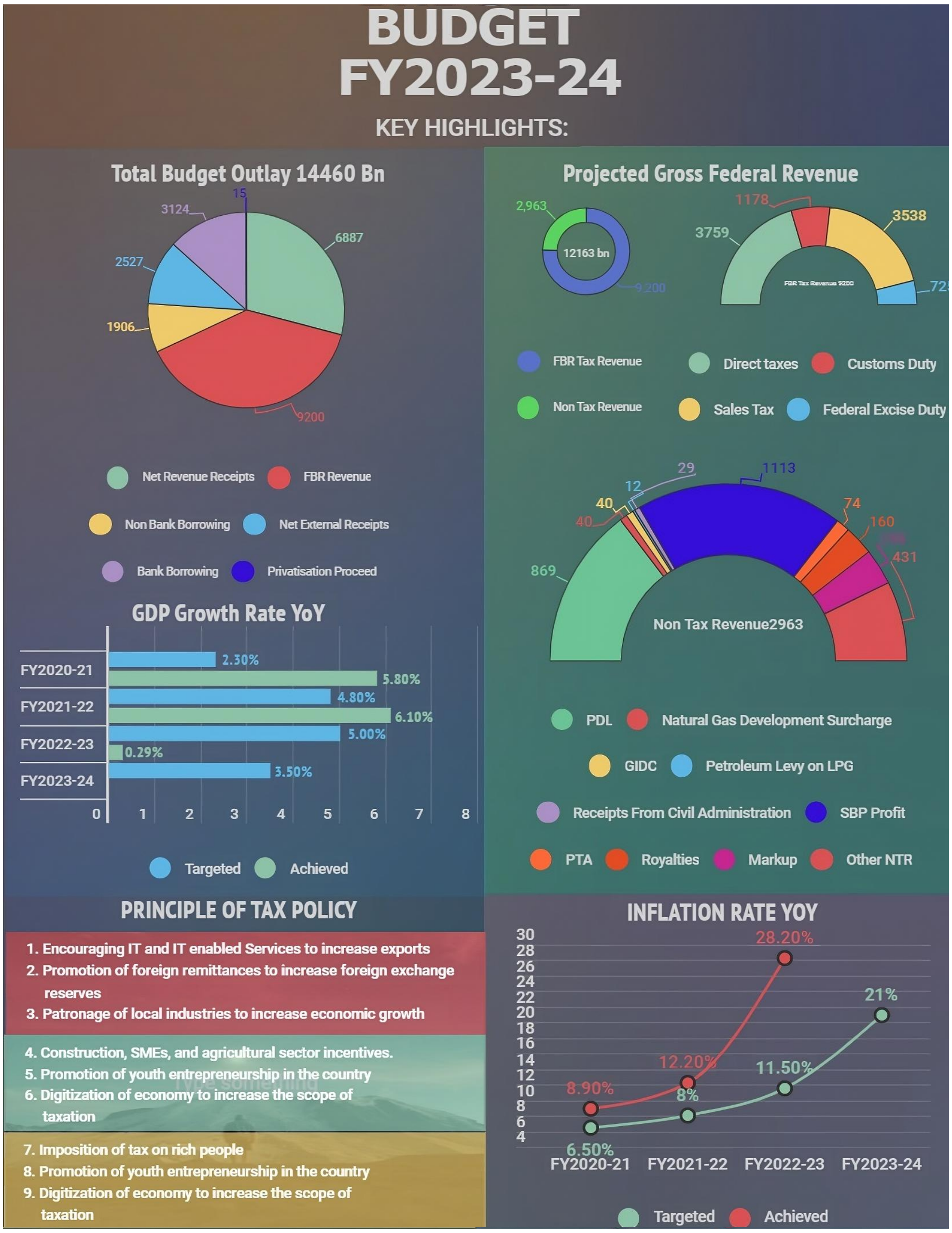
# Maximizing the Impact: Evaluating the FY 2023-24 Budget for Optimal Resource Allocation, Socio-Economic Addressal, and Sustainable Development

