



PRIME PLUS

JULY 2025

QUARTERLY REPORT ON
PAKISTAN'S ECONOMY WITH
SPECIAL FOCUS ON
THE BUDGET 2025-26



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SECTION-I: Staying Afloat: An Analysis of Pakistan's FY2025-26 Budget

Introduction:

The Government presented the Finance Bill 2025 with the aspiration to “foster competition” and “economic productivity”. The budget followed an economic stabilization achieved under the framework of the International Monetary Fund (IMF). The stabilization achieved on account of falling inflation to 4.61 percent in July-May 2024-25, from 24.5 percent last year; a current account surplus of \$1.8 billion from a deficit of \$1.57 billion last year; and a primary surplus of 2.2 percent of GDP compared to a surplus of 0.4 percent last year. However, despite this stabilization, economic growth remains weak, with GDP expanding by just 2.68% in FY2025—a figure contested by independent experts, who argue it overstates the real economic momentum.

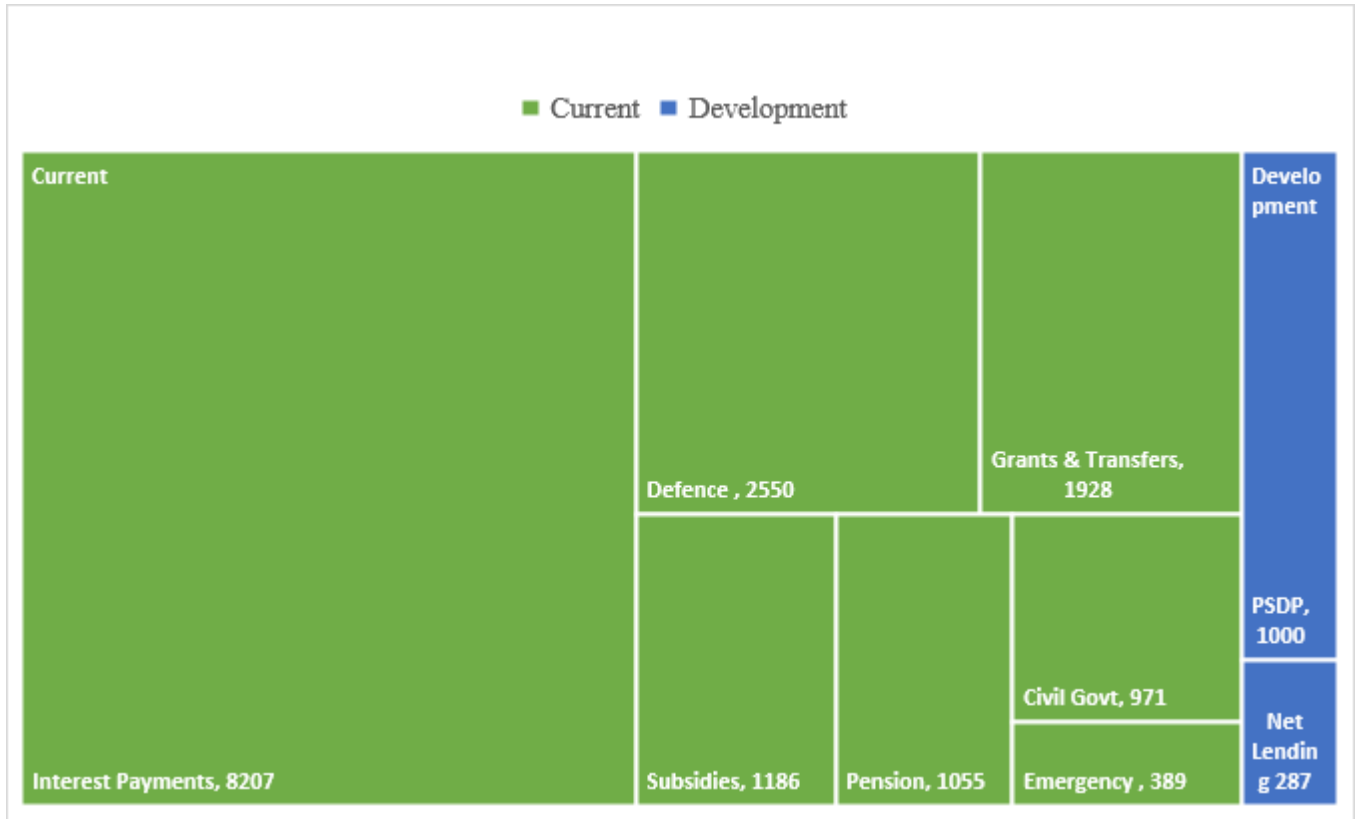
1. Overview of Total Expenditure

The federal budget for FY2025-26 amounts to PKR 17,573 billion, which is approximately 13.6% of GDP, reflecting a tight fiscal stance under an IMF program. This outlay is roughly 2% higher in nominal terms than the revised spending of around PKR 17,249 billion in FY2024-25 but in real terms (after adjusting for inflation), it marks a contraction, indicating an austerity-oriented budget. The fiscal deficit is targeted at PKR 6,501 billion, bringing it down from an estimated 5.6% of GDP in FY2024-25 to 3.9% of GDP in FY2025-26. Achieving this improvement hinges on ambitious revenue growth and restraint in expenditures.

1.1 Composition of Expenditure

Understanding the composition of expenditure in the budget is essential for discerning the government's operational priorities in the upcoming fiscal year. The total expenditure includes current expenditure and development expenditure. The table below summarizes the composition of expenditures in the budget, where current expenditure is Rs. 16,286 billion and development and net lending is Rs. 1287 billion.

Figure 1: Expenditure Composition in Budget for FY2025-26 (Rs. Billions)



A. Current Expenditure

Current expenditure constitutes the lion’s share of the budget, consuming virtually all available resources before development is accounted for. For FY2025-26, current spending is budgeted at PKR 16,286 billion, making up over 90% of the total outlay. This reflects the rigid cost structure of interest, defense, and other obligatory expenses. Key components of current expenditure include interest payments, subsidies, pension, defense, grants and transfers, civil government, and emergency transfers.

Interest Payments are by far the single largest component of the budget, costing approximately half of total federal spending. Debt servicing costs have surged with rising public debt and interest rates, eclipsing every other expenditure category. This reflects the country’s inefficient financial management, and thus, the expenditure burden is met by loans from the IMF and other friendly countries every year. The second major share is taken up by the defense budget, which this year

has been increased by roughly 16-17% compared to last year, due to recent conflicts with the neighboring country.

One cannot emphasize enough the poor and unsustainable pension structure of Pakistan. This year's budget includes Rs. 1055 billion for pensions. Pension liabilities continue to grow faster than revenues in the country, and studies estimate that if left unreformed, pension spending could cost 56% of the federal budget by 2050 (Kakar, 2018), leaving little or no room for education and health spending. This calls for urgent structural reform, including a possible shift toward contributory pension models, parametric reforms, and improved actuarial assessments to ensure long-term fiscal sustainability.

Grants and Transfers constitute around PKR 1,928 billion, constituting 10% of the budget. Similarly, while the subsidies allocation has decreased this year by 17%, the subsidies still cost Rs. 1186 billion. Most of the subsidy allocation is directed to the power sector, including ~PKR 400 billion for tariff differentials and PKR 125 billion for IPP payments, with smaller provisions for agriculture (e.g., PKR 24 bn for fertilizer) and social support (PKR 40 bn for wheat/flour subsidy). The provision of subsidies raises concerns about potential impacts on the power sector and the sustainability of such subsidies. The running of Civil Government saw a moderate increase (around 10% higher than last year's spending) due to pay raises and inflation adjustments. In a country that faces climate emergencies almost every year, which cost both infrastructure and lives, only PKR 389 billion is reserved for Emergencies.

Growth drivers and rigidities:

The bulk of current expenditure growth is driven by mandatory obligations, chiefly debt servicing and defense. Interest payments, while slightly lower than last year's peak (the FY2024 revised interest was even higher due to rate hikes and currency depreciation effects), still grew in absolute terms and remain exceptionally high. Defense spending's sizable increase further adds to the rigidity, as such expenditures are politically and strategically sensitive to cut. Pension outlays also continue to rise, given underlying demographics and a lack of systemic pension reform. In contrast, subsidies have been targeted for cuts – a rare flexible element being tightened under IMF guidelines. The net effect is a current budget that is largely inflexible: over four-fifths of it comprises interest, defense, pensions, and statutory grants that cannot be easily adjusted in the

short term. This rigidity crowds out more productive or welfare-oriented spending, and any revenue shortfall during the year often forces cuts in the only flexible area – development spending – to keep the deficit in check.

B. Development Expenditure (PSDP)

Federal development expenditure is channeled through the Public Sector Development Programme (PSDP). For FY2025-26, the federal PSDP is set at PKR 1,000 billion, a 10% reduction from last year's PKR 1.1 trillion (revised) allocation. This cutback reflects the government's austerity drive and re-prioritization of spending. It's noteworthy that the original PSDP for FY2024 was even higher (PKR 1.4 trillion) but was scaled down mid-year to ~PKR 1.1 trillion to meet IMF targets and accommodate other urgent needs. The new PSDP thus cements those cuts into the baseline.

Importantly, development spending is now a small fraction (about 7%) of the federal budget, which raises concerns about declining public investment. The PSDP is categorized into federal ministries' projects, special areas, and corporations, with the FY2025-26 plan focusing resources on a few priority sectors and politically driven schemes:

Furthermore, development in Pakistan is a shared responsibility between the federal and provincial governments. While the federal PSDP is PKR 1.0 trillion, the provincial Annual Development Programs (ADPs) combined are around PKR 2.87 trillion. This means provinces are collectively allocating nearly three times the federal amount for development, bringing the total national development outlay to roughly PKR 3.8 trillion. Notably, provinces increased their ADPs by ~20% from last year, even as the federal PSDP was cut.

This divergence is partly because many social services (education, health, etc.) are now devolved to provinces, and also because federal fiscal constraints are tighter under the IMF program. The federal PSDP now constitutes only about a quarter of Pakistan's overall public development spending, reflecting the post-devolution landscape where provinces shoulder more of the development budget, especially for social sectors.

1.2 Execution Capacity and ADP Comparison:

Execution of development funds has historically been a challenge due to capacity constraints and bureaucratic delays. However, FY2024-25 saw a marked improvement in federal PSDP utilization – 96% of the revised PSDP (about Rs 1.04 trillion)¹ was utilized, the highest ever implementation rate. This absorption indicates that the government pushed hard to use allocated development funds (helped by downward revisions that made targets more realistic). It demonstrates improved execution capacity at the federal level for that year. Provinces, on the other hand, often struggle to fully utilize their larger ADPs, though data for FY25 provincial utilization is still emerging. The ramp-up of provincial development plans by 20% this year assumes they can implement more projects; execution will be critical. Given that the federal PSDP has been cut in absolute terms, the onus is on provinces to drive development expenditures, especially in social sectors. There is some concern that despite allocation, if revenue falls short or austerity is tightened, development spending will be the first casualty, as was the case last year when the PSDP was trimmed mid-year.

2. Year-on-Year Comparison of the Budgetary Expenditure:

This year-on-year (YoY) comparison underscores that the budget is largely status quo in nominal spending, with most adjustments coming from reducing the development program and hoping for higher revenues.

On a YoY basis, current expenditure is decreased from 16,390 billion to 16,286 billion, and this is due to a sharp decline in debt servicing, which is decreased by 9% this year, driven by reductions in both domestic and foreign debt servicing. This is attributed to a fall in interest rate in the current year, which was gradually reduced from 22% to 11%. Current expenditure has declined in this fiscal year, but this reduction does not reflect any proactive fiscal consolidation or efficiency measures by the government. Instead, it is largely attributed to a temporary decline in debt servicing obligations, which remain the single largest component of current expenditure. The absence of structural reforms in areas such as pensions, subsidies, or government operational costs

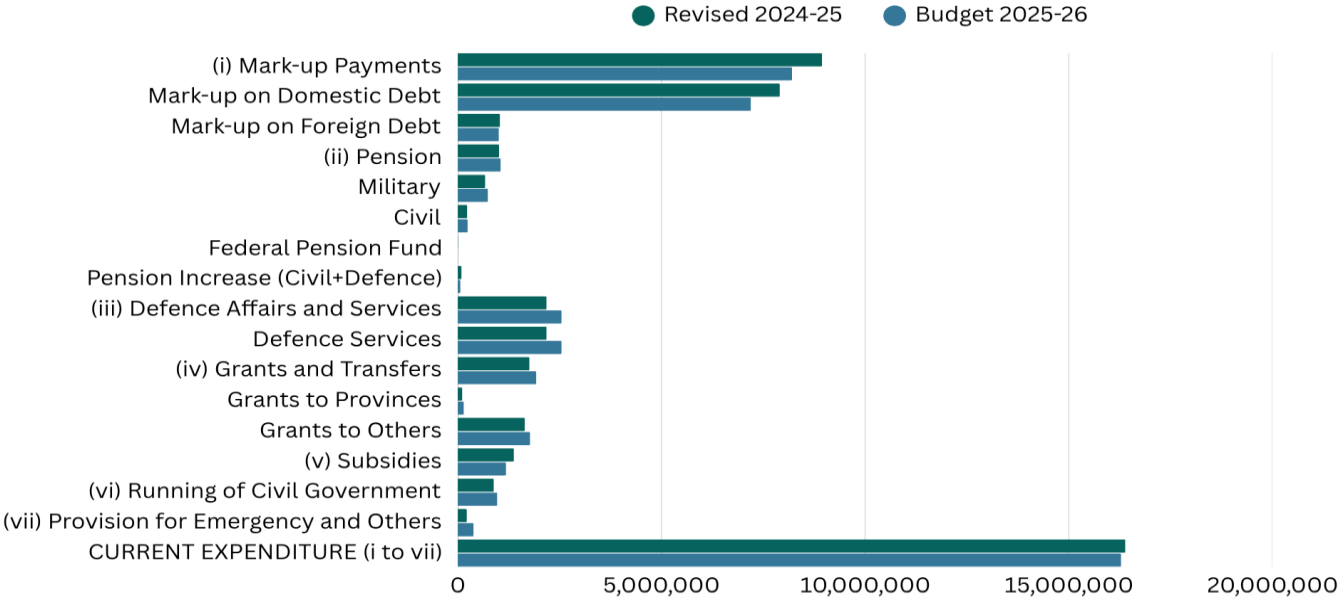
¹ Pakistan sees record 96% PSDP utilization <https://mettisglobal.news/Pakistan-sees-record-96-PSDP-utilization-53728>

suggests that this decrease is cyclical rather than policy-driven, and may not be sustainable without deeper expenditure rationalization.

