Fiscal Policy

Fiscal and primary balances somewhat improved in FY23 compared to FY22, but missed the budget targets by wide margins. The improvement vis-à-vis last year was mainly due to deceleration in growth of non-interest expenditures. Revenue balance, on the other hand, deteriorated with growth in current expenditures outpacing the growth in total revenue. Within the revenue, non-tax revenue grew substantially, supported by higher PDL collection, while growth in tax revenue decelerated due to slowdown in demand-cum-economic activity and contraction in imports. The entire increase in tax collection came from direct taxes, supported by increased bank profitability and imposition of higher super tax on firms. The growth in expenditures was mainly led by marked increase in interest payments on the back of rising interest rates and stock of debt, especially the floating rate debt, while growth in non-interest expenditures decelerated. Moreover, provincial surplus, though lower than FY22, helped in containing the overall fiscal deficit.

4 Fiscal Policy

4.1 Fiscal Trends and Policy Review[1]

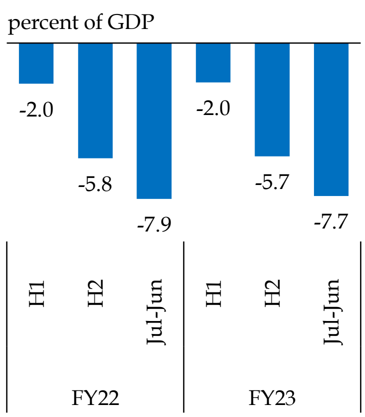
Fiscal deficit at 7.7 percent of GDP in FY23, was slightly lower than 7.9 percent in FY22, but substantially higher than the budget target of 4.9 percent and revised estimate of 7.0 percent (**Figure 4.1a**). Importantly, the envisaged fiscal consolidation could not be achieved as there was a primary deficit of 0.8 percent of GDP, against the budgeted surplus of 0.2 percent of GDP (**Figure 4.1b**). It, nevertheless, shows improvement compared to a primary deficit of 3.1 percent recorded in FY22. Moreover, revenue deficit increased to 5.8 percent of GDP in FY23, from 5.2 percent in FY22 (**Figure 4.1c**).

The improvement in fiscal indicators, fiscal and primary deficits, compared to FY22, is attributed to marked deceleration in growth of non-interest expenditures. Additionally, provinces posted a combined surplus of 0.2 percent of GDP in FY23, though lower than 0.5 percent achieved in the previous year, which helped contain primary as well as overall fiscal deficit.[2] The deterioration in revenue balance was, however, on account of higher interest payments that kept the growth in current expenditures higher than the growth in total revenues (**Table 4.1**).

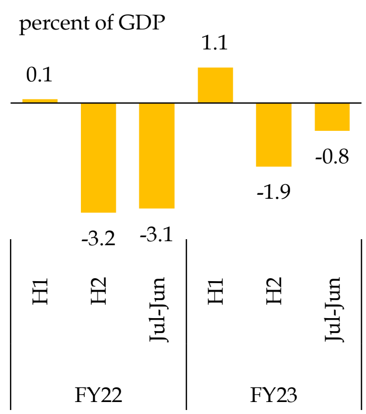
Total expenditures grew by 21.5 percent in FY23 as compared to 29.0 percent in the previous year.[3] The slower growth in expenditures was largely because of a sluggish growth in non-interest expenditures amid lower grants and subsidies, as well as deceleration in the growth of overall development spending and net lending. Within the current expenditures, however, a sharp increase in interest payments more than offset the impact of reduction in grants and subsidies. Interest payments on both the domestic and external debt soared in the backdrop of rising debt stock and interest rates.

Despite deceleration in growth of expenditures, it remained higher than the growth in revenues, which also recorded some acceleration. The

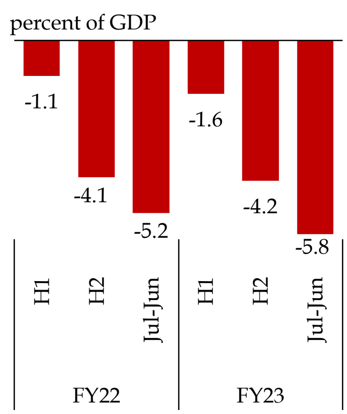
Fiscal Balance **Figure 4.1a**



Primary Balance **Figure 4.1b**



Revenue Balance **Figure 4.1c**



Sources: Ministry of Finance, and SBP calculations

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[1] *Fiscal balance* is total revenue minus total expenditure; *primary balance* is fiscal balance adjusted for interest payments; *revenue balance* is total revenues minus total current expenditures.

[2] The provincial surplus at Rs 154.6 billion in FY23 was considerably lower than the budgeted Rs 750 billion for the year and Rs 351 billion in FY22.

[3] In absolute terms, total expenditures stood at Rs 16.2 trillion in FY23, against the budget target of Rs 9.6 trillion and actual expenditure of Rs 13.3 trillion in FY22.

Consolidated Fiscal Indicators — **Table 4.1**

billion Rupees; percent

	Values		Growth in percent					
			H1		H2		Jul-Jun	
	FY22	FY23	FY22	FY23	FY22	FY23	FY22	FY23
1. Total revenue (a+b)	**8,035**	**9,634**	**18.0**	**18.8**	**14.8**	**21.0**	**16.4**	**19.9**
(a) Tax revenue	6,755	7,819	29.9	16.9	26.5	14.7	28.1	15.7
Federal	6,143	7,169	32.1	17.4	26.2	16.1	28.9	16.7
Provincial	612	650	10.3	11.7	29.9	1.6	20.5	6.1
(b) Non-Tax	1,280	1,815	-14.6	26.4	-29.9	64.5	-21.5	41.8
Federal	1,152	1,649	-17.8	28.5	-28.1	65.5	-22.2	43.1
Provincial	128	166	43.1	4.5	-41.1	56.8	-14.6	29.3
2. Total expenditure (a+b+c)	13,295	16,155	18.7	19.8	37.0	22.7	29.0	21.5
(a) Current expenditure	11,521	14,583	16.0	29.6	35.4	24.5	26.8	26.6
Mark-up payments	3,182	5,831	-1.5	77.1	35.7	88.4	15.7	83.2
Defence	1,412	1,586	7.0	22.7	7.4	6.2	7.2	12.3
Non-markup	8,339	8,752	26.2	8.2	35.3	2.9	31.6	5.0
(b) Development expenditure & net lending	1,657	1,953	24.8	11.4	26.6	21.2	26.0	17.8
(c) Statistical discrepancy	116	-381	-	-	-	-	-	-
3.Overall budget balance	-5,260	-6,521	-	-	-	-	-	-
percent of GDP	*-7.9*	*-7.7*	-	-	-	-	-	-
4.Primary balance	-2,077	-690	-	-	-	-	-	-
percent of GDP	*-3.1*	*-0.8*	-	-	-	-	-	-
5. Revenue balance	-3,486	-4,950	-	-	-	-	-	-
percent of GDP	*-5.2*	*-5.8*	-	-	-	-	-	-
6. Financing (a+b)	5,260	6,521					54.6	24.0
(a) External (Net)	1,178	-680					-11.9	-157.7
(b) Domestic (Net)	4,081	7,201					97.6	76.4
Non-Bank	981	3,673					399.8	274.5
Bank	3,101	3,529					65.9	13.8

Source: Ministry of Finance

acceleration in revenue growth was led by non-tax revenue on account of higher petroleum development levy (PDL) collection in spite of decline in petroleum sales. Transfer of the SBP profits, a major component of the non-tax revenues, decreased due to changes in transfer mechanism of SBP profits after amendments in the SBP Act. On the other hand, growth in tax revenue decelerated considerably. Contraction in dutiable imports, slowdown in economic activity, and floods negatively impacted tax collection, while higher inflation, rising interest rates, and revenue mobilization measures taken in the Finance Act 2022 and Finance (Supplementary) Act 2023 propelled tax collection.

With slower growth in tax collections, the FBR tax-to-GDP ratio fell to 8.5 percent in FY23 amidst narrow tax base with increased reliance on indirect and withholding taxes. This combined with substantial subsidies and grants, which resulted in persistently high fiscal deficit and mounting debt servicing, are posing challenges for maintaining debt sustainability. The steady increase in interest expense is not sustainable as it may limit fiscal space for development, and other essential spending for social protection.

