Pakistan’s Trade Imbalance & Melting Down of Economy

Dr. Qadar Bakhsh Baloch*

Abstract
Pakistan’s negative trade balance is a constant problem since 50s and its causes lie not in international trade but mainly in domestic factors affecting international capital flows. The stage has come when the problem of a deficit coupled with high inflation and low economic growth is causing the balance of payments problems to be more serious. The meager foreign reserves are rapidly shrinking day by day and no worthwhile inflow to compensate the loss is likely to be replenished in near future. Downgraded risk rating has made market borrowing least likely and privatization of national assets in ongoing recession period does not offer prices worth assets and borrowing from the IMF has started showing stresses on the public. The research article intends to diagnose and prognoses the problem of trade imbalance.

Introduction

The balance of trade is the relationship between a nation's imports and exports of goods and services. Any imbalance in these trade implies an equal and opposite imbalance in asset trade. A positive balance of trade is known as a trade surplus and consists of exporting more than is imported; a negative balance of trade is known as a trade deficit or, informally, a trade gap. A trade deficit (more properly labeled as a current account deficit) means that exports are insufficient to pay for imports and a trade surplus is the opposite of it -corresponding to the capital account deficit. Trade deficit risks jeopardizing nation’s economic growth because current account deficit leads to net selling of international assets. Hence, current account trade surplus increases

* Dr. Qadar Bakhsh Baloch is Associate Professor and Head of Management Science Department, Qurtuba University of Science and Information Technology, D.I.Khan. E-mail: qbuzdar@yahoo.com
country’s international asset position correspondingly and a trade deficit decreases the net international asset position accordingly. The balance of trade is generally affected by the factors like: Prices of goods manufactured at home, trade agreements, tariffs and non-tariff barriers, exchange rates, state of business cycle at local or international market.

**Prevailing Economic Environment: An Overview**

For decades, Pakistan’s balance of trade remained negative, though not as high as now. Imports have exceeded exports in almost every year since 1950, and Pakistan had a deficit on its balance of trade each year from FY 1973 through FY 2008.\(^2\) Resultantly, Pakistan with negative current account was obliged to remain dependent on the foreign donors, and creditors to pay for the short fall of its balance of payment. Piling up of external financial liabilities and debt service payments had put on constant constraint to appropriate resources from the national developmental goals. The debt burden and social development deteriorated to such an extent that today our foreign debts are standing at $44.5 billion and would reach to the tune of over $52 billion US with the addition of $7.6 billions of IMF loan. Substantial chunk of foreign reserves are siphoned off at alarming rate in debt servicing.\(^3\) Inflation is running at nearly 25 percent on average\(^4\) and about 25 percent of the population of 169 million is living below the poverty line of $1 a day.\(^5\)

Following the policy of liberalization, deregulation and privatization instead of containing imports, Pakistan went for ‘cheap’ imports not realizing that this addiction could lead to lethal after-effects even on economies like the US. In 1996-97 it touched $ 3.52 billion; then it doubled to $6.183 billion in 2004-05, In 2005-06 the trade deficit doubled again to $12.011 billion, and in 2006-07 it rose further and in FY 2007-2008 it was a staggering figure of $20.75 billion.\(^6\) The deficit
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widened to $20.746 billion in 2007-08 from $13.563 billion in fiscal 2006-07 sets very alarming indicators for economic policy makers of Pakistan.

Table 2: Pakistan’s Balance of Trade- 2003/04 – 2007-08

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<th>Year / Month</th>
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<th>Imports</th>
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<td>2,682,071.7</td>
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<td>-1,270,397.3</td>
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</tbody>
</table>

Source: Federal Bureau of Statistics

Last year we witnessed a most disappointing state of trade balance especially after Standard & Poor’s, rated Pakistan to a position superior only to the Seychelles that had already defaulted. The rupee has slumped by more than 30 percent against the US dollar since the beginning of the year and share prices have crashed by 40 percent since their all-time high in April. Most of the inflows other than workers remittances were nearly dried up. By the end of October 2008 wrecked by political instability and hard hit by ever deepening global financial crisis Pakistan was at the verge of bankruptcy. The country’s foreign reserves had fled out of the country and around $4.5 billion were left behind to pay for only six weeks of imports. After failing from obtaining funds/ any kind of financial support from China, Saudi Arabia and other Friends of Pakistan, we were constrained to bow before IMF for assistance. IMF 1st traunche of $3.1 billion helped Pakistan to stabilize its
foreign reserve in order to meet the imports bill. The strings attached with these bitter pills such as; an end to price subsidies, tighter monetary policy and other austerity measures would lead to further price hike and squeeze the already meager share of public spendings.

