# 4 Fiscal Policy & Public Debt

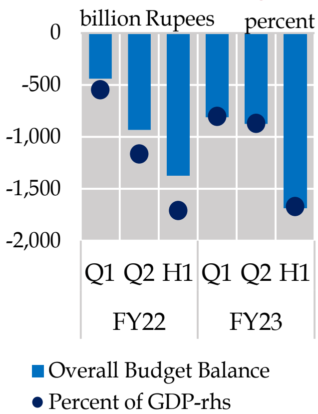
*Fiscal deficit remained unchanged as percent of GDP in H1-FY23 from last year; whereas, primary surplus recorded notable improvement, mainly on account of marked slowdown in non-interest spending, aided by relatively higher pace of expansion in overall revenue. Non-interest spending slowed down mainly through substantial decline in subsidies and grants. Government's revenue mobilization measures, inflation, and elevated interest rates led to higher tax collections – mainly direct taxes; whereas, increase in the petroleum levy and mark-up payments by the PSEs and provinces augmented non-tax revenue collections. On the other hand, the revenue deficit deteriorated, reflecting the higher pace of growth in current expenditure relative to overall revenues. While government exercised restraint in development expenditure, interest spending rebounded sharply from last year's fall. Moreover, FBR missed the half-year target due to import contraction, and lackluster economic activity. Due to the paucity of external financing, government resorted to domestic resources to finance its fiscal deficit. Additional debt accumulation was tilted towards longer-tenor, floating instruments – PIBs and Ijara Sukuks. While lengthening of debt profile lowered the prospects of rollover risk, it stoked the repricing risk amid the rising interest rate environment.*

## 4.1 Fiscal Trends and Policy Review[1]

Fiscal deficit stood at 2.0 percent of GDP in H1-FY23 – unchanged from the same period last year (**Figure 4.1a**).[2] However, moderation in non-interest spending along with the decent increase in revenues led to higher surplus in the primary balance. The primary balance posted a surplus of 1.1 percent of GDP in H1-FY23, against 0.1 percent in H1-FY22 (**Figure 4.1b**).

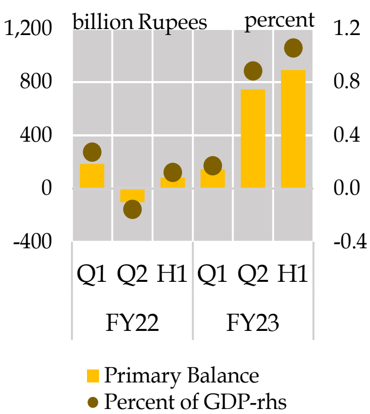
However, revenue balance, which gauges the capacity of overall revenues to finance current expenditures, deteriorated in H1-FY23 compared to last year (**Figure 4.1c**). This was driven by substantial acceleration in markup payments compared to the same period last year. Besides, the aggregate provincial accounts also posted a lower surplus of 0.1 percent of GDP compared to 0.7 percent last year (**Table 4.1**).

**Fiscal Balance** **Figure 4.1a**

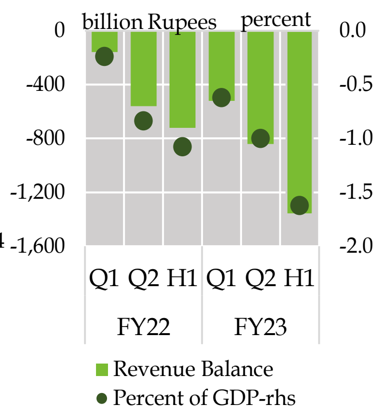



Source: Ministry of Finance

**Primary Balance** **Figure 4.1b**




**Revenue Balance** **Figure 4.1c**

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[1] Revised GDP is used to measure H1-FY23 performance of different indicators and variables as percent of GDP in this section and the rest of the chapter.
[2] In H1-FY23, fiscal deficit was 44.3 percent of the annual target, compared to 28.9 percent in H1-FY22.

**Consolidated Fiscal Indicators in H1** **Table 4.1**

values in billion Rupees; growth in percent

| | Values | | Growth | | As Percent of GDP | |
|---|---|---|---|---|---|---|
| | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 |
| **1. Total Revenue (a+b)** | **3,956.0** | **4,698.9** | **18.0** | **18.8** | **5.9** | **5.6** |
| (a) Tax Revenue | 3,191.0 | 3,731.9 | 29.9 | 16.9 | 4.8 | 4.4 |
| Federal | 2,919.8 | 3,428.8 | 32.1 | 17.4 | 4.4 | 4.1 |
| Provincial | 271.2 | 303.0 | 10.3 | 11.7 | 0.4 | 0.4 |
| (b) Non-Tax | 764.9 | 967.1 | -14.6 | 26.4 | 1.1 | 1.1 |
| Federal | 697.4 | 896.4 | -17.8 | 28.5 | 1.0 | 1.1 |
| Provincial | 67.6 | 70.7 | 43.1 | 4.5 | 0.1 | 0.1 |
| **2. Total Expenditure (a+b+c)** | **5,327.8** | **6,382.4** | **18.7** | **19.8** | **8.0** | **7.6** |
| (a) Current expenditure | 4,675.7 | 6,061.2 | 16.0 | 29.6 | 7.0 | 7.2 |
| Mark-up payments | 1,452.9 | 2,573.1 | -1.5 | 77.1 | 2.2 | 3.1 |
| Defence | 520.5 | 638.9 | 7.0 | 22.7 | 0.8 | 0.8 |
| Non-markup current expenditure | 3,222.8 | 3,488.2 | 26.2 | 8.2 | 4.8 | 4.1 |
| (b) Development expenditure & net lending | 571.5 | 636.6 | 24.8 | 11.4 | 0.9 | 0.8 |
| (c) Statistical discrepancy | 80.6 | -315.4 | 4,145.4 | -491.2 | 0.1 | -0.4 |
| **3.Overall budget balance** | **-1,371.8** | **-1,683.5** | **20.6** | **22.7** | **-2.0** | **-2.0** |
| **4.Primary balance** | **81.1** | **889.6** | **-76.0** | **997.3** | **0.1** | **1.1** |
| **5. Revenue balance** | **-719.7** | **-1,362.3** | **6.1** | **89.3** | **-1.1** | **-1.6** |
| **6. Financing (a+b)** | **1,371.8** | **1,683.5** | **20.6** | **22.7** | **2.0** | **2.0** |
| (a) External (Net) | 1,025.6 | -296.3 | 125.7 | -128.9 | 1.5 | -0.4 |
| (b) Domestic (Net) | 346.2 | 1,979.8 | -49.4 | 471.9 | 0.5 | 2.4 |

Source: Ministry of Finance

To put things into context, amid the ongoing fiscal consolidation efforts under the IMF Extended Fund Facility (EFF) program, the government had envisaged a significant reduction in budget deficit to 4.9 percent of GDP in FY23 from 7.9 percent recorded in the previous year. A strong expansion in tax collection and rationalizing of energy subsidies and grants were the key elements of the desired fiscal outcomes. However, a sharp increase in interest spending and below target growth in FBR taxes kept the fiscal deficit during H1-FY23 almost at the same level seen during H1-FY22, in terms of GDP.

Growth in the overall expenditures in H1-FY23 remained marginally higher than last year, attributed to expansion in both current and development spending. More than half of the entire increase in current spending came from large markup payments, which rebounded sharply due to higher outstanding debt stock in an increasing interest rate environment and growing share of floating rate debt. The non-interest current spending declined on account of substantial fall in subsidies and grants, whereas other expenses including pension, running of civil government and defence services recorded sizeable increase in

H1-FY23. The higher expenditures incurred on running of civil government reflects the announcement of ad-hoc relief allowances and upward adjustment in salaries of federal civil, defence and PSEs employees. Similarly, pension payments also scaled up due to yearly increment in pension rates.

On the other hand, the power sector subsidies including tariff differential payments under Circular Debt Management Plan (CDMP) to Discos, IPPs Wapda/Pepco and K-Electric remained largely short of budgeted targets irrespective of higher accumulation in circular debt during H1-FY23. Similar contraction is also visible in the volume of overall grants, mainly due to absence of Covid-related payments.[3] The flood payouts disbursed through National Disaster Management Authority (NDMA) and Benazir Income Support Program (BISP) were among the largest federal grants. The overall development spending showed a moderate growth during H1-FY23 compared to same period last year.

On the revenue side, both tax revenue and non-tax revenue grew in H1-FY23. Specifically, non-tax revenue reversed trends from last year, and aided in pushing revenue growth slightly higher than the same period last year. The entire growth in tax revenue emanated from domestic taxes (direct taxes, sales tax, FED), unlike last year when import-related taxes had mainly propelled the growth. Growth in domestic taxes, in turn, is almost completely explained by direct taxes, which received major stimulus from revenue-mobilization measures introduced in the FY23 budget—including imposition of new super tax on banks and non-bank firms; revenue impact of elevated inflation and interest rates; and higher collections through FBR's demand notices. FBR's tax administration efforts and reforms also complemented these developments.

Import-related taxes caused a drag on tax revenue, which were mirrored in the slowdown of imports. Weakening demand, disruptive floods, and zero GST on imported crude and POL products to give relief to masses also proved challenging for tax collections. Together, these factors also led to deceleration in tax revenue, with the FBR missing the half-yearly target. Non-tax revenue, on the other hand, was lifted by higher petroleum levy, mark-up payments (from PSEs and others) to government, and royalties on oil and gas paid by government entities when oil prices were trending high.

Amid a large fiscal deficit, the government's financing needs increased in H1-FY23. With limited external financing, most of the deficit was financed through domestic resources. In terms of composition, the public debt was skewed towards long-term, variable rate instruments, particularly PIBs and GoP Ijara Sukuks. The government partially retired its stock of T-bills and external commercial loans. While the lengthening of debt profile through floating rate instruments reduced the rollover risk, repricing risk came to the fore in the backdrop of high interest rate environment. Moreover, the repayment capacity of the country deteriorated during H1-FY23 on account of increasing interest payments, accompanied by the lower-than-targeted FBR revenue collections and insufficient external financing.

[3] The Covid-related grants remained a major source of federal grants in H1-FY22 with an outlay of Rs 102 billion.

**Total Revenue Collection in Pakistan** **Table 4.2**

billion Rupees; growth in percent

| | Collections | | | | | | Growth | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1 | | Q2 | | H1 | | Q1 | | Q2 | | H1 | |
| | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 |
| **Total Revenue (1+2)** | **1,809** | **2,017** | **2,147** | **2,682** | **3,956** | **4,699** | **22.3** | **11.5** | **14.7** | **24.9** | **18** | **18.8** |
| 1.Tax Revenue | 1,533 | 1,782 | 1,658 | 1,950 | 3,191 | 3,732 | 36.6 | 16.3 | 24.4 | 17.6 | 29.9 | 16.9 |
| *Federal* | *1,398* | *1,634* | *1,522* | *1,795* | *2,920* | *3,429* | *38.3* | *16.9* | *26.9* | *17.9* | *32.1* | *17.4* |
| *Provincial* | *135* | *148* | *136* | *155* | *271* | *303* | *20.6* | *9.9* | *1.8* | *13.5* | *10.3* | *11.7* |
| 2.Non-Tax Revenue | 276 | 235 | 489 | 732 | 765 | 967 | -22.6 | -14.8 | -9.2 | 49.7 | -14.6 | 26.4 |

Source: Ministry of Finance

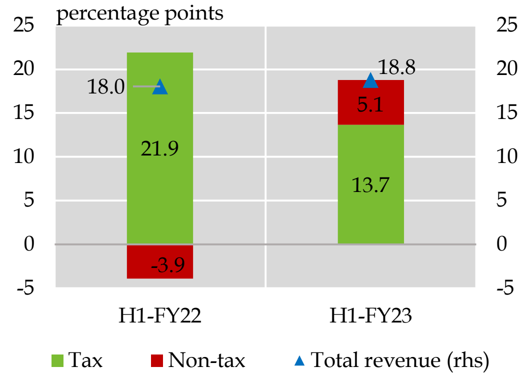
## 4.2 Revenue

Total revenue rose by 18.8 percent in H1-FY23, registering a slight increase from last year's 18.0 percent growth (**Table 4.2**). While growth rate of tax revenue, a major contributor, almost halved from last year, growth of non-tax revenue (NTR) turned from negative to notable positive (**Figure 4.2**).

Quarterly data shows that total revenue accelerated sharply in Q2 vis-à-vis Q1 of FY23. It was due to positive contribution of non-tax revenue in the second quarter, which, in turn, was propelled by mark-up payments (from PSEs and others), oil and gas royalties, and transfer of SBP's surplus profit (including arrears from last year). Tax revenue grew at an almost the same pace in both the quarters.

While the federal tax revenue received impetus from administrative and revenue mobilization measures of the FBR, as well as the revenue impact of inflation and rising interest rates, they faced headwinds from the slowdown in imports, floods, and lackluster economic activity. Exchange rate depreciation partially offset the impact of declining imports.

**Percent Contribution in Revenue** **Figure 4.2**




Source: Ministry of Finance

### FBR Taxes

FBR's net tax collection posted 17.4 percent expansion in H1-FY23, against last year's 32.5 percent (**Table 4.3**). Almost the entire growth was achieved on the back of domestic direct taxes, which recorded 56.3 percent growth in H1-FY23. There was also growth in domestic sales tax and FED collections; however, it was overshadowed by the decline in import-related counterparts (including customs duties). All domestic taxes (direct taxes, sales tax, and FED) drove growth in H1-FY23, as opposed to last year when import-related taxes (sales tax, customs duties, and FED) had played a pivotal role (**Figure 4.3**).

**FBR Tax Revenue in H1** **Table 4.3**

billion Rupees; growth in percent

| | Collections | | Percent Change | | Contribution in FY23 Growth | Target (H1-FY23) | Percent of Target |
|---|---|---|---|---|---|---|---|
| | FY22 | FY23 | FY22 | FY23 | | | |
| **A. Direct Taxes** | **1,021** | **1,526** | **23.6** | **49.4** | **17.3** | **1,547** | **99** |
| Imports | 141 | 149 | n.a* | 6.1 | 0.3 | - | - |
| Domestic | 881 | 1,376 | n.a* | 56.3 | 17.0 | - | - |
| **B. Indirect Taxes (1+2+3)** | **1,899** | **1,903** | **37.8** | **0.2** | **0.2** | **2,099** | **91** |
| **1. Sales Tax** | **1,275** | **1,272** | **39.1** | **-0.2** | **-0.1** | **1,376** | **92** |
| *Imports* | *892* | *825* | *75.4* | *-7.6* | *-2.3* | - | - |
| *Domestic* | *383* | *447* | *-6.2* | *16.8* | *2.2* | - | - |
| **2. FED** | **146** | **164** | **15.3** | **12.3** | **0.6** | **179** | **92** |
| *Imports* | *12* | *6* | *27.6* | *-53.3* | *-0.2* | - | - |
| *Domestic* | *134* | *159* | *14.3* | *18.3* | *0.8* | - | - |
| **3. Customs** | **477** | **467** | **42.8** | **-2.1** | **-0.4** | **543** | **86** |
| *Import* | *477* | *467* | *42.8* | *-2.1* | *-0.4* | *543* | *86* |
| *Domestic* | - | - | - | - | - | - | - |
| **Grand Total (A+B)** | **2,920** | **3,429** | **32.5** | **17.4** | **-** | **3,646** | **94** |

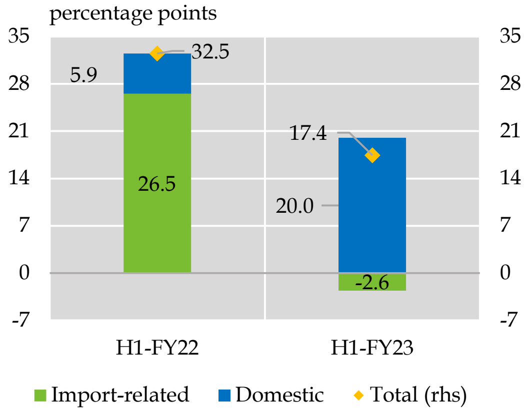
*Bifurcated data for Direct Taxes not available

Source: Federal Board of Revenue

There was deceleration in tax revenue growth in H1-FY23 compared to last year, which is traced to the import contraction, crimping demand, downbeat economic activity amidst devastating floods, and FBR missing targets due to some revenue-enhancing measures being contested in the courts.