The situation warrants efforts to address these long-standing structural problems in order to reduce fiscal deficit and generate primary surplus to lessen the pace of debt accumulation. Besides broadening of tax base, paring losses of inefficient Public Sector Enterprises (PSEs), particularly related to power sector, is much

Total Revenue Collection Table 4.2
collections in billion Rupees; growth in percent; contributions in percentage points

	Collection		Growth						Contribution	
	Jul-Jun		H1		H2		Jul-Jun		Jul-Jun	
	FY22	FY23	FY22	FY23	FY22	FY23	FY22	FY23	FY22	FY23
Total revenue (1+2)	**8,035**	**9,634**	**18.0**	**18.8**	**14.8**	**21.0**	**16.4**	**19.9**	**-**	**-**
1.Tax revenue	6,755	7,819	29.9	16.9	26.5	14.7	28.1	15.7	21.5	13.2
Federal	6,143	7,169	32.1	17.4	26.2	16.1	28.9	16.7	20.0	12.8
Provincial	612	650	10.3	11.7	29.9	1.6	20.5	6.1	1.5	0.5
2.Non-tax revenue	1,280	1,815	-14.6	26.4	-29.9	64.5	-21.5	41.8	-5.1	6.7
Federal	1,152	1,649	-17.8	28.5	-28.1	65.5	-22.2	43.1	-4.8	6.2
Provincial	128	166	43.1	4.5	-41.1	56.8	-14.6	29.3	-0.3	0.5

Sources: Ministry of Finance, and SBP calculations

needed to achieve fiscal discipline and reducing debt stock to sustainable levels of 60 percent of GDP.[4] This would, in turn, help create fiscal space for enhancing productivity by investing in infrastructure, health, education, training, and research and development.

4.2 Revenue

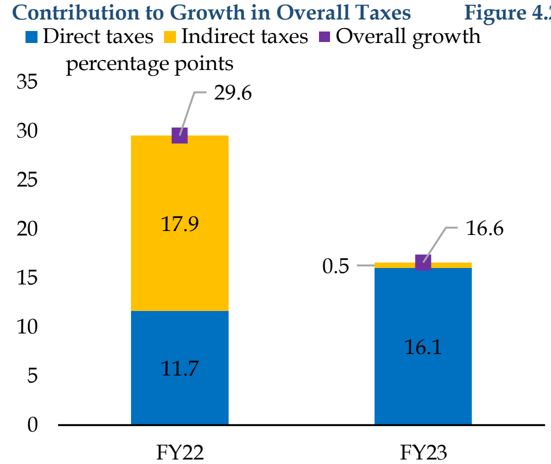
Total revenue grew by 19.9 percent in FY23 compared to 16.4 percent in FY22 (**Table 4.2**). The acceleration in revenue growth was mainly due to increase in non-tax revenue (NTR) in FY23, which was, in turn, propelled by higher PDL collections. On the other hand, growth in tax revenue decelerated in FY23 due to contraction in imports and low economic activity, despite a sharp rise in market prices. Growth in provincial revenues was slower, impacted by various tax relief measures announced by provinces.[5]

FBR Tax Revenue

FBR tax revenue grew by 16.6 percent in FY23, almost half the previous year's growth of 29.6 percent (**Table 4.3**). As a result, FBR tax to GDP ratio fell to 8.5 percent in FY23, from 9.2 percent in FY22. This was despite additional revenue measures announced in the Finance (Supplementary) Act in February 2023. A confluence of factors contributed to this slower growth in FBR taxes, including import compression; a considerable moderation in domestic demand; contraction in LSM output; devastating floods; zero GST on POL products and crude; and ad-hoc exemptions on duties, for instance taxes on imports and supply of relief goods—mainly medicines, food items, and ambulances— in the wake of floods.

The additional tax measures – increase in super tax, GST, and FED, however, helped the FBR to get close to the target for FY23. The breakdown shows that collection of direct taxes surpassed the target, almost compensating for the shortfall in indirect taxes. More specifically, withholding taxes and voluntary payments contributed majorly to the growth in direct taxes. On the other hand, indirect tax collection grew only marginally due to import curtailment, especially

Contribution to Growth in Overall Taxes Figure 4.2



Sources: Federal Board of Revenue, and SBP calculations

[4] As per Fiscal Responsibility and Debt Limitation Act 2005
[5] See "**Provincial Fiscal Operations**" section for more details on provincial revenue.

of dutiable imports, which dented the import-related collections of sales tax, FED, and customs duties.

There are four main factors that contributed to growth in FBR taxes in FY23. First, high inflation that helped indirect taxes to record increase despite fall in sales. Second, increase in interest income on investment in government securities, saving certificates, saving deposits, banks' profits, and income taxes paid thereof. Third, increase in tax rates in the Finance Act 2022 and Finance (Supplementary) Act 2023. For example, increase in income tax rates on salaries, increase in super tax from four percent to ten percent on high-earning persons; increase in GST from 17 to 18 percent; increase in GST on locally manufactured cars and luxury imports to 25 percent. Fourth, administrative efforts by FBR to improve tax compliance and ease of doing business (**Box 4.1**).

Box 4.1: FBR's Administrative Measures

The measures taken by the FBR during FY22 and FY23 are summarized as follows:

a) ADR (Alternative Dispute Resolution), an out-of-court dispute-solving mechanism that facilitates ease of doing business, was revised through the Finance Act 2022, to make it more efficient and effective. One of the key changes was that disputes involving question of both fact and law could now be brought up for resolution; earlier, it was just the question of fact.

b) SWAPS (Synchronized Withholding Administration and Payment System), an automated system of collection and deduction of withholding taxes, was rolled out through the Finance Act 2022, which is initiated to streamline WHT collection, deduction, and payment to FBR, by the withholding agents.

c) Discontinuance of gas and electricity connections of sales tax agents, as well as Tier-1 retailers, who do not register for sales tax purpose, or notified tier-1 retailers registered but not integrated with the FBR's computerized system. This compliance-enhancing measure was implemented through the Finance Act 2022.

d) Introduction of National Sales Tax Return (NSTR) in January 2022 to facilitate ease of doing business by simplifying and consolidating the sales tax returns filing. NSTR aims to streamline the older process, where sales tax agents had to file separate sales tax returns every month to each of the different sales tax collecting authorities.

Direct taxes led growth in FBR taxes

Direct taxes grew by 43.2 percent in FY23, driving almost the entire growth in overall taxes (**Figure 4.2 & Table 4.3**). Domestic collections constituted a little over 90 percent of total direct tax collections, which, in turn, mainly comprised of withholding taxes (61.3 percent) and voluntary payments (29.6 percent) in FY23 (**Table 4.4**).

<u>*Withholding taxes*</u>

Withholding taxes grew by 30.8 percent in FY23 compared to 24.0 percent increase in the previous year. The growth was also broad-based, with major contribution from taxes on bank interest and securities, contracts, and salaries (**Table 4.4**).[6]

Collection of withholding tax on bank interest and securities more than doubled in FY23 compared to the previous year. As mentioned above, this was mainly because of rising interest rates and increased investment in government securities and other saving instruments. Moreover, withdrawal of tax benefit on investment in federal government securities also supported higher collection. Earlier, profit on debt of all persons (other than banking companies) was taxed at a reduced rate of 15 percent. As per the Finance Act 2022, this rate applies only to those persons whose profit does not exceed Rs 5 million.[7]

Collection of withholding tax on contracts maintained the previous year's momentum

[6] It may be noted here that the tax rate for persons not on Active Taxpayer List (ATL) is usually double the rate for those on ATL.
[7] The scope of the reduced rate benefit was curtailed in the Finance Act 2022.

