



# **Wrong Policies, Poor Governance and Way Forward**

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# Wrong Policies, Poor Governance and Way Forward

## Pakistan Economy

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### Introduction

Pakistan's economy is in an extremely fragile state today. Foreign exchange reserves stand at below \$7 billion, barely enough to provide import cover of 1.3 months, when the minimum 'safe level' is three months. The external debt stands at \$127 billion, equivalent to 40% of the GDP. The external financing requirement is at least \$26.5 billion in 2022-23. In the first five months of the year the gross inflow from international lenders (excluding \$1.16 billion from IMF) has been \$3.7 billion, while the amortization payments have been \$4.1 billion.

This dire situation of the economy has led international credit agencies like Standard and Poor, Fitch and Moody's to downgrade Pakistan's credit rating from 'stable' to 'negative'. Recently Moody's and Fitch have gone one step further and brought Pakistan's rating down further from B3 to Caa1. Pakistan is now in the group of countries like Angola, Congo, Tunisia, Nigeria, etc., who are considered as perilously close to default.

The domestic financial situation is not much better. By the end of 2021-22 the total public debt had risen to Rs 49.2 trillion, equivalent to 74% of the rebased and higher GDP. In the absence of rebasing, it would have approached 86%.

The build-up of public debt is the consequence of rising fiscal deficits. The deficit approached 8% of the GDP in 2021-22, when the target was 6.3% of the GDP. This divergence has taken place despite a massive cut in federal development spending by 54%. The slow-down in the implementation of major infrastructure projects will inevitably impact on the future GDP growth rate.

The people of Pakistan today face the highest ever rate of inflation of 25%. This is the consequence of a rapidly depreciating currency and the phenomenal increase in international commodity prices due to the global supply shortages created by the Russia-Ukraine war.

Now the country has to contend with the worst natural disaster of floods in its history. The economic loss is estimated at almost \$30 billion. This comes in the wake of the negative impact of COVID-19. There are estimates that after the poor performance of the economy and the large negative shocks, over 92 million people of Pakistan are below the poverty line today.

The time has come for a hard and careful evaluation of the economic performance over the last two decades. The objective is to identify the wrong policies, absence of structural reforms and problems of misgovernance which have brought Pakistan to a situation today of near default in its external payment obligations. God forbid, if it does happen then the rate of inflation will hit the roof. There will be widespread shortages of food and other essential items and the GDP will contract. We have seen this happen in Sri Lanka after the country defaulted. Even the IMF has identified the risk of a social disorder in Pakistan.

There is absolutely no doubt that wide-ranging and strong policies will have to be adopted, along with major structural reforms and improved governance. The objective of this report is to identify the big moves that will have to be made to fundamentally transform the extremely difficult situation and effectively constitute the key elements of any future 'charter of the economy'.

The report is in four parts. In view of the near default situation, the focus first is on sustaining trade and balance of payments. This is followed by a diagnosis of the poor state of public finances and comprehensive reforms identified to raise quickly the tax-to-GDP ratio and reduce unproductive expenditure, especially on large subsidies to the energy sector.

The third part of the report focuses on changes in the development strategy and institutional reforms for facilitating the process of economic growth while simultaneously tackling the problems of the twin deficits in the current account of the balance of payments and public finances. The fourth part identifies improvements in economic governance including the transition from 'boom and bust' cycles to a more orderly process of growth.

## Pakistan Economy

### Key Data

KSE100 Index	41,301
KSE-All Share Value (PKRmn)	4,168
KSE-All Share Value (USDmn)	18.5
KSE-All Share Volume (Shmn)	139.7
Market Capitalization (PKRtn)	6.6
Market Capitalization (USDmn)	29.2
KSE100 Index 1 Year High	46,970
KSE100 Index 1 Year Low	39,541

Source: PSX, Next Research

### 1 Year KSE100 Index Performance



Source: PSX, Next Research

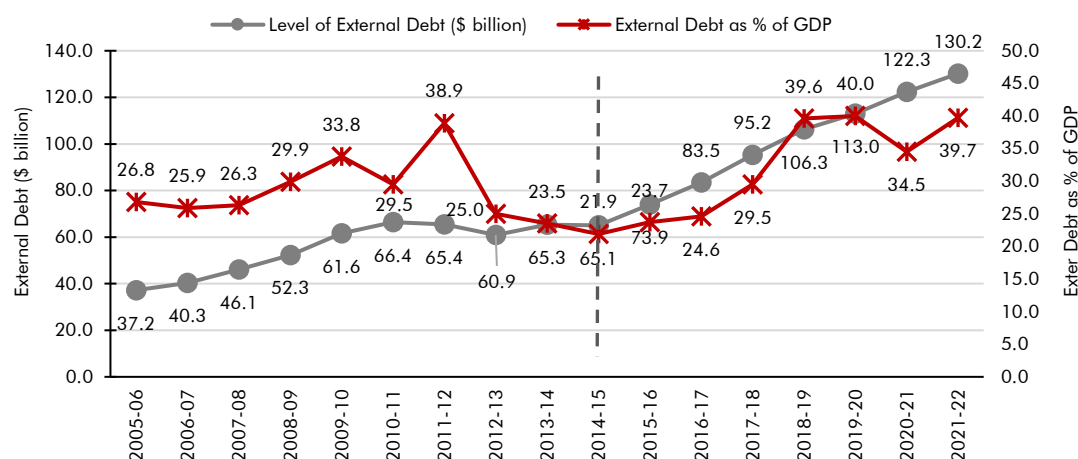
# Part 1 – Trade and Balance of Payments

## 1.1. Position of balance of payments and FE reserves

Pakistan has witnessed a very big deterioration its external financial position over the years as indicated by the following:

- (i) The external debt has doubled since 2014-15 to \$130 billion, as shown in Chart 1.1. It was 24% of the GDP in 2014-15 and now stands at 40% of the GDP, following the recent GDP rebasing. Otherwise, it would have exceeded 46% of the GDP.

**Chart 1.1 Level of external debt (in billion \$) and External debt as % of GDP**



\*GDP has been adjusted for rebasing

Source: SBP

- (ii) The annual external debt repayment has trebled since 2014-15. It was \$4 billion in 2014-15, which increased to \$12 billion in 2021-22. It is projected at over \$14 billion in 2022-23, net of rollovers.

This deterioration is primarily the consequence of large current account deficit as % of the GDP. During the last seven years, the average current account deficit has been 3.5% of the GDP. The peak year was 2017-18 when it rose to 6.4% of the GDP. In 2021-22 it was also relatively high at 4.6% of the GDP. Cumulatively, the current account deficit over the period, 2014-15 to 2021-22, is \$75.4 billion. This has been financed to the extent of \$65 billion by buildup of external debt.

The main factor contributing to the large current account deficit is the rising trend in the trade deficit in goods as a percentage of the GDP, as shown in Table 1.1. It was small at 2.1% of the GDP in 2000-01. By 2021-22, it has risen almost six times to over 12% of the GDP. Fortunately, home remittances have made an increasing contribution to financing the trade deficit.

**Table 1.1 Trend in exports, imports and trade deficit as % of GDP (% of GDP)**

Years	Exports	Imports	Trade Deficit	Home Remittances	Current Account Deficit
2000-01	12.9	15.1	-2.1	1.5	-0.7
2005-06	12.0	22.5	-9.5	2.9	-4.5
2010-11	11.6	18.9	-7.3	5.2	+0.1
2015-16	6.6	14.2	-7.6	6.3	-1.6
2016-17	6.0	15.6	-9.6	5.7	-3.6
2017-18	6.5	17.0	-10.5	5.6	-5.4
2018-19	7.1	17.0	-9.9	6.8	-4.2
2019-20	7.1	14.8	-7.7	7.7	-1.5
2020-21	7.3	16.2	-8.9	8.5	-0.8
2021-22	9.9	22.0	-12.1	8.0	-4.6

Source: PES

There has been a continuing decline in the level of exports as a percentage of the GDP. In 2000-01 they were at almost 13% of the GDP, but have declined since virtually every year to come down close to 7% of the GDP by 2020-21. Fortunately, there was improvement to 10% of the GDP in 2021-22.

Imports, on the other hand, have shown a rising trend as percentage of the GDP, from 15% of the GDP in 2000-01 to 22% of the GDP in 2021-22. The average trade deficit over the last seven years has been as high as 9.5% of the GDP.

The rapidly increasing external debt repayment is attributable to changing composition of external debt. In 2005-16, the share of short-term and medium-term debt was 13%, which has increased to 35% by 2021-22.

**Table 1.2 Composition of public external debt (\$ billion)**

	2005-06	2010-11	2015-16	2021-22
<b>LONG-TERM DEBT</b>	<b>30.1</b>	<b>45.3</b>	<b>45.9</b>	<b>65.1</b>
Paris Club	12.8	15.5	12.7	9.2
Multilateral	16.6	25.8	26.4	34.0
Other Bilateral*	0.7	2.4	5.4	18.0
Allocation of SDRs	0.0	1.6	1.4	3.9
<b>SHORT-AND MEDIUM-TERM DEBT</b>	<b>4.4</b>	<b>11.9</b>	<b>15.4</b>	<b>34.8</b>
Euro-Sukuk Global Bonds	1.9	1.6	4.6	8.8
Commercial Loans/Credits	0.1	0.0	0.9	10.5
Central Bank Deposits	0.7	1.0	0.7	2.7
SWAP Loans	1.5	8.9	6.0	6.9
Short-Term Loans	0.2	0.4	1.7	1.3
<b>TOTAL PUBLIC EXTERNAL DEBT</b>	<b>34.5</b>	<b>57.2</b>	<b>61.3</b>	<b>99.9</b>
Share of Short-Term and Medium-Term Debt	12.9	20.8	25.2	34.6

\*Mostly China

Source: SBP

The precarious financial position with regard to external payment obligations is aptly highlighted by the worsening in the ratio of foreign exchange reserves at the start of a year to the magnitude of external financing requirements during the year, which is the sum of the current account deficit and net external debt repayment during the year. This was over 150% seven years ago. It is now down to the lowest ever level of 36.5%.

**Table 1.3 Ratio of foreign exchange reserves at the start of a year and the external financing requirements during the year (\$ billion)**

Years	FE Reserves at Start of Year	External Financing Requirement During the Year			Ratio of FE Reserves to Financing Requirement
		Current Account Deficit (in absolute terms)	External Debt Repayment	Total	
2015-16	13.5	5.0	3.9	8.9	1.517
2016-17	18.1	12.3	6.6	18.9	0.957
2017-18	16.1	19.2	5.2	24.4	0.659
2018-19	9.8	13.4	8.6	22.0	0.445
2019-20	7.3	4.4	11.3	15.7	0.464
2020-21	12.1	2.8	11.2	14.0	0.864
2021-22	17.3	17.3	12.1	29.4	0.588
2022-23 (Projected)	9.8	12.3	14.5	26.8	0.365

Source: SBP, IMF

Therefore, it is not surprising that Pakistan has been included in the list of 25 countries prone to default in their external payments by the International Sovereign Debt Vulnerability Ranking of Investor Education. Pakistan's vulnerability is relatively high as indicated by its fourth position in this list.

The negative perceptions internationally of Pakistan's credit-worthiness have been highlighted by the recent downgrading of Pakistan's credit rating from B3 to Caa1. This rating is for countries very close to a default and includes other countries like Angola, Barbados, Congo, Gabon, Iraq, Maldives and Tunisia. Pakistan is the largest country in this group of vulnerable countries.

Why has Pakistan reached a near default position? What are the policies or their lack thereof which have contributed to this debacle. These are described in subsequent sections along with the steps required to reverse the consequential failures.

