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A Report on the Economic Performance of the Caretaker Government

Policy Research Institute of Market Economy

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Overview

In the **first section** of the report, the taxation reform proposed by the caretaker government is analyzed. The report argues that only restructuring of the FBR will not be sufficient to address the challenges of low tax revenue collection and narrow tax base. The government needs to devise a comprehensive tax policy to guide the tax administration and provide rationale for levying taxes. The progress on privatization drive of the government is also analyzed.

In **Section 2** we present economic data on major macro indicators including Inflation, Current Account, Public Debt, Foreign Direct Investment, Government borrowing, and a general trend of how the economy is behaving, where we reach the conclusion that Pakistan's economy is currently facing insurmountable challenges and not performing at its potential level.

Section 3 paints an economic outlook of the country. Pakistan like other countries around the globe is experiencing severe inflationary pressures and a slowdown in economic activity due to disruptive trade policies, the continuity of the war Russia-Ukraine war, a decline in foreign exchange reserves and volatility in the exchange rate. Petroleum prices have moderated in the recent months but gas prices remain elevated and government faces problems in the timely procurement. Pakistan's external financial obligations are expected to remain high; even with a slight improvement in reserves, it will be reliant on the IMF and bilateral and multilateral assistance, which could keep the country vulnerable to external shocks. The economic activity, especially the output of the manufacturing sector, has experienced a declining trend due to hike in energy prices, trade barriers and high cost of borrowing. Therefore, proactive measures at the fiscal and monetary policy fronts along with easing of trade restrictions to mitigate the slowdown of the economy. Furthermore, reforms are needed in the energy sector to ensure sustainability and promote economic activity in the country.

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Proposed FBR Reform does not address Structural Issues

1. Introduction

Pakistan is currently at an intersection, encountering formidable challenges on the domestic and external fronts. The most prominent is the economic crisis. Due to the inability of the governments to successfully address the structural issues in the economy, Pakistan is currently availing 23rd International Monetary Fund (IMF) Programme. The country's inability to swerve from economic crises is due to continuous fiscal mismanagement, specifically the distorted taxation system. The caretaker government has taken some initiatives towards structural reforms that led to the successful completion of IMF Stand-By-Arrangement (SBA) review and improved outlook. However, the limited mandate and tenure make the outcome of the initiatives dependent on the elections and continuity of reforms by political governments. The uncertainties prevail and continue to mount until elections are held and the elected political government lays out its economic priorities.

1.1. State of Economy

The importance and urgency of tax reforms cannot be overemphasized as the country is struggling to generate sufficient revenues to meet expenditure requirements. Fiscal deficit stood at 7.1 percent of GDP in FY 2022 and 7 percent of GDP in FY 2023[1]. It is important to highlight that the growth in expenditures of 28 percent in FY 2022 and 21 percent in FY 2023 surpassed the growth in tax revenues of 22 percent in FY 2022 and 19 percent in FY 2023. This necessitated the government to borrow money from domestic and international bilateral and multilateral sources, which resulted in the accumulation of debt and a higher burden of debt servicing.

[1] Data is taken from Budget in Brief documents from FY 2021-2024, Ministry of Finance.

Although FBR surpassed the Rs. 7 trillion tax revenue mark for the first time in FY 2023, the analysis of the composition of collected revenues makes this achievement rather disturbing.

1.2. Upcoming Elections and Need for Reform

General elections will be held on 8th February, 2024. Political parties will be presenting their manifestos to lay out their reform agenda. A manifesto represents the essence of a party's ideals, aspirations, and commitment to its constituents. This binding commitment holds a party answerable to its stated goals and empowers the electorate to demand transparency in the realization of those promises (Haque and Hussein, 2023[2]). The absence of an economic revival strategy and political parties' views on taxation reforms make the initiative taken by the caretaker government uncertain.

The solvency of the government and sustainable economic growth of the country depends upon the government's taxation policy. This report attempts to review the performance of the country's taxation system, highlight reforms proposed by the caretaker government, and present the contours of effective reforms. The period under analysis is from 2008-9 to 2021-22.

2. Performance of Taxation System

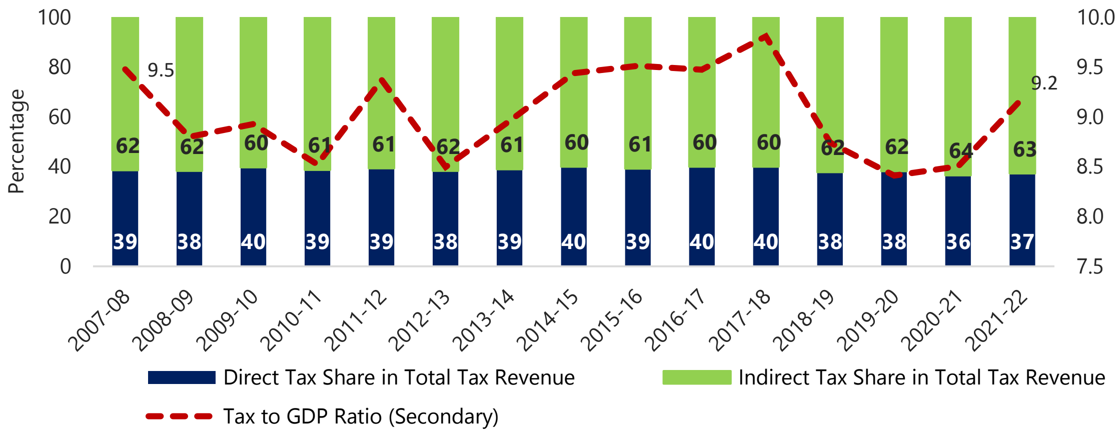
The taxation system of the country has remained under criticism due to low revenue collection and a narrow tax base. Usually, revenue targets put forth in the budgets have been increased continuously but the composition of the collected tax revenues and their implications are the case in review. Tax revenues have been titled towards indirect sources, which are believed to be distortionary and regressive as the burden felt by lower income groups is much higher.

2.1. Composition of Tax Revenues

The suboptimal performance of the tax administration can be illustrated by the low Tax to GDP ratio of Pakistan. It can be observed that the Tax to GDP ratio has hovered around 9 percent in the last 15 years starting from 8.8 percent in 2009 to 9.2 percent in 2022 (Figure 1). In terms of the performance of political parties in revenue generation, the Tax to GDP ratio witnessed a slight decline from 8.8 percent to 8.5 during the Pakistan People Party (PPP) tenure. The ratio improved during the Pakistan Muslim League (Nawaz) tenure from 8.5 percent to 9.8 percent, and then it declined to 9.2 percent during the Pakistan Tehreek-e-Insaf tenure.

[2] Dr. Nadeem Ul Haque and Saddam Hussein analyzed the manifestoes of political parties in PIDE Knowledge Brief "Manifestoes Without Substance".

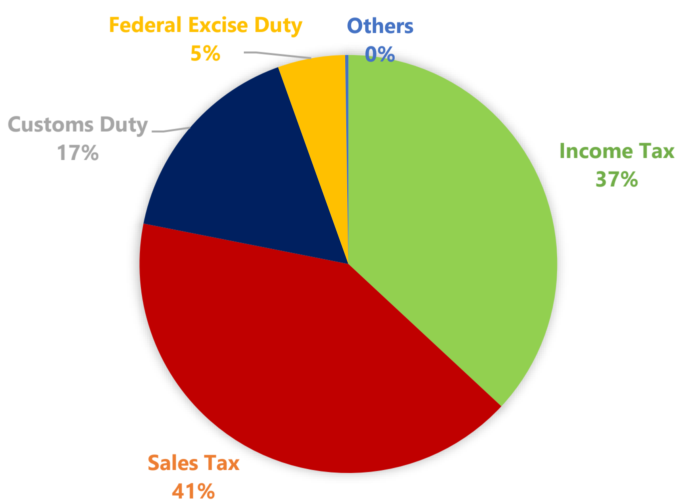
Figure 1: Tax Revenue Collection in Pakistan



Source: FBR Yearbooks

The composition of tax revenues shows that more than 60 percent of revenues are collected from indirect taxes as compared to less than 30 percent from direct taxes. It is also important to note that out of total tax revenues, 41 percent is the sales tax, 37 percent is income tax, 17 percent is customs duty and 5 percent is federal excise duty (Figure 2). The collection of taxes from indirect sources has not only distorted the country's trade but also hindered industrial activity, made the FBR complacent, and discouraged the citizens from becoming part of the documented economy.

