TECHNICAL ASSISTANCE REPORT

PAKISTAN

Improving Budget Practices

AUGUST 2024

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Fiscal Affairs Department

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Abbreviations

AGP	Accountant General Pakistan
APCC	Annua Plan Coordination Committee
BCC	Budget Call Circular
BSP	Budget Strategy Paper
CGA	Controller General of Accounts
DMO	Debt Management Office
DIPAT	Digitalization of PFM Assessment Tool
EAW	Economic Adviser Wing
ePADS	e-Pakistan Acquisition and Disposal System
FABS	Financial Accounting and Budgeting System
FAD	Fiscal Affairs Department
FBR	Federal Board of Revenue
FRDLA	Fiscal Responsibility and Debt Limitation Act 2005
FY	Fiscal Year (runs July 1st to June 30th)
GDP	Gross Domestic Product
IMF	International Monetary Fund
iPAS	Intelligent Project Management System
MFPU	Macro-fiscal Policy Unit
MTFF	Medium-Term Fiscal Framework
NEC	National Economic Council
OECD	Organization of Economic Cooperation and Development
PAO	Principal Accounting Officer
PDSI	Planning, Development and Special Initiative
PFM	Public financial management
PFMA	Public Financial Management Act 2019
PSDP	Public Sector Development Plan
PSDP-CC	Public Sector Development Plan Call Circular
Rs	Pakistani rupee
SBP	State Bank of Pakistan
SOE	State-owned enterprise
TSA	Treasury single account
CDWP	Central Development Working Party
CPEC	China-Pakistan Economic Corridor
ECNEC	Executive Committee of the NEC
EIA	Environmental Impact Assessment
EME	Emerging market economies
FAD	Fiscal Affairs Department
GHG	Greenhouse gas
GDP	Gross domestic product
IMF	International Monetary Fund

Preface

At the request of the Minister of Finance, Revenue and Economic Affairs of Pakistan, a team from the IMF's Fiscal Affairs Department (FAD) visited Islamabad during December 5-18, 2023 to identify key challenges in budget practices relevant for Pakistan, both at planning and execution stages, and make recommendations to improve these practices. The mission also advised on how digital solutions can be leveraged to streamline and improve Pakistan's budgetary processes.

The FAD team was led by Fazeer Rahim (Senior Economist, FAD) and comprised Sybi Hida (Senior Economist, FAD), Richard Allen, and Soren Langhoff (both FAD experts). The team also benefited from the remote support of Graham Prentice and Claude Wendling (both FAD), and Mr. Ismael Momoniat (FAD expert).

The team held discussions with: Dr. Shamshad Akhtar, Minister of Finance, Revenue and Economic Affairs; Mr. Imdad Bosal, Finance Secretary; Mr. Iftikhar Amjad, Additional Finance Secretary Budget; Mr. Shehryar Sultan, Additional Finance Secretary Expenditure; Mr. Qumar Sarwar Abbassi, Additional Finance Secretary Corporate Finance; Mr. Amjed Mehmood, Additional Finance Secretary Internal and Provincial Finance; Dr. Imtiaz Ahmed, Economic Adviser; Mr. Mohsin Chandna, Director General Debt; Mr. Arshad Hayat, Joint Budget Secretary II; Mr. Obeid Rana, Joint Budget Secretary III; Ms. Iffat Malik, Joint Secretary Provincial Finance; Mr. Adnan Azeem, Director Budget Computerization; and staff of the Budget, Economic Advisor, Expenditure, Corporate Finance, Provincial Finance, Investment and External Finance Wings of the Finance Division.

The team also met with Mr. Maqbool Gondal, the Controller General of Accounts; Mr. Raja Naeem Akbar, Secretary Law, Ministry of Law and Justice; Mr. Mushraque, Joint Chief Economist, Ministry of Planning, Development and Special Initiatives; Mr. Ammar Naqvi, Deputy Auditor General; Mr. Owais Ahmed, Director Financial Accounting and Budgeting System (FABS); Mr. Mujhid Shedil, Finance Secretary Punjab; Mr. Habib-ur-Rehman, Finance Special Secretary Baluchistan; and staff of the Accountant General of Pakistan Revenue (AGP), Controller General of Accounts, Ministry of Planning, Development, and Special Initiatives, Ministry of Law and Justice, the Auditor General Office of Pakistan.

The team is grateful to the authorities for the open discussion and close cooperation, and to World Bank, ADB and FCDO staff based in Islamabad for helpful discussions. The FAD team would like to express its appreciation to Mr. Arshad Hayat in the Finance Division for facilitating the organization of this mission, and Ms. Esther Perez, IMF Resident Representative, Mr. Muhammad Ali, Office Manager, and staff of the Resident Representative Office in Islamabad for their support.

Executive Summary

Pakistan faces a tight fiscal situation, which will require strong control over the budget in coming years. Public debt has increased considerably, and interest payments now absorb 60 percent of budgeted revenue. Multiple external shocks and the unprecedented floods in 2022 have buffeted the economy and the government's fiscal position. These shocks have been compounded by policy slippages including unbudgeted subsidies, and delays in implementing revenue measures. The authorities now have the difficult task of converting a primary deficit of 1.3 percent of GDP for FY23 into a primary surplus for FY24 and continuing to exercise fiscal restraint, while preserving essential social and development spending.

In this context, it will be crucial to further enhance the country's Public Financial Management (PFM) system, as well as strengthening revenue mobilization and administration. This report focuses on how to strengthen budget preparation, execution, and controls, including ways to harness digital technologies for that purpose. There are other important areas in PFM where the authorities are making progress, such as the oversight of state enterprises, cash and debt management, the Treasury Single Account (TSA), and public investment management, which have been the focus of previous IMF technical reports.

An examination of Pakistan's recent budgetary outcomes reveals substantial deviations from planned budgets. While these discrepancies are partially due to an unstable external environment and political uncertainties, the establishment of stronger fiscal institutions can help deliver a more credible budget, tighten its execution, and prevent policy slippages. This report identifies how this can be done in Pakistan. Its main findings are:

- **Macro-Fiscal Forecasting.** Macro-fiscal functions are distributed among different institutions which are responsible for forecasting macroeconomic indicators, tax revenue, public debt service, and development spending (largely comprising capital projects), but are poorly coordinated. A macro-fiscal policy unit (MFPU) has been put in place in the Economic Adviser's Wing but is at an early stage of development and does not yet provide effective support for the Finance Division, particularly its Budget Wing. A National Macro-Fiscal Framework is prepared but does not kickstart the budget preparation process.
- **Budget preparation.** A top-down, strategic phase at the start of budget preparation could be strengthened, with spending ministries and agencies required to prepare their budget submissions under relatively weak constraints and insufficient guidance on the available fiscal space. Several other budgeting practices could be strengthen: (i) there is an inefficient dual budgeting system with a bloated pipeline of projects in the Public Sector Development Plan (PSDP) and separate decision-making processes for recurrent and development spending; (ii) the budget call circular (BCC) provides spending ministries and divisions with little guidance on budget priorities and spending ceilings are out of date; and (iii) the organization of the Finance Division is fragmented and not well tuned to provide effective policy advice on the budget, and effective scrutiny of budget proposals.
- **Budget execution.** The Executive is a relative outlier internationally in terms of its ability to award in-year supplementary grants without ex-ante approval from the National Assembly, and without any limit on their size. Extensive use of these grants has been made in recent years. They amounted to 14 percent of approved spending in the last two years. In addition, technical supplementary grants, or

reallocations across budget appropriations, amounted to another 13 percent of approved spending in the last two years. While legislative approval may occasionally hinder prompt responses to emergencies, a balanced solution should be adopted in Pakistan, as is the case elsewhere. The example of the previous caretaker government, which is overseeing the budget without resorting to supplementary grants, shows that strong commitment can lead to effective budget management without total flexibility. Another challenge in budget execution is the absence of comprehensive commitment control mechanisms, which, at a minimum, affects proper budget monitoring, but can, more worryingly, lead to overcommitment of spending, unwanted supplementary grants, and arrears.

- **Digitalization of budget processes.** The Ministry of Finance has put in place measures to (i) enhance the digitalization of the budget preparation and execution processes; and (ii) improve fiscal monitoring and reporting. Despite several reforms, however, budget processes still involve significant manual and paper-based steps. Fully digitalized processes are yet to be prepared and implemented in the Financial Accounting and Budgeting System (FABS). The Finance Division has designed a data warehouse to store fiscal data and made available a set of dashboards for use by stakeholders, but this is hampered by the lack of timely data provided by some key entities. As a result, fiscal reporting is not yet comprehensive and timely. The regulatory framework and fiscal data governance (FDG) practices, including data exchange, do not yet fully address these challenges.

The report provides the following high-level recommendations:

- Strengthen capacity at the Finance Division to lead and coordinate macro-fiscal forecasts to support budget preparation, as well as increasing forecast cycles and synchronizing them with the budget.
- Introduce a strategic phase to the budget process, in line with the Public Financial Management Act (PFMA) 2019 and the accompanying Budget Manual; include more guidance and binding ceilings in the Budget Call Circular; and undertake actions to minimize dual (“recurrent/capital”) budgeting.
- Consider reorganizing the Finance Division with a focus on its budget and budget management functions, to bring the structure into line with good international practice.
- Implement the Supreme Court ruling on supplementary grants No. 20 of 2013 that Supplementary Budget Statements be subject to the same scrutiny and procedure as the Annual Budget statement, including ex-ante approval by the National Assembly of supplementary grants. Relevant laws and rules can be amended to ensure greater certainty and clarity on the interpretation and application of this ruling, including potentially Article 84 of the Constitution. Propose the creation of a Contingency Reserve in the budget to maintain budget flexibility. Concurrently, the Auditor General of Pakistan (AGP) could conduct a special audit of the mechanisms and effectiveness of supplementary grants in past years.
- Prepare a PFM Digitalization Master Plan, establish a high-level Steering Committee to oversee coordination and implementation of the Plan, strengthen Fiscal Data Governance (FDG) practices, consider next steps after SAP life support ends in 2025, and review the budget preparation and budget execution business processes in FABS.

Table 1 below summarizes the detailed recommendations of this report, including the suggested time frame and lead entities.

Table 1. Summary of Recommendations

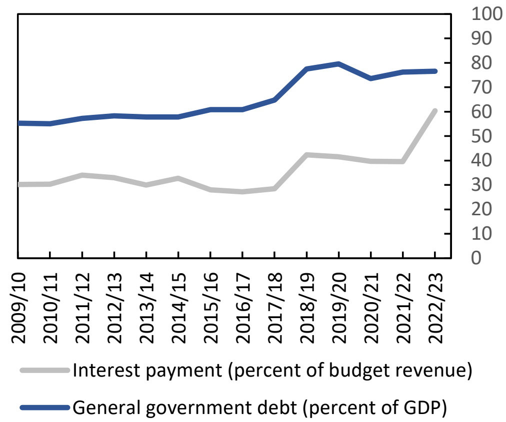
Recommendations	Action	Time horizon
Budget Preparation and Macro-Fiscal Forecasting		
Require line ministries to prepare their budget submissions within a binding budget ceiling and explain any request for additional resources. The IBCs should reflect the latest estimate of the resource envelope (based on up-to-date macro-fiscal projections) as well as Cabinet-level policy decisions on sector priorities	Budget Wing	FY2024/25
Include in the BCC for FY2025/26 budget the latest macro-fiscal projections prepared by the MFPU, as well as aggregate spending ceilings for the next budget year and updated individual budget ceiling for line ministries. Continue to build a strong working relationship between the Budget Wing and the MFPU	Budget Wing, Economic Advisor Wing	January 2025
Produce macro-fiscal forecasts before or concurrently with the issuance of the budget call circular (BCC) for FY2025/26 budget. Establish protocols and templates to facilitate exchange of information among key players engaged in macro-fiscal forecasting.	Economic Advisor Wing	January 2025
Prepare monthly reports on budget performance, including potential measures to achieve budget targets if projections indicate deviations, for the Finance Secretary. Publish ex-post analysis of the accuracy of previous macro-fiscal forecasts and budget estimates i**n Monthly Economic Update and Outlook.**	Economic Advisor Wing, with other relevant entities (FBR, Budget and Expenditure Wings)	FY2024/25
Increase the participation of the Budget/Expenditure Wings in the budget negotiations with the ministries/divisions both on recurrent and development spending.	Budget Wing, Expenditure Wing, Planning Division	FY2024/25
Expand the scope and coverage of the BCC to cover. Changes could be introduced incrementally if required. Issue the Budget Call Circular jointly by the Finance Division and the Planning Division.	Budget Wing	January 2025
Consider a reorganization of the Finance Division to reduce fragmentation and improve effective decision-making. Support the reorganization with a functional review of the Division's structure and staffing.	Finance Division	FY2025/26

Recommendations	Action	Time horizon
Budget Execution		
Initiate legal changes required to limit the discretionary powers granted to the Federal Government over the use of supplementary grants, while maintaining some flexibility in budget execution	Next elected government	FY2024-25
Undertake a special audit on the mechanism, efficiency, and effectiveness of supplementary grants over the last ten years	Auditor General	FY2024-25
Review and revise Commitment Controls and redesign the Budget Execution Process accordingly	FABS, with support from Controller General of Accounts (CGA) and Finance Division	December 2025
Digitalization		
Prepare a costed PFM Digitalization Masterplan with time bound objectives and priorities reflecting the considerations set in the report	MoF, Finance Division and CGA	February 2025
Establish a high-level Steering Committee to monitor and guide the implementation of the Digitalization Master plan	MoF	July 2025
Review and update the regulatory framework to ensure that MoF has the authority to request comprehensive and timely delivery of fiscal data of adequate quality to the FABS data warehouse and prepare Fiscal Data Governance guidelines	MoF	December 2024
Review process designs of budget preparation and budget execution to reflect new and future requirements	CGA (FABS department)	June 2025

I. Introduction

1. Pakistan faces a tight fiscal situation. The ratio of public debt-to-GDP has risen significantly in recent years, growing by around 16 percentage points of GDP between FY17 and FY23 (Figure 1). This is due to a combination of factors, including weaker-than-expected GDP growth, a depreciation of the rupee, the high cost of responding to natural disasters and the pandemic, underperforming State-Owned Enterprises (SOEs), but also the general challenges in delivering on planned fiscal consolidation. Concurrently, the proportion of budget revenue consumed by interest payments has doubled since FY17 and now stands at 60 percent of tax revenue. The authorities have the difficult task of converting a primary deficit of 1.3 percent of GDP for FY23 into a primary surplus of 0.4 percent of GDP for FY24. This goal is predicated on the materialization of additional revenues from recent measures and significant restraint across all areas of expenditure, while prioritizing social and development spending. The objective in the medium term is to bring down debt below 60 percent of GDP, from 74 percent currently,[1] in line with the Fiscal Responsibility and Debt Limitation Act (FRDLA) of 2005.

