

THE STATE OF PAKISTAN'S ECONOMY 2022-23

STRUGGLING WITH UNCERTAINTY

Editors
Junaid Alam Memon
Muhammad Asif Iqbal

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IBA Press



www.cber.iba.edu.pk

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Foreword

It has become a cliché to talk about Pakistan's economy in terms of it being in a state of crisis, facing extreme uncertainty, being near default, and other such descriptive terms. However, perhaps today all these clichés seem more like real truths, said with far more confidence and certainty. The last few weeks have been one of extreme uncertainty and precariousness regarding Pakistan's economy and its politics, with few analysts or actors being assured of what lies ahead. Despite changes in managing the economy, there are no signs that things might take a turn, if not for the better, but certainly for some stability.

Even when the government has succeeded in agreeing to get back on to the IMF programme, this is not a moment for much celebration. This is bitter medicine to swallow, and the consequences will be far from positive. In fact, even after many weeks of the IMF programme, there has been no improvement in Pakistan's economy, no stability or direction ahead. Moreover, with a global slowdown and a probable recession, with interest rates climbing and a huge surge in commodity prices, Pakistan continues to be faced with severe, possibly insurmountable, challenges in the short term, especially with surging inflation. Only deep-seated and thorough structural reforms will put Pakistan on the road to progress and sustainable and equitable development. Who is going to bring about these urgent and critical reforms, is a question which seems to have no answer.

S Akbar Zaidi
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1. Introduction

Junaid Alam Memon

Apart from some fleeting moments of relief, Pakistan's economy has been in turmoil for quite some time now. Falling short on the economic growth targets, higher inflation, inability to widen tax base and poor performance of important economic sectors, exchange rate depreciation, declining foreign reserves and high external deficits are some of the long enduring and frequently occurring macroeconomic issues. Post 90s nominal GDP has shown cycles of boom and bust; however, the numbers confirm that both real wages and long-term growth are declining in the country. When it comes to budgeting, debt servicing extracts a large chunk of the country's revenue and only a small amount of funds is left for development after pensions, civil service, and military expenditure.

On the development front, literacy is stuck, fertility is high, and the country is still a power deficient terrain despite its huge fossil and renewable endowments. Pakistan's per capita income is lower than both India and Bangladesh and so is its life expectancy, despite their shared history and starting point. A recent report by the World bank reveals that almost 80% of the country's wealth is parked in the residential buildings and other unproductive and rent-seeking activities. While the poor in the country face crisis after crisis, the relatively well-off section of the society skips taxes and remains immune from accountability and consequences. The country's policies are protectionist in nature and unable to boost productivity in any sector including even agriculture and small and medium enterprises which employ the majority of its labour force, and where opportunities are relatively hanging low.

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Due to its political instability, uncertainty and economic turmoil, Pakistan has once again temporarily postponed a default on foreign debt repayments with the approval of its 24th IMF program. The country frequent runs to IMF and “friendly countries” for assistance have a history of short-sightedness with the primary concerns being the maintenance of emergencies like foreign exchange reserves. The country is stuck in a vicious loop of structural issues and lacks the will and capacity of serious reforms and longer-term transformation. Political instability, fear of negative propaganda and misinformation have discouraged politically tough decisions and have promoted a culture of cosmetic changes and populist policies.

While these concerns are frequently echoed in public expressions, business communities demands and various echelons of public policy making, perhaps now more forcefully now than ever before, the dearth of data and evidence-based understanding suppresses the genuine demand for reforms. Realizing this, the School of Economics and Social Sciences (SESS) at IBA initiated a yearly report in 2020 to keep citizens, business community, and other stakeholders informed on the state of Pakistan’s economy. The first two reports were successful in this endeavour and received wide scale projection and appreciation from the targeted stakeholders.

The current report, *The State of Pakistan's Economy: Struggling with Uncertainty 2022-23*, is 3rd in the series and is compiled by the Center for Business and Economic Research (CBER). It is a contribution by the SESS faculty along with collaborators from other institutions particularly the Social Policy and Development Center (SPDC). The report has been written in the times when countries are struggling with a host of uncertainties on economic and political fronts and amid global slowdown, recession and extremely high oil and commodity prices. Each of the chapters in this report reflect on certain aspects of this uncertainty and try to present the best possible analysis and way-outs.

The arrangement of the first three analytical chapters is consistent with previous two reports with the aim of providing the bird’s eye view of Pakistan’s economy in terms of future growth projection, fiscal performance, and outlook and the analysis of monetary policy. In Chapter 2, Wali Ullah and Fatima Sadik present the macroeconomic projections for 2022-23 and provide insights on the future state of Pakistan’s economy. Chapter 3 by Muhammad Sabir is a thorough commentary on the federal government’s fiscal performance and outlook and helps glean through the fiscal planning of the government. More importantly, it also offers insights on what is reasonable to expect in FY 2022-23. In Chapter 4, Muhammad Nasir provides an income disaggregated inquiry into the monetary policy and provides in-depth analyses of prices, inflation and its

sources and offers useful insights for policies aiming to set conditions for long term economic growth.

The rest of the chapters do not comply closely with the previous two reports and are arranged somewhat thematically. In Chapter 5, Faiz Ur Rehman and Asma Hyder take the stock of Pakistan's performance on institution building and present the case analyses of the State Bank of Pakistan's autonomy and higher education reforms. In Chapter 6, Aadil Nakhuda and Qazi Masood Ahmed unpack Pakistan's import composition and provide a critical reflection on the government's recent policy for handling imports. In Chapter 7, Heman Das Lohano, Junaid Alam Memon and Naveed Hayat explore the potential of the livestock value chains and provide deeper insights on setting the direction for the growth, productivity and export potential that can be tapped with the improved these value chains. In Chapter 8, Aadil Nakhuda and Qazi Masood Ahmed analyse the SBP-IBA data to sketch the business confidence landscape in Pakistan. In Chapter 9, Arooj Waheed Dar deals with the undocumented sector and its resilience and provides a fresh perspective on understanding the country's informal sector. In Chapter 10, Lubna Naz addresses the food security issue by looking into the diets and their compositions.

Based on the insights from these analytical chapters, Muhammad Asif Iqbal draws important conclusions and suggest the ways forward in the last chapter. While making these contributions, the authors and editors together with IBA and CBER management hope that the readers will enjoy reading this report and will find its content useful and informative

2. Future Landscape of the Economy

Wali Ullah & Fatima Sadik

Introduction

Following the COVID-19 outbreak and the resulting negative growth in FY2020, Pakistan posted a V-shaped recovery in FY2021 and preserved the real GDP growth of 5.97%¹ in FY2022. However, the country is facing various external and internal challenges, as alluded in Chapter 1, which posit a threat to its sustained economic growth.

During the FY22, the growth was geared forward by sales and manufacturing of cars, machinery imports, inflow of remittances, petroleum sales and household consumption. Expansionary monetary and fiscal policies that were formed in response to the pandemic led to an increase in aggregate demand. Large Scale Manufacturing Index experienced a growth of 10.4%. However, the gap between domestic demand and production asserted pressure on domestic prices.

The Russian invasion of Ukraine served as a dual shock to the global commodity markets at the time when markets were already realigning with the after-effects of a prior supply shock – the COVID-19 pandemic. Commodity prices are projected to increase and remain high. For instance, the price of Brent crude oil is forecasted to rise to \$100/bbl in

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¹ Pakistan Economic Survey 2021-22

2022, which is the highest since 2013.² Global food prices have also spiked due to the war. Pakistan being the net importer of edible oil, wheat, pulses, and sugar is facing escalated import bills. In addition to that, weakened exchange rates, double-digit inflation, political uncertainty, and burgeoning fiscal and current account deficits paint a gloomy picture of the future trajectory of Pakistan's economy. The World Bank projected 4% and 4.2% growth for FY23 and FY24 respectively.³

The path to sustained economic growth is challenging yet necessary for future prosperity of Pakistan. The fiscal deficit as percentage of GDP shows no improvement (6.1 in FY2021 vs 6.3 FY2022). Similarly, trade deficit has increased by 55.5% and business confidence remains low.⁴ The need to overcome the challenges to the sustained growth of Pakistan cannot be overstated. In the following analysis different policy scenarios are considered and based on the projections of macro-indicators, key components of an optimal policy are discussed.

Assumptions and Baseline Projections Scenarios

Here, we make projections of the major macroeconomic indicators under three different scenarios for the upcoming three years, i.e., FY23, FY24, and FY25. The indicators include the overall economy (real GDP growth), the prices, and the external sector. The common assumptions across all three scenarios are:

- US-GDP growth rate forecasts for 2022-2025 are taken as reported by IMF.
- Oil prices forecasts are from International Energy Agency.
- Data for all domestic variables in 2021-22 is taken as reported in the Pakistan Economic Survey 2021-22 and website of the State Bank of Pakistan (SBP).

The projections are given for three different scenarios, which are discussed below.

Baseline Scenario

Under this scenario, we assume that:

- The country will not go into political crisis.

² Commodity Market Outlook, April 2022 <https://openknowledge.worldbank.org/bitstream/handle/10986/37223/CMO-April-2022.pdf>

³ Pakistan Development Update: Financing the Real Economy

⁴ 55 as of April 2022 compared to 64 reported in June 2021, SBP <https://www.sbp.org.pk/research/BCS-Report/2022/Apr/BCS-Report.pdf>

- The US economy will grow at the rate projected by the IMF. The international oil prices will grow at the rate given by International Energy Agency.
- For FY2022, the data from Economic Survey 2021-22 has been used to project the future path of macroeconomic indicators in FY23, FY24, and FY25.

Scenario 1- The Budget FY22- Proposed Spending and Current Policy Rate Based Scenario

On 10th June 2022 the Government of Pakistan (GoP) released its annual budget for FY23. The federal government has set GDP growth target of 5% along with the revenue target of PKR 9 trillion to meet its current and developmental expenditures.

Using budget 2022-23 and the facts and figures presented in the Pakistan Economic Survey 2021-22 for the projection of the future path of macroeconomic indicators, we assume in this scenario that the Baseline optimistic scenario prevails during FY23.

The exogenous variables (policy variables, for instance, government expenditure, credit to private sector and State bank policy rate, etc.) in the model are assumed to be same as released in the budget 2022-23 and Pakistan Economic Survey 2021-22.

Scenario 2- The Optimal Spending and Current Policy Rate Based Scenario

- The Baseline optimistic scenario prevails during FY22.
- The federal government investment expenditures with no new taxes, credit to the private sector, and policy rate during the upcoming three years to be as follows (Table 1).

Table 1: Scenario-2 Optimal Policy Interventions

FY	Government Investment	Credit to Private Sector	Policy Rate
2022-23	20.25%	14.00%	13.75%
2023-24	24.25%	15.50%	13.75%
2024-25	25.25%	16.00%	13.75%

Macroeconomic Growth Projections

Using the scenarios defined above, the GDP, private investment, consumption expenditures, exports, imports, and price levels are projected for the upcoming three fiscal years.

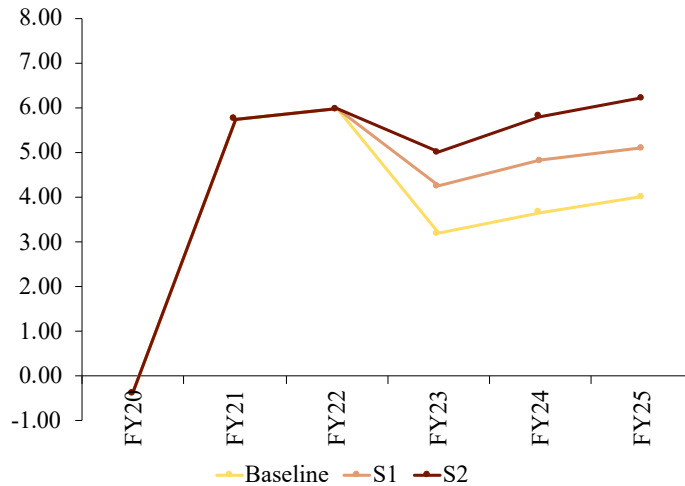
Using the macro-econometric model, we have estimated the growth path of major macroeconomic indicators, using data from 1973 to 2022, and have projected the forecasts for the upcoming three fiscal years.

GDP and It's Components Growth Projections

After the V-Shaped recovery in FY21, the GDP maintained its momentum in FY22. However, during FY23 GDP growth is projected to decline and then pick up in FY24 and FY25. The growth rate of 5.97% seems plausible due to the following interventions by the government:

- Increased credit to private sector
- Low policy rate for most part of the FY22
- High government investment

Figure 1: Projected GDP Growth Rate



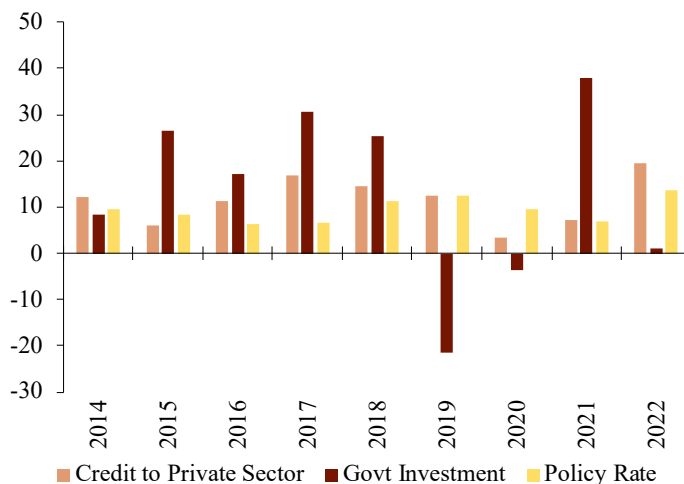
Source: Authors' Calculations

The rationale behind this growth seems to be that:

- To mitigate the risk for investors and provide incentives
- If investors have low confidence in the economy, they are unlikely to invest
- Given the risks and poor trust of the investor, it is incumbent on the government to invest to promote private investment.

In all the scenarios, GDP growth for FY23 is positive and ranges between 3.19 and 5.1%. In the baseline scenario and scenario 1, achieving the targeted growth rate of 5% seems unlikely. However, under scenario 2 the targeted growth rate is achievable.

Figure 2: Policy Rate, Government Investment and Private Sector Growth



Source: Authors' Calculations

Thus, the proposed growth path can be attained if:

- The government increases its developmental expenditures and credit to private sector along with fixed policy rate as given in Table 1. This will lead to higher private capital investment thereby leading to more job creations, more revenue generation, higher incomes, and a higher impact upon output growth due to the multiplier effect.
- To achieve the targeted growth of 5% in FY23, the government should increase the public investment to 20% along with increase in the credit provision to private sector to 14% by relaxing credit restrictions and focusing on financial inclusion.

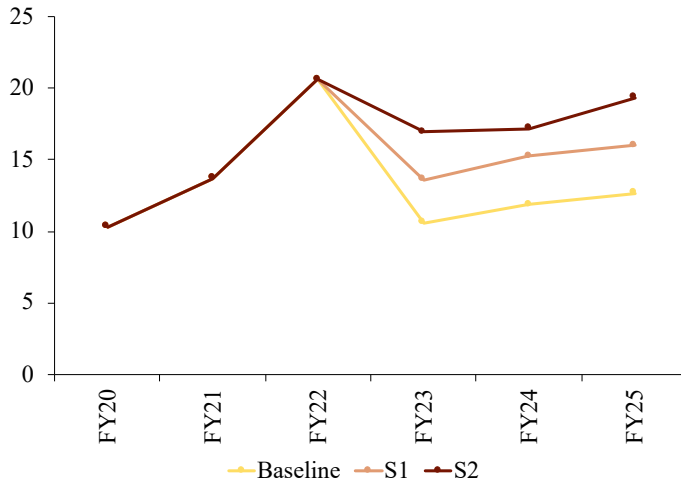
Growth of Private Investment

The private investment shows a growth rate of 20% during the current FY22 and a downward trajectory during FY23 in all three scenarios with a gradual return to FY22 level in

FY25 in the Scenario 2. In FY23, the growth rate is between 10.58-16.94%. The fall in private investment during FY22 may be due to:

- Political uncertainty and shaky economic outlook of Pakistan
- Private investment plays an integral role in economic development. However, following the COVID-19, geo-political world situation, and current political uncertainty in Pakistan, private investors are reluctant to invest. To fill the gap, government investment and innovative policies are required.
- The private investment could be enhanced to achieve the targeted growth rate through easing the private credit channels and lowering the policy rate.

Figure 3: Projected Growth Rate for Private Investment



Source: Authors' Calculations

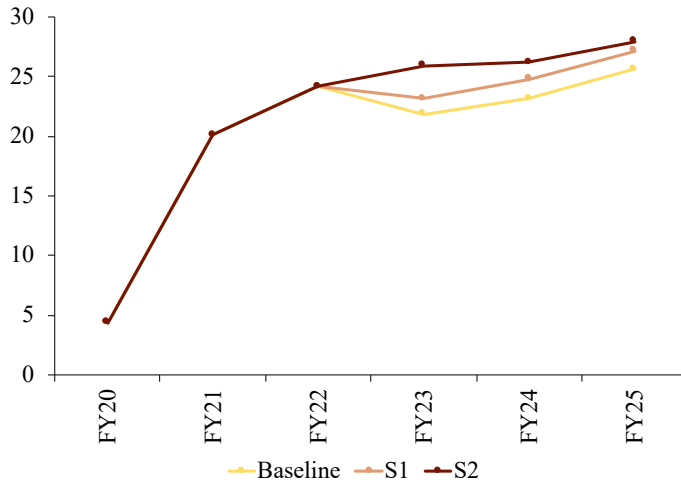
Private Consumption Growth

Despite the inflationary pressure, higher interest rate, and weakened exchange rate, household consumption grew in FY22. Consumption has maintained the highest share in GDP. In FY23, consumption in baseline scenario and scenario 1 declines, whereas grows marginally in scenario 2.

- Consumption in FY22 increased on account of higher remittances and cash transfers received by households, which fueled inflation.

- Consumption growth decline in FY23 is probably due to high food and non-food inflation witnessed globally
- However, government subsidies, cash grants to low-income households and credit availability will lead to 25.9% growth in consumption in scenario 2.

Figure 4: Projected Growth Rate of Consumption



Source: Authors' Calculations

Prices Growth Projections

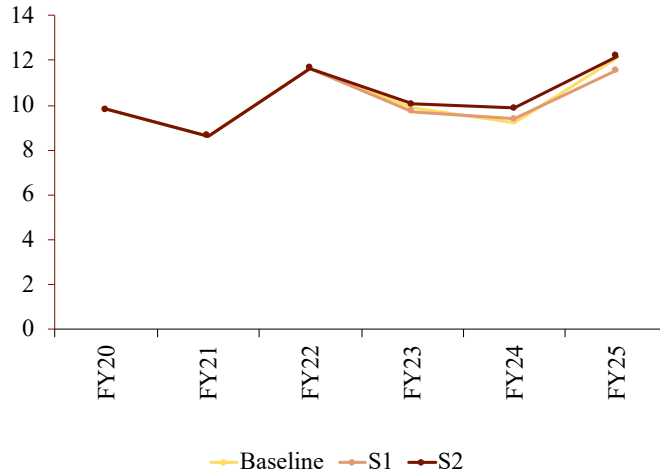
While the world was recovering from the COVID-19 pandemic, another supply shock, the Russia-Ukraine war, disrupted the global supply chains. Russia and Ukraine are major exporters of wheat, fertilizers, and energy. The disruption in world trade due to the war has spiked prices of various commodities including food and energy across the globe. During the outgoing FY, inflation stood at 11.64% compared to 8.62% in the preceding FY.

- During the FY23, inflationary pressures will subside under all three scenarios, ranging between 9.7-10.06%, which is still considerably high.
- These numbers may change if the war in Ukraine ends.

Food inflation growth is projected to decline marginally in FY23 under all scenarios, after maintaining a high level of 12.14% in FY22. Due to the Russia-Ukraine war, wheat

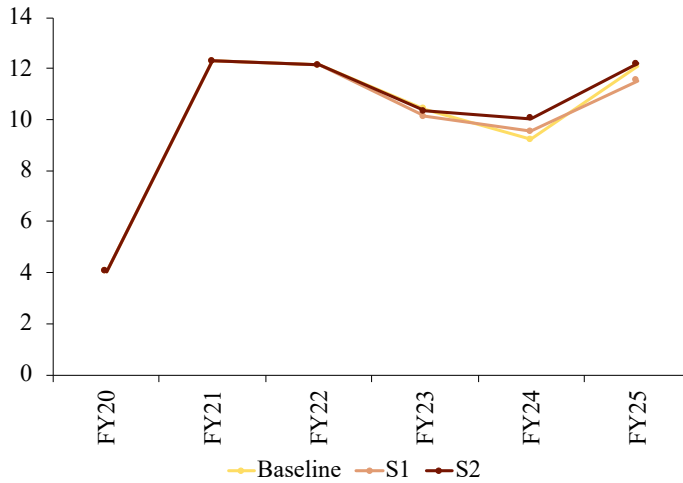
prices are historically high. Pakistan is importing wheat, hence vulnerable to the global price hike.

Figure 5: Projected Inflation Rate



Source: Authors' Calculations

Figure 6: Projected Food Inflation



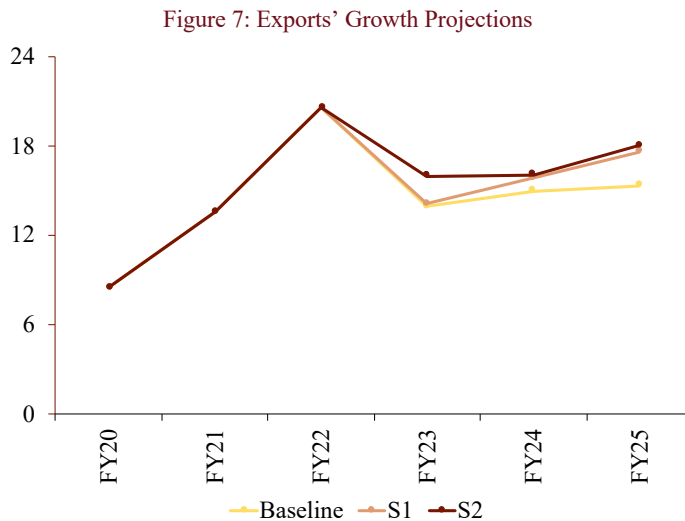
Source: Authors' Calculations

Pakistan is the net importer of cooking oil, and the price of cooking oil has also increased by 14.2% since the beginning of the war. The possible reasons for decline in food inflation are:

- Opening of food supply chains and increased mobility
- Government's crackdown on hoarder and profiteers especially in sugar
- Availability of credit to farmers
- Subsidized prices of wheat, sugar, and vegetable ghee⁵

External Sector Growth Projections

Exports and imports will witness a sharp decline in FY23 after sustained growth in FY20 and FY21. Textile sector exports remained highest mainly due to favorable government policies concessionary refinance schemes from State Bank of Pakistan (SBP), followed by leather goods and rice. The government remains determined to boost exports, through various policies and incentives such as duty-free imports of textile machinery, however export base remains narrow. Depreciation of nominal and real effective exchange rates aided the competitiveness of exports in the world market.

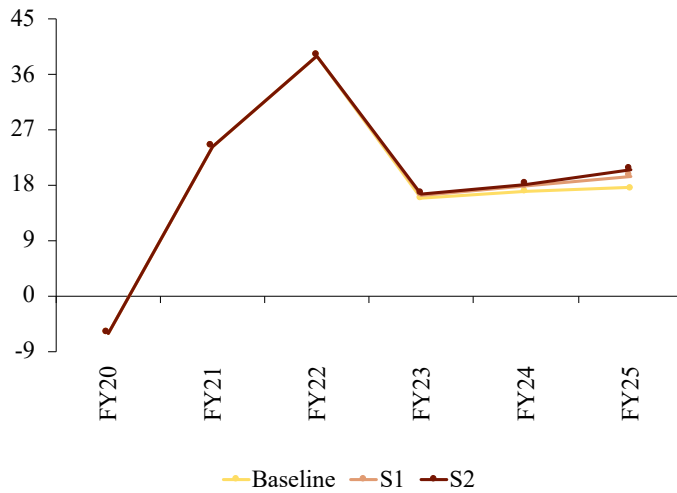


Source: Authors' Calculations

⁵ ECC allowed subsidizing prices of wheat to Rs800/20kg, sugar Rs70/kg and discount of 190/kg on vegetable ghee.

The import bill grew manifold mainly due to rising domestic demand and government spending. Higher growth in imports as compared to exports and has depleted foreign exchange reserves putting the country in serious economic crisis. To preserve foreign exchange reserves and lighten the current account deficit, the government banned imports of non-essential times.

Figure 8: Imports' Growth Projections



Source: Authors' Calculations

These growth projections suggest that:

- Rising uncertainty in global market and resulting increase in freight and shipping cost can pose challenge to exports
- Export base must be broadened, and incentives should be provided for IT sectors and financial services to resume the export growth in upcoming FY.
- Rising energy cost will make textile exports uncompetitive.
- There is heavy dependence on remittances to balance the current account. However, higher remittances translate into higher consumption and demand for imports since domestic output does not meet aggregate demand. Moreover, increasing remittances indicate that working age population is unable to find employment within country.

