PAKISTAN's MISSING 95 TRILLION RUPEES

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I'm a son and grandson of Air Force officers. My grandfather taught at Petaro Cadet School after migrating to Pakistan in 1947. My father served as an Aeronautical Engineer in PAF. He was transferred back from East Pakistan a little before the '71 war broke out. I was born in a Sunni Punjabi family at the Okara Cantt. Hospital.

I have lived in Peshawar, Rawalpindi, Lahore and Karachi. I have been lucky to travel around Pakistan - from Hunza to Gwadar, from Quetta to Multan.
I was fortunate to see village life in Sahiwal and Okara, and to experience living at PAF Base Badaber, Army Cantonment Chaklala and DHA Karachi. I was educated in PAF schools, at a government college (FC College Lahore) and at an Air Force supported institute (IoBM). I was Project Director of the National Incubation Centre in Karachi fully funded by the Ministry of Information Technology and Telecommunication.

From my birth, to my education, to the care of my parents at military hospitals, to parts of my work life - I am a beneficiary of the system in place: both public and private. I am, you might say, as fully Pakistani as you can be by any definition.

But does this system truly work for me? Does it work for young people growing up in today's Pakistan? Does it work for you and your children? What is our journey and our destiny as a nation? Would I have done better as a Chinese entrepreneur building my career as part of a Rising China of the '90s and 2000s or as a privileged Pakistani in a struggling Pakistan? Would I do better in a country filled with hopes and dreams, or a country entangled in fear and despair?

STRIVE FOR A BIG VISION, WHY NOT

We should want to be a prosperous society, a thriving economy, and a vibrant culture in 2047 after a hundred years of this nation. How do we go in that direction?

Our national poet Iqbal has urged us:

Khudi ko kar buland itna ke har taqdeer sey pehley,

Khuda bandey sey yeh khud poochey, bata teri raza kiya hai.

I approach this problem from three angles. As a life-long entrepreneur who has worked with and advised over a thousand entrepreneurs, as someone who runs a global venture building firm working with diverse teams in the Middle East, Africa and America, and as someone who studied economics deeply without becoming an economist.

ECONOMISTS GET IT WRONG, AND INSIST WE LISTEN

Economists around the world are famously unable to predict what happens to the economy. Whether it is American economists who were caught unaware by the 2008 mortgage crisis, or the Fed economists who failed to see the inflation after 2020 whilst rapidly increasing money supply, or the Pakistani economists who suggest remedies for Pakistan with no positive effect. Why is that?

Every field of study has its share of conventional wisdom. The reason it is conventional, traditional and acceptable is because it is generally correct. Any innovation must prove its efficacy before becoming conventional.

Economics, unfortunately, does not work like that. Economists have built an imaginary world of assumptions. Their theories work in this fictional world. And when the reality differs from their fiction (which is more common than they would like to concede), they stick to the fiction because 'reality is too complex' anyway. I wish we could, as citizens and as a nation, live in their fictional world. But we have to face reality as it is and not as we want it to be. Economists, on the other hand, get paid despite living in their delusional world.

I won't go into a detailed explanation of why economists choose to ignore reality. But as they say: follow the money. Since economic policy is a tool to distribute wealth, resources and opportunities, economists tend to work for those who have and want to keep a tight grip on resources. In most cases, they do it as part of a well-funded group-think than any organised conspiracy.

In our case, the driving force of our economic policy is the global economic elite. We serve at the pleasure of international financial capital - and whoever controls it. We listen to Western consultants, we follow the path set for us by the World Bank and IMF, and we allow ex-bankers to become our Finance Ministers and Prime Ministers. We pretend to be free, even though we are not.

Let's look at some of the assumptions and mistakes we are making from one particular angle: money supply.

MOVING TOWARDS A SOLUTION

Traditional economics would suggest that 'banks don't create money out of thin air'. We are also told that if you have too much inflation, increasing interest rates will bring it down by reducing the supply of money. We are told that we should try to get more foreign capital to build infrastructure like roads and power plants.

All of the above is incorrect. Banks do create money out of thin air, interest rates are not the core control mechanism of inflation and we don't need foreign capital to build infrastructure.

This is proven by the successes of Japan, South Korea, Taiwan and China.

We should pay attention.

The money story of a nation has two parts: the local currency where supply is controlled by the State Bank, and foreign currency that you have to earn by selling more goods and services than you buy.

Using these two levers, and understanding their interrelationship, is the essential ingredient for a successful and fast-growth economy. It should be obvious that there is no limit to the supply of local currency: the state bank can decide to create it. The problem is that as you issue more local currency, the demand for goods rises. This rise is met by an increase in imports if the local productive capacity is not simultaneously enhanced. Those imports have to be paid for in dollars, which creates a balance of payments crisis.

