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PAKISTAN ECONOMIC SURVEY FY 22

June 2022

Pakistan Economic Survey FY 22

Exceeding everyone's expectation, the estimate for GDP FY 22 growth is almost 6%. That is cause for relief. More importantly though, this paper analyzes what caused the unexpected growth. And why the economy cannot keep the growth momentum. In fact, that growth has left the economy in a deep crisis, with a gaping budget and current account deficit and Forex reserves on the precipice.

Inflation is high, though along with the rest of the world. Year on year, CPI grew by 11.3% for July- May 2022. The sensitive price index was higher by 16.7% and wholesale prices were up an ominous 23.5%. Food inflation was even higher. Rupee has been on a steady and at times sudden decline of about 30% since June 2021. This added to inflation and has discouraged investment. For FY 22, the Current Account deficit is expected to reach 4% of GDP and the budget deficit could be an unprecedented 9% of GDP.

During the fiscal year the economy progressed well in some areas, GDP and export growth, but not in some key targets set at the beginning of the year. Critical among these is the current account deficit. The effects of COVID 19 had ended, but since February 2022 invasion of Ukraine created a ripple effect of steep fuel and commodity price increase and supply chain dislocation.

The Pakistan Economic Survey brings home to us once again a fact that is now known widely. That is, the macro framework and budget estimates shared by GoP at the start of the fiscal year have little basis in fact. This has gone on for decades. Data given in later paragraphs will validate this fact.

For years, the economy has been bound in a vicious circle of weak fundamentals, weak growth, leading further to weak fundamentals. Added to this was unwise economic policy making during the year and continued unfavourable political economy. The longer Pakistan postpones economic reforms and allows no political oversight on economic decision making, the worse would be the effect on the economy.

This Institute has said so for years. Without revisiting our paradigm for policy making, Pakistan should not expect an improved economy. No amount of IMF loans, whose pain is felt more by the common person, or spin or bluster can fix that. There are three areas that hinder economic progress:

- No political oversight of economic policy. Two clear examples are reversal by the executive of the 'Mini-budget' within a month of its approval by parliament. Continued borrowing by the executive from domestic and external sources exerting pressure on public finance that takes away resources from all relief and development objectives. Changes in tax rules with no input from parliament.
- Continued transfer of resources to sectors that earn surplus profits because of guarantees and concessions.
- Inability to fix tax policy and tax administration.

Year on Year, for July-March, total federal and provincial revenue grew by 17.6%, about equal to inflation plus GDP growth rate. This amount includes tax and non-tax revenue. Total federal and provincial tax collection for the same period grew by 12.8% Year on Year. FBR tax collection grew by 29% July-March 2022, again Year on Year.

	Revenue FY 22 July March	Revenue FY 21 July March	% Growth
Total Revenue Fed and provincial	5,874.2	4,992.6	17.7
Tax Revenue	4,821.9	3,765.0	28.1
Federal Revenue	5,366.3	4,560.5	17.7
FBR Tax Revenue	4,383.6	3,394.9	29.1
Direct Taxes	1,578.6	1,246.4	26.7
Indirect Taxes	2,805.0	2,148.5	30.5
• Customs	714.8	541.0	32.1
• Sales tax	1,866.1	1,415.8	31.8
• Fed Excise	224.1	191.7	16.9
Non-Tax Revenue	982.7	1,165.6	-16

Growth in FBR revenues was led by indirect taxes with an increase of over 30% in both custom duty and GST. Direct taxes too grew by 26%. Yet, contrary to how widely it was advertised, there was no reform of tax administration and tax to GDP ratio is expected to stay at about 9.5%. There was a time in our history that Pakistan achieved tax to GDP ratio of 13%.

Non-tax revenue fell because of low petroleum levy collection and a steep fall in defence receipts. By end June, FBR is expected to be close to its revenue target.

Below is a recap of the economy's performance during FY 22. How the economy performed should not be a surprise. Sustained economic growth will come with reorienting spending priorities, ensuring economic inclusion, and by investing in and empowering the people of Pakistan. Disregard of this fundamental truth about nation building is what keeps the economy sub-optimal and dependent on others for survival.