- There should be focus on sustainable ways to maintain foreign exchange reserves and manage the current account deficit rather than depending on remittances.

Conclusions

The projections of the major macroeconomic indicators show that with the current set of economic policies the economic growth targets for FY 2023 and beyond are difficult to achieve. The optimal policy solutions to achieve the targeted growth would be a mix of fiscal and monetary measures with increased role of government in stimulating private investment and shielding the poor against rising inflation.

Despite reporting a 5.97% GDP growth in FY22, Pakistan would be unable to sustain it. This seems so primarily because of a combination of entrenched structural problems with-in the economy and external challenges. Growth in Pakistan is predominantly consumption led, which puts pressure on demand, price levels, and subsequently the import bill. Private investment in Pakistan remains low due to low business confidence and a volatile economic and political environment in and outside the country.

To move towards sustained economic growth, the government needs to maintain and enhance export competitiveness in the current volatile global environment, broaden export base, and provide a stable environment to investor.

3. Fiscal Policy: Performance and Outlook Under Uncertainty

Muhammad Sabir

Introduction

The fiscal year 2022-23 federal budget was presented against a backdrop of mixed macroeconomic performance and an uncertain outlook. While estimates of GDP growth paint a rosy picture, GDP growth exceeded its target of 5% and is expected to be around 6%. GDP growth exceeds almost all 2021-22 targets and is distributed across all sectors of the economy. The most notable growth is seen in large-scale manufacturing, which is estimated to be around 11%. In contrast, unprecedented high inflation, much higher-than-expected imports, a high current account deficit, and dried-up foreign resources, particularly from the IMF, proved to be the economy's most serious challenges. Despite high petroleum subsidies until May, in 2021-22, year-on-year CPI growth (general consumer inflation) was around 21.3%, and wholesale price index growth (a proxy for producer inflation) was around 38.9%. These developments have significant implications for fiscal policy and its role in redistribution. Despite higher-than-expected FBR taxes, the current fiscal year's budget paints a bleak picture. The analysis of taxes, current and development expenditures, the fiscal deficit, and its financing is as follows.

Federal Taxes: The Tale of Surpassed Target

Table 2 shows the FBR tax revenue targets and actual collection and reveals that FBR surpasses the target marginally in all major tax heads except the excise duty. As per the

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revised estimates, the FBR is likely to surpass its tax target of PKR5.8 trillion by roughly PKR225 billion in 2021-22. A look at tax collection reveals that customs and sales tax generated the most revenue (around PKR 3.5 trillion). Head-wise, this was the second consecutive year where the revenues from customs and sales tax surpassed their targets, largely due to imports which were \$72 billion against the target of \$55 billion.

Table 2: Comparison of Target and Actual FBR Tax Revenues (Rs. Billions)

		2019-20	2020-21	2021-22*	2022-23
FBR Tax Revenues					
	Target	5,555.0	4,963.0	5,829.0	7,470.0
	Actual	3,997.4	4,734.3	6,050.0	
Surplus (+)/Shortfall (-)		-1,557.6	-228.7	221.0	
Actual as % of Target		72.0	95.4	103.8	
FBR Direct Taxes					
	Target	2,081.9	2,043.0	2,182.0	3,039.0
	Actual	1,523.4	1,726.0	2,234.0	
Surplus (+)/Shortfall (-)		-558.5	-317.0	52.0	
Actual as % of Target		73.2	84.5	102.4	
Import Duties					
	Target	1,000.5	640.0	785.0	953.0
	Actual	626.6	747.3	817.0	
Surplus (+)/Shortfall (-)		-373.9	107.3	32.0	
Actual as % of Target		62.6	116.8	104.1	
Federal Excise					
	Target	364.8	361.0	356.0	402.0
	Actual	250.5	279.6	344.0	
Surplus (+)/Shortfall (-)		-114.3	-81.4	-12.0	-402.0
Actual as % of Target		68.7	77.5	96.6	0.0
Sales Tax					
	Target	2,107.7	1,919.0	2,506.0	3,076.0
	Actual	1,596.9	1,981.4	2,655.0	
Surplus (+)/Shortfall (-)		-510.8	62.4	149.0	
Actual as % of Target		75.8	103.3	105.9	

* Revised estimates for 2021-22 instead of actuals.

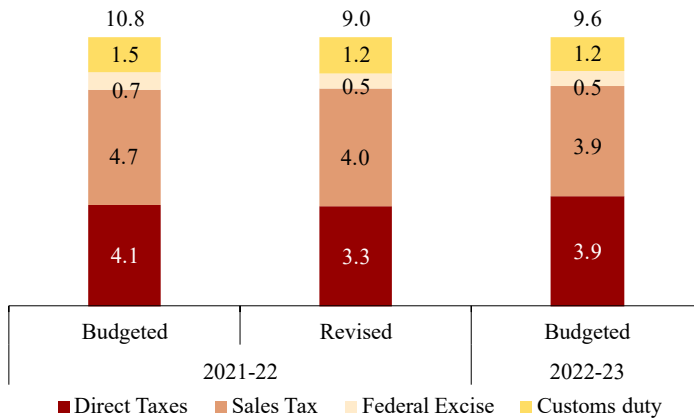
Source: Targets from Federal Budget in Brief (various issues), Actual Taxes from FBR Yearbook 2021-21

The depreciation of the Pakistani rupee and higher domestic inflation also contributed to the achievement of these tax targets. However, the collection from excise duty has not shown any dynamism and did not meet its target. This is the first time in recent history when the direct taxes also surpass the target of PKR 2.2 trillion by PKR 52 billion; this

is commendable. This can be attributed to higher-than-expected GDP growth, particularly in LSM. However, the higher share of indirect taxes indicates that FBR still heavily relies on potentially regressive tax collection measures. The actual collection seems higher than the revised estimates as per the press release of FBR.⁶

Figure 9 shows the tax-to-GDP ratio in 2021-22 and 2022-23. It reveals, as per the revised estimates, both direct taxes and indirect taxes missed the tax-to-GDP targets. The target set for direct taxes was slightly higher than 4% of GDP, while the revised estimates showed a relative collection of slightly higher than 3.3% of the revised GDP. Similarly, the target for indirect taxes was set around 6.8%, and revised estimates showed a collection of 5.7%. It was expected that the custom duty and sales tax were likely to achieve their targets. However, both taxes missed their targets of 1.5% and 4.7% and ended up at 1.2% and 4% of the revised GDP, respectively.

Figure 9: FBR Tax Collection (as % of GDP)



Source: Federal Budget in Brief 2022-23

All these statistics show the overall target of 10.8% tax-to-GDP is missed by 1.8 percentage points, reaching only 9%. The i FBR largely focuses on the targets in absolute numbers and not in terms of tax-to-GDP ratio and suggests that this approach needs to be changed. The higher reliance on indirect taxes reflects a compromise on equity and progressivity. The country is bearing a very high and regressive inflation tax burden, which may further worsen the society's income distribution.

⁶ <https://www.fbr.gov.pk/pr/fbr-creates-history-by-exceeding-the-upward-r/173492>

Federal Non-tax Revenues: Lacklustre Performance

Table 3 shows the non-tax revenues and their key heads. Both in 2019-20 and 2020-21, non-tax revenues serve the purpose of supporting the federal budgetary position either by surpassing or achieving more than 90% of the targets. However, non-tax receipts, as per revised estimates, are expected to be flat in 2021-22. Non-tax revenues for the federal government collapsed to PKR1.3 trillion and did not meet the target of PKR2 trillion.

Table 3: Comparison of Target and Actual Non-Tax Receipts (PKR Billion)

		2019-20	2020-21	2021-22*	2022-23
Non-Tax Revenues					
	Target	1,161.6	1,610.2	2,080.0	1,934.9
	Actual	1,784.4	1,480.4	1,315.2	
Surplus (+)/Shortfall (-)		622.7	-129.8	-764.8	
Actual as % of Target		153.6	91.9	63.2	
Petroleum Development Levy					
	Target	216.0	450.0	610.0	855.0
	Actual	293.7	424.7	135.0	
Surplus (+)/Shortfall (-)		77.7	-25.3	-475.0	
Actual as % of Target		135.9	94.4	22.1	
SBP Profits					
	Target	406.1	620.0	650.0	300.0
	Actual	935.5	650.5	474.0	
Surplus (+)/Shortfall (-)		529.4	30.5	-176.0	
Actual as % of Target		230.4	104.9	72.9	
Mark up and Dividends					
	Target	269.6	210.7	265.8	279.6
	Actual	298.4	150.2	300.1	
Surplus (+)/Shortfall (-)		28.8	-60.6	34.2	
Actual as % of Target		110.7	71.3	112.9	
Other Non-Tax Revenues					
	Target	269.9	329.5	554.1	500.2
	Actual	256.8	255.0	406.1	
Surplus (+)/Shortfall (-)		-13.2	-74.5	-148.1	
Actual as % of Target		95.1	77.4	73.3	

* Revised estimates for 2021-22 instead of actuals

Source: Federal Budget in Brief (various issues), Actual Non-Taxes from Fiscal Accounts (various issues), Ministry of Finance, GoP

This is largely due to significantly lower petroleum development levy revenues of only PKR 135 billion compared to the target of PKR 610 billion. This decrease is due to higher global oil prices and the government's decision not to pass on their full impact to domestic consumers. The second major dent in non-tax revenues was the SBP profit, which fell by more than PKR 175 billion compared to its target of PKR 650 billion for 2021-22. Because of its independence, the SBP can transfer its debt to private banks and borrow more from them. This was not a one-off thing specific to 2021-22 but has become a reality that the federal government will continue losing an important source of revenues despite paying very high interest payments. The only non-tax revenue major head that surpassed the target is markup and dividends. This head shows the mark-up receipts from provinces and autonomous bodies, dividends from corporations, and profit and license fees from Pakistan Telecommunication Authority. Overall, the decline in non-tax receipts has significantly worsened the position of the federal government as these revenues are exclusively theirs.

Shortfall in Federal Gross and Net Revenues

Gross revenue receipts of the federal government contain both tax and non-tax revenues. As previous sections show that the FBR collects the bulk of these receipts through direct and indirect taxes, while non-tax revenue contribution is relatively smaller. Table 4 shows that recently the federal government has fallen short on its gross revenue targets.

Table 4: Comparison of Target and Actual Gross and Net Revenues (PKR Billion)

Receipts and Transfers		2019-20	2020-21	2021-22	2022-23
Gross Revenue Receipts					
	Target	6,716.6	6,573.2	7,909.0	9,404.9
	Actual	5,781.8	6,214.7	7,365.2	
Surplus (+)/Shortfall (-)		-934.9	-358.5	-543.8	
Actual as % of Target		86.1	94.5	93.1	
Transfer to Provinces					
	Target	3,254.5	2,873.7	3,411.9	4,372.6
	Actual	2,504.0	2,741.9	3,541.4	
Surplus (+)/Shortfall (-)		-750.5	-131.8	129.5	
Actual as % of Target		76.9	95.4	103.8	
Net Revenue Receipts					
	Target	3,462.1	3,699.5	4,497.1	5,032.3
	Actual	3,277.8	3,472.8	3,823.8	
Surplus (+)/Shortfall (-)		-184.4	-226.7	-673.3	
Actual as % of Target		94.7	93.9	85.0	

While, in 2021-22, FBR met its tax targets in absolute numbers, the shortfall in non-tax revenues dented the gross revenue receipts by more than Rs 540 billion. After the exclusion of transfers to provinces, the remaining revenues are referred to as net revenues. As a result, the federal government's net revenues are nearly PKR 700 billion less than the target of PKR 4.5 trillion, while federal transfers to provinces are PKR 129 billion more than the target of PKR 3.4 trillion.

Transfers to Provinces: A Blessed Year

The 7th National Finance Commission (NFC) Award includes three streams of revenues to be transferred to the provinces: divisible pool transfers, straight transfers, and grants and subventions. The divisible pool transfers consist of 57.5% of five major FBR taxes: taxes on income, capital value tax, sales tax (excluding sales tax on services), customs duties, and federal excise (excluding excise duty on natural gas) after deduction of one-percent collection charges. While the 7th NFC award completed its constitutional tenure in 2014-15, the formula is continued under the 9th NFC Award.

Table 5 shows that 2021-22 was a blessed year for provinces as collectively they received an additional PKR 129 billion against the targeted amount of PKR3.8 trillion. While in the past two years, they did not receive the targeted revenues. For instance, in 2019-20 provinces collectively received PKR 2.5 trillion against the target of PKR 3.2 trillion resulting in a shortfall of PKR 750 billion. The shortfall created vulnerabilities in provincial fiscal management as these transfers are the financial lifeline of the provinces. The surplus in 2021-22 has provided much-needed fiscal space to the provincial governments.

Feasibility of Tax Targets for 2021-22

The federal government has set a relatively moderate target of raising the tax-to-GDP ratio from 9% to 9.6% in 2022-23. The tax-wise targets (as % of GDP) indicate that collection of sales tax is likely to be 3.9% - almost the same as it was in 2021-22. The sales tax target of more than PKR 3 trillion shows a growth of 15.9% of the revised estimates. Given the level of inflation in the country, an assessment of FBR sales tax target based on the discretionary changes and estimates of buoyancy presented in the Finance Act 2022 shows that the target is feasible. Similarly, the PKR 953 billion target for customs also looks feasible due to rigidity in imports, the falling rupee, and international inflationary pressure. Similarly, the FED target also looks feasible.

Table 5: Analysis of Growth in FBR Tax Collections

	2019-20	2020-21	2021-22	2022-23
	Actual	Actual	RE	BE
FBR's Tax Revenues	3,997	4,734	6,050	7,470
Tax-to GDP Ratio	8.4	8.5	9.0	9.6
Growth		18.4%	27.8%	23.5%
Direct Taxes	1,523	1,726	2,234	3,039
Growth		13.3%	29.4%	36.0%
% Share in Taxes	38.1	36.5	36.9	40.7
Indirect Taxes	2,474	3,008	3,816	4,431
Growth		21.6%	26.8%	16.1%
% Share in Taxes	61.9	63.5	63.1	59.3
Customs	627	747	817	953
Growth		19.3%	9.3%	16.6%
Federal Excise	251	280	344	402
Growth		11.6%	23.0%	16.9%
Sales Tax	1,597	1,981	2,655	3,076
Growth		24.1%	34.0%	15.9%

Source: Budget and Revised Estimates from Federal Budget in Brief 2022-23, Actual Taxes from FBR Yearbook 2020-21

In the nutshell, FBR follows a relatively realistic approach in setting the target of indirect taxes. The real action is visible in the direct taxes, where FBR on the advice of IMF set a higher target of more than Rs 3 trillion which shows a growth of 36%. For 2022-23, the federal government has announced a relatively different income tax strategy. The Finance Act 2022 contains many amendments to the Income tax Ordinance 2002 related to salary and non-salary tax rates and structure, increase in corporate tax rates particularly in the banking sector, imposing a super tax on ten sectors and high-income individuals, and other amendments aimed to tap revenues from the wealthy and real state. These amendments have macroeconomic consequences, which are likely to affect GDP growth. Therefore, despite these changes, the target of direct taxes seems unfeasible.

Tax Rate Changes and Impact on Salary Income

Most of the discretionary changes in the Income Tax Ordinance 2001 look progressive. While an in-depth analysis of each amendment is beyond the scope of this chapter, the impact of changes in tax on salary class is reviewed for 2021-22 and 2022-23 with the perspective of tax burden and progressivity and is reported in Table 6.

Table 6: Comparative Effective Tax Rates on Salary Income

Salary Income	Tax Amount		Difference	Effective Tax Rate	
	2021-22	2022-23		2021-22	2022-23
600,000	0	0	0	0.00%	0.00%
1,200,000	30,000	15,000	-15,000	2.50%	1.25%
1,800,000	90,000	90,000	0	5.00%	5.00%
2,400,000	180,000	165,000	-15,000	7.50%	6.87%
2,500,000	195,000	185,000	-10,000	7.80%	7.40%
2,900,000	265,000	265,000	0	9.14%	9.14%
3,500,000	369,999	384,999	15,000	10.57%	11.00%
3,600,000	389,999	404,999	15,000	10.83%	11.25%
5,000,000	669,999	754,999	85,000	13.40%	15.10%
6,000,000	894,999	1,004,999	110,000	14.92%	16.75%
8,000,000	1,344,999	1,654,998	310,000	16.81%	20.69%
12,000,000	2,344,998	2,954,998	610,000	19.54%	24.62%
30,000,000	7,294,998	9,254,998	1,960,000	24.32%	30.85%
50,000,000	13,294,998	16,254,997	2,960,000	26.59%	32.51%
75,000,000	21,419,997	25,004,997	3,585,000	28.56%	33.34%

Source: Author's calculations based on Finance Act 2022

It shows an inconsistent pattern of increase in tax burden. For instance, there is a tax relief of PKR 15,000 for individuals having an annual income of PKR 1.2 million or PKR 2.4 million. However, no relief is given to the individuals having a salary income of PKR 1.8 million. After, a salary income of PKR 2.9 million the tax burden starts increasing. Despite these anomalies, the proposed changes by and large are progressive.

Priorities in Federal Expenditures

Economists categorize expenditures into two: current (non-development) expenditures and development expenditures. Where the former are recurring operational costs involved in the provision and maintenance of a range of government services, the latter represent outlays to develop new physical and social infrastructure like new buildings, roads, facilities, or even new administrative functions. In a broader sense, this distinction between non-development and development expenditures is like consumption and investment. Consequently, if any government aims for higher public investment, it generally implies higher development expenditures. The higher share of development expenditure may generate higher employment and crowd in⁷ private investment.

⁷ Crowding in occurs when higher government spending encourage private firms to invest because there are now more profitable investment opportunities.

In this context, Table 7 presents the priorities in the federal government outlays from 2019-20 to 2021-22 and allocation for 2022-23. It shows that the level of current expenditure increased from PKR 6 trillion in 2019-20 to PKR 8.5 trillion in 2021-22. In contrast, development spending declined from PKR 1.1 trillion to PKR 550 billion during the same period. As a percent of total expenditure, the share of development expenditures declined from 16% to a meager 6%.

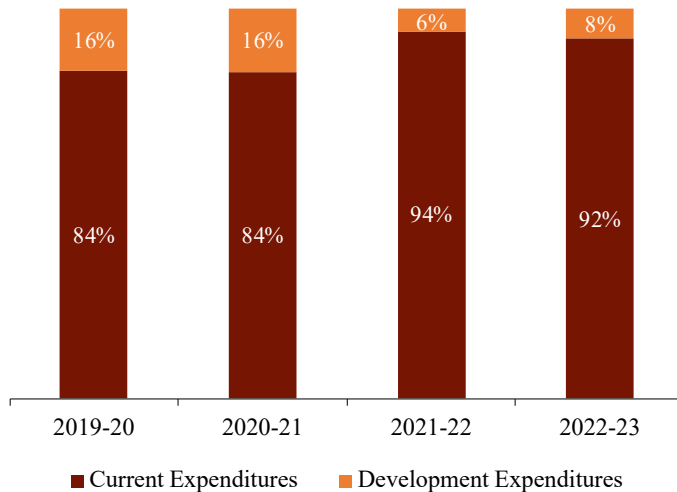
Table 7: Composition of Federal Government Expenditure (PKR. Billion)

Federal Expenditures	2019-20	2020-21	2021-22	2022-23
Current Expenditures	6,016	6,349	8,531	8,709
Development Expenditures	1,155	1,239	550	727
Net Lending + Statistical Discrepancy	39	16	52	144
Total Expenditure	7,133	7,571	9,133	9,580

Source: Federal Budget in Brief 2022-23, Actual from Fiscal Accounts (Various), Ministry of Finance, GoP

The composition of federal government expenditures in terms of development and non-development for the four years is presented in Figure 10. It shows that 2021-22 is the most challenging year for development expenditures as these collapsed from 16% to 6%.

Figure 10: Composition of Federal Government Expenditure



Source: Federal Budget in Brief 2022-23, Fiscal Accounts (Various), Ministry of Finance, GoP

This massive decline is an outcome of over-runs of current expenditures and has severe economic and welfare implications. The development expenditure consists of projects and a cut in development spending results in a high through forward for the coming year. In the presence of high prevailing inflation, the project cost escalates every year and will result in many projects losing their effectiveness due to these delays and rises in cost.

Current Expenditures: Over-runs

Table 8 presents the composition of current expenditures in terms of budget and revised estimates for 2021-22 and allocations for 2022-23. It shows that the overall current expenditure is likely to overrun by more than a trillion rupees in 2021-22. While this is consistent with the historical trend as current expenditure is generally underestimated at the time of preparing budget estimates, this massive increase is unprecedented. A look into each category of the current expenditures reveals a plausible explanation and unexplained variation. The massive increase in servicing of foreign interest payments and subsidies is an outcome of external shocks particularly the Russia-Ukraine war which resulted in a hike in international petroleum products and created a supply shock. For Pakistan, this resulted in a higher import bill, devaluation of the currency, and massive subsidies on petroleum products and electricity.

Table 8: Comparison of Budgeted and Actual Federal Current Expenditures (PKR Billion)

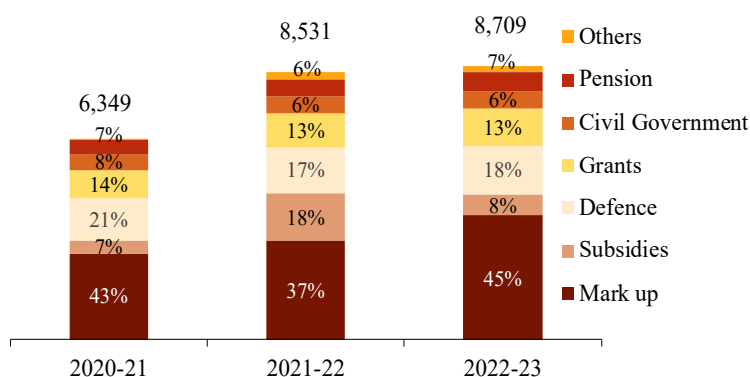
	2021-22			2022-23	
	Budget	Revised	Growth	Budget	Growth
Domestic Debt Servicing	2,757.2	2,770.4	0.5%	3,439.1	24.1%
Foreign Debt Servicing	302.5	373.2	23.4%	511.0	36.9%
Subsidies	682.0	1,514.9	122.1%	664.0	-56.2%
Defence Affairs and Services	1,373.3	1,483.9	8.1%	1,566.7	5.6%
Transfers and Grants	1,167.5	1,090.4	-6.6%	1,174.5	7.7%
Pensions	640.0	540.0	-15.6%	609.0	12.8%
Health Affairs & Services	28.4	154.9	446.3%	19.6	-87.4%
Education Affairs & Services	92.0	90.9	-1.2%	90.6	-0.3%
Others	480.5	512.6	6.7%	634.2	23.7%
Current Expenditure Total	7,523.2	8,531.1	13.4%	8,708.5	2.1%

Source: Federal Budget in Brief 2022-23

The budget 2021-22 did not allocate the resources for these unforeseen external shocks and current expenditures depart more than Rs 900 billion under these two heads. In contrast, an increase of more than PKR 100 billion in health expenditure is unexplained as the country is passing through the Covid-19 cases and the need for vaccination should

be incorporated at the time of budgeting. Similarly, PKR 110 billion increase in the defence outlays compared to allocation is largely unexplained. A look into the composition of current expenditures of the federal government indicates that more than two-thirds have been spent on and allocated to domestic and foreign interest payments. These interest payments have profound implications on investment and equity. From the investment perspective, these payments provide private banks a risk-free guaranteed return and crowd out the investment from the industry and productive sectors to finance government consumption expenditures. On the other hand, these interest payments are direct transfers to the account holders and capital class having liquid assets and further increase inequality in the country Figure 11.

Figure 11: Priorities in Federal Government Current Expenditure



Source: Federal Budget in Brief 2022-23, Fiscal Accounts (Various), Ministry of Finance, GoP

Apart from interest payments and defence two other major heads are subsidies and grants. The grants contained spending on Benazir Income Support Programme (BISP), grants to provinces and contingent liabilities. The subsidies require further analysis which is discussed in the subsequent section.

Unpacking Federal Subsidies

Table 9 shows the magnitude of subsidies for 2021-22 and 2021-23. In 2021-22, the subsidies overshoot by more than 120% and caused increase in current expenditures. The subsidies are heavily skewed towards WAPDA and KE, as the combined share of both is more than 70% of the total subsidies for 2021-22. Out of PKR 1,072 billion on this account, Rs 240 billion is to household as a tariff differential subsidy that is the sum of differences between the NEPRA proposed and the government-approved tariff rates.

