Chapter 4
Fiscal Policy

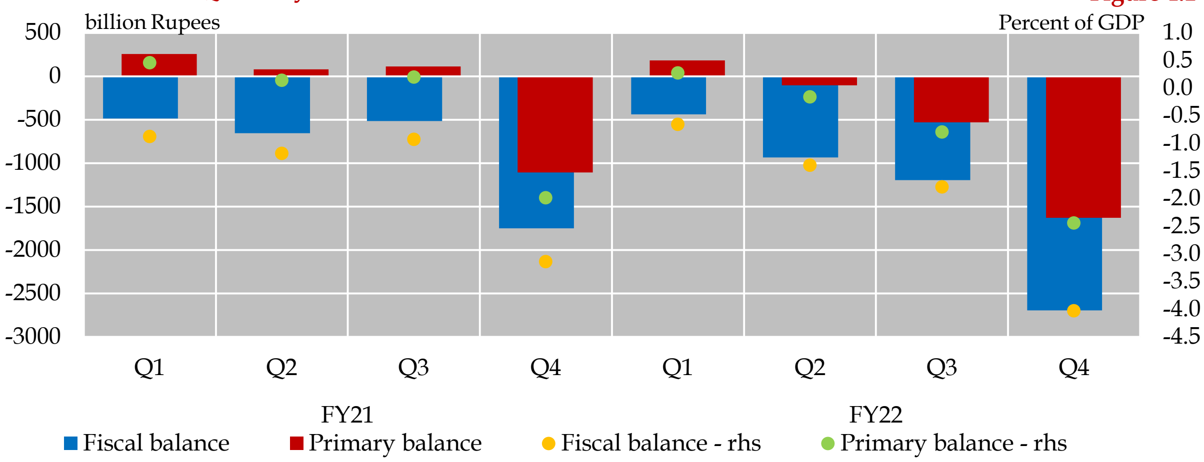
Following two years of fiscal consolidation during Covid, FY22 saw an unbudgeted and large fiscal expansion. The increase in overall expenditures masked an otherwise substantial growth in tax revenues and widened the fiscal deficit to 7.9 percent of GDP in FY22, compared to 6.1 percent last year. The deterioration was also witnessed in primary balance and revenue balance reflecting a rise in current and non-interest expenditures relative to overall revenues. Quarterly analysis indicates that fiscal indicators deteriorated as the fiscal year progressed. Particularly, current expenditures increased sharply during the last quarter amid higher grants, circular debt settlement under CDMP and POL subsidies. Meanwhile, higher interest spending due to rising interest rate amid increasing share of floating rate debt and recommencement of deferred payments under Debt Service Suspension Initiative (DSSI) to bilateral creditors further added to the worsening of fiscal balance. The entire increase in revenues was attributed to tax revenues, which effectively compensated the decline in non-tax revenues. The upward revised tax target of FBR was successfully achieved on the back of robust economic activity, fiscal measures and continued administrative efforts. However, non-tax revenues on the other hand declined during FY22. First, the change in timing of profit transfer led to partial transfer of SBP profits. Second, withdrawal of petroleum development levy in Q4-FY22 led to lower revenue collection. Provinces on the other hand continued with their fiscal consolidation efforts and delivered a combined surplus of 0.5 percent of GDP in FY22. The provincial surplus helped contain the overall consolidated fiscal deficit.

4.1 Fiscal Trends and Policy Review

Fiscal performance deteriorated during FY22 compared to a notable improvement in the previous year. Fiscal deficit as percent of GDP increased to 7.9 percent during FY22 compared to deficit of 6.1 percent realized last year (**Table 4.1**). The primary deficit more than doubled to 3.1 percent of GDP against a deficit of 1.2 percent during FY21, reflecting higher growth in non-interest expenditures vis-à-vis revenues. After two years of consolidation, this represented a large and unplanned fiscal stimulus at a time when the economy was already recovering very strongly from Covid. The budgeted overall and primary deficits were 6.3 and 0.7 percent of GDP, respectively. The revenue deficit also widened from 3.9 percent in FY21 to 5.2 percent of GDP in FY22. The deterioration in fiscal indicators is attributed to a sharp rise in expenditures, which more than offset a substantial growth in revenues. Provinces, on the other hand posted a combined surplus of 0.5 percent of GDP in FY22 compared to 0.6 percent last year.[1]

Total expenditures surged by 29.0 percent on YoY basis compared to a muted growth of 6.8 percent a year earlier. [2] Both current and development expenditures contributed to this growth. The rise in current expenditures was due to rising interest payments, social protection grants and subsidies. The disbursements made under Circular Debt Management Plan (CDMP), unplanned POL subsidies under the PM's relief package and industrial support package explain higher than targeted increase in overall subsidies.[3] Specific to interest expenditures, significant part of debt servicing payments came from the rise in domestic interest rates amid rising debt stock. The overall development expenditures also recorded a YoY growth of 26 percent in FY22 compared to 9.3 percent in FY21.[4] The impetus largely came from provincial spending, as federal government cut the development expenditures.

Fiscal Indicators - Quarterly **Figure 4.1**



Source: Ministry of Finance

[1] The provincial surplus recorded at Rs 351 billion in FY22 compared to Rs 263.3 billion last year. While the budgeted target for FY22 was Rs 570 billion.

[2] In absolute term, total expenditures recorded at Rs 13.3 trillion in FY22 against the target of Rs 8.5 trillion and actual expenditure of Rs 10.3 trillion in FY21

[3] The government disbursed Rs 564 billion in terms of CDMP, Rs 241.4 billion under PM's relief package, and Rs 132.3 billion for industrial support (including provision of subsidized LNG to industrial sector); together these subsidies added up to 1.4 percent of GDP.

[4] In absolute term, development expenditures recorded at Rs 1,657.4 billion in FY22 against Rs 1,315.7 billion in FY21.

Consolidated Fiscal Indicators **Table 4.1**

billion Rupees, growth in percent

	Q4		Jul-Jun		YoY growth (Q4)		YoY growth	
	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22
1. Total Revenue (a+b)	**1,910.8**	**2,161.2**	**6,903.4**	**8,035.4**	**20.8**	**13.1**	**10.1**	**16.4**
(a) Tax Revenue	1,507.7	1,933.3	5,272.7	6,755.2	44.1	28.2	19.5	28.1
Federal	1,369.4	1,759.2	4,764.3	6,142.8	43.6	28.5	19.2	28.9
Provincial	138.3	174.1	508.4	612.4	49.7	25.9	22.9	20.5
(b) Non-Tax	403.1	228.0	1,630.7	1,280.2	-24.8	-43.4	-12.4	-21.5
Federal	335.0	193.4	1,480.4	1,151.9	-34.8	-42.3	-15.8	-22.2
Provincial	68.1	34.6	150.3	128.3	199.1	-49.3	46.8	-14.6
2. Total Expenditure (a+b+c)	**3,662.1**	**4,855.5**	**10,306.7**	**13,295.3**	**11.9**	**32.6**	**6.8**	**29.0**
(a) Current Expenditure	2,998.6	4,143.3	9,084.0	11,521.4	2.7	38.2	6.5	26.8
Of which : Mark-up	645.9	1,064.0	2,749.7	3,182.4	-12.7	64.7	5.0	15.7
Defence	532.5	529.8	1,316.4	1,411.6	29.6	-0.5	8.5	7.2
Non-markup	2,352.7	3,079.4	6,334.3	8,338.9	7.9	30.9	7.1	31.6
(b) Development Expenditure & net lending	592.7	606.3	1,315.7	1,657.4	40.3	2.3	9.3	26.0
(c) Statistical Discrepancy	70.8	105.8	-93.0	116.5	-200.5	49.5	6.6	--
3.Overall Budget Balance	-1,751.3	-2,694.3	-3,403.3	-5,259.9	3.6	53.8	0.8	54.6
percent of GDP	-3.1	-4.0	-6.1	-7.9				
4.Primary Balance	-1,105.4	-1,630.3	-653.6	-2,077.5	16.3	47.5	-13.6	217.9
percent of GDP	-2.0	-2.4	-1.2	-3.1				
5. Revenue balance	-1,087.8	-1,982.1	-2,180.6	-3,486.0	-18.7	82.2	-3.5	59.9
percent of GDP	-1.9	-3.0	-3.9	-5.2				
6. Financing (a+b)	1,751.3	2,694.3	3,403.3	5,259.9	3.6	53.8	0.8	54.6
(a) External (Net)	775.9	197.0	1,338.1	1,178.4	264.0	-74.6	49.4	-11.9
(b) Domestic (Net)	975.3	2,497.3	2,065.2	4,081.5	-34.0	156.0	-16.8	97.6
Non-Bank	-95.9	448.1	196.2	980.6	-169.4	-567.0	-63.7	399.8
Bank	1,071.3	2,049.2	1,869.0	3,100.9	-20.0	91.3	-3.7	65.9