At the centre of the economy's travails were several negative developments. Sharp decline in Rupee value and a tight monetary policy with high markup that has reduced demand. They also increased input cost for businesses, which were hit toward the end of the year by increase in world energy prices, though government did not pass through their full impact. Since the upheaval in Ukraine, these effects have been felt globally.

As a result, global developments and political instability towards the end of the fiscal year have affected the economy, as firms suffered both from the demand and supply sides.

Pakistan's external account is especially vulnerable when the economy grows at 5-6%. Imports shoot up without the exports to fund them. This year, increase in commodity prices added to the vulnerability. So, compared to a target of a current account deficit of $ 2.2 billion, about 0.5% of GDP, the deficit was more than $ 13 billion by March 2022, or 4% of GDP. This deficit and external debt servicing obligations of another 4% of GDP has sent the economy in a tailspin.

Economic Performance FY 22

Below is GDP growth rates against targets approved by the NEC in Annual Plan 2021-22. Most growth targets were more than achieved. Against a target of 4.8% for FY 22, the estimated GDP growth is 5.97 % Table below:

	Target FY 22 %	Actual FY 22 %
GDP growth	***4.8***	***5.97***
Industry	***6.5***	***7.19***
Manufacturing	6.2	9.8
LSM	6.0	10.48
Mining	4.1	-4.47
Electricity and Gas Generation and Distribution	10.7	7.86
Construction	8.3	3.14
Agriculture	***3.5***	***4.4***
Crops:	--	6.58
Important crops	2.2	7.24
Other crops	3.2	5.44
Ginned Cotton	10.0	9.19
Livestock	3.7	3.26
Forestry	5.0	6.13
Fishery	5.0	0.35
Commodity producing (Industry + Agriculture)	***5.0***	***5.66***
Services	***4.7***	***6.19***
Wholesale * Retail	4.6	10.04
Transport & Communication	4.7	5.42
Finance & Insurance	5.2	4.93
Housing Services (OD)	4.0	3.7
General Government Services	4.5	-1.23
Other Private Services	5.0	3.76

Source: Targets Annual Plan 2021-22, Actual PES/National Accounts FY 22

Manufacturing was especially encouraging growing at 9.8%. LSM grew by 10.5%. Agriculture which was on a decline for a few years saw robust growth. After some years, we see a boost in the productive sector of the economy.

Production of our main crop, cotton, has fallen drastically. Despite recovery this fiscal, cotton production is down 40% from its 2015 peak, at a high cost to the downstream industry. Area under cotton cultivation too has fallen, as has the yield per hectare, leading to rapid fall in production. Wheat production fell by 4% this year from FY 21. It leaves the economy short by 3 to 4 million tons. Sugarcane another major crop has done well this year growing by about 9%.

Partly, the robust GDP growth comes from a low base effect on the back of low and negative growth in FYs 19 and 20 respectively.

Government revenue is estimated to come close to the agreed target of Rs. 6.1 trillion. It may fall short by 2 to 3%.

The coming fiscal year would be a year of stability and prudent economic policy. The present fiscal and monetary crisis forecloses any other option.

The economy is presently in freefall, though that collapse would be temporarily arrested under the expected restored IMF programme. As stated before, our economy stays stable when it grows at about 2-3%. Macro imbalances result when it grows at a higher rate. This is the combined cost of the political economy that survives through external borrowing and dependence. It diverts investment from productive and export industries to those enjoying surplus profit. Resultantly, in the last two decades, as a percent of GDP, saving and investment have fallen as have exports. Growth does not have support of savings, investment and exports. So, imported plant and machinery and raw material are financed by foreign capital.

Consequently, July-April goods and services trade deficit is US$ 42.9 billion, up 65.4% from last year . Exports and remittances are not enough to meet the high current account deficit, which in July-April FY 22 was US$ 13.8 billion compared to a deficit of US$ 0.5 billion during the same period last year. The widening of the current account deficit together with a build-up in inflationary pressures in the backdrop of the geopolitical situation has created major challenges for the economy. Combined with political developments and inflation, they have dented business confidence and have resulted in significant macroeconomic imbalances.