Since we can't create dollars (or euros or yens), we have to earn them or borrow. The issue is not in creating more local currency (we can always do this instantly) - the challenge is making sure that as you create more currency, you can meet this new demand by increasing the supply of goods locally or by growing exports to match your enhanced dollar imports.

Pakistan's problem is simple: we keep creating more currency without enhancing our productive capacity. We have a chronic trade deficit because of this reason. To finance this deficit, we need to borrow more foreign currency. As we borrow more, we have to accommodate more demands from our lenders which leads to further deterioration in our balance of trade (they expect us to open up our economy to more trade and investment to their benefit). Trade is good for an economy; it allows for to specialisation and scaling. The problem is the terms: if you are not deciding the terms, someone else is. They also ask us to devalue our currency which leads to an exponential increase in our payables - government revenue is in PKR and our foreign loans are in USD.

DOES DEBT CAUSE TRADE DEFICITS?

Pakistan's Public Sector Domestic Debt is PKR 42 trillion. That's roughly 45% of our GDP. Pakistan's Public Sector Foreign Debt is about PKR 25 trillion. Are these high or low?

On the face of it, it doesn't seem to be very high when you look at other rich or fast-growing economies: China is 77%, Vietnam is 37%, South Korea is 49%, Japan is 264% and so on. What's so uniquely bad about our public sector debt?

To answer the above question, you have to ask another critical question: as the government spends more money, how does it affect the balance of trade? Government borrowing does not directly or indirectly grow the exports of a country or reduce the imports. It does increase the money supply which increases imports. Its impact on our balance of trade is therefore, in general, negative.

Other countries that have a similar or higher level of public sector debt as Pakistan are able to sustain it. Why is that? It's because whilst their public sector debt may be higher than ours, their private sector debt is multiple times more than ours.

PAKISTAN'S PRIVATE SECTOR DEBT IS 9% OF GDP

Why is this a problem?
Here is a comparison with other fast growing or rich economies:

1. China - 194%
2. Singapore - 130%
3. Israel - 110%
4. Japan - 120%
5. South Korea - 176%
6. Norway - 118%
7. Switzerland - 167%
8. Pakistan - 9%

By setting up our economy in a way that Private Sector Debt (or liquidity available for enterprise) is only 9% of the GDP, we have starved our industry, agriculture and business of capital. Without capital, they are unable to trade and grow effectively.

Whilst these figures are worrying, they illustrate a nonavailability of capital for productive enterprises: the problem runs deeper.

How much of this private sector debt is used by:

1. Unilever Pakistan
2. Packages Limited (TetraPak)
3. Atlas Honda
4. Indus Motors (Toyota)
5. Etc.

All of these enterprises and more are seemingly Pakistani companies. But the truth is when you buy a Toyota Corolla from Indus Motors, a Honda Civic from Atlas, a MilkPak from Packages or a consumer product from Unilever, they sell you stuff where parts, ingredients and in some cases entire products are imported. And once they make money, the profits have to be sent back to their parent companies. They have a net negative impact on our balance of trade and we actually fund them.

Look at our power sector. Companies take loans in PKR, but our government pays them the tariff in USD - backed by sovereign guarantees.

Our economy is not failing because we don't have a competitive local export-driven private sector, our economy is failing because we have designed it exactly the way it is performing.

Quran 13:11: Indeed, Allāh will not change the condition of a people until they change what is in themselves.

MONEY IS THE DRIVING FORCE, AND WE KEEP IGNORING IT

The Japanese and Chinese experience show this clearly: credit creation is the driver of growth. Whilst banks create credit 'out of thin air', it's the nation's Central Bank which can and should provide guidance. In Pakistan's case, the State Bank is busy trying to be independent instead of serving its primary purpose: managing liquidity to grow the economy.

The State Bank of Pakistan currently uses interest rate as a lever to manage money supply and devaluation as a response to inflation. This approach requires a revision. Inflation is dependent on two aspects (and none of them is the interest rate): directly managing the supply of money and enhancing the country's productive capacity.

The business case is simple: if new credit enhances the productive capacity of the economy more than demand for goods and services, it will lead to growth. If it does the opposite, the country will end up with a bigger trade deficit. Sometimes something obvious can be obscured by convoluted gymnastics of logic and words.

We want to fix the economy and we are listening to economists and bankers who want to distract us. Let's focus on the core issue: money.

THE 95 TRILLION QUESTION

Looking at other rich and fast-growing economies, we have to set a goal: Private Sector Debt (or liquidity available to enterprise) has to grow to 100% of GDP from the current 9%. That's almost 95 trillion rupees.

Unlocking this invisible asset effectively will lead to the 10%+ year-on-year growth experienced by East Asian economies and more recently China.

There is nothing stopping us except us.

The author is an entrepreneur, part-time philosopher and venture builder. Having spent most of his life in Pakistan, he is now exploring European history and hiking in Portugal.