	10,907	5,085	15,991
2015	12,193	5,188	17,380
2016	13,626	6,051	19,677
2017	14,849	6,559	21,409
2018	16,416	8,537	24,953
2019	20,732	11,976	32,708
2020	23,283	13,116	36,399
2021	26,265	13,601	39,866
2022	31,085	18,157	49,242
2023	35,076	24,171	59,247

Source: Finance Division - State Bank of Pakistan, Debt Management Office(Division, 2023)

The overall cause-and-effect cycle in fiscal mismanagement indicates that sovereign debt crises result from governance failures and unjust systems, leading to a cycle of borrowing, economic deterioration, and loss of state capacity. Pakistan's history of colonial rule and subsequent governance deficiencies have contributed to its persistent public debt burden.(Zaman, 2023) Resultantly, the increase in public debt during specific periods indicates the challenges faced by the country in managing its debt burden. Domestic and external debt harm economic growth, with domestic debt being associated with increased consumption expenditure and exports but decreased investment. External debt is found to affect consumption and investment while positively impacting exports (Syed et al., 2022).

4.4 Weak Tax Base and Reliance on the Informal Sector

Another factor contributing effectively to Pakistan's economic challenges is its weak tax base and heavy reliance on the informal sector. The limited tax collection hampers the government's ability to finance essential public services and infrastructure projects.(Khalid et al., 2023) Moreover, the informal sector's dominance leads to a loss of potential tax revenue and a lack of formalization, impeding economic growth and hindering the implementation of effective regulatory measures. The higher tax rates have a positive and significant impact on the size of the informal economy, indicating tax evasion, and studies have proved a positive association between the informal economy and tax evasion.(Qamar et al., 2020) Pakistan faces the challenge of a low tax-to-GDP ratio due to weak tax administration, widespread tax evasion, and a narrow tax base. The limited revenue collection capacity hampers the government's ability to finance public expenditure and invest in critical infrastructure. Table 7 presents the overall Tax Collection Structure of the Federal Board of Revenue.

Table No 7: Federal Tax Revenue

Year	Total FBR	Tax Rev (% of GDP)	Direct Taxes (Billion Rs)	Indirect Taxes (Billion Rs)
FY2016	3,112.7	9.5	1,217.3 (39.1%)	1,895.4 [60.9%]
FY2017	3,367.9	9.5	1,344.2 [39.9%]	2,023.7 [60.1%]
FY2018	3,843.8	9.8	1,536.6 [39.7%]	2,307.2 [60.0%]
FY2019	3,828.5	8.7	1,445.5 [37.8%]	2,383.0 [62.2%]
FY2020	3,997.4	8.4	1,523.4 [38.1%]	2,474.0 [61.9%]
FY2021	4,745.0	8.5	1,731.3 [36.5%]	3,013.7 [63.5%]
FY2022	6,148.5	9.2	2,284.9 [37.2%]	3,863.6 [62.8%]
FY2023 (B.E)	7,470.0	9.6	3,039.0 [40.7%]	4,431.0 {59.3%}

Source: Federal Board of Revenue

Although the informal economy is vital in addressing unemployment and poverty, it also distorts official economic estimates and hinders effective policymaking. Balancing the benefits and limitations of the informal sector is crucial for promoting inclusive and sustainable economic development in developing countries. However, the studies suggest that factors such as a lack of institutional infrastructure, ineffective policies, and complex regulations may contribute to the growth of the underground economy. When citizens perceive corruption, mismanagement of tax revenue, and a weak rule of law, they are more likely to engage in informal economic activities. (Ali & Hussain, 2021) In the contemporary economic and political condition of Pakistan, the formalization of the informal economy would be beneficial as it has multiple benefits, including increased tax revenues, improved business activities through digitalization and skill development, expansion of small businesses, enhanced production and diversification, and better conditions for low-wage earners.(Khan et al., 2020)

4.5 Monetary Policy and Challenges

Monetary policy refers to the actions and strategies implemented by a country's central bank. The primary goal of monetary policy is to achieve specific macroeconomic objectives, such as controlling inflation, controlling prices, promoting economic growth, and maintaining full employment through various tools such as Open Market Operations, Reserve Requirements, Discount Rates, and Interest Rate Policy. The current condition of inflation, unemployment, and stagnant economic growth shows that the central bank of Pakistan or Pakistan’s monetary authority, failed in its strategies to control and regulate the money supply and interest rates and could not maintain stability in the economy.

