INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/27

PAKISTAN

February 2022

2021 ARTICLE IV CONSULTATION, SIXTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, AND REQUESTS FOR WAIVERS OF APPLICABILITY AND NONOBSERVANCE OF PERFORMANCE CRITERIA AND REPHASING OF ACCESS—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PAKISTAN

In the context of the Article IV Consultation and Sixth Review Under the Extended Arrangement Under the Extended Fund Facility, and Requests for Waivers of Applicability and Nonobservance of Performance Criteria and Rephasing of Access , the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its February 2, 2022 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 2, 2022, following discussions that ended on November 18, 2021, with the officials of Pakistan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 22, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Supplementary Information** updating information on recent developments.
- A **Statement by the Executive Director** for Pakistan in response to the staff report and Executive Board discussion.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2021 Article IV Consultation for Pakistan and Completes the Sixth Review of the Extended Fund Facility

FOR IMMEDIATE RELEASE

- *The Executive Board of the International Monetary Fund (IMF) concluded the 2021 Article IV Consultation with Pakistan. The Executive Board also completed the sixth review under the Extended Fund Facility (EFF) for Pakistan, allowing the authorities to draw the equivalent of SDR 750 million (about US$1 billion). This brings total purchases for budget support under the program to SDR 2,144 million (about US$3 billion, or 106 percent of quota).*
- *Economic activity rebounded strongly from the first waves of the ongoing COVID-19 pandemic, however, pressures also started to build, reflected in a widening current account deficit and rising inflationary pressures. The authorities' recent economic and financial policy efforts were appropriate to safeguard macroeconomic stability and debt sustainability.*
- *Further ambitious efforts to remove structural impediments and facilitate the structural transformation of the economy will help unlock sustainable and resilient growth, foster job creation, and improve social outcomes for the benefit of all Pakistani citizens.*

Washington, DC – **February 2, 2022:** The Executive Board of the International Monetary Fund (IMF) concluded the 2021 Article IV consultation[1] (press release to follow) and the sixth review of the extended arrangement under the Extended Fund Facility (EFF) for Pakistan. The completion of the review allows the authorities to draw the equivalent of SDR 750 million (about US$1 billion), bringing total purchases for budget support under the program to SDR 2,144 million (about US$3 billion, or 106 percent of quota).

The EFF was approved by the Executive Board on July 3, 2019 (see Press Release No. 19/264) for SDR 4,268 million (about US$6 billion at the time of approval, or 210 percent of quota). The program aims to support Pakistan's policies to help the economic recovery from the COVID-19 pandemic, ensure macroeconomic and debt sustainability, and advance structural reforms to lay the foundations for strong, job-rich, and long-lasting growth that benefits all Pakistanis.

Pakistan entered the COVID-19 pandemic with strengthened buffers, following the approved EFF program. A strong economic recovery has gained hold since summer 2020, benefiting from the authorities' multifaceted policy response to the unprecedented shock. At the same time, external pressures also started to emerge in 2021, including a widening current account

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

deficit and depreciation pressures on the exchange rate which also reinforced domestic price pressures.

The recent policy adjustment was appropriate to address these challenges and maintain economic stability. The economy is set to continue recovering in FY 2022, with real GDP growth projected at 4 percent, while inflation is expected to pick up this year before gradually slowing down. Continued commitment to a market-determined exchange rate and a prudent macroeconomic policy mix will help reduce the current account deficit, and ease external pressures over the medium term.

However, Pakistan remains vulnerable to possible flare-ups of the pandemic, tighter international financial conditions, a rise in geopolitical tensions, as well as delayed implementation of structural reforms. Strengthening the medium-term outlook hinges on ambitious efforts to remove structural impediments and facilitate the structural transformation of the economy. To this end, increased focus is needed on measures to strengthen economic productivity, investment, and private sector development, as well as to address the challenges posed by climate change.

The Executive Board also approved today the authorities' request for waivers of applicability and nonobservance of performance criteria.

Following the Executive Board's discussion on Pakistan, Ms. Antoinette Sayeh, Deputy Managing Director and Acting Chair, issued the following statement:

“The Pakistani economy has continued to recover despite the challenges from the COVID-19 pandemic, but imbalances have widened and risks remain elevated. The authorities’ recent policy efforts to strengthen economic resilience are welcomed. Timely and consistent implementation of policies and reforms remain essential to lay the ground for stronger and more sustainable growth.

“The authorities have taken important measures to strengthen fiscal policy and put public finances on a sounder footing. Along with careful spending management, revenue mobilization will help to create space for much-needed spending on infrastructure and social protection, while improving debt sustainability. Maintaining the momentum on the reform of personal income taxation and harmonization of general sales taxes is essential. Broader reforms in tax administration and public financial and debt management are expected to further improve the fiscal framework.

“The adoption of amendments to the central bank Act is a welcome step toward strengthening its independence to pursue its mandates of price and financial stability. The recent monetary policy tightening was necessary and continued proactive, data-driven monetary policy would help to anchor inflation. Closer oversight of financial institutions to ensure they remain well capitalized would help to maintain financial stability. Preserving a market-determined exchange rate is crucial to absorb external shocks, maintain competitiveness, and rebuild reserves. The authorities are committed to removing the existing exchange restrictions and multiple currency practices when BOP conditions stabilize.

“Strong efforts to advance electricity sector reform are needed to restore the sector's financial viability and address adverse spillovers on the budget, financial sector, and real economy. The IFI-supported Circular Debt Management Plan (CDMP) will help to guide the planned management improvements, cost reductions, alignment of tariffs with cost recovery levels, and better targeting of subsidies to the most vulnerable.

“Ambitious steps to remove structural impediments and facilitate structural transformation remain essential to boost growth and job creation and improve social outcomes. The authorities are focused on state-owned enterprises reform, fostering the business environment and reducing corruption, promoting financial inclusion; and addressing the challenges posed by climate change.”

Pakistan: Selected Economic Indicators, 2018/19–2021/22 1/

Population: 212.5 million (2020/21)
Quota: SDR 2,031 million
Main exports: Textiles (US$15.4 billion, 2020/21)
Key export markets: European Union, United States, United Arab Emirates

Per capita GDP: US$1,394.1 (2020/21)
Poverty rate: 21.9 percent (natl. line; 2018/19)

	2018/19	2019/20	2020/21	2021/22
			Est.	Proj.
Output				
Real GDP at factor cost (% change)	2.1	-0.5	3.9	4.0
Prices				
Consumer prices, period average (%)	6.7	10.7	8.9	9.4
Consumer prices, end of period (%)	8.0	8.6	9.7	10.2
General government finances				
Revenue and grants (% GDP)	13.0	15.2	14.5	15.9
Expenditure (% GDP)	21.9	23.2	21.6	22.8
Budget balance, including grants (% GDP)	-9.0	-8.0	-7.1	-6.9
Budget balance, excluding grants (% GDP)	-9.0	-8.1	-7.1	-6.9
Primary balance, excluding grants (% GDP)	-3.6	-1.8	-1.4	-1.3
Underlying primary balance (excluding grants) 2/	-3.6	-1.8	-0.6	0.0
Total general government debt excl. IMF obligations	82.9	84.5	81.1	78.9
External general government debt	28.5	28.4	26.1	27.0
Domestic general government debt	54.4	56.0	55.1	51.9
General government debt incl. IMF obligations (% GDP)	85.3	87.6	83.6	82.0
General government and government guaranteed debt (incl. IMF; % GDP)	90.5	93.2	88.6	86.7
Monetary and credit				
Broad money (% change)	11.3	17.5	16.2	15.8
Private credit (% change)	11.9	3.0	11.5	16.0
Six-month treasury bill rate (%) 3/	10.2	11.9	7.3	…
Balance of Payments				
Current account balance (% GDP)	-4.9	-1.7	-0.6	-4.0
Foreign Direct Investment (% GDP)	0.5	1.0	0.6	0.8
Gross reserves (in millions of U.S. dollars) 4/	7,274	12,175	17,297	21,211
In months of next year's imports of goods and services	1.7	2.4	2.7	3.2
Total external debt (% GDP)	37.4	41.6	39.1	40.6
Exchange rate				
Real effective exchange rate (% change)	-15.1	3.4	7.3	…

Sources: Pakistani authorities; World Bank; and IMF staff estimates and projections.

1/ Fiscal year ends June 30. Revised FY 2019 and FY 2020 GDP as well as provisional FY 2021 GDP were published by the authorities in May 2021, affecting ratios.

2/ Excludes one-off transactions, including asset sales. In FY 2021 it excludes PHPL debt clearance, IPPs related arrears clearance, and COVID-19 spending; in FY 2022 it excludes IPPs related arrears clearance and COVID-19 spending.

3/ Period average.

4/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.

INTERNATIONAL MONETARY FUND

PAKISTAN

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION, SIXTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, AND REQUESTS FOR WAIVERS OF APPLICABILITY AND NONOBSERVANCE OF PERFORMANCE CRITERIA AND REPHASING OF ACCESS

December 22, 2021

EXECUTIVE SUMMARY

Context. Economic activity has rebounded strongly on the back of waning COVID-19 infections and expansionary fiscal and monetary policies. However, strong import growth—fueled by the macroeconomic policy mix, higher international commodity prices, and credit growth—have led to a marked deterioration of the external position. The current account deficit has widened, the rupee depreciated markedly, and inflation remains persistently high.

Program performance. Since the April 2021 reviews, program implementation has been uneven: fiscal policy became increasingly expansionary and several key EFF commitments were reversed. The end-June performance criterion (PC) on the general government primary budget deficit and three continuous PCs on the non-intensification of exchange restrictions, non-modification of multiple currency practices (MCP), and zero new flow of SBP credit to the government were missed. Moreover, several structural benchmarks (SBs) were not met. More recently, however, the authorities have taken decisive action to bring the EFF back on track, including through a supplementary budget (to lock in key tax reforms), tighter monetary policy, and electricity tariff adjustments. In addition, they plan to pass amendments to the central bank act to consolidate its operational independence.

Key policy recommendations. Combined Article IV and review discussions focused on the need to sustain the implementation of program policies and structural reforms to entrench macroeconomic stability and ensure sustainable growth. To this end, the program builds on restoring fiscal discipline and debt sustainability while protecting social spending, safeguarding monetary and financial stability, and maintaining a market-determined exchange rate. New structural benchmarks support current efforts to strengthen revenue mobilization, public financial management, energy sector viability, governance/anti-corruption, and the AML/CFT framework.

Staff views. Staff supports the rephasing of access and completion of the sixth review based on strong corrective actions, but program risks remain exceptionally high. The review will make available SDR 750 million and help catalyze essential external financing.

Approved By
Thanos Arvanitis and Kenneth Kang

Discussions were held over recent months, and more recently during October 4–November 18, 2021. The staff team comprised Ernesto Ramirez Rigo (head); Kerstin Gerling, Tannous Kass-Hanna, Jan Möller, and Christine Richmond (all MCD); Ignatius de Bidegain (FAD); Hui Miao (MCM); Faezeh Raei (SPR); Teresa Daban-Sanchez (Resident Representative); Zafar Hayat and Saher Masood (both Islamabad office). Jonathan Pampolina (LEG) joined for parts of the discussions. Marijn Verhoeven (FAD) assisted the team on tax reform discussions. Saeed Ahmed (OED) participated in policy discussions. Jesus Sanchez (MCD) provided research assistance and Nataliya Bondar (MCD) document management assistance.

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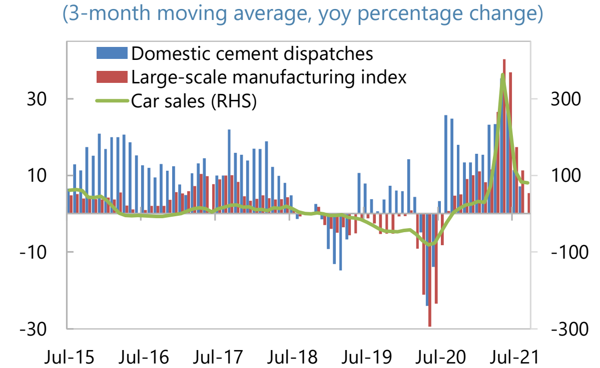
RECENT ECONOMIC DEVELOPMENTS

1. Pakistan is once again at a crossroads. After being on the brink of a severe currency and fiscal crisis, the EFF program—approved in July 2019—managed to stabilize the economy by rebalancing the macroeconomic policy mix and helping Pakistan to avoid a disorderly adjustment. The gains during the first nine months of the program strengthened buffers and allowed Pakistan to weather the unprecedented COVID-19 shock. However, Pakistan has a long history of stop-and-go economic policies and weak implementation of structural reforms (Box 1). This has resulted in elevated vulnerabilities and low investment and growth, which weigh on the population, including through high poverty incidence, weak development indicators, and limited progress in achieving the UN's Sustainable Development Goals (SDGs). Despite significant efforts to bring the program back on track earlier in the year (which led to the completion of the combined second–fifth EFF reviews in March 2021), the authorities' efforts shifted toward expansionary macroeconomic policies and reversed some earlier reforms in an attempt to spur growth.

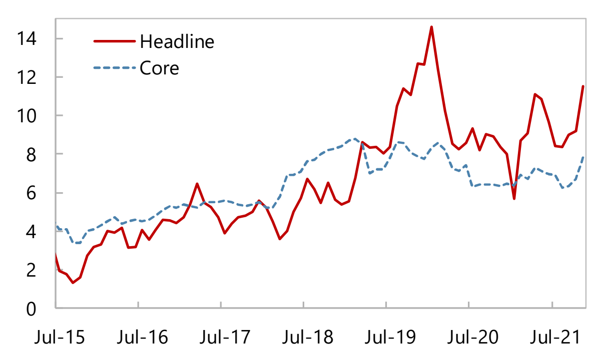
2. The fiscal relaxation came at a time when economic activity had started to rebound. In FY 2021, real GDP growth strengthened to 3.9 percent, supported by a robust performance of the manufacturing and wholesale and trade sectors, the lifting of lockdowns thanks to contained COVID-19 infections, and the authorities' supportive COVID-19 stimulus package. Inflation averaged 8.9 percent—down from 10.4 percent in FY 2020—despite the delayed implementation of energy tariff adjustments, reduced petroleum development levy (PDL) to offset rising international oil prices, and a relatively stable, until then, exchange rate. The current account deficit declined to 0.6 percent of GDP, the smallest deficit in 10 years, helped by record remittances. Gross international reserves rose to US$17.3 billion, the highest level in more than 4½ years, while the SBP's net short swap/forward forex position was reduced to just US$4.9 billion during FY 2021.

Pakistan: Key High-Frequency Indicators, 2015M07–21M09
(3-month moving average, yoy percentage change)



Sources: Pakistani authorities; IMF staff calculations.

Pakistan: CPI Inflation, 2015M07–21M11
(Yoy percentage change, FY 2015/16=100)

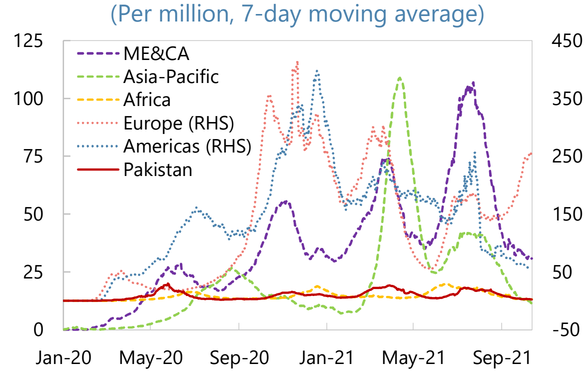


Sources: Pakistani Bureau of Statistics; IMF staff calculations.

3. **As a result of buoyant domestic demand and the terms of trade shock, external imbalances increased rapidly in the early months of FY 2022** (Tables 1–8). The current account in the first quarter of FY 2022 widened to an annualized 4.2 percent of GDP. The combination of a pro-cyclical macroeconomic policy mix, a widening trade deficit, exchange rate pressures, and central bank interventions raised the risks of repeating previous boom-bust patterns without a policy correction.

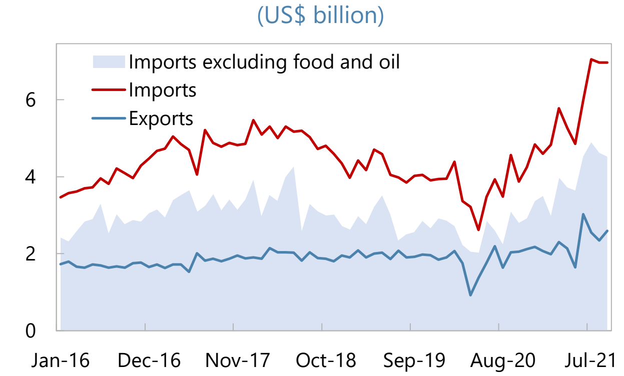
4. **On the positive side, Pakistan managed to avoid severe COVID-19 outbreaks**. Pakistan's infection rate has generally remained lower than in peer countries. The fourth wave is waning, with daily cases below 1,000 as of mid-November for more than one month and a positivity rate of about 1.5 percent. The vaccine rollout has accelerated, with more than 124 million doses administered as of early-December, covering 38 percent of the population with at least one shot and 24 percent fully vaccinated. This, together with the extra resources provided by the recent SDR allocation, is keeping within reach the authorities' objective to fully cover more than 78 million people by end-December. Considering the structure of the economy (with large informality and agricultural sectors), persistent damage to supply capacity (or scarring) is likely limited.

Pakistan: COVID-19 Infection Rates, 2020M01-21M11
(Per million, 7-day moving average)



Sources: University of Oxford; IMF staff calculations.
Note: According to criteria published by WHO in May 2020, a positive rate of less than 5 percent is one indicator that the epidemic is under control in a country.

Pakistan: Goods Exports and Imports, 2016M1–21M09
(US$ billion)



Sources: SBP; IMF staff calculations.

Box 1. Pakistani Authorities' Implementation of Past Fund Advice

Fund advice has aimed at reducing fiscal deficits and restoring public debt sustainability, reforming the energy sector, allowing more exchange rate flexibility, enhancing SOE governance, and generating higher and sustainable growth. The implementation of past Article IV recommendations was generally weak. The government renewed its commitment to this agenda supported by the EFF program, despite some delays and policy slippages since the start of the COVID-19 pandemic.

Fiscal policy. Fund advice centered on tax revenue mobilization to underpin medium-term fiscal adjustment and ensure fiscal sustainability, with a focus on reducing tax concessions and exemptions, strengthening collection of provincial taxes, and more efficient tax administration. Staff advised the federal and provincial authorities to better align revenue and expenditure responsibilities to strengthen the intergovernmental fiscal framework as well as step up social safety nets by broadening population coverage under the main unconditional cash transfer program (Benazir Income Support Program, BISP) and increasing educational transfers. Procyclical fiscal policies, mostly due to renewed tax concessions, led to a surge in the FYs 2018 and 2019 fiscal deficits and public debt, financed with central bank borrowing. Under the program, the authorities are stepping up tax revenue collection efforts, including by avoiding new preferential tax treatments or exemptions and reforming tax policy to simplify and streamline. In that context, the authorities have advanced corporate income tax (CIT) reform, while further reforms to general sales taxes (GST) and personal income taxes (PIT) have stalled. Social safety nets are being expanded, with greater resources being allocated to women and children, and the authorities' recently finalized update of the BISP beneficiaries' database with a coverage of 33 million households.

Monetary and financial sector policies. Fund advice included maintaining a prudent monetary policy stance, with positive real interest rates, rebuilding external buffers, and allowing greater exchange rate flexibility. Staff also called for greater State Bank of Pakistan (SBP) independence and reducing government borrowing from the SBP. Financial sector policy recommendations focused on strengthening the sector's resilience to ensure that undercapitalized banks are regulatory compliant and ensuring effective implementation of the regulatory and supervisory framework, including strengthening AML/CFT effectiveness to support exit from the FATF grey list. In the run-up to the current program, a de facto fixed exchange rate, supported by sizeable forex interventions, contributed to a build-up of external imbalances. Interest rates were kept low to support consumption- and import-driven growth, while the government increased its borrowing from the SBP. Ahead of program approval in July 2019, the SBP transitioned to a market-determined exchange rate and raised the policy interest rate to be positive in real terms. However, the COVID-19 shock required a reversal of monetary policy to aid the economy, while preserving the exchange rate flexibility under very difficult circumstances. Under the program, external buffers are being rebuilt, supported by the current account adjustment, and inflation is starting to stabilize. The authorities are taking action to strengthen the independence of the central bank, including the submission to parliament of amendments to the SBP Act in consultation with IMF staff, and have not extended credit to the government since the program came into effect. Two small private sector banks are undercapitalized, and the authorities are committed to strengthening and modernizing the bank resolution and crisis management frameworks.

Structural policies. Fund advice focused on ensuring a financially sound energy sector by addressing circular debt and strengthening the regulatory framework, restructuring SOEs to improve efficiency, and boosting the business climate as well as governance and anti-corruption frameworks to support private investment and job creation. However, lackluster progress in structural reforms has hampered investment, allowing inefficient SOEs to linger, and a large informal economy to remain. Increases in power and gas tariffs have been insufficient to stem the accumulation of quasi-fiscal losses. The authorities approved amendments to the NEPRA Act, introducing automaticity in the notifications of the determined tariff changes, and just recently caught up with passing through pending power tariff adjustments. In terms of SOE reforms, the authorities undertook a triage in 2020 to examine the functions and financial performance of individual SOEs and identify which to (i) retain under state ownership; (ii) restructure; or (iii) privatize. They have also prepared a new SOE law to improve governance and transparency in the sector in line with IMF staff advice, but it has not been approved by parliament. Major shortfalls remain in taking anti-corruption and good governance actions, including in establishing a robust asset declaration system, and in ensuring transparency around COVID-related spending and procurement.

PROGRAM PERFORMANCE

5. **Overall program performance has been uneven** (MEFP Tables 1–2). Several quantitative criteria were missed and gaps in implementing particularly the fiscal and structural reform agenda arose amid challenging circumstances, including the COVID-19 pandemic and spillovers from Afghanistan, but also a waning decisiveness to push forward agreed reforms.

- ***Performance criteria (PCs)***. All but four PCs were met (MEFP Table 1). The end-June 2021 PCs on net international reserves (NIR), net domestic assets (NDA), and the net foreign currency swaps/forward position of the SBP, as well as on no net government budgetary borrowing from the SBP and the amount of government guarantees were observed. Also, the continuous PC on zero external public payment arrears was observed. However, the authorities narrowly missed the PC on the general government primary budget deficit at end-June 2021, mainly owing to large revenue shortfalls accommodated by a significant spending underexecution. In addition, they missed three continuous PCs on the: (i) non-intensification of exchange restrictions and (ii) non-modification of MCPs after expanding the requirement for a 100-percent cash margin on the import of certain goods to an additional 114 items in late-September (taking the total number of items requiring a 100-percent cash margin to 525); and (iii) zero new flow of SBP credit to the government after the on-lending of SDR to the general government for budget financing of the vaccine drive in November.

- ***Indicative targets (IT)***. Four out of six ITs were observed at end-June 2021: budgetary health and education spending, net FBR tax revenues, the net accumulation of tax refund arrears, and the flow of new power sector payment arrears. However, two ITs fell short: (i) the targeted cash transfer spending (BISP) by a small margin because of the reallocation of some spending (PRs 5 billion) to a different government authority (i.e., the Pakistan Poverty Alleviation and Social Safety Fund); and (ii) the gross issuance of longer-term debt instruments (i.e., PIBs, Sukuks, and Eurobonds) mainly because of low investor appetite for longer-term instruments and bottlenecks in the issuance of Sukuks.

- ***Structural benchmarks (SBs)***. The authorities met one SB on time and implemented five SBs with delay. Specifically, the authorities made the Treasury Single Account (TSA-1) operational in September (*end-May 2021 SB*) and finalized the update of the National Socio-Economic Registry (NSER) in October (*end-June 2021 SB*). They also reduced CPPA-G payables to independent power producers (IPPs) in June (*end-May 2021 SB*) and increased tariffs toward cost recovery through the notification of the FY 2021 annual rebasing on November 5 (*June 1, 2021 SB*) and all pending adjustments up to FY 2021-Q3, including the one for FY 2020-Q4 effective on October 1 (*end-September 2021 SB*). While the authorities did not grant further tax amnesties (*continuous SB*), they granted new preferential tax treatments (*continuous SB*), most of which will be reversed through the upcoming supplementary finance bill (¶11). Another two SBs—publishing key information on all COVID-related awarded procurement contracts (*end-April 2021 SB*) and an ex-post audit of the procurement of COVID-related medical supplies (*end-April 2021 SB*)—will be implemented through two of the five prior actions (PAs) for the sixth review (MEFP Table 2).[1] Finally, three outstanding SBs, some of which saw significant progress but faced capacity constraints, will be reset (MEFP Table 2), whereas two missed SBs will be dropped without corrective action: (i) the audit of the Utility Stores Corporation (*end-April 2021 SB*) as crucial information inputs for an audit assessment were not recorded at end-FY 2020; and (ii) the track-and-trace system for tobacco products (*end-June 2021 SB*) as capacity constraints make a full reintroduction unlikely within the remaining program period.

OUTLOOK AND RISKS

6. **The economy is set to continue recovering, but risks remain high in FY 2022** (Text Table below and Tables 1–8).

Pakistan: Selected Economic Indicators, FY 2017/18–25/26

	2017/18	18/19	19/20	20/21	21/22	22/23	23/24	24/25	25/26
							Proj.		
Real GDP growth (%)	5.5	2.1	-0.5	3.9	4.0	4.5	5.0	5.0	5.0
Consumer prices (period average, % change)	3.9	6.7	10.7	8.9	9.4	7.8	6.5	6.5	6.5
Gen. gov. overall balance (incl. grants, %GDP)	-6.4	-9.0	-8.0	-7.1	-6.9	-4.4	-4.4	-3.9	-3.5
Gen. gov. primary balance (underlying, excl. grants, %GDP) 1/	-2.2	-3.6	-1.8	-0.6	0.0	1.2	1.3	1.4	1.5
Gen. gvt. debt (incl. guarantees and IMF obligations, %GDP)	76.2	90.5	93.2	88.6	86.7	82.1	78.1	73.8	70.4
Current account balance (%GDP)	-6.1	-4.9	-1.7	-0.6	-4.0	-3.5	-3.3	-3.0	-2.7
External debt (%GDP)	30.0	37.4	41.6	39.1	40.6	40.1	39.1	37.7	35.2
Gross official reserves (billions of US$)	9.8	7.3	12.2	17.3	21.2	20.7	20.1	20.9	23.1
Gross official reserves (months of next year's GNFS imports)	1.9	1.7	2.4	2.7	3.2	3.0	2.8	2.8	2.8
Gross official reserves (% IMF reserve adequacy metrics) 2/	48.3	35.0	55.2	73.8	81.2	72.3	65.9	64.4	72.0

Sources: Pakistani authorities; IMF staff estimates and projections.
Notes: 1/ Excludes one-off transactions, including asset sales (Tables 4a and b). 2/ Assumes a flexible exchange rate and no capital controls.

- ***Real GDP growth*** is projected at 4 percent in FY 2022—consistent with the forecasted course of the pandemic and vaccinations, global recovery, and commodity prices in the WEO baseline—as confidence and investment take hold, and all COVID-related restrictions have been lifted. Assuming sustained policy and reform implementation, growth is expected to reach its medium-term potential of 5 percent.

- ***Average CPI inflation*** is expected to temporarily increase in the coming months and average 9.4 percent in FY 2022 due to the recent terms of trade shock, continued energy price adjustments, and GST reforms. It is expected to be within the SBP's 9–11 percent inflation range forecast in the next 12 months, before slowing to 6.5 percent over the medium term.

- ***The current account deficit*** is forecast to widen to 4 percent of GDP in FY 2022, driven by strong import growth, fueled by strong domestic demand, higher commodity prices, and slightly

[1] However, the beneficial ownership element of the SB will not be implemented by the PA due to the need to first adopt legal regulations. Adoption of the latter is thus subject of a new SB for end-March 2022 and will be broader than originally envisaged, covering all large contracts (not just COVID-related spending).

receding remittances. Under the WEO baseline, moderating commodity prices, export growth and stronger policies will help the current account deficit to converge toward 2.5 percent of GDP over the medium term. In this regard, continued commitment to a market-determined exchange rate and prudent macroeconomic policy mix will help ease external pressures. It would also help, together with the IMF's recent SDR allocation and tighter monetary policy stance, strengthen the reserve cover to some 2.8 months of imports by the end of the forecast horizon, up from less than 2 months of imports at the onset of the program.

- ***Debt levels*** are projected to continue their downward path with narrower twin deficits on the back of the planned fiscal adjustment and robust growth: public debt is projected to fall toward 70 percent and total external debt to decline toward 35 percent of GDP by FY 2026.

7. Downside risks to the outlook and program continue to dominate (RAM, Annex I). The authorities and staff agree that these fall under five broad groups. First, with still low vaccination coverage, Pakistan remains vulnerable to a worsening of the pandemic trajectory. The authorities expect that outbreaks would still have a smaller domestic economic impact than in the past, as they plan to favor localized restrictions with limited scope over strict lockdowns. They remain concerned though about high global uncertainty around the pandemic, which affects the prospects for global growth, trade, and remittances. Second, policy slippages remain a risk, as has also become more visible in recent months, amplified by weak capacity and powerful vested interests. Socio-political pressures could also weigh on policy and reform implementation, especially with the next general election expected in mid-2023, while the absence of a majority in the upper house may hinder the adoption of legislation critical to the program. All this could affect policy decisions and undermine the program's fiscal adjustment strategy, in turn jeopardizing debt sustainability (the DSA in Annex II confirms that public debt remains sustainable with strong policies under the baseline, but also points to risks from policy slippages and contingent liabilities). Third, further delays on structural reforms, especially those related to governance and the authorities' Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) action plan with the Financial Action Task Force (FATF), could hamper external financing and investment and thus limit the economic recovery. Fourth, geopolitical tensions (especially related to Afghanistan) could cause disorderly migration, worsen security conditions, and generate higher volatility in basic food prices (if supply is disrupted) and the exchange rate. Apart from direct spillovers to Pakistan, the tensions could cause an adverse shift in investor sentiment and affect external financing. Finally, climate change risks are mounting, including a tendency for more frequent climate-related disasters.

POLICY DISCUSSIONS

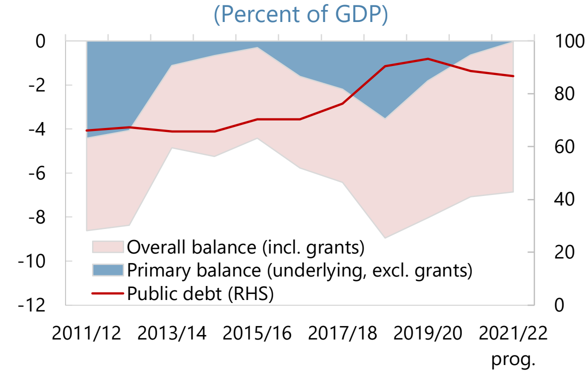
Pakistan's economy needs strong reforms that work in a challenging socio-political environment with substantial development needs and constrained capacity. The policy dialogue focused on near- and medium-term macroeconomic policies and structural reforms to address the rapidly increasing economic imbalances and achieve the EFF's objectives of entrenching macroeconomic stability; ensuring debt sustainability; and boosting resilient, strong, and sustainable growth. To this end, action *in five policy areas is needed: (i) reinforcing fiscal discipline by mobilizing revenues and controlling current spending to make space for more infrastructure and social spending; (ii) ensuring disinflation through a tighter monetary policy stance; (iii) maintaining the market-determined exchange rate and building external buffers; (iv) restoring the financial viability of the energy sector; and (v) advancing structural reforms, including by addressing deficiencies in the AML/CFT regime, SOE governance, and business climate, as well as stepping up to the challenges posed by climate change.*

A. Fiscal Policies

Background

8. The EFF's key fiscal anchor has been a gradual improvement in the primary balance to ensure fiscal sustainability, entrench macroeconomic stability, and build resilience. The elevated debt burden makes Pakistan susceptible to shocks, requiring the authorities' firm commitment to the program's fiscal strategy based on an ambitious revenue mobilization effort supported by high-quality, permanent tax policy and administration reforms, and discipline on current spending. The authorities still strive for a medium-term increase in tax revenues by 3–4 percentage points of GDP, as set out at EFF program inception, but will fall short of achieving this during the EFF program period due to the COVID-19 shock, the ensuing large revision to the growth path, and repeated policy delays (particularly of major tax reforms, see below). Nevertheless, increasing revenues over the medium term will be essential to ensure debt sustainability while creating space for much-needed social and development spending.[2]

Pakistan: Fiscal Developments, FY 2011/12–21/22
(Percent of GDP)



Sources: Pakistani authorities; IMF staff calculations.

9. The FY 2021 fiscal outturn showed a mixed performance against program targets. The underlying primary deficit (excluding grants and one-off expenditures) reached 0.6 percent of GDP, improving considerably over FY 2021, and missing only narrowly the target of 0.5 percent of GDP. However, this was achieved by a large underspending of budget allocations, particularly in Q4, in the face of revenue shortfalls, which were mainly related to the petroleum levy, provincial taxes, and nontaxes. Public debt declined somewhat, although remained elevated at 88.6 percent of GDP at end-FY 2021, thanks to robust nominal GDP growth, a strong end-FY 2021 exchange rate, and negative real interest rates. Domestic bank and external financing covered the government's borrowing needs, which continued to refrain from SBP borrowing since the EFF-supported program started.

[2] Pakistan has a long history of weak tax revenue mobilization, with repeated efforts to raise revenue failing to achieve its goal in a sustainable manner. This mainly owes to a very narrow tax base, the extensive use of tax concessions and exemptions which undermines competitiveness and growth, weaknesses in revenue administration, low taxpayer compliance on the back of high informality, and vulnerabilities to corruption. The inherent challenges to boost revenues are further exacerbated by Pakistan's fiscal federalism model, which leads to significant fragmentation and inefficiencies in revenue administration (for instance, there are more than ten tax administrations in Pakistan).