Table 9: The Burden of Federal Subsidies (PKR Billion)

	2021-22			2022-23	
	Budget	Revised	Growth	Budget	Growth
Electricity Subsidies -WAPDA+KE	596	1,072	79.9%	535	-50.1%
Tariff Differential	240.0	240.0	0.0%	285.0	18.8%
IPPs	136.0	434.0	219.1%	180.0	-58.5%
Industry	63.0	63.0	0.0%	40.0	-36.5%
Ex FATA Districts	25.6	25.6	0.0%	20.0	-21.9%
Agriculture Tube well	11.4	9.4	-17.5%	7.0	-25.5%
PHPL	118.0	118.0	0.0%		
AJK	2.0	2.0	0.0%	3.0	50.0%
Coal Plants		100.0			
TDS (PM Package)		80.0			
Subsidy to Petroleum	20.0	377.0	1785.0%	71.0	-81.2%
LNG for Industry	10.0	81.0	710.0%	40.0	-50.6%
PSO, APL Others	10.0	10.0	0.0%	6.0	-40.0%
SNGPL (domestic Consumers)		36.0		25.0	-30.6%
Petroleum General Subsidy		250.0			
PASSCO:	7.0	7.0	0.0%	7.0	0.0%
Utility Store Corporation	6.0	21.0	250.0%	17.0	-19.0%
Others	53.0	37.9	-28.5%	34.0	-10.3%
Wheat Subsidy to GB	8.0	8.8	10.0%	8.0	-9.1%
Metro Bus Subsidy	1.0	2.0	100.0%	4.0	100.0%
Fertilizer Plants Subsidy	6.0	25.0	316.7%	15.0	-40.0%
Others:	38.0	2.1	-94.5%	7.0	233.3%
Total Subsidies	682.0	1,514.9	122.1%	664.0	-56.2%

Source: Federal Budget in Brief 2022-23

Apart from this PKR 80 billion is spent on the PM package, which is PKR 5 per unit to all households irrespective of their categorization as rich or poor households. As rich households consume more electricity, this subsidy is heavily skewed towards rich households and is regressive. In addition to the regular energy subsidies, in 2021-22 under the circular debt management plan (CDM), the government spent PKR 434 billion and PKR 118 billion for Independent Power Plants (IPP) and Power Holding Private Limited (PHPL) to reduce the circular debt and corresponding interest payments.

Several times in the past, the government tried to fix the circular debt problem by injecting a bulk of subsidies. However, the problem arises from time to time despite the involvement of the World Bank and IMF. The solution lies in the structural reforms to fix the problem.

Another new head of coal subsidy also emerges in 2021-22 that costs PKR 100 billion to the federal government. Given that coal is not environmentally safe, this subsidy is likely to have adverse climatic effects and huge future mitigation and adaptation costs. The three other regular heads of consumption subsidies are subsidies to Ex-Fata districts, AJK, and agriculture tube wells with a cumulative cost tag of PKR 37 billion. Similarly, the much-debated general petroleum subsidies show an additional amount of PKR 250 billion in 2021-22.

Current Expenditures Outlook for 2021-22

The current expenditure outlook do not show any radical change or departure from past practices. As shown in Table 10 the allocation is heavily skewed towards debt servicing, this single head accounts for more than 45% of allocations and reached to an alarming PKR 4 trillion magnitude in 2022-23. If the rise in the interest rate and growth in public debt remains uncontrolled, it will surpass half of the current expenditure and further erode the fiscal space for other spending heads such as development expenditures. Similarly, there is no shift in the structure of the subsidies in 2022-23 and by and large, these subsidies are directed toward consumption and not towards investment.

Moreover, these subsidies are allocated towards fossil fuels and structural rigidities and not clean fuel and enhancing generation capacities from renewables. The other current expenditure heads show under allocation in health. These estimates are vulnerable to any internal and external shocks. It seems the full impact of salary increases and pensions is not incorporated. There is a very high chance that next year's estimates will show a similar trend of over-run in the current expenditures.

Development Expenditure Priorities

The size of the Public Sector Development Programme (PSDP) is budgeted to be PKR 900 billion in 2021-22, reflecting a sizable increase of 43% over last year's revised estimates of Rs 630 billion. However, the revised estimate showed a massive cut of Rs 350 billion, or a 39% decline compared to the budget estimates. The reduction in the developmental spending has exhibited a very interesting pattern and shows a decline across the board except in the kitty of the cabinet division which shows a massive increase of 39% compared to their allocations for 2021-22. It is unclear whether this increase can be attributed to an uncertain political situation or if the cabinet division has some high-priority development projects that need to be protected and financed through this additional allocation.

Table 10: Priorities in PSDP (PKR Billion)

Government Entity	2020-21			2020-21	
	Budget	Revised	Growth	Budget	Growth
Federal Ministries/Divisions	628.3	409.3	-34.8%	565.0	38.0%
Cabinet Division	46.2	64.0	38.7%	70.1	9.5%
Climate Change Division	14.3	9.6	-33.1%	9.6	0.2%
Education	9.7	4.6	-52.6%	7.2	57.4%
Finance Division	123.1	45.8	-62.8%	1.7	-96.4%
HEC	42.5	26.3	-38.0%	44.2	67.7%
Housing & Works Division	24.2	14.3	-40.8%	14.0	-2.4%
National Health Services	21.7	12.6	-42.0%	12.7	0.4%
Pak Atomic Energy Commis.	27.0	18.9	-30.0%	26.0	37.5%
Railways Division	30.0	17.8	-40.6%	32.6	83.1%
Water Resources Division	103.5	90.6	-12.5%	99.6	9.9%
Special Areas (AJK & GB)	70.0	45.9	-34.4%	52.6	14.7%
Other Federal Ministries	116.1	58.9	-49.2%	194.7	230.4%
Corporations	183.2	133.2	-27.3%	161.5	21.2%
National Highway Authority	113.8	86.7	-23.8%	118.4	36.6%
NTDC / PEPCO	69.5	46.5	-33.1%	43.1	-7.3%
ERRA and Others	88.5	7.426	-91.6%	0.5	-93.3%
Total Federal PSDP	900.0	550.0	-38.9%	727.0	32.2%

Source: Federal Budget in Brief 2022-23

The priorities in 2022-23 are almost the same as all spending heads show growth except the Finance Department. However, these growth rates are meaningless as any shortfall in the resources or increase in the current expenditure mean a drastic cut in the development expenditures.

Fiscal Sustainability and Budget Deficit

Table 11 shows the absolute and relative (as % of GDP) magnitudes of three sets of fiscal deficits, including federal and overall budget deficits along with the overall primary deficit. The main idea is to understand whether Pakistan is trapped in the vicious cycle of higher deficits and rising debt or not. The federal budget deficit for 2021-22 was estimated to be almost PKR 4 trillion, while the revised estimates indicate a budget deficit of slightly more than Rs 5.3 trillion – a further increase of around PKR 1.3 trillion. This deficit is more than double to federal net revenue receipts, PKR 1.6 trillion more than the debt servicing payments, and 7.9% of the GDP. This also implies that in 2021-22, the federal government borrowed to finance the debt servicing obligations, the entire PSDP, and other expenditures of Rs 1.5 trillion.

The provincial cash surplus computed by the federal government reduced the budget deficit to PKR 4.7 trillion but was unable to convert the primary deficit into a surplus. The overall primary deficit is a sign of unsustainable fiscal policy, which reached PKR 1.5 trillion. This is alarming and unsustainable. If the federal government continued with this size of the budget deficit then the default is inevitable as debt servicing will further increase and all the federal net receipts will be insufficient to finance the debt servicing.

The indicators for 2022-23 portray a similar picture indicating a higher federal fiscal deficit of PKR 4.5 trillion, a much higher provincial surplus of PKR 750 billion, an overall budget deficit of PKR 3.8 trillion, and an overall primary surplus of PKR 153 billion. The primary deficit is the key to fiscal sustainability and if the federal government converted its primary deficit into a primary surplus then the country will likely move in the direction of fiscal sustainability.

Conclusions

The revised estimates show a dismal fiscal performance of the federal government during 2021-22, particularly when reviewed in relation to other macroeconomic indicators. For instance, despite more than anticipated growth in nominal GDP, and more than targeted tax collection, the federal government revenues show a decline instead of an increase. The high magnitude of current expenditures eroded the finances for development and also geared-up fiscal deficit to an unsustainable level.

To gear the fiscal policy toward a sustainable direction, following measures are proposed:

- The government should reconsider its decision to borrow from the private sector rather than a combination of SBP and private banks. This action not only crowds out much-needed private investment but also has a significant fiscal cost in the form of lost SBP profit revenue.
- Subsidies need to be rationalized. Instead of electricity subsidies, it is proposed that subsidies be given to renewable energy production to both households and electricity-producing firms.
- Electricity subsidies for high-income individuals who consume more than 500 units per month should be withdrawn.
- Solar and wind energy should be used in government buildings.
- The provision of free electricity and fuel to high-ranking government officials should be withdrawn.

Table 11: Computation of Overall Budget Deficit (PKR Billion)

Aspect of Budget		2021-22		2022-23	Growth	
		Budget	Revised	Budget	(%)	
		A	B	C	B/A	C/B
Federal Budget Surplus (+)/Deficit (-) (I-II)		-3,990	-5,309	-4,547	33.1%	-14.4%
Overall Budget Surplus (+)/Deficit (-) (I-II+III)		-3,420	-4,739	-3,797	38.6%	-19.9%
Overall Primary Surplus (+)/Deficit (-)		-360	-1,596	153	343.0%	-109.6%
As % of GDP						
Federal Budget Deficit		-7.4%	-7.9%	-5.8%		
Overall Budget Deficit		-6.3%	-7.1%	-4.9%		
Overall Primary Deficit		-0.7%	-2.4%	0.2%		
Revenue Receipts						
	Gross Revenue Receipts	7,909	7,365	9,405	-6.9%	27.7%
	(Minus) Transfer to Provinces	3,412	3,541	4,373	3.8%	23.5%
I	Net Revenue Receipts	4,497	3,824	5,032	-15.0%	31.6%
Federal Expenditure & Net Lending						
	Debt Servicing	3,060	3,144	3,950	2.7%	25.7%
	Other Current Expenditures	4,464	5,388	4,758	20.7%	-11.7%
	Public Sector Development Program	900	550	727	-38.9%	32.2%
	Net Lending	64	52	144	-18.6%	177.6%
II	Federal Expenditure & Net Lending	8,487	9,133	9,580	7.6%	4.9%
III	Provincial Budget Surplus/Deficit	570	570	750	0.0%	31.6%
GDP (MP)		53,867	66,950	78,197	24.3%	16.8%

Source: Federal Budget in Brief 2022-23

- Instead of providing electricity subsidies for agricultural tube wells, a one-time subsidy should be provided to encourage the use of renewables such as solar or wind energy.
- Priority development expenditures for nuclear and solar energy should be protected even if there is any inevitable cut in the development expenditures.
- The project with a throw forward of less than 10% should be completed as soon as possible.

4. Monetary Policy and Economic Spark

Muhammad Nasir

Introduction

The FY22 ended by recording CPI inflation of 21.3% (y-o-y) in June, the highest in the last decade and a half. It jumped from 13.8% (y-o-y) in May 2022. This huge increase is the result of reversing the unsustainable energy subsidy package. The course correction was needed because (i) the subsidy was becoming sustainable, and (ii) the completion of review by the IMF program was conditioned on it. This, however, has severely daunted the purchasing power of the households, especially those on the lower end of the income distribution. This increase has also prompted the State Bank of Pakistan (SBP) to increase the policy rate by 125 basis points to 15%.

The recent wave of inflation is primarily driven by commodity price super cycle (especially food prices) and the massive increase in energy prices. The on-going Russia-Ukraine war has tremendously affected global oil prices. The prices in the international energy market are becoming unaffordable for developing countries like Pakistan. With China expected to go back to full production, the competition over energy resources is just going to get intense in the coming months. This situation of upward pressure on energy prices is expected to remain for at least the next couple of years. For Pakistan, this would mean further increase in fuel and utility prices.

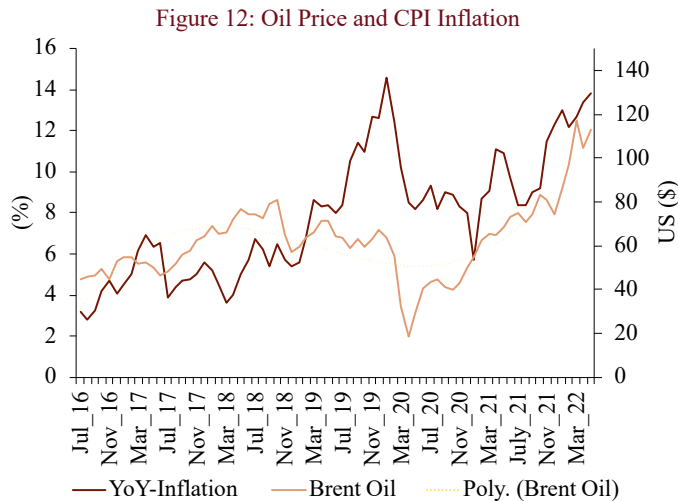
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The inflation in FY23 could remain around 20% which would also drive inflation expectations upward. The SBP intends to moderate and manage this situation by increasing the policy rate to around 18%. This, in turn, would severely affect growth and employment, and could lead the country into stagflation. An optimal monetary policy is required not only to minimize inflation variability but also to reduce the output loss. However, in the supply-side transmission mechanism, welfare loss may increase further (high inflation and low output) if a central bank responds by only considering the traditional demand channel of monetary policy. In this backdrop, it is important to explore whether the SBP response of tight monetary policy is desirable or not. In this chapter, we discuss the source and components of the current wave of inflation, the relationship between policy rate, inflation, and output, and a way forward to deal with the current and expected inflation wave in the country.

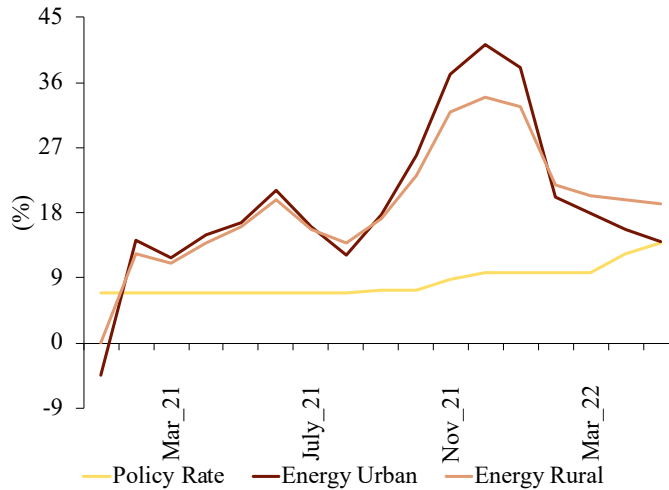
Sources of Inflation

First up, it is important to examine the main sources of the current inflationary period. Figure 12 shows the graphical relationship between oil price (Brent) and CPI inflation for the last several years. It is evident from the figure that, after COVID-19 subsided, a consistent increase in oil price since January 2021 is followed by a rise in inflation. Specifically, with escalated tension between Russia and Ukraine early this year, there had been a sharp jump in the global oil price and a highly correlated increase in inflation.



Source: SBP Inflation Monitor

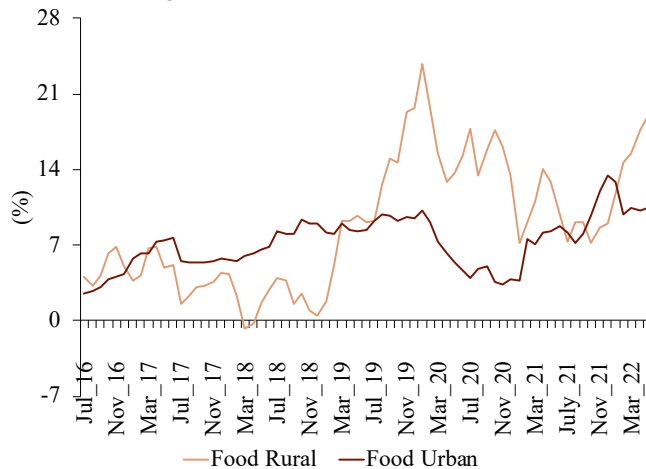
Figure 13: Energy Inflation in Pakistan



Source: SBP Inflation Monitor

The increase in global oil price translates into energy inflation domestically due to increase in fuel and utility prices. Figure 13 shows that both urban and rural energy inflation experienced a sharp increase following the global increase in oil price since January 2021. In both regions policy rate does not correlate with energy inflation.

Figure 14: Food Inflation in Pakistan



Source: SBP Inflation Monitor

Similarly, food inflation is also a major contributor to the current wave of inflation in the country. This can be confirmed from Figure 14 above which depicts the trends of food prices in urban and rural areas in the country. The food prices have generally been high and volatile for the last few years but show a specific increasing trend since the beginning of FY22.

Above mentioned figures confirm that the recent inflationary period is primarily driven by food inflation, and energy prices caused by a jump in the global oil prices. This situation is further exacerbated by the Russian invasion of Ukraine. Hence, the recent increase in inflation is powered by supply side shocks – both foreign and domestic.

Components of Inflation

Before we discuss what are the main components of CPI inflation, it is important to understand what these components are and how they are constructed. The CPI data is collected for 356 items and 244 items for the calculation of Urban and Rural CPIs, respectively. These items are grouped into 12 commodity groups. In addition to reporting general and regional (rural/urban) CPIs, the Pakistan Bureau of Statistics – the institution responsible for collection of price data – also reports information for CPI of these commodity groups. These commodity groups are assigned weights based on their share of the total budget. However, those weights are assumed the same for all households, irrespective of where they lie on the income distribution. But it is incorrect to assume that these shares would remain the same for all households. The spending shares tend to change for different commodities across income groups (e.g., income deciles).

To take care of these issues, we make use of the Household Integrated Economic Survey (HIES). The latest HIES was conducted for the year 2018-19, which covers 27,062 households for four provinces, AJK and Gilgit Baltistan (GB). The total number of expenditure items covered in the survey is 283. The expenditure data is grouped into 12 main categories according the Classification of Individual Consumption According to Purpose (COICOP)⁷ as follows: 1) food and non-alcoholic beverages, 2) alcoholic beverages and tobacco, 3) clothing and footwear, 4) housing, water, electricity, gas and other fuels, 5) furnishings, household equipment and routine maintenance of the dwelling, 6) health, 7) transport, 8) communications, 9) recreation and culture, 10) education, 11) hotels, cafes and restaurants and 12) miscellaneous goods and services (Baez et al. 2021).

As discussed above, the weights assigned to each commodity group in the CPI is assumed to be the same for each household (Figure 13). For instance, the weight for housing and utilities is 23.63, which means each household, irrespective of income, spends 23% of their budget on housing and utilities. This, however, is not the case. Households spending share on this commodity group (and others) vary when moving across the income ladder. Since the commodity groups in CPI are consistent with COICOP categories, it is possible to combine these two dataset sets. The HIES provides the share of expenditure for each commodity group in the budget for each household.

Table 12: Weights of Commodities Groups in CPI (2015-16 Base)

Group	Commodity Groups	Weight
1	Food & Non-Alcoholic Beverages	34.58
2	Alcoholic Beverage, Tobacco	1.02
3	Clothing & Footwear	8.60
4	Housing, Water, Electricity, Gas and Other Fuels	23.63
5	Furnishing & Household Equipment Maintenance	4.10
6	Health	2.79
7	Transport	5.91
8	Communication	2.21
9	Recreation & Culture	1.59
10	Education	3.79
11	Restaurants & Hotels	6.92
12	Miscellaneous Goods & Services	4.87
	Total	100

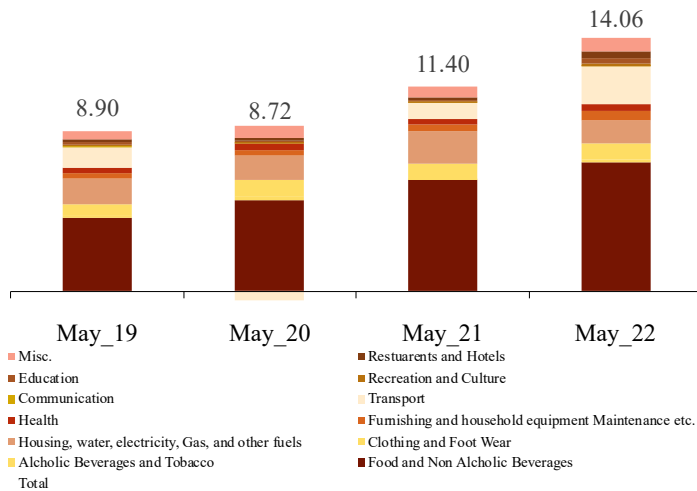
Source: Household Integrated Income and Consumption Survey (HIICS 2015/16) (PBS)

Since the commodity groups in CPI are consistent with COICOP categories, the two datasets can be combined at the commodity groups level to estimate the household level inflation rates in Pakistan. Multiplying the share of each commodity group at household level the inflation of the respective group gives the inflation for each commodity group at household level.

Aggregating these household level inflation rates of commodity groups estimates the inflation rate at household level. Then these households are put in their specific decile on the basis of per adult equivalent household's consumption expenditures to get the decile specific inflation rates. These inflation rates take into account the inflation heterogeneity across income groups. The decile-specific inflation for each COICOP category is also estimated in the same way. For instance, to estimate the inflation for the

first commodity group, the sum of household level inflation of this group in the first decile is divided by total number of households in this decile. This is done for all commodity groups and for all deciles to get the components of inflation for each decile. Now that we have discussed the construction of these components, let us now see the contribution of these components to overall (y-o-y) inflation for the month of May for the last four years (2019-2022) which are provided in Figure 15.

Figure 15: Components of Inflation



Source: Author's Calculations Based on Data from PBS

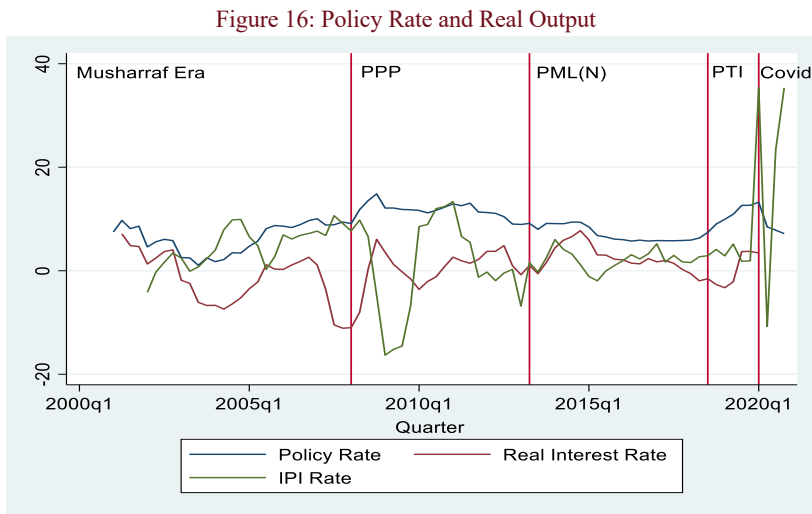
The first point to note here is that year-on-year inflation for the month of May is different from the officially reported value. For instance, the official inflation rate reported is 13.8% (y-o-y) for the month of May. However, our reported figure shows it to be 14.06%. This is because we have taken account of the inflation inequality across income groups using the method discussed in the previous paragraphs. This suggests that the official figure underestimates the true inflation when they assume homogeneity of inflation across income groups. The second point which needs attention is that y-o-y inflation is on rise since FY20 and is highest in the FY22.

Thirdly, the overall share of food and non-alcoholic beverages is the highest among all the components. It contributes more than 50% to the overall inflation in that particular month for the years 2019-2022. Another important point to note is the increasing share of transport over the years. For instance, in May 2019, the transport inflation was 1.15%, which constituted 13% of the overall inflation in Pakistan. However, in FY22, the

transport inflation is found to be 2.05% or 14.5% of the overall inflation for the month. This is due to the reversal of fuel subsidy. However, since the reversal took place at the end of the month, we expect the higher share of transport (as well as utilities) inflation in the coming months. The central bank is responding to this through an increase in policy rate. But this could impact the real output as is discussed in the next section.

Interest Rate and Real Output

Figure 16 provides trend analysis for the policy rate, real interest rate, and Industrial Production Index (IPI). Although there is no strong relationship between the policy rate and IPI rate, the rate of IPI responds to the real interest rate. Whenever the real interest rate decreases, the rate of IPI starts picking up, which reinforces the argument on the cost channel of monetary policy because the real interest rate decreases either due to the reduction in the nominal interest rate or an increase in the inflation rate.



Source: SBP Inflation Monitor

The historical analysis shows that monetary policy responds to headline inflation without decomposing the variation in inflation into demand and supply shocks. The use of demand management policies to reduce inflation could lead to a further fall in output. Moreover, this may also result in higher inflation through the cost channel of monetary policy, as explained above (Rehman et al 2010).

Way Forward

From this analysis, it is confirmed that both food and fuel prices are primarily responsible for the high inflationary episode. Since the energy prices are expected to remain higher in the international market, we should expect further increase in inflation in coming months. The central bank is responding to this increase in inflation by raising policy rates. Although this may curtail some of the demand side inflation, the big jumps coming from supply side shocks (which are beyond the government's control) will have a net effect of increase in inflation.