**Contribution in Tax Revenue** **Figure 4.3**

percentage points




Source: Federal Board of Revenue

Further, tax collections were impeded by zero GST on imported petroleum products and crude, and temporary exemptions on all duties and taxes extended under the ambit of flood relief. Moreover, refunds issued in H1-FY23 were also 18.1 percent higher than the same period last year.

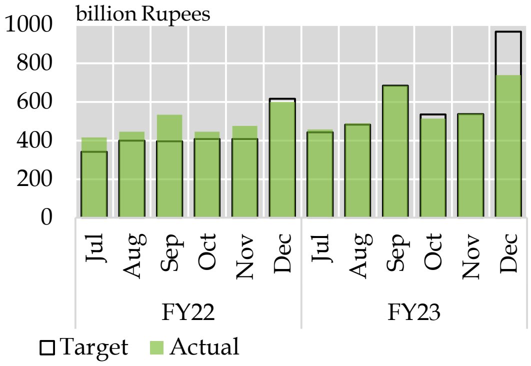
That being said, the growth in tax revenue in H1-FY23 was achieved on the back of following major factors:

**a)** Revenue mobilization measures introduced in the Finance (Supplementary) Act 2022 and Finance Act 2022, including revisions in income tax rates; imposition of super tax on high-earning persons; measures to widen tax base—for example tax on deemed income from property; and removal of domestic GST exemptions. **b)** FBR's administrative efforts to improve tax compliance and ease of doing business, including rollout of Synchronized Withholding Administration and Payment System (SWAPS); revamping of Alternate Dispute Resolution Mechanism; National

Sales Tax Return; Track and Trace System (TTS) for tobacco and sugar. **c)** Inflation in goods and services, as well as increase in government salaries, also cushioned tax collections in the first half. **d)** Rising interest rates pushed up returns on government securities, saving deposits, saving certificates, banks' profitability, and income taxes paid thereof.

In terms of budget targets, aggregate tax collections accounted for 94 percent of the target in H1-FY23; last year in the first half, these collections had surpassed the cumulative target by a large margin. Monthly data indicates that the major slippage occurred only in the month of December 2022 (**Figure 4.4**). According to the FBR, it was because of some revenue-enhancing measures, worth Rs 250 billion, announced in the Finance Act 2022 that could not be implemented, as they were being contested in courts.[4] In addition to that,

**Monthly Performance of Actual Collections vis-a-vis Targets** **Figure 4.4**




Source: Federal Board of Revenue Press Releases

import compression in the second quarter led to tax collections from imports falling short of the target (**Table 4.3**).

## FBR's administrative measures

Various administrative measures taken by the FBR in FY22 and FY23 proved instrumental in propelling tax collection, improving tax compliance, and propping up ease of doing business. Some of those measures are worth-accentuating here:

**a)** Alternative Dispute Resolution (ADR), an out-of-court dispute-solving mechanism that facilitates ease of doing business, was revamped through the Finance Act 2022, to make it more efficient and effective.

**b)** Automated System of Collection and Deduction of Withholding Taxes (SWAPS) was introduced in the Finance Act 2022 that aims to simplify and streamline collection and deduction of withholding tax by the withholding agents.

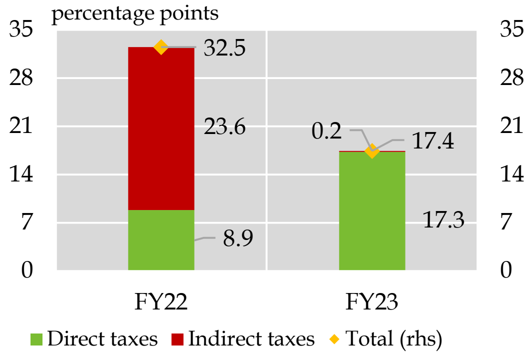
**c)** Discontinuance of gas and electricity connections of sales tax agents, including Tier-1 retailers, who fail to register for sales tax purpose, or notified tier-1 retailers registered but not integrated with the Board's Computerized System. This measure was announced in the Finance Act 2022.

**d)** A Point-of-Sale (POS) Prize Scheme, rolled out during late 2021, encourages consumers to buy from Tier-1 retailers, which are registered and integrated with the FBR's online POS system.[5]

[4] Source: FBR Press Release dated December 31, 2022. Source: www.fbr.gov.pk/pr/fbr-achieves-unprecedented-growth-of-66-in-di/173748/2022

[5] A consumer wins cash prizes in electronic draws by verifying the invoices through Tax Asaan application, which become part of the draws. First draw was held on 15-January-2022, followed by

**Contribution of Direct and Indirect Taxes in Tax Revenue Growth in H1** **Figure 4.5**




Source: Federal Board of Revenue

**e)** Introduction of National Sales Tax Return (NSTR) in January 2022 to increase ease of doing business by simplifying and consolidating the sales tax returns filing.[6]

**f)** Track and Trace System (TTS) for tobacco and sugar industries, introduced in Q2-FY22, is bearing positive results. In H1-FY23, sales tax collected from the sales of sugar and cigarettes increased by 9.2 percent and 25.9 percent respectively.

### *Direct taxes drove the YoY increase in tax revenue*

Direct taxes' growth rate and contribution to tax revenue doubled in H1-FY23 vis-à-vis the same period last year, whereas indirect taxes stood stagnant (**Figure 4.5 and Table 4.4**). The breakdown of direct taxes shows that major contributions came from withholding taxes, voluntary payments, followed by collection on demand.

**Direct Taxes Collected in H1** **Table 4.4**

billion Rupees; growth in percent

| | Collections | | YoY Growth | |
|---|---|---|---|---|
| | FY22 | FY23 | FY22 | FY23 |
| **Collection on Demand** | **20.3** | **49.2** | **-47.3** | **142.7** |
| **Voluntary Payment** | **312.0** | **543.7** | **21.5** | **74.2** |
| Advance tax | 245.3 | 449.0 | 15.9 | 83.0 |
| **Withholding taxes** | **665.1** | **923.8** | **16.8** | **38.9** |
| Bank interest & securities | 64.5 | 138.4 | -4.6 | 114.6 |
| Contracts | 133.8 | 183.3 | 11.2 | 37.1 |
| Salaries | 84.5 | 117.7 | 21.0 | 39.3 |
| Electric bills | 31.8 | 55.7 | 22.9 | 74.9 |
| Imports | 132.4 | 148.5 | 45.8 | 12.1 |
| Transfer of immoveable property | 35.6 | 68.7 | *n.a* | 93.3 |
| **Net Direct Tax (DT)** | **1,021** | **1,526** | **23.6** | **49.4%** |

Note: Net DT is adjusted for DT refunds. Other amounts in the table are on gross basis.

Source: Federal Board of Revenue

### ***Withholding taxes (WHT)***

Withholding tax collection from bank interest and securities increased markedly due to two main factors: **a)** withdrawal of exemption of reduced rate benefit on investment in federal government securities. Earlier, profit on debt of all persons other than banking companies was taxed at 15 percent; now under the Finance Act 2022, this rate applies only to those persons whose profit does not exceed Rs 5 million;[7] the rate is doubled for those not on the Active Taxpayer List (ATL); **b)** Rising interest rates led to higher returns on bank deposits investment in government securities, and national saving certificates, which aided WHT collections.

monthly draws until October 15, 2022. The scheme was temporarily suspended on November 15, 2022 until January 15, 2023.

[6] NSTR is being implemented gradually across the country.

[7] The scope of this reduced rate benefit has been cut back.

In case of contracts, taxable services were expanded to incorporate REIT management services and National Clearing Company of Pakistan Limited.[8] Second, sale of goods or services under section 153, including edible oils, rice, transport services, freight forwarding services, air cargo services, courier services, among others, led to higher WHT collection due to inflationary spillovers.[9]

Withholding tax collection from electric bills also witnessed growth due to rise in per unit cost of electricity.[10] Moreover, in order to increase tax net, retailers and some service providers have to pay fixed income tax through their electricity bills (**Table 4.5**).[11]

**Withholding Tax on Retailers and Service Providers** **Table 4.5**

| Gross Monthly Bill | WHT |
|---|---|
| Where the amount does not exceed Rs. 30,000 | Rs 3,000 |
| Where the amount exceeds Rs. 30,000 but does not exceed Rs 50,000 | Rs 5,000 |
| Where the amount exceeds Rs. 50,000 but does not exceed Rs 100,000 | Rs 10,000 |
| Retailers and service providers as notified by the Board in the income tax general order | Up to Rs 200,000 |

Source: Finance Act 2022

Similarly, progressive rates for income tax slabs were revised upward in the budget. While slabs were reduced from 12 to 7, there was an increase in the tax liability of salaried individuals with taxable income nearer to the upper bound of the middle slab (Rs 2.4 million to Rs 3.5 million) or exceeding Rs 3.6 million (top three slabs), when compared to their tax liabilities under FY22 slabs. Besides this, salaries of government officials or employees were also raised in the FY23, which propped up the taxable income. These measures led to higher WHT collections under the sub-head of salaries in **Table 4.4**.[12]

Additionally, withholding tax on sale, purchase or transfer of immoveable property was also enhanced from 1 percent to 2 percent. Furthermore, this tax was to be collected irrespective of the holding period.[13] For purchasers not on the ATL, it would be increased by 250 percent. These measures led to higher WHT collections from the property transactions. Lastly, WHT collections from imports also received a push from increased tax rates—up from 2 percent to 3.5 percent; the rate is double for those importers not on the ATL.

***Voluntary payments***

Collections under this head rose significantly by 74.2 percent in H1-FY23, surpassing last year's 21.5 percent growth (**Table 4.4**). This growth can be traced to three main factors:

**a)** Minimum tax on banks' income increased from 35 percent to 39 percent for FY23.

**b)** Tax on income generated from investment in government securities, which is linked to

[8] 'Contracts' here refer to section 153 of the Income Tax Ordinance 2001. And, section 153 includes sale of goods or services, and execution of contracts.
[9] For instance, transport services witnessed 57.8 percent YoY inflation in H1-FY23. Source: Pakistan Bureau of Statistics
[10] Electricity charges grew 31.4 percent in H1-FY23 over last year. Source: Pakistan Bureau of Statistics
[11] Source: Finance Act 2022
[12] BPS-2022 replaced BPS-2017 pay structure, and the pay brackets were revised upwards. Furthermore, ad-hoc relief fund at 15 percent of the basic pay was also rolled out; earlier it was 10 percent. Source: Ministry of Finance. Source: www.finance.gov.pk/circulars/circular_01072022.pdf
[13] Earlier this tax was zero if holding period was more than 4 years.

**Income Tax on Earnings from Government Securities Linked to Advance-to-Deposit (ADR) Ratio** — **Table 4.6**

| Slab | FY22 & onwards | Previous Rate |
|---|---|---|
| ADR =< 40% | 55% | 40% |
| 40% < ADR =< 50% | 49% | 37.5% |
| ADR > 50% | 35% for FY22*<br>39% for FY23* | 35% |

*they are equal to the minimum taxes on banks' income in respective Tax Years
Source: Finance Act 2022

advances-to-deposit ratio (ADR), was enhanced for FY22 and onwards (**Table 4.6**).

**c)** Imposition of cascading super tax on high-earning persons under the new section 4C (**Table 4.7**). There was an upward revision in super tax from 4 to 10 percent for the banking companies whose income exceeded Rs 300 million for FY23.[14] For non-bank firms, super tax of 10 percent was imposed retrospectively for FY22. Furthermore, banks' profitability amidst a high-interest rate environment was also considerably higher than the year before. In Jan-Dec 2022, banks' overall profit-before-tax was 55.8 percent higher than the comparable period last year. This resulted in higher income tax collections from banks in H1-FY23.

***Collection on Demand:***

Reversing the declining trend from last year, collection on demand grew by 142.7 percent in H1-FY23, against a low base. Main reason was that last year the recovery date of the tax payable claimed in demand notices by the FBR had been extended beyond 90 days—instead of 30 days—through the Finance Act

**Super Tax on High Earning Persons for Fiscal Year 2023** — **Table 4.7**

| S.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 & 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

2021. In H2-FY22 and H1-FY23, impact of this extension tapered off.[15]

Another factor could be that issuance of assessment order in demand notices was extended from five to six years in the Finance Act 2022. Furthermore, FBR was also able to collect due income taxes from banks, which had not earlier deposited their quarterly

[14] Until FY2022, super tax was being applied under section 4B—"Super tax for rehabilitation of temporary displaced persons". In FY2023, a new section, 4C, was introduced---"Super tax on high-earning persons", targeting the wealthier sections of the country.
[15] In H2-FY22 and H1-FY23, CoD grew by 94 percent and 142.7 percent, respectively.

advance tax payments (voluntary payments). Given banks' high profitability, CoD received a major boost in H1-FY23.

## Indirect taxes levelled off

Indirect taxes stood stagnant in H1-FY23, as they recorded a mere 0.2 percent YoY increase in the first half. Last year, they had grown by 37.8 percent, receiving major impetus from import-related taxes. In contrast, this year domestic collections stood out, as import-related taxes slumped below last year levels (**Figure 4.6a**).

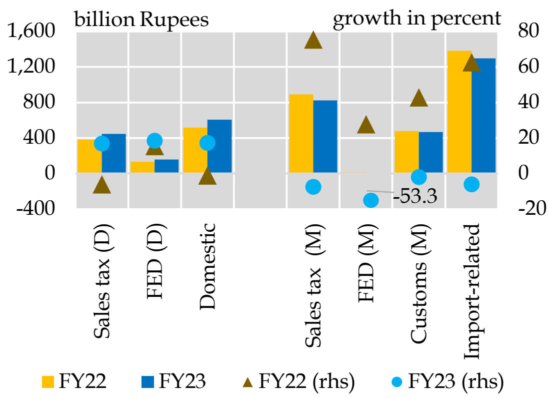
### *Declining imports bring down import-related tax collection*

Collections under indirect import-related taxes dropped by 6.1 percent in the first half of FY23, against last year's high growth (**Table 4.8**). This year imports (in PKR terms) fell in the second quarter, leading to lower collections under customs duties, sales tax, and FED in the first half (**Figure 4.6a** and **4.6b**).