Figure 1. Debt and Debt Service



Source: IMF

2. In recent years, actual fiscal outcomes at the Federal level have fared worse than the projections (Figure 2**).** The actual fiscal deficit exceeded the budgeted deficit by 25 percent on average over the period FY17–23. Budget estimates for revenue have consistently been overestimated. The performance of non-tax revenue (against budgeted amounts) has notably deteriorated in recent years, experiencing a year-on-year drop of 53 percent in FY19 and 43 percent in FY22. In years prior to FY20, this revenue shortfall was met by spending offsets, particular by cuts in non-interest recurrent expenditure and development expenditure. In recent years, however, the authorities have failed to contain spending, despite making large cuts to development spending. At the same time, interest payments have risen sharply, due to the increase in public debt, largely domestic and non-concessional in nature, and a rise in borrowing costs.

[1] Using the national definition of the debt stock.

Figure 2. Deviations of Fiscal Indicators from Budget Estimates, FY2011-12 – FY2022-23,

	FY11-12	FY12-13	FY13-14	FY14-15	FY15-16	FY16-17	FY17-18	FY18-19	...	FY21-22	FY22-23
Gross Federal Receipts	↓ -11.3	↓ -14.2	↓ -0.23	↓ -7.17	↓ -7.17	↓ **-7.5**	↓ **-11.6**	↓ **-21.6**	...	↓ **-7.3**	↓ **-5.6**
Tax Revenue	↓ -6.19	↓ -18.2	↓ -8.60	↓ -10.1	↓ -10.1	↓ -7.8	↓ -6.1	↓ -16.7	...	↑ 5.4	↓ -4.0
Non Tax Revenue	↓ -27.3	↓ -0.49	↑ 26.23	↑ 4.22	↑ 4.22	↓ -6.0	↓ -35.7	↓ -52.8	...	↓ -43.0	↓ -11.6
Provincial Share	↓ -9.43	↓ -16.7	↓ -6.39	↓ -10.6	↓ -10.6	↓ -8.0	↓ -7.0	↓ -7.4	...	↑ 5.2	↓ -3.4
Total Expenditure	↓ **-7.88**	↑ **5.35**	↓ **-11.1**	↓ **-13.8**	↓ **-14.5**	↓ -10.9	↓ -7.8	↓ -5.6	...	↑ 8.0	↑ 16.4
Non-interest current expenditure	↓ -17.1	↓ -6.6	↓ -23.9	↓ -19.8	↓ -18	↓ -13.6	↓ -3.6	↓ -14.2	...	↑ 18.0	↑ 5.8
Interest Payment	↑ 12.4	↑ 7.042	↓ -0.5	↓ -1.62	↓ -1.29	↓ -0.9	↑ 10.0	↑ 29.1	...	↑ 4.0	↑ 44.2
Development expenditure	↓ -15.8	↓ -27.2	↓ -9.87	↓ -25.1	↓ -25.9	↓ -19.2	↓ -41.1	↓ -36.5	...	↓ -51.0	↓ -27.4
Balance (deficit)	↓ -2.2	↑ 26.1	↓ -24.07	↓ -23.5	↓ -19.7	↓ -15.9	↑ 2.2	↑ 24.4	...	↑ 34.7	↑ 42.1

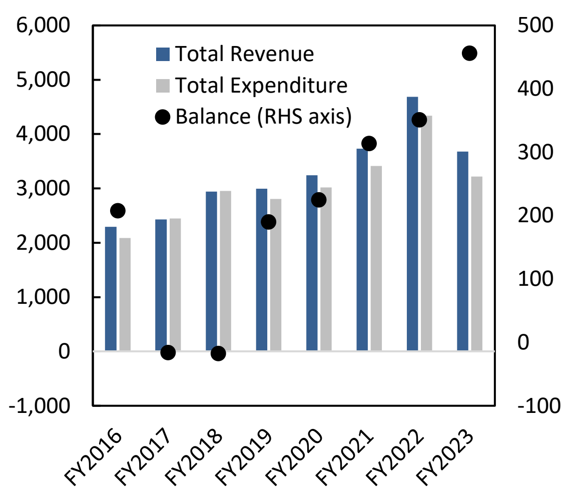
Source: Federal Annual Budget Statements and Fiscal Operations, Finance Division.

Note: Red arrow means actuals are less than budget estimates; Green arrow means actuals are higher than budget estimates. Assessments exclude COVID-19 period.

3. **Provinces, on the other hand, have generated fiscal surpluses since FY19 (Figure 3).** In addition to their own source revenue, the four provinces have a direct call on the "divisible pool" of Federal taxes, as defined by Amendment 18 (2011) of the Constitution. The last National Finance Commission Award allocates this divisible pool "vertically" between Provinces and the Federal government in the ratio 58:42; then "horizontally" across provinces based on factors such as population size, population density, and poverty. Provinces' revenue from the divisible pool represents around three quarters of their total revenue. Their spending comprises roughly two-thirds recurrent and one-third development, largely in education and health. In recent years, each Province has signed a Memorandum of Understanding with the Federal government which includes a desired, but non-binding, level of fiscal surplus.

Figure 3. Provincial Finances

(billions of rupees)



Source: Pakistan Economic Survey 2022-23. Figures for FY2023 are preliminary

4. **The Federal government's recent poor fiscal performance is attributable to several factors.** These include the devastating floods of 2022, with losses estimated at 5 percent of GDP; substantial volatility in commodity prices; and tightening external and domestic financing conditions. These unforeseen challenges have complicated budget planning and execution. The government was required to undertake emergency measures in response to the floods, the slowdown in economic growth and the rise in consumer prices.

5. **Policy slippages have also contributed to the current tight fiscal situation.** In FY23, unplanned and untargeted subsidies, and delays in rolling out planned revenue measures delayed planned fiscal adjustments. At the same time, the restrictions on imports throughout the year directly

hampered revenue collection from import-related sales tax and custom duties and contributed to the broader decline in tax revenue through a downturn in economic activities and the closure of several industrial facilities. In FY22, amid political tensions, a relief package provided generous subsidies on petrol and diesel, lowered electricity tariffs, and provided tax exemptions and a tax amnesty. These measures were accompanied by increases in public wages and pensions, and additional food subsidies.

6. **As a result, there have been substantial changes to the size and composition of spending compared to the approved annual budget.** These in-year changes have occurred either through technical supplementary grants—which are effectively virements between grants—and through supplementary and excess grants (henceforth "supplementary grants"), which are additional grants approved during the year not met by the surrender of existing grants (as defined by Article 84 of the Constitution). In FY23, the sum of these supplementary grants exceeded 50 percent of budget spending (Table 2). As discussed later in this report, given that extraordinary latitude taken by the Executive in its interpretation of Article 84 of the Constitution to approve these grants without the prior approval of the National Assembly, this means that a significant proportion of spending does not undergo the prior scrutiny of the latter.

Table 2. In-year Changes to the Budget

	Technical Supplementary grants		Supplementary grants		Total
	Rs. Billion	percent of approved budget	Rs. Billion	percent of approved budget	percent of approved budget
FY2022-23					
Current	943.6	10.8	1910.4	21.9	32.8
Development	191.1	21.9	-	-	21.9
					54.7
FY2021-22					
Current	1106.9	14.7	715.0	9.5	24.2
Development	45.6	4.7	-	-	4.7
					28.9

Source: Finance Division

7. **Effective control over the budget will be paramount, both this year and in the foreseeable future.** While these discrepancies identified above are due to an unstable external environment and policy slippages, the establishment of stronger fiscal institutions can help deliver a more credible budget and tighten its execution. This report identifies how this can be done in Pakistan through addressing some key shortcomings of the PFM system, especially by strengthening budget preparation and tightening budget execution. This report provides specific recommendations on these two aspects, including on using digitalization as an enabling factor. Other areas of PFM reforms are equally critical, such as SOE reforms, the implementation of the Treasury Single Account (TSA), and proactive cash and debt management, and have been dealt with in other IMF reports, but they fall outside of the scope of this report.

II. Strengthening the budget process

8. **The budget process is clearly defined in legislation.** The PFMA sets the principles behind budget preparation and presentation, the role of the Finance Division, the Planning Division and Special Initiatives (PD&SI), Principal Accounting Officers (PAOs), and Chief Finance and Accounting Officers. Further details are set out in the Budget Manual 2020 (prescribed by the PFMA), which clarifies the roles and responsibilities of the Minister and other actors, the budget cycle and calendar, budget documentation, and the processes for preparing and presenting a medium-term based budget. A separate manual (the Manual for Development Projects 2020) guides the preparation of capital infrastructure ("development") projects to be included in the budget.

9. **The Budget Wing and Expenditure Wing of the Finance Division lead the process of preparing the budget for recurrent expenditure.** They are supported by other units of the Finance Division on specific topics. For example, the Corporate Finance Wing provides advice on proposals for new subsidies for the power sector or transfers to support loss-making state-owned enterprises. The Economic Adviser's Wing includes a small and developing Macro-Fiscal Policy Unit (staffed by highly qualified economists, many with doctorates) that provides advice to the Budget Wing on fiscal developments and medium-term macro-fiscal projections. The Budget Wing comprises nearly 40 professional staff and the Expenditure Wing has around 30 professional staff divided into ten teams each of which cover 3-4 ministries/divisions. The Expenditure Wing also outsources an officer to some line ministries who supports the work of the Chief Finance and Accounting Officer and acts as the eyes and ears of the Finance Division.[2] The staff of the Budget and Expenditure Wings are members of the elite civil service administration group in Pakistan who are generalists but receive specific training in subjects such as economics, finance and law that are required for good public administration.

10. **The budget process is defined by a calendar set out in the Budget Call Circular (BCC).** Ministries are divided into 44 divisions, (a division may also supervise other agencies and entities) which are the primary units on which the budget is prepared. The BCC is issued to all of these 44 divisions in January each year.[3] The Circular requests the PAO of each division to prepare submissions ("demands") for recurrent expenditure for the next budget year. These submissions separate the demands for employee-related expenditure (wages and pensions) from other recurrent spending (e.g., utilities and goods and services). The BCC requests PAOs to base their submissions on the Indicative Budget Ceilings (IBCs) set in April the year before, as part of the rolling Medium-Term Budget Estimates.

11. **The Planning Commission leads a separate, parallel process for preparing the budget for projects included in the Public Sector Development Plan (PSDP).** A PSDP Call Circular (PSDP-CC) issued by the Planning Commission kickstarts the process, where PAOs are asked to prepare and submit new project request to the Planning Commission through PSDP-I forms, which later will be

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[2] This feature is reminiscent of the outsourcing of finance ministry officials in France to spending entities. It is an effective way of exerting more control over these entities and extracting valuable intelligence on budget and financial issues for the finance ministry.

[3] Government of Pakistan, Finance Division, *Budget Call Circular FY 2023-24*, January 2023.

reviewed and approved by relevant Demand Review or Priorities Committees led by the Finance Division.

12. After the issuance of BBCs and PSDP-CCs, the main steps in the budget process comprise:

i. The submission of proposals by PAOs (mid-March).

ii. Demand Review Committee meetings led by the Finance Division and including representatives of the Expenditure Wing, the Economic Affairs Wing – responsible for external borrowing – the Planning Commission, and the ministry/division whose submission is being reviewed—starting in late March.

iii. The issuance of a Budget Strategy Paper containing medium-term macro-fiscal projections, priorities for the mobilization of tax and non-tax revenues, IBCs for each division, and a fiscal risk statement, which is approved by the Cabinet (mid-April).

iv. Issuance by the Finance Division of final IBCs for recurrent spending and an aggregate ceiling for development spending (late April). PAOs are asked to prepare revised budget estimates for their ministries/divisions.

v. A second round of technical meetings by the Annual Plan Coordination Committee (APCC) and the National Economic Council (NEC), led by the Finance Division and Planning Commission to discuss and finalize the recurrent and development budgets respectively (April/May).

vi. The Planning Commission allocates individual IBCs for Ministries and Divisions on the basis of sectoral priorities and the throw forward of approved projects in the PSDP, while consulting the NEC from time to time on those priorities (April/May)).

vii. Compilation of the budget by the Budget Wing (May).

viii. Presentation of the budget to the Cabinet (May/June)

ix. Submission of the Annual Budget Statement by the Federal Government to the National Assembly. and the National Assembly (June).