Pakistan: General Government Fiscal Operations, FY 2020/21–21/22
(Percent of GDP)

	FY2020/21		FY2021/22		
	Program (CR/2021/073)	Outcome (prel.)	Program (CR/2021/073)	Budget (IMF estimate)	Supl. budget (IMF estimate)
Revenue and grants	**15.8**	**14.5**	**17.0**	**14.6**	**15.9**
Tax revenue	12.7	12.1	14.2	12.2	13.3
Federal	11.5	11.0	12.8	11.0	12.1
FBR	10.2	10.0	11.5	10.7	11.2
o/w: GST	4.2	4.2	4.9	4.6	5.1
Other federal	1.3	1.0	1.3	0.3	0.9
o/w: PDL	1.1	0.9	1.2	0.1	0.7
Provincial	1.2	1.1	1.4	1.2	1.2
Nontax revenue	2.9	2.4	2.7	2.4	2.5
Federal	2.6	2.1	2.4	1.9	2.1
o/w: SBP profits	1.4	1.4	1.4	0.8	1.0
Provincial	0.4	0.3	0.4	0.5	0.5
Grants	0.1	0.1	0.1	0.1	0.1
Expenditure	**22.9**	**21.6**	**22.5**	**23.2**	**22.7**
Current expenditure	20.2	19.1	19.7	20.0	19.5
Interest	6.1	5.8	5.9	5.6	5.6
Other federal	7.9	7.4	7.7	9.0	8.3
o/w: subsidies (incl IPPs)	1.0	0.9	1.0	1.7	1.4
o/w: grants and COVID provision	1.9	1.8	1.9	2.8	2.4
Provincial	6.2	5.9	6.2	5.3	5.6
Development and net lending	2.7	2.7	2.9	3.2	3.3
o/w: provincial	1.5	1.6	1.5	2.2	2.4
Overall balance (incl. grants)	**-7.1**	**-7.1**	**-5.5**	**-8.6**	**-6.8**
Primary balance (underlying, excl. grants) 1/	**-0.5**	**-0.6**	**0.8**	**-2.0**	**0.0**

Sources: Pakistani authorities; IMF staff calculations.
1/ Excludes 0.7 percent of GDP for PHPL debt repayment, IPP arrears clearance, and COVID-19 spending in FY 2021; and 1.2 percent of GDP for IPP arrears clearance and spending on COVID-19 vaccines in FY 2022.

Box 2. Pakistan: Key Policy Reversals in Pakistan's FY 2022 Budget

(i) ***Reduction of taxes***, notably (a) a zero-rate excise on fuel (PDL), which had seen a gradual decrease from PRs 30/liter to zero since December 2020; and (b) a downward adjustment of the GST on petrol and diesel from 17 percent to 16.4 percent. Both actions were intended to offset rising international fuel prices but came with a large revenue impact of almost 1 percent of GDP and against the commitment of not lowering the PDL at the time of the EFF program approval.

(ii) ***Reinstatement of zero-rated GST*** for some domestic industries, which had been removed at the time of the EFF program approval.

(iii) ***Omission of PIT and GST tax policy reforms*** from the budget, which was a key commitment in the second–fifth EFF reviews.

(iv) ***Introduction of new preferential tax treatments*** for the technology sector, automotive and other export-oriented industries, and certain food products, which breached the related continuous SB (¶5).

(v) ***Omission of presenting all guarantees expected to be issued in FY 2022*** with the budget, which was a commitment as part of actions to address a recent misreporting.

10. However, the approved FY 2022 budget marked a departure from EFF objectives and contributed to rapidly increasing macroeconomic vulnerabilities. It delivered a significant fiscal relaxation through large spending increases and the unwinding of several EFF tax revenue commitments, notwithstanding the past revenue underperformance. Approved in June, the budget was on track to deliver an adjusted primary deficit of 2 percent of GDP, representing a fiscal loosening of 1.4 percent of GDP compared to the FY 2021 outturn. On the expenditure side, it allowed for large increases in public wages and allowances, a doubling of subsidies, and an increase in investment of over 50 percent. On the revenue side, it expected unrealistically strong tax revenue growth (from marked improvements in tax administration and strong domestic demand, notably imports) and high non-tax revenue receipts, thus introducing significant risks of fiscal slippages. In addition, the budget delayed key reforms and reversed some key policies (Box 2), damaging revenue prospects.

Policy Discussion

11. A gradual fiscal adjustment remains a central part of the program. In view of recent developments, the authorities acknowledged the need to withdraw some fiscal stimulus and to resume efforts to broaden revenue mobilization. To this end, they agreed to pass a supplementary finance bill for FY 2022 (*PA*) that strikes a balance between addressing growing macroeconomic imbalances and sustaining growth. It targets an underlying primary balance (deficit of 0 percent of GDP, excluding grants and one-off spending subject to adjustors). Although this would result in a smaller adjustment this year than envisaged at the time of the second–fifth EFF reviews, it implies a realistic and still ambitious effort, given some half-year implementation delay of key measures (including the GST reform). At the same time, it will ensure a moderately tight fiscal stance and preserve the downward debt trajectory, while protecting social spending and allowing investment to grow in real terms. Key aspects of the revised FY 2022 fiscal program are (MEFP ¶7):

- ***Stronger revenues***. Tax revenues are expected to increase by 1.2 percentage points of GDP from FY 2021, boosted by (i) revenue measures; (ii) reinforced tax administration efforts; and (iii) automatic stabilizers. The main additional tax measures are:
  - *Implementing the reform of General Sales Taxes (GST)*. Parliament will adopt the GST reform as part of the supplementary budget, in line with staff recommendations (PA), to broaden the GST tax base and eliminate about 2/3 of the tax expenditures on GST. This is achieved by undoing policy reversals that extended preferential treatment to numerous goods in the FY 2022 Finance Act; by moving most goods from zero-rating (Fifth Schedule) or reduced rates (Eighth Schedule) to the standard sales tax rate; by eliminating exemptions (Sixth Schedule) for most goods excluding basic food, live animals for human consumption, and health- and education-related goods; and by applying the standard rate to higher-end cellphone devices (previously under the Ninth Schedule).
  - *Increasing the Petroleum Development Levy* (PDL). In early November, the authorities started to gradually increase the PDL in gasoline and diesel by PRs 4 per liter, with a further PRs 4

per liter in December (PA) and will continue to increase the PDL by PRs 4 per liter per month until a maximum of PRs 30/liter is achieved, which was in place in the past.

- ***Reprioritizing and improving spending efficiency***. Clear policy commitments from the authorities will limit the increase in spending to 1.1 percentage points of GDP above the FY 2021 outturn by: (i) rationalizing non-priority current spending and streamlining non-targeted subsidies (notably energy, ¶28); and (ii) recalibrating investment spending in line with realistic execution rates. At the same time, the supplementary budget supports a sizable scaling-up of development and social spending from their FY 2021 outturn, including through: (i) a substantial expansion of the Benazir Income Support Program (BISP) by 50 percent (excluding COVID-related one-off spending) (¶15) and of spending on health and education by 27 percent; and (ii) the newly launched Kamyab Pakistan Program (KPP) and food subsidy program of 0.2 percent of GDP (¶15). In addition, the program accommodates two spending items through adjusters of up to 0.6 percent of GDP each: the purchase of COVID-19 vaccine to contain the pandemic and the clearance of arrears to independent power producers (IPPs) to unlock critical medium-term cost savings in the power sector (¶28).

- ***Provincial contributions***. The provinces committed again to contribute to the federal government's fiscal strategy via Memoranda of Understanding (MoU), targeting a surplus of about 0.5 percent of GDP in FY 2022, conditional on FBR tax collection. To achieve this, they will boost their tax revenues by at least 0.1 percent of their respective provincial GDPs relative to their FY 2021 performance and constrain the expenditure side, while protecting health and education spending. The authorities will continue to work with provincial governments to ensure their expenditures remain consistent with revenues and the projected deficit path if emerging deviations make the ambitious revenue targets unlikely to materialize.

- ***Financing***. The authorities remain committed to relying on market sources (external borrowing and the domestic banking system) to finance the budget, whilst seeking to lengthen maturities to reduce rollover risks. The authorities intend to use up to US$2 billion from the recent SDR allocation (about US$2.75 billion) to complement other sources of vaccine finance and the remainder to reduce reliance on expensive T-Bills.[3]

Implementation risks are considerable, particularly if tax buoyancy declines in a scenario of slowing imports. In this situation, staff would recommend considering bringing forward plans to expand the number of removed exemptions to include fertilizers and tractors, which constitute 23 percent of current GST tax expenditures and whose removal is under consideration as a 2023 budget measure.

12. Additional tax policy reforms remain key in the period ahead. This will help Pakistan address its perennial challenge of a low revenue base, which weighs on debt sustainability and severely constrains much-needed fiscal space for growth-enhancing spending on infrastructure,

[3] This would occur through an exceptional on-lending from the SBP to the government of the rupee equivalent backed by an MoU signed between the SBP and Ministry of Finance regarding the servicing of interest-related costs, similar to the MoU signed related to the EFF and RFI resources.

education, healthcare, and social support (Section B below). Against this backdrop, staff urged the authorities to continue broadening the tax base, reducing informality, and simplifying and modernizing the tax system. Concretely, the next reform steps focus on:

- ***Personal income tax (PIT)***. The authorities are in the process of drafting PIT legislation by end-February 2022 (*new end-February 2022 SB*) to ensure it will be ready to come into effect on July 1, 2022 with the FY 2023 budget. Aiming at simplifying the system, increasing progressivity, and supporting labor formalization,[4] it will: (i) reduce both the number of rates and income tax brackets; (ii) reduce tax credits and allowances (except those for disabled and senior citizens, and Zakat receipts); (iii) introduce special tax procedures for very small taxpayers; and (iv) bring additional taxpayers into the tax net. Low-income households will remain protected as the reform preserves the current PIT threshold (almost 3 times income per capita).

- ***GST base harmonization***. This will be critical to improve competitiveness and the business environment. Under the current system, the sales tax base is fragmented, with services subject to provincial taxation and goods under federal government taxation. The fragmentation of the tax base has severely compromised tax policy design and administration, generated disagreements over tax base definition and crediting, caused cascading and double taxation for businesses, and significantly increased compliance costs (Annex III). Indeed, the system is cumbersome and harms competitiveness by increasing the cost of doing business.

13. Other broad-based reforms will improve the fiscal framework. Specifically (MEFP ¶¶8–10):

- ***Strengthening tax administration***. The authorities recognize that tax administration reforms and enforcement efforts need to complement their tax policy measures. Leveraging TA (including from the IMF and World Bank), the authorities plan over the medium term to: (i) introduce a centralized, risk-based compliance function; (ii) update IT and automation; (iii) use third-party data, cross-checks, and analysis; (iv) simplify registration and filing processes; (v) modernize and target audit practices; and (vi) bolster the large taxpayer office (LTO). In line with standing IMF TA advice, staff discouraged the use of third-party audits in favor of developing an adequate compliance risk management framework. Efforts will also be made to establish a single filing, taxpayer, and return portal, and redress high outstanding tax arrears. To contain smuggling, the authorities are in the process of reintroducing the track-and-trace system for tobacco products but a full roll-out remains delayed on account of capacity constraints (*end-June 2021 SB*).

- ***Enhancing Public Financial Management (PFM)***. With IMF TA, the authorities have created new coordination mechanisms for cash and debt management, tightened procedures for supplementary grants, and disclosed, for the first time, fiscal risks, and contingent liabilities in the FY 2021 budget. They are also ramping up operations in the recently established macro-fiscal

[4] At only 2.1 percent of GDP in FY 2018, PIT collection is low relative to peer countries. This is due to (i) high labor market informality with only 1.9 percent of the labor force being active PIT taxpayers; (ii) insufficient progressivity with only incomes above 91 times per capita GDP p.c. paying the top marginal rate of 35 percent and 72 percent of taxpayers paying 5 percent or less; and (iii) generous tax expenditures, including exemptions and tax credits.

unit in the Ministry of Finance to better monitor fiscal risks, and in the planning commission to improve the efficiency of public investment spending. While some steps have faced delays, the authorities achieved a functional single treasury account (TSA-1) in September (*end-May 2021 SB*). They also started to move swiftly to TSA-2 and improve, with EU assistance, their annual and multi-annual commitments control systems. Improving the budget process to achieve greater spending efficiency and control remains another priority.

- ***Safeguarding the quality and transparency of COVID-related spending***. The authorities are committed to the timely publication of: (i) key information of all COVID-related awarded procurement contracts on the publicly accessible website of the Public Procurement Regulatory Agency (*end-April 2021 SB, PA*); and (ii) an ex-post audit by the Auditor General of Pakistan (AGP) of the procurement of COVID-related supplies and social payments in FY 2020 (*end-April 2021 SB, PA*). Further efforts underway include the audit of all COVID-related spending and social payments for FY 2021, the rollout of an e-procurement system by end-2022 (supported by the World Bank), and the issuance of regulations to collect and be able to publish beneficial ownership information of companies awarded PRs 50 million and above public procurement contracts (*new end-March 2022 SB*).

- ***Improving debt management***. Notwithstanding notable strides in enhancing debt reporting and debt management, more progress on tackling long-standing institutional and technical capacity weaknesses is crucial, most importantly by: (i) fully implementing the medium-term debt strategy (to be updated annually and published); (ii) establishing a central debt management office (DMO); and (iii) amending the Fiscal Responsibility and Debt Limitation Act to support the DMO's formal establishment and functioning.[5] In addition, the authorities continue to focus on lengthening the maturity profile of public debt to lower rollover risks, while balancing the impact on financing costs.

B. Poverty Reduction and Social Protection

Background

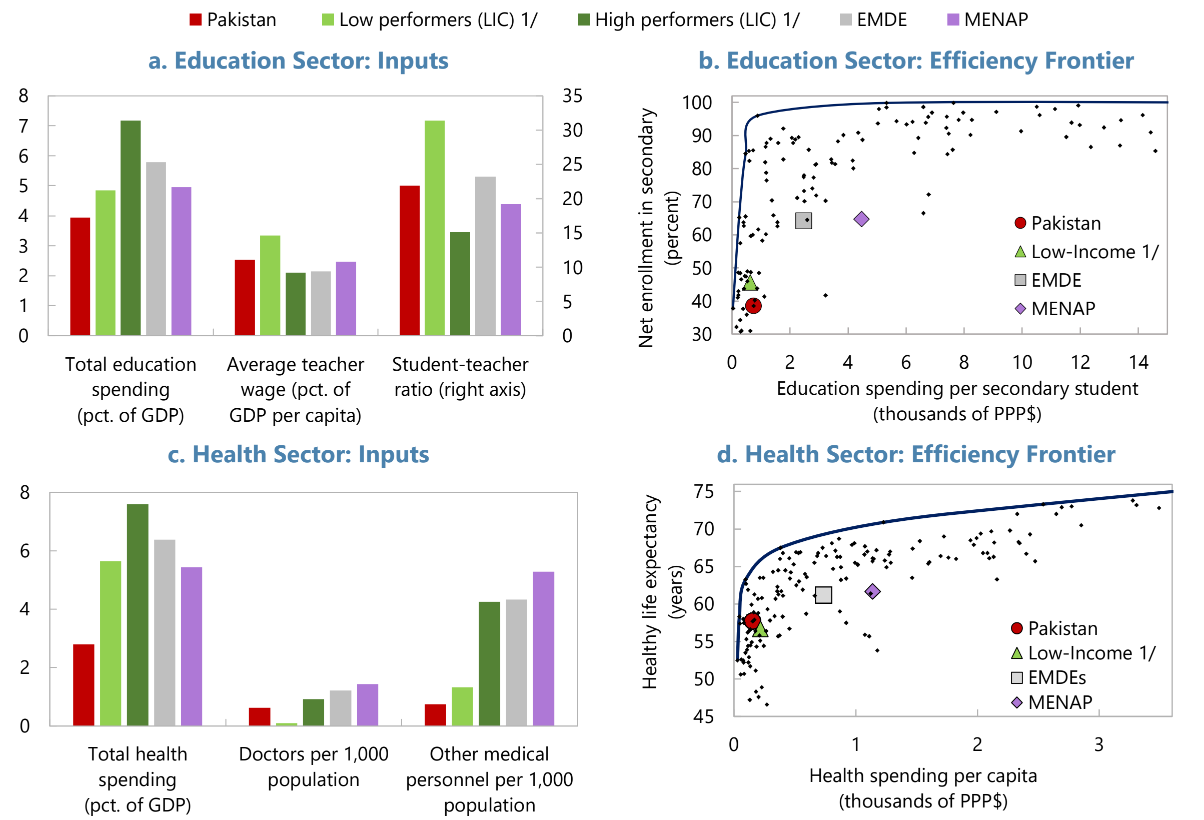
14. Despite recent progress with the social agenda, Pakistan is far from meeting the Sustainable Development Goals (SDGs). It still lags peers' levels of economic and human development, including higher poverty indicators and lower education and health outcomes.[6] Moreover, while income inequality is relatively moderate, gaps in education and health outcomes between the richest and poorest quintiles remain sizeable. Gender inequality is pervasive, with Pakistan ranking very low in the Gender Gap Index (153 out of 156 countries in 2021), mostly

[5] Amendments focus on establishing the central DMO, namely: (i) parliamentary approval over the proper rules of business; (ii) setup of the front, middle, and back offices; (iii) recruitment of staff; and (iv) migration of relevant functions to the new DMO from other government agencies.

[6] For instance, stunting rates among children of over 40 percent.

reflecting poor economic participation and opportunities for women.[7] Progress in these areas will support social outcomes, unleash inclusive growth, and garner broad buy-in for reforms.

Pakistan: Inputs and Efficiency (latest available) 1/



Source: Accompanying Selected Issues Paper on "Spending Needs for Reaching the Sustainable Development Goals."
1/ Countries with GDP per capita below US$3,000.

Policy Discussion

15. Reducing poverty and boosting social protection remains a key pillar of the EFF (MEFP ¶¶11–12). With the COVID-related Ehsaas Emergency Cash (EEC) program coming to an end in FY 2022,[8] the authorities are refocusing their efforts on strengthening their regular BISP programs.

- ***Improving targeting***. The authorities completed the update of the National Socio-Economic Registry (NSER) in October (*end-June 2021 SB*), covering about 33 million families. They already use the registry for a well-targeted expansion of the BISP beneficiary base and reassessment of Pakistan's poverty structure, which will facilitate the design of new programs (with the support of international partners).

[7] Provided by the World Economic Forum, the index measures the gap between men and women in four categories: economic participation and opportunity, educational attainment, health and survival, and political empowerment.

[8] Launched in April 2020 in response to the COVID-19 shock, it provided almost half of the population with a one-off transfer in FY 2021, at a budgetary cost of PRs 41 billion. Another PRs 20 billion is set aside for FY 2022.

- ***Boosting BISP spending***. Staff embraced the authorities' budgeted envelope of PRs 250 billion for BISP in FY 2022 and called for a full execution. The allocation will support the ongoing expansion of BISP's regular cash transfer program; both in terms of the number of beneficiaries (by 30 percent to 8 million families by end-FY 2022) and monthly benefit levels (by 8 percent from January 2022). Going forward, staff also encouraged regularly (i) applying the mechanism for periodic inflation updates of all BISP cash transfers; and (ii) reviewing the value of educational cash transfers under BISP.

At the same time, the authorities have recently launched two new social programs outside BISP. To foster financial inclusion and development, the Kamyab Pakistan Program (KPP) seeks to promote small and medium enterprises (SMEs), agriculture, and low-cost housing financing through highly subsidized loans backed by a 50 percent government guarantee (pari passu). The program has been initially rolled out on a pilot basis in poor areas and aims to reach up to 3 million households and to provide cumulative financing of PRs 1.63 trillion over the next three years. Moreover, to provide relief from high food prices, a new food subsidy program seeks to provide a monthly stipend to 20 million low-income households (covering three products that account for about a quarter of their food layouts). The authorities agreed on the need to ensure full and transparent financing for, and execution of, these new schemes in a sound and transparent way.[9]

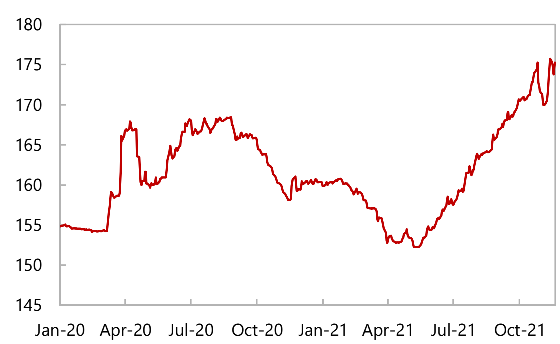
16. In addition, more investment in human and physical capital is crucial. Staff estimates that achieving the SDGs will require an additional 16 percent of GDP in annual spending by 2030.[10] While this may be not be feasible in the remaining time, it underlines the urgency to create considerable fiscal space—for example, by broadening the tax base—to make substantial progress toward the SDGs. Beyond resources, it will also require strengthening governance, capacity, and coordination among various stakeholders.

C. Monetary, Exchange Rate, and Financial Sector Policies

Background

17. External pressures started to increase rapidly in Q4 FY 2021. Strong demand in the foreign exchange market—in the context of accelerating imports and a higher current account deficit that exceeded US$1 billion per month—put significant pressure on the rupee. The SBP responded by letting the exchange rate depreciate gradually and intervening in the foreign exchange (FX) market, anticipating the spike in FX demand to

Pakistan: Interbank Exchange Rate, 2020M01–21M11 (PRs per US$)



Sources: SBP; IMF staff calculations.

[9] The fiscal baseline already includes PRs 25 billion under subsidies for the KPP for FY 2022 to cover the subsidy interest rate component of the program and guarantee provisions in government debt. The estimated cost of the food subsidy program (PRs 120 billion during FY 2022) will be shared between the federal government and provinces.

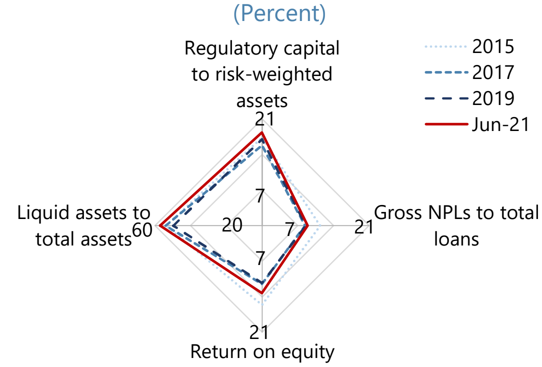
[10] See accompanying Selected Issues Paper on "Spending Needs for Reaching the Sustainable Development Goals."

be temporary. However, pressures persisted and increased in early FY 2022, bringing the rupee to a historic low of PRs 175 per U.S. dollar in mid-November, notwithstanding FX intervention by the SBP.

18. The monetary policy stance is broadly neutral on a 12-months forward basis, due to the recent tightening. Along with exchange rate pressures, inflation persists at relatively high levels of around 8–9 percent and near-term risks for inflation to rise further remain, in part due to the unwinding of policies geared toward containing price pressures for consumers. These include tax measures, notably the reduction of the PDL and GST on petrol and diesel, and delays in the implementation of the GST reform (¶11) and administrative price adjustments (notably power and gas, ¶28). After being on hold for 15 months, the SBP raised the policy rate by 25 bps in October, 150 bps in November, and 100 bps in mid-December to 9.75 percent and increased banks' cash reserve requirement by 100 bps (in November).

19. The banking sector appears stable (Table 6). It has weathered well the COVID-19 shock, also thanks to the SBP's temporary response measures (including the targeted sectoral schemes). As of end-June 2021, banks' capital adequacy ratio (CAR) was stable at 18.3 percent, well above the regulatory minima of 11.5 percent (including the 1.5 percent capital conservation buffer).[11] Non-performing loans (NPLs) declined to 8.9 percent, but the banking sector remains highly exposed to the energy and textile sectors (each at 15 percent of outstanding loans) and the sovereign (70 percent of total credit). However, provisioning of NPLs stood high at 88.8 percent. Deposit growth continued to be robust, while real credit growth reached 6.2 percent yoy in September, supported by low-cost central bank refinancing to commercial banks. In March, the SBP duly reversed the relaxations on macroprudential measures related to consumer credit introduced at the outset of the pandemic.

Pakistan: Financial Soundness Indicators
(Percent)



Sources: Pakistani authorities; IMF staff calculations.

Policy Discussion

20. Tight monetary policy is critical to support disinflation (MEFP ¶13). In view of the solid recovery, inflation outlook, fiscal stance, and mounting balance of payments (BOP) pressures, the authorities and staff concurred that it was time to start tapering off the significant monetary stimulus introduced since the onset of the COVID-19 pandemic in order to achieve real positive interest rates. The authorities concurred that monetary policy should remain data-driven on a forward-looking basis to anchor inflation within the SBP's target range of 5–7 percent over the medium term, with due consideration of public policies' price impact and tradeoffs. Staff and the SBP agreed that the pace of policy rate adjustment should take into account the broader policy mix and the degree of

[11] As part of the COVID-19 relief measures, in March 2020 the countercyclical capital buffer (CCB) was reduced from 2.5 percent to 1.5 percent. It will be restored to 2.5 percent effective January 1, 2023. Thereafter, the capital adequacy ratio (CAR) requirement will revert to 12.5 percent. Three banks with 1.25 percent of banking sector assets (total) are below the regulatory minimum (¶26).

fiscal adjustment. Staff similarly noted that the effort to tighten monetary conditions should also be reflected through scaling back refinancing facilities and reducing the interest rate subsidy vis-à-vis the policy interest rate. Staff supported the continued use of forward guidance in monetary policy statements, the 6-month forward-looking calendar for the monetary policy committee, and the move to 8 meetings per year, which will help improve communication and monetary policy transmission.[12]

21. The SBP remains committed to maintaining a market-determined exchange rate and building reserves. Staff and the authorities agreed that the current market-determined exchange rate remains appropriate to act as a shock absorber and that FX interventions should be limited to avoid disorderly market conditions (DMCs). However, the authorities noted that given the temporary component in the terms of trade shock, a role for interventions is also appropriate to smooth the depreciation trend. Staff cautioned that the room for intervention was highly limited given the still low level of reserves and more permanent nature of the terms of trade adjustment, and that thus bigger fiscal and monetary policy efforts were needed given the constraints in policy space. Going forward, the authorities will continue to (MEFP ¶13): (i) limit FX sales to only offset DMCs; and (ii) use purchases in the FX interbank market to rebuild reserve buffers amid favorable market conditions, but not to influence the exchange rate trend.

22. The authorities agreed with staff's external assessment. Staff's assessment—based on a host of considerations, including the External Balance Assessment (EBA) methods—suggests the external position was broadly in line with fundamentals in FY 2021, although the high uncertainty surrounding the appropriate current account norm for Pakistan calls for caution when using the EBA estimates (see Annex IV). Staff and the authorities also agreed that despite significant improvements in the gross and net international reserves since the onset of the program (import coverage up from 1.7 months to 3 months in June 2021), reserves remain below the adequacy levels as suggested by the ARA metric (74 percent in June 2021) and that continued policy efforts remain crucial to further strengthen the central bank balance sheet and external buffers.

23. The authorities are committed to remove the existing exchange restrictions and MCP when BOP conditions stabilize within the next 12 months. Pakistan maintains: an exchange restriction and MCP arising from the imposition of a 100-percent cash margin requirement (CMR) on imports of certain goods (imposed in 2017). This measure was intensified as the requirement for a 100-percent cash margin on the import of certain goods was extended to an additional 114 items in late-September. Consequently, the relevant PCs on non-intensification of exchange restrictions and on non-modification of MCPs were missed. Pakistan also continues to maintain an exchange restriction resulting from the limitation on advance payments for imports against letters of credit (LCs) and advance payments up to the certain amount per invoice (without LCs) for the import of eligible items (imposed in 2018). Staff emphasized that more prominence should be given to exchange rate flexibility as means to address the BOP pressures rather than to administrative and

[12] Monetary policy transmission remains weak, mainly due to a delayed interest rate pass-through that reflects sizable refinancing schemes at subsidized fixed rates, shallow mortgage and secondary markets for government securities and private bonds, and high demand for currency that reduces the money multiplier.

exchange measures. The authorities requested more time to eliminate them when BOP conditions permit during the next twelve months (MEFP ¶19).

24. Progress with institutional and operational SBP reform continues.

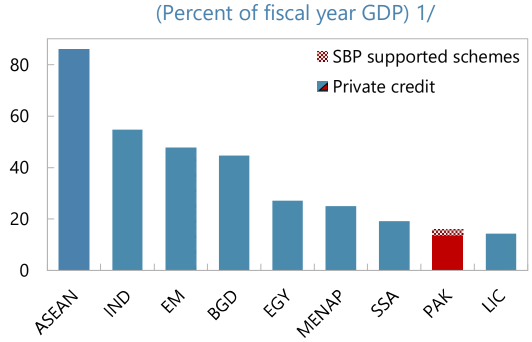
- ***Bolstering the SBP's autonomy, governance, and mandate*** (MEFP ¶16). Once adopted by parliament (*PA*), the amendments to the SBP Act (prepared in consultation with IMF staff and submitted to parliament in March 2021) will: (i) establish domestic price stability as the primary objective; (ii) create the SBP's functions to help achieve its objectives; (iii) strengthen financial autonomy; (iv) prohibit the extension of direct credit or guarantees to the general government; (v) lay the statutory basis for audits; (vi) secure stronger protection of senior officials' personal autonomy; (vii) improve the decision making at the executive management level through the introduction of a collegial decision-making mechanism; (viii) provide stronger oversight by the Board; and (ix) improve the SBP's accountability to the public vis-à-vis the conduct of monetary policy and achievement of objectives.

- ***Upgrading the monetary policy framework***. As economic stability becomes entrenched and the independence of the SBP is strengthened with the approval of the SBP Act reform, the SBP should gradually advance the preparatory work to formally adopt an inflation target (IT) regime, underpinned by a forward-looking and interest-rate-focused operating framework. While some key elements of IT are already in place, including a medium-term inflation objective and a prohibition on monetary financing, additional efforts are needed, aimed at: (i) modernizing the SBP's operational framework; (ii) working to strengthen the monetary transmission, which will require both increasing the interest rate on lending through refinancing facilities to reflect interest rate developments as well as their eventual phasing-out; (iii) bolstering the SBP's analytical capacity, including systematic inflation expectations surveys and introduction of an inflation report; and (iv) further strengthening communication. The authorities agreed, noting that *Vision 2020* lays out their plans to enhance the effectiveness of monetary policy.

Pakistan: Private Credit

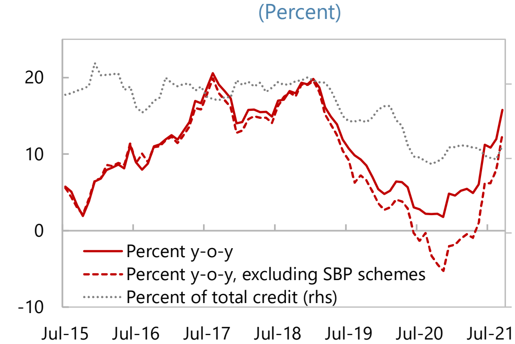
a. Pakistan and Peers: Private Credit, 2020

(Percent of fiscal year GDP) 1/



b. Pakistan: Private Sector Credit, 2015M07–21M09

(Percent)



Sources: WEO; IFS; SBP; IMF staff calculations.
1/ PAK observation is for 2021; ASEAN = Association of Southeast Asian Nations; EM = Emerging Markets; LIC = Low-Income Countries; MENAP = Middle East and North Africa, Afghanistan and Pakistan; SSA = Sub-Saharan Africa.

25. Pakistan has embarked on a significant effort to close the gap with peers in financial development, which is hindering private sector growth. The authorities and staff agreed that further efforts at fostering financial deepening and inclusion were important to increase economic resilience, growth, and formalization of the economy, while also enhancing the credit channel of monetary policy. In addition to removing impediments to financial deepening, the authorities' current strategy also includes suboptimal measures, including providing highly subsidized lending through refinancing schemes from the SBP, setting bank-level sectoral lending targets, and expanding existing government schemes backed by guarantees (KPP, ¶15).

- ***Refinancing schemes*** (MEFP ¶15). Already prior to the crisis, the SBP had been expanding refinancing schemes to address long-standing large credit gaps and market failures. It has further expanded those since March 2020 by (i) establishing three new temporary facilities, one of which is still disbursing; (ii) expanding the existing ones, including in recent months; and (iii) introducing a new facility for SMEs.[13] As of end-September 2021, the outstanding amount for all facilities was PRs 1,225 billion (15.5 percent of private credit), of which PRs 322 billion were related to temporary COVID-19 schemes. Staff warned that this expansion, if not temporary, would undermine the SBP's efforts to credibly implement monetary policy, achieve its primary objective, and improve monetary policy transmission channels. To support the eventual phasing-out of the refinance facilities, the authorities agreed: (i) for the Ministry of Finance and SBP to jointly design a plan, in consultation with other stakeholders, to establish an appropriate Development Finance Institution by end-April 2022 (*new end-April 2022 SB*) as a basis for a plan to transfer the refinancing schemes to the government; and (ii) assess the Export Refinancing Scheme (EFS) by end-February 2022 and take needed actions to improve its effectiveness. Going forward, the amended SBP Act allows refinancing facilities only in pursuit of the SBP's mandate and without compromising the primary objective of price stability.

- ***Housing and construction*** (MEFP ¶14). The SBP introduced two key measures: (i) in July 2020, mandatory targets on banks to double to 5 percent the share of their domestic private sector lending portfolio to the housing and construction sectors by December 2021; and (ii) in June 2021, amendments to the capital adequacy regulations to lower the applicable risk weight to 100 percent (from 200 percent previously) on bank and development finance institution investments in real estate investment trusts. Staff urged the authorities to unwind these measures out of concerns for financial stability. It noted that a direct and well-targeted budget subsidy program for the vulnerable parts of the population would be a more effective way to achieve social policy objectives. It also recommended stronger focus on addressing long-standing structural deficiencies to support private sector lending, in particular on mortgages and housing finance. The authorities will establish a working group comprised of relevant stakeholders to produce a strategy paper by end-February 2022 aimed at offering solutions to the structural impediments to the development of the housing and construction sector.