	Revenue FY 22 July March	Revenue FY 21 July March	% Growth
Total Revenue Fed and provincial	5,874.2	4,992.6	17.7
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Fiscal deficit:

In the budget speech in 2021, MoF targeted the fiscal deficit at 6.3% of GDP with primary deficit of 0.7%. Actual deficit for July-March FY 22 is already 4%. Experts forecast a high budget deficit of between 8.5 to 9% of GDP. Throwing caution to the wind, political decision making in the second half of the fiscal year has exacerbated an already difficult situation.

In any case, government's main target now is the primary and not the fiscal deficit. As GoP spends considerable sums of money on debt servicing, the primary deficit is easy to control. Fiscal deficit minus debt servicing, is primary deficit.

Balance of Payment:

Imbalances have caused a sudden rise in the current account, growing astronomically from last year. See Table below. Ten-month actual current account deficit is USD 13.8 billion against last year's USD 370 million for the same period. Estimated current account deficit for FY 22 is likely to be about 4% of GDP. Trade deficit for July-April FY 22 is up 65%. For the same period remittances have grown by 7.1% and net FDI was USD 1.3 billion, down by over 30%. All this means that net Forex reserves have taken a major hit. It stood at $ 9.2 B on 3 June 2022, less than two months import. This is a fall of 47% from June 2021 when it was $ 17.3 billion.

In the coming FY 23, government estimates a GDP growth rate of 5%. International agencies and the country's economic experts forecast 4% and 3% respectively. It is better to limit growth and stabilize the economy than to face another crisis.

FY 22 exports of goods and services combined is estimated to touch $ 37 billion against a target of USD 34 Billion for the year. Likewise, FDI is estimated to reach $ 1.5 billion against a target of $ 2.5 billion. Workers' remittances during FY 22 have grown and by year end it is estimated to be $ 33 to 34 billion

Balance of Payment Major Indicators					
	Target FY 22	FY 21	July- Mar FY22	July-Mar FY21	Change +/- Jul-Mar
			Million USD		%
Current Account Balance	-2,276	2,820	-13,169	-275	4700
Trade Deficit FOB (incl. Services)	-30,943	-31,150	-33,276	-21,292	56.3
Workers' Remittance	31,257	29,370.9	22,952.0	21,436.5	7.1
FDI	2,516	-30.4	1,285.1	1,311.1	-2.0

Merchandise Trade Flows July-April FY 22			Million USD
	July-April FY 22	July-April FY 21	% +/- Jul-April
Exports	26,247	20,905	25.5
Imports	65,537	44,731	46.51
Trade Deficit	-39,290	-23,826	64.9

Source: Pakistan Bureau of Statistics

Trade and Services Flows July-April FY 20			Million USD
	July-April FY 22	July-April FY 21	% +/-
Exports	32,035.9	25,802.4	24.1
Imports	74,902.2	51,719.1	44.8
Trade Deficit	42,866.3	25,916.7	65.4

Source: PBS

Low savings and investment:

Low savings and Investment affect growth. Along with low technology content in our production base, this is one of the most enduring predicaments of our economy. As per the Economic Survey, investment was 15.1 % of GDP up to March 2022. Between the 1970s and 2008, investment to GDP was between 17.5 and 20% of GDP. With an Incremental Capital Output Ratio of OVER 4 or more, 20% investment is needed to generate 4% GDP growth.

National savings has been between 12 and 15%. But domestic savings have fallen. Domestic savings, which used to be about 10% now stays between 6 and 8% of GDP. This too is a cause for concern. There is a direct relationship between savings, investment, manufacturing and export.

Inflation:

CPI for July-May FY 22 grew by 11.3% against 8.8% for July May 21. YoY growth in May 2022 was 13.8% against 10.9% in May 2021. See Table below:

Inflation: July-May FY 22 and YoY May 21 %				
	Average July-May		YoY May 2022	
	FY 22	FY 21	May '22	May '21
CPI	11.3	8.8	13.8	10.9
SPI	16.7	13.5	14.1	19.7
WPI	23.6	8.4	29.6	19.4

Inflation was in check until 2018, based on an artificial Rupee value. The combination of correction of exchange rate, perhaps more than what was needed, brought import driven inflation. This was aggravated by continuous increase in administered prices of utilities and essentials. Recent hike in commodity prices have made it worse

Fiscal Operations:

Overall, the economic fundamentals have been weak, a trend that has continued through the periods of booms and busts and still continues. GoP's focus on borrowing to meet budget expenses and to meet current account balance is firefighting not strategy, which has brought frequent crises.

