RENEWABLES FIRST

Budget 2025-26

A balancing act between climate ambitions and fiscal realities

The Federation's fiscal compulsions overshadow its climate ambitions

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The intersection of climate considerations and fiscal frameworks

- Pakistan's federal budget for FY26, with an outlay of **PKR 17.573 trillion (T)**, targets a fiscal deficit of **3.9% of GDP**, the lowest level since FY08.
- For the first time, the country had to budget for two separate IMF programmes: the Extended Fund Facility (EFF) and the Resilience and Sustainability Facility (RSF) for climate change.
- The budget introduces several climate-related fiscal measures while pursuing economic stabilization objectives.

Key Measures

Carbon Levy	Carbon levy of **PKR 2.5 per liter** on petrol, high-speed diesel, and furnace oil, scheduled to increase to **PKR 5 per liter** by FY27
New Energy Vehicle Adoption Levy	New Energy Vehicle adoption levy ranging from **1-3%** on internal combustion engine vehicles
Petroleum Levy	Petroleum levy collections targeted at **PKR 1.46 T**, representing a 27% increase
Levy on Captive Power Plants	A budgeted target of **PKR 105 billion** has been set through the imposition of a levy on Off-the-Grid (Captive Power Plants) for the next fiscal year
Total Subsidy Outlay	The total subsidy outlay is reduced through a **13%** cut in Power sector subsidies

The budget is an attempt to integrating climate considerations within fiscal policy frameworks while maintaining growth targets. Revenue mobilization through environmental and energy transition levies contributes to overall fiscal consolidation efforts

If the (economic) survey serves as a diagnostic report on the country's economic performance during the outgoing fiscal year, then the budget for the next fiscal year is intended to be the prescription to fix any shortcomings.

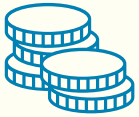
***Dr. Abid Qaiyum Suleri, Executive Director, Sustainable Development Policy Institute (SDPI)**

**Quoted from The News article: Budget 2025-26: read the fine print?*

Fiscal consolidation takes priority over development expenditure

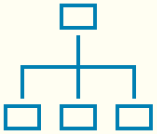
Fiscal Framework

Total government expenditure is projected to grow by 1.9% year-on-year, reflecting controlled spending expansion. FBR tax revenues are targeted at **PKR 14.13 T**, representing 18.7% growth that exceeds the projected 13% nominal GDP growth rate.



Revenue Structure

The government pursues its third consecutive primary surplus, targeting 2.4% of GDP or **PKR 3.17 T**. This relies on enhanced tax enforcement and compliance measures, particularly targeting non-filers of tax returns.



Expenditure Management

Debt servicing costs decrease by 8.3% to **PKR 8.207 T**, benefiting from lower domestic interest rates. Power sector subsidies face around 13% reduction while maintaining targeted support mechanisms. The Federal Public Sector Development Program allocation was down to PKR 1.0 T from PKR 1.1 T in the last budget.

Indirect Taxation

Majority of the revenue growth will come from indirect taxes rather than expanding direct taxation. The continued heavy reliance on indirect taxes (**estimated at PKR 7.2 T**) including fuel levies is regressive, placing a disproportionate burden on lower-income groups and potentially worsening inequality.

IMF Program Alignment

The budget operationalizes components of the IMF's Resilience and Sustainability Facility, particularly regarding green budgeting practices and climate assessments for major development projects exceeding **PKR 7.5 B**. However, the implementation mechanisms for these initiatives remain largely primitive and inadequately developed.