Snapshot of FBR Tax Collection – Growth and Contribution **Table 4.3**

values in billion Rupees; growth/net achievement in percent; contribution in percentage points

	Values		Growth		Contribution in Overall Growth		Achievement (Percent of Target)	
	FY22	FY23	FY22	FY23	FY22	FY23	FY22	FY23
1. Direct Taxes	**2,285**	**3,272**	**32.0**	**43.2**	**11.7**	**16.1**		**114.8**
Import	288	290	31.8	0.8	1.5	0.0	-	-
Domestic	1,997	2,982	32.0	49.3	10.2	16.0	-	-
2. Indirect Taxes	**3,864**	**3,897**	**28.2**	**0.9**	**17.9**	**0.5**	**99.8**	**89.6**
Sales Tax	2,532	2,592	27.4	2.4	11.5	1.0	98.3	92.3
Import	1,741	1,618	56.0	-7.0	13.2	-2.0	-	-
Domestic	792	974	-9.3	23.0	-1.7	3.0	-	-
FED	321	370	15.7	15.3	0.9	0.8	95.2	80.9
Import	23	14	16.2	-38.5	0.1	-0.1	-	-
Domestic	298	356	15.7	19.4	0.9	0.9	-	-
Customs	1,011	935	35.0	-7.5	5.5	-1.2	105.3	86.2
Grand Total (1+2)	**6,148**	**7,169**	**29.6**	**16.6**	**29.6**	**16.6**	**-**	**99.6**

Note: Tax revenue numbers of FBR and Ministry of Finance may not tally

Sources: Federal Board of Revenue, and SBP calculations

despite slowdown in economic activity.[8] Two major developments helped in steadying the growth in collection from contracts. One, under the Finance Act 2022, the scope of taxable services was expanded to include Real Estate Investment Trust (REIT) management services and services offered by National Clearing Company of Pakistan Limited (NCCPL). Two, sale of goods or services under section 153, including rice, edible oils, transport services, air cargo services, courier services, freight forwarding services, and others, led to higher WHT collection amid higher prices.[9] For instance, transport services witnessed 54.6 percent inflation in FY23, compared to 15.1 percent last year. Similarly, charges of inland courier services spiked by 13.4 percent in FY23, almost double the increase in previous year.[10]

Withholding tax on salaries was up by 40.7 percent in FY23, compared to 29.3 percent increase in FY22. Upward revision in progressive rates for income tax slabs in the Finance Act 2022 provided the major impetus to collection from salaries. Across the seven slabs (previously 12), there was an increase in tax liability of salaried individuals with taxable income exceeding Rs 3.6 million (top three slabs), or closer to the upper limit of the middle slab (that is, Rs 2.4 million to 3.5 million), when compared to their tax liabilities under last year slabs. Moreover, salaries of the federal government employees were also increased in FY23.[11]

WHT collections from electricity bills almost maintained the pace observed in the previous year, despite a fall in electricity generation, and hence its supply, during FY23. The improved collection mainly owes to increase in electricity charges that offset the impact of lower electricity generation in FY23.[12] Imposition of fixed income tax on retailers and some service providers in their electricity bills in the Finance Act 2022 provided further boost.

The growth in WHT on imports decelerated, despite increase in rate from 2.0 percent to 3.5

[8] 'Contracts' refers to sale of goods or services, and execution of contracts, as per section 153 of the Income Tax Ordinance 2001.

[9] Source: Pakistan Bureau of Statistics

[10] Source: Pakistan Bureau of Statistics

[11] BPS-2022 replaced BPS-2017 pay structure, and the pay brackets were revised upwards. In addition, an ad-hoc relief was given equal to 15 percent of the basic pay, up from 10 percent. Source: Ministry of Finance; ww.finance.gov.pk/circulars/circular_01072022.pdf

[12] Electricity generation was down 9.5 percent in FY23. Source: NEPRA

Direct Tax Collection **Table 4.4**

values in billion Rupees; growth in percent; contribution in percentage points

	Values		Growth		Contribution to Total Direct Taxes (net)	
	FY22	FY23	FY22	FY23	FY22	FY23
Collection on demand	**101.1**	**161.7**	**26.2**	**59.9**	**1.2**	**2.7**
Voluntary payment	**676.4**	**1,093.6**	**44.6**	**61.7**	**12.0**	**18.3**
Advance tax	597.9	974.6	44.5	63.0	10.6	16.5
Withholding taxes	**1,534.3**	**2,007.0**	**24.0**	**30.8**	**17.2**	**20.7**
Bank interest & securities	155.0	314.9	14.8	103.2	1.2	7.0
Contracts	341.4	424.5	25.5	24.3	4.0	3.6
Salaries	196.2	276.1	29.3	40.7	2.6	3.5
Electric bills	71.4	98.6	39.2	38.0	1.2	1.2
Telephone/mobile phones	67.9	86.9	7.4	28.1	0.3	0.8
Export	65.0	77.3	54.0	19.0	1.3	0.5
Imports	281.6	289.8	28.9	2.9	3.6	0.4
Dividends	83.3	87.1	30.6	4.5	1.1	0.2
Net direct tax*	**2,284.9**	**3,272.4**	**32.0**	**43.2**	**32.0**	**43.2**

* Net Direct Tax is adjusted for Direct Tax refunds. Components are recorded on gross basis

Sources: Federal Board of Revenue, and SBP calculations

percent, largely due to lower import values. Moreover, withholding tax on sale, purchase or transfer of immoveable property was also enhanced from 1.0 percent to 2.0 percent. Additionally, Finance Act 2022 also removed a holding period condition, under which taxpayer did not have to pay the tax if holding period exceeded four years.[13]

Voluntary Payments

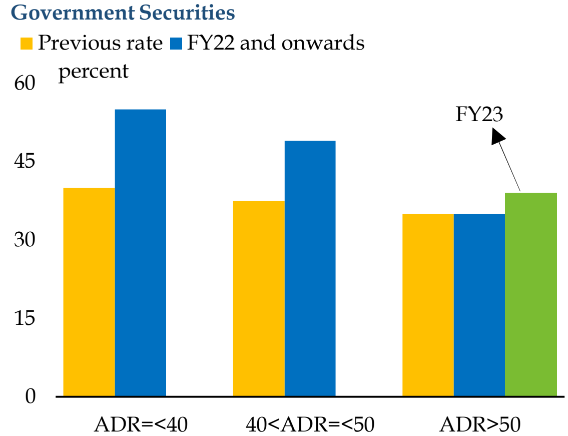
Voluntary payments grew by 61.7 percent in FY23, as compared to 44.6 percent last year. The major factors resulting in higher voluntary payments include:

i. Imposition of cascading super tax on high-earning persons under the new section 4C, replacing 4B, of the Income Tax Ordinance.[14] Under the section 4C, super tax on banking companies, whose income exceeded Rs 300 million in FY23, was raised from 4.0 percent to 10.0 percent. In case of non-banking companies, 10.0 percent super tax was imposed retrospectively for FY22 (**Table 4.5**).

ii. Upward revision in tax on income generated from investment in government securities; this tax is determined based on banks' advances-to-deposit ratio (ADR) (**Figure 4.3**).[15]

iii. Increase in minimum tax on banks' income from 35.0 percent to 39.0 percent in FY23.

ADR-linked Tax on Investment in Government Securities **Figure 4.3**



Source: Finance Act 2022

[13] For purchasers not on the ATL, the tax was increased by 250 percent.

[14] Until FY22, super tax had been applied under section 4B, 'Super tax for rehabilitation of temporary displaced persons'. In FY23, a new section, 4C ('Super tax on high-earning persons'), replaced it; it was purported to target the wealthier sections of the country, as per Finance Act 2022.

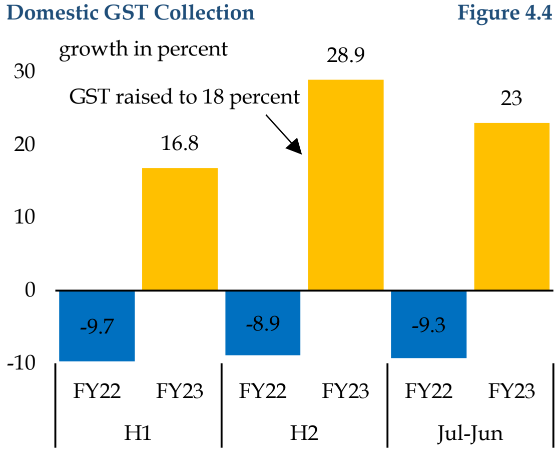
[15] It may be noted here that these ADR-linked taxes have been abolished in FY24 budget. Source: FBR SRO 226(I)/2023, dated February 27, 2023

It is important to note here that banks' profits increased considerably in CY22 in a high interest rate environment, which augmented the impact of aforementioned tax revisions on voluntary payments. In CY22, banks' overall profit-before-tax grew by 55.8 percent, which is about six times the average growth of previous five years (CY17-CY21).[16] Scheduled banks' net investment in government papers, which rose from 50.6 percent of total credit in December 2021 to 54.6 percent in December 2022 and 58.4 percent in June 2023, remained the main source of bank profitability.[17]

Growth in indirect taxes remained flat, dragged by contraction in import-related taxes

Indirect tax collection increased by only 0.9 percent in FY23, compared to 28.2 percent growth in the previous year. This sharp deceleration was led by decline in import-related taxes (sales tax, FED, and customs duty).