The monetary policy is made and run by State Bank of Pakistan and have nothing to do with fiscal policy makers. The two instruments of the monetary policy such as money supply and interest rate, are interconnected with each other. according to the monetary policy of Pakistan, State Bank announces the discount rate (interest rate) in every three months.

4.6 Trade Imbalance and Persistent Current Account Deficit

The trade imbalance can lead to external imbalances, which can have positive (Foreign Capital Inflows and Consumption and Investment) and negative (Debt Accumulation, Currency Depreciation, External Vulnerability, and Loss of Competitiveness) effects on the economy (Ali & Audi, 2023). According to the literature and reports reviewed for this article, Pakistan is facing adverse effects so far. Frequent energy shortages and an inadequate power supply infrastructure have been major macroeconomic hurdles in Pakistan. Insufficient energy availability has negatively impacted industrial productivity, hindered investment, and constrained economic growth.

South Asian economies, including Pakistan, have persistently high current account deficits, impacting growth and living standards. Pakistan has sought multiple bailouts from organizations such as the International Monetary Fund (IMF), World Bank, Asian Development Bank (ADB), and various countries to finance development projects, address the balance of payment challenges, and support economic reforms. While expert studies indicate that real appreciation (depreciation) can lead to an improvement (deterioration) in the current account balance, trade openness and population growth positively affect the deficit, and increasing Net Foreign Assets (NFA) helps reduce the deficit. (Shah, 2022)

Pakistan's trade imbalance, with imports surpassing exports, has contributed to a growing current account deficit. Structural issues, such as a lack of export diversification and limited competitiveness, have hindered efforts to address trade imbalances and promote sustainable economic growth. The trend of Pakistan's exports of significant items remains more or less similar, having concentrated on three things: cotton manufacturing, leather and rice (See Table 8). These three categories account for 68.1 per cent of total exports during Jul-Mar FY2023.

Table No 8: Percentage Share of Major Exports of Pakistan

Commodity	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**July-March**	
							2021-22	**2022-23**
Cotton Manufactures	56.5	61.7	56.4	56.6	59.0	59.3	59.2	57.3
Leather and Leather manufactured	4.1	4.2	3.7	3.6	3.3	3.0	3.0	3.2
Rice	8.8	7.7	9.0	10.2	8.1	7.9	7.7	7.6
Sub-Total of three Items	**69.4**	**73.6**	**69.1**	**70.4**	**70.4**	**70.2**	**69.9**	**68.1**
Other items	30.6	26.4	30.9	29.6	29.6	29.8	30.1	31.9
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Pakistan Bureau of Statistic-Finance Division GOP(GOP, n.d.)

Taking the exports of FY2023 (See Table 9), Pakistan's export landscape exhibited mixed results across sectors. In Basmati, exports of rice (Food Group) decreased significantly, notably to Afghanistan and China. Fruit exports declined despite increased quantity, while vegetables fell in value and quantity. Fish and fish preparation exports grew due to lifted sanctions and diversification. Meat exports surged, particularly to Gulf countries and Malaysia. The textile sector faced multiple challenges, resulting in a 12.4 per cent decline in exports. Other sectors like petroleum, leather, sports goods, cement, guar, chemicals, and pharmaceuticals experienced fluctuating export values and quantities influenced by various factors. The medical sector grappled with evolving regulations and changing market preferences. Adapting to global trends and regulations is vital for sustained export growth.

Table No 9: Variation in Pakistan's Exports-FY 2021-22/2022-23

Groups	July-March Values in Million USD		
	2021-22	2022-23	Percentage Change
Food Group	3947.7	3815	-3.4
Textile Manufactures	14242.6	12476.4	-12.4
Petroleum Group	235.9	216.1	-8.4
Other Manufactures	4693.8	4306.5	-8.3
All Other items	1941.2	1605.1	-17.3
Total	23350.0	21036.2	-9.9

Source: Ministry of Finance Government of Pakistan(GoP, n.d.)

On the other hand, in fiscal year 2022-23 (See Table 10), Pakistan saw an increase in food imports by 3.8%, mainly driven by higher imports of edible oils like soybeans and palm oil. However, the petroleum group imports declined by 11.7%, largely due to reduced imports of petroleum products. Machinery group imports dropped by 48.2%, with notable power-generating and textile machinery declines. Telecom imports decreased by 65.1%, while transport and metal group imports also saw significant reductions of 54.4% and 33.3%, respectively. Additionally, there was an increase in raw cotton imports within the textile group, rising by 6.1% in quantity and 16.3% in value compared to the previous year.

