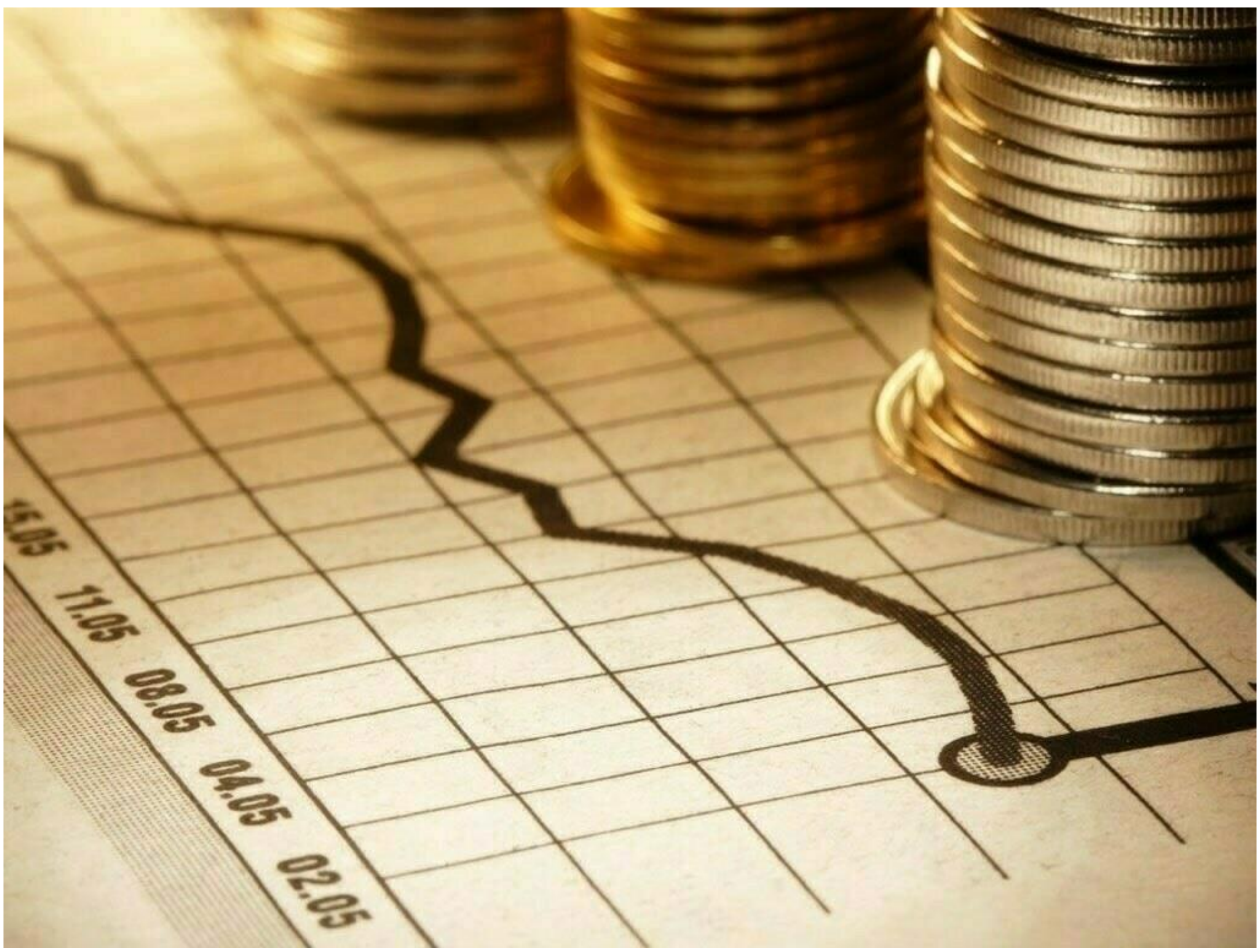
BUSINESS RECORDER

From fragility to fidelity: why Pakistan must end fiscal policy uncertainty

Amna Riaz | 30th May, 2025



Pakistan's economy has never lacked ambition — but it has often lacked consistency. As Budget 2025–26 looms, one of the most corrosive threats to macroeconomic stability and investor confidence is fiscal policy uncertainty (FPU). While the headlines are often filled with deficits and debt ratios, what flies under the radar is how unpredictable fiscal strategies are systematically eroding the country's economic foundations.

Fiscal policy uncertainty refers to the unpredictability in taxation, government spending, and fiscal direction over time. In Pakistan, this uncertainty is not episodic; it is structural.