Source: Ministry of Finance

The overall revenues recorded a growth of 16.4 percent in FY22 compared to 10.1 percent last year. The entire increase in revenues emanated from tax revenues which more than compensated the decline in collection through non-tax revenues. Tax revenues remained higher than last year both at federal and provincial levels. In fact, FBR taxes registered a six-year high growth of 29.1 percent in FY22, compared to 18.7 percent last year. An uptick in economic activity, fiscal measures such as removal of exemptions and imposition of new taxes in the Finance Supplementary Act introduced in January 2022 and continuous administrative efforts played an instrumental role in ensuring high tax collection. The breakup of tax revenues shows that more than two-thirds of FBR tax collection emanated from import-related taxes. Higher domestic demand and depreciation of PKR against the US dollar kept the rupee value of imports at elevated levels. Non-tax revenues on the other hand, recorded a decline owing to partial transfer of SBP profits due to a change in the timing of the transfer amended in SBP Act, and reduced collection from petroleum levy on account of withdrawal of PDL levy in the last quarter of the fiscal year.

The quarterly analysis revealed that most of the fiscal slippage started to emerge from Q2-FY22 onwards (**Figure 4.1**). This was in contrast to the reduced fiscal spending and robust revenue growth achieved in Q1-FY22. Fiscal deficit widened at the end of Q2-FY22, whereas the primary surplus recorded during Q1-FY22 turned into a deficit during Q2-FY22. These fiscal slippages continued to persist in the subsequent quarters of FY22, and both fiscal and primary deficits experienced sharp worsening. This deterioration was attributed to a large increase in both interest and non-interest expenditures especially due to the fuel subsidies announced under PM's relief package in February 2022 that persisted for

Consolidated Revenue Collection **Table 4.2**

billion Rupees, growth in percent

	Collection						Growth					
	H1		H2		Jul-Jun		H1		H2		Jul-Jun	
	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22
Total Revenue (1+2)	**3351.2**	**3956.0**	**3552.2**	**4079.4**	**6903.4**	**8035.4**	**3.7**	**18.0**	**16.8**	**14.8**	**10.1**	**16.4**
1. Tax Revenue (a+b)	**2455.9**	**3191.0**	**2816.8**	**3564.1**	**5272.7**	**6755.2**	**6.4**	**29.9**	**23.4**	**26.5**	**11.1**	**28.1**
(a) Federal	2210.0	2919.8	**2554.3**	**3223.0**	4764.3	6142.8	5.6	32.1	22.6	26.2	9.9	28.9
(b) Provincial	245.9	271.2	**262.5**	**341.1**	508.4	612.4	14.7	10.3	31.8	29.9	22.9	20.5
2. Non Tax	**895.3**	**764.9**	**735.4**	**515.3**	**1630.7**	**1280.2**	**-3.1**	**-14.6**	**-2.9**	**-29.9**	**7.0**	**-21.5**

Source: Ministry of Finance

much of the fiscal year. Moreover a slowdown in revenues was witnessed primarily on account of lower collections from petroleum products

The expansionary fiscal policy stance followed in FY22 marked a divergence from the fiscal consolidation witnessed during last two years. The resultant increase in the fiscal deficit and hence borrowing requirements further augmented the burden of debt servicing. There is a need to address structural challenges by expediting reforms in PSEs. Particularly, power sector reforms ought to be made a priority to avoid further accumulation of circular debt. Similarly, there is also a need to widen the fiscal space by ensuring a sustained increase in tax collection through broadening the tax base. This can be achieved through the elimination of exemptions, improvement in tax design and reducing the over-reliance on indirect taxes.

4.2 Revenues

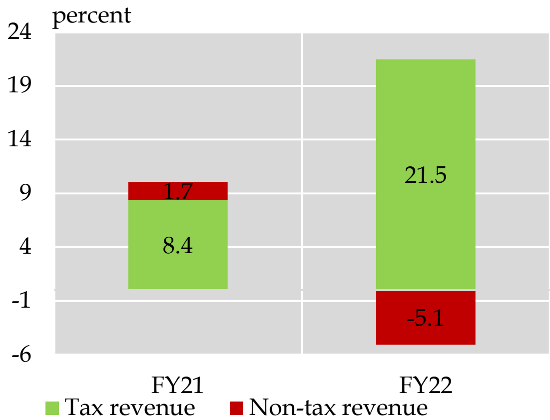
The overall revenues grew by 16.4 percent in FY22 compared to 10.1 percent last year (**Table 4.2**). The entire contribution came from tax revenues as non-tax revenues witnessed a decline during the period under review (**Figure 4.2**). Tax revenues remained higher than last year both at federal and provincial levels. A confluence of factors such as robust economic activity, higher imports, higher inflation, removal of tax exemptions, imposition of new taxes in the Finance (Supplementary) Act 2021[5] and continuous administrative efforts were instrumental in ensuring high tax collection.

Within tax revenues, almost two-thirds of FBR tax collection emanated from import-related activity. Higher domestic demand, elevated global commodity prices and depreciation of PKR against the US dollar kept the rupee value of imports at elevated levels, which in turn resulted in higher revenues. Collection through domestic sales tax, however, declined as the government withdrew sales tax on POL products during the H2-FY22. Receipts from direct taxes also remained higher than last year due to fiscal measures announced in the Supplementary Finance Bill.

FBR Taxes

FBR taxes registered a six-year' high growth of 29.1 percent in FY22, exceeding its previous year's growth of 18.7 percent. Moreover, the annual target was surpassed despite an upward revision (**Figure 4.3**). The tax collection target was set at Rs 5,800 billion initially, which was revised upwards to Rs

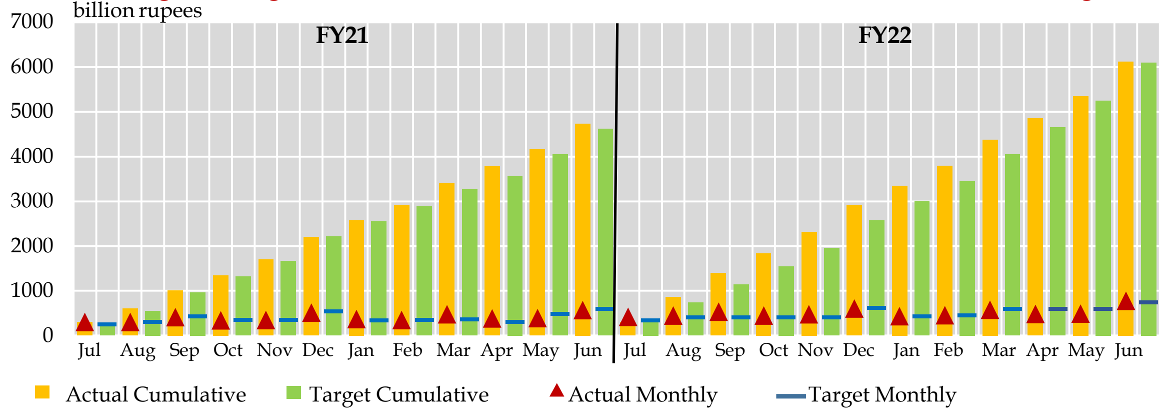
Growth Contribution in Revenues **Figure 4.2**



Source: Ministry of Finance & SBP calculations

[5] Finance (Supplementary) Act 2021 was enacted on January 15th, 2022.

Tax collection against Target and Actual Collection **Figure 4.3**



Source: Federal Board of Revenue

6,100 billion, the actual collection stood at Rs 6, 126.1 billion during FY22.