Figure 2: Composition Of Tax Revenues In FY 2022



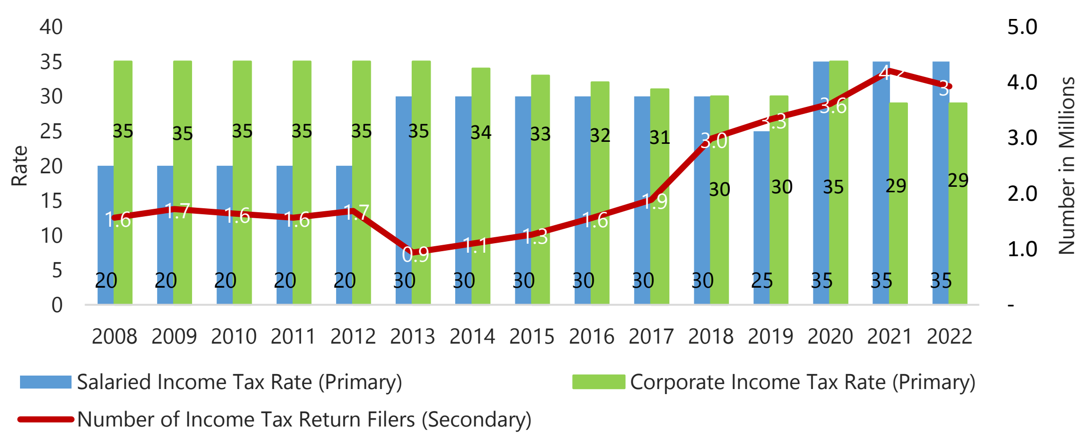
The analysis of the composition of the tax revenues indicates that despite the claim of tax reforms by successive governments, there is no significant change.

2.2. Compliance of Taxpayers

The analysis of the tax rate and compliance of the citizens holds critical importance in the evaluation of the tax system. It can be observed that the maximum income tax rate for salaried income has increased significantly from 20 percent in 2008 to 35 percent in 2022 (Figure 3). The maximum tax rate for the corporate sector, excluding the banking sector, has decreased from 35 percent in 2008 to 29 percent in 2022. It is pertinent to mention that taxes on corporate income have actually increased due to the imposition of the Super Tax on income greater than Rs. 150 million. Therefore, it can be said that the effective income tax rate has increased in reality and the increase in direct tax revenue collection could be attributed to an increase in the tax rates. The relationship between tax revenues and tax rates was presented by the Laffer Curve, which indicates that increasing tax rates lead to higher revenues to a certain point after which revenues start decreasing (Dr. Arthur B. Laffer).

The compliance of income tax and growth in the tax base can be represented by a number of people filing income tax returns. Over the last 15 years, there has been growth in the number of people filing income tax returns from 1.6 million in 2008 to a maximum of 4.2 million in 2021 and a slight decline to 3.9 million in 2022. However, this does not indicate that all the people filling returns have actually made payments or how many have filed nil returns. Moreover, the extent of the informal economy or the number of people not filing returns but having taxable income is not known.

Figure 3: Maximum Income Tax Rate and Compliance



Source: FBR Biannual/Quarterly Review Reports

Similarly, it is also important to analyze the performance of tax administration in the sales tax mode. Due to the unavailability of data on sales tax, the current performance and progress could not be analyzed.

3. Highlights of Past Reforms

Before delving into the reforms proposed by the caretaker government, it is imperative to highlight the initiatives taken by successive governments to overhaul the country's taxation system and improve revenue collection. In the last 15 years, there are 4 major initiatives aimed at improving the performance of tax administration, broadening the tax base, and increasing revenue collection. A brief description is illustrated below

1. **Tax Administration Reforms Program (TARP):** TARP started in 2005 to promote transparency, achieve targets, and provide ease to taxpayers. The cost of the project was Rs. 6.4 billion and completed in 2011. The reforms included (i) establishment and upgradation of infrastructure, (ii) purchase and installation of four softwares i.e. Integrated Tax Management System, Human Resource Information System, SAP Materials Management and Financial Modules, and Data Warehouse software, and (iii) purchase of equipment. The procurement of equipment and installation of software was a step towards digitization for better service delivery. FBR claimed that revenue targets were achieved and the Tax to GDP ratio increased by 0.3 percent every year[3]. However, from 2005 to 2015, FBR was able to achieve targets in 3 years only i.e. 2005, 2006 and 2008, when the project was in the implementation stage. Furthermore, the Tax to GDP ratio declined from 9.1 percent in 2005 to 8.8 percent in 2011 at the end of the project[4].
2. **Declaration of Domestic and Foreign Income and Assets:** The government introduced an amnesty scheme in 2018[5] with the view of documentation of the economy and generating revenues in the short term by giving an opportunity to the people to disclose their income and assets within and outside the country. The tax rates ranged from 2 percent to 5 percent. Around 83,120 returns were filed with the declaration of more than Rs. 3 trillion worth of assets and the collection of Rs. 121 billion as taxes (Ahmed, Malik and Nawaz, 2019)[6]. Although the outcome of the schemes looked satisfactory, the moral compass makes this exercise unethical and unjust towards the compliant taxpayers. Moreover, it creates incentives for the evaders to stay out of

[3] The information on the outcome of TARP can be accessed at https://www.fbr.gov.pk/outcomes-reforms/142253/165.
[4] Data is taken from FBR Yearbooks.
[5] Source: FBR. The information can be accessed at https://www.fbr.gov.pk/Events/tax-amnesty-scheme-2018---in-respect-of-undis/21232
[6] The information on outcome of amnesty scheme was taken from an article "Pakistan: Economy Under Elites- Tax Amnesty Scheme" authored by Muhammad Ashfaq Ahmed, Ikram Ali Malik and Nasreen Nawaz. The article can be accessed at https://mpra.ub.uni-muenchen.de/113918/1/MPRA_paper_113918.pdf

the formal economy and when presented with the opportunity, to document their hidden assets with impunity. This also highlights the fact that tax rates are high in Pakistan due to which people prefer to operate in the informal economy and evade taxes.

3. **Asset Declaration Ordinance 2019:** The government introduced an amnesty scheme in 20197 again with the view of documentation of the economy. Under the scheme, around 125,349 declarations were filed of worth Rs. 2.26 trillion assets, and tax collected was Rs. 64.66 billion8. The scheme could not achieve the target of documenting the assets proclaimed by the government as a justification for the scheme.
4. **Pakistan Raises Revenue Program (PRRP):** The government initiated PRRP[9] in 2019 with $400 million in funding from the World Bank. The project aims at broadening of tax base and promoting compliance through simplification of procedures and institutional development. In the project, transparency will be promoted through the publication of reports such as Tax Gap, Tax Expenditure, and Revenue Forecasts, which the government has already started to publish. Another feature is the implementation of the Track and Trace system, which has been employed in 4 sectors (Tobacco, cement, sugar and fertilizer). The project has also resulted in the simplification of the procedures for filing sales and income taxes. Moreover, Point of Sale (POS) is also being implemented for better monitoring and documentation. The milestones of the project have been achieved but the actual outcome will become clear in coming years.
5. **Reforms and Resource Mobilization Commission (RRMC):** The Pakistan Democratic Movement (PDM) government constituted a commission in December 2022 to suggest reforms in the taxation system to generate higher tax revenues. The recommendations put forth by the commission only focused on increasing rates of taxes[10] such as (i) advance income tax of 5 percent on future profits listed companies and 7.5 percent on non-listed companies, (ii) increasing tax on sole proprietors by more than 10 percent, (iii) advance income tax on non-corporate exporters increased from 1 percent to 8 percent (iv) imposition of additional income tax on exporters who delay the return of proceeds and (v) imposition of 1 percent tax on Wholesale dealers, Distributors and Retailers who are filers and 4 percent on non-filers. However,

[7] The information on the components of the scheme can be accessed at https://fbr.gov.pk/assets-declaration-scheme-2019/132009

[8] The information on outcome of amnesty scheme was taken from an article "Pakistan: Economy Under Elites- Tax Amnesty Scheme" authored by Muhammad Ashfaq Ahmed, Ikram Ali Malik and Nasreen Nawaz. The article can be accessed at https://mpra.ub.uni-muenchen.de/113918/1/MPRA_paper_113918.pdf

[9] The information on the project can be accessed at https://documents.worldbank.org/en/publication/documents-reports/documentdetail/458051560736948947/pakistan-raises-revenue-project

[10] The analysis on the proposed reforms was carried out by PRIME. It can be accessed at https://primeinstitute.org/primes-position-paper-on-tax-reforms/

the government refused to implement the suggestions as they proposed a mere increase in tax rates, which is the cardinal reason behind low compliance and tax evasion.

The brief description of reforms or initiatives taken by the government in the last couple of years indicates that the focus remained confined to broadening the tax base and generating more revenues. But it can also be indicated that no effort was made to devise a Tax Policy to guide the government to undertake reforms that are more suitable for addressing the problems of the country. Resultantly, the objectives envisaged could not be accomplished and the performance of tax administration remained inadequate to meet the needs of the country.

4. Tax Reforms Proposed by Caretaker Government

The caretaker government, while realizing the need to expedite the documentation drive and grow the revenue generation capacity of the government, has proposed a plan to restructure the FBR. The suggested reform aims to improve the efficiency of tax administration while at the same time promoting transparency and accountability. The current organizational structure of FBR comprising 11 board members headed by Chairman FBR and 21 Director Generals (DG) will be changed.

