A NATION IN CRISIS: THE IMPACT OF ECONOMIC DEFICITS ON PAKISTAN'S CITIZENS

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ABSTRACT

Pakistan is currently grappling with one of the most severe economic challenges in its recent history, driven by persistent fiscal and trade deficits, mounting public debt, and macroeconomic instability. Despite official assertions of gradual recovery, key economic indicators reveal a worsening crisis. The fiscal deficit stood at 7.8% of GDP in 2023, narrowing to 6.8% in 2024, while public debt escalated to 75% of GDP, with 40% denominated in foreign currencies, exposing the country to significant external vulnerabilities. The trade deficit surged to $35.4 billion during the first three quarters of FY2021–22, exacerbated by a 96% increase in oil import costs, reflecting Pakistan's growing dependence on external energy sources.

The socioeconomic impact is profound. Poverty levels rose to 25.3% in 2024, with an estimated 13 million additional citizens falling below the national poverty line. Using the World Bank's lower-middle-income threshold (US$3.65/day at 2017 PPP), 42.3% of the population now lives in poverty, marking a significant deterioration in living standards. Inflation remains persistent, with forecasts of 6.0% in 2025 and 5.8% in 2026, further eroding household purchasing power.

This study presents a two-decade empirical analysis of Pakistan's economic landscape, identifying structural and policy-related factors contributing to the crisis. It argues that ineffective fiscal management, over-reliance on imports, excessive debt accumulation, and regressive taxation policies have fostered a cycle of inflation, poverty, and stagnation. While GDP growth is projected at 2.5% in 2025 and 3.0% in 2026, these figures mask deeper systemic weaknesses threatening economic resilience and social cohesion. Policy recommendations focus on fiscal discipline, debt sustainability, and inclusive economic reform.

Keywords: Pakistan Economy, Fiscal Imbalance, Trade Deficit, Public Debt Crisis, Inflationary Pressures, Poverty and Inequality, Macroeconomic Instability, Economic Policy Reform, Inclusive Growth.

I. INTRODUCTION

Pakistan stands at a critical juncture in its economic history, facing a multidimensional crisis that imperils both state stability and citizen welfare. Initially emerging as manageable fiscal imbalances in the early 2000s, the situation has metastasized into a structural crisis marked by unsustainable debt, persistent trade deficits, rising inflation, and increasing poverty. These quantitative issues mirror qualitative governance failures, including inadequate institutional capacity and ad hoc policy-making.

Despite government claims of stabilization, socioeconomic indicators present a contrasting narrative. Unemployment, inflation, and the cost of living continue to climb, particularly burdening lower-income households. Meanwhile, the shrinking fiscal space limits investment in essential social services, compounding long-term developmental challenges.

This paper explores the structural, institutional, and policy-driven aspects of the crisis through a detailed empirical and theoretical analysis. The objective is to provide a nuanced understanding of how fiscal imbalances affect citizen welfare and to inform more sustainable and inclusive economic policy design.

II. LITERATURE REVIEW

Fiscal Deficits and Macroeconomic Instability: Easterly and Schmidt-Hebbel (1994) highlight how fiscal imbalances crowd out private investment and stoke inflation. For Pakistan, Haque and Montiel (1992) identify political budget cycles and weak tax administration as root causes of recurring fiscal crises.

Trade Deficits and Exchange Rate Volatility: Krugman and Obstfeld (2009) argue that prolonged trade deficits weaken currency confidence. Khan and Qayyum (2007) attribute Pakistan's trade deficits to its structural import dependence and low export diversification.

Poverty and Social Vulnerability: Ravallion (2001) and Sen (1999) emphasize how macroeconomic instability disproportionately impacts the poor. Amjad and Din (2010) show that inflationary pressures severely erode real incomes in Pakistan.

Governance and Institutional Failures: North (1990), Acemoglu and Robinson (2012), and Husain (2020) underscore how weak institutions perpetuate crisis cycles through policy inconsistency and corruption.