26. Efforts in support of financial sector stability and governance need to be sustained.

[13] In August 2021, the SBP introduced a new refinancing scheme for lending to SMEs without collateral, with a 40–60 percent first loss guarantee provided by the government. In October 2021, the SBP eased the conditions for renewable energy solution providers under the Refinance Scheme for Renewable Energy.

- ***Maintaining financial sector soundness*** (MEFP ¶17). Staff encouraged the authorities to remain vigilant and intensify efforts to safeguard financial sector stability. Staff further emphasized the importance of continuing to: (i) ensure that all banks meet the minimum capital requirements and strongly urged that two private sector banks complete the first-stage recapitalization (*new end-May 2022 SB*)[14] and one public sector bank move ahead with privatization; (ii) accurately measure NPLs and potential losses, which highlights the importance of implementing IFRS 9; and (iii) upgrade the resolution and crisis management frameworks (including the deposit insurance scheme) by submitting related draft amendments (prepared in consultation with IMF TA) to cabinet by end-January 2022.

- ***Bolstering AML/CFT effectiveness*** (MEFP ¶18). The authorities made substantial progress by satisfactorily completing 26 of the 27 items in their 2018 AML/CFT action plan (*end-June 2021 SB; reset to end-March 2022*). Staff urged the authorities to: (i) complete the last remaining item in the 2018 AML/CFT action plan on effectiveness of terror financing (TF) investigations and prosecutions of senior leaders of UN-designated terrorist groups; (ii) promptly address the deficiencies identified in Pakistan's Asia Pacific Group on Money Laundering (APG) Mutual Evaluation Report under the 2021 AML/CFT action plan; and (iii) review by end-June 2022 the implementation of AML/CFT controls by financial institutions with respect to the tax amnesty program for the construction sector.

- ***Advancing the fintech environment***. The authorities have leveraged the pandemic to advance fintech adoption as evidenced by: (i) an increase in internet and mobile banking users of 32 and 29 percent yoy (respectively) in FY 2021, with e-banking transaction volumes growing by 31 percent yoy; and (ii) the opening of more than 273,000 Roshan Digital Accounts (introduced in September 2020 to attract deposits from overseas Pakistanis) as of end-October 2021, with US$2.6 billion received and more than half being invested in government securities. Separately, the SBP launched the first instant payment system (Raast) in 2020 and introduced digital cheque clearing and a unified QR code for payments in August 2021. While welcoming the authorities' ongoing fintech efforts, staff flagged the need for enhanced supervisory and AML/CFT oversight (and capacity) as fintech grows (given the strong preference for cash in Pakistan and the potential benefits for financial inclusion).

D. Energy Sector Policies

Background

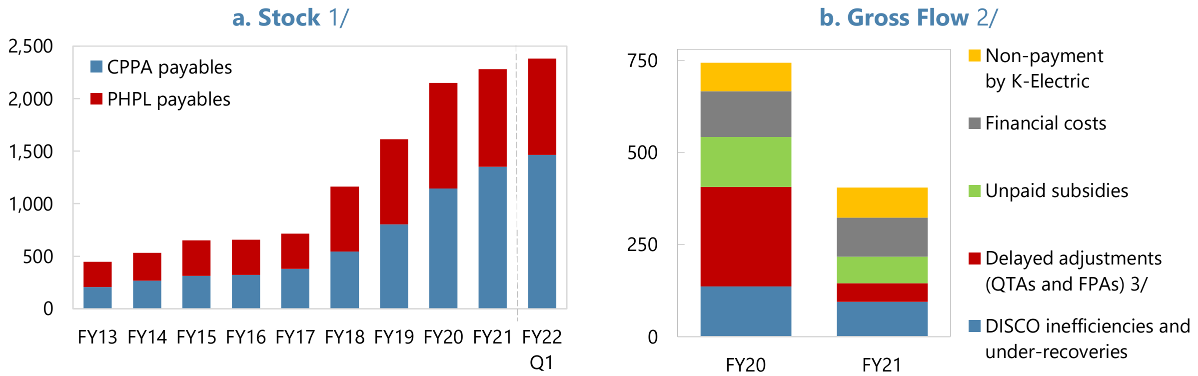
27. The energy sector is in a precarious situation because of long-standing deficiencies. Over the past decade, they have resulted in an unsustainable stock of arrears (circular debt, CD) that affects the entire power-gas/petroleum chain and weighs on the financial sector, budget, and real economy. Sectoral viability eroded further during FY 2021, despite the collection of deferrals granted

[14] The first-stage recapitalization requires the completion of capital injections, with documentation submitted to, and accepted by, the SBP to fill 50 percent of the capital shortfall calculated as of September 30, 2021, which will result in the banks achieving positive capital.

in FY 2020, as the authorities continued to delay regular price adjustments and grant temporary subsidies.

- ***Power***. The CD flow in the power sector reached 0.6 percent of GDP in FY 2021, growing the CD stock to 4.8 percent of GDP at end-FY 2021.[15] More generally, the CD flow has remained well above the levels expected since the start of the program, mainly because of the delay in tariff adjustments,[16] high debt costs, and operational losses by distribution companies (DISCOs).

Pakistan: Circular Debt in the Power Sector, FY 2013/14– 21/22
(Billions of Pakistani rupees)



Sources: Pakistani authorities; IMF staff calculations.
1/ Only the part held by the Power Holding Private Limited (PHPL) is publicly guaranteed. 2/ Excludes arrears-reducing flows of PRs 108 billion (prior-year adjustments). 3/ Includes impact of delayed ARs.

- ***Gas***. A substantial CD stock of more than 1 percent of GDP has also accumulated in the gas sector, pending the finalization of the authorities' ongoing cleanup of the underlying data. The main drivers are high unaccounted for gas losses (UFG), often delayed sales price adjustments, uncovered subsidies (especially for export and zero-rated industries), and collection shortfalls.

Policy Discussion

28. Restructuring the energy sector requires sustaining the reform efforts. This is particularly important as recovery costs are poised to increase in the near term with the coming-on-stream of new generation capacity, rise in international commodity prices, and recent rupee depreciation. While some recent measures (including the enactment of the NEPRA Act amendments in late July and renegotiation of IPP contracts) will help tackle rising arrears, making a dent requires steadfast implementation of a comprehensive, socially-balanced reform strategy (MEFP ¶¶20–23):

- ***Monitoring and the Circular Debt Management Plan (CDMP)***. The authorities remain guided by the CDMP to achieve an ambitious and sustained decline in the accumulation of power sector arrears. They have followed through with their monthly monitoring scheme since spring 2021

[15] This includes 1.9 percent of GDP held by PHPL.

[16] Each month of delaying an adjustment of PRs 1 per kWh adds about PRs 8½ billion to the stock of arrears.

and also updated the CDMP regarding its underlying assumptions and reform progress (in close consultation with World Bank, Asian Development Bank (ADB), and IMF staff).

- ***Aligning power tariffs with cost recovery levels***. Staff stressed that the regular implementation of tariff adjustments in line with established formulas is critical to lend credibility to the newly independent energy regulator, halt the accumulation of arrears, and implement the CDMP. The authorities noted that the delays aimed to alleviate the cost of the COVID-19 pandemic to the population, support the economic recovery, and dampen persistent inflation. As the economy has gained momentum, they have implemented all pending tariff adjustments in two steps: (i) the FY 2020-Q4 quarterly tariff adjustment (QTA) on October 1 (*end-September 2021 SB*), along NEPRA's scheduled QTAs covering FY 2021-Q1/2 in October and FY 2021-Q3 in November; and (ii) the remaining FY 2021 annual rebasing (AR) on November 5 (*June 1, 2021 SB*).[17] The FY 2022 AR is on track to be notified by February 2022 as per the updated CDMP, which will help contain monthly fuel price adjustments (FPA).

- ***Better targeting power subsidies***. The authorities concur that a subsidy reform is needed to effectively protect the vulnerable, introduce more fairness, and reduce budget costs. Key elements are a smaller group of subsidized consumers and a more progressive tariff structure. To this end, they completed some first reforms in September,[18] which however failed to reduce total net subsidies (as previously envisaged in the *end-June 2021 SB*). Supported by the World Bank, the authorities will therefore seek cabinet approval by end-January 2022 (*new end-January 2022 SB*) for: (i) removing the previous slab benefit; and (ii) increasing the effective tariff of the unprotected slabs by at least PRs 0.5 per kwh. The next step would be for NEPRA to approve the new tariff structure by end-February 2022.

- ***Implementing the renegotiated purchasing power arrangements (PPAs)***. The government made a first payment of PRs 90 billion (0.2 percent of GDP) to settle IPP arrears in early June (*end-May 2021 SB*), which immediately unlocked lower tariffs for the covered IPPs. It plans to settle another PR 311 billion in CPPA-G payables in FY 2022, while any additional reduction will depend on adequate fiscal space and implementation progress of the CDMP.

- ***Pursuing other medium-term reforms to reduce costs and CD***. The authorities remain committed to working with the World Bank and ADB to: (i) reduce commercial and technical losses (including by introducing smart metering, cutting off delinquent consumers, and scaling up the transmission and distribution infrastructure to be at par with generation capacity); (ii) improve DISCO governance and accountability (also as per the new SOE law and policies, ¶34), introduce private participation, and progress with their phased privatization (as per the recent triage, ¶34); (iii) introduce competition; (iv) actively seek similar PPA renegotiations with other

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[17] Note that implementing the (i) QTAs was almost tariff-neutral thanks to expiring QTAs from the previous year; and (ii) the AR only increased the base tariff by 2 percent thanks to a concurrent sales-mix adjustment.

[18] This included: (i) a more stringent eligibility criterion for protected consumer slabs (based on households' maximum usage from the previous 6-months consumption rather than the average over the previous 12 months); (ii) a lower threshold for protected consumer slabs (of 200 rather than 300 units per month, reducing the share of protected consumers from 93 to 46 percent); (iii) a breakdown of the unprotected 301-700 units slabs (into slabs of 100); and (iv) an expanded definition of lifeline consumers (also covering residential consumers with 50-100 units per month).

groups of power producers, including state-owned; and (v) implement the recently approved National Electricity Policy 2021.[19] The authorities also agreed that gradually absorbing maturing publicly-guaranteed PHPL debt into cheaper central government debt (such as the 0.1 percent of GDP through FY 2021) will strictly depend on adequate fiscal space in FY 2022 and beyond. They also intend to use several proceeds to reduce the CD stock, including privatization proceeds from power sector assets and recoveries from the outstanding stock of receivables.

- ***Turning around the gas sector***. The authorities agreed that this objective requires action on several fronts. They are currently working on revising end-user prices, which would be the first since September 2020. Staff reiterated the importance of the parliamentary adoption of the OGRA Act by end-June 2022 (*end-June 2021 SB; reset to end-June 2022*) to support regular and full cost recovery going forward. Moreover, the two T&D companies have stepped up measures to bring down UFG losses (including through infrastructure improvements, network rehabilitation and theft control programs). Staff noted that the unbundling of the T&D companies would further incentivize a speedy implementation of these UFG-reducing programs.[20] While the recently introduced regular UFG monitoring reports help transparency and better planning, steadfast implementation of cost-reducing reforms is needed as well as the establishment of accountability and mitigation measures for missed UFG targets.

E. Structural Policies

29. Pakistan needs resilient, sustainable, and strong growth to improve incomes, job opportunities, and social outcomes. This is even more important in the context of the COVID-19 pandemic and the mounting impact of climate change, given their sizable human costs and economic disruptions, with ripple effects on poverty and inequality. However, lifting growth in a sustained way can only be achieved through a structural transformation of the economy that boosts productivity and investment. This requires removing impediments that have played a role in holding back the development of a vibrant private sector and the creation of high-quality jobs for a rapidly growing labor force. The authorities acknowledged that such impediments mainly arise from an uneven playing field between the private sector and a large and inefficient SOE sector, corruption, and red tape. While welcoming recent efforts, staff called for accelerated action to bolster governance, the business environment, and climate change.

Background

30. Pakistan's SOE sector is saddled by poor performance and weak corporate governance, posing significant fiscal risks.[21] Non-financial commercial SOEs held total assets amounting to

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[19] The reform plan also includes expanding cheaper and cleaner energy generation as per the Alternative and Renewable Energy (ARE) Policy; and making the wholesale power market competitive with multiple buyers and sellers through the establishment of a Competitive Trading Bilateral Contract Market (CTBCM).

[20] The unbundling implies in the first phase a separation of supply (gas sale) from network functions (T&D).

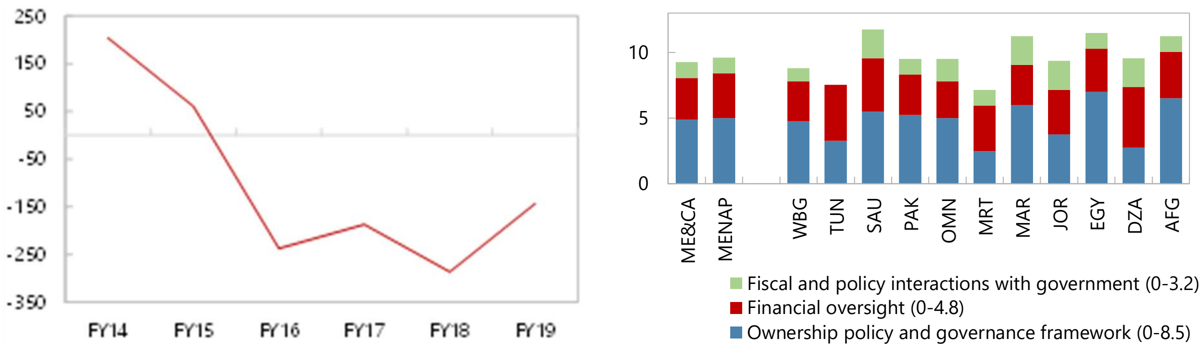
[21] See accompanying Selected Issues Paper on "State-Owned Enterprises in Pakistan: Footprint, Performance, Fiscal Risks, and Governance."

44 percent of GDP in 2019 (up from 31 percent of GDP in 2015), but only provided about 0.7 percent of total formal employment. Based on a comprehensive triage report published by the Ministry of Finance in 2021, which provides a snapshot of the federal-level SOE landscape as of end-FY 2019, there are 213 SOEs, of which only 85 are commercial operations (18 financial and 67 non-financial). The overall revenues of all non-financial commercial SOEs in FY 2019 were about PRs 5 trillion (14 percent of GDP). Despite their important role in the economy, the financial performance of many SOEs is weak, with one-third consistently generating losses.

Pakistan: State-Owned Enterprises

a. Pakistan: SOEs' Net Profit, FY 2013/14–18/19
(Billions of Pakistani rupees)

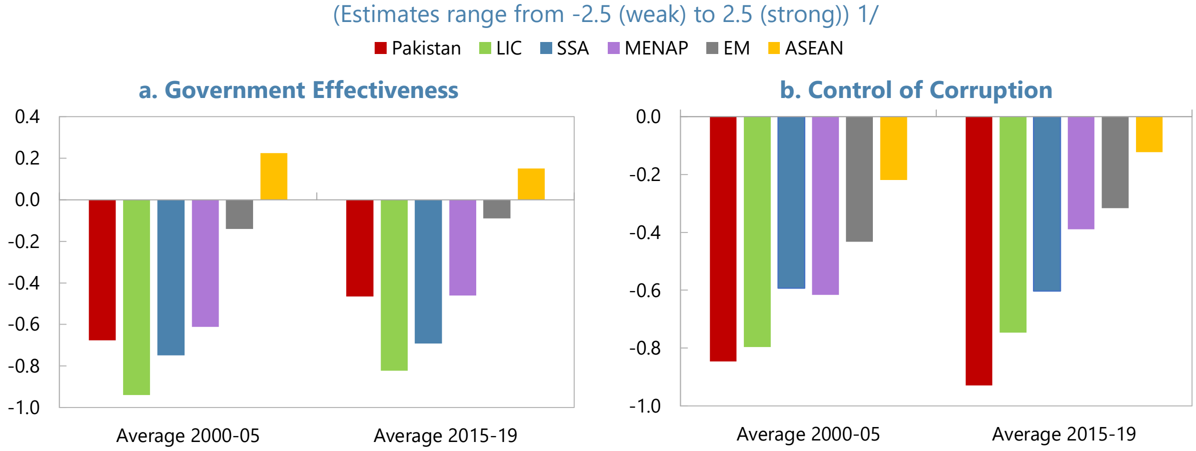
b. Pakistan and Peers: SOE Corporate Governance Index (Score from 0–16.5) 1/



Sources : Pakistani authorities; Ramirez Rigo et al. (2021); IMF staff calculations.
1/ Higher values show closer adherence to OECD guidelines and greater fiscal transparency (see Ramirez Rigo et al., 2021).

31. Weak governance and government effectiveness weigh on the business environment. Businesses remain discouraged from investing and expanding activities, mainly on account of an inefficient bureaucracy—especially excessive regulations and licensing requirements, obstacles to paying taxes in a cumbersome tax system, and difficulties trading across borders and registering property), which in turn increases corruption risks. As a result, private firm, and job creation as well as investment remain low, also relative to peers (as evidenced by Pakistan ranking among the lowest quarter in global competitiveness reports).

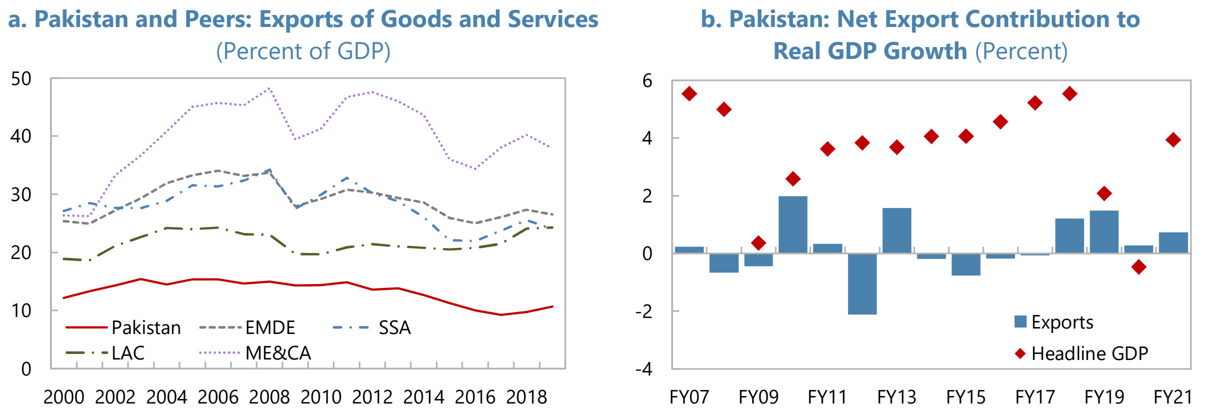
Pakistan and Peers: Indicators of Governance, 2000–19
(Estimates range from -2.5 (weak) to 2.5 (strong)) 1/



Source: Worldwide Governance Indicators; IMF staff calculations.
1/ Estimates are derived from perceptions-based data. Caution is needed when comparing these indicators across countries and over time.

32. Trade provides little impetus to growth and economic development. Pakistan remains a very closed economy compared to other emerging and developing economies, with openness quasi stagnating since the 1990s and net exports often acting as a drag on growth. Only a small number of firms export (primarily low value-added textile products) and fiscal revenues continue to rely on import tariffs, undermining trade integration and further weakening export competitiveness.[22]

Pakistan: Exports, 2000–20



Sources: PBS; IMF WEO and staff calculations.

33. Pakistan is highly affected by climate change, while only contributing about 1 percent of global greenhouse gas emissions (GHG). The country has experienced a trend increase in temperatures, fluctuating levels of precipitation, and extreme climate shocks, putting it among the 10 countries worldwide with the largest damages from climate-related disasters since 2000 (Germanwatch 2021). Over the past two decades, 120 recorded events have caused an estimated US$22 billion in material damages, left more than 55 million people affected and 11 thousand killed (EM-DAT 2021). Relative to peers worldwide, Pakistan stands out in terms of frequency and material damages, while human losses are sizable too (see Table below). These damages mainly reflect the impact of hydrological hazards[23] and low resilience. Going forward, Pakistan's main climate stressors are predicted to be extreme temperatures, more erratic precipitation, and rising sea levels (especially around Karachi, Pakistan's commercial center and main deep-sea port). At the same time, Pakistan only emits about 1 percent of global GHG, which still puts it in the group of 20 largest emitters worldwide on an absolute basis.[24]

[22] See accompanying Selected Issues Paper on "Trade as a Source of Growth and Economic Development."

[23] For instance, the 2020 and 2010 monsoon-driven floods in the Sindh region and the Indus river, respectively, affected about 20 million people each.

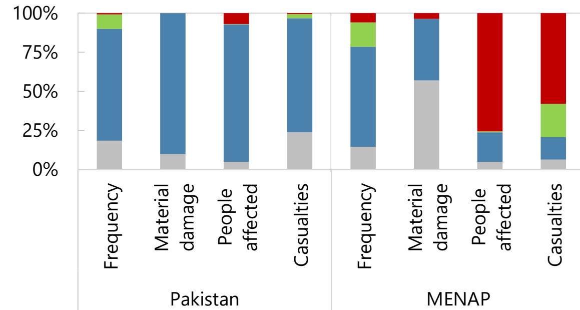
[24] See accompanying Selected Issues Paper on "Climate Mitigation in Pakistan."

Pakistan and Peers: Climate-Related Disaster Damages, 2000–20 1/

a. Frequency and Damages
(Annual average)

			Rest of the World	
	PAK	MENAP	EMDEs	AMs
Frequency	5.71	1.20	2.01	2.06
Material damage (pct. of GDP)	0.55	0.05	0.46	0.06
Affected people (pct. of pop.)	1.44	1.44	2.02	0.12
Casualties (per mille of pop.)	0.003	0.006	0.008	0.004

b. Main Hazards
(Share of total)



Source: EMDAT; WB; WDI; IMF WEO and staff calculations.
1/ There are four climate hazards: (i) meteorological (e.g., extreme temperatures and storms); (ii) hydrological (e.g., floods and landslides); (iii) biological (e.g., epidemics and insect infestations); and (iv) climatological (e.g., droughts and wildfires).

Policy Discussion

34. **In the SOE sector, both stronger governance and a smaller footprint of the state are crucial to boosting efficiency** (MEFP ¶25). Staff called on the authorities to accelerate the legal, regulatory, and policy framework update of the SOE sector. A key element remains the parliamentary approval of the SOE law in line with IMF recommendations (*new end-June 2022 SB*). It aims to: (i) define a rationale for state ownership; (ii) ensure commercially sound SOE operations; and (iii) regulate oversight and ownership arrangements. Additional steps include defining a new ownership policy, amending several SOEs' Acts, and operationalizing a central monitoring unit within the Ministry of Finance. To further foster efficiency and reduce fiscal risks, staff also advised to follow through with a gradual reduction of the footprint of the state in the economy, with only a small number of SOEs considered strategic under state ownership (as determined in the triage finalized with World Bank TA in March 2021). This includes finalizing the divestment of two LNG-based power plants and two small public banks. Staff insisted that regular and timely audits of key SOEs remain crucial, including of the Utility Stores Corporation, which is still under review at end-2021 (*end-April 2021 SB*).

35. **In parallel, structural reforms need to support private sector development and job creation**. The authorities and staff concurred on the following multi-pronged strategy:

- ***Boosting the business environment*** (MEFP ¶26). Staff urged the authorities to press ahead with digitalization, legal, and regulatory reforms aimed at: (i) simplifying procedures to start a business and eliminating other unnecessary regulations; (ii) streamlining the FDI approval process; (iii) improving trading across borders by reducing custom-related processing time and reducing hours to prepare import/export documents; and (iv) simplifying and harmonizing the process of paying taxes. However, to expand Pakistan's information technology, digitalization, and outsourcing sectors going forward, it will also be important to invest more in education and human capital, improve product market access, and increase the adoption of information and communication technologies (ICT).

- ***Strengthening the effectiveness of anti-corruption institutions*** (MEFP ¶27). Priority measures include the establishment of an asset declaration system with a focus on high-level public officials (including federal cabinet members) by end-January 2022 (*end-June 2021 SB, reset to end-January 2022*), publication of the second review cycle report under the UN Convention against Corruption, and review of the institutional framework for Pakistan's anticorruption institutions by independent experts with international experience.

- ***Enhancing the use of AML tools to support anti-corruption efforts*** (MEFP ¶27). The authorities acknowledged the benefits of effectively supervising financial institutions to comply with due diligence obligations for politically exposed persons and suspicious transaction reporting. Staff highlighted the need to enhance the effectiveness of Pakistan's financial intelligence unit and recommended pursuing membership to the Egmont Group.

- ***Improving external competitiveness***. Consensus emerged on several priority measures: (i) continuing to work to further rationalize the tariff structure as part of implementing the approved national tariff policy (based on timebound strategic protection) to reduce the level of protection while reducing also input costs to promote competition, exports, and domestic production ("Made in Pakistan") for import substitution purposes;[25] (ii) pursuing high-standard Free Trade Agreements (FTAs) with large, important trading partners to gain market access for exporters;[26] (iii) supporting new and small exporters, including through export financing instruments and helping promote products in new markets; and (iv) facilitating joining global supply chains, including by improving product quality, firm reliability, and firm registration with all necessary entities for tax and business purposes. Strengthening Pakistan's Trade Development Authority would further support these efforts.

36. Durable and resilient growth also depends on adequate climate change action. The authorities have long acknowledged the challenges posed by climate change. They established a Ministry of Climate Change in August 2017 to coordinate various public climate change initiatives and to manage the Environmental Protection Agency created in 1997.[27] Staff welcomed the preparation of a National Adaptation Plan (NAP), supported by the UNFCCC and Green Climate Fund. Expected to be finalized by 2023, the NAP will build on Pakistan's existing nature-based approaches—which include the Ten Billion Trees Tsunami Program, the Ecosystem Restoration Fund, and the Recharge Pakistan initiative—with the aim to reduce the country's vulnerability to climate impacts by integrating adaptation measures into national policy. Important recent milestones comprise the enactment of the Climate Change Act in 2017 and national electric vehicle policy. In parallel, staff recommended to prioritize more no-regret measures,[28] such as enhancing early

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[25] As domestic tax revenue mobilization strengthens, there will be space to rationalize tariffs in line with international practices, which should aim for low tariffs at uniform rates.

[26] Existing FTAs include those with China, Indonesia, and Sri Lanka.

[27] In parallel, the Prime Minister has a Committee on Climate Change since 2018, which uses the Global Change Impact Studies Centre (GCISC, established in 2002) as a Secretariat.

[28] Those are cost-effective measures that deliver simultaneously on multiple objectives, including economic growth, development, and climate change—both now and under several climate scenarios.

warning systems for local communities living in flood- and drought-prone areas. On the mitigation side, staff advised the authorities to accelerate efforts to meet their international GHG reduction commitments. Key measures could include reforming energy prices, subsidies, and taxes (which would also help mobilize significant and easily collected revenues, e.g., to help finance the SDGs).[29]

PROGRAM MODALITIES

37. Staff supports the authorities' request for waivers of nonobservance for the missed continuous PCs and a waiver of applicability for the end-December PCs on which data is not available (¶5).[30] As corrective actions for the end-June QPC on the general government primary budget deficit and of the continuous PCs related to the intensification of exchange restrictions and modification of MCPs, the authorities: (i) agreed to adopt a supplementary FY 2021/22 budget law with a lower deficit especially thanks to strong tax measures (¶11); and (ii) committed to phase out the modified and existing exchange restrictions and MCP inconsistent with Article VIII when BOP conditions stabilize within the next 12 months (¶23). Staff supports the approval of the exchange restriction for the next 12 months, as the measures giving rise to this restriction are maintained for BOP reasons, are not discriminatory, and are temporary. Moreover, the breach of the PC on zero new flow of SBP credit to the government is minor, as it reflects the on-lending of the SDR allocation to the general government for budget financing of the vaccine drive.

38. Strong and focused conditionality continues to guide program implementation.

- ***Quantitative targets***. New PCs for end-December 2021, end-March 2022, and end-June 2022 will support fiscal deficit reduction, limit public debt built-up through public guarantees, contain inflationary pressures through a deceleration of base money growth and a cap on government borrowing from the SBP, and support adequate reserve coverage (MEFP Table 1). Three additional adjusters are proposed for the accommodation of: (i) expenditures on COVID-19 vaccines, which affect the PCs on NIR (TMU ¶11.d), NDA (TMU ¶14.d) and the general government primary budget deficit (TMU ¶19.h); (ii) allowing part of the SDR allocation to be used for budget support, which affects the PC on net government budgetary borrowing from the SBP (TMU ¶21); and (iii) changes in the average cash reserve ratio, which affects the PC on NDA (TMU ¶14.e).

- ***Structural benchmarks***. Staff proposes to reset three delayed SBs, drop two SBs (¶5), and set six new SBs on critical next steps for already ongoing reforms (MEFP Table 2).

- ***Review schedule and access***. Staff agrees with the authorities' request to modify the schedule of reviews and retain the quarterly schedule of reviews until end-June 2022 to closely guide

[29] See accompanying Selected Issues Paper on "Climate Mitigation."

[30] The newly established end-December 2021 PCs are controlling for the sixth review.

policy implementation in the face of persisting macroeconomic vulnerabilities and remaining uncertainty arising from the still ongoing COVID-19 pandemic. Staff also concurs with

the authorities' request to rephase the remaining access under the program in line with the quarterly schedule from this review onwards as suggested in Table 9b in line with BOP needs.

- ***Modified and existing exchange restrictions and MCP***. Staff supports the authorities' request for approval under Article VIII of the IMF's Articles of Agreement of their temporary retention and extension, given the authorities' renewed commitment to fully eliminate them when BOP conditions stabilize within the next 12 months (¶23 and Information Annex).

39. The program remains fully financed. Financing commitments from bilateral and multilateral partners, and the temporary suspension of debt service to official bilateral creditors granted under the G20 DSSI initiative,[31] will help cover public gross external financing needs in FY 2022 and until the end of the program in October 2022 (Table 3b).[32] On aggregate, key bilateral creditors have increased their exposure to Pakistan in recent months, thanks to one creditor reinstating its original exposure and all others maintaining theirs. Staff encourages all key bilateral creditors to maintain their exposure to Pakistan in line with program commitments.

40. Pakistan's capacity to repay the IMF is adequate subject to program implementation. The IMF's exposure reaches SDR 5,560.34 million (or 274 percent of quota and about 40 percent of gross reserves) with this review. With full purchases, it will peak at 344 percent of quota in 2022 (Table 7). As assessed before, elevated risks—notably from delayed adoptions of reforms, high public debt and gross financing needs, and low reserves—could jeopardize program objectives, and erode repayment capacity and debt sustainability. Uncertainty about global economic and financial conditions amid the COVID-19 pandemic add to those risks. The strong framework for program monitoring (including continued quarterly reviews and updated program conditionality, ¶38), focused technical assistance in support of program implementation (Annex V), and adequate execution of existing financing commitments are essential mitigation strategies.

41. The 2019 safeguards assessment found a broadly strong safeguards framework at the SBP. The financial reporting, external and internal audit mechanisms, and an enterprise-wide risk management framework all highlight sound practices. Areas that require strengthening include the SBP legal framework (¶24) and involvement in quasi-fiscal activities which need to be phased out in the medium term (¶25) and are being addressed through amendments to the SBP Act and commitments under the program. Importantly, four out of eight non-executive director positions on

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[31] The DSSI covers about US$3.8 billion falling due over May 2020–Dec 2021, of which about (i) US$1.1 billion relate to the second round of DSSI covering the January–June 2021 debt service and (ii) US$1.0 billion to the third DSSI round covering July–December 2021.

[32] The FY 2022 official financing includes support from China (US$6.6 billion, including the rollover of US$4 billion SAFE deposits), UAE (rollover of US$2 billion), World Bank (US$2.4 billion), Asian Development Bank (US$1.2 billion), Islamic Development Bank (US$1 billion), and other bilateral support under the G20 initiative (US$1 billion).

the SBP Board have been vacant for a prolonged period of time and need to be filled urgently to strengthen independent oversight of the SBP.

STAFF APPRAISAL

42. The Pakistani economy has recovered quickly, but imbalances have grown just as rapidly. A strong economic recovery has gained hold since summer 2020, benefiting from the authorities' multifaceted policy response to the COVID-19 pandemic that has helped contain its human and macroeconomic ramifications. At the same time, external pressures have started to emerge since spring 2021: a widening of the current account deficit and depreciation pressures on the exchange rate—mainly reflecting the compound effects of the stronger economic activity, an expansionary macroeconomic policy mix, and higher international commodity prices. This has also reinforced inflation pressures.

43. Although staff regrets recent policy reversals which undermine the ability of the program to achieve its objectives, it is encouraged by the authorities' willingness to adjust policies. On the fiscal side, a supplementary budget targets a gradual reduction of the primary deficit based on: (i) high-quality revenue measures to make the tax system simpler and fairer (including through the adoption of reforms to the GST system); and (ii) prudent spending restraint, while fully protecting social spending. Although with a delay, the SBP has increased the policy rate by 275 basis points to 9.75 percent, raised banks' reserve requirements, tightened some macroprudential measures to contain consumer credit growth, and provided forward guidance. The authorities also implemented some key structural reforms, including on consolidating central bank autonomy, improving cost recovery in the power sector, and strengthening public sector governance. All these are critical to ensure economic stability in the near term, and together with policy commitments to lay the basis for sustainable growth.