All these taxes declined in tandem with the fall in PKR-denominated imports bill in the second quarter.[16] Steep depreciation in the first quarter had offset the revenue impact of decrease in USD-denominated imports bill. However, in the second quarter, a steep decline in import growth outweighed the impact of exchange rate depreciation. The adjacent fall in import-related taxes in the second quarter resulted in decline in the first half collections, compared to the same period last year.[17] That said, PKR depreciation served as a cushion against the otherwise sharply contracting USD imports in the first half.

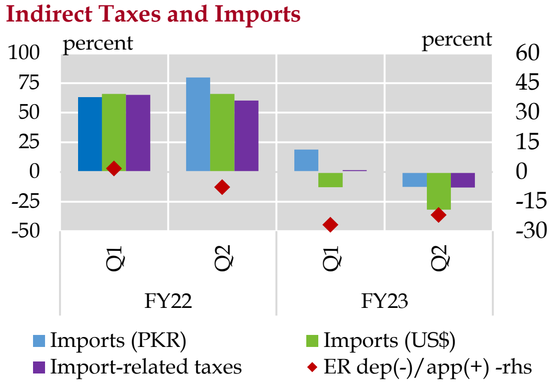
In terms of products, the decline in imports (in PKR terms) in the second quarter occurred in most of the major import categories, including vehicles, electrical and mechanical machineries, POL products, and

**Breakdown of Indirect Taxes in H1** **Figure 4.6a**




Source: Federal Board of Revenue

**Growth Rates of Import-related Indirect Taxes and Imports** **Figure 4.6b**




Source: Federal Board of Revenue & Pakistan Bureau of Statistics

[16] Import-related taxes and duties are assessed in PKR. Imports bill, originally recorded in US$, is converted into PKR using the current exchange rate.
[17] Collections of import-related taxes are directly linked to the PKR-denominated imports bill, other things constant.

**Major Revenue Spinners of Import-related Indirect Taxes in H1** **Table 4.8**

billion Rupees; growth and contribution in percent

| | Collections | | Growth in FY23 | Contribution in FY23 |
|---|---|---|---|---|
| | FY22 | FY23 | | |
| **Customs duties (M)** | **477.2** | **466.9** | **-2.1** | **-0.7** |
| POL | 112.5 | 90.1 | -19.9 | -1.6 |
| Vehicles | 94.5 | 43.7 | -53.7 | -3.7 |
| Iron and steel | 33 | 5.9 | -82 | -2.0 |
| Photosensitive semiconductor devices | 29 | 10.6 | -63.4 | -1.3 |
| Machinery | 23.4 | 12.2 | -47.8 | -0.8 |
| Animal/vegetable fats & oils | 20.4 | 14.1 | -30.7 | -0.5 |
| **Sales Tax (M)** | **892.3** | **824.9** | **-7.6** | **-4.9** |
| POL | 282.3 | 155.4 | -45 | -9.2 |
| Vehicles | 70.7 | 46 | -34.9 | -1.8 |
| Iron and steel | 71.8 | 65 | -9.5 | -0.5 |
| Oil seeds & fruits | 22.7 | 18.8 | -17.5 | -0.3 |
| Photosensitive semiconductor devices | 34.5 | 31.6 | -8.5 | -0.2 |
| Animal/vegetable fats & oils | 55.7 | 82.2 | 47.6 | 1.9 |
| **FED (M)** | **12.4** | **5.8** | **-53.3** | **-0.5** |
| **Import-related, total** | **1,381.8** | **1,297.5** | **-6.1** | **-4.4*** |
| **Indirect taxes, total** | **1,898.5** | **1,903.2** | **0.2** | **-** |

* Contribution in 'indirect taxes, total'. All other contributions are in relation to 'import-related, total'

Source: Federal Board of Revenue

iron and steel. The decline was due to the strong regulatory and administrative measures to curtail imports by the government, among other factors.[18]

With regards to the specific taxes, sales tax received bigger hit than the customs duties (**Table 4.8**). One reason was zero GST on four imported POL products, including petrol, kerosene, high-speed diesel oil, light diesel oil.[19] Another reason was that sales tax is calculated on top of customs duties. With dutiable imports receding by 0.5 percent in H1-FY23 (10.6 percent in Q2), sales tax collections dropped more sharply (7.6 percent in H1 and 15.2 percent in Q2) than the custom duties collection (2.1 percent in H1 and 8.3 percent in Q2).[20]

### *Collections of domestic sales tax and FED shored up indirect taxes*

Domestic collection of indirect taxes (sales tax and FED) increased by 17.2 percent in H1-FY23, after declining by 1.1 percent same period last year. This increase was led by different factors, including removal of GST exemptions through the Finance

[18] For more details, see Chapter 5 – External Sector

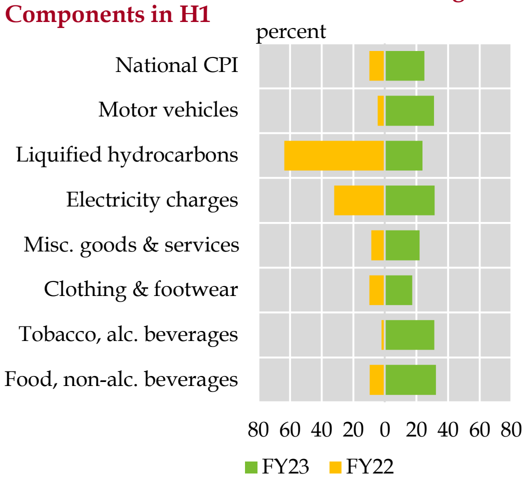
[19] GST on these products was removed in January 2022 through the Finance (Supplementary Act) 2022.

[20] For example, the assessed value of an imported good is Rs 100, customs duty is 10 percent and sales tax is 17 percent. First, customs duty is applied (Rs 100*1.1 = Rs 110), and then the sales tax on the resulting value (Rs 110*1.17 = Rs 128.7). Say, the same imported good is worth Rs 90 now; the values after customs duty and sales tax will be Rs 99 and Rs 115.83 respectively. The fall in sales tax collection (Rs 12.87) is more than customs duty collection (Rs 11).

(Supplementary) Act 2022 and Finance Act 2022.[21]

Elevated inflation in the first half of FY23 also translated into higher GST collections, offsetting the adverse impact of lackluster economic activity and zero GST on the four imported POL products, as well as crude.[22] Growth in the national CPI accelerated markedly in H1-FY23 from the year before (**Figure 4.7**). Major revenue spinners of domestic indirect taxes are shown in **Table 4.9**. Electrical energy was the major spinner for sales tax, given one-third increase in electricity charges in H1-FY23 from the year ago. In case of cigarettes and sugar, the Track and Trace System also aided in higher collections.

**Growth in National CPI and its Components in H1** **Figure 4.7**




Note: alc. is short for 'alcoholic'
Source: Pakistan Bureau of Statistics

Furthermore, some revenue-mobilization measures were taken in the Finance Act 2022. For instance, the ambit of Tier-1 retailers was expanded by adding jewelers (except those with shop size less than 300 square feet) to the Tier-1 retailers' list.

Besides, to make Tier-1 and other retailers more compliant in their responsibility to register and integrate with the FBR's real-time reporting of sales system, a disincentive was created in the form of discontinuance of gas and electricity bills of retailers not registering for sales tax purposes. This provision was also applicable on other sales tax agents. Moreover, a monetary penalty system was also implemented in FY23 for the non-compliant Tier-1 retailers.[23]

**Table 4.9** shows there was a jump in GST collections from the sales of POL products. With zero GST on four imported POL products and crude, these collections represent still-in-place tax on other POL products, including furnace oil, HOBC, JP-1, and JP-8. With international crude prices trending higher than the year before and tying into the products prices, GST collections from other POL products came out 12.4 percent higher than last year.

Domestic FED collection, which witnessed greater growth than last year, was propelled by increase in the tax on cigarettes and air travel in club, business and first class (**Table 4.9**).

[21] This phenomenon reflected in the revised tax expenditures for FY22, which showed year-on-year declines in sales tax exemptions for FY22. Source: Finance Act 2022
[22] GST on crude and products was removed through the Finance (Supplementary) Act 2022 in January 2022 and in March 2022 through FBR's SRO No. 321(I)/2022, respectively.
[23] Penalty of Rs 500,000 for first default; one million for second default after 15 days of order for first default; two million rupees for third default after fifteen days of order for second default; three million rupees for fourth default after fifteen days of order for third default; notwithstanding above, premises might be sealed as well.

**Major Revenue Spinners of Domestic Indirect Taxes in H1** **Table 4.9**

billion Rupees; growth and contribution in percent

| | Collections | | Growth in | Contribution |
|---|---|---|---|---|
| | FY22 | FY23 | FY23 | in FY23 |
| **Sales Tax (D)** | **382.7** | **447.1** | **16.8** | **12.4** |
| Electrical energy | 78.7 | 131.9 | 67.6 | 10.3 |
| POL | 68.9 | 77.5 | 12.4 | 1.7 |
| Cigarettes | 14 | 17.6 | 25.9 | 0.7 |
| Sugar | 31 | 33.9 | 9.2 | 0.6 |
| Natural Gas | 17.8 | 20.7 | 16.0 | 0.6 |
| Cement | 17.1 | 18.6 | 9 | 0.3 |
| Aerated waters/beverages | 9.8 | 10.5 | 6.7 | 0.1 |
| Cotton Yarn | 40.7 | 26.1 | -35.9 | -2.8 |
| **FED (D)** | **134** | **158.5** | **18.3** | **4.7** |
| Cigarettes | 52.6 | 63.1 | 20 | 2.0 |
| Concentrates used in beverages & foods | 8.3 | 13.3 | 59.9 | 1.0 |
| Air travel | 3.2 | 8 | 154 | 1.0 |
| Motor Cars | 6.9 | 11.5 | 67 | 0.9 |
| **Domestic, total** | **516.7** | **605.6** | **17.2** | **4.7*** |
| **Indirect taxes, total** | **1,898.5** | **1,903.2** | **0.2** | - |

* Contribution in 'indirect taxes, total'. All other contributions are in relation to 'domestic, total'

Source: Federal Board of Revenue

## Non-tax Revenue

Non-tax revenue (NTR) swelled by 26.4 percent in H1-FY23, after declining by 14.6 percent last year (**Table 4.10**). Major drivers were petroleum levy, mark-up on loans extended to PSEs and others by the government, royalties on oil and gas, and dividend payments from PSEs.[24] Quarterly data further shows that the entire growth in the NTR occurred in the second quarter. Among other things, this was due to the below-target petroleum levy collections in the first quarter, and change in mechanism of transfer of SBP's profits to the government in H2-FY22.[25]

In terms of budgeted annual targets, collections under the NTR were 50 percent of the target this year, as compared to last year's 36.8 percent. This was due to higher collections under the aforementioned sub-heads compared to the budgeted estimates.

Collections from petroleum levy in H1-FY23 surpassed last year's level. It was due to higher levels of the levy imposed in H1-FY23 (**Figure 4.8**), which also compensated for declining POL sales. It may be pointed out here that collections from petroleum levy were just 20.8 percent of the target, despite excelling last year's percentage. It was because the levy increased gradually to Rs 50

[24] 'Mark-up to PSEs and others' refers to mark-up collected from: cash development loans to the provincial governments; loans to local bodies, financial and non-financial institutions and other corporations; capital outlays of the Federal Government in the commercial departments.

[25] Instead of quarterly transfers, transfers are made annually—starting FY23. Notwithstanding that, the second quarter saw transfer of SBP's profits, which were arrears from last fiscal year.

**Non-Tax Revenue (NTR) Collection in Pakistan** **Table 4.10**

billion Rupees; growth in percent

| | Collections | | | | | | Growth | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Q1 | | Q2 | | H1 | | Q1 | | Q2 | | H1 | |
| | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 |
| Petroleum levy | 13.3 | 47.5 | 56.7 | 130.3 | 70 | 177.8 | -90.2 | 255.7 | -59.2 | 130 | -74.6 | 154 |
| Mark-up (PSEs/others) | 19.5 | 28.8 | 13.1 | 48.8 | 32.6 | 77.6 | -24.1 | 48 | -28.4 | 272.1 | -25.9 | 138.2 |
| Royalties on oil/gas | 21.7 | 20.7 | 17.3 | 36 | 39.1 | 56.7 | 48.5 | -4.9 | -15.5 | 107.7 | 11.2 | 45 |
| Dividend | 1.9 | 24.7 | 24.1 | 16.2 | 26 | 40.8 | 27.3 | 1,195.4 | 132 | -32.8 | 118.8 | 57.2 |
| Surplus profit of SBP | 109 | 0 | 271 | 371.2 | 380 | 371.2 | 3.8 | -100 | 1.3 | 37 | 2 | -2.3 |
| Profit PTA | 30.1 | 13.1 | 8.8 | 19.5 | 38.9 | 32.6 | 269.2 | -56.6 | -16.1 | 122.1 | 108.9 | -16.2 |
| Passport fee | 6.1 | 6.7 | 4.3 | 9.7 | 10.4 | 16.4 | 106.7 | 9.9 | 6.8 | 126.2 | 49.2 | 57.9 |
| Defense receipts | 2.8 | 3.8 | 4.9 | 5.5 | 7.7 | 9.3 | -1.3 | 33.5 | 34.3 | 11.4 | 18.6 | 19.5 |
| GIDC | 6.5 | 3 | 4.6 | 3 | 11.2 | 6 | 30.8 | -54 | 2.1 | -35.1 | 17.1 | -46.1 |
| **Total NTR** | **275.7** | **234.9** | **489.2** | **732.2** | **764.9** | **967.1** | **-22.6** | **-14.8** | **-9.2** | **49.7** | **-14.6** | **26.4** |

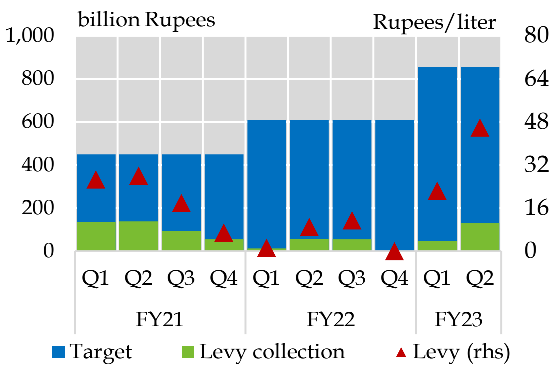
Source: Ministry of Finance

per litre—as budgeted—during the first half of FY23, in order to mellow down associated inflationary impact on the masses.