Domestic GST Collection **Figure 4.4**



Source: Federal Board of Revenue

Super Tax on High Earning Persons for FY23 **Table 4.5**

No.	Income under section 4C	Rate for FY23
1	Where income does not exceed Rs.150 million	0%
2	Where income exceeds Rs 150 million but does not exceed Rs 200 million	1%
3	Where income exceeds Rs 200 million but does not exceed Rs 250 million	2%
4	Where income exceeds Rs 250 million but does not exceed Rs 300 million	3%
5	Where income exceeds Rs 300 million	4%
6	Where income exceeds Rs 300 million and the business is banking	10%
7	Where income exceeds Rs 300 million and persons are engaged in the business of airlines, automobiles, beverages, cement, chemicals, cigarette & tobacco, fertilizer, iron & steel, LNG terminal, oil marketing, oil refining, petroleum & gas exploration & production, pharma, sugar & textiles	10% for the FY22*

Note: S. No. 1 to 5 pertain to income from any business--banking or otherwise. S.No. 6 and 7 pertain to banking & a group of specific businesses, respectively, provided their income levels are exceeding Rs 300 million apiece.
*This tax applies retrospectively for the FY22
Source: Finance Act 2022

While PKR depreciation partially offset the impact of contraction in imports in dollar terms, it was mainly the decline in dutiable imports – automobile, cell phones, and other luxury items – that led to lower import-related taxes.[18] Moreover, there was an increase in GST on imports of non-essential luxury items to 25 percent during H2-FY23.[19] Together, these factors limited the fallout of the reduction in imports on tax collection in FY23.[20]

Nevertheless, decline in import-related taxes was offset by higher collections of domestic sales tax and FED. These were supported by higher inflation translating into higher GST and FED;[21] increase in GST from 17 percent to 18

[16] Data source: State Bank of Pakistan
[17] These ratios are calculated using end-June stocks.
[18] Import-related taxes are assessed based on values of import in PKR. Hence, exchange rate movements, among other factors, play pivotal role in tax collection on imports. Import values in PKR fell by only 5.2 percent as depreciation partially offset the decline in imports in USD.
[19] New tax rate applied over 800 tariff lines, including cars (CBU); home appliances (CBU); aerated water and juices; confectionery; sanitary and bathroom wares; carpets; chandeliers; chocolates; doors and window frames; leather jackets and apparels; articles of jewelry; and others. Source: FBR SRO No. 297(I)/2023, dated Mar 08, 2023; www.download1.fbr.gov.pk/SROs/2023382232741774SRO-297-OF-2023.pdf
[20] Import-related taxes (sales tax, FED, and customs) fell by 6.7 percent in FY23, as compared 45.7 percent increase in FY22. Source: Federal Board of Revenue
[21] For more details, see Inflation section in Chapter 3.

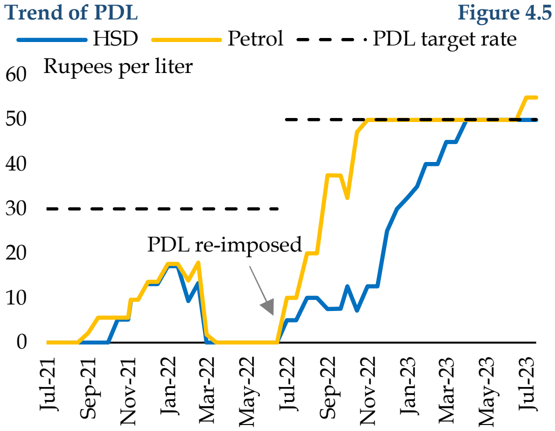
percent in the Finance (Supplementary) Act 2023 (**Figure 4.4**); and increase in GST on locally manufactured cars to 25 percent.[22]
The revenue measures announced in the Finance Act 2022 were already expected to boost GST and FED collections in FY23. The major revenue measures included: (i) expansion in the categories of Tier-1 retailers by adding jewelers (except those with shop size less than 300 square feet); (ii) discontinuation of gas and electricity utilities for retailers not registered with FBR's real-time sales reporting system aimed at enhancing compliance of retailers, as well as other sales tax agents, with digitalization protocols of FBR; additionally, a penalty system was also enforced for the non-compliant Tier-1 retailers;[23] and (iii) increase in FED on cigarettes and air travel in club, business and first class in the Finance Act 2022 and Finance (Supplementary) Act 2023.

In the light of these developments, domestic sales tax and FED rose despite subdued economic activity and zero GST on POL products (MS and diesel) and crude.[24] Domestic GST collection from POL products still posted a notable increase of 41.9 percent in FY23 compared to the previous year. This is explained by GST on other POL products, including furnace oil, HOBC, JP-8, and JP-1. Additionally, there was a positive revenue impact of the international crude prices trending higher in Jul-Jan FY23 than same period last year, as well as sharp exchange rate depreciation, both of which lifted the base prices of the POL products.

Non-Tax Revenue

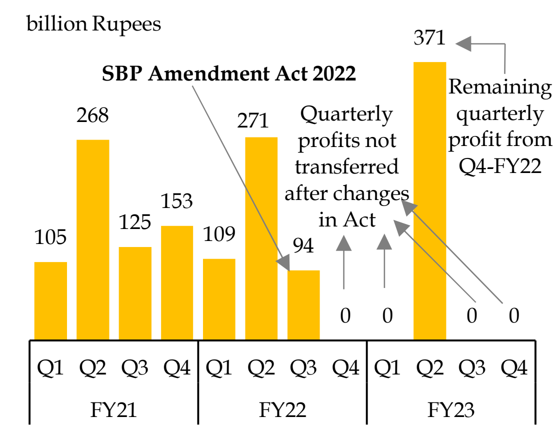
After recording declines in the preceding two years, NTR increased by 41.8 percent in FY23 (**Table 4.6**). Almost the entire growth came on the back of sharp increase in collection form petroleum development levy (PDL), which reached Rs 579.9 billion in FY23. In FY22, the levy was kept either zero or much below the budget target (**Figure 4.5**), as the government attempted to provide relief to masses in the face of rising international oil prices. However, starting from July 2022, the levies on petrol and hi-speed diesel were re-imposed, and gradually increased to the budgeted target of Rs 50 per liter apiece. This provided boost to PDL

Trend of PDL **Figure 4.5**



Sources: Pakistan State Oil, and Oil and Gas Regulatory Authority

Trend of Transfer of SBP's Surplus Profits **Figure 4.6**



Source: Ministry of Finance

[22] Source: FBR SRO No. 297(I)/2023, dated Mar 08, 2023; www.download1.fbr.gov.pk/SROs/2023382232741774SRO-297-OF-2023.pdf
[23] Penalty of a half million rupees for first default; Rs 1.0 million for second default after 15 days of order for first default; Rs 2.0 million for third default after 15 days of order for second default; Rs 3.0 million for fourth default after 15 days of order for third default; regardless of these penalties, premises of retailers might be sealed as well.
[24] GST on these products was removed in March 2022 through FBR SRO 321(I)/2022, with effect from February 2022.