## PIDE MacroPolicy Lab

Federal annual budget for fiscal year 2023-24 has laid out important allocations and objectives, marking a significant milestone in the process of crucial economic decision-making. The PIDE MacroPolicy Lab has conducted a thorough evaluation of the budget proposal, leveraging their expertise to offer invaluable insights and recommendations. The Lab's analysis focuses on optimizing resource allocation, addressing socio-economic challenges, and fostering sustainable development. By incorporating the Lab's analysis into the decision-making process, the government can effectively maximize the budget's impact and ensure its alignment with national goals.




**Acknowledgement:** The Macro Policy Lab would like to thank the research colleagues from PIDE who contributed to this document in their areas of expertise. These include: Dr. Faheem Jehangir, Dr. Jehangir Khan, Saddam Hussein, Dr. Uzma Zia, Shahid Mehmood, Afia Malik, Dr. Faisal Ali, Tehmina Asad

## Recommendations

To maximize the budget's impact and align it with national needs, the government should consider the following policy recommendations while debating for approving the presented budget:

## 1 Focus on Export Promotion

It was expected from the government to boost investors' confidence and encourage the business environment. Pakistan cannot prosper until it stabilizes its exports sector and starts providing high value-added products. Below are few PIDE takeaways on budget from the context of exports specifically and industry in general:

### 1.1 IT industry and Freelancing

Budget proposals give incentives to import software and hardware equal to 1% of their exports without paying taxes. This step will encourage IT services exports in the long run. However some more steps were expected in the budget to boost businesses overall. Similarly, there will be no sales tax return filing requirement for freelancers exporting $2000 per month. The concessional tax of 0.25% is imposed for freelancers to boost services exports. Government has also given freelancers an access to refunds on exports up to $24,000 annually and exemption from sales tax registration. This will encourage the freelancing market. There seem no overall incentives on employment generating business sectors which was direly needed for other sectors which are more employment intensive.

### 1.2 Freelancing Potential

Pakistan's earning through freelancing is estimated at USD 0.5 billion but estimated to have a much higher potential. A large chunk of the earnings does not make it to the country as freelancers for various reasons continue to keep their earnings in digital accounts and wallets. The govern ment must allow registered freelancers to open and maintain a dollar account in local commercial banks to encourage them for remitting earnings and savings to Pakistan while also furthering the dollar reserves in the economy.

### 1.3 New taxes on food items

Apparently new taxes on industrial products such as packed dairy items, packed poultry items which will raise the prices on one hand and on the other hand it will be difficult to control the market for further increase in prices of food. It's imperative to observe that the impact on the economy will depend on some factors such as the magnitude of the tax rates, the responsiveness of consumers and producers to price changes.

## 1.4 Exemption on duty of import of raw material

The exemption on custom duty on import of raw material for batteries, solar panels and inverters is encouraging as the government has learnt that banning imports affected the country's exports in the past. The raw material availability should not be interrupted to keep our exports increasing. Overall, the duty exemption on above items may positively impact the economy by promoting domestic manufacturing, boosting exports, and supporting the growth of the renewable energy sector. Still, it's critical for the government authorities to monitor the policy impact so that the country should achieve its intended growth objectives.

## 1.5 Export Council

Export Promotion Council sort of set up has been PIDE's proposal in its Charter of Economy. A welcome step indeed. However, it must be led by technical and professional people, while formulating the incentive system for export promotion but with clear-cut annual targets as a whole and for each firm as well. The incentives should be linked with sunset clauses. Moreover, the incentives should be to promote competitiveness and not protectionism.

## 1.6 Bilateral Import Duty Reductions

Similarly, awarding favor of 0 percent import duty on imports by certain Arab nations is a questionable move. Why just a few Arab nations? Why not the European or North American dignitaries who are two of our biggest export markets? Or is it down to another of those shady deals that the public will never learn about?