44. Sustained implementation of a gradual, revenue-based fiscal adjustment remains crucial to build confidence and reduce elevated vulnerabilities. Successfully steering the economy back to a sustainable, balanced growth path and addressing current macroeconomic imbalances depends on carefully executing the supplementary budget for FY 2022. Staff reiterated that the recently adopted reforms of general sales taxes this FY and corporate taxation last FY are important first milestones to improve fairness, transparency, and revenue collection over the medium term. The same is true for the reform of personal income taxation and harmonization of general sales taxes, which are both penciled in for the FY 2023 budget. Along with careful spending management, this revenue mobilization will create space for much-needed spending on development infrastructure and social protection, while keeping public debt on a downward trajectory.

45. Reducing poverty and boosting social protection requires greater coordination and efforts to increase fiscal space. Staff supports the scaling-up of social spending, and welcomed the finalization of the NSER update, which is already being used to support a targeted expansion of the BISP beneficiary base and analyzing the needs of the vulnerable to customize more effective programs. At the same time, staff cautioned about the launch of new programs outside the authorities' flagship program BISP, which risks undermining a comprehensive, fully financed, and coordinated scaling-up of a well-targeted social safety net.

46. Monetary and financial sector policies need to remain proactive and data-based to curb inflation and safeguard financial sector stability. Staff welcomed the recent policy rate hike and sees continued monetary tightening critical to support much-needed disinflation. This involves not only using the interest rate as an instrument but also phasing out various liquidity-enhancing facilities over the medium term (i.e., the refinancing schemes that support purposes outside of the SBP's core mandate). Monetary policy should remain data-driven on a forward-looking basis to anchor inflation within the SBP's objective of 5–7 percent over the medium term. At the same time, maintaining financial stability warrants closer oversight of financial institutions. In this vein, a more proactive approach to addressing financial institutions that continue to be undercapitalized is needed and the SBP should seek to accelerate the recapitalization process using their existing powers with a view to strengthen financial sector resilience. Moreover, banks' housing lending targets could present risks to financial stability and entail a misallocation of credit. Ongoing work to strengthen the bank resolution and crisis management frameworks is welcomed and should be a key priority. On the institutional side, the adoption of the SBP Act will be a very important step toward strengthening the central bank's independence, governance, and mandate. It will also allow the SBP to move closer to formally adopt an inflation target regime. Enhancing the effectiveness of the AML/CFT framework remains another urgent priority to progress in completing their 2018 and 2021 action plans with the FATF.

47. Preserving a market-determined exchange rate remains crucial to absorb external shocks, maintain competitiveness, and rebuild international reserves. For FY 2021, staff finds that the external position was broadly in line with fundamentals and desirable policy settings. All in all, strong macroeconomic policies and structural reforms will help further build confidence in the rupee. However, greater two-way flexibility is justified. In parallel, staff encouraged the authorities to continue to strengthen the central bank balance sheet, including by building buffers.

48. Stronger ownership is critical to advance electricity sector reform, which remains vital. It will not only help restore the sector's financial viability, but also tackle its adverse spillovers on the budget, financial sector, and real economy. In this regard, steadfast implementation of the IFI-supported Circular Debt Management Plan (CDMP) will help guide the planned management improvements, cost reductions, timely alignment of tariffs with cost recovery levels, and better targeting of subsidies to the most vulnerable. Substantially lowering supply costs, however, will require a modern electricity policy that: (i) ensures that PPAs do not impose a heavy burden on end-consumers; (ii) tackles the poor and expensive generation mix, including a wider use of renewables; and (iii) introduces more competition over the medium term.

49. A stronger medium-term outlook depends on accelerating structural reforms. Boosting sustainable and resilient growth, creating jobs, and improving social outcomes to the benefit of all Pakistanis hinges on ambitious efforts to remove structural impediments and facilitate the structural transformation of the economy. To this end, staff called on the authorities to speed up measures that strengthen economic productivity, investment, and private sector development. This requires above all: (i) improving the governance, transparency, and efficiency of the SOE sector; (ii) fostering the business environment and control of corruption; (iii) unleashing competitiveness and exports; (iv) promoting financial deepening and inclusion. Beyond this, investing more in education and human capital remains crucial for socio-human development and strong growth.

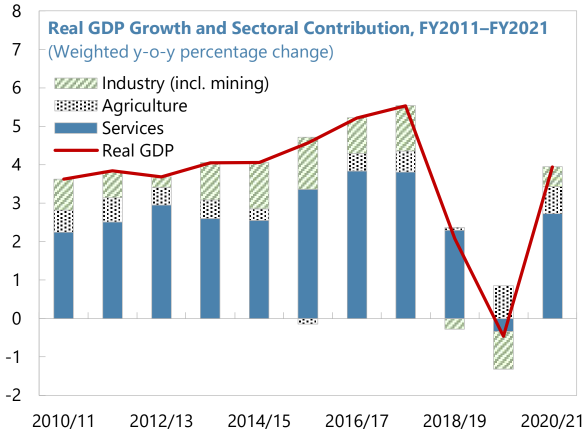
50. Risks continue to be tilted to the downside, both on the domestic and external front. The outlook for growth, trade, and remittances remains clouded amid the ongoing COVID-19 pandemic, especially at the global level, while inflation may rise further than expected as commodity prices feed through to domestic prices. In addition, political tensions over reforms could weaken policy implementation, and undermine Pakistan's adjustment path, debt sustainability, and growth potential. Moreover, reform fatigue and the political cycle could quickly narrow the window to undertake critical reforms. Tapering, geopolitical tensions, and waning reform efforts could affect external financing conditions. Close program monitoring, interlinked TA, and financing assurances from key lenders somewhat mitigate those risks.

51. While recognizing risks, staff supports the authorities' request for completion of the sixth review under the EFF. In view of the authorities' recent efforts to strengthen program performance and implement a comprehensive set of corrective measures, staff supports: (i) granting waivers of nonobservance for the missed continuous PCs; (ii) rephasing access consistent with the modified review schedule; (iii) setting new quantitative targets for end-December 2021, end-March 2022, end-June 2022; (iv) granting a waiver of applicability for end-December 2021 PCs; and (v) making the disbursement related to the sixth EFF review available for budget support; and (vi) approving modified and existing exchange restrictions and MCP, because they are temporary, non-discriminatory, and needed for BOP reasons.

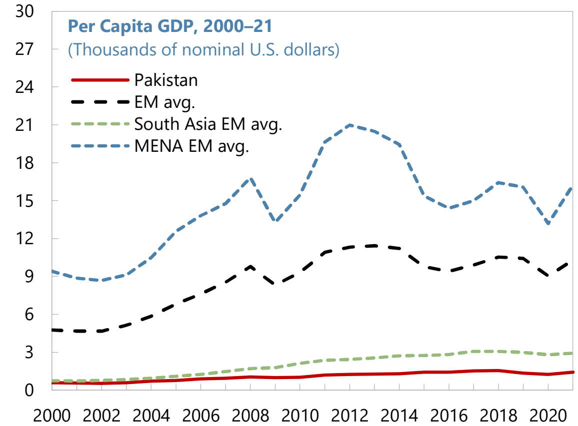
52. It is recommended that the next Article IV consultation with Pakistan be held on the 24-month cycle, in accordance with Decision No. 14747– (1096) on consultation cycles.

Figure 1. Pakistan: Selected Economic Indicators

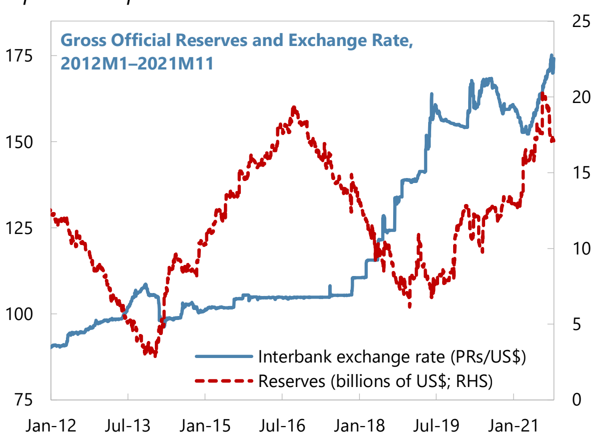
The economy rebounded sharply in FY 2021 …



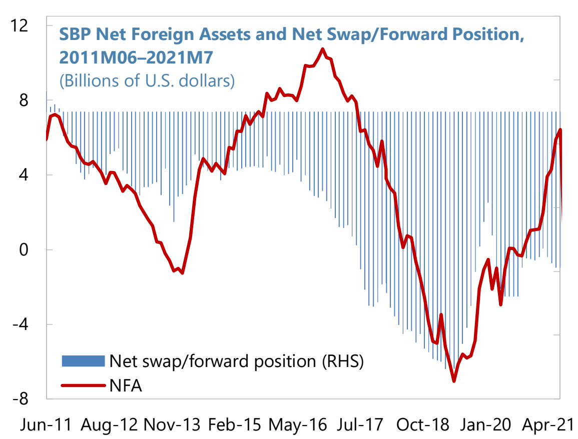
…however, Pakistan continues to lag regional peers and other EMs in economic convergence.



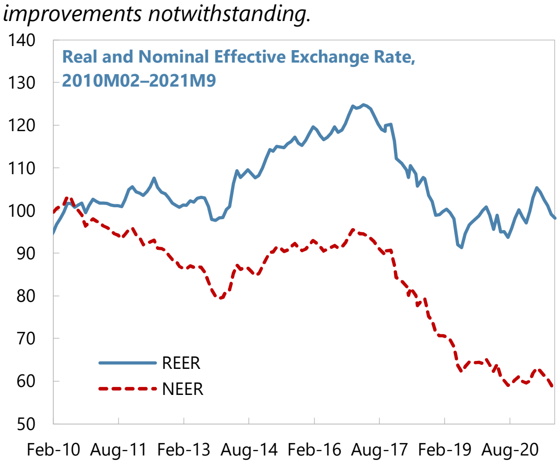
Despite foreign reserves reaching a 5-year high, supported by the SDR allocation, the exchange rate has faced depreciation pressures.



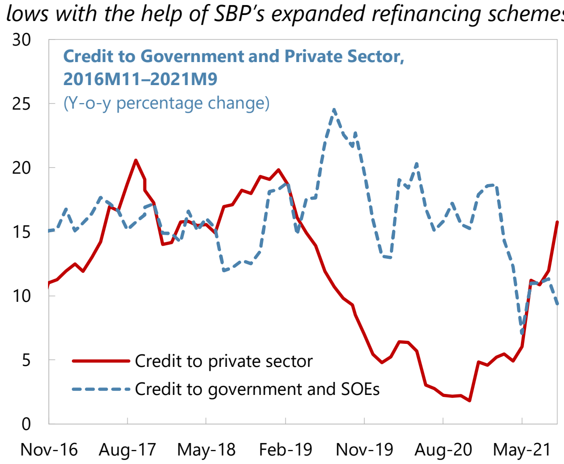
As a result, improvements to SBP's derivative position have stopped.



External competitiveness remains weak, some recent improvements notwithstanding.



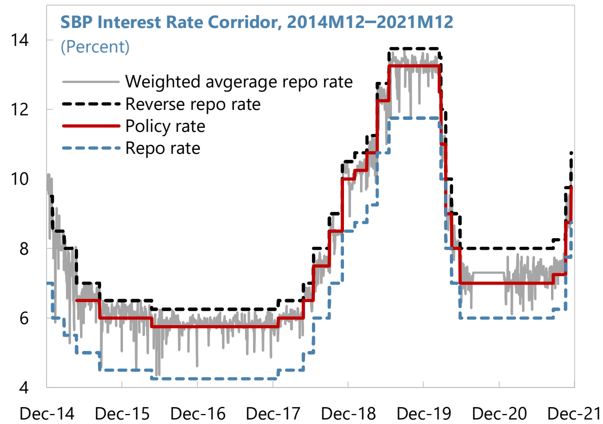
Private sector credit growth has rebounded from FY 2021's lows with the help of SBP's expanded refinancing schemes.



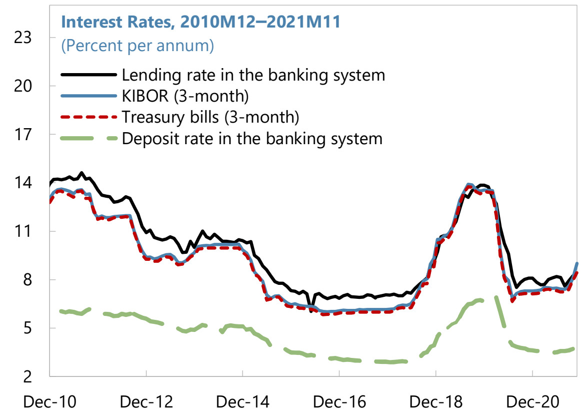
Sources: Pakistani authorities; IMF World Economic Outlook Database; and IMF staff calculations.

Figure 2. Pakistan: Selected Financial Indicators

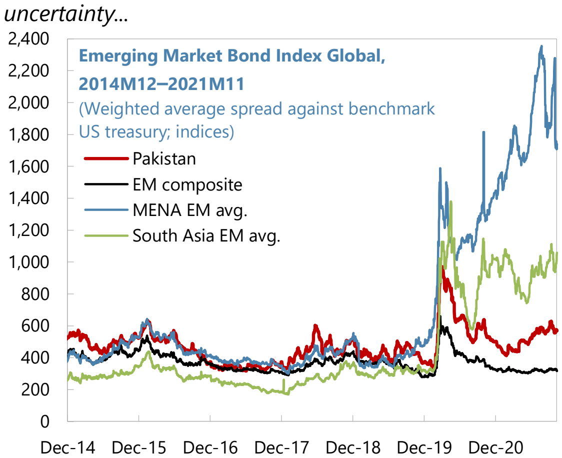
The SBP recently started to tighten monetary policy after the sharp loosening early into the COVID-19 shock…



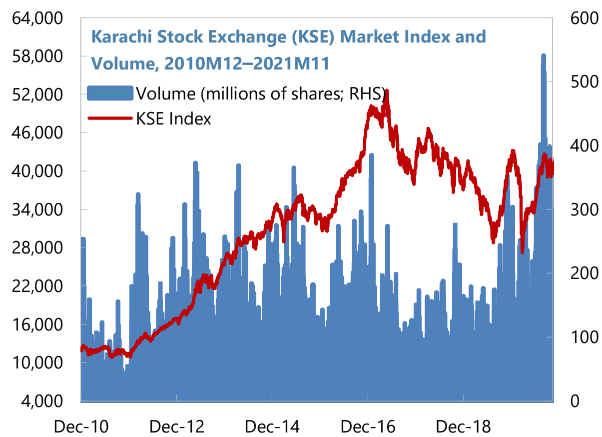
…while market rates have moved in line with the policy rate.



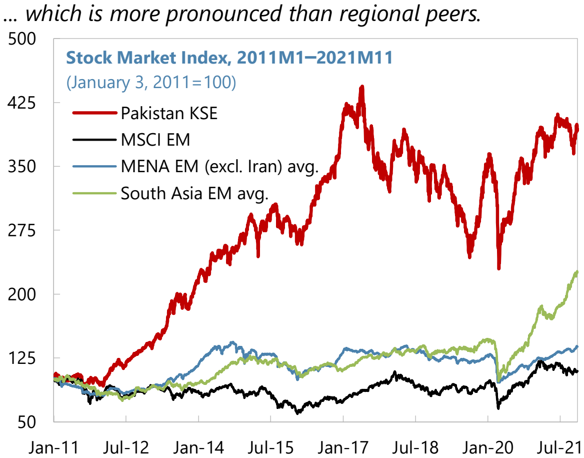
Pakistan's bond spreads have widened, reflecting ongoing uncertainty…



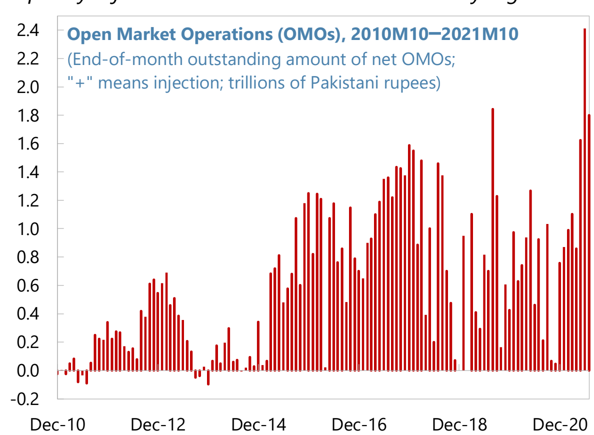
…mirrored by volatility in the stock market…



… which is more pronounced than regional peers.



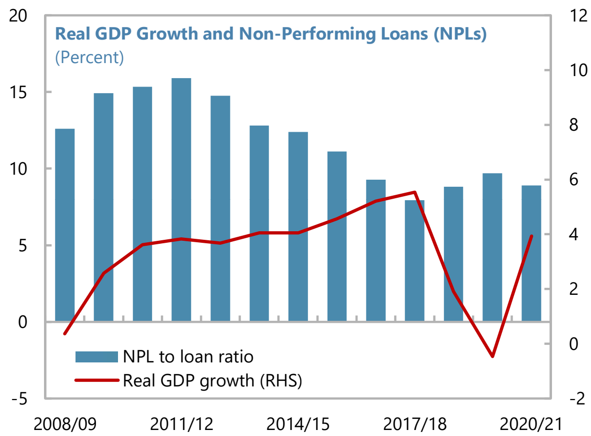
Liquidity injections via OMOs continue to be very high.



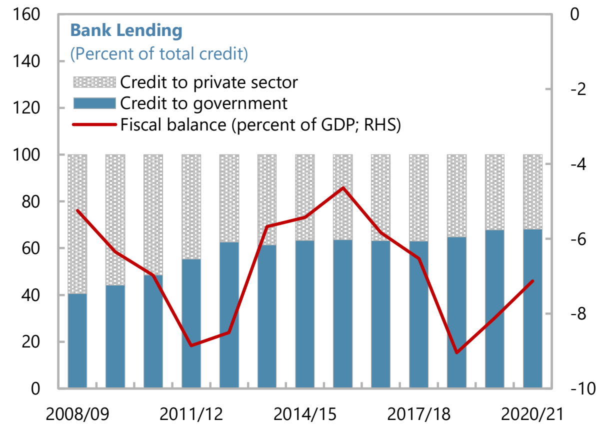
Sources: Pakistani authorities; Bloomberg; and IMF staff calculations.

Figure 3. Pakistan: Selected Banking and Financial Indicators, 2008/09–2020/21

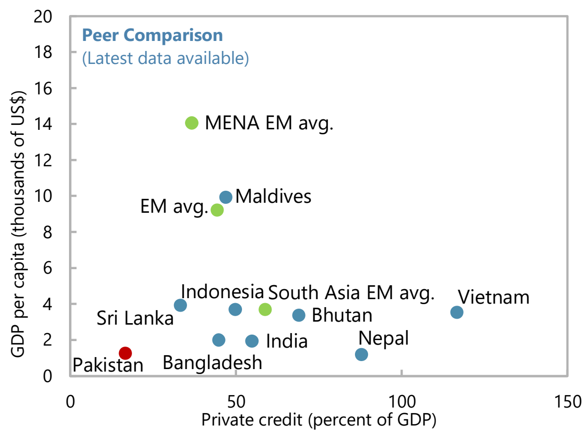
NPLs have declined as the economy recovers.



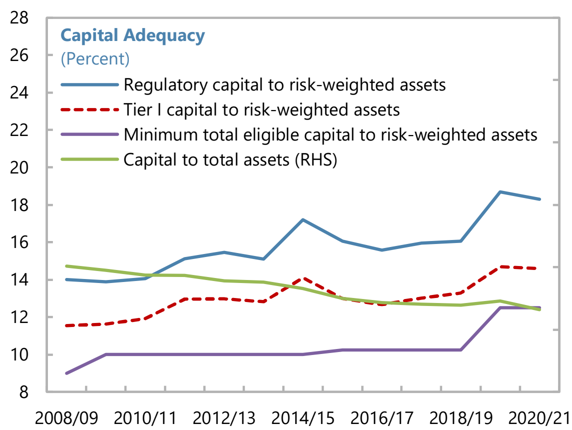
The banking system's remains oriented toward providing credit to the government...



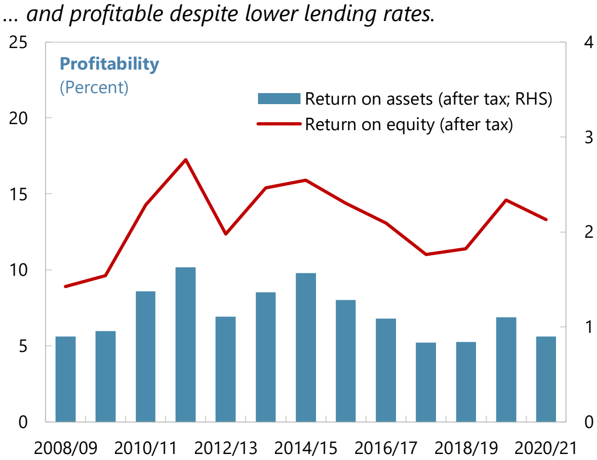
...leaving Pakistan behind its peers in terms of private credit relative to the size of the economy.



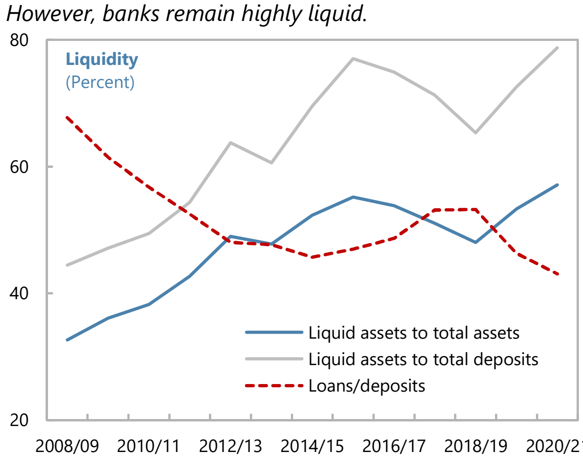
Nonetheless, the banking sector remains well capitalized overall...



... and profitable despite lower lending rates.



However, banks remain highly liquid.



Sources: Pakistani authorities; Bloomberg; and IMF staff calculations.

Table 1. Pakistan: Selected Economic Indicators, 2017/18–2021/22 1/

Population: 212.5 million (2020/21)
Per capita GDP: US$1,394.1 (2020/21)
Poverty rate: 21.9 percent (at national line; 2018/19)

Main exports: Textiles (US$15.4 billion, 2020/21)
Unemployment: 6.9 percent (2018/19)

	2017/18	2018/19	2019/20	2020/21		2021/22	
				Prog.	Est.	Prog.	Proj.
Output and prices	(Annual percentage change)						
Real GDP at factor cost	5.5	2.1	-0.5	1.5	3.9	4.0	4.0
GDP deflator at factor cost	2.4	8.6	10.1	8.7	9.8	8.0	9.4
Consumer prices (period average)	3.9	6.7	10.7	8.7	8.9	8.0	9.4
Consumer prices (end of period)	5.2	8.0	8.6	10.0	9.7	7.9	10.2
Pakistani rupees per U.S. dollar (period average)	5.5	24.4	15.5	...	0.5	...	...
Pakistani rupees per U.S. dollar (end of period)	15.9	31.7	5.0	...	-6.3	...	...
Saving and investment	(Percent of GDP)						
Gross saving	11.2	10.8	13.6	14.0	14.6	14.1	14.1
Government	-2.2	-6.3	-5.4	-4.6	-4.5	-2.8	-3.4
Nongovernment (including public sector enterprises)	13.4	17.1	19.0	18.6	19.1	16.8	17.4
Gross capital formation 2/	17.3	15.6	15.3	15.5	15.2	15.9	18.1
Government	4.2	2.6	2.6	2.5	2.5	2.7	3.4
Nongovernment (including public sector enterprises)	13.1	13.0	12.7	13.0	12.7	13.2	14.6
Public finances							
Revenue and grants	15.2	13.0	15.2	15.8	14.5	17.0	15.9
Expenditure (including statistical discrepancy)	21.6	21.9	23.2	22.9	21.6	22.5	22.8
Budget balance (including grants)	-6.4	-9.0	-8.0	-7.1	-7.1	-5.5	-6.9
Budget balance (excluding grants)	-6.5	-9.0	-8.1	-7.2	-7.1	-5.6	-6.9
Primary balance (excluding grants)	-2.2	-3.6	-1.8	-1.1	-1.4	0.3	-1.3
Underlying primary balance (excluding grants) 3/	-2.2	-3.6	-1.8	-0.5	-0.6	0.8	0.0
Total general government debt excl. IMF obligations	69.9	82.9	84.5	84.4	81.1	79.9	78.9
External general government debt	22.5	28.5	28.4	28.8	26.1	27.2	27.0
Domestic general government debt	47.4	54.4	56.0	55.6	55.1	52.7	51.9
General government debt incl. IMF obligations	72.1	85.3	87.6	87.7	83.6	83.3	82.0
External general government debt	24.7	30.9	31.5	32.0	28.5	30.6	30.0
Domestic general government debt	47.4	54.4	56.0	55.6	55.1	52.7	51.9
Monetary sector	(Annual changes in percent of initial stock of broad money, unless otherwise indicated)						
Net foreign assets	-5.6	-8.1	5.6	3.4	5.9	3.2	1.4
Net domestic assets	15.3	19.4	11.9	12.6	10.3	10.0	14.4
Broad money (percent change)	9.7	11.3	17.5	16.0	16.2	13.2	15.8
Reserve money (percent change)	12.7	19.9	16.8	16.5	12.8	13.3	16.3
Private credit (percent change)	14.9	11.9	3.0	7.0	11.5	14.2	16.0
Six-month treasury bill rate (period average, in percent)	6.0	10.2	11.9	...	7.3	...	...
External sector	(Annual percentage change, unless otherwise indicated)						
Merchandise exports, U.S. dollars	12.6	-2.1	-7.1	5.0	13.7	5.5	17.4
Merchandise imports, U.S. dollars	16.0	-6.8	-15.9	8.8	23.3	8.7	24.1
Current account balance (in percent of GDP)	-6.1	-4.9	-1.7	-1.5	-0.6	-1.8	-4.0
Financial account (billions of U.S. dollars)	13.6	11.8	6.5	5.1	7.7	7.5	14.8
	(Percent of exports of goods and services, unless otherwise indicated)						
External public and publicly guaranteed debt	216.9	234.8	266.5	281.5	267.8	269.2	244.9
Debt service	26.9	40.7	52.4	46.6	34.7	56.9	42.8
Gross reserves (in millions of U.S. dollars) 4/	9,789	7,274	12,175	14,356	17,297	17,798	21,211
In months of next year's imports of goods and services	1.9	1.7	2.4	2.9	2.7	3.3	3.2
Memorandum items:							
Underlying fiscal balance (excl. grants; % GDP) 3/	-6.5	-9.0	-8.1	-6.7	-6.4	-5.1	-5.7
General government and government guaranteed debt (incl. IMF; % GDP)	76.2	90.5	93.2	92.9	88.6	88.2	86.7
Net general government debt (incl. IMF; % GDP)	66.5	76.9	80.0	80.7	75.0	77.3	75.2
Real effective exchange rate (annual average, percentage change)	-6.4	-11.5	-3.9	...	2.2	...	...
Real effective exchange rate (end of period percentage change)	-11.0	-15.1	3.4	...	7.3	...	...
Terms of trade (percentage change)	-1.5	-1.4	1.1	-0.6	2.4	-1.0	5.3
Real per capita GDP (percentage change)	3.6	0.2	-2.3	-0.4	2.0	2.1	2.0
GDP at market prices (in billions of Pakistani rupees)	34,616	38,086	41,556	45,778	47,709	52,057	54,382
Per capita GDP (in U.S. dollars)	1,543.4	1,340.2	1,243.2	...	1,394.1	...	...
Population (millions)	201.0	204.7	208.6	212.5	212.5	216.5	216.5
GDP at market prices (in billions of U.S. dollars)	313.1	276.9	261.7	...	299.0	...	...

Sources: Pakistani authorities; World Bank; and IMF staff estimates and projections.

1/ Fiscal year ends June 30. Revised FY 2019 and FY 2020 GDP as well as provisional FY 2021 GDP were published by the authorities in May 2021, affecting ratios.

2/ Including changes in inventories.

3/ Excludes one-off transactions, including asset sales. In FY 2021 it excludes PHPL debt clearance, IPPs related arrears clearance, and COVID-19 spending; in FY 2022 it excludes IPPs related arrears clearance and COVID-19 spending.

4/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.

Table 2. Pakistan: Medium-Term Macroeconomic Framework, 2017/18–2025/26 1/

	2017/18	2018/19	2019/20	2020/21		2021/22		2022/23	2023/24	2024/25	2025/26
				Prog.	Est.	Prog.	Proj.	Proj.		Proj.	
				(Annual percentage change, unless otherwise indicated)							
Output and prices											
Real GDP at factor cost	5.5	2.1	-0.5	**1.5**	3.9	**4.0**	4.0	4.5	5.0	5.0	5.0
Net exports (percent contribution to real GDP at factor cost)	-2.0	0.6	1.9	**-0.7**	-2.7	**-0.7**	-1.5	0.5	0.7	0.1	-0.2
GDP deflator at factor cost	2.4	8.6	10.1	**8.7**	9.8	**8.0**	9.4	7.8	6.5	6.5	6.5
Consumer prices (period average)	3.9	6.7	10.7	**8.7**	8.9	**8.0**	9.4	7.8	6.5	6.5	6.5
						(Percent of GDP)					
Saving and investment balance	-6.1	-4.9	-1.7	**-1.5**	-0.6	**-1.8**	-4.0	-3.5	-3.3	-3.0	-2.7
Government	-6.4	-9.0	-8.0	**-7.1**	-7.1	**-5.5**	-6.8	-4.4	-4.3	-3.8	-3.4
Nongovernment (including public sector enterprises)	0.3	4.1	6.3	**5.6**	6.4	**3.7**	2.8	0.9	1.0	0.8	0.7
Gross national saving	11.2	10.8	13.6	**14.0**	14.6	**14.1**	14.1	14.2	14.7	15.2	15.8
Government	-2.2	-6.3	-5.4	**-4.6**	-4.5	**-2.8**	-3.4	-1.4	-1.3	-0.7	-0.3
Nongovernment (including public sector enterprises)	13.4	17.1	19.0	**18.6**	19.1	**16.8**	17.4	15.6	16.1	16.0	16.1
Gross capital formation	17.3	15.6	15.3	**15.5**	15.2	**15.9**	18.1	17.7	18.0	18.2	18.5
Government	4.2	2.6	2.6	**2.5**	2.5	**2.7**	3.4	2.9	3.0	3.1	3.1
Nongovernment (including public sector enterprises)	13.1	13.0	12.7	**13.0**	12.7	**13.2**	14.6	14.7	15.0	15.2	15.3
				(Billions of U.S. dollars, unless otherwise indicated)							
Balance of payments											
Current account balance	-19.2	-13.4	-4.4	**-4.2**	-1.9	**-5.4**	-13.0	-12.2	-12.4	-12.2	-11.8
Current account balance (in percent of GDP)	-6.1	-4.9	-1.7	**-1.5**	-0.6	**-1.8**	-4.0	-3.5	-3.3	-3.0	-2.7
Net capital flows 2/	13.1	11.9	6.9	**5.3**	7.0	**7.8**	14.8	11.7	13.6	14.6	14.6
Of which: foreign direct investment 3/	2.8	1.4	2.7	**2.1**	1.8	**2.5**	2.3	3.1	3.7	4.2	4.5
Gross reserves	9.8	7.3	12.2	**14.4**	17.3	**17.8**	21.2	20.7	20.1	20.9	23.1
In months of imports 4/	1.9	1.7	2.4	**2.9**	2.7	**3.3**	3.2	3.0	2.8	2.8	2.8
External debt (in percent of GDP)	30.0	37.4	41.6	**42.1**	39.1	**41.7**	40.6	40.1	39.1	37.7	35.2
Terms of trade (annual percentage change)	-1.5	-1.4	1.1	**-0.6**	2.4	**-1.0**	5.3	-4.4	-8.3	-1.9	-0.2
Real effective exchange rate (annual average, percentage change)	-6.4	-11.5	-3.9	**...**	2.2	**...**	...	...	...	...	...
Real effective exchange rate (end of period, percentage change)	-11.0	-15.1	3.4	**...**	7.3	**...**	...	...	...	...	...
						(Percent of GDP)					
Public finances											
Revenue and grants	15.2	13.0	15.2	**15.8**	14.5	**17.0**	15.9	16.7	16.7	16.8	16.9
Of which: tax revenue	12.9	11.7	11.4	**12.7**	12.1	**14.2**	13.3	14.0	14.1	14.2	14.3
Expenditure (including statistical discrepancy)	21.6	21.9	23.2	**22.9**	21.6	**22.5**	22.8	21.1	21.1	20.6	20.4
Of which: current	17.3	19.1	20.7	**20.2**	19.1	**19.7**	19.5	18.0	18.0	17.4	17.1
Of which: development	4.2	2.6	2.6	**2.6**	2.5	**2.7**	3.4	2.9	3.0	3.1	3.1
Primary balance (including grants)	-2.1	-3.5	-1.7	**-1.0**	-1.3	**0.4**	-1.2	1.3	1.3	1.4	1.5
Primary balance (excluding grants)	-2.2	-3.6	-1.8	**-1.1**	-1.4	**0.3**	-1.3	1.2	1.3	1.4	1.5
Underlying primary balance (excluding grants) 5/	-2.2	-3.6	-1.8	**-0.5**	-0.6	**0.8**	0.0	1.2	1.3	1.4	1.5
Budget balance (including grants)	-6.4	-9.0	-8.0	**-7.1**	-7.1	**-5.5**	-6.9	-4.4	-4.4	-3.9	-3.5
Budget balance (excluding grants)	-6.5	-9.0	-8.1	**-7.2**	-7.1	**-5.6**	-6.9	-4.5	-4.5	-3.9	-3.5
Underlying fiscal balance (excl. grants) 5/	-6.5	-9.0	-8.1	**-6.7**	-6.4	**-5.1**	-5.7	-4.5	-4.5	-3.9	-3.5
General government and government guaranteed debt (incl. IMF)	76.2	90.5	93.2	**92.9**	88.6	**88.2**	86.7	82.1	78.1	73.8	70.4
General government debt (incl. IMF)	72.1	85.3	87.6	**87.7**	83.6	**83.3**	82.0	77.7	74.1	70.1	66.9
Net general government debt (incl. IMF)	66.5	76.9	80.0	**80.7**	75.0	**77.3**	75.2	71.7	68.7	65.3	62.6
Memorandum item:											
Nominal GDP (market prices, billions of Pakistani rupees)	34,616	38,086	41,556	**45,778**	47,709	**52,057**	54,382	61,682	68,953	77,799	86,950

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Fiscal year ends June 30. Revised FY 2019 and FY 2020 GDP as well as provisional FY 2021 GDP were published by the authorities in May 2021, affecting ratios.