Total debt servicing is on the rise as new loans service old ones. In FY 21, interest payment on foreign and domestic debt is 78% of federal government's net revenue. Net revenue is gross receipts of the federal government minus transfer to provinces. This means that most expenditure on running the government and for development, other than interest (78%), subsidy (12%) and grants (26%), which together amounts to 116% of federal revenue, came from loans. That trend grew further in FY 22, when the three combined were 132% of federal revenue receipt. Money spent on everything else was loan. During FY 21, GoP paid Rs. 2,749.7 billion in mark-up, and payment on subsidy and grants grew by 125%.

Meanwhile, circular debt has grown to Rs. 3 trillion, for which government has no known plan to address once for all.

PSDP spending has received large cuts in recent years. The combined federal and provincial PSDP budget for FY 22 was Rs. 1,954 billion. Until March 2022, government has spent Rs. 1,051 billion or 53%. There are reports that releases in the last quarter have been stopped. If so, PSDP will be 1.6% of GDP. In the last 20 years, public development spending has fallen from about 5% of GDP to about 1%. There is a cost to such capricious decision making.

In the last several years, the main economic focus seems to have been on taking on debt and meeting its obligation.

With interest payments rising, fiscal deficit has been hard to control. July-March FY 22 fiscal deficit was 4 % of GDP, compared to 3.6% same period last year. Total federal expenditure increased by 28 % (current by 25 %).

As in past years, government this year too has not addressed the issue of PSE losses. Each year, this is a major drain on GoP resources. While taxpayers are rightly being asked to fulfill their responsibilities as citizens and pay the taxes due, government has yet to show strong urgency in creating expenditure efficiencies. Unrestrained PSE losses is money that could go to development, security, or to improve services. Plans for strong action have been afoot, but so far, there is nothing on ground. Subsidy for PSEs are a particular concern. Despite claims to contrary, government has done very little, if at all, to restructure and turn around PSEs or to privatize them.

Accumulated PSEs losses are routinely estimated to be between Rs. 1.2 to 1.4 Trillion. This includes revenue loss by DISCO, which government must control but has been unable to do so. Government does not clearly disclose PSE losses. During July-March 2022, payment of subsidies and grants was Rs. 1,566 billion compared to Rs. 695 billion in July-March 2021, an increase of 125%.

After meeting debt servicing and subsidies, the public kitty is empty and government has to skimp on spending on security, PSDP and public welfare.

During July-March FY 22, federal PSDP spending was a paltry 9 % of total expenditure. Debt servicing and defence had a share of 56 % in total expenditure. Add to it grants, subsidy, and pensions and their combined share is 81 % of total. Debt servicing, PSE and power subsidies make a formidable charge on federal funds and are a cause of concern. We cannot have a prudent fiscal policy with this approach.

Similarly, for the current account. GoP's external financing needs are on the rise and without corresponding growth in exports it must rely on more debt to balance its external account. It is not clear what strategy GoP is pursuing. Because what it is doing now will not succeed. IMF estimates foreign financing need of $ 35 billion to 40 billion in its medium-term macro framework.

