

# Pakistan's Economy and Upcoming Federal Budget

## Challenges and Policy Efforts

### Policy Brief

*Pakistan's economy is passing through a critical phase marked by fragile macroeconomic stabilization alongside deep-rooted structural vulnerabilities. The forthcoming federal budget for 2026-27 assumes heightened significance as the country navigates inflationary pressures, external sector risks, IMF conditionalities, and growing demands for inclusive development. This policy brief examines the current state of the economy, outlines the key challenges confronting the budget, and presents policy recommendations aimed at shifting economic management from short-term stabilization toward long-term, development-oriented growth.*

#### 1. State of Pakistan Economy

Pakistan's economy is currently going through a delicate phase of stabilization during which some macroeconomic indicators have witnessed improvement, such as a prolonged period of exchange rate stability, vibrancy in remittances and IT exports, fiscal consolidation, and a steady recovery in growth rate with lower inflation. However, there are underlying structural weaknesses that constrain improvement, such as FDI falling by 45%, rising poverty incidence and unemployment, exports remaining sluggish, and growth remaining narrowly based. Recent growth estimates at 3.7% suggests that it is approaching the potential level, primarily driven by the services sector and supported by agriculture and industry.

The industrial sector's contribution to the economy continued to decline as import dependency grew, while exports remained stagnant at around \$30 billion. At the same time, consumable imports have increased substantially, thereby intensifying pressure on the balance of payments (BOP). The country is increasingly relying on imports even in sectors where it previously enjoyed self-sufficiency, including selected food commodities. Consequently, concerns regarding food security and future food inflation are rising.

Inflationary pressures are also expected to intensify in the coming months. Experts estimate that inflation may rise close to 15% over the next two months, which may compel the monetary policy committee to raise the policy rate. Such a development would substantially increase debt servicing obligations in the upcoming budget, potentially requiring an additional Rs. 500–600 billion.

The hard-earned macroeconomic stability, achieved at the expense of growing inequality and poverty, limits options for combating contagion from developments in the Gulf, which are further complicated by stabilization measures. Recent household survey findings indicate that poverty and inequality have already increased, suggesting that economic gains remain concentrated among limited segments of society. The burden of taxation disproportionately falls on the salaried class through direct and indirect taxation, while many influential sectors remain outside the effective tax net.

Another important concern is the issue of data availability, authenticity, and coordination. Fragmented and inconsistent economic data across institutions has weakened evidence-based policymaking and reduced the effectiveness of planning and resource allocation. Weak coordination

between federal and provincial institutions has further complicated economic governance.

Notwithstanding fiscal consolidation and primary surplus, Pakistan's fiscal situation also remains under significant stress. Approximately 47% of government expenditures are devoted to debt servicing, while dependence on loans continues to increase. Non-development expenditures remain high, whereas investment in research and development, productive sectors, and human capital remains insufficient. Moreover, the country continues to suffer from governance challenges, circular debt in the energy sector, weak institutional implementation, and inadequate local governance mechanisms.

## **2. Economic Issues and Challenges for the 2026-27 Budget**

The upcoming federal budget is expected to face multiple domestic and international challenges simultaneously.

### **Rising Inflation and Debt Servicing**

The expected rise in inflation and policy rates may significantly increase debt servicing requirements. Additional fiscal space would therefore be needed to manage interest payments, further constraining development expenditures and social sector allocations.

### **Balance of Payments Pressures**

Pakistan's external sector remains vulnerable due to stagnant exports and increasing imports. April current account deficit (CAD) numbers are alarming. Weak export diversification, low industrial productivity, and poor export facilitation continue to hinder outcomes on external accounts.

### **Food Security and Import Dependence**

Increasing reliance on imported consumable goods and emerging food security concerns may create additional inflationary pressures. Future food inflation is likely to impact lower-income households disproportionately.

### **Weak Tax Structure**

The country's tax-to-GDP ratio remains significantly below desired levels, hovering around 10% against a target closer to 15%. The salaried class continues to bear a disproportionate tax burden, while sectors such as agriculture, retail, and informal businesses remain insufficiently taxed due to weak implementation and a lack of political will.

## **IMF Program Constraints**

Pakistan's ongoing IMF program places additional conditionalities on fiscal management and budget preparation. While stabilization objectives remain central, prolonged stabilization-oriented policies may continue to suppress growth and investment.

## **Governance and Institutional Fragmentation**

The absence of strong coordination between federal and provincial institutions, weak local governments, and the absence of provincial finance commission mechanisms have reduced policy effectiveness. Additionally, multiple social protection initiatives continue to operate in silos without integration.

## **Human Development Challenges**

A substantial proportion of children remain out of school, increasing the risk of future poverty and unemployment. Weak investment in education, research and development, and skill enhancement may undermine long-term productivity growth.

## **Shrinking Development Orientation of the Budget**

The budget process has increasingly shifted toward revenue targeting and short-term stabilization rather than economic development planning. Five-year development plans remain largely disconnected from annual budgetary priorities.

## **3. Policy Inputs for Upcoming Budget**

In light of the prevailing economic conditions, the following policy considerations may be incorporated into the upcoming federal budget:

### **Shift from Stabilization to Development-Oriented Budgeting**

The upcoming budget will primarily focus on mitigating the likely impact of the US-Iran standoff. The budget should move beyond short-term stabilization objectives and adopt a broader, development-oriented framework focusing on productivity, investment, employment generation, and income growth.

### **Broadening the Tax Base**

The government should prioritize effective taxation of under-taxed sectors, including agriculture, retail, wholesale, and segments of the informal economy. Political commitment and implementation mechanisms are essential in this regard.

### **Export Promotion and Industrial Revival**

The budget should introduce targeted incentives for industrial productivity, export diversification, and value-added manufacturing. Special attention should be given to districts with no export contribution to broaden the export base geographically.

### **Food Security and Agricultural Support**

Agriculture should be treated as a strategic priority area. Measures may include facilitating affordable agricultural inputs, supporting mechanization, strengthening storage and supply chains, and improving domestic food production capacity to reduce import dependence.

### **Rationalization of Non-Development Expenditures**

Expenditure reforms should focus on reducing unnecessary non-development expenditures and improving fiscal efficiency, while safeguarding development spending in productive sectors.

### **Data Governance and Institutional Coordination**

A comprehensive framework for authentic, integrated, and coordinated economic data management should be developed to improve evidence-based policymaking and planning.

### **Strengthening Social Protection Mechanisms**

Existing social protection programs should be integrated and streamlined to improve efficiency, targeting, and impact, particularly for vulnerable populations affected by inflation and unemployment.

### **Investment Promotion and Documentation of the Economy**

The budget should prioritize local investment promotion, business facilitation, and documentation of the informal economy to improve productivity and broaden economic participation.

### **Human Capital and R&D Investment**

Greater allocations should be directed toward education, technical training, universities, and research and development to strengthen long-term economic competitiveness and reduce future poverty risks.

### **Defining the Role of the State**

The government should clearly redefine its role and scope in economic management, focusing on governance reforms, efficient service delivery, and strategic development planning to increase per capita income and economic sovereignty.



Prepared by:

**Dr. Zafar ul Hassan Almas**  
IPS Senior Associate &  
Former Joint Chief Economist

**Dr Asim Ehsan**  
Senior Research Officer  
Institute of Policy Studies, Islamabad

For queries:

**Shafaq Sarfraz**  
Head of Operations  
Institute of Policy Studies, Islamabad  
[shafaq@ips.net.pk](mailto:shafaq@ips.net.pk) | [www.ips.org.pk](http://www.ips.org.pk)