Mark-up payments by PSEs and others also saw a jump of 138.2 percent against last year's decline. This was in tandem with the trend of policy rate (**Figure 4.9**). For the year FY22, Ministry of Finance had raised the mark-up rate from 10.3 to 11.2 percent, leading to higher mark-up payments to the government in FY23.[26]

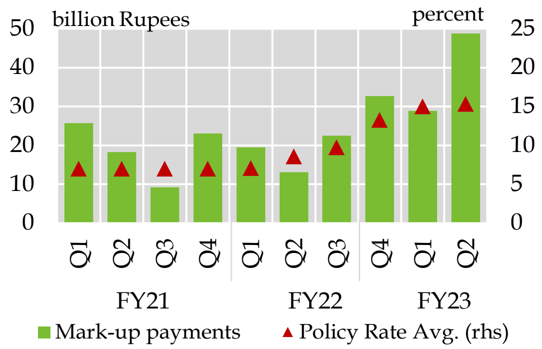
Royalty payments also witnessed growth in H1-FY23. Elevated international crude prices, coupled with exchange rate

**Quaterly Petroleum Levy Collections Vis-a-Vis Annual Targets** **Figure 4.8**




Source: FBR, MoF, and OGRA

**Mark-up Payments Linked to Policy Rate Environment** **Figure 4.9**




Source: Ministry of Finance & State Bank of Pakistan

[26] For the year FY21, the government had cut back the mark-up from 12.2 percent to 10.3 percent. Source: www.finance.gov.pk/circulars/circular_17112022.pdf

**State of Federal Expenditures in H1** **Table 4.11**

billion Rupees, growth in percent

| | Cumulative Flows | | YoY Growth | | Percent Contribution in Expenditure Growth | | As Percent of GDP | |
|---|---|---|---|---|---|---|---|---|
| | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 |
| **Total expenditures* (a+b)** | **3705.7** | **4567.2** | **20.4** | **23.2** | **20.4** | **23.2** | **5.6** | **5.6** |
| **(a) Current expenditure** | **3351.3** | **4390.2** | **19.4** | **31.0** | **17.7** | **28.0** | **5.0** | **5.2** |
| Mark-up payments | 1452.9 | 2573.1 | -1.5 | 77.1 | -0.7 | 30.2 | 2.2 | 3.1 |
| Domestic | 1312.5 | 2273.5 | -3.3 | 73.2 | -1.4 | 25.9 | 2.0 | 2.7 |
| Foreign | 140.4 | 299.6 | 18.7 | 113.4 | 0.7 | 4.3 | 0.2 | 0.4 |
| Non-interest current spending | 1898.5 | 1817.1 | 42.5 | -4.3 | 18.4 | -2.2 | 2.8 | 2.2 |
| Defence affairs and services | 520.5 | 638.9 | 7.0 | 22.7 | 1.1 | 3.2 | 0.8 | 0.8 |
| Pension | 251.7 | 321.2 | 19.6 | 27.6 | 1.3 | 1.9 | 0.4 | 0.4 |
| Running of civil govt. | 209.9 | 226.7 | 7.4 | 8.0 | 0.5 | 0.5 | 0.3 | 0.3 |
| Subsidies | 313.4 | 196.6 | 143.0 | -37.3 | 6.0 | -3.2 | 0.5 | 0.2 |
| Grants to provinces and others | 603.0 | 433.7 | 94.1 | -28.1 | 9.5 | -4.6 | 0.9 | 0.5 |
| Grants to provinces | 54.1 | 44.6 | 19.4 | -17.6 | 0.3 | -0.3 | 0.1 | 0.1 |
| Grants to others | 548.9 | 389.2 | 106.9 | -29.1 | 9.2 | -4.3 | 0.8 | 0.5 |
| **(b) Development expenditure and net lending** | **354.3** | **177.0** | **31.2** | **-50.1** | **2.7** | **-4.8** | **0.5** | **0.2** |
| Total development expenditure | 288.3 | 161.7 | 18.6 | -43.9 | 1.5 | -3.4 | 0.4 | 0.2 |
| PSDP | 288.3 | 161.7 | 24.2 | -43.9 | 1.8 | -3.4 | 0.4 | 0.2 |
| *Development grants to provinces* | *88.7* | *25.3* | *56.5* | *-71.4* | *1.0* | *-1.7* | *0.1* | *0.0* |
| Net lending | 66.0 | 15.2 | 145.3 | -77.0 | 1.3 | -1.4 | 0.1 | 0.0 |
| Provinces | 59.9 | -30.5 | -456.4 | -150.9 | 2.5 | -2.4 | 0.1 | 0.0 |
| Others | 6.1 | 45.7 | -86.1 | 650.6 | -1.2 | 1.1 | 0.0 | 0.1 |

* Excluding statistical discrepancy

Source: Ministry of Finance

depreciation, led oil and gas exploration public sector enterprises, like OGDC and PPL, to thrive and generate higher sales revenues, thereby pushing up payments of royalties and levies.[27, 28]

## 4.3 Federal Expenditures[29]

During H1-FY23, federal expenditures grew by 23.2 percent compared to 20.4 percent in the corresponding period last year. The upsurge was mainly led by broad based increase in current spending, mainly the markup payments, pension, defence affairs and services and running of civil governments **(Table 4.11).** The federal development spending on the other hand fell sharply during first half of FY23.

### Federal Current Expenditures

Federal current expenditures witnessed significant growth of 31.0 percent during H1-FY23, as compared to 19.0 percent growth in H1-FY22. Almost 60 percent of the

[27] According to the Ministry of Finance, royalty is 12.5 percent of the gate value of petroleum. Source: Explanatory Memorandum on Federal Receipts

[28] Royalty paid by the OGDC and PPL rose by 37.8 percent and 74.5 percent in H1-FY23, respectively.

[29] The discussion in this section is based on expenditures excluding statistical discrepancy.

expansion seen in current spending came from interest payments, which were mainly driven by domestic markup payments. Rest of the contribution came from higher spending on defence affairs and services, running of civil government and pension accounts **(Table 4.11).** The fall in non-interest current spending in H1FY23 was in line with the downward revisions in quarterly ceilings on grants and appropriations (**Figure 4.10**).[30]

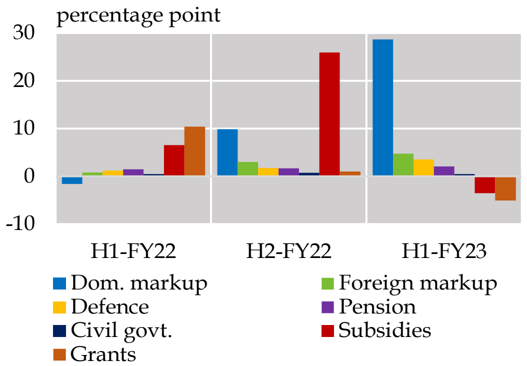
### *Interest spending increased sharply*

The markup payments grew by 77 percent and reached Rs 2.6 trillion in H1-FY23 mainly on account of substantial surge in interest expense on domestic debt. External debt servicing also showed a significant increase of 113.4 percent during H1-FY23.

In Budget FY22-23, the government had allocated Rs 3.9 trillion for markup on both external and domestic debt.[31] However, the interest payments have crossed 65 percent of full year target in December 2022. This is in contrast to H1-FY22, when the interest payments could only had stretched to 47.5 percent of fiscal year target of Rs 3.0 trillion. Consequently, the full year payments also remained broadly under the assigned limits. The significant escalation in outstanding debt stock, increasing interest rate environment and growing share of floating rate debt mainly explain the rising momentum in domestic interest payments during H1-FY23.

The foreign interest payments edged up due to sharp depreciation of PKR against the US dollar and the resumption of markup payments to bilateral creditors after expiration of Debt Service Suspension Initiatives (DSSI).[32]

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




Source: Ministry of Finance

The increasing share of interest spending not only puts pressure on existing constrained resources, it also reduces available fiscal space for other expenditures, specially the development spending (**Figure 4.11a and 4.11b**).

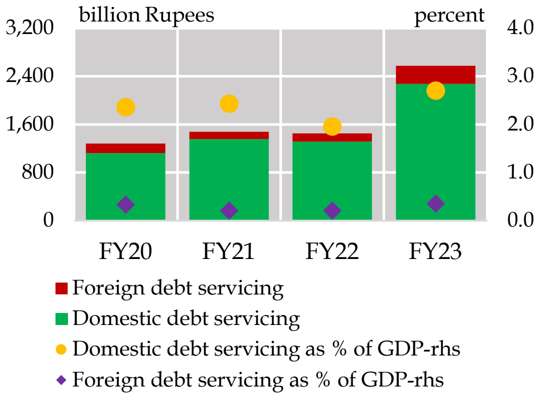
### *Broad-based deceleration in grants and subsidies*

The expenses on federal grants and subsidies experienced marked slowdown during H1-FY23 compared to H1-FY22. The sluggish movement in these outlays is also visible from lower actual expenses relative to budgeted targets in H1-FY23 (**Figure 4.12**)

**Grants**: The disbursement of grants fell by 28.1 percent to Rs 433.7 billion in H1-FY23 from Rs 603 billion in H1-FY22. The deceleration was broad-based with notable

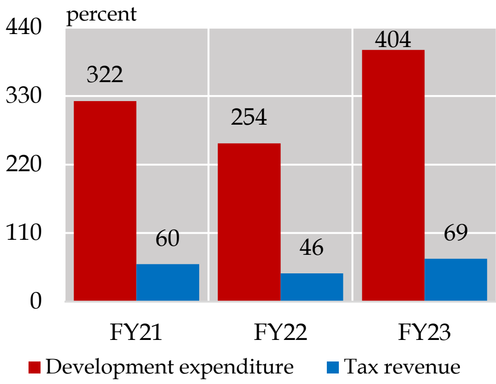
[30] On 24 Aug 2022, the Finance Division squeezed the target of recurrent budget to maximum of 17% in quarter 1, previously the assigned limit was 20% for Q1-FY23. Source: Budget Updates, No F. 3(l)FO/2022-23, dated August 24, 2022, Budget Wing, Finance Division.
[31] The target was around 30 percent higher than Rs 3.1 trillion envisaged for FY22.
[32] For details, see Section 4.5

**Trend in Interest Payments in H1** **Figure 4.11a**




Source: Ministry of Finance

**Markup Payments Relative to Development Expenditures and** **Figure 4.11b**



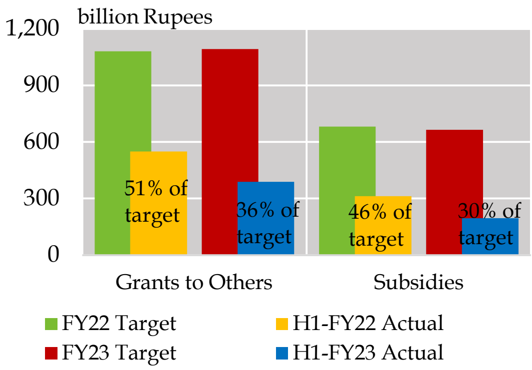

Source: Ministry of Finance

decline observed in grants payout to contingent liabilities account, Covid-related programs, railways and HEC.

The Benazir Income Support Program (BISP) was a major beneficiary of federal grants of Rs 192 billion in H1-FY23, compared to Rs 65.4 billion in same period last year. A part of the BISP was allocated to provision of emergency cash assistance to flood affected families. Initially the government had announced a cash assistance package of Rs 28 billion, however with heightened severity of human crisis, the target was increased to Rs 70 billion. Through BISP, government provided emergency cash assistance of Rs 25000 per family in calamity hit districts; as of December 2022, around 2.76 million families were assisted under BISP in flood affected regions of all provinces including GB (**Figure 4.13**).[33]

The rest of BISP payments of around Rs 122 billion were directed to support other ongoing programs including Unconditional Cash Transfer (UCT) and Conditional Cash Transfer (CCT) programs. Under the major UCT scheme i.e., 'Benazir Kafaalat', BISP released Rs 55 billion to disburse per family cash assistance of Rs 7000 to around 7.7 million families. Within CCT program, 'Benazir Taleemi Wazaif' scheme received Rs 13 billion to dispense scholarships to the children of BISP beneficiaries.[34] To support

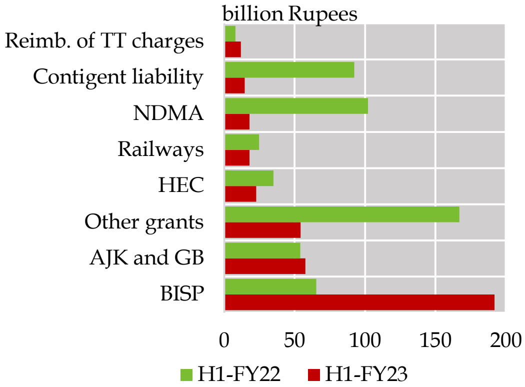
**Target Versus Actual Estimates of Federal Subsidies and Grants** **Figure 4.12**




Source: Ministry of Finance

[33] Source: Benazir Income Support Program. www.bisp.gov.pk/
[34] According to BISP, Benazir Taleemi Wazaif Scheme was initially introduced in Nov 2012 in five districts around the country; the coverage expanded gradually, and in 2020 all districts of the country were

**Disbursement of Federal Grants** **Figure 4.13**




Source: Ministry of Finance

children's health, BISP runs another CCT program named as 'Benazir Nashonuma' the coverage of this program has been extended to 118 districts with 169 facilitation centers are made operationalized.[35, 36]

The major fall in grants came under grants to National Disaster Management Authority (NDMA), mainly due to suspension of Covid-related programs in FY23. During FY22, government issued number of grants to Ministry of National Health Services Regulation and Coordination (NHSR&C) under different vaccine programs such as IVAC, Asia Pacific Vaccine program, and Pandemic Response Effectiveness in Pakistan.[37] These grants were supported by multilateral institutions such as World Bank, IDB and ADB. Besides, in H1-FY22, government also disbursed Rs 102 billion to NDMA for National Disaster Management Fund (Covid-19). During H1-FY23, NDMA received funds of Rs 18.0 billion to arrange procurement of relief goods and logistics related to flood related rescue, relief and rehabilitation activities (**Figure 4.14**).

**Subsidies:** The volume of overall subsidies declined to Rs 196.6 billion during H1-FY23 compared to Rs 313.4 billion in the same period last year. In terms of GDP, overall subsidies recorded at 0.8 percent in H1-FY23 against 1.3 percent in H1-FY22.

The releases of both energy and non-energy subsidies remained low (**Figure 4.15**), most of the deceleration was evident in subsidies to energy sector. The payments to major energy entities such as IPPs, Wapda/Pepco, K-Electric and SNGPL remained considerably lower than the amount envisaged in budget 2022-23 (**Figure 4.16**). These payments were due against different heads including: 1) industrial support packages;[38] 2) RLNG support to general

covered. Under this scheme, the children of BISP families are provided with quarterly stipend (varied with sex, age and education level) with the condition of enrolment in school and 70 percent attendance in enrolled institution. As of Jun 2022, 9.4 million children have been enrolled in the scheme, Rs 40 billion has been disbursed, of which Rs 20 billion was disbursed in FY22 alone to 5.2 million students.

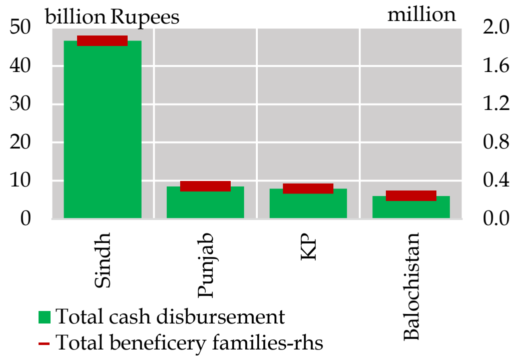
[35] The objective of Benazir Nashonuma program is to address the stunting prevention in children during the first two years. Under this CCT scheme, the additional quarterly payments (Rs 2000- Rs2500) are made to BISP beneficiary families with the condition that mother attends regular antenatal health checks and awareness sessions during pregnancy, consuming specialized nutritious food (SNF), and completes child's immunization and regular health checks.

