Medium Term
Budget Strategy Paper
2022-23 – 2024-25

June, 2022

Government of Pakistan
Finance Division

Foreword

Budget Strategy Paper is a tool to state Government's strategic priorities and medium term objectives. Public Finance Management Act2019 requires presentation of a Medium-Term Budget Strategy Paper for consideration and approval of the Cabinet. The Medium-Term Budget Strategy Paper for FY 2022-23 to FY 2024-25 has been formulated with a focus on economic stabilization, lowering inflation, increasing revenue, resolving of energy issues, enhancing exports and protecting vulnerable segments of society.

The Paper provides a two-pronged budget strategy. On the one hand, it encompasses optimal mobilization of revenue through broadening and deepening of tax base and increase in the tax net, removal of irrational exemptions, simplification of procedures, and augmentation of the capacity of revenue administration, especially through IT-enabled services such as track and trace system. On the other hand, it is based on reduction in non-development expenditure without compromising social and development priorities of the government.

The new government under the leadership of Mian Muhammad Shahbaz Shareef, the Prime Minister of Pakistan shall endeavour to steer the country out of the prevailing economic crisis.

In the coming weeks, the government will seek input from all stakeholders on its proposed taxation and expenditure policies to align them further with the imperatives of equitable, inclusive and sustainable economic growth. I would like to avail this opportunity to commend the efforts of Dr. Aisha Ghaus Pasha, Minister of State for Finance & Revenue and Mr. HamedYaqoob Sheikh, Finance Secretary and his team at the Finance Division and Mr. Asim Ahmad, Chairman, Federal Board of Revenue and his team for their hard work in the preparation of this Paper which sets the strategic direction of Budget 2022-23.

Dr. Miftah Ismail
Minister for Finance and Revenue

Preface

The approval of Medium-Term Budget Strategy Paper containing quantified macroeconomic and fiscal projections by Federal Government is a legal requirement under section 3 of the Public Finance Management Act, 2019. The Paper presents strategic priorities of the government's revenue and spending policies and specifies indicative spending levels for various Divisions and Offices of Federal Government.

The medium-term projections have been prepared on a three-year rolling basis. The Budget for FY 2022-23 will form basis of the first year of the medium term, whereas the projections for the remaining two years have been worked out on the basis of forecast of resources and expenditure, aligned with the policy objectives and priorities of the new government. The Budget Strategy Paper also reflects the strong emphasis of the government for efficiency in fiscal management, responsive budgeting, transparency and accountability.

I would like to acknowledge the commendable work done by the staff of Finance Division, Federal Board of Revenue and Planning, Development and Special Initiatives Division of the Federal Government in the preparation of this Paper. In particular, I would like to express my deepest appreciation of Mr. Muhammad Tanvir Butt, Additional Finance Secretary (Budget) for leading the development of this important document.

Finally, I would like to express my gratitude to Dr.Miftah Ismail, Minister for Finance and Revenue and Dr. Aisha Ghaus Pasha, Minister of State for Finance and Revenue for their insightful guidance in the preparation of this Paper.

Hamed Yaqoob Sheikh
Secretary
Finance Division

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A. Current Economic Situation

Pakistan's economy had shown periodic 'boom-bust' growth cycles. There always existed wide-ranging economic challenges like shrinking fiscal space, exchange rate pressure, mounting current account deficit, inflation, energy sector crisis, and lack of conducive investment environment for the private sector. The instability on the political front also posed significant threats to economic performance by creating uncertainty among investors and the business community.

2. These challenges have been compounded by the complex policy environment surrounding the country. Internal security, geopolitical conditions, and regional and global challenges are hindering investors to make timely investment decisions. The economic situation has suffered three major external shocks. First, a once-in-a-lifetime pandemic Covid-19 (December 2019 onwards). Second, a commodity 'super-cycle' (since January 2021).Third, the deteriorating regional situation in Afghanistan and the Russia-Ukraine conflict. The Government of Pakistan has to deal with these unprecedented challenges having grave socio-economic repercussions.

3. Pakistan's economy posted growth of 5.97 percent in FY 2022. It rebounded from the pandemic (0.9 percent contraction in FY2020) and continued to post a V-Shaped economic recovery which is higher than 5.74 percent recorded in last year (FY2021). Within Agriculture, the production estimates of important crops for FY 2022 are encouraging e.g: Cotton 8.3 million bales, Sugarcane 88.7 million tons, Rice 9.3 million tons, Maize 10.6 million tons. While Wheat production stood at 26.4 million tons.

4. Within the industrial sector, LSM posted a growth of 10.4 percent during Jul-Mar FY2022. The CPI inflation was recorded at 11.3 percent during Jul-May FY2022 against 8.8 percent in the same period last year. Pakistan being a net importer of food and oil items was adversely effected by the upsurge in international food & fuel prices. This upsurge occurred due to supply chain disruptions.

5. To counter inflationary pressure and for sustainable economic recovery, SBP has moved to monetary policy tightening at the end of the first quarter of FY2022 which was kept unchanged since June 2020. The policy rate has been increased by cumulative 675 basis points till May 2022. The decisions were

adopted on account of significant uncertainty around the outlook for international commodity prices and global financial conditions.

