

## CAUSES AND COSTS OF FINANCIAL CRISIS IN PAKISTAN

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### ABSTRACT:

Financial crisis occurs when financial system becomes illiquid or insolvent. The basic reason of financial crisis in Pakistan is macroeconomic mismanagement including excessive public deficits and over borrowing abroad. The analysis of financial crisis and the appropriate policies needed to prevent them highlights the way various factors interact and amplify risks. These includes inadequate macroeconomic policies, surges in capital flow, fragility of domestic financial systems, weak corporate governance, and ill prepared financial and capital liberalization.

### INTRODUCTION:

The basic elements of a sound financial system are a stable macroeconomic environment, a dynamic private sector, a supportive legal framework that provides for both strong internal governance in financial institutions, and external discipline by market forces, and firm regulation and supervision. It goes almost with saying that stable macroeconomic conditions are important for a robust banking and financial system. It is not possible to establish and maintain bank soundness unless prices and other nominal variables in the economy are the evolving in relatively stable fashion and economic activity is expanding at a reasonable pace.

Pakistan is developing country, where real sector stability is particularly important. Real sector instability has been a perennial source of financial system instability in Pakistan. The basic causes of financial crises in Pakistan is no healthy macroeconomic environment, sound and stable banking system, clear legal and ownership framework that facilitates the enforcement of financial contracts, loan recovery, and realization of collateral. Because of above mentioned causes, Pakistan is facing huge amount of bad debts, higher inflation, higher rate of unemployment, devaluation of domestic currency, political instability, corruption and ethnic clashes etc.

### CAUSES OF FINANCIAL CRISIS IN PAKISTAN

**Fiscal Development:** Fiscal consolidation and financial discipline lie at the heart of structural reforms. Reducing fiscal deficit through broadening the tax base and rationalizing the tax rates on the one hand and containing the