## 1.2. Lack of Emphasis on Export-Led Growth

Pakistan followed an import substitution strategy of growth up to the mid-90s. This policy was reversed by a rapid reduction in the level of import tariffs as described in the next section. Initially, there was success in achieving significant export-led growth.

Table 1.4 gives estimates of the extent of export-led growth in different periods. It was as high as 48% in the period, 2000-01 to 2005-06. A double-digit growth rate was achieved in the volume of exports of goods and services. Thereafter, the growth rate of exports has fallen sharply. Between 2010-11 and 2015-16, the quantum exports actually declined.

**Table 1.4 Extent of export-led growth (at constant prices)**

	Annual Rate of Growth Exports* (%)	Share in GDP of Exports** (%)	GDP Growth Rate (%)	Contribution of Exports GDP Growth Rate*** (%)
2000-01 to 2005-06	10.3	14.8	5.7	48.5
2005-06 to 2010-11	2.1	18.6	2.8	24.7
2010-11 to 2015-16	-2.6	13.6	4.5	-13.9
2015-16 to 2021-22	6.7	8.7	4.0	26.1
2000-01 to 2021-22	4.0	13.6	4.1	23.8

\*Volume of Exports Goods and Services

\*\*In the first year of the period

\*\*\*Contribution =  $m \cdot s_x \frac{g_x}{g_y}$ , where  $m$  is the multiplier,  $s_x$  = share of exports in GDP,

$g_x$  = growth rate of exports,  $g_y$  = GDP growth rate

Source: SBP, PES

Table 1.5 highlights the fact that export performance has been linked to the buoyancy in world trade in terms of the increase in international prices. From 2010-11 to 2019-20, the unit value of Pakistan's exports in US\$ has fallen. Consequently, during the last decade there has been only limited growth in exports.

The falling profitability of exports has been compounded further by the policy of maintaining an overvalued exchange rate through interventions in the exchange market. The real effective exchange rate was raised by as much as 15% from 2010-11 to 2015-16. The motivation was to reduce the component of imported inflation but it led to a fall in the volume of exports by 10% and Pakistan saw a big increase in the current account deficit.

**Table 1.5 growth in value, unit value and volume of exports in different periods annual growth rate (%)**

	Value (in \$)	Unit Value (in \$)	Volume	REER
2000-01 to 2005-06	12.2	2.4	9.8	1.0
2005-06 to 2010-11	8.1	7.6	0.5	0.2
2010-11 to 2015-16	-4.3	-2.1	-2.2	2.9
2015-16 to 2021-22	1.9	-5.4	7.3	-5.3
2000-01 to 2021-22	4.6	1.0	3.6	0.0

Source: World Bank, WDI.

## Recommendations

There is need for a comprehensive review of export policies. The current account deficit has risen once again to \$17.4 billion in 2021-22, equivalent to 4.6% of the GDP. There is need to learn from the success of countries like Bangladesh and India in South Asia and Thailand in East Asia.

Chart 1.2 presents the prevailing export incentives and institutions in a sample of countries. As compared to India, Bangladesh and Thailand, Pakistan does not offer now the following for export:

- ▶ Concessionary export finance, which was withdrawn recently
- ▶ Full export insurance, guarantees and quality management
- ▶ Export performance requirement for access to incentives
- ▶ Export cash subsidy

The classic case of an export cash subsidy is that of Bangladesh. An export cash incentive of 2% to 20% is offered on 24 export products. The rate is higher for more valued-added exports, emerging exports and on exports to new markets. India operates a duty scrip scheme. Thailand allows the double input tax deduction on domestic sales tax paid by exporters.

**Chart 1.2 Export incentives and institutions in different countries**

	India	Pakistan	Bangladesh	Thailand
1. Duty Drawbacks	Yes	Yes	Yes	Yes
2. Concessionary Export Finance	Yes	No	Yes	Yes
3. Exports Insurance & Guarantees	Yes	No	Yes	Yes
4. Export Quality Management	Yes	No	No	Yes
5. Export Processing Zones	Yes	Yes	Yes	Yes
6. Export Performance Requirement	Yes	No	Yes	Yes
7. Lower Income Tax	Yes	Yes	Yes	Yes
8. Export Promotion Agency	Yes	Yes	Yes	Yes
9. Export Cash Subsidy	Yes	No	Yes	Yes

Sources: Diverse

Clearly, Pakistan needs to greatly strengthen its export related institutions like the Trade Development Authority of Pakistan (TDAP) and The Pakistan Standard and Quality Control Authority (PSQCA).

The appropriate decision has been taken recently to levy a subsidized tariff on electricity at Rs 19.99 per kwh on export sectors. There is need also to explore the zero-rating of the domestic sales tax in export industries as was the case prior to 2019-20. Further, a cash incentive may be offered on emerging exports. Very importantly, the exchange rate should not be overvalued, and the REER should remain close to 95.

## 1.3. Over-Liberalization of Imports

As highlighted above, there has been a rapid and deep process of liberalization of imports from the mid-90s onwards. This has sometimes been undertaken under the pressure of the IMF in an on-going program.

Table 1.6 shows that in the early to mid-90s, the import tariff wall was very high. There were ten slabs and the maximum tariff was as high as 120%. The average tariff on imports was above 22%. Following six to seven moves to rationalize the tariff structure, the maximum tariff is now down to only 20%. There are three other slabs of 3%, 11% and 16% respectively. Some items have also been subjected to regulatory duties under different SROs. The average tariff on imports has now come down to only 7% from 22% two decades ago.



**Table 1.6 Number of import tariff slabs, average effective tariff and the average level of effective protection to domestic production**

	Number of Slabs	Minimum Tariff (%)	Maximum Tariff (%)	Average Weighted Tariff (%)	Average Effect Rate of Protection (%)	Revenues from Customs Duty (% of GDP)
Early to mid-90s	10	0	120	22.5	177	5.1
2007-08 to 2010-11	7	0	35	7.1	65	1.4
2012-13	7	0	30	5.7	52	1.6
2014-15	6	1	25	7.0	48	1.0
2015-16	5	2	20	7.2	35	1.0
2016-17*	4	3	20	9.0	33	1.4
2019-20*	4	0	20	9.2	33	1.5
2021-22	4	0	20	7.0	33	

\*Higher because of Regulatory Duties

Source: FBR Customs Tariffs and Estimates

There is need to recognize also that today Pakistan has even lower tariffs than India and Bangladesh, as shown in Table 1.7, despite the much stronger export base of these two countries, the average MFN tariff is 11% in Pakistan, while it is 14% in Bangladesh and over 18% in India. The latter country has kept very high import tariffs on agricultural items to protect its domestic agricultural sector. As opposed to this, Pakistan, for example, has a zero duty on cotton imports.

**Table 1.7 comparison of import tariffs in Pakistan, India and Bangladesh (average MFN tariff)**

	Year	Agriculture	Non-Agriculture	Overall
India	2021	39.2	14.9	18.3
<b>Pakistan</b>	<b>2021</b>	<b>13.4</b>	<b>10.9</b>	<b>11.2</b>
Bangladesh	2021	17.6	13.4	14.0

Source: WTO, World Tariff Profiles

The extremely large scaling down of import tariffs since the mid-90s has also implied substantial revenue losses. At its peak, the revenues from customs duty in the early 90s were as high as 5% of the GDP. They are now down to below 1.5% of the GDP. This has also implied consequential losses in revenues from the import sales tax.

## Recommendations

The level of imports reached an all-time peak of 22% of the GDP in 2021-22, due particularly to the explosion in the international commodity prices after the start of the Russia-Ukraine war. This has now led to a global recession and prices are coming down significantly. This is an opportune time for raising the level of import tariffs without impacting significantly on the domestic price level. The recommended move is enclosed. The maximum tariff will rise from 25% to 35%. However, the import tariffs on basic food items and medicines should remain unchanged at present levels.

Slab	Present Tariff (%)	Proposed Tariff (%)
1	3	5
2	11	15
3	16	25
4	20	35

The Customs department should develop a system of determining from different sources the latest international prices, like the UNCOMTRADE database, and comparing them with the actual prices in import invoices. There is considerable evidence of significant under-invoicing by importers.

Also, a 1% handling charge should be levied on the c.i.f. value of an import consignment, as is the case in India currently.

## 1.4. Maintaining an Overvalued Exchange Rate

The Real Effective Exchange Rate (REER) compares Pakistan's rupee against the weighted average of the currencies of its major trading partners. It is an indicator of the international competitiveness of a nation in comparison with its trading partners. A rising or high REER indicates that Pakistan is losing its competitive edge, with relatively expensive exports and relatively cheap imports.

The SBP computes the REER of Pakistan on a monthly basis. It is in the form of an index with the base year of 2010 = 100. The latest REER is as follows:



	REER
July 2021	99.6
September 2021	96.7
December 2021	96.8
March 2022	96.7
June 2022	94.0
July 2022	93.2
August 2022	94.3

Therefore, the Pakistani rupee has been depreciating in relation to other currencies since July 2021. However, since end-July the rupee has appreciated by 10% and the REER stands currently at close to 100.

The long-term trend in the nominal value of the rupee and the REER since 2000-01 is given in Table 1.8. Substantial variation can be observed in the magnitude of the REER in different periods.

The first epoch was from 2000-01 to 2004-05 when it remained significantly below 100. Thereafter, it remained close to 100 up to 2013-14. The PML-N government adopted the policy of Keeping the REER very high above 100 to severely quell the component of imported inflation. As opposed to this, the successor PTI government adopted the policy of sharp depreciation of the rupee and brought down the REER to 94 from 115. The objective was to reduce the current account deficit from the highest ever level of \$19.4 billion in 2017-18 and restore a semblance of sustainability in the balance of payments.

**Table 1.8 trend in the nominal and the real effective exchange rate**

Years	Nominal Exchange Rate (Rs/\$)	Real Effective Exchange Rate (1990-91 = 100)	Years	Nominal Exchange Rate*	Real Effective Exchange Rate* (1990-91 = 100)
2000-01	58.44	96.47	2010-11	85.50	102.30
2001-02	61.42	98.40	2011-12	89.24	104.18
2002-03	58.49	98.42	2012-13	96.73	100.74
2003-04	57.27	95.57	2013-14	102.86	97.69
2004-05	59.36	92.29	2014-15	101.29	112.85
2005-06	59.86	101.36	2015-16	104.24	118.28
2006-07	60.63	100.00	2016-17	104.70	123.26
2007-08	62.54	98.67	2017-18	109.84	115.54
2008-09	78.49	97.09	2018-19	136.69	97.47
2009-10	83.80	99.49	2019-20	158.02	95.72
			2020-21	160.02	96.33
			2021-22	177.85	93.98

Above 98 in 13 out of 22 years

\*Average for year

Source: SBP

The impact on the volume of exports and imports during these two periods is given below:

Annual Growth Rate in Volume (%)				
Parties	Period	Average REER	Exports	Imports
PML(N)	2013-14 to 2017-18	113.52	0.3	11.6
PTI	2018-19 to 2021-22	95.87	6.6	4.2

Source: SBP, WDI

It is clear that the policy of bringing down the REER was successful in raising the growth rate of the volume of exports and reducing the growth rate of the volume of imports during the tenure of the PTI government.

## Recommendations

Based on the above analysis, the policy ought to be to keep the REER close to 95. The over 9% appreciation of the rupee from the end of July to the 10th of October 2022 is likely to have raised the REER to almost 100. This has increased the risk of a widening of the trade deficit in the coming months of 2022-23.

### 1.5. Over-Emphasis on Textile Exports

Pakistan's exports have been characterized by a high level of dependence on textile exports. the share of textile exports in total exports stands currently at 56.6%. It has declined only marginally from 61.8% in 2005-06. The other two product groups are agricultural commodities and other manufactures with shares of 16.6% and 26.8% respectively in 2021-22, as shown in Table 1.9.