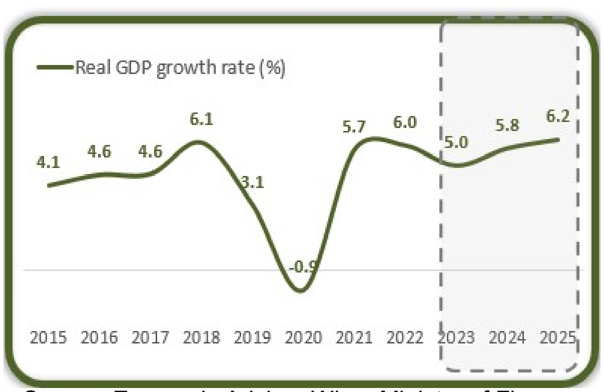
6. Within the external sector, exports during Jul-May FY2022 grew by 27.8 percent to $ 28.8 billion against $ 22.6 billion last year. Imports during the said period grew by 44.3 percent to $ 72.2 billion against $ 50.0 billion last year. Remittances during Jul-Apr FY2022 increased by 7.6 percent to $26.1 billion against $24.3 billion last year. Thus, the current account deficit reached $13.8 billion during Jul-Apr FY2022 against a deficit of $0.5 billion last year. FDI decreased by 1.6 percent to $ 1,455.6 million in Jul-Apr FY2022 against $1,480.0 million last year. Total liquid foreign exchange reserves held by the country stood at US$ 15.2 billion (SBP: $9.3 billion, Commercial banks: $5.9 billion) as of 2nd June 2022. KSE-100 index recorded at 41315 points (as of 3rd June 2022).

B. Medium-Term Macroeconomic Projections

7. It is the prime aim of the Government to steer the economy onto a higher, sustainable, and inclusive growth path. The present government believes that this will be achieved by stimulating the drivers of economic growth. Pakistan's economy underwent significant adjustments like an increase in the policy rate, moving toward a flexible exchange rate in an favourable global environment. The consequences of these factors for growth and stability in the medium-term are likely to be significant. Furthermore, the corrective measures will help in reducing the macroeconomic imbalances in the medium term.

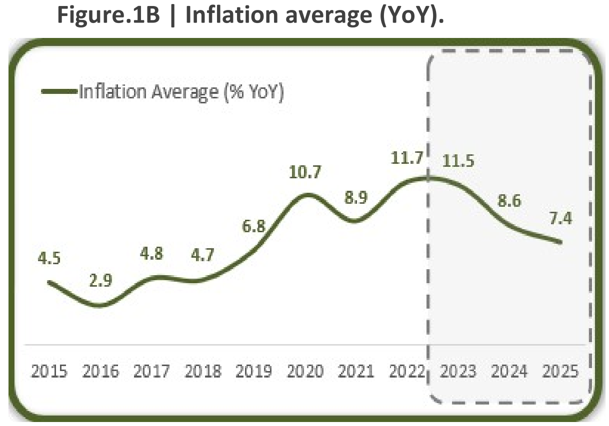
8. In order to address the macroeconomic imbalances, for FY 2023, real GDP growth is expected to slow down, however, afterwards, strong recovery of the economy is expected. Thus, Over the medium-term, growth is expected to return to levels even higher than historical trends with average rates of 6.0 percent in FY24-25. For FY 2023, inflation is expected to be 11.5 percent on account of increase in international commodities prices.

Figure. 1A | Real GDP growth rate (%)



Source: Economic Adviser Wing, Ministry of Finance

Figure.1B | Inflation average (YoY).



9. Medium-Term Macroeconomic Projections have been developed which are given in Table -1:

Table 1: Medium Term Macroeconomic Framework*

	Actual	B.E	R.E	Projections		
	2020-21	2021-22		2022-23	2023-24	2024-25
Economic Growth - %	**5.7%**	**4.8%**	**5.97%**	**5.0%**	**5.8%**	**6.2%**
Inflation - %	**8.9%**	**8.0%**	**11.7%**	**11.5%**	**8.6%**	**7.4%**
FBR Revenue - % GDP	8.5%	10.8%	8.9%	9%	9.4%	10%
Overall Budget Deficit - %GDP	-6.1%	-6.3%	-7.1%	-4.9%	-4%	-2.9%
Primary Balance - %GDP	-1.2%	-0.7%	-2.4%	0.2%	0.9%	1.8%
Public Debt- %GDP	71.8%	71.5%	72.4%	69.1%	68.0%	66.0%
Imports-$bn	54.3	55.3	72.8	69.2	69.5	71.8
Exports-$bn	25.6	26.8	31.3	32.8	35.3	38.1
Current A/c Deficit- $bn	2.8	2.3	15.6	9.0	6.4	4.6
Reserves- months of import	2.7	3.5	1.7	2.1	2.5	2.8
GDP - (Rs Billion)	**55,796**	**53,867**	**66,950**	**78,197**	**90,801**	**102,152**

* Projections are provisional and based on available data.

C. Projections of Development Partners and Others

10 A. IMF World Economic Outlook 2022

In its World Economic Outlook Report, April 2022, IMF has projected Pakistan's GDP growth rate of 4% for FY 2021-22. It has further projected an 11.2 percent average rate of inflation for the current year against 8.9 percent last year. It has estimated Pakistan's current account deficit at 5.3 percent of GDP (up from just 0.6 percent last fiscal year) and 7 percent unemployment rate, slightly lower than 7.4 percent of last year. Going forward, the IMF has projected that the economic growth rate will recover to 4.2 percent of GDP during FY 2022-23. Further, the inflation would come down to 10.5 percent and current account deficit to 4.1 percent of GDP.

10 B. Pakistan Development Update, 2022 (World Bank)

According to the World Bank's Pakistan Development Update 2022, economic activity in Pakistan maintained its momentum during July-December 2021, high demand pressures and rising global commodity prices led to double-digit inflation and a sharp rise in the import bill during this period. These developments have had an adverse impact on the rupee. Moreover, long-standing structural weaknesses of the economy including low investment, low exports, and low productivity growth pose risks to a sustained recovery. Rising food and energy prices are expected to decrease the purchasing power of households, disproportionally affecting poor and vulnerable households. On the back of high base affects and recent monetary tightening, real GDP growth is expected to moderate to 4.3 and 4.0 percent in FY22 and FY23, respectively. Thereafter, economic growth is projected to slightly recover to 4.2 percent in FY24, provided that structural reforms to support fiscal sustainability and macroeconomic stability are implemented rapidly, and that global inflationary pressures dissipate.