[36] Source: Press Release No. 290, Finance Division, Government of Pakistan

[37] Source: Finance Division, Government of Pakistan

[38] The industrial support package was announced in November 2020, in which the peak and off-peak tariff structure for industrial consumers were abolished initially for the period from Nov2020 till April 2020, however the package was extended till Jun 2022 and then till October 2023. (Source: NEPRA (2021, State of Industry Report)

**Coverage of Emergency Cash Assistance through BISP** **Figure 4.14**

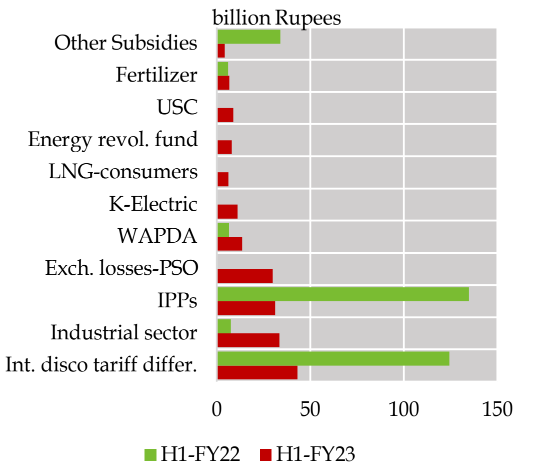



Source: National Disaster Management Authority, Floods (2022) SITREP - 2022

industry, zero-rated export sectors and consumers; 3) consumers of FATA; 4) tube well subsidy to agriculture-sector in Baluchistan and 5) tariff differential subsidy to AJK government.

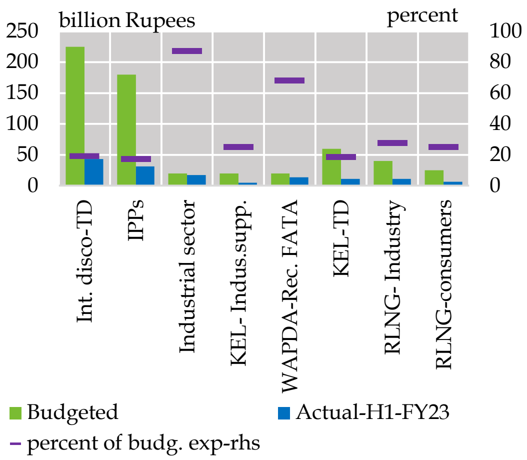
Keeping in view the growing volume of outstanding subsidies, government initiated different measures to resolve prevalent structural issues especially in power and gas sector. For instance, to address the growing circular debt in gas sector, ECC approved the upward revision in gas prices for different consumer categories including commercial connections, general industry, domestic consumers, captive power and CNG sector etc.[39] These prices were approved and subsequently announced by OGRA in February 2023 and are applicable from January 2023.[40] The ECC also streamlined subsidized energy charges to five export-oriented sectors;[41] particularly the RLNG

**Disbursement of Federal Subsidies** **Figure 4.15**




Source: Ministry of Finance

**Energy Subsidies--Absolute Amount and Realized as Percent of Budgeted Expenditures** **Figure 4.16**




Source: Ministry of Finance

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[39] The circular debt in gas sector rose due to non-revision of gas prices in line with revenue requirement, gas sector CD edged up to Rs 1.2 trillion by end-June 2022 from Rs 3 billion in end-June 2018.
[40] Source: Oil and Gas Regulatory Authority, Gas Price Notification, effective January 01, 2023.
[41] In August 2021, the government announced to provide energy to five export-oriented sectors namely textile, jute, leather, carpet, surgical and sport goods at regional competitive rates with an objective to reduce cost of manufacturing and enhance exports. Source: Press Release No. 79, Ministry of Finance

charges increased from US$ 6.5 per MMBTU to US$ 9 per MMBTU in July 2022.[42] Government also made upward revisions in electricity tariff in Jul-Dec FY23.

*Pension and salaries expenses rose significantly during H1-FY23*

Similar to H1-FY22, both pensions and running of the civil government expenditures grew significantly during H1-FY23. In addition to relief measures for current and retired employees announced in FY22, the government provided 15 percent ad-hoc relief allowance to all federal employees and employees of autonomous/ semi-autonomous bodies and corporations in July 2022.[43] Besides, government also announced upward revisions in salary scale of BPS-1 to BPS-21 civil servants.[44]

For pensioners, the government made upward adjustments in existing rate of increase in pension from 10 percent granted in 01-April-2022 to 15 percent with effect from Jul 1st, 2022, this revision was applicable for civil and armed forces retirees.[45] All of these measures accelerated the overall expenditures incurred on running of civil government (mainly salaries).

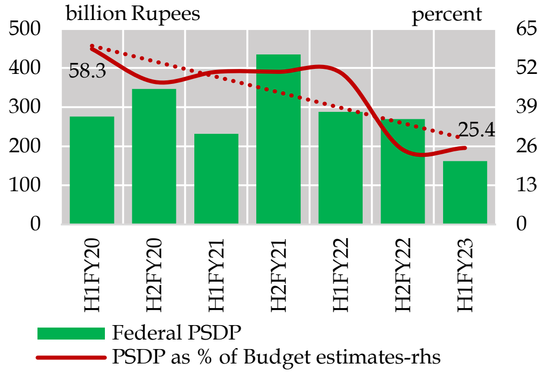
## Federal Development Expenditures

In the absence of sufficient fiscal space and external support to deal with catastrophic floods, government made a major reallocation of funds from development projects to flood relief activities. Resultantly, the outlays of federal PSDP slashed by 44 percent from Rs 270 billion in H1-FY22 to Rs 162 billion in first half of FY23 (**Figure 4.17**).

Aside from flash floods, fiscal imbalances that began to rise in H2-FY22 also put a dent on the development spending. In the last two quarters of FY22, the government realigned the spending priorities and cut number of projects from 371 to 170, the full year PSDP recorded at Rs 550 billion against the target of Rs 900 billion. The government was cognizant of the lingering fiscal issues and set a lower PSDP target of Rs 800 billion for FY23. However, the unprecedented floods further narrowed the PSDP spending which could only reach 25.4 percent of the full year target in H1-FY23 (**Figure 4.17**). These disbursements did not even meet revised targets announced in federal PSDP release strategy in August 2022.[46] The limited provision of development funds is also visible from the current

[42] Source: Economic Survey 2021-22 and Press Release No. 79, Ministry of Finance
[43] Measures from FY22 included ad-hoc relief allowance of 10 percent for federal and autonomous/semi-autonomous bodies and corporations, increase in integrated orderly allowance and minimum wage and upward revision in pension.
[44] Office Memorandum F. No. 1(2) Imp/2022-283, dated July 01, 2022, Regulations Wing, Finance Division
[45] Office Memorandum No. F.4 (1) Reg.6/2022-486, dated July 01 , 2022, Regulations Wing, Finance Division
[46] In the initial PSDP release strategy announced in July 2022, PSDP was targeted at the level of 20 percent for Q1, 5 percent for Q2, 30 percent for Q3 and 25 percent for Q4. In August 2022, government issued a revised release strategy according to which the funds shall be released at maximum level of 10 percent for Q1, 20 percent for Q2, 30 percent for Q3 and 40 percent for Q4 of the approved budget. Source: Strategy

**Half Yearly Trend in Federal PSDP** **Figure 4.17**




Source: Ministry of Finance and Planning Commission

ministry/division-wise summary of PSDP allocation during Jul-Dec 2023 (**Table 4.12**).

The major development projects envisaged in Budget 2022-23 include; i) ongoing development project in merged districts of Khyber Pakhtunkhwa; ii) construction of roads and infrastructure specially motor way sections; iii) major dams, including Diamer Basha and Mohmand dams; and iv) power projects such installation of coal fired power project in Jamshoro and enhancement in transmission capacity of NTDC system etc.

**PSDP Targets vs. Disbursements** **Table 4.12**

billion Rupees

| Ministry/ Division | PSDP Allocation | Expenditure | |
|---|---|---|---|
| | | Jul-Dec | Percent of Allocation |
| Provinces and Special Areas (Previously under FD/KA&GB) | 139.6 | 20.6 | 14.7 |
| National Highway Authority | 117.3 | 25.9 | 22.1 |
| Water Resources Division | 97.6 | 22.1 | 22.6 |
| Cabinet Division | 87.1 | 13.2 | 15.2 |
| Higher Education Commission | 44.7 | 5.2 | 11.6 |
| NTDC / PEPCO | 43.0 | 36.5 | 84.8 |
| Planning, Development & Special Initiatives Division | 37.2 | 1.4 | 3.8 |
| 3 Railways Division | 32.6 | 4.5 | 13.7 |
| Housing & Works Division | 18.7 | 2.6 | 14.1 |

Sources: PSDP 2022-23, Ministry / Division-wise Summary (July - December, 2022), Planning Commission Ministry of Planning, Development & Special Initiatives

## 4.4 Provincial Fiscal Operations

The consolidated provincial surplus declined to Rs 101.2 billion during H1-FY23, from Rs 480.8 billion in same period last year. The deceleration in surplus mainly came on account of lower revenue generation in Q1-FY23, which was further exacerbated by higher development and current expenditures incurred during Q2-FY23 (**Table 4.13** and **Figure 4.18**). By the end of H1-FY23, the surplus could only reach 13.5 percent of fiscal year target which recorded at a mere 0.1 percent of GDP.

From the provincial accounts, the most notable deceleration came from Punjab followed by Balochistan and Sindh. KPK on the other hand posted a deficit of Rs 5.4 billion **(Figure 4.19)**.

### Provincial Revenues

The overall provincial revenues witnessed a relatively modest growth of 2.6 percent

for Release of Funds for Development Budget Financial Year 2022-23, issued on July 07, 2022 and August 04, 2022.

**Provincial Fiscal Operations** **Table 4.13**

billion Rupees, growth in percent

| | H1-FY22 | H1-FY23 | YoY growth H1-FY22 | YoY growth H1-FY23 | Q1-FY23 | Q2-FY23 | YoY growth Q1-FY23 | YoY growth Q2-FY23 |
|---|---|---|---|---|---|---|---|---|
| **A. Total revenue (a+b+c)** | **2,235.8** | **2,293.1** | **34.8** | **2.6** | **1,050.7** | **1,242.4** | **-2.5** | **7.3** |
| a. Provincial share in federal revenue | 1,694.3 | 1,880.0 | 32.4 | 11.0 | 880.3 | 999.7 | 9.0 | 12.7 |
| b. Fed loans and transfers | 202.7 | 39.4 | 138.0 | -80.6 | -10.6 | 49.9 | -110.4 | -50.8 |
| c. Provincial own revenue | 338.8 | 373.7 | 15.6 | 10.3 | 180.9 | 192.8 | 7.0 | 13.5 |
| Taxes | 271.2 | 303.0 | 10.3 | 11.7 | 148.2 | 154.9 | 9.9 | 13.5 |
| Non-taxes | 67.6 | 70.7 | 43.1 | 4.5 | 32.8 | 37.9 | -4.3 | 13.6 |
| **B. Total expenditures (a+b+c)** | **1,755.0** | **2,191.9** | **25.1** | **24.9** | **832.7** | **1,359.2** | **4.0** | **42.4** |
| a. Current | 1,396.2 | 1,733.3 | 9.0 | 24.1 | 714.0 | 1,019.3 | 10.2 | 36.2 |
| b. Development | 365.8 | 454.4 | 60.7 | 24.2 | 152.2 | 302.2 | -1.0 | 42.6 |
| c. Statistical discrepancy | -6.9 | 4.1 | -93.4 | -160.0 | -33.6 | 37.7 | 3,693.2 | -724.3 |
| **Overall balance (A-B)** | **480.8** | **101.2** | **88.4** | **-79.0** | **218.0** | **-116.9** | **-21.3** | **-157.3** |

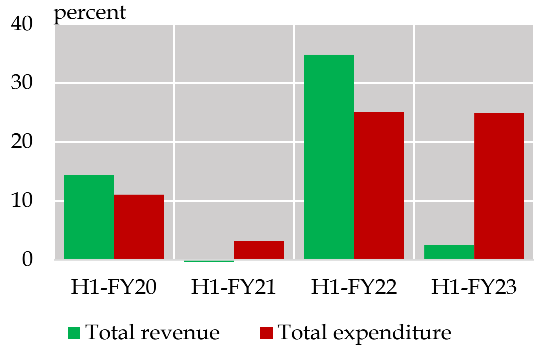
Source: Ministry of Finance

during H1-FY23; this was mainly due to slowdown in growth of federal transfers to provinces and provincial own revenues.

Further deceleration came from fall in federal loans and transfers. The own-source revenue collection posted an increase of Rs 373.7 billion in H1-FY23 against Rs 338.8 billion in H1-FY22. Most of the expansion emerged from tax revenues, which edged up by Rs 303 billion. Within tax revenues, sales tax on services witnessed significant collection in all provinces followed by other taxes and stamp duties.

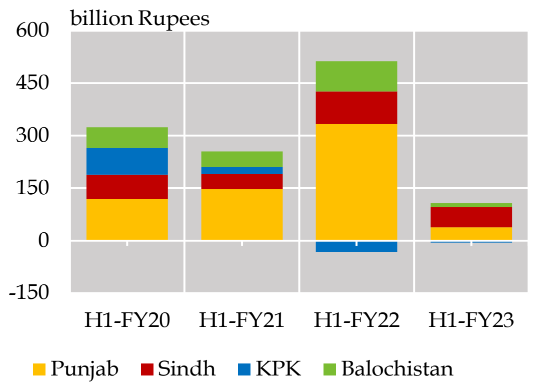
The province-wise breakup suggests that Punjab posted the largest tax collection, followed by Sindh and KPK (**Figure 4.20**). In their respective budgets presented for 2022-23, different tax measures were announced

**Provincial Revenues and Expenditures (YoY Growth)** **Figure 4.18**




Source: Ministry of Finance

**Provincial Surplus during H1** **Figure 4.19**




Source: Ministry of Finance

by the provinces. For instance, tax reform measures undertaken by Punjab revenue authorities include; 1) extension of the reduced rate of sales tax on services for more than 30 sectors; 2) synchronization of provincial tax procedures with other revenue authorities including FBR; 3) 90 percent motor vehicle registration and token tax exemption on electric vehicles; 4) increase in stamp duty for urban areas from 1 percent to 2 percent; 5) increase in rate on luxury house tax.[47]

Similar to the last fiscal year, the provincial authorities in Sindh did not announce any new tax in Budget 2022-23. Moreover, GoS has undertaken number of measures including; 1) special moratorium is placed on collection of cotton fee, professional tax and entertainment duty; 2) exemption of levy on Sindh Infrastructure Development Cess for export oriented sector; 3) exemption of sales tax on services on toll manufacturing services and reduced rate on recruiting agents; 4) reduced rate of levy of 10 percent for services provided by cable TV operators, whereas those operating in rural areas with PEMRA license 'R' are exempted from SST; 5) Reducing the rate of SST from 13 percent to 8 percent for commission charges received by food delivery channels from home chefs.[48]

The KPK government maintained the reduced rate of taxes announced in last fiscal year for Budget 2022-23. Besides, on first time registration of motor vehicles, consumer will get 20 percent exemption in excise duty. The government also announced zero tax on land with full exemption from capital value tax (CVT) and registration fee.[49]

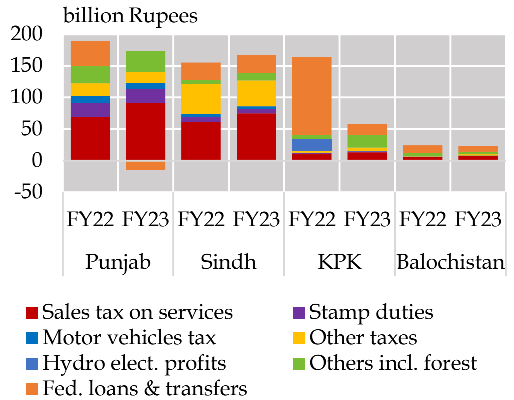
The non-tax provincial revenues decelerated sharply from 43.1 percent in H1-FY22 to 4.5 percent in H1-FY23. The dismal growth is mainly attributed to non-transfer of hydroelectricity profit in the provincial exchequer specifically to the accounts of Khyber Pakhtunkhwa.

