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A YEAR OF APATHY AND LAPSES: PAKISTAN ECONOMIC SURVEY FY 23

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A year of apathy and lapses: Pakistan Economic Survey FY 23

In the Pakistan Economic Survey 2022-23 issued today, the only surprising economic outcome was that the GDP growth rate had a positive number[1]. This was a year when most economic development in Pakistan were adverse. Part of it was inherited. Partly, global events sent the world supply chains into chaos. A lot of it was effect of the flood disaster. Mismanagement also played a part and there were occasions when the government seemed out of its depth in facing up to the slew of economic and political problems that burst forth. Everyday added to the misery of citizens. Yet, keeping the current account deficit in check was a major achievement, despite dire warnings.

In FY 24, debt servicing alone will be $ 22 billion. It will increase to $ 25 billion in FY 25 and is estimated to be $ 23 billion the following year. Perhaps it is early for the government to celebrate. Rather than celebrating this achievement, not small, continued stability in the external sector will be a challenge.

It is even more important to bring price stability to ease the pain of citizens. Government must improve business confidence and find space to increase investment and production. The focus on jargons such as 5Es and 4 RFs do nothing for improving the economy. Government must look at practical, though modest, steps for increasing economic activity. The Survey touches on this subject sparingly.

Inflation has been high. Year on year CPI for May 2023 grew by 38%. CPI for July- May FY 23 was 29% and SPI 33%. YoY food prices were up 50% in May 2023. Overall, manufacturing fell by almost 4% and largescale manufacturing was down 7.98%, Table 4. With commodity production falling, the services sector barely grew. The reports of job losses should not be a surprise. Estimated rate of unemployment was 6.3 %. The external sector has been in near default for months. Net forex reserves stood at 4,458 million at end April 2023, barely covering three months imports. Debt servicing is in addition.

The budget deficit of 3.7% of GDP for the first nine months of 2022-23 suggests that with ever rising interest payments and power subsidies, current year's budget deficit would be over 7%, compared to GoP's target of 4.9%. According to GoP, interest expense alone may climb to Rs. 5.2 trillion for FY 23, an estimated 64% above FY 2022.

The annual plan had set a target of 5% growth for the GDP. In the budget speech, the finance minister declared that the GDP growth target for fiscal year 2022-23 was "at least 5 percent growth … without a balance of payment problem". As it turned out, the actual growth rate was 0.29% and the balance of payment in distress. Manufacturing was to grow by 7% and LSM by 7.4%.

The Pakistan Economic Survey brings home to us once again a fact that we see every year. As events turn out, the macro framework and budget estimates shared by GoP at the start of the fiscal year have little basis in fact, though this year's failure are more glaring than ever.

Even more disturbing are the press reports about government's internal deliberations. Seemingly, there is yet no serious analysis about what are the causes for the regular bouts of economic crises that Pakistan faces. And what are government's plans to address them.

[1] The growth rate was announced at the National Accounts committee on 24 May 2023

These problems have not arisen at once. So far, we have not heard from the government their views about the problems and what it plans to do about them.

Government managed well the current account deficit by restricting imports, Table 3. Despite the weak rupee, export of goods and services fell by 11 % because of import restrictions and increase in input costs.

For years, the economy has been bound in a vicious circle of weak fundamentals, weak growth, leading further to weak fundamentals. This year, its problems accumulated sufficiently to create a major crisis.

Added to this was unwise economic policy. Forcibly keeping the interbank exchange rate at less than Rs. 230/$ 1 stalled inflow of remittances and triggered largescale flight of capital. The political leadership does not involve itself in inquiring into the causes of economic problems. Without political leadership there cannot be meaningful reforms. The longer Pakistan postpones economic reforms and allows no political oversight on economic decision making, the worse would be performance of the economy.

Without revisiting our paradigm for policy making, Pakistan should not expect an improved economy. No amount of spin or bluster can fix that. There are three areas that hinder economic progress:

- No political oversight of economic policy. Intervention in the exchange rate was one reason for the delay in the IMF programme. It led to sudden sharp decline in Rupee value and added to the inflation. Price of energy and power especially climbed. Inflation has necessitated raising interest rates, forcing many firms to postpone investment decisions.
- Continuation of policy to offer generous incentives to the independent power producers, the auto sector (though this year they have been affected by import restrictions) and the construction industry has diverted investment form manufacturing for exports to the incentivized sectors.
- Inability to fix tax policy and tax administration. Letting special interests dominate tax collection, be they big farmers or wholesalers.