10 C. Asian Development Bank Outlook 2022

According to Asian Development Bank Outlook Report issued in April 2022, Pakistan's GDP growth is projected to slow to 4 percent in FY 2022 from 5.6 percent as government applies measures to reduce the current account deficit, raises international reserves and cut inflation. Growth is expected to accelerate to 4.5 percent in FY 2023 due to stronger private consumption and investment.

10 D. State Bank of Pakistan Monetary Policy Statement

The State Bank of Pakistan in its monetary policy statement dated 23rdMay, 2022 has stated that the current account deficit continues to be moderate. In April, it fell to \$623 million, from \$ 1,015 million in March, on the back of lower imports and record remittances. Based on PBS data, the trade deficit shrank by 24 percent relative to its peak last November. These developments are in line with SBP's projected current account deficit of around 4 percent of GDP this year.

Headline inflation rose from 12.7 percent (y/y) in March to 13.4 percent in April, driven by perishable food items and core inflation. The rise in core inflation reflects strong domestic demand and second-round effects of supply shocks. SBP has increased the policy rate by 150 bps to 13.75 percent.

10 E. Fitch Rating (Feb 2022)

Fitch Ratings affirmed Pakistan's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'B-' with a Stable Outlook. Pakistan's rating reflects external vulnerabilities, a narrow fiscal revenue base and low governance indicator scores, with GDP growth and most public finance metrics largely in line with peers following a rebasing of GDP. Fitch has forecast the general government fiscal deficit will fall further to 5.6 percent in FY22 and 4.7 percent in FY23, from 6.1 percent in FY21, on the back of revenue reforms passed in the recent supplementary budget and planned for the FY23 budget. These measures could put public finances on a more sustainable footing. However, high interest payments, which we forecast at 35.6 percent of revenue in FY22 ('B' median: 11.5 percent), constrain fiscal flexibility.

II. MEDIUM-TERM FISCAL FRAMEWORK

15. Amongst the primary objectives of the Medium-Term Fiscal Framework is to facilitate medium term policy-formulation based on reliable projections of revenue and expenditure. It reflects various sources of revenues and heads of expenditures, in view of the historical trends as well as new measures, specific needs, and the government's strategic priorities in the medium term. The framework also highlights the fiscal balance and primary balance of the federal and general government. In order to project overall fiscal balance, estimated levels of provincial surpluses have also been worked out.

16. Pakistan's gross federal revenues are expected to be at 11% of GDP in FY22 and stabilize at around 12 percent of GDP in the medium term. Transfers to provinces are expected to follow the same dynamics assumed in the gross federal revenues.

17. The cornerstone of the Government's plan is to reduce deficits to restore fiscal sustainability in the medium to long term. Fiscal deficit is the key driver of macroeconomic instability in Pakistan. During the last three years, fiscal deficit was Rs.4,000 billion per annum on average. From FY 2014 to 2018, however, the fiscal deficit was only Rs.1,671 billion per annum. The higher fiscal deficit not only results in an increase in debt but also puts a strain on the current account balance. The key reason for a high fiscal deficit in the last 4 years has been the decrease in tax-to-GDP ratio of the country. In 2017-18, FBR tax-to-GDP ratio was 11.7 percent which decreased to just 8.5 percent in FY 2020-21. On the other hand, there were slippages in expenditure which further exacerbated the fiscal deficit situation in the country.

18. In view of the foregoing, the key objective of budget for FY 2022-23 is to reduce fiscal deficit. This will be done by increasing tax-to-GDP ratio and curtailing unnecessary expenditure. On the expenditure side, the Government will strive to rationalize untargeted subsidies, reduce the losses of public sector enterprises through improved governance and cut down ostentatious expenditure through an austerity drive.

19. Budget 2022-23 will aim to move away from untargeted subsidies to create fiscal space to protect the poor from inflation. The CPI inflation during July-Mar FY2022 was recorded at 10.8 percent as against 8.3 percent during the same period last year. The government will take all possible measures to contain the current surge of inflation. However, given the worldwide environment, bringing current inflation down will require some time and should not come at the cost of a recession. Therefore, the Government plans to divert resources form un-targeted subsidies towards protection of poor. These subsidies will be tailor-made to provide relief to poor in the difficult time. The Government will continue with the social protection programme through greater funding for BISP.

20. Optimal mobilization of revenue, broadening of tax base, reduction in exemptions, efficiency in revenue administration. Key strategic priorities of the government include optimal revenue mobilization, broadening of tax base and increase of tax net, reduction in tax expenditure, efficiency in revenue administration, increase in ratio of direct taxes and simplification of procedures for facilitation of taxpayers. In view thereof, challenging revenue projections have been worked out for the medium term.

21. The Government will continue the programme for PFM reforms with a view to get better value of its expenditure. The Government will continue its policy of implementation of the Public Finance Management Act, 2019. In this regard, new set of Rules and Regulations are being developed. The expansion of the Treasury Single Account beyond Divisions and Attached Departments will be continued and the effectiveness of result-based budget management will be improved for greater accountability for the public expenditure.

22. Government will work on the new NFC Award in accordance with the provisions of Constitution of Pakistan. It is high time to consider sharing of expenditures on social sector and other subjects including health, education, agriculture and community development with the provincial governments. Federal PSDP shall focus on core strategic national level development projects only.

23. Government will also focus on cash forecasting, commitment control and cash management leading to Treasury Single Account System. The implementation of efficient cash management system will improve the overall public finance management system of the country.