Climate-lens budgeting marks a turning point as vulnerabilities manifest

Climate Data	Pakistan experienced its 9th warmest year on record in 2024, with temperatures 0.71°C above average and rainfall 31% above normal levels. Economic losses from extreme weather events between 1980-2024 total **USD 36.4 Billion (B)** across 224 events.
Recent Climate Events	The 2022 floods resulted in **USD 15 B** in economic losses and affected 33 million people, highlighting Pakistan's exposure to climate risks despite contributing less than 1% of global greenhouse gas emissions.
Policy Response	The budget attempts at a strategic shift toward climate-resilient planning, with climate-responsive grants comprising 0.2% of allocations and nearly half of subsidies targeting climate objectives.
Allocation of Proceeds	The breakdown allocated **USD 85.43 B** for climate adaptation, **PKR 603 B** for emission reduction and clean technology transition, and **PKR 28.33 B** for capacity building and research.
Tracking Proceeds	Climate Budget Tagging (CBT) tool, which classified climate-sensitive expenditures according to the National Climate Change Policy. The government tagged over 5,000 cost centers across three main categories and 40 sub-categories.

Climate change poses an existential threat to Pakistan, one of the world's most climate-vulnerable countries. Over the past 16 months, Pakistan has prioritized climate finance, securing a USD 40 B partnership with the World Bank and IFC over the next decade. After year-long negotiations, the IMF approved a USD 1.4 B Resilience and Sustainability Facility for climate resilience. The government has also launched green bonds (sukuk) to fund eco-friendly projects through local markets.

***Muhammad Aurangzeb, Federal Finance Minister**

*Quoted from Budget Speech 2025-26

The green component in numbers

Green Component of Revenues (PKR B)

Category	Specification	Description of Tax or Non-tax Revenue with climate relevance	Budget 2025-26
Energy (including fuel for transport)	Energy products used for products	Petroleum Levy	**1,468**
		Petroleum Levy on LPG	**5**
Transport (excluding fuel for transport)	Motor vehicles, Road usage	Vehicle registration, route permits etc.	**12.5**
Pollution	GHG emissions control	EV adoption Levy	**10**
Natural Resources	Extraction and Natural resource management	Gas Development	**49.4**
		Discount retained on local crude price	**30**
		Windfall Levy against Crude Oil/Gas	**20**
		Gas Infrastructure Development Cess	**2.4**
		Oil and Gas Royalties	**207**

Green Component in Subsidies (PKR B)

Sector	Classification	Category*	Green Component
Energy	Mitigation	A	529
Food	Adaptation	B	20
Industries	Mitigation	A	9
Transport	Mitigation	A	7.3
Agriculture	Adaptation	B	22
	Total:		**587.3**