**Table 1.9 Product diversification of exports (\$ billion)**

	2005-06	2010-11	2015-16	2019-20	2021-22
Agricultural Commodities Group	2.0 (12.0)*	4.5 (18.1)	4.0 (19.2)	4.4 (20.6)	5.4 (16.6)
Textile Group	10.2 (61.8)	13.8 (55.6)	12.4 (59.6)	12.5 (58.4)	18.4 (56.6)
Other Manufactures Group	4.3 (26.2)	6.5 (26.3)	4.4 (21.2)	4.5 (21.0)	8.7 (26.8)
<b>TOTAL</b>	<b>16.5</b>	<b>24.8</b>	<b>20.8</b>	<b>21.4</b>	<b>32.5</b>
Index of Export Diversification**	0.535	0.589	0.563	0.573	0.581

\*Share of total exports

\*\*This is  $I = 1 - \sum_{i=1}^n S_i^2$  where  $S_i$  is the share of the  $i^{th}$  product group

Source: SBP

The Index of Export Diversification is estimated at 0.581, with the maximum value of 1. It has shown only a minor improvement from 0.535 to 0.581. This is largely attributable to the rise in the share of agricultural commodities.

Table 1.10 presents the list of exports currently in the following ranges:

Traditional Export:	Above \$1 billion
Emerging Export:	\$500 million to below \$1 billion
Nascent Export:	\$250 million to below \$500 million

The list has seven export items with exports above \$1 billion, consisting of textile products and rice, and total exports of \$18.3 billion. There are four emerging exports of sports goods, leather manufactures, chemicals and made-up textiles. They have a share of 9% in total exports.

The prospects for export diversification are enhanced by the ten exports in the nascent list. They include agricultural items like fish, fruit, vegetables and meat. Industrial items are art silk and synthetic textiles, surgical goods, plastic materials, pharmaceuticals, engineering goods and cement.

**Table 1.10 Traditional, emerging and nascent exports of Pakistan 2021-22**

> 1 billion		\$500 million to \$1 billion		\$250 million to \$500 million	
Traditional		Emerging		Nascent	
Rice	2211	Made-up Articles	806	Fish	419
Cotton Yarn	1200	Sports Goods	506	Fruits	469
Cotton Cloth	2338	Leather Manufactures	649	Vegetables	274
Knitwear	4516	Other Chemicals	797	Meat	352
Bedwear	3254			Art Silk & Syn. Textile	342
Towels	1080			Surgical Goods	474
Readymade Garments	3698			Plastic Materials	440
				Pharmaceuticals	273
				Engineering Goods	313
				Cement	314
<b>TOTAL</b>	<b>18297</b>	<b>TOTAL</b>	<b>2758</b>	<b>TOTAL</b>	<b>3670</b>

Source: SBP

## Recommendations

There is need to provide strong incentives and prepare an export development plan for emerging and nascent export items. As such, the recommendations include the following:

- The Commerce Ministry and the Pakistan Trade Development Authority should identify the principal constraints to the growth in emerging and nascent exports, in collaboration with an international Multilateral agency like the World Bank. The steps and projects necessary for removing the constraints should be identified and implemented on a priority basis.
- The 10 emerging or nascent manufactured goods identified in Table 1.10 should be declared as zero-rated industries and not subject to domestic sales tax.
- All SMEs in both the agricultural and manufactured goods categories should enjoy the benefit of special access to commercial bank loans with access to special tax credit facility for the banks.

## 1.6. Under Development of Service Exports

Pakistan has largely failed to exploit the potential for service exports. As shown in Table 1.11, these exports aggregate to only \$7 billion, and have shown a modest growth rate of only 4% since 2015-16. Fortunately, starting from a low base, telecom and information services have shown rapid growth rate of 20% and have now emerged as the largest service export at \$2.6 billion. However, this still stands in sharp contrast to high level of IT exports of India of \$120 billion.

**Table 1.11 Trend in export of services (\$ million)**

	2015-16	2021-22	ACGR (%)
<b>TOTAL SERVICES EXPORT</b>	<b>5455</b>	<b>6957</b>	<b>4.0</b>
Transport	1125	807	-5.5
Travel	323	541	8.6
Financial Services	110	112	0.0
Telecom & Information Services	788	2165	20.0
Other Business Services	1009	1644	8.1
Government Services	1946	1071	-10.0
Others	154	167	1.3

Source: SBP

## Recommendations

The Ministry of Information Technology may be given special development funds to expand the capacity for basic and advanced training to undergraduate students in engineering universities and business schools in IT. Also, efforts must be made to bring the export earnings from IT into formal channels.

### 1.7. One-Sided FTA with China

There has been a special bilateral trade relationship between China and Pakistan since 2006, with a number of items of each country subject to zero or concessionary import tariffs. The Pak-China early harvest agreement included the lists of these items.

The Phase-II of the CPFTA was signed on the 28th of April 2019 in Beijing. The major features are as follows:

- (i) Market Access: China will immediately eliminate tariffs on 313 most priority lines of Pakistan's interest. Included are textiles and garments, sea food, meat prepared foods, leather, chemicals, plastics, oil seeds, etc.
- (ii) China will liberalize 75% of its tariff lines in a period of 10 years and Pakistan will do so in 15 years. Some safeguard measures have been included, but they have generally not been applied.

The trend in bilateral trade between the two countries is shown in Table 1.12. The FTA has resulted in a very imbalanced pattern of trade between the two countries. China exports to Pakistan over six times as much as it imports from Pakistan. It is the largest exporter to Pakistan with a share in Pakistan's imports of almost 25%.

**Table 1.12 Trend in trade with China (\$ million)**

EXPORTS	2005-06	2010-11	2015-16	2019-20	2021-22
China Exports to Pakistan	2706	3534	12098	13301	17296
Pakistan's Exports to China	464	576	1670	2043	2781
Ratio	5.83	6.13	7.24	6.51	6.22

Source: SBP

### Recommendations

There is need for review and renegotiation of the FTA with China. It is extremely unusual that there is so much imbalance in trade between two countries in an FTA. China should be asked to expedite the process of moving to zero tariffs, especially on the full range of textile products, on import from Pakistan.

A comprehensive review must be undertaken by the Ministry of Commerce along with the National Tariff Commission to determine if particular duty-free imports from China have inflicted severe damage to different industries. In such cases, the zero-import tariff may be withdrawn in consultation with China.

### 1.8. Increasing Return on Roshan Digital Accounts

Cumulative inflow under the Roshan Digital Accounts (RDA) reached \$5.14 billion at the end of September, 25 months since the programme was launched, according to data released by the State Bank of Pakistan (SBP).

RDA inflows decreased by 10% month-on-month to \$168 million in September, down from \$187 million in August, 2022 and representing the lowest monthly inflow since January 2021.

Meanwhile, out of the overall \$5.149 billion deposited in RDAs, \$3.262 billion or almost 63.35% have been invested in Naya Pakistan Certificates (NPCs). Of this, \$1,691 million have been invested in conventional NPCs, whereas \$1,571 million have been invested in Islamic NPCs.

Overseas Pakistanis from 175 countries have so far opened some 472,023 accounts under RDA. On a monthly basis, the number of accounts opened has increased by 3%.

This is the first time in Pakistan's history that non-resident Pakistanis (NRPs) are being provided an opportunity to remotely open an account in Pakistan through an entirely digital and online process without any need to visit a bank branch.

The RDA is a very innovative initiative of the State Bank, in collaboration with commercial banks in Pakistan, to provide innovative banking solutions to NRPs, including Non-Resident Pakistan Origin Card (POC) holders, seeking to undertake banking, payment and investment activities in the country. The initiative was launched in September 2020 by the SBP and offered up to 7% profit on US dollar investment.

The central bank increased the rate of return for investment in PKR-denominated NPCs by up to 550 basis points (bps) in August. However, the rate of return on US dollar-dominated certificates has remained unchanged.

The rate of return on 3-Month PKR-dominated NPCs, with a minimum investment of 10,000 with integral multiples of 1,000, has increased from 9.50% to 15%, and the rate of return on 6-Month PKR-dominated certificates rose by 5.25% to 15.25%.

In addition, the rate of return on 12-Month PKR-dominated NPCs surged by 5% to 15.50%, for 3-year certificates it went up from 10.75% to 14%, while the rate of return on 5-year NPCs increased from 11% to 13.5%.

### Recommendations

The time has also come for raising the rate of return dominated RDAs in the presence of a global upsurge in interest rates and heightened risk perceptions of investment in Pakistan. As such, the recommendation is that the rate of return be enhanced by 2 percentage points. The cost will still be lower than the flotation of Euro/Sukuk bonds.

The above comprehensive set of recommendations in the eight sections in this part of the report on trade and balance of payments should facilitate faster growth of exports and restrict the rise in imports substantially. They will need to be implemented soon to restore a semblance of sustainability in the balance of payments of the country and reduce the likelihood of a default.

## Part 2 – Managing the Public Finances

### 2.1. Introduction

The worrying state of public finances is aptly reflected by the accumulation of Central Government Debt, as shown in Table 2.1. The Fiscal Responsibility and Debt Limitation Act of 2005 placed a limit on the size of the government debt at 60% of the GDP. As of June 2022, it was Rs 47.8 trillion, equivalent to 71.4% of the rebased GDP. In the absence of the recent rebasing of the GDP, it would have been as high as 83%.

**Table 2.1 Trend in central government debt (Rs in billion)**

	DOMESTIC DEBT		EXTERNAL DEBT		TOTAL DEBT	
	Level	% of GDP	Level	% of GDP	Level	% of GDP
2009-10	4653	29.2	3789	23.8	8442	53.0
2010-11	6014	30.4	4159	21.0	10173	51.4
2011-12	7637	34.9	4544	20.8	12181	55.7
2012-13	9520	38.7	4487	18.2	14007	56.9
2013-14	10906	39.1	4877	17.5	15783	56.6
2014-15	12192	39.8	4775	15.6	16967	55.4
2015-16	13626	41.6	5417	16.6	19043	58.2
2016-17	14849	41.8	5919	16.6	20768	58.4
2017-18	16416	41.9	7795	19.9	24212	61.8
2018-19	20732	47.3	11055	25.2	31787	72.2
2019-20	23282	49.0	11824	24.9	35107	73.9
2020-21	26265	47.1	12439	22.2	38704	69.3
2021-22	31036	46.4	16746	25.0	47782	71.4

Source: SBP

The share of relatively high-cost domestic debt has increased from 55% to 65%, while that of external debt has declined from 45% to 35%. The annual cost of debt servicing has risen from 2.8% of the GDP to 4.8% of the GDP, due also to a rise in the average interest rate. This has not only implied a higher budget deficit but has also led to a squeezing out of development spending, with the inevitable impact on GDP growth.

The primary factor contributing to the rapid increase in government debt is the growing divergence between the level of revenues and the level of expenditure, as shown in Table 2.2. Consequently, with a rising budget deficit, the financing needs through borrowing have increased exponentially.