24. The projected medium term fiscal framework in Table 2:

(Rs. In billion)

Table – 2: Medium Term Fiscal Framework**

	Actual	B.E	R.E	Projections		
	2020-21	2021-22		2022-23	2023-24	2024-25
FBR Revenue	**4,764**	**5,829**	**6,000**	7,004	8,500	9,800
Non-Tax Revenue	**1,506**	**2,080**	**1,315**	2,000	2,033	2,642
Gross Federal Revenue	**6,270**	**7,909**	**7,315**	9,004	10,533	12,442
Transfer to Provinces	2,742	3,412	3,512	4,100	4,975	5,736
Net Federal Revenue	**3,528**	**4,497**	**3,803**	**4,904**	**5,558**	**6,706**
Total Federal Expenditure	**7,245**	**8,487**	**9,118**	**9,502**	9,965	10,375
Federal Deficit	**-3,717**	**-3,990**	**-5,315**	**-4,598**	**-4,407**	**-3,670**
As % of GDP	-6.7%	-7.4%	-7.9%	-5.9%	-4.9%	-3.6%
Provincial Surplus	314	570	570	800	800	850
Overall Fiscal Deficit	**-3,403**	**-3,420**	**-4,745**	**-3,798**	**-3,607**	**-2,820**
As % of GDP	-6.1%	-6.3%	-7.1%	-4.9%	-4.0%	-2.8%
Overall Primary Balance	**-654**	**-360**	**-1,602**	**152**	**793**	**1880**
As % of GDP	-1.2%	-0.7%	-2.4%	0.2%	0.9%	1.8%
GDP (Nominal)	**55,796**	**53,867**	**66,950**	**78,197**	**90,801**	**102,152**

**** Note: Projections are based on available information**

III. Strategic Priorities of Governmentfor Revenue Mobilization

(a) FBR Revenue

25. Like most developing countries, Pakistan is plagued with issues of an undocumented economy the consequence of which is a burgeoning tax gap due to a narrow base and ineffective enforcement. In order to resolve the problem a

robust program will be pursued. The main pillars of this approach would be strengthening enforcement measures for both broadening and deepening of tax base as well as policy measures aimed at simplifications and harmonization of tax laws.

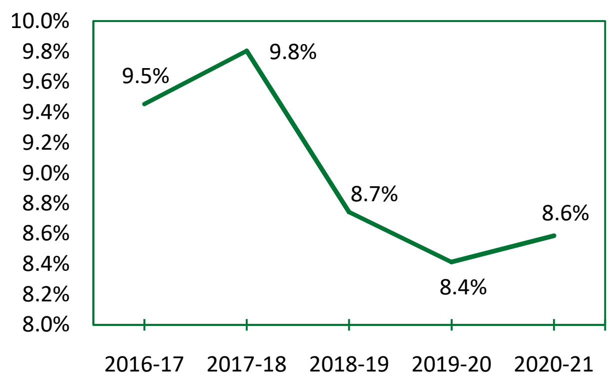
Table 3: FBR Collection Trends 2016-17 to 2020-21(Rs. in billions)

	2016-17	2017-18	2018-19	2019-20	2020-21
(a) Direct Taxes	**1,343**	**1,537**	**1,446**	**1,524**	**1,732**
(b) Indirect Taxes	**2,018**	**2,306**	**2,384**	**2,474**	**3,032**
Customs Duties	496	608	685	626	765
Sales Tax	1,323	1,491	1,465	1,597	1,990
Federal Excise	199	206	234	250	277
FBR Taxes (a+b)	**3,361**	**3,842**	**3,829**	**3,998**	**4,764**
Growth Rate		**14%**	**0%**	**4%**	**19%**

Source: FBR

26. The growth in FBR tax collection was quite low especially after FY 2017-18. On average during the last four years, the growth was about 9 percent. As a result, the tax-to-GDP ratio continued to go down. The Covid-19 and other factors mainly contributed to it.

Fig-2: FBR Tax-to-GDP Ratio



Source: FBR

26. Due to critical importance of tax collection to reduce fiscal deficit, the Government aims to undertake major reforms to revive growth of tax collection. A summary of these measures is explained below:

(i) Revenue Structuring

Direct taxes have more welfare value and help improve equity of the system as compared to consumption based indirect taxes. However, direct taxes in Pakistan have come across problems of a narrow base. Efforts are underway to broaden tax base through field surveys, data analytics and use of third-party data. Greater effort will be made to document revenue buoyant sectors. For this purpose, the scope of role of NADRA and SBP will also be enhanced as data source for identifying persons who are outside of tax net. As regards indirect taxes, FBR will also continue to focus on sectoral/ industrial analysis and prioritize sectors with high revenue potential apart from plugging leakages of indirect taxes through creating incentives for taxpayers to help stop leakages.

(ii) Use of Technology for Revenue Mobilization

The Government will enhance use of IT to boost tax collection and stop leakages. Directorate General of Digital Invoicing and Directorate General of Input-Output Co-efficient will be operationalized at the earliest to promote use of IT in taxation. Further, the coverage of track and trace system will beincreased as the technology has been successfully used for tobacco and sugar industries. Similarly, the coverage of Point of Sale (POS) machines will also be increased to ensure that Government revenues are deposited to the public exchequer.

(iii) Reduction in Tax Exemptions

In order toeliminate distortions from the tax system, broadening of tax base, filling the gaps in supply-chain, providing a level playing field to all and documentation of the economy, the Government will review exemptions in tax laws. Through recent legislation a large number of tax exemptions (direct and indirect) have been withdrawn. The Government intends to review policy with a view to end all unnecessary and discriminatory exemptions.

(iv) Efficient Management of Tax Litigation

In the presence of liberal tax regime coupled with independent judiciary the volume of litigation has increased. Resultantly, more than Rs.4 trillion tax revenue is stuck in litigation at various appellate fora. In order to address this problem, Government is considering toengagepanels of professionally sound advocates and ‘Special Prosecutors’ in certain cases with aim to putting maximum efforts to get resolved the pending issues while protecting the revenue.