Table No 10: Variation in Pakistan's Imports-FY 2021-22/2022-23

Groups	July-March Value in Million USD		
	2021-22	2022-23	Percentage Change
Food Groups	7068.1	7333.7	3.8
Machinery Group	8676.3	4496.4	-48.2
Petroleum Group	14,810.1	13,083.1	-11.7
Consumer Durables	4,335.2	2,603.2	-40.0
Raw Materials	9,596.6	7123.9	-25.7
Telecom	2137.1	744.9	-65.1
All Other Items	4411.1	3439.5	-22.0
Total	58858.5	43727.2	-25.7

Source: Ministry of Finance Government of Pakistan

The critical issues of the Current Account deficit and Budget Deficit and its effects on Pakistan's economy are crucial to be examined. A recent study indicated them as a twin deficit phenomenon, where an increasing budget deficit exacerbates the trade deficit and negatively impacts the economy through inflation, public and external debt growth, lower living standards, and reduced purchasing power. Financing the budget deficit through borrowing adds to the national debt. While a budget deficit can stimulate short-term economic growth, persistent and large deficits can lead to inflation, higher interest rates, and economic slowdown. The twin deficits in Pakistan have long-term implications for economic development and may trigger debt and currency crises (Waheed & Akram, 2023).

The data illustrates a persistent current account deficit for the last decade (See Table 11). A current account deficit occurs when a country's goods, services, and investments (debit) imports exceed its exports (credit). This deficit implies that the country consumes more than it produces and relies on foreign sources to finance this gap. This trend suggests that the country has been relying on external financing or drawing down its foreign exchange reserves to sustain its consumption and economic activities, which can affect the overall health of its economy and its external debt.

Table No 11: Balance of Payment – Current Account

Period	Current account - Original Series (Million USD)		Current account - Seasonally Adjusted Series (Million USD)	
	Credit	Debit	Credit	Debit
FY 2013-14	51,153	54,283	51,084	54,264
FY 2014-15	52,897	55,712	52,774	55,567
FY 2015-16	51,242	56,203	50,945	55,891
FY 2016-17	52,218	64,488	52,094	64,353
FY 2017-18	55,145	74,340	55,327	74,593
FY 2018-19	55,791	69,225	56,036	69,313
FY 2019-20	54,254	58,703	54,066	58,403
FY 2020-21	65,119	67,939	65,056	67,726
FY 2021-22	73,196	90,677	73,104	90,813
FY 2022-23	64,548	66,935	64,517	67,176
FY 2023-24	4,871	5,680	5,008	5,561

The amounts of the Current Account include all Goods and Services as well as Primary and Secondary Income.
Source: Pakistan Bureau of Statistics(GOP, 2023)

4.7 Energy Crisis

The energy crisis in Pakistan has been a persistent challenge that has severely impacted the country's economy, industries, and the daily lives of its citizens. Power shortages, inadequate energy infrastructure, and an imbalance between energy supply and demand characterize the crisis.(Khan et al., 2020) Several factors have contributed to the energy crisis in Pakistan, such as insufficient energy production capacity, overreliance on fossil fuels, inadequate investment in energy infrastructure, theft and line losses, population growth and urbanization, and geopolitical factors. Pakistan struggles with high energy prices, high demand, and a global economic downturn contributing to supply-chain disruptions.

Currently, and specifically after the beginning of the Russo-Ukraine war, Pakistan's energy sector is highly influenced by external political factors; oil price volatility greatly affected stock returns in 13 Asian economies. The war's impact on global humanitarian and economic activities, especially the energy sector, influence stock markets non-uniformly.(Raifu et al., 2023) This energy crisis in Pakistan has significant consequences for the country's already halted economic growth, industrial productivity, and social well-being. Frequent power outages disrupt business operations, hamper economic activities, and affect the quality of life for citizens, particularly during hot summer months when electricity demand is at its peak. The pressing challenge of the energy crisis demands a two-fold approach. Firstly, building resilience in the energy sector is essential to ensure a stable and reliable power supply. Secondly, supporting financial markets through domestic capital financing and implementing safeguards against potential crises is crucial for economic stability and growth.

4.8 Weak Governance, Corruption and Political Instability

The economic crisis in Pakistan has been significantly exacerbated by factors such as weak governance, corruption, and political instability. These issues have worsened existing challenges and impeded the country's ability to achieve sustainable economic growth. Weak governance has led to policy inconsistencies, insufficient economic planning, and mismanagement, further contributing to the economic woes faced by Pakistan (Kalim & Afridi, 2020). Inadequate regulatory oversight allows rent-seeking and resource misuse, hampering private sector development and investment. Moreover, public services and infrastructure inefficiencies hinder economic productivity and competitiveness, limiting the country's growth potential. Corruption in Pakistan undermines public trust in institutions and deters domestic and foreign investments due to the climate of uncertainty.