Federal loans and grants which are mainly released to finance ongoing development expenditures in merged districts of Khyber Pakhtunkhwa received only Rs 39.0 billion in current year as against Rs 202.7 billion in H1-FY22.

## Provincial Expenditures

The growth in overall provincial expenditures remained almost unchanged at 24.9 percent during H1-FY23 compared to last year. The expansion was driven by current expenditures; whereas, development expenditures saw moderation in growth during H1-FY23 (**Figure 4.21**).

**Major Source of Provincial Revenues (Excl. Share in Federal Revenues)** **Figure 4.20**




Source: Ministry of Finance

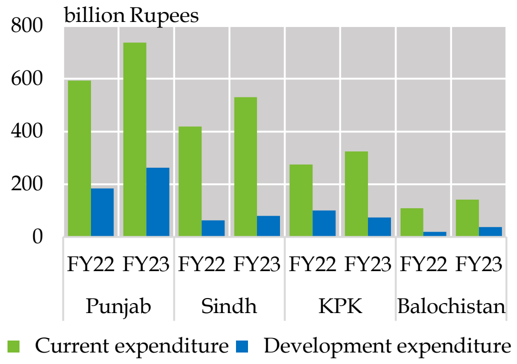
[47] Source: Budget Highlights, 2022-23, Finance Department, Government of Punjab
[48] Source: Budget Speech, 2022-23, Finance Department, Government of Sindh
[49] Source: Budget Speech, 2022-23, Finance Department, Government of Khyber Pakhtunkhwa

The increase in current expenditures is primarily attributed to expenses by executive & legislative organizations, financial and fiscal affairs which mainly cover salaries and pension expenditures of respective provinces. More specifically, Punjab has announced 15 percent increment in salaries for all employees along with a special allowance of 15 percent for those employees who are currently receiving allowances lower than the assigned limits.[50]

Whereas, Sindh provided the adhoc relief allowance at the rate of 15 percent in addition to disparity allowance of 33 percent (on basic pay) for employees fall in the grade of BPS1-16 and 30 percent for higher cadre employees. Khyber Pakhtunkhwa issued an adhoc relief allowance at the rate of 15 percent excluding disparity reducing allowance (DRA); the province also announced 15 percent increment in pensions for FY23.

Moreover, education, health, public order and safety and social protection remained focus of current spending for almost all provinces in H1-FY23. Specific to education sector, Sindh spent Rs 115.5 billion during H1-FY23, the amount represents around 22 percent of province's current expenditures and surpassed the aggregate education expenses of Punjab, KPK and Balochistan of Rs 88.6 billion. Health spending remained a major focus in almost all of the provinces with most of the spending directed to hospital services and health administration.

**Provincial Current and Development Expenditure Revenues during H1** **Figure 4.21**




Source: Ministry of Finance

The spending under transfers remained robust specifically in Punjab, this spending reflects the transfer of funds to district health and education authorities with an aim to empowering local governments to address public needs.[51]

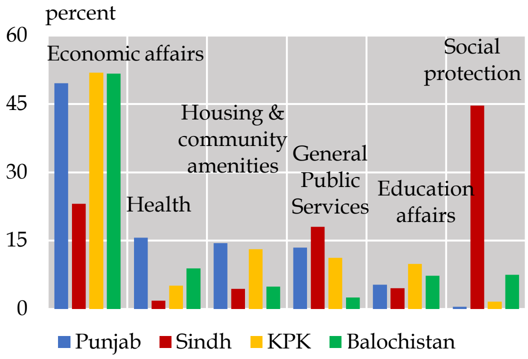
The provincial development spending increased by 24.2 percent in H1-FY23 against the expansion of 60.7 percent achieved in H1-FY22. Construction and transport remained priority of development spending in Punjab, KPK and Balochistan. The focus of Sindh's development spending was remained on agriculture and allied sectors and provision of social protection services. KPK disbursed most of the development spending on transport and construction, agriculture and allied sectors, community development program and tertiary education affairs and services during H1-FY23 (**Figure 4.22**).

## 4.5 Public Debt

The stock of outstanding public debt edged up to Rs 52.7 trillion at the end of December 2022- an addition of Rs 3.5 trillion in H1-FY23 compared to Rs 2.8 trillion in H1-FY22. The pace of debt accumulation during H1-FY23 was around 7.2 percent, quite similar to

[50] Budget Speech, 2022-23, Finance Department, Government of Punjab
[51] Source: White Paper, Budget FY2022-23, Finance Department, Government of Punjab

**Development Spending Priorities (Share in Development Expenditures)** **Figure 4.22**




Source: Ministry of Finance

the corresponding period last year. Whereas, in terms of GDP, the public debt reduced to 62.7 percent at the end of December 2022 compared to 63.8 percent in end-December 2021 (**Figure 4.23**).[52]

The major increase in the public debt during H1-FY23 came from domestic sources; it contributed around 58.9 percent (**Figure 4.24**). The underlying cause of this increase in domestic debt was a large fiscal deficit and inadequate external inflows. Resultantly, the GoP had to rely on domestic debt to fulfil its financing requirements.

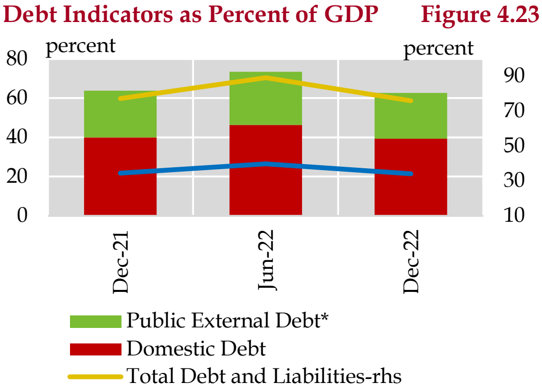
Moreover, there was a decline in the stock of external debt (in US dollar) which resulted from scheduled principal repayments and limited foreign financing.

In terms of maturity, the public debt inclined towards long-term instruments with the addition of PIBs and GoP Ijara Sukuks, and the retirement of short-term instruments such as T-bills (net of maturity) and external commercial loans (**Figure 4.25a, 4.25b & 4.25c**).

Although the lengthening of debt profile has reduced the rollover risk, the repricing risk has increased as a bulk of financing was raised through floating rate instruments. As these instruments' coupon payments (or rental rates) are linked to 3-month and 6-month T-bills, spike in interest rates has led to repricing risk along with soaring interest payments on domestic debt.

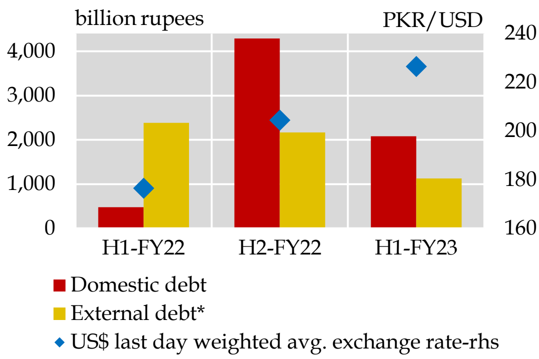
In the backdrop of growing debt servicing, both domestic and external, accompanied by

**Debt Indicators as Percent of GDP** **Figure 4.23**




*Government External Debt + Debt from IMF
Estimated GDP for FY23
Source: State Bank of Pakistan

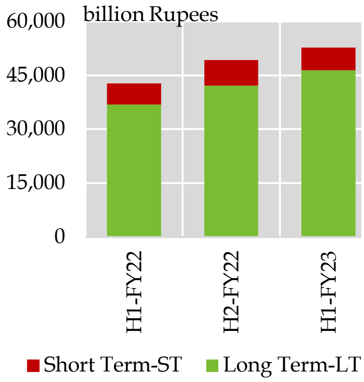
**Composition-wise Change in Public Debt** **Figure 4.24**




*including debt from the IMF
Source: State Bank of Pakistan

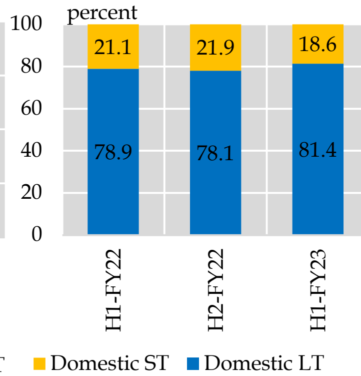
[52] Public debt for the end of December 2022 is measured against the estimated GDP for FY23.

**Composition of Public Debt** **Figure 4.25a**



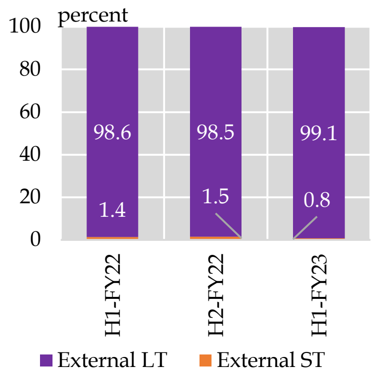

Source: State Bank of Pakistan

**Composition of Domestic Debt** **Figure 4.25b**




Source: State Bank of Pakistan

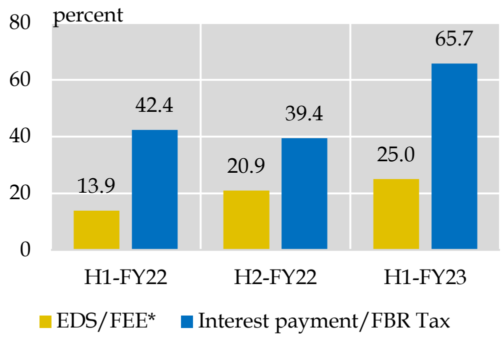
**Composition of External Debt** **Figure 4.25c**




Source: State Bank of Pakistan

lower than targeted FBR revenues and lower external inflows, the repayment capacity of the country has deteriorated during H1-FY23 (**Figure 4.26**).[53] The FBR's revenue collection remained below the target owing to a sharp drop in imports[54], whereas, the decline in foreign exchange earnings (FEE) was due to sluggish exports and workers' remittances. Moreover, the investments in NPCs also decreased **(Figure 4.27)**. The slack in NPCs came from monetary tightening by the central banks, especially Fed, and rise in the country risk. Moreover, in line with increasing Fed rate, the uptick in LIBOR amplified external interest payments due to flexible rate external debt.

**Debt Repayment Capacity** **Figure 4.26**




*EDS: External debt Servicing
*FEE: Foreign Exchange Earnings
Source: Ministry of Finance & State Bank of Pakistan

## Domestic Debt

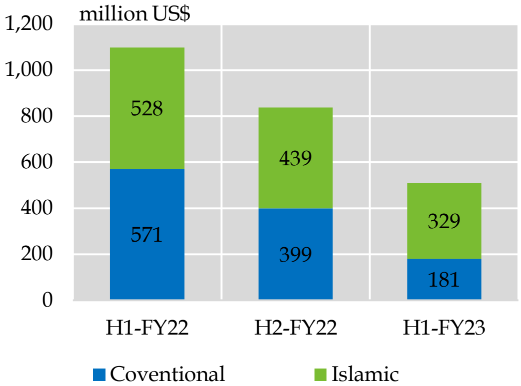
The stock of domestic debt increased to Rs 33.1 trillion at the end of December 2022- a growth of 6.7 percent in H1-FY23 compared to 1.8 percent in H1-FY22 **(Table 4.14)**. The underlying factors for this surge were increase in financing requirements and inadequate external inflows, which compelled the government to rely on domestic market despite high interest rates.

### *Most of the government debt was financed through non-banks in H1-FY23*

The institution-wise data illustrates that most of the domestic debt during H1-FY23 came from non-banks amid their keen interest in T-

[53] The repayment capacity is assessed by two ratios: (1) domestic interest payments-to-FBR taxes and (2) Public external debt servicing (EDS)-to-Foreign Exchange Earnings (FEE).
[54] The import-related taxes contributed around 42 percent (on net basis) in the total tax revenues in H1-FY23 compared to 52 percent in H1-FY22.

**Quarterly Investments in NPCs** **Figure 4.27**




State Bank of Pakistan

bills and other government securities due to lucrative rates and low risk **(Figure 4.28a & 4.28b)**.

***The entire increase in domestic debt was concentrated in PIBs and GoP Ijara Sukuks***

Most of the expansion in domestic debt in H1-FY23 resulted from PIBs and Shariah compliant bonds. Whereas, National Saving Schemes (NSS) (net of prize bonds) and T-bills registered net outflows during H1-FY23 **(Figure 4.29).**

The increase in reliance on long-term instruments resulted from GoP's strategy to enhance public debt profile by shifting towards long –term and Shariah-compliant instruments. However, the large concentration of domestic debt in floating rate instruments has increased the share of floater PIBs and GoP Ijara Sukuks (VRR) from 41.6 percent at the end of June 2022 to 49.5 percent at the end of December 2022. Consequently, the repricing rate risk has increased in rising interest rate environment. While, it is putting pressure on interest payments, it has decreased rollover risk due to lengthening of public debt profile.