The growth of FBR taxes was more pronounced during H1-FY22 - an average monthly YoY growth of 33.4 percent compared to 26 percent during H2-FY22 (**Table 4.3**). The increase in FBR taxes during H1 FY22 was driven by a continuous uptick in economic activity as reflected by LSM growth, domestic demand indicators and higher growth in imports (**Table 4.4**). In addition, FBR's continuous efforts to strengthen tax administration, higher global commodity prices and depreciation of PKR that translated into higher domestic inflation played their part in high collection. Lastly, removal of exemptions and fiscal measures enacted in the Finance Supplementary Bill also helped achieve the collection target during FY22. It is important to highlight that higher collection was recorded despite the large refunds to POL, fertilizers, pesticides and pharmaceuticals compared to last year.[6] In terms of composition, the expansion in FBR taxes mainly came from import-related taxes (20.6 percentage points) during FY22 (**Figure 4.4**). This was attributed to a surge in imports volume reflecting high domestic demand, higher commodity prices and depreciation of PKR against the US dollar.[7]

FBR administrative efforts had an important role

Tax authorities continued reforms related to tax administration throughout FY22 with an

FBR Tax Collection **Table 4.3**

billion Rupees, growth in percent

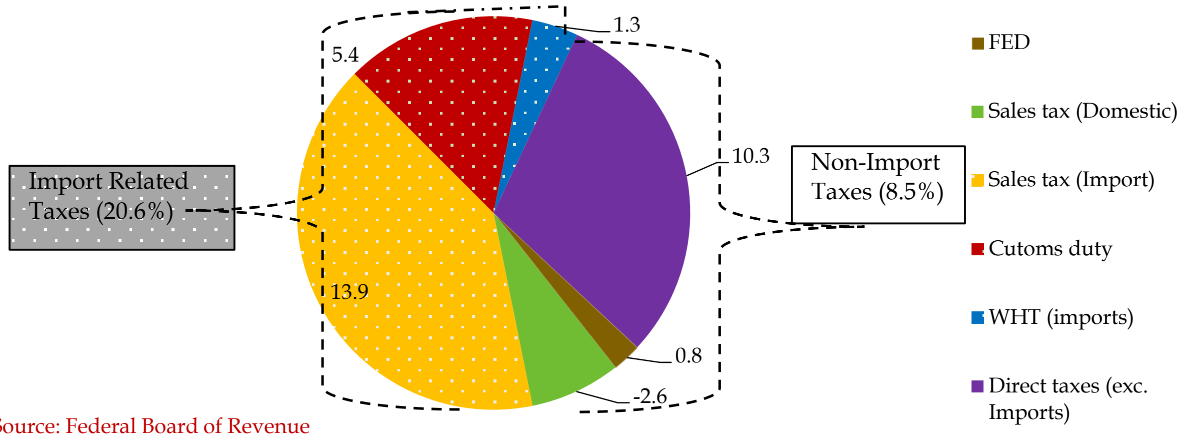
	Collection						Growth					
	H1		H2		Jul-Jun		H1		H2		Jul-Jun	
	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22
FBR Taxes (a+b)	**2,210.0**	**2,919.8**	**2,534.1**	**3,206.3**	**4,744.2**	**6,126.1**	**5.6**	**32.1**	**33.1**	**26.5**	**18.7**	**29.1**
(a) Direct Taxes	830.8	1,019.5	900.3	1,260.6	1,731.1	2,280.1	5.9	22.7	21.8	40.0	13.6	31.7
(b) Indirect Taxes	1,379.2	1,900.3	1,633.9	1,945.7	3,013.1	3,846.0	5.4	37.8	40.3	19.1	21.8	27.6
Custom Duties	337.9	480.3	409.1	521.5	747.0	1,001.8	3.0	42.2	37.1	27.5	19.2	34.1
Sales Tax	918.1	1,274.5	1,064.3	1,248.0	1,982.5	2,522.4	6.9	38.8	44.2	17.3	24.1	27.2
Imports	508.6	892.3	647.3	924.9	1,155.9	1,817.2	13.8	75.4	50.7	42.9	31.9	57.2
Domestic	408.1	383.7	418.4	321.5	826.6	705.2	-0.7	-6.0	35.2	-23.2	14.7	-14.7
Federal Excise	123.2	145.5	160.4	176.2	283.6	321.7	0.8	18.1	25.1	9.9	13.2	13.4

Source: Federal Board of Revenue

[6] The amount of refunds issued during FY22 increased by 34.0 percent to Rs 336.9 billion compared to Rs 251.5 billion last year

[7] With an increase of 59.0 percent in rupee value of imports in FY22 compared to 27.8 percent growth last year, the share of collection from import related taxes significantly increased.

Growth Contribution of Import Related Taxes in Overall FBR Tax Collection **Figure 4.4**

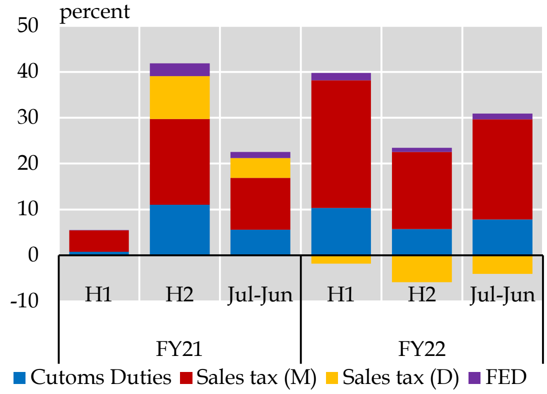


Source: Federal Board of Revenue

objective to enhance administrative efficiency, limit tax evasion and ensure ease of doing business. The introduction of Track and Trace System for tobacco and sugar sectors facilitated documentation of the economy and reduced tax evasion in these sectors[8] [9]. Similarly, in continuation of previous year's introduction of POS invoicing system by integrating tier 1 retailers, it was further extended to large retailers. Since its introduction, a total of 4,563 retailers were integrated into this system with the installation of 10,611 POS machines till the end of FY22.[10]

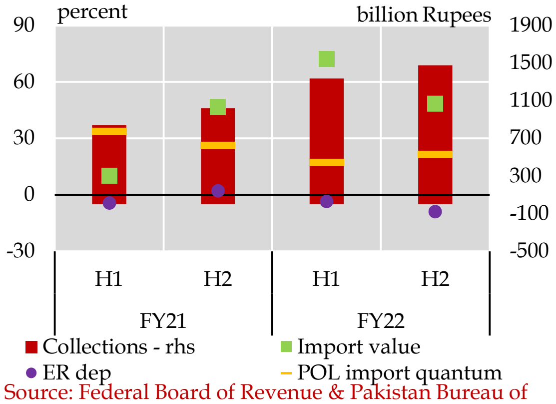
In continuation of these ongoing efforts, FBR targeted to integrate the largest 500 retailers in this system in FY22. FBR also introduced a single sales tax portal in collaboration with the provincial revenue authorities. This initiative reduced the cost of doing business by containing the time and expense of tax compliance. This portal allowed taxpayers to file single monthly sales tax returns instead of six returns on provincial revenue portals, previously. Another initiative of FBR was the introduction of the Pakistan Single Window (PSW) in order to reduce clearance times for legitimate trade. Lastly, the mechanism of e-hearing was formulated to provide contact-less tax administration resulting in reduced compliance time.

Growth Contribution in Indirect Taxes **Figure 4.5**



Source: Federal Board of Revenue

Main Drivers of Import Related Collections **Figure 4.6**



Source: Federal Board of Revenue & Pakistan Bureau of Statistics

[8] TTS on tobacco and sugar was introduced in October and November 2021 respectively.
[9] With the implementation of TTS for sugar industry, the sales tax collection from this sector posted a 31 percent growth in FY22.
[10] FBR press release dated: 30 June 2022

Direct Taxes **Table 4.4**

billion rupees, percent

			Growth	
	FY21	FY22	FY21	FY22
Collection on Demand	**80.1**	**101.1**	**31.8**	**26.1**
Voluntary Payment	**467.8**	**676.4**	**15.6**	**44.6**
Advance tax	413.7	597.9	--	44.5
Withholding Taxes	**1237.3**	**1534.0**	**13.3**	**24.0**
Imports	218.5	280.6	9.4	28.4
Salaries	151.8	197.3	17.3	29.9
Dividends	63.8	83.3	15.8	30.6
Bank Interest & Securities	135.0	154.9	5.2	14.7
Contracts	272.0	341.0	14.6	25.4
Export	42.2	64.9	9.7	53.7
Cash Withdrawal	15.1	0.3	-0.4	-98.2
Electric bills	51.3	71.4	12.9	39.3
Telephone	63.2	67.9	15.7	7.5
Total direct taxes	**1,731.3**	**2,280.1**	13.6	**31.7**

Source: Federal Board of Revenue

Collection from Indirect taxes surged amid rising imports

Indirect taxes witnessed a broad-based growth of 26.9 percent in FY22, compared to 22.5 percent last year.