Though tax collection shows a healthy increase of 17% from last year, it is well below the rate of increase in CPI, Table 2. In real terms tax collection fell. Indirect taxes especially took a hit as the economy ground to a halt. With economic slowdown, decline in growth of tax revenue was expected. Yet, there was no reform of tax policy or improvement in enforcement.

With a sluggish economy, government is expected to miss its tax revenue target by a wide margin. FBR's target tax collection was set at Rs. 7,470 billion and revised to Rs. 7,600 billion. Total FBR collection could be short by about Rs. 350 to 400 billion by fiscal year end. At the start of the year, GoP announced levy of a fixed Rs. 10,000 on traders. That house of cards fell with the announcement. GoP caved at the first sign of resistance by the traders and withdrew the tax.

All this meant a drop in economic activity.

Below is a recap of the economy's performance during FY 23. How the economy performed should not be a surprise. As we borrow to repay past loans, there is no end in sight to GoP's distorted spending priorities. 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.

As stated above, at the centre of the economy's travails were several negative developments, that were entirely because of flawed policies. Sharp decline in Rupee value and the resultant tight monetary policy with high markup reduced demand. They also increased input cost for businesses, which were hit throughout the year with high tariffs on power and gas. In fact, all administrative prices increased. This way businesses suffered both from the demand and supply sides. That such policy making defies logic does not reduce the pain that it caused.

The combined effect of sharp devaluation, high interest, restriction on imports and high tariff and indirect tax rates took a toll on the economy. It was as though government had given up policy making altogether.

Economic Performance FY 20

Below is GDP growth rates against targets approved by the NEC in Annual Plan 2022-23. Against a target of 5.01% for the current fiscal, the expected GDP growth is 0.29%, see Table below:

Table 1: GDP performance

	Target FY 23 %	Actual FY 23 %
GDP growth	***5.01***	***0.29***
Industry	***5.9***	***-2.64***
Manufacturing	7.1	-3.91
LSM	7.4	-7.98
Mining	3.0	-4.41
Electricity and Gas Generation and Distribution	3.5	6.03
Construction	4.0	- 5.53
Agriculture	***3.9***	***1.55***
Crops:	--	-2.49
Important crops	3.5	-3.20
Other crops	5.0	0.23
Ginned Cotton	6.0	-23.01
Livestock	3.7	3.78
Forestry	4.5	3.93
Fishery	6.1	1.44
Commodity producing (Industry + Agriculture)	***4.8***	***-0.51***
Services	***5.1***	***0.86***
Wholesale * Retail	6.5	-4.46
Transport & storage	4.5	4.73
Finance & Insurance	5.1	-3.82
Housing Services (OD)	3.8	4.02
General Government Services	4.0	3.92
Other Private Services	4.8	5.39

Source: Targets Annual Plan 2022-23, Actual PES/National Accounts FY 23

Within the GDP, all key sectors that are drivers of economic growth showed very weak performance. Under industry, all sectors except power and energy had negative growth. With high interest rate and slow imports, manufacturing was especially hit. Demand fell and input cost rose. LSM fell sharply by almost 8%. It was targeted to grow by 7.4%. Overall, manufacturing was down by about 4% against a target growth rate of 7%. Production of crops, especially important crops fell. Agriculture's modest positive growth has come on the back of growth in livestock, fishery and forests. In addition to the floods this year, the sector has suffered from continued weak policy and underinvestment. Together, the commodity producing sector was down by 0.5%. Decline of the productive sector meant less demand for services. A slow economy meant fall by 3.8% in the usually buoyant areas of finance and insurance.

With such economic conditions, it was no surprise that direct taxes would stay at last year's level. If we account for the inflation effect, real tax collection fell. Expanding the tax base entails political cost. Thus far, it is at best work in progress. As in the past, government took the easy route of raising indirect taxes. These taxes are driven by demand and transactions. With soft demand, indirect taxes did not grow. Direct taxes showed a healthy increase.