Summarized Fiscal Operations					in Billions Rs
	July-March FY 22	July-March FY 21	% +/-	July-June FY 21	% Share in total expenditure, FY21
Total Exp Fed and Prov	8,439.8	6,644.6	**27**	10,306.7	100
Total Exp Fed	5,947.6	4,639.5	**28**	7,244.8	100
Current Exp	5,280.7	4,223.6	**25**	6,348.7	88
Defence	881.9	783.9	12.5	1,316.4	18
Interest payment	2,118.5	2,103.8	1	2,749.7	38
Pensions, grants, subsidies	1,961.4	1,023.9	90	1,776	25
Sub-Total of above 3	4,961.8	3,911.6	27	5,842.1	81
Balance for civil government	318.9	312	2	506.6	7
PSDP	452.3	353.0	28	667.3	9
Budget Deficit	-4.0	-3.6	11	-7.1	
Primary Budget Balance	-0.7	1.0	-	-1.4	

Public Debt:

Public debt has not grown simply because of change in Rupee value. In 6 months between June 2021 and December 2021, GOP has borrowed $ 7.1 billion in external public debt alone. Its commercial finance stock and its short-term debt have increased.

In the last two decades there were two occasions when Pakistan had large fiscal space to build its production base and revive the economy for sustained GDP and export growth. On both occasions, we missed the opportunity. The first was after 9/11, when Pakistan received massive aid and foreign funds from the US and other bilateral and multilateral donors. Along with rescheduling of USD 28 Billion of Paris Club debt for fifteen years, estimates of the total space available to Pakistan was about USD 60 Billion. The second was during 2015-2018 when along with IMF's Extended Fund Facility, Pakistan received massive Chinese assistance for CPEC. Both times Pakistan did little to build competitiveness and exports. On the second occasion we at least built infrastructure, albeit imported coal power plants is luddite thinking. During 2001-2007, when most flows were either grant or Coalition Support Fund and concessional multilateral funds, we did not even do that. The energy shortage and the circular debt are products of that decade. Over many governments, we have repeated the same mistakes. That is why the macro-economic indices forever stay weak.

While under an IMF arrangement, we exercise discipline to stay in the programme. Even then, more often than not the programmes do not go beyond the first couple of tranches. Space provided by IMF should be used to institute deep structural reform. During the programme, we test IMF's patience. Once the programme is over, we go back to our ways. In the past, we should have contained spending, chosen infrastructure development carefully to boost exports, and invested in our technical capacity. Reforms of revenue and spending policy (public finance) would have corrected major inequities. That was needed to build competitiveness.

We neither stabilized nor built competitiveness. There could not have been a worse use of IMF space and other assistance such as US aid and CPEC finance. Since then, tight monetary policy and adjustments in Rupee value and in utility tariffs have dampened investment plans.

Inevitably, growth would fall and will remain so for a couple of years. The discipline being imposed by IMF was much needed. The test lies in what the government does once the arrangement ends and whether it has the foresight and the willingness to correct the economy's structural flaws. We have to move from a crony and elite economy to an efficient dispensation. The future of the economy rests on that decision.

GoP has been unable to reduce revenue leakage in the power sector. If successfully done, this will reduce the circular debt to an extent. With expected tariff increase in power and gas sectors and regular increases in the past couple of years, GoP hopes to recover fully their cost and restore financial order to the sector. However, this has not happened. Because higher tariff encourage leakage.

In FY 22 too public debt including external debt grew rapidly, as in the past years. Resultantly, debt servicing has taken an increasing share in expenditure, see table on fiscal operations. Total public debt stood at Rs. 39.9 trillion in June 2021 and Rs. 44.4 billion in March 2022, an increase of 11% in 9 months.

Pakistan Total Debt and Liabilities Billion Rs.					
	Jun-07	Jun-13	Jun-21	Dec 2021	Growth March 2022/Jun21
Total Debt and Liabilities	5,024	16,228	47,830.9	**51,724.2**	8.1
Domestic Debt	2,597	9,833	27,702	**28,250.7**	1.9
Government	*2,597*	*9,521*	*26,265.4*	***26,746.9***	*1.8*
PSEs	--	*312*	*1,436.7*	***1,503.8***	*4.6*
External Debt	2,341	5,698	17,846.3	**21,853.6**	22.4
Government	*2,135*	*4,311*	*12,433.8*	***14,810.0***	*19.11*
IMF	*85*	*435*	*1,161.5*	***1,188.4***	*2.3*
PSEs & Private incl intercompany	*121*	*952*	*4,251*	***5,855.2***	*37.7*
Total Debt	4,935	15,531	45,548.3	**50,104.3**	10
Liabilities	89	697	2,282.6	**2,292**	0.4