**Table 2.2 Long-term trends in the public finances of Pakistan**

	TOTAL REVENUES			TOTAL EXPENDITURE		DEFICIT	
	Tax Revenues	Non-Tax Revenues	Total Revenues	Debt Servicing	Total Expenditure	Budget Deficit	Primary Deficit/Surplus
2005-06	9.4	3.2	12.6	2.8	16.4	-3.8	-1.0
2010-11	8.6	5.4	14.0	3.5	17.4	-3.4	0.1
2015-16	11.2	2.4	13.6	3.9	17.7	-4.1	-0.2
2016-17	11.2	2.7	13.9	3.8	19.1	-5.2	-1.4
2017-18	11.4	1.9	13.3	3.8	19.1	-5.8	-2.0
2018-19	10.2	1.0	11.2	4.8	19.1	-7.9	-3.1
2019-20	10.0	3.2	13.2	5.5	20.2	-7.0	-2.5
2020-21	9.5	3.9	12.4	4.9	18.5	-6.1	-1.2
2021-22	10.1	1.9	12.0	4.8	19.9	-7.9	-3.1

Source: MOF, Fiscal Operations

There has been virtually no increase in the tax to GDP ratio as shown in Table 2.3. It reached a peak of 11.4% of the GDP in 2017-18 and has since actually fallen to 10.1% of the GDP in 2021-22. Simultaneously, the non-tax to GDP ratio has shown a fluctuating trend. Overall, total revenues have fallen from the peak of 13.9% of the GDP in 2016-17 to 12% of the GDP in 2021-22.

Total expenditure has been showing a rising trend. It has increased from 16.4% of the GDP in 2005-06 to almost 20% of the GDP in 2021-22. Overall, the budget deficit has risen rapidly from 3.8% of the GDP to almost 8% of the GDP in 2021-22.

**Table 2.3 Trend in individual tax and overall tax-to-GDP ratio**

Year	FEDERAL TAXES*					PROVINCIAL TAXES			Overall Tax-to-GDP Ratio
	Income Tax	Sales Tax	Customs Duty	Excise Duty	Total	Sales Tax on Services	Others	Total	
1999-2000	2.7	2.8	1.4	1.3	8.2	0.0	0.4	0.4	8.6
2004-05	2.5	3.3	1.5	0.7	8.0	0.0	0.3	0.3	8.3
2009-10	3.4	3.4	1.0	0.8	8.6	0.0	0.3	0.3	8.9
2014-15	3.4	3.6	1.0	0.5	8.5	0.4	0.3	0.7	9.2
2019-20	3.2	3.3	1.3	0.5	8.3	0.5	0.4	0.9	9.2*
2020-21	3.1	3.6	1.4	0.5	8.6	0.5	0.4	0.9	9.5
2021-22	3.4	3.8	1.5	0.5	9.2	0.5	0.4	0.9	10.1

\*Petroleum levy transferred to non-taxes

Source: MOF

## 2.2. Low tax-to-GDP ratio

As highlighted above, the tax-to-GDP ratio of Pakistan is relatively low. It currently stands at close to 10% of the GDP. As compared to this, the tax-to-GDP ratio of India is 20%. Results of research on the magnitude of the 'tax potential' of Pakistan is that it is close to 15% of the GDP.

The other structural problem with Pakistan's tax system is that it is heavily tilted towards indirect taxes, implying greater regressivity. Almost two-thirds of the revenue is from indirect taxes. A further complication is the reliance on withholding collections in the income tax regime, many of which are in the nature of indirect levies.

The tax gap of 5% of the GDP is partly explained by the widespread 'tax expenditures' in the tax system. These are revenues foregone due to tax exemptions, reliefs and concessions. According to the FBR, the total tax expenditure was Rs 1482 billion in 2021-22, equivalent to 2.7% of the GDP. Therefore, even if these tax expenditures largely continue, there is still scope for raising an additional 2.3% of the GDP through wide-ranging and deep tax reforms. This will enable generation of an additional Rs 1500 billion and contribute in a big way to improving the state of public finances in the country.

The agenda of proposed tax reforms is given below.

### Income Tax

#### Recommendations

**Transition from Block to Comprehensive income:** Currently, the practice is to tax blocs of income separately. This has greatly reduced the progressivity of the tax system. Usually, the tax return contains only earned income. Unearned income in the form of interest, dividends, property income and capital gains are subject to presumptive taxation separately. For example, interest income is subject to a fixed tax of 15%.

There is need for taxation of comprehensive income by adding all types of income. This will usually imply that the marginal tax rate on unearned income becomes higher. As such, the existing presumptive taxes should be transformed into advance withholding taxes. It will lead to a fairer tax system with persons having total income of less than Rs 600,000 or lower marginal tax rate being able to claim a tax refund.

**Capital Gains Tax:** The concept of holding period has been applied on capital gains and property and shares. Beyond the holding period there is zero tax. Within the holding period, the entire capital gain will be subject to taxation, at rates given below.



Holding period < 1 year	Tax rates		
	Open Plot/ Shares	Constructed Property	Flats
> 1 - < 2 years	15%	15%	15%
> 2 - < 3 years	12.5%	10%	7.5%
> 3 - < 4 years	7.5%	5%	0% (2.5%)
> 4 - < 5 years	5%	0% (2.5%)	0% (2.5%)
> 5 - < 6 years	2.5%	0% (2.5%)	0% (2.5%)
> 6 years	0% (2.5%)	0% (2.5%)	0% (2.5%)

The proposal is for a minimum rate of capital gains tax of 2.5%, irrespective of the holding period, as shown in the above table.

**Rationalization of the Withholding Tax Regime:** The withholding tax system within income tax contributed 69% to revenues in 2021-22. There are at least 70 levies in the form of advance or fixed and final taxes. The top levies are on imports, contracts and services, salaries, dividends, interest, technical fees, exports, income from property, cash withdrawal from banks and on electricity bills. Collectively, they contribute 84% to the total revenue from withholding taxes.

There is a strong case for reducing the number of small withholding taxes and thereby contributing to greater ease of doing business. The advance tax on electricity bills should be developed as a way of taxing incomes in the informal sector. Also, the same advance tax rates should be charged from filers and non-filers, as the latter may be genuinely exempt.

**Changing the Tax Credit Scheme:** The tax credit scheme for individual and corporate taxpayers is as follows:

TAX CREDIT ON	UP TO
<ul style="list-style-type: none"> <li>Charitable Donations</li> </ul>	<ul style="list-style-type: none"> <li>30% of individual taxable income</li> <li>20% in the case of companies</li> </ul>
<ul style="list-style-type: none"> <li>Investment in Shares and Insurance</li> </ul>	<ul style="list-style-type: none"> <li>20% of individual taxable income</li> </ul>
<ul style="list-style-type: none"> <li>Investment in Health Insurance</li> </ul>	<ul style="list-style-type: none"> <li>5% of taxable income</li> </ul>

The formula for determining the tax credit is as follows:

$$\text{Tax Credit} = \frac{A}{B} \times C$$

where A = amount of tax assessed, B = taxable income, C = amount spent for claiming the tax credit. This favors the larger taxpayer whose average tax rate is higher. As such, a fixed tax credit should be given at a rate equal to 20% of the amount spent for claiming the tax credit, subject to the condition that the minimum overall income tax liability is zero, with the provision of carryover.

Further, a tax credit facility may be offered on repayment of housing loans up to 15% of income or 20,000 per month whichever is lower.

In addition, detection of evasion can also be done via personal (domestic) electricity bills. For unclear reasons, the exemption limit of the withholding tax has been raised enormously by FBR to Rs 75000 per month of electricity bill. The proposal is as follows:

#### WITHHOLDING INCOME TAX ON DOMESTIC ELECTRICITY BILLS

Monthly Electricity Bill (Rs)	Advance / Withholding Tax Rate
Less than Rs 20,000	Exempt
Rs 20,000 to Less than Rs 40,000	5%
Rs 40,000 to less than Rs 60,000	7½%
Rs 60,000 and above	10%

Now, this withholding tax has been introduced only on persons who are not in the Active Tax payers list and have a bill above Rs 25000.

**Progressive Corporate Income Tax:** There are many corporate entities which are favorably placed in the market situations and enjoy a degree of monopoly power. Sometimes, higher profits are also due to access to a scarce natural resource or because of rise in prices of competing imports.

The proposal is to introduce a degree of progressivity in the corporate income tax system, as follows:

#### PROPOSED STRUCTURE OF CORPORATE INCOME TAX

Pre-Tax Net Return on Equity	Tax Rate (%)   (on Net Profits)
0% to less than 17.5%	29%
17.5% to less than 25%	29% + 10% on the profit above 17.5% on equity*
25% and above	29% + 20% of the profit above 17.5% of equity**

\*For example, if the pre-tax return on equity is 24% then the effective tax rate will be 29.65%

\*\*For example, if the pre-tax return on equity is 30% then the effective tax rate is 31.5%

**Incentives for Filing Returns:** The following incentives may be given to induce tax filing by more income earners:

- An individual taxpayer who files a tax return for the first time to be exempt from audit for the first three years.
- An individual who has been an active taxpayer for at least the last three years to be exempt from audit if income declared is 20% higher than the previous year.

**Prevention of under invoicing of imports:** The approach adopted should be to introduce International Trade Prices (ITPs) on imports likely to be under invoiced. These ITPs should be based on export data of the items to other countries.

**Rationalization of Tax Expenditures:** The proposals for rationalization of various tax expenditure are as follows:

- Large pensions are subject to taxation in most countries. As such a flat rate of 10% may be charged on pension amounts above 2,000,000 annually.
- The tax credit to NGOs should be made available only to those NGOs operating in the fields of education, health, or social safety nets.

The Initial Depreciation Allowance and the Tax Credit on BMR should be retained as fiscal incentives for higher investment. The revenue foregone will be more than recovered by the expansion in the value added tax base due to the investment. However, the first facility has been withdrawn in the budget for 2021-22.

**Minimum Taxation of Rental Income:** The total revenue collected from rental income taxation is Rs 20 billion, which is not even 1.5% of the total revenues from the income tax. The estimated rental income on property owned by households in the top two income quintiles is over Rs 780 billion. As such, the potential revenue is at least three times the actual revenue.

Therefore, to control the underreporting of rental incomes, it is proposed to introduce a minimum tax on rental incomes. The minimum rental value of a property may be set at 3% of the capital value as per the Valuation Tables of FBR for neighborhoods in the cities of Pakistan.

**Income Taxation of Commercial Banks:** The credit extended by commercial banks to socially preferred sectors including agriculture, SMEs, housing, micro credit, and infrastructure is only 12% of total advances. There is need for raising the share of these sectors.

A taxation scheme is proposed as follows:

FIRST PART	SECOND PART	THIRD PART
If the share is below 20% the corporate income tax rate will be higher at 45%	For increase in credit share to beyond 20% a tax credit of 5% of the additional credit will be made available	The provision for tax deductibility for bad loans in these sectors will be increased to 10% of total advances to these sectors

**Taxing the Informal Sector:** The pragmatic approach to taxing sectors which are informal in nature and income earners are prone to tax evasion due to lack of documentation is to operate a regime of presumptive taxes. Proposed new measures will replace the large number of existing small withholding taxes.

The proposed withholding tax system on electricity bills for commercial establishments, engaged in wholesale and retail trade and other services is as follows:

	Size of Monthly Electricity Bill
Exemption limit	Rs 1,000
Rs 1,001 – 5,000	5%
Rs 5,000 – 15,000	7½%
Rs 15,000 and above	10%

Some changes have been introduced in this withholding tax in the latest Budget, which have since been withdrawn.

### Indirect Tax Reforms

The share of indirect taxes, inclusive of income withholding taxes, is very high in Pakistan at 82% and it has been increasing in recent years. Therefore, the focus should be more on broad-basing and reduction in tax rates rather than on enhancement of tax rates. The implementation of direct tax reforms described above should be followed by a reduction in the general sales tax rate to 15%.

### Recommendations

The following reforms are proposed in indirect taxes.