The proposed plan envisages the separation of Inland Revenue (IR) and Customs where each will be headed by respected DGs and supervised by oversight boards. Customs will be responsible for dealing with trade management issues while Inland Revenue will be responsible for revenue collection. The objective of oversight boards will be to evaluate the performance of respective departments. The prerogative of imposing taxes will be taken from Customs and Inland Revenue, and given to Tax Policy Board. Under these reforms, the responsibility for formulating income tax, sales tax, and federal excise policies will be transferred to the Revenue Division. The Revenue Division, headed by the Secretary of the Revenue Division, will consist of a tax policy office called the Federal Policy Board.

- Customs Oversight Board would consist of 10 members comprising the Secretary Revenue Division, Secretary Finance Division, Secretary Commerce Division, an Economist, International Trade and WTO expert, International Maritime/ Logistics expert, Security and Border Controls expert, E-Commerce Expert, representative of trade and industry, and Director General Customs.
- Inland Revenue Oversight Board would consist of 10 members comprising the Secretary Revenue Division, Secretary Finance Division, Secretary Commerce Division, International Tax Law Expert, Inland Revenue Economist, Income Tax Expert, Sales Tax and Excise Expert, Technology Expert, representative of trade and industry, and Director General Inland Revenue.

5. What kind of Reforms does Pakistan need?

The initiative taken by the caretaker government to overhaul the tax administration is a much-needed development. The current structure of FBR has not shown any satisfactory performance in promoting transparency, compliance of citizens through broadening of tax base and growth in revenues. It is pertinent to highlight that the growth in revenues achieved so far has been on the basis of increasing tax rates and imposing new taxes. The prevalence and recent hike in smuggling and the inability of the FBR to bring retailers/wholesalers into the tax base show that reforms are indispensable.

According to a survey published by the World Customs Organization in 2020[11], around 27 percent of countries have integrated Customs and Inland Revenue administrations, mostly visible in the developing world. Whereas, 73 percent of countries, such as the US, China, Russia, Vietnam, etc., have separate Customs and Inland administrations. The proposed reform is in harmony with the international best practices where countries have higher Tax to GDP ratios and compliance. The rationale behind the segregation of the two is to make departments focus on their respective roles and promote transparency if anyone is failing to perform.

The reform proposed by the caretaker government focuses on the restructuring of tax administration. However, the underlying causes of low tax revenue collection and low compliance remain unaddressed. One of the cardinal factors behind the unsatisfactory performance of tax administration is the absence of a comprehensive tax policy. Until now, the governments have imposed taxes and increased rates solely focusing on the budgetary needs and revenue targets. There is no other objective or rationale behind the tax. Moreover, the absence of a tax policy has resulted in an increase in taxes and duties on trade, and half of the revenues are collected at the import stage. This has also contributed to de-industrialization and loss of competitiveness of local industry. A tax policy needs to be formulated keeping in view the broader picture where budgetary needs do not take precedence over the economic performance of the country.

The proposed reforms fail to address an important issue faced by the citizens. At present, after the 18th Constitutional Amendment, some taxes fall in the provincial domain while some are in the federal. As a result, individuals and businesses have to deal with multiple tax authorities which not only makes compliance difficult and cumbersome but also presents opportunities to bypass the regulations and evade taxes (Bukhari and Haq, 2020[12]). This problem is intensified by a lack

[11] https://tribune.com.pk/story/2453794/stalemate-over-fbr-overhaul

[12] Huzaima Bukhari and Dr. Ikramul Haq wrote a book "Tax Reforms in Pakistan: Historic and Critical View". Authors highlighted the problems emanating from fragmented tax system.

of coordination between federal and provincial tax administrations. Therefore, any reform being considered to improve the taxation system should also address this issue.

Another factor that should be kept in mind is that the caretaker government is constituted to ensure the smooth operation of the government until elections are held and an elected government is formed. It is not a wise policy to put the burden of difficult reforms on the caretaker government and relieve elected governments of their main responsibilities. The elected governments intentionally ignore the governance and structural economic issues just to save their political capital. They prefer political aspirations and focus on popular decisions. Moreover, the caretaker government cannot be held accountable like the elected governments for bad policies.

The composition of the Oversight Boards warrants some caution. The objective of the oversight board is to examine and supervise the performance of the respective departments. If the members representing the government are the same on both boards, then it may hinder the effectiveness of the boards as the private members have remained unheard and decisions are taken by the few powerful.

The current restructuring initiative of the caretaker government should address the issues mentioned above to improve the performance of tax administration and induce trust in citizens in the country's taxation system. The proposed reform has been approved by Special Investment Facilitation Council (SIFC), a forum comprising civil and military leadership. Moreover, caretaker government is pushing to expedite the reform process. However, it is recommended that reforms should not be carried out in haste and without due deliberation.

6. PRIME's View on Tax Reforms

The overhaul of taxation system is imperative for the financial sustainability of country. The exorbitant tax rates are one of the reasons behind the inability of the government to expand the tax base and promote compliance of people. Therefore, a flat, low-rate, broad and predictable tax system is an alternative to address the existing issues and promote compliance (Bukhari and Haq, 2020[13]). This argument also coincides with the Laffer Curve that low tax rates lead to higher revenue collection.

[13] Huzaima Bukhari and Dr. Ikramul Haq wrote a detailed book "Towards Flat, Low-rate, Broad and Predictable Taxes) published by PRIME. Authors presented an alternative taxation system.

The need of a tax policy cannot be overstressed as the imposition of taxes; their rates and the nature of taxes should be based on broader economic agenda. Also, the impact of tax on any sector or industry should be carefully evaluated to prevent distortions and inefficiencies.

The country's taxation system is complex and involvement of multiple agencies make the overall system inefficient. Therefore, a National Tax Agency is recommended. A National Tax Agency (NTA) with the mandate to impose a simple and harmonized tax code should be established to replace/restructure Federal Board of Revenue (FBR) and all other federal tax authorities in the country. It will be responsible for collecting taxes at the federal level with active role of National Tax Council (NTC). Provincial tax authorities will be similarly structured and streamlined to provide ease and simplicity to the taxpayer. The NTA will report to the Parliament through the Minister of Finance and the appointment of chairman and members shall be through a public hearing by a joint select committee of the National Assembly and the Senate. It will not assume the role of legislator and policymaker, which under the constitution is the sole prerogative of the people of Pakistan through their elected representatives (PRIME Charter of Economy, 2023[14]).

Review of Privatization Process

The caretaker government initiated the reform process after assuming power in August 2023 and appointed Mr. Fawad Hassan Fawad as the privatization minister in September. The privatization minister while addressing the media reiterated the need for privatization by highlighting that State Owned Enterprise (SOE) losses were 7 percent of GDP in 2020 and the government allocated Rs. 2.54 trillion to support them between 2018 and 2020. The total losses of commercial SOEs in FY 2022 was Rs. 760 billion[15]. After one week of assuming responsibility, the caretaker privatization minister set timelines to carry out the privatization of Pakistan International Airline, Pakistan Steel Mill, and other SOEs in a transparent manner.

On November 15, 2023, after reaching a staff level agreement on the first review of the Stand-By-Arrangement, the IMF issued a press release indicating that Pakistan needs SOE and governance reforms to improve the business environment, investment, job creation, and fiscal sustainability.

In the last four and half months, the privatization minister convened five board meetings to expedite the process of privatization and achieve targets set by the caretaker government. The process was initiated by hiring a financial advisory firm to provide requisite support.

[14] The Charter of Economy prepared by PRIME can be accessed at https://primeinstitute.org/prime-charter-of-economy/

[15] State Owned Enterprises Consolidated Report FY 2020-22, Ministry of Finance

The caretaker government was able to initiate the privatization process and seven transactions[16] are in the advanced stages while the only transaction that was completed was of the Heavy Electrical Complex. This transaction resulted in the proceeds of Rs. 1.4 billion[17]. Whereas, the caretaker government remained unsuccessful in completing other transactions. The process of the privatization of PIA was initiated but remained inconclusive due to structural and legal challenges. The proposed plan was a segregation of core and noncore assets where Rs. 640 billion of the total Rs. 825 billion liabilities will be transferred to a holding company and core assets will be presented for privatization. The transfer of liabilities would be carried out by getting a No Objection Certificate (NOC) from the creditors. Banks are demanding 16.6 percent interest rate[18] for deferring their recovery of Rs. 281 billion against the NOC while the government is insisting on a 10 percent interest rate. This deadlock has contributed to delays in the privatization of the PIA and missing the deadlines.