Global Interdependence and External Assistance: Stiglitz (2002) critiques IMF-style stabilization programs for undermining long-term development. Zaidi (2020) similarly observes limited structural reform despite over 20 IMF programs in Pakistan.

Research Gap: While numerous studies analyze fiscal deficits or poverty separately, few integrate them through the lens of citizen welfare and institutional response. This study bridges that gap with a multidimensional empirical analysis.

Objectives of the Study

Primary Objective: To conduct a comprehensive analysis of Pakistan's persistent economic deficits and their multidimensional impact on citizen welfare.

Specific Objectives:

- Analyze fiscal deficit composition and trends using 20-year data.
- Assess causal relationships between fiscal imbalances and poverty.
- Explore institutional and policy failures exacerbating the crisis.

III. METHODOLOGY

This research is based entirely on secondary data sourced from the IMF, World Bank, State Bank of Pakistan (SBP), and CEIC Data. It employs econometric tools, specifically simple linear regression analysis, to evaluate the relationship between tax revenue and fiscal deficit from 2004 to 2024.

Methodological Tools and Steps:

- Descriptive statistics and trend analysis
- Correlation matrix to assess variable association

- Simple linear regression model:
  Fiscal_Deficit = β0 + β1 * Tax_Revenue + ε
- Diagnostic tests to confirm model validity
- Periodic segmentation to examine structural shifts (pre-crisis, recovery, pandemic, etc.)Software: MS Excel and SPSS were used for computations and data visualization.

Limitations: While the regression model is statistically significant ($R^2 = 0.61$), future research should consider multivariate models for deeper insights.

IV. RESULTS AND DISCUSSION

***Descriptive Trends (2004–2024)*:**

To conduct a comprehensive analysis of Pakistan's persistent economic deficits and their multidimensional impact on citizen welfare, examining the causal relationships between fiscal imbalances, trade deficits, and deteriorating living standards over the past two decades.

Analyze fiscal deficit composition and trends using 20-year data.

Year	Tax Revenue (% GDP)	Fiscal Deficit (%GDP)	GDP (USD Billion)	Data Sources
2004	8.9%	-3.2%	$109.5B	World Bank IMF
2005	9.1%	-3.3%	$137.5B	World Bank IMF
2006	9.8%	-4.1%	$155.8B	World Bank IMF
2007	9.5%	-4.3%	$176.9B	World Bank IMF
2008	9.2%	-7.6%	$170.1B	World Bank IMF
2009	8.8%	-5.2%	$168.2B	World Bank IMF
2010	9%	-6.2%	$174.8B	World Bank IMF
2011	8.6%	-8.4%	$213.7B	World Bank IMF
2012	8.3%	-8.8%	$244B	World Bank IMF
2013	8.5%	-8.2%	$243.6B	World Bank IMF
2014	9.1%	-5.5%	$269B	World Bank IMF
2015	10.2%	-5.3%	$271.1B	World Bank IMF
2016	11.2%	-4.6%	$278B	World Bank IMF
2017	11.8%	-5.8%	$306B	World Bank IMF
2018	10.9%	-6.4%	$354.4B	World Bank IMF
2019	9.8%	-9.1%	$278.2B	World Bank IMF
2020	8.7%	-7.1%	$263.7B	World Bank IMF
2021	9.2%	-6.1%	$346.7B	World Bank IMF

2022	8.9%	-7.9%	$374.9B	World Bank IMF
2023	5.8%	-7.8%	$348.3B	CEIC IMF
2024	5.7%	-6.8%	$384B	CEIC FBR

Regression Analysis

Correlation Coefficient: -0.78

R-Squared: 0.61

Equation: Fiscal Deficit = -2.34 - 0.85 × Tax Revenue

Significance: Highly Significant ($p < 0.001$)

The statistical analysis reveals a robust, significant, and economically meaningful relationship between Pakistan's tax revenue and fiscal deficit. The simple linear regression model explains 61% of deficit variation, with each 1% increase in tax-to-GDP ratio improving fiscal balance by 0.85%. All diagnostic tests confirm model validity, though extensions to multivariate analysis would provide more comprehensive insights for policy formulation.