Misallocating resources and bribery disrupt market forces, resulting in economic inefficiencies and reduced productivity. Diversion of public funds through corrupt practices hampers investments in crucial sectors like healthcare, education, and infrastructure, hindering overall economic development (Sakib, 2021). Political instability in Pakistan fosters uncertainty, eroding investor confidence and causing capital flight and reduced investments (Tabassam et al., 2016). Frequent policy reversals and delays in economic reforms hinder progress in addressing structural issues and macroeconomic imbalances. The lack of policy continuity and short-term focus impede sustainable economic development, hindering long-term planning and growth prospects.

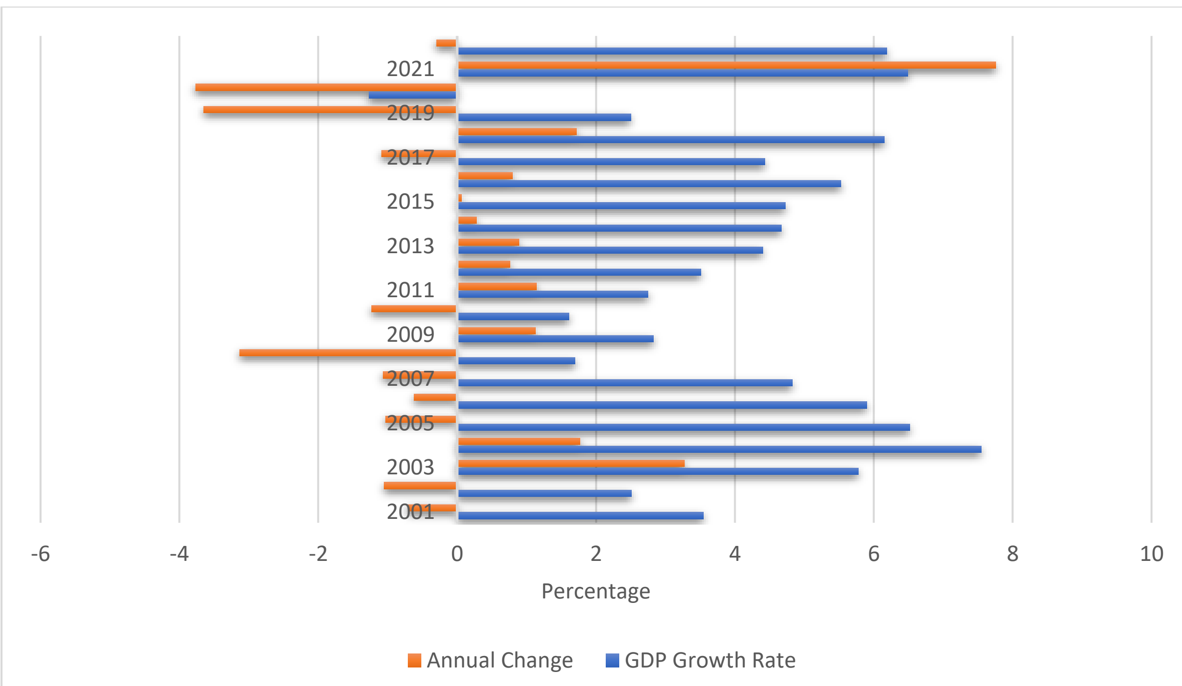
4.9 Implications of Macroeconomic Challenges

The study has found the effects of the economic meltdown through various indicators such as:

4.10 Economic Growth

The macroeconomic problems faced by Pakistan have hampered economic growth rates. Insufficient public investment, limited resources for human capital development, and a challenging business environment have impeded productivity and hindered overall economic progress. The macroeconomic challenges have contributed to persistent inflationary pressures in Pakistan. Rising prices erode purchasing power, disproportionately affecting vulnerable populations and exacerbating socio-economic inequalities.