Import related taxes (sales tax on imports and custom duty) contributed the most in the indirect taxes during FY22 (**Figure 4.5**). The uptick in domestic demand as evident by the acceleration in economic activity translated into higher imports of POL, iron & steel, vehicles, edible oil and machinery, which augmented revenue collection. The increase in global commodity prices and depreciation of PKR also contributed in higher collections.

In particular, the rising automobiles' demand in the domestic market and the ensuing increase in import of Completely Knocked Down (CKD) and Completely Built-Up (CBU) vehicles also bolstered import related taxes during FY22. Similarly, further impetus in tax collection came from food imports, which was mainly driven by price hikes; higher prices of food items in global markets boosted import values and helped increase collection (**Figure 4.6 & Chapter 5**).

On the other hand, collection through domestic sales tax decelerated compared to last year. This slowdown is attributed to lower tax collection on POL products as the government withdrew sales tax on these products during H2-FY22. Lower sales volume of POL along with government's relief package (cut in fuel prices) explain lower revenue collection particularly in Q3-FY22. Meanwhile, relief measures, such as, subsidy on POL, fertilizers, vehicles, ghee have dented revenue collection by approximately Rs 188 billion during the months of March - May, 2022 alone.[11] Nonetheless, collection from non-POL products remained robust.

Collection from direct taxes increased further

Direct taxes also posted a significant increase of 31.7 percent in FY22 compared to 13.6 percent last year (**Table 4.4**). This growth mainly came from withholding taxes. Fiscal measures such as removal of exemptions and imposition of advance taxes helped in higher revenue collection. Both voluntary payments and collection on demand (CoD) contributed positively as the contest time was extended from 90 to 180 days.

Within withholding taxes (WHT), higher volume of imports, increase in salaries by the federal and provincial governments, higher interest rate environment and revival in economic and construction activity were the main contributors in higher collection from WHT. The continuously increasing usage of telecom services due to online educational activities and virtual meetings during the pandemic, helped increase the collections from telecom services. This increase is evident from the higher number of cellular subscribers as well as the higher broadband data usage during the period (**Figure 4.7**).

4.3 Non-Tax Revenue

The overall non-tax revenues declined for the second consecutive year (**Table 4.5**). Transfer of SBP profits to the government remained lower than last year due to change in the

[11] FBR press releases for the month of March, April and May 2022.

Non-tax Revenues during (consolidated) **Table 4.5**

billion Rupees, growth in percent

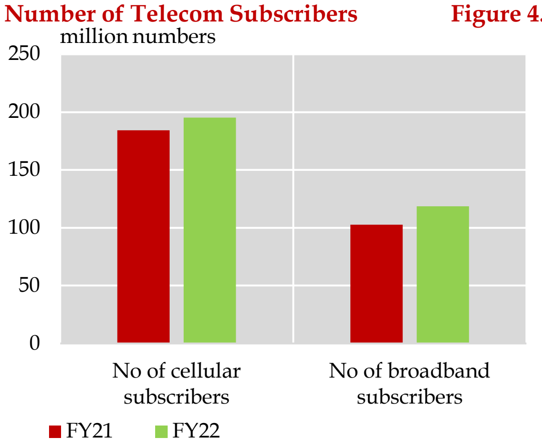
	Collection				Growth	
	H1		Jul-Jun		H1	Jul-Jun
	FY21	FY22	FY21	FY22	FY22	FY22
SBP profits	372.5	380.0	650.5	473.6	2.0	-27.2
Petroleum Levy	275.3	70.0	424.7	127.5	-74.6	-70.0
PTA profits	18.6	38.9	39.1	103.4	108.9	164.8
Mark-up (PSEs & others)	44.0	32.6	76.2	87.8	-25.9	15.2
Royalties on gas & oil	35.1	39.1	70.9	90.8	11.2	28.1
Dividends	11.9	26.0	43.9	42.9	118.8	-2.2
Passport & other fees	7.0	10.4	13.0	21.6	49.2	65.7
Defense	6.5	7.7	14.9	17.3	18.6	16.2
Total	**895.3**	**764.9**	**1630.7**	**1280.2**	**-14.6**	**-21.5**

Source: Ministry of Finance

transfer mechanism. Previously, SBP profits were transferred to the government at the end of each quarter. However, with the amendments in the SBP Act, now the SBP profits are transferred to the government after finalizations of annual financial statement at the end of each fiscal year, implying some lag in the transfer beyond the fiscal year. This change in mechanism become effective from Q3-FY22.

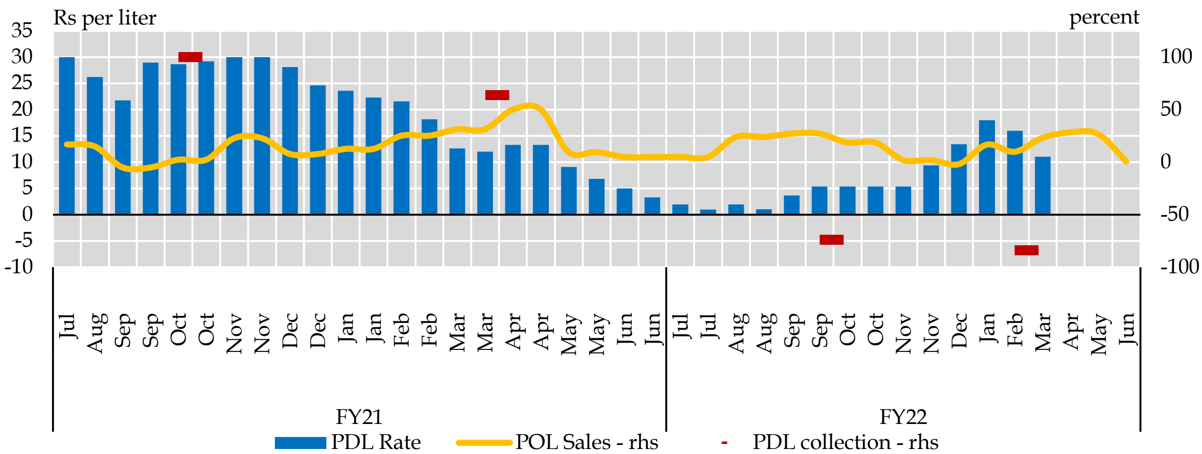
Collection through PDL also declined in FY22 as the government removed the levy from April 2022 onwards (**Figure 4.8**). Even the PDL rate before April 2022 was lower than last year.[12] On the other hand, PTA profits rose amid issuance of spectrum licenses to two cellular companies.

Number of Telecom Subscribers **Figure 4.7**



Source: Pakistan Telecommunication Authority

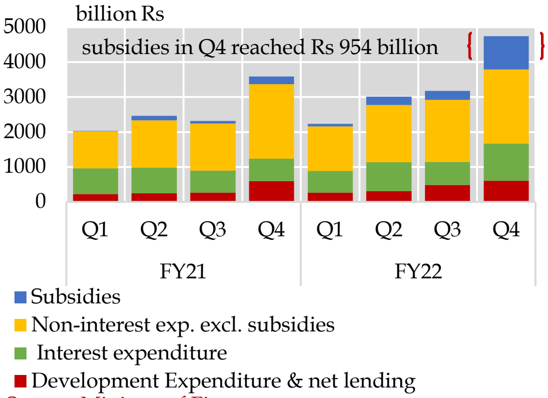
PDL Rates and Half Yearly Collections Growth (YoY) **Figure 4.8**



Source: Ministry of Finance

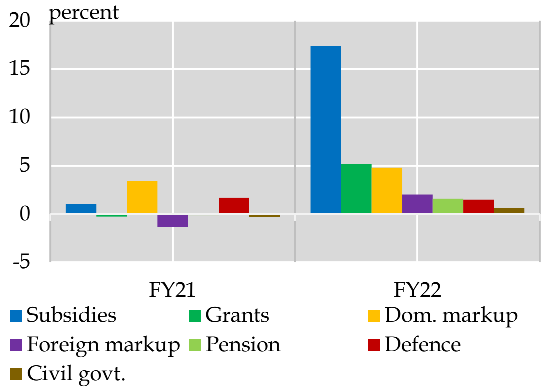
[12] The PDL rates was dropped to Rs 2 at the start of FY 22, which was gradually increased to Rs 18 till the month of March 2022. These rates were dropped to zero in order to minimize the impact of rising POL prices on end consumers in Q4-FY22.