Non-Tax Revenue (NTR) Collection - Consolidated **Table 4.6**

percent

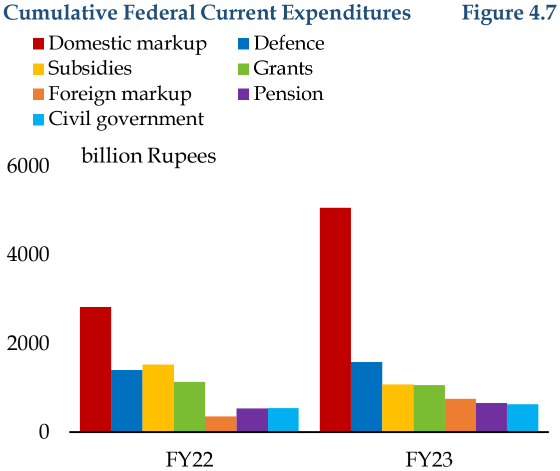
	Growth						Contribution to Total NTR	
	H1		H2		Jul-Jun		Jul-Jun	
	FY22	FY23	FY22	FY23	FY22	FY23	FY22	FY23
(a) Federal	**-17.8**	**28.5**	**-28.1**	**65.5**	**-22.2**	**43.1**	**-20.1**	**38.8**
Petroleum levy	-74.6	154.0	-61.5	599.0	-70.0	354.7	-18.2	35.3
Mark-up (PSEs & others)	-25.9	138.2	71.2	21.5	15.2	64.8	0.7	4.4
Royalties on oil\gas	11.2	45.0	44.8	22.9	28.1	32.4	1.2	2.3
Dividend	118.8	57.2	-47.2	64.8	-2.2	60.2	-0.1	2.0
Windfall levy against crude oil	590.9	188.3	302.5	39.4	373.1	92.6	0.7	1.0
Passport fee	49.2	57.9	84.8	61.1	65.7	59.6	0.5	1.0
Profits of PTA	108.9	-16.2	215.7	-19.4	164.8	-18.2	3.9	-1.5
Surplus profit of State Bank of Pakistan	2.0	-2.3	-66.3	-100.0	-27.2	-21.6	-10.9	-8.0
(b) Provincial	**43.1**	**4.5**	**-41.1**	**56.8**	**-14.6**	**29.3**	**-1.3**	**2.9**
Non-tax Revenue (a+b)	**-14.6**	**26.4**	**-29.9**	**64.5**	**-21.5**	**41.8**	**-21.5**	**41.8**

Sources: Ministry of Finance, and SBP calculations

collection, particularly in the second half, even compensating for falling POL sales.[25] As a result, the government overshot the revised target of Rs 542 billion.[26]

On the other hand, SBP profit transfers were significantly lower in FY23 due to change in transfer mechanism in light of the amendments to the SBP Act (**Figure 4.6**). As per the new rules, the surplus profits are to be transferred to the government within 30 days of making the annual financial statements public by the SBP.[27] It may be noted here that there was a transfer of Rs 371 billion in Q2-FY23 in arrears from Q4-FY22.[28] On the other hand, provincial non-tax revenue also grew by 29.3 percent in FY23, compared to decline of 14.6 percent in FY22, mainly on account of charges collected from transfer of property, and administration charges and fees.

Cumulative Federal Current Expenditures **Figure 4.7**



Source: Ministry of Finance

4.3 Federal Expenditures

Federal expenditures grew by 21.2 percent in FY23, slightly lower from 26.3 percent growth in FY22. Slower growth in expenditures, despite a surge in mark-up payments, was due to decline in non-interest current expenditures, primarily on account of reduction in subsidies and grants. In contrast, other current expenditures including defence, pension and running of civil government increased. In particular, the defence affairs and services witnessed a higher growth in FY23 relative to FY22 (**Figure 4.7**). Importantly, development expenditures

[25] Sales of petrol and diesel fell by 16.8 percent and 28.5 percent, respectively, in FY23 from the year ago. Sources: Ministry of Finance and Oil Companies Advisory Council

[26] The government was initially falling short of the budget target of Rs 855 billion during FY23, which could be ascribed to gradual—instead of one-off—increase in PDL to budget target of Rs 50 per liter, as well as lower POL sales.

[27] Source: SBP Act 2022 (Amended); https://www.sbp.org.pk/about/act/SBP-Act.pdf

[28] The changes in Act will see transfer of first full year surplus profits of SBP in first half of FY24.

State of Federal Expenditures **Table 4.7**

billion Rupees, growth in percent

	Absolute		Growth		As percent of Total Expenditures		As percent of GDP	
	FY22	FY23	FY22	FY23	FY22	FY23	FY22	FY23
Total expenditures (a+b)	**9,350.1**	**11,332.4**	**26.3**	**21.2**	**100**	**100**	**14.0**	**13.4**
(a) Current expenditure	**8,451.6**	**10,867.2**	**33.1**	**28.6**	**92.3**	**92.4**	**12.6**	**12.8**
Mark-up payments	3,182.4	5,831.1	15.7	83.2	34.8	49.6	4.8	6.9
Domestic	2,828.6	5,071.2	12.1	79.3	30.9	43.1	4.2	6.0
Foreign	353.9	759.9	56.6	114.7	3.9	6.5	0.5	0.9
Defence affairs and services	1,411.6	1,585.5	7.2	12.3	15.4	13.5	2.1	1.9
Pension	541.9	666.3	23.1	23.0	5.9	5.7	0.81	0.8
Running of civil government	546.7	634.0	8.1	16.0	6.0	5.4	0.8	0.7
Subsidies	1,529.6	1,080.3	259.9	-29.4	16.7	9.2	2.3	1.3
Grants to provinces and others	1,239.3	1,070.0	36.0	-13.7	13.5	9.1	1.9	1.3
Grants to provinces	97.5	82.0	16.2	-15.9	1.1	0.7	0.1	0.1
Grants to others	1,141.8	988.0	37.9	-13.5	12.5	8.4	1.7	1.2
(b) Development expenditure and net lending	**701.1**	**890.4**	**-11.1**	**27.0**	**7.7**	**7.6**	**1.0**	**1.1**
Total development expenditure	**558.1**	**743.0**	**-19.6**	**33.1**	**6.1**	**6.3**	**0.8**	**0.9**
PSDP	558.1	743.0	-16.4	33.1	6.1	6.3	0.8	0.9
Development grants to provinces	157.7	91.0	-30.3	-42.3	1.7	0.8	0.2	0.1
Net lending	**143**	**147.3**	**51.4**	**3.0**	**1.6**	**1.3**	**0.2**	**0.2**
Provinces	102.6	87.5	485.2	-14.8	1.1	0.7	0.2	0.1
Others	40.4	59.9	-47.5	48.2	0.4	0.5	0.1	0.07

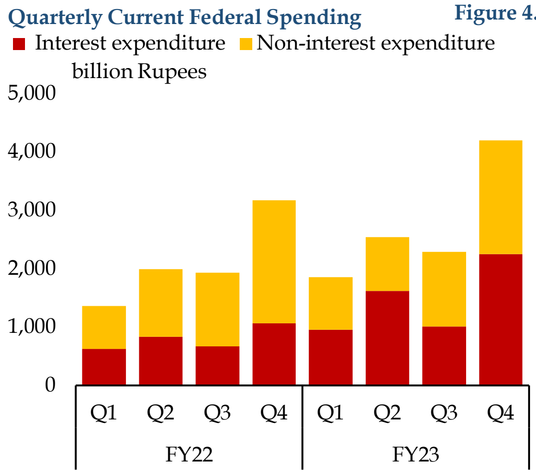
Source: Ministry of Finance, and SBP calculations

increased in FY23, against a decline observed in the previous fiscal year (**Table 4.7**).

Federal Current Expenditures

Growth in federal current expenditure decelerated slightly to 28.6 percent in FY23 from 33.1 percent in FY22. The deceleration was primarily due to lower subsidies and grants. Substantial increase in interest payments, remained the major contributor to still elevated growth in current expenditures, accounting for 54 percent of the federal current expenditures during FY23 (**Figure 4.8**). Meanwhile, defence, pensions and running of civil government also witnessed higher spending during FY23.