A. The lack of a strategic and top-down phase

13. Pakistan's current budgetary process is largely bottom up and designed to gather information from divisions/ministries. Thus, no up-to-date fiscal projections or budget ceilings (in aggregate of broken down by sector) are included in the BCC that launches the budget process in January. The Finance Division issues IBCs to ministries/divisions, but these figures are generally based on the previous year's ceilings and are not adjusted for inflation, new policy proposals or fiscal developments that may have reduced (or increased) the available fiscal space. The Budget Strategy Paper, which includes medium-term macro-fiscal projections, and an assessment of the available fiscal space is not released until April, three months after the launch of the budget process.

14. A top-down approach to budgeting is sometime called a "strategic phase" because it requires the finance ministry to define policy objectives for the budget, and its priorities for spending and revenue mobilization. Top-down budgeting is therefore closely linked to the government's strategic policy goals and objectives, as set out in national or sectoral development plans or other strategic documents (e.g., on climate change). In many countries, a top-down approach—in which an aggregate resource envelope as well as indicative or binding ceilings for spending ministries are set by the finance ministry—is commonplace. For example, a recent survey showed that 21 out of 25 OECD countries set aggregate and/or sector ceilings in a budget circular that launches the budget process.[4] Box 1 describe how top-down budgets are prepared in France and the Netherlands. A similar approach is followed in many emerging markets and low-income developing countries.

15. Top-down budgeting requires close coordination between the Budget Wing and the MFPU so that the former has immediate access to the latest economic data, and timely estimates of revenues, expenditure, borrowing, debt, and the available fiscal space. As discussed in Section II B below, Pakistan's MFPU has been established in 2022, and although it has demonstrated commendable performance across various functions, its relationship with the Budget Wing is currently under development (with technical support from the World Bank). Further developing this relationship will be key to strengthening the budget process.

16. There could be two options for adding a strategic phase to the budget process in Pakistan. First, the Budget Strategy Paper, currently released in April, could be brought forward to January, and issued with the Budget Call Circular. This approach makes it difficult to assemble the necessary data to update the economic and fiscal projections in time. Second, the existing timetable for preparing and publishing the Budget Strategy Paper could be retained but a preliminary analysis of macro-economic developments and updated macro-fiscal projections and a calculation of available fiscal space and the IBCs could be included in the Circular. The second option would represent a substantial improvement from existing practice because it would include the latest assessment (from the Economic Adviser's Wing) of the state of the economy[5] as well as the most recent data on fiscal trends and indicators which can be highly volatile even over short periods of time (see Section B below).

17. It should be noted that the principles set out in the PFMA and the Budget Manual 2020 both require a strategic phase to the budget that is not currently applied. The PFMA proposes that the budget preparation cycle starts with a Budget Strategy Paper which should indicate, inter alia, the "*strategic priorities of the Government's revenue and spending policies and specify indicative levels of spending in various Ministries and Divisions*." (Chapter 3, Article 3). The Budget Manual is even clearer: "*The budgeting cycle starts with setting of budget strategy and completes with approval of budget …. the Federal Government sets priorities and a comprehensive budget strategy to be followed by all the Public Sector Entities*" (Paragraph 5.1). The current starting point of the budget process, which requires divisions to prepare their budget submissions based on last year's budget estimates and where the Budget Strategy Paper is not published until three months after the launch of the budget process in January, is inconsistent with these principles.

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[4] OECD, *International Budget Practices and Procedures Database*, 2019.

[5] For example, data on car sales, energy consumption, consumer spending, etc. would provide a good indication of economic developments before the Pakistan Bureau of Statistics produce their formal quarterly national accounts data.

Box 1. Top-down Budgeting in France and the Netherlands

France. The French Organic Budget Law (2001) provides for a strategic phase early in the budget process. The law was amended in 2021 to bring forward this phase. The Ministry of Finance kicks off the budget process early in the calendar year (same as fiscal year), with a top-down proposal for a multi-annual limits on aggregate spending. These limits are included in a law ('Loi de programmation des finances publiques') passed in April. At the same time, the Budget Department carries out analytical work to identify savings and/or inefficiencies that help prepare the budget negotiations, and it sends a budget call circular (in April) to line ministries with strategic direction. For example, it can state that as per Council of Minister decision, retiring/departing staff will not be replaced, or current spending and transfers will be reduced buy x percent or some high-priority ministries will see their budget expanding, others decreasing. Ministries come up with their own proposals, the sum of which often greatly exceeds the aggregate ceiling. These proposals are discussed between the line ministries and the Budget Directorate in May. Sometimes, a Ministerial Retreat takes place at this time to encourage discipline. After this strategic phase, there is a reconciliation and negotiation process which may lead to another Ministerial Retreat to put a formal end to the negotiations. Ceilings are then set for three years and letters sent to line ministries, signed by the Prime Minister.

Netherlands. In March, the Minister of Finance will generally send a Framework Letter ('Kaderbrief') to line ministries, setting the stage for the upcoming budget negotiations. This letter summarizes the impact of the new economic forecasts (from the Central Planning Bureau) on the fiscal position of the government. Estimates of the budgetary consequences of the implementation of existing policies for the current and next years' budgets are also presented. Finally, the letter may indicate the (negative) fiscal space available, compliance with the Dutch expenditure limit, the relevant government priorities, and possible consolidation needs. In April, the Framework Letter is discussed by the Council of Ministers. Following this discussion, the budgetary negotiations between the Ministry of Finance and line ministries are held, leading to an agreement on the supplementary budget for the current year and the line ministries' ceilings for next year's budget (including the medium-term budgets). This agreement is tabled in the Council of Ministers' meeting in parallel to the submission of the Netherlands' Stability Program to the European Commission.

Source: IMF Mission

B. Better macro-fiscal forecasting to support budget formulation

19. Credible macro-fiscal forecasts are crucial for governments in formulating effective fiscal policies. Timely and accurate macro-fiscal forecasts serve as the foundation for a credible budget and provide information on necessary actions to meet government macroeconomic goals. Like many countries, Pakistan has adopted a fiscal rule through its fiscal responsibility framework, setting a public debt limit at 50 percent of GDP by FY2032-33 to guide its fiscal policy.[6] This makes the role of forecasting and a credible budget more relevant for achieving the debt limit target.

20. In Pakistan, the production of macro-fiscal forecasts is distributed across various government institutions. The MFPU of the Economic Advisor Wing (EAW) is tasked with performing

[6] The FRDLA, enacted in 2005 and amended in 2022, mandates a reduction in total public debt to 60 percent of GDP by FY 2018-19 and further to 50 percent of GDP by FY2032-33, which represents the hard limit thereafter. Currently, the total public debt stands at 74 percent of GDP.

macro-fiscal functions, but the forecasting of specific fiscal indicators is delegated to different divisions or institutions. Tax revenue forecasts are conducted by the Federal Board of Revenue (FBR), the revenue administration body, and non-tax revenue forecasts are coordinated by the Budget Wing. Borrowing and interest payment forecasts involve three institutions. The Economic Affairs Division oversees external borrowing, primarily related to financing public development projects. The Debt Management Office (DMO) of the Finance Division and the State Bank of Pakistan handle domestic borrowing. Expenditure forecasts are prepared by the Budget Wing. This dispersion of macro-fiscal functions requires strong coordination. In response, the government created the MFPU in January 2020 to ensure consistency between macroeconomic developments and projected revenues and expenditure. This unit started to operate only in 2022, and its skills and capacities are still developing. Moreover, it has not yet been given the authority to prepare macro-fiscal forecasts for the preparation of the budget.

21. Several institutions are responsible for making revenue forecasts. The FBR prepares tax revenue forecasts for the annual budget, but its primary responsibility is to optimize government revenue while ensuring compliance with tax and related laws. This setup raises concerns about potential conflicts of interest as the main FBR focus is on the efficient collection of tax revenues rather than accurate forecasting. Also, it necessitates continuous collaboration with other government institutions. For instance, in-year reductions and reallocations of expenditures can impact the tax base, particularly through cuts in development spending. To address these challenges and for other reasons, many countries have established tax policy units within their finance ministries, dedicated to designing tax policy, conducting tax policy analysis, and revenue forecasting. On the other hand, spending ministries/divisions may have an incentive to overestimate their non-tax revenues in the expectation that this will encourage the Finance Division to give them a larger resource envelope in the budget. Although challenging to quantify, an analysis of the past ten years (see Figure 2) revealed that non-tax revenue has been overestimated in seven of those years.

22. The internal processes for preparing macro-fiscal forecasts are not fully aligned with the budget cycle. Currently, macro-fiscal forecasts are produced only once during the fiscal year, usually in March, as part of the Budget Strategy Paper (BSP), which presents the Federal government's medium-term fiscal strategy. This timing restricts the potential of the medium-term fiscal framework (MTFF) to effectively guide fiscal policy. As the budget preparation process starts in January with the issuance of the Budget Call Circular (see Section III), the latest macro-fiscal indicators are still based on the previous year's BSP. Despite possibly substantial economic and fiscal developments since the publication of the BSP, the macro-fiscal forecasts are not revised. This makes budget preparation challenging. As illustrated in Figure 4, the projections in the BSP differ significantly from budget estimates. In FY23, expenditure forecast in the BSP for FY22 – FY24 (published in April 2021) were Rs. 1,162 billion (1.2 percent of GDP) less than approved in the annual budget statement. In FY24, projections in the BSP for FY23 – FY25 (published in June 2022) were Rs. 4,988 billion (around 5 percent of GDP) less than the annual budget statement estimates.

Figure 4. Comparison Between BSPs and Budgets, FY2021-22 – FY2023-24 (in Rs. Billions)

	BSP April 2021		BSP June 2022		BSP June 2023	Annual Budget Statements			Deviations from BSP Forecasts	
	FY2021-22	FY2022-23	FY2022-23	FY2023-24	FY2023-24	FY2021-22	FY2022-23	FY2023-24	FY2022-23	FY2023-24
		(a)		*(b)*		*(b22)*	*(b23)*	*(b24)*	*(b23 - a)*	*(b24-b)*
Gross Federal Revenue	**7,989**	**8,775**	**9,004**	**10,533**	**12,163**	**7,909**	**9,405**	**12,378**	**630**	**1,845**
Transfer to Provinces	3,527	3,796	4,100	4,975	5,276	3,412	4,373	5,399	577	424
Net Federal Revenue	4,462	4,979	4,904	5,558	6,887	4,497	5,032	6,979	53	1,421
Total Federal Expenditure	**8,056**	**8,570**	**9,502**	**9,965**	**14,460**	**8,661**	**9,732**	**14,953**	**1,162**	**4,988**
Federal Deficit	-3,594	-3,591	-4,598	-4,407	-7,573	-4,164	-4,700	-7,974	-1,109	-3,567

Source: Budget Strategy Papers and Federal Annual Budget Statements, Finance Division.

23. To improve budget credibility, the role of macro-fiscal functions should be strengthened within the Finance Division. This will require increasing the role of Economic Adviser's Wing and MPFU in macro-fiscal forecasting and fiscal analysis. This Wing is staffed with 15 economists, of which 5 hold a PhD in economics, and can support the MPFU in achieving its mission. It should take an active role in both budget preparation and budget execution. This should be complemented with the fiscal risk management function which the MFPU has also been tasked with.

24. The budget preparation process should rely on the most up-to-date macro-fiscal forecasts. Consequently, the Economic Adviser's Wing should produce the medium-term macro-fiscal framework before or concurrently with the issuance of the budget call circular. While the Economic Adviser may encounter challenges in forecasting due to data limitations, his economists should leverage on leading and partial economic indicators. These indicators, such as new car registrations, the number of construction permits, or electricity/fuel consumption, offer a viable alternative for estimating the economy. By incorporating these indicators in their forecasting models, the Economic Adviser can provide the Budget Wing with a preliminary MTFF in January to kickstart the budget process. This practice would align with good international standards; for instance, South Africa releases its macro-fiscal forecasts before the start of the budget process and revises them later (see Box 2).

Box 2. Macro-Fiscal Forecasts in South Africa

Forecasts of key economic indicators and their components are presented twice a year, with underlying assumptions. The Medium-Term Budget Policy Statement, published six months before the end of the fiscal year, sets out the macro-fiscal framework underpinning the budget, and includes forecasts for the budget year, three outer years and outcomes for the three previous years. The Budget Review, which sets out budget narrative, economic outlook, and key policies underpinning the budget numbers, is published 1-2 months before the end of the fiscal year and provides forecast revisions incorporating latest economic developments.

Source: IMF Mission and South Africa Fiscal Transparency Evaluation 2023.