Quarterly Flows in Current Federal Spending **Figure 4.9**



Source: Ministry of Finance

Growth Contribution in the Federal Current Expenditures **Figure 4.10**



Source: Ministry of Finance

4.4 Federal Expenditures[13]

During FY22, federal expenditures witnessed a relatively higher growth of 28.2 percent compared to an increase of 4.7 percent last year. The major push came from current expenditures as both interest and non-interest payments including subsidies rose sharply, especially during H2-FY22 (**Figure 4.9**). Besides, increase in pension, running of civil government, and grants also contributed in this expansion in federal current expenditures. In contrast, development expenditures reduced by 19.6 percent in FY22 compared to a marginal rise of 1.0 percent observed during the last fiscal year (**Table 4.6**).

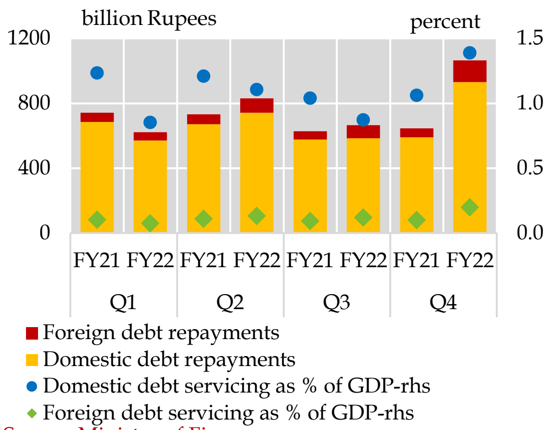
Federal Current Expenditures

After witnessing a marginal increase in FY21, the current spending posted significant growth in FY22. The expansion mostly emanated from subsidies which crossed the mark of Rs 1.5 trillion in FY22 almost 3.6 times higher than FY21. The tariff differentials payments to IPPs under the circular debt management plan (CDMP) along with POL subsides partly explain the hefty disbursement under the subsidy account. Meanwhile, the grants to provinces, domestic and foreign markup payments, pensions and running of civil government also increased significantly during FY22 (**Figure 4.10**).

Higher trajectory of growth in interest expenses

The interest payments that remained largely muted until Q3-FY22[14], could not sustained this trend in the following months. During Q4-FY22, domestic and foreign mark-up payments accelerated the overall interest expenditures which crossed Rs 1 trillion mark in absolute term and 1.6 as percent GDP. The higher mark-up payments were attributed to the rising trend in domestic interest rates amid increasing share of floating rate debt and recommencement of deferred payments under Debt Service Suspension Initiative (DSSI) to bilateral creditors (**Figure 4.11**).[15]

Quarterly Trend in Interest Payments **Figure 4.11**



Source: Ministry of Finance

[13] The discussion in this section is based on expenditures excluding statistical discrepancy.
[14] The overall interest payment experienced a marginal growth of 0.7 percent during Jul-Mar FY22, relative to 11.9 percent during same period of FY21
[15] For details, see Chapter 5 on "Domestic and External Debt."

State of Federal Expenditures **Table 4.6**

billion Rupees, growth in percent

	FY21	FY22	YoY growth FY21	YoY growth FY22	As percent of total expenditures FY21	As percent of total expenditures FY22	As percent of GDP FY21	As percent of GDP FY22
Total expenditures* (a+b)	**7137.7**	**9152.7**	**4.7**	**28.2**	**100.0**	**100.0**	**12.8**	**13.7**
(a) Current expenditure	**6348.7**	**8451.6**	**4.2**	**33.1**	**88.9**	**92.3**	**11.4**	**12.6**
Mark-up payments	2749.7	3182.4	5.0	15.7	38.5	34.8	**4.9**	**4.8**
Domestic	2523.8	2828.6	9.1	12.1	35.4	30.9	4.5	4.2
Foreign	225.9	353.9	-26.3	56.6	3.2	3.9	0.4	0.5
Defence affairs and services	1316.4	1411.6	8.5	7.2	18.4	15.4	2.4	2.1
Pension	440.1	541.9	-1.6	23.1	6.2	5.9	0.79	0.81
Running of civil govt.	505.8	546.7	-3.5	8.1	7.1	6.0	0.9	0.8
Subsidies	425.0	1529.6	18.1	259.9	6.0	16.7	0.8	2.3
Grants to provinces and others	911.6	1239.3	-1.8	36.0	12.8	13.5	1.6	1.9
Grants to provinces	83.8	97.5	9.8	16.2	1.2	1.1	0.2	0.1
Grants to others	827.7	1141.8	-2.8	37.9	11.6	12.5	1.5	1.7
(b) Development expenditure and net lending	**789.1**	**701.1**	**8.6**	**-11.1**	**11.1**	**7.7**	1.4	1.0
Total development expenditure	**694.6**	**558.1**	**1.0**	**-19.6**	**9.7**	**6.1**	**1.2**	**0.8**
PSDP	667.3	558.1	7.2	-16.4	9.3	6.1	**1.2**	**0.8**
o/w Development grants to provinces	226.1	157.7	46.3	-30.3	3.2	1.7	0.4	0.2
Other development expenditure	27.3	0.0	-58.3	-0	0.4	0.0	0.0	0.0
Net lending	**94.5**	**143.0**	**144.7**	**51.4**	**1.3**	**1.6**	**0.2**	**0.2**
Provinces	17.5	102.6	-276.7	485.2	**0.2**	**1.1**	0.0	0.2
Others	76.9	40.4	58.5	-47.5	**1.1**	**0.4**	0.1	0.1

* Excluding statistical discrepancy

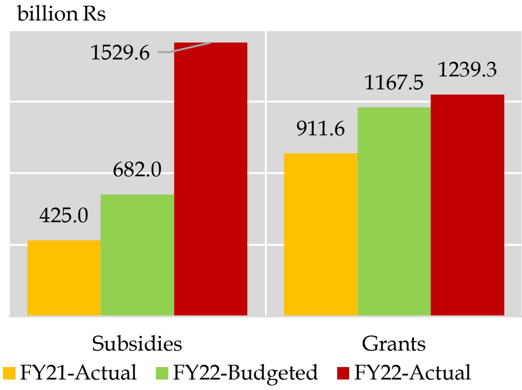
Source: Ministry of Finance

Substantial increase in subsidies and grants

Subsidies and grants grew markedly during FY22 compared to FY21, and surpassed the budgeted amount by a wide margin (**Figure 4.12**).

Subsidies: The volume of overall subsidies reached Rs 1529.6 billion in FY22 compared to Rs 425.0 billion last year. While, in terms of GDP it increased to 2.3 percent in FY22 from 0.8 percent in FY21. [16] Within subsidies, most of the disbursement comprised of power sector related payments which included tariff differentials and receivables to DISCOs, PHPL, K-electric and WAPDA/PEPCO (**Figure 4.13**). A part of these expenditures was disbursed to IPPs under the revised CDMP. The revised plan was approved in February 2022 by the Cabinet Committee on Energy (CCoE) to

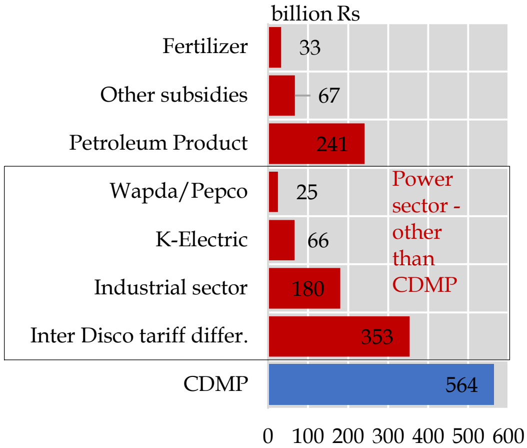
Targets Versus Actual Estimates of Federal Subsidies & Grants **Figure 4.12**



Source: Ministry of Finance

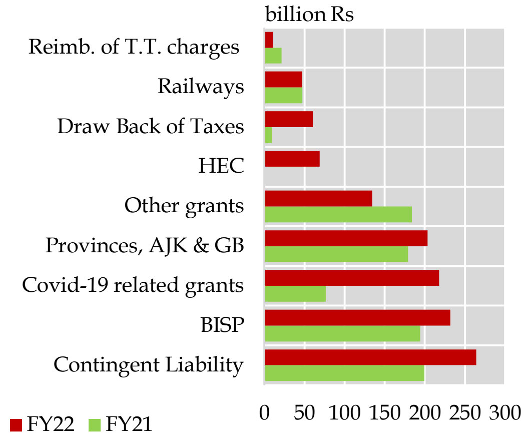
[16] The target for overall subsidies was set at Rs 682 billion, from which Rs 596 billion were allocated to power sector including circular debt payments. Against this allocation, power sector received Rs 1026.3 billion during FY22, the large deviation from target disbursement was mainly due to higher accumulation of circular debt and payments made under fiscal package.