** Categories:*

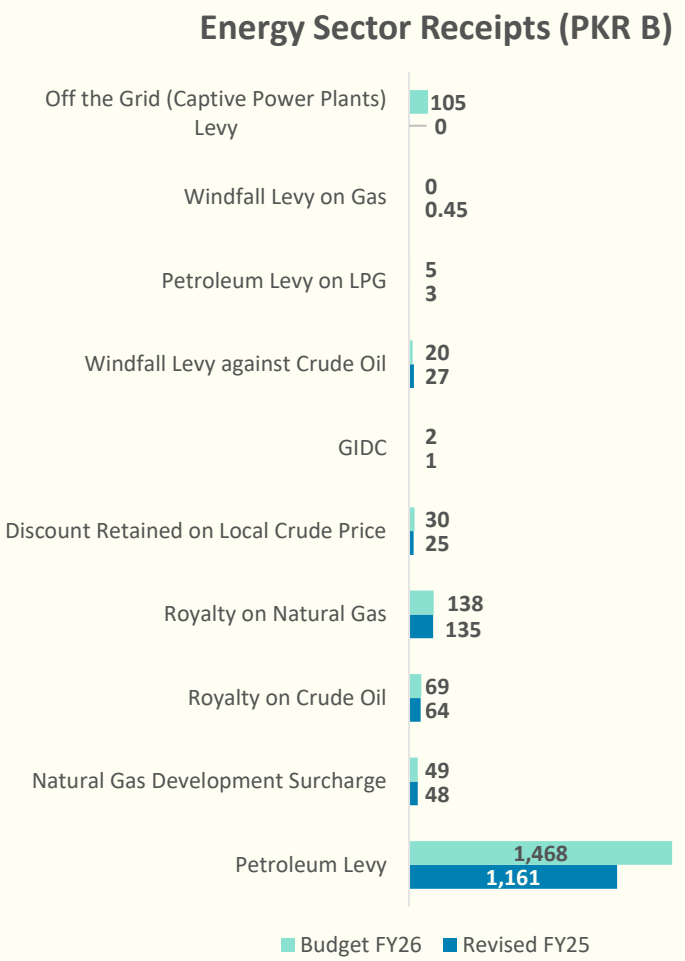
A. Directly Favorable

B. Indirectly Favorable

PKR Million **(M)**	**Budget**		
Climate	**2023-24**	**2024-25**	**2025-26**
Adaptation	**55,047**	**46,625**	**85,435**
Mitigation	**133,122**	**212,861**	**603,000**
Supporting Areas	**18,347**	**18,887**	**28,331**

The energy sector continues to serve as the cornerstone of Pakistan's fiscal architecture

Current Energy Profile	Pakistan's installed electricity capacity stands at **46,605 MW**, with renewables comprising **4.24%** of the total. The generation mix includes 53.7% from hydroelectric, nuclear, and renewable sources, while electricity consumption declined 3.6% in FY25.
Tariff Differential Subsidies (TDS)	High Transmission & Distribution losses have inflated the revenue requirement of many DISCOs. When adjusted for losses, the power purchase price is more than **50% higher** compared to a zero-loss scenario. This contributes to the need for large power sector subsidies despite current fiscal consolidation efforts.
Structural Changes	The privatization of three distribution companies (Faisalabad, Gujranwala, and Islamabad DISCOs) has reportedly reached **50%** completion according to the budget speech. However, minimal privatization proceeds in the revenue allocation suggest that the process may face further delays.
New Revenue Measures	A levy on captive power plants is expected to generate PKR 105 B in revenue while encouraging industrial consumers to connect to the national grid instead of maintaining independent power generation. The levy currently stands at **5%** (PKR 791 per MMBTU) on the gas price of PKR 3,500 per MMBTU for exporters, but will rise to **10%** from July 2025, 15% from February 2026, and 20% by August 2026.



High Transmission & Distribution losses have inflated the revenue requirement of many DISCOs, leading to a need for sizeable TDS

FY26	Unit	QESCO	HESCO	SEPCO	PESCO
Units received	GWh	3,522	5,409	3,948	11,951
Units sold	GWh	2,624	4,006	2,526	7,261
Units lost	GWh	898	1,403	1,422	4,690
T&D losses	**GWh**	**25.5%**	**25.9%**	**36.0%**	**39.2%**
Power Purchase Price	PKR M	78,563	167,157	104,211	302,678
Distribution/Supply Margin	PKR M	33,824	33,693	25,302	48,681
PYA	PKR M	16,298	5,755	25,552	29,344
Others	PKR M	-	-	7,199	3,423
Revenue Requirement	**PKR M**	**128,685**	**206,605**	**162,264**	**384,126**
PPP - Unadjusted	PKR/KWh	22	31	26	25
PPP - Adjusted	PKR/KWh	30	42	41	42
Distribution/ Supply Margin PKR/KWh	PKR/KWh	13	8	10	7
PYA	PKR/KWh	6	1	10	4
Others	PKR/KWh	-	-	3	0
Average rate	**PKR/KWh**	**49.04**	**51.57**	**64.24**	**52.9**

Regressive taxation is cloaked in the rhetoric of promoting green mobility and transport sector decarbonization

Carbon Levy Structure	The budget introduces a carbon levy beginning at **PKR 2.5** per liter on petrol, high-speed diesel, and furnace oil in FY26. This rate is scheduled to double to **PKR 5** per liter in FY27, applying to transport and industrial fuel consumption.
Petroleum Development Levy	The federal budget raises the petroleum levy by 26.4% after increasing the maximum limit from **PKR 70 to PKR 90** per liter. The government has budgeted PKR 1.47 T in petroleum levy for the upcoming fiscal year, a substantial increase of PKR 0.31 T from the current revised estimate of PKR 1.16 T and higher than the original PKR 1.28 T budgeted for 2024-25.
Vehicle Policy Framework	The New Energy Vehicle adoption levy establishes differentiated rates based on engine capacity. Sales tax on vehicles under 850cc increases from **12.5% to 18%**, removing previous concessions.
Policy Objective	These measures aim to achieve the government's target of **30% electric vehicle** share in new sales by 2030, supported by a viability gap funding framework for charging infrastructure development.