25. Enhanced coordination is necessary among stakeholders involved in producing macro-fiscal forecasts. The Economic Adviser's Wing, through the MFPU, should take a proactive role in leading this process and ensure consistency between macroeconomic developments and projected revenues and expenditures as outlined in its Terms of Reference. The unit, with the support of the Finance Division's management, should establish protocols and templates to facilitate exchange of information among key players engaged in macro-fiscal forecasting. Furthermore, the Economic

Adviser's Wing could provide expertise to other stakeholders by providing customized forecasting models.

26. The Economic Adviser's Wing does not assess the accuracy of the macro-fiscal forecasts. To improve the quality of the forecast, it is important to examine past forecast errors and analyze the reasons for these errors. The Economic Adviser's Wing should publish its macroeconomic projections regularly, together with the underlying assumptions, as well as an ex-post analysis of the accuracy of previous forecasts. Some countries include projections from other institutions in their medium-term framework. For example, South Africa's National Treasury includes domestic economic growth projections from the IMF's World Economic Outlook as a point of comparison in its medium-term budget policy statements. The Economic Adviser's Wing should publish and explain the reasons for any differences between consecutive MTFF/BSP forecasts, and differences between budget projections and actual outturns. These analyses should be published either as a standalone document or as part of the BSP.

27. High quality fiscal reports are the foundation of effective fiscal management. Fiscal transparency provides legislatures, markets, and citizens with the information they need to hold governments accountable for their fiscal performance and use of public resources.[7] Although all budget-related information is accessible on the Finance Division website, the classification of budget data significantly differs from the actual data, posing challenges for comparison and hampering fiscal transparency. To enhance transparency, projected fiscal data and actual data presented in the BSP and budget reports should adhere to the same classification. For instance, fiscal operations reports should include a column for initial budget estimates, which allow researchers and analysts to compare their performance. Furthermore, macro-fiscal data can be published in an easily readable format, such as Microsoft Excel. For example, the Office of Budget Responsibility of the United Kingdom publishes macro-fiscal data in Microsoft Excel format to support their forecasts and other analysis.[8]

C. Addressing the dual budgeting process

28. Pakistan has a dual budgeting system at federal level[9] in which the Finance Division prepares the recurrent budget and decision-making on development (capital) projects in the budget is led by the Planning Division. Dual budgeting—which may take several forms—involves a separation of the processes for preparing (and executing) recurrent and capital budget and it can lead to inefficiencies. It prevents the finance ministry from taking a holistic view of the spending priorities of spending ministries, and considering trade-offs between capital spending and recurrent spending, and between alternative investment projects to include in the budget. The Pakistan Planning Division, like their counterparts in other countries, does not have a mandate or incentive to consider the budgetary implications of capital investment, but rather to promote new projects to meet the country's

[7] IMF (2018) Fiscal Transparency Handbook.

[8] https://obr.uk/data/

[9] At the provincial level, there may be more flexibility. In Punjab Province, for example, since 2018, spending departments can decide how to allocate their budgets between capital projects and recurrent spending.

developmental objectives.[10] The IMF's recent PIMA assessment of Pakistan has called for a "cleaning" of Pakistan's PSDP, and a substantial reduction in its size.[11]

29. Dual budgeting can also result in the development of project proposals which only take account of the recurrent costs of projects to the point at which they are executed. The Finance Division, however, needs to assess the longer-term budgetary implications of a project once it is fully operational—for example the need to supply hospitals with administrators, doctors, nurses, medical equipment, and pharmaceutical supplies. In Pakistan such costs are not considered during the preparation of the development budget, and are only later considered by the Budget Wing, after the hospitals or schools are already fully operational.

30. Evidence from other countries provides a contrast to practices in Pakistan. For example, based on the 2019 Survey noted above, about 50 percent of OECD countries have a fully integrated approach for considering recurrent and capital spending. Other OECD countries may have separate decision-making processes for capital spending, but decisions on both recurrent and capital spending in almost all these countries are under the jurisdiction of the finance ministry. According to a recent IMF study[12] (2021) about half of developing countries have separate planning ministries or planning commissions, and about half have a PSDP or equivalent. But again, this study confirms that, even in countries with separate planning ministries, finance ministries typically are in the lead in determining budget allocations for capital investment projects.

31. According to the IMF's 2023 PIMA report, planning of public investment is relatively well managed in Pakistan by the Planning Division. In addition, there are important avenues of coordination that exist in principle. For example, the demands for development and non-development budget of each Ministry are discussed in the Priority Committee of the Finance Division jointly chaired by the Secretaries of Finance, Planning and Economic Affairs Divisions. The Finance Division is an active member of all development for a like DDWP, CDWP, ECNEC, APSS, NEC, ECC etc. hence, development budget is finalized within the indicated IBC and consultation with Finance Division. Nevertheless, despite these mechanisms, the bloated PSDP remains a reality which needs to be addressed, as mentioned earlier. Without disrupting these arrangements need not be disrupted, within existing procedures/regulations there should be scope for increasing the role of the Finance Division's Budget and Expenditure Wings in their dialogue with the Planning Division and ministries/divisions, and for joint decision making on budget allocations.

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[10] As a result, the Planning Division's Public Sector Development Program (PSDP) is enormous, containing more than 1,400 investment projects which would require at least 14 years to complete.

[11] IMF, Fiscal Affairs Department, *Pakistan: Public Investment Management Assessment – PIMA and Climate PIMA*, August 2022.

[12] See Allen, R., et. al., 2021, "Integrating Infrastructure Planning and Budgeting", Chapter 12 in Schwartz, G. et. al. (Eds.) *Well Spent: How Strong Infrastructure Governance can End Waste in Public Investment,* IMF.

D. Improving the Budget Call Circular

32. **To improve the budget preparation process, it would be necessary to revise the Budget Call Circular.**[13] It is apparent that many other countries, at a similar level of development to Pakistan, and with a similar administrative background, include much more information in their call circulars, and operate a budget process that has a strategic focus as well as including bottom-up elements. Table 3 below compares Pakistan with several other countries. All of these countries (apart from India where the content of whose annual budget circular is similar to Pakistan's) include some or all of the following elements in their circulars: (i) information on the economic and fiscal context for the budget; (ii) a statement of budgetary goals and objectives; (iii) macro-fiscal projections; (iv) an aggregate resource envelope available for the next budget, and indicative (or in some cases binding) budget ceilings; (v) economic assumptions (e.g., on GDP, inflation, interest rates, etc.) for spending agencies to use in preparing their budget submissions; (vi) an assessment of infrastructure priorities; as well as (vii) detailed budget instructions and forms to complete.[14] In Pakistan, only item (vii) is currently included. Thus, the BCC should be viewed, not as a strategic planning document, but as a tool to obtain basic information from line ministries.

33. **Pakistan would benefit from including many of these additional elements in the BCC.** As discussed in Section III B, the inclusion of macro-fiscal projections, an aggregate resource envelope, and updated IBCs would provide a strong top-down focus to budget preparation. Inclusion of other elements identified in Table 3 could also be considered—for example, an overview of budget/infrastructure priorities, more analysis of Pakistan's current fiscal/budget position, and an assessment of the budget projections and outcomes for the previous fiscal year.

[13] The BCC is supported by the more detailed instructions in the Budget Manual (2020).

[14] As an example of good practice, the Philippines" Call Circular: "defines the budget framework, sets the economic and fiscal targets, enumerates the primary thrusts and programs, puts emphasis on infrastructure development, provides support for climate change and disaster risk vulnerable areas, and harmonizes the guidelines, forms and instructions for budget preparation."

Table 3. Content of Budget Call Circulars in Selected Countries

Topic	Pakistan / India	Nigeria	Sri Lanka	Kenya	Philippines
Economic and fiscal context	No	Yes	Yes	Yes	Yes
Budget goals and objectives	No	Yes	No	No	Yes
Economic assumptions	No	Yes	Yes	Yes	Yes
Macro-fiscal projections	No	Yes	Yes	Yes	Yes
Includes capital spending	No	Yes	Yes	Yes	Yes
Infrastructure priorities	No	Yes	No	No	Yes
Total resource envelope	No	Yes	Yes	Yes	No
IBCs	No	Yes	No	Yes	No
Detailed budget instructions	Yes	Yes	Yes	Yes	Yes

Source: IMF Mission

E. Reorganizing the Finance Division

34. The current organization of the Finance Division is relatively fragmented and presents an obstacle to achieving a more strategic approach to budgeting. This was highlighted in a recent World Bank Report.[15] Some weaknesses include the lack of specialized staff, fragmented management, weak budget contestation, excessive focus on operations rather than policy, lack of coordination of federal-provincial relations, and limited use of IT to support decision making. The report also identified some functions that were missing or substantially under resourced (e.g., tax policy, debt management) and presented some specific proposals for reorganizing the various units that comprise the Finance Division. Another weak area noted earlier is the lack of effective coordination between the MFPU in the Economic Adviser's Wing and the Budget Wing. The Deputy Auditor General supported the World Bank's findings when he informed the mission that the Budget Wing had little capacity to scrutinize ministries' budget proposals, most of which were accepted without challenge.

35. To improve budget formulation and the monitoring of budget performance, a single Budget Office, merging the Budget and Expenditure wings could be considered. Such an integrated structure will allow the pooling of resources to work along the lines of sectors or ministries. A dedicated team will work on say the education sector, both to challenge the budget proposal of this sector and to supervise the budget operations of the ministry. The team would act as acts as the representative of the Finance Division through the monitoring of budget execution, approving changes to the budget, preparing budget decisions, establishing / supervising baseline estimates, supervising budget preparation, leading the discussion on budget submission at the demand review committees for

[15] World Bank, *Pakistan. Restructuring the Finance Division*, November 2021.

the sector, “Sectoral” teams could represent around two-thirds of the resources of this Office; the other third will comprise of teams responsible for consolidating the overall preparation of the budget and other cross-cutting issues.

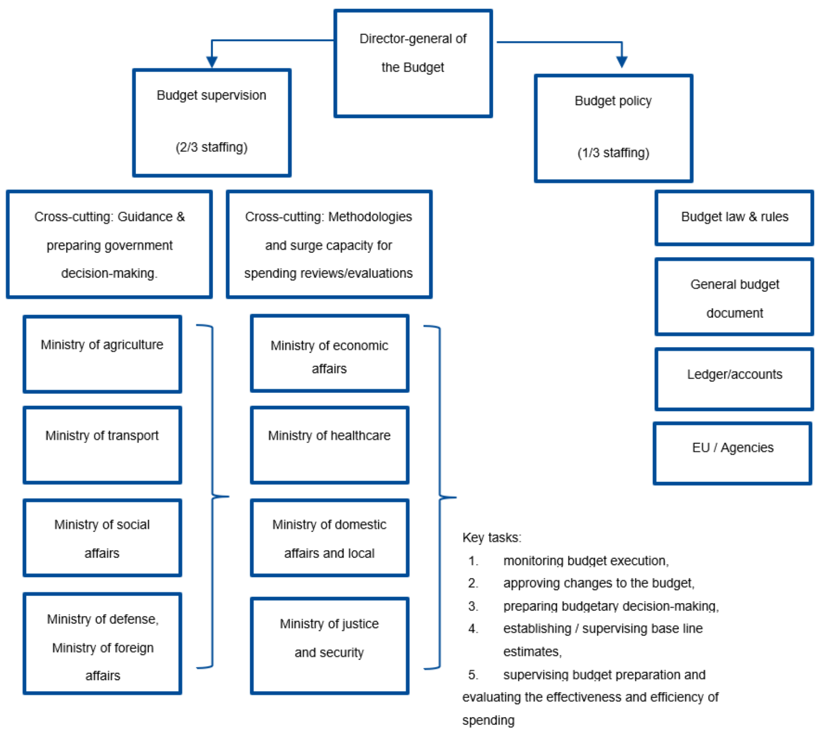
36. A consolidated budget office with much stronger expertise across key sectors is the norm in many advanced countries. To illustrate, Box 3 provides some information on how the budget function is organized in France and the Netherlands. The total number of staff working in the French Budget Directorate is roughly comparable to the combined staff complement in the Budget and Expenditure Wings in the Finance Division,[16] but the skills/experience of the staff, and the distribution of functions is different, as is the fact that the French structure comprises one single Directorate. A similar organizational structure, and staff complement can be found in the UK. Countries such as France, the UK and the Netherlands also have also have well-functioning macro-fiscal units that provide regular and timely information for the Budget Directorate on fiscal trends and fiscal space, medium-term macro-fiscal projections, and analysis of the fiscal implications of budget proposals, as required by a top-down approach to budget preparation (see Section II A).

[16] The Planning Division has a vastly superior staffing complement compared to the Finance Division: around 600 staff divided into 20 sector teams.

Box 3. Organization of the Budget Directorates in France and the Netherlands

France. The Budget Directorate of the Finance Ministry contains a total of around 180 staff. About 30-40 staff work in a central unit that is responsible for coordinating the preparation of the annual budget and the medium-term budget framework, issuing guidelines and instructions to line ministries, monitoring budget execution, and managing the related IT systems. The central unit is complemented with seven sector units, each comprising around 20 staff, responsible for the main areas of the budget such as agriculture, defense, education, heath, and so on. These staff engage in intensive discussions with the finance departments of line ministries on their budget submissions as well as closely monitoring the execution of their budgets. The staff working in the Budget Directorate are primarily accountants, economists, financial analysts, political scientists, and lawyers. Some staff have had experience of working in line ministries which brings advantages of local knowledge and stronger leverage in the budget negotiations.