(v) Harmonization of Sales Tax

The current lack of harmonization of sales tax caused by a collection of sales tax on goods by the Federal Government and that of The current lack of harmonization of sales tax caused by a collection of sales tax on goods by the

Federal Government and that of sales tax on services by provincial governments has resulted in major costs for businesses is the country. Therefore, the Government plans to work with the provincial governments with the aim to harmonize scope, rate etc. and bring in a system where a single sales tax return could be submitted by businesses.

(vi) Efficiency in Revenue Administration

Government has directed FBR to keep a strict check on its administration with the aim to increase administrative efficiency. For, this FBR is considering effective tools to create incentives and deterrence for its employees, i.e. considering various parameters to incentivize the best performers through special allowances, rewards on achieving targets, etc. FBR also aims to enhance capacity of the tax machinery through various targeted trainings, workshops, etc.

(vii) Progressivity of taxation

In addition to revenue structure, tax progressivity is one of the most important elements for effective tax policy. Progressivity will be pursued through reduction in tax brackets and reviewing tax exemptions under direct taxes and through withdrawal of exemptions/reduced rates under indirect taxes.

(viii) Simplification of Tax Statues

Presently the taxation structure is complex and increases cost of compliance as well as cost of implementation. Simplification of tax laws is to be undertaken as an ongoing process. To this end FBRis in the process of drafting a Unified Inland Revenue Code wherein which all the federal internal taxes namely income tax, sales tax, FED and ICT on services are to be combined as one statute. Provisions relating to common themes such as registration, audit, recovery and appeal, etc. to be applicable to all the four taxes on the basis of a single statue.

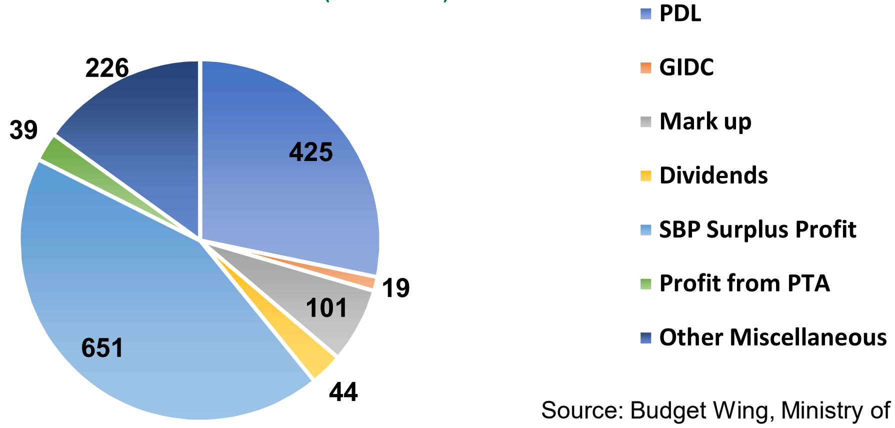
(b) NON TAX REVENUE

28. The revenues collected by the FBR are distributed among the four Provinces and Federal Government as per the NFC formula under the Constitution of Pakistan. While Federal as well as Provincial Governments have their own resources for revenue generations. Federal Government has two main

resources including Taxes other than FBR (PDL, GIDC, ICT and others) and Non tax Revenue receipts including Surplus profits of Regulatory Bodies, Dividends, Mark-ups and Others. Government has enacted special provisions in the PFM Act 2019 for collection of these revenue receipts.

29. The Federal Government continues to, with an avowed resolve, to pursue increase in non-tax revenue through greater cost recovery and rationalizing regulatory fees where possible to maintain real value of such levies.

Fig 3: Non-Tax Collection FY 2020-21 (Rs. billion)



Source: Budget Wing, Ministry of Finance

Table 4: Non-Tax Revenue FY 2016-17 to FY 2020-21 (Rs. in billions)

	2016-17	2017-18	2018-19	2019-20	2020-21
PDL	167	179	206	294	425
GIDC	42	15	21	9	19
Mark up	114	104	59	131	101
Dividends	70	57	60	40	44
SBP Surplus Profit	228	233	13	936	651
Profit from PTA	34	16	18	127	39
Other Miscellaneous	533	250	229	247	226
Total	**1,188**	**854**	**606**	**1,784**	**1,505**

30. The NTR collection during FY 2021-22 has remained well below the budget estimates. The major reasons for this shortfall were the lower receipt on account of SBP profit and Petroleum Development Levy (PDL). As a result of recent amendments to SBP Act, a portion of profit will be withheld by the central bank to cover the risk of losses. This provision in the Act has resulted in a reduction of the profit for the Government.

31. Due to increase in the international price of Petroleum Products, the Government decided to bring down the rate of PDL to protect consumers from high rates. However, due to this, the target of revenue collection under PDL could not be achieved. In addition, the collection of GIDC has not been possible even after the decision of the Supreme Court.Another setback to NTR collection in FY 2020-21 was the non-recovery of outstanding balance of Rs.48.0 billion of Benazir Employees Stock Options Scheme (BESOS) as the scheme was declared against the law by the courts.The efforts for improving the collection of NTR through rationalization as well as the additional imposition of NTR in the light of PFM Act, 2019 will be geared-up during the next financial year.

(c) TRANSFERS TO PROVINCES

30. The major fiscal challenge being faced by the Federal Government since the introduction of the 18th constitutional amendment and 7th NFC Award is transfer of 57.5 percent of divisible pool taxes and the straight transfers to the provinces, constituting almost 59.7 percent of the gross federal revenues, which leaves very limited fiscal space for current and development spending for the Federal Government.