The highest share of losses is incurred by power sector Distribution Companies (DISCO). Among the top ten highest loss incurring SOEs, 7 are the DISCOs. The inefficiencies in the energy sector are increasing exponentially. The power sector's circular debt has reached Rs. 2.7 trillion till the end of December 2023. In the last couple of months, the power division under the supervision of the caretaker government has been unable to devise a plan to overcome inefficiencies and privatize DISCOs. The only plan proposed by the power division was to set up Performance Monitoring Units (PMU) in DISCOs headed by personnel from the army, police, bureaucracy, and intelligence agencies. The plan was rejected by the Finance division on the grounds that internal capacity should be developed for efficient monitoring.

There are other SOEs in the privatization list of the government but insignificant progress has been made thus far. The caretaker government did not face opposition from political parties and enjoyed the support of Special Investment Facilitation Council (SIFC) but could not overcome the challenges posed by the bureaucracy.

The limited tenure of the caretaker government and complexity of the procedures may have slowed down the process but lack of clarity on the way forward proved to be a real challenge. In the absence of a clear framework of privatization policy, the privatization minister Mr. Fawad Hassan Fawad engaged with PRIME Institute and other stakeholders. As a result, an unofficial framework for privatization was developed and published. The framework address that

[16] https://www.dawn.com/news/1803798
[17] https://privatisation.gov.pk/NewsDetail/MzE3OWIxMmQtNjliOS00NTE5LTkwNzEtMGY3MjNhZDZkNDJj
[18] https://tribune.com.pk/story/2454083/banks-seek-166-interest-on-pia-loan

1. No court other than a specialized Privatization Appellate Tribunal should be allowed to examine/adjudicate civil or criminal cases related to any privatization transaction. In the past, even government entities have gone into litigations against the federal government.

2. Major modifications must be made in the privatization Commission ordinance as well as the regulations to modernize the privatization framework, and to incorporate international best practices.

3. Contradictory and conflicting legislation/statutes which create procedural uncertainties must be reviewed and synchronized to eliminate procedural ambiguities in the privatization process.

4. Political parties should clarify their position on the privatization of SOEs, and specify their plans to a certain degree, so that political uncertainty around the issue can be mitigated.

5. A System of reward and punishment be adopted for the bureaucracy overseeing the privatization process, and regular performance appraisal of the management overseeing the privatization must be arranged periodically to ensure process continuity, and management effectiveness. Line Ministries managing SOEs must have answerable/accountable bureaucracies.

__________End of Section 1__________

SECTION TWO: MACROECONOMIC ANALYSIS

Economic Analysis

The global economic landscape remains volatile as the world is moving from one crisis to another. The pandemic enforced restrictions and subsequent supply chain disruptions gave rise to inflation, which exhibited rigidity and started to subside at the start of CY 2022. The conflict between Russia and Ukraine started in early 2022 and continues to affect food and energy prices. At the end of CY 2023, the conflict between Palestine and Israel evolved into a war causing instability in the Middle East. These conflicts have disturbed the trade routes and made the global growth prospects bleak. Moreover, the disagreement between the members of Oil Producing and Exporting Countries (OPEC) on the production cuts to keep prices stable at a higher level led to the exit of Angola, the second highest oil producer in Africa, from the group. Moreover, expansion in the production of petroleum products by the US has played an important role in keeping prices from elevating.

The growth in world GDP is expected to be lower than previously anticipated. According to the United Nations report “World Economic Situation Prospects 2024”, the world GDP will grow at the rate of 2.4 percent against the previous estimation of 2.7 percent and developing economies by 3.9 percent. The report forecasts that Pakistan will grow by 2 percent in 2024 and inflation will remain elevated to around 28 percent. The World Bank has downgraded the growth prospects of Pakistan to 2 percent against the government’s budgetary target of 3.5 percent. One positive development is the publication of quarterly GDP figures, which will help the government review the progress of the country and make timely policy decisions.

The economic and financial conditions of the country have improved in the last couple of months and slow recovery is observed both on the external and domestic fronts. In the second quarter of FY 2024 (October-December), the country experienced some stability on the economic front due to the completion of the first review of the $3 billion Stand-By Arrangement with IMF and the release of the $700 million tranche. The caretaker government has taken some difficult decisions such as revision of power and gas prices, which has promoted financial stability. However, on the political front, pressure continues to mount as the country is approaching elections.

Inflation

Inflation remains a big challenge for the government and the public at large as the latter continues to face financial pressure and erosion of their purchasing power. In the second quarter of FY 2024, the average CPI inflation stood at 28.7 percent as compared to 24.9 percent in FY 2023. The YoY CPI inflation in October, November, and December cloaked at 26.8 percent, 29.2 percent, and 29.7 percent respectively. The MoM CPI inflation in October, November, and December cloaked at 1.0 percent, 2.7 percent, and 0.8 percent. The average SPI inflation in the second quarter of FY 2024 stood at 33.3 percent and WPI inflation stood at 26.1 percent. The inflation in the first half of FY 2024 stood at 28.7 percent. The underlying cause of the inflation is a significant increase in utility prices. The price hike has resulted in suppressed demand but due to the capacity payments, the government is increasing prices as a quick fix and the public is facing the brunt of the government's inefficient policies. It is important to highlight that inflationary pressure from the external front has moderated as the exchange rate and currency remained stable.

Fiscal Sector

Public finance has remained under pressure at the start of FY 2024 due to higher financial obligations in the form of debt servicing and the requirement from the IMF to achieve a primary surplus. The government was able to collect Rs. 3,484 billion in the first four months of FY 2024 as compared to Rs. 2,688 billion last year, a growth of 29 percent. In contrast, the total government expenditures increased by 35 percent to Rs.3,706 billion against Rs.2,737 billion last year. As a result, the fiscal deficit cloaked at 0.8 percent of GDP i.e. Rs. 861.7 billion in Jul-Oct FY 2024 from 1.5 percent of GDP i.e. Rs.1,265.8 billion last year.

FBR collected Rs. 2,427 billion in the second quarter of FY 2024. Revenue collection in December was Rs. 982 billion, compared to a target of Rs. 975 billion. During the first half of FY 2024 (July-December), the FBR collected Rs4.449 trillion, beating the Rs4.425 trillion target by Rs24 billion. Because of the slowdown in imports, revenue collection at the import stage was low compared to previous years.

The total government spending outpaced the revenue collection and therefore, the government had to borrow money from domestic and external sources. In the second quarter of FY 2024, total government borrowing increased by Rs. 624 billion as compared to a fall of Rs. 134 billion last year. At the end of the second quarter of FY 2024, the total government borrowing was cloaked at Rs. 25.7 trillion. The outstanding government borrowing from the State Bank of

Pakistan fell by Rs. 1.46 trillion as compared to a fall of Rs. 253 billion last year thus indicating massive debt retirement. The outstanding credit from SBP stands at Rs. 3,481 billion. The government borrowing from the scheduled banks increased by Rs. 2,087 billion in the second quarter of FY 2024 as compared to an increase of Rs. 120 billion last year. The outstanding credit from scheduled banks stood at Rs. 22.26 trillion.

The government borrowing from domestic and external sources to finance the fiscal deficit and external payments resulted in the accumulation of debt. The central government's public debt increased by Rs. 1.1 trillion in the first two months (Oct-Nov) of the second quarter of FY 2024 as compared to Rs. 1.5 trillion last year. The central government's total debt stood at Rs. 63.4 trillion out of which domestic debt is Rs. 41.0 trillion and external debt is Rs. 22.4 trillion.

Foreign Investment

The inflow of foreign investment in Pakistan improved in the second quarter of FY 2024 as compared to the previous year. The net Foreign Direct Investment (FDI) was $465 million as compared to $160 million last year. The inflow of FDI was $628.3 million and the outflow was $163.4 million. Net FDI in Pakistan grew by $410 million during the first half of FY 2024 to $871.4 million from $460.9 million last year. The growth in foreign investment is due to improvement in the financial position of the country and political stability. Last year, the country faced difficulty to meet external financial obligations, IMF programme remained stalled and foreign exchange reserves fell to a level not sufficient for one month of imports.

Credit to Private Sector

The private sector borrowing illustrated a positive trend in the second quarter of FY 2024. The total private sector borrowing increased by Rs. 512 billion as compared to an increase of Rs. 423 billion last year.

The total private sector borrowing stood at Rs. 7.62 trillion till the end of December 2024. The long-term fixed financing (LTFF) declined by Rs. 15 billion in the second quarter of FY 2024 as compared to a fall of Rs. 17 billion last year. The LTFF stood at Rs. 582 billion till the end of December 2024.

The short-term financing (working capital) increased by Rs. 33 billion in the second quarter of FY 2024 as compared to the growth of Rs. 26 billion last year and total short-term financing stood at Rs. 346 billion at the end of December 2024. The private sector borrowing under the export financing scheme increased by Rs. 9 billion as compared to the growth of Rs. 15 billion last year and total export financing stood at Rs. 662 billion. The positive growth of private-sector borrowing can be attributed to the improvement in the business environment of the country, stability in the exchange rate and access to international credit due to IMF SBA. Another important factor is the ease of administrative controls on imports as compared to the previous year.