Netherlands. A key function of the Budget Directorate in the Ministry of Finance is to supervise the policies and budgets of the line ministries and related entities (see organizational chart). Two-thirds of the resources of the Directorate are devoted to supervision work, grouped in teams by sectors (line ministries). There is also a unit responsible for consolidating the overall preparation of the budget (budget policy). Some of the guiding principles behind the current structure are to deliver on the following: (i) close oversight of line ministries; (ii) close integration of the work on planning and executing the budget; (iii) sufficient resources for supervising spending outturns and raising red flags if needed; (iv) sufficient capacity to challenge new projects, programs and policies; (v) close involvement in the planning and implementation of expenditure reviews.



Line ministries each have their own finance/budget directorates (approximately 50-60 staff), which have a functional relation to the Budget Department in the finance ministry. The Minister of Finance approves the nomination of the directors. Typically, budget staff will start their career with responsibility for the budget management system (approving virements for example) and develop their knowledge to become responsible for a set of program budgets. The staff typically rotate from supervising one ministry to another after a few years to avoid 'turning native'.

Source. IMF Mission

F. Recommendations

Recommendation 1. Top-down budgeting. Require line ministries to prepare their budget submissions within a binding budget ceiling and explain any request for additional resources. The IBCs should reflect the latest estimate of the resource envelope (based on up-to-date macro-fiscal projections) as well as Cabinet-level policy decisions on ministry/division priorities.

Recommendation 2. Top-down budgeting. Include in the BCC the latest macro-fiscal projections prepared by the MFPU, as well as aggregate spending ceilings for the next budget year and updated budget ceilings for line ministries. Continue to build a strong working relationship between the Budget Wing and the MFPU.

Recommendation 3. Macro-Fiscal analysis and forecasting. Produce macro-fiscal forecasts before the issuance of the BCC. Establish protocols and templates to facilitate exchange of information among key players engaged in macro-fiscal forecasting.

Recommendation 4. Macro-fiscal analysis and forecasting. Prepare monthly reports on budget performance, including potential measures to achieve budget targets if projections indicate deviations, for the Finance Secretary. Publish ex-post analysis of the accuracy of previous macro-fiscal forecasts and budget estimates in Monthly Economic Update and Outlook.

Recommendation 5. Addressing dual budgeting. Increase the participation of the Budget/Expenditure Wings in the budget negotiations with the ministries/divisions on capital spending.

Recommendation 6. Improving guidance on budget preparation. Expand the scope and coverage of the BCC to align it with international good practice. Changes could be introduced incrementally if required. Issue the Budget Call Circular jointly by the Finance Division and the Planning Division.

Recommendation 7. Strengthening capacity at the Finance division. Consider a reorganization of the Finance Division to reduce fragmentation and improve effective decision-making. Support the reorganization with a functional review of the Division’s structure and staffing. This review could focus on the Budget and Expenditure Wings or the whole Finance Division.

III. Strengthening Budget Execution

37. This section focuses on how to respond to two issues in budget execution on which advice was requested by the authorities: (i) the management of supplementary grants; and (ii) the implementation of commitment controls.

A. Managing supplementary grants

38. Article 84 of the Constitution empowers the Federal Government to sanction additional grants from the Federal Consolidated Fund within the fiscal year, to cover expenditures surpassing the limits approved by the National Assembly. This article outlines specific conditions under which this power can be utilized:

- Additional expenditure for an existing service in the current financial year is warranted only if the previously authorized funds prove insufficient. It also applies in cases where there is a need to allocate funds for a new service that was not included in the initial Annual Budget Statement.
- It is mandatory for the Federal Government to present a Supplementary or Excess Budget Statement to the National Assembly in such instances.
- This Supplementary or Excess Budget Statement must adhere to the guidelines set out in Articles 80 to 83 of the Constitution, which are also applicable to the Annual Budget Statement. Notably, Article 83 of the Constitution emphasizes that: "*no expenditure from the Federal Consolidated Fund shall be deemed to be duly authorized unless it is specified in …[a] schedule laid before the National Assembly.*"

39. Supplementary grants have become a regular feature of the budgeting process in Pakistan. Traditionally, the Government authorizes these grants as and when necessary, within the fiscal year. Box 4 outlines the procedures that exist within the Government for the approval of these grants. Approval from the National Assembly is sought at the time at which the Annual Budget Statement for the next fiscal year is being presented, which typically occurs a month before the fiscal year concludes.[17] This process effectively regularizes the supplementary grants after the fact and often undergoes limited scrutiny in the National Assembly, especially as attention shifts towards the forthcoming year's budget.

[17] Supplementary grants approved by the Federal Government until May 15th of the current year are presented for approval by Parliament. Grants approved between May 15th and June 30th are presented for approval in the following year.

Box 4. Internal Approval of Supplementary Grants

The Budget Manual (2020) and the General Financial Rules (GFR) of 2019 issued by the Finance Division guide the management of supplementary grants within the government. Ministries and divisions cannot spend beyond the amounts appropriated in the budget. They are required to submit proposals for supplementary grants to the Finance Division before mid-May, or earlier if unforeseen supplementary needs arise. These proposals are then assessed by the Budget Wing. Once approved, requests for supplementary grants are submitted for approval to the Cabinet's Economic Coordination Committee. The same procedures are followed for technical supplementary grants, but the authority for approval remains in the Finance Division.

Source: IMF Mission

40. **Recent years have seen a notable increase in the volume of supplementary grants.** This escalation, particularly evident in the last two fiscal years, is attributed to various factors such as responses to devastating floods, rising interest payments, but also significant policy slippages (as detailed in Table 2 and Figure 5). Additionally, these grants are augmented with technical supplementary grants, which reallocate funds by decreasing approved funds in certain areas to bolster others. Notably, development spending has frequently been the target of significant reductions over the past decade (illustrated in Figure 5).

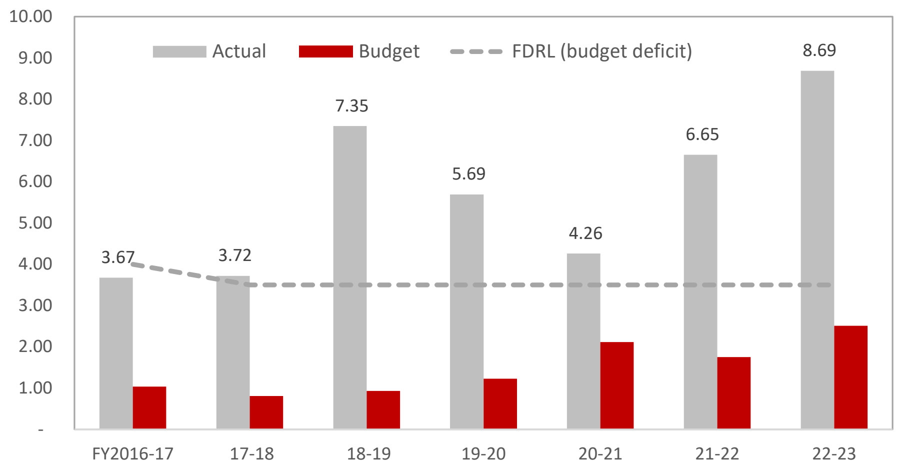
Figure 5. Supplementary and Technical Grants, Differences between Budget Estimates and Revised Estimates, FY2016-17 – FY2022-23

	Units	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23	Average	Absolute Average
Interest Payment	*Rs Billion*	35.1	1.1	163.2	367.1	-182.1	-95.4	83.9	1,570.4		
	in %	*2.7*	*0.1*	*12.0*	*22.7*	*-6.3*	*-3.2*	*2.7*	*39.8*	*8.8*	*11.2*
Pension	*Rs Billion*	5.0	0.0	85.4	0.0	42.4	0.0	60.0	0.0		
	in %	*2.2*	*0.0*	*34.4*	*0.0*	*10.1*	*0.0*	*12.5*	*0.0*	*7.4*	*7.4*
Defence Affairs and Services	*Rs Billion*	-5.3	-18.7	79.1	37.4	74.9	8.8	110.2	23.9		
	in %	*-0.7*	*-2.2*	*8.6*	*3.4*	*6.5*	*0.7*	*8.0*	*1.5*	*3.2*	*4.0*
Grants and Transfers	*Rs Billion*	8.4	-59.2	31.4	0.4	65.8	27.8	-77.1	-19.3		
	in %	*2.0*	*-13.4*	*7.3*	*0.1*	*7.9*	*3.1*	*-6.6*	*-1.6*	*-0.2*	*5.3*
Subsidies	*Rs Billion*	58.9	28.4	8.8	80.2	78.0	221.0	832.9	439.1		
	in %	*42.8*	*20.2*	*6.3*	*45.9*	*28.7*	*105.7*	*122.1*	*66.1*	*54.7*	*54.7*
Pay and Pension Increase	*Rs Billion*	0	0	0	0	-79	0	-160	0		
	in %					*-100.0*		*-100.0*		*-100.0*	*100.0*
Running of Civil Government	*Rs Billion*	13.7	46.0	25.2	-3.1	52.5	11.3	51.0	0.0		
	in %	*4.2*	*13.0*	*6.7*	*-0.7*	*12.2*	*2.4*	*10.6*	*0.0*	*7.9*	*8.2*
Provision for Emergency and others	*Rs Billion*	0.0	0.0	0.0	0.0	-115.0	45.0	107.0	-195.0		
	in %					*-100.0*	*90.0*	*85.6*	*-100.0*	*-6.1*	*93.9*
Total Recurrent Expenditure (a)	*Rs Billion*	**115.9**	**-2.5**	**393.0**	**482.0**	**-62.5**	**218.4**	**1,007.9**	**1,819.1**		
	in %	*3.7*	*-0.1*	*11.3*	*11.5*	*-1.0*	*3.4*	*13.4*	*20.9*	*7.9*	*8.2*
Development Expenditure - Federal PSDP (b)	*Rs Billion*	**-38.7**	**-84.9**	**-251.0**	**-300.0**	**-167.8**	**-20.0**	**-350.0**	**-12.8**		
	in %	*-5.5*	*-10.6*	*-25.1*	*-37.5*	*-23.9*	*-3.1*	*-38.9*	*-1.8*	*-18.3*	*18.3*
Total (a+b)	*Rs Billion*	**77.2**	**-87.4**	**142.0**	**182.0**	**-230.3**	**198.4**	**657.9**	**1,806.3**		
	in %	*2.0*	*-2.1*	*3.2*	*3.7*	*-3.3*	*2.8*	*7.8*	*19.1*	*4.1*	*5.5*

Source: Federal Annual Budget Statements and Fiscal Operations, Finance Division.
Note: Changes showing difference between the revised estimates with initial budget estimates.

41. The net result of employing these instruments has been an increase in domestic borrowing beyond initial projections (Figure 6), which was compounded by revenue shortfalls. This surge in borrowing has had knock on implications on interest costs and debt.

Figure 6. Net Domestic Borrowing, FY2016-17 – FY2022-23, (Rs Billion)



Source: Federal Annual Budget Statements and Fiscal Operations, Finance Division.

42. Pakistan stands as an exception in terms of the National Assembly's oversight regarding the practice of supplementary grants, which deviates from good international practice. The IMF Fiscal Transparency Code[18] advises that "*any significant amendments to the total budgeted expenditure should necessitate a supplementary budget beforehand*." The Code further defines advanced practice as requiring "a *supplementary budget ahead of any substantial changes to the total budgeted expenditure or its composition*."

43. There is a strong rationale for requiring prior approval by the legislature which extends beyond the need for transparency and accountability. It allows the legislature the opportunity to examine and assess proposed changes to the budget in a similar manner to its initial scrutiny of the proposed annual budget. It provides a crucial check to ensure a disciplined budget preparation process and to mitigate policy slippages during its implementation. Conversely, frequent reliance on methods that alter budget allocations without the legislature's input can lead to suboptimal macro-fiscal forecasts, inadequate costing of public policies, ineffective budget preparation, and relaxed control over the implemented budget by the Ministry of Finance. Due to these concerns, many countries have adopted the practice of seeking their National Assemblies' prior approval for supplementary spending. Box 5 includes examples of countries adhering to good or advanced practices in this regard.

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[18] https://www.imf.org/en/Topics/fiscal-policies/fiscal-transparency

Box 5. Supplementary Budgets – Country Experiences

Chile. Expenditure exceeding the overall approved budget total can only be authorized by law requiring Congressional approval. Amendments to the annual budget laws are not common in practice. The executive has the flexibility to determine the rules on transfers, increases or reductions and other budgetary modifications through an annual decree with instructions for budget adjustments, within limits specified in the annual budget law. The limits include transfers from capital to current spending, and those that increase the payroll.

Colombia. Only Congress can approve changes, additions, or transfers across budget lines to the approved appropriations in the annual budget law. If there is a need to increase appropriations or add a new expenditure in the budget, the government can present bills to Congress for reallocating and supplementing the approved budget. Reallocations across ministries or other public institutions, and across programs within a ministry or institution, are thus not permissible without Congressional approval. The law further demands that supplementary appropriations are obtained only after clearly establishing additional sources of funding to meet those expenditures, and on a certification by the General Accounting Office, or the head of budget in case of a public institution, of the availability of such resources.