Quarterly Current Federal Spending **Figure 4.8**



Source: Ministry of Finance

Steep rise in interest expenses

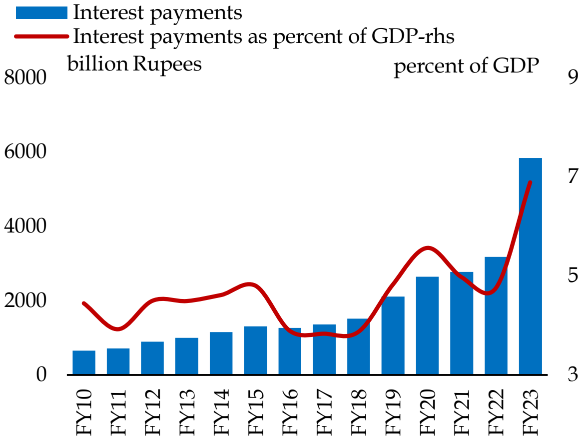
The mark-up payments surged by 83.2 percent in FY23, compared to 15.7 percent increase in the

Interest Payments as Percent of Major Fiscal Accounts **Table 4.8**

	Average FY17-FY21	FY22	FY23
Fiscal balance	71.6	60.5	89.4
Total tax revenues	46.6	47.1	74.6
Total expenditure	23.7	23.9	49.6
Current expenditures	28.4	27.6	53.7
Defence	180.9	225.4	367.8
Pension	527.2	587.3	875.1
Running of civil govt.	424.4	582.1	919.7
Subsidies	927.2	208.1	539.8
Grants	377.3	278.7	545.0
Development expenditures	154.2	192.0	654.9

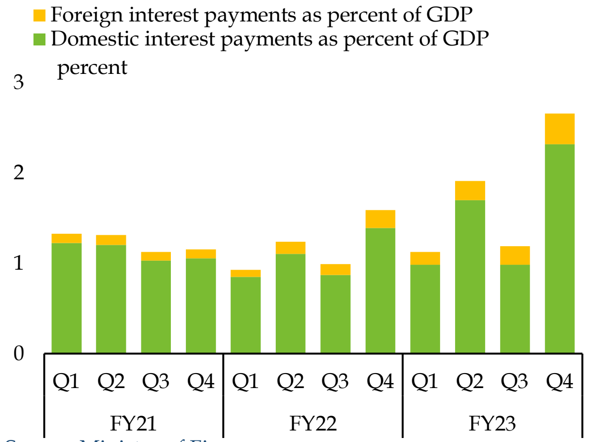
Source: Ministry of Finance

Interest Payments **Figure 4.9a**



Source: Ministry of Finance

Quarter-wise Interest Payments **Figure 4.9b**



Source: Ministry of Finance

previous year. In absolute terms, interest payments rose to Rs 5.8 trillion (**Figure 4.9a**); about 70 percent of tax revenues and 93 percent of the fiscal deficit in FY23 (**Table 4.8**). Unlike in FY22, when interest payments remained relatively muted until March 2022 and then rose in last the quarter, these rose steadily throughout FY23 (**Figure 4.9b**). Though interest payments on both the domestic and foreign debt rose sharply, mark-up on domestic debt constituted around 87 percent of the total expense.

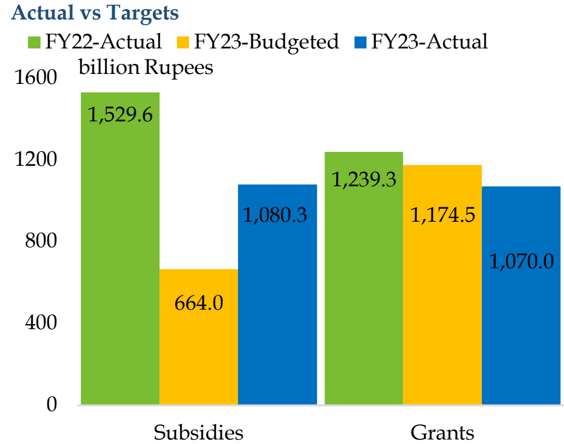
The actual markup payments exceeded the budgeted target of Rs 3.9 trillion for FY23 by 48.7 percent.[29] Increased borrowing, mostly via short-term T-bills and floating rate PIBs, resulted in higher mark-up payments on domestic debt in FY23. In addition, higher debt servicing reinforced financing requirement to pay off high priced loans. Moreover, the rising share of floating rate instruments in the outstanding debt further increased the buildup of interest payments.

External debt servicing posted a significant increase of 114.7 percent during FY23. This mainly reflects the impact of PKR depreciation and the resumption of markup payments to bilateral creditors after expiration of Debt Service Suspension Initiative (DSSI).[30]

Subsidies and grants, despite steep fall, remain substantial

Total subsidies decreased to Rs 1.1 trillion (1.3 percent of GDP) in FY23 from Rs 1.5 trillion (2.3 percent of GDP) in the previous year (**Figure 4.10**).[31] Almost 67 percent of the subsidies in FY23 were meant for power sector, mainly

Federal Subsidies and Grants: Actual vs Targets **Figure 4.10**



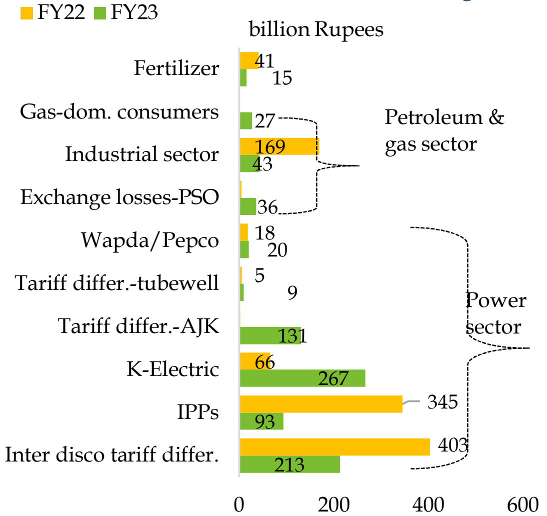
Source: Ministry of Finance

[29] This was against the target of Rs 3.1 trillion budgeted in FY22.

[30] For details, see **Chapter 5 - Domestic and External Debt**

[31] The target for overall subsidies was set at Rs 664 billion, out of which Rs 463 billion were allocated for power sector, including for settlement of circular debt. Against this, power sector received Rs 870 billion during FY23. This large deviation from the target was mainly due to higher accumulation of circular debt and payments made under fiscal package.

Disbursement of Federal Subsidies **Figure 4.11**



Source: Ministry of Finance

including tariff differential payments related to AJK, agriculture tube wells, receivables to DISCOs, K-Electric and WAPDA/PEPCO (**Figure 4.11**).[32]

After power, a substantial amount of subsidies was provided on petroleum products; which comprised subsidies to industrial sector, domestic consumers and payment to PSO on account of exchange losses. The industrial sector remained the major recipient of petroleum and gas subsidies, which include subsidized LNG and electricity and extension of industrial support package (ISP).[33]

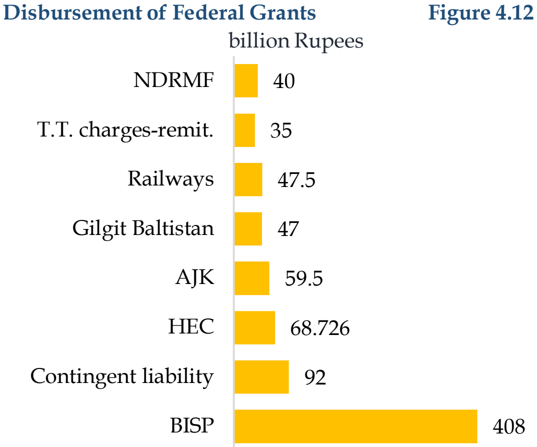
Moreover, the government also provided subsidy of Rs 44 billion in flood affected areas, specifically on fertilizer (Rs 15 billion), mark up on Mera Pakistan Mera Ghar Scheme (Rs 10 billion), markup subsidies & risk sharing scheme for farmers (Rs 3 billion) and markup subsidy for Rabi crops (Rs 8 billion).

Similar to subsidies, total grants were recorded at Rs 1,070.0 billion in FY23, lower by 13.7 percent from Rs 1,239.3 billion in FY22 (**Figure 4.12**). Benazir Income Support Program (BISP) remained a major recipient of federal grants, followed by contingent liabilities, other grants and grants to HEC.

In FY23, the BISP received Rs 408 billion against the budgeted amount of Rs 360 billion. Through BISP, emergency cash assistance of Rs 70 billion was disbursed to 2.72 million families affected due to floods during 2022.[34] Under this cash assistance program, the government provided emergency assistance of Rs 25,000 per family.[35] Moreover, the BISP program also covered the ongoing schemes carried under Unconditional Cash Transfer (UCT) and Conditional Cash Transfer (CCT) programs.