Manufacturing Sector

The performance of large-scale manufacturing (LSM) remained subdued. The LSMI output decreased by 4.08 percent for October 2023 when compared with October 2022 and 2 percent when compared with September 2023. Output of the Large-Scale Manufacturing Sector declined by 0.44 percent in the first four months of FY 2024 (Jul- Oct) when compared with the same period of last year.

The sectors showing positive growth were food, wearing apparel, chemicals, coke and petroleum, Pharmaceuticals, and nonmetallic minerals.

The slowdown in the manufacturing sector is due to the high cost of borrowing, exponential increase in the prices of utility, removal of the energy subsidy, and shortage of foreign exchange from the crackdown of the government on the currency exchange market at the end of September 2023.

Monetary Sector

The policy rate has remained unchanged at 22 percent during the last six months. The Monetary Policy Committee evaluated that real interest rates are positive on a 12-month ahead basis, and expected a decline in headline inflation in the second half of FY2024. However, the inflation remained higher than expected in November and December 2023 mainly due to an increase in utility prices. The ability of the interest rate to control inflation in Pakistan is limited as the government remained the majority borrower of capital from the banking sector and used money to finance current expenditures. Therefore, the money supply continues to grow, aggregate demand cannot be restricted while the supply suffers due to high cost of borrowing.

External Sector

The exports of Pakistan increased by 14 percent in the second quarter of FY 2024 and by 17 percent as compared to the first quarter of FY 2024. The total exports stood at $8.07 billion. The exports in October, November, and December were $2.69 billion, $2.57 billion and $2.81 billion respectively. The increase in exports can be attributed to ease in the restriction on imports and availability of raw materials.

The imports of the country declined by 7.9 percent in the second quarter of FY 2024 and by 26 percent as compared to the first quarter of FY 2024. The total imports stood at $13.9 billion in the second quarter. The imports in October, November, and December were $4.86 billion, $4.53 billion, and $4.51 billion respectively. The total trade deficit declined by 27 percent in the second quarter of FY 2024 and stood at $5.87 billion.

Remittances play an important role in the managing inflow and outflow of foreign exchange and fulfilling the country's external obligations. The inflow of remittances increased by 11.4 percent in the second quarter of FY 2024 as compared to last year. Pakistan received remittances of $7.09 billion in the second quarter of FY 2024 as compared to an inflow of $6.36 billion last year and $6.32 billion in the first quarter of FY 2024.

The current account balance posted a surplus of $198 million in Oct-Dec FY24, compared to a deficit of $1,983 million in the same quarter last year. Despite low inflows and higher outflows for debt servicing, the current account was in surplus by $397 million in December compared to a deficit of -$1,111 million as compared to the same month last year. Nonetheless, the current account deficit for the first half (Jul-Dec) of the FY 2024 was reduced to $831 million, a 77 percent decrease from the $3.63 billion in the same time last fiscal year.

The exchange rate appreciated in the second quarter of FY 2024 by 4.8 percent from Rs. 297 at the end of September 2023 to Rs. 283 at the end of December 2023. The appreciation in the value of the rupee resulted from IMF -SBA, crackdown on smuggling of foreign exchange, policy revision of currency exchange companies, and improvement in the political environment of the country.

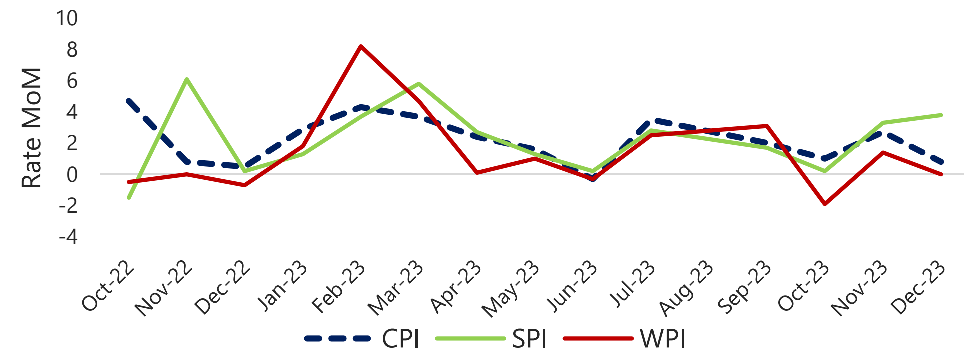
The foreign exchange reserves of the government increased by 6.5 percent i.e., $ 500 million in the second quarter of FY 2024 from $7.7 billion at the end of September to $8.2 billion at the end of December 2023. The increase in reserves can be attributed to the rollover of debt, a slight increase in exports and remittances, and funding from multilateral.

Stock Market

The KSE-100 Index stock position at the start of the second quarter was 46,627 and it increased to 62,451 at the end of December 2023, a growth of 34 percent in the second quarter of FY 2024. The market capitalization increased by 31 percent in the first quarter of FY 2024, compared to a fall of 5.6 percent last year. The total market capitalization till the end of December 2023 stood at Rs. 9.06 trillion. The improvement in KSE-100 is due to the improvement in the current account balance, continuity of the IMF programme, stability in the exchange rate, and improvement in political stability from the clarity on the schedule of elections.