France. In line with the Budget Organic Law, a contingency reserve is included in the appropriations with a limit of Euro 500 million, or 0.1 percent of total expenditure. The executive can utilize the contingency reserve for emergency situations, transfer funds between programs of the same "mission" (policy objective) up to 2 percent of their initial appropriations, reallocate funds between different programs up to 1 percent of their initial appropriations, and cancel appropriations up to 1.5 percent of appropriations of the total budget, but with ex ante information of the Finance Committees of the National Assembly and the Senate. Changes above these limits should be implemented only through a supplementary budget, which require legislative approval with full discussion and vote in plenary by the two Chambers of the National Assembly.

Ireland. Any increase in total expenditure or movements between Votes requires approval by the National Assembly. This approval takes the form of a Supplementary Estimate, which is required whenever (i) additional money is needed for an existing service; (ii) additional funds are needed to cover a shortfall in appropriations in aid (non-tax revenue collected by departments); (iii) to use surplus appropriations in aid to finance additional expenditure; (iv) to transfer appropriation from one departmental Vote to another; or (v) to transfer funds between services within a Vote, when this cannot be done through administrative virements.

South Africa. Virements between budget programs within a vote are limited up to 8 percent of program allocation without requiring legislative approval. Larger virements, virements between votes, or increases to allocations require legislative approval through an adjustments budget, which helps to ensure the credibility of the approved budget. PFM Act permits the use of funds for emergency circumstances up to 2 percent of total appropriations without legislative approval, but this has only been used once in the past 10 years (0.4 percent of total appropriations).

Source: IMF Fiscal Transparency Evaluation reports.

44. In 2013, the Supreme Court of Pakistan issued a ruling on the interpretation and application of Article 84 of the Constitution in relation to the discretionary powers granted to the Federal Government on budgetary issues. This was initiated through a petition to the Court, seeking a decision on whether the Constitution allows the Executive to allocate funds through supplementary grants at its sole discretion.[19] The Supreme Court's judgment yielded several key observations:

- The Federal Government is obligated to present a Supplementary Budget Statement to the National Assembly *that "is subjected to the same scrutiny and procedure as is applicable to the Annual Budget Statement*".
- The Supplementary Budget Statement should be presented within the current fiscal year.
- Although Article 84 is not clear on the timing of the approval of the Supplementary Budget Statement by the National Assembly, the Supreme Court took note of the Rules and Procedures and Conduct of Business in the National Assembly 2007 as a source of interpretation to conclude that "*in the case of supplementary grants, the assent of the National Assembly is to be obtained before these funds are made available*."[20]

  A petition to overturn this judgement was presented by the Government to the Supreme Court in 2014, but this petition was dismissed.

45. Notwithstanding the Supreme Court's final and binding judgement supporting the ex-ante approval of supplementary grants, relevant laws and rules can be amended to ensure greater certainty and clarity on its interpretation and application. In 2019, a Constitutional Amendment was proposed to the Senate, aiming to revise Article 84 to require prior resolution from the National Assembly before the approval of supplementary grants, except in cases of emergencies.[21] The Bill failed to secure the necessary Constitutional majority for passage. There may be other mechanisms through which the Supreme Court judgement can be enshrined. This could include amending the PFMA (e.g., Article 10) and the General Financial Rules 2019 (Rules 96-196), and/or reinstating the principle of ex-ante approval of the GFR. Alternatively, another attempt at amending Article 84 may be needed. Legal experts within the Ministry of Justice are best placed to provide guidance to the Federal Government on the approach to take in the light of the Supreme Court judgment.

46. Future attempts to tighten the use of supplementary grants must tackle the primary justification for the current approach, which centers on maintaining flexibility in budget management. While it is true that legislative approval may occasionally hinder prompt responses to emergencies, a balanced solution can be found in Pakistan, as is the case in numerous countries (see Box 6). The example of the caretaker government, which is currently overseeing the budget without resorting to supplementary grants, shows that strong commitment can lead to effective budget management without total flexibility. A viable solution would be to provide the government with limited,

[19] Constitutional petition No. 20 of 2013

[20] Para 197 of the Rules and Procedures and Conduct of Business in the National Assembly 2007, states, " The procedure of dealing with the Supplementary estimates of expenditure and excess demand shall, as far as possible, be the same as prescribed for the budget, except that, if on demand for a supplementary grant, funds to meet the expenditure on a new purpose are available for re-appropriation, a demand for the grant of a token sum may be submitted to a vote of the assembly and if the assembly assents to the demand, funds may be made available."

[21] Under article 232 of the Constitution

rather than unrestricted, flexibility. This can be achieved by setting upper limits on supplementary grants and establishing a contingency reserve.

Box 6. Country Experiences in Balancing Budget Flexibility and Accountability to the Legislature

A recent study by the OECD of its member countries examines the various ways its members maintain budget flexibility ("Medium-Term and Top-Down Budgeting in OECD Countries", OECD Journal of Budgeting, December 2023). A large majority of OECD countries set allowances for emergencies in their annual budget (and for future spending pressures in outer years in case they have a medium-term budget framework). There are differences, however. While countries like **Sweden** and **Latvia** have specific safety margins set in their budgets in case fiscal risks materialize, **Australia, New Zealand** and **Germany** emphasize the setting of a prudent policy stance, as opposed to keeping a specific margin.

South Africa exemplifies a balanced approach to financial flexibility and accountability, as explained in Box 5. Under the PFM Act, the executive can allocate up to 2% of total appropriations for emergencies without needing legislative approval. However, any significant modifications, like in-year virements or budget increases, demand prior approval through an adjustments budget. In the **United Kingdom**, the budget includes a reserve fund amounting to 2% of the last year's budget, earmarked for unforeseen expenses. **France** adopts a different approach, maintaining a smaller contingency reserve of 0.1 percent of the total budget. However, as explained in Box 5, French law permits the (limited) transfer of funds within and across missions under programs and missions to give flexibility to the government.

Source: IMF mission

47. Establishing a budgetary reserve margin or a distinct contingency fund will support budget flexibility. The size of this reserve margin could be determined by examining the size of unexpected calls on the budget in recent years, due to external factors such as a depreciation of the rupee, or weather-related shocks that necessitated budget funding. This analysis should be tempered by a relatively conservative approach to maintaining reserves to prevent unwarranted calls on them during budget execution. The rules for accessing this fund should be clearly stipulated in the PFMA, complemented by guidelines issued by the Finance Division. This initiative also demands a shift towards more effective budget planning, as previously detailed in Section II. Moreover, the Finance Division and Finance Committees in the National Assembly should intensify their examination of the budgetary impact of requests for supplementary grants. This process could be formalized through legislative measures. In addition, both could be required to only endorse supplementary grants after reviewing in-year fiscal performance and forecasts for the rest of the year. Publication of these could also be made mandatory. With a reasonable reserve margin set aside, Cabinet should make it clear, at the start of the financial year, that there will be no recourse to supplementary grants, while technical supplementary grants will be highly regimented, and only approved in exceptional circumstances.

48. To underpin possible changes in the regime for managing supplementary grants, a special audit of the efficiency of these grants over the past decade can be undertaken. This review, which could be assigned to the Auditor General, would provide valuable insights and lessons into the reasons for and impact of supplementary grants, and would support the case for reform.

B. Strengthening commitment controls

49. Commitment control is one of the most important instruments to ensure that the budget is implemented as planned and that expenditure arrears are avoided. Recent years have seen convergence in international practices towards an increased focus on ex-ante controls over expenditure commitments and a shift from controlling only cash expenditure towards controlling the accumulation of accrued liabilities as well. Good and comprehensive commitment controls are generally considered the most effective tool to avoid expenditure arrears. And the government's recent Commitment Control Guidelines[22] refer to expenditure arrears from previous years as a major source of fiscal indiscipline and poor budget credibility.

50. The Pakistani Commitment Control system is well defined in the PFM legal framework. The PFM Act (section 26) states that the Finance Division shall approve, and issue guidelines related to annual and multi-annual commitment control systems. The (apportionment) release of the budget is done through the Schedule of Authorized Expenditure, to each ministry and to AGP, as set out in the Accounting Policies and Procedures Manual section 3.3.11. The Accounting Manual further defines the sanctioning of expenditure (section 4.2.2) which includes two functions: namely a Budget Availability Review (Commitments Control) and the raising of a Purchase Order. The budget availability review function assesses whether the expenditure or commitment entered is provided in the Schedule of Authorized Expenditure. Finally, Commitment Control Guidelines were issued in March 2022 further outlining procedures for commitment control.

51. The Commitment Control Guidelines define an expenditure commitment as "an obligation to make a future payment, the funds for which are reserved against the allocated budget of an entity." However, commitment control practices are not fully aligned with the definition. The Guidelines further define that the commitment control system shall limit commitments to the projected cash availability (Schedule of Authorized Expenditure) and approved budget allocations. These rules include multi-year commitments and are broadly in line with international good practices.[23] However, despite the express requirement that the PAO of a ministry/division must ensure available cash and allotment when approving new expenditure, commitments are only registered in FABS when the approved Payment Voucher (Payment Order) is presented to the Controller General of Accounts. This may give rise to more than one procurement activity being carried out on a single budget line.

52. Best practices suggest that the authorities apply the principle of pre-commitment or reservation. At this stage, there is no commitment, but it is known that the expense will be incurred during the budget year and, therefore, that reserved funds should not be used for other activities. This setting aside of an allotment for a future expenditure is not yet a legal commitment as no specific contract is signed at this stage. The reservation stage is particularly useful regarding expenditure that involves a lengthy procurement process where competing demands on the appropriation line may arise prior to the issue of a Purchase Order. This risk may be exacerbated because a linkage between FABS

[22] The Commitment Control Guidelines Notification, Finance Division, Budget Wing, March 2022.

[23] See Sailendra Pattanayak, "Expenditure Control: Key Features, Stages and Actors", IMF Technical Notes and Manuals, 2016.

and e-Pakistan Acquisition and Disposal System (ePADS), the procurement IT system, has yet to be implemented.

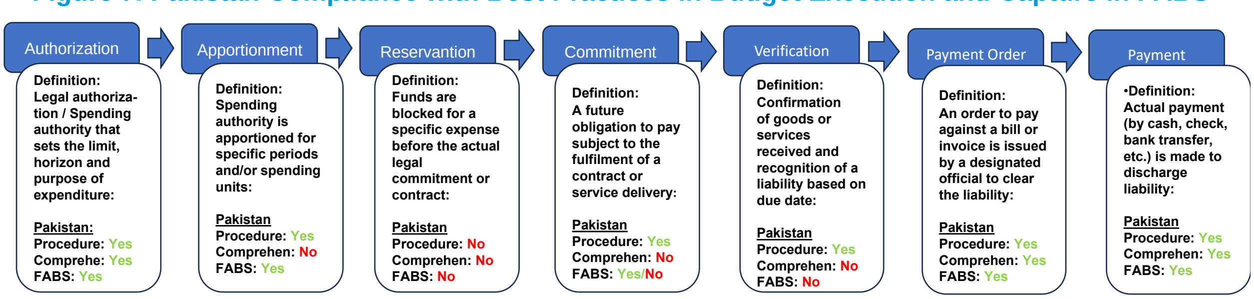
53. **Commitment controls in Pakistan have a limited scope and do not include interest payments, payroll expenses and pensions (see Table 4).** This is contrary to international good practices which recommend that all expenditure classes be covered by the commitment control system**.** Indeed, in Pakistan spending covered by commitment controls in 2021-22 constituted less than 10 percent of total expenditure at the Federal level. The Commitment Control Guidelines only define the scope of annual commitments as encompassing recurrent and development budgets for procurement of goods, services and the carrying out of civil works thus leaving out interest payments, payroll and pensions. International good practices suggest that in cases where the expenditure is subject to a previous ongoing contract (e.g., wages, utilities, rent, debt service) or statutory obligations (e.g., transfers to provinces), an estimate of the obligation to pay should be made and treated as a commitment. More specifically on payroll and pensions, the Organization & Management (O&M) Module of SAP will need to be implemented to lock payroll against sanctioned posts. On interest payments and provincial transfers, linkages of the IT systems in the EAD, Debt Office and PF Wing in the Finance Division and close coordination with FABS will need to be established.

Table 4. Pakistan Compliance with Best Practice in Budget Execution and Commitment Controls

Stages of expenditure	Authorization of expenditure	Apportionment of expenditure for specific periods and specific spending units	Reservation	Commitment	Verification	Payment Order	Payment
Pakistan legislation	√	√	√	√	√	√	√
Old Model	√	√	./	√ (Manual)	√	√	√
New model	√	√	./	√	√	√	√
Pakistan Comprehensiveness	√	√	./	./	√	√	√

54. **Finally, several stages of the expenditure process are carried out manually and are not presently captured in FABS.** The authorities are developing new functionalities in FABS (such as the On-Line Bill Submission) which once fully rolled out will serve to capture commitments at an earlier stage in the expenditure process. However, FABS will still not capture all information on budget execution as international good practice recommends. Figure 7 compares procedures used in Pakistan with international good practice.