Under the Benazir Kafalat, which is a major UCT program,[36] the government provided cash assistance of Rs 7,000 per family to around 7.7 million families in first half of FY23, which was

Disbursement of Federal Grants **Figure 4.12**



Source: Ministry of Finance

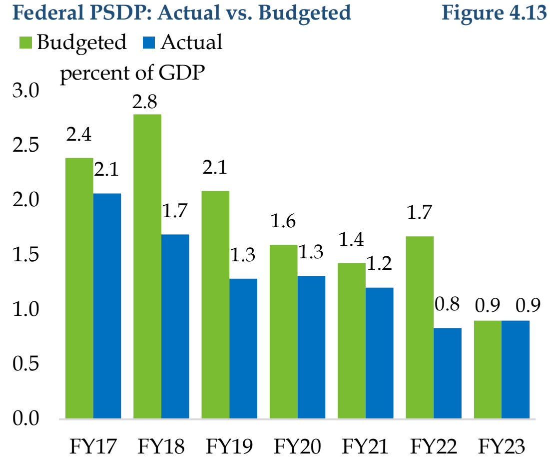
32 Figure 4.11 is based on data of Jul-Mar period.
33 To generate demand for ample available electricity and boost industrial activity, the government had announced ISP scheme in November 2020. Under the scheme, peak and off-peak tariff structure for industrial consumers was abolished initially for the 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)
34 Initially the government announced package of Rs 28 billion which was increased to Rs 70 billion. (Source: MoF press release, August 30, 2022 (PR No. 106)
35 Source: Benazir Income Support Program. www.bisp.gov.pk/
36 Initiated in 2008, the objective of "Benazir Kafaalat Program" is to cushion against negative effects of slow economic growth, food crisis and inflation on the poor, particularly women, through provision of cash assistance to eligible families.

later increased to Rs 8,750 with an inflation adjustment of 25 percent with effect from January 01, 2023. The coverage of UCT Kafalat program was also extended to 9 million families based on the live National Socioeconomic Registry (NSER) database. The major CCT program, i.e. 'Benazir Taleemi Wazaif' scheme, disbursed Rs 23.4 billion during FY23 to the children of BISP beneficiaries.[37] Other than BISP, the government also carried out non-budgeted Pakistan Poverty Alleviation Fund (PPAF) program. One of the major schemes under the program was Interest-Free Loan (IFL) Program, which provides funding to the microenterprises of poor and marginalized households.

Increase in salaries and pensions

Expenditures on both pension and running of the civil government recorded a significant increase during FY23. The major impetus came from relief measures for serving and retired employees announced in FY22. In July 2022, the government had announced 15 percent ad-hoc relief allowance for all federal employees and employees of autonomous/ semi-autonomous bodies and corporations. In addition, government also made upward revisions in salary scale of BPS-1 to BPS-21 civil servants.[38] Moreover, a special allowance was granted to civil employees in grades BPS 1 to BPS 16.[39] Similarly to increase in salary, pension was also increased by 15 percent to Rs 666.3 billion in FY23, which also resulted in higher current expenditures.[40]

Federal PSDP: Actual vs. Budgeted **Figure 4.13**



Source: Ministry of Finance

Federal Development Expenditures

The federal development expenditures increased sharply by 33.1 percent in FY23, against a decline of 16.4 percent in FY22, mainly reflecting higher disbursements under federal PSDP. In terms of GDP, the PSDP saw a slight increase to 0.9 in FY23 percent from 0.8 percent last year.

Federal development spending has consistently fell short of the budgeted amount during the last few years, owing to growing fiscal imbalances and rising subsidies, grants and interest payments.[41] In contrast to FY22, when the targeted PSDP was higher than the previous two years, the government envisaged a lower target for FY23 **(Figure 4.13).**

During the first half of FY23, the federal PSDP releases were lower than the previous year, in line with the strategy of releasing 10 percent of the allocation in Q1, 20 percent in Q2, 30 percent in Q3, and 40 percent in Q4. Further, the ongoing PSDP projects also faced some operational bottlenecks including difficulties in opening of Letter of Credits (LCs) for import of

[37] According to BISP, Benazir Taleemi Wazaif Scheme was initially introduced in five districts in November 2012; the coverage was expanded gradually, and in 2020 all districts of the country were covered. Under this scheme, the children of BISP families are provided with quarterly stipend (varies with sex, age and education level) with the condition of enrolment in school with 70 percent attendance. As of June 2023, 12.0 million children have been enrolled in the scheme and Rs 63.3 billion has been disbursed.
[38] Office Memorandum F. No. 1(2) lmp/2022-283, dated July 01, 2022, Regulations Wing, Finance Division
[39] Office Memorandum F. No. 9(7) R-1/2014-62/2023, dated Feb 14, 2023, Regulations Wing, Finance Division
[40] Office Memorandum No. F.4 (1) Reg.6/2022-486, dated July 01, 2022, Regulations Wing, Finance Division
[41] The PFM reforms comprises: (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) ease and authority to make rules

PSDP Targets vs. Disbursements **Table 4.9**

billion Rupees

Ministry/Division	PSDP Allocation	Expenditure			
		Jul-May	Percent of Allocation	Jul-Jun	Percent of Allocation
Provinces and Special Areas (Previously under FD/KA&GB)	128.8	61.0	47.4	100.5	78.0
National Highway Authority	99.2	62.1	62.6	114.8	115.7
Water Resources Division	102.6	80.6	78.6	115.5	112.6
Cabinet Division	116.1	64	55.1	93.4	80.5
Higher Education Commission	44.7	30.5	68.2	43.0	96.2
NTDC/PEPCO	50.1	89.5	178.5	116.7	232.7
Planning, Development & Special Initiatives Division	5.4	2.8	52.1	4.4	82.4
Railways Division	26.1	25.3	96.9	25.3	97.0
Housing & Works Division	22.9	11.2	48.8	22.2	96.9

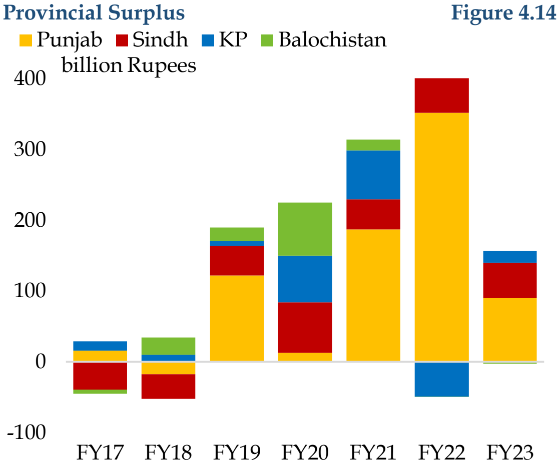
Sources: PSDP 2022-23, Ministry / Division-wise Summary (July - May and Jul-Jun, 2023), Planning Commission Ministry of Planning, Development and Special Initiatives

machinery.[42]

The pace of releases further decelerated when the government reallocated funds from development projects to flood relief activities amid a limited fiscal space and external support to deal with catastrophic floods. Thus, disbursement under federal PSDP remained at Rs 499.8 billion during FY23 against the budgeted Rs 727 billion.[43]

Around 164 projects were completed during FY23. The major development projects envisaged in the Budget 2022-23 included: i) ongoing development project in merged districts of Khyber Pakhtunkhwa; ii) construction of roads and infrastructure specially motorway sections; iii) major dams, including Diamer Bhasha and Mohmand dams; and iv) power projects, such as installation of coal fired power project in Jamshoro and enhancement in transmission capacity of NTDC system etc. The comparison of ministry-wise allocation and actual position of expenditures suggests that most of the federal ministries and other institutions received less than the targeted allocation till May 2023, the actual disbursement bounced sharply in June 2023 (**Table 4.9**).

Provincial Surplus **Figure 4.14**



Source: Ministry of Finance

4.4 Provincial Fiscal Operations

The provincial fiscal accounts exhibited deterioration in FY23. In consolidated terms, the overall provincial surplus contracted sharply from Rs 351.0 billion (0.5 percent of GDP) during FY22 to Rs 154.6 billion (0.2 percent of GDP) in FY23 year. The surplus could only reach 20.6 percent of the Rs 750 billion target envisaged for FY23.[44]

[42] For details, see **Chapter 6**

[43] Planning Commission of Pakistan

[44] FY23 budget envisaged an increase of 31.6 percent to Rs 750.0 billion, compared to Rs 570.0 billion last year.