Figure No 3: Economic Growth Rate of Pakistan



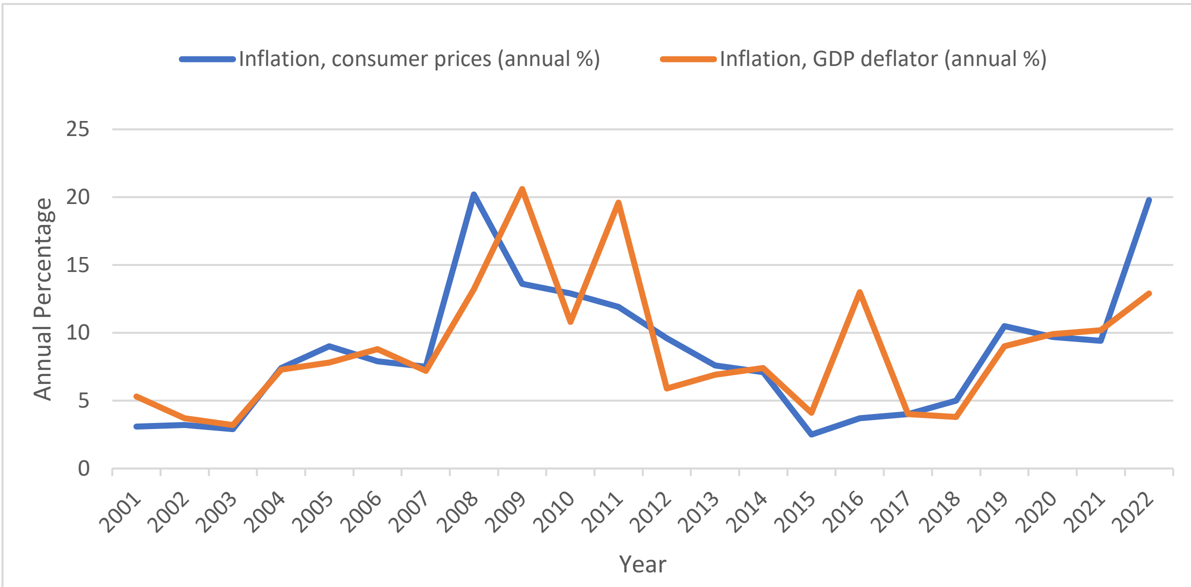
Source: Macrotrends and WDI, Author's Compilation

4.11 Inflation and Purchasing Power

The annual inflation rates based on consumer prices and the GDP deflator from 2001 to 2022 (See Figure 4) show the varying inflation levels over the years, with a notable increase in 2008 during the financial crisis and elevated rates in 2010, 2011, and 2019 for consumer prices.

While consumer price inflation generally remains lower and more stable, GDP deflator inflation experienced higher fluctuations, notably in 2009, 2011, and 2022. A dip in both metrics in 2016 suggests unique economic conditions, and the years 2020 and 2021 stand out with elevated

Figure No 4: Inflation in Pakistan



inflation, potentially influenced by global events.

Source: World Bank

1. Inflation, consumer prices (annual %): This metric reflects the annual percentage change in consumer prices, indicating the general increase in the cost of living.
2. Inflation, GDP deflator (annual %): This metric measures the annual percentage change in the GDP deflator, representing overall economic price changes relative to a base year.

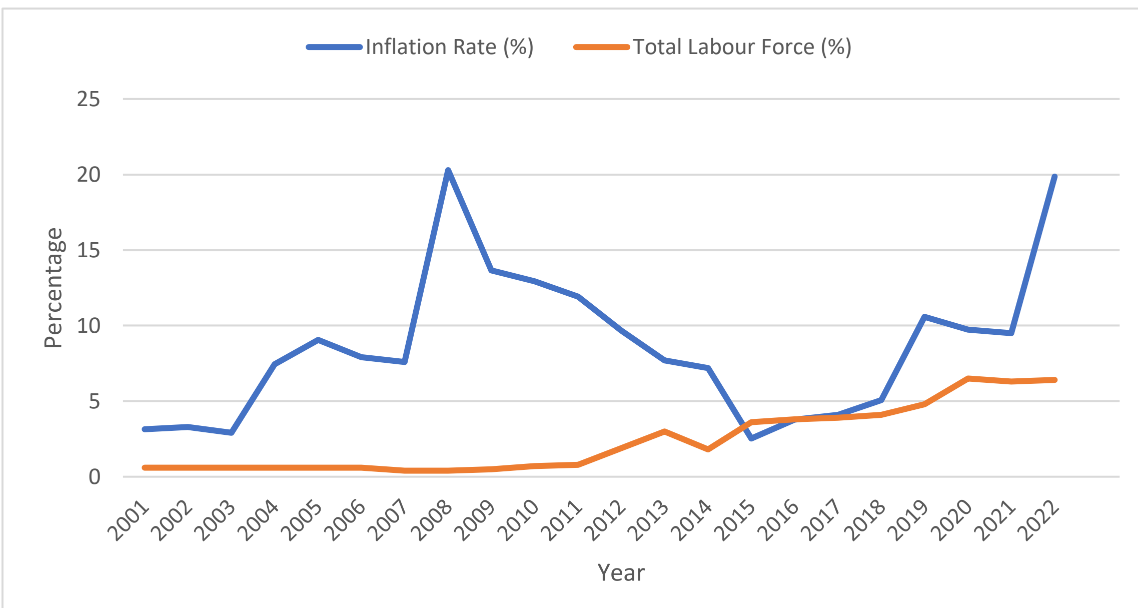
Consumer spending, government expenditure, variation in cost input of final good production, taxes, money supply, interest rates, prices and wage decision, and currency depreciation influence inflation.(Shaikh et al., 2022) The expert studies explored a long-run relationship between money supply, interest rates and inflation in Pakistan, which suggests that changes in the money supply and interest rate significantly impact the overall price level in the economy. Money supply and the rate of interest have a positive relationship with inflation. An increase in money supply and higher interest rates can contribute to inflationary pressures in the economy (Nasir et al., 2021).