Table 5: Transfers to Provinces from FY 2016-17 to FY 2020-21(Rs. in billions)

	2016-17	2017-18	2018-19	2019-20	2020-21
Provincial share in federal taxes	1,966	2,217	2,398	2,504	2,742
Current grants to provinces	22	25	28	76	84
Development grants to provinces	8	85	60	155	226
Grants to AJK	32	41	49	55	58
Grants to GB	25	28	31	34	37
Total transfers to provinces and federal territories	**2,053**	**2,396**	**2,566**	**2,824**	**3,147**

32. In order to attain the projected overall fiscal balance, the provinces will be required to have the desired levels of provincial surpluses by increasing their own revenues and rationalizing the expenditures. For the future, the Federal Government, Provincial Governments and Other Special Areas Governments have to mutually agree on the revenue distribution and sharing of expenditures formulas.

IV. SPENDING POLICIES AND INDICATIVE LEVELS OF SPENDING

Table 6: Expenditure Trends of the Federal Government FY 2016-17 to FY 2020-21 (Rs. In billions)

	2016-17	2017-18	2018-19	2019-20	2020-21
(a) Current Expenditure	**3,494**	**3,815**	**4,804**	**6,093**	**6,349**
Mark-up Payments	**1,348**	**1,450**	**2,091**	**2,620**	**2,750**
Domestic	1,220	1,323	1,821	2,313	2,524
Foreign	128	177	270	307	226
Defense Services	888	1,030	1,147	1,213	1,316
Pension	304	334	393	447	440
Running of Civil Govt.	426	428	508	524	506
Subsidies	154	114	195	360	425
Grants	374	409	470	928	912
(b) PSDP & Net lending	**867**	**890**	**795**	**726**	**789**
(c) Statistical Discrepancy	**69**	**17**	**74**	**61**	**107**
Total Expenditure (a+b+c)	**4,431**	**4,722**	**5,673**	**6,880**	**7,245**

33. On the current side, expenditure trends of the Government during last 5 years have been shown in the above Table. Conspicuous in the trends is the rise in the level of mark-up payments, increase in pension expenditure and subsidies and decrease in development expenditure and net lending. The total outlays of the previous year's provide that Government has to take concrete measures control rising expenditures. Government has been facing Fiscal Deficit and in order to finance the deficit, Government has to borrow on higher rates from domestic market through government securities (T-bills, PIBs, Sukuk etc.). withthe increased SBP policy rate and other factors, the borrowing cost of Federal Government is increasing. The debt raising by CDNS is not showing positive trends. The non-borrowing from SBP has been effecting the fiscal position of the Government.

34. Public Sector Development Programme (PSDP) plays an integral role in the mobilization of indigenous resources to uplift the social-economic conditions of the people. Development funds under PSDP are allocated and utilized on development projects and programmes duly approved by the competent fora in line with sectoral and regional priorities outlined in the Annual Plan /Growth Strategy.

35. The provisions contained in the Public Finance Management Act 2019are being followed while allocating resources under federal PSDP. The focus of the federal PSDP is on financing and completion of mega /important projects of national importance particularly relating to infrastructure, being the primary responsibility of the federal government.

Table 7: PSDP Expenditure Trends 2016-17 to 2020-21 (Rs. In billion)					
	2016-17	**2017-18**	**2018-19**	**2019-20**	**2020-21**
PSDP	**733**	**661**	**562**	**622**	**667**

36. Within infrastructure, priority is assigned to water sector in line with water policy 2018 for augmentation and preservation of water resources. Among others, preference will be given to construction of large dams. For regional connectivity and smooth logistic movement, priority will also be given to roads, rails, aviation, and ports projects particularly those under the CPEC initiative. Substantial funding would be ensured for important projects for timely completion.

37. The Federal Government also attaches equal importance tothe social sector including health, higher education etc. In order to foster the culture of innovation and research, the Federal Government has initiated a number of programmes/projects in the sector of IT & S&T under knowledge economy initiative for which substantial funds would be required in next FY 2022-2023. The private sector will be encouraged to invest in potential disciplines. To ensure self- sufficiency in food and productivity enhancement in the country, the programmes like agriculture emergency input, Special Economic Zones have been initiated for which substantial funding would be required.

38. Public Sector Development Program spending levels are provided in the table given below:

Table 8: Medium-Term Indicative Budgetary Spending Levels (Rs. In billion)					
	Actual		**Projections**		
	2020-21	**2021-22**	**2022-23**	**2023-24**	**2024-25**
PSDP of which	**667**	**550**	**727**	**800**	**850**
Infrastructure	436	324	383	432	436

Table 8: Medium-Term Indicative Budgetary Spending Levels (Rs. In billion)					
	Actual		Projections		
	2020-21	2021-22	2022-23	2023-24	2024-25
Social	126	132	155	176	198
Science & IT	12	18	21	24	27
Regional Development	84	66	77	88	99

V. BUDGETARY SPENDING LEVELS

39. Medium-Term Indicative Budgetary Spending Levels are based on policy priorities of the government. During the upcoming years, government budgeting, particularly spending shall be performance-based. Indicative spending levels are provided in the table given below.

Table 9: Medium-Term Indicative Budgetary Spending Levels (Rs. in billion)				
	2021-22	2022-23	2023-24	2024-25
Interest Payment	3,144	3,950	4400	4,700
Defense Services	1,450	1,523	1,570	1,630
Grants	1,090	1,242	1,200	1,200
Subsidies	1,515	699	600	550
Pension	525	530	546	568
Running of Civil Government	530	550	572	601
PSDP	550	727	800	850
Provisions	232	200	100	100

40. Divisions and Department wise level of current spending would be linked with the achievement of targets and goals. The Federal Government has been following the Medium-TermBudgetary Framework for performance-based budgeting to assure service delivery outcomes. The medium-term spending levels would be finalized keeping in view the targets achieved as outlined in "Green Book" as per the PFM Act 2019.

41. Over the years, government spending on running of civil government and pensionspending has increased. In order to break this trend, the government is working on reducing non-development expenditures as a proportion of the budget and bringing reforms in the pension payment system to rationalize pension cost.