Figure 7. Pakistan Compliance with Best Practices in Budget Execution and Capture in FABS



C. Recommendations

Recommendation 8. Initiate legal changes required to limit the discretionary powers granted to the Federal Government over the use of supplementary grants, while maintaining some flexibility in budget execution.

Recommendation 9. Request the Auditor General to undertake a special audit on the mechanism, efficiency, and effectiveness of supplementary grants over the last ten years.

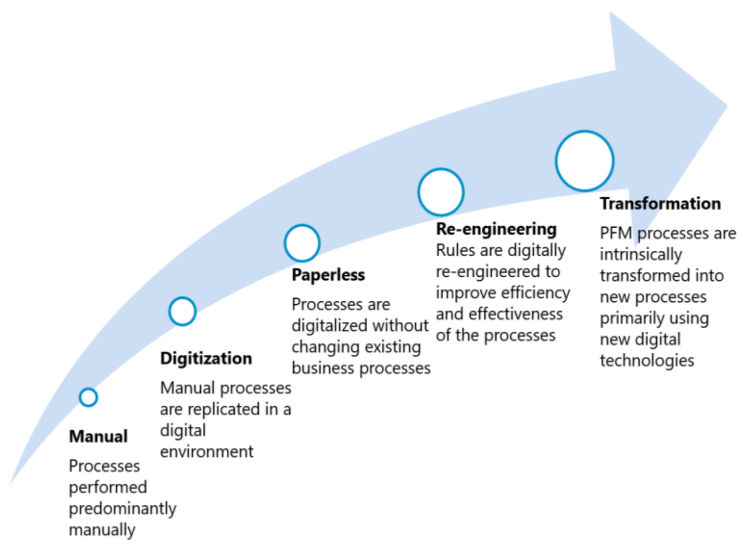
Recommendation 10. Review the various stages of commitment controls to make them comprehensive and aligned with international good practices and redesign the budget execution process accordingly.

IV. Digitalizing the budget process

55. Pakistan has made advances in digitalizing PFM processes in recent years, particularly in budget execution. According to the World Bank's GovTech maturity index[24] digitalization of PFM in Pakistan is broadly equivalent to its peers. FABS is at the heart of the PFM system. It is a tool designed to support budget preparation and execution at the federal and provincial levels. FABS captures budget data and processes for more than 33,000 cost centers across government, of which 5,500 are at the federal level. In addition, the FABS department, located in the Office of the Controller General of Accounts, has implemented a Data Warehouse where fiscal data is collected and made available to stakeholders through a set of dashboards. The planning and implementation of development projects, including the submission of project proposals, appraisal, approval and monitoring and evaluation of projects, are supported by the Intelligent Project Automation System (iPAS); and procurement is supported by the ePADS. The FABS department is planning to employ the e-Office system operated by the Pakistan National Information Technology Board which would provide an interface with FABS and reduce the number of required FABS licenses.

56. This section assesses the existing state of digitalization of the budget preparation and execution processes and considers the factors that can enable more effective digitalization going forward. The analysis is based on a tool currently under development by the IMF's Fiscal Affairs Department, called the Digitalization of PFM Assessment Tool (DIPAT).[25] It identifies five states of digitalization: (i) manual; (ii) digitization; (iii) paperless; (iv) re-engineering; (v) transformation, as illustrated in Figure 88. The tool identifies factors enabling effective digitalization (FEED) over five domains: (i) IT system features; (ii) data governance; (iii) regulatory framework; (iv) IT infrastructure, (v) governance and capacity. These factors are summarized in Box 6.

Figure 8. States of Digitalization According to DIPAT



Source: IMF, DIPAT Note (forthcoming)

[24] WB Gov Tech Maturity Index database, October 2022 update.

[25] This exercise was conducted through the administration of a questionnaire prior to the mission, and a three-day workshop with relevant stakeholders

Box 6. Five Domains Enabling Effective Digitalization (FEED)

1. **IT Systems.** Refers to critical characteristics of the IT systems that are required for each state of digitalization. For example, digitization may be achieved by a single system mimicking manual processes, a way an Integrated Financial Management Information System has often been implemented. The legacy systems, with less flexibility, can slow adoption of new technologies. Therefore, critical IT systems characteristics include open, interoperable, and service-oriented systems that are flexible and can be updated individually for different PFM processes and related services.

2. **Data Governance.** IT systems do not function as expected if there are data gaps or data is of inferior quality. Data governance is critical in advancing PFM process digitalization. Inadequate data governance can inhibit the availability, quality, and usability of data required for digitalization. It can lead to incomplete or inaccurate data, undermining the effectiveness and efficiency of digital PFM systems. For example, in many countries the accounting process is digitized without accurate opening balances for assets, liabilities, and transitory accounts, creating problems in preparing reliable financial statements.

3. **Regulatory Framework.** The regulatory framework includes laws, regulations, and policies supporting PFM digitalization. It ensures interoperability and compatibility between IT systems used across PFM processes. It focuses on common regulatory issues such as IT security, interoperability, data governance and authentication.

4. **IT Infrastructure.** This domain includes the required hardware and network connectivity and covers software that provides a foundation for the functioning of individual IT systems, for example, digital signature and data backup applications.

5. **Governance and Capacity.** The governance and capacity factors oversee and coordinates digitalization efforts across different entities involved in PFM processes. It ensures that the necessary resources, including financial, human, and technical, are available for successful leapfrogging. It also includes assessing digital literacy and skills of the staff to operate digitalized processes effectively.

Source: DIPAT Explanatory Note

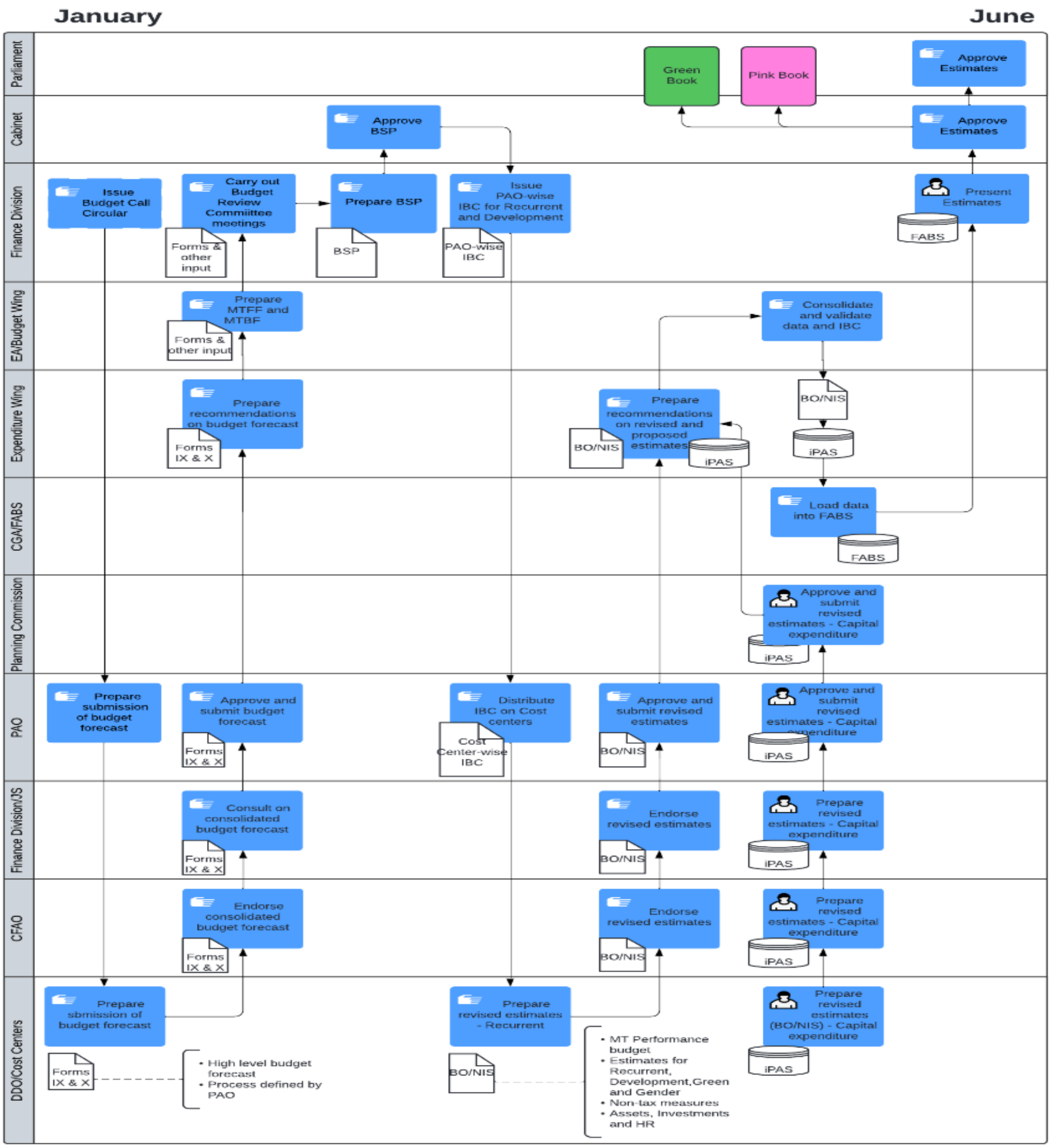
A. The Assessment

Budget preparation

57. **The analysis carried out by the mission using the DIPAT tool concluded that the current budget preparation process in Pakistan is predominantly manual.** While the process for preparing the budget for development projects has been fully digitalized in the iPAS system, the one for recurrent expenditure is carried out manually. After the issue of the BCC, two procedures are carried out. First, PAOs prepare their budget submissions separately for recurrent and development spending. Second, once the BSP is approved and the IBCs are issued by the Budget Wing, PAOs prepare detailed budget estimates through budget orders and New Item Statement forms. Figure 99 outlines the various steps during budget preparation and identifies those where manual processes are involved (marked with a hand:). The chart also clearly shows that the use of FABS is only made at the last stage of budget preparation when the budget estimates are to be consolidated. During that stage, despite the fact the

preparation of the development budget has been fully digitalized in iPAS, data for development projects are still manually captured in FABS due to the lack of integration between iPAS and FABS.

Figure 9. Steps in Budget Preparation



58. An attempt was made in 2019 to digitalize the recurrent budget preparation process. Ten divisions submitted their budgets using the SAP Budget Preparation Module. This initiative benefited from the expertise of a certified SAP Business Planning and Coordination lead but was abandoned when this person left the FABS Department. With the introduction of new requirements for budget preparation following the PFMA, and the introduction of the iPAS, renewing this effort would benefit from a prior review and possible redesign of the budget preparation process, including through a consultation with relevant stakeholders (e.g., the Planning Division and other Divisions). It would also provide an opportunity to incorporate elements relevant for budget execution which are currently not prepared, for example inclusion of a procurement plan and expenditure plans for all expenditure classes. An expert is currently being hired at FABS to support this effort.

Budget execution

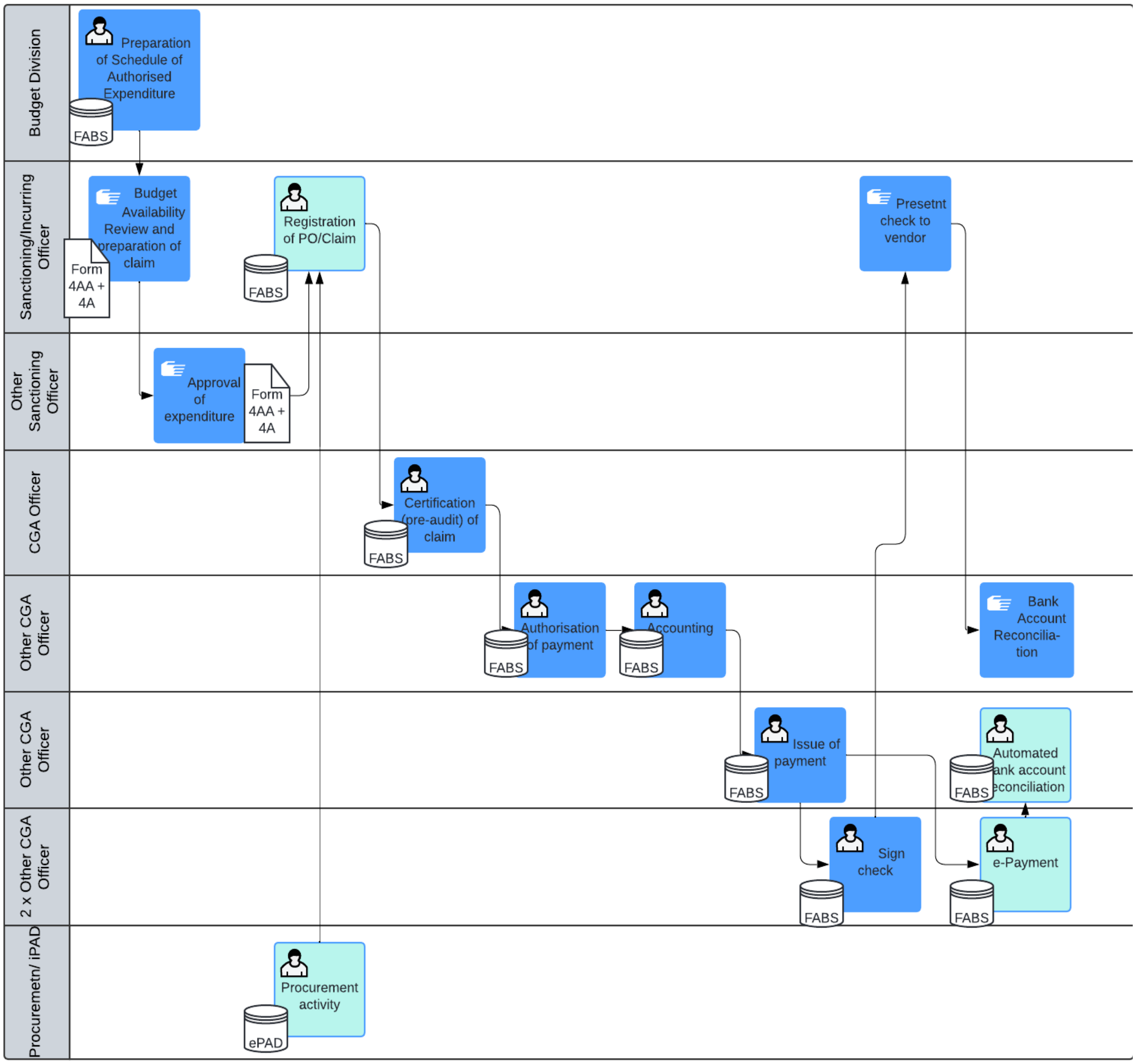
59. The DIPAT found that some stages of the current budget execution process are still manual. In the current budget execution process, cost centers manually validate if planned expenditure can be accommodated by the budget released by the Budget Wing (commitment ceiling). After procuring goods and services the Payment Voucher is presented to the Controller General of Account (CGA) department for registration in FABS. It should be noted that this is the first time that a registration is made in FABS. After successful processing, a check is issued, signed by CGA staff, and sent to the relevant Cost Center for handing over to the vendor. After the check has cleared a laborious process of devolving the used check from the bank to the CGA is carried out to finalize the bank account reconciliation. Figure 10 shows the various steps involved in budget execution. Most of these steps are undertaken through FABS, although some processes remain manual (e.g., a budget availability check and preparation of claims, approval of expenditure, presentation of checks to vendors, and bank account reconciliation).