% of GDP		
	June 2020	**June 2021**
Total debt & liabilities	93.8	86.2
Gross public debt	76.6	71.8
Total Debt of the Government - FRDLA Definition	69.9	64.3
Total External Debt & Liabilities	40.0	34.6
Commodity Operation and PSEs Deb	6.7	6.1

High budget deficit over many years and an unprecedented one approaching 9% this year, means that government has continued to incur debt. In December 2021, total debt and liabilities stood at almost Rs. 51.7 Trillion or 81 % of GDP. Debt and liabilities have grown by Rs. 3.9 trillion from the debt stock on 30 June 2021, or 8.1% in 6 months.

External debt and liabilities alone are now 35 % of GDP. Measured in dollars, external debt has grown by $ 8.4 billion in 6 months. Public debt has grown from $ 95.2 billion in June 2021 to $ 102.3 Billion in December 2021. Public debt has added $ 1.2 billion monthly. Total debt and liabilities stood at $ 130.6 billion end December 2021, compared to $ 122.2 billion in June 2021, up 6.8 %.

We have also seen more commercial debt. The increase in market-based debt with limited tenure and high cost was a great factor in causing fragility in the economy.

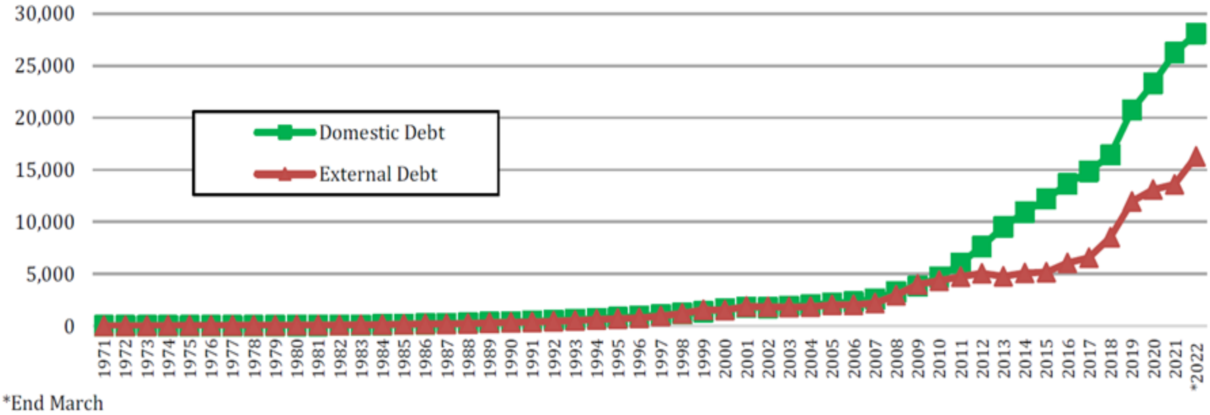
Pakistan external debt and liabilities

Billion $

	Jun-07	Jun-13	Jun 21	Dec 2021	Change Dec/Jun 21 /%
Public Debt + Forex Liabilities	36.7	50.2	95.2	**102.3**	7.5
Multilateral and concessional bilateral	32.5	44.2	59.4	**64.64**	8.8
Bonds, Sukuks, commercial, PIBs	2.8	1.6	17.5	**19.9**	13.7
Short-term debt	0	0	0.86	**1.2**	38
IMF	1.4	4.4	7.4	**6.7**	-10
Forex Liabilities			8.8	**11.6**	31.8
PSEs + Private debt	2	6.8	22.9	**23.9**	4.3
Total External Debt + Guaranteed Liabilities	38.7	57	118.1	**126.2**	6.8
Forex Liabilities non-guaranteed	1.5	2.8	4.1	**4.4**	7.3
Total Ext Debt & Liabilities	40.2	59.8	122.2	**130.6**	6.8

Debt increase is a long-standing issue in public finance. The debatable fact is that it is not invested to generate GDP and export growth. It is used for consumption and to pay back past debt.

Trend in Domestic and External Debt (end-Jun position) (Rs in billion)



*End March

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