42. Since the Pension bill is becoming unsustainable, Government has to re visit the pension policy as a whole particularly the family pension to control the leakages and misappropriation of the public money. Government has introduced various reforms including Biometric for proof of life and conversion to Direct Credit System (DCS) for all the civil and military pensioners. Government has to finalize the scheme for contributory pension fund for the future.

43. With regard to subsidies particularly power and petroleum sectors, Government has to review the whole scheme and go for the targeted subsidies for the vulnerable sectors of the society. The government has to control the circular debt issues in the power and petroleum sectors. Similarly, regarding Grants-in-Aid to the various Organizations and Bodies, Government is framing Rules and Procedures to control and manage the increasing recurring allocation of funds. These allocations shall be for limited period and specific to achievement of the laid down targets.

44. Ministries/Division-wise level of development spending will be finalized by the Ministry of Planning, Development and Special Initiatives.Indicative spending level for public sector development programme during the medium-term period would range between Rs. 700 – 900 billion. The provisions of PFM Act 2019 would be followed with regard to approval of the Development Projects.

45. The major expenditure priorities for the Government during the medium term will be as under:

i. Protection of vulnerable segments through BISP program.
ii. Reduction of inflation and price control mechanism.
iii. Financing of circular debt and energy subsidies.
iv. Harmonization of pay and allowances of Federal Government employees.
v. Allocation for research and development and socio-economic uplift.

VI. PUBLIC DEBT

46. The Debt to GDP ratio will increase and record at around 72.4 percent at the end of ongoing fiscal year (FY22) primarily due to higher federal fiscal deficit and depreciation of Pak Rupee against US Dollar. However, Debt-to-GDP ratio is

expected to reduce to 69.1 percent at the end of the next fiscal year (FY23) on the back of fiscal consolidation efforts of the government.

47. Over the medium term, the government's objective is to bring and maintain its Public Debt-to-GDP ratio to sustainable levels through a combination of greater revenue mobilization, rationalization of current expenditure, and efficient/productive utilization of debt.

48. Government also aims to reduce its "Gross Financing Needs (GFN)" through various measures mainly including (i) better cash flow management through a treasury single account; (ii) lengthening of maturities in the domestic market keeping in view cost and risks trade-off; (iii) developing regular Islamic based lending program and (iv) avail maximum available concessional external financing from bilateral and multilateral development partners to benefit from concessional terms and conditions.

Table 10: Public Debt Amount in PKR Billion (Otherwise Stated)

	FY 2020-21	FY2021- 22	FY 2022-23
Stock of Public Debt			
Public Debt	**39,866**	**48,477**	**54,109**
External	13,601	18,085	20,561
Domestic	26,265	30,392	33,548
Public Debt (% of GDP)			
Public Debt	**71.5%**	**72.4%**	**69.1%**
External	24.4%	27.0%	26.3%
Domestic	47.1%	45.4%	42.8%
Memo			
GDP	**55,796**	**66,950**	**78,331**

VII. FISCAL RISKS SCENARIO ANALYSIS

1. **Three illustrative scenarios are presented to analyze fiscal risks.**

Three scenarios are built upon the forecasts presented earlier to illustrates the fiscal and debt implications of these options would look like.

2. Alternative scenarios are developed with the following assumptions:

Scenario 1 "Higher cost of funding": This scenario assumes an increase in the cost of the new disbursement implying higher expenditures. In particular, the exercise uses a higher interest rate for each new financing instrument than the baseline scenario. This increase generates an increment in the fiscal deficit, not affecting the primary deficit.

Scenario 2 "External shock and non-fiscal adjustment": This scenario assumes lower petroleum & gas levies and surcharges and, at the same time, higher subsidies. The scenario assumes half petroleum & gas revenues and double expenditure in subsidies compared to baseline.

Scenario 3 "Higher cost of funding and non-fiscal adjustment": This scenario combines weakening revenues due to lower economic growth and growing expenditures due to higher subsidies as calculated in the previous scenarios.

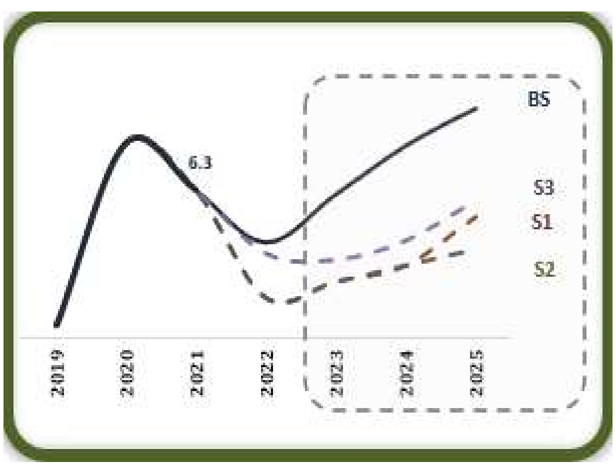
3. **Lower growth will reduce both tax and non-tax revenue which will in turn reduce Net Federal Revenues in all Scenarios** i.e., Scenario 1, 2 and 3 as shown in Figure – 1.

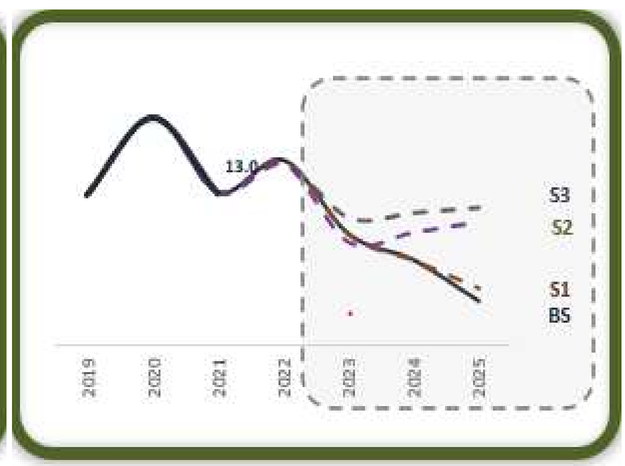
4. **Higher subsidies will have more impact on the expenditure side**, Thus, Federal Expenditure as percent of GDP will increase in all scenarios 1, 2, and 3 as shown in Figure - 2.

