Budget 2023-24 Analysis

Economic Assessment and Critique of Pakistan's Budget 2023-24: Addressing Challenges and Missed Opportunities

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Executive Summary

The economic assessment of Pakistan's budget for the fiscal year 2023-2024 reveals a deepening economic crisis characterised by minimal reserves, escalating public debt, high inflation, and a depreciating currency. While the budget aims to tackle these challenges and unlock remaining funds from an IMF bailout programme, it presents both gains and setbacks across various sectors. The budget focuses on facilitating industrial growth, promoting energy efficiency, and supporting the IT sector, but it also imposes taxes that may discourage bonus shares, hinders the formal economy with cash withdrawal taxes for non-filers, and poses challenges to the textile sector's competitiveness. Additionally, the budget lacks a clear path to sustainable fiscal architecture and falls short in expanding the tax base, investing in education and human development, and ensuring fair tax revenues from key sectors.

To enhance the budget's value, incorporating best practices from international experiences is recommended. Following the UK's lead in technology-driven sectors can diversify Pakistan's economy and boost productivity. Implementing agri-environmental schemes and innovation funds, as seen in the Dutch model, can promote sustainable farming practices and competitiveness in the agriculture sector. Encouraging investment in renewable energy infrastructure through green bonds and accelerated depreciation allowances and adopting successful Public-Private Partnership (PPP) models from Canada for infrastructure development, can further contribute to Pakistan's economic growth. In conclusion, refining the budget's measures, incorporating international best practices, and maintaining a balanced and objective approach will foster a more constructive and inclusive economic environment.

Budget 2023-24 at Glance

Resources	Rs. in Billion	Expenditures	Rs. in Billion
Tax Revenue (FBR)-Consolidated Fund	9200	A. Current	13320
Non-Tax Revenue	2963	Interest Payments	7303
a. Gross Revenue Receipt	12163	Pension	761
b. Less Provisional Share	5276	Defence Affairs and Services	1804
I. Net Revenue (a-b)	6887	Grants and Transfer to Provinces & Others	1464
II. Non-Bank Borrowing (NSSs & Others) - Public Account	1906	Subsidies	1074
III. Net External Receipt - Fed. Consolidated Fund	2527	Running of Civil Govt.	714
IV. Bank Borrowing (T-Bills, PIBs, Sukuk) - Fed. Consolidated Fund	3124	Provision of Emergency and Others	200
V. Privatization Proceeds-Fed. Consolidated Fund	15	B. Development and Net Lending	1140
Total (II+III+IV+V)	7572	Federal PSDP	950
Deficit (Net Revenue – Total Resources)	(7573)	Net Lending	190
Total Resources (I to V)	**14460**	**Total Expenditure (A + B)**	**14460**

The economic crisis in Pakistan is deepening, showing no signs of an imminent recovery, let alone sustainable growth. The country is grappling with severe financial strain, characterised by minimal reserves, escalating public debt, record-breaking inflation, and a rapidly depreciating currency.

Against the backdrop of this economic meltdown, political uncertainty, and impending elections, the federal government presented the annual budget for the fiscal year 2023-2024 on 9 June 2023. The budget aims to unlock over USD 2.5 billion remaining from a USD 6.5 billion IMF bailout programme, which is set to expire this month. With a total budget outlay of PKR 14.46 trillion, the government aspires to achieve a GDP growth rate of 3.5 per cent during the fiscal year 2023-2024, while anticipating an inflation rate of approximately 21 per cent for the same period. Additionally, the government has set a target fiscal deficit of 6.54 per cent of the GDP, slightly lower than the revised estimate of 7 per cent for the current year. The current deficit is around PKR 7573 billion.

Here are the sectors that stand to gain and lose under this budget:

A. Prominent Gains

1. **Facilitating Industrial Growth:**

    a) ***Reduction in Customs Duties:*** The budget encourages industrialisation and investment by significantly reducing customs duties and additional customs duties on imports of intermediary/industrial inputs falling under 10 PCT codes. This measure aims to lower production costs and promote the growth of domestic industries. Noteworthy concessions include reduced customs duties on raw materials/inputs for manufacturers of capacitors, flavouring powders for food preparation, organic composite solvent and thinners, and pet scraps.

    b) ***Import Duty Exemptions for Essential Items:*** To support industrial production, the budget avoids imposing increased duties on essential items such as raw materials for industrial production, fertilizers, and seeds for agricultural production. This exemption will help maintain affordable inputs and sustains productivity in key sectors.

2. **Boosting Agricultural Sector:**

    a) ***Custom Duty Exemptions:*** The government provides incentives for the agriculture sector by exempting custom duties on the import of vital inputs. These exemptions cover imports of seeds, shrimps/prawns/juveniles, and roasted peanuts. The aim is to support agricultural productivity, enhance food security, and promote self-sufficiency.