- Move towards a nationally integrated sales tax on goods and services with VAT features. This will lead to a closer approximation of the tax to a comprehensive value added tax. Both taxpayers of sales tax on goods and services respectively will file the same tax return. There will be one tax rate throughout the country and the same for goods and services. This fundamental reform will both widen the coverage and substantially reduce evasion.
- The time has come for the imposition of an import duty and sales tax on selected services. The 'reverse charge' principle can be applied to the collection of the tax.
- Reduction of tax evasion can be achieved by a levy of the sales tax on more goods on the manufacturer on the basis of the notified retail price. Most luxury consumer goods and consumer durables should be taxed on the retail price and paid for by the manufacturer.
- The excise duty is leviable on items which can be considered as harmful. As such, it should be extended on all and services which pollute the environment or lead to the depletion of natural resources that are important from the environmental point of view like wood products, brickkilns, chemicals, etc.

### Provincial Tax Reforms

As highlighted earlier, the total revenue from provincial taxes is only 0.9% of the GDP, despite the presence of large tax bases of the agricultural income tax; sales tax on services and the urban immovable property tax.

### Recommendations

The proposed reforms in agricultural income tax which currently yields only Rs 3 billion in the four Provinces combined are as follows:

The flat rates by farm size of the agricultural income tax to be set as follows given below:

Farm Size (Acres)*	Tax Rate per Acre
< 25	Exempt
25 – 50	Rs 250 per acre above 25 acres
50 – 100	Rs 6250 + Rs 500 per acre above 50 acres
100 – 150	Rs 31250 + Rs 1000 per acre above 100 acres
150 and above	Rs 81250 + Rs 2500 per acre

\*Barani acres. Twice the farm size for irrigated acres

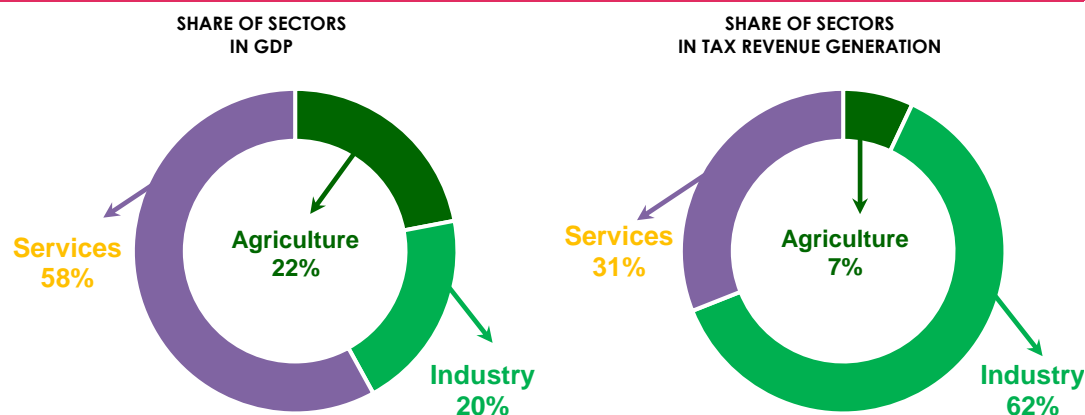
The urban immovable property tax yields only Rs 26 billion annually and only Rs 10 billion in Karachi. There is significant revenue potential of this tax. Exemptions should be given on properties located on plots of up to 240 sq yds or with covered area of less than 800 sq ft.

Beyond the exemption, the Gross Annual Rental Values may be assessed initially at equal to 2% of the capital value of properties. These capital values can be obtained at the level of localities from the nationwide comprehensive valuation of properties by FBR.

### 2.3. Lack of Broadening of the Tax System

The tax system of Pakistan is currently heavily skewed towards the industrial sector. Research reveals that the distribution of nominal incidence by sector is as shown in Figure 2.1.

**Figure 2.1 Sectoral share of GDP and tax revenue generation**



The effective tax incidence as % of value added is as follows:

Agriculture	Industry	Services
2.4	26.4	4.7

Therefore, there is a strong case for sectoral diversification of the Federal and Provincial tax systems.

### Recommendations

Based on the above-mentioned reforms, the incidence of taxes on the agricultural sector and the services sector respectively will be achieved in the following ways:

#### SERVICES SECTOR

- Development of the Sales Tax on Services
- Levy of withholding income tax on electricity bills of commercial consumers
- Introduction of import duty and sales tax on imports of services

- (iv) Higher collection from the urban immovable property tax

#### AGRICULTURE SECTOR

- Development of the Agricultural Income Tax

The recommendations now focus on the expenditure side of the Federal and Provincial Governments.

#### 2.4. Increases in Employee Remuneration

The salaries and allowances of government employees have increased rapidly due to periodic awards announced in the budgets. Also, the employment in the Public Administration and Defence sector has increased significantly by almost 4.9% per annum, especially in the social services.

An analysis is undertaken of the trend in real incomes of government employees in Table 2.4. The perhaps not so surprising finding is that the levels of compensation, after adjusting for inflation, have risen in real terms from 2015-16 to 2020-21 by 10%. This has happened at a time when real wages in the private sector have tended to fall.

**Table 2.4 Growth in compensation of government employees (Rs in billion)**

	2014-15	2020-21	Annual Growth Rate (%)
Total Bill of Compensation to Government Employees, Civil and Military	1911	3424	11.7
% of Current Expenditure	33.0	37.7	
Employment - (million)	3.95	4.62	3.1
Compensation per Employee - (Annual in Rs)	483,800	741,000	8.5

Source: PES, MOF

The consequence is that with a near 5% growth annually in employment and almost 9% in average compensation, the salary bill is consuming a larger part of the budget of federal and provincial governments. The share of the salary bill has gone up from 33% to almost 38%.

#### Recommendations

The time has come for restricting the employment growth in the government sector. Barring the service departments, there should be a ban on recruitment for the next three years and all vacancies currently notified be cancelled. Further, the increase in emoluments should be restricted to a maximum of 10% each year.

#### 2.5. Down-sizing of Federal Government

Following the 18th Amendment and the potential transfer of functions to Provincial Governments, there was the expectation that the Federal Government would contract in size. But this has not happened. There are 33 Ministries, 48 Divisions and over 100 Attached Departments/Autonomous Bodies.

#### Recommendations

The time has come a high priority zero-based budgeting exercise to rationalize the size of the Federal Government, starting with the handover of higher education to Provincial Governments.

#### 2.6. Managing the Cost of Pensions

The pensions paid annually have risen to almost Rs 1000 billion (Federal and Provincial Governments: Rs 600 billion. Military: Rs 400 billion), with near doubling over the last five years.

#### Recommendations

The following proposals may be implemented:

- (i) Setting a target of zero growth in pension liabilities over next 3 years.
- (ii) Extension of retirement age from 60 to 63.
- (iii) Increasing superannuation minimum limit to 30 years of service.
- (iv) Federal and provincial governments to establish contributory scheme for all new entrants in government service.

- (v) Establishment of Pension Funds: The Federal Government has made a small beginning this year with Rs 10 billion contribution to a Pension Fund.

## 2.7. Improved Management and Privatization of SOEs

The burden placed by SOEs on the Federal Budget has become very large due to the following:

- (i) Subsidies to the SOEs, especially in the Power Sector.
- (ii) Cost of Servicing Guaranteed Debt of the SOEs.

The cost has approached Rs 1500 billion in 2021-22 and is now even larger than the budget for defence services.

There is a strong case for privatization of some of the 85 commercial SOEs, especially the loss-making ones.

### Recommendations

The following criteria are suggested for Evaluating an SOE for privatization:

#### CRITERIA FOR EVALUATING CASE FOR PRIVATIZATION

S. #		Score	S. #		Score
1.	<b>Profit-Making</b>		4.	<b>Outstanding Liabilities</b>	
	▪ If losses	1		▪ If no or small liabilities	1
	▪ If small profits	½		▪ If large liabilities	0
	▪ If large profits	0	5.	<b>Performance of Core Social or Economic Functions</b>	
2.	<b>Monopoly</b>			▪ If functions not performed	3
	▪ If in a competitive market	2		▪ If performed	0
	▪ If a monopoly	0	6.	<b>Over employment</b>	
3.	<b>Regulatory Authority</b>			▪ If large over employment	0.5
	▪ Yes	1		▪ If no or small over employment	0
	▪ No	0			

The application of these criteria to a sample of SOE's reveals the following:

#### CASE FOR PRIVATIZATION OF A SAMPLE OF SOEs

YES	Score	NO	Score
Pakistan Steel Mill	8.5	Pakistan State Oil	4.0
National Shipping Corporation	8.0	Sui Southern Gas Company	3.5
National Investment Trust	8.0	Sui Northern Gas Ltd.	3.5
SME Bank	7.5		
Heavy Electrical Complex	7.5	Pakistan Railway	2.5
State Life Insurance Corporation	7.5		
National Power Construction Company	7.5		
Pakistan Reinsurance Company	7.0		
Pakistan International Airlines	7.0		
<b>TOTAL</b>	<b>9</b>	<b>TOTAL</b>	<b>4</b>

Source: MOF

Even with this limited exercise, 9 SOEs qualify to be considered for Privatization.

Management of the Power Sector: The power sector has truly emerged as the 'black hole' of the national economy. It received a subsidy of Rs 1100 billion 2021-22 and the Government had to cover contingent liabilities of the sector of Rs 330 billion. In addition, fuel costs have increased enormously, and the Fuel Adjustment Charge reached the peak level of Rs 9.90 per kwh, which led to a phenomenal percentage increase in bills especially of small consumers. Further, transmission, distribution and billing losses remain very high by international standards. The level of circular debt has reached Rs 2.7 trillion. Moreover, despite adequate generation capacity there continues to be power loadshedding, because of shortages of fuel.

The time has come for taking major decisions about the future structure and management of the power sector. The following options may be explored.

- (i) Privatization of DISCOs. The experience with K-Electric needs to be reviewed.
- (ii) Provincialization of DISCOs.

- (iii) Handing back power distribution to WAPDA as was the case up the mid-90's, which will also facilitate power sector vertical integration.

## 2.8. Better Debt Management

The primary problem relates to the policy on and management of domestic debt. External debt inflows are primarily determined by donors and lending agencies. Given problems of declining credit-rating, external inflows are drying-up and much greater reliance is being placed on domestic debt. Table 2.5 shows the exponential increase in the annual domestic borrowing to finance the growing budget deficit.

The Table 2.5 also reveals the big changes in the pattern of borrowing in the form of additions to the domestic permanent and unfunded debt of long-term nature versus short-term floating debt. From 2005-06 to 2012-13 there was generally greater resort to the flotation of short-term market treasury bills. Thereafter, there has been variation in the annual mix of PIBs and market treasury bills. Since 2018-19 there has been extreme reliance on flotation of long-term PIBs.

One of the basic principles of proper debt management is that during periods of high inflation a 'lock-in' effect of high interest rates should be avoided by floating more short-term debt and having a steeper yield curve. This has been violated, for example, in 2021-22, when 104% of the borrowing has been in the form of PIBs. Consequently, this will imply higher cost of debt servicing in coming years.

**Table 2.5 Composition of government domestic debt (Rs in billion)**

	Total Increase	Permanent Debt		Unfunded Debt		Floating Debt	
		Increase	Share (%)	Increase	Share (%)	Increase	Share (%)
2005-06	170	-1	0	8	5	163	95
2006-07	278	53	19	59	21	166	60
2007-08	668	58	9	80	12	530	79
2008-09	587	70	12	250	43	267	45
2009-10	798	116	15	187	23	495	62
2010-11	1362	328	24	198	15	836	61
2011-12	1624	574	35	143	9	907	56
2012-13	1879	478	25	348	19	1053	55
2013-14	1387	1825	132	158	11	-596	43
2014-15	1285	1009	79	266	21	10	0
2015-16	1438	927	64	113	8	393	28
2016-17	1223	-407	-33	82	7	1548	126
2017-18	1567	-875	-56	103	7	2339	149
2018-19	4344	7427	171	276	6	-3389	-77
2019-20	2550	1943	76	529	21	78	3
2020-21	2955	1881	64	-28	-1	1102	37
2021-22	4752	4939	104	-309	-6	122	2
Cumulative	28829	20342	71	2463	8	6024	21

Source: SBP

## Recommendations

The Debt Office in the Federal Ministry of Finance needs to be strengthened. The SBP policy rate is high at 15% currently in the presence of high rates of inflation approaching 25%. The policy on debt management should be to the extent possible increase the inflow of short-term and medium-term borrowing, instead of long-term borrowing.