## 1.7 Restricting Import of Cars

High duties on import of car parts will work in favor of the already highly protected, inefficient automobile sector, dominated by three companies who have enjoyed government's protection against competition. Decades of protection afforded to domestic manufacturers under the guise of infant industry and other excuses has resulted in only 11 percent domestication of parts production plus doling out low-quality vehicles at very high rates in the country. The loser, of course, is the consumer who has nowhere to go but to buy a car given that the country lacks a viable public transport system.

# 2 Evaluate Taxes and Withholding

The targets, like taxation target (and specifically the direct tax target) seems wishful given the weak administrative capacities.

## 2.1 Detrimental effects of Withholding taxes

Withholding tax on cash withdrawal will seriously dent financial inclusion. It will increase the cash-based economy especially those who are not drawing their regular salaries. Despite having the previous experience of such a regime, it is again proposed. Decisions like increasing the taxes on cash withdrawals point to lack of evidence-based policies by economic managers considering ground realities, whereby we already have a huge cash economy, set to further expand with these kinds of measures. To facilitate this transition, the use of digital payments should be promoted and ensured in certain cases. Such as payments to be made at stores and petrol purchases etc.

## 2.2 The political consideration of the tax net

The government fails to suggest any measure to increase the tax net, which shows the myopic nature of the budget. Agricultural income is not considered, not the retail sector is brought in the tax net.

# 3 Prioritize Productive Growth

There is a need to prioritize and support sectors that have the potential to generate higher value-added outputs, create employment opportunities, and contribute to overall economic development:

**3.1** By forcing a 3.5 percent GDP growth rate upon itself, the Government has committed to higher public consumption expenses rather than incentivizing the private sector to take up the mantle of investment that could spur GDP growth. The concept of a government setting GDP growth rate is controversial to begin with, since it is difficult to tell what circumstances will be a month, a quarter or two quarters from now.

**3.2** We are again incentivizing the real sector more than the manufacturing sector. Agriculture and IT sector focus is good, as it can bear fruits in the short run, but we have to focus on the export sector more for real productivity gains, otherwise we would always get back to square one.

**3.3** Critical areas like Research and Development (R&D) were again short sighted as if they have nothing to do with the fortunes of Pakistan. A portion of the budget should be dedicated to research and innovation grants, encouraging faculty and students to engage in cutting-edge research. This can foster a culture of innovation, contribute to scientific advancements, and address national challenges.

**3.4** Agriculture sector incentives: The government has proposed special incentives for the agriculture sector in the federal budget 2023-24 including duty exemption on the import of seeds and abolishment of sales tax on plant saplings, combine harvesters, dryers for agricultural products, no-till-direct seeders, planters, trans-planters, other planters, and bovine semen. Certified seeds are one of the major requirements to increase productivity. However, the system of provisioning for these certified seeds needs to be improved.

**3.5** Federal government also has allocated 30 billion rupees for converting 50,000 tube wells to solar. Which is going to provide some relief on higher cost of energy through regular electricity. 5 billion worth subsidized credit would also be provided. Along with that tax exemptions to food processing units have been allocated. Further agri credit is increased to 2250 billion rupees. Subsidized markup rates in collaboration with provinces are provided with 10 billion rupees allocation.

**3.6** However, considering, agriculture is a provincial subject post 18th Amendment, should it not be the provinces who should be announcing these kinds of measures? Second, within these exemptions, one again finds the failure to ameliorate domestic productivity issues and current expenses. For example, there are more than 100 agricultural research institutes spread across the country, both at the federal and provincial level. If quality seeds have to be imported in the end, what is the use of domestic research institutes? This question assumes added importance in lieu of the billions of rupees in current expenses earmarked for these institutes. Additionally, the exemptions in relation to various forms of machineries raises the question about our domestic capacities. And last but the least, relative to agriculture, the sector mostly remains outside of the income tax net.