3. **Promoting Energy Efficiency and Conservation**

    a) ***Duty Exemptions for Solar Equipment:*** The budget focuses on energy efficiency by exempting custom duties on the import of machinery, equipment, and inputs used in solar panels and related installations. This measure encourages the adoption of renewable energy sources and sustainable practices in the energy sector.

b) ***Imposition of Excise Duty:*** To discourage energy-inefficient consumption, the budget levies an excise duty (FED) on energy-inefficient fans at the rate of PKR 2,000 per fan and on incandescent bulbs at the rate of 20 per cent. This move will promote the use of energy-efficient alternatives and reduce overall energy consumption.

4. **Boosting Information Technology (IT) Sector**

   a) ***Tax Exemptions for IT Equipment Imports:*** In a bid to promote the growth of the IT sector and IT-enabled services, the budget exempts taxes on imports of IT equipment by exporters. This step aims to facilitate the expansion of the IT industry, enhance exports, and foster technological advancements.

5. **Encouraging Remittances and Currency Stability:**

   a) ***Exemption of Foreign Remittances:*** The budget exempts foreign remittances up to USD 100,000 from being questioned by the Federal Board of Revenue (FBR). This measure will reduce administrative hurdles and encourage the inflow of remittances, ultimately stabilising the fluctuating exchange rate and fostering economic stability.

6. **Impact on Local Tile Manufacturers:** The government's decision to reduce the regulatory duty on imported tiles is expected to negatively affect local manufacturers. This measure, however, aligns with the objective of eliminating protectionist policies that have hindered trade development in Pakistan. While local manufacturers may face immediate challenges, this step aims to foster competitiveness in the longer run. The reduction of regulatory duty will compel local manufacturers to enhance the quality and competitiveness of their products, ultimately contributing to the growth and resilience of the tile manufacturing industry.

B. Notable Setbacks

1. ***Impact on Pakistan Stock Exchange (PSX):*** Imposition of Final Tax on Bonus Shares: The budget imposes a 10 per cent final tax on the issuance of bonus shares, potentially discouraging companies from offering such shares. This

measure may reduce market trade volume and negatively affect the Pakistan Stock Exchange.

2. ***Implications for Non-Filers:*** Advance Tax on Cash Withdrawals: Non-filers face a 0.6 per cent advance tax on cash withdrawals exceeding PKR 50,000. This step could incentivise non-filers to operate outside the formal ecosystem, potentially leading to a rise in cash-based transactions and hindering efforts to expand the formal economy.

3. ***Challenges faced by the Textile Sector:*** The textile sector is confronted with several challenges following the recent budget announcement. The budget introduces an increase in the sales tax on retail point-of-sale (POS) sales of textiles and leather products, raising it from 12 per cent to 15 per cent. This tax hike poses a significant burden on the textile sector, potentially impeding its ability to remain competitive in the global market. The higher sales tax will not only increase the cost of production for textile manufacturers but also affect their pricing strategies. The industry may face difficulties in maintaining price competitiveness, potentially leading to reduced demand and a negative impact on exports. It is crucial for the government to closely monitor the implications of this tax increase on the textile sector's growth and consider measures to support its sustainability and international competitiveness.

C. Lacunas

1. ***Recognition of the Severity of the Crisis:*** The budget fails to recognise the severity of the economic crisis and lacks a clear path to a sustainable fiscal architecture. To overcome the persistent challenges Pakistan faces, it is crucial to take decisive reforms that address the economy's fundamental weaknesses.

2. ***Insufficient Measures for Crucial Matters:*** The budget is insufficient in addressing crucial matters such as expanding the tax base, investing in education and human development, managing the growing fiscal deficit, and establishing a favourable business environment. These areas are essential for Pakistan's economic growth and must be adequately addressed.

3. ***Need for Increased Exports and Fair Tax Revenues:*** For Pakistan to thrive, it is imperative to increase exports and ensure fair tax revenues from sectors like real estate, agriculture, and retail. Unfortunately, the budget fails to address

these areas, placing an additional tax burden on already compliant formal sectors. This approach hampers capital formation and impedes growth-oriented initiatives, particularly in the manufacturing sector.

4. ***Unfavourable Actions and Traditional Approach:*** The inclusion of medium-scale enterprises earning PKR 150 million in the expanded super tax policy is evidently unfavourable towards businesses and may promote tax evasion. Furthermore, increasing government employee salaries from 30 to 35 per cent at a time when the government is struggling to revive the IMF programme reflects a traditional approach that lacks innovative solutions for addressing the current economic malaise.

5. ***Burden on National Exchequer and Counterproductive Measures:*** The budget's increase in salaries and Public Sector Development Program (PSDP) funding will burden the national exchequer and aggravate the fiscal deficit. This will be financed by borrowing, leading to inflation. Additionally, imposing a 0.6 per cent tax on cash withdrawals through bank transactions for non-filers will prove counterproductive as it serves as an incentive for them to withdraw from the formal ecosystem and engage in cash-based transactions.

6. ***Missed Opportunities and Contradictions:*** The budget missed the opportunity to implement essential reforms by imposing taxes on sectors that have not been adequately taxed, such as wholesale, retail, and real estate. Furthermore, there is no mention of initiatives to gather data on non-filers and utilise NADRA (National Database and Registration Authority) to expand the tax base. The claim of 'No new Taxes on Industry' contradicts the reality, as there is an increase in the super tax that is not implemented in a fully progressive manner.