The wide-ranging reforms and improved management of practices should lead to a fundamental improvement in the budgetary position of the Federal and Provincial Governments. A feasible target is to bring down the consolidated budget deficit from close to 8% of the GDP in 2021-22 to 5% of the GDP by 2023-24. This will facilitate the bringing down the level of Government debt to 60% of the GDP as stipulated in the Fiscal Responsibility and Debt Limitation Act.

Very importantly, a big reduction in the budget deficit will also lead to a strong containment of aggregate demand in the economy. This will reduce the demand for imports and simultaneously facilitate reduction of the current account deficit of the balance of payments.

## Part 3 – Removing Impediments to Growth

The economy of Pakistan has been demonstrating a loss of growth momentum over the last two decades. Between 2000-01 and 2005-06 the GDP growth rate of 6% has come down in the last five years to 4%. Some of the decline is attributable to exogenous factors like COVID-19, floods, etc. However, much of the fall in the growth rate is attributable to negative and flawed policies which have impacted both on the level of savings and investment. Today, Pakistan has a fixed investment rate of 13.4% as compared to above 18% at the start of this century.

A series of recommendations are made in this part of the report on reviving the growth process in the economy. This is conditional, of course, on achieving stabilization of the economy to provide sustainable basis for higher growth. The first two parts of the report have already focused on policies for containing the current account deficit and for reducing the budget deficit.

### 3.1. ‘Crowding’ Out of Development Spending

Table 3.1 shows how the uncontrolled expansion in current expenditure has cut into development spending so as to limit the size of the budget deficit.

**Table 3.1 Trend in current and development expenditure (Rs in billion)**

	Current Expenditure	% of GDP	Development Expenditure	% of GDP
2000-01	645	13.9	72	1.6
2005-06	1121	13.2	367	4.3
2010-11	2901	14.7	514	2.6
2015-16	4694	14.3	1314	4.0
2020-21	9084	16.3	1315	2.4
2021-22	11521	17.2	1657	2.5
Δ		+3.3		-1.5*

\*From the peak in 2015-16

Source: MOF

### Recommendations

Based on rapid implementation of measures identified in Part 2 of the report, there is a dire need for raising the level of development spending by the Federal and Provincial governments combined to at least 4% of the GDP.

The priorities in the enlarged developed program should be on augmentation of water resources through early completion of dams and on investment in upgrading and modernizing the electricity distribution system. These sectors should be given higher priority and allocations as compared to highways, which have traditionally enjoyed the highest priority.

### 3.2. The ‘Spreading Thin’ of Development Spending

There are major issues today with the development planning, project approval and execution process, especially at the Federal level. The increasing budget deficit has implied large cuts in the Federal PSDP. It was budgeted at Rs 900 billion in 2021-22. However, the actual development spending was cut down by more than 50% to only Rs 400 billion.

Nevertheless, there continues the practice of including new projects in the PSDP. This has result in a big ‘spreading thin’ of implementation of projects, both in terms of financing and execution capacity.

Table 3.2 gives details of number development projects in the Federal PSDP of 2022-23. There are in the development portfolio as many 1219 projects. The throw forward of on-going projects is over Rs 10000 billion, while the allocation to on-going projects is only Rs 516 billion. In effect, each project will take almost 19 years to be completed. This delay will lead to further increase in project costs.

The five major project sectors are highlighted in Table 3.2. Water Resource sector is perhaps the most vivid example of ‘spreading thin’. The number of on-going schemes in 74 and 58 more new schemes will be added in 2022-23. These new projects will pre-empt almost 22% of the sectoral allocation. Consequently, despite a throw forward of Rs 1933 billion, the funds available for on-going projects are only Rs 143 billion.

**Table 3.2 Key statistics on the federal PSDP, 2022-23 (features of large investment sector)**

	No. of New Schemes	On-Going Schemes	Est. Cost (Billion Rs)	Throw forward (Billion Rs)	Allocation (Billion Rs)	Ratio*	% to New Projects
Higher Education Commission	13	138	382	271	44	7.1	13
Railways	4	35	1261	1207	33	44.7	18
Water Resources	58	74	3336	1933	181	21.5	50
National High Authority	46	64	2504	1235	117	11.0	6
Power	7	31	78	63	24	3.5	27
<b>TOTAL OF ABOVE</b>	<b>128</b>	<b>342</b>	<b>7561</b>	<b>4709</b>	<b>400</b>	<b>15.2</b>	<b>23</b>

\*Ratio of throw forward to Allocation

Source: Federal PSDP\*

<b>TOTAL NUMBER IN THE PSDP</b>	<b>1219 Projects</b>	<b>TOTAL PSDP SIZE</b>	<b>Rs 727 Billion</b>
---------------------------------	----------------------	------------------------	-----------------------

### Recommendations

Given the acute scarcity of development funds, the time has come for a moratorium on the preparation, approval and financing of new projects for at least the next three years. Maximum priority must be given to early completion of mature on-going projects so as to generate the largest development impact.

### 3.3. Back to Agriculture

The growth rate of agriculture has also been steadily declining. It attained a peak of 5.4% in the decade of the 80s, especially after the commissioning of the Tarbela Dam. Thereafter, it fell to 4.4% in the 90s, 3.2% from 2000 to 2010 and to only 2.8% from 2010 to 2022.

An interesting historical fact is that the economy of Pakistan between 1950-51 and 2021-22 achieved a growth rate of above 7% in twelve out of the 51 years. Eight of these years were years when the growth rate of the agriculture exceeded 6% due to bumper crops. This was transmitted to an over 10% growth in the manufacturing sector.

The fundamental reason for the high growth impact of improved performance of agriculture is its strong linkages with other sectors. Almost 45% of the manufacturing sector is agro-based. Many service activities like wholesale and retail trade and transport are also linked to agriculture. Overall, almost 46% of the economy of Pakistan is directly or indirectly dependent on agriculture.

### Recommendations

The 'back to agriculture' slogan must be backed with the following measures:

- Agriculture receives very low import tariff protection in Pakistan as compared to, for example, to India. The average agricultural tariff in India is 34% as compared to only 13% by Pakistan. It is truly incomprehensible that there is a zero-import duty on cotton, in the presence of a duty-drawback scheme for exporters of textiles. Barring basic food imports of pulses and wheat, the average import duty on agricultural imports must be increased to the average of 20%.
- The procurement / support policy is flawed. During the decade of the 90s there used to a price support policy for wheat, cotton and sugarcane. Thereafter, it was dropped from cotton. This explains the large-scale substitution of the cotton crop by sugarcane, thereby converting Pakistan from being a cotton exporter to importer. Fortunately, the price support mechanism has been reintroduced recently for cotton. It should now be dropped for sugarcane.
- The rise in procurement / support prices has not kept pace with the increase in input costs. With 2010-11 as the base year of the output price index to input price index with a value of 100 it now stands at 87.80. Therefore, the terms of trade for agriculture have worsened by almost 13% leading thereby to a significant loss of profitability to farmers and a fall in yields.

The issue currently is the setting of the wheat procurement price for the crop season, especially in the wake of the flood devastation which could delay the sowing of the crop. The latest c.i.f. import price of wheat in September 2022 is Rs 3593 per mound. Therefore, the recommended price of procurement is Rs 3600 per mound. This will increase the price by over 60% in relation to last season's price of, and will have to be backed up by a sizeable subsidy to PASSCO. However, it is essential in view of the likelihood of a global and domestic food shortage.

- (iv) The rise in input prices has been driven by the jump in fertilizer prices. During 2021-22, the price of urea has gone up by 10% and that of DAP by as much as 74%. There is need for introducing a cross subsidy for DAP by raising somewhat the concessional sales tax on urea.

All efforts have to be made to raise the growth rate of the agricultural sector from 2.8% during the last decade to 4% once again.

### 3.4. Underinvestment in Human Capital

Pakistan has for the first time fallen into the category of countries with 'low human development' in 2021-22, according to the latest UNDP Global Human Development Report. The HDI of Pakistan is 0.544 and it is ranked 161st out of 191 countries. As compared to this both India and Bangladesh are in the category of 'medium human development'. India has a HDI of 0.633 and is ranked 132nd, while the HDI of Bangladesh is even higher at 0.661 and it is ranked 129th.

The basic reasons for the low HDI lie especially in education. The mean years of schooling in Pakistan is only 4.5 years of the adult population as compared to 7.4 years in Bangladesh and 6.7 years in India. Also, the life expectancy is 63.8 years in Pakistan and 65.8 years in India, and 70.6 years in Bangladesh.

### Recommendations

Government expenditure on education is low at 1.8% of the GDP in 2020-21 and has fallen from 2% of the GDP in 2015-16 as shown in Table 3. The corresponding estimate, for example, for India of 4% of the GDP. Further, the share in expenditure of higher education has increased despite the fact that the unemployment rate is the highest at 16%.

India levies an education cess of 3% on the total taxable amount of an income tax payer. There is a strong case for the levy of such a cess also in Pakistan. Revenues of up to Rs 75 billion can be largely earmarked for technical and vocational training and for training of graduate students in information technology. This will not only provide better employment of youth, but also increase the cutting edge of exports.

**Table 3.3 Government expenditure on education and health (Rs in billion)**

	EDUCATION			HEALTH		
	Primary & Secondary Education & Technical Education	High Education	Total	Preventive	Curative	Total
2005-06	89 (1.0)	52 (0.6)	141 (1.6)	7 (0.1)	32 (0.4)	39 (0.5)
2010-11	187 (0.9)	136 (0.4)	323 (1.3)	38 (0.2)	68 (0.3)	106 (0.5)
2015-16	451 (1.4)	212 (0.5)	663 (2.0)	70 (0.2)	198 (0.6)	268 (0.8)
2020-21	676 (1.2)	312 (0.6)	988 (1.8)	209 (0.4)	448 (0.7)	657 (1.1)

### 3.5. 'Crowding out' of Bank Credit to the Private Sector

The exponential increase in the size of the federal budget deficit has implied much higher levels of borrowing from the banking system, leading thereby to a 'crowding out' of the credit to the private sector and consequential reduction in the level of private investment.

Table 3.4 highlights the increasing per-emption of the banking system by government budgetary borrowing. The year, 2021-22, saw the level of budgetary borrowing of Rs 3220 billion compared to Rs 1612 billion of additional credit to the private sector.

**Table 3.4 Stock of government budgetary borrowing and private sector credit by the banking system (Rs in billion)**

	2012-13	2015-16	2020-21	Δ	2021-22	Δ
Government Budgetary Borrowing	3120	5705	9973	4268 (57.0)	13293	3320 (67.3)
Credit to Private Sector	3779	4449	7629	3180 (42.7)	9241	1612 (32.7)
Ratio	0.825	1.282	1.307	7448 (100.0)	1.438	4932

## Recommendations

The recommendations are as follows:

- (i) Given the full autonomy of the SBP after the recent big amendments to the SBP Act, there is need at the start of the year for agreement with the Government on the ceiling to Government borrowing from the banking system and the quantum of SBP OMOs to support this magnitude. This should be adhered to.
- (ii) The Government has greatly reduced its reliance on domestic non-bank borrowing, especially through the National Savings Schemes. The contribution of non-bank borrowing was 20% in 2015-16, which has fallen to only 9% in 2020-21.