Grants and Transfers increased from PKR 1.76 trillion to PKR 1.93 trillion, mostly due to increased grants to others, indicating more off-budget or contingent financing needs.

Subsidies, on the other hand, reduced from PKR 1.37 trillion to PKR 1.18 trillion. This indicates alignment of budget with IMF conditionalities—a move to rein in untargeted subsidies (particularly in the energy sector). Slight expansion of administrative or salary-related costs is evident from the increase in the running of the civil government from PKR 886 billion to PKR 971 billion. While Provision for Emergency and Others jumped from PKR 223 billion to PKR 389 billion, this is still low because of the country’s vulnerability to climate-related challenges.

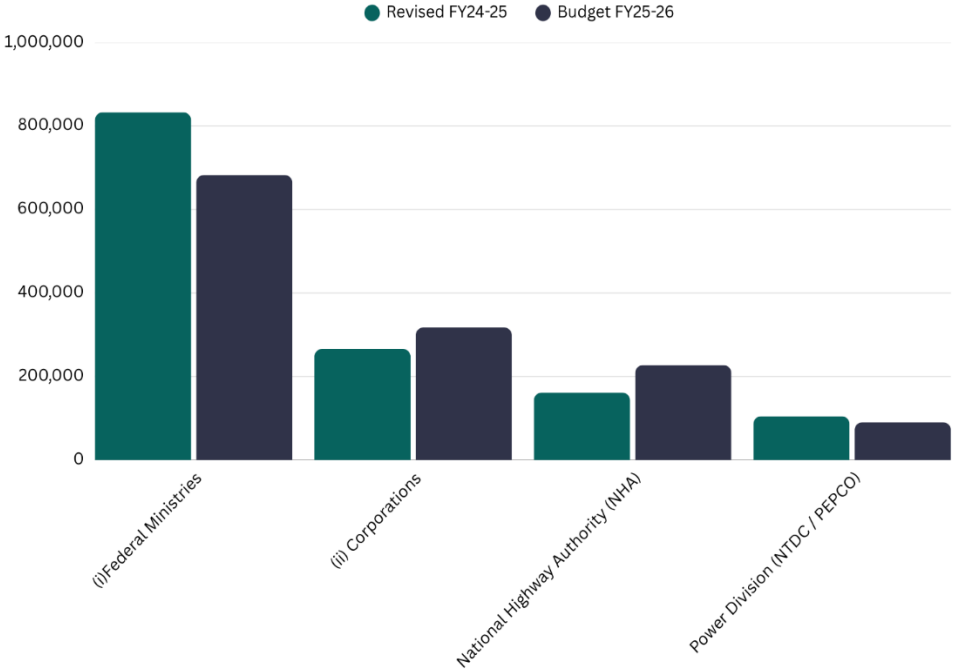
Figure 2: YoY Comparison of components of Current Expenditure



The Public Sector Development Programme (PSDP) allocation for FY2025-26 shows a highly concentrated spending structure. Federal Ministries account for over two-thirds of the total PSDP outlay (PKR 682.8 billion), indicating a centralized development approach where ministries dominate planning and project execution. Corporations receive PKR 317.2. The National Highway

Authority (NHA) receives PKR 227 billion, and the Power Division (NTDC/PEPCO) gets PKR 90.2 billion, highlighting the state-owned enterprises that cost heavily to the budgetary expenditure, underlining persistent investment in energy transmission and system stability.

Figure 3: YoY comparison of components of Development Expenditure



3. Sectoral Allocation and Priorities

Given the expenditure composition above, Pakistan’s budget reveals clear sectoral priorities – and omissions. The major sectors by share of federal spending are those tied to obligatory or strategic needs (debt, defense), whereas human development and social sectors receive a relatively small slice federally (with provinces expected to fill some of that gap). We can assess sectoral allocations in two broad buckets: current expenditure by functional sector, and development expenditure by sector.

3.1 Current Expenditure by Sector/Function:

In functional terms, the largest sector is General Public Services, which includes debt servicing. This alone accounts for around 47% of total expenditure, whereas defense (military affairs) is the

next largest functional sector (~15% of total, as noted). Economic affairs/Infrastructure (e.g., transport, energy subsidies, etc.) and Public order (police, law courts) also feature but are much smaller than the big two. Social sectors (education, health, social protection) in the federal current budget are relatively minor: education and health current expenditures are mostly at the provincial level after devolution, so the federal current budget for these is limited (largely ministry administrative costs). One can infer priorities from the fact that interest + defense outlay (over PKR 10.7 trillion) dwarfs spending on education or health many times over. For instance, the federal Ministry of Education's current budget plus HEC recurring grants pale in comparison to a single day's interest payments on public debt. Social protection in current spending includes schemes like the Benazir Income Support Programme (BISP), which is a federal cash transfer program for the poorest. BISP's allocation for FY26 is PKR 140 billion as part of a broader PKR 734 billion social protection outlay (which includes pensions and other welfare), but even this is less than 0.8% of GDP, modest given the scale of poverty and inflation impact. Overall, the current expenditure structure indicates the government's hands are tied: it must service debt and pay salaries/ pensions and security costs first, which leaves relatively scant fiscal room for proactive social or economic spending.

3.2 Development Expenditure by Sector:

The expenditure mix appears tilted toward consumption and obligation rather than growth-centric investment. With 84-93% of spending absorbed by current expenditures (salaries, interest, defense, pensions, subsidies) and only 7% for development, the budget does not starkly pivot toward growth. The development budget was cut, meaning fewer resources for infrastructure, human capital, or technology that yield future growth. A growth-oriented budget would typically boost development spending, especially in productivity-enhancing areas, but here development outlay is pared back to contain the deficit. Moreover, within development, as discussed, politically driven projects received precedence over perhaps more growth-critical investments in education, innovation, or export industries. That suggests the expenditures are influenced by short-term considerations, and there is a mismatch between some spending priorities and Pakistan's critical national needs. For example, Pakistan desperately needs investment in education, health, and climate adaptation – areas that directly improve human capital and resilience. The heavy allocation

to interest payments is essentially past consumption (paying for yesterday's deficits) – it doesn't contribute to current growth. Defense spending, necessary as it may be for security, does not directly contribute to economic productivity. Thus, one could argue the budget is *not fundamentally development- or growth-driven; it is largely about financing the state's consumption and liabilities*. The government itself touted “fiscal discipline” as a means to long-term growth, but that hinges on subsequent budgets freeing resources for growth, which this budget only marginally sets the stage for. In the near term, growth is expected to be modest (around 3-4%), and that will rely more on external factors and private sector resilience than on a big public spending push.

The budget does little to address structural issues in expenditures, such as reforming the pension system (which will become an even larger burden), tackling losses of SOEs that lead to recurring grants, or reforming subsidies to permanently reduce their cost while protecting the vulnerable. Without such reforms, each year the budget will face the same trade-offs and likely continue sacrificing development when belts need tightening.

The federal PSDP priorities indicate which sectors the government is emphasizing for development. As noted, about 60% of federal development funds go to physical infrastructure (roads, highways, rail) and some energy projects. The transport infrastructure sector (e.g., NHA's road projects, railways) takes the biggest chunk, aligning with the government's goals of connectivity and also the reality that such projects are often highly visible. The energy sector (power generation, transmission) is another major recipient, crucial for reducing load-shedding and supporting industry. Water infrastructure (dams, canals) also sees significant funding (over 13% of PSDP). By contrast, education and health development projects together are around 5–6% of the PSDP (roughly Rs 53 bn for HEC and education, Rs 14 bn for health). Other sectors like IT, housing, climate change, etc., each get only a tiny share (generally under 2% each of the PSDP). Provincial ADPs, however, are said to be largely focused on education, health, water supply, and other social services. This is by design of the 18th Amendment: provinces now prioritize social sector investment, while the federal government handles big infrastructure and national projects. In total, if one includes provinces, the social sector development spending is larger, but at the federal level, the sectoral allocation skews toward hard infrastructure over human development.

4. Key observations on priorities:

The budget's spending pattern appears skewed more toward sustaining the government and debt (consumption) than toward new growth initiatives. The decline in development spending (especially in education, health, and technology) suggests the budget is not strongly growth-oriented in the short term. It prioritizes stability and meeting financing requirements (a “survivalist budget” under IMF constraints) over big expansions in productive or pro-growth expenditures. While infrastructure can boost growth, the emphasis on roads over, say, education and R&D could be questioned in terms of long-term growth quality.

Outside the budget, many SOEs (in power, PIA, railways, etc.) run losses that eventually require fiscal support. The budget allocated PKR 255 billion in development funding for SOEs' projects, but their operational losses and debt remain an ongoing risk. For example, the power sector's circular debt is being addressed partially by budgeted payments, but not fully; residual amounts are being rolled over as debt. If reforms in those sectors falter, the government may have to assume more debt. This would raise debt servicing further and derail fiscal consolidation.

In the big picture, sustainability is precarious: the budget *does* show a primary surplus, meaning that if achieved, debt would eventually stabilize. However, the public debt is so large and expensive that even a 3.9% fiscal deficit keeps adding to the debt stock (albeit at a slower rate). To truly ensure sustainability, Pakistan needs a combination of continuous primary surpluses, lower interest rates (or debt re-profiling), and solid GDP growth. The budget addresses the first partially, assumes the second, but doesn't strongly catalyze the third due to limited development impetus.

In conclusion, the critical perspective is that this budget was a difficult balancing act in a tough economic context – it manages to impose some discipline and avoid populist spending sprees, but it falls short of being a strategic document for economic transformation.

5. Overview of Federal Revenues:

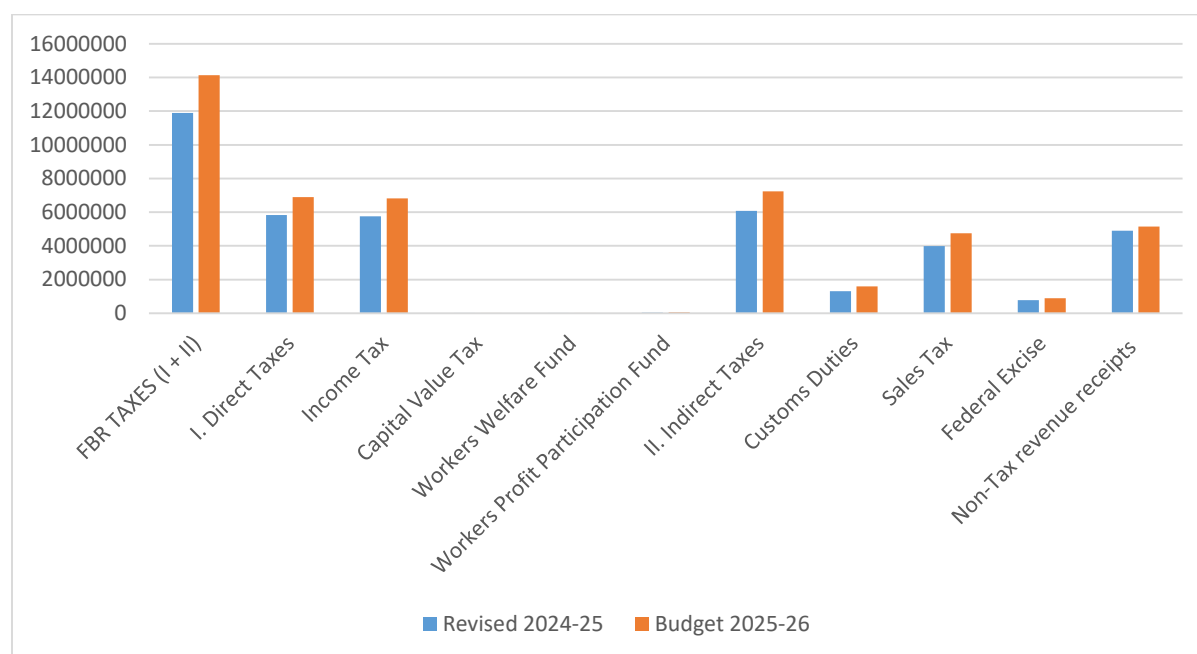
A tax collection target of Rs. 14,131 billion has been assigned to the government for FY 2025–26, representing an increase of 18.8% from the supplementary FY 2024–25 estimate. The revenue strategy remains heavily dependent upon direct taxes, and their estimated contribution would be Rs. 6,902 billion, making up around 48% of the total taxes. This represents a notable shift in tax policies in favor of progressive taxation given that share of direct taxes has increased from 40% to 48% gradually over the years.

Income Tax still leads the direct tax collections, with a goal of Rs. 6,811 billion, marking a growth of 18.5% compared to the revised estimate. This indicates the requirement for further efforts to increase the tax base or enhance compliance/enforcement. Workers Welfare Fund and Workers Profit Participation Fund, despite being very nominal in absolute value in comparison with other taxes, also register 18.5% hikes, suggesting greater formalization or better collections from corporate sources.