### Pakistan Investment Bonds (PIBs)

The stock of PIBs grew by 14.8 percent in H1-FY23 to reach Rs 20.3 trillion, compared to the growth of 4.0 percent in H1-FY22 **(Table 4.14)**. This sharp increase in PIBs was

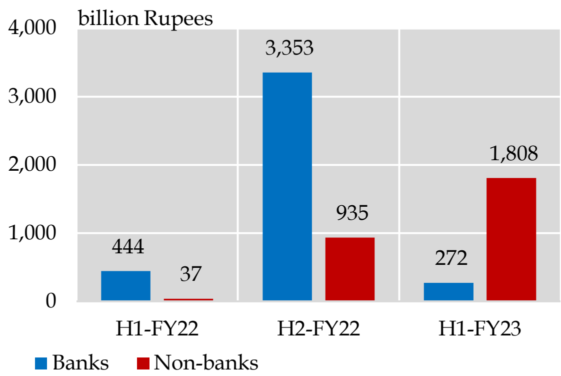
**Government Domestic Debt and Liabilities (Jul-Dec)** **Table 4.14**

billion Rupees

| | Stock | | Share in Domestic Debt | | Flows | | Growth | |
|---|---|---|---|---|---|---|---|---|
| | **Dec-21** | **Dec-22** | **Dec-21** | **Dec-22** | **FY22** | **FY23** | **FY22** | **FY23** |
| **I. Permanent Debt** | 17,452.2 | 23,829.6 | 65.3 | 72.0 | 1,548.1 | 2,985.9 | 9.7 | 14.3 |
| GOP Ijara Sukuk | 1,297.8 | 2,644.6 | 4.9 | 8.0 | 632.5 | 364.8 | 95.1 | 16.0 |
| Bai-Muajjal of Sukuk | 128.5 | 23.2 | 0.5 | 0.1 | -72.6 | - | -36.1 | - |
| PIBs | 15,174.9 | 20,301.2 | 56.7 | 61.3 | 584.9 | 2,614.2 | 4.0 | 14.8 |
| Prize Bonds | 372.0 | 381.6 | 1.4 | 1.2 | -71.7 | 7.0 | -16.2 | 1.9 |
| **II. Floating Debt** | 5,643.5 | 6,156.3 | 21.1 | 18.6 | -1,036.9 | -647.7 | -15.5 | -9.5 |
| Market Treasury Bills | 5,592.2 | 6,091.1 | 20.9 | 18.4 | -1,084.8 | -661.3 | -16.2 | -9.8 |
| **III. Unfunded Debt** | 3,604.0 | 3,073.2 | 13.5 | 9.3 | -42.0 | -262.8 | -1.2 | -7.9 |
| NSS (Net of Prize Bonds) | 3,465.3 | 2,961.1 | 13.0 | 8.9 | -32.6 | -247.2 | -0.9 | -7.7 |
| **IV. Foreign Currency Instruments** | 7.5 | 9.5 | 0.0 | 0.0 | 0.8 | 0.8 | 11.3 | 9.8 |
| **V. Naya Pakistan Certificates** | 39.2 | 47.5 | 0.1 | 0.1 | 10.9 | 2.5 | 38.6 | 5.6 |
| **Government Domestic Debt (I+II+III+IV+V)** | **26,746.5** | **33,116.3** | **100.0** | **100.0** | **481.1** | **2,078.8** | **1.8** | **6.7** |

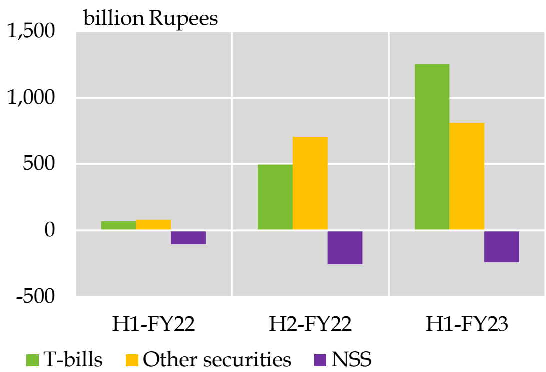
Source: State Bank of Pakistan

**Increase in Domestic Debt Holding by Institution** **Figure 4.28a**




Source: State Bank of Pakistan

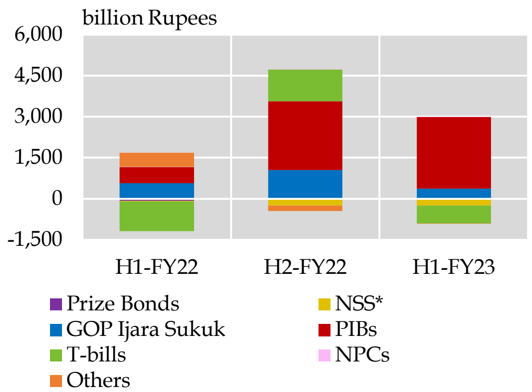
**Non-bank Investments in Domestic Debt (Net Flows)** **Figure 4.28b**




Source: State Bank of Pakistan

majorly due to floating-rate PIBs (PFLs)-around 78.3 percent, as the investors were investing in PFLs due to lucrative returns. However, PFLs has increased the cost of borrowing for the government amidst rising interest rates **(Figure 4.30a)**. Furthermore, the offered amount in the auction profile of fixed PIBs shows that due to high interest rates, the investors were more interested in medium term instrument **(Figure 4.30b)**.

**Instrument-wise Net Flows of Domestic Debt** **Figure 4.29**




Source: State Bank of Pakistan

## GOP Ijara Sukuk

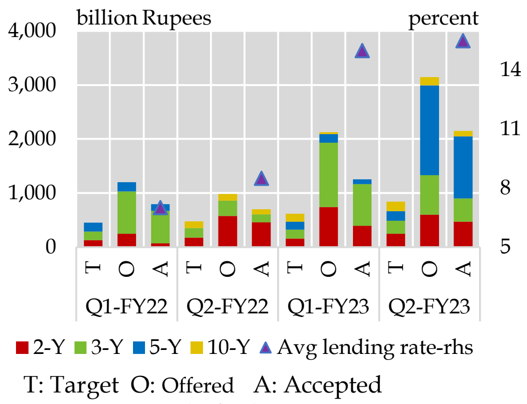
The Government mobilized Rs 364.8 billion worth of Ijara Sukuks (on net basis), mainly variable rental rates (VRR), during H1-FY23 compared to Rs 632.5 billion in H1-FY22 **(Figure 4.31a and Table 4.14)**. Like the conventional debt instruments, the investors remained inclined towards investing in flexible rate Shariah-compliant instruments to benefit from lucrative returns. However, the government accepted less than the targeted amount in H1-FY23 due to higher rates and longer maturity of sukuks **(Figure 4.31b)**.[55]

## Prize Bonds

The prize bonds exhibited net inflows in H1-FY23, for the first time after H1-FY19 **(Table 4.14).** Most of the net inflows came from Rs 1500 denomination bonds followed by Rs 750 and Rs 25000 (premium) denomination bonds. The government discontinued higher denomination bearer bonds[56] and replaced them with premium bonds of Rs 25000 and

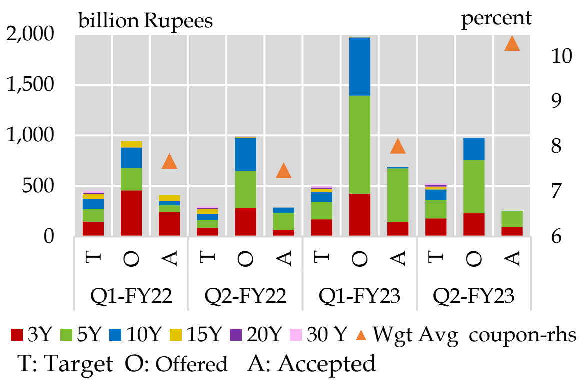
[55] Most of the Sukuks are of five years; only Rs 10 billion Sukuks are of three-year tenors, issued at variable rates.
[56] Government has discontinued Prize bonds of Rs 7,500; Rs 15,000; Rs 25,000 and Rs 40,000 in FY21.

**Auction of PFLs** **Figure 4.30a**




Source: State Bank of Pakistan

**Auction of Fixed PIBs** **Figure 4.30b**




Source: State Bank of Pakistan

Rs 40000 to improve documentation of the economy and to further strengthen the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime. Consequently, the investors decided to move towards other bearer bonds.

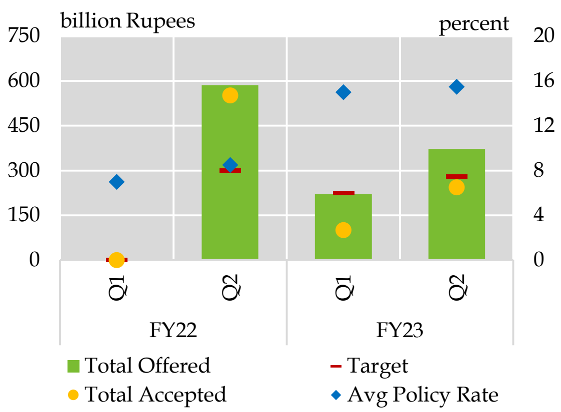
## T-bills

The government retired T-bills worth Rs 661.3 billion (net of maturity) during H1-FY23. Resultantly, the stock of T-bills has reduced to Rs 6.1 trillion. The main reason behind this reduction is the acceptance of less than targeted amount due to high bid rates **(Figure 4.32)**. Moreover, the investors' interest in 3-month T-bills amidst increasing interest rate put a pressure on government's financing which compelled the government to accept less than the targeted amount.

## National Saving Schemes (NSS)-net of Prize Bonds

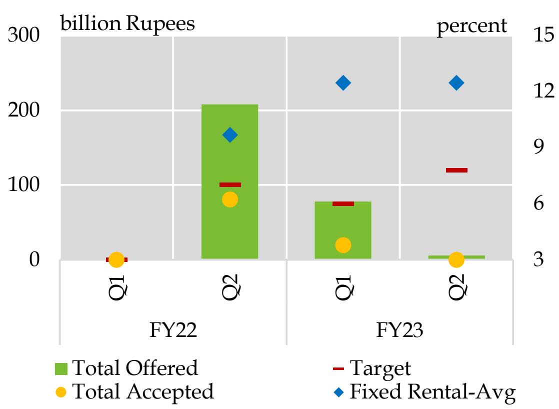
There was a decline in gross receipts in most of the NSS schemes in H1-FY23 compared to H1-FY22 **(Figure 4.33).** Moreover, there are continuous net outflows in Defense Saving Certificates (DSC) and Special Saving Certificates (SSC) since Q2-FY21 in the

**Auction of GoP Ijara Sukuks-VRR** **Figurea 4.31a**



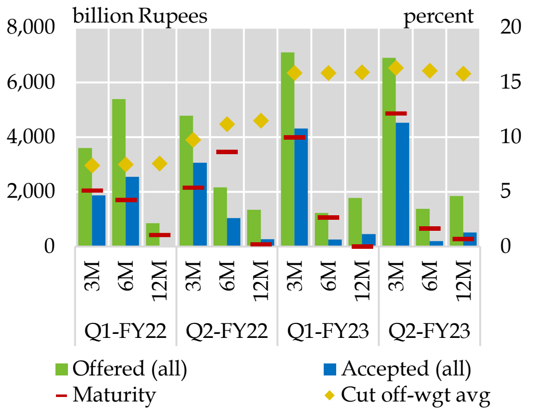

Source: State Bank of Pakistan

**Auction of GoP Ijara Sukuks-Fixed** **Figure 4.31b**



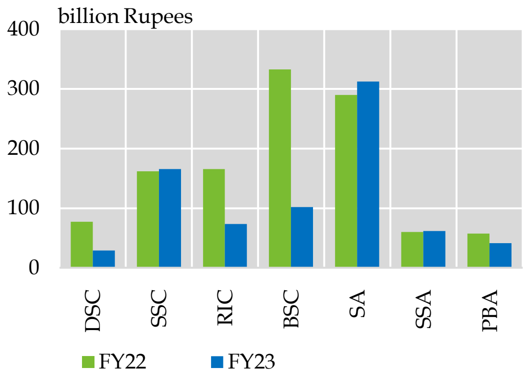

Source: State Bank of Pakistan

**Auction of T-bills: Instrument-wise** **Figure 4.32**




Source: State Bank of Pakistan

**National Saving Schemes Gross Inflows in H1** **Figure 4.33**




Source: State Bank of Pakistan

backdrop of institutional withdrawal and relatively low returns.[57] Meanwhile, Pensioners' Benefit Account (PBA) exhibited continuous inflows during the same period due to pensioner's interest in these papers as a result of increasing profit rates. However, the Regular Income Certificates (RIC) and Special Saving Accounts (SSA) showed net outflows after H1-FY22 due to non-competitive profit rates compared to government securities. Meanwhile, Behbood Saving Certificates (BSC) exhibited outflows in H1-FY23 as a result of downward revision of profit rates.[58]

***There was a significant increase in domestic interest payments in H1-FY23***

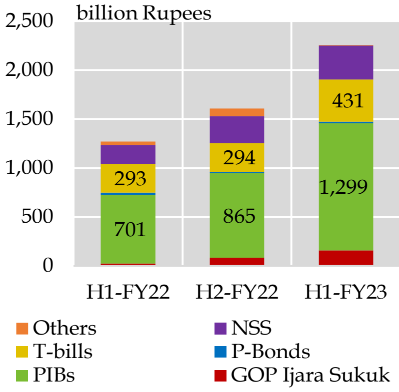
The interest payments on domestic debt raised to Rs 2.2 trillion in H1-FY23 compared to Rs 1.3 trillion in H1-FY22. The increase in interest rate in H1-FY23 largely emanated from PIBs, T-bills and NSS as a consequence of increase in the policy rate **(Figure 4.34a)**. Resultantly, the cut off rates of T-bills and coupon rates of PIBs increased in H1-FY23 by almost 700-800 bps compared to H1-FY22.

Moreover, on the back of rising share of floating rate PIBs in the outstanding debt stock, the interest payments on these instruments have particularly increased.[59] In addition, the interest payments on T-bills also intensified due to 3-month paper. The government mobilized most of the amount in T-bills through these papers and on a high interest rate in Q4-FY22 and Q1-FY23 which led to increase in interest payments of 3-month T-bills in H1-FY23 **(Figure 4.34b)**.

The higher interest payments were also witnessed in NSS, specifically in Special Saving Accounts (SSA) and in Special Saving Certificates (SSC) as a consequence of increase in profit rates and profit payments on previous stock **(Figure 4.34c)**.

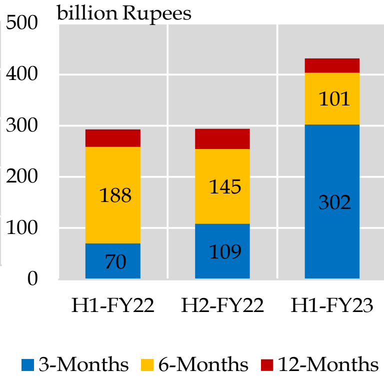
[57] On average, the spread between SSC and the government securities (PKRV-monthly average) was around 200bps in H1-FY23 whereas, for DSC and government securities the average spread was around 64bps.
[58] In October 04, 2022, the profit rate on BSC was revised to 13.92 percent from 14.16 percent.
[59] Quarterly and semi-annual interest payments of floater PIBs are linked to the cutoff rates of 3-month and 6-month T-bills.

**Interest Payments of Domestic Debt** **Figure 4.34a**



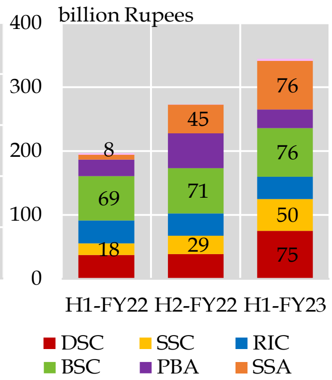

Source: State Bank of Pakistan

**Interest Payments of T-bills** **Figure 4.34b**




Source: State Bank of Pakistan

**Interest Payments of NSS** **Figure 4.34c**




Source: State Bank of Pakistan

## Public External Debt & Liabilities

The outstanding stock of public external debt reduced by around US$ 2.2 billion in H1-FY23 compared to an addition of around US$ 4.1 billion in H1-FY22 **(Table 4.15)**. The main drivers behind this reduction were: first, higher principal repayments; second, limited external financing amidst delays in the completion of IMF's ninth review and third, tight financial market conditions.