Table 2: Revenue Collection

Rs. Billion

	Target FY 23	Revenue FY 23 July March	Revenue FY 22 July March	% Growth
Total Revenue Fed and provincial		6,938	5,874	18
Tax Revenue		5,618	4,822	17
Federal Revenue	9,405	6,397	5,366	19
FBR Tax Revenue	7,470	5,156	4,384	18
Direct Taxes	3,039	2,309	1,579	46
Indirect Taxes	4,431	2,847	2,805	2
• Customs	953	701	715	-2
• Sales tax	3,076	1,901	1,866	2
• Fed Excise	402	245	224	9
Non-Tax Revenue	1,935	1,241	983	26

Source: Budget from Budget in Brief FY 20, Revenue actuals from respective Fiscal Operations

Budget deficit: In the budget speech, the fiscal deficit was targeted to be 4.9 %. The July-March actual was 3.7%. Expenditures have risen because of higher interest rate and overall inflation. The slowdown of economic activity has kept indirect taxes barely above last year's total. Important import items like vehicles and machinery declined affecting customs duty and GST revenue. Total federal and provincial revenue is down to 5.6% of GDP compared to 7.3% of GDP in FY 22. The budget deficit is expected to cross 7% of GDP and the primary deficit is expected to be above 1%.

As GoP biggest expense is on debt servicing, the primary deficit is well below the overall budgetary balance.

Balance of Payment:

This year's major achievement is a substantial reduction in the current account balance by 76%. Ten-month actual current account deficit is USD 3.2 billion against last year's USD 13.7 billion for the same period last year. The current account deficit for FY 23 would likely stay well below this year's target of USD 9 billion in the annual plan. Last fiscal, the current account deficit was against USD 17.5 last fiscal year. Trade deficit for July-April FY 20 fell by 39%. For the same period, remittances also fell by 14 %. Net Forex Exchange Reserves with the SBP stood at $ 4.4 B at end April 2023. We don't have the dollars to import investment or consumption goods.

As exports and remittances have fallen, the current account balance's correction is mainly because of fall in imports. While fall in Rupee value has not helped exports, it has certainly hurt exports. For July-April FY 23, imports fell by 25.5%. Import of all commodities, except food, fell. Import of transport and machinery fell by 57% and 49% respectively. Import of even petroleum products declined despite increase in world energy price, as high cost reduced demand. Import of petroleum products was over 14 million tons in July-April FY 22. Year on year, it fell to 8.75 million tons this year.

Other than its immediate causes, exports will also grow with increase in competitiveness and production of higher value goods. It does not respond to Rupee value alone. Even in Pakistan's mainstay export of textiles, quantity growth often comes from drop in unit value.

FY 23 export of goods and services is estimated to be USD 35 Billion against a target of USD 39.5 billion for the year. Overall, current account deficit will be well below the target of USD 9,019 million. Workers remittance during FY 23 fell by 14% to 23,538 million. By year end it is estimated to be USD 29 billion, about 10% below last year's total.

Table 3: Summary of Balance of Payment
Major Indicators

	Target FY 23	FY 22	July-April FY 23	July-April FY22	Change +/-
	Million USD				%
Current Account Balance	-9,019	-17,481	-3,258	-13,654	-76
Trade Deficit FOB (incl. Services)	-34,048	-44,890	-22,394	-36,559	-39
Workers' Remittance	32,495	32,573	23,538	27,248	-14

Table 3.1: Trade Flows July-April FY 23, goods and services

Million USD

	Target FY 23	FY 22	July-April FY 23	July-April FY 22	% +/-
Exports	39,522	39,595	29,220	32,781	-10.8
Imports	78,165	84,485	51,614	69,348	-25.5
Trade Deficit	38,648	44,890	22,394	36,594	-39

Low savings and investment: Low savings and investment affect growth. Along with low technology content in our production base, this has been an enduring predicament of our economy. As per the Economic Survey, investment was 13.6 % of GDP against a target of 14.7 % of GDP. In the last two years, total investment was 15.7% and 14.5%. With an Incremental Capital Output Ratio of 4 or more, 20% investment is needed to generate 5% GDP growth.