Disbursement of Federal Subsidies **Figure 4.13**



Source: Ministry of Finance

Disbursement of Federal Grants **Figure 4.14**



Source: Ministry of Finance

contain the flow of circular debt, which surpassed Rs 2.2 trillion at end-June 2022.[17]

The added growth in subsidies during FY22 came from price differential claims on petroleum products specifically motor spirit and diesel announced under PM's relief package introduced in February 2022, which persisted for much of the rest of the fiscal year. The aim of this package was to insulate domestic consumers from the impact of rising petroleum prices in international markets. Initially, the package was expected to continue till June 2022, however, due to rising subsidy cost and revival of the IMF program, it was rolled back in May 2022. The package cost Rs 241.4 billion to the national exchequer in terms of fuel subsidies (**Figure 4.13)**.[18]

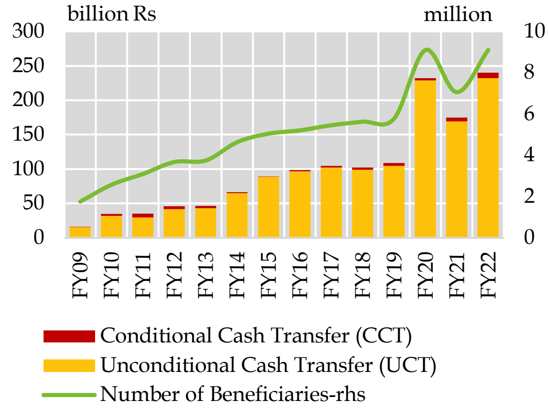
The subsidies to industrial sector also recorded a marked increase of Rs 219.7 billion during FY22 compared to Rs 37 billion in FY21 and the target of Rs 73 billion. The notable increase in subsidies to industrial sector falls under different categories, for instance; 1) provision of LNG to industry at subsidized rates; 2) supply of electricity at lower rates to zero-rated export sector and; 3) extension of industrial support package (ISP).[19]

Grants: The total disbursements under grants reached Rs 1,239.3 billion in FY22 compared to Rs 911.6 billion disbursed in FY21 (**Figure 4.14**). The contingent liabilities remained a major recipient of federal grants, followed by Benazir Income Support Program (BISP) and Covid-19 related grants.

Specific to social protection, the BISP program was the major beneficiary of federal grants of Rs 232 billion, however, it missed the budgeted target of Rs 246 billion. The program included different protection schemes covered under non-conditional and conditional cash transfer programs. The major recipients of BISP grants were unconditional cash transfer (UCT) programs including Ehsaas Kafaalat, Ehsaas Cash Assistance and specific relief assistance provided to LOC AJK, Hernai and Tirah valley.[20] In terms of

[17] IMF (2022), Country Report No. 22/288
[18] The PM's relief package was announced on 28th February 2022 and implemented from March 2022 onwards, hence the disbursement of subsidies started in April 2022. Government disbursed Rs 66.8 billion under POL price differential claims in April 2022, followed by Rs 89.2 and Rs 85.4 billion in May and June 2022 respectively.
[19] To generate the demand for ample available electricity and boost the industrial activity, the government had announced ISP scheme in November 2020. Under this scheme the peak and off-peak tariff structure for industrial consumers was abolished initially for the period from November 2020 till end April 2020. However, due to higher energy demand, the package was first extended till June 2022 and then till October 2023. (Source: NEPRA (2021), State of Industry Report)
[20] Pakistan Economic Survey (2021-22), Finance Division.

Disbursements in BISP **Figure 4.15**



Source: Benazir Income Support Programme

coverage, the growing size of BISP not only reflects the higher budgetary allocations but also mirrors the larger inclusion of households (**Figure 4.15**).[21]

Meanwhile, different Covid-related programs also witnessed notable expansion during FY22. For instance, the National Disaster Management Fund (COVID-19) received Rs 102 billion. Similarly, the government issued different disbursements to the Ministry of National Health Services Regulation and Coordination (NHSR&C) including; 1) COVID 19 Vaccine Support Project under the Asia Pacific Vaccine program received Rs 81 billion[22]; 2) Pandemic Response Effectiveness in Pakistan (PREP) raised Rs 23 billion[23]; and 3) Rs 11.9 billion under 'IVAC Covid-19 Vaccine support for Pakistan[24].

Increase in salaries and pensions

In contrast to a decline in FY21, pensions as well as running of the civil government expenditures saw considerable rise in FY22. More specifically, under the austerity drive in FY21, the government had kept the annual increase in salaries of government employees and pensions on hold. However, the government introduced some relief measures for federal employees and pensioners in Budget 2021-22 which included; 1) ad-hoc relief allowance of 10 percent to all federal employees and employees of autonomous/ semi- autonomous bodies and corporations given that they have adopted the federal government's Basic Pay Scales Scheme; 2) annual increment in pensions by 10 percent ; 3) rise in orderly allowance from current Rs 14,000 to Rs 17,500; 4) increase in integrated allowance[25] from current level of Rs 450 to Rs 950 per month for employees placed in BPS grade 1-5; and 5) increase in minimum monthly wage from Rs 17,000 to Rs 20,000.[26]

Moreover, the disparity reduction allowance of 15 percent was announced on 23rd Feb 2022 which was admissible to all federal employees on their basic pay scale of 2017. Similarly, on 14th April 2022, pension rate was also revised upward by 10 percent, the announced rate was effective from 1st April 2022.[27]

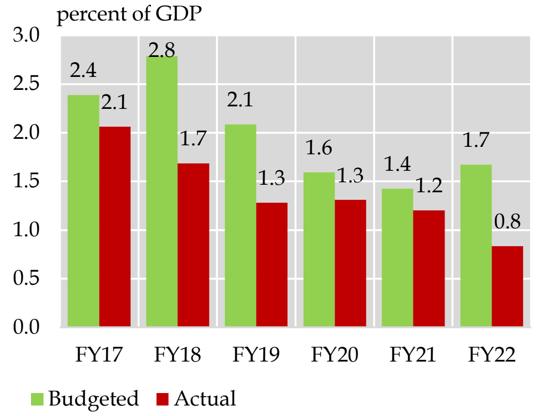
As a result of these measures, the overall expenditures incurred on running of civil government (mainly comprised salaries) and pension crossed Rs 1 trillion mark in FY22, compared to Rs 946 billion in FY21.[28]

Federal Development Expenditures

The federal development expenditures fell by 19.6 percent in FY22, compared to marginal growth of 1.0 percent in FY21, mainly reflecting the subdued disbursement under federal PSDP. Since last few years, the share of federal PSDP has been continuously declining

[21] The last NSER was conducted in 2010-11 that identified 27 million beneficiaries, the coverage increased to around 33 million in 2021.
[22] COVID-19 Vaccine Support Project under the Asia Pacific Vaccine Access Facility was funded by Asian Development Bank.
[23] This program was initiated with the support of World Bank
[24]This funding was committed by Islamic Development Bank (IDB) Source: Finance Division
[25] Integrated allowance is offered to Naib Qasids, Qasids and Daftaries.
[26] Budget speech 2021-22, Finance Division
[27] Finance Division
[28] Furthermore, in Budget 2022-23 government once again announced an increment of 15 percent in pension, with effect from Jul 2022.