War on terror and Pakistan Army’s stepped up operation on the ever widening front has cost Pakistan over 21 trillion Rupees with loss of 260 billion in 2005, 301 billion in 2006, 484 billion in 2007, and 678 billion in 2008. Last quarter of 2008 Pakistan was virtually facing a worst socio-economic crisis that include food and energy shortages, escalating fuel costs, a sinking currency and a massive flight of foreign capital accelerated by an escalating insurgency. No money, no energy, no food, no water, no government. The dooming economy was further axed by the Benazir Income Support Program to the amount nearly 50 billion rupees. Though Pakistan succeeded in avoiding default, however 2009 confronts a looming economic and political crisis.

The graph below suffices to depict the alarming state of Pakistan’s balance of trade to support our contentions:

The towering figure of over 1.64 billion US$ trade deficit only in January 2009, 49.9 % more then January 2008, is seriously eroding confidence in the country’s economy rather creating a directionless
economy. The figures show rising dependence on external sources to finance consumption as well as the waste that goes along with it. Except for workers’ remittances, no other source depicts any stability because all of them depend on political and economic stability. The situation seems further worsening with the looming financial crisis in US and world over. The Lehman Brothers bankruptcy has triggered the world, forcing Moscow stock exchange to remain shut for four days and jolting capital markets world over including Pakistan to freeze. The trade deficits are doubling with every passing month and correspondingly reserves are shrinking. Besides, the alarming state of economicy, another bomb that is ticking is unskilled and unemployed youth and the country lacks the capacity to convert them into human resources. That is the crux of the matter.

**Anomalies of Pakistan’s Trade Deficit**

Though high imports coupled with rising oil and food import bill are the chief reasons for current raise in the current account deficit however, detailed analysis of the daunting deficit in trade and persistent current account shortfall indicates the following:

*Worsening Energy Crisis:*

Serious energy shortage, massive electricity failure from KESC and WAPDA, long spells of load-shedding and falling to the lowest ebb oil reserves are looming risks to our production level and economy. Pakistan’s already weak production base has been further hit hard by the energy crisis. The load shedding in the country, during the last one year in particular, has played havoc with the industrial sector, as textile, plastic, steel and other units have suffered heavily. Around 25 percent of textile units have been closed because of shortage of electricity while a
sizable number of units are likely to be closed. Out of around 1,200 textile units, 300 mills including spinning, weaving and ginning are closed in Punjab while almost the same numbers of mills are facing grave problems. It has caused severe problems in production cycle and resultantly the cost of production has increased. The export target $19.2 billion set for 2007-08 went with the short fall of around 30% and the situation of 2009 is expected to be worst if the current power shortage persists any further. Hence, the government should make a comprehensive plan for overcoming the problem otherwise besides the trade deficit; unemployment and inflation are also likely to shoot-up. In short-term measures, the government should talk to IPPs and evolve a strategy for rapid power production while in long term planning, it should focus on making dams and adding thermal, coal and nuclear energy. The protection of domestic consumer hinges upon smooth running of the industry and if the industry of the country is facing closure threat, Pakistan would not be able to maintain growth rate.