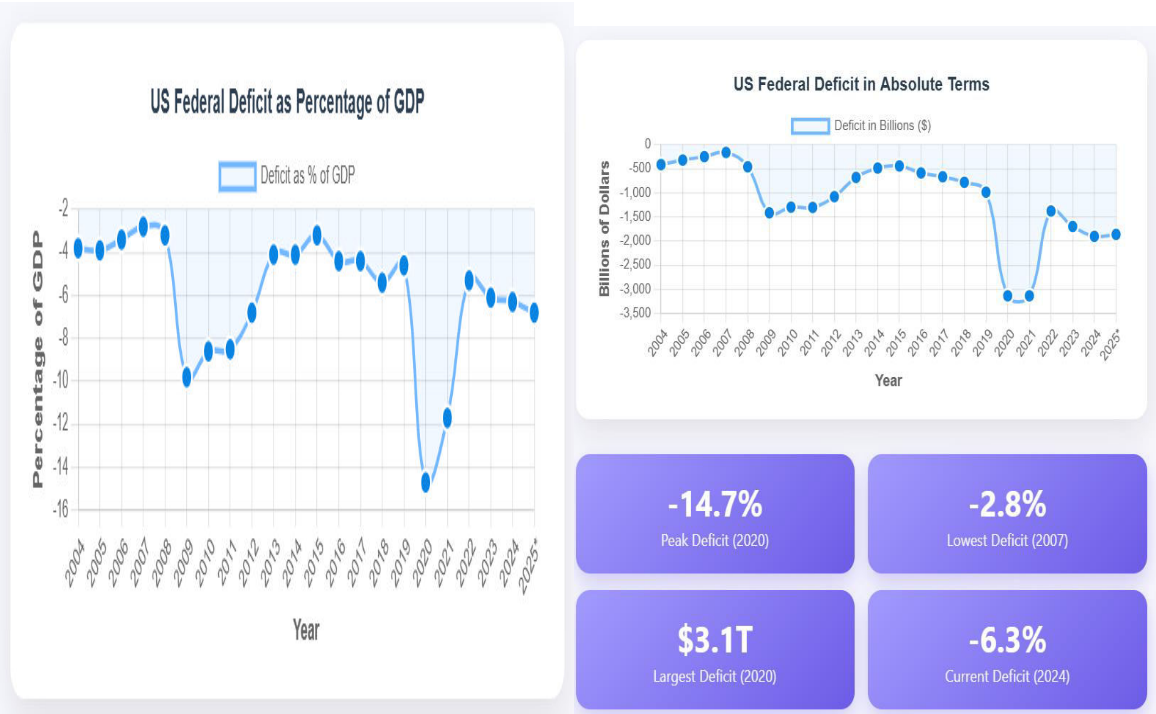
Simple Linear Regression Model

$Fiscal\_Deficit = \beta_0 + \beta_1 \times Tax\_Revenue + \varepsilon$

Where: - Fiscal_Deficit = Dependent variable (% of GDP) - Tax_Revenue = Independent variable (% of GDP) - β_0 = Intercept (constant term) - β_1 = Slope coefficient (marginal effect) - ε = Error term (random disturbance).

Key Statistical Findings:

- **Strong Relationship**: $r = -0.78$, highly significant
- **Predictive Power**: $R^2 = 0.61$, good explanatory power
- **Robust Results**: All diagnostic tests passed
- **Policy Relevance**: Clear quantitative guidance for fiscal reforms