Continuous increase in policy rate, on one hand, is going to affect the real output, and on the other, may also contribute to increase in inflation through operationalization of the cost channel of monetary policy. The central bank needs to be careful in increasing the policy rate further as it could take the economy into stagflation. The current policy rate of 15% is already going to affect the government's target of achieving growth around 5%. With further increase, the growth could come down to 3%, which is going to affect employment, and subsequently a second-round downward effect on demand.

Given the current situation, there is a need for unconventional measures. For instance, to protect the lower income groups against rising inflation, target subsidies should be given. The BISP's National Socioeconomic Registry (NSER) can be utilized to identify the neediest households. Similarly, given that the energy issues are going to persist for the next few years or even longer, it is high time to shift towards renewable energy resources. Pakistan has huge potential for solar throughout the country and wind energy potential in various pockets in Sindh and Punjab. The coastal areas in Sindh and Balochistan could be utilized for in and off-shore windmills to generate environmentally and economically electricity and to reduce the country's oil import bill.

Similarly, the removal of GSP on import of solar panels is a step in the right direction. This should further be encouraged by urging people to adapt net-metering and other means of prosumership. The sludge (administrative delays in the net-metering process) of around 6 months to one year should be removed. All government buildings should also be shifted to solar energy. Lastly, to save on fuel and electricity cost, the government should start moving towards a four working day model or at least allow one day of work from home. This will substantially reduce the fuel and electricity consumption thereby reducing the import of fuel and pressure on forex.

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5. Institutions, Autonomy and Governance: Case of State Bank of Pakistan and Higher Education Commission

Faiz Ur Rehman & Asma Hyder

Introduction

Institutions and their effectiveness are one of the most important instruments to explain the economic and political dynamics of growth and sustainable development. Inclusive institutions can be described as the ‘prerequisite’ of sustainable development (Socoliuc, Pohoacă, & Diaconășu, 2020) and are those which foster economic activity, growth and development and prove to be the “engines of prosperity” (Robinson & Acemoglu, 2012). Political and economic institutions interact with each other beyond sectoral lines to bring peace and prosperity of nations. Macroeconomic policies such as fiscal and monetary policies and policies on education can prove crucial in promoting inclusive sustainable development (Morgan, 2022). However, institutions concerned with these policies are directly affected by political and governance obstacles. This chapter aims to discuss the functional structure and role of two such institutions in Pakistan vis-à-vis State Bank of Pakistan and Higher Education Commission which remained a matter of much debate in Pakistan in the previous year.

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State Bank of Pakistan

The SBP Autonomy in a Historical Perspective

The regulatory structure of the State Bank of Pakistan (SBP) has undergone a lot of changes since its inception in 1948. At the time of its creation, the SBP did not enjoy autonomy either in monetary management or the regulation of commercial banks in Pakistan. The first comprehensive legislation to strengthen the role of the SBP was the 1956 State Bank of Pakistan Act, however, the SBP did not receive the autonomy necessary for prudent monetary policy and fiscal responsibility (GoP, 1956).

The role of the Federal Government in public debt management was strengthened by the State Bank of Pakistan Act 1956. Subsection 2 of Section 21 (21.2) states that the conditions of public debt management and disbursement of new loans will be set with the agreement of the Government and the State Bank of Pakistan. However, Subsection 3 states that in case of the failure to reach agreement “the Federal Government shall decide the conditions and its decision shall be final”. The decisions regarding monetary policy, debt management, and credit facilitation to the provincial and federal governments were taken by the Central Board.

It is important to note that the governor of the Bank was the chairman of the Central Board but the other nine members were the government representatives and the decisions were finalized by the majority's vote. The governor could make the necessary measures in an emergency but had to “report such measure for the approval of the Central Board at its next meeting.” On the other hand, the Monetary and Fiscal Policy Coordination Board consisted of five members and was chaired by the Finance Minister. Furthermore, the conditions to sell and buy the foreign exchange were also set by the government (GoP, 1956).

The control of the government over the central bank was implicit in the law. Until 1962 SBP did not have the full authority over the commercial banks and regulations of the banks were based on the pre-partition model. In 1962, however, a few important legislations such as “Banking Companies Ordinance 1962” and the dissolution of the Pakistan Banking Council made SBP the sole regulator of banking sector in Pakistan. Nevertheless, the problem of government influence over monetary policy decisions, especially debt management, remained intact. The government possessed significant control over the credit creation and the public debt management of the country.

The State Bank of Pakistan Act 1956 has been amended a few times since its inception. The first two revisions were made in 1994 and 1997 respectively and the role of the central bank did not change from being mere advising body to the government on macro-economic stability and the state of the economy. The deciding vote over the monetary policy and the credit limitation was still occupied by the government (GoP, 1994, 1997).

The third and important amendment in the SBP Act 1956 was made in 2012. It was incorporated in the Act that two prominent researchers and academics will be appointed by the Federal Government to advise the board. More importantly, the time limit was set on the government to pay back its loans taken from the central bank. A limit on borrowing from the government was also prescribed but the Central Board remained in charge of determining that limit. Furthermore, the government was held accountable in case of the failure to pay back the loans within the set time limits and the finance minister was required to provide justification for that failure in the Parliament (GoP, 2012).

The State Bank of Pakistan was also permitted in the 2012 through an amendment to conduct Open Market and Credit Operations by buying and selling the financial instruments, but the Central Board decided the types of these instruments. The State Bank of Pakistan was also permitted to issue certificates to regulate the monetary and credit system in the country. However, in 2015, the Senate of Pakistan passed the most comprehensive and important amendment to the State Bank of Pakistan Act 1956. According to this amendment an autonomous Monetary Policy Committee was created to regulate and control the monetary policy in the country. The members of this committee constitute the Governor, three senior executives of the Bank, three members of the Board of Directors (previously the Central Board), and three external members which are professionals from the field of economics and appointed by the Federal Government on the recommendation of the Board of Directors. The Monetary Policy Committee has the responsibility to achieve the intermediate monetary objectives by regulating key interest rates and other tools (GoP, 2015).

As much as the 2015 amendment has achieved in terms of autonomous regulation of the monetary system of the country, the influence of the government over the public debt management remained intact. In fact, the time limit for the government was increased to pay back its outstanding loans to the central bank. Before going to the latest amendment in the SBP Act, it is important to discuss and analyze another part of the legislation i.e., the Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 (amended in 2016). FRDL Act was introduced to “provide for reduction of general fiscal deficit and ratio of public debt to GDP to a prudent level by effective public debt management”. The Act

described the principles of prudent debt management such as limiting the fiscal deficit (excluding foreign sources) to 4% of GDP for the three years from 2017 to 2018 and 3.5% after that. The legislation also aimed to reduce the total public debt to 60% by 2017 with a proposed decrease of 0.5% every year until 2024 and 0.75% after that.

However, the government failed to achieve these targets and a new amendment is in process for resettling these targets and an extension of ten years to achieve the target of reduction in public debt to 60% of GDP. The Act, however, permitted the government to depart from these targets in case of “unforeseen demands on the finances of the Government due to national security, acts of terrorism, war, riots and projects of national importance or natural calamity including earthquake, drought, torrential rains, floods, etc.” (GoP, 2017). It is important to keep in mind that during the last two years the COVID-19 caused unforeseen and extraordinary fiscal pressure on the government.

Lastly, the latest amendment to the State Bank of Pakistan Act was passed in 2022, and it is one of the major steps toward the autonomy of SBP. Section 9C “Limitation on Federal Government Borrowing” was substituted with “Prohibition on the Government Borrowing”. Subsection 1 of section 9C prohibits the Central Bank from extending any direct credit to the government or fulfilling any government obligations. Meanwhile, subsection 3 prohibits the purchase of government securities on the primary market. The objective of this amendment was the prohibition of limitless credit facilitation to the Government directly or through open market operations from the Bank (GoP, 2022).

The SBP Act and Government Domestic Borrowing

Government domestic debt has jumped from PKR 3.72 trillion to PKR 26.26 trillion in 13 years⁸ from 2008 to 2021 corresponding to an increase of 605% (State Bank of Pakistan, 2009, 2021). Graph 1 shows the absolute value of domestic borrowings by the government for the fiscal year 20018-2019 (FY09) to the fiscal year 2020-2021 (FY21). Meanwhile, Figure 17 shows two of the components of the domestic debt pertinent to our discussion. The implications of the SBP Act on the changes in debt can also be observed in Figure 17. We can further divide these graphs into three parts to see how the level and composition of the domestic debt have changed during the last three democratic governments from FY09 to FY13, from FY14 to FY18, and from FY19 to FY21.

⁸It is not the total government debt which includes other sources as well such as external debt, borrowing from IMF etc. The total government debt stood at RS. 35.74 trillion at the end of FY21.

Government borrowing from domestic sources during the tenure of the Pakistan People's Party rose from PKR 3.86 to PKR 9.52 trillion (an increase of 146% (State Bank of Pakistan, 2009, 2013). It is important to note that during that time there has been no significant advancement toward putting any limits on government borrowing or making the State Bank of Pakistan autonomous in this regard. A limit on the borrowing from the central bank was prescribed, as mentioned in section 1 but the Central Board had the decisive role.

Figure 17: Government's Domestic Debt (Rs. Trillion)

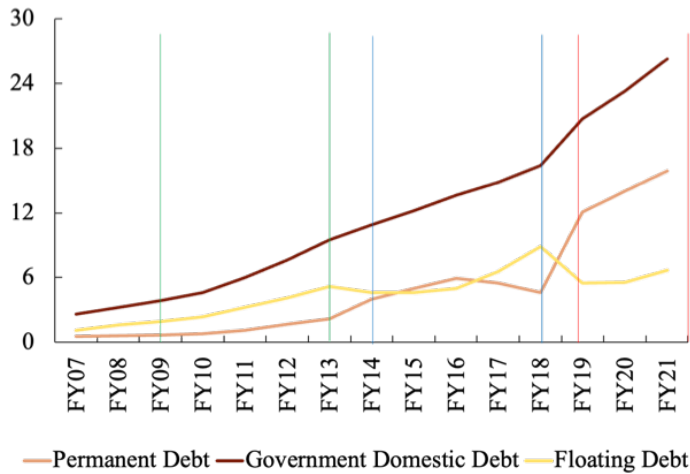


Figure 17 further shows the increasing trend in floating permanent debt during the same period.⁹ This type of debt mainly comprises of different T-bills and represents an important part of the government borrowing from SBP. During this time, the government continuously breached its limits (put forward by IMF). For example, the government borrowed PKR 1.2 trillion and PKR 1.4 trillion from SBP during FY10 and FY11 respectively, and PKR 530 billion during only the 1st quarter of FY13 (State Bank of Pakistan, 2010, 2011, 2012, 2013).

At the end of the tenure of PML(N) i.e., FY18, the domestic government borrowing reached PKR 16.41 trillion or an increase of 72% (State Bank of Pakistan, 2018). The government followed the Medium Term Debt Strategy 2014-2018 which provided it with

⁹ Floating debt is the short-term debt and in Pakistan it comprises of Market Treasury Bills (MTBs) and Market Related Treasury Bills (MRTBs). Permanent debt is the long run debt and comprises of different types of bonds e.g., Pakistan Investment Bonds (PIBs), Ijara Sukuk and Prize Bonds.

the framework to achieve the targets and limits set by the IMF and SBP Act (State Bank of Pakistan, 2012). During this period, the government focused on achieving the targets set by the IMF and FRDL Act (amended in 2016). During FY15 and FY16 the government managed to keep the borrowing from the central bank within the limits through issuing securities and borrowing from commercial banks.

However, during the last two fiscal years i.e., FY17 and FY18, the government again shifted towards borrowing from SBP while borrowing heavily from commercial banks as well. Investment bonds issued by the government matured during FY17 and the government had to borrow from SBP to return the principal of these bonds. Moreover, during the last quarter of FY18, the government borrowed a record high amount of PKR 2.2 trillion through T-bills to meet its financial needs (State Bank of Pakistan, 2014, 2015, 2016, 2017, 2018). This phenomenon can also be observed in Figure 17 which shows a decrease in floating debt during the start but an increase in it during the last years of the PML(N) government.

Latest Measures Taken by the Government

After FY18, the new government's preference shifted from floating debt to permanent debt (see Figure 17). This shift corresponds to the government's preference for borrowing from commercial banks instead of SBP during FY20 and FY21 and the government relied on zero fresh borrowing from the State Bank of Pakistan (State Bank of Pakistan, 2019, 2020, 2021). It is also important to note, furthermore, that the government passed the latest amendment (2021) to SBP Act which bestows the central bank more autonomy over the debt management. It does not mean, however, that the domestic public debt has fallen down the targets set by IMF or the FRDL Act. At the end of FY21, the government public debt stood at 26.26 Trillion PKR (an increase of 60% during PTI's government). This increase is mainly due to government's reliance on commercial banks hence the sharp rise in permanent debt in terms of Ijara Sukuk, Investment Bonds, etc.

Conclusions

The increase in government domestic borrowing in absolute terms has kept increasing for the last 13 years. Initially, the State Bank of Pakistan did not enjoy any autonomy either in the case of monetary policy or debt management. The government has kept the decisive role until 2015 in the case of monetary policy and until 2021 in the case of borrowing from the central bank. Analyzing the amendments in SBP Act 1956 and its

implications on the government's domestic debt, it can be observed that the borrowing from the central bank has been kept under prescribed limits during the past decade but afterwards it has increased sharply – through from commercial banks and other sources. The objective of limiting the domestic debt from the central bank should be accompanied by the objective of reducing the government deficit to achieve fiscal responsibility and debt limitation in true spirit.

It is clear that government borrowing has a continuous upward trend. It is also evident that the government borrowing from commercial banks and other domestic sources has increased in the recent years. Without any prudent debt management policy and reduction of the budget deficit, it is hard to reduce total domestic borrowing even if the government stops borrowing from SBP. As mentioned earlier, the government has implemented the “zero new borrowing from SBP” policy recently but at the same time the borrowing from other domestic sources has increased. Without any comprehensive debt policy, the policy of limited or zero borrowing from SBP results in this ‘crowding out’ of the debt and the total domestic debt keeps mounting primarily to meet its budgetary deficits.

Furthermore, the government, on the advice from the IMF, has increased the autonomy of the State Bank of Pakistan but this autonomy is only in deciding the appropriate tools to achieve the targets which are still set by the government (GoP, 2022; PIDE, 2021). The State Bank of Pakistan does not enjoy the autonomy in setting either the monetary policy targets or the domestic debt management targets. The autonomy in setting these targets can further help the State Bank of Pakistan efficiently manage credit and inflation in the country.

Higher Education Commission of Pakistan

HEC was established in 2002 with a vast scope of functions, including but not limited to the evaluation, improvement and promotion of the higher education, and research and development in the country. The foremost objective of the commission¹⁰ is to formulate policies, guiding principles and priorities for universities to promote country's socio-economic development. Initially, the institution played an encouraging role in higher education, especially by providing resources to universities and students through a facilitation process. However, in later years it became a bureaucratic organization.¹¹

¹⁰ Higher Education Commission Ordinance, 2002

¹¹ Raja Rafiullah, Quality of higher education in Pakistan. June 2, 2021. PIDE Blog

Many in academic community think that HEC is becoming a hurdle in achieving excellence at least for a few universities. Some even perceive that the functions of the commission are now limited to the opening of new campuses at the whim of political leaders, the useless policies in the name of quality and accreditation, fund allocations to different centers without any analysis of outcomes etc.^{12,13} Considering this isn't easy to analyze all aspects, this section reflects upon only a few which are arguably more fundamental in nature.

Tension between Broader Accessibility and Excellence

Since its establishment, the accessibility and quantity of higher education has remained the focus of HEC. Policies like recognition of low-quality journals, massive investment in building campuses across the country, and faculty's private investment in terms of time and effort to publish large number of papers without any solid content and ideas lead us nowhere. Some of the statistics mentioned below suggest that HEC couldn't succussed in achieving a decent level of excellence in academia. Figure 18 shows the number of local journals in different disciplines, 354 locally published journals are initiated without solid policies, editors, and well-defined review process. Most of the journals are poor in quality and don't follow a rigorous review process. Similarly, the considerable number of journals and locally produced papers is a significant investment if the cost of time and effort is included along with other tangible costs. The promotion policy of HEC on publication numbers without much regard to their quality led to useless papers, publication in predatory open access outlets¹⁴, forged publication practices, etc. This practice destroyed the true spirit of knowledge creation and creativity.

The excellence in higher education and access are synergistic. Thus, without excellence one shouldn't expect innovation or creativity as an outcome of higher education in any society. There are approximately 235 universities in 160 districts.¹⁵ Of these, 55 universities have 119 campuses. Wider access to higher education also becomes a political issue as the establishment of a university in a constituency has significant impact on ballot outcomes. Thus, many campuses and universities are the result of political

¹² PIDE-IBA joint Webinar, Future of higher education in Pakistan, May 12, 2020

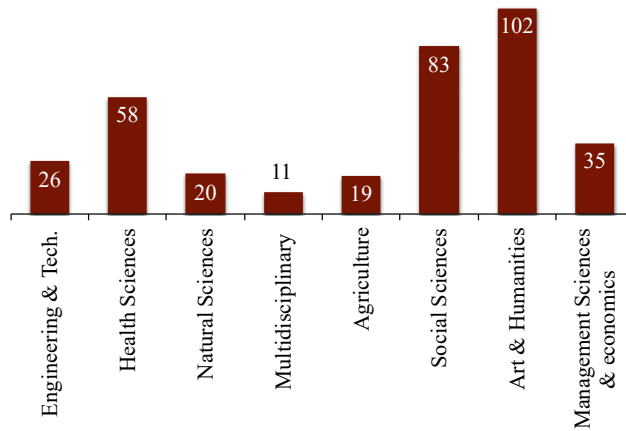
¹³ Survey conducted by author from 13 public sector universities of Pakistan on social science research to provide feedback to HEC, June 2019.

¹⁴ Open access journals are highly criticized in academic circles because universities, through public spending and individuals at their private cost, paid for bogus papers to get published in open access journals. In most cases, the purpose remains limited to speedy publication with minimal review quality.

¹⁵ Few districts have many universities, and few don't have a single campus. Still this rough estimate, which is based on averages, is a judgement call for these investments.

pressures without any demand analysis. However, the establishment of women universities is very commendable initiative of HEC and contributed toward female access to higher education.

Figure 18: Number of Local Journals



The relationship between the production of papers and innovation/creativity is weak and puzzling in higher education institutions. Pakistan ranked at 99th position among 132 countries in Global Innovation Index. A comparative analysis shows that Pakistan, India, and Bangladesh are ranked 7th, 1st, 10th position respectively in innovation, among the ten economies of central and southern Asia. Considering the high investment in higher education during the last two decades, the outcomes are not substantial in Pakistan. Higher education, and research & development outcomes can be usefully analyzed in a comparative sense because of massive globalization.

It is quite interesting to compare ourselves with the rest of the world or at least with our peer countries. Table 13, shows our comparative standing and performance on different indicators, especially in knowledge diffusion, impact, linkages, and absorption etc. and clearly numbers are not encouraging as compared to our peer countries. Thus, the focus of further investment should be on excellence, diffusion, and innovation instead of access to higher education in every nook and corner of the country. This structural shift is critical in higher education and a strong system with a connection between primary, secondary, and tertiary level education is required besides having a socially well respected and valued stream of skill education.

Table 13: A Comparative Analysis of Innovation

Aspect of Innovation	Pakistan	India	Bangladesh	Indonesia	Malaysia	Iran
Human Capital & Research	117	54	128	92	39	49
Knowledge & Technology Output	71	29	92	71	31	46
Creative Outputs	87	68	123	83	37	46
Creative Goods & Services	126	55	121	69	10	113
Knowledge Intensive Employment	105	90	113	92	55	80
Knowledge Linkages	78	50	96	71	38	100
knowledge Absorption	78	34	109	78	24	117
Knowledge Diffusion	71	13	111	72	14	119
Knowledge Impact	74	51	71	55	30	85
Global Innovation Index	99	46	116	85	36	60

Governance and Capacity of the Commission

Higher Education Commission couldn't develop a long-term vision in the last 20 years.¹⁶ Due to lack of direction, the most decisions and policies are based on personal whim and ideas. While writing this note, we conducted a few informal interviews¹⁷ in different departments of HEC. Almost everyone mentioned a lack of capacity to design and implement relevant policies at HEC. The employees working in a certain department have little understanding of technicalities of the subject i.e., department regarding local journals and their recognition, R&D sections, curriculum design etc.

In response to a question on trainings, a typical answer received is that the training sessions are almost non-existent. If there are any training options available, no one is interested because of their uselessness and poor quality. Few foreign effective trainings were conducted earlier, but they are not considered anymore in recent years. Staffing seems to be another serious issue at HEC. The interview outcomes show that many key positions at HEC have been vacant for a long. Different people are posted to those

¹⁶ During informal interviews we received mixed views. Few HEC staff members said that the vision is only a document and never practiced in its full spirit, but few employees were of the view that the HEC vision is quite clear and followed.

¹⁷ We are not disclosing the identity of the officials to maintain their privacy and confidentiality.

positions on an ad hoc basis; thus, the temporarily assigned officials hardly take any firm decisions on important matter. Another serious concern from a governance perspective is irregular and delayed meetings of the commission, which causes delay in many important decisions.

Absence of synergies between community colleges and universities is an important finding of unstructured interviews conducted for this essay. Many areas lack the provision of undergrad education and even schooling, but HEC allowed to provide funds for the establishment of the university. Many universities like Nusrat Bhutto University, Al-Qadir University, Abbottabad University, Gwadar University, and a few other universities were built without a formal feasibility study. Such decisions are primarily based on political pressures and raise questions on HEC's autonomy.

Similarly, the synergies between federal HEC and provincial HEC are very weak if not completely absent. HEC is not an exception, the relationship between federal and provincial institutions is not well defined in many other cases. The policies, and plans are designed without deliberations with provincial HECs, which create a lot of conflict. Whether in higher education or otherwise, the policies need stability and revisions initiated only periodically. In case of HEC, the guidelines are frequently revised for minor changes and sometimes for more considerable amendments are done through notifications and no effort to reconcile these in form of a comprehensive document. This creates confusion and lack of clarity for the university managements and cause reluctance with HEC.

Socio-economic Development

Social return on education reflects individuals' behaviors and determines the social fabric of any society. The related parameters may include responsible citizens, social norms and ethics, interfaith harmony, and finally the public knowledge – these subjects are vital components of any democratic society. Making higher education work for the social and economic development are the most critical dimensions where HEC has failed miserably. The poor indicators of social progress and citizenry are highly linked with tertiary education. The social progress index shows that Pakistan is in tier 6 country in terms of social progress, this is the lowest tier of the corresponding index.¹⁸

¹⁸ To see the empirical evidence on significant role of higher education in social development: Redding et al. 2019, Ali and Bibi (2017). and Spiel et al., (2018).

HEC deliberately, through discriminatory policies, discourages universities, faculty and youth to engage in the supply and demand of advance degrees in humanities and social sciences disciplines. Strangely, however, the improvement in the social structure and social progress are among the main objectives of HEC; and now, after two decades of heavy investments, the imprint of these objective on society is still blurred. Few indicators in Table 14 are low to an extent of embarrassment. The lower ranking in freedom of expression, religious practices and even in academic performance indicators raise a serious question mark for HEC and universities collectively.

Table 14: Social Progress Indicators¹⁹

	Pakistan		India		Bangladesh		Nepal	
	Score	Rank ²⁰	Score	Rank	Score	Rank	Score	Rank
Deaths from interpersonal violence (death/100,000)	6.72	116	2.91	77	2.42	69	1.74	56
Freedom of expression (0-1)	0.49	126	0.55	114	0.29	141	0.79	69
Freedom of religion (0-3)	1.30	158	2.36	137	3.19	110	3.02	116
Discrimination & violence against minorities (1-10)	8.80	150	8.20	137	8.60	145	9.40	158
Academic freedom (0-1)	0.56	105	0.46	120	0.26	139	0.85	60

A historical issue in measuring the demand for education is that the parameters originate either from industry or from economy. In contrast, HEC has hardly made any attempt to estimate the need for education from a social, cultural, and communal perspective. For instance, there is limited research to examine the importance of subjects such as philosophy, civics, ethics, literature, morals, etc., or on the intangible cost of excluding these disciplines. Contrary to this, most of the research focuses on private return to education and completely ignores the social return to education, which are equally or probably more important for a constantly decaying society like ours.

¹⁹ www.socialprogress.org

²⁰ Out of 168 countries.

Resistance to Change: A Recent Experience

HEC is an independent institute, and the chairman of HEC is appointed with autonomy and authority. It has been observed that any reform is a complicated process, and usually, the status quo is maintained. The position of the present HEC chairman became controversial mainly for two reasons. First, because he challenged many funding practices under different heads, and posed accountability on a few individuals and their institutions which received recurrent grants HEC. Second, the chairman of HEC was removed through a presidential order of amendment in the HEC Ordinance of 2002.