## 4 Address Debt and Debt Servicing

In FY 2022-23, the federal government repaid over USD 5 billion of international commercial loans, while USD 3 billion was rolled over by Saudi Arabia and China each. Subsequently, the external public debt stood at USD 85.2 billion at the end March 2023. The domestic debt at the same time stood at PKR 35,076 billion. This takes Pakistan's total public debt to PKR 59, 247 billion at March end 2023. In FY 2023-24, the federal government has set aside PKR 7,303 billion for interest payments. This makes up the highest allocation in the expenditure for the fiscal year, and equals half of the total federal government expenditure for the year and is more than the federal earnings post provincial transfers. Assuming the government is able to achieve its tax revenue target of PKR 9,200 billion, almost 80 percent of the tax receipts will be used for interest repayments. Federal primary deficit of PKR 471 billion is less than the previous year's value but still it does not show the government's adherence to fiscal discipline. The rates are highly unlikely to come down significantly anytime soon, meaning additional borrowings leading to additional debt burden.

**4.1** Consequently, after interest repayments and transfers to provinces and other subsidies, the government will be left with only enough money to pay off its pension liability. To finance all other expenses, further debt will have to be accumulated by the government. A development expenditure of over PKR 1.1 trillion thus gets completely debt financed. Missing out on the revenue target will add on to the financing gap and hence force the government to accumulate further debt.

**4.2** While the external debt remains a significant threat, the domestic debt is no less of a worry either. The domestic debt, as of end March 2023, forms almost 60 percent of the total public debt and with such extravagant budgetary expenditures is expected to further rise. Government must look towards managing its long-term domestic debt profile as well, while also turning towards domestic debt restructuring.

**4.3** Expenditures in FY 2023-24 will be majorly debt driven. This increases the challenge for the government to stick to the budget and avoid a mini budget, particularly in case of revenue shortfalls.

## 5 Public Sector Development Program

Amid the unprecedented economic crunch Pakistan is facing right now, allocating to schemes such as PKR 10 billion for laptops seems inefficient utilization of resources, especially because there is no economic evaluation exercise for the last exercise. Targeting it to certain segments and sector promotion context needs to be done. PIDE study on the laptop scheme (previous) shows several issues so the allocations instead could be given for youth investment programs and establishing digital labs to learn about startups. Instead of owning a laptop as a student, use it in labs where multiple people can use the same resource and "learn to earn" schemes can be introduced.

**5.1** The 'quality' of growth remains absent, with focus (as always) on quantity through brick-and-mortar infrastructure projects. A number of these projects have been repeatedly 'inaugurated' before, like the K4 project in Karachi. These create more liabilities for the future rather than act as productive assets. The budget also lacks any turnaround plan for loss-making SOEs, whose losses are an estimated Rs. 500 billion annually.

**5.2** Setting aside funds for monitoring and evaluation mechanisms is crucial to ensure transparency, accountability, and the effective utilization of the budget. Regular assessments should be conducted to evaluate the impact of budget allocation on various aspects of higher education.

## 6 Foreign Exchange Measures

'Diamond Card' for overseas Pakistanis; The federal government has decided to add a new category of remittance cards. Plots, perks, Roshan Digital Accounts type schemes, exemptions on source declaration on amounts up till $100,000 etc., are all aimed at extracting more dollars out of the diaspora. But there is no or little roadmap for attracting FDI, which is now down to a quibble in context of our foreign loans. Neither is there any roadmap on how to diversify exports, which remain heavily dependent upon textiles, whose performance in turn itself is heavily dependent upon subsidies.

## 7 Expenditure Highlights

A significant increase in Government employees' salaries and pensions is partially justified but it will put pressure on the fiscal side. Perhaps it should have been increased only for BPS 1-16, with no increase in other allowances i.e. daily and mileage allowance. For the grade 17 and above already 150% executive allowance has already been provided. We really need to look at the way this whole system works. PIDE has done an excellent report **"Cash Poor, Perk Rich! Civil Service Compensation"** with proposals to handle this issue. A lump sum increase, especially in pensions, is not warranted. There is no viable proposal to tackle the pension bomb, especially that of the armed forces whose pension share is more than 80 percent. For those who are raking in more than 0.5 million in pensions and wages (like Judges of Supreme Court and High Court), there is little or no need for increasing their wages at the same rate as that of low wage employees. These kinds of differentiation increase work towards addressing the pressing income inequalities, though the quantum may be small. But still, it would be symbolic.