Macroeconomic Indicators

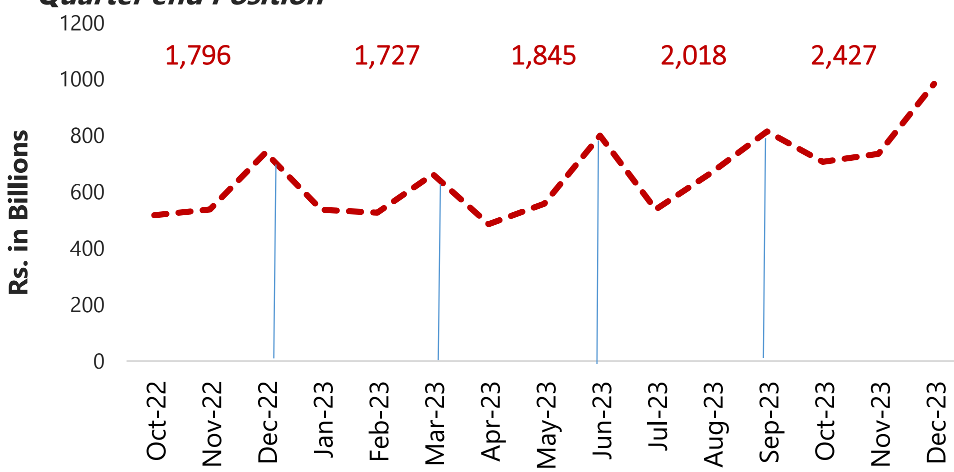
Figure 4: Inflation



Source: Pakistan Bureau of Statistics

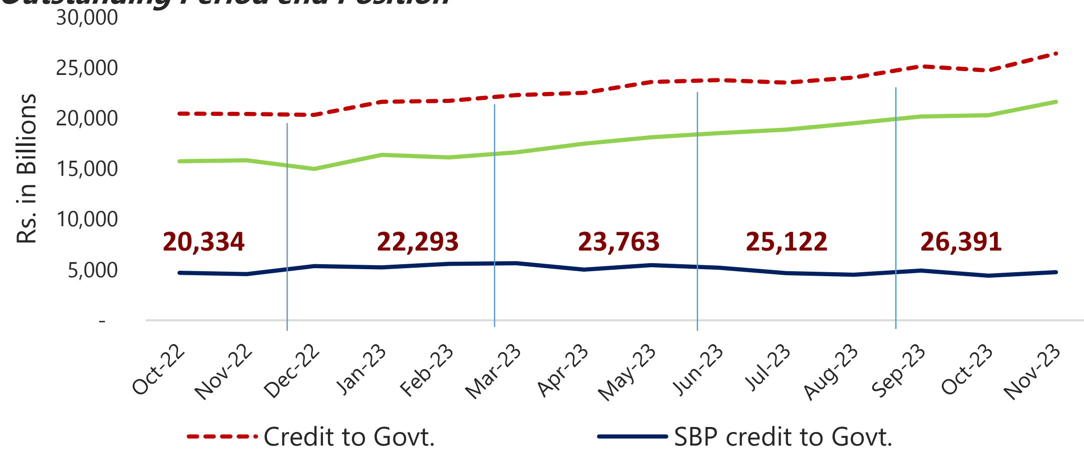
Figure 5: Revenue Collection

Quarter end Position



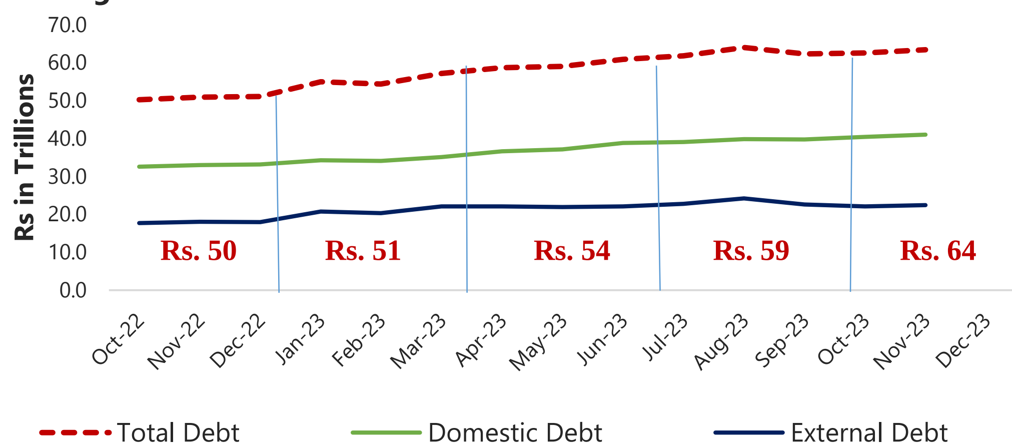
Source: Federal Board of Revenue

Figure 6: Government Domestic Borrowing
Outstanding Period end Position



Source: State Bank of Pakistan

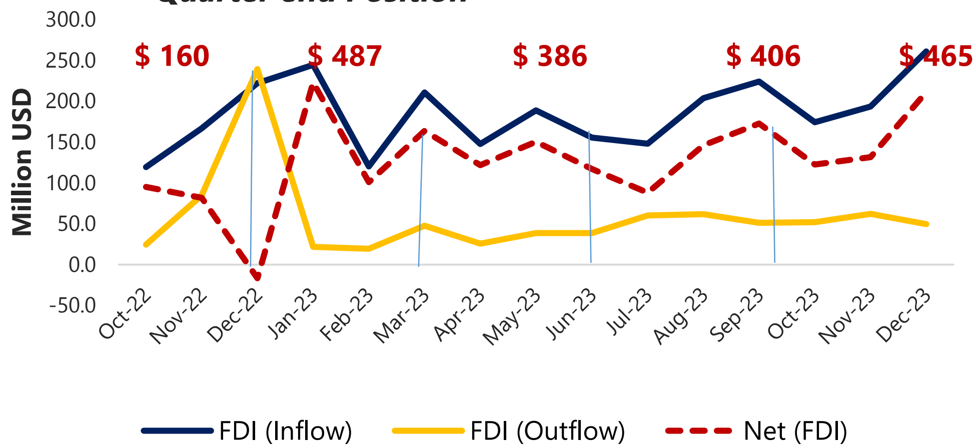
Figure 7: Public Debt of Pakistan
Outstanding Period end Position



Source: State Bank of Pakistan

Figure 8: Foreign Investment in Pakistan

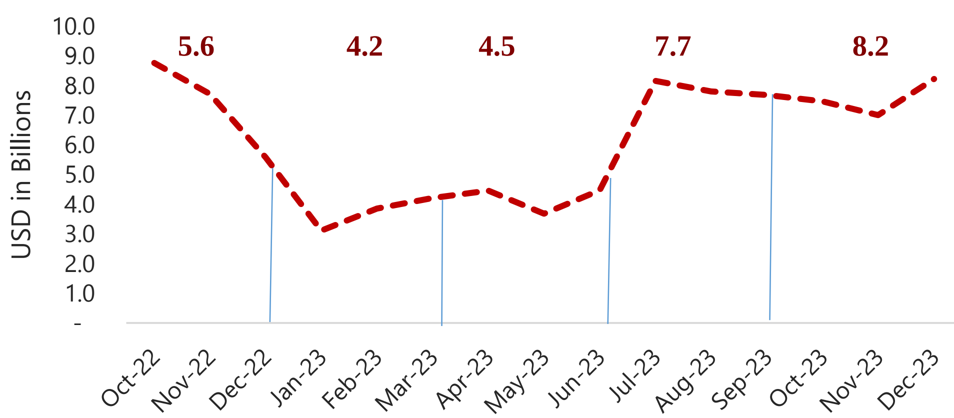
Quarter end Position



Source: Pakistan Bureau of Statistics

Figure 9: Foreign Exchange Reserves of Government

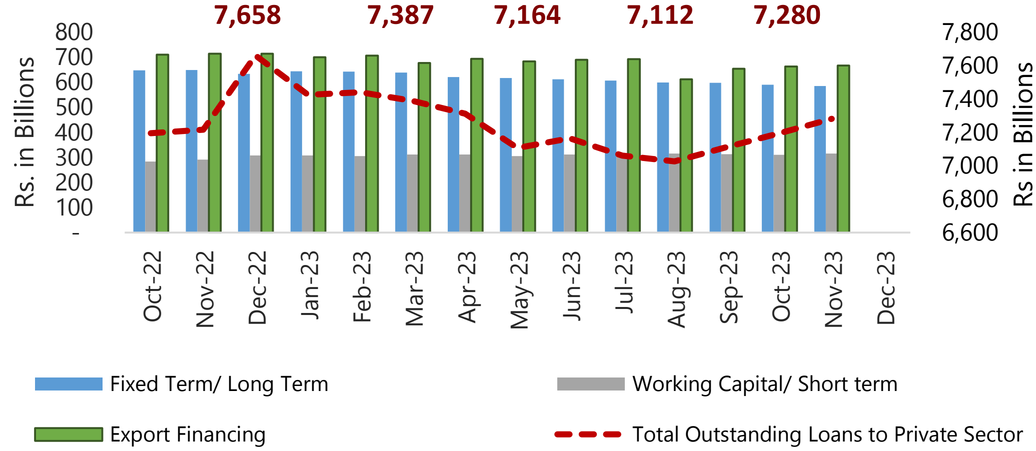
Period end Position



Source: State Bank of Pakistan

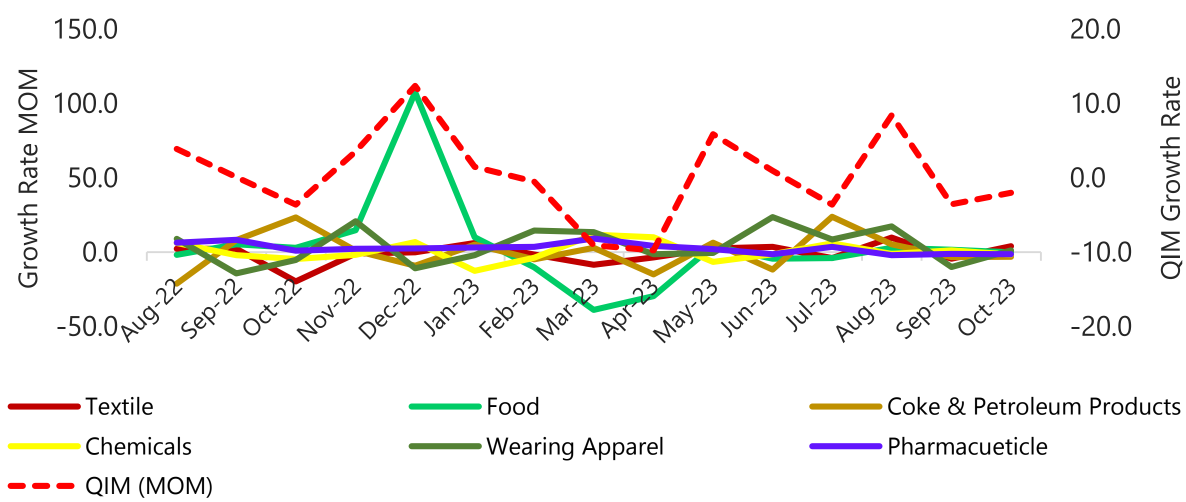
Figure 10: Private Sector Borrowing from Banks