The second argument of the removal of the chairman raised the question of the autonomy of the commission. On a similar note, the state bank's independence and authority were the right step in many aspects but providing autonomy to one institution in isolation will not serve the purpose of effective governance unless all the parallel institutions like HEC, courts, NEPRA, FBR, PEMRA, etc. have the same autonomy. Similarly, the appointment criteria for heads of such national institutions should be strict and carefully designed and closely observed. The ecosystem of institutions can create collaborations and complementarities only if they all enjoy the same level of authority and follow the same vision - A long way to go!

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6. Pakistan's Import Flow Dilemma: Analyzing the Import Composition

Aadil Nakhoda & Qazi Masood Ahmed

Introduction

Pakistan is yet again on the brink of a balance of payment crisis. The dollar outflows far exceed the inflow of dollars into Pakistan. The foreign exchange reserves held by the State Bank of Pakistan have decreased and the import cover has fallen to drastically critical levels. The trade deficit in the first nine months of fiscal year 2022 was at \$35 billion. The highest ever reported in a calendar year was \$36.6 billion in 2018. The main contributing factor to the trade deficit is imports, which has grown at more than 50% year-on-year in the current fiscal year. Unfortunately, although exports too have performed exceptionally well this fiscal year and increased at 25% year-on-year, they have failed to keep pace with the imports.

This widening gulf between exports and imports needs a deeper analysis. Several issues related to the lack of export growth have already been discussed in the previous volumes of this book and still remain relevant today. These issues relate to low export unit value generated from export, the lack of diversification in exports and the biased approach of the government to support select sectors such as textile industry. In this edition, the focus is on import-related issues as a discussion on this direction of trade flow is equally important.

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One of the remedies often put forward to curtail import growth is to raise tariffs and increase protection so that the local industry manufacturers substitute away from imports and eventually transform into well-established enterprises that contribute to much needed export revenue. However, such policies have often failed to provide Pakistan the desired result as industries remain nascent and fail to become globally competitive even with years of enjoying high rates of tariff protection. Varela et al. (2020) present stylized facts on import duties in Pakistan. The main messages from the study highlight that the import duties are a tax on exporting activities as they increased production cost and restricted technological change. Import tariffs negatively affected economic performance, particularly if they are imposed on intermediate goods and raw materials as they hurt smaller producers and has had a detrimental effect on Pakistani economy.

Several countries are now opting for technical non-tariff measures (NTMs) instead of increasing tariffs to ensure that substandard and dangerous goods that hurt consumer welfare do not enter their domestic markets. The NTMs may involve certifications, testing, inspection, packaging, labelling and marking requirements to ensure that imported products follow certain pre-defined standards and processes. However, efforts must be made to ensure that they are not burdensome. Nakhoda and Niu (2022) find that NTMs imposed by China on its imports increase the exports of goods to China from low-income countries. Imports from low-income countries are likely to be less sophisticated than goods produced in more developed countries and more likely to face quality-related issues. NTMs can help increase the trade of higher quality goods and subdue the imports of poor quality goods. Ghodsi (2021) too finds that certain NTMs imposed by importing countries may help contribute towards increasing the quality of imports.

It is often noted that imports into Pakistan are typically non-essential consumer goods that aim to fulfill the needs of the elite consumers. However, this is unlikely to be true as the data suggests that Pakistan imports goods with relatively low unit values. Goods imported for the elite would be mainly high-end luxury goods, reporting relatively higher unit values. It is believed that curtailing imports of such goods can help reduce the trade deficit and encourage domestic production. This study undertakes a detailed comparative analysis of the import composition and the unit value of different product categories.

First, the imports are grouped on the basis of their unit value. Countries importing the same goods, classified at HS six digit level, at a higher unit value would be ranked higher than those importing goods at a lower unit value. It is likely that imports satisfying the needs of the elite population would be imported at higher unit values rather than at lower unit values. Second, the imports are then considered based on their product categories (i) consumer goods, (ii) unfinished goods for industries, (iii) capital goods. Lastly, the goods

are divided on the basis of their value of imports, with goods more commonly imported into Pakistan deemed as more essential than those less commonly imported. Products are sorted according to their value of imports, with the top 50% of the products, in terms of number of products imported, labelled as ‘More Commonly Imported Products’²¹.

The purpose of this study is to not only determine the unit value of goods imported into Pakistan compared to other developing countries but also to gauge the level of tariffs and NTMs imposed by Pakistan and regional counterparts on their imports categorized according to the aforementioned groups.

Data

The data on trade unit value and import flow is extracted from *CEPII*’s Trade Unit Values database and *BACI* database respectively²². The time period considered is 2019 as it is the latest data available in the trade unit values database at the time of publication. Besides, this period will not be influenced by the pandemic shock, which can severely distort trade values across different trading partners. Trade unit value is a useful proxy for trade prices. Berthou and Emlinger (2011) compute bilateral trade at a high-level of disaggregation to allow for cross-country comparisons. As there can be several discrepancies in calculating trade data due to missing flows that can lead to biases, Gaulier and Zignago (2010) reconcile mirror figures to correct such discrepancies.

The reference on product classifications, which includes categories such as consumer goods, intermediate goods, raw materials and capital goods, is extracted from the World Bank’s World Integration Trade Solution (WITS)²³. The raw materials and intermediate goods categories are merged and labelled as ‘unfinished goods’. Data on tariff rates, taken as weighted average of all trading partners across reporting countries, is also extracted from World Bank’s WITS, using the UN-TRAINS data source²⁴. Data on non-tariff measures (NTMs) is extracted from UNCTAD’s NTM Hub, using TRAINS Portal^{25,26}.

²¹ Import demand is likely to be highly skewed. The bottom 50% of the products imported, ranked in terms of import value, are likely to have insignificant levels of demand. However, this is important to our analysis as the less commonly imported products can be deemed non-essential. On the other hand, approximately 50% of the imports are concentrated in not more than 115 products across the four reporting countries.

²² Trade Unit Values: http://www.cepii.fr/CEPII/en/bdd_modele/bdd_modele_item.asp?id=2, BACI dataset: http://www.cepii.fr/CEPII/en/bdd_modele/bdd_modele_item.asp?id=37

²³ Product reference data: <https://wits.worldbank.org/referencedata.html>

²⁴ Tariff data: <https://wits.worldbank.org/Default.aspx?lang=en>

²⁵ NTMs data: <https://trainsonline.unctad.org/home>

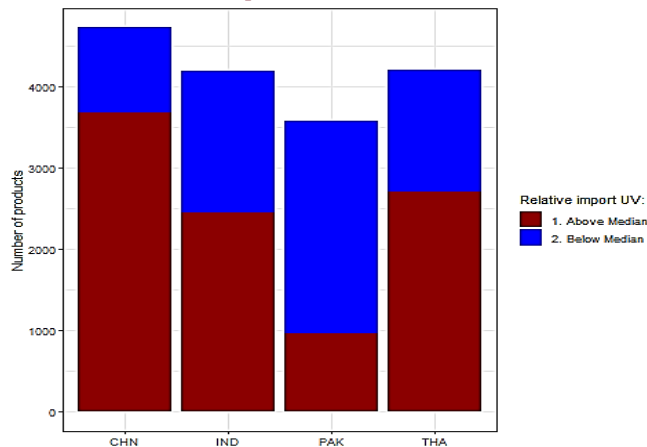
²⁶ NTMs for China, Pakistan and Thailand were extracted from through TRAINS Portal. However, the data on India was extracted from the ‘researcher file’, previously available on UNCTAD’s NTM Hub.

Analysis in this chapter is done based on bilateral import value and unit value (US Dollar/metric ton). The average weighted unit value, using import value as weights, is calculated for each commodity imported by a reporting country. The higher the average weighted unit value reported by an importing country, higher the quality of goods imported. The median is calculated across middle income countries, defined as lower middle income and upper middle income countries (see World Bank's classification). Pakistan, being a lower middle income country, may be consuming the variety of goods that is likely to be similar to the other middle income countries rather than high or low income countries. Products are also classified according to the level of import demand such that those reporting relatively higher levels of import value, in respect to the product ranked at the 50th percentile, are labelled as 'More Commonly Imported Products'.

Key Trends

Imports into Pakistan were \$65.5 billion in the first 10 months of FY22 and exports from Pakistan were \$26.2 billion. The trade deficit was \$39.2 billion. All three figures are at their highest level in the first 10 months of a fiscal year. This is likely to create significant balance-of-payment challenges. Export-related issues are commonly discussed and have been presented in the earlier versions of this report. It is crucial to discuss the import-related issues. Hence, this chapter focuses on import-related issues.

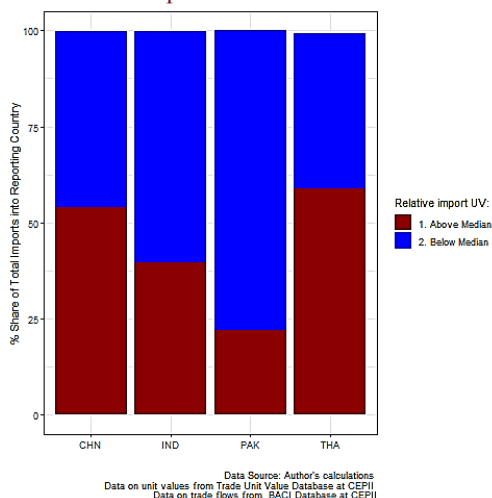
Figure 19: Number of Products Imported by the Reporting Countries Based on the Relative Import Unit Values



Data Source: Author's calculations.
Data on unit values from Trade Unit Value Database at CEPII
Data on trade flows from BACI Database at CEPII

In comparison to China, India and Thailand, Pakistan is more likely to import products that report unit values below the median value, relative to middle income countries, as presented in Figure 19. Approximately, 2.5 times the number of products imported by Pakistan report unit values below the median value than above the median value. On the other hand, approximately 3.5 times the products imported by China report unit values above the median value than below the median value.

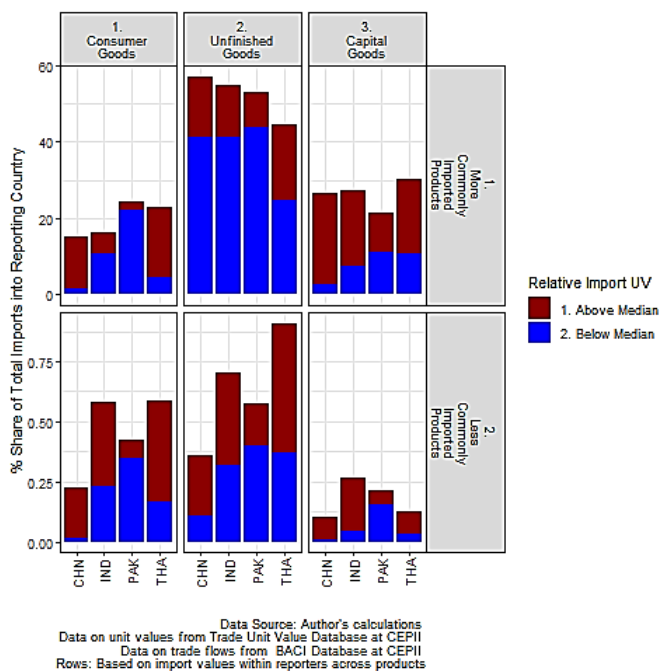
Figure 20: Percentage Share of Total Imports into the Import Country Based on the Relative Import Unit Values



The share in total imports of products according to the classification in terms of unit values is presented in Figure 20. Approximately 80% of Pakistan's imports are of products with relatively lower unit values, while the percentage is better distributed across the two classifications for the other countries. China and Thailand are more likely to import products at higher unit values than their lower income country counterparts, while Pakistan and India are more likely to import products with relatively lower unit values.

However, the large difference between the two bars for Pakistan suggests that its imports are more likely to be of lower quality in comparison to that of the other countries. This is the dilemma that should concern the policymakers as the import flow increases. Pakistani consumers are likely to demand imports of relatively poorer quality than the consumers in regional counterparts. The decomposition of imports into different product categories and the following discussion on the tariff structure and the lack of imposition of NTMs will help gauge the complexity of the import-related issues.

Figure 21: Percentage Share of Total Imports into the Reporting Country Based on the Relative Import Unit Values Distributed by Product Categories and the Product-Level Value of Imports

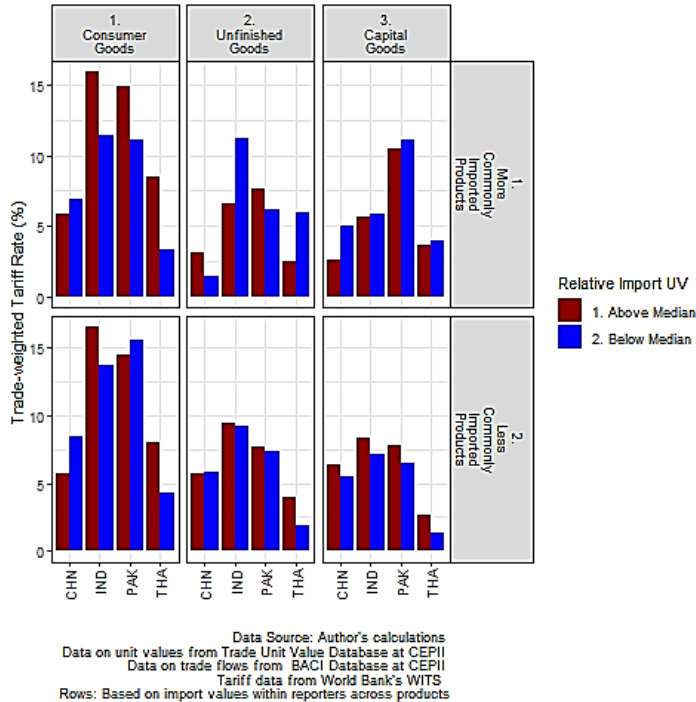


The share in total imports of products according to the classification in terms of unit values and distributed by aforementioned product categories and the level of importance of product in terms of import flow into the importing countries is presented in Figure 21. Liquified petroleum gas and liquified natural gas is classified as consumer goods, while crude oil is classified as unfinished goods. Capital goods commonly imported into Pakistan include mobile phone sets and photosensitive electrical apparatus. Unfinished goods constitute a large proportion of the value of imported goods into the country given their share in imports and the level of import value. As unfinished goods are likely to be used as inputs into production and further processed into consumer goods by the industries, it is likely that importers obtain the most competitive priced goods and transform these into manufactured goods.

This may not be true for consumer goods and capital goods, particularly if the importers have a preference for higher quality products. Interestingly, China, India and Thailand import a higher proportion of consumer and capital goods with relatively higher unit values than Pakistan suggesting that consumer goods imported into Pakistan are likely

to be of low quality. Pakistani producers are likely competing against low priced and low-quality imports. The following analysis will discuss the tariff rates imposed on different products imported by China, India, Pakistan and Thailand.

Figure 22: Import Tariff Rates Based on the Relative Import Unit Values Distributed by Product Categories and the Product-Level Value of Imports

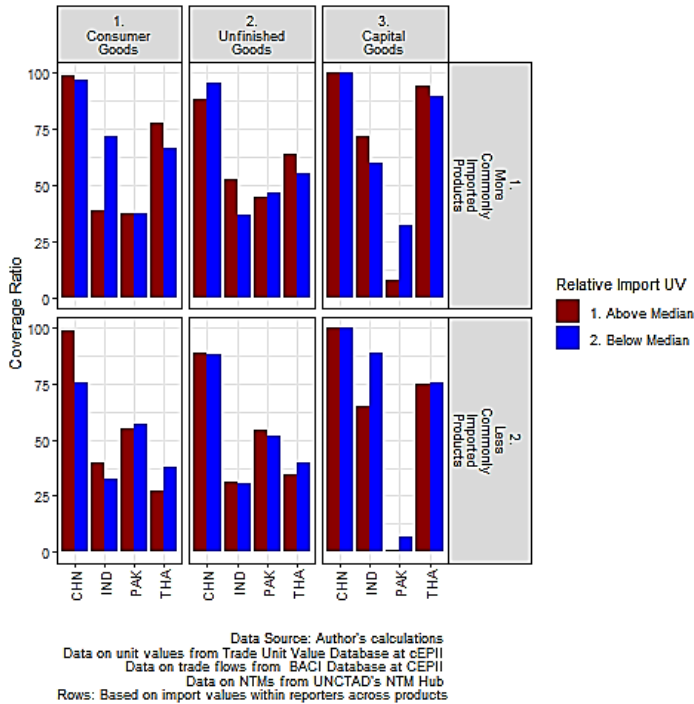


Pakistan and India have the highest tariff rates imposed on consumer goods as presented in Figure 22. Tariffs are likely to increase the price of low-quality goods imported into Pakistan. The cascading tariff rates, the difference in tariff rates between consumer goods and unfinished goods, is evident for Pakistan across both types of goods according to the relative import unit value. The cascading tariff rates may lead to an anti-export bias as explained by Varela et al (2020). India imposes higher tariffs on the imports of unfinished goods with relatively lower unit values, while imposing lower tariffs on unfinished goods of relatively higher quality.

Although, this could be to encourage imports of higher quality inputs, a greater discussion is out of scope for this study. Further, Pakistan imposes high tariff rates on the imports of capital goods, while the other three countries impose lower tariff rates. In

essence, Pakistan may not only be protecting its domestic producers from foreign competition by imposing higher tariff rates on consumer goods, but higher import tariffs on imports of capital goods may also deter new investments and suppress competition amongst domestic producers.

Figure 23: Coverage Ratio of Non-Tariff Measures (NTMs) Based on the Relative Import Unit Values Distributed by Product Categories and the Product-Level Value of Imports



The coverage ratio of technical NTMs is presented in Figure 23. Pakistan and India report the lowest levels, across the three product categories. The coverage of NTMs on the imports of capital goods into Pakistan is also relatively low. In essence, Pakistan relies mainly on tariff measures to limit imports and imposes NTMs with lower intensity relative to its regional counterparts. China imposes technical NTMs on the imports of almost all its goods, while India is likely to cover a larger proportion of its imports of low valued consumer goods with technical NTMs. In essence, the lack of technical NTMs imposed by Pakistan on its imports is disconcerting given the low valued goods, which is likely to be of poorer quality relative to the imports of regional counterparts. It is imperative to reconsider trade policies as regional counterparts shift from tariff measures towards non-tariff measures on imports.

Main Findings and Recommendations

- Pakistan mainly imports goods that have lower unit values relative to the imports flowing into other major regional counterparts. This suggests that imports into Pakistan are likely to be of lower quality, given that the comparison is across countries with similar range of development.
- Although, all regional counterparts import unfinished goods of lower unit value, the imports of consumer goods and capital goods into China, India and Thailand are more likely to be of higher unit value. Pakistan's consumer and capital goods imports reflect relatively lower unit values and are likely to be of poorer quality. Import competition from higher unit value goods, which are likely to be of higher quality, seems to be limited in the case of Pakistan.
- Pakistan and India impose higher tariff rates on consumer goods, which can lead to anti-export bias as the tariffs on unfinished goods are lower. However, Pakistan also imposes higher tariffs on the imports of capital goods, which can limit further investments in major industries. This can have a detrimental effect as it not only makes producers inward looking but also reduces the ability of new competitors and innovators to enter production.
- Pakistan seems to have a low rate of adoption of non-tariff measures (NTMs) on imports. Relatively lower unit values and the absence of NTMs means that Pakistan may be a dumping ground of low-quality imported goods.
- It is recommended that Pakistani policymakers gradually shift from tariff measures towards adopting technical NTMs that may not only raise the quality of imports into the country but also ensure that imports of dangerous and sub-standard goods remain prohibited. This process should start with consumer goods as that could help prevent consumption of substandard and dangerous goods, followed by imposing NTMs on unfinished goods and capital goods.

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7. Value Chain Development in Agriculture: The Livestock Sector

Heman Das Lohano, Junaid Alam Memon & Naveed Hayat

Introduction

Despite its declining share in the GDP, agriculture is still the economic mainstay for millions of Pakistanis, especially in rural areas and for females. As per the Labor Force Survey 2020-21, agriculture accounts for 37.4% of the total 67.25 million employed labor force in Pakistan. Total population of Pakistan is 222.4 million, of which 64% belong to rural areas. In rural areas, the employed labor force is 45.70 million, of which 52% are employed in the agriculture. Furthermore, 67.9% of 15.34 million employed females are engaged in the agriculture sector (GOP, 2021a). Pakistan's climatic conditions favor a huge diversity of agricultural produce, enabling the country to stand among the world's largest producers of milk, rice, wheat, cotton, sugarcane, mango, dates, and citrus (FAO 2022). The country has invested heavily in developing irrigation infrastructure with a cumulative capital cost tag of more than USD 300 billion since the 1950s (Young 2019). Through these supported investments though the sector at least keeps the majority of the country's workforce economically active and engaged, it has failed to keep pace with other economic sectors or pull substantial numbers of its rural population out of poverty trap (Liu et. al 2019).

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Within agriculture however, the sub-sectoral performance varies significantly. Pakistan's cropping sector, despite historically enjoying major subsidies in form of almost free surface irrigation (nominal rates), subsidized fertilizers, and support in seeds and pesticides, has remained the worst performer. During the past two decades, from 2000-01 to 2020-21, the average growth rate of agriculture sector real GDP was 2.5%. The sub-sectoral accounting shows that the average growth rate of crops subsector was only 1% while that of livestock, fishing and forestry was 3.7% (Lohano 2021).

Young 2019 analyzed the comparable cohorts of Pakistan and revealed that crop water productivity per m³ in Pakistan is one of the lowest and much smaller than countries such as Senegal, Sudan, Haiti, and Tanzania. On the contrary, the livestock, that has been largely neglected, reportedly constitutes 62% of Pakistan's agricultural GDP (GOP, 2022) besides acting as a hedge for rural poor who live in precarious areas and are exposed to various natural disasters including floods and pest attacks that frequently destroy their lives, livelihood, and property (Ullah 2022).

Agriculture sectors around the world have increased their output in monetary units by changing the product mix and moving towards high value products in response to quickly growing demands of a burgeoning urban middle class. Often the best way forward for the sector is to move from low value grains to high value products including fruits, vegetables, and livestock products that at the same time may also improve the quality of diet. This is often the growth path that is pushing farmers forward, especially in areas with good market access. Farmers can potentially increase their incomes by shifting from the staple to the high value crops. In a similar way, farmers can potentially produce more livestock products, dairy and meat especially, which have higher value and are increasingly demanded.

There is also a growing consensus that Pakistan's agriculture has a gigantic potential to claim sizable share from global agricultural value chains – tapping which require a major agricultural sector and rural transformations. A recent IFPRI working paper (Ali 2018) reveals that Pakistan exports its agricultural produce at throwaway prices and imports agricultural commodities closer or higher than the international commodity prices. On the other hand, just bringing the yields and quality of Pakistan's agricultural produce closer to the global averages may bring billions of USD export revenue (Ali 2018) and change the fate of millions who add their blood, sweat and tears in agricultural production functions in a hope of earning decent livelihoods.

High food import bill on account of commodities that Pakistan's agriculture sector may easily supply and overreliance on a few low value crops is an evidence that Pakistan's agriculture sector is not responding to market signals and explains substantial part of its

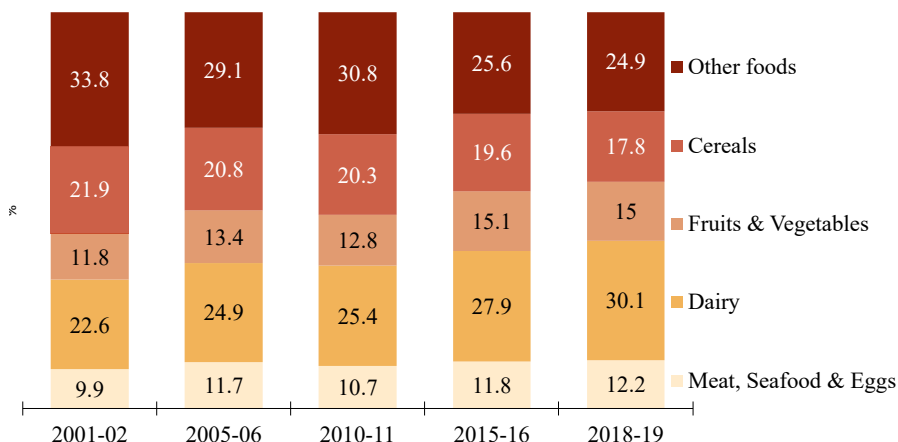
underperformance story. Fixing this failure on the other hand, may enable the sector to make its due economic contribution, improve the country's national food security, boost the country global trade in both volume and terms of trade, earn badly needed exchequer besides triggering the long-desired but still awaited rural transformation in Pakistan, and improve resilience to natural shocks and calamities (Nazir and Lohano 2022).

With this in hindsight, this chapter studies market trends in the livestock sector namely, meat and dairy products and highlights the problem in their supply chain to offer insights to help the country unlock the true potential of its agriculture sector. It is organized as follows: Section 2 depicts the trend in composition of household food expenditures in Pakistan and argues that the food basket of Pakistan is changing. The next section provides a detailed analysis of the market trends of high value livestock products. In the succeeding section, a glimpse of the food waste along the related supply chain nodes in Pakistan is provided to highlight the potential of improvement. Based on this, the final section makes a way forward for Pakistan's agricultural transformation.

