

# Budget Deficits of Pakistan

## Introduction :-

Two major problems of any economy are :

1. Balance of payment Crises
2. Budget deficit

These both are also known as twin economic problems. A budget deficit occurs when a government total expenditure exceeds its total revenue over a specific period resulting in a negative balance. Pakistan also faces the same problem because the collection of Pakistan is less and expenditure is more.

For example, In Fiscal Year 2021-2022, the total amount left with centre was 4.1 trillion Pkr while total expenditure was 8.4 trillion Pkr and the shortfall of 4.3 trillion pkr occurred. The issue is same in every fiscal year as given below;

In Fiscal Year 2021-22, Budget deficit

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Was 5.259 trillion PKr.

In Fiscal Year 2020-21, It was 4.4 trillion PKr.

In 2019-20, It was 4.1 trillion PKr

In the last 10 Fiscal Years, the average deficit was 3.5 trillion PKr

In the last 20 Fiscal Years, the average deficit was 2.3 trillion PKr.

Sources:- Economic survey of Pakistan, Finance Division of Pakistan, IMF

While, in Fiscal Year 2022-2023 following were the estimates

Gross federal Revenue Total expenditure

12,163 ▲	▲ 14,461
3,759 Direct taxes	Debt Servicing 7,303
5,441 Indirect taxes	Defence 1,804
2,963 Non-tax Revenue	Other 4,213

- PSDP = Rs 1,150 billion
- Transfer to the provinces under the NFC Award - Rs 5,276bn
- Estimate provincial surplus = Rs 650bn
- PSDP 950
- Other 190
- current expenditure
- ▨ Development expenditure

Source :- Dawn News

Deficit Rs 6,923bn in billion of Rupees.

6.54<sup>cent</sup> Per of GDP

• All amounts

There are multiple reasons and massive negative implications for it and it requires undertaking major steps to convert budget deficit to budget surplus.

## Reasons for budget deficit:-

### Flawed taxation System

Flawed taxation system results into lesser collection. One of the major contributory factors leading to the political upheaval that resulted in the French revolution is said to have been the taxation system of the ancient regime which was ridiculed for being:-

“excessive, in-efficient and unfair”

→ It was excessive because France in the late 18<sup>th</sup> century became one of the highest taxing states in Europe.

→ It was inefficient because it encouraged corruption and tax avoidance.

→ It was unfair because the bulk of the nation's direct taxation was levied on the common people.

Not unlike the pre-revolutionary France,

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there is a growing sense of grievance among the Pakistani urban salaried classes and corporates that they bear the burden of generating a disproportionately large part of direct taxes. This sense of unfairness is exacerbated by the fact that many other affluent segments of society with vast amount of wealth that generate considerable income stubbornly refuse to contribute taxes to the national exchequer.

Pakistan has been unable to expand taxation. Despite several donor-supported reform attempts, the tax-to-GDP ratio continues to hover around 10% of GDP. Pakistan's tax system generate just 10.3 percent of the GDP in revenues for over the past decade and just one area (next year's mark up alone) would consume over 6 percent of GDP.

Pakistan collects more than 70 percent

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Of revenue through indirect taxation. Between 2008 and 2021, Pakistan's federal Government collected between 36% to 39% of its tax revenue from direct taxes while the rest came from indirect taxes.

#### • Tax evasion :-

The economy of Pakistan like any other economy is of two types :-

1. Documented or Formal economy
2. Undocumented or Informal economy.

Documented economy connotes that the business as well as employment is registered with the relevant registration authorities, as well as taxation authorities.

On the other hand, undocumented economy is not registered with the authorities.

According to IMF, 35% of our economy is not registered or documented.

Undocumented or informal economy does not contribute to fiscal revenue.

Business units are partially documented or not documented at all. When a

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business unit is too big to hide, it is documented but partially they are doing tax evasion.

The sales tax and income tax bases remain narrow and personal income taxes on average are lower than in comparable regional countries such as India and Bangladesh as well Pakistan's overall tax-to-GDP ratio remains one of the lowest among comparable countries, since those who avoid documentation escape the tax net altogether or pay very little.

Among these tax evaders are, Real state business, Builders and property dealers, Retailers, Industry, hotels, private hospitals, elite educational institutes etc.

Tax avoidance:-

Majority of small businesses are not registered. Wood industry is most common in all. Private Clinics, laboratories, radiology, local shopkeepers are tax avoiders.

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Administration problem with taxation  
System of Pakistan:-

Undocumented economy:-

Over the last several years, Pakistan has been experiencing a growing fiscal deficit which surfaced mainly on account of poor tax collections. Obstructions faced by Pakistan in documentation of the economy are endless.

Percentage of the <sup>un</sup>recorded business has declined in developed economies over past few decades primarily due to the digitization of processes however, the rising trend of unrecorded economy is a major challenge for developing countries. In Pakistan, informal economy is soaring and is reported around half of the GDP.