2/ Difference between the overall balance and the current account balance.

3/ Including privatization.

4/ In months of next year's imports of goods and services.

5/ Excludes one-off transactions, including asset sales. In FY 2021 it excludes PHPL debt clearance, IPPs related arrears clearance, and COVID-19 spending; in FY 2022 it excludes IPPs related arrears clearance and COVID-19 spending.

Table 3a. Pakistan: Balance of Payments, 2017/18–2025/26
(In millions of U.S. dollars, unless otherwise indicated)

	2017/18	2018/19	2019/20	2020/21		2021/22		2022/23	2023/24	2024/25	2025/26
				Prog.	Est.	Prog.	Proj.		Proj.		
Current account	-19,195	-13,434	-4,449	-4,154	-1,916	-5,419	-12,994	-12,163	-12,363	-12,230	-11,789
Balance on goods	-30,903	-27,612	-21,109	-22,533	-28,188	-25,253	-36,686	-35,514	-36,529	-36,861	-37,995
Exports, f.o.b.	24,768	24,257	22,536	23,635	25,630	24,937	30,078	31,642	33,224	35,550	37,891
Imports, f.o.b.	55,671	51,869	43,645	46,168	53,818	50,190	66,764	67,157	69,754	72,411	75,887
Services (net)	-6,426	-4,970	-3,316	-3,092	-1,957	-3,368	-3,603	-4,428	-4,752	-5,244	-5,356
Services: credit	5,851	5,966	5,437	4,912	5,882	5,601	6,349	6,805	7,878	8,716	9,444
Of which: Coalition Support Fund	0	0	0	0	0	0	0	0	0	0	0
Of which: 3G Licenses	0	0	0	0	0	0	0	0	0	0	0
Services: debit	12,277	10,936	8,753	8,004	7,839	8,969	9,951	11,233	12,630	13,960	14,800
Income (net)	-5,437	-5,610	-5,459	-5,742	-4,613	-5,549	-4,983	-5,515	-6,163	-6,020	-6,897
Income: credit	726	578	479	303	580	174	1,437	1,045	1,192	1,361	1,499
Income: debit	6,163	6,188	5,938	6,045	5,193	5,723	6,421	6,561	7,356	7,381	8,395
Of which: interest payments	3,056	3,647	3,792	1,899	2,760	3,115	3,680	4,223	4,625	4,957	5,380
Of which: income on direct investment	3,217	2,848	2,664	2,895	2,637	2,608	2,766	2,338	2,731	2,424	3,015
Balance on goods, services, and income	-42,766	-38,192	-29,884	-31,367	-34,758	-34,170	-45,272	-45,458	-47,444	-48,125	-50,248
Current transfers (net)	23,571	24,758	25,435	27,213	32,842	28,751	32,278	33,295	35,082	35,894	38,459
Current transfers: credit, *of which:*	23,800	24,990	25,802	27,451	33,135	28,910	32,473	33,454	35,241	36,053	38,618
Official	1,007	761	468	439	278	335	349	400	400	400	400
Workers' remittances	19,914	21,740	23,131	24,667	29,370	26,179	29,621	30,285	31,714	33,186	34,663
Other private transfers	2,879	2,489	2,203	2,345	3,487	2,397	2,503	2,769	3,127	2,467	3,555
Current transfers: debit	229	232	367	238	293	159	195	159	159	159	159
Capital account	376	229	285	188	235	249	223	127	113	120	39
Capital transfers: credit	376	229	288	188	235	249	223	127	113	120	39
Of which: official capital grants	375	219	273	127	212	249	220	127	113	120	39
Capital transfers: debit	0	0	3	0	0	0	0	0	0	0	0
Financial account	13,611	11,759	6,479	5,115	7,726	7,533	14,806	11,525	13,516	14,525	14,575
Direct investment abroad	-10	74	54	-63	-76	-26	-88	-80	-79	-78	-78
Direct investment in Pakistan	2,782	1,362	2,598	2,135	1,862	2,526	2,438	3,143	3,769	4,280	4,556
Portfolio investment (net)	2,161	-1,562	-639	1,413	2,756	2,630	3,280	4,710	5,760	6,548	6,328
Financial derivatives (net)	0	0	8	-1	0	0	0	0	0	0	0
Other investment assets	-273	67	127	-2,781	-471	-3,228	-962	-701	-1,019	-1,055	-1,234
Monetary authorities	0	0	0	0	0	0	0	0	0	0	0
General government	-41	-48	-48	1	-13	0	4	0	0	0	0
Banks	322	92	-140	-1,186	256	-1,200	87	505	321	418	384
Other sectors	-554	23	315	-1,596	-714	-2,028	-1,054	-1,206	-1,340	-1,474	-1,617
Other investment liabilities	8,855	11,530	4,101	4,411	3,641	5,632	9,940	4,372	5,044	4,807	4,979
Monetary authorities	1,548	5,495	-498	-1,486	-1,468	0	3,002	0	0	0	0
General government, *of which:*	4,894	4,294	3,085	4,741	5,232	912	2,842	1,588	946	1,956	2,196
Disbursements	8,507	8,255	10,347	13,272	9,304	13,001	11,148	12,565	13,332	17,316	15,678
Amortization	4,107	5,982	7,299	9,672	5,855	12,088	8,658	10,977	12,386	15,360	13,492
Banks	-109	467	-124	-334	-279	1,268	-8	80	80	80	80
Other sectors	2,522	1,274	1,638	1,490	156	3,451	1,332	2,704	4,018	2,771	2,702
Net errors and omissions	-933	-58	150	-34	-991	0	-185	0	0	0	0
Reserves and related items	6,141	1,504	-2,465	-1,116	-5,054	-2,363	-1,851	511	-1,266	-2,414	-2,824
Reserve assets	6,227	1,880	-4,554	-1,670	-4,473	-3,442	-3,900	533	546	-725	-2,198
Use of Fund credit and loans	-86	-376	2,089	554	-581	1,079	2,049	-22	-1,812	-1,689	-626
Memorandum items:											
Current account (in percent of GDP)	-6.1	-4.9	-1.7	-1.5	-0.6	-1.8	-4.0	-3.5	-3.3	-3.0	-2.7
Current account (in percent of GDP; excluding fuel imports)	-1.9	0.2	1.8	2.1	2.6	1.9	0.1	0.5	0.4	0.4	0.6
Exports f.o.b. (growth rate, in percent)	12.6	-2.1	-7.1	5.0	13.7	5.5	17.4	5.2	5.0	7.0	6.6
Exports volume (growth rate, in percent)	8.4	-1.7	-1.0	6.7	3.0	4.7	4.0	8.9	15.0	8.5	4.8
Remittance (growth rate, in percent)	2.9	9.2	6.4	6.6	27.0	6.1	0.9	2.2	4.7	4.6	4.4
Remittances (in percent of GDP)	6.4	7.9	8.8	9.0	9.8	8.9	9.3	8.8	8.5	8.2	7.9
Imports f.o.b. (growth rate, in percent)	16.0	-6.8	-15.9	8.8	23.3	8.7	24.1	0.6	3.9	3.8	4.8
Imports volume (growth rate, in percent)	8.2	-9.5	-13.0	8.0	20.8	7.0	8.7	1.0	4.3	3.3	4.2
Oil imports (in million US$, cif)	13,263	13,929	9,280	9,859	9,747	11,044	13,273	13,912	13,769	13,931	14,245
Terms of trade (growth rate, in percent)	-1.5	-1.4	1.1	-0.6	2.4	-1.0	5.3	-4.4	-8.3	-1.9	-0.2
Foreign Direct Investment (in percent of GDP)	0.9	0.5	1.0	0.8	0.6	0.9	0.8	0.9	1.0	1.1	1.0
External debt (in millions of U.S. dollars)	93,963	103,548	108,770	114,841	116,848	122,831	129,574	138,568	145,774	152,873	153,816
o/w external public debt	72,508	76,605	82,238	88,994	91,766	92,009	98,720	103,027	104,950	109,004	111,233
Gross external financing needs (in millions of U.S. dollars) 1/	30,005	25,552	23,430	27,013	21,551	23,643	30,417	35,068	41,882	39,123	36,600
End-period gross official reserves (millions of U.S. dollars) 2/	9,789	7,274	12,175	14,356	17,297	17,798	21,211	20,678	20,131	20,857	23,064
(In months of next year's imports of goods and services)	1.9	1.7	2.4	2.9	2.7	3.3	3.2	3.0	2.8	2.8	2.8
GDP (in millions of U.S. dollars)	313,073	276,942	261,726	…	298,994	…	…	…	…	…	…

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

2/ Excluding foreign currency deposits held with the State Bank of Pakistan (cash reserve requirements) and gold.

Table 3b. Pakistan: Gross Financing Requirements and Sources, 2017/18–2025/26

(In millions of U.S. dollars, unless otherwise indicated)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
				Est.			Proj.		
Gross External Financing Requirements (A)	**30,005**	**25,552**	**23,430**	**21,551**	**30,417**	**35,068**	**41,882**	**39,123**	**36,600**
(In percent of GDP)	9.6	9.2	9.0	7.2	9.5	10.1	11.2	9.6	8.4
Current account deficit	19,195	13,434	4,449	1,916	12,994	12,163	12,363	12,230	11,789
(In percent of GDP)	6.1	4.9	1.7	0.6	4.1	3.5	3.3	3.0	2.7
Amortization	10,724	11,742	18,236	18,555	16,416	21,798	27,707	25,204	24,185
Public Sector	5,651	6,982	12,799	13,943	11,658	16,977	22,957	20,360	19,292
Short-term Borrowing	1,488	1,538	1,182	784	2,715	3,100	4,000	4,900	4,000
Long-term Borrowing (non-IMF)	4,163	4,444	10,617	13,159	7,942	12,877	17,957	15,460	13,492
Bonds	0	1,000	1,000	0	1,000	1,000	1,000	0	1,800
Private Sector 1/	5,073	4,760	5,437	4,612	4,758	4,821	4,750	4,844	4,893
Short-term Borrowing	4,094	3,474	3,610	3,365	3,514	3,381	3,414	3,471	3,520
Long-term Borrowing	979	1,286	1,827	1,247	1,244	1,440	1,336	1,373	1,373
IMF Repurchases	86	376	745	1,080	1,007	1,107	1,812	1,689	626
Available Financing (B)	**23,873**	**21,103**	**25,497**	**26,174**	**31,275**	**33,450**	**41,335**	**39,848**	**38,808**
Foreign Direct Investment (net) 2/	2,772	1,436	2,652	1,786	2,350	3,063	3,690	4,201	4,478
Disbursement	21,658	19,496	22,418	25,144	26,120	30,259	37,532	35,527	34,292
From private creditors	13,326	8,366	15,430	11,508	13,899	17,794	20,929	24,594	24,594
Disbursement to Private Sector 3/	8,110	4,268	12,052	4,221	5,317	8,394	10,329	8,912	10,303
Disbursement to Public Sector 4/	5,216	4,098	3,377	7,287	8,582	9,400	10,600	15,682	14,291
From official creditors (non-IMF)	8,332	11,130	6,989	13,636	12,222	12,465	16,603	10,934	9,697
o/w Project Loans	3,458	2,582	1,588	1,876	1,647	1,770	2,416	2,378	2,042
o/w China	1,811	1,574	487	204	63	100	127	127	0
o/w Program Loans	261	288	3,666	2,120	2,479	2,182	2,093	1,974	2,144
o/w WB	205	150	729	1,009	1,379	1,182	1,093	974	1,144
o/w ADB	50	87	2,347	858	738	1,000	1,000	1,000	1,000
o/w Rollover of short-term debt	5,344	8,244	12,631	8,945	10,567	10,014	10,043	10,395	9,703
o/w Public Sector	1,871	6,193	4,627	5,245	7,100	7,100	7,100	7,100	7,100
o/w Private Sector	3,474	2,051	8,004	3,700	3,467	2,914	2,943	3,295	2,603
Other Net Capital Inflows (net) 5/	-557	171	427	-756	38	127	113	120	39
IMF SDR allocation	0	0	0	0	2,767	0	0	0	0
Remaining Financing Needs (C=A-B)	**6,132**	**4,449**	**-2,067**	**-4,623**	**-858**	**1,618**	**546**	**-725**	**-2,208**
Borrowing from IMF (D)	**0**	**0**	**2,834**	**499**	**3,056**	**1,085**	**0**	**0**	**0**
Reserve Assets (decrease = +) (E=C-D)	6,132	4,449	-4,901	-5,122	-3,914	533	546	-725	-2,208
Memorandum items:									
Gross official reserves (stock, in US$ billions)	9.8	7.3	12.2	17.3	21.2	20.7	20.1	20.9	23.1
(In months of prospective imports)	1.9	1.7	2.4	2.7	3.2	3.0	2.8	2.8	2.8
(In percent of IMF ARA metric: assuming fixed ER)	37.1	32.3	35.4	46.4	52.1	47.1	42.9	42.0	46.0
(In percent of IMF ARA metric: assuming flexible ER)	48.3	35.0	55.2	73.8	81.2	72.3	65.9	64.4	72.0
Net FX derivative position (in US$ billions)	6.7	8.1	5.8	4.9	4.0	4.0	4.0	4.0	4.0

Sources: State Bank of Pakistan, and Fund staff estimates and projections.

1/ Includes banks and non-bank private sector.

2/ Includes privatization receipts.

3/ Includes equity and debt portfolio inflows, and borrowing by banks and other sectors.

4/ Includes syndicated loans and Euro bonds.

5/ Includes capital account, financial derivatives, errors and omissions.

Table 4a. Pakistan: General Government Budget, 2017/18–2025/26
(In billions of Pakistani rupees)

	2017/18	2018/19	2019/20	2020/21		2021/22		2022/23	2023/24	2024/25	2025/26
				Prog.	Est.	Prog.	Proj.		Proj.		
Revenue and grants	5,265	4,934	6,306	7,210	6,933	8,861	8,652	10,272	11,530	13,049	14,679
Revenue	5,228	4,901	6,273	7,166	6,903	8,814	8,620	10,222	11,479	13,002	14,632
Tax revenue	4,467	4,473	4,748	5,819	5,755	7,395	7,237	8,640	9,712	11,009	12,405
Federal	4,066	4,072	4,334	5,251	5,247	6,666	6,582	7,804	8,739	9,911	11,177
FBR revenue	3,842	3,829	3,998	4,691	4,764	5,963	6,100	7,255	8,137	9,246	10,425
Direct taxes	1,537	1,446	1,524	1,789	1,732	2,233	2,182	2,711	3,082	3,522	3,997
Federal excise duty	206	234	250	275	277	365	356	406	463	538	611
Sales tax/VAT	1,491	1,465	1,597	1,926	1,990	2,563	2,777	3,295	3,677	4,172	4,693
Customs duties	608	685	626	700	765	802	785	843	914	1,014	1,125
Petroleum surcharge	179	206	294	511	424	607	356	406	427	463	514
Gas surcharge and other	30	14	33	40	39	45	66	75	98	111	126
GIDC	15	21	9	10	19	52	60	68	76	91	112
Provincial	401	402	414	568	508	729	655	836	974	1,098	1,227
Nontax revenue	761	427	1,524	1,347	1,147	1,420	1,383	1,582	1,767	1,993	2,228
Federal	614	341	1,422	1,179	997	1,234	1,136	1,300	1,452	1,638	1,831
Provincial	147	86	102	167	150	185	247	282	315	355	397
Grants	37	33	33	45	31	47	32	49	51	47	47
Expenditure (including statistical discrepancy)	7,488	8,345	9,649	10,477	10,306	11,731	12,381	12,994	14,567	16,060	17,716
Current expenditure	5,982	7,274	8,597	9,254	9,111	10,244	10,600	11,107	12,384	13,568	14,901
Federal	3,918	4,946	6,081	6,426	6,292	7,042	7,579	7,688	8,576	9,287	10,117
Interest	1,500	2,091	2,620	2,813	2,750	3,060	3,073	3,523	3,967	4,112	4,348
Domestic	1,323	1,821	2,313	2,646	2,524	2,734	2,757	2,983	3,335	3,405	3,514
Foreign	177	270	306	162	226	307	303	516	605	688	821
IMF budget support	0	0	1	5	0	19	13	24	27	19	12
Other	2,418	2,855	3,462	3,617	3,542	4,001	4,519	4,189	4,636	5,194	5,781
Defense	1,030	1,147	1,213	1,283	1,316	1,444	1,400	1,586	1,771	1,998	2,233
Other	1,387	1,708	2,249	2,334	2,226	2,557	3,119	2,603	2,865	3,196	3,547
Of which : subsidies	114	195	360	459	425	530	780	490	532	585	639
Of which : grants	512	612	917	884	855	980	1,326	1,010	1,128	1,263	1,412
Provincial	2,065	2,328	2,516	2,829	2,819	3,202	3,021	3,419	3,808	4,281	4,784
Development expenditure and net lending	1,494	1,049	1,139	1,223	1,288	1,487	1,782	1,887	2,182	2,492	2,815
Public Sector Development Program	1,456	1,008	1,090	1,169	1,211	1,426	1,871	1,810	2,096	2,395	2,707
Federal	576	502	468	503	441	627	554	559	674	770	881
Provincial	880	506	622	665	770	799	1,317	1,251	1,423	1,625	1,826
Net lending	38	41	49	54	77	61	-90	77	86	97	108
Statistical discrepancy ("+" = additional expenditure)	12	22	-87	0	-93	0	0	0	0	0	0
Overall Balance (excluding grants)	-2,260	-3,445	-3,376	-3,311	-3,404	-2,917	-3,761	-2,771	-3,088	-3,057	-3,084
Overall Balance (including grants)	-2,223	-3,412	-3,343	-3,266	-3,373	-2,871	-3,730	-2,722	-3,037	-3,010	-3,037
Financing	2,223	3,412	3,343	3,266	3,373	2,871	3,730	2,722	3,037	3,010	3,037
External	785	417	896	1,093	1,418	892	1,350	1,065	785	1,199	673
Of which: privatization receipts	0	0	0	0	0	0	0	0	0	0	0
Of which: IMF	0	0	390	267	80	379	520	193	0	0	0
Domestic	1,438	2,995	2,447	2,173	1,955	1,979	2,379	1,657	2,252	1,812	2,364
Bank	1,086	2,230	1,907	1,521	1,746	1,385	1,665	1,160	1,576	1,268	1,655
Nonbank	353	765	540	652	209	594	714	497	675	544	709
Memorandum items:											
Underlying fiscal balance (excl. grants) 1/	-2,260	-3,445	-3,376	-3,059	-3,051	-2,647	-3,098	-2,771	-3,088	-3,057	-3,084
Provincial balance	-17	190	225	156	314	571	405	954	1,086	1,247	1,431
Primary balance (excluding grants)	-760	-1,353	-756	-498	-654	143	-688	751	879	1,054	1,264
Underlying primary balance (excluding grants) 1/	-760	-1,353	-756	-246	-301	413	-25	751	879	1,054	1,264
Primary balance (including grants)	-723	-1,320	-723	-453	-623	189	-657	801	930	1,101	1,311
Total security spending	1,030	1,147	1,213	1,283	1,316	1,444	1,400	1,586	1,771	1,998	2,233
Energy sector circular debt accumulation	450	447	538	...	130	...	...	...	...	...	...
Energy sector circular debt clearance	147	200	200	...	163	...	...	...	...	...	...
General government debt incl. IMF obligations	24,950	32,487	36,388	40,126	39,879	43,387	44,583	47,943	51,102	54,528	58,144
Domestic debt	16,416	20,732	23,281	25,454	26,265	27,433	28,244	29,901	32,153	33,964	36,329
External debt	8,534	11,756	13,107	14,672	13,614	15,954	16,339	18,042	18,950	20,563	21,815
General government and government guaranteed debt (incl. IMF)	26,386	34,456	38,732	42,510	42,286	45,898	47,171	50,637	53,873	57,446	61,233
Net general government debt (incl. IMF)	23,022	29,300	33,225	36,963	35,772	40,224	40,876	44,236	47,395	50,820	54,437
Nominal GDP (market prices)	34,616	38,086	41,556	45,778	47,709	52,057	54,382	61,682	68,953	77,799	86,950

Sources: Pakistani authorities; and IMF staff estimates and projections.
1/ Excludes one-off transactions, including asset sales. In FY 2021 it excludes PHPL debt clearance, IPPs related arrears clearance, and COVID-19 spending; in FY 2022 it excludes IPPs related arrears clearance and COVID-19 spending.

Table 4b. Pakistan: General Government Budget, 2017/18–2025/26

(In percent of GDP, unless otherwise indicated)

	2017/18	2018/19	2019/20	2020/21		2021/22		2022/23	2023/24	2024/25	2025/26
				Prog.	Est.	Prog.	Proj.		Proj.		
Revenue and grants	15.2	13.0	15.2	15.8	14.5	17.0	15.9	16.7	16.7	16.8	16.9
Revenue	15.1	12.9	15.1	15.7	14.5	16.9	15.9	16.6	16.6	16.7	16.8
Tax revenue	12.9	11.7	11.4	12.7	12.1	14.2	13.3	14.0	14.1	14.2	14.3
Federal	11.7	10.7	10.4	11.5	11.0	12.8	12.1	12.7	12.7	12.7	12.9
FBR revenue	11.1	10.1	9.6	10.2	10.0	11.5	11.2	11.8	11.8	11.9	12.0
Direct taxes	4.4	3.8	3.7	3.9	3.6	4.3	4.0	4.4	4.5	4.5	4.6
Federal excise duty	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Sales tax	4.3	3.8	3.8	4.2	4.2	4.9	5.1	5.3	5.3	5.4	5.4
Customs duties	1.8	1.8	1.5	1.5	1.6	1.5	1.4	1.4	1.3	1.3	1.3
Petroleum surcharge	0.5	0.5	0.7	1.1	0.9	1.2	0.7	0.7	0.6	0.6	0.6
Gas surcharge and other	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
GIDC	0.0	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Provincial	1.2	1.1	1.0	1.2	1.1	1.4	1.2	1.4	1.4	1.4	1.4
Nontax revenue	2.2	1.1	3.7	2.9	2.4	2.7	2.5	2.6	2.6	2.6	2.6
Federal	1.8	0.9	3.4	2.6	2.1	2.4	2.1	2.1	2.1	2.1	2.1
Provincial	0.4	0.2	0.2	0.4	0.3	0.4	0.5	0.5	0.5	0.5	0.5
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Expenditure (including statistical discrepancy)	21.6	21.9	23.2	22.9	21.6	22.5	22.8	21.1	21.1	20.6	20.4
Current expenditure	17.3	19.1	20.7	20.2	19.1	19.7	19.5	18.0	18.0	17.4	17.1
Federal	11.3	13.0	14.6	14.0	13.2	13.5	13.9	12.5	12.4	11.9	11.6
Interest	4.3	5.5	6.3	6.1	5.8	5.9	5.7	5.7	5.8	5.3	5.0
Domestic	3.8	4.8	5.6	5.8	5.3	5.3	5.1	4.8	4.8	4.4	4.0
Foreign	0.5	0.7	0.7	0.4	0.5	0.6	0.6	0.8	0.9	0.9	0.9
IMF budget support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	7.0	7.5	8.3	7.9	7.4	7.7	8.3	6.8	6.7	6.7	6.6
Defense	3.0	3.0	2.9	2.8	2.8	2.8	2.6	2.6	2.6	2.6	2.6
Other	4.0	4.5	5.4	5.1	4.7	4.9	5.7	4.2	4.2	4.1	4.1
Of which : subsidies	0.3	0.5	0.9	1.0	0.9	1.0	1.4	0.8	0.8	0.8	0.7
Of which : grants	1.5	1.6	2.2	1.9	1.8	1.9	2.4	1.6	1.6	1.6	1.6
Provincial	6.0	6.1	6.1	6.2	5.9	6.2	5.6	5.5	5.5	5.5	5.5
Development expenditure and net lending	4.3	2.8	2.7	2.7	2.7	2.9	3.3	3.1	3.2	3.2	3.2
Public Sector Development Program	4.2	2.6	2.6	2.6	2.5	2.7	3.4	2.9	3.0	3.1	3.1
Federal	1.7	1.3	1.1	1.1	0.9	1.2	1.0	0.9	1.0	1.0	1.0
Provincial	2.5	1.3	1.5	1.5	1.6	1.5	2.4	2.0	2.1	2.1	2.1
Net lending	0.1	0.1	0.1	0.1	0.2	0.1	-0.2	0.1	0.1	0.1	0.1
Statistical discrepancy ("+" = additional expenditure)	0.0	0.1	-0.2	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (excluding grants)	-6.5	-9.0	-8.1	-7.2	-7.1	-5.6	-6.9	-4.5	-4.5	-3.9	-3.5
Overall Balance (including grants)	-6.4	-9.0	-8.0	-7.1	-7.1	-5.5	-6.9	-4.4	-4.4	-3.9	-3.5
Financing	6.4	9.0	8.0	7.1	7.1	5.5	6.9	4.4	4.4	3.9	3.5
External	2.3	1.1	2.2	2.4	3.0	1.7	2.5	1.7	1.1	1.5	0.8
Of which: privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: IMF	0.0	0.0	0.9	0.6	0.2	0.7	1.0	0.3	0.0	0.0	0.0
Domestic	4.2	7.9	5.9	4.7	4.1	3.8	4.4	2.7	3.3	2.3	2.7
Bank	3.1	5.9	4.6	3.3	3.7	2.7	3.1	1.9	2.3	1.6	1.9
Nonbank	1.0	2.0	1.3	1.4	0.4	1.1	1.3	0.8	1.0	0.7	0.8
Memorandum items:											
Underlying fiscal balance (excl. grants) 1/	-6.5	-9.0	-8.1	-6.7	-6.4	-5.1	-5.7	-4.5	-4.5	-3.9	-3.5
Provincial balance	-0.1	0.5	0.5	0.3	0.7	1.1	0.7	1.5	1.6	1.6	1.6
Primary balance (excluding grants)	-2.2	-3.6	-1.8	-1.1	-1.4	0.3	-1.3	1.2	1.3	1.4	1.5
Underlying primary balance (excluding grants) 1/	-2.2	-3.6	-1.8	-0.5	-0.6	0.8	0.0	1.2	1.3	1.4	1.5
Primary balance (including grants)	-2.1	-3.5	-1.7	-1.0	-1.3	0.4	-1.2	1.3	1.3	1.4	1.5
Total security spending	3.0	3.0	2.9	2.8	2.8	2.8	2.6	2.6	2.6	2.6	2.6
Energy sector circular debt accumulation	1.3	1.2	1.3	...	0.3	...	...	...	...	...	...
Energy sector circular debt clearance	0.4	0.5	0.5	...	0.3	...	...	...	...	...	...
General government debt incl. IMF obligations	72.1	85.3	87.6	87.7	83.6	83.3	82.0	77.7	74.1	70.1	66.9
Domestic debt	47.4	54.4	56.0	55.6	55.1	52.7	51.9	48.5	46.6	43.7	41.8
External debt	24.7	30.9	31.5	32.0	28.5	30.6	30.0	29.3	27.5	26.4	25.1
General government and government guaranteed debt (incl. IMF)	76.2	90.5	93.2	92.9	88.6	88.2	86.7	82.1	78.1	73.8	70.4
Net general government debt (incl. IMF)	66.5	76.9	80.0	80.7	75.0	77.3	75.2	71.7	68.7	65.3	62.6
Nominal GDP (market prices, billions of Pakistani rupees)	34,616	38,086	41,556	45,778	47,709	52,057	54,382	61,682	68,953	77,799	86,950

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Excludes one-off transactions, including asset sales. In FY 2021 it excludes PHPL debt clearance, IPPs related arrears clearance, and COVID-19 spending; in FY 2022 it excludes IPPs related arrears clearance and COVID-19 spending.

Table 5. Pakistan: Monetary Survey, 2017/18–2021/22

	2017/18	2018/19	2019/20	2020/21					2021/22				
				Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
							Prog.	Est.	Proj.	Proj.	Proj.	Prog.	Proj.
	(Billions of Pakistani rupees, unless otherwise indicated)												
Monetary survey													
Net foreign assets (NFA)	-208	-1,507	-516	-209	63	167	**189**	725	692	739	707	**969**	1,058
Net domestic assets (NDA)	16,206	19,306	21,424	21,377	22,008	22,363	**24,064**	23,573	23,755	25,371	25,901	**26,486**	27,079
Net claims on government, *of which:*	10,200	12,337	14,547	14,772	14,906	15,183	**15,834**	16,352	16,326	16,771	17,077	**17,219**	17,752
Budget support, *of which:*	9,284	11,546	13,471	13,722	14,022	14,269	**14,955**	15,335	15,199	15,899	16,293	**16,270**	16,778
Banks	5,744	4,857	7,016	7,633	8,137	9,142	**9,361**	9,974	10,250	11,239	11,633	**11,245**	12,118
Commodity operations	820	756	813	754	734	701	**878**	904	914	872	785	**948**	974
Credit to nongovernment	7,034	8,073	8,372	8,286	8,690	8,855	**9,003**	9,092	9,332	10,219	10,386	**10,216**	10,462
Private sector 1/	5,989	6,703	6,906	6,831	7,253	7,412	**7,390**	7,680	7,908	8,639	8,798	**8,442**	8,908
Public sector enterprises	1,044	1,370	1,466	1,455	1,437	1,444	**1,613**	1,413	1,424	1,581	1,588	**1,774**	1,554
Privatization account	-41	-41	-41	-41	-41	-41	**-41**	-41	-41	-41	-41	**-41**	-41
Other items, net	-987	-1,063	-1,455	-1,640	-1,548	-1,635	**-732**	-1,831	-1,863	-1,579	-1,521	**-908**	-1,094
Broad money	15,997	17,798	20,908	21,168	22,071	22,530	**24,253**	24,298	24,447	26,110	26,608	**27,455**	28,137
Currency outside scheduled banks	4,388	4,950	6,142	6,102	6,206	6,541	**7,043**	6,910	7,021	7,345	7,599	**7,903**	7,927
Rupee deposits	10,780	11,739	13,691	13,965	14,811	14,983	**16,067**	16,342	16,306	17,664	17,907	**18,375**	19,063
Foreign currency deposits	829	1,110	1,075	1,102	1,054	1,006	**1,143**	1,046	1,119	1,101	1,102	**1,177**	1,147
State Bank of Pakistan (SBP)													
NFA	12	-1,127	-181	-48	164	300	**524**	931	904	945	913	**1,304**	1,264
NDA	5,472	7,701	7,861	7,579	7,527	7,636	**8,423**	7,733	7,564	8,135	8,472	**8,833**	8,808
Net claims on government	3,600	6,676	6,524	6,242	5,939	5,280	**5,698**	5,320	5,082	4,756	4,767	**5,134**	4,728
Of which: budget support	3,539	6,689	6,455	6,089	5,885	5,127	**5,595**	5,361	4,950	4,660	4,660	**5,026**	4,660
Claims on nongovernment	-8	12	19	21	23	25	**19**	26	28	26	24	**11**	22
Claims on scheduled banks	570	683	877	1,007	1,194	1,199	**1,214**	1,282	1,318	1,318	1,318	**1,264**	1,318
Privatization account	-41	-41	-41	-41	-41	-41	**-41**	-41	-41	-41	-41	**-41**	-41
Other items, net	1,350	371	482	350	412	1,173	**1,533**	1,140	1,175	2,075	2,403	**2,466**	2,792
Reserve money, *of which:*	5,485	6,573	7,680	7,531	7,692	7,936	**8,947**	8,663	8,467	9,080	9,385	**10,137**	10,071
Banks' reserves	814	1,246	1,171	1,047	1,081	1,009	**1,258**	1,307	977	1,048	1,083	**1,425**	1,162
Currency	4,644	5,294	6,468	6,431	6,553	6,871	**7,689**	7,288	7,420	8,032	8,302	**8,712**	8,909
	(Annual percentage change, unless otherwise indicated)												
Broad money	9.7	11.3	17.5	18.2	17.9	16.6	**16.0**	16.2	15.5	18.3	18.1	**13.2**	15.8
NFA, banking system (in percent of broad money) 2/	-5.6	-8.1	5.6	5.8	3.7	4.5	**3.4**	5.9	4.3	3.1	2.4	**3.2**	1.4
NDA, banking system (in percent of broad money) 2/	15.3	19.4	11.9	12.4	14.2	12.1	**12.6**	10.3	11.2	15.2	15.7	**10.0**	14.4
Budgetary support (in percent of broad money) 2/	7.7	14.1	10.8	12.8	13.0	11.0	**7.1**	8.9	7.0	8.5	9.0	**5.4**	5.9
Budgetary support	13.7	24.4	16.7	20.1	21.0	17.5	**11.0**	13.8	10.8	13.4	14.2	**8.8**	9.4
Private credit 1/	14.9	11.9	3.0	2.2	4.8	5.5	**7.0**	11.2	15.8	19.1	18.7	**14.2**	16.0
Currency	12.2	12.8	24.1	16.5	17.5	15.3	**14.7**	12.5	15.1	18.3	16.2	**12.2**	14.7
Reserve money	12.7	19.9	16.8	18.3	14.1	13.4	**16.5**	12.8	12.4	18.1	18.2	**13.3**	16.3
Memorandum items:													
Velocity	2.3	2.3	2.2	2.2	2.1	2.1	**2.0**	2.1	2.1	2.1	2.1	**2.0**	2.1
Money multiplier	2.9	2.7	2.7	2.8	2.9	2.8	**2.7**	2.8	2.9	2.9	2.8	**2.7**	2.8
Currency to broad money ratio (percent)	27.4	27.8	29.4	28.8	28.1	29.0	**29.0**	28.4	28.7	28.1	28.6	**28.8**	28.2
Currency to deposit ratio (percent)	37.8	38.5	41.6	40.5	39.1	40.9	**40.9**	39.7	40.3	39.1	40.0	**40.4**	39.2
Foreign currency to deposit ratio (percent)	7.1	8.6	7.3	7.3	6.6	6.3	**6.6**	6.0	6.4	5.9	5.8	**6.0**	5.7
Reserves to deposit ratio (percent)	7.0	9.7	7.9	6.9	6.8	6.3	**7.3**	7.5	5.6	5.6	5.7	**7.3**	5.8
Budget bank financing (change from the beginning of the fiscal year; in Rs billions), *of which:*	1,121	2,262	1,925	251	551	798	**1,484**	1,864	-136	564	958	**1,315**	1,442
By commercial banks	-119	-887	2,159	-3,538	1,122	2,126	**2,345**	2,958	276	1,266	1,659	**1,884**	2,144
By SBP 3/	1,240	3,150	-234	3,789	-571	-1,328	**-861**	-1,094	-411	-702	-702	**-569**	-702
NFA of SBP (change from beginning of the year; in billions of U.S. dollars)	-7.8	-9.4	8.1	0.8	2.2	2.9	**4.2**	6.7	-0.1	0.4	0.4	**4.4**	2.5
NFA of commercial banks (millions of U.S. dollars)	-2,107	-3,127	-2,092	-1,026	-656	-799	**-1,992**	-1,225	-1,279	-1,287	-1,347	**-1,936**	-1,306
NDA of commercial banks (billions of Pakistani rupees)	10,733	11,605	13,563	13,798	14,481	14,727	**15,641**	15,840	16,192	17,236	17,429	**17,653**	18,271

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Items pertaining to Islamic Financing previously reported under "Other assets" have been reclassified as "Credit to private sector" beginning March 2016.