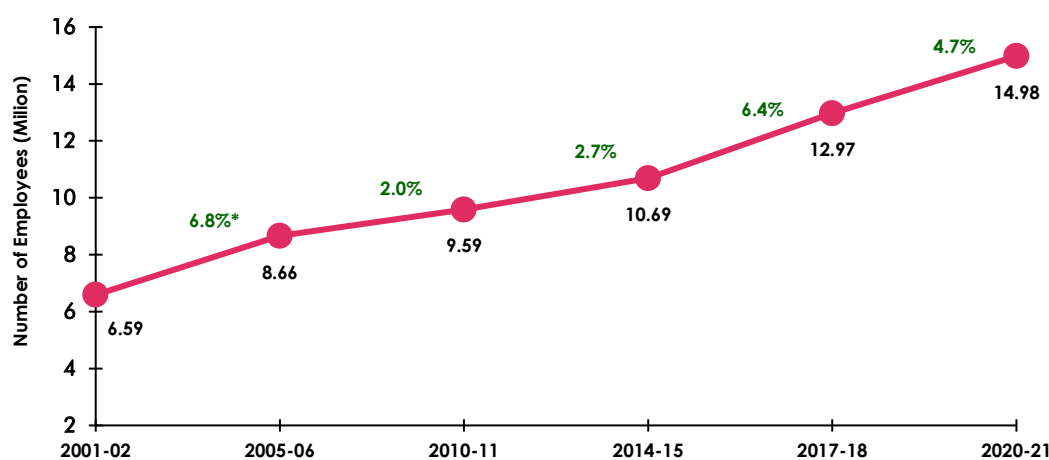
The merit of developing the NSS is that they can provide an incentive for higher saving by households. There is need to make the returns more attractive and expand the network of National Savings Centres. However, there is no need for prize bond flotations.

### 3.6. Lack of Emphasis on Developing SMEs

There are almost three million Small and Medium Enterprises in Pakistan today. According to the 2020-21 Labor Force Survey by the PBS, the total employment in SMEs was 14.9 million. This represents a share of the total non-agricultural employment in Pakistan of over 35%. Therefore, SMEs play as important role in the national economy.

The growth in employment in SMEs is shown in Figure 3.1.

**Figure 3.1 Number of workers in SMEs**



\*Annual Growth Rate

Source: LFS, PBS

SMEs have also been at the cutting edge of Pakistan's exports, with exports like sports goods, surgical instruments, leather products, etc.

## Recommendations

The following recommendations are made for promoting the growth of SMEs in Pakistan:

- (i) SMEs have a share in private sector credit of only 6%, despite their contribution of over 35% to non-agricultural employment in the country. As highlighted in the second part of the Report, there should be a minimum target for lending to socially preferred sectors in Pakistan of 20%, which if not attained by banks will lead to a higher corporate income tax rate. If the share exceeds 20% then a tax credit can be made available. Also, there should be a tax credit provision for bad debt.
- (ii) The SMEDA and SME bank have been passive institutions up till now. The time has come to activate them and promote their role better in technology extension services, vocational training and preparation of feasibility reports for small projects in different sectors, along with arrangements for funding of eligible investors.

### 3.7. Wrong Fuel Mix for Power Generation

The fuel mix in power generation is given in Table 3.5.

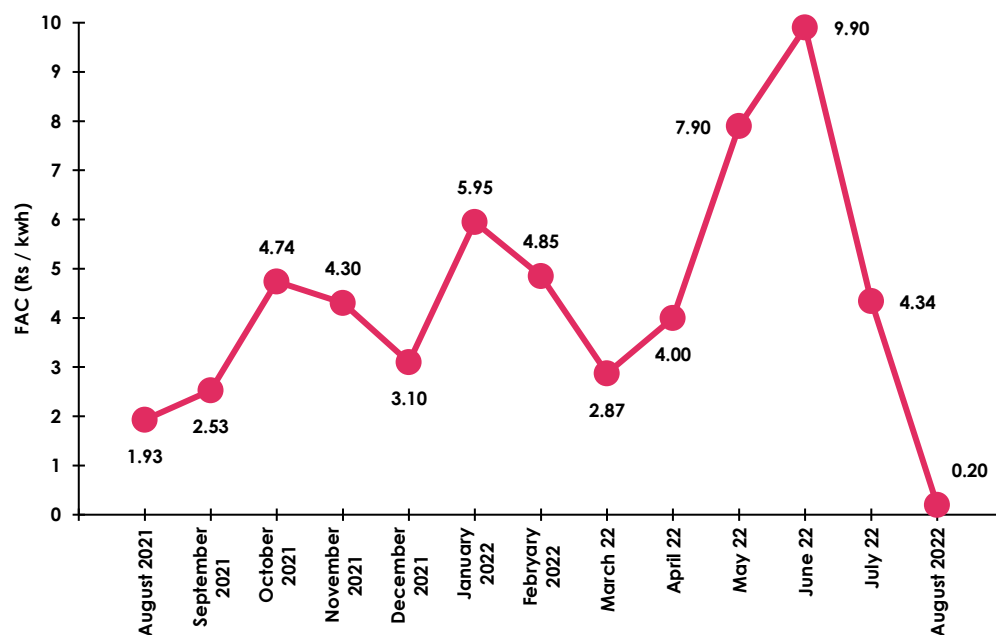
**Table 3.5 Fuel mix in power generation capacity installed capacity (mw)**

	Total Installed Capacity	Share of (%)								Total
		Thermal	%	Hydro-electric	%	Nuclear	%	Renewable	%	
2010-11	22471	15209	67.6	6481	28.8	787	3.6	-	0.0	100.0
2015-16	25889	17115	66.1	7122	27.5	750	2.9	902	3.5	100.0
2021-22	41557	24710	59.5	10251	24.7	3647	8.8	2949	7.0	
<b>Change</b>										
2010-11 to 2015-16	3418	1906	55.7	641	18.8	-37	1.1	902	26.6	100.0
2015-16 to 2021-22	15668	7595	48.5	3129	20.0	2897	18.5	2047	13.1	100.0

Source: PES

There has been an unprecedented surge in electricity tariffs due to the component of the fuel adjustment charge from August 2021 onwards, as shown in Figure 3.2.

**Figure 3.2 Monthly fuel adjustment charge**



The FAC attained an all-time peak of Rs 9.90 per kWh in June 2022. This was attributable to rise in imported fuel prices. The comparison with reference price is given below by imported fuel:

	June 2022 % Above Reference Price	Share in Electricity Generation (%)
Coal	187	13.6
RFO	153	10.0
Gas (RLNG)	216	24.4

#### Recommendations

- The enormous hike in imported fuel prices as shown above has conveyed a very important message. The time has come to invest more in domestic fuel supplies. This implies greater exploitation of Thar coal deposits and faster and bigger shift to solar and nuclear energy. Incremental capacity will need to be in these sources predominantly.

- (ii) Quarterly tariff adjustments have been delayed by NEPRA. This is one factor which has contributed to the extraordinary hike in the FAC. Accordingly, the reference price for determining the FAC should be adjustment upwards in time.
- (iii) The FAC has been fixed in absolute terms per kwh for consumers irrespective of size of electricity consumed. The domestic tariff is progressive in nature. As such, the FAC should be fixed at a percentage of the base tariff, so that larger consumers pay more in absolute terms.
- (iv) The exploration of gas and other minerals has declined. The expenditure annually used to \$1 billion or more over a decade ago has come down to less than \$500 million, especially by foreign exploration companies. This has been caused by negative perceptions about Reko Diq. This dispute should be resolved soon.
- (v) The pricing of electricity is counter to the practice as shown below in other countries. The price for industrial consumers is relatively higher in Pakistan than in other countries as compared to the price for domestic consumers. This implies that there is a case for raising the average consumer tariff and reducing it for industrial consumers, especially the exporters.

**Electricity Price (As of October 2022) (cents/kwh)**

	Industry	Domestic	Ratio
Bangladesh	8.5	5.3	1.60
India	10.0	7.3	1.37
Thailand	10.2	9.9	1.03
Philippines	11.3	16.5	0.68
<b>Pakistan</b>	<b>16.3</b>	<b>5.5</b>	<b>2.96</b>

### 3.8. Loss of Momentum of CPEC

The process of contracting of loans and credits with China under the framework of CPEC has completely broken down, as shown in Table 3.6.

The total investment proposed under CPEC by China in Pakistan was \$60 billion. It stands at \$20.6 billion currently in terms of the value of loans and credits contracted with China for projects. In 2021-22, there was no commitment by China.

**Table 3.6 Contracting of loans and credits with China (as of October 2022) (cents/kwh)**

Years	Annual	Cumulative
2012-13	448	448
2013-14	6493	6941
2014-15	37	6978
2015-16	9422	16400
2016-17	729	17129
2017-18	500	17629
2018-19	2000	19629
2019-20	0	19629
2020-21	1000	20629
2021-22	0	20629

### Recommendations

Absolutely the highest priority must be attached to CPEC. In particular, the focus must be on establishment of Industrial Zones at different locations to attract Chinese investment in labor-intensive projects, given the relatively low wage rate in Pakistan. Also, agricultural exports should be promoted by application of latest technology and funding from China. This will facilitate greater participation in the global value chain. Adequate fiscal incentives, including at least a five-year tax holiday and duty-free import of machinery should be offered to Chinese investors.



## Part 4 – Economic Governance

### 4.1. Manipulation of Statistics

There have been numerous attempts over the year to present through manipulation of statistics a picture of the economy better than the underlying reality.

The following types of manipulation have been observed:

- (i) Overstatement of the GDP growth rate. For example, the growth rate of the economy is reported as 6% in 2021-22. But for this to have happened, the household consumption expenditure was shown as having achieved a phenomenal growth rate of 10%, well beyond the realm of possibilities. The actual growth rate was probably closer to 4.5%.
- (ii) The unemployment rate is a politically sensitive number. It has been understated by showing a bigger increase in employment or a smaller increase in the labor force. For example, the LFS of 2020-21 shows a faster growth in employment than the growth of output in the industrial sector. The reported unemployment rate is 6.3%, whereas it is close to 7.5%.
- (iii) Budget deficit estimates have been understated by including a large negative statistical discrepancy in expenditure or by including revenues which should actually have been shown below the line as financing and so on.
- (iv) The rate of inflation has been understated by assuming, for example, a lower rate of increase in rents and understating the rise in the electricity tariff by not including the fuel adjustment charge. The rate of inflation is reported at 12.1% in 2021-22 whereas it is actually closer to 14.5%. Similarly, the inflation rate is reported at 23% in September 2022 whereas it is closer to 25.5%.

Overall, there is need for improvement in the quality of statistics prepared and released, especially by the PBS.

#### Recommendation

The work of the PBS is overseen by the Governing Council as per the General Statistics (Reorganization) Act of 2011. The Governing Council was chaired by the Federal Minister for Finance, with six other members and four from the private sector. This created a 'conflict of interest' as the Finance Minister is the key minister responsible for the performance of the economy. Therefore, he had a vested interest in reporting better economic statistics. This was the case particularly from 2013 to 2018 and more recently in 2021-22, even though the Council meeting is now chaired by the Planning Minister. There is need for amendment of the Act such that one of the four private members acts as Chairman of the Council and ministries are represented at the Secretary level.

### 4.2. Problems with Accuracy of Projections

An annual Plan for every forthcoming year is prepared by the Ministry of Planning. There is a strong tendency for presenting an optimistic picture of the economic prospects as can be seen for two recent years, 2018-19 and 2021-22.