Changing Food Basket in Pakistan

Figure 24 presents the share of consumption expenditure on livestock products and other food items in total food expenditure by households in Pakistan. In Pakistan the share of dairy products has increased from 22.6% to 30.1%, the share of meat, fish, seafood, and eggs has increased from about 10 to 12 percent, and the share of fruits and vegetables has increased from 11.8% to 15% between 2001-02 and 2018-19.

Figure 24: Trends in the Composition of Household Food Expenditures Per Capita (%)



Source: Authors' computations using data from HIES (GOP, various years)

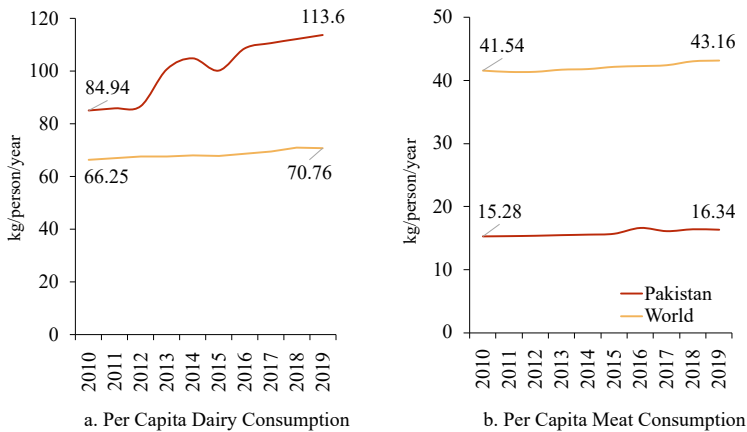
Overall, the share of these high value food products has increased from 44.3% to 57.3% while the share of cereals and other food items has decreased during this period. The data suggest that the pattern of food consumption has changed over time with a shift towards livestock and other high value food products. Overall income growth, growing middle class size, changes in consumer tastes and preferences, and urbanization may explain these changing food preferences in Pakistan.

Market Trends in Livestock Products

Per Capita Consumption of Livestock Products in Pakistan and the World

Figure 25a presents the trends in annual per capita consumption of dairy products from 2010 to 2019 and shows an increasing trend for Pakistan from 84.9 kg to 113.6 kg and the world from 66.3 to 70.8 kg. The gap between Pakistan and the world has increased over time. In 2019, per capita consumption of milk and milk products in Pakistan was 61% higher than that in the world.

Figure 25: Annual Per Capita Consumption of Livestock Products in Pakistan and the World

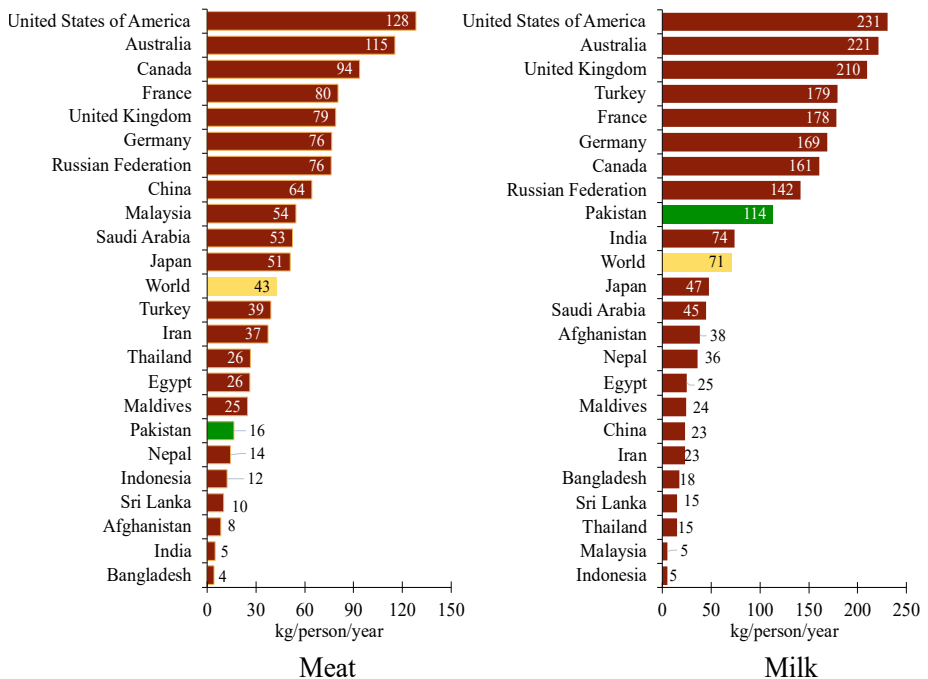


Source: Data from FAOSTAT (2022)

Figure 25b presents the trends in annual per capita consumption of meat in Pakistan and the World from 2010 to 2019. It has slightly increased from 15.3 to 16.3 kg in Pakistan while it has similarly increased from 41.5 to 43.2 kg in the world. The per capita consumption of meat in Pakistan has remained substantially lower than the world average. In 2019, per capita consumption of meat in the world was almost three (2.64) times higher than that in Pakistan.

Figure 26 puts Pakistan's meat and dairy product consumption in the larger picture to further reinforce the trends elaborated in the preceding paragraphs. Figure 26a presents the country's annual per capita consumption of meat, select countries, and the world in 2019. Data for these countries show that Pakistan ranks 147th in terms of per capita consumption of meat. Nevertheless, Pakistan stands better than many of its South Asian countries including India for which there may be cultural and religious reasons for low consumption of meat.

Figure 26: Annual Per Capita Consumption of Livestock Products in Pakistan, Selected Countries, and the World in 2019



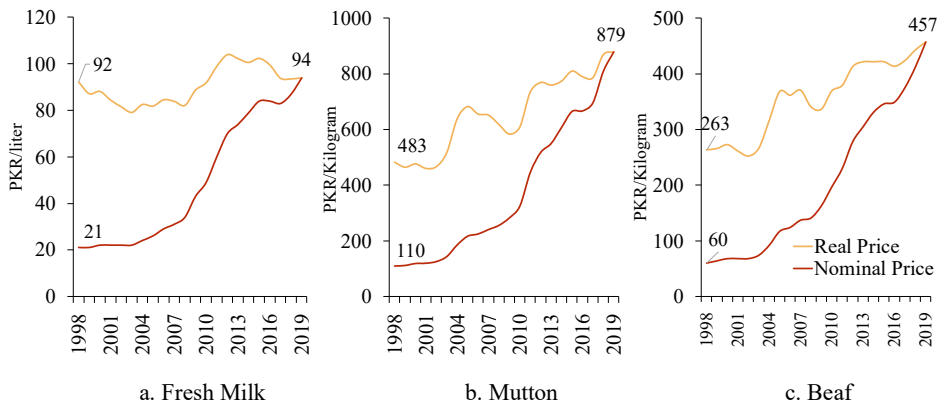
Source: Data from FAOSTAT (2022)

Similarly, Figure 26b presents the annual per capita consumption of milk and milk products in 2019 in Pakistan, the selected countries and the world. Data for these countries show that Pakistan ranks 54th in terms of per capita consumption of milk and milk products and stands higher than many of our neighboring countries and the world. One of the reasons for higher ranking of milk and dairy products in Pakistan may be the higher consumption of milk tea and sweets made from milk.

Trend in Retail Price of Livestock Products

Figure 27 present the retail prices of fresh milk, mutton, and beef, respectively, in Karachi from 1997-98 to 2018-19. The real prices have been computed after adjusting for inflation using CPI and computed in PKR value of 2018-19. Figure 27a shows that the real price of milk has slightly increased from PKR 92 to 94 per liter during this period and shows that the supply of fresh milk has almost kept pace with the growth in its demand in Karachi. As mentioned earlier, the demand may have been driven by burgeoning population, income growth and other factors.

Figure 27: Retail Price of Selected Livestock Products in Karachi (in 2018-19 PKR)



Source: Authors' Computations Using Data from Pakistan Statistical Yearbook and Pakistan Economic Survey (Various Years)

Figure 27b shows that the real price of mutton in Karachi has increased from PKR 483 to 879 per kg from 1997-98 to 2018-19 signifying an increase of 82% during this period and at 2.9% compound annual growth rate. These results show that the supply of mutton has not kept pace with the growth in demand for mutton in Karachi City. Figure 27c shows that the real price of beef has increased from PKR 263 to 457 per kg during this period corresponding to an increase of 74% during this period and at a 2.7% compound annual growth rate. These results show that the supply of beef has also not kept pace with the growth in demand for beef in Karachi.

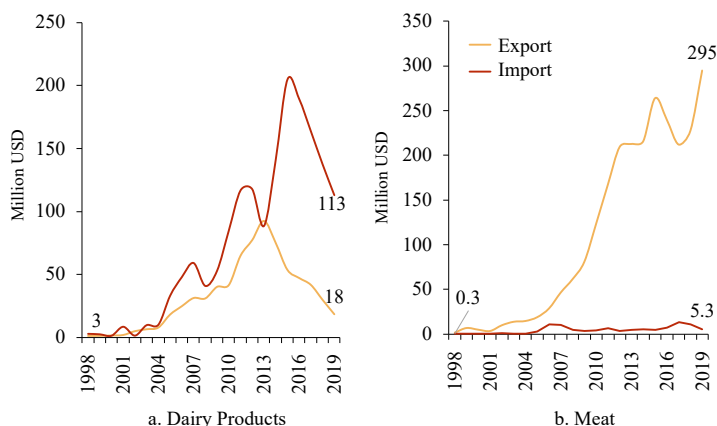
Trend in Exports and Imports of Livestock Products

Quite ironically and sadly, Pakistan is a net importer of dairy products despite its huge livestock population. Figure 28a presents the value of exports and imports of dairy

products for Pakistan from 1998 to 2019. During this period, the country's exports have increased from USD 1.0 to 18 million but could not keep pace with the imports which have increased massively from USD 2.7 to 113 million. Pakistan's net imports have grown at a compound annual growth rate of 21% during this period.

Pakistan mainly imports high value dairy products including dry milk and cheese, which are increasingly preferred by the local consumers, while Pakistan exports mainly different kinds of UHT milk valued at 18 million. Some 85% of value was earned from the milk that was exported to Afghanistan while the remaining 15% was from the exports to Tajikistan, UAE, USA, and other countries. This suggest how urgently Pakistan needs to diversify its dairy products and well dairy market outreach to the destinations where purchasing powers are higher.

Figure 28: Trend in Exports and Imports of Livestock Products in Pakistan (Million USD)



Source: Data from UN Comtrade (2022)

Figure 28b presents the value of exports and imports of meat in Pakistan from 1998 to 2019 and suggest that Pakistan is a net exporter of meat. During this period, the meat exports have increased manifold from USD 1.7 to 295 million. While the imports have also increased manifold (from USD 0.3 to 5.3 million), these remain meagre in terms of absolute value comparison with exports. The net exports of meat have grown at a compound annual growth rate of 29% during this period.

The export market of Pakistan however concentrates mostly on the gulf countries and (for some 8%) on Vietnam. Such look into the destination of Pakistan's meat and dairy exports suggests that targeting countries where purchasing power are higher, the country may fetch better prices for its agricultural products and improve its balance of payment.

Supply Chain Losses of Livestock Products

While preceding sections highlighted the demand side of different livestock products and prices, the purpose of this section is to highlight the issue of losses along the supply chain of important livestock products that is one of the important supply side issues. Table 15 illustrates the losses occurring at different nodes of food supply chains of three products namely Meat, Milk and Eggs. While losses occur throughout the supply chain, identifying the most important nodes may help target the policy efforts. In case of meat, the production losses account for almost half of the losses whereas losses occurring during processing stage account for more than one-third of available edible meat. Similarly, most important nodes in the Milk supply chain occur at post-harvest and handling stage and during wholesale stage.

Table 15: Supply Chain Losses in the Livestock and Poultry

Detail of Losses	Meat	Milk	Eggs
Production Losses	6.50%	2.69%	2.09%
Post-Production H&S Losses	0.74%	5.20%	0.00%
Processing Losses	4.48%	1.47%	0.25%
Wholesale Losses	0.46%	6.05%	0.86%
Retail Losses	0.14%	2.56%	1.72%
Total Losses	12.32%	17.97%	4.92%
Production (millions tonnes)	3.66	44.29	0.81
Quantity Lost (million tonnes)	0.45	7.96	0.04

Source: Calculated Based on Memon and Kanwal 2021

It is also important to note that the losses shown in Table 1 account for the quantity losses and provide no indication of the quality losses. Memon and Kanwal (2021) have shown how improvements in poultry farming²⁷ and other supporting technologies²⁸ have brought substantial reductions in the poultry losses occurring on account of bird mortality and spoilage of eggs. Controlling these losses can save economic and environmental resources used to produce these commodities. Controlling these losses require targeted policy efforts within and outside the value chain such as rural infrastructure that support these activities (Memon and Bilali 2017).

Conclusions and Way Forward

Despite policy dedication to support, Pakistan's agriculture sector has been underperforming largely because of its overreliance on a few low value crops and the

²⁷ Such as controlled environment sheds, improved road infrastructure, and adaptation of better packaging

²⁸ Such as tubeless tires in commodity transportation vehicles.

sector's inability to respond to the market signals. As a result, though the sector provides underpaid employment to millions, it could neither keep pace with the growth of other sectors nor has been making satisfactory contributions to strategic objectives such as the national food security and poverty eradication.

More importantly, the sector is unable to meet the demand for even those high value food items that it can easily supply. Production systems are still traditional, farmers are producing without paying any heed to buyers' demand and preferences. As a result, the sector fails to contribute to rural development and help the country to maintain its international trade balance.

Agriculture is not realizing its full potential and requires major transformations in agricultural supply and value chains. In this connection, the chapter has focused on the livestock subsector and has shown that demand for high value products including milk and dairy products, meat, fish, seafood, eggs, fruits, and vegetables is on steady rise in Pakistan. Household food expenditures on these products have increased from 44% to 57% during 2001-02 to 2018-19 primarily due to overall income growth, growing middle class, changes in consumers' tastes and preferences and urbanization in Pakistan.

The country needs investments in developing and improving agricultural value chains for quality, quantity, and loss reduction. This is essential not only to link the production to regular rise in consumer demand and enable farmers and other actors in the agricultural value chains to take advantage of new opportunities in the domestic and export markets but also to earn sizable additional foreign exchange and improve overall quality of diet and state of food security and other social objectives such as poverty eradication.

Also Pakistan needs to invest in value addition. Rural-based processing is largely rudimentary and limited to sugar, rice-milling, and cotton ginning, while value addition facilities for high value agricultural produce, such as milk, the processing facilities are largely absent. Most fruits and vegetables, as well as a large portion of grains and oilseeds are traded in the wholesale agricultural markets. There are also several restrictive and non-transparent marketing arrangements which create large gaps between prices paid at retail outlets and what farmers receive. Lack of storage and processing facilities, along with opaque market practices cause massive fluctuations in prices (GOS, 2018). Improving the value chain of high value and water thrifty crops will create a market for these products and will also reduce the price risks of the engaged farmers.

Much of the enabling environment in Pakistan has focused on the production and supply side of the agriculture sector. Pakistan needs to pay more attention to the market demand for the attributes of products, especially those having high market value. It is therefore

very important to understand and prioritize sectors, subsectors and activities where substantial demand exists, where there is possibility of substantial gain from resource use optimization and where there is significant export potential.

It is important to understand where the leaks in supply and value chain exist, work on the ways to remove key obstacles and hindrances in the development, integration and working of efficient agricultural markets. Farmers are generally risk averse and are cultivating traditional crops in face of extremely unreliable water supplies and find safety in low value and high delta crops. Providing them some sort of affordable insurance may give them confidence to take risks associated with high value crops and activities and thereby make positive contribution to their own livelihood and to the economy.

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8. The Business Confidence Index

Aadil Nakhoda & Qazi Masood Ahmed

Introduction

Policymakers commonly use the Business Confidence Surveys, which provide important input on business activities, as crucial information on the conditions prevailing in the economy. The Business Confidence Survey (BCS) is conducted by the State Bank of Pakistan (SBP) in collaboration with the Institute of Business Administration (IBA), Karachi. It is a bi-monthly telephonic survey conducted in the even numbered months of the calendar year. The survey includes firms belonging to the manufacturing, construction, financial services, retail and wholesale and services sectors across Pakistan.

Approximately 400 to 500 firms are surveyed in every wave. These businesses share their perceptions on the current and expected (in the next six months) performance of the economy via several different indicators. Although, all indicators provide critical information to policymakers, this study will focus on those related to the business environment, employment and the purchasing manager's index. The detail is available at State Bank's website on the Business Confidence Survey²⁹. The trend in the indicators provided in the BCS are compared to those of major indicators on economic activity that are easily available, namely large-scale manufacturing index and exporting activities.

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²⁹ The website can be accessed through the following url: <https://www.sbp.org.pk/research/BCS.asp>

Methodology

The results of the Business Confidence Survey are reported in the form of a diffusion index. This index is calculated based on the answers received on each indicator. The responses are collected on the basis of five options scale, ranging from 'very positive' to 'very negative'. The diffusion index can fall between 0 and 100, with 50 indicating a neutral perception, greater than 50 indicating a positive perception and less than 50 indicating a negative perception. The sample of firms was extracted from the business registry provided by the Securities and Exchange Commission of Pakistan (SECP). Firms with the highest paid up capital within selected sectors were selected for BCS data collection.

Main Results

The diffusion index for major indicators are presented in the following figures. These include the Business Confidence Index, Employment index and the Purchasing Manager's Index. In order to obtain a better understanding of the current and expected economic and business conditions, the current business and expected confidence indices and the current and expected employment indices are also analyzed. If the perceptions on the economy hold and are a good predictor of the actual conditions, the trend in the business confidence index should follow the trend in indicators that account for the actual level of production. Large-scale manufacturing index and the exporting activities are likely to show similar trends as the business confidence index.

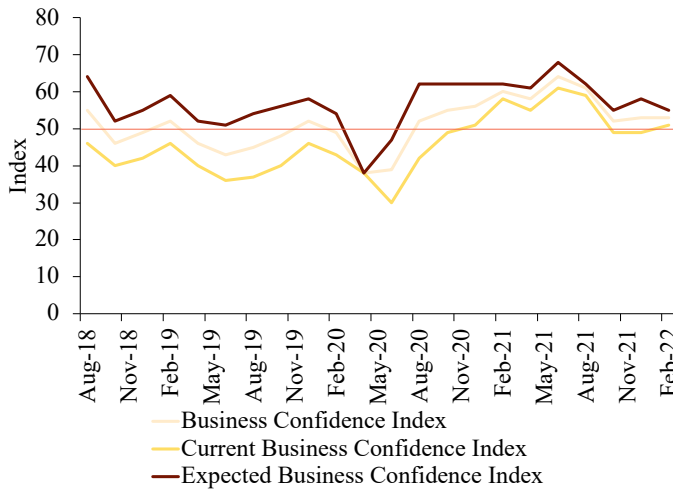
The following analysis shows that the business confidence index as determined in the SBP-IBA Business Confidence Survey follows a similar trend to the large-scale manufacturing index and the level of exports from Pakistan. The data on the quantum index of large-scale manufacturing (base year 2005-06) and on total exports from Pakistan is borrowed from Pakistan Bureau of Statistics (PBS). The period considered is August 2018, when the previous PTI-led government was formed, to February 2022³⁰.

The business confidence index (BCI), which is the average of the current business confidence index (CBCI) and the expected business confidence index (EBCI), was in the positive zone (above 50) in August 2018. It however fell into the negative zone in the

³⁰ It is not the purpose of this exercise to econometrically prove the validity of the business confidence index. The main purpose is to present the business confidence index and report on its trend along with that of major indicators on economic activity.

next wave, recovered for a brief period in February 2019 and then receded back into the negative zone. The trough reported in June 2019 coincides with the approval of the IMF's US\$ 6 billion 39-Month Extended Fund Facility program. The recovery continued till February 2020 as the BCI entered back into the positive zone. This too was short-lived as the pandemic hit the Pakistani economy, plummeting the BCI into the negative zone.

Figure 29: The Trend in Business Confidence Index

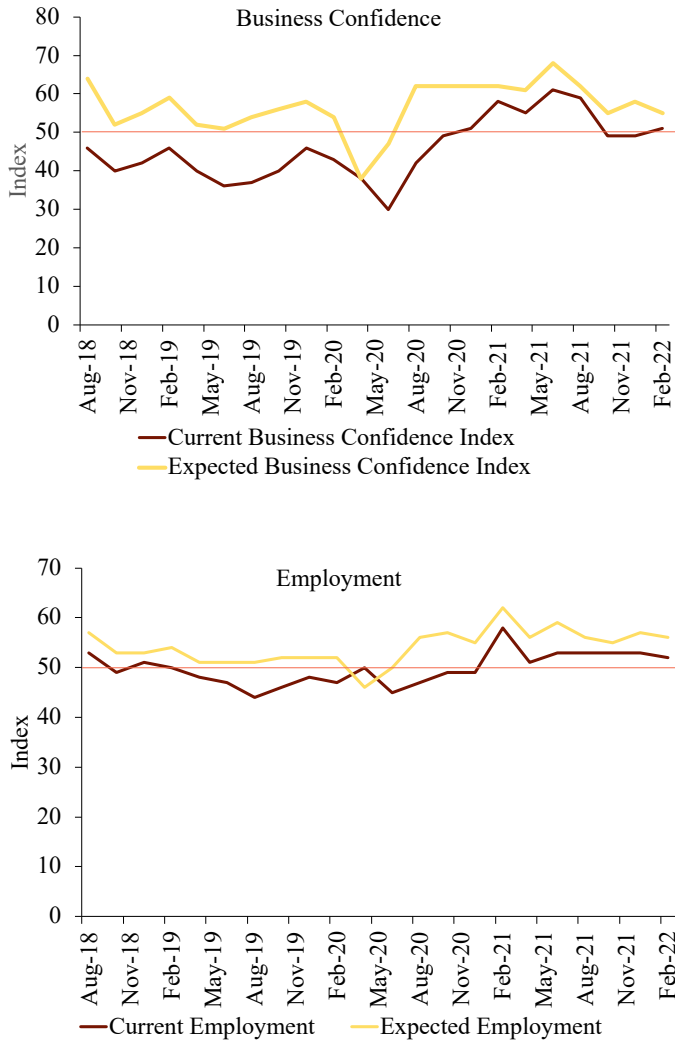


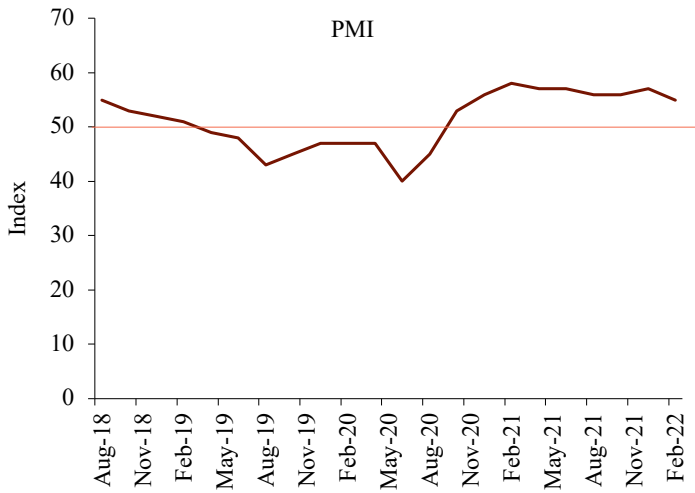
As the government was able to control the spread of the pandemic and mitigate the consequences of the strict lockdown that eroded economic activity but lasted only for a few weeks, the BCI indicator reported a sharp recovery after the lockdown was lifted. This suggested improved confidence of the business community in the economic conditions. It entered into the positive zone in August 2020 and continued to mostly increase till June 2021. It started a downward trend at the start of fiscal year 2022. Several of the COVID-19 related schemes to encourage business investment had been withdrawn by mid-2021.

Further, as noted in the Monetary Policy Statement release in September 2021, the SBP had shifted towards policies that sustain growth rather than enhance it, keep inflation expectations from rising and consequently decrease the pressure on the current account. The most interesting aspect has been the expected business confidence index, which has remained in the positive zone much throughout the 2½ years. On the other hand, the

current business confidence index, which has remained in the negative zone between August 2018 and December 2020 was now mainly in the positive zone as well. This clearly indicates that the perception of the business community on the economy, although had declined in the previous months, remained positive.