New Energy Vehicle Adoption Levy

The levy is imposed upon the invoice price/ assessed price of the vehicle (inclusive of all taxes)

Vehicle Type	Engine Capacity	Collected by	Amount
ICE	< 1300 cc	Manufacturer	**1%**
ICE imported	< 1300 cc	Importer	**1%**
ICE	1300 -1800 cc	Manufacturer	**2%**
ICE imported	1300 -1800 cc	Importer	**2%**
ICE	> 1800 cc	Manufacturer	**3%**
ICE imported	> 1800 cc	Importer	**3%**
ICE bus/truck	NA	Manufacturer	**1%**
ICE bus/truck imported	NA	Importer	**1%**

Government-led and IMF-advocated power sector reforms anchor macroeconomic stability

Circular Debt Management	The government plans to convert up to 80% of existing circular debt into sukuk instruments, which offer lower financing costs compared to current arrangements.
Debt Service Surcharge	The budget removes the ceiling on the Debt Service Surcharge (DSS), previously capped at 10% of the national average electricity tariff. With the government increasing bank borrowing to address circular debt, electricity consumers will pay the DSS for at least six more years, potentially exceeding 10% if required.
Tariff Reform	Annual tariff rebasing at full cost recovery levels is scheduled to begin in July 2025. The approach shifts from broad-based cross-subsidization toward targeted subsidies delivered through the Benazir Income Support Program, focusing support on the bottom 40% of energy consumers.
Market Structure	Distribution company privatization continues with the process at the halfway stage for three major companies. The closure of government-owned generation companies eliminates inefficient public sector capacity while creating space for private investment.
Grid Integration	The captive power levy creates price incentives for industrial consumers to abandon on-site generation in favor of grid electricity, improving overall system efficiency and utilization rates.
IMF Conditionalities	Key structural benchmarks include removing the debt service surcharge cap by end-June 2025 and achieving zero new circular debt flows by FY31.

Payment to IPPs and lumpsum provisions are intended to be utilized for clearance of CD stock payments

Subsidy to Power Sector (WAPDA/PEPCO/KESC) - PKR M	FY25 Budgeted	FY25 Revised	FY26 Budgeted
Subsidies for Tariff differential to Agri Tube Wells in Balochistan (PEPCO)	9,500	9,500	4,000
Subsidies for Inter-DISCO Tariff Differential	276,000	276,000	249,136
Subsidies for Merged District of KP erstwhile FATA	65,000	65,000	40,000
Subsidies for Tariff Differential to AJK	108,000	108,000	74,000
Pakistan Energy Revolving Fund (PERA)	48,000	48,000	48,000
Provision for Power Subsidy	14,000	-	-
Subsidies to K-Electric for Tariff Differential	174,000	174,000	125,000
Subsidies to KESC for Tariff for Agriculture Tubes Wells in Balochistan	500	500	1,000
Payment to IPPs	-	115,000	95,000
lumpsum Provision for Power Subsidy	509,000	394,000	400,000
Subtotal (WAPDA/PEPCO/KESC)	**1,204,000**	**1,190,000**	**1,036,136**

Revenue pressures have led to the short-sighted misstep of introducing solar panel taxation

The government removed exemptions and reinstated import duties on solar panels at 18%, ostensibly to boost domestic manufacturing. With solar imports crossing USD 2 B last year, this revenue-focused measure expects to generate PKR 110-130 B while monetizing the solar boom under the guise of supporting local industry.

The approach creates policy contradictions. While taxing solar panels, the government imposed carbon levies on fossil fuels and planned electricity tariff surcharges for capacity payments.