National savings is 12.6% of GDP in the current fiscal against a low target of 12.5%. Domestic savings (i.e., national savings minus remittances) was a low 6.3% of GDP. Over the years, domestic savings have progressively fallen. This is grave cause for concern and yet not mentioned in GoP's policy discussion. There is a direct relationship between savings, investment, manufacturing and export.

Inflation: CPI for July-May FY 23 grew by 29.2% Vs 11.3% for July May 22. YoY growth in May 2023 was 37.9%. See Table below:

Table 4: Inflation: July-May FY 20 and YoY May 20

				%
	Average July-May		YoY May 2020	
	FY 23	FY 22	May 2023	May 2022
CPI	29.2	11.3	37.9	13.8
SPI	32.8	16.7	42.9	14.1
WPI	33.9	23.6	32.8	29.6

The combination of sharp fall in exchange rate, import driven inflation was aggravated by continuous increase in tariff of utilities and essentials. Despite the present slow growth, inflation is high.

Fiscal Operations:

With debt servicing making up the bulk of GoP's expenditure, there is not much analysis left to do. In the last five years, debt servicing and subsidies and grants have gained share over all other spending, including defence and PSDP. Expenditure on defence ranged between 18 and 24% in the last decade. It will likely be under 15% of total federal expenditure in FY 23.

Development expenditure: PSDP has fallen consistently in government's priority. It averaged a healthy 8.7% of GDP for the decade 1976 to 1985. In the last decade 2011-2020, it averaged 3.9% of GDP. In FY 23, it is estimated to be just a notch above 2% of GDP. The trend is not just because of present challenges. It also reflects political choice.

While development fell, budget deficit stayed high averaging 6% of GDP for the past 30 years. Current expenditure on interest and subsidy have left little space for development. Thus, constant fall in GDP growth rates were inevitable and expected.

Total debt servicing is expected to be Rs. 5.2 trillion in FY 23, or 52% of total expenditure. Some estimates expect an even higher number reaching Rs. 6 trillion. Today, federal government's net revenue receipt is expected to be less than the debt servicing cost. For FY 22, GoP paid Rs. 3,182 billion in mark-up, 85% of net revenue receipts. This year mark up will be above 110% of net revenue. This means all other expenditure on running the government and development, salary, defence, BISP, subsidy and PSDP is being funded by loans. There is no discussion about how to exit the debt burden. The only focus is on accessing more credit and increasing tax revenue to pay the. This is questionable public finance management and impoverishes the economy.

Table 5: Summarized federal fiscal operations

Billion Rs.

	July-March FY 23	July-March FY 22	% +/-	July-June FY 22	% Share in total expenditure FY22
Total	6,978	5,948	17	9,340	100
Current	6,675	5,281	13	8,452	91
Defence	1,001	882	13	1,412	15
Debt servicing	3,582	2,118	69	3,182	34
Subsidies and grants	1,209	1,566	-23	2,769	30
Pension	487	395	23	542	6
Sub-Total of above 3	6,279	4,961	27	7,905	85
Balance for civil government	396	320	24	547	6
PSDP	428	535	-20	701	8
Fiscal Deficit /GDP %	-3.7	-3.8	--	-7.9	--
Primary Balance/GDP %	0.6	-0.7	--	-3.1	--

In past decades, there were occasions when Pakistan had large fiscal space to build its production base and give boost to the economy for sustained GDP and export growth. On both occasions, we missed the opportunity. Post 9/11, Pakistan received massive aid and foreign funds from bilateral and multilateral donors. Along with rescheduling of $ 28 billion of Paris Club debt for fifteen years, estimates of the total space available to Pakistan was about $ 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 nothing to build competitiveness and exports. On the second occasion we at least built infrastructure, albeit with generous incentives. 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. There is yet no discussion on these lines.

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 tranche. 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.

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.

Inevitably, we now find the economy beseeched by extensive challenges. Getting out of the mess calls for making difficult policy choices. There is no sign that this is about to happen. The discipline being demanded by IMF is 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 mitigate the circular debt. With considerable tariff increase in power and gas sectors, GoP hopes to recover fully their cost and restore financial order to the sector. However, this has not happened, as the incentive for losses increases with tariff rates. Meanwhile, circular debt continues to grow.