The indirect taxes contribute 52% of the total taxes, among which sales tax is the largest component and is projected at Rs. 4,753 billion and up from the revised figure, indicating rate stabilization or exemption reductions. Customs duties and federal excise show modest growth, despite tariff rationalization and reduction of tariff rates and slabs. Non-tax revenue receipts are projected to increase by 5% in FY2025–26, rising from Rs. 4,902 billion (revised) to Rs. 5,147 billion. This modest growth reflects higher expected earnings from sources like petroleum levies, SBP profits, and dividends from state-owned enterprises. While the 2% carbon levy can generate additional profits, the SBP profit may see a decline this year because of the low interest rate compared to last year. Thus, the targeted non-tax receipts could be higher than what can be achieved.

The overall trend signals a policy tilt toward direct taxation, which is a positive move toward equity and efficiency. However, indirect taxes still dominate in absolute terms, posing continued concerns over regressive impacts. Achieving these targets will require robust enforcement, reduction in exemptions, and possibly economic recovery to support compliance and consumption.

Figure 4: YoY Comparison of tax revenues (Rs. Millions)



5.1 Income Tax

The government has also introduced new taxes and reformed the existing taxes. The details are given below for each type of tax and its possible implications on the economy.

- **Changes in Tax Rates**

To rationalize the burden of taxes on the salaried class, the government has revised the tax slabs in the Finance Bill 2025–26. Individuals earning between Rs 0.6–1.2 million annually will see a reduction in the tax rate from 5% to 1%, while those earning between Rs 1.2–2.5 million will be taxed at 11% instead of 15%. For income between Rs 2.5–3.2 million, the tax rate has been reduced from 25% to 23%. While these revisions aim to increase the disposable income of salaried individuals, the relief measures are modest amid persistently high living costs and real wage stagnation. Over the past few years, household purchasing power has continued to erode due to sustained inflation, making this tax reduction too small to ease the financial pressure on middle-income earners significantly.

According to the World Bank, Pakistan's poverty rate has increased, and the shrinking middle class now faces a compounded burden of both direct income taxes and high indirect taxes, particularly sales tax.

The government's decision to reduce the super tax for income earners above Rs 10 million from 10% to 9%, framed as an effort to curb brain drain, also appears insufficient. These individuals already contribute through standard income tax, and a mere 1% reduction in super tax does little to incentivize high-income professionals to remain in the country meaningfully. Similarly, the 0.5% reduction in super tax for corporates lacks strong justification in terms of economic impact or employment creation.

While no significant relief is provided to the salaried class, and even though the retail and wholesale sector accounts for 18–20% of GDP, the budget fails to address this segment with any concrete measures to improve tax compliance or widen the base.

- **Interest Income Tax and Tax on Debt Income**

The Finance Bill also increased interest income tax for high-income individuals by raising it from 15% to 20%. This measure targets individuals who derive significant earnings from bank deposits, term accounts, and other interest-generating instruments, thus aligning their tax liability more closely with their financial capacity.

Furthermore, a flat 25% tax has been proposed on income earned through debt instruments, including Government securities (e.g., T-bills, PIBs), corporate debt, Sukuks, and other interest-bearing financial instruments.

This measure is part of a broader attempt to discourage rent-seeking behavior and equalize the tax treatment of capital income (especially debt income) with that of business or labor income.

- **Tax on Annual Pension receipts**

5% tax on annual pension receipts exceeding Rs 10 million is proposed. However, the scope of the tax is limited because only a fraction of the population earns this much pension.

5.2 Withholding Tax Changes

- **Advance Tax and Withholding Tax adjustment on property transactions**

One of the major reliefs for buyers comes from a reduction in the advance income tax and Withholding Tax (WHT) on the purchase of the property. To facilitate and incentivize transactions, the purchase WHT is reduced as per the following on existing slabs

- From 4% to 2.5%
- 3.5% reduced to 2%
- 3% reduced to 1.5%

The withholding tax (WHT) on the purchase of immovable property has been downwardly revised to support the construction sector. While this reduction in WHT for buyers is a positive step for real estate, which in turn can promote LSM, its potential to significantly boost compliance or stimulate economic activity remains limited. This is because the WHT for sellers has been increased by

- 3% to 4.5% on property valuing up to 50m
- 5% on transactions from 50m to 100m
- 5.5% on transactions above 100m

The increase in advance tax on property sellers across all value slabs is likely to affect the real estate market's supply-demand dynamics. On the supply side, higher transaction costs may discourage property owners and developers from selling, especially in the formal sector, leading to reduced listings. On the demand side, limited supply could drive prices upward in key urban markets, while speculative investors may shift to alternative, less-regulated sectors. Overall, this move could constrain market liquidity and distort natural price adjustments, especially if not paired with reforms that support genuine end-user demand and housing affordability.

Apart from that, property transactions in Pakistan still incur high aggregate costs, including capital gains tax, advance adjustable tax, and other levies. Without a holistic rationalization of the entire transaction cost structure, the WHT cut alone is unlikely to unlock meaningful investment in the

sector. Given that LSM is essential for expanding industrial capacity and exports, stronger and more targeted incentives may be needed.

- **Withholding Tax on Services:**

As a part of the amendments to the Income Tax Ordinance, 2001, the government has increased the withholding tax rate on payments for services. For specified services such as professional consulting, accounting, and legal services, the withholding tax rate has been increased from 4 percent to 6 percent, excluding IT and IT-enabled services, which continue to be taxed at the concessional rate of 4 percent to sustain growth and export potential in the digital sector. For non-specified services, a uniform withholding tax rate of 15 percent will now apply. Additionally, the withholding tax on payments to sportspersons has been increased from 10 percent to 15 percent.

The increase in withholding tax rates from 4 percent to 6 percent for specified services and a flat 15 percent for non-specified services and sportspersons reflects the government's ongoing efforts to enhance revenue from the service sector. However, this approach risks creating further distortions in an already fragmented tax system. Multiple withholding rates across service categories not only complicate compliance but also violate the principle of tax uniformity. This complexity discourages voluntary registration and incentivizes informal operations to avoid the burden altogether. A uniform low tax rate, applied across sectors, would be far more effective in encouraging documentation and broadening the tax base.

- **The Digital Presence Tax Act 2025**

The Digital Presence Tax Act 2025 is an act targeted at international vendors that provide goods and services to Pakistan. The act applies to foreign vendors with a significant presence in Pakistan, whether physically or digitally. These vendors are also liable to pay tax on advertisement payments received from Pakistan. The Finance Bill outlines specific criteria to define the digital presence of a vendor, including annual supplies exceeding PKR 1 million, the presence of user data, local payment processing, etc. These vendors are required to pay a 5% tax, and payment intermediaries—such as banks and licensed institutions—will act as withholding agents.

It is to be noted that the Digital Presence Proceeds Tax Act is different (yet complementary) from withholding tax on offshore digital service fees, which also applies to non-resident vendors and has been increased from 10% to 15%. While Pakistan aims to digitize its economy and broaden its digital footprint, these measures of increasing taxes can discourage Pakistani SMEs and digital entrepreneurs from adopting modern digital tools, slowing down the overall digitization push due to increased costs. Simultaneously, these measures can deter global firms from integrating into Pakistan's digital landscape. As evident from the recent exit of Microsoft in 2025 and the announced exit of Careem in July 2025, new taxes can reduce foreign investments and reduce the availability of advanced infrastructure.

- **Digital Services Tax**

The Digital Transactions Proceeds Levy Act, 2025, introduces a new taxation framework targeting domestic digital business activity. Under this law, earnings from online vendors and gig workers—such as freelancers, ride-hailing drivers, and sellers on e-commerce platforms—will now be subject to a withholding tax. Banks, online payment processors, and courier services have been designated as withholding agents. They are responsible for deducting the levy at the point of transaction: 1 percent of the gross amount for payments made through digital or banking channels, and 2 percent of the gross amount for payments made via Cash on Delivery through courier services. This levy functions similarly to a digital sales tax or GST collected at source, allowing the government to expand the tax base to include the rapidly growing e-commerce and gig economy sectors, areas that have historically remained underreported and lightly taxed.

5.3 Sales Tax

- **Sales Tax on Solar Panel Imports**

The Finance Bill 2025–26 introduces an 10% sales tax on the import of solar panels, ostensibly to harmonize with the domestic solar industry. However, this move contradicts Pakistan’s stated commitments under the National Climate Change Policy and international clean energy goals. At a time when global energy markets are shifting toward renewables, such taxation risks discouraging solar adoption, particularly among middle-income households and small businesses. Tax on Solar also hurts the agriculture sector, where small farmers are moving towards sustainable energy instead of relying on the power sector. An imposed tax may provide short-term revenue gains, but it could undermine long-term benefits like reduced fuel import dependence, lower circular debt, and climate resilience.

- **New Energy Vehicles Levy:**

In the budget, the government has introduced the New Energy Vehicles (NEV) Adoption Levy Act, 2025, which places a special levy on all new internal combustion engine vehicles, whether locally manufactured or imported. The rate on different engines will be as follows.

- 1%: ICE vehicles and motorcycles with engine capacity < 1,300 cc
- 2%: ICE vehicles with engine capacity 1,300–1,800 cc
- 3%: ICE vehicles with engine capacity > 1,800 cc
- 1%: ICE buses and trucks (regardless of engine size)

Electric and zero-emission vehicles are exempt from this levy. In addition, the general sales tax on cars under 850cc, which previously enjoyed a concessional rate of 12.5 percent, was raised to a uniform 18 percent to remove distortions.

The NEV aims to discourage fossil-fuel vehicles by imposing a special levy on all new internal combustion engine vehicles and removing the concessional sales tax on cars under 850cc, raising it to 18 percent. While the policy aligns with Pakistan’s climate goals, it risks placing an additional financial burden on consumers without creating viable alternatives. Increasing sales tax on small

cars will make even basic vehicles unaffordable for low and middle-income groups, reducing mobility options rather than supporting a green transition.

- **Carbon Levy on Fuels:**

The Government has imposed a carbon levy of Rs 2.5/liter on petrol, diesel, and furnace oil. This is essentially a carbon tax embedded in fuel prices. It is projected to raise Rs45 billion² in FY2026. The levy will increase to Rs. 5/liter in FY2027. This measure aims to internalize the environmental cost of fossil fuels and encourage cleaner alternatives. In theory, making carbon-intensive fuels more expensive should discourage their use and generate funds that could be used for climate projects.

5.4 Tariff Rationalization:

National Tariff Policy 2025-30 has been announced by the government to simplify the customs structure and gradually reduce import duties on raw materials, intermediate, and final goods. In case of the structure, 4 customs tariff slabs: 0, 5%, 10% and 15% have been introduced. In the first phase, FBR has abolished Additional Customs Duty (ACD) on the import of goods falling under the customs duty slabs of zero percent, 5 percent, and 10 percent from July 1, 2025³. The Regulatory Duty (RD) on the import of 1,022 items has also been reduced. For industries such as textiles, engineering, chemicals, etc., the imported inputs will become slightly cheaper, which could improve their competitiveness. This is in continuation of Pakistan's transition from protective tariffs toward a more open trade regime in line with the IMF/WTO recommendations.

The economic rationale behind these reforms is simple: reducing import duties on raw materials and intermediate goods lowers input costs, which in turn can enhance productivity, reduce the cost of production, and improve the competitiveness of export-oriented industries. This move is especially important in light of past protectionist policies, which often insulated inefficient

² <https://www.dawn.com/news/1918333/budget-2025-26-era-of-amnesty-schemes-is-over-says-aurangzeb>

³ <https://www.brecorder.com/news/40370673/fbr-abolishes-acd-on-imports-under-0pc-5pc-and-10pc-duty-slabs>

domestic industries, discouraged innovation, and increased costs for downstream manufacturers. By contrast, a lower and more predictable tariff structure encourages industrial upgrading, deeper participation in global value chains, and fairer competition.

Tariff rationalization is expected to enhance trade compliance and encourage higher volumes of documented imports. Despite a reduction in certain tariff rates and the withdrawal of Additional Customs Duties (ACDs) on many items, the Federal Board of Revenue (FBR) has set a significantly higher customs duty collection target, underscoring its expectation of a net positive revenue effect. According to budget documents, actual customs duty collection in FY 2023–24 was Rs. 1,211 billion, which was later revised upward to Rs. 1,324 billion. For FY 2024–25, the government has projected customs collections to reach Rs. 1,591 billion—a notable 20% year-on-year increase. This rise, despite reduced rates, clearly indicates that the government expects higher import volumes, improved compliance, and a broader tax base to more than compensate for the rate cuts.

5.5 Withdrawal of Federal Excise Duty on Property Transfers:

The government has abolished the 7% FED that previously applied to the transfer of commercial properties, plots, and houses. This eliminates a key cost burden that often discourages the formal registration of transactions and inflates end-user prices. Thus, it can stimulate the real estate and housing sector by lowering the overall cost of formal property transactions. Alongside this, the budget also penalizes non-filers by introducing higher WHT taxes for them, thus effectively targeting speculative investments that operate outside the tax net. These measures can encourage greater documentation and help improve access to formal housing finance, especially in urban centers.

Similarly, Stamp duty in Islamabad, one of the key transaction costs in property deals, has been significantly reduced from 4% to 1% in the FY 2025–26 budget. This move sets a precedent, and if replicated by other provinces, could lead to a broader revitalization of Pakistan’s formal real estate market.

6. Suggestions for Improving Expenditure Efficiency and Revenue Enhancement:

To improve expenditure efficiency and enhance revenue collection, the following suggestions are provided.