Solar panel taxes discourage clean energy investments, while carbon levies push consumers toward expensive fossil fuels without alternatives. Anticipated reductions in net metering buyback rates further diminish solar adoption incentives.

This disjointed policy mix risks reinforcing fossil fuel dependence and making Pakistani exports vulnerable to emerging carbon tariffs. A more coherent approach would involve subsidy replacement mechanisms.

Since over 50% of electricity consumers fall under protected categories and direct cash transfers through BISP may prove unsustainable, the government could have rechanneled fuel levies like PDL to provide subsidized panels to vulnerable segments. Remaining subsidy funds could then rationalize tariffs for grid consumers, particularly industries.

PSA
PAKISTAN SOLAR ASSOCIATION

Currently, the high cost of solar installations is already a barrier for many. Increasing prices further through taxation will make solar less competitive compared to fossil fuels such as oil and petrol - which are not only environmentally damaging but also contribute to Pakistan's rising import bill and balance of payments issues.

Official Statement from Pakistan Solar Association

To Renewable or not to? The planning conundrum continues...

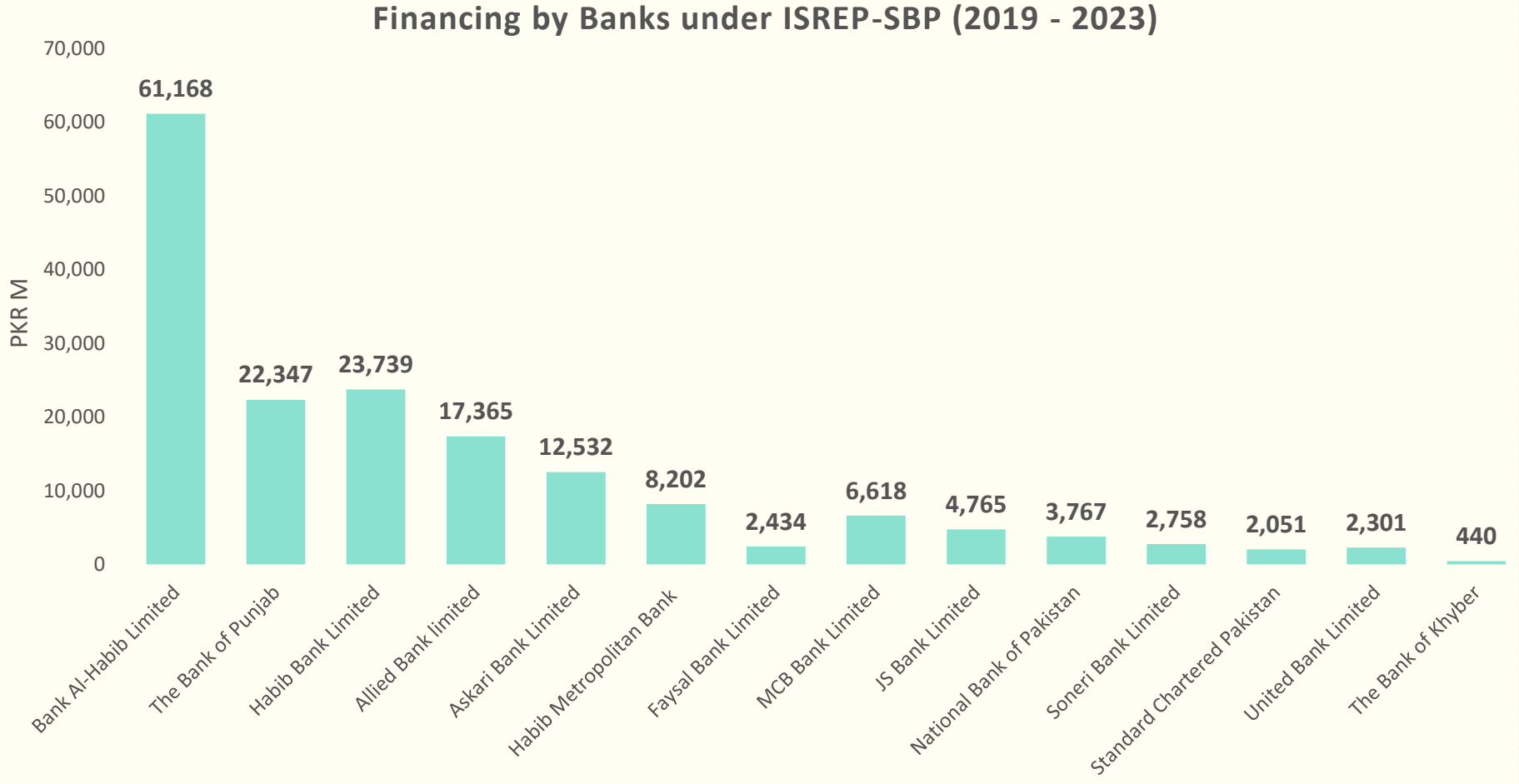
Transformation Targets	Pakistan's Indicative Generation Capacity Expansion Plan in its base case targets 54% renewable energy in the generation mix by FY34, increasing from the current 31%. This involves expanding hydropower from 24% to 38% while variable renewables from 7% to 15%.
Fossil Fuel Reduction	The plan envisions significant decreases in fossil fuel dependence, with RLNG falling from 24% to 15% of the generation mix and residual fuel oil dropping from 12% to 2% by FY34.
Implementation Considerations	Achieving 54% renewable integration while maintaining grid stability requires substantial investment in transmission infrastructure, energy storage systems, and advanced grid management capabilities.
Subsidised Financing	Access to concessional capital remains critical for enabling energy transition investments as evidenced by the State Bank's Financing Scheme for Renewable Energy. The policy enabled financing of over PKR 170 B provided through various banks. However, the latest budget doesn't provide any such financing scheme for the sector due to IMF conditionalities.