**7.1** The pension fund is a welcome step. PIDE has been proposing this for a long time. Pensions should be contributed by the individuals/government, otherwise pensions would be unsustainable and the major expenditure of the government in a couple of years.

**7.2** The government has again relied on burdened social sector programs like BISP - a swift way of gaining political benefits. Rather, higher funds should have been diverted toward education. Social sector protection is important but given the government's very weak financial position, it should be targeted. Rest, the government is not a welfare organization, it should make its citizens self-sustainable which contributes and are not just at the receiving end.

**7.3** Health Insurance for Journalists; Why would only Journalists be afforded health insurance? Why not continue with the universal health insurance that had been extended to all the country? The only thing needed was to depoliticize that program and continue its funding and improvement in service delivery. Rather, it remains in limbo due to non-payments and non-releases by the federal government. A good initiative should be continued irrespective of who or which party initiated the program.

**7.4** Implementation of Minimum Wage (MW) is very hard especially for small businesses. India has several MW structures based on many factors. Therefore, targets set for MW must not be ambitious and following g steps in implementation are significant. a) Improving the strength of Labour officers ( for factories inspection) and Labour inspectors (for shops and establishment inspection). b) Ensuring the transfer for MW through bank accounts so that compliance is ensured.

## 8 Revamping Energy Sector

In the energy sector, it is the same old story of subsidies for maintaining uniform tariffs across the country, even for the privatized utility K-electric. On one hand, the GOP is in the process of implementing the Competitive Trading Bilateral Contract Market (CTBCM); to generate competition among market players to benefit consumers in terms of pricing. But subsidies allocated for tariff differential claims (PEPCO and K-Electric), means business as usual, continuation of inefficiencies and circular debt growth. There will be no competitive market when accounts of all distribution companies are treated as one, and the uniform tariff is charged. The privatization of state-owned distribution companies is on the GOP plan. A uniform tariff policy is no incentive for a privatized company. Providing subsidies is not a sustainable solution, the power sector needs tariff structure reforms.

**8.1** With payments to IPPs through subsidies, some burden of circular debt will be reduced, but only for the time being. The burden of capacity payments is increasing. Several plants are underutilized (e.g., RLNG plants). Not only the government but the consumers will keep bearing the burden of these capacity payments. What we need is the productive utilization of this capacity and not keeping it under or un-utilized. Likewise, we have enough capacity, there is no point in adding more capacity (even if it is renewable) in the short to medium run, if we really want to get rid of circular debt. The new planned capacity (10,000 MW) will not be without costs.

**9** We hope that in the coming days while the debate in legislative corridors happens, these insights would help formulate policy recommendations into the decision-making process, which can enhance economic growth, promote sustainable development, and achieve national goals not only in FY 2023-24 but in the future as well.

The aforementioned budget analysis and policy recommendations are based on years of policy research conducted at the Pakistan Institute of Development Economics. This includes, but not limited to, the following research products of the organization:

- The PIDE Reform Agenda for Accelerated and Sustained Growth
  https://t.ly/w5CH

- Pakistan One Year Growth Strategy
  https://t.ly/CcrIJ

- PIDE Commentary on the 23rd IMF Program for Pakistan
  https://t.ly/SLZL

- Cash Poor, Perk Rich! Civil Service Compensation: Incentives, Dissatisfaction, And Costs
  https://t.ly/EXzI

- Doing Development Better
  https://t.ly/nyH5

- Power Sector: An Enigma with no Easy Solution
  https://tinyurl.com/2wd2vhru

- PIDE Sludge Series
  Sludge Audit Vol 1: https://tinyurl.com/f3tyuk9t
  Sludge Audit Vol 2: https://tinyurl.com/3d94p2c7