6.1 Prioritize Expenditure Reforms in Rigid Areas:

Launch reforms in areas like pensions, subsidies, and government administration to gradually reduce the rigid burden. For example, pension reform (such as shifting to contributory schemes for new hires, or merging military and civilian pension pools for better management) can slow the exponential growth of the pension bill. Similarly, continuing energy subsidy reforms, as planned with better targeting for electricity and gas, will reduce wasteful spending. Rationalizing the size of government (e.g., merging redundant departments, curbing non-essential administrative costs) can also free up some resources without harming core functions.

6.2 Public-Private Partnerships (PPPs) for Infrastructure

To relieve the budget, Pakistan can engage the private sector in infrastructure development. Projects in power, transport, logistics, and even social infrastructure (hospitals, schools) can be structured as PPPs, attracting private investment and expertise. This would reduce the PSDP burden and potentially deliver projects more efficiently, as long as contracts are well-structured and transparently bid. The budget's constraints make a strong case for leveraging private capital for development needs, with the government's role shifting to enabler and regulator.

6.3 Broadening the Tax Base:

Even after decades of debate regarding tax reforms, no genuine effort has been put forward by the government toward reducing overall tax rates, reducing distortive levels of taxation, or toward uniform taxation. Distortions in the tax system of Pakistan continue to persist, such as a 10% sales tax on imported solar panels and 18% on domestically manufactured ones—undermining the policy uniformity. Instead of stimulating domestic industry, this disparate treatment foments confusion as much as it does investor distrust.

A larger share of taxation in sectors such as manufacturing that contribute approximately 14% to GDP yet bear 58% of the tax wedge when compared to the retail sector contributing 18% to GDP while paying only 4% in taxes⁴ indicates that the taxation structure taxes the productive formal sector while leaving big informal sectors under-taxed and more or less unaccountable. This gap not only discourages industrialization and investment, but also maintains structural imbalances in the economy. Furthermore, digital tax reforms are being rolled out without sufficient piloting or user research, making them a source of friction for companies as much as for consumers. The result is a policy environment defined by unpredictability and weak implementation, with reforms that aim to widen the tax base more often than not becoming counterproductive.

What's missing is not only a coherent tax policy but also an effective tax administration. Enforcement remains selective while capacity remains underutilized, whereas loopholes, exemptions, and regressive taxes continue to dominate the system. Unless significant structural reforms such as simplifying GST, aligning rates across industries and provinces, lowering overall tax rates, and effective use of technology are not undertaken, Pakistan's tax-GDP ratio will not enhance and fiscal space for development and delivery of public services will never be generated.

6.4 Debt Management and Reduction:

Proactive debt management is key. This means not just aiming for primary surpluses, but also exploring debt re-profiling or negotiations to ease the interest burden. For external debt, seeking lower-interest, long-maturity loans (as the new Resilience and Sustainability Facility from the IMF aims to do) can help. For domestic debt, diversifying the investor base (encouraging non-bank investors, perhaps through Islamic instruments or pension funds) and lengthening maturities would reduce rollover risk. Over the medium term, as primary surpluses are maintained, setting debt-to-GDP reduction targets (e.g., bring it down by say 10 percentage points over 5 years) can anchor fiscal policy and restore buffers. This will gradually shrink the portion of the budget eaten by interest, freeing resources for other uses.

⁴ Pakistan's Fiscal Crisis by Naghma-e-Tehniat Jerral, Consortium for Development Policy Research

6.5 Strengthening Fiscal Federalism

Reforming the fiscal relationship between federal and provincial governments can improve overall expenditure effectiveness. The NFC Award (which dictates provincial revenue shares) could be revisited to encourage provinces to raise their revenues and use funds more prudently. For example, incentives or conditions for provinces to spend on health/education or maintain surpluses in downturns could be built in. A National Fiscal Council could coordinate fiscal policy across governments, ensuring that provincial surpluses or deficits align with federal needs. Without better coordination, federal budgets will continue to assume provincial behavior that might not materialize. Medium-term, a new NFC that addresses vertical and horizontal imbalances and clarifies responsibilities could make public spending more coherent and reduce waste/overlap.

6.6 Public Sector Reform:

Finally, a cross-cutting priority is to reform the public sector's efficiency, including civil service reforms (to control the wage bill growth while improving service delivery) and SOE reforms (to stop the bleeding of enterprises that require government bailouts). For SOEs, a mix of privatization (where feasible) and restructuring is needed so they do not remain a drag on the budget (the government has signaled some intent by budgeting modest privatization proceeds and allocating funds for SOE development projects). Over the medium term, successful reform/privatization of big loss-makers (like the national airline or steel mill) could remove the need for recurring budgetary support to them, saving money. Civil service reforms such as rightsizing bureaucracy, digitization, and performance-based pay can improve output without just increasing costs annually.

Conclusion:

In conclusion, the FY25-26 budget is a tightrope walk aimed at stabilization. It makes hard choices but leaves much to be done to meet Pakistan's development needs. The budget falls short of addressing structural weaknesses in Pakistan's fiscal structure. The absence of serious efforts to harmonize the tax rates and rationalize the sectoral tax burden reflects either a lack of will or capacity to undertake meaningful reforms. In this year's budget, while certain sectors such as tariffs and real estate received some relief, others were subjected to aggressive taxation—most notably the e-commerce sector, which is still in its developmental phase. While the tariff rationalization initiative is a positive aspect of the budget, it cannot be equated and definitely not replaced by tax reforms. This is because Pakistan's structural issues are not rooted just in high tariffs but in chronic high tax rates and a narrow inequitable tax base. Thus the overall lower tax rates and uniform (and low) taxation rates are essential to enhance both tax compliance and tax base.

In addition to that, it is pertinent to mention the budget's reliance on levies and withholding taxes (WHTs) as main revenue instruments, with most of them being regressive, distortive, and burdensome to compliant taxpayers. The proliferation of WHTs on commodities such as banking, telecommunications, and digital services inflates the cost of compliance disproportionately for businesses and individuals alike. Similarly, petroleum levies and carbon levy—which are not shared with provinces—have been ramped up, further straining household budgets amid inflation. This undue reliance on indirect instruments reflects a lack of boldness in reforming basic taxation and a short-term revenue-centric strategy as opposed to a transition toward sustainable and progressive taxation.

Going forward, staying the course on fiscal discipline while aggressively pursuing tax reforms to boost revenues and trim rigid expenditures will be vital. Only then can Pakistan gradually redirect its budget from merely paying debts and salaries towards building infrastructure, educating its youth, improving healthcare, and protecting the vulnerable – the expenditures that truly foster long-term growth and social well-being. The recommendations above chart a path in that direction, emphasizing that tough reforms today will pay dividends in more fiscal space and a more resilient economy tomorrow.



TURNING THE TIDE: HOW TARIFF REFORMS CAN RESCUE PAKISTAN'S ECONOMY

BY DR. MANZOOR AHMAD

Trade has long been recognized as an engine of economic growth. Countries that expanded their international trade consistently achieved prosperity more rapidly than those that remained inward-looking. While liberalizing trade may initially lead to trade deficits, the long-term gains, including increased foreign direct investment and improved productivity, often far outweigh the short-term costs.

Countries that isolate themselves through high tariffs and non-tariff barriers risk stagnation as productivity declines. Lack of competition makes domestic industries complacent; the quality of their products deteriorates while prices continue to rise. Although high protective barriers were common in many developing countries until the 1970s, more forward-looking economies such as Japan, Taiwan, and Singapore were the first to take the lead and began liberalizing their import tariffs. Witnessing their success, others including South Korea, China, Vietnam, and Turkey, adopted similar strategies from the 1980s onward, regardless of political system. Today, all these countries boast export volumes several times higher than Pakistan's, although most of them lagged behind Pakistan until about the 1980s.

India and Pakistan were late starters and only began liberalizing their economies under IMF programs in 1991. While India continued steadily until 2006, lowering its maximum tariffs to 10%, Pakistan followed a stop-and-go approach and halted its reform in 2002–03 after reaching a 25% maximum customs duty, excluding sectors like automobiles. Although Pakistan remained less liberalized than its peers, the early 2000s reforms yielded clear results: between FY2002 and FY2007, exports nearly doubled from \$9 billion to \$17 billion. However, when the global financial, fuel, and food crises hit in 2008, tariff reforms were wrongly blamed for the resulting economic turbulence, prompting a reversal of earlier liberalization.

Starting in FY 2008, Pakistan imposed extensive regulatory duties on hundreds of products to curb imports and reduce the trade deficit. These were followed by Additional Customs Duties (ACDs) in 2014, further complicating the tariff structure. These measures turned Pakistan into one of the most inward-looking economies, with detrimental effects on macroeconomic indicators. Poverty, which had declined from 34% in 1990 to 17% by 2007–08, began to rise again. As of 2024, poverty has returned to levels seen before the reform era.

The writer is a member of the Prime Minister's Steering Committee on the Implementation of the National Tariff Policy. He has previously served as Pakistan's Ambassador to the World Trade Organization and as the Food and Agriculture Organization's Representative to the United Nations in Geneva. He also chaired the Board of Directors at PRIME during 2017-2021.

Starting in FY 2008, Pakistan imposed extensive regulatory duties on hundreds of products to curb imports and reduce the trade deficit. These were followed by Additional Customs Duties (ACDs) in 2014, further complicating the tariff structure. These measures turned Pakistan into one of the most inward-looking economies, with detrimental effects on macroeconomic indicators. Poverty, which had declined from 34% in 1990 to 17% by 2007–08, began to rise again. As of 2024, poverty has returned to levels seen before the reform era.

To shield select industries from these complexities, the government introduced a patchwork of concessionary schemes. However, as a World Bank study noted, these disproportionately benefited large, politically connected firms. This diverted investment away from productive sectors and encouraged rent-seeking behavior. The cost of such exemptions is estimated at Rs. 550 billion, nearly half the total customs duty collected. Meanwhile, Pakistan's competitors deepened their integration into regional and global trade agreements, pursued export-led growth strategies, and invested in trade facilitation.

Pakistan's share in global exports has since declined by an average of 1.45% annually, while others surged ahead. Vietnam, which lagged behind Pakistan in the 1990s, aggressively liberalized trade, joined multiple free trade agreements (FTAs), and integrated into global value chains. Between 2001 and 2022, its exports increased more than tenfold to \$370 billion, becoming a key manufacturing hub. Similarly, Turkey, with exports similar to Pakistan's in 1980, embraced reforms and EU integration, reaching \$254 billion in exports by 2022.

In contrast, Pakistan remained outside major trade blocs, failed to diversify its export basket, and remained dependent on low-value goods such as textiles and rice. This lack of strategic engagement and reform has left the country increasingly marginalized, unable to seize global trade opportunities.

Multilateral institutions including the World Bank, IMF, and WTO along with local think-tanks and experts, have been critical of Pakistan's trade policies ever since it reversed its tariff reforms from 2008 onwards. In particular, studies by the World Bank and PRIME, which focused on Pakistan's tariff policies, showed that it has one of the most restrictive tariff regimes in the region, characterized by high average tariffs, numerous regulatory and additional duties, and exemptions that distort the allocation of resources to more productive sectors. These distortions are widely seen as the root cause of Pakistan's export underperformance.

In March 2024, the newly elected government committed to doubling exports during its term. To support this objective, it announced a shift from import-substitution to export-led growth, aiming to integrate more deeply into global and regional value chains. A tariff reform committee headed by the Commerce Minister was established, which, after extensive consultations, produced a new tariff policy for 2025–2030 aimed to reduce the cost of doing business, streamline the tariff system, and restore Pakistan’s competitiveness in global markets.

The main elements of the new policy include:

- Simplifying tariffs into uniform 0%, 5%, 10%, and 15% slabs with no exceptions
- Eliminating Regulatory Duties (RDs) and Additional Customs Duties (ACDs)
- Phasing out exemptions to establish a transparent, neutral tariff regime

The World Bank's GTAP model analysis demonstrated that, contrary to common concerns, the proposed tariff reforms are unlikely to harm the balance of payments or customs revenue. On the contrary, the model projected a reduction in the trade deficit, alongside increases in exports, tariff revenue, investment, and net employment, with imports rising more slowly than exports. The reforms are also expected to improve allocative efficiency by channeling resources toward more productive, export-oriented sectors.

Pakistan stands at a pivotal crossroads. After decades of trade policy reversals and missed opportunities, the 2025–2030 tariff reform plan offers a much-needed reset. The GTAP model's projections and the experience of many successful developing countries reinforce the argument that a transparent, simplified, and outward-looking tariff structure can reinvigorate exports, stimulate investment, and create jobs. But reforms on paper are not enough. Their success will depend on swift implementation, clear communication, and political commitment. If managed well, these steps can finally help Pakistan reclaim its lost ground in global trade.



RIGHTSIZING THE GOVERNMENT: NOTHING IS BINDING, AND THERE'S NO DEADLINE

DR. KHALIL AHMAD

It is a vacuum. There is no push, nor any driving force. That is why what one witnesses is the dead governance, the SOE governance also. Here is the evidence: the SOEs' profit falls as power sector losses hit Rs.5.9tr.

If one traces the movement of the government's statements and its actions regarding the four areas that this report focuses on, that is, 1) physical size of the government, 2) non-development spending, 3) power sector reforms, and 4) liberalization and deregulation, what one finds is a zigzag with no specific direction.

For example, after more than a year of noise under this coalition government created around the theme of rightsizing and downsizing of the departmental size of the federal government, including the number of employees, here is the backtracking.