A vivid example of the bias in targets is that for the current account deficit in 2021-22 as shown in Table 4.1. The Annual Plan set the target at \$2.7 billion. The actual outcome was a huge deficit of \$17.4 billion.

The problem with very optimistic Annual Plan Targets is that they create a false sense of complacency in economic Ministries and delayed reaction to divergent trends.

**Table 4.1 Annual plan projections and actuals**

	2018-19			2021-22		
	Plan Projection	Actual	Divergence	Plan Projection	Actual	Divergence
GDP Growth Rate (%)	6.2	3.1	-3.1	4.8	6.0	1.2
Total Investment (% of GDP)	17.2	15.1	-2.1	16.0	15.1	-0.9
Rate of Inflation (%)	6.0	6.8	0.8	8.0	12.2	4.2
Budget Deficit (% of GDP)	-4.9	-7.9	-3.0	-6.0	-7.9	-1.9
Current Account Deficit (\$ billion)	-13.4	-13.4	0.0	-2.7	-17.4	-14.7

## Recommendations

All Plans should include a clear statement of risks associated with the achievement of any macroeconomic target. The National Economic Council, a constitutional body chaired by the Prime Minister, should meet quarterly to review and suggest policy changes to facilitate achievement of the targets. The Planning Commission should act as the Secretariat to the Council.

### 4.3. Stopping the 'Boom and Bust' Cycle

This is the last sub-section of the report. It highlights the 'boom and bust' cycles that Pakistan has witnessed since the start of the 21st century. This cyclical pattern is the consequence of a cycle of expansionary and growth promoting fiscal and monetary policies leading to higher growth and increasing strongly the demand for imports. This has led to a big rise in the current account deficit causing a precipitate decline in foreign exchange reserves. At this time, there has generally been resort to an IMF program of two to three years. Thereafter, recovery of reserves leads to a premature end of the program and a return back to expansionary policy measures. This cycle is presented in Chart 4.1.

The expansionary and contractionary periods are identified below:

Years	Type of Growth Path
1999-2000	IMF Program
2000-01	Contractionary
2001-02	Contractionary
2002-03	Expansionary
2003-04	Expansionary
2004-05	Expansionary
2005-06	Expansionary
2006-07	Expansionary
2007-08	Expansionary*
2008-09	IMF Program
2009-10	Contractionary
2010-11	Contractionary

\*Election Years

Years	Type of Growth Path
2011-12	Expansionary
2012-13	Expansionary*
2013-14	IMF Program
2014-15	Contractionary
2015-16	Contractionary
2016-17	Expansionary
2017-18	Expansionary*
2018-19	IMF Program
2019-20	Contractionary
2020-21	Expansionary
2021-22	IMF Program
2022-23	IMF Program

\*Election Years

The path of foreign exchange reserves is shown in Figure 4.1

Figure 4.1 The path of foreign exchange reserves

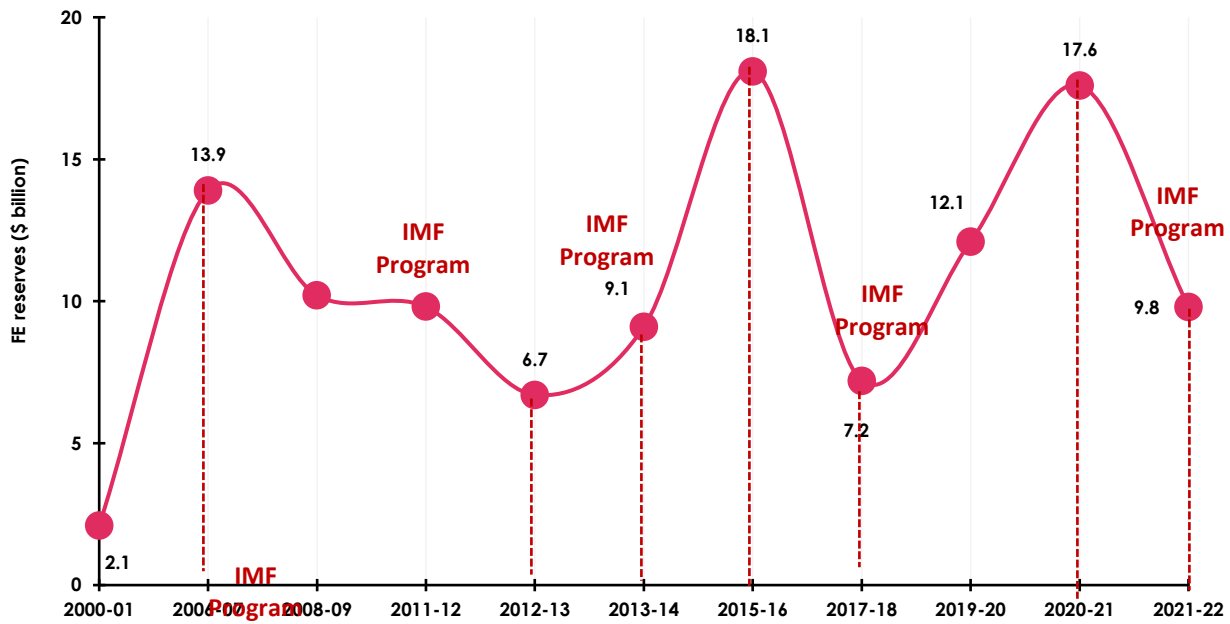
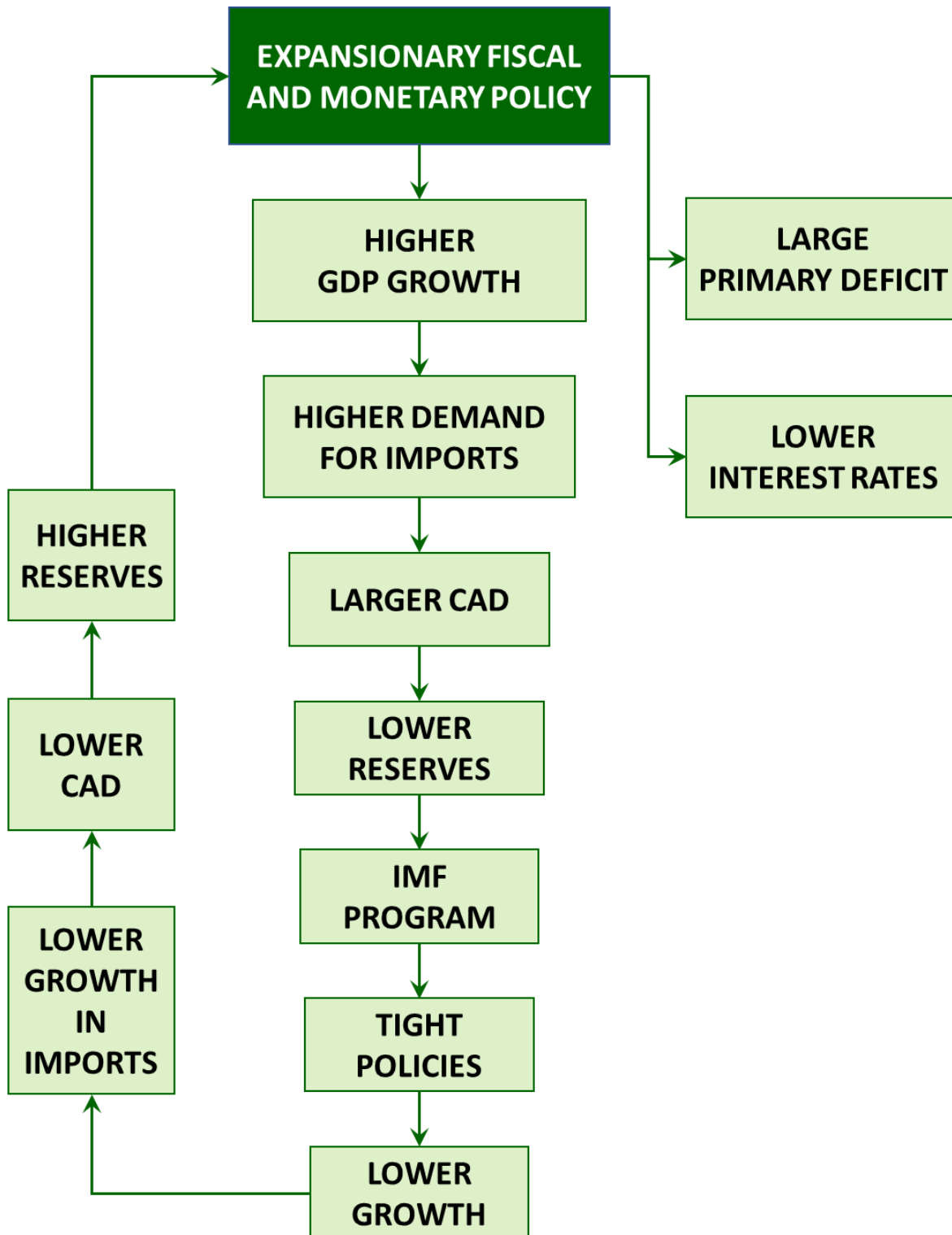


Chart 4.1 The 'boom and bust' cycle



**Table 4.2 Nature of policies**

Years	GDP Growth Rate	Nature of Policies*		Imports as % of GDP (%)	Current Account Deficit (% of GDP)	FE Reserves (\$ billion)***
		Primary Budget Deficit/ Surplus (% of GDP)	Interest Rate** (%)			
2000-01	2.0		13.5	15.1	-0.7	2.1
2001-02	3.1	0.1	13.4	14.4	+1.9	4.8
2002-03	4.7	0.4	12.9	14.8	+1.3	9.7
2003-04	7.5	1.0	7.8	15.9	-1.6	10.8
2004-05	9.0	-0.1	7.0	18.5	-4.5	10.3
2005-06	5.8	-1.0	10.2	22.5	-3.6	11.2
2006-06	6.8	-0.1	11.1	21.2	-4.3	13.9
2007-08	3.7	-2.6	11.6	24.4	-8.2	9.1
2008-09	0.4	-0.3	14.6	21.5	-5.5	9.5
2009-10	2.6	-1.8	13.2	19.6	-2.2	13.1
2010-11	3.6	-2.5	13.4	18.9	0.1	15.7
2011-12	3.8	-2.2	11.9	20.0	-2.1	10.8
2012-13	3.7	-3.4	11.0	19.3	-1.1	6.0
2013-14	4.1	-0.8	10.9	18.4	-1.3	9.1
2014-15	4.0	-0.5	10.9	16.9	-1.0	13.5
2015-16	4.7	-0.2	8.4	14.2	-1.7	18.1
2016-17	4.6	-1.4	7.6	15.6	-4.0	16.1
2017-18	6.1	-1.9	7.6	17.0	-6.1	9.8
2018-19	3.1	-3.1	9.8	17.0	-4.8	7.2
2019-20	-0.9	-1.6	12.8	14.8	-1.5	12.1
2020-21	5.7	-1.2	7.9	16.2	-0.8	17.3
2021-22	6.0	-3.1	9.6	22.1	-4.6	9.8

\*Fiscal and Monetary Policies

\*\*Average Interest Rate on Advances, Mid-Year

\*\*\*End-June of Financial Year

## Recommendations

How can the 'boom to bust' cycle be broken? The following recommendations are made.

- (i) There has to be a fundamental move away from Annual Plans to Three-Year Action Plans and 10-Year Perspective Plans.
- (ii) The Role of the National Economic Council has to be greatly enhanced. This is a Constitutional forum with the Prime Minister as the Chairman and Chief Minister of the Provinces as members. There are four other members, one from each Province.

The NEC is required to meet at least twice a year. This has generally not been the case in the past. The NEC must concentrate on the design, approval mentioning of implementation of major structural policies. Three-year Plans should be subject to debate and approval in the Parliament.