Figure 30: The Trend in Selected Indicators from the SBP-IBA Business Confidence Survey



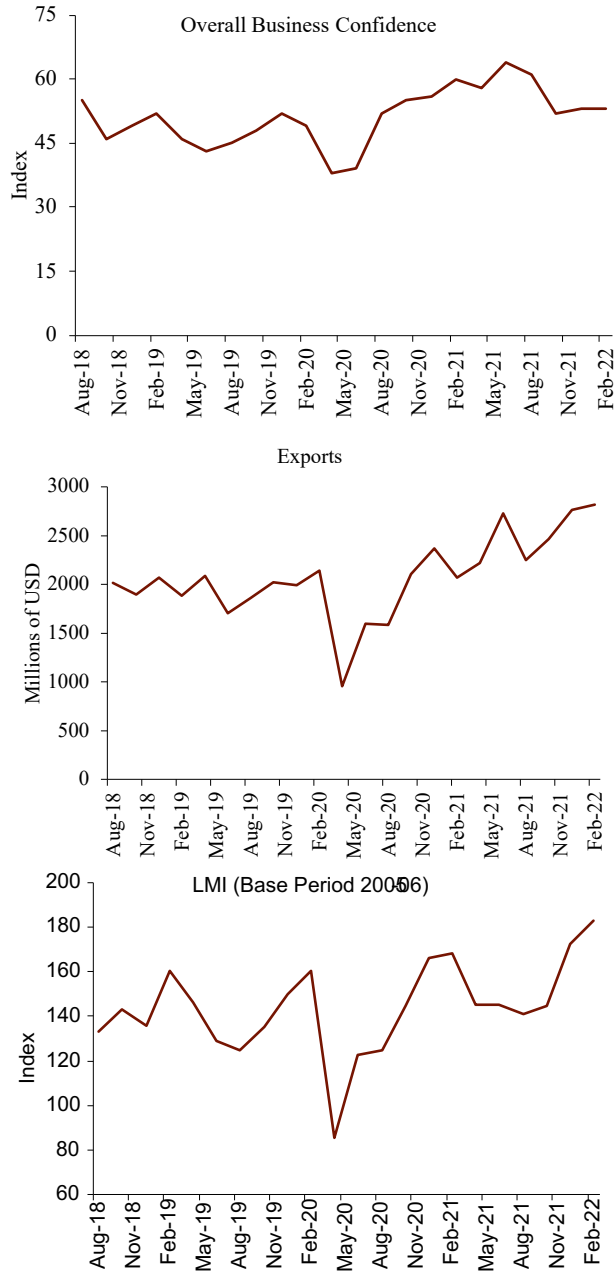


The three selected indicators from the survey are reported in Figure 30. It is clear that expected levels, both for the business confidence and employment, have remained in the positive zone much throughout the 3½ years. The only time it plummeted into the negative zone was during the first two waves conducted in the pandemic-era, when Pakistan imposed a strict lockdown. The business confidence index did decline into the negative zone in October 2021 and December 2022, it was albeit not by much. It had recovered into the positive zone in February 2022.

The trend in the business confidence index is presented in relation to the trends in exporting activities and LMI in Figure 31. All three indicators reported a trough in the summer months of 2019 as the confidence of the business community declined. The agreement with the IMF reversed the declining trend and the economic indicators showed an improvement till February 2020. As the pandemic hit Pakistan, there was a sharp decline in the three indicators as expected. The LMI fell below 100 in April 2020, first time since July 2016.

However, with the recovery, the LMI indicator has breached levels never observed since July 2016. The growth tapered off post February 2021 as the index returned to pre-pandemic levels. However, it has started an upward trend in the last quarter of 2021, with the index again reporting its highest level since July 2016. It is important to note that the index is calculated using 2005-2006 base year. The level in February 2021 was at 168.5 and the level in February 2022 was at 182.7.

Figure 31: The Trend of Business Confidence Index in Relation to Exports and LMI



The same trend can be seen for the exports from Pakistan. Exports plummeted to below \$1 billion in April 2020 at the onset of the pandemic. The exports have now recovered to their highest levels. Pakistan has been consistently reporting exports of \$2 billion per month for the past several months. In February 2022, it had surpassed \$2.8 billion. In essence, the business confidence index does well overall in following the trend of LMI and of exporting activities in Pakistan. The trend in business confidence was similar to the trend in LMI and exports during the COVID-19 slump and the subsequent recovery phase. It is imperative that policymakers closely analyze the business confidence index in order to ensure that the right mix of economic policies are adopted.

Conclusions

The business confidence index remained in the negative zone for most of the period between August 2018 to August 2020. However, since August 2020 after the stimulus packages offered to counter the challenges due to COVID-19 began to take effect, it has mainly remained in the positive zone. The expected business confidence index has always performed more positively than the current business confidence index. Other than the business confidence index, the employment index and the purchaser's manager index have also both been in the positive zone since late 2020. The business community was positive on their hirings and their purchases, suggesting good business prospects in the economy. The conditions remained so till early 2022, the last reported wave.

The large-scale manufacturing index and the exporting activities from Pakistan were also showing an upward trend, particularly in late 2021. This correlation highlights that the business confidence index does well in explaining the economic trend in Pakistan. The Business Confidence Index published by the State Bank of Pakistan in collaboration with Institute of Business Administration, Karachi is an excellent tool for economists, policymakers and analysts as it does well to determine the prevailing economic conditions.

9. The Undocumented Sector of Pakistan: Benefit or Burden in the Face of Natural Disasters?

Arooj Waheed Dar

Introduction

In recent times, the world has witnessed a plethora of unanticipated events³¹ that have disrupted the traditional workings of economies. The most significant of these events was COVID-19 that left economies around the world struggling for rejuvenation. Such occurrences tend to adversely hit economies by causing widespread unemployment, incapacitating daily wagers the most. However, during the course of pandemic recovery, Pakistan exhibited remarkable resilience as the Labor Force Survey (LFS) data show that the unemployment rate stood at 6.9% in 2018-19, and at 6.3% in 2020-21.

According to *The Economist*, Pakistan ranked 1st on the global normalcy index in November 2020 (The News International, 2021) and ranked 2nd in January 2021 (Rohmetra 2022). Another matter of grave concern lately has been climate change which is threatening South Asian economies more adversely than others (Roome 2022). Pakistan has witnessed a dramatic increase in climatic disasters over the last few years including locust attacks, droughts, floods, heat waves, etc.

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³¹ Including COVID-19, climatic disasters, Russian-Ukrainian war, and so on.

Natural disasters, including pandemics, have the tendency of impacting the most vulnerable segments of societies most severely. In case of Pakistan, the segment most susceptible to economic hardships is the one that is employed in the informal sector. Their vulnerabilities are due to the absence of job security, income stability, medical insurance, and other non-wage benefits. The proportion of informal sector of Pakistan has remained consistently above 70% of total employment for over a decade³². The undocumented sector of any economy is generally associated with lost tax revenues, unfair competition, low productivity, labor rights abuses, and environmental degradation. However, one cannot overlook the potential for innovation, entrepreneurship, flexibility, and resilience that characterizes this very sector³³.

The analysis presented in this chapter focuses on the impact of recent natural events on employment, particularly in the informal sector of Pakistan, by comparing employment levels during 2018-19 and 2020-21. I shall see if formal and informal employment has grown over time, shrunk, or remained stagnant, analyze the impact of these events on marginalized groups of the economy and probe the potential causes of the changes, if any, and see how government policies have attempted to mitigate the negative effects.

Pakistan's Informal Sector & COVID-19: A Story of Remarkable Resilience

The informal sector is generally characterized by lack of proper documentation, lack of registered employees, lack of coverage by social security system, and lack of contractual employment³⁴. Pakistan's economy is predominantly comprised of the informal sector which remains largely undocumented and is generally perceived as problematic as it results in inaccurate estimation of GDP, meagre tax collection, lack of data to provide targeted subsidies, etc. However, having a large informal sector provides economies the margin to absorb large-scale disruptions, such as those caused by recent natural disasters (Ndouna FK, Nanfosso RT, Biloa Essimi JA, Ambassa L-F, 2021) or COVID-19. While employment can go down in the short run, the informal nature of enterprises gives employers the allowance to adapt to changing circumstances and re-hire workers as and when the economy starts to recover.

³² <https://www.ilo.org/islamabad/areasofwork/informal-economy/lang--en/index.htm>

³³ <https://www.iied.org/informal-economy-sustainable-development>

³⁴ <https://ilostat.ilo.org/resources/concepts-and-definitions/description-informality/>

In this chapter, I shall try to determine if the informality of the labor market acted as a burden or benefit during the pandemic. We shall further see if the resilience, or the V-shaped recovery³⁵, demonstrated by Pakistan's economy in terms of employment can be attributed to the flexibility granted by the informal sector.

Initial reports on the impact of COVID-19 on employment suggest that the informal sector was at the frontlines of the economic crisis and the daily wagers were the first ones to be let go from work, losing access to incomes (Bokhari J., 2020). LFS 2020-21 shows that out of all the individuals that lost access to work during the time of survey, 54.1% individuals were unable to work due to COVID-19. The pandemic also accounted for 18.5% of underemployment during 2020-21.

It is important to note, however, that 56.8% of all persons that were unable to work at the time of the survey reported that they would return to work once COVID-19 restrictions were lifted. To see if this impact was, in fact, short-lived, I delved deeper into the numbers. As the pandemic was expected to hurt informal and marginalized workers the most, I specifically looked at changes in employment numbers for these two sectors.

For this analysis, informal employment is defined as persons employed who:

1. are working without a contract or working on a contract less than 1 year.
2. are working on daily wages.
3. are employed by a firm that does not keep written accounts (for non-agricultural, non-fishing, and non-forestry sectors).
4. are not working in a formal working place such as an office, shop, business, or industry.

If an employed person meets any or more of the above criteria, they are classified as belonging to the informal sector.

Using the Labor Force Survey, I estimated that the informal sector stood at 86.3% in 2018-19, and at 86.8% in 2020-21. Using account-keeping as proxy for formal employment, I estimate that informal employment in non-primary sectors³⁶ fell from 70% in 2018-19 to 66.7% in 2020-21. Overall, informal employment has increased across every dimension. Between 2018-19 and 2020-21, the proportion of daily wagers has increased from 7.3% to 8.8%; the proportion of people employed without a contract or on temporary basis has increased from 28.2% to 32.3%; and the percentage of persons working from an informal workplace has increased from 62.2% to 64.6% respectively.

³⁵ Pakistan Economic Survey 2020-21.

³⁶ By non-primary sectors, we refer to non-agricultural, non-fishing, and non-forestry sectors.

This shows that regardless of the criteria used, the proportion of informal employment as compared to formal employment has increased overall. If total informal employment has increased, the fall in informal employment in non-primary sectors suggests that informal employment in agriculture, fishing, and forestry has risen over the last few years. Given that the total unemployment rate for Pakistan also fell during this time, these numbers present a story of remarkable resilience and perseverance. Not only were lost jobs recovered, but new jobs were created during this period as well.

In April 2022, it was reported that the government created over 5.5 million jobs over the last three years through policy intervention (The Nation, 2022). Most of these new jobs were created in the textile and construction industry (Khan 2022), which potentially explains the increase in formal employment in non-primary sectors. Furthermore, measures were taken by the then government to attempt to formalize micro-, small-, and medium-enterprises by incentivizing them to register. According to the new SME policy, it was promised that banks will provide collateral-free loans of Rs10 million each to 30,000 new SMEs at a concessional interest rate of 9% with hassle-free registration. (Aazim 2021).

We classify an individual as marginalized in Pakistan if they:

1. Are non-male
2. Have migrated recently (up to 3 years)
3. are differently abled
4. belong to indigenous groups. For our analysis, we take difficulty or inability to communicate due to language barrier as proxy for belonging to indigenous groups.

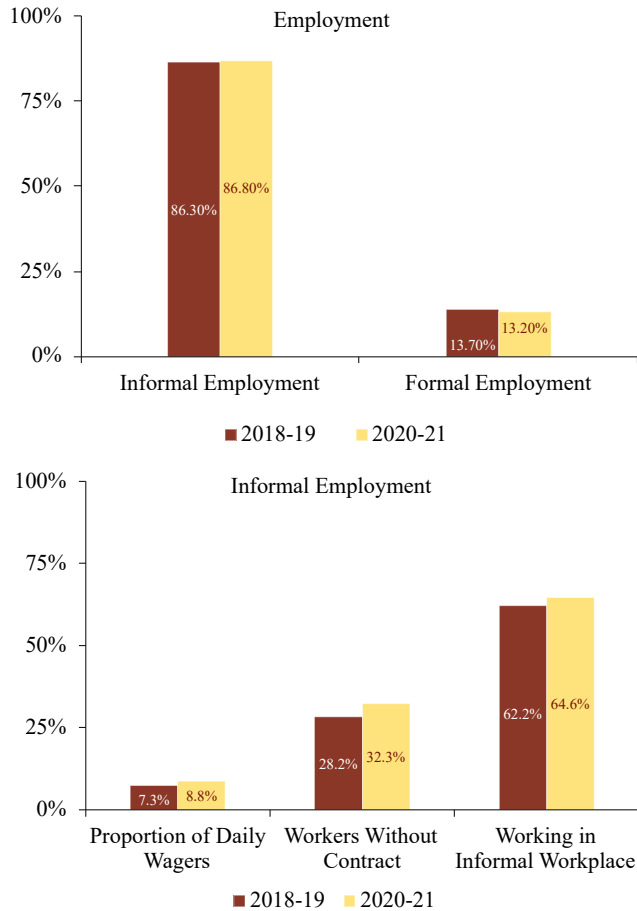
According to these criteria, in 2020-21, 30.5% of informal employment was accounted for by marginalized groups.

However, to compare with 2018-19, due to non-availability of data, we limited our criteria for marginalized groups to the following:

1. Are non-male
2. Have migrated recently (up to 3 years)

While COVID-19 was expected to have disastrous impacts on the informal sector, we notice that there have not been any structural changes in the informal workforce. In 2019-20, agriculture and small-scale industries in the informal sector reported growth as opposed to the formal sector, which was faced with contraction in their revenues (Bokhari 2020). Due to job and income insecurity, informal workers in developing countries have adopted strategies as a coping mechanism whereby they acquire a multitude of skills so they can switch jobs when needed. There are also evidences that households distribute members in different jobs to diversify risk (Gautam et.al 2016).

Figure 32: Employment Status 2018-19 & 2020-21



Furthermore, small, informal businesses have little capital and minimal fixed costs which allow them to switch the nature or scope of their activity depending upon economic circumstances. With the onset of COVID-19 and the resultant lockdowns, many individuals in the informal sector resorted to these strategies to minimize their losses, often violating laws (Morales 2020). The adaptability and resilience of different sectors is difficult to measure due to its subjectivity. However, it plays an important role in explaining the regional variations in economic performance observed post-crises, COVID-19 in the current scenario (Martin 2016). Further research is needed to determine if the informal sector was key in cushioning the effect of this economic upheaval due to the flexibility it offers.

Informal Sector and Inclusivity During COVID-19

In most economies, the informal sector is dominated by marginalized communities as these are the ones who are often ignored by governments as often these are too much focused on formal sector. To estimate the impact of the pandemic on marginalized communities in Pakistan, I estimated the proportion of informal employment is accounted for by marginalized labor before and after pandemic and found that they accounted for 26.5% of total informal employment in 2018-19, and for 25.6% 2020-21.

Overall, female unemployment has decreased from 10% in 2018-19 to 8.9% in 2020-21. Despite this, female employment as a proportion of total employment has barely risen from 22.2% in 2018-19 to 22.5% in 2020-21, hinting toward significant gender disparity along the 'Economic Participation' dimension. Females remain majorly over-represented in the informal sector with 94% of all employed women engaged in the informal sector. This proportion has persisted at this formidable level over the last few years. Of the 20 million home-based workers employed in the informal sector, 12 million are female with no legal protection (Pasha 2022).

Despite increases in total female employment, the constant rate of female employment in the informal sector implies that female representation in the formal sector has improved. This can be attributed to the special feature of the new SME policy which provides 25% tax rebate to female-led SMEs in addition to all the other facilities pledged under the policy (Aazim 2021). Furthermore, the rapid digitalization that was inadvertently facilitated by the lockdowns during the pandemic had resulted in a more inclusive environment. Females that were previously incapacitated in their ability to access work due to immobility are no longer constrained as hybrid and work from home (WFH) models provide them the flexibility and a way to bypass these constraints.

Climate Change and Informal Sector

Climate change is one of the most pressing issues faced by economies around the world today. Natural disasters occurring frequently and disrupting life presents itself as a major challenge across South Asia. Global indices suggest that Pakistan ranks amongst the top ten countries most vulnerable to climate change (Anadolu Agency, 2022). Recently, the country has faced an unprecedented number of natural disasters ranging from rising temperatures and heatwaves, floods, droughts, melting glaciers, changing rainfall and snowfall patterns, wildfires, landslides, to locust and other pest attacks. Amongst other

issues, these climatic disasters are contributing to major problems for the informal labor force. Given the eclectic nature of climatic disasters that have impacted Pakistan recently, informal employment in a broad array of sectors has been suffering consequently including agriculture, livestock farming, etc. (Anadolu Agency, 2022).

Pakistan has witnessed a spike in the number of floods and flash floods over the last few years. In August 2020, torrential rains in Karachi led to widescale disruption as thousands of properties, including workplaces, were uprooted (The Guardian, 2020), impacting nearly 2.4 million individuals (CFE-DM, 2021). LFS 2020-21 shows that bad weather conditions account for 3.45% of underemployment in Pakistan. Also, at the time of the survey, out of all the persons that had lost access to work, 1.3% individuals were unable to work due to bad weather conditions. Recent floods that have uprooted more than one-third of Pakistan (a once in a 100-year event) are expected to increase these figures manifold. The full impact is not known to date.

Extreme weather events, resulting in loss of income and livelihoods and reduction of opportunities, can fuel labor migration as an adaptation strategy (ILO, 2017). Drought-like conditions, which began in late 2018 and continued through 2019, affected nearly five million people in Pakistan (CFE-DM, 2021). Moreover, melting glaciers and shifting monsoon season resulted in irregular access to water, damaging agricultural output on most farmlands and forcing cultivators to migrate to areas with favorable conditions (Anadolu Agency, 2022).

Millions of people involved in livestock farming in the mountainous regions of Pakistan also had to bear the brunt of climate change as pastures were destroyed, forcing farmers to relocate (Anadolu Agency, 2022). LFS 2020-21 shows that natural disasters account for approximately 0.3% of migrations during 2020-21. It is interesting to note that for the first time, natural disasters have emerged as a notable reason for migration of workers in the LFS 2020-21. Unregulated migration stands the danger of exposing workers to forced labor and other forms of exploitation, especially in the informal sector which is prone to precarious working conditions and labor rights violations (ILO, 2017). Between 2018-2019 and 2020-21, the number of injuries at work due to improper ventilation has increased by 130%. Most of these injuries were sustained in the informal sector as most employers fail to provide or do not feel responsible to provide safe and adequate working conditions to their workers³⁷. With soaring temperatures each year (Anadolu Agency, 2022), this number is bound to increase exponentially.

³⁷ <https://www.ilo.org/islamabad/areasofwork/informal-economy/lang--en/index.htm>

Rising temperatures not only create unfavorable working conditions, but also reduce productivity significantly as heat stress reduces the ability of workers to perform tasks during the hottest hours (ILO, 2019). Despite having policies such as ‘The Punjab Labor Policy 2018’ which promises implementation of labor standards, improvements in workplace safety, and excellence in labor inspections regime³⁸, conditions remain inadequate as there is a serious lack of follow through.

This paints a picture of despondency as the threat to the informal economy from climate change looms larger than ever before. But how do we protect a sector from a disaster it itself contributed to? Research shows that the informal sector is a major contributor to climate change. In recent years, noticeable deterioration in air quality in most parts of Pakistan can be linked to climate change which is being created by informal sector. Growing amounts of CO₂ emissions and greenhouse gas emissions (GHGs) are being created by informal workers (Abid 2015) as a result of seasonal crop burning (Ali 2021). Moreover, the informal economy is most often dependent upon natural resources for their livelihood. As environmental regulations largely apply to formal sectors only where too their implementation is a matter of serious debate and concern, the informal sector continues to exploit natural resources with impunity, contributing to climate change without any formal check³⁹.

The only note-worthy project initiated by PTI during its tenure to counter climate change was the “Ten Billion Tree Tsunami” (Sadaqat 2021) under which PTI vowed to plant ten billion trees across Pakistan. Even if we set aside biodiversity concerns and consider the project as an effective tool to combat climate change in the long run, some immediate measures need to be taken to curb the negative effects on the environment by informal workers. Given that climatic disasters are only expected to intensify in coming years, the government must take steps to regulate the informal economy to slow down the process of climate change.

Policy Recommendations

There has been much debate about the general benefits and burdens of the informal economy. The most crucial is the humanitarian aspect of the debate which focuses on the exploitation of workers by informal employers that fail to provide adequate working

³⁸ <https://www.ilo.org/islamabad/areasofwork/informal-economy/lang--en/index.htm>

³⁹ https://www.c40knowledgehub.org/s/article/How-to-support-informal-workers-and-economies-in-a-green-and-just-recovery?language=en_US.

conditions. However, to date, the focus of the government has primarily been on regularizing the informal sector to bring more people and businesses into the tax net (Bokhari 2020), which is perhaps the reason why most individuals are hesitant to register their businesses. Therefore, to effectively formalize the economy, the government needs to shift its focus on creating opportunities for innovation and entrepreneurship.

With a significant youth bulge to capitalize on, there is a huge margin for starting new ventures abuzz with innovation. The government should try to create incentives for businesses by promising them support rather than giving them a taxing feel, thereby encouraging them to create solutions for the very problems potentially created by the informal economy. The focus should be on inclusive development by creating equal opportunities for all and raising the overall living standard for workers. In this regard, the new SME policy is a step in the right direction.

During its tenure, PTI made vigorous attempts to formalize the economy, raising the number of registered taxpayers to a record 2.7 million. However, tax collection remained meagre as there was much resistance from groups that did not want to be dragged into the tax net (Bokhari 2020). There is genuine lack of trust toward the government fueled by allegations of corruption, red-tapism, and mismanagement. The general perception is that the government merely wants a piece of the pie.

Formalization of the economy should be aimed at furthering sustainable development goals by furthering labor rights, environmental protection laws, and inclusivity. In order to achieve the desired results and to ensure significant increases in formal employment, further measures are needed to ease the process of registration and to make sure these reforms are made more public (Aazim 2021).

The government recognizes that the Technical and Vocational Education and Training (TVET) program is crucial for technology-driven, skill-based economic development, which is why it has developed training centers across Pakistan. However, the problem lies with enrolment which stands low. Most young individuals opt for apprenticeships, otherwise known as the “ustad-shagird” system. Among the individuals that enroll in TVET programs, gender stereotyping remains a chronic issue as most women are enrolled in “gender-appropriate” trainings, such as beautician courses, cooking courses, etc. One cannot emphasize enough the need for just and inclusive human development which can only be achieved if equal work and education opportunities are promised and

delivered for all. Diversity in the profile of entrepreneurs can lead to development of new products and services by promoting innovation and economic diversification⁴⁰.

Most importantly, there is a need to improve physical working conditions for all workers by ensuring that all businesses, formal or informal, resort at least to ILO standards in terms of providing safe and adequate working conditions. Employers need to be held accountable for occupational injuries even if they are sustained in the informal sector. Moreover, informal employees also need to be brought into the social security net. This can be done by providing targeted subsidies. In this regard, the newly introduced RAAST instant payment system is a great initiative as it will formalize the economy to a huge extent without making subscribers liable to tax regulation. The government can use the data it gathers in the process to provide targeted subsidies to the most deserving segments of the economy.

Conclusions

Pakistan's economy is largely dominated by the informal sector. While there are many downsides to having a largely undocumented economy, the flexibility that characterizes it is potentially the reason why Pakistan was able to demonstrate such elasticity in the face of the pandemic. This is not contrary to economic theory that suggests that flexible factor prices lead the economy adjusting to full employment level of output and employment. The lack of contracts in the informal sector grant employers the liberty and flexibility they need to adjust wages and number of employees during economic shocks. This, also, potentially explains the reason behind the relatively stagnant unemployment rates in Pakistan.

Thus, the informal sector had a key part to play in the swift recovery demonstrated by the employment sector during the pandemic. However, we cannot rely on this flexibility to deal with all natural disasters. While the informal sector was effective in buffering the negative impact of the pandemic, we need to be cognizant of the fact that the informal sector is not just a victim to climatic disasters, it is also a contributor to it. Therefore, the government needs to act in accordance and take initiatives to bring structure to the informal economy. Otherwise, the time is not far when this informal sector will need relief from the very calamities it facilitated.