**Surging Imports:**

Pakistan’s trade deficit is widening as imports grow fast while exports are moving up slowly. It is not a new phenomenon but since 50s Pakistan is importing more than it is exporting. This import depends upon country’s demand and production capacity. Since the local producers are unable to produce enough goods and services to satisfy domestic demand therefore imports are drawn to fill in the gap. Further lowering of tariffs as per IMF and WTO requirements has actually led to an increase in imports, and an infiltration of consumer goods produced in the developed world. Pakistan’s economy during 2007-08 registered imports worth $40bn while its exports stood only at around $20billion. In its trade policy for the fiscal year 2007-08, the government had targeted imports
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at $29.6 billion and exports at $19 billion with a trade deficit of $10.6bn but due to high import oil bill the trade deficit ended up with $20 billion. A high volume of imports especially capital goods, and diminishing exports is one of the major causes of Pakistan’s trade/current account deficit. The graph below suffices to present the state on Pakistan trade imbalances in the last six-seven years.

The most alarming aspect is the declining trend in agriculture growth that ranged from 1.5% to 6.5% during the last six years thereby threatening our food security. Instead of giving boost to export and add to our current accounts Pakistan’s total imports for food group are reported at $4.21 billion in 2008 against 2007 imports of $2.74 billion. Realizing the devastating effects of the ever-increasing import Government of Pakistan constituted a high-powered committee to devise a strategy for curtailing lavish imports to a minimum level in order to minimize the trade deficit. Seeing the track record of such government committees,
however, it appears highly unlikely that the new committee will be able to succeed in its task before the new budget.

*High Level of Consumption:*
Higher the rate of consumption lowers the rate of domestic savings and evaporates the money available for domestic investment causing inflow of foreign investment. Pakistan has set new record of consumption during the last few years and gravitated huge imports resulted in to widening state of trade deficit and shrinking current account. Pakistan is earning less foreign exchange through exports and spends almost double on imports, with the result that there was precarious trade deficit of $20 billion last year. If sum of $5.5 billion of remittances by expatriate Pakistanis and foreign direct investment of $3.5 billion is taken into account, still there is current account balance of $10 billion. It is high time to cut and curtail imports substantially. Reportedly, Pakistani politicians, industrialists and businessmen have at least $125 billion stashed in foreign banks or invested in bonds and real estate in the US, UK, Spain and other European countries.\(^{13}\) The nation expects of them to bring their money back to the country so that we could overcome the financial crisis. They have to realize that in the event of international economic crisis and recession, their dollars would not hold much value. So why not to oblige their own starving nation.

*Workers Remittance:*
Workers Remittance\(^ {14}\) plays an important role in economic survival of Pakistan. Remittances from Pakistani workforce from Gulf States, Europe, America and other parts of the world have always been a meaningful contribution to Pakistan’s current account health. It decreases the current account deficit and substantially supports the domestic
investment capacity of the country. Table below expresses that performance of this source of our current economy is showing very encouraging signs.

Table-4: **Workers’ Remittances 2005 –2008**

| ($ Million) |
|------------|----------------|
| 2005-06    | 4600           |
| 2006-07    | 5494           |
| 2007-08    | 6451           |

Source: Ministry of Finance, Government of Pakistan

The inflows of worker remittance in 2007 reached over $6.45 billion making new record in nation’s history by bringing Pakistan world’s 12th largest remittance recipient country. In 2008, workers’ remittances showed an increase of 17.43 percent since 2007. From 2007-2008, Pakistan received over $6.45 billion from overseas nationals, beating last year’s record of $5.49 billion.

**Flaws in Agriculture Productivity:**

Being an agriculture country, our economy has to be agriculture centered. Therefore, main stay of our exports has been on rice, cotton etc or other value added products to decrease its foreign trade deficit. But
during the last many years Pakistan’s performance in agriculture sector has dwindled without any consistency and the worst year was 2008.\textsuperscript{16} The shortfall in cotton crop compelled textile industry to spend $1.291 billion US to import $4.6 billion bales to meet its requirement.\textsuperscript{17} Seeing the expected shortfall this year too we will be spending over $1 billion to cater for cotton deficit only.\textsuperscript{18} The food bill paid in 2008 amounting to $4 billion is a pointer of our poor agro performance and tantamounts to a criminal negligence on the part of agro management.