“Rightsizing delayed as focus shifts to FBR

ISLAMABAD: Moving well past its original June deadline for completing the rightsizing of the federal government, the Cabinet Committee on Rightsizing (CCR) turned its attention to reforming the Federal Board of Revenue (FBR), describing it as “at the core of Pakistan's fiscal architecture.” [Dawn - July 9, 2025]

During the period under review, it is only in the housing ministry that 1,847 posts are reported to have been abolished; however, 945 of those posts were abolished earlier, and the remaining 902 posts were declared as dying cadre. Regarding this, other reports are future-oriented.

A bit of the good news is that in the Senate panel, the income tax bill (rightsizing of government) has been deferred, but the relevant body of the National Assembly has approved the same bill.

As far as the Utility Stores Corporation, there are mixed reports. One report says 1,203 stores have been closed; another reveals that a panel of the national assembly appeals for a review of USC's divestment. Yet, another report tells that, in the budget, USC's demand for Rs.66 billion has not been granted. So, the net result somehow is positive.

In the case of power sector reforms, there are no positive signals. Mostly the things are messy there. Neither a single DISCO nor a GENCO is on the track to be privatized soon. So far as the privatization of DISCOs is concerned, the new buzzword is the Turkish model to be followed.

Likewise, in the case of giant SOEs, the selling of the PIACL is nowhere on the horizon; only the zigzag movements are identifiable. However, the case of Pakistan Steel Mills has finally found a clear-cut way out, and an agreement between Pakistan and Russia has been signed to revive and expand the Pakistan Steel Mills.

The Roosevelt Hotel in New York is yet to see a final decision regarding the way it will be disposed of.

The same is the case with other SOEs, while the losses of only 15 SOEs surge to a staggering Rs5.9 trillion.

The power sector is sucking the blood of the people, and everybody knows that it crucially requires urgent reforms, but there is no hurry to enable the people to choose an electricity distribution entity of their choice. The only report states that regarding the Competitive Trading Bilateral Contracts Market (CTBCM), the power division has invited comments from stakeholders.

The fiscal outlook is further clouded by Pakistan's external debt servicing obligations, with nearly \$70 billion due over the next three years (FY2025–28). This staggering repayment schedule leaves little fiscal space.

If the reader is interested in having a look at the “zigzag movement” of the government, a presentation is given below (See Annexure).

Whatever relevant information was reported in various newspapers regarding the incumbent government's efforts to limit its footprint in the economy from April 15, 2025, to July 13, 2025, has briefly been arranged in chronological order with issues and entities collated together.

SECTION-II: Macroeconomic Analysis

Introduction

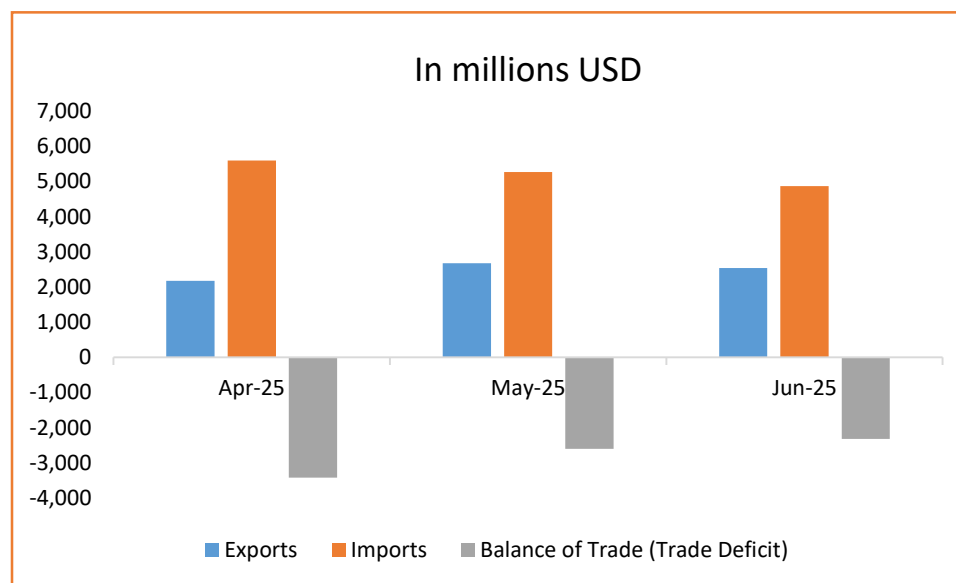
This macroeconomic section provides a general assessment of the economic conditions in Pakistan over the last quarter of FY 2024-25, using macroeconomic indicators. The analysis of growth encompasses data related to trade activity, industrial output, agricultural development, government economic influence, investment flow, financing options, and broad market trends. To evaluate macroeconomic stability, a focus on inflation and external sectors will be taken.

1. Economic Growth

External trade, productivity, and agricultural development are used to study a broader economic picture, anchored by a focus on growth. Monthly and cumulative data on exports, imports, and trade deficits are presented, followed by industrial production, which is scaled by the Quantum Index of Large-Scale Manufacturing (QIM).

1.1 Imports and Exports

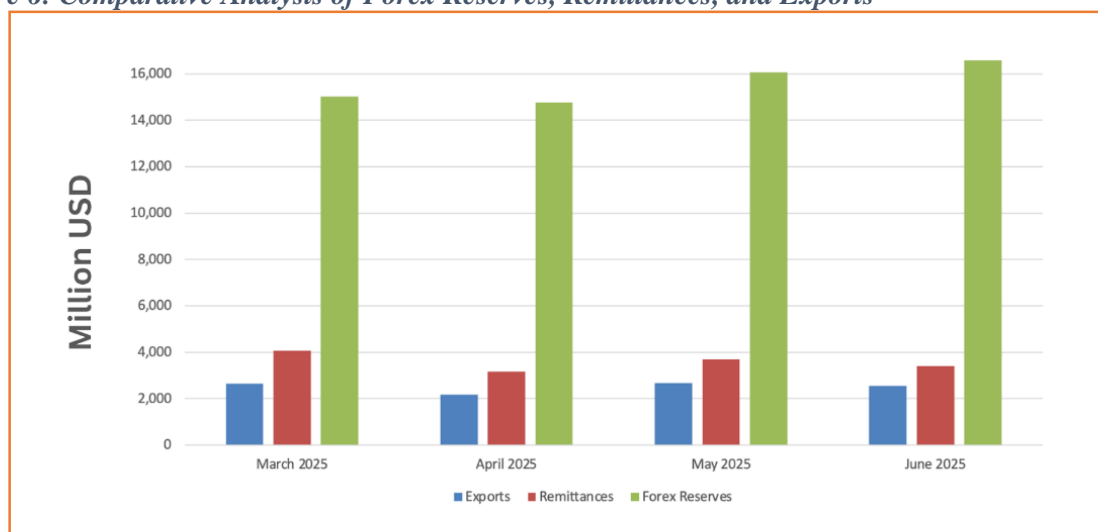
Figure 5: Imports, Exports, and Trade Deficit



Source: Pakistan Bureau of Statistics (PBS)

Data sourced from the Pakistan Bureau of Statistics (PBS) indicates Pakistani exports decreased by 17.66% month-on-month (MoM) over April 2025, with a \$2.1 billion reach from a previous \$2.6 billion in March 2025. Imports, however, increased by a whopping 16.22% from \$4.8 billion in March 2025 to \$5.6 billion in April 2025. Zooming out for a year-on-year (YoY) analysis, PBS indicates that exports fell by 5.77% from April 2024 to April 2025 while imports increased by 15.79%, which pushed an additional 37.6% YoY trade deficit, alleviating a much larger MoM deficit of 57.26%. In May 2025, exports increased to \$2.6 billion, showing a 22.9% increase. On the other hand, imports decreased by 5.77%, leading to a much needed decrease of just under 24% in the trade deficit. However, a YoY analysis from May 2024 to 2025 exhibits a 25.3% increase in trade deficit, a decrease of 5.88% in exports, and an increase of 7.28% in imports. In June 2025, exports and imports both decreased by 4.79% and 7.08% respectively. Exports went from \$2.6 to \$2.5 billion, whereas imports went from \$5.2 to \$4.8 billion. The trade deficit dropped by 9.47%. Moving towards a YoY basis, exports decreased by a mere 0.59%, imports decreased by just under 2%, and the trade deficit decreased by 3.45%. For the concluding quarter of FY 2024-25 (July-June), a total cumulative export trend demonstrates a 4.67% increase from FY 2023-2024—from \$54.7 to \$58.3 billion. Additionally, imports also increased by 6.57%, contributing to a 9% increase in the trade deficit as compared to FY 2023-24, presenting a cumulative trade deficit of \$26.2 billion. Overall, a noticeable trend of falling trade deficits over the past three months can be observed.

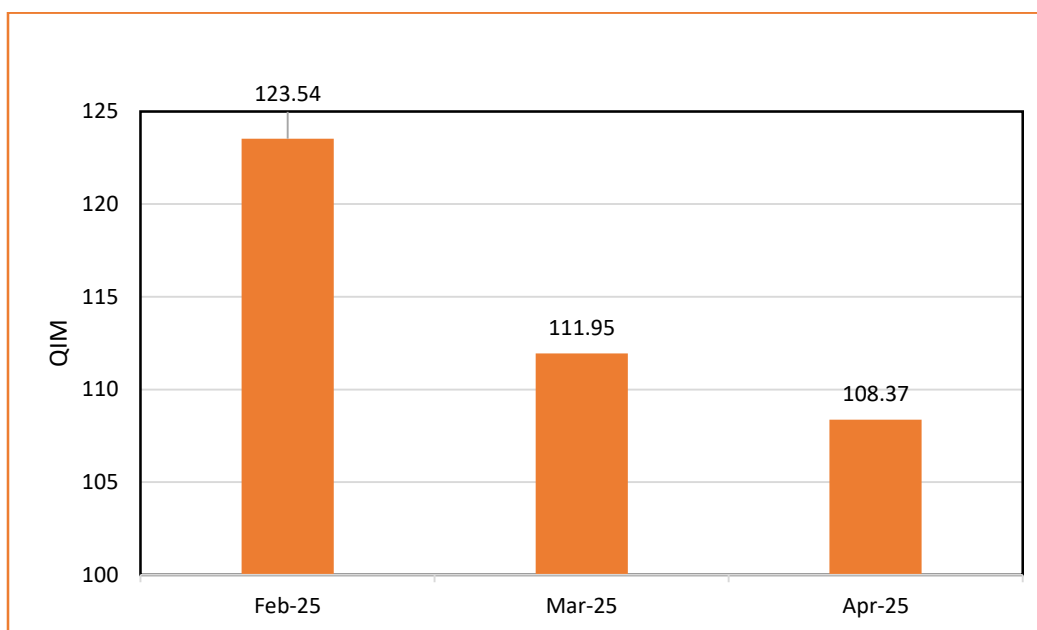
Figure 6: Comparative Analysis of Forex Reserves, Remittances, and Exports



Source: State Bank of Pakistan and Pakistan Bureau of Statistics

1.2 Quantum Index of Large-Scale Manufacturing

Figure 7: Monthly Quantum Index of Large-Scale Manufacturing (QIM)



Source: Pakistan Bureau of Statistics

The Large-Scale Manufacturing (LSM) sector in Pakistan showed a declining trend in the final quarter of FY2024-25, according to the Quantum Index of Manufacturing (QIM). After a modest 2.09% month-on-month (MoM) increase in January 2025 (129.86), the index dropped consecutively in the following months, as shown by 123.54 in February, 111.95 in March, and 108.37 in April 2025. This downward movement erased earlier gains, resulting in an overall year-on-year (YoY) contraction for the first ten months of the fiscal year. The persistent decline reflects ongoing challenges, including high production costs, weak domestic demand, and lack of incentive for investment in key industries.

An overall decline in growth of 1.21% as compared to indices observed in FY2023-24 can be mainly attributed to Textile (0.46) Garments (0.80), Petroleum Products (0.33), Automobiles (0.78), Food (-0.41), Non Metallic Mineral Products (-0.51), Iron & Steel Products (-0.43), and Electrical Equipment (-0.38). Textile and garments have shown promise due to rising demand from export markets, as indicated by the previous quarter as well. However, industries that contributed to dragging down LSM performance include Food, Non Metallic Mineral Products, and Iron and

Steel. These may also reflect domestic challenges such as stagnating and contracting demand, increased input costs, such as energy shortages, and delayed investment recovery in capital-intensive sectors. Additionally, the sharp drop in the QIM index from January to April underscores the fragility of Pakistan’s industrial recovery, signaling the need for targeted support to revive struggling sectors and stabilize production levels in the coming fiscal year.