Federal PSDP, Actual versus Budgeted Figure 4.16



Source: Ministry of Finance

in overall GDP, both at budgeted and at execution stage. Specifically, during the last two years covid-led expenditures, reduced the fiscal space. In addition, Public Financial reforms[29] also partly explain the slowdown in PSDP release. For FY22, government had envisaged a target for PSDP (1.7 percent of GDP) higher than the last two years (**Figure 4.16**). In the first half of FY22, the quarterly releases of federal PSDP remained on track; however, the releases were put on hold in H2-FY22 mainly to contain the rising fiscal imbalance. In overall terms, the federal PSDP stood at Rs 558 billion against the budgeted amount of Rs 900 billion, this spending cut had squeezed the number of development projects that were initially expected to be completed by end-June 2022 from 371 to 170.[30]

The ministry-wise allocation suggests that more than 60 percent of federal development funds were allocated to five main divisions and corporations including NHA, finance, water resource, cabinet and power divisions. Under these ministries, the funds were allocated to major infrastructure and hydropower projects such as Dasu hydropower, Diamer Basha Dam, K4-greater water supply scheme and Neelum Jehlum

PSDP Targets vs. Disbursements **Table 4.7**

billion Rupees, percent

Main Projects	Allocation (2021-2022)*	Revised estimates**	Execution as percent of allocation**
NHA	113.8	86.7	76.2
Of which. Improvement of Jaglot - Skardu Road	10	5.9	59.0
Khyber Pass Economic Corridor Project	8.5	0.075	0.9
Motorway- Burhan - Hakla on M-I to Dera Ismail Khan	8	10.8	135.0
Finance Division	123.1	45.8	37.2
Of which. Merged Districts of Khyber Pakhtunkhwa 10 Years Development Plan	54	44.3	82.0
Land Acquisition Swat Motorway	10	5	50.0
Water Resource Division	103.5	90.6	87.5
Of which. Dasu Hydro Power Project	56.5	na	na
Diamer Basha Dam Project (Dam Part)	15.5	7.5	48.4
K-IV Greater Water Supply Scheme	15.1	15.1	100.0
Neelum Jhelum Hydro Power Project	14.2	na	na
Cabinet Division	46.2	64	138.7
Of which. Sustainable Development Goals Achievement Program	46	64	139.1
Power Division (through PSDP)	69.5	46.5	66.9
Of which. Interconnection of Isolated Makran Network	5.0	3.0	60.0
Secondary Transmission Lines & Grid Stations -SEPCO	6.6	0.0	0.0
Secondary Transmission Lines & Grid Stations- HESCO	5.2	0.0	0.0

Sources: *Public Sector Development Programme 2021-22, Planning Commission Ministry of Planning, Development & Special Initiatives, **Details of Demands for Grants and Appropriations Volume IV, Development Expenditure, Ministry of Finance

[29] The PFM reforms comprised of; (i) budget management; (ii) development projects, maintenance and use of public assets; (iii) control of public finance consolidated fund and public account; (iv) treasury management; (v) special purpose funds; (vi) accounting and reporting; (vii) public entities; (viii) non tax revenue and; (ix) removal of difficulty and power to make rules.

[30] Planning Commission of Pakistan

Provincial Fiscal Operations **Table 4.8**

billion Rupees, growth in percent

	Cumulative Flows		YoY growth	
	FY21	FY22	FY21	FY22
A. Total revenue (a+b+c)	**3,728.0**	**4,687.5**	**15.0**	**25.7**
a. Provincial share in federal revenue	2,741.9	3,589.0	9.5	30.9
b. Federal loans and transfers	327.5	357.8	48.2	9.3
c. Provincial own revenue	658.6	740.7	27.6	12.5
Taxes	508.3	612.4	22.9	20.5
Non-taxes	150.3	128.3	46.8	-14.6
B. Total expenditures (a+b+c)	**3,414.4**	**4,336.5**	**7.9**	**27.0**
a. Current	2,844.2	3,200.8	11.9	12.5
b. Development	770.3	1,216.6	23.8	57.9
c. Statistical discrepancy	-69.1	-80.9		17.1
Overall balance (A-B)	**263.3**	**351.0**	**241.7**	**33.3**

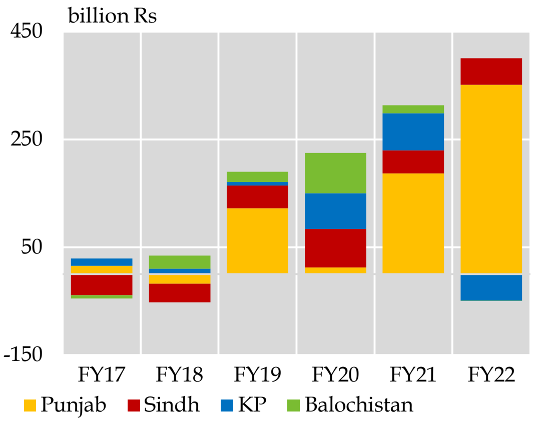
Source: Ministry of Finance

hydro power projects. The 10-year development plan for merged districts of Khyber Pakhtunkhwa and sustainable development goal achievement program remained as major non-infrastructure programs being allocated to Finance division and Cabinet divisions, respectively (**Table 4.7**).

4.5 Provincial Fiscal Operations

On a consolidated basis, the provincial financial account posted a surplus of Rs 351 billion during FY22, which while staying higher than FY21 was far behind the annual target of Rs 570 billion (**Table 4.8**). The provincial surplus was mainly due to higher

Provincial Surplus **Figure 4.17**



Source: Ministry of Finance

increase in revenues which more than offset the upsurge seen in provincial expenditure. From the provincial accounts, the positive contribution came from surplus recorded by Punjab and Sindh; whereas, Khyber Pakhtunkhwa and Balochistan recorded deficit during FY22. (**Figure 4.17**).

Provincial Revenues

The provincial revenue mobilization remained robust during FY22 mainly on account of increased share in federal divisible pool. Further impetus came from higher allocation of federal loans and transfers and increase in provincial tax and non-tax revenues (**Figure 4.17 and 4.18**).

Sales tax contributed the most in own-source revenues

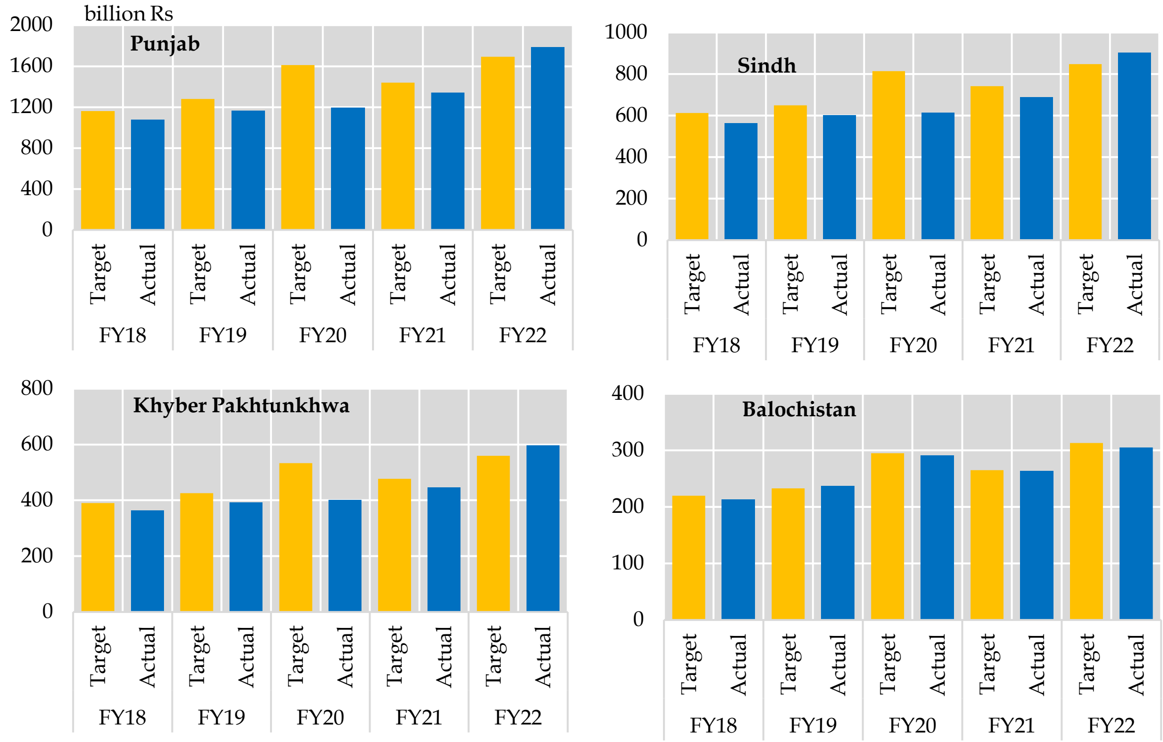
On consolidated basis, the own-source revenues collection grew by 12.5 percent in FY22, compared to 27.6 percent in FY21. The lower receipts under non-tax revenues mostly explains the deceleration in growth. The tax revenues went up by 20.5 percent, driven by sales tax on services.