Similarly, spending a big chunk of foreign reserves on imports of edible oil and milk powder is also an indicator of incompetence and lethargic attitude. Pakistan produces 4.2 billion litters of milk/ per year, out of which 600 million litters (amounting to R. 12 billion @ Rs. 20 per litter) is wasted. Similarly, 15-20 percent of our fruit products rot due to inadequate facility of storage and transportation to the markets.

\begin{itemize}
  \item 1.291 billion US$ to import 4.6 billion bales in 2008
  \item Food bill paid in 2008 amounting to $4 billion
  \item Imports of edible oil and milk powder
  \item export of wheat on a marginal prices and then importing it back on higher prices
  \item Non-availability of Urea fertilizers and pesticides
\end{itemize}

The agriculture sector also offers plenty of other examples of grave mismanagement. One such case is the export of wheat on a marginal prices and then importing it back on higher prices. Non-availability of Urea fertilizers and pesticides this year during the peak season i.e. December 2008 and January 2009 is indicative of one thing that we haven’t learnt from the past and we are not serious to address the emerging national crisis.

\textit{Rupee Devaluation}:
According to economic theory and the Marshall-Lerner condition, (Marshall and Lerner were the pioneers of the elasticity approach to the balance of payments), devaluation may be a cure for some countries balance of payments deficits but not for all. The condition itself states that devaluation will improve the current account only if the sum of foreign elasticity of demand for exports and the home country elasticity of demand for imports is greater than unity. If the sum is less than one, the devaluation is likely to lead to a deterioration of the current account. It has been argued that devaluation may work better for industrialized rather than developing countries, since many such countries like Pakistan are heavily dependent on their imports so their price elasticity of demand is likely to be very low. The difficulty here is that this elasticity relate to long run responses; they describe the effects of an exchange rate change after enough time has passed for consumers and producers to find new suppliers and customers. The short-run elasticity are shorter and do not always satisfy the Marshall-Lerner condition. Therefore even if the elasticity’s are high enough for a devaluation to work for a developing country like Pakistan, the current account balance may turn worse before it improves in response to devaluation. Furthermore analysts opine that the constant increase in import bill is putting pressure on Pakistan’s forex reserves and fast depleting reserves tend to cause depreciation of our currency (i.e. rupee).

Balancing the Trade Deficit:
The question is: when Pakistan Government will finally face up to the fact that Pakistan’s deficits are Pakistan’s problems requiring Pakistani action? Reducing the trade deficit is not going to be easy. For one thing, since the government obviously has no control over international oil prices and international food prices. It has no means of knowing in
advance what the import bill for these items is going to be through the coming months of fiscal 2008-09 and the years ahead. For another, the rising demand for oil and other imports is directly linked to GDP growth and the increase in population. These, again, are factors that no committee can control. Experience has shown, however, that the demand for oil-based energy tends to increase by two per cent more than the percentage of annual GDP growth. This suggests that cutting oil imports would lead to a reduction in GDP growth. No government, therefore, can afford to adopt a policy that would have the effect of slowing down the country’s economy, adding to the already high level of unemployment and increasing the number of people living below the poverty line. In order to reduce the trade deficit, what is needed are long-term measures aimed at controlling the rapidly growing trade gap between imports and exports. Arresting the trading gap by increasing in export level would improve current account, and balance of payment. The recommendations in this regard could be:

**Revitalizing Agriculture Base:**

Pakistan economy is mainly agriculture centered and strengthening agriculture base would strengthen our economy accordingly. Seeing the wastage, backwardness and mismanagement in agriculture sector, its grave impact on negative trade balance ought to be at the top agenda in our restructuring campaign. Beside, saving the foreign exchequers on imports of these products, Pakistan can earn current account by improving production and storage techniques, up gradation of forms to market road network, and establishment of cool chains for diary milk and other perishables can save billions of rupees loss. The management also needs to rely on thorough planning and fixing the government support prices. Efforts must be done to avoid recurrence of the phenomenon of
first exporting on cheaper price and then importing (the same commodity) on higher prices as it happened in case of wheat in 2008. The government is expected to address this issue by providing incentives to agriculture. Import of edible oil could be controlled by increasing production of oil seed and import of milk powder can be substituted by dairy farming. Improvement in cotton production will enable our textile industry to operate at optimum capacity to utilize 16 million bales of cotton and exploit the opportunity window being offered by the ongoing economic global crisis.\textsuperscript{19} It may be underscored further that agriculture itself is based on the supply of water. Here we are confronting a very grave situation so much so that India and Pakistan may avoid nuclear war but they are positively advancing to a war on water. India is reportedly engaged in construction of more than 50 dams on Chenab River. By this way she is planning to choke the supply of water to Pakistan and turn over our fertile and arable lands to deserts. Obviously we can’t revitalize the agriculture sector without forcing India to respect international law on the flow of rivers and Indus Basin Treaty. If we fail to bring India to senses through international pressure, war would become inevitable.

\textit{Diversifying the Export Base:}

Pakistan exports rice, furniture, cotton fiber, cement, tiles, marble, textiles, clothing, leather goods, sports goods, surgical instruments, electrical appliances, software, carpets and rugs and food products. Pakistan now is being very well recognized for producing and exporting cements in Asia and Mid-East. Main exports partners are United States, UAE, UK and China. Diversifying the range of exportable products to make Pakistan less dependent on textile (which currently account for over 60 per cent of total exports) and other routine exports. Furthermore, Pakistan’s quality of manufactured goods mostly mismatches the
prevailing international standards as evident from the products from EU, American, Japanese and other South East Asian states. And this can be done by giving monetary and other incentives to manufacturers to engage in research aimed at developing new value-added products for the export market. Putting in place a more effective marketing mechanism aimed at finding new markets for the country’s export products. Pakistan needs to push up exports and substitute imports with local products and for this we have to widen a meaningful production base with matching capacity. Presently, out of a total of over 5,000 items being traded in the world, Pakistan has hardly 1,400 items in its kitty that are mostly of low value. However, we must have to register as a pre-requisite any export enhancement drive depends upon availability of a good number of value added items of decent quality and diverse products to our export profile otherwise exports cant take a quantum leap.

Cost Competitiveness:
There is no denying the fact that Michael Porter’s ‘cost leadership strategy’ is lynchpin of success in today’s competitive world. Unless the cost of doing business is lowered, the drive to boost our exports and reduce the trade deficit is likely to flounder. Sharp fluctuations in energy prices keep industry indecisive and tentative round the year and hence miss competitive market orders. IMF’s credit facility-carrying price tag is likely to push up energy costs and interests rates will have telling effects on our manufacturing sector. Such an anti-industrialization clause conflicts government much propagated resolve to bring shift in ‘consumption-led to production-led growth’. Therefore Pakistan’s industry shall improve its production techniques and minimize on wastage rates. Encourage new small and medium size export enterprises,
and create motivation at workplace to bring down production cost and make exports globally competitive.

Cost Effective Energy Tariff to maintain Competitiveness:
But no effort to boost exports can succeed if the government keeps imposing mandated increases in the prices of manufacturing and agricultural inputs, including electricity and gas tariffs and taxes on POL products. Pakistan’s electricity tariffs are already the highest in the world. Every increase in these tariffs increases prices across the board, raising manufacturing and farming costs and making our products less competitive in export markets. Following several rounds of mandated price increase for POL products in recent months, inland freight costs, for example, have gone up by 100 per cent since January this year. Industrial, agricultural, commercial and domestic consumers of electricity and gas have also been badly hit by several rounds of tariff increases. High cost energy would make our products further costly and hence less competitive in foreign markets. Irony of the situation is that oil prices world over has nose dive from $160 to $38 since end November but Pakistan Government has virtually refused to cut the domestic prices of petroleum products in its last four fort nights. Whereas, in the past, they have been very quick in rising domestic POL prices whenever international oil prices have risen. All this suggests that our trade gap is not likely to squeeze, our production cost will not go down and our export earnings will not go up unless the domestic prices of petroleum products are cut and electricity tariffs are reduced.