2/ Denominator is the stock of broad (reserve) money at the end of the previous year.

3/ Includes use of government deposits.

4/ Includes valuation adjustments.

Table 6. Pakistan: Financial Indicators for the Banking System, 2013–21

	2013 Dec.	2014 Dec.	2015 Dec.	2016 Dec.	2017 Dec.	2018 Dec.	2019 Dec.	2020 Mar.	2020 Jun.	2020 Sep.	2020 Dec.	2021 Mar.	2021 Jun.
Capital adequacy													
Regulatory capital to risk-weighted assets 1/	14.9	17.1	17.3	16.2	15.8	16.2	17.0	17.2	18.7	19.5	18.6	18.3	18.3
Tier I capital to risk-weighted assets	12.6	14.3	14.4	13.0	12.9	13.2	14.0	13.8	14.7	15.5	14.8	14.6	14.6
Capital to total assets	9.0	10.0	8.4	7.8	7.1	7.1	7.2	7.3	7.3	7.5	7.2	6.9	6.6
Asset composition and quality													
Nonperforming loans (NPLs) to gross loans	13.3	12.3	11.4	10.1	8.4	8.0	8.6	9.1	9.7	9.9	9.2	9.3	8.9
Provisions to NPLs	78.4	79.8	84.9	85.0	87.2	83.8	81.4	81.9	81.6	84.6	88.3	87.6	88.8
Net NPLs to total eligible capital	14.7	10.1	7.7	7.3	5.8	7.8	8.9	9.0	9.0	7.4	5.3	5.9	5.1
Earnings and profitability													
Return on assets (after tax)	1.1	1.5	1.5	1.3	0.9	0.8	0.8	0.8	1.1	1.1	1.0	0.9	0.9
Return on equity (after tax)	12.4	16.1	15.6	14.4	11.5	10.7	11.3	11.0	14.6	14.8	13.8	12.7	13.3
Net interest income to gross income	70.4	71.3	70.4	71.2	72.7	75.4	79.3	80.7	79.2	79.3	79.7	78.1	78.1
Noninterest expenses to gross income	57.2	53.3	47.8	53.1	57.1	60.2	57.6	56.6	48.9	47.9	50.0	54.8	53.4
Liquidity													
Liquid assets to total assets	48.6	49.2	53.8	53.7	54.0	48.7	49.7	49.8	53.3	54.4	54.8	55.4	57.1
Liquid assets to total deposits	61.3	64.5	73.3	72.1	76.1	67.2	68.4	69.3	72.6	73.8	74.3	77.0	78.7
Loans/Deposits	49.5	48.2	46.4	46.6	50.1	55.8	51.7	51.4	46.3	45.0	44.8	45.2	43.1

Source: State Bank of Pakistan.

1/ Starting Dec. 2015 and in line with Basel requirements, the authorities used regulatory capital instead of balance sheet capital for the calculation.

Table 7. Pakistan: Indicators of Fund Credit, 2015–27
(In millions of SDR, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
							Projections 1/						
	Projected level of credit outstanding based on existing and prospective drawings												
Total	**3,600.0**	**4,393.0**	**4,393.0**	**4,243.0**	**4,867.0**	**5,192.5**	**4,810.3**	**6,982.2**	**5,996.1**	**4,732.2**	**3,963.0**	**3,481.5**	**2,770.2**
Of which:													
ECF, SBA, and ENDA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Extended Fund Facility and Rapid Financing Instrument	3,600.0	4,393.0	4,393.0	4,243.0	4,867.0	5,192.5	4,810.3	6,982.2	5,996.1	4,732.2	3,963.0	3,481.5	2,770.2
In percent of quota	348.3	216.3	216.3	208.9	239.6	255.7	236.8	343.8	295.2	233.0	195.1	171.4	136.4
In percent of end-period gross official reserves	31.4	32.4	44.1	81.6	59.2	55.7	43.5	48.4	37.8	30.7	23.8	19.4	14.3
As a share of external debt	7.3	7.9	7.1	6.0	6.1	6.7	5.7	7.5	6.0	4.6	3.6	3.0	2.2
	Projected debt service to the Fund based on existing and prospective drawings												
Total	**338.1**	**51.1**	**75.0**	**248.0**	**532.7**	**361.5**	**832.2**	**850.5**	**1,145.9**	**1,375.5**	**834.2**	**524.1**	**745.4**
Of which:													
Principal	303.0	0.0	0.0	150.0	420.0	330.0	732.2	702.2	986.0	1,263.9	769.2	481.5	711.3
Interest and charges	35.1	51.1	75.0	98.0	112.7	31.5	100.0	148.4	159.9	111.6	65.0	42.6	34.0
SBA and ENDA principal	303.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Extended Fund Facility principal	N.A.	N.A.	N.A.	150.0	120.0	330.0	732.2	702.2	732.2	756.2	515.3	481.5	711.3
Rapid Financing Instrument principal	N.A.	N.A.	N.A.	0.0	0.0	0.0	0.0	0.0	253.9	507.8	253.9	0.0	0.0
In percent of quota	32.7	2.5	3.7	12.2	26.2	17.8	41.0	41.9	56.4	67.7	41.1	25.8	36.7
In percent of end-period gross official reserves	2.9	0.4	0.8	4.8	6.5	3.9	7.5	5.9	7.2	8.9	5.0	2.9	3.9
As a share of total external debt service	7.2	1.1	1.1	3.6	5.3	4.0	10.0	6.7	9.4	9.2	5.2	3.0	4.0
Memorandum items:													
Quota (millions of SDRs)	1,034	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031
Total external debt (percent of CY GDP)	25.0	25.7	28.5	33.1	41.2	40.0	38.6	40.0	40.4	38.9	38.5	38.1	37.8
Total external debt service (millions of U.S. dollars)	6,468	6,217	9,664	9,498	13,921	13,124	11,914	18,545	17,775	21,984	23,699	25,548	27,541

Source: IMF staff projections.

1/ Using the GRA rate of charge = 1.05 as of November 25, 2021 for projected charges.

Table 8. Pakistan: Selected Vulnerability Indicators, 2017/18–2025/26

	2017/18	2018/19	2019/20	2020/21		2021/22		2022/23	2023/24	2024/25	2025/26
				Prog.	Est.	Prog.	Proj.		Proj.		
Key economic and market indicators											
Real GDP growth (factor cost, in percent)	5.5	2.1	-0.5	**1.5**	3.9	**4.0**	4.0	4.5	5.0	5.0	5.0
CPI inflation (period average, in percent)	3.9	6.7	10.7	**8.7**	8.9	**8.0**	9.4	7.8	6.5	6.5	6.5
Emerging market bond index (EMBI) secondary market spread (basis points, end of period)	582	420	650	**…**	518	**…**	…	…	…	…	…
Exchange rate PRs/US$ (end of period)	121.5	160.1	168.1	**…**	157.5	**…**	…	…	…	…	…
External sector											
Current account balance (percent of GDP)	-6.1	-4.9	-1.7	**-1.5**	-0.6	**-1.8**	-4.1	-3.5	-3.3	-3.0	-2.7
Net FDI inflows (percent of GDP)	0.9	0.5	1.0	**0.8**	0.6	**0.8**	0.7	0.9	1.0	1.0	1.0
Exports (percentage change of U.S. dollar value; GNFS)	9.7	-1.3	-7.4	**2.1**	12.7	**7.0**	15.6	5.5	6.9	7.7	6.9
Gross international reserves (GIR) in billions of U.S. dollars	9.8	7.3	12.2	**14.4**	17.3	**17.8**	21.2	20.7	20.1	20.9	23.1
GIR in percent of ST debt at remaining maturity (RM) 1/	88.3	46.1	75.6	**68.3**	122.1	**66.0**	99.8	84.2	67.9	66.3	78.4
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 1/	54.6	32.0	54.1	**51.9**	83.1	**53.2**	76.3	66.4	54.7	53.2	61.0
Total gross external debt (ED) in percent of GDP, *of which:*	30.0	37.4	41.6	**42.1**	39.1	**41.7**	40.6	40.1	39.1	37.7	35.2
ST external debt (original maturity, in percent of total ED)	6.4	5.5	5.1	**3.8**	4.3	**4.1**	5.6	6.6	6.3	4.8	4.3
ED of domestic private sector (in percent of total ED)	33.4	32.1	30.8	**30.9**	33.4	**33.7**	34.5	37.6	41.2	43.7	44.2
ED to foreign official sector (in percent of total ED)	66.6	67.9	69.2	**69.1**	66.6	**66.3**	65.5	62.4	58.8	56.3	55.8
Total gross external debt in percent of exports	306.9	342.6	388.8	**402.3**	370.8	**402.2**	355.7	360.4	354.7	345.3	324.9
Gross external financing requirement (in billions of U.S. dollars) 2/	28.5	26.6	19.8	**16.5**	14.8	**18.0**	27.2	30.9	34.0	34.9	32.5
Public sector 3/											
Overall balance (including grants)	-6.4	-9.0	-8.0	**-7.1**	-7.1	**-5.5**	-6.9	-4.4	-4.4	-3.9	-3.5
Primary balance (including grants)	-2.1	-3.5	-1.7	**-1.0**	-1.3	**0.4**	-1.2	1.3	1.3	1.4	1.5
Debt-stabilizing primary balance 4/	2.1	5.4	0.5	**-0.8**	-7.1	**-3.2**	-1.9	-3.0	-1.7	-2.2	-1.6
Gross PS financing requirement 5/	31.7	36.7	29.1	**27.7**	23.3	**26.1**	27.0	23.0	21.2	19.5	16.8
General government and government guaranteed debt (incl. IMF)	76.2	90.5	93.2	**92.9**	88.6	**88.2**	86.7	82.1	78.1	73.8	70.4
General government debt incl. IMF obligations	72.1	85.3	87.6	**87.7**	83.6	**83.3**	82.0	77.7	74.1	70.1	66.9
Net general government debt (incl. IMF) 6/	66.5	76.9	80.0	**80.7**	75.0	**77.3**	75.2	71.7	68.7	65.3	62.6
Financial sector 7/											
Capital adequacy ratio (in percent)	15.9	16.1	18.7	**…**	18.3	**…**	…	…	…	…	…
Nonperforming loans (NPLs) in percent of total loans	7.9	8.8	9.7	**…**	8.9	**…**	…	…	…	…	…
Provisions in percent of NPLs	87.1	78.4	81.6	**…**	88.8	**…**	…	…	…	…	…
Return on assets (after tax, in percent)	0.8	0.8	1.1	**…**	0.9	**…**	…	…	…	…	…
Return on equity (after tax, in percent)	11.0	11.4	14.6	**…**	13.3	**…**	…	…	…	…	…
FX deposits held by residents (in percent of total deposits)	7.1	8.6	7.3	**…**	6.0	**…**	…	…	…	…	…
Government debt held by FS (percent of total FS assets)	63.8	69.3	69.6	**…**	67.3	**…**	…	…	…	…	…
Credit to private sector (percent change)	14.9	11.9	3.0	**…**	11.2	**…**	…	…	…	…	…
Memorandum item:											
Nominal GDP (in billions of U.S. dollars)	313.1	276.9	261.7	**…**	299.0	**…**	…	…	…	…	…

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Debt at remaining maturity is defined as maturing short-, medium-, and long-term external official debt.

2/ Current account deficit plus amortization of external debt.

3/ Public sector covers general (consolidated) government.

4/ Based on the end of period debt stock in year t-1, and the baseline assumptions for the relevant variables (i.e., growth, interest rates, inflation, exchange rates) in year t.

5/ Overall balance plus debt amortization.

6/ Net debt is defined as gross debt minus government deposits with the banking system.

7/ Financial sector includes all commercial and specialized banks; for government debt also includes nonbanks, but excludes State Bank of Pakistan.

Table 9a. Pakistan: Original Schedule of Reviews and Purchases

Availability Date	Amount of Purchase		Conditions
	Millions of SDRs	Percent of Quota	
July 3, 2019	716	35	Approval of arrangement
December 6, 2019	328	16	First review and end-September 2019 performance/ continuous criteria
March 5, 2021	350	17	Second, Third, Fourth, and Fifth reviews performance/ continuous criteria 1/
June 4, 2021	750	37	Sixth review and end-March 2021 performance/ continuous criteria
September 3, 2021	491	24	Seventh review and end-June 2021 performance/continuous criteria
December 3, 2021	491	24	Eighth review and end-September 2021 performance/ continuous criteria
March 4, 2022	491	24	Ninth review and end-December 2021 performance/ continuous criteria
September 2, 2022	651	32	Tenth review and end-June 2022 performance/ continuous criteria
Total	4,268	210	

Source: IMF staff estimates.

1/ The purchases have become available on March 6, 2020, June 5, 2020, September 4, 2020, and March 5, 2021, respectively.

Note: On April 16, 2020 the authorities made a SDR 1,015.5 million purchase (50 percent of quota) under the Rapid Financing Instrument.

Table 9b. Pakistan: Proposed Schedule of Reviews and Purchases After Rephasing

Availability Date	Amount of Purchase		Conditions
	Millions of SDRs	Percent of Quota	
July 3, 2019	716	35	Approval of arrangement
December 6, 2019	328	16	First review and end-September 2019 performance/ continuous criteria
March 5, 2021	350	17	Second, Third, Fourth, and Fifth reviews performance/ continuous criteria
September 3, 2021	750	37	Sixth review and end-June 2021 performance/continuous criteria
March 4, 2022	687	34	Seventh review and end-December 2021 performance/ continuous criteria
June 3, 2022	687	34	Eighth review and end-March 2022 performance/ continuous criteria
September 2, 2022	750	37	Ninth review and end-June 2022 performance/ continuous criteria
Total	4,268	210	

Source: IMF staff estimates.

Note: On April 16, 2020 the authorities made a SDR 1,015.5 million purchase (50 percent of quota) under the Rapid Financing Instrument.

Table 10. Pakistan: Decomposition of Public Debt and Debt Service by Creditor, FY 2020/21–FY 2022/23 1/

	Debt Stock (end of period)			Debt Service					
	2020/21			2020/21	2021/22	2022/23	2020/21	2021/22	2022/23
	(In US$ million)	*(Percent total debt)*	*(Percent GDP)*	*(In US$ million)*			*(Percent GDP)*		
Total	268,410	100	88.6	71,830	83,868	40,549	24.0	26.3	11.7
External	91,766	34.2	30.3	11,578	16,899	15,579	3.9	5.3	4.5
Multilateral creditors[2]	41,726	15.5	13.8	4,057	3,896	3,497	1.4	1.2	1.0
IMF	7,384	2.8	2.4						
World Bank	18,135	6.8	6.0						
ADB/AfDB/IADB	13,423	5.0	4.4						
Other Multilaterals	2,783	1.0	0.9						
o/w: IsDB	1,512	0.6	0.5						
AIIB	835	0.3	0.3						
Bilateral Creditors	30,307	11.3	10.0	3,325	5,227	6,954	1.1	1.6	2.0
Paris Club	10,726	4.0	3.5	10	584	1,175	0.0	0.2	0.3
o/w: Japan	5,427	2.0	1.8						
France	1,725	0.6	0.6						
Non-Paris Club	19,581	7.3	6.5	3,314	4,643	5,779	1.1	1.5	1.7
o/w: China*	18,434	6.9	6.1						
Saudi Arabia	961	0.4	0.3						
Bonds**	8,615	3.2	2.8	362	1,516	1,460	0.1	0.5	0.4
Commercial creditors	10,287	3.8	3.4	3,834	6,260	3,668	1.3	2.0	1.1
o/w: Chinese commercial banks	6,735	2.5	2.2						
Other	3,552	1.3	1.2						
Other international creditors	831	0.3	0.3						
o/w: NPC/NBP/BOC deposits/PBC***	831	0.3	0.3						
Domestic	176,644	65.8	58.3	60,251	66,969	24,971	20.2	21.0	7.2
T-Bills	42,404	15.8	14.0	34,958	40,939		11.7	12.8	
Held by: local banks	37,975	14.1	12.5						
local non-banks	4,429	1.7	1.5						
Bonds****	98,108	36.6	32.4	14,755	18,848	19,288	4.9	5.9	5.6
Held by: central bank	42,025	15.7	13.9						
local banks	42,901	16.0	14.2						
local non-banks	13,182	4.9	4.4						
NSS/Other	26,163	9.7	8.6	10,539	7,182	5,683	3.5	2.2	1.6
Held by: local non-banks	26,163	9.7	8.6						
Memo items:									
Public guarantees	15,278	5.7	5.0						
Central bank deposit liabilities	2,700	1.0	0.9						
Central bank bilateral SWAP liabilities	4,650	1.7	1.5						
Nominal GDP	298,994								

1/As reported by Country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA. Debt service for FY 2021/22 and FY 2022/23 are preliminary estimates.

2/Multilateral creditors are institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears)

* Includes China State Adminstratation of Foreign Exchange (SAFE) deposits of $4bn at June 2021.

** Includes local currency bonds (T-Bills and PIBs) held by non-residents.

*** Pakistan Banao Certificates (PBC) and Naya Pakistan Certificates (NPC) are issued by Government of Pakistan for overseas Pakistanis.

**** Includes Government Ijara Sukuk.

Annex I. Risk Assessment Matrix

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact 1/	Policy Response
EXTERNAL				
Intensified geopolitical tensions and security risks. Geopolitical tensions in selected countries/regions (notably Afghanistan) cause economic/political disruption, disorderly migration, higher volatility in commodity prices (if supply is disrupted), and lower confidence, with spillovers to other countries (including Pakistan).	**High**	**Short Term**	**High** • Financial volatility raises risk aversion, causing financing pressures and capital outflows from emerging markets, including Pakistan. • Inflow of refugees and concessions to interest groups raise spending or lower growth, weakening the underlying fiscal position. • Weaker confidence and supply disruptions drag on economic growth.	• Implement strong policies and strengthen institutions as a foundation of strong and sustainable growth. • scale up targeted social assistance. • Resist pressures to weaken fiscal discipline and preserve fiscal and debt sustainability. • Build fiscal and external buffers.
Uncontrolled COVID-19 local outbreaks and subpar/volatile growth in affected countries. Outbreaks in slow-to-vaccinate countries force new lockdowns. For many Emerging Markets and Low-Income Countries, policy response to cushion the economic impact is constrained by lack of policy space, with some market access countries facing additional financial tightening as a reassessment of growth prospects triggers capital outflows, depreciations, and debt defaults.	**High**	**Short Term**	**Medium** • Disruptions in supply chains and distribution channels weakening economic activity and raising prices. • Worsening sentiment and lower demand for Pakistan's assets resulting in the deterioration of the stock market, increased funding costs, and/or reduced capital inflows.	• Reallocate resources to health spending to accelerate the vaccination drive and efficiently manage the pandemic. • Provide targeted support to the vulnerable, while maintaining fiscal and debt sustainability. • Maintain market-determined exchange rate, while intervening during disorderly market conditions. • Maintain financial stability.

Global resurgence of the COVID-19 pandemic. Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.	Medium	**Short Term**	Medium • Disruptions in trade channels leading to lower exports as main trading partners experience slowdown. • Financial volatility raises risk aversion, raising financing pressures and driving capital outflows. • Weakening global demand decreases commodity prices.	• Accelerate the vaccination drive and provide targeted support. • Maintain market-determined exchange rate to support competitiveness, while intervening only during disorderly market conditions. • Maintain financial stability.
Disorderly transformations. COVID-19 triggers structural transformations, but the reallocation of resources is impeded by labor market rigidities, debt overhangs, and inadequate bankruptcy resolution frameworks. This, coupled with a withdrawal of COVID-19-related policy support, undermines growth prospects and increases unemployment, with adverse social/political consequences. Adjustments in global value chains and reshoring (partly driven by geostrategic and national security concerns) shift production activities across countries.	Medium	**Medium Term**	Medium • In the absence of efficient reallocation of domestic resources, structural change weighs down on growth and increases unemployment. • A change in global demand patterns, and a shift in trade channels, lead to lower exports as main trading partners resort to more agile economies.	• Preserve fiscal and debt sustainability. • Create fiscal space to invest in infrastructure and human capital. • Enhance bankruptcy resolution frameworks. • Enact labor market reforms to limit rigidities and inefficiencies in both the private and the public sectors. • Maintain market-determined exchange rate to support competitiveness.
De-anchoring of inflation expectations in the U.S. leads to rising core yields and risk premia. A fast recovery in demand (supported by excess private savings and stimulus policies), combined with COVID-19-related supply constraints, leads to sustained above-target inflation readings and a de-anchoring of expectations. The Fed reacts by signaling a need to tighten earlier than expected. The resulting repositioning by market participants leads to a front-loaded tightening of financial conditions and higher	Medium	**Short to Medium Term**	Medium • Worsening sentiment and lower demand for Pakistan's assets resulting in increased funding costs or reduced capital inflows. • Stock market deteriorates. • Reduced interest in privatization portfolio.	• Maintain market-determined exchange rate to support competitiveness. • Continue building fiscal and external buffers. • Decisive progress on structural reforms should anchor confidence and improve competitiveness. • Maintain an appropriate medium-term debt strategy.

risk premia, including for credit, equities, and emerging and frontier market currencies.				• Maintain financial stability to weather external shocks, tighten supervision to monitor banking risks.
Rising commodity prices amid bouts of volatility. Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads to bouts of volatility, especially in oil prices.	**Medium**	**Short to Medium Term**	**Medium/ High** • Higher energy prices could weaken energy sector's financial position, especially if not permitted to pass along price increases, leading to buildup of more arrears. • Higher headline inflation.	*Short term:* • Allow energy prices increases to be passed through to end-users. • Press ahead with reforms of the energy sector. *Medium term:* • Maintain financial stability to weather external shocks.
Higher frequency and severity of natural disasters related to climate change cause severe economic damage to smaller economies susceptible to disruptions and accelerate emigration from these economies. A sequence of severe events in large economies reduces global GDP and prompts a recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility.	**Medium**	**Medium to Long Term**	**Medium** • Weaker confidence and supply disruptions drag on economic growth. • Higher risk aversion, and higher risk premia leading to financing pressures and capital outflows from vulnerable countries. • Trade disruptions leading to commodity price levels and volatility, hence heightening external imbalances. • Disorderly migration	• Implement strong policies and strengthen institutions as a foundation of strong and sustainable growth. • Maintain market-determined exchange rate to support competitiveness. • Maintain financial stability. • Advance policies and reforms aiming at climate risk mitigation, adaptation, and transition to a low-carbon economy. • Build fiscal and external buffers.
DOMESTIC				
Slippages in policy implementation. Pressures on the government could rise to provide incentives/exemptions to key groups. Political resistance or hesitation to delivering on structural reforms could undermine effective reform implementation and lessen the prospects for durable adjustment and sustainable and inclusive growth.	**High**	**Short to Medium Term**	**High** • Weaker fiscal discipline could compromise the quality and durability of fiscal adjustment; expose debt sustainability risks.	• Implement strong policies and strengthen institutions as a foundation of strong and sustainable growth. • Resist pressures to weaken fiscal discipline and preserve fiscal sustainability. • Build external buffers.

			• Unfinished structural reform agenda would reduce growth prospects, preserve over-reliance on the public sector and large informal economy, and leave unaddressed contingent liabilities. • Subdued economic growth.	• Foster more inclusive growth through scaling up targeted social assistance. • Improve external competitiveness and reduce red tape to reduce the costs of doing business.
Deterioration in security conditions. Regional tensions and possible retaliation against ongoing domestic security operations could increase security concerns.	**Medium**	**Short to Medium Term**	**Medium/ High** • Eroded confidence and discouraged investment would disrupt economic activity and reduce growth prospects. • Increased military spending/ fiscal burden could strain fiscal sustainability.	• Instill confidence through strong implementation of the economic stabilization program and structural reforms. • Maintain engagement with donors. • Build external buffers. • Preserve fiscal sustainability.
Bottom line assessment: The balance of risks is tilted to the downside.				
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within one year and three years, respectively.				

Annex II. Public and External Debt Sustainability Analysis

Pakistan's public debt continues to be judged as sustainable, consistent with the DSA published at the time of the second-fifth reviews in March 2021. Debt ratios have since been revised down due to a slightly stronger-than-projected exchange rate at end-FY 2021 and a higher growth outturn. While the extension of the Debt Service Suspension Initiative (DSSI) until end-December 2021 (covering about US$1 billion of debt service in FY 2022) continues to provide relief in the short term, the forward-looking path for gross financing needs (GFN) has been revised upwards due to larger-than-expected reliance on short-term domestic issuance since late-March 2021. Nevertheless, public debt and GFN to GDP are projected to firmly decline over the medium term, supported by the EFF program fiscal adjustment path and efforts to enhance cash and debt management.

1. **Over the near-term horizon of the DSA public debt levels are lower than projected at the time of the second-fifth reviews in March 2021, and they continue to be on a clear downward path**. This owes mainly to (i) an upward revision to FY 2021 real growth from 1.5 percent to 3.9 percent, and (ii) a stronger exchange rate path (around 7.5 percent revision at end-FY 2021). Total debt is estimated at 88.6 percent of GDP at end-June 2021 (4.6 percentage points lower than at end-FY 2020), reversing the increase associated with the COVID-19 crisis and falling below end-FY 2019 levels before the start of the EFF program. The trajectory of debt is expected to continue to decline to 70.4 percent of GDP by end-FY 2026, supported by a favorable interest rate-growth differential outlook, and fiscal adjustment efforts in the context of the EFF program.

2. **Although slower than previously projected, the maturity structure of debt is expected to continue to improve, thus lowering GFN over the medium term, on account of multi-pronged efforts**. The successful reprofiling of government debt held by the SBP into longer-term instruments in June 2019 has supported debt sustainability. Since then, the authorities succeeded in lengthening the average time to maturity (ATM) of domestic debt held by the market by 0.6 years to 2.6 years at end-FY 2020. As a result, GFN have been brought down from 36.6 percent of GDP in FY 2019 to an estimated 27.7 percent of GDP in FY 2021. Although the latter figure is lower than previously projected for FY 2021—due to a better economic performance—the GFN path in the following years has been revised upwards due to a higher reliance on short-term domestic financing than previously projected and due to a higher primary fiscal deficit path. As a result, GFN is expected to increase in FY 2022 despite the extension of the DSSI as the authorities failed to meet their commitments to lengthen the maturity profile of domestic debt in FY 2021, as reflected in the Indicative Target added at the time of the second-fifth reviews. However, a better alignment with this objective in FY 2022 would help the GFN path resume a downward path to 19.1 percent of GDP by end-FY 2026. Efforts that will lower gross financing needs over the medium term include: (i) fiscal discipline; (ii) better cash flow management through a treasury single account; (iii) establishment of a central Debt Management Office; and (iii) a successful implementation of the Medium-Term Debt Strategy, in particular by continuing to lengthen the maturity profile of debt and diversifying instruments and investor base especially by scaling up Shariah-compliant instruments. With SBP financing no longer available, the government has been nevertheless successful in securing financing

primarily from domestic commercial banks, through the issuance of short-term T-Bills and long-term PIBs denominated in domestic currency, as well as from successful international Eurobond issuances.

3. **Macro-fiscal shocks continue to pose a risk in the medium term, despite an improvement in the debt profile (see heatmap below)**. The most extreme shock to medium-term debt dynamics would emanate from a large and sustained real interest rate shock. Under this stress test, debt levels and GFN would still decline to 77 and 24 percent of GDP, respectively. However, the paths for debt and GFN under alternative scenarios (historical and constant primary balance scenario, Figure 4) highlight the risks to debt sustainability from delayed implementation of fiscal and structural reforms and from the continuation of low growth.

4. **Contingent liabilities from loss-making SOEs— to the extent not covered by government guarantees—continue to represent additional risks to debt sustainability**. The authorities have recognized some contingent liabilities in the context of circular debt worth PRs 450 billion (1.0 percent of GDP). Remaining contingent liabilities from circular debt (amounting to less than 0.8 percent of GDP) as well as contingent liabilities from other loss-making SOEs (assumed to be in the range of 5–6 percent of GDP) and/or from the financial sector are accounted for by a stress test to debt dynamics consisting of a contingent liability shock, illustrated in the graphs below. Staff aims to continue the strengthening of transparency related to contingent liabilities from loss-making SOEs.

5. **The authorities have remained engaged with external creditors to secure financing to meet the program debt sustainability objectives**. China has maintained its exposure by renewing (and augmenting) the US$4.6 billion swap (US$3 billion at the time of EFF approval), as well as by renewing maturing commercial loans, though some at shorter maturity. China also provided an additional US$1 billion loan in July 2020 through the State Administration of Foreign Exchange, raising its deposits to US$4 billion. Recently, the authorities have also secured a US$3bn deposit at the central bank and a deferred oil financing facility from Saudi Arabia. The G-20 Debt Service Suspension Initiative (DSSI)—recently extended by a third round until December 2021—has helped reduce short-term financing risks and provided around US$3.8 billion in total (1.3 percent of FY 2021 GDP) of debt service suspension and rescheduling to outer years. Nonetheless, near term financing risks remain elevated, reflecting the large size of public sector amortization needs.