Outstanding Period end Position



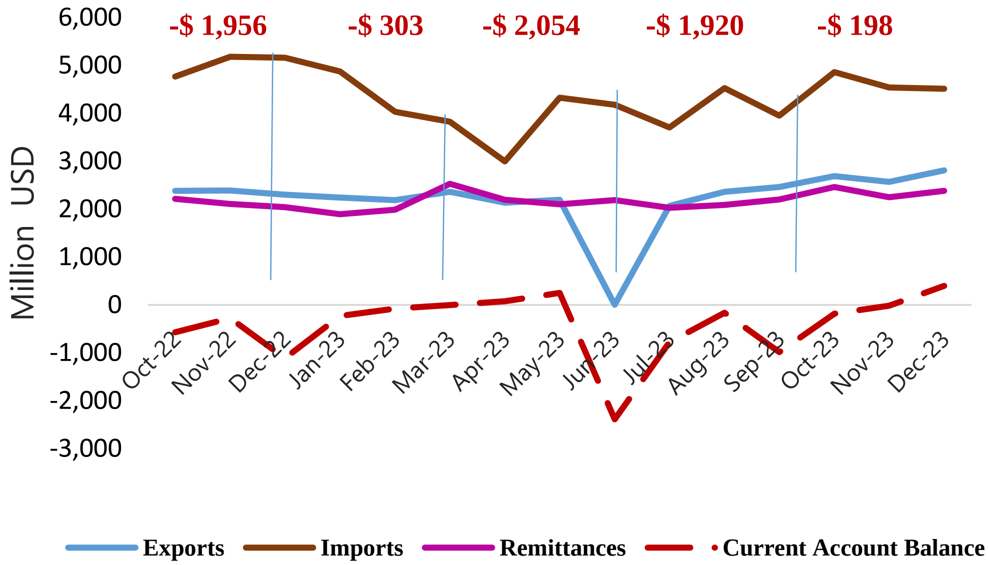
Source: State Bank of Pakistan

Figure 11: Large Scale Manufacturing Sector Performance



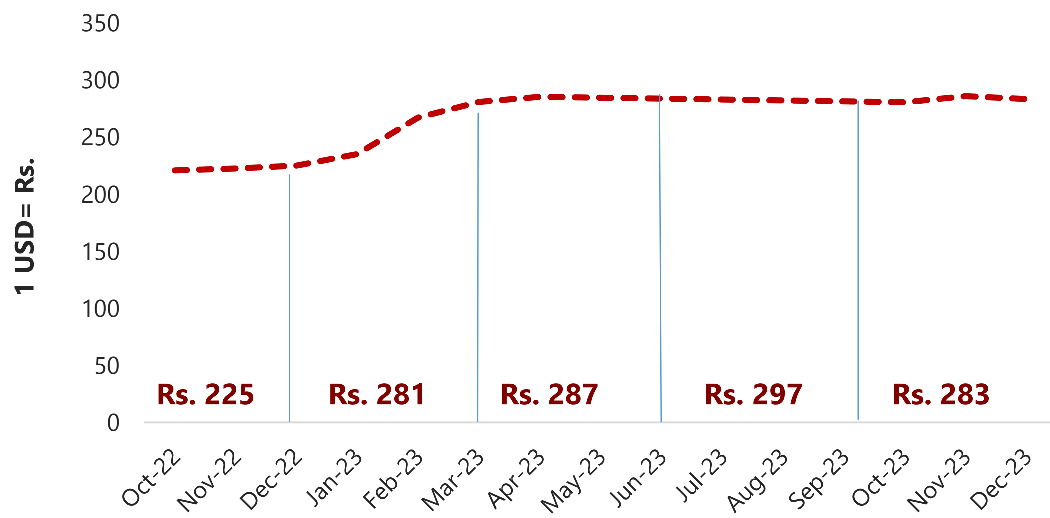
Source: Pakistan Bureau of Statistics

Figure 12: Current Account Balance
Quarter end Position



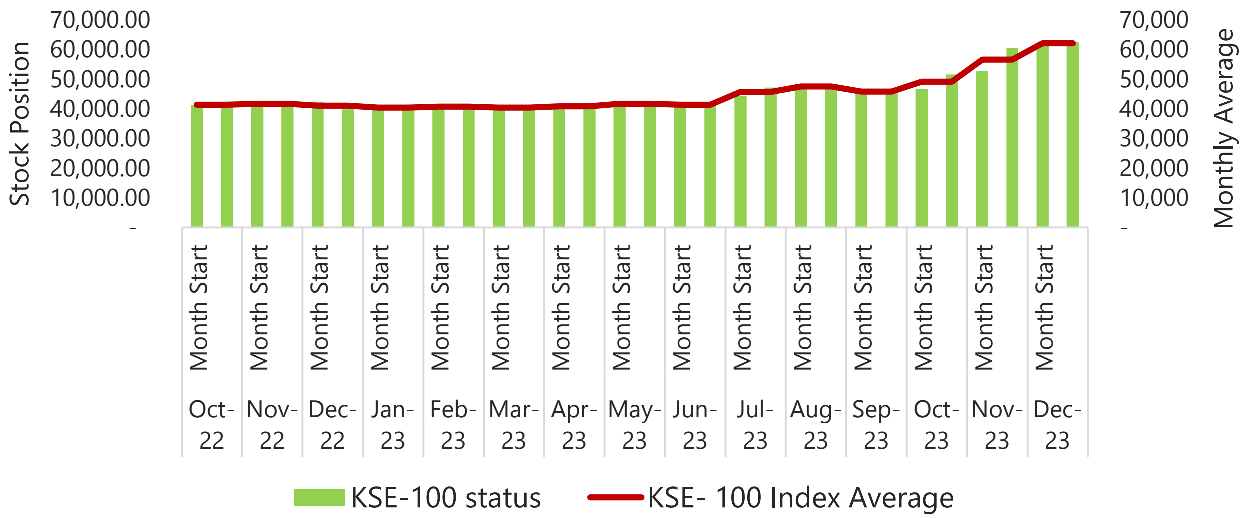
Source: Pakistan Bureau of Statistics

Figure 13: Exchange Rate Trend
Period end Position



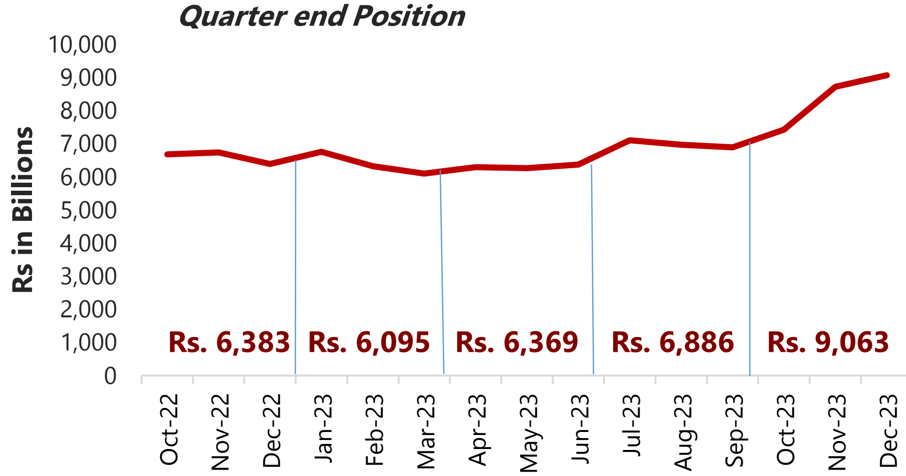
Source: State Bank of Pakistan

Figure 14: Stock market Performance



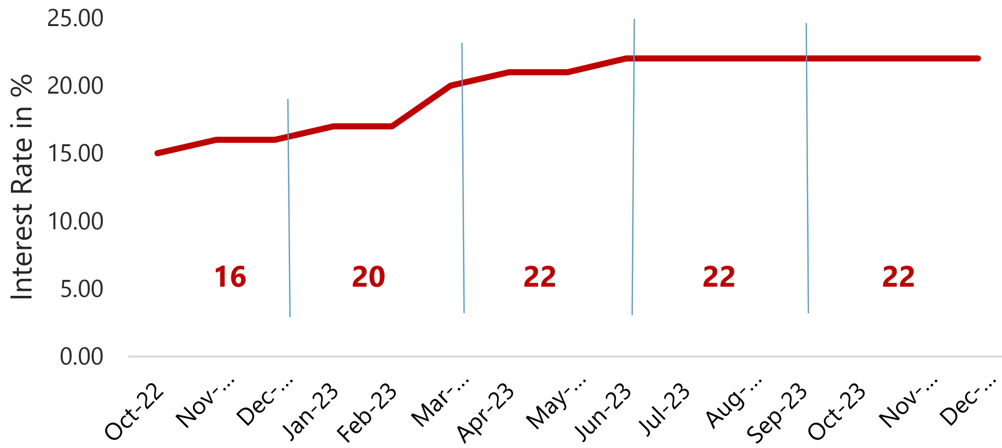
Source: Pakistan Stock Exchange

Figure 15: Market Capitalization in Stock Market
Quarter end Position



Source: Business News, Dawn

Figure 16: Policy Rate
Period end Position



Source: State Bank of Pakistan

SECTION THREE: MACROECONOMIC OUTLOOK

Macroeconomic Outlook

Pakistan's external financial obligations are expected to remain high; even with a slight improvement in reserves, it will be reliant on the IMF and bilateral and multilateral assistance, which could keep the country vulnerable to external shocks. On the external front, the country's foreign exchange reserves are insufficient to finance two months of import bills. However, it is expected that the government will be able to significantly reduce the current account deficit in the remaining half of the fiscal year keeping in previous performance. The exchange rate has shown stability in the last couple of months due to changes in the policy of managing currency.