Cauterization of Industry:
Clustering of five to ten small or medium enterprises help them to pool their resources for improving production techniques, cutting down on
unnecessary expenditure, take up research and development and come out with a better product and market in domestic and export market. Reportedly, Industrial Cluster Development Program\(^{21}\) has achieved considerable success in consolidation of industries producing electric fans, cutlery in Wazirabad, garments in Lahore, leather and leather products in Korangi and gems and jewelers in Saddar (Karachi).\(^{22}\) Similarly, Sialkot Chamber of Commerce and Industry intended initiative ‘Cluster Network Development wing’ aiming to develop five clusters, sports goods, surgical instruments, gloves and personal protective equipment, sports wear and leather and leather products can be a good example to be followed in this regard.

**Technical Skills:**
Increasing exports requires bigger surpluses of goods and commodities, range of exportable products with quality matching the international standards. Quality production with differentiation requires technical skills to people entering in the industry requires. To improve productivity by enhancing education level and technical expertise it is suggested that the government should set up a chain of polytechnics for the people intending to enter industrial job market. An international survey carried out a few years ago found that the productivity of the average Japanese female factory worker was four times higher than the productivity of the average Pakistani male factory worker.

**World Trade Regulation of Agriculture Trade:**
Delay in implementation of WTO Doha round on trade in agriculture goods is also denying Pakistan to earn foreign revenue from developed world (USA, EU etc). The main irritant blocking global trade in agriculture products is the reluctance of the USA, EU, and Japan not
willing to cut the huge subsidies they give to their own farmers. These subsidies, which are currently running at a staggering $350 billion a year, have made it increasingly difficult for developing countries like Pakistan to compete with home growers on level playing field in agricultural exports to rich countries. Present government has step up her efforts in expediting the early conclusion of the trade agreement at WTO by joining hands with Group 21 and 22 in this regard.

**Conclusion**

Pakistan’s negative trade balance is a constant problem since 50s and its causes lie not in international trade but in factors affecting international capital flows. The stage has come when the problem of a deficit coupled with high inflation and low economic growth is causing the balance of payments problems to be more serious. Friendly countries are reluctant and market borrowing does not seem likely because of Pakistan’s downgraded risk rating. Privatization of national assets on dismally low prices during the period of ongoing recession is poor choice and borrowing from the IMF has started showing stresses on the public. Factors affecting the trade deficit are largely of domestic origin and that can be fixed or alleviated by the tools of the national budget and trade policy both. As a solution then, the trade gap can only be narrowed if exports are increased with wider base and a larger volume. There is no short cut but to mobilize all relevant sources. The policy needs to be aimed at reducing imports and increasing exports with broadened production base. For this there is dire need to bolster internal resources through improving system of governance, well thought out plans, fiscal discipline and broadened tax base, reviving domestic industry, and improving agricultural growth to balance the trade and repay the debts. Sharp drop in international fuel prices and expected bumper crops of rice
and wheat this year are offering an opportunity for Pakistan to control its import bill and turn the direction of trade deficit. There is a case for optimism in this regard especially if consistent efforts are made at marketing and promoting Pakistan's major export goods.
Annexure-‘A’

Imports & Exports Of Pakistan

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*Source: Federal Bureau of Statistics*
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End Notes:

2 See Annexure ‘A’ attached at the end of this paper.
4 The inflation figure measured by the sensitive price index (SPI) reached 30 percent in the week ending October 9.
5 An Oxfam report released in October 2008 estimated that “the number of poor in the country has risen from 60 to 77 million because of food inflation”.
7 Federal Statistics Bureau
8 Daily Nawai Waqt, Rawalpindi, 15th November, 2008
9 Hamid Jamal, “Hope and despare”, *The Pakistan Observer* (on line), October 11, 2008
10 Pakistan Economic Survey 2007-2008, p.vii
13 Hamid Jamal, “Hope and despair “, opcit
14 Remittances are basically foreign exchange that is remitted by the people who are living abroad to their own countries.
18 Ibid;
21 The project was initiated in 2001 by Trade Development Authority of Pakistan
22 Sabihuddin Ghausi, “Options for reducing trade deficit”, opcit