The government has achieved savings of over PKR 7,000 B through power sector reforms, including abandoning 9,000 MW of expensive power plants, revising IPP agreements, reducing electricity prices by over 50% for 18 million protected consumers, and cutting industrial tariffs by more than 31%.

***Muhammad Aurangzeb, Federal Finance Minister**

**Quoted from Budget Speech 2025-26*

Financing by Banks under erstwhile Incentive Scheme for Renewable Energy Programs (ISREP) by SBP



Complementary financing arrangements for climate initiatives could deliver the critical fiscal relief

Islamic Finance	Pakistan's PKR 30 B green sukuk represents the country's entry into Islamic sustainable finance markets. This instrument provides an alternative financing mechanism aligned with Islamic finance principles while supporting climate projects.
Regulatory Framework	The Securities and Exchange Commission has mandated climate risk disclosure for listed companies, while the State Bank has issued climate risk management guidelines for commercial banks. A green taxonomy is being developed in partnership with the World Bank.
International Finance Flows	Pakistan accesses climate finance through multiple channels, including the USD 1.4 B IMF Resilience and Sustainability Facility and USD 82 M from the Green Climate Fund across four approved projects.
Market Development	The green taxonomy enables classification of climate-friendly investments while preventing misrepresentation of environmental benefits. This framework supports both domestic and international investor confidence in Pakistani green investments.
Institutional Coordination	Various disaster and climate funds are being consolidated into a unified National Solidarity Fund to improve coordination and effectiveness of climate finance deployment across government agencies.

Largely overlooked, agricultural adaptation challenges can undermine future economic progress

Investment in Mechanization

The budget allocates PKR 7 B for farm mechanization through risk-sharing schemes, aimed at improving agricultural productivity while building climate resilience.

Water Management

Funding priorities include integrated dam and irrigation systems, along with enhanced early warning systems for floods and droughts. The Seed Policy 2025 emphasizes development and distribution of climate-resilient crop varieties.