1.3 Agriculture Sector

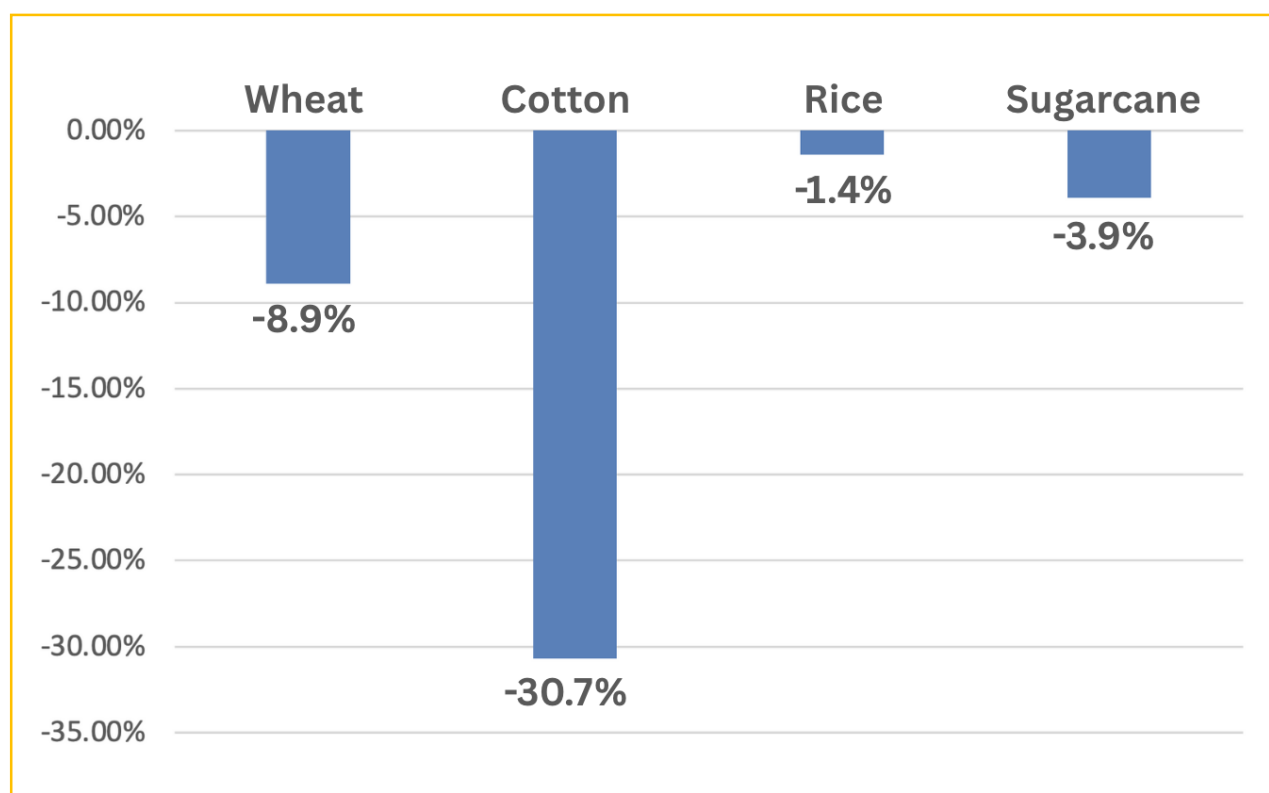
Table 1: Quarterly Change in Agricultural Statistics

| Sectors | 2023-24 (Q2) | 2023-24 (Q3) | 2024-25 (Q1) | 2024-25 (Q2) | 2024-25 (Q3) |
|-----------------|--------------|--------------|--------------|--------------|--------------|
| Agricultural | 5.59 | 3.77 | 7.27 | 1.15 | 0.56 |
| Crops | 10.13 | 2.34 | 13.49 | -5.93 | -6.82 |
| Important Crops | 14.64 | 1.69 | 26.99 | -11.19 | -13.49 |
| Other Crops | -1.14 | -0.6 | -1.68 | 2.08 | 4.78 |
| Livestock | 2.57 | 4.86 | 5.07 | 4.89 | 4.72 |
| Forestry | -1.23 | -3.47 | -2.82 | 0.78 | 3.03 |
| Fishing | 0.82 | 0.83 | 0.86 | 0.82 | 1.42 |

Ministry of Finance, State of Pakistan’s Economy, Half Yearly Report (July-Dec 2024)

Pakistan’s agriculture sector showed mixed performance in FY2024-25, with modest overall growth of 0.56% in Q4 overshadowed by sharp declines in key crops. Wheat production fell by 8.9%, cotton plummeted 30.7%, rice dipped 1.4%, and sugarcane declined 3.9%, contributing to a 6.82% contraction in the crops sector. However, livestock remained resilient with 4.72% growth, while other crops (4.78%), forestry (3.03%), and fisheries (1.42%) provided some offsetting gains. The downturn in major crops reversed the previous year’s strong growth, highlighting vulnerabilities to weather and supply-side constraints.

Figure 8: YoY change in Production of Crops



Source: Finance Division of Pakistan (June 2025)

Despite these challenges, farm modernization efforts continued, with agricultural machinery imports rising 10% to \$69.2 million and credit disbursement growing 15.7% to Rs 2,066.6 billion. Fertilizer demand also surged, with DAP offtake jumping 135.2% year-on-year. Looking ahead, the government has set ambitious targets for Kharif 2025-26, including 10.18 million bales of cotton, supported by improved input availability. While the sector faces near-term pressures, sustained investment in mechanization and inputs could help drive recovery in the coming seasons.

2. Economic Freedom via Government Size

The Heritage Foundation has ranked Pakistan 150th out of 184 countries in its 2025 Index of Economic Freedom, the current score being 49.1. This shows a continuing, although slight, drop from the previous year's score of 49.5. Economic freedom is a composite of different indices such as government size, regulatory efficiency, open markets, and rule of law. Pakistan's tax burden score is 78.3, government spending is 88.9, and government integrity is 28.4. Other notable scores include judicial effectiveness (28.9), fiscal health (8.1), and financial freedom (40). A scale of

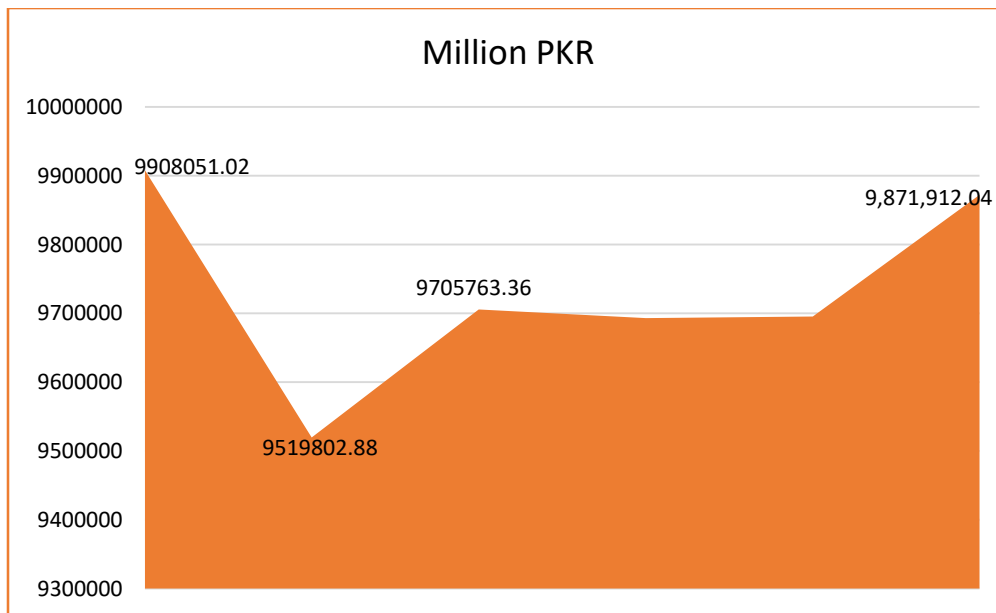
government size is a significant part of economic freedom due to elements such as public spending, subsidies, domestic borrowing, public debt, and transfer—all of which indicate the leeway governmental bodies allow citizens within their economy. Additionally, these factors also contribute to economic stability, credit availability to the private sector, and overall economic growth.

2.1 Credit to the Private Sector

In the first half of FY2024-25, the Private Sector Credit demonstrated an upward trend, which shifted as it approached the close of the third quarter. Upward trends might have been attributed to the second quarter, which features monetary easing, cautious lending, and overall lowering of interest rates that fostered investment. However, over the third and fourth quarter of the fiscal year, the trend declined from PKR 10.82 trillion in December 2024 to a stagnant PKR 9.69 trillion in May 2025.

On a month-on-month basis, PSC stagnated from March to May 2025, with minimal changes from March to April—a 0.12% decrease—and April to May—a 0.03% increase. Although, it did slightly recover from the sharp fall of 8.4% in January 2025 and another 3.9% decrease in the following month by a 1.9% from February to March. The stagnation suggests the caution and delays in new credit decisions by businesses which caused the initial sharp decline has subsided.

Figure 9: Credit to the Private Sector



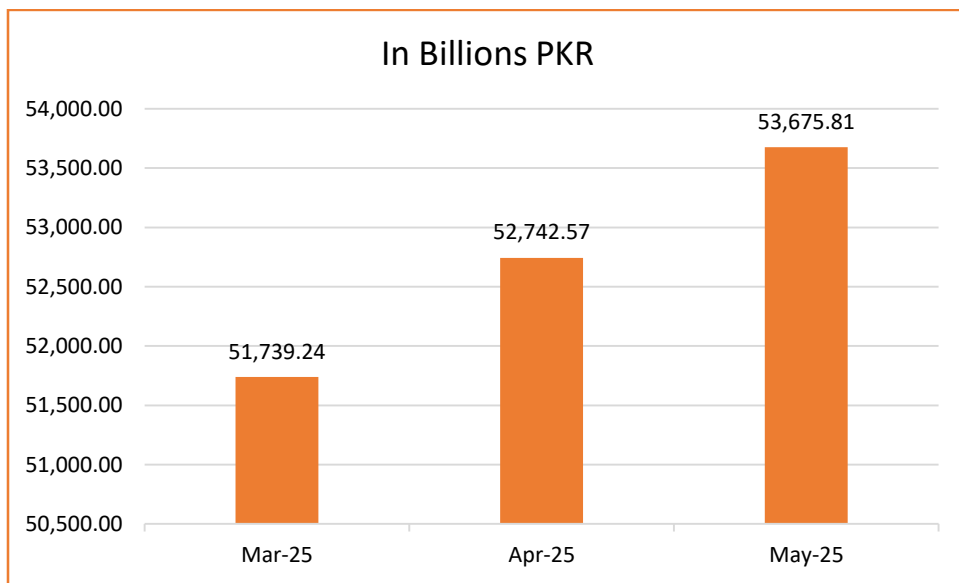
Source: State Bank of Pakistan

The stagnation also suggests any caution that has subsided can also pave way to facilitate more credit access, as shown by the first quarter of FY2024-25 which featured gains supported by improved macroeconomic indicators like declining inflation and lowering governmental restraint. Further policy support and demand in the Pakistani economy can also begin to pull PSC up.

2.2 Government Domestic Debt

The government domestic debt has been continually increasing over the past fiscal year, demonstrating fiscal deficits, high debt servicing costs, and economic dependence on domestic borrowing. Factors such as domestic debt also create investor hesitance due to uncertainty, progressing unsustainability, and overall economic paralysis.

Figure 10: Government Domestic Debt



State Bank of Pakistan

This trend has been consistent since the second quarter, now increasing in March 2025 from PKR 51.7 trillion to PKR 52.7 trillion in April and reaching a concerning PKR 53.67 trillion. This major YoY growth in government domestic debt can be attributed to different factors. For example, rising interest rates, increasingly limited financing options, and increased domestic borrowing. In the

same line, a significant chunk of this debt is considered “permanent,” typically pertaining to federal government bonds, and prize bonds.

3. Business Environment

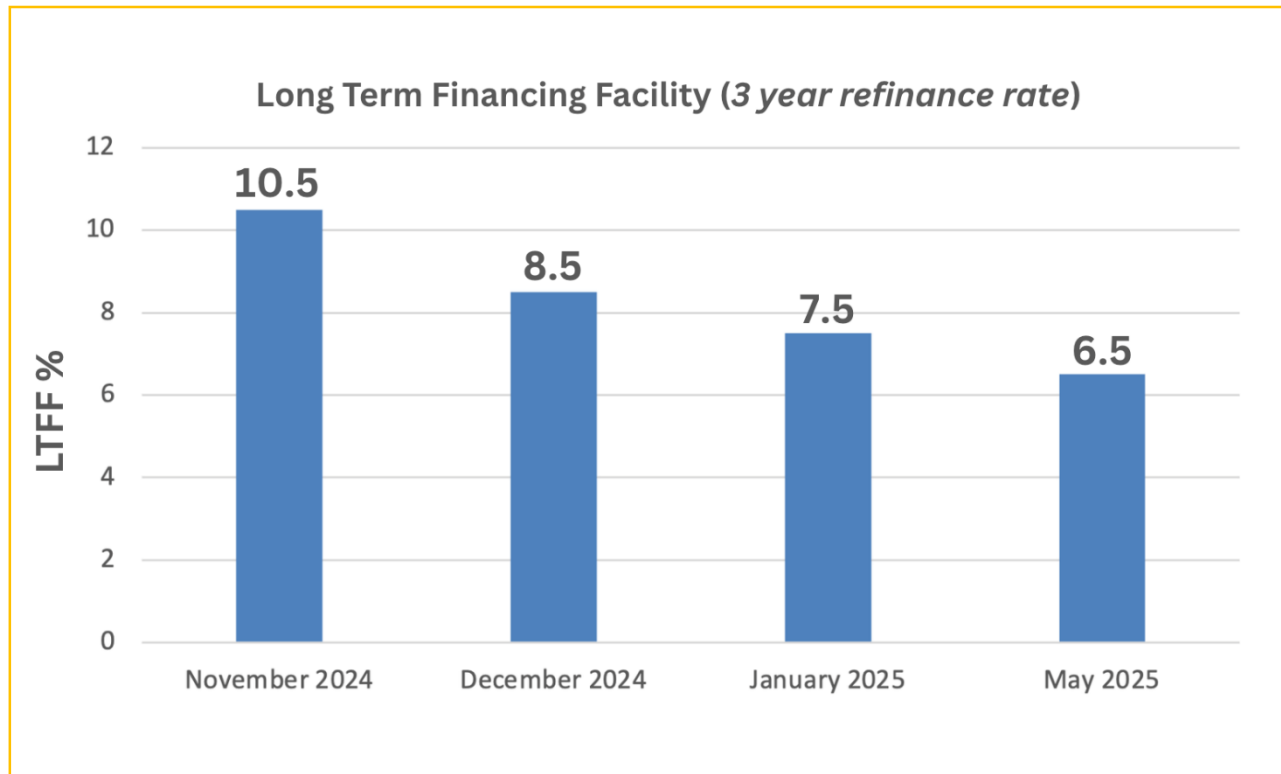
In the third quarter of FY2024-25, the business environment was impacted by many factors including the Long-Term Financing Facility (LTFF), constant performance of stock market, the shifts in foreign direct investment (FDI). These also reflect the overall investment opportunities, and capital allocation.