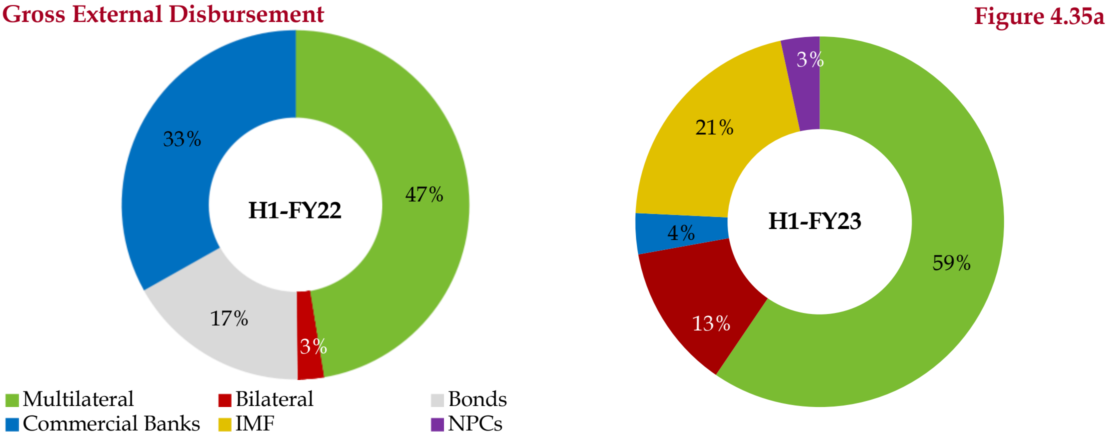
**Public External Debt in Jul- Dec** **Table 4.15**

million US$

| | Stock | | Share in Public External Debt (percent) | | Change in Stock during H1 | | Growth in H1 (percent) | |
|---|---|---|---|---|---|---|---|---|
| | Dec-21 | Dec-22 | Dec-21 | Dec-22 | FY22 | FY23 | FY22 | FY23 |
| **Public external debt (1+2)** | 90,556 | 86,565 | | | 4,099 | -2,273 | 5 | -3 |
| **1. Government external debt** | 83,824 | 78,949 | 93 | 91 | 4,751 | -2,992 | 6 | -4 |
| of which | | | | | | | | |
| i) Long term (>1 year) | 82,547 | 78,261 | 91 | 90 | 4,332 | -2,331 | 6 | -3 |
| Paris club | 10,146 | 8,459 | 11 | 10 | -580 | -773 | -5 | -8 |
| Multilateral | 34,634 | 36,376 | 38 | 42 | 798 | 2,353 | 2 | 7 |
| Other bilateral | 17,929 | 18,035 | 20 | 21 | 3,107 | -18 | 21 | -0 |
| Euro Sukuk global bonds | 7,800 | 7,800 | 9 | 9 | - | -1,000 | - | -11 |
| Commercial loans/credits | 10,218 | 6,894 | 11 | 8 | 522 | -2,587 | 5 | -27 |
| Naya Pakistan Certificates | 1,338 | 658 | 1 | 1 | 529 | -295 | 65 | -31 |
| ii) Short term (<1 year) | 1,277 | 688 | 1 | 1 | 419 | -661 | 49 | -49 |
| of which | | | | | | | | |
| Multilateral | 1,067 | 687 | 1 | 1 | 561 | -640 | 111 | -48 |
| Local Currency Securities | 210 | - | 0 | - | -142 | -22 | -40 | -99 |
| **2. From IMF** | 6,732 | 7,616 | 7 | 9 | -651 | 719 | -9 | 10 |
| **Foreign exch. liabilities** | 11,642 | 10,979 | - | - | 2,879 | -155 | 33 | -1 |
| Central Bank deposits | 2,700 | 2,700 | - | - | - | - | - | - |
| Allocation of SDR | 4,149 | 3,906 | - | - | 2,739 | 9 | 194 | - |

Source: State Bank of Pakistan

**Gross External Disbursement** **Figure 4.35a**




Source: Ministry of Economic Affairs, EAD

### *Naya Pakistan Certificates(NPCs) (held by non-residents) recorded net outflows*

In the backdrop of global increase in interest rates and hike in the country risk, NPCs (held by non-residents) exhibited a net outflow of around US$ 295 million in H1-FY23, despite upward revision of rate of returns in November 2022. Moreover, Moody and Fitch's rating downgrades may have undermined the investors' trust in Pakistani bonds.

### *There were limited Gross External Disbursements against Budget Estimates in H1-FY23*

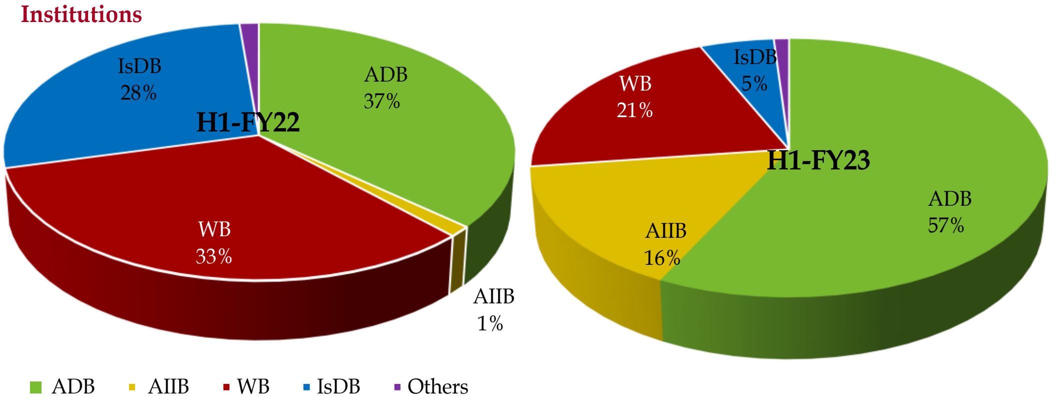
Pakistan received around US$ 5.5 billion in H1-FY23 as Gross external disbursements (including public grants & loans) against budget estimates of US$ 22.8 billion for FY23. Whereas, in H1-FY22, US$ 6.1 billion (excluding time deposits) were disbursed against a budget estimate of US$ 14.0 billion in FY22.[60] The disaggregated analysis shows that multilateral sources were the main source of financing in first halves of both FY22 and FY23. After multilateral organizations, most of the financing in H1-FY22 came from commercial banks and Euro bonds. Whereas, in H1-FY23, multilateral was followed by IMF and friendly countries **(Figure 4.35a)**. However, no amount was raised through Eurobonds in H1-FY23 despite having budget estimates of US$ 2.0 billion for FY23 and only US$ 200 million were received from commercial banks against commitments of US$ 7.4 billion due to macroeconomic uncertainty.

Moreover, within Multilateral category, around 57 percent of the financing came from Asian Development Bank (ADB), followed by Asian Infrastructure Investment Bank (AIIB) and World Bank group(WB) in H1-FY23. Whereas, in H1-FY22, most of the external financing was from ADB, WB and Islamic Development bank (IsDB/IDB) **(Figure 4.35b).**

Meanwhile, in bilateral category, Saudi Arabia was the main financer in H1-FY23, followed by China and the USA. Whereas, in H1-FY22, most of the financing came from

[60] Source: Ministry of Economic Affairs, Economic Affairs Division

**Gross External Disbursements - Multilateral Institutions** **Figure 4.35b**




Source: Economic Affairs Division

the latter two countries (China and the USA) **(Figure 4.35c).**

*A bulk of foreign inflows were utilized for program/budgetary support*

The analysis shows that most of the external financing was utilized for program/ budgetary support in H1-FY23, followed by project aid and short-term credit for the import of oil and LNG **(Table 4.16)**.

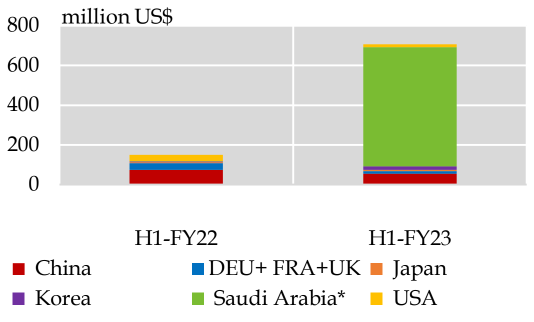
*External Debt Servicing recorded a significant increase in H1-FY23*

Pakistan repaid US$ 8.9 billion public external debt in the first half FY23 compared to US$ 5.0 billion in the same period last year **(Table 4.17)**.[61] Moreover, US$ 111 million was paid against Foreign Exchange Liabilities in H1-FY23 compared to US$ 173 million in H1-FY22.

The disaggregated analysis shows that both principal repayments and interest payments contributed in the soaring debt servicing in H1-FY23. However, the major increase was in principal repayments which posted a growth of around 78.8 percent while the interest payments grew by around 65.8 percent in H1-FY23 compared to the same period last year.

Further analysis depicts that a bulk of debt servicing was of Commercial Banks, followed by Euro Bonds and Multilateral organizations. The reason for higher debt servicing in H1-FY23 was first, scheduled

**Gross External Disbursement - Bilateral** **Figure 4.35c**




* does not include time deposit of US$ 3.0 billion in H1-FY22

Source: Eonomic Affairs Division

[61] Sovereign debt includes both principal and interest payments.

**Gross External Disbursement and Utilization of Major Donors in H1** **Table 4.16**

million US$

| | Project | | Program/Budgetary Support | | Others | | Total | |
|---|---|---|---|---|---|---|---|---|
| | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 |
| **ADB** | 753 | 282 | 310 | 1,624 | - | - | 1,063 | 1,906 |
| **AIIB** | 38 | 21 | - | 500 | - | - | 38 | 521 |
| **IsDB** | 4 | 16 | - | - | 800* | 161* | 805 | 177 |
| **IMF** | - | - | - | 1,166 | - | | - | 1,166 |
| **WB** | 513 | 380 | 425 | 293 | 24^ | 16^ | 962 | 690 |
| **China** | 366 | 55 | - | - | - | - | 366 | 55 |
| **Saudi Arabia** | 1 | - | - | - | 3,000** | 600* | 3,001 | 600 |
| **USA** | 33 | 14 | - | - | - | | 33 | 14 |

*Short-term credit; ^TDPs

** Time deposits; not included in public external debt as they are part of external liabilities.

Source: Economic Affairs Division

principal repayments;[62] second, increase in LIBOR rates amidst global monetary tightening. For instance, the LIBOR rate for 12M USD increased from 3.5 percent to 5.4 percent during H1-FY23. As most of external loans were contracted on LIBOR rate[63], the uptick in LIBOR has led to increase in interest payments. Third, expiry of DSSI in December 2021 which helped in deflating debt servicing in H1-FY22. In the absence of this relief the external debt servicing increased in H1-FY23.

### *External Debt Sustainability deteriorated in the first half of FY23[64]*

Most of the debt sustainability indicators deteriorated in H1-FY23 amidst higher debt

**Public External Debt (Jul-Dec)** **Table 4.17**

million US$

| | Total | | Principal | | Interest | |
|---|---|---|---|---|---|---|
| | FY22 | FY23 | FY22 | FY23 | FY22 | FY23 |
| **1. Public external debt (a+b+c)** | 5,055 | 8,927 | 4,202 | 7,512 | 853 | 1,415 |
| **a. Government debt** | 4,189 | 7,485 | 3,420 | 6,232 | 769 | 1,253 |
| Paris Club | 6 | 621 | 5 | 521 | 1 | 101 |
| Multilateral | 1,059 | 1,096 | 843 | 820 | 216 | 276 |
| Other Bilateral | 71 | 818 | 23 | 558 | 47 | 260 |
| Euro/Sukuk global bonds | 1,307 | 1,319 | 1,000 | 1,000 | 307 | 319 |
| Commercial loans /credits | 1,732 | 2,960 | 1,549 | 2,722 | 183 | 238 |
| NPCs | - | 645 | - | 610 | - | 35 |
| **b. IMF** | 585 | 617 | 516 | 480 | 69 | 137 |
| **c. Short-term government debt** | 281 | 825 | 266 | 801 | 15 | 24 |
| **2. Foreign exchange liabilities** | 173 | 111 | - | - | 173 | 111 |

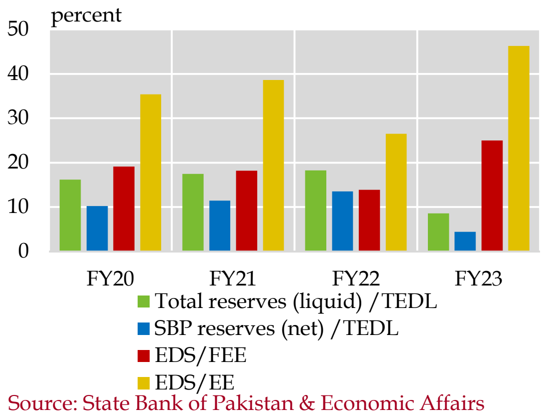
Source: State Bank of Pakistan

[62] According to Annual Debt Review FY2021-22 of Ministry of Finance, around US$ 14.0 billion Public External Debt is maturing in FY23.

[63] Source: Ministry of Economic Affairs, Economic Affairs division.

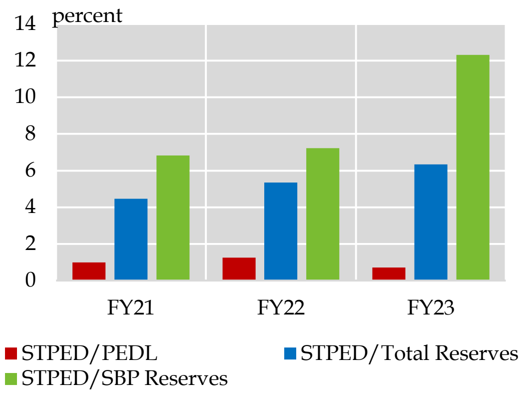
[64] See SBP's Annual Report on State of Pakistan Economy 2021-22 for explanation of External Debt Sustainability

**Solvency Indicators in H1** **Figure 4.36a**




Source: State Bank of Pakistan & Economic Affairs Division

**Liquidity Indicators in H1** **Figure 4.36b**




Source: State Bank of Pakistan & Economic Affairs Division

servicing and lower external inflows, particularly export earnings (EE) and remittances. The slowdown in global demand amidst inflation and floods in the country has led to reduction in export receipts. Moreover, higher kerb premium may have diverted a part of the external inflows such as remittances to informal channels. Furthermore, delays in disbursement of IMF's tranche has impeded financing from bilateral and multilateral creditors.

Consequently, there was deterioration in Total Reserves- to- Total External Debt and Liabilities (TEDL) and SBP reserves- to- TEDL ratios **(Figure 4.36a)**. Moreover, the decline in export receipts and remittances exacerbated External Debt Servicing (EDS) - to- Export Earning (EE) and EDS- to- Foreign Exchange Earning (FEE) ratios in H1-FY23. It is important to note that H1-FY22 showed better solvency indicators as a result of: (1) decrease in EDS due to restructuring of debt under DSSI, and (2) uptick in both exports and remittances.

The factors that underpinned weakened liquidity indicators were reduction in foreign reserves and increase in debt servicing **(Figure 4.36b)**. Meanwhile, the slight improvement in Short Term Public External Debt (STPED) -to-Public External Debt and Liabilities (PEDL) resulted from retirement of short-term commercial loans and inflows from multilateral organizations and IMF (long-term)