Subsidy expense has seen consistent increase in its share in total expenditure. Eighty percent of it is as tariff differential for the independent power producers. Each year, IPPs receive subsidy of about a trillion Rupees. A UNDP report says that IPPs "are a key example of favourable pricing formula, with their power tariff set so that the Government fully covers their capacity charges and fuel costs. This cost-plus practice of pricing has greatly reduced market risks for IPPs". It allows "Some have had a 25 to 30 percent return on equity (ROE) in different years". This is an area where correction in policy and governance (by restraining DISCO losses) could yield large savings in public expenditure.

PSDP has consistently been cut for many years. The PSDP budget for FY 23 was Rs. 701 billion. As of 5 June 2023, total spending was Rs. 466 billion, or 35% below allocation. Rupee utilization was just Rs. 330 billion, 48% below allocation. Long term cuts in PSDP and weak project selection has depressed growth.

With FBR taxes not growing, in real terms, fiscal deficit has been hard to control. July-March FY 23 fiscal deficit was -3.7% of GDP. Total expenditure grew by 17 %, below the rate of inflation. In a slow economy, taxes grew unevenly, by 18%. Non-tax revenue grew by 26%. SBP profits and petroleum levy are its main component.

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 service provision to the people. Plans for strong action have been have afoot, but so far, there is nothing on ground.

Grants 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.

After meeting debt servicing and subsidies and grant, not much of government spending is left for stimulating growth or for public welfare. During July-March FY 23, PSDP spending was a paltry 6 % of total expenditure. Debt servicing, subsidy and grant and defence had a share of 79 % in total expenditure, which will increase to about 90% by year end.

Public Debt:

Public debt including external debt grew rapidly, as in the past years. Part of the increase in liability is because of loss in value of the Rupee that overstates foreign debt. Public debt was 81% of total debt and liability. In nine months from June 2022, it grew by 20% to Rs. 59,247 billion.

Resultantly, debt servicing has taken an increasing share in expenditure. External debt and liabilities comprise 48% of total debt and stands at 40% of GDP. The share of external debt in total debt and in GDP has consistently increased, though this year inflows were restricted.

Table 6: Total debt and liabilities

Rs. Billion

	June 2013	June 2018	June 2022	March 2023
Total Debt and Liabilities	**16,228**	**29,861**	**59,698**	**72,979**
Growth from previous col %	--	84	100	22
Domestic Debt	**9,833**	**17,483**	**32,712**	**36,667**
Growth from previous col%	--	78	87	12
Government	9,521	16,415	31,036	35,076
PSEs	312	1,068	1,676	1,591
External Debt	**5,698**	**8,537**	**24,334**	**32,526**
Growth from previous col%	--	50	185	34
Government	4,311	7,796	16,747	22,047
IMF	435	741	1,410	2,125
PSEs and Private inc intercompany	952	2,399	6,177	8,355
Total Debt	**15,531**	**26,020**	**57,046**	**69,193**
Growth from previous col				
Liabilities	**697**	**1,442**	**3,410**	**4,260**
Domestic	470	820	1,134	1,111
External	227	622	2,276	3,149
Gross Public Debt			49,242	59,247 20%

	As percent of GDP, March 2023
Total Debt and Liabilities	89.7
Gross Public Debt	73.9
Total Debt of the Government - FRDLA Definition	66.6
Total External Debt & Liabilities	40.0
Commodity Operation and PSEs Debt	6.3

Consistently, high budget deficit for many years has caused government to incur debt. Total debt and liabilities stood at almost Rs. 72,979 billion or over 90 % of GDP. As of March 2023, debt and liabilities have grown by Rs. 13.3 trillion from the stock on 30 June 2022, or by 22%. Since June 2022, domestic debt has grown by 12 % and external debt by 34 % (including the effect of a devalued Rupee).

External debt and liabilities alone is now over 40% of GDP. In dollar terms, external debt has fallen because of paucity of inflows awaiting IMF nod. Total external debt and liability as of March 2023 was $ 125.7 billion. Of this, public debt was $ 96.3 billion, 77% of total.

In the last several years, we have also seen increase in commercial debt, though there is a slight correction this year. The increase in market-based debt with limited tenure and high cost was a great factor in causing fragility in the economy.

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