Within tax revenues, sales tax on services recorded significant collections in all provinces, whereas collection under stamp duties also remained higher than FY21. The province-wise segregation suggests that on YoY basis major impetus to growth in tax collection came from Punjab, followed by Khyber Pakhtunkhwa and Sindh **(Figure 4.19**). Punjab not only achieved highest growth in overall tax collection, its revenues also surpassed the target set for FY22.

For FY22, the provinces announced different tax relief measures in their respective budgets. Specific to Punjab, the provincial authorities continued with the tax relief measures initially introduced in FY20 including; 1) Zero percent rate of sales tax on health insurance and services provided by doctors and hospitals; 2) reduced rate of service tax of 5 percent for 32 sectors and; 3) reduction of stamp duty from 5 percent to 1 percent in urban areas.[31] Fiscal

[31] White Paper Budget FY22-23, Finance Department, Government of Punjab.

Share in Fed. Div. Pool Transfers-Target vs. Actual Disbursements **Figure 4.18**

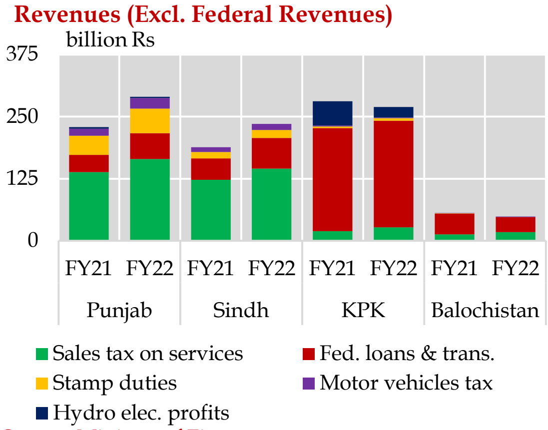


Source: Ministry of Finance

authorities in Sindh also introduced tax relief measures in the form of exemption of sales tax on services on health insurance policies and reduction on stamp duty from 2 percent to 1 percent on conveyance and other instruments.[32] In Khyber Pakhtunkhwa, different tax relief measures were announced in budget 2021-22 to encourage economic activity including; 1) introduction of reduced rate of sales tax on services on twelve different categories, and extension of reduced rates on 17 categories; 2) exemption of tax on profession, land and agriculture; 3) reduction of motor vehicle registration fee to Rs 1 and free of cost re-registration of vehicles; 4) lower property tax for regular tax payers.[33]

The different tax relief measures in place, the improvements in tax collection mainly reflects the pick-up in domestic activity. Besides, it also shows the effectiveness of measures commenced by provincial tax authorities in terms of broadening the tax base. For instance, Punjab Revenue Authority conducted a number of workshops for private sector withholding agents, which were attended by more than one thousand representatives of organizations in Punjab, the authority also arranged workshops, seminars and tax clinics for specific sectors such as travel agents and architects.[34] Sindh Revenue Board (SRB) notified SRB POS, the real time invoicing

Major Sources of Provincial Revenues (Excl. Federal Revenues) **Figure 4.19**



Source: Ministry of Finance

[32] Budget 2021-22, Finance Department, Government of Sindh.
[33] Budget 2021-22, Finance Department, Government of Khyber Pakhtunkhwa.
[34] Punjab Revenue Authority

system in February 2022 to optimize sales tax collection.[35]

The non-tax provincial revenues fell by 14.6 percent in FY22, this was mainly attributed to lower proceeds in hydroelectricity profit disbursed to Khyber Pakhtunkhwa. The province received Rs 21 billion including 9.1 billion of current year profit along with Rs 11.9 billion as reconciled arrears.[36] In other non-tax revenues, the largest contribution came from Punjab[37] followed by Khyber Pakhtunkhwa and Sindh.

For federal loans and grants, Khyber Pakhtunkhwa remained the major recipient[38] and received Rs 214.6 billion during FY22, most of these grants and loans were issued to finance ongoing development expenditures in merged districts of Khyber Pakhtunkhwa.[39]

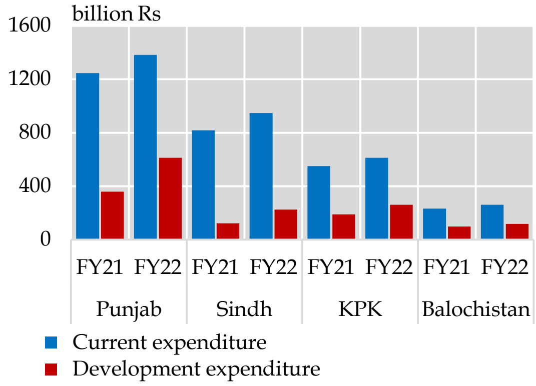
Provincial Expenditures

The provincial expenditures grew by 27.0 percent in FY22 compared to 7.9 percent in FY21, both current and development expenditures have shown significant increase.

The current spending increased by 12.5 percent during FY22, against 11.9 percent in FY21. The budgeted increase in pension and salaries of government employees in all provinces accelerated the current spending. Besides, other major areas of spending were *general public services* comprising of executive & legislative organizations, financial & fiscal affairs and transfers, *public order and safety affairs* including police and law courts, *health* consists of hospital and public health services and *economic affairs* pertaining to sectors such as agriculture, food, irrigation and industrial sector.

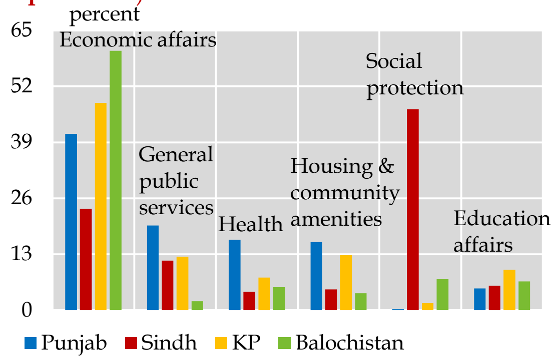
The development expenditures rose substantially during FY22, all four provinces witnessed double-digit growth in their development spending (**Figure 4.20**). The surge was mainly explained by social sector spending and expenditures on infrastructure projects including construction of roads and transport services in Sindh, Punjab and Khyber Pakhtunkhwa. In Sindh, the major ongoing infrastructure projects include Malir Expressway Project M9-N5 Link Road Project, and Ghotki-Kandhkot Bridge.[40]Punjab continued to focus on local government and

Segregation of Provincial Expenditures **Figure 4.20**



Source: Ministry of Finance

Priorities in Development Spending (percent share in provincial development expenditure) **Figure 4.21**



Source: Ministry of Finance

[35] SRB Press Release, 28th April 2022.
[36] In FY21, Khyber Pakhtunkhwa received net hydel profit of Rs 49.25, including reconciliation arrears of Rs 36.8 billion.
[37] In Punjab, within other non-tax revenues, the only traceable account was the *receipts under the mines & oil-fields & mineral development* which showed receipts of Rs 11.2 billion.
[38] Khyber Pakhtunkhwa received 60 percent of overall grants and loans issued to provinces during FY22.
[39] In May 2018, the Federally Administered Tribal Areas (FATA) were merged into Khyber Pakhtunkhwa.
[40] Sindh Budget Speech 2022-23

community development schemes such as District Development Package having 752 schemes for basic infrastructure and Punjab Rural Sustainable Water Supply and Sanitation Project.[41]

Within social services, health and education received renewed interest of different provincial governments. For instance, Sindh had prioritized grants and funds to number of hospitals, health institutions, NGOs, and trusts and also introduced Rescue 1122 services to provide immediate medical aid and shifting in case of emergencies. Similarly Punjab spent Rs 100.2 billion on provision of health services in the province, out of which Rs 65.3 billion were allocated to insurance and preventive health services alone (**Figure 4.21**).

[41] Source: White Paper (2022-23), Finance Department, Government of Punjab.