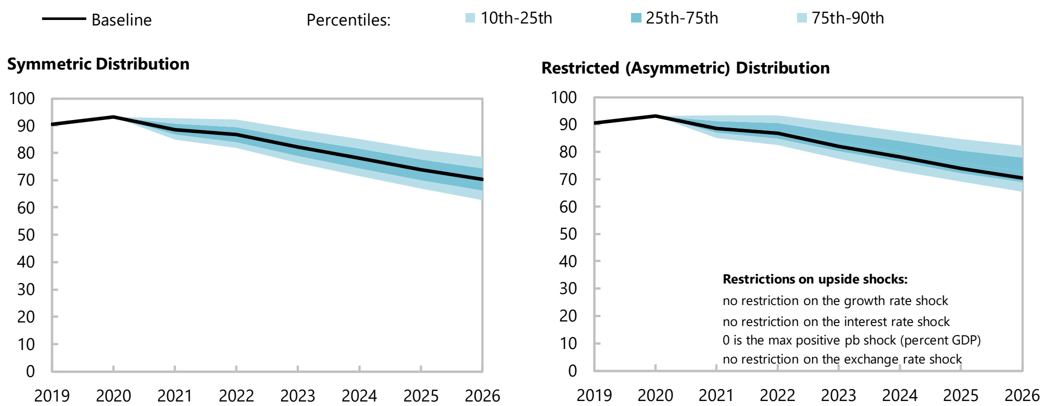
Figure 1. Pakistan: Public DSA – Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

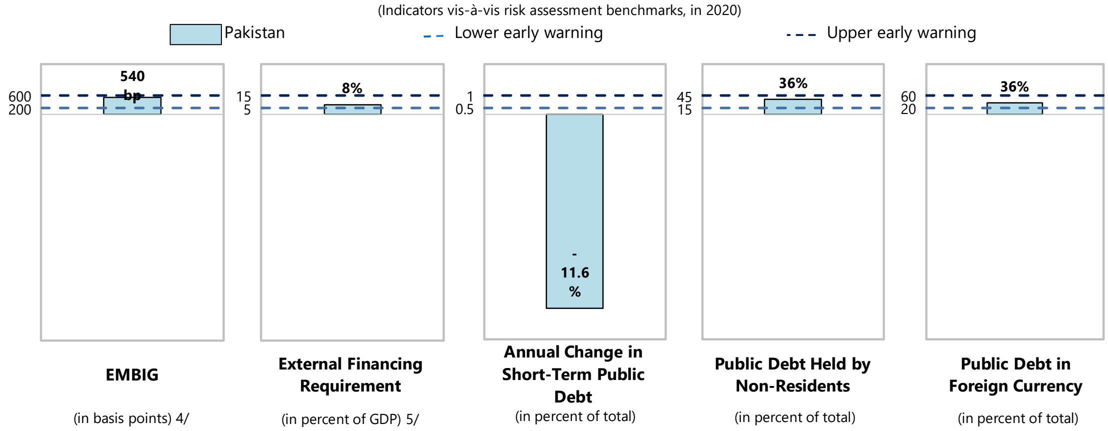
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

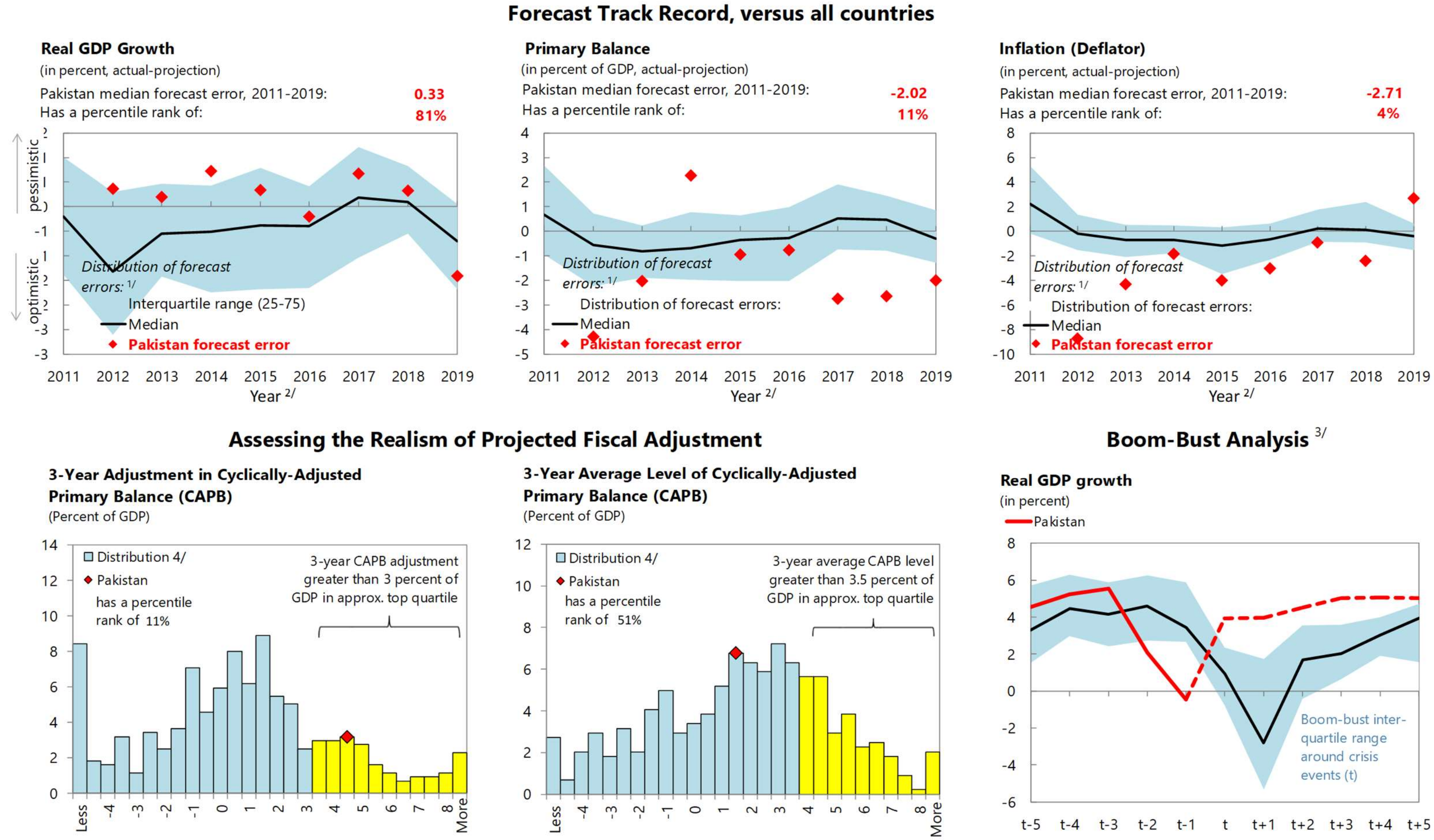
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 18-Aug-21 through 18-Nov-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 2. Pakistan: Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Pakistan has had a positive output gap for 3 consecutive years, 2018-2020. For Pakistan, t corresponds to 2021; for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 3. Pakistan: Public DSA – Baseline Scenario

(In percent of GDP, unless otherwise indicated)

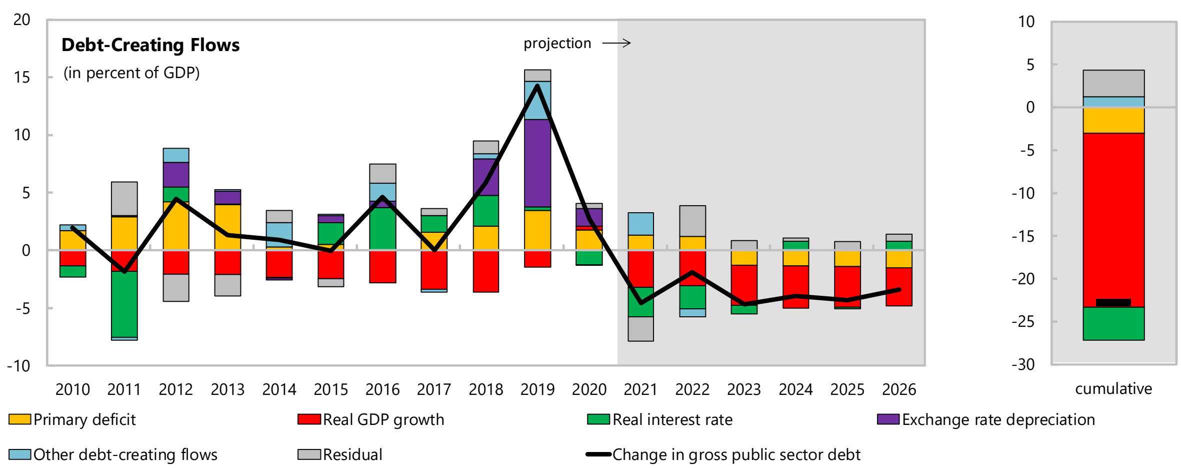
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2012-2018 [2]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	68.1	90.5	93.2	88.6	86.7	82.1	78.1	73.8	70.4
Of which: guarantees	2.9	5.2	5.6	5.0	4.8	4.4	4.0	3.8	3.6
Public gross financing needs	30	36.6	29.0	27.7	29.1	25.0	23.4	20.6	19.1
Real GDP growth (in percent)	4.4	2.1	-0.5	3.9	4.0	4.5	5.0	5.0	5.0
Inflation (GDP deflator, in percent)	4.9	7.8	9.6	10.5	9.6	8.5	6.5	7.4	6.4
Nominal GDP growth (in percent)	9.6	10.0	9.1	14.8	14.0	13.4	11.8	12.8	11.8
Effective interest rate (in percent) [4]	7.7	8.4	8.1	7.7	7.5	7.9	7.8	7.6	8.0

As of November 19, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		575
5Y CDS (bp)		395
Ratings	Foreign	Local
Moody's	B3	n.a.
S&Ps	B-	n.a.
Fitch	B-	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2012-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [10]
Change in gross public sector debt	2.5	14.2	2.7	-4.6	-1.9	-4.6	-4.0	-4.3	-3.4	-22.8	
Identified debt-creating flows	2.5	13.2	2.3	-2.5	-4.6	-5.5	-4.2	-5.0	-4.0	-25.9	
Primary deficit	1.8	3.5	1.7	1.3	1.2	-1.3	-1.3	-1.4	-1.5	-3.1	-2.5
Primary (noninterest) revenue and grants	14.6	13.0	15.2	14.5	15.9	16.7	16.7	16.8	16.9	97.5	
Primary (noninterest) expenditure	16.4	16.4	16.9	15.8	17.1	15.4	15.4	15.4	15.4	94.4	
Automatic debt dynamics [5]	0.0	6.4	0.6	-5.8	-5.0	-4.2	-2.9	-3.6	-2.5	-24.1	
Interest rate/growth differential [6]	-1.1	-1.1	-0.9	-5.8	-5.0	-4.2	-2.9	-3.6	-2.5	-24.1	
Of which: real interest rate	1.6	0.3	-1.3	-2.6	-2.0	-0.8	0.8	-0.1	0.8	-3.8	
Of which: real GDP growth	-2.7	-1.4	0.4	-3.2	-3.1	-3.4	-3.7	-3.5	-3.3	-20.2	
Exchange rate depreciation [7]	1.1	7.6	1.5	…	…	…	…	…	…	…	
Other identified debt-creating flows [8]	0.8	3.3	-0.1	2.0	-0.7	0.0	0.0	0.0	0.0	1.2	
Residual, including asset changes [9]	-0.1	1.0	0.4	-2.1	2.7	0.9	0.3	0.8	0.6	3.1	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as guarantees to PSEs.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ In 2019 and 2020, "other identifed debt creating flow" is driven by the accumulation and drawdown of cash buffers, respectively.

9/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

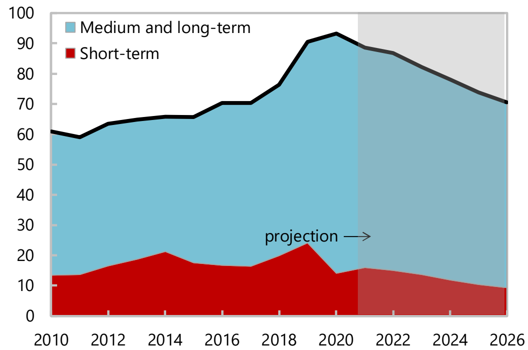
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 4. Pakistan: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

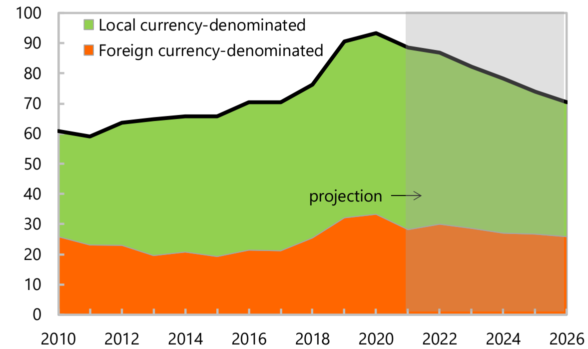
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

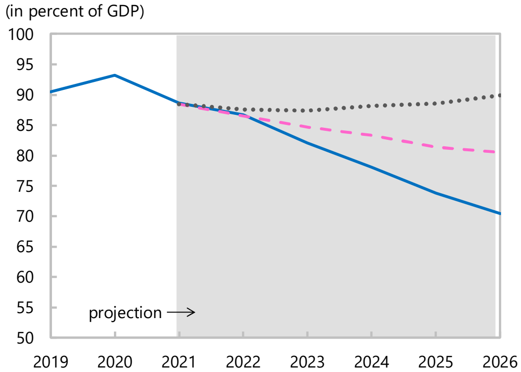


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

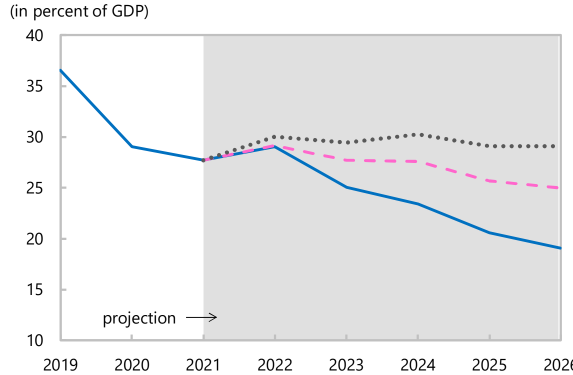
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

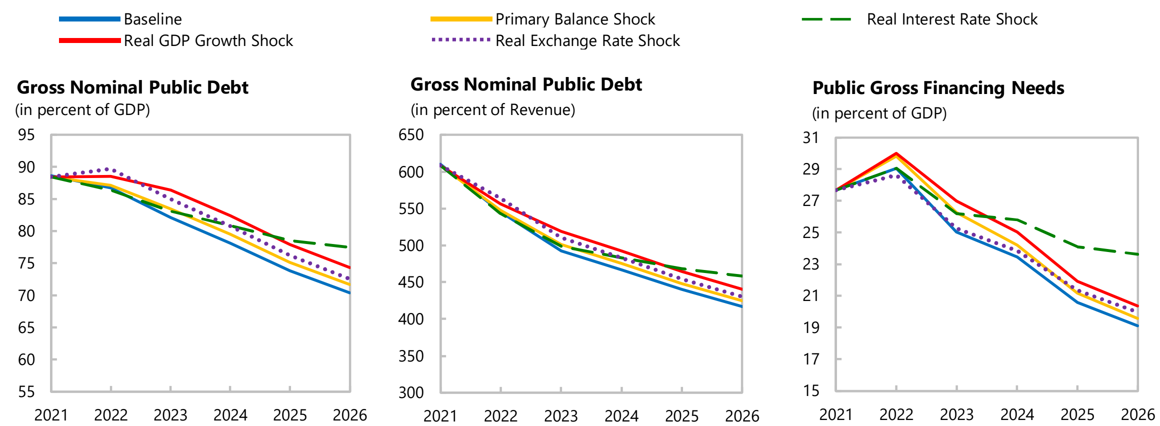
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	3.9	4.0	4.5	5.0	5.0	5.0
Inflation	10.5	9.6	8.5	6.5	7.4	6.4
Primary Balance	-1.3	-1.2	1.3	1.3	1.4	1.5
Effective interest rate	7.7	7.5	7.9	7.8	7.6	8.0
Constant Primary Balance Scenario						
Real GDP growth	3.9	4.0	4.5	5.0	5.0	5.0
Inflation	10.5	9.6	8.5	6.5	7.4	6.4
Primary Balance	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	7.7	7.5	8.0	7.8	7.5	8.0

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	3.9	3.6	3.6	3.6	3.6	3.6
Inflation	10.5	9.6	8.5	6.5	7.4	6.4
Primary Balance	-1.3	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	7.7	7.5	8.3	8.3	8.2	8.5

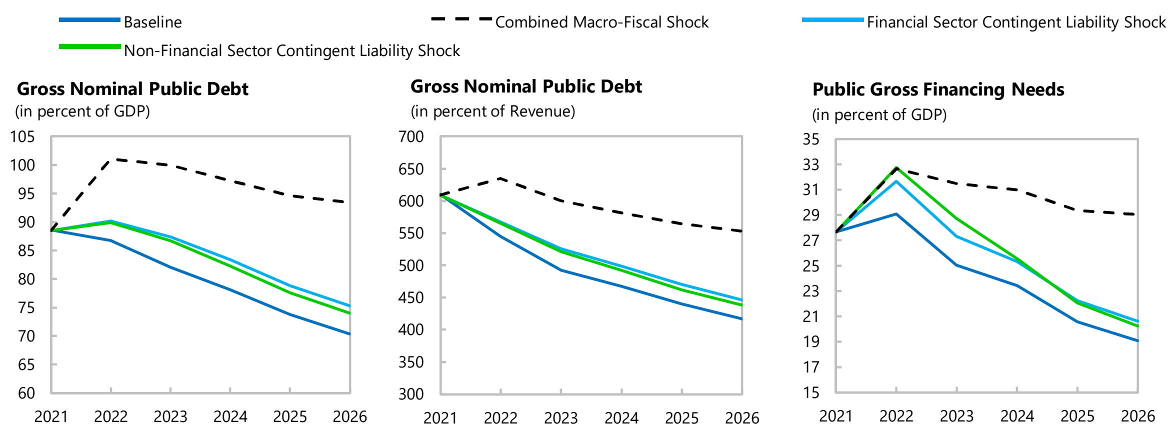
Source: IMF staff.

Figure 5. Pakistan: Public DSA – Stress Test

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	3.9	4.0	4.5	5.0	5.0	5.0
Inflation	10.5	9.6	8.5	6.5	7.4	6.4
Primary balance	-1.3	-2.0	0.5	1.3	1.4	1.5
Effective interest rate	7.7	7.5	8.0	7.9	7.6	8.0
Real Interest Rate Shock						
Real GDP growth	3.9	4.0	4.5	5.0	5.0	5.0
Inflation	10.5	9.6	8.5	6.5	7.4	6.4
Primary balance	-1.3	-1.2	1.3	1.3	1.4	1.5
Effective interest rate	7.7	7.5	9.6	10.3	10.8	11.6
Combined Shock						
Real GDP growth	3.9	2.2	2.8	5.0	5.0	5.0
Inflation	10.5	9.2	8.1	6.5	7.4	6.4
Primary balance	-1.3	-2.0	0.5	1.3	1.4	1.5
Effective interest rate	7.7	7.9	8.9	10.3	10.8	11.6

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	3.9	2.2	2.8	5.0	5.0	5.0
Inflation	10.5	9.2	8.1	6.5	7.4	6.4
Primary balance	-1.3	-1.6	0.7	1.3	1.4	1.5
Effective interest rate	7.7	7.5	8.0	7.9	7.6	8.0
Real Exchange Rate Shock						
Real GDP growth	3.9	4.0	4.5	5.0	5.0	5.0
Inflation	10.5	20.2	8.5	6.5	7.4	6.4
Primary balance	-1.3	-1.2	1.3	1.3	1.4	1.5
Effective interest rate	7.7	7.9	7.4	7.4	7.2	7.6
Contingent Liability Shock						
Real GDP growth	3.9	2.2	2.8	5.0	5.0	5.0
Inflation	10.5	9.2	8.1	6.5	7.4	6.4
Primary balance	-1.3	-2.8	1.3	1.3	1.4	1.5
Effective interest rate	7.7	8.0	8.0	7.9	7.6	8.0

Source: IMF staff.

Table 1. Pakistan: External Debt Sustainability Framework, 2016–26

(Percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2016	2017	2018	2019	2020	10-Year Historical Average	10-Year Standard Deviation	2021	2022	2023	2024	2025	2026	Debt-stabilizing non-interest current account 6/
Baseline: External debt	**26.1**	**27.0**	**30.0**	**37.4**	**41.6**			**39.1**	**40.6**	**40.1**	**39.1**	**37.7**	**35.2**	**-2.4**
Change in external debt	2.4	0.9	3.0	7.4	4.2			-2.5	1.5	-0.5	-1.0	-1.4	-2.5	
Identified external debt-creating flows (4+8+9)	0.3	1.0	4.5	8.2	2.9			-1.4	1.9	0.9	0.5	0.2	-0.1	
Current account deficit, excluding interest payments	1.0	3.2	5.2	3.5	0.3			-0.3	2.9	2.3	2.1	1.8	1.5	
Deficit in balance of goods and services	8.2	10.1	11.9	11.8	9.3			10.1	12.6	11.5	11.1	10.4	9.9	
Exports	9.9	9.2	9.8	10.9	10.7			10.5	11.4	11.1	11.0	10.9	10.8	
Imports	18.0	19.2	21.7	22.7	20.0			20.6	24.0	22.7	22.1	21.3	20.7	
Net non-debt creating capital inflows (negative)	-0.9	-0.8	-0.9	-0.5	-1.0			-0.6	-0.7	-0.9	-1.0	-1.0	-1.0	
Automatic debt dynamics 1/	0.1	-1.5	0.2	5.2	3.6			-0.5	-0.3	-0.5	-0.6	-0.6	-0.5	
Contribution from nominal interest rate	0.8	0.8	1.0	1.3	1.4			0.9	1.2	1.2	1.2	1.2	1.2	
Contribution from real GDP growth	-1.1	-1.2	-1.5	-0.7	0.2			-1.4	-1.4	-1.7	-1.9	-1.8	-1.8	
Contribution from price and exchange rate changes 2/	0.4	-1.0	0.7	4.6	2.0			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.1	-0.1	-1.5	-0.9	1.3			-1.1	-0.4	-1.5	-1.4	-1.6	-2.4	
External debt-to-exports ratio (in percent)	265.0	294.7	306.9	342.6	388.8			370.8	355.7	360.4	354.7	345.3	324.9	
Gross external financing need (in billions of US dollars) 4/	**11.6**	**22.0**	**28.5**	**26.6**	**19.8**			**21.6**	**30.4**	**35.1**	**41.9**	**39.1**	**36.6**	
in percent of GDP	4.2	7.2	9.1	9.6	7.6			7.2	9.5	10.1	11.2	9.6	8.4	
Scenario with key variables at their historical averages 5/								**39.1**	**40.2**	**40.5**	**40.5**	**40.6**	**39.2**	**-1.1**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	4.6	5.2	5.5	2.1	-0.5	3.6	1.7	3.9	4.0	4.5	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	-1.6	4.1	-2.6	-13.3	-5.1	0.7	7.8	9.9	2.7	3.7	2.7	3.6	2.6	
Nominal external interest rate (in percent)	3.4	3.3	3.7	3.9	3.7	3.0	0.6	2.5	3.1	3.3	3.3	3.4	3.5	
Growth of exports (US dollar terms, in percent)	-8.5	1.8	9.7	-1.3	-7.4	1.6	10.0	12.7	15.6	5.5	6.9	7.7	6.9	
Growth of imports (US dollar terms, in percent)	-0.2	16.9	16.0	-7.6	-16.6	3.8	11.0	17.7	24.4	2.2	5.1	4.8	5.0	
Current account balance, excluding interest payments	-1.0	-3.2	-5.2	-3.5	-0.3	-1.5	1.8	0.3	-2.9	-2.3	-2.1	-1.8	-1.5	
Net non-debt creating capital inflows	0.9	0.8	0.9	0.5	1.0	0.7	0.2	0.6	0.7	0.9	1.0	1.0	1.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

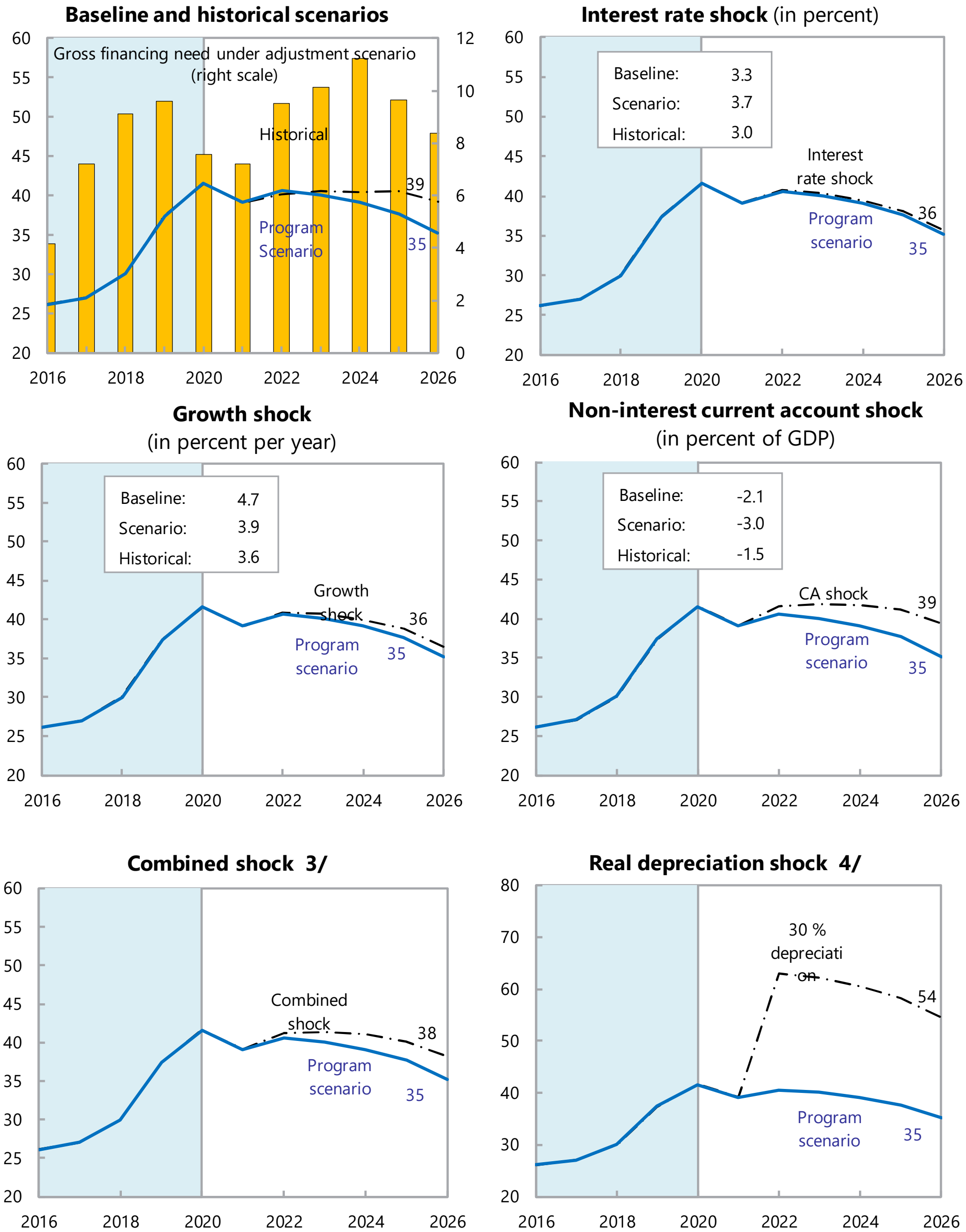
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 6. Pakistan: External Debt Sustainability: Bound Tests 1/ 2/

(Percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in first projection year.

Annex III. General Sales Taxation and Competitiveness in Pakistan[1]

The current general sales tax (GST) system, with its cascading effect, undermines competitiveness and ease of doing business, biases production toward simple manufacturing activity, and discriminates against exporters and import-competing industries.

1. **Pakistan is a federation with taxation powers shared between federal government and provinces**. Under the current system, and as laid out in the Constitution, the sales tax base is fragmented with services subject to taxation at the provincial level, and goods at the federal level. As a result, taxpayers face different taxes across multiple jurisdictions, and in addition to FBR, they need to deal with four separate sales tax administrations—one in each province. The use of multi-jurisdictional inputs along the value chain means that the federal and provincial revenue authorities are interacting repeatedly in each transaction. For example, a good being sold (sales tax paid federally) can have services input taxes from multiple provinces that need to be credited, as well as sales tax paid on the purchase of any goods inputs. The current system makes this crediting incomplete.[2] It has also led to disputes over base definition and coverage, causing problems of double taxation for businesses, as certain activities are jointly claimed by both the federal authority and provinces.

2. **Cascading effect results in high export price**. The fragmented GST system as it stands now has a cascading effect since there is no systemic mechanism to ensure that all tax paid on input can be credited against a final sale (the output tax). This results in the cumulative taxation of intermediate inputs of production and distorts the prices that producers face in buying and selling from one another. It therefore causes a significant divergence of nominal and effective tax rates in the price of final goods (Ahmad, 2011). Under the current system it is harder to generate full information on all aspects of the value chain, which is critical to eventually remove all taxation from exports. As a result, Pakistani exports carry unrecovered tax on their input, and exporters' prices are systemically higher than those of exporters in countries without the cascading effect of the GST system (see Box 1). This also contributes to a heavy reliance of the tax revenues on manufacturing, which is the main exporting sector of the economy. Manufacturing, which accounts for only 14 percent of GDP, represents 58 percent of total tax revenue (ADB, 2018).

3. **The GST system creates an incentive for low value-added production, and hampers integration in the global value chains (GVC)**. The cascading GST system hampers the development of sophisticated manufacturing and accentuates incentives for low value-add manufacturing partly as a result of low competitiveness and to limit tax burden. As it gets unclear what the effective rates on inputs and outputs will be, relative prices across the value chain get distorted, which encourages inefficient production choices (e.g., switching from superior to inferior quality inputs). The higher cost of intermediate goods or services due to GST makes more costly to incorporate advanced technology into production and thus affecting productivity and competitiveness, discouraging

[1] Prepared by Svetlana Cerovic (MCD).

[2] Note that problems with crediting are only in part due to tax policy features. Other challenges are administrative in nature, relating to information sharing and refund delays, which are often unpredictable.

integration into the global value chains (GVC). The end results of this, is that import competing sectors face a disadvantage with imported final goods. Export oriented industries are also heavily skewed to low value-added products, requiring few manufacturing stages. For example, textile exports (60 percent of total exports) are mainly comprised of simple knitwear, bed wear, cotton cloth, and readymade garments, while food exports (20 percent of total exports) are mostly made up of rice and fish. These low value-added and non-branded goods mean that Pakistani exporters operate in the most competitive segments in the international markets and with limited profitability.

References

Ehtisham Ahmad, 2011, "Why is it so Difficult to Implement a GSTA in Pakistan," International Growth Center.

M. Khan, 2018, "Analysis of Pakistan's Export Performance Main Challenges and Issues," Asian Development Bank.

Box 1. Pakistan: Illustrative Case on the Cascading Effect of GST in Pakistan

Pakistan exporters competitiveness is impacted because of the cascading effect of GST. For example, the cotton ginning company buys PRs 1,000 value of raw materials for production of cotton fiber, and with GST rate of 10 percent, pays total sales tax on goods of PRs 100. In addition to purchased raw material, it also uses certain services for PRs 500, like transportation, consulting, marketing. Assuming the same tax rate of 10 percent on services, it pays additional PRs 50 in taxes. Input tax paid is therefore: PRs 100 (to the federal government) + PRs 50 (to a province) = PRs 150. Total input costs are (1000+500+100+50) = 1650. The company then adds value of PRs 100 and sells the cotton fiber to a textile manufacturer. Given the fragmented tax base, it will be very difficult for the cotton company to claim and collect tax credits on input tax on services (PRs 50) initially paid, and the sale price will carry over that segment of the tax. The sale price will therefore be: total input costs (1650) +value added (100)-input tax that will be credited after the sale, in this case on goods (100) = PRs 1650, instead of PRs 1600 in a fully harmonized GST system. At the sale stage the company will collect output tax of PRs 165 and remit it to the FBR but will only be refunded for the portion of the input tax. The net tax paid by the cotton ginning company will be 165–100=65, instead of 160–100–50=10 in a system of fully harmonized GST. In other words, the effective tax rate will be 65 percent (tax paid/value added), significantly diverging from the nominal tax rate of 10 percent.

In the next stage, the textile manufacturer, in addition to purchased cotton fiber for PRs 1650 (on which sales tax PRs 165), uses certain input services of PRs 800, and produces finished fabrics. Similar to the previous stage, the textile manufacturer pays input taxes of PRs 245 = PRs 165 (on goods) + PRs 80 (on services), adds value of PRs 200, and sells the fabrics to a garment factory for PR 2,730 = 2308+10 percent GST (230.8). If only input tax on goods will be recovered, the net tax paid by the textile manufacturer will be PRs 108, while in the case of fully harmonized GST the producer will pay only PRs 20. The production costs for the textile manufacturer are therefore PRs 40 higher compared to a fully harmonized tax base regime.

Production chain		Stage 1 Cotton Ginning		Stage 2 Textiles		Stage 3 Export	
		PAK 1/	Fully hamonized	PAK	Fully hamonized	PAK	Fully hamonized
Input costs	goods	1000	1000	1650	1600	2730	2600
	services	500	500	800	800	10	10
Input VAT (@10%)	goods	100	100	165	160	273	260
	services	50	50	80	80	1	1
Total input costs		**1650**	**1650**	**2695**	**2640**	**3014**	**2871**
Value Added		**100**	**100**	**200**	**200**	**10**	**10**
Output price		1650	1600	2730	2600	2751	2620
Output VAT (@10%; Exports @0%)		165	160	273	260	0	0
Total output price		**1815**	**1760**	**3003**	**2860**	**2751**	**2620**
Net VAT payable(+)/refund(-)		65	10	108	20		
Effective VAT rate (%)		**65.0**	**10.0**	**54.0**	**10.0**		

1/ Input credit only available for goods inputs.

Note: At the final stage, the garment factory produces a dress for export, and even though export is zero-rated, the exporter will have to charge higher price compared to the fully harmonized system. Not all taxation is removed from exports and additional costs are incurred in each segment of the production value chain, which disadvantages them at international market.

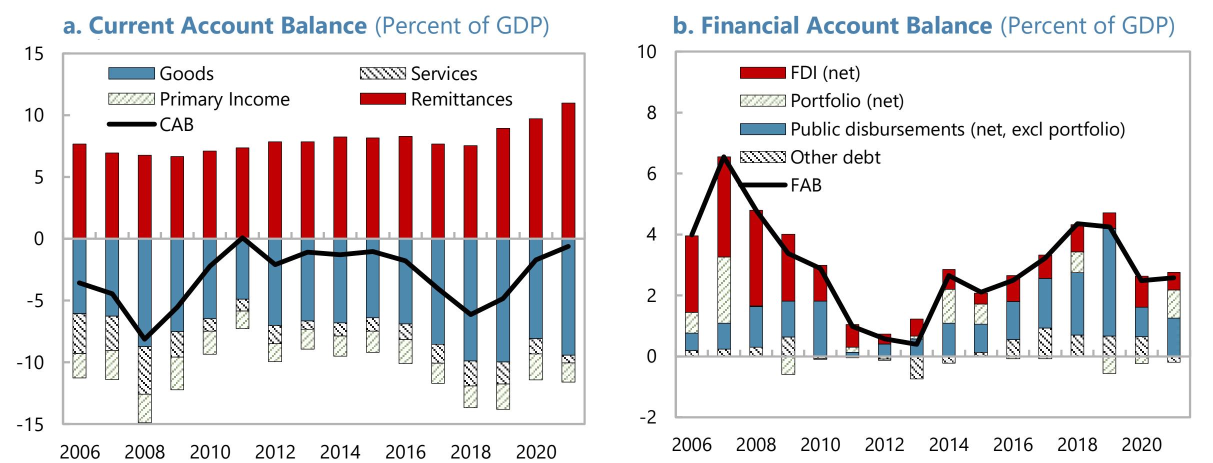
Note: Effective VAT rate is expressed as a percentage of value added at that stage of the production process.