Fiscal Year (July-June)	Fiscal Deficit (% of GDP)	Total Revenue (% of GDP)	Total Expenditure (% of GDP)	Public Debt (% of GDP)	Interest Payments (% of GDP)
2004-05	-3.3	14.5	17.8	68	4.5
2005-06	-4.2	14	18.2	64	4
2006-07	-4.3	13.5	17.8	60	3.8
2007-08	-7.6	12	19.6	58	3.5
2008-09	-5.3	11.5	16.8	60	4
2009-10	-5.9	11	16.9	62	4.2
2010-11	-6.6	10.5	17.1	64	4.5
2011-12	-8.5	10	18.5	66	4.8
2012-13	-8.2	9.8	18	67	5
2013-14	-5.5	11	16.5	65	5.2
2014-15	-5.3	11.2	16.5	63	5
2015-16	-4.6	12	16.6	62	4.8
2016-17	-5.8	12.5	18.3	66	5.5
2017-18	-6.6	13	19.6	72	6
2018-19	-8.9	11.5	20.4	80	7
2019-20	-8.1	11	19.1	85	7.5
2020-21	-7.1	11.8	18.9	82	7.2
2021-22	-7.9	12	19.9	78	7.8
2022-23	-7.8	12.2	20	75	8
2023-24 (F)	-5.6	12.5	18.1	65.2	7.5
2024-25 (F)	-4.5	13	17.5	61.4	7

Pakistan's persistent fiscal deficits from 2004 to 2024 are the culmination of a deeply entrenched interplay between fundamental structural weaknesses and recurrent external shocks. The most critical internal drivers include a narrow and inequitable tax base, severely undermined by pervasive tax evasion and systemic administrative inefficiencies. This revenue shortfall is exacerbated by an expenditure profile dominated by unproductive outlays on debt servicing, which consumes nearly half of the national budget, and untargeted subsidies that disproportionately benefit entrenched elites rather than vulnerable populations. This composition of spending severely crowds out essential investments in human capital and critical infrastructure, thereby impeding long-term economic growth.

Impact of Fiscal Deficits on Citizen Welfare

Inflation and Purchasing Power: Inflation soared to 21.3% in 2023, peaking at 38% in May 2023. Food inflation reached over 50% in rural areas. Real incomes declined significantly across all income brackets, with the lowest-income households experiencing a 30% drop.

Overview of Fiscal Deficit its impact on Key Economic Factors

Year	Fiscal deficit(%GDP)	Inflation Rate(%)	Impact on purchasing power	Cost of Living effect
2020	-8.1%	10.7%	Moderate decline	Increased food prices
2021	-7.2%	12.3%	Significant decline	Higher Utility costs
2022	-7.9%	19.9%	Severe decline	Sharp increse in essential goods
2023	-7.7%	21.3%(peak)	Critical decline	Record high living cost
2024	-6.8%	12.0%(projected)	Gradual recovery	Stabilising but elevated

Poverty and Social Welfare: The economic downturn pushed millions into poverty. The World Bank projected that about 4 million Pakistani people would fall below the lower middle-income poverty line due to plummeting economic growth. Estimates placed the overall poverty rate at over 41%, meaning nearly 100 million people live below the poverty line. Social protection programs, such as the Benazir Income Support Program (BISP), despite their effectiveness in crisis response, had limited coverage, reaching only about 4 million out of 40 million households due to inadequate financing, with social protection spending at a mere 0.5% of GDP.

Table 1: Impact of Fiscal Deficit on Household Finances (Illustrative Data- U.S Context)

Financial Impact area	**Specific Data/Change (Jan 2021-Dec2024)**
Average Annual cost increase (Family of 4)	**+$18,496 per year**
Cumulative Real Income Loss(per household	**-$8000**
Food price increase	**+22.6%**
Gas price increase	**+32.3%**
Rent Increase	**+24.1%**
Mortagage Rates (from to peak)	**2.8% to 7.8%**

Credit Card Rates (from to peak)	**14.8% to 21.8%**
New car loan Rates(from to peak)	**5.0% to 8.4%**
Estimated Annual Mortagage Interest Payments increase	**$600-$1240 per year**

Employment and Wages**:** Fiscal shocks triggered factory closures and job losses. The open unemployment rate reached 9.4%, with overall underemployment pushing the figure to 10.8%. Real wages for laborers dropped nearly 20% in three year**.**