Considering the energy sector, if electricity is produced from oil resources (Fossil fuels due to their high prices), it will contribute to an increase in inflation, which depicts that the availability and cost of energy and the level of government spending can impact the price levels in the economy. A decrease in broad money (money supply) and the real effective exchange rate led to higher inflation in the long run. Specifically, a 1% increase in electricity production is associated with a 0.079622% increase in inflation and a 1% increase in agriculture prices is associated with a 2.3349% increase in inflation. On the other hand, a 1% increase in broad money and the real effective exchange rate decreases inflation by -0.38241% and -0.44913%, respectively (Khan & Chaudhary, 2020). This implies that controlling the money supply and maintaining a stable exchange rate can help to lower inflation.

4.12 Inflation and Unemployment

There are significant reasons for inflation. Pakistan is suffering from inflation due to reasons such as Demand-Pull Inflation (Strong consumer spending, Expansionary fiscal policies, loose monetary policies), Cost Push Inflation (Increase in input costs, Supply disruptions due to Natural disasters and geopolitical tensions), Built-in inflation (wage-price inflation), and currency depreciation (as Pakistan is dependent on imports than exports). Therefore, it will not be said wrong that Pakistan is not only in the phase of inflation but stagflation (Fernando, 2024). The graph below shows the relative rising inflation and unemployment rates since 2001.

Figure No 5: Inflation vs Unemployment



Source: World Bank WDI

4.13 Poverty and Social Unrest

Pakistan is struggling with a multidimensional poverty having three dimensions, such as health (indicators: nutrition and child mortality), education (indicators: schooling years and attendance), and living standard (indicators: energy, sanitation, drinkable water, housing and assets). The macroeconomic problems have resulted in high unemployment and underemployment rates, contributing to poverty and social unrest. Insufficient job creation, particularly in the formal sector, challenges inclusive growth and poverty reduction.

Indicators	2020	2021
Maternal Mortality Ratio (Per 100,000 Births)	154	-
Neonatal Mortality Rate (Per 1,000 Live Births)	40.4	39.4
Mortality Rate, Infant (Per 1,000 Live Births)	54.4	52.8
Under-5 Mortality Rate (Per 1,000 Live Births)	65.5	63.3
Incidence of Tuberculosis (Per 100,000 People)	255	264
Life Expectancy at Birth, (Years)	66.3	66.1
Births Attended by Skilled Health Staff (% of Total)	68.0	-
Immunization, Measles (% of children ages 12-23 months)	83.0	81.0
Prevalence of HIV, Total (% of Population Ages 15-49)	0.2	0.2
	2018	***2019***
Prevalence of Anemia in Women of Reproductive Age (Aged 15-49) %	41.4	41.3
Infants Exclusively Breastfed (Aged 0-5 months) %	47.5	47.8
Stunting Prevalence Among Children (Under Age 5) %	37.6	-
Wasting Prevalence Among Children (Under Age 5) %	7.1	-