Figure - 1 | Net Federal Revenues (% of GDP)

Figure - 2 | Expenditures (% of GDP)

Baseline — Scenario 1 — Scenario 2 — Scenario 3



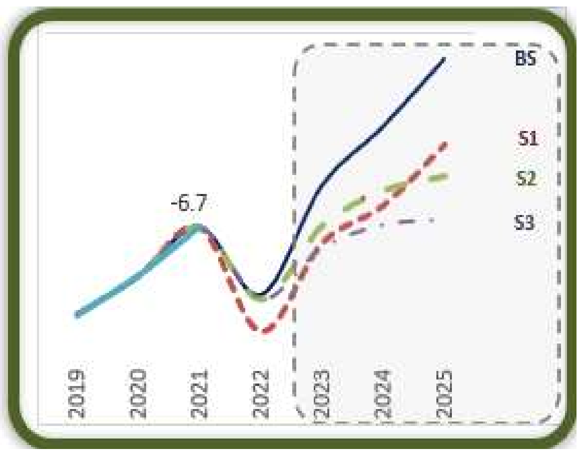


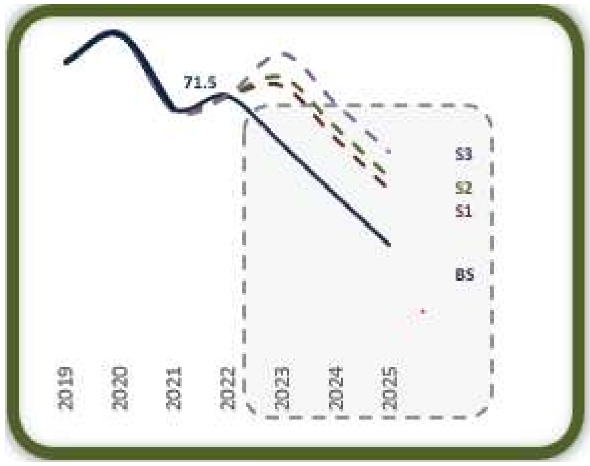
5. Corresponding to above two figures, all the scenarios analyzed exhibit higher fiscal deficit compared to baseline as shown in Fig - 3. However, none of the scenario presents an explosive increase in the public debt-to-GDP ratio. All the estimated scenarios have federal fiscal deficit-to-GDP ratio higher than that in FY 2022 . Further, all three scenarios present a gradual reduction in the public debt-to-GDP ratio as shown in Figure – 4

Figure - .3 | Federal Fiscal Deficit (% of GDP)

Figure - 4 | Public Debt (% of GDP)

Baseline — Scenario 1 — Scenario 2 — Scenario 3





VIII. CONCLUSION

49. This Medium-Term Budget Strategy Paper being presented under the provisions of the Public Finance Management Act 2019 reaffirms the commitment of the Federal Government to implement the principles of transparency, responsiveness, inclusiveness, and better financial management during the ensuing three years. The continuity of the fiscal policies, new policy measures, and well-planned government expenditures will facilitate the achievement of the targets and objectives announced by the government in the annual budget before the Parliament.

FISCAL VARIABLES (Rs.Billion)					
			Projections		
	FY20/21	FY21/22	FY22/23	FY23/24	FY24/25
Federal Revenues (net)	**3,545**	**3,803**	**4,114**	**5,558**	**6,706**
Federal Revenues (Gross)	**6,269**	**7,315**	**8,214**	**10,533**	**12,442**
Tax Revenues	4,764	6,000	7,004	8,500	9,800
FBR revenues	4,764	6,000	7,004	8,500	9,800
Direct Taxes	*1,732*	2,211	2,594	3,139	3,584
Sales tax/VAT (Goods)	*1,990*	2,686	2,940	3,562	4,103
Custom duties / taxes on international trade	*765*	759	1,050	1,285	1,508
Federal Excise duty	*277*	344	420	514	604
Non-Tax revenues	1,505	1,315	2,000	2,033	2,642
Levies and surchages	470	165	790	795	800
Other Non-Tax revenues	1,035	1,150	1,210	1,238	1,842
Transfers to Provinces	*2,724*	3,512	4,100	4,975	5,736
Expenditures	**7,245**	**9,086**	**9,502**	**9,965**	**10,376**
Current Expenditures	**6,349**	**8,454**	**8,694**	**9,088**	**9,449**
Interest Payments	*2,750*	3,144	3,950	4,400	4,700
Pension	*440*	525	530	546	568
Defence	*1,316*	1,450	1,523	1,570	1,630
Grants	*912*	1,090	1,242	1,200	1,200
Susidies	*425*	1,515	699	600	550
Running of Civil Government	*506*	530	550	572	601
Provisions		**200**	**200**	**200**	**200**
Net Lending	**789**	**82**	**81**	**77**	**77**
Federal (PSDP)	*667*	550	727	800	850
Provincial (Current)	*2,844*	3,562	3,953	4,471	5,057
Provincial (Development)	*770*	1,449	1,639	1,854	2,096
Primary Deficit (Federal)	-967.0	(2,172)	(648)	(157)	930
Federal Fiscal Deficit	-3,716.9	(5,315)	(4,598)	(4,407)	(3,670)
Provincial Surplus	313.6	570	800	800	850
Overall Fiscal Deficit	-3,403.3	-4,745.3	-3,798.0	-3,607.0	-2,820.0
Primary Deficit(consolidated)	-653	-1,601	152	793	1,880