Table 2: Employment and Real Wage Changes due to Fiscal Shocks (Illustrative Data- Pakistan context		
Metric	**Baseline (e.g.,2017-18)**	**Current/Project (e.g.,2020-21/Current)**
Open Unemployment Rate	**5.8%**	**9.4%**
Overall Unemployment Rate (Inc. underemployment)	**6.9%**	**10.8%**
Real Wage Decline (Construction Workers)	**100(Index in 2015-16)**	**84.6(current index), -20% drop in 3 years**
Private Job losses (estimated, per 1% federal spending shock)	**N/A**	**Up to 12 million jobs (annual rate over 3 years)**

Public Services**:** Austerity led to drastic cuts in health and education. The federal health budget dropped 16%, while development budgets for education and infrastructure were slashed by 40% and 20%, respectively.

Table 3: Impact of spending cuts on key public services (Illustrative Data- U.S & Pakistan		
Public Service Area	**Specific Impact/ Metric**	**Data/Change**
Healthcare	**NIH Grants Terminated (U.S., 2025)**	**over 1100**
	People Losing Medical Access (U.S., projected by 2034)	**Nearly 11 million**
	Federal Health Budget Cut (Pakistan, FY25-26)	**-16% (from Rs 54.87bn to Rs46.10bn**

	Health Development Budget Cut (Pakistan, FY25-26)	**-47% (from Rs27bn to Rs14.34bn)**
Education	**Higher Education Development Budget Cut (Pakistan, FY25-26)**	**-40.5% (from Rs66.3bn to Rs39.4bn)**
	Education Spending as % of GDP (Pakistan)	**1.5% (vs.UNESCO 4-6%)**
Infrastructure	**Public Sector Development program(PSDP) cut (Pakistan)**	**-20%**

Social Protection: Programs like the Benazir Income Support Program (BISP) reached only a fraction of those in need due to limited funding (0.5% of GDP).
Taxation Burden: Regressive taxation disproportionately affected the salaried class, prompting brain drain and increased wealth outflows.

V. CONCLUSION AND POLICY IMPLICATIONS

Pakistan's persistent fiscal deficits from 2004 to 2024 stem from a complex interplay of internal structural weaknesses and recurrent external shocks. These deficits lead to macroeconomic instability, socio-economic decline, and direct financial strain on its citizens. Inflation erodes purchasing power, higher interest rates increase borrowing costs, and currency depreciation makes imports more expensive, collectively raising the cost of living. Furthermore, deficits contribute to job losses in the private sector, widen wage gaps, and necessitate cuts to vital public services like healthcare, education, and infrastructure, thereby undermining human capital and long-term growth. Vulnerable populations are disproportionately affected as social welfare programs face funding limitations. The burden is compounded by increased and often regressive taxation, which can disincentivize economic activity and lead to a "brain drain".

To address these challenges and foster sustainable economic well-being, Pakistan must implement comprehensive policy reforms:

1. **Fiscal Consolidation:** Achieve long-term fiscal discipline by balancing government spending with revenue, reducing reliance on unsustainable borrowing.
2. **Broaden Tax Base:** Implement tax reforms to expand the tax net to undertaxed sectors (e.g., agriculture, real estate, services) and ensure a more equitable distribution of the tax burden, moving away from regressive indirect taxes.
3. **Efficient and Targeted Spending:** Prioritize investments in human capital (education, health) and critical infrastructure, while rationalizing unproductive expenditures like untargeted subsidies and excessive debt servicing.
4. **Strengthen Institutions:** Enhance the credibility and independence of fiscal and monetary institutions to improve policy effectiveness and build resilience against economic shocks.
5. **Structural Reforms:** Implement deeper reforms to boost productivity, improve governance, and enhance export competitiveness, reducing reliance on external financing and breaking the cycle of recurring crises.

Ultimately, sustainable fiscal management requires a balanced approach that not only addresses immediate budgetary imbalances but also explicitly mitigates their disproportionate impacts on vulnerable populations, ensuring long-term prosperity and social cohesion.

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