Table No 12: Health and Nutrition Indicators

Sources: Pakistan Economic Survey 2022-23

Table No 13: Literacy Rate 2020-2021

Area	Male	Female	Total
Pakistan	73.4	51.9	62.8
Rural	67.2	40.8	54.0
Urban	83.5	70.8	77.3
Punjab	74.2	58.4	66.3
Rural	69.0	48.9	58.8
Urban	82.5	74.3	78.5
Sindh	72.9	49.7	61.8
Rural	58.8	26.8	43.3
Urban	85.2	69.9	77.9
Khyber Pakhtunkhwa	72.8	37.4	55.1
Rural	70.1	33.5	51.7
Urban	85.8	57.8	72.3
Balochistan	69.4	36.8	54.5

Rural	65.0	31.1	49.5
Urban	80.0	50.9	66.8

Source: Labour Force Survey, Pakistan's Economic Survey 2023, GOP

4.14 Balance of Payments and Foreign Exchange Reserves

The trade imbalances and limited export competitiveness have strained the balance of payments and put pressure on foreign exchange reserves. This vulnerability has implications for exchange rate stability, import capabilities, and external debt sustainability.

Table No 14: Monetary Indicators

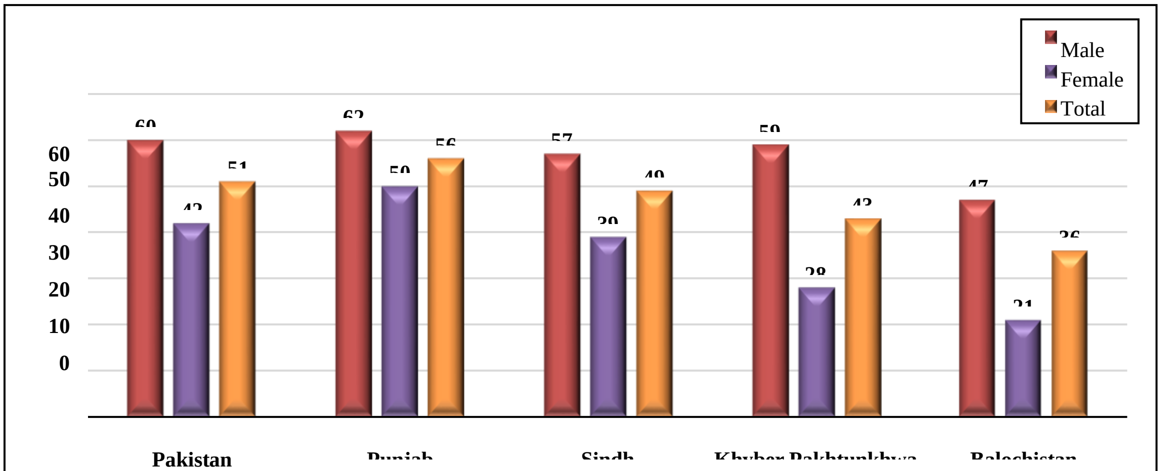
		Flow			
Indicators		**FY2021**	**FY2022**	**31-March-2023**	**01-Apr-2022**
Net Foreign Assets (NFA)	-753.2	1,240.9	-1,478.0	-2060.6	-1197.7
Net Domestic Assets (NDA)	28,355.9	2,148.8	4,782.9	3254.2	1896.2
Net Government Borrowing	19,622.9	1,717.9	3,357.7	2389.7	883.4
Borrowing for Budgetary Support	18,506.5	1,625.2	3,133.0	2414.5	938.5
From SBP	5,141.4	-1,206.3	-191.1	405.8	52.4
From Scheduled Banks	13,365.0	2,831.5	3,324.1	2008.8	886.1
Credit to Private Sector	9,241.2	766.2	1,612.1	302.2	1199.3
Credit to Public Sector Enterprises (PSEs)	1,393.4	-53.8	-43.3	197.1	4.2
Broad Money	27,602.6	3,389.7	3,304.9	1193.7	698.4
Reserve Money	9,326.5	983.6	663.1	816.7	391.5
Growth in M2 (%)		16.2	13.6	4.32	2.87
Reserve Money Growth (%)		12.8	7.7	8.76	4.52