60. The authorities are transitioning to a new model for budget execution. New systems and functionalities are expected to be being rolled out in the next two to four years including: (i) the online submission of bills; (ii) the ePADS; (iii) the e-Office, which would provide an interface to the FABS system and reduce the number of required FABS licenses to improve FABS access; (iv) electronic payments (EFT – electronic funds transfer); and (v) automated bank account reconciliation. At the same time, the FABS department is reviewing the SAP commitment control module to improve commitment controls. When all these initiatives have been implemented (the expected time horizon is 2-4 years) the budget execution process will be predominantly digitized with a few steps still manual, including pre-commitment control and funds reservation.

61. The FABS department is working on several parallel initiatives that will partly digitalize the budget execution process. When fully implemented these initiatives should significantly improve the budget execution process. However, as discussed in Section III B, the digitalization of commitment controls will be incomplete even after the implementation of improved budget execution functionalities. Several major expenditure classes (e.g., interest payments and payroll) will be excluded as will the pre-commitment and reservation stages of the budget execution cycle.

62. The government has not prepared an updated review and redesign of the budget execution process. The absence of such a review and redesign of the budget execution process can jeopardize digitalization efforts if future requirements are not properly incorporated, for example the possible future transition to accrual-based accounting, revised commitment controls, and new payment and bank account reconciliation processes.

Figure 10. Steps in Budget Execution



B. Factors enabling effective digitalization

63. **Results from the FEED analysis are promising: conditions are in place for the government to implement a "Paperless" state of digitalization, but further work is needed to support the "Reengineering" state.** The output matrix from this analysis is shown in Table 5 below, and the remaining part of this section summarizes its key findings.

Table 5. FEED Assessment

Domain	Manual (1st state)	Digitization (2nd state)	Paperless (3rd state)	Reengineering (4th state)	Transformation (5th state)
IT Systems Features	100%	100%	100%	100%	0%
Data Governance	100%	100%	50%	50%	0%
Regulatory Framework	100%	100%	33%	50%	0%
IT Infrastructure	100%	100%	100%	67%	0%
Governance and Capacity	100%	100%	100%	67%	33%
State-wise Feed Strength	**100%**	**100%**	**80%**	**71%**	**7%**

FABS and staffing of the FABS Department

64. **FABS is the main system for budget planning and execution.** FABS has been the core of the Pakistan PFM system since 2006. It is based on the SAP system and comprises a total of 14 SAP modules. Accounts for all cost centers at federal and provincial level are processed through FABS. The FABS department has not applied standard SAP methods for developing the FABS functionality which hinders upgrades of FABS provided by SAP. At the federal and provincial level 500 terminals across cost centers have access to enter transactions into SAP, but this number is expected to increase.

65. **The FABS department currently has limited capacity to undertake development activities, due to low staffing levels, but it is expected that new staff positions will be created soon.** The FABS department is established with 61 staff, but currently only half of these positions are filled. Since 2019 FABS has lost about half of the staff, including many SAP programmers. This is mainly due to staff being offered higher paid positions outside of government. Due to a government-wide hiring freeze the department has not been able to replenish positions but recently the recruitment of new staff has been approved. The FABS Director expects that during the first quarter of 2024 most of the vacant positions will be filled. Overall, the understaffing of the department has caused several projects to be halted but once new staff have been appointed more projects and development work can be undertaken.

The regulatory framework

66. **The regulatory framework overall supports advances in digitalization, but improvements could be made in enforcing paperless processes and improved procedures for data exchange improvements.** In 2002 the National Assembly passed the Electronic Transactions Ordinance Act. The Act legalizes the use of electronic signatures and electronic records. Going forward, the legislation could

be amended to include considerations regarding digital privacy, cybersecurity and provide guidelines for use of artificial intelligence in PFM related decision-making processes. Other gaps in the regulatory framework that limit the advancement of digitalization include:

- The PFM regulatory framework generally lacks reference to FABS and does not specify the use of FABS as a mandatory element in digitalizing PFM processes.
- No FABS user manual has been prepared and the on-line support to FABS is limited. However, it is noted that the FABS department has established a call/support center.
- The regulatory framework fails to identify the Finance Division as the authoritative entity in questions concerning FABS, Fiscal Data Governance (FDG), data delivery and data exchange. This apparently has the implication that several entities have not met the request of Finance Division to deliver timely data to FABS.

IT infrastructure

67. The IT infrastructure is overall satisfactory, but further investments in rolling out access to FABS and enhancing data center facilities are needed. The FABS department administers the FABS infrastructure, including several data centers to support FABS operations and disaster recovery but none of these centers has a 'Tier-3'[26] security status and is subject to some operational risk. The FABS department is working to expand network access through secure channels which will enable an expansion of the number of connected FABS users. User connectivity to FABS is generally stable but the FABS department could consider preparing plans for elevating the tier grading of data centers.

Fiscal Reporting and Fiscal Data Governance

68. Good FDG—management of the fiscal data quality —is essential to ensure that IT systems function as expected without data gaps or data of inferior quality is currently a challenge for FABS. In Pakistan, fiscal data governance is of particular importance because the FABS department has implemented a Data Warehouse (DW) solution to collect and store fiscal data from various systems not directly linked to FABS. Data are then presented through several dashboards. However, the FABS department has not been able to monitor and ensure the quality of data delivered to the data warehouse. Although the sources are audited by the Auditor General of Pakistan this does not guarantee the data quality.

69. Access to and collection of fiscal data outside of FABS can be improved. The Data Warehouse collects data from various sources, including the Federal Revenue Board, SOEs, external and internal debt management, and the State Bank of Pakistan. It is noted that budget execution and non-tax revenues at both federal and provincial level are captured (albeit often with some delay) in FABS. Several of the data sources outside FABS deliver information to the Data Warehouse with significant delay. Most external data is consolidated within 20 days and a few pockets of data are delivered with a delay of up to 90 days. In the best case, FABS and the Ministry of Finance would have a legal mandate to request data sources to connect to the Data Warehouse and deliver this information to

[26] A tier-3 data center has multiple paths for power and cooling, and redundant systems that allow the staff to work without taking the center offline.

FABS in real-time. The FABS department could consider dedicating resources to monitor and ensure high-quality fiscal data in DW. To ensure high-quality fiscal data in the FASB, a tailored Fiscal Data Governance program could be designed to support strong FDG practices, including wider government policies[27]. FAD can help the authorities in developing a tailored FDG program.

Management and Governance of PFM digitalization

70. Digitalization efforts in the MoF are not supported by a costed medium-term reform strategy with time bound objectives and priorities. The absence of an overall digitalization plan makes prioritization, planning, monitoring, coordination, and evaluation of the government's digitalization effort difficult. A few projects, for example the implementation of the SAP commitment module and the roll-out of on-line Bill submission, have been incorporated in the development budget as capital expenditure. Overall, however, there does not seem to be a costed plan for digitalization efforts which can make it challenging for the Ministry of Finance and the FABS department to identify and prioritize activities. The wide variety of stakeholders involved in PFM digitalization points to the need for overall coordination of digitalization efforts. Other countries have established a high-level committee to coordinate digitalization efforts, a mechanism that is currently absent in Pakistan.[28]

71. Process design and reengineering of processes is an important element In PFM digitalization and often requires a cross-cutting approach because many PFM processes and systems interact. Support to PFM business processes in FABS can be improved in several ways. FABS does not capture all steps in business processes which is a pre-requisite for successful digitalization and harvesting of the advantages of digital processing. By not capturing all steps in business processes some steps will require manual intervention and preparation of paper-based documentation and forms. This hampers efforts to automate procedures and reduces transparency in the processes.

72. Addressing the above elements could allow PFM digitalization to skip the digitization and paperless stages and advancing directly (leapfrogging) to the re-engineering state. Although not identified as an element in the FEED analysis leapfrogging improvements in digitalization would also require enhancements of governance, coordination, and planning structures. Enhanced capacities could be developed through the preparation of PFM digitalization strategy or masterplan (Box 7 suggests some elements that could form part of this Masterplan), and the establishment of a strong Digitalization Steering Committee headed by the Minister of Finance and including relevant stakeholders inside and outside of the MoF. The Masterplan should be costed and define time bound objectives and priorities. Implementing such a strategy would require additional capacity in the FABS department to develop competencies in program and project management.

[27] https://moitt.gov.pk/Detail/ZTA5MTI4ZWUtMzdhMS00ZDRhLWE0YmUtZjJjNThhYTdjNzdl and https://nitb.gov.pk/#section-features

[28] Country examples include Lesotho, Kosovo, Seychelles and Eswatini.

Box 7. Suggested Elements in a PFM Digitalization Masterplan

Master plan objectives: Coordinate and prioritize PFM digitalization initiatives. Plan and cost initiatives to ensure that they are affordable and add value.

Governance arrangements: Supported and monitored by a High-level Steering Committee. The FABS Department to constitute a Secretariat to service the Steering Committee.

Examples of possible prioritized digitalization initiatives:

- Review FABS support to the budget execution process to improve:
    - Commitment controls
    - Full roll-out electronic payments
    - Integration with iPAS and ePADS
    - Use of e-Office.
- Review and implement a fully digitalized budget preparation process.
- Review FDG practices including interoperability to ensure high quality fiscal data to support data driven decision making.
- Increase FABS Department staff and prepare a capacity building plan.
- Finalization of re-coding of FABS (SAP) customized modules to allow for version update of FABS.

As SAP life support to the current version comes to an end in 2025, this may be an opportunity to reconsider a different approach towards less centralized, open-source, scalable solutions. **Medium to longer term**

- Build capacity of FABS Department in various tools and applications (Fiscal Data Governance, Data Exchange, project management tools (PMI and PRINCE II).
- Prepare a change management and communication strategy for implementing the Masterplan.
- Prepare a plan for the deployment of further functionalities based on the FABS Conceptual Framework.
- Prepare a plan for investment in Data Center upgrades, an increase of on-line access to FABS and an upgrade of user infrastructure.

Source: IMF mission

73. **Overall, the DIPAT assessment points to the possibility of some quick digitalization gains.** These could include: (i) a review and revision of FABS support to the budget execution process to improve commitment controls and fully roll-out electronic payments; (ii) a review and implementation of a fully digitalized budget preparation process; (iii) a review of FDG practices, including data exchange, regulatory framework, to ensure timely delivery of quality fiscal data thus enhancing fiscal monitoring and reporting; and (iv) overall improvement of the coordination and implementation of fiscal digitalization by preparing a Digitalization Masterplan supported and monitored by a high-level Steering Committee.

C. Recommendations

Recommendation 11. Prepare a costed PFM Digitalization Masterplan with time bound objectives and priorities reflecting the considerations in *Box 7*.

Recommendation 12. Establish a high-level Steering Committee to monitor and guide the implementation of the Digitalization Masterplan.

Recommendation 13. Review and update the regulatory framework to ensure that the MoF has the authority to request comprehensive and timely delivery of fiscal data of adequate quality to the FABS data warehouse and prepare Fiscal Data Governance guidelines.

Recommendation 14. Review process designs of budget preparation and budget execution to reflect new and future requirements.