• Lack of automation:-

Many of business are not computerized or automated. Major businesses are human dependent. Inspection is done by inspector through paper

documented data

The state has not properly invested in the capacity building of FBR.

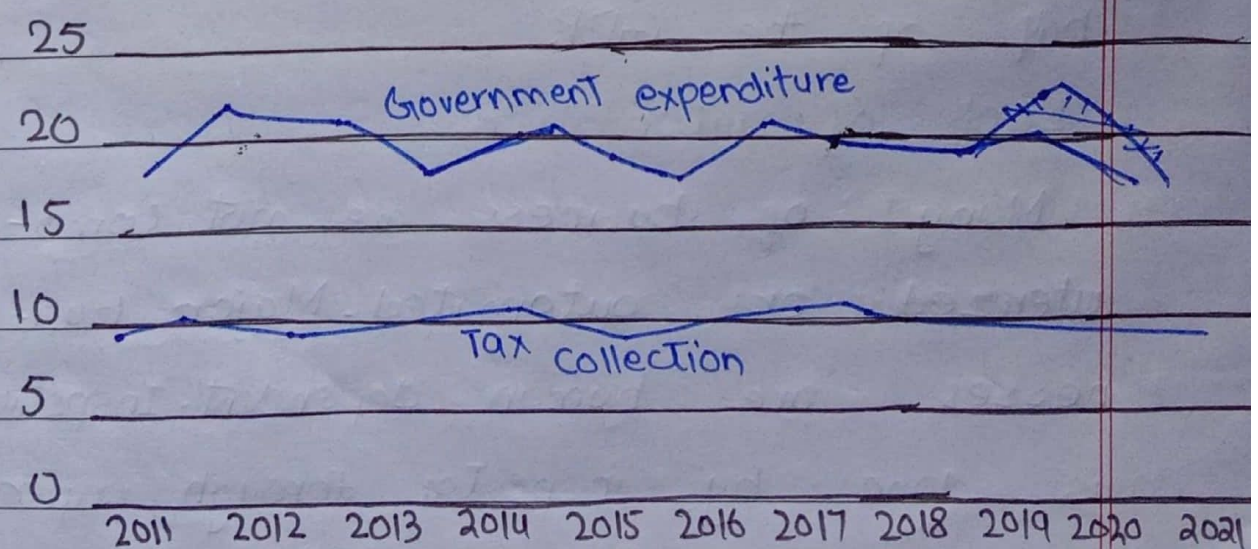
The international standards set by IMF, World Bank, ECB, ADB say that; "At least 2% of the collected amount must be spent on tax collecting bodies."

While Pakistan spends 0.6% on FBR.

This is why documentation and automation could not be done by FBR.

Furthermore, salaries are less of IRS and custom officers so they might involve in corrupt practices and corruption reduces transparency and is an important cause of swelling informal economy.

Tax collection verses government spending as a percentage of GDP





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## Debt Servicing

Another issue with budget of Pakistan is debt servicing because it takes the lion's share in budget. The minimum 35-40% of the expenditure portion is allocated to debt servicing. In the year 2021-22, the total expenditure was 8.4 trillion PKR while 3.4 trillion PKR was allocated for debt servicing.

We have unparalleled levels of debt generated through living on borrowed resources. The large budget deficits have resulted in the build up of public debt, reaching 78% of GDP in Fiscal Year 2022 just shy of record high of 81.1 percent of GDP in Fiscal Year 2020.

## Subsidies:-

The spending pressures in the large areas are constant especially on burgeoning subsidies. In 2021-22 budget, there are around 2 trillion PKR subsidies.

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These subsidies are on electricity, gas, petrol and diesel. There are more than 32 state own enterprises and 400 billion pkr bail out packages are given to enterprises like PIA, PAK railway and Pakistan post etc. The state own enterprises are burden on budget of Pakistan.

Depence Spending:-

Pakistan being faced by many security threats both internal and external so spending of defence is inevitable. Unfortunately, the economy of Pakistan is weak it cannot afford huge spending which is around above 2 trillion PKR.

Solutions:-

→ Fundamental expenditure reforms need to be a key ideological area of the budget. The reform must focus on reducing unnecessary expenditures on devolved subjects from the centre, moving away

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- From state-guaranteed pensions and improving the quality of the country's development spending. Spending is direct driver of ongoing deficits.
- Collections need to be increased by proper documentation and digitization of economy, by increasing investment to GDP ratio. In India investment to GDP ratio is 23%, in Bangladesh it is 28% while in Pakistan it is below 14%. Investment to GDP ratio must be improved for generation of businesses which can provide more opportunity for tax collection.
- The job of Government is not to run business but to play the role of regulator therefore state own enterprises must privatize to decrease the burden on budget.