⁴⁰ oecd.org/employment/leed/Building-Resilience-Long-term-Challenges.pdf

Appendix: Summary Table

Indicators	2018-19	2020-21
Total Informal Sector	86.27%	86.81%
Working Without Contract or With Contract of less than 1 Year	28.22%	32.38%
Working on Daily Wages	7.36%	8.87%
Do Not Keep Written Accounts (Non-Primary Sector)	69.97%	66.69%
Working at an Informal Workplace	62.24%	64.58%
Female Employment (% of Total Employment)	22.23%	22.52%
Female Informal Employment (% of Total Female Employment)	94.06%	94.11%
Migrant Informal Employment (as a % of Total Informal Employment)	2.63%	1.58%
Marginalised Informal Employment (Only Females & Migrants)	26.53%	25.58%
Marginalised Informal Employment	-	30.55%
Unable to Work Last Week Due to Bad weather		1.27%
Unable to Work Last Week Due to COVID		54.10%
Underemployment Due to Bad Weather		3.45%
Underemployment Due to COVID		18.53%

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10. Food Security - A Country Level Analysis

Lubna Naz

Introduction

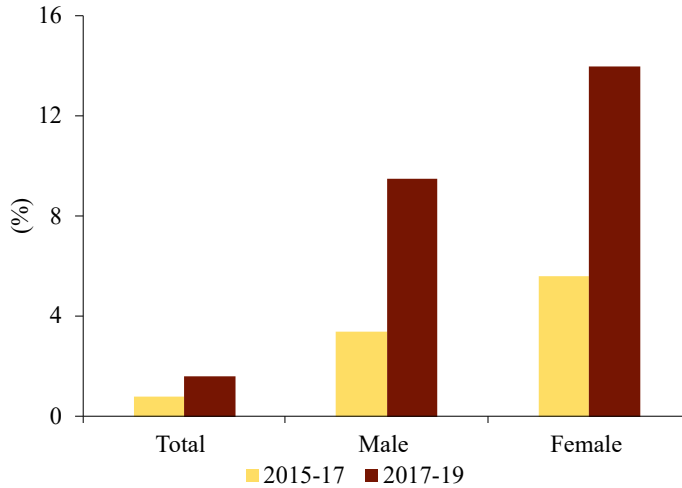
Pakistan's first food security policy was launched in 2018 by the Ministry of National Food Security and Research (MNFSR). The policy aimed to overcome the challenges in attaining food and nutrition security, and monitoring progress towards achieving the Sustainable Development Goals, specifically SDG 1 (end poverty in all its forms everywhere) and SDG 2 (zero hunger) (Government of Pakistan 2018). Out of 113-116 countries, Pakistan often appear at lower ranks on the Global Food Security Index (GFSI) since past several years, 75th in 2021, 80th in 2020, 78th in 2016 and 2019 (FAO 2021). Likewise, among 118 developing countries, it ranks lower (88th) on the Global Hunger Index (GHI) in 2020 and dropped further to 92nd position in 2021 (SIPRI 2021).

The prevalence of severe undernourishment doubled from 0.8% in 2015 to 1.6% in 2019. It increased disproportionately for men (from 3.4% to 9.5%), and reproductive age women (from 5.6% to 14%) during the same period (Figure 33). The malnourishment among under-five children is also very high, with an estimated 38% of them being stunted, 28% being underweight, 8% being wasted, and 2.5% being overweight (Naz et. al. (2020). Malnourishment at an early age imply adverse long-term impacts on cognitive development, human capital accumulation, and labour market productivity. Estimated yearly malnutrition cost to Pakistan is USD 7.6 billion that approximates to 3% of our GDP (WFP 2022).

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Figure 33: Prevalence of Severe Food Insecurity in the Total Population in Pakistan (3-Year Average)



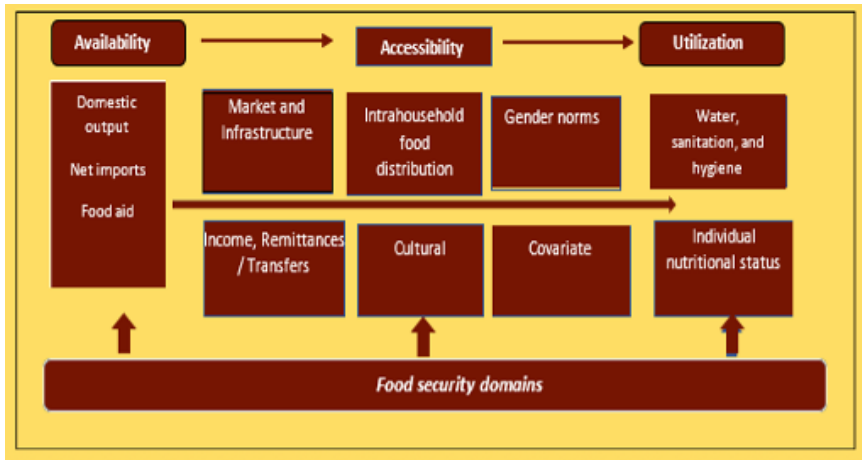
Source: FAOSTAT <https://www.fao.org/faostat/en/#data/FS>

Pakistan is predominantly a rural economy wherein agriculture contributes 20% to its GDP, and 38% to overall employment. More than 60% of the population obtains their livelihood from agriculture. Out of the 79.6 million hectares of land, 23 million hectares is used for growing crops; the rest comprises rangelands, forests, and culturable waste land. Canal irrigation covers up over 40%-60% of the total cultivated area. Pakistan is also included in top-ten countries in the production of wheat, rice, sugarcane, mangoes, citrus and oranges (FAO 2022). Despite the satisfactory performance in food production of basic foods, the rise in food and nutrition security raises alarm on the fair access to food and nutrition and outreach of social safety nets. It is now common scholarship that food problem is just a basic dimension of food security and having enough food in the country does not guarantee its access to all. Amartya Sen contends in his book “Poverty and Famines” (Sen 1983):

“that access to food rather than a lack of physical availability of food is what causes starvation”

A widely accepted definition of food security, proposed in the World Food Summit in 1996, incorporates access to food as an important factor in securing diet and nutrition, as follows, “food security exists when all people, at all times, have physical and economic access to sufficient, safe and nutritious food that meets their dietary needs and food preferences for an active and healthy life” (FAO 2006).

Figure 34: Diagrammatic Representation of the Food Security Framework



Besides, this definition demonstrates that food insecurity is a dynamic issue rather than static. It calls for continuous monitoring of the incidence of food insecurity and its causes to promote evidence-informed policymaking. Figure 34 presents a diagrammatic framework of all four domains of food security for understanding the complex system of food security and its components at the national level.

In Pakistan, the limited economic access to food is not only an urban issue. Most rural households comprise small, technologically or formally uneducated and resource poor farmers. They do not have direct access to inputs, such as seeds and fertilisers, and are generally at the mercy of middlemen (*Arthi*) for the timely supply of inputs and credit at the time of cultivation and again for selling their output. The dual exploitation of small farmers leaves them with no option but repurchasing their own produce from the market at higher prices. The unprecedented increase in wheat prices during 2008-2009 caused an alarming increase in food insecurity and vulnerability to slip into poverty (PIDE 2021).

Dreze and Sen (1991) in their book “Hunger and Public Action” make the case that:

“in a private ownership economy, control over food can be established by either growing the food oneself and having property rights over what is grown, or selling other goods and using the proceeds to buy food”

Social protection programs in Pakistan involve disbursement of meagre cash transfer unconditionally to the poorest households with the purpose to address acute poverty and food insecurity. However, the amount disbursed has been proven to have not reduced undernourishment, especially at times of national catastrophes, due to spending on non-food needs by the beneficiaries. Moreover, it's crucial to explore socio-cultural factors of nutritional security such as gender bias in intrahousehold food distribution, curtailing of food expenses to support extravagant weddings and dowry, and lack of knowledge about the usefulness of nutritious food intakes. An integrated food security policy requires concrete evidence on economic and socio-cultural factors that limit food access.

Food insecurity is closely linked with national security. During 1775, food shortages and high pricing in the cities and villages of the Paris Basin helped ignite the French Revolution. In just over three weeks, there were more than 300 recorded riots and grain-plundering expeditions. The “*Flour War*” was the name given to the surge of public displeasure with the policies of rulers (Miller 1992). Likewise, social unrest in Egypt, during 2001-2011, was also an upshot of government-cut subsidies on wheat, oil, and other items (The Guardian Egypt 2008). Recently, in Sri Lanka, the swift shifting to organic farming caused hurdles in supply chains. As a result, food shortages occurred across the country leading to violent public protests (The New York Times 2021).

In Pakistan, a district-level food security analysis shows that more than one-third of the districts (38/120) having extremely food insecure populations were ridden with political conflicts and poor rule of law in 2003 (SDPI 2009). In another similar survey, seven districts of the Federally Administered Tribal Areas (FATA) and eleven districts of Northwest Frontier Province (NWFP) (now merged with Khyber Pakhtunkhwa) were found to be extremely food-insecure; all those districts were encountering with Taliban perpetrated conflict and violence in 2008-09 (Malik 2011).

Recent Russia and Ukraine conflict has changed global trade, production, and consumption patterns in ways that will keep food prices at historically high levels through the end of 2024, aggravating food insecurity and inflation. Moreover, the COVID-19 pandemic has caused severe turbulence in the global food supply chains during 2019-2021. Pakistan is a net food importing country, higher global food prices, locust attack on domestic crops last year, and weather-related shocks have created food shortages in the local food markets and food inflation in the last three years. According to the State Bank of Pakistan, double-digit year-on-year food inflation rates have been recorded in most months since mid-2019 which have reached as high as 23.6% in January 2020, 17.8% in July 2020, and 15.9% in April 2021 (World Bank 2021).

Table 16: Percentage of Food Secure Households (Per Capita Basis)

Status of Food Security	2015-16 (%)	2018-19 (%)
<i>Rural</i>		
Food Secure Households	86.75	80.40
Food Insecure Households	13.25	19.60
Total Households	100	100
<i>Urban</i>		
Food Secure Households	82.98	68.68
Food Insecure Households	17.02	31.32
Total Households	100	100
<i>National</i>		
Food Insecure	16	24

Author's Calculation Based on HIES 2015-16 and HIES 2018-19 Data

Table 17: Percentage of Food Secure Households (Adult-Equivalent Calorie Intake)

Status of Food Security	2015-16	2018-19
<i>Rural</i>		
Food Secure Households	87.64	75.68
Food Insecure Households	12.36	24.32
Total Households	100	100
<i>Urban</i>		
Food Secure Households	80.94	59.57
Food Insecure Households	19.06	40.43
Total Households	100	100
<i>National</i>		
Food Insecure Households	17	30

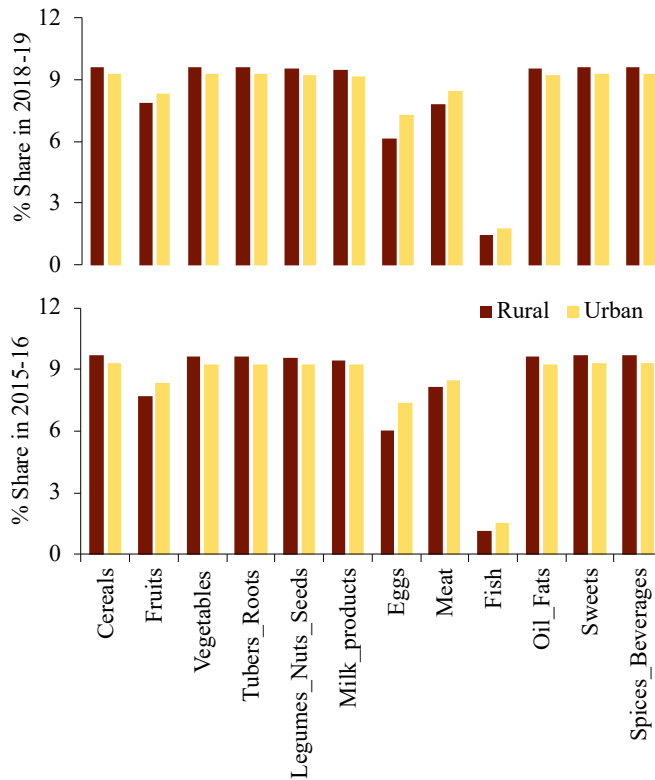
Author's Calculation Based on HIES 2015-16 and HIES 2018-19 Data

A regional (rural and urban) comparison of food groups in 2018-19 and 2015-16 suggests minor differentials in the consumption of cereals and other products, except meat, egg, and fish. The dependence on cereals, especially on wheat and rice, of both rural and urban households, is an indication of the significance of the staple food in caloric intakes in Pakistan. Wheat makes up 37% of the protein and energy in diet. With a per capita consumption of 124 kg annually, it makes up 72% of Pakistan's total food basket, which is the largest per capita consumption of wheat in the world.

However, the year-wise comparison indicates a slight decrease in the cereal consumption, and an increase in the consumption of oils and fats, fish and animal proteins, vegetables, and fruits in both rural and urban households. In the urban areas,

the rapid boom of restaurant culture has also contributed to the shifting to non-staple preferences in the form of meat and broiler chicken (though the latter's importance as a sustainable healthy and hygienic food option in Pakistan itself is highly debatable).

Figure 35: Regional Comparison of Food Group Shares in 2018-19 & 2015-16



These trends are also consistent with the brief analysis done by Heman et. al in Chapter 7 of this book. They have rightly argued that food preferences in Pakistan are rapidly changing, and the country's local food production is unable to catch food market signal and subsequently fails to cater the demand that results from these changes. This failure mean more import bill, expensive food the local markets and a host of other micro and macro problems associated with this phenomenon and overall volatility of food prices and overall food system in the country.

Table 18: Diet Diversity Scores Based in 14 Days Recall Period (2015-16 And 2018-19)

HDDS	Food Groups ⁴¹	(2018-19) (%)	(2015-16) (%)
1	Cereals and Grain Products	0.06	0.05
2	Tubers and Roots	0.1	0.06
3	Legumes, Nuts and Seeds	0.06	0.07
4	Vegetables	0.13	0.11
5	Fruits	0.12	0.1
6	Meat	0.06	0.11
7	Eggs	0.33	0.16
8	Fish and Other Sea Foods	3.72	3.12
9	Milk and Milk Products	10.7	9.03
10	Oils and Fats	26.77	22.22
11	Sweets	48.96	51.62
12	Spices, Condiments and Beverages	8.99	13.35
	Total	100	100

Conclusion and Recommendations

The chapter discussed the state of food insecurity in Pakistan during the last three years. It uses secondary data sources such as Household Integrated Expenditure Surveys (PBS 2022) (conducted by Pakistan Bureau of Statistics) to compute different survey-based food security indicators, and FAOSTAT for looking at changes in the prevalence of severe undernourishment in the Pakistani population area and gender wise. Besides, the chapter presents a critical review of the policies which could not help in dealing with the undesirable increase in food and nutrition insecurity in Pakistan.

The exploratory analysis suggests a disproportionate increase in food insecurity and severe malnourishment and worsening state of diet diversity between 2015-16 and 2018-19. The alarming increase in adult-equivalent calorie deficiency may be attributed to limited outreach of social safety nets, efficiency and transparency issues in cash transfers, market imperfections, inadequate targeted interventions for taking care of maternal, child and elderly nutritional and healthcare needs, and increased poverty. Similarly, a tilt was noticed towards the non-staple food. It may be either due to decline in the production of the staple food or availability of relatively cheaper non-food staples

⁴¹ Details given in Appendix

in the market. The situation calls for using a multipronged approach to address challenges in food availability, access to food, and its utilisation.

Currently, the government provides a huge subsidy by procuring wheat which unfortunately benefits only a few large farmers while leaving small farmers at the mercy of the middleman (Arthi). Similarly, a huge subsidy is offered to the flour mills which are largely owned by politicians or their supporters and never trickles down to consumers. Such inefficient provision of subsidies needs to be immediately eliminated. The public sector's involvement should be restricted to staple market stability and keeping a "*contingency reserve*" for use during food shortages. Additionally, it ought to reallocate subsidies freed up by these measures to improve prospects for inclusive growth and food security. Food production in Pakistan can help secure a local supply of food, but also inclusive economic growth will increase the poor's income that is necessary for improving the affordability of food.

To improve access to food, the government needs to expand social safety coverage, invest in nutrition schemes for poor women and children, improve food price monitoring, and impose severe penalties on hoarders and smugglers. For the adequate utilisation of food, food wastage needs to be curtailed. Currently, food wastage comprises food loss in production, post-harvest food loss, and food losses during distribution and utilisation. Around 36 million-ton food goes wasted annually in parties, weddings, and households (DAWN 2018), a figure that may be exaggerated and controversial but does not undermine the gravity of the issue.

In this regard, Punjab food authority (PFA) has promulgated a new regulation, Disposal of Excess Food Regulation 2019 (Government of Punjab 2019), the law allows non-governmental organisations and food banks to collect left-over food from restaurants and hotels and distribute it to the needy, while maintaining the food safety standards as per law. The rule is the first of its type to be implemented in Pakistan and other provinces need to come forward and legislate similar rules to avert food wastage in the country. However, much larger proportion of food loss as suggested in Chapter 7 may be at the upstream at the food supply chain, which mean investment in reducing post harvest losses, through improved transportation and storage facility, on farm or local processing and other actions in this direction.

The right to food is a fundamental human right. Article 25 of the Universal Declaration of Human Rights 1948 acknowledged the right to food, "as part of the right to an acceptable standard of living", and the article 11 of the 1966 International Covenant on

Economic, Social, and Cultural Rights (UOCHR Undated) formally recognized this right. Additionally, it is safeguarded by national constitutions and regional treaties, and international accords. Pakistan has ratified the law in 2008 (Comploi et. al. 2022), which binds the government to achieve zero hunger and food security on war-footing using all its means.

Appendix: FAO Recommended Food Groups for Calculating Dietary Diversity Scores

Food Group No. & Name		Items Included
Plant Origin Food Groups		
1	Cereals and Grain Products	Wheat, Rice, Sorghum, Maize, Millet, Barley
2	Tubers and Roots	Potato, Turnip
3	Legumes, Nuts and Seeds	Pulses, Beans, Lentils, Peas, Nuts and Seeds
4	Vegetables	Vitamin-A-Rich Vegetables, Dark Green Leafy Vegetables, Other Vegetables
5	Fruits	Vitamin-A Rich Fruits, Other Fruits
Animal Origin Food Groups		
6	Meat	Organ Meat, Flesh Meat, Poultry
7	Eggs	Chicken Eggs
8	Fish and Other Sea Foods	Fresh and Dry
9	Milk and Milk Products	Milk, Cheese, Yogurt, Butter
Others		
10	Oils and Fats	Ghee, Butter, Vegetable Oils
11	Sweets	Sugar, Honey, Gur, Sweetened Soda, Juice Drinks, Chocolate, Candies, Cookies Cakes
12	Spices, Condiments and Beverages	Salt, Pepper, Condiments, Tea, and Coffee

Source: FAO, (2010).

*Household Dietary Diversity Scores (HDDS) means number of food groups consumed by household in the past 14 days. There are a total 12 food groups, so maximum score is 12 and minimum score is 1.

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11. Way Forward

Muhammad Asif Iqbal

Despite showing good recovery from the pandemic shocks in terms of GDP growth during the last two years, Pakistan's key macroeconomic indicators remain rather weak. The country still confronts various external and internal challenges that pose a threat to sustaining the growth momentum in 2022-23. The economy suffers from high levels of inflation along with trade, current account, and fiscal deficits. All these factors, coupled with the political uncertainty, are contributing to a rapid and continuous depreciation of the national currency, dried-up foreign reserves, and an increasing debt burden.

The analyses presented in the first few chapters of this report depict worrisome prospects for the economy in the short run. For example, the results of policy simulations of the macro-econometric model indicate that the growth targets are unlikely to be achieved given the current set of economic policies. Similarly, fiscal policy analysis suggests that the budget 2022-23 is fragile and risky. The level of fiscal deficit, particularly the primary deficit, is alarming and unsustainable. In 2021-22, the government had to borrow to finance the debt servicing obligations, the entire PSDP and other expenditures. As far as the fiscal targets for 2022-23 are concerned, revenue projections under direct taxes appear to be unfeasible, given the prevailing macroeconomic situation.

The monetary policy analysis concludes that the recent episode of high inflation is mainly driven by commodity, food, and energy prices. The SBP has responded to this situation by raising policy rates and intends to further increase these to around 18%. This measure shall negatively affect the real output and further fuel the already high inflation, eventually pushing the country into stagflation.

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The role of SBP is also crucial for fiscal responsibility and debt management. Although the borrowing from the SBP has remained under the prescribed limits during the past few years, the government's reliance on commercial banks and other sources has substantively increased. It may result in the loss of federal government revenue in the form of interest payments to SBP. Since the SBP has no autonomy in setting the domestic debt management targets, the policy of limited or zero borrowing from the SBP leads to 'crowding out' of borrowing, and the total domestic debt continues to burgeon.

The balance of payment crisis is another chronic issue facing Pakistan's economy, which is mainly driven by the high level of trade deficit. Although exports performed exceptionally well in 2021-22, the quantum of imports far exceeded exports. The challenge is to address the structural problems in the country's export sector. The SBP-IBA Business Confidence Index (BCI) also reflects a trend that is similar to the level of exports from Pakistan and the large-scale manufacturing index. The BCI remained in the positive zone from August 2020 to June 2021 and showed a downward trend at the start of the fiscal year 2021-22.

Moreover, the agriculture sector, a vital component of Pakistan's economy, is not realizing its full potential and requires a major transformation in agricultural supply and value chains. All the challenges on the macroeconomic front find some solution in agricultural development. Its development in an appropriate direction has profound implications for the country's trade, foreign reserves and balance of payment, import bill and overall food security.

The informal sector cushioned the pandemic's adverse impact, though to a marginal extent. The informal sector stood at 86.3% in 2018-19 and at 86.8% in 2020-21. Nevertheless, it needs to be considered that this contribution is made at the cost of labour rights and safety since the flexibility of employment conditions exercised by the informal sector employers does not conform to international labour standards.

The analysis on food security reveals that the number of food-insecure rural households has increased from 13% in 2015-16 to 19.6% in 2018-19. During the same period, the number of urban food-insecure households increased from 17% to 31.3%.

Given this backdrop, the government, to achieve its objectives of economic stabilization and sustainable growth, needs to address the multifaceted issues confronted by the country, such as fiscal imbalance, high inflation and the gigantic trade deficit. Also, the need for taking effective measures to protect people from economic misfortune cannot

be overemphasized. Some specific recommendations and directions are summarized below:

- The government plans to attain an optimistic target of 5% GDP growth in 2022-23 for which a proactive investment strategy needs to be adopted to enhance public investment as well as facilitate private investment. Based on the simulation results, it is recommended to increase the development expenditures in the range of 18%-20% and provide credit to the private sector at a fixed policy rate of 13.75%.
- The current policy of limited or zero borrowing from SBP has implications for the private sector development since it crowds out private investment. A combination of borrowing from SBP and private banks would help create more space for private investment. It would also contribute to enhanced revenue from SBP profit that can help reduce the overall fiscal deficit to a certain extent. Moreover, progressive taxation policies, with greater reliance on direct taxes, need to be adopted for resource mobilization to contain the fiscal deficit.
- The circular debt crisis in the power sector is another critical issue that needs to be resolved to reduce the fiscal deficit. While sharp adjustments in power tariffs may occasionally be required, the solution lies in the structural reforms to address the fundamental problems such as the high cost of power generation, high transmission and distribution losses and other operational inefficiencies of the distribution companies.
- It is also recommended that measures should be taken to rationalize the subsidy mechanism. For example, subsidies may be provided to households and electricity-producing firms for renewable energy production. Similarly, electricity subsidies for high-income individuals who consume more than 500 units per month should be withdrawn. Likewise, instead of providing electricity subsidies to farmers for the use of agricultural tube wells, a one-time subsidy may be given to encourage solar or wind energy use and energy exchange with the grid.
- The current wave of inflation is more of a demand-side problem that needs to be tackled by taking unconventional measures to protect people from rapidly increasing food and energy prices. These measures may include targeted cash transfers to the poor and shifting toward renewable energy resources,
- To address the balance of payment crisis, the country is in dire need of structural reforms in the export sector aiming at expanding the export base through

diversification, exploring new export markets, and encouraging private investment. Some tariff and non-tariff measures are required to be considered. Pakistan and India impose higher tariff rates on consumer goods – a measure that has an anti-export bias since tariffs on unfinished goods are lower. However, higher tariffs are also imposed on the imports of capital goods in Pakistan, which has negative implications for investments in major industries. It is recommended that tariff rates on capital goods be rationalized. Similarly, technical non-tariff measures should be adopted to prevent the import of inferior-quality goods. The process may be initiated by imposing NTMs on consumer goods and gradually extending it to unfinished and capital goods.

- The agriculture sector is the backbone of Pakistan's economy, for being the main livelihood of the rural population and having backward and forward linkages with other sectors such as industry, transport, wholesale, and retail trade, etc. While the demand for high-value food products is increasing over time, farmers have not been able to realize the supply potential due to the lack of coordination within value chains and risks associated with cultivating crops as per market signals. There is a need to adopt a value-chain approach in agricultural development to move towards high-value and high-quality products. This would lead to higher volumes of products with improved quality that can be marketed locally and exported to earn the much-needed foreign exchange. It would also enhance the income of the farmers and other stakeholders.
- As far as the employment sector is concerned, the government must ensure that all businesses, formal or informal, comply with the ILO standards to provide safe, adequate, and decent working conditions. Moreover, workers in the informal sector need to be brought into the social security net.
- The current economic stresses are likely to have disproportionately adverse effects on the poor and vulnerable population. It is imperative that adequate measures be immediately taken to safeguard the economic well-being of people. These measures may include expanding social safety coverage, investing in nutrition schemes for poor women and children, improving food price monitoring, and imposing severe penalties on hoarders.



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