In the fourth quarter of FY2024-25, business environments have been impacted by various factors such as the Long-Term Financing Facility (LTFF), constant performance of the stock market, and changes in foreign direct investment (FDI). These also reflect overall investment conditions and opportunities, and how changes in capital allocation can impact business ecology.

3.1 Long-Term Financing Facility (LTFF)

The LTFF was established to support export-oriented industrial projects in need of assistance due to fiscal deficits, economic uncertainty, and reduced production. In the previous third quarter of FY2024-25, the LTFF rate for refinance up to 3 years sharply declined from 10.5% to 8.5% in December. However, it has begun to stagnate from a mere 7.5 to 6.5 from January to May 2025. The decline of LTFF could become a source for industrial expansion; however, not indicate significant growth due to recent plateauing. Although a gradual stagnation may indicate falling reliance, the Pakistani Economy is infamous for uncertainty and unpredictability. Alas, no conclusions can be made from this by itself. However, by looking at other macroeconomic indicators such as Foreign Direct Investment (FDI) and stock market performance, a more absolute conclusion can be reached.

Figure 11: Long-Term Financing Facility (LTFF)

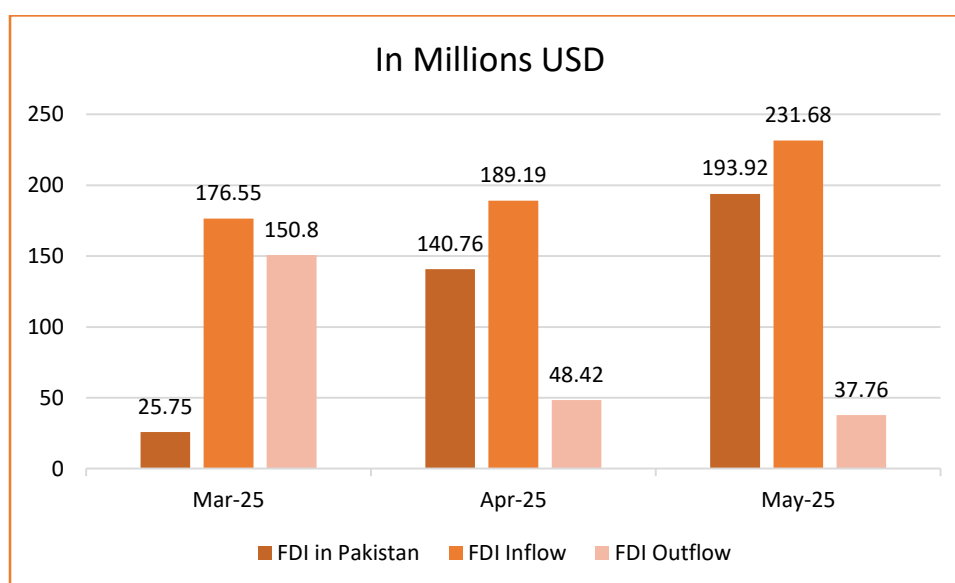


Source: State Bank of Pakistan

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3.2 Foreign Direct Investment (FDI)

Figure 12: Foreign Direct Investment Inflow, Outflow, and Pakistan



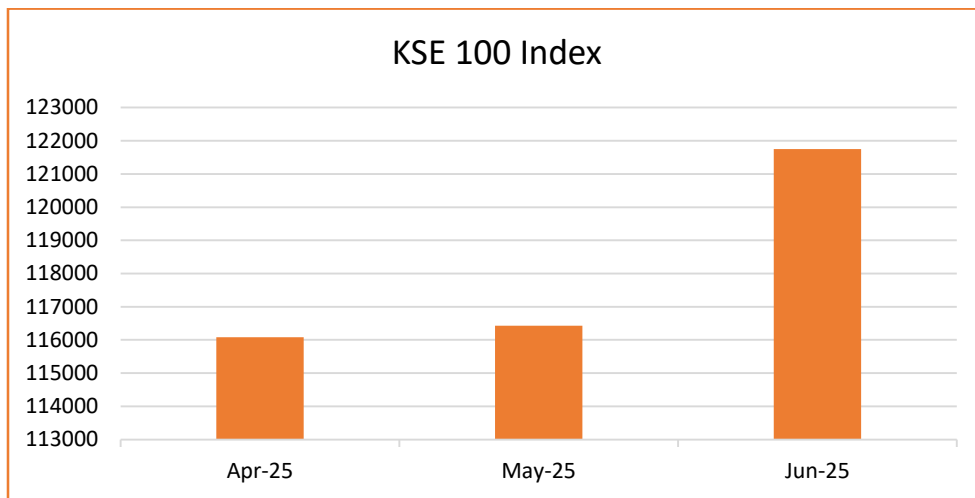
State Bank of Pakistan

Foreign Direct Investment (FDI) is crucial to any economy, but is especially needed in Pakistan's context. The flow of capital is essential to transferring technology, boosting labor productivity, increasing employment, opportunities, and overall output to place an economy at the forefront of global competition. However, FDI demonstrated mixed performance in the previous quarter (December 2024 to February 2025). At the end of the final quarter in FY2024-25, with the last reported FDI data being from May 2025, it can be concluded that FDI has been gradually increasing. Net FDI in March 2025 was US\$25.75 million, with inflows at US\$176.55 million and outflows at US \$150.8. The following month observed a drastic increase in net FDI of US\$140.76, a notable increase in inflow at US \$189.19 and an outflow decrease at US\$48.42. The drastic increase in net FDI can be attributed not to a relative increase in inflows but to a drastic decrease in outflows. Over May 2025, the net FDI increased further at US\$193.92, which *can* be attributed to an increase of investment inflow of US\$231.68, and a slight decrease in outflow of US\$37.76. The changes in FDI reflect further increased investor caution amid ongoing macroeconomic and political uncertainty in Pakistan, with global risk aversion considering emerging markets added to the mix.

3.3 Stock Market Performance

The KSE-100 index in the final quarter of FY2024-25 demonstrated improving macroeconomic indicators as it reached 121,752 points in June 2025. This has been a notable increase from April (116,078 points) and May (116,429 points). April and May were both a decline from the performance that the stock market showed in March (117,606.74 points), increasing 4% from February. However, contrasting against the previous quarter's stock market performance, which rose due to an increase in remittances, April, May, and June saw a fluctuation in remittances.

Figure 13: Stock Market Performance (KSE-100 Index)



Source: Pakistan Stock Exchange

From April to May, remittances increased by 16%, and from May to June, remittances decreased by 7.5%. Thus, performance can be attributed to households and aggregate demand, which contribute to Pakistan's foreign exchange reserves, which amounted to US\$20 billion as last reported on July 4th, 2025.

The KSE-100's upward trajectory in Q4 reflects a broader economic stabilization, driven by resilient household demand, improved forex reserves, and policy reforms. While remittance fluctuations introduced some uncertainty, the market's performance demonstrates growing confidence in Pakistan's macroeconomic management and long-term growth prospects. Furthermore, another major factor that played a role in market performance is the staff-level agreement between Pakistan and the IMF. This focus on fiscal management, tax reforms, and

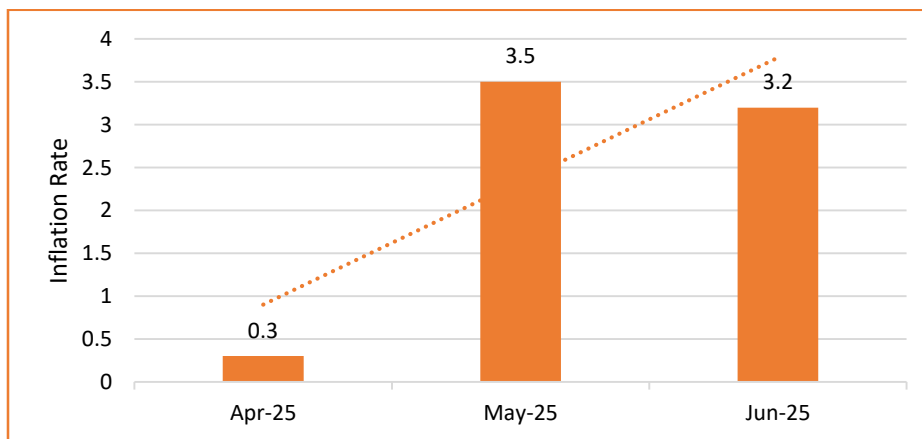
investment opportunities enabled an ease of caution for foreign and domestic stakeholders in the equity market.

4. Macroeconomic Stability

An assessment of the overall macroeconomic stability of Pakistan's economy assess key influencing and indicating factors. To create a macroeconomic barometer, factors that stand out include inflation, exchange rate trends, balance of payments, fiscal deficit, money supply growth, and foreign exchange reserves which show a detailed and multifaceted picture of the economic strengths and challenges.

4.1 Inflation Rate

Figure 14: Inflation Rate



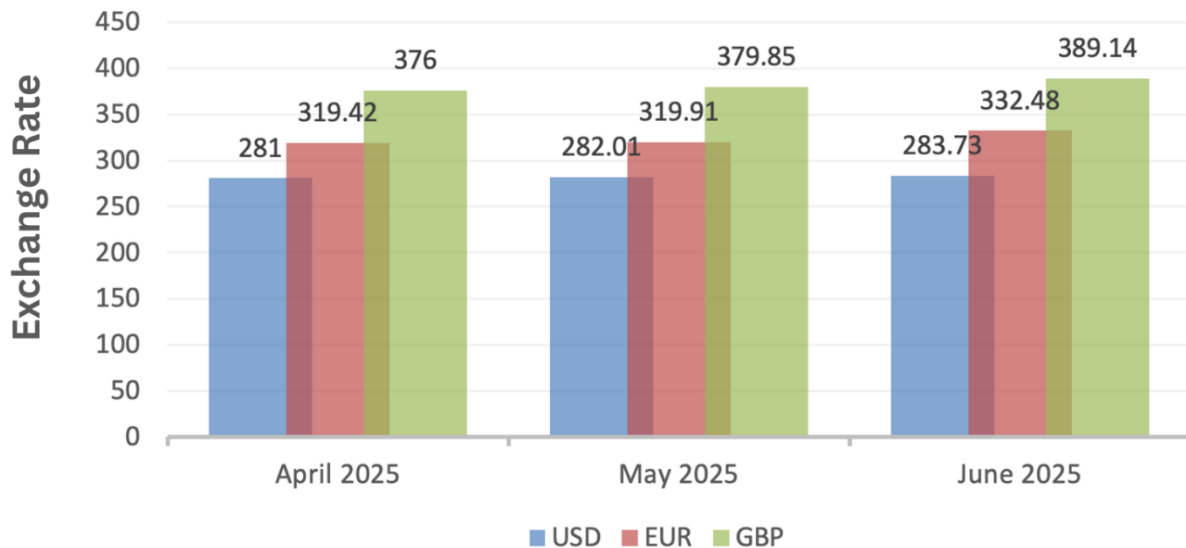
Source: State Bank of Pakistan & Pakistan Bureau of Statistics

The inflation rate exhibited fluctuations in the last quarter of FY2024-25 (April to June). The previous quarter demonstrated a strong decline, which continued into April at a mere 0.3%. However, during May 2025, the inflation rate shot up to 3.5%, a sharp increase which did not calm significantly during June 2025, at 3.2%. However, May and June were significantly demure when compared to inflation rates at the same time in the previous year, 11% in May 2024 and 12% in June 2024. For a YoY basis, June had a 75.6% decrease and May had a 70.3% decrease, painting a relatively positive outlook for Rupee stabilization. If current trends continue within the range of 1.0-4.0% over the next fiscal year, inflation may be under control. However, considering supply

shocks or price volatility, whether domestic or international, which the Pakistani economy is susceptible to, it cannot be concluded that any rupee inflation is out of question.

4.2 Exchange Rate Trends

Figure 15: Exchange Rates (USD, EUR, GBP)



Source: State Bank of Pakistan

The Pakistani Rupee demonstrated depreciation against major foreign currencies such as USD, EUR, and GBP. Although the previous quarter demonstrated significant stability, reflecting ongoing macroeconomic improvements, the final quarter of FY2024-25 experienced fluctuating exchange rates.

The exchange rate amounted to PKR 281 in April, PKR 282.04 in May, and PKR 283.73 per USD in June. This demonstrated a depreciation of 0.97% over three months. The currency also depreciated against the euro, amounting to PKR 319.42 in April, PKR 319.91 in May, and PKR 332.48 per EUR in June—a 4.08% depreciation. However, this was not dissimilar to the 4.2% depreciation over the previous quarter, which demonstrates further increasing Euro Strength.

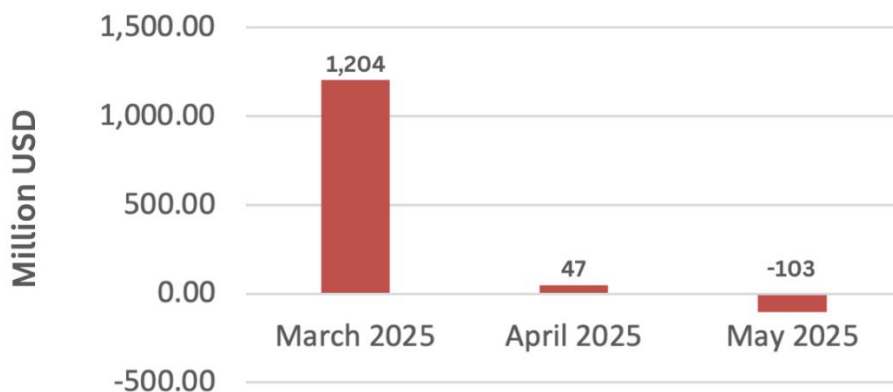
Similarly, the Rupee depreciated 3.49% against the British Pound over three months, a low but observable difference against the 4.6% decline over the third quarter of FY2024-25. The Rupee stood at PKR 376 in April, PKR 379.85 in May, and PKR 389.14 per Pound in June.