Source: State Bank of Pakistan

3.15 Currency Depreciation

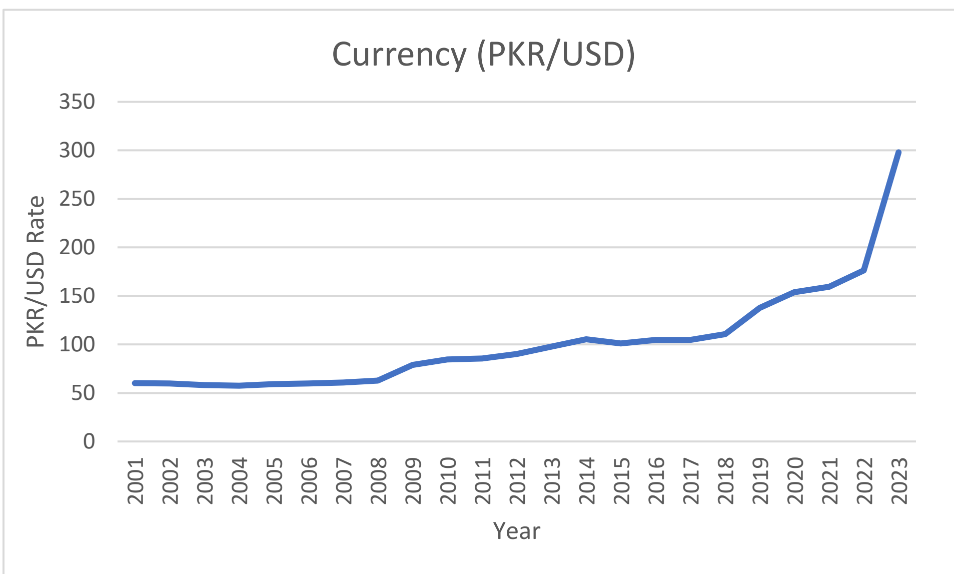
Pakistani currency has undergone a substantial depreciation over the past two decades. According to data obtained from reputable sources such as the World Bank and other prominent economic databases (See Figure 5), a discernible trend of depreciation is evident in the exchange rate between the Pakistani Rupee (PKR) and the United States Dollar (USD) over 22 years. To elucidate, in 2001, the exchange rate stood at 60 PKR per USD, whereas as of 2023, the exchange rate has surged to a noteworthy valuation of 298 PKR per USD. This data underscores a considerable devaluation of the Pakistani Rupee vis-à-vis the United States Dollar during the period above.

Figure No 6: Population that has Completed Primary School or Higher



Source: PSLM Survey 2019-20

Figure No 7: Currency Depreciation



Source: *World Development Indicators - Data Bank*(*World Development Indicators | DataBank*, n.d.)*, Author's Compilation*

5. Conclusion and Recommendations

In the context of the above set of macroeconomic analysis of Pakistan, a set of relevant fiscal and monetary policies must be adopted according to the state's economic condition, as they both play critical roles in influencing the overall economic conditions and achieving specific policy objectives. Still, in the current macroeconomic crisis, Pakistan needs active macroeconomic management gears of both monetary and fiscal ends to revise its policies to revive the country's economy.

1. On the monetary end, to control the inflation rate of 39.5%, currently, banking departments need to control the excessive money supply through the issuance of bonds, increasing the discount rates and investment rates as these monetary tools are inversely proportional to the money circulation.
2. On the fiscal end, the government needs to shift from an expansionary fiscal policy to a contractionary fiscal policy, such as reducing government expenditure or increasing taxes to control inflation or consolidate debt, which results in a lower fiscal deficit. However, through understanding the need, the government must not increase the taxes to burden the already burdened taxpayers. Still, it should design policies to formalize informal economies and stop non-taxpayer evasion. The government can decrease its borrowing needs and work towards stabilizing or reducing the public debt-to-GDP ratio.
3. Additionally, strict action against illegal transaction systems and registering them for tax purposes can generate legitimate income and ensure proper tax collection. It is also crucial to establish regularized tax rates.
4. Policymakers, along with effective fiscal management, should focus on enhanced domestic revenue generation and improved public expenditure quality to alleviate the burden of public debt.
5. Addressing trade imbalances is crucial for enhancing external sustainability and reducing reliance on foreign borrowing. Policymakers must prioritize export-oriented policies, diversify the export base, and encourage competitiveness to bolster trade prospects.
6. Encouraging foreign and domestic investment and promoting industrial growth is essential for more productivity and also for job creation and long-term economic sustainability.
7. To address persistent current account deficits and external imbalances, Pakistan needs to implement a mix of policies, including promoting export-oriented industries, encouraging foreign direct investment, improving domestic productivity, implementing sound fiscal and monetary policies, and managing external debt responsibly. Sustainable economic growth and stability are key to addressing external imbalances and ensuring long-term economic prosperity.
8. It is crucial to improve institutional quality, promote shared responsibility between citizens and authorities, and implement effective governance systems that reduce the size of the informal economy. The government should prioritize integrating sub-sectors like

agriculture, livestock, mines and minerals, information and computer technologies, and other sub-sectors of both the formal and formal economic sectors.

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