PKR M	Budget FY25	Revised FY25	Budget FY26
Subsidy to Food (PASSCO):			
Subsidy to PASSCO for Wheat Reserve Stock	8,000	7,990	14,000
Subsidy to PASSCO on Account of Cost Differential for Sale of Wheat	4,000	4,000	6,000
Other Subsidies			
GIDC	2,500	1,000	2,400
GIDC for ISGS	40,000	22,000	4,000
Production & Supply of Urea Fertilizer (Fertilizer Plants)	3,000	3,000	-
USC Sugar Subsidy Arrears	5,000	5,000	15,000
Wheat Subsidy to GB	15,872	15,872	20,000
Subsidy on Import of Urea Fertilizer	10,000	10,000	15,000
Mark-up Subsidy and Risk Sharing Scheme for Farm Mechanization/Kissan Package	5,000	5,000	7,000
Mark-up Subsidy on Agri Loans by ZTBL to farmers	-	1,086	-
Solarization of Agri Tube Wells in Balochistan	-	14,000	-

While regulatory momentum toward energy efficiency appears inevitable, the speed of implementation, sluggish or swift, remains to be seen

Appliance Standards	Minimum Energy Performance Standards are being implemented for key appliances including fans, LEDs, refrigerators, air conditioners, and motors. Public procurement policies require compliance with these standards, leveraging government purchasing power.
System Efficiency	The captive power plants levy encourages industrial consumers to connect to the grid rather than maintaining independent generation, improving overall system efficiency and reducing per-unit costs for all consumers.
Pricing Mechanisms	Time-of-use tariffs and progressive rate structures provide price signals that encourage consumption during off-peak periods and overall energy conservation. These mechanisms reduce system costs while improving grid stability.
Implementation Strategy	Demand response programs complement technological interventions, building awareness while providing incentives for efficiency investments. This creates positive feedback loops that accelerate adoption of efficient technologies and practices.

For the first time in Pakistan's history, building codes based on energy-saving principles have been approved, and federal and provincial institutions have been directed to fully implement these regulations so that all future constructions are energy-efficient and effective.

***Muhammad Aurangzeb, Federal Finance Minister**

**Quoted from Budget Speech 2025-26*

Multiple simultaneous shocks could severely amplify fiscal pressures, demanding comprehensive risk management and strong contingency planning

Macroeconomic Vulnerabilities	Slower GDP growth, inflation shocks, and exchange rate volatility pose primary risks. A one percentage point GDP slowdown could widen the fiscal deficit by 0.13% of GDP through reduced revenues and higher social spending.
Revenue Collection Charges	Tax buoyancy remains fragile with multiple pressure points: halved tax revenue growth could increase the deficit by 0.4% of GDP, while a 30% decline in State Bank profit transfers adds another 0.32%. Petroleum levy shortfalls present additional 0.2% GDP risk.
Debt Servicing Pressures	Interest rate increases of 2 percentage points domestically and 1 percentage point externally could raise the fiscal deficit by 0.42% of GDP. Exchange rate depreciation compounds external debt servicing burdens.
State Enterprise & Climate Risks	SOE dividend shortfalls and increased government support could add 0.4% to the deficit. Climate adaptation spending ranges from 0.28% GDP under moderate scenarios to higher long-term costs under severe climate projections.
Critical Risk Factors	Natural disasters represent the largest single risk at 1.03% of GDP without proper financing mechanisms, reducible to 0.44% with effective disaster risk tools. Oil price increases (USD 20/barrel) add 0.37% GDP pressure through subsidies and import costs.

The federation adopted a carrot and stick approach, unfortunately, the carrot appears rather wilted while the stick has been unusually sharpened

The government's constrained position under two separate IMF programs left little room for creative policymaking and predictably, they made no attempt to break new ground.

What emerges is a budget offering mere crumbs of relief, scattered across a harsh platter of austerity measures served on an IMF-designed dish.

Yet even this modest serving requires careful preparation: diligent monitoring and evaluation, seamless federal-provincial coordination, and crucially sustained political stability that allows the government to address looming challenges including climate change, food security, and water scarcity. The recipe for success remains as demanding as ever, whether the government can execute it remains the ultimate test.

Renewables First (RF) is a think tank for energy and environment. Our work addresses critical energy and natural resource issues with the aim to make energy and climate transitions just and inclusive.

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