This slow depreciation against the major foreign currencies is partly driven by strengthening European currencies amid global market shifts. Additionally, fluctuating remittance inflows and import pressures likely contributed to the rupee's gradual weakening, despite earlier stability from improved macroeconomic indicators.

4.3 Balance of Payments and Fiscal Deficit

Pakistan's external account balances have been experiencing significant instability without any clear signs of stabilization. According to the data provided by the State Bank of Pakistan, Pakistan had an account surplus of US \$ US\$1.204 billion in March 2025, attributed to remittances and a limited trade deficit. However, this trend shifted downwards to US\$47 million in April 2025 and a deficit of US\$103 million in May 2025. The trend demonstrates an increase in imports and primary income outflows, similar to the fluctuating trends in the previous quarter.

Figure 16: Current Account Balance



Source: State Bank of Pakistan

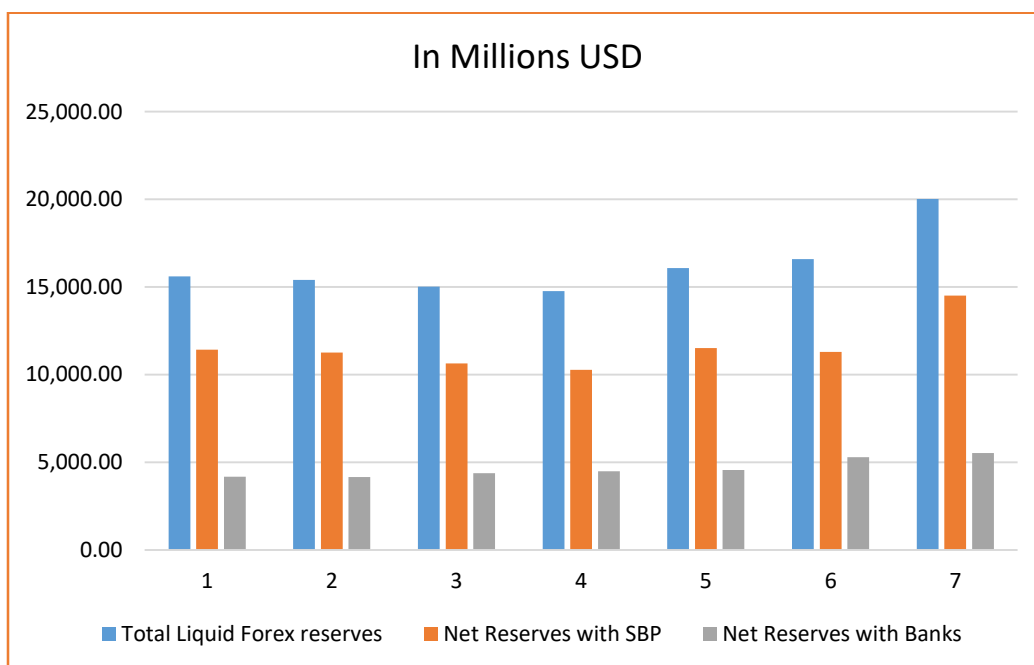
Pakistan's current account performance dropped further compared to the already dropped third-quarter performance. Overall, a current account deficit of US\$103 million during March-May of FY2024-25 has been recorded as compared to a US\$500 million in June 2024. This may be

attributed to the US \$21.8 billion worth of goods exported with a—as of last quarter—7.2% YoY increase. Additionally, remittances may have also impacted the balance.

The deficit following the first month of 2025 demonstrated that, besides improvement in the current account, there are further challenges that may arise in the prices of global commodities or an increase in demand for imports.

iv. State Bank of Pakistan’s Forex Reserves

Figure 17: Total Liquid Forex Reserves



Source: State Bank of Pakistan

Pakistani foreign exchange reserves have recovered from challenging declines in FY2021-22 and FY2022-23, where reserves were US\$15.45 billion and US\$9.16 billion, respectively. The declines were attributed to external debt repayment and continuous trade imbalances that distorted economic stability over the fiscal years.

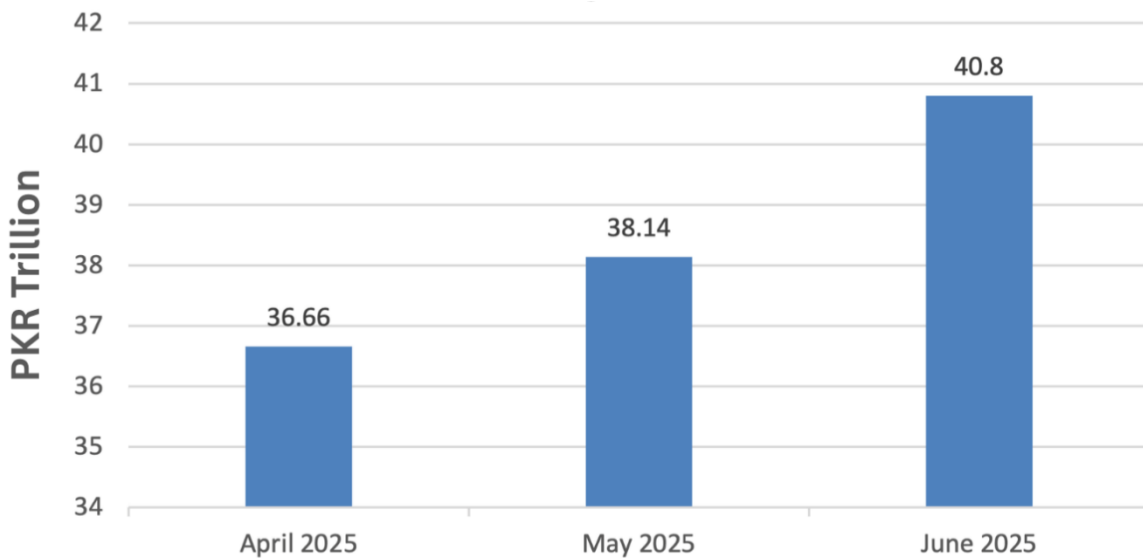
In FY2023-24, total liquid foreign exchange reserves mounted up to US\$13.99 billion by the end of June 2024. In June 2025, the total liquid foreign exchange reserves show a confident increase to US \$20 billion. This upward shift has been continuing throughout FY2024-25, reaching US\$16.13 billion in the second quarter. Reserves fluctuated in the final quarter of FY2024-25 from

April to June, shifting between a low of US \$ US\$14.75 billion in April and a high of US\$16.59 billion in June.

The increase and change in trends from previous years demonstrate increased remittances and support from different financial institutions. The data shows improved foreign exchange position, albeit with some challenges that require economic reforms, increase in exports, and most notably, independence from external borrowing.

v. Money Growth

Figure 18: Money Growth



Source: State Bank of Pakistan

In the final quarter of FY2024-25, money supply or broad money (M2), has continued the upward trend seen in the previous quarter. M2 demonstrated an increase from PKR 36.66 trillion in April, to PKR 38.14 trillion in May, and finally PKR 40.8 trillion in June of 2025. This demonstrated a significant increase of 11.2% over the three months. An increase of liquidity in the economy has been shown in the data. Furthermore, the persistent growth in money supply can be a consequence of many factors, including high government borrowing and loose monetary policy. The increase in M2 might also be beneficial for economic activity and investments. However, with increased activity and investment, it may also contribute to inflation, which needs to be closely monitored and controlled.

Conclusion

Pakistan's economy in the final quarter of FY2024-25 presented a mixed yet cautiously optimistic outlook, marked by recovering forex reserves, moderated inflation, and stock market resilience, but weighed down by industrial contraction, trade imbalances, and rupee depreciation.

While improved macroeconomic stability—supported by IMF-led reforms and rising FDI—signaled progress, persistent challenges like weak LSM growth, fiscal deficits, and external debt pressures underscore the need for structural reforms. Moving forward, sustaining recovery will require enhanced export competitiveness, disciplined fiscal management, and targeted industrial support to balance growth with stability in an uncertain global environment.

1. Physical Size: Government Departments and Employees

- 40,000 posts being axed to save Rs36 billion; one-fifth of savings will come from reducing positions in lowest pay grade-1
- Housing ministry abolishes 1,847 posts; out of these, 945 posts have been abolished while 902 posts have been declared as dying cadre
- Senate panel defers income tax bill (rightsizing of gov)
- NA body approves rightsizing bill
- 1,203 Utility Stores closed under USC's restructuring, NA panel told
- NA panel urges review of Utility Stores Corporation divestment
- USC has not been granted Rs60 billion earmarked for current year, further straining its operations
- Panel on rightsizing reviews matters of railways, maritime affairs ministries
- Rightsizing delayed as focus shifts to FBR

3. Power Sector: Privatization of GENCOs and DISCOs

- Provinces to get control of Discos in two months: PM
- DISCOs fail to slash losses; ECC members voice concern over performance of new boards of power companies
- DISCOs seek recovery of billions; submit tariff hike requests under MYT regime to meet annual revenue needs
- ADB approves plan for digital overhaul of Discos
- PC to appoint FAs for more Discos to assess sell-off potential
- Discos' sell off: 'Turkish model' under consideration
- PAC unhappy with proposed sale of Muzaffargarh power plant, recruitment in PARC
- Govt fails to sell three inefficient power plants
- Auction of power plants draws only one bid
- Govt receives technical bid for Jamshoro power station, no offers for other projects
- Process begins to name advisers for four power companies, two plants
- Ageing power plants auction gets tepid response; this is highlighting both opportunities and challenges in government's broader push for energy sector reforms
- Concerns raised over move to shift Sindh's captive power plants to national grid
- KP budget 2025-26: KP to have own power regulator, provincial assembly told
- SOEs' profit falls as power sector losses hit Rs5.9tr

4. The SOEs: Privatization of PIA, Pakistan Steel Mills, Etc.

- PIA privatisation delayed again; despite IMF commitment, govt unlikely to meet Rs30b privatisation target
- Fresh expressions of interest for PIA
- Govt tightens PIA bidding terms; targets financially sound investors, bars provincial govts from bidding

- Transparency central to PIA privatisation: PM emphasised importance of roadshows and fully engaging investors in privatisation process
 - No expressions of interest received for the divestment of PIACL, the government extended the deadline for submission to June 19.
 - PIA sale draws interest from leading firms, army company ahead of deadline: report
 - 5 bidders join race to buy PIA in revived privatisation push
 - Latest push for privatisation comes amid ongoing fiscal pressure and efforts to reform state-owned enterprises
 - PIACL shares along with management control: Eight potential buyers submit EOIs to PC
 - Govt confident of PIA selloff with IMF waivers, better books
 - Petition against PIA sell-off dismissed
 - Cement makers in race to buy PIA
 - Four 'big names' to bid for PIA
 - Rabbani smells a rat in PIA privatisation
 - PIA incurs net loss of Rs4.6 billion; finance ministry says Rs26b 'accounting profit' is not sign of operational earnings
 - Loans, subsidies, grants and equity: Cash-strapped SOEs receive Rs616bn from govt in first six months of FY25
 - Pakistan, Russia to set up steel mill in Karachi
 - Pakistan wants to establish state-of-the-art steel mill on existing site of Pakistan Steel Mills (PSM)
 - Tribunal reduces penalty on steel mill; the CCP had imposed a penalty of Rs25 million for PSM's anti-competitive and discriminatory conduct
 - Pakistan to revive PSM with Russian assistance
 - Soviet-built PSM: Russia, Pakistan discuss revival
 - Pakistan and Russia signed an agreement to revive and expand the Pakistan Steel Mills (PSM)
 - Privatisation Commission board okays transaction structure for Roosevelt Hotel
 - Govt exploring JV option to run Roosevelt Hotel: Asif
 - Cabinet committee also approves joint venture model for sale of Roosevelt Hotel
 - Roosevelt Hotel sale nears as Pakistan finalises valuation
 - Roosevelt Hotel valuation, investment: Financial adviser firm to charge Rs2.1bn for its services
 - Pakistan eyes \$1bn valuation in Roosevelt Hotel JV
 - Adviser to be hired for ZTBL privatization push; its reform is considered central to improving rural credit delivery and fostering private-sector participation in agri-financing
 - Financial advisers for ZTBL appointed
 - Financial scandal looms over shuttered Railway Construction Pakistan
-
- 23 SOEs drained Rs5.5tr in a decade, NA panel told
 - Govt required to step up efforts aimed at implementing SOE governance framework across all SOEs
 - Rs288bn plan being rolled out for SOEs' growth without federal funding; officials say move signals shift towards performance-based public investment and fiscal self-reliance
 - Govt admits poor SOE governance
 - Cumulative losses of state firms increased to record Rs5.9tr by Dec 2024
 - State-Owned Enterprises: CCoSOEs concerned over staggering losses
 - Country reports losses of SOEs amounting to Rs5.8 trillion
 - Losses of 15 SOEs surge to whopping Rs5.9 trillion
 - SOEs' profit falls as power sector losses hit Rs5.9tr

5. Liberalization and Deregulation

- Electricity market under CTBCM: Power Div invites comments from stakeholders
- Sector-wide reforms initiated
- Digitisation, licensing overhaul, and fee restructuring at core of reform push

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