Over the years, frequent mini-budgets, abrupt tax policy revisions, erratic subsidy programs, and unstable revenue projections have embedded unpredictability into the DNA of economic governance. Investors and businesses alike struggle to plan beyond a single fiscal year, let alone a full business cycle.

Recent global research provides a sobering benchmark. According to Azzimonti (2018), fiscal gridlock in the United States has caused output losses of about 1% annually due to shaken investor confidence.

Similarly, Baker, Bloom, and Davis (2016) argue that economic policy uncertainty globally can reduce GDP growth by 0.5% each year, with noticeable impacts on private investment and job creation. In the Eurozone, Born and Pfeifer (2014) find that fiscal uncertainty can lead to 0.6% drops in output due to increased borrowing costs and risk premiums. The broader literature—from Julio and Yook (2012) to Fernandez-Villaverde et al. (2015)—underscores how deeply such uncertainty damages growth, consumption, and employment across both developed and emerging economies.

Pakistan's case is even more acute. Academic analyses within the country, including MPhil theses from PIDE and empirical VAR-based models, show that fiscal uncertainty in Pakistan can reduce GDP by up to 1.5% annually and crowd out over 15% of private investment. Inflation, interest rates, and exchange rate volatility all rise under fiscal ambiguity, disproportionately hurting small businesses and low-income households.

The core issue is not simply how much the government spends, but how reliably and transparently it does so. Take tax policy, for example. Pakistan has a historically narrow tax base, yet instead of broadening it through sustained reform, governments often resort to abrupt rate hikes, short-term amnesties, or politically expedient exemptions. These arbitrary changes increase compliance burdens, discourage investment, and dilute policy credibility.

Similarly, budget execution is plagued by unpredictability. Development spending is often frontloaded in budgets but backloaded in actual disbursement. Capital projects are approved but remain unfunded. Discretionary allocations balloon while social sector expenditures are trimmed in the name of austerity. Over time, this has created a credibility deficit: even when good policies are proposed, stakeholders doubt their durability.

Moreover, Pakistan's fiscal framework is routinely realigned to meet the conditionalities of international lenders—particularly the IMF—rather than to serve a coherent national growth strategy. This creates a dual tension: policy is both externally dictated and internally inconsistent. Businesses are left navigating a terrain where fiscal signals are neither stable nor strategic.

To end this cycle, Budget 2025–26 must pivot from a firefighting document to a forward-looking fiscal constitution. The first step is to institutionalize predictability through a rules-based fiscal framework. This would entail legally binding medium-term targets for budget deficits, debt ratios, and development spending. Tax policies should be part of a multi-year framework agreed upon with all political stakeholders to avoid volatility across electoral cycles.

Second, fiscal transparency must become non-negotiable. The Ministry of Finance should publish an annual "Fiscal Confidence Report" that evaluates how far actual indicators diverged from targets and explains why. This report must be vetted by an independent fiscal council, empowering the legislature and the public with the tools to hold the government accountable.

Third, budget composition needs to prioritize growth enablers over political optics. For years, spending on education, health, and innovation has been sacrificed to make room for defense, debt servicing, and poorly targeted subsidies. This is not just inequitable—it is economically inefficient. Development spending as a share of GDP has steadily declined, coinciding with rising fiscal uncertainty. This correlation is no accident. When fiscal planning is uncertain, long-term investments are the first to be axed.

The government must also better integrate fiscal and industrial policy. For instance, fiscal incentives should align with sectors that generate employment and exports—like IT, agro-processing, and green manufacturing. This would ensure that budgetary support translates into economic dividends.

Institutional reforms are also critical. Coordination between federal and provincial governments on tax assignments and expenditure responsibilities must improve. At present, the mismatch between revenue collection and spending mandates creates duplication, waste, and further unpredictability. A harmonized fiscal federalism framework, anchored in data and performance-based transfers, can mitigate this.

Finally, restoring confidence requires leadership. Investors respond not just to numbers, but to narratives. Pakistan must communicate a clear, credible fiscal vision that inspires confidence. This vision should emphasize policy continuity, not volatility; strategic patience, not populist swings.

To be sure, uncertainty can never be eliminated entirely. Global shocks, political cycles, and market dynamics will always pose challenges. But fiscal uncertainty should not be self-inflicted. It is one of the few economic risks that lies entirely within our control.

In the words of economist John Taylor, “A credible and predictable fiscal policy reduces uncertainty and contributes to economic stability.” For Pakistan, this wisdom must now become policy.

The 2025–26 budget offers a defining opportunity. It can either continue the tradition of ad hocism, or it can chart a path to fiscal fidelity. It is time to give investors, entrepreneurs, and citizens a reason to believe—not just in growth, but in the government’s ability to deliver it with consistency and conviction.

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