Provincial Fiscal Operations **Table 4.10**
billion Rupees; percent

	Values		Growth	
	FY22	FY23	FY22	FY23
A. Total revenue (a+b+c)	**4,687.5**	**5,299.4**	**25.7**	**13.1**
a. Provincial share in federal revenue	3,589.0	4,223.5	30.9	17.7
b. Fed loans and transfers	357.8	260.5	9.3	-27.2
c. Provincial own revenue	740.7	815.4	12.5	10.1
Taxes	612.4	649.6	20.5	6.1
Non-taxes	128.3	165.9	-14.6	29.3
B. Total expenditures (a+b+c)	**4,336.5**	**5,144.8**	**27.0**	**18.6**
a. Current	3,200.8	3,859.6	12.5	20.6
b. Development	1,216.6	1,241.0	57.9	2.0
c. Statistical discrepancy	-80.9	44.2	17.1	-154.6
Overall balance (A-B)	**351.0**	**154.6**	**33.3**	**-56.0**

Source: Ministry of Finance

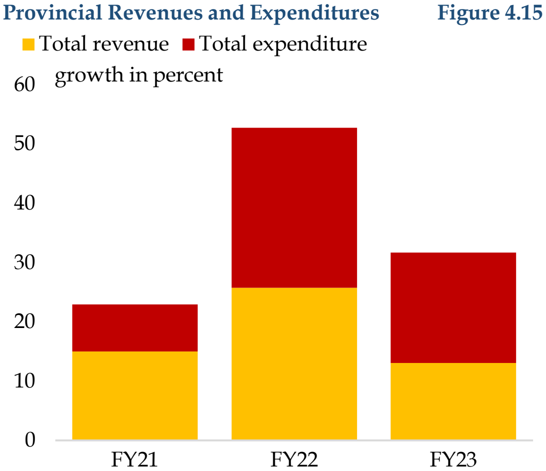
Province-wise analysis reveals that Punjab contributed the most in overall contraction in provincial surplus, whereas Balochistan posted a deficit during FY23. On the contrary, Sindh and KP generated higher surplus during FY23 compared to last year (**Figure 4.14**). The reduction in provincial surplus mainly came from slower growth in revenues, coupled with higher current expenditures (**Table 4.10 and Figure 4.15**).

Provincial Revenues

Growth in provincial revenues decelerated to 13.1 percent in FY23 from 25.7 percent in in the previous year. The deceleration is explained by lower provincial share in federal revenues, and decline in provincial own revenue.

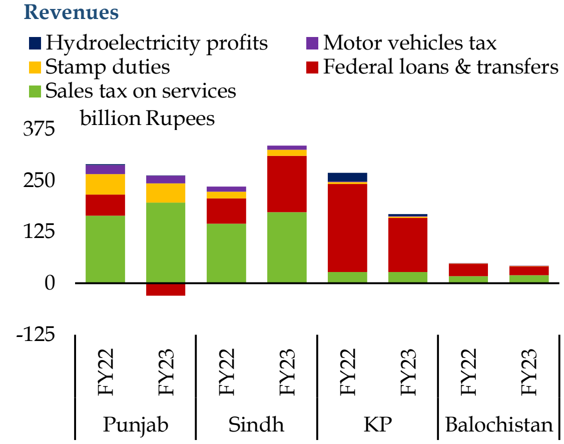
Provincial own revenue collection grew by 10.1 percent in FY23, against 12.5 percent increase in FY22. The deceleration in provincial own revenue came from tax revenues, which recorded a growth of 6.1 percent to Rs 649.6 billion in FY23 compared to Rs 612.4 billion last year. Among different sources of taxes, sales tax on services contributed the most, followed by other taxes and stamp duties. Within provinces, around 46 percent of the taxes were collected by Punjab, 44 percent by Sindh and 6.4 percent and 4.0 percent by KP and Balochistan respectively (**Figure 4.16**).

Provincial Revenues and Expenditures **Figure 4.15**



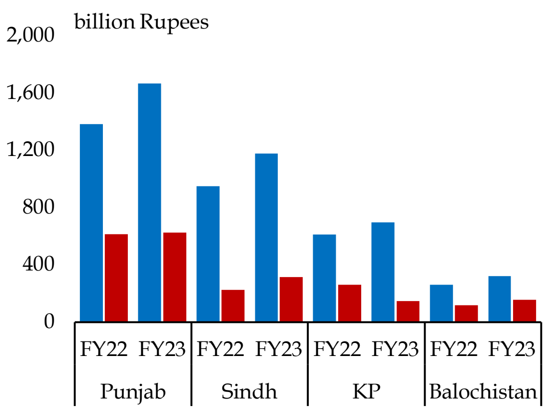
Source: Ministry of Finance

Major Sources of Provincial Own Revenues **Figure 4.16**



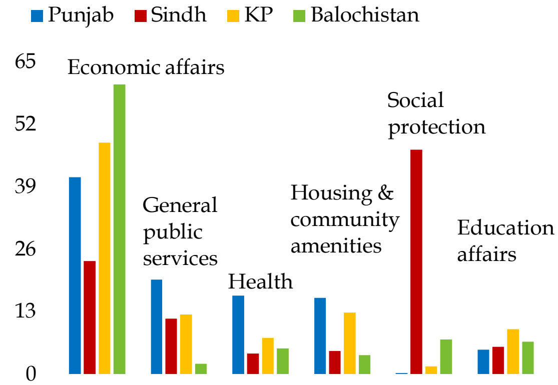
Source: Ministry of Finance

Segregation of Provincial Expenditures **Figure 4.17**



Source: Ministry of Finance

Priorities in Development Spending in FY23 (percent share in provincial development expenditure) **Figure 4.18**



Source: Ministry of Finance

The moderation in growth of provincial own tax collection during FY23 may be attributed to different tax relief measures announced in respective budgets of provinces. For instance, extension of the reduced sales tax rate on services for more than 30 sectors and registration and token tax exemption on electric vehicles in Punjab. Moreover, no new taxes were announced by Sindh in its FY23 budget, whereas special moratorium was placed on collection of cotton fee, professional tax and entertainment duty. Sindh also exempted export-oriented sector from Sindh Infrastructure Development Cess, reduced rate of levy for services provided by cable TV operators, and lowered the Sindh Sales Tax from 13 percent to 8 percent for commission charges. KP also provided relief on various taxes and fee in FY23, which include 20 percent exemption in excise duty on first time registration of motor vehicles, and zero tax on land with full exemption from capital value tax (CVT) and registration fee.

Provincial non-tax revenues registered a growth of 29.3 percent in FY23, against a decline of 14.6 percent in the previous year. The growth mainly came on account of other non-tax sources, including receipts of forests department. In contrast, the major non-tax sources, transfer of hydroelectricity profits to KP, which remained lower at Rs 4.9 billion in FY23 compared to Rs 21.0 billion during last year. This was because most of the federal grants and loans were diverted to finance the food related activities in Sindh.

Provincial Expenditures

The growth in provincial expenditures also decelerated to 18.6 percent during FY23, from 27.0 percent in FY22. The deceleration was due to slower growth in development expenditures, while current expenditures grew sharply (**Figure 4.17**).

The current expenditures rose by 20.6 percent in FY23, compared to 12.5 percent in FY22, majorly driven by increased expenditures on executive & legislative organizations, financial and fiscal affairs including salaries and pension expenditures of respective provinces. The increase in salaries and pension was due to special ad-hoc relief and disparity allowance to employees announced by different provinces in their FY23 budgets. Public order and safety affairs, was other major head that recorded 13.3 percent increase in FY23. The increase was mainly driven by a 15.5 percent more allocation to police department compared to previous year.

Provincial development spending increased by only 2.0 percent in FY23, compared to 58.0 percent increase recorded in FY22. Khyber Pakhtunkhwa witnessed a major decline, whereas Punjab and Sindh also contained the pace of development spending. Within the development spending, major thrust came from economic affairs, as funds were diverted to finance the ongoing projects in construction and transport sector specifically in Punjab, KP and Balochistan. In Sindh, the provincial resources were diverted to social protection and agriculture and allied sectors (**Figure 4.18**).