7. ***Impractical Tax Collection Targets and Strain on Fiscal Deficit:*** The set targets for tax collection (PKR 9.2 trillion) appear impractical, and the rise in government salaries and pensions will exert strain on the fiscal deficit. This suggests the inevitability of a mini budget in the future to address these challenges.

D. Adding Value to the 2023-24 Budget: Best Practices from International Experiences

In light of Pakistan's recent budget, it is evident that the country is grappling with significant economic challenges that demand urgent attention. To explore potential solutions, it is essential to draw upon the experiences of other nations that have successfully navigated similar economic crises.

By examining best practices from around the world, one can identify practical strategies and policy measures that could be adapted and implemented to complement this FY's budget, especially in areas where the budget is trying to enhance revenue generation and foster a favourable business environment:-

1. Technology/IT Sectors

One notable best practice from the United Kingdom that could be considered in Pakistan's economic context is the focus on innovation and technology-driven sectors. The UK has placed significant emphasis on fostering a thriving ecosystem for startups, entrepreneurship, and digital innovation. The government has implemented various initiatives such as tax incentives, research and development grants, and venture capital funding to support the growth of technology-driven industries.

Embracing the UK's best practice of prioritising technology-driven sectors can enable Pakistan to harness the power of digital transformation, enhance productivity, and diversify its economy, leading to sustainable economic growth and job creation.

2. Agriculture Sector

The Netherlands has implemented several agricultural policies that provide economic incentives to promote sustainable farming practices, enhance productivity, and ensure environmental stewardship. Some specific economic incentives that the government should consider from the Dutch model include:

a) ***Agri-Environmental Schemes:*** The Netherlands has implemented agri-environmental schemes that provide financial support to farmers who adopt environmentally friendly practices. These schemes offer financial incentives for actions such as reducing the use of pesticides and fertilizers, implementing sustainable water management practices, preserving biodiversity, and promoting animal welfare. Farmers receive direct payments or subsidies based on their compliance with specific environmental targets and requirements.

b) ***Innovation Funds and Research Grants:*** The Netherlands has established innovation funds and research grants dedicated to the agricultural sector. These funds provide financial support to farmers and agricultural businesses for implementing innovative technologies and practices that enhance efficiency, reduce resource consumption, and promote sustainable farming methods. The grants help cover the costs of research and development, technology adoption, and pilot projects that contribute to the agricultural sector's long-term sustainability and competitiveness.

c) ***Market-Based Instruments:*** Netherlands has introduced a system of tradable pollution permits for livestock farmers to regulate and reduce nitrogen emissions. Farmers who successfully reduce their nitrogen emissions below a certain threshold can sell their surplus permits to those who exceed the limits, creating a market-driven approach to environmental conservation while rewarding sustainable farming practices.

d) ***Subsidies for Agricultural Investments:*** The Dutch government provides subsidies and financial support for farmers to invest in modernising their farming infrastructure and adopting sustainable technologies. These subsidies cover a range of investments such as precision agriculture equipment, energy-efficient machinery, renewable energy systems, and improved livestock housing facilities. By offering financial assistance for such investments, the Netherlands encourages farmers to adopt sustainable and efficient production methods that benefit both the environment and their economic performance.

3. Energy Sector

a) ***Green Bonds:*** Pakistan has Green Bonds guidelines, which are specialised financial instruments used to raise funds for environmentally friendly projects. This scheme should be effectively marketed since it offers attractive interest rates / tax advantages to investors, encouraging them to support the development of renewable energy infrastructure.

b) ***Accelerated Depreciation:*** Implement accelerated depreciation allowances for renewable energy assets, allowing businesses to depreciate their investments in renewable energy equipment at a faster rate than standard depreciation schedules. This would provide tax advantages by reducing taxable income and improving the financial viability of renewable energy projects.

4. Infrastructure

a) Canada has also implemented successful PPP models in the development and operation of public transportation systems. One notable example is the Canada Line in Vancouver, British Columbia. This rapid transit line was delivered through a PPP arrangement, where a private consortium was responsible for designing, building, financing, and operating the system. The private partner received revenue through fare collection and a long-term concession agreement with the government. This PPP model allowed for timely delivery, cost efficiency, and improved service quality. Pakistan could consider adopting similar PPP approaches for the development of urban mass transit systems, such as metro lines or bus rapid transit systems, to enhance public transportation infrastructure and address the growing mobility needs of its urban areas. Implementing these PPP models would require careful planning, robust legal frameworks, transparent procurement processes, and effective risk-sharing mechanisms.

E. Conclusion

In summary, the budget presented for the fiscal year highlights several areas that require further attention and consideration. While it may not fully address all the persistent economic challenges faced by Pakistan, it is important to recognise the complexity of the issues at hand. The budget does make some efforts to address certain sectors and implement measures aimed at revenue generation and economic stability. However, it is essential to continue evaluating and refining these measures to ensure their effectiveness in the long run. Ultimately, a balanced and objective approach will contribute to a more constructive and inclusive economic environment for Pakistan's future growth.