The financial stability of the country will remain volatile due to evolving global dynamics including conflict in the Middle East. Until now, countries have restrained themselves from getting involved but the crisis may escalate if countries decide to pursue their strategic interests. The recent tension in the Red Sea has slightly disrupted global trade and any escalation may result in supply chain bottlenecks, and hike in petroleum and commodity prices. On the other hand, the Russia and Ukraine war continues to disrupt the global energy market. Pakistan may struggle to procure gas to meet the needs of the country.

On the political front, it is expected that elections will result in stability and improve the business environment of the country. The recent hike in security challenges and terrorist attacks poses grave risks to the stability of the country and needs to be addressed proactively by the incoming elected government. Pakistan has suffered economic losses in the past due to terrorism and may lose more if the situation is not handled effectively.

The IMF programme has kept the government in line on the fiscal front where expenditures are closely monitored and undue subsidies are strictly discouraged. The high debt servicing obligations required the government to evaluate its spending patterns; however, cutting development expenditure is the short-term solution the government resorts to. After the completion of SBA in April 2024, the government may need to negotiate another IMF programme keeping in view the financing needs of the country.

Energy sector sustainability has emerged as an insurmountable challenge for the government as circular debt has surpassed Rs. 5.7 trillion including power and gas sectors. The only solution the government has found is to raise tariffs and impose taxes. This has resulted in lower demand and greater pressure to finance capacity payments. Moreover, no significant mechanism has been devised to overcome transmission and distribution losses while the privatization initiative of the caretaker government has not achieved any prominent milestone. Therefore, the overall economic performance of the country may remain sluggish keeping in view energy constraints.

The performance of the industrial sector has remained dismal despite the low base effect. The challenges prevalent in the industrial sector remain unaddressed and power sector cross subsidy diminishes the competitiveness of the local industry. The governments have resorted to fiscal stimulus in the form of power and gas subsidies, which proved to be futile. In the coming months, the government needs to address these challenges otherwise industrial activity may further slowdown.

Inflation remains a huge challenge for the government and the public at large. The governments have resorted to administrative controls to stabilize prices but failed miserably every time. The removal of supply side disruptions and efficient utilization of resources are needed, which require structural and institutional reforms. The trade barriers put in place by the government and often increased from time to time have contributed significantly to lower domestic productivity and inflation. In the coming months, no significant improvement is expected in this arena. Although international commodity and energy prices have remained stable, the local dynamics have pushed prices to remain high and it is expected that inflation will remain high in the remaining half of the current fiscal year.

__________End of Section 3_________

ANNEXURE

Table 1: Current Account Indicators of Pakistan

Month	Exports	Imports	Remittances	Current Account Balance
	Million USD			
Oct-22	2,384	4,771	2,216	-827
Nov-22	2,391	5,182	2,108	-142
Dec-22	2,304	5,161	2,041	-345
Jan-23	2,244	4,875	1,894	-230
Feb-23	2,191	4,034	1,988	-36
Mar-23	2,367	3,828	2,533	750
Apr-23	2,137	2,997	2,198	78
May-23	2,200	4,328	2,103	255
Jun-23	2,366	4,180	2,184	-2387
July-23	2,068	3,705	2,029	-775
Aug-23	2,366	4,528	2,093	-160
Sep-23	2,465	3,954	2,206	-985
Oct-23	2,690	4,864	2,463	-184
Nov-23	2,573	4,539	2,250	-15
Dec-23	2,812	4,514	2,381	397

Table 2: Foreign Direct Investment in Pakistan

Month	Net	Inflow	Outflow
	Million USD		
Oct-22	94.9	119.2	24.3
Nov-22	81.8	166.5	84.7
Dec-22	-17.0	222.0	239.0
Jan-23	222.6	244.3	21.6
Feb-23	100.9	120.2	19.3
Mar-23	163.4	210.7	47.3
Apr-23	121.6	147.3	25.6
May-23	149.6	178.0	28.4
Jun-23	114.3	141.4	27.1
July-23	87.7	147.7	60.0
Aug-23	146.1	197.6	51.5
Sep-23	172.6	223.8	51.2
Oct-23	122.5	174.2	51.7
Nov-23	131.4	193.5	62.2
Dec-23	211.1	260.6	49.5

Table 3: Inflation

Month	CPI	SPI	WPI
Oct-22	4.7	-1.5	-0.5
Nov-22	0.8	6.1	0
Dec-22	0.5	0.2	-0.7
Jan-23	2.9	1.3	1.8
Feb-23	4.3	3.7	8.2
Mar-23	3.7	5.8	4.7
Apr-23	2.4	2.7	0.1
May-23	1.6	1.3	1.0
Jun-23	-0.3	0.2	-0.3
Jul-23	3.5	2.8	2.5
Aug-23	1.7	4.1	4.2
Sep-23	2.0	1.7	3.1
Oct-23	1.0	0.2	-1.9
Nov-23	2.7	3.3	1.4
Dec-23	0.8	3.8	0.0

Table 4: Public Debt of Pakistan

Month	Public Debt	Domestic Debt	External Debt
		Rs. in Trillions	
Oct-22	50.2	32.5	17.7
Nov-22	50.9	32.9	18.0
Dec-22	51.0	33.1	17.9
Jan-23	54.9	34.3	20.7
Feb-23	54.3	34.0	20.2
Mar-23	57.1	35.1	22.0
Apr-23	58.6	36.5	22.0
May-23	59.0	37.1	21.9
Jun-23	60.8	38.8	22.0
July-23	61.7	39.0	22.7
Aug-23	64.0	39.8	24.2
Sep-23	62.3	39.7	22.6
Oct-23	62.5	40.4	22.1
Nov-23	63.4	41.0	22.4

Table 5: Domestic Borrowing of Government

Month	Total Credit	SBP Credit to Government	Banks Credit to Government
	Rs. in Trillions		
Oct-22	20,453	4,708	15,744
Nov-22	20,424	4,576	15,848
Dec-22	20,334	5,358	14,976
Jan-23	21,633	5,260	16,373
Feb-23	21,731	5,597	16,134
Mar-23	22,293	5,670	16,622
Apr-23	22,516	5,033	17,483
May-23	23,582	5,454	18,127
Jun-23	23,763	5,222	18,541
Jul-23	23,531	4,663	18,868
Aug-23	24,031	4,533	19,498
Sep-23	25,122	4,944	20,178
Oct-23	24,723	4,427	20,297
Nov-23	26,391	4,764	21,628

Table 6: Private Sector Borrowing (Rs. in Billions)

Month	Total loans to Private Sector	Fixed-Term/ Long Term	Working Capital/ Short term	Export Financing
Oct-22	7,195	646	283	710
Nov-22	7,214	648	291	714
Dec-22	7,658	633	308	713
Jan-23	7,424	643	308	699
Feb-23	7,439	641	305	706
Mar-23	7,387	638	311	676
Apr-23	7,311	621	311	693
May-23	7,106	617	304	683
Jun-23	7,164	611	311	688
Jul-23	7,060	606	310	691
Aug	7,026	598	315	611
Sep-23	7,112	597	313	653
Oct-23	7,195	590	310	662
Nov-23	7,280	585	315	666

Table 7: Exchange Rate and SBP Reserves

Month	Policy Rate	Exchange Rate	SBP Reserves (USD Billions)
Oct-22	15.00	220.9	8.8
Nov-22	16.00	222.8	7.7
Dec-22	16.00	225.2	5.6
Jan-23	17.00	235.2	3.1
Feb-23	17.00	267.2	3.9
Mar-23	20.00	281.0	4.2
Apr-23	21.00	285.4	4.5
May-23	21.00	286.0	3.7
Jun-23	22.00	287.0	4.5
Jul-23	22.00	281.7	8.2
Aug-23	22.00	290.8	7.8
Sep-23	22.00	297.9	7.7
Oct-23	22.00	280.8	7.5
Nov-23	22.00	286.0	7.0
Dec-23	22.00	283.6	8.2

Table 8: Performance of Stock Market

Month	KSE-100 Index Status		Monthly Average	Market Capitalization (Rs. in Billions)
	Month Start	Month End		
Oct-22	41,129	41,602	41,365	6,674
Nov-22	41,204	42,071	41,668	6,733
Dec-22	42,348	39,747	41,048	6,383
Jan-23	40,815	39,871	40,344	6,757
Feb-23	40,619	40,784	40,702	6,317
Mar-23	40,815	39,848	40,332	6,095
Apr-23	40,000	41,580	40,791	6,289
May-23	41,927	41,340	41,634	6,265
Jun-23	41,330	41,452	41,391	6,369
Jul-23	44,207	47,077	45,642	7,099
Aug-23	48,230	46,770	47,500	6,972
Sep-23	45,312	46,232	45,773	6,886
Oct-23	46,627	51,482	49,054	7,423
Nov-23	52,656	60,502	56.579	8,718
Dec-23	61,691	62,451	62,071	9,063


Bid
Ask
Auto
GBPUSD M15
1.00
SL/TP