Annex IV. External Sector Assessment

Pakistan's external position in FY 2021 is assessed to have been broadly in line with fundamentals and desirable policies. The current account improved in FY 2020 and FY 2021 on the back of a pick-up in remittances, which supported the buildup of reserves amid continued policy commitment to exchange rate flexibility. Nonetheless, going forward vulnerabilities remain as reserves are still below adequate levels, external financing needs are sizable, and the exchange rate could come under pressure as domestic demand picks up. Continued commitment to exchange rate flexibility and advancing structural reforms to improve export competitiveness will be essential for the continued buildup of reserves and ensuring external stability going forward.

1. The **current account** deficit, improved from a peak of 6.1 percent of GDP in FY 2018 to 0.6 percent of GDP in FY 2021 (July-June), helped by a surge in remittances in the aftermath of the pandemic and some moderation of the trade deficit over FY 2020 and FY 2021. However, the deficit has begun to widen in recent months with the pick-up in imports and domestic demand and is projected to reach about 4 percent of GDP in FY 2022. Remittances recorded a significant increase after the first COVID-19 wave, likely reflecting a multitude of factors including some formalization of transfer channels due to travel restrictions and helped by several digital transfer initiatives undertaken by the central bank. Nonetheless, the structure of the current account exhibits persistence over time, characterized by a large trade deficit (9½ percent of GDP in FY 2021) covered by remittances (9.8 percent of GDP).

Pakistan: Balance of Payments, FY 2006-21



Source: SBP and IMF staff calculations.

2. **The financial account balance** hovered around US$8–12 billion over FY 2019–21, helping to finance the current account balance and to accumulate reserves. However, the structure of the financial account shows reliance on debt creating flows rather than on FDI, with the latter remaining relatively limited over the last decade. After two negative years, net portfolio flows turned positive in FY 2021 on the back of government's recent Eurobond issuance. The net **International Investment**

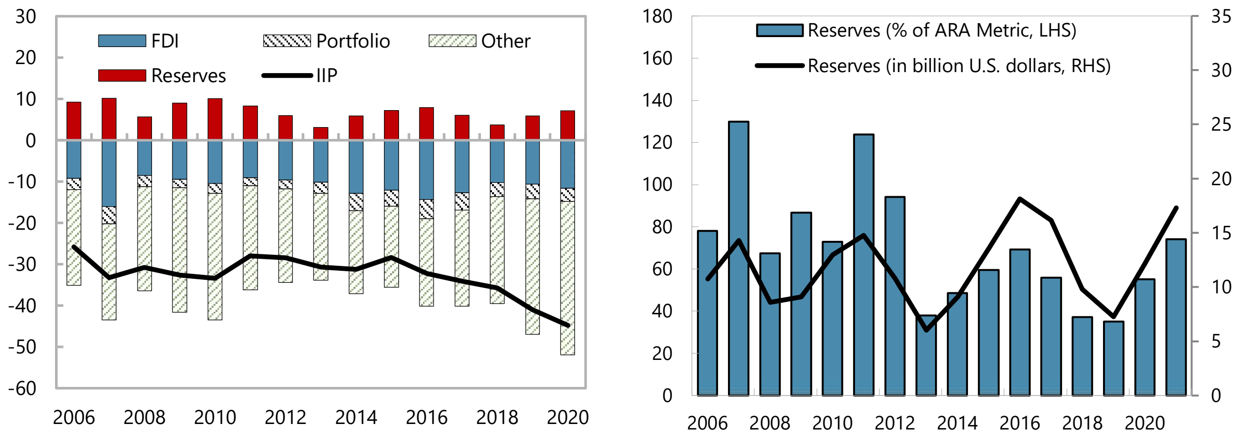
Position (IIP) has been slightly declining in recent years and is dominated by debt instruments on the liability side, reflecting the accumulation of debt creating flows.

3. Gross reserves have improved by about US$10 billion since the onset of the EFF-supported program and stood at $17.3 billion in June 2021 (3 months of import coverage, up from pre-program of 1.7 months). However, reserves remained below the adequacy level as suggested by the ARA metric (74 percent in June 2021).

Pakistan: Select Aspects of the External Sector

a. International Investment Position
(Percent of GDP)

b. Gross International Reserves



Source: SBP and IMF staff calculations.

4. The external position in FY 2021 is assessed to have been broadly in line with the levels implied by fundamentals and desirable policies. Standard EBA models applied to FY 2021 in the context of the cross-country EBA exercise, indicate a CA gap of 0.8 percent of GDP in FY 2021 based on the EBA Current Account (CA) model, within the range of {-1,1}, considered to be broadly in line with fundamentals and desired policies (Text Table). This indicates a modest real effective exchange rate (REER) undervaluation of about 7 percent for FY 2021. The REER-based EBA model and the External Stability (ES) model also suggest modest undervaluation of 4-6 percent.

Table 1. Pakistan: Results of External Balance Approach (EBA), FY 2021

	CA model	REER model	ES model 2/
CA-Actual	**-0.6**		**-0.6**
Cyclical contributions (from model)	0.1		
Additonal temporary/statistical factors 1/	0.7		
Adjusted CA (cyclical and other)	**-1.4**		
CA norm	**-2.2**		**-1.4**
CA GAP	**0.8**		**0.7**
Semi-elasticity of CA/GDP to REER	0.11		0.11
REER Gap (- is undervaluation)	**-7%**	**-4%**	**-6%**

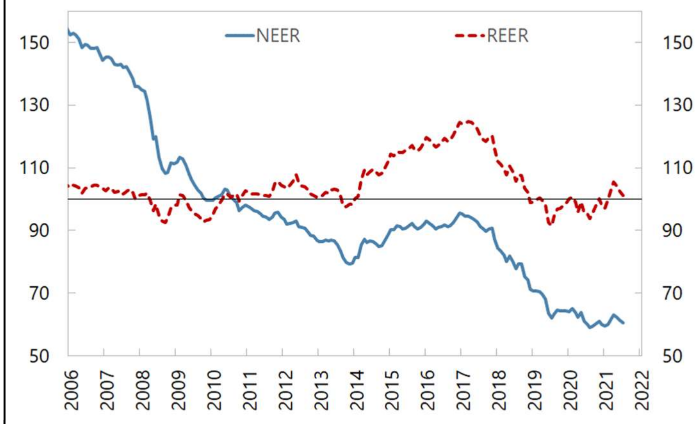
1/ Additional temporary adjustments reflect a staff estimated adjustor for remittances (-0.7). Negative indicates revising actual CA down.

2/ REER gap is based on CA gap with CA norm of –3.5 (the CA/GDP stabilizing NFA/GDP at 2020 level of -46 percent).

5. Considering the significant uncertainty from the pandemic including the positive impact of remittances on the observed FY 2021 deficit to be partly temporarily, this assessment, however, should be interpreted with caution and is subject to significant model uncertainty as well as uncertainties related to the temporary versus permanent impact of the pandemic. Since May 2021, with the widening of both the capital account and trade deficits, increase in commodity prices, recent exchange rate developments, and central bank interventions, the external position have somewhat weakened. Continued exchange rate flexibility, fiscal adjustment, and structural reforms to boost competitiveness would help the external position to converge to levels conducive to external stability and building buffers.

Pakistan: Nominal and Real Effective Exchange Rates

(Index, 2010=100)



Source: IMF staff calculations.

Annex V. Agenda for Technical Assistance

(IMF FYs 2019/20–2021/22)

	Receiving Agency 1/	Status 2/
Fiscal Affairs Department (FAD)		
• Medium-term tax policy, including e.g., on general sales tax (GST) harmonization, corporate income tax (CIT) simplification, and tax policy diagnostics	FBR/MOF	ongoing since FY 2019/20
• Public financial management, including cash management and treasury functions, fiscal risks, and PFM law	MOF	ongoing since FY 2019/20
• Revenue administration, including on tax administration diagnostics, compliance risk management, and reform of the inland revenue service	FBR	ongoing since FY 2019/20
• Sustainable development goals (SDG) costing	MOF	delivered FY 2019/20
Legal Department (LEG)		
• State-owned enterprise law	MOF	delivered FY 2020/21
• State-owned enterprise governance	MOF	delivered FY 2019/20
• Anti-money laundering and combating the financing of terrorism (AML/CFT), incl. e.g., on supervision and legislative drafting	SBP/MOF/MOI	ongoing since FY 2019/20
• Bank resolution framework (jointly with MCM)	SBP	partly delivered FY 2021/22, more upcoming
• Central bank law reform	SBP	delivered FY 2019/20
Monetary and Capital Markets Department (MCM)		
• Debt management	MOF	delivered FY 2019/20
• Banking resolution framework (jointly with LEG)	SBP	partly delivered FY 2021/22, more upcoming
• Cyber risks	SBP	delivered FY 2019/20
Statistics Department (STA)		
• National Accounts rebasing	PBS	planned for FY 2021/22

1/ Ministry of Finance (MOF), Ministry of Interior (MOI), Federal Board of Revenue (FBR), State Bank of Pakistan (SBP), and Pakistan Bureau of Statistics (PBS).
2/ Technical assistance may be delivered in multiple missions and/or continuously over a longer time period, including remotely.

Appendix I. Letter of Intent

Ms. Kristalina Georgieva Islamabad, December 17, 2021
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431
USA

Dear Ms. Georgieva:

1. Pakistan, like the rest of the world, continues to fight against the COVID-19 pandemic. We have weathered the fourth wave well and our vaccine rollout is accelerating. As of November 30, we had a positivity rate of around 1 percent, with new daily cases less than 400. We remain hopeful that we will be able to meet our objective of fully vaccinating 70 million people in CY 2021 as vaccination rollout has picked up and we have been administering 1 million doses per day since mid-August. As of end-November, we have fully vaccinated 51.1 million people, with an additional 30 million receiving a single dose.

2. The available data suggest that our economy is recovering strongly from the COVID-19 shock. Provisional growth estimated by Pakistan Bureau of Statistics shows the economy grew 3.9 percent in FY 2021, after the contraction experienced in FY 2020, while more recent high frequency indicators show this trend has continued. But at the same time there are emerging vulnerabilities, with the widening of the current account deficit and elevated inflation due to higher international commodity prices, stronger economic activity, and accelerating government spending.

3. To address these imbalances, we have taken a series of strong actions, including by raising our key policy rate cumulatively by 275 basis points since September to 9.75 percent as of mid-December 2021. We also revised the prudential regulations for consumer financing and imposed a 100 percent cash margin on some additional import items in an effort to moderate import and demand growth and raised the average cash reserve requirement (CRR) to 6 percent. On the fiscal front, the national assembly will adopt a supplementary finance bill (**prior action, PA**) for completion of the review), which the President will sign into law, to ensure that we can deliver a zero percent of GDP adjusted primary balance based on (i) adopting an appropriate GST reform and withdrawing the zero-rated GST on some domestic industries; (ii) ensuring that fuel excises will deliver the agreed revenues; and (iii) reversing the preferential tax treatments introduced in the FY 2022 budget. We have also lowered spending to more prudent levels, while being mindful to protect social spending. Moreover, for the first time we are laying before the National Assembly all guarantees expected to be issued in the remainder of FY 2022, which will be treated as a ceiling during this period. These actions are expected to strengthen the external position thereby reducing vulnerabilities and lay the foundation for more durable and robust growth going forward.

4. We have also reinvigorated our structural reform agenda, to support the EFF program and economic reforms more broadly. Importantly, amendments of the NEPRA Act were adopted by parliament in June 2021 and the corporate income tax reform was adopted alongside the FY 2022 budget, thereby making permanent the actions we took via temporary presidential ordinances in March 2021 due to the closure of the national assembly.

5. Finally, in addition to the supplementary finance bill, as **prior actions** for the review: (i) parliament will adopt amendments to the State Bank of Pakistan Act, which will be signed into law by the President; (ii) an ex-post audit of the procurement of COVID-19 related supplies and social payments during FY 2020 will be conducted by the Auditor General of Pakistan and published on the Ministry of Finance website (**end-April 2021 SB**); and (iii) we will publish key information of all COVID-related awarded procurement contracts on the Public Procurement Regulatory Authority (PPRA) website (https://www.ppra.org.pk/pcontract.asp) (**end-April 2021 SB**).

6. Despite the challenges, our quantitative program performance has been strong, with our actions ensuring that all but one end-June 2021 and three continuous performance criteria (PCs) were observed. This included the floor on net international reserves (NIR), net general government budgetary borrowing from the State Bank of Pakistan (SBP), net domestic assets (NDA) of the SBP, SBP's stock of net foreign currency swaps/forward position, and government guarantees. However, the ceiling on the general government primary budget deficit was missed. Furthermore, the extension of a 100 percent cash margin requirement on the import of certain goods to an additional 114 items in late-September resulted in the breach of the PCs on the non-imposition and non-intensification of exchange restrictions as well as on the non-imposition and non-modification of the Multiple Currency Practice (MCP). In November the SBP on-lent the SDR allocation to the federal government for budget financing of the vaccine drive breaching the PC on the zero new flow of SBP credit to the government. An additional two of six indicative targets (ITs) for end-June 2021 were missed: (i) the floor on targeted cash transfers spending (BISP) was missed for technical reasons because PRs 5 billion were spent by another program, the Poverty Alleviation Fund, and not counted towards the definition of this IT; and (ii) the floor on the gross issuance of PIBs, Sukuks, and Eurobonds due to reduced investor appetite for longer-term instruments, bottlenecks in the issuance of Sukuks, and the delayed Eurobond issuance.

7. Based on the strong steps that we have already taken and our commitments for the period ahead, we request a (i) waiver of applicability for the end-December 2021 QPCs and (ii) waivers of nonobservance for the missed continuous PCs on the non-imposition and non-intensification of exchange restrictions as well as on the non- imposition and non-modification of the MCP and the continuous PC on zero new flow of SBP credit to the government. Additionally, we request the rephasing of access and modification of the review schedule due to delays in completing the review as well as to better align them with our reform agenda. The program will continue to be monitored through quarterly reviews as well as quantitative and structural conditionality (through PAs, quantitative performance criteria, indicative targets, and SBs) as described in the attached memorandum of economic and financial policies (MEFP) and Technical Memorandum of Understanding (TMU).

8. Overall, as described in the attached MEFP we remain committed to the objectives of the economic program supported by the Fund's Extended Fund Facility, and the policies described in previous MEFPs. We believe that these policies are strong and a guarantee for the successful implementation of our program, although we remain committed to taking any additional measures that may be appropriate for this purpose. In view of this, we request the completion of the sixth review under the EFF, and a disbursement in the amount of SDR 750 million. We are committed to consult with the IMF on the adoption of any additional measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. We will supply the IMF with timely and accurate data that are needed for program monitoring. Reaffirming our commitment to our policy of transparency, we consent to the IMF's publication of this letter, the MEFP, the TMU, and the accompanying Executive Board documents.

Sincerely yours,

/s/
Shaukat Tarin
Advisor to the Prime Minister on Finance and Revenue

/s/
Dr. Reza Baqir
Governor of the State Bank of Pakistan

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

A. Recent Economic Developments and Outlook

1. **Pakistan's economy is showing signs of a robust recovery**, notwithstanding the significant impact COVID-19 had throughout FY 2021. Provisional estimates for FY 2021 indicate growth reached 3.9[1] percent, supported by large scale manufacturing (LSM), construction, and wholesale and retail trade. High frequency indicators (HFIs) pointed to an acceleration and business sentiment reached a record high since 2018. The COVID-19 fourth wave—which is quickly waning—seems to have had limited impact on overall economic activity. Inflation in FY 2021 reached 8.9 percent yoy, mainly on account of rising food and fuel prices, however core inflation has remained more subdued at 6.6 percent. The current account deficit improved sharply to 0.6 percent of GDP, posting the smallest deficit in the last ten years, supported by continued strong remittance inflows. This allowed us to achieve our highest level of gross reserves in more than 4.5 years.

2. **However, as our recovery picked up speed in Q4 FY 2021 there have been signs of imbalances, exacerbated by a sizeable swing in our terms of trade.** Strong growth momentum continued into Q1 FY 2022, while the current account deficit has experienced a substantial widening since June, fueled by an accommodative monetary-fiscal policy mix and rising international commodity prices. As of end-October 2021, imports have topped US$5 billion for five consecutive months, the exchange rate has steadily depreciated since May, and inflationary pressures from energy and food prices have remained.

3. **We expect our corrective measures as described in this memorandum to address the emerging challenges, reduce vulnerabilities, and lay the foundation for more sustainable growth going forward.** Reflecting recent developments and agreed upon policies, we see the following baseline macroeconomic scenario:

- ***Real GDP*** is expected to expand close to 5 percent in FY 2022 and will gradually rise to above 5 percent over the medium term on account of the gradual abatement of the COVID-19 pandemic, stronger investment, and improved market confidence supported by an appropriate macroeconomic policy mix.

- ***Annual headline CPI inflation*** is projected to average 9-11 percent in FY 2022 driven by the effects of supply constraints to some food items, higher international commodity prices, including oil, and moderate energy tariff increases. Over the medium-term inflation is expected to remain at the upper end of SBP's 5-7 percent inflation range.

- ***The current account deficit*** is expected to widen in FY 2022 to around 4 percent of GDP and settle at about 2 to 3 percent of GDP in the medium term as the terms of trade shock facing imports dissipates and the trade deficit moderates. However, reserve cover is expected to

[1] Based on provisional results published by the Pakistan Bureau of Statistics in May 2021.

strengthen, including on the back of the SDR allocation, and remain at about three months of imports. External financing will continue to rely mostly on official and multilateral creditors, but also on issuances of Eurobonds and international Shariah compliant Sukuks.

4. **Risks to the baseline remain high.** Successful and swift rollout of vaccines in Pakistan and global economic recovery are two upside risks, which could help bolster growth. Yet, increased demand along with higher-than-expected international commodity prices are widening the current account deficit, thereby increasing our external vulnerabilities. We recognize that delays in implementing structural reforms, particularly in the area of tax reform and the power sector, may compromise the durability of the fiscal adjustment, which in turn could hamper the reduction of public debt, and limit the economic recovery. The corrective measures being committed to, and structural changes since the start of the program (including a flexible exchange rate, fiscal consolidation of 2.2 percent of GDP despite COVID-19 during the first two years, and adherence to zero central bank financing of the budget), negate the risk of a boom-bust cycle. Lastly, geopolitical tensions, especially from Afghanistan, could cause economic/political disruptions, disorderly migration, as well as disrupting prices and the exchange rate and weakening growth prospects. They could also result in increased risk premia and tighten our external financing conditions.

B. Economic Program

Fiscal Policy

5. **The FY 2021 fiscal outturn marked the second consecutive year of fiscal consolidation.** The general government posted a primary deficit of 1.4 percent of GDP, marking a 0.4 percent of GDP improvement on top of the 1.8 percent of GDP improvement in FY 2020, although it missed the underlying program target by a small margin (0.1 percent of GDP) due to lower collection of non-tax revenue and higher spending late in the fiscal year.

6. **This strong performance was partially reversed in the first part of FY 2022**. During Q1, spending increased by 38 percent, mostly due to procurement of COVID-19 vaccines and subsidies. Although FBR tax revenue grew strongly by 38 percent yoy, driven mainly by import taxes which benefited from strong import growth, this was not enough to offset the higher spending, and the overall primary surplus was smaller than envisaged. Moreover, on the basis of underlying trends and policy measures, the deficit target for the end of FY 2022 was at risk to be exceeded by a wide margin, as our push for growth-friendly fiscal measures contributed to strong demand growth and are exacerbating external pressures.

7. **As part of our efforts to address these pressures, we will adopt a supplementary finance bill, which will be signed into law by the President, after national assembly approval, for FY 2022, aiming to balance supporting growth while remaining on the path of fiscal consolidation (PA).** The revised FY 2022 legislation aims for an underlying general government primary balance of 0 percent of GDP—excluding PRs 352 billion COVID-19 vaccine-related spending (see TMU) and payments related to the clearance of outstanding arrears to some IPPs. This amounts

to a moderate primary fiscal adjustment of 0.1 percent of GDP compared to the previous year and will support a reduction of public debt to about 82 percent of GDP by end-FY 2022. Notably, for the first time we are laying before the National Assembly all guarantees expected to be issued in FY 2022, which we will treat as a ceiling. Key elements of our revised legislation include:

- ***Revenue.*** Federal tax revenue is projected to grow by more than 25 percent, buttressed by durable fiscal reforms (detailed below) and tax administration efforts. It will also be supported by higher environmental taxation by ensuring the petroleum development levy (PDL) on gasoline and diesel is consistent with the new revenue target. As such, we will raise by PRs 8/liter the PDL (**PA**) and we commit to raise the PDL by PRs 4/liter per month for the remainder of FY 2022 until the maximum of PRs 30/liter is achieved. We also reaffirm our commitment to not granting further tax amnesties (**continuous SB**) and avoiding the practice of issuing new preferential tax treatments or exemptions (**continuous SB**).

    - *General sales tax (GST) reform.* The reform is estimated to yield 0.5 percent of GDP in FY 2022 (0.8 percent of GDP in annualized terms). Notably, it undoes numerous policy reversals that were included in the FY 2022 Finance Act and also: (i) eliminates most zero-rated goods (Fifth Schedule) and moves them to the standard sales tax rate; (ii) removes reduced rates under the Eighth Schedule and brings most of those goods to the standard sales tax rate; (iii) eliminates exemptions (Sixth Schedule) excluding a small subset of goods (i.e., basic food, medicines, live animals for human consumption, education and health-related goods) and brings all others to the standard rate; (iv) removes the Ninth Schedule to replace a specific tax rate for cell phones with the standard rate, which are imported in completely built unit (CBU) condition having a price of US$200 or more; and (v) raises the point of sale (POS) GST to the standard rate. Low-income households are protected from most of the impact of the reform as several key items will remain tax exempt, notably: (i) essential food products; (ii) sales by informal markets and small retailers; and (iii) food consumption from home production. In all, about 60 percent of tax expenditures were removed. However, we require additional time to design a more equitable subsidy scheme to replace tax expenditures on fertilizers, pesticides, and tractors—currently accounting for 23 percent of total tax expenditures—which we will implement in the FY 2023 budget after deliberations in the Fertilizer Commission constituted by the Government. Lastly, the process of harmonizing the service sales tax across provincial jurisdictions, with support from the World Bank, was launched in September 2021 with a decision to create common definitions for goods and services between the provinces and FBR as a first step towards reducing the current fragmentation in the sales tax system and broadening the tax base.

    - *Personal income tax (PIT) reform.* We are committed to reforming our PIT to change the existing tax rate structure by reducing the number of rates and income tax brackets (slabs) to simplify the PIT system and increase progressivity. It will also reduce tax expenditures and allowances. To support the reform, we will prepare the draft legislation by end-February 2022 (**new end-February 2022 SB**) to ensure that it will be ready to come into effect on July 1, 2022 with the FY 2023 budget. These PIT reforms will yield an estimated 0.3 percent of

GDP in revenue gains in FY 2024. Low-income households will be protected as the reform preserves the current PIT threshold (almost 3 times income per capita).

- ***Expenditure.*** To support the recovery and protect the most vulnerable, we have budgeted PRs 250 billion for social spending under the BISP program (up 26 percent from the FY 2021 budget), and PRs 2,014 billion for health and education spending (18 percent increase from the FY 2021 budget). To address Pakistan's sizable development needs, federal PSDP spending (excluding development grants to provinces) is budgeted at PRs 554 billion, an increase of about 25 percent. We will also support other important sectors, including through the newly launched Kamyab Pakistan Program (KPP), which is being rolled out to support farmers, small businesses, and low- and middle-income homebuyers with a 50 percent government guarantee (pari passu) and a food subsidy program for low-income households. After 1 year of frozen nominal wages, we raised wages and pensions by 10 percent for all civil servants and provided an additional 25 percent increase to lower paid staff in order to reduce the existing allowance disparities.

- ***Agreement with provinces*.** As was done in the context of the FY 2020 and FY 2021 budgets, we have signed new formal written agreements with the provinces on the fiscal strategy and the required provincial fiscal efforts, including revised revenue and fiscal surplus targets by province for FY 2022 and implications in case of missed targets. We have made these agreements public to ensure accountability and measure progress and performance.

8. To underpin the fiscal consolidation, limit risks, and strengthen institutions, we are pursuing the following broad-based fiscal structural reforms:

- ***Public financial management (PFM) reforms.*** We formally established and made the treasury single account (TSA-1) functional in September 2021 (**end-May 2021 SB**). We have also taken steps to implement TSA-2, including the development of the design and implementation plan, the process of approval, and promulgation of TSA-2 Treasury rules. We expect the make the TSA-2 operational in June 2022. To realize the benefits of the TSA and allow for more efficient debt and cash management, we are also making progress in cash management and forecasting. In this respect, we created the Treasury and Cash Management Unit and the Cash Forecasting Unit, and we will develop monthly and quarterly cash forecasts starting from January 2022. Finally, as part of our on-going efforts to strengthen budget execution and expenditure controls, we are developing guidelines related to annual and multi-annual commitments control system, which we anticipate coming into effect in end-March 2022.

- ***Tax administration*.** We are committed to improving tax administration in order to raise the efficiency of revenue collection. Our priorities are: (i) developing an overarching compliance strategy and setting up a Central Risk Management Unit and a Compliance Risk Management Committee at the central level; (ii) systematic identification and assessment of compliance risks; (iii) adopting a more project-based approach to addressing specific high-risk areas in tax compliance; and (iv) strengthening data collection and analysis. We also recognize the need for (i) simplifying tax filing and expanding e-services for taxpayers; (ii) accelerating the resolution of refunds and administrative appeals; and (iii) strengthening the large taxpayer office. In March

2021 we launched a *Collectible Tax Debt Campaign* to redress the high percentage of outstanding debt. We also reintroduced and rolled out the track-and-trace system for tobacco products in one company in October 2021 (**end-June 2021 SB**). Going forward, the track and trace system is likely to cover the full tobacco as well as cement, sugar, and fertilizer sectors. However, given technical capacity issues, we cannot commit to finalizing a full rollout of the track-and-trace system to all companies within the program period and therefore request to drop this SB. To support GST harmonization, we will establish the single filing portal by December 2021, which will remove filing with five different tax administrations and simplify with a single tax base, which would improve the ease of doing business and enhance the trust of taxpayers.

9. We continue to aspire to achieving the highest levels of quality and transparency in all COVID-related spending programs in line with international best practices. The enacted emergency measures will remain targeted and temporary and will not result in permanent distortions of the overall fiscal envelope. To help safeguard the quality of emergency spending in the health sector through the transparency of COVID-related spending (by the executing agencies), we are publishing key information of all COVID-related awarded procurement contracts on the Public Procurement Regulatory Authority (PPRA) website (https://www.ppra.org.pk/pcontract.asp) (**end-April 2021 SB, PA for completion of the review**). To further deepen transparency reforms, the PPRA and SECP will enter into an agreement enabling PPRA direct and full access to beneficial ownership information of companies bidding for public contracts. The PPRA will issue regulations to require collection for publication of beneficial ownership information from companies which are awarded public procurement contracts for PRs 50 million and above (**new end-March 2022 SB**). With support from the World Bank, we will also pilot by end-June 2022 an e-procurement system that would support transparency and accountability of procurement contracts and link with beneficial ownership, tax and national ID registries. The Auditor General of Pakistan (AGP) also completed an ex-post audit of the procurement of COVID-related supplies and social payments made during FY 2020, which identifies shortcomings and proposed recommendations for improvement. The report was submitted to the national assembly in September 2021 for review and published in full on November 19, 2021 on the website of the AGP and Ministry of Finance (MoF) (**end-April 2021 SB, PA for completion of the review**).[2] The audit of all COVID-related spending and social payments for FY 2021 is underway, and the AGP is expected to complete the audit report by end-April 2022 with submission to the national assembly by end-July 2022.

10. Notwithstanding progress achieved over the past year, public debt remains high and a key source of vulnerability, and together with our fiscal consolidation efforts, we will continue to take actions to strengthen debt sustainability. Despite the unprecedented COVID-19 shock and supported by uninterrupted fiscal consolidation, our debt—excluding government guarantees—fell to 83.5 percent of GDP at end-FY 2021, down more than 4 percentage points compared to FY 2020, on the back of the nominal appreciation of the PRs/US$ during the year and a

[2] https://www.agp.gov.pk/SiteImage/Policy/53.%20Covid-19%20Audit%20Report%2008.06.2021.pdf

strong economic recovery. Nonetheless, public debt remains high and to address debt vulnerabilities, are efforts include:

a. ***Securing debt relief under the DSSI*** through which we will reduce Pakistan's external debt service through December 2021 by an estimated US$3.8 billion (1.2 percent of FY 2022 GDP) over and above the assurances currently in place under the EFF.

b. ***Lengthening the maturity profile of domestic debt.*** Since FY 2019 and until recently, our domestic borrowing strategy has been tilted towards issuing medium- and long-term debt instruments, thereby reducing our reliance on short-term debt issuance. However, with unexpected obstacles to the reintroduction of Shariah compliant Sukuks, early discontinuation of prize bonds, and increased financing requirements to build up our cash buffer, we resorted in H2 of FY 2021—notably from March through May—to a strong reliance on T-bills, reversing our efforts made prior to CY 2021. This trend has been partially reversed in the first few months of FY 2022 as we are committed to implementing our medium-term debt strategy. We are also exploring options to partially use the newly allocated SDR to reduce the reliance on short-term instruments.

c. ***Updating and implementing our Medium-Term Debt Strategy (MTDS)*****,** which among other things explicitly targets a Gross Financing Needs (GFN) figure lower than 24 percent of GDP by FY 2023, down from around 29.2 percent of GDP in FY 2020. To effectively implement this strategy, a number of steps have been taken including the: (i) reintroduction of 15-, 20-, and 30-year fixed rate Pakistan Investment Bonds (PIBs); (ii) reintroduction of Shariah Compliant Sukuks of longer tenors (5-years); (iii) introduction of new long-term instruments (including 3- and 5-year floating rate PIBs); (iv) imposition of a ban on institutional investments in National Savings Schemes with effect from July 1, 2020 in order to enhance institutional participation in competitive primary and secondary markets of long-term debt; (v) discontinuation of the sale of some prize bonds to improve the transparency of our investor base; (vi) the expansion of Naya Pakistan Certificates that tap into Pakistani emigrants abroad; and (vii) the successful issuance of US$2.5 billion worth of Eurobonds in April 2021 and reopening US$1 billion in July 2021 through a multi-tenor transaction of 5-, 10- and 30-years. Going forward, we intend to explore further financing instruments such as (i) green Sukuks to overseas investors to take advantage of the strong global demand for ESG bonds; (ii) gender bonds earmarked to promoting gender equality and women empowerment; (iii) Panda bonds to tap into the Chinese market through Renminbi-denominated instruments, and (iv) the resumption of international Shariah-compliant Sukuks. To further help support the implementation of the MTDS and the lengthening of the maturity profile of debt, we are committed to the floor on the cumulative gross issuance of PIBs, Sukuks, and Eurobonds (**Indicative Target**).

d. ***Establishing a debt management office (DMO)*** to strengthen our debt management strategy. In line with World Bank and IMF recommendations, we have established the proper rules of business, describing the activities and organization of the DMO, as we are in the process of amending the Fiscal Responsibility and Debt Limitation Act (2005). The Draft Bill for requisite amendments was submitted to the National Assembly in June 2021 and was subsequently referred to the Standing Committee of the National Assembly. In the interim, the Finance Division has assigned additional functions to the existing Debt Policy and Coordination Office and we approved an organogram which has allowed us to initiate the hiring of additional staff commensurate with the responsibilities. We are currently in the process of setting up the front office/middle office/back office of the new DMO (to be completed by end-November 2022) and we are committed to hiring part of the staff by end-November 2021. Migration of relevant functions to DMO from other parts of government agencies will be completed by end-March 2022. Moreover, we are enhancing cooperation with other government units, the Economic Affairs Division in particular, to ensure accurate compilation and reporting of debt-related statistics, through the Working Group we established in February 2021.

Poverty Reduction and Social Protection

11. We are proud of our Ehsaas Emergency Cash (EEC) program, which was recognized by the World Bank in May 2021 as being in the top 4 globally for the number of people covered (almost 101 million by end-FY 2021). Launched in April 2020 as a swift response to the first COVID-19 wave, our one-time cash assistance disbursed PRs 40.6 billion in FY 2021 in two rounds, covering about 47 percent of our population.[3] Amid a third COVID-19 wave over the summer 2021, we decided to extend the second round of our emergency support to our vulnerable population through the early months of FY 2022.

12. We remain committed to expanding social safety nets and reducing poverty. The COVID-19 pandemic has laid bare the disparities facing our vulnerable population, which we need to address to foster inclusive growth and ensure that our country becomes more resilient to future shocks. To this end we are advancing efforts to strengthen our social support, including:

a. ***Using the National Socio-Economic Registry (NSER) to ensure adequate targeting*.** We formally announced the finalization of our NSER update in October 2021 (**end-June 2021 SB**), covering approximately 33 million households through a combined door-to-door survey and desk-based self-registration mechanism. Alongside, we have already—based on an initial PMT increase—started to add newly eligible BISP beneficiaries to the program in Q3 FY 2021, began to exit undeserving BISP beneficiaries from the program in Q1 FY 2022, and established live registry points in all regions to give people an opportunity to re-declare their status in case of a shock (including, for instance, to personal circumstances or from a regional climate disaster).

b. ***Strengthening BISP spending.*** During FY 2021, we increased enrollment in our regular BISP cash benefit program by 16 percent to 6.1 million families. Regrettably, we still missed the end-June 2021 IT on BISP cash transfers by a small margin despite of having fully executed

[3] EEC beneficiary households are those that just fall above the eligibility threshold of our proxy means-tested (PMT) regular cash transfer program. The one-off cash transfer amounts to PRs 12,000.

our revised budget allocation (PRs 194.3 billion).[4] In FY 2022 we allocated PRs 250 billion to BISP, marking a 50 percent increase over the FY 2021 budget allocation (excluding COVID-related EEC spending). These additional resources will allow us to expand both (i) the monthly benefit level (by 8 percent from January 2022); and (ii) the coverage of the regular cash transfer program to at least 8 million families (by end-FY 2022) that were found to be deserving in line with household information captured in the updated NSER.[5] Assisted by the World Bank, we also adopted a mechanism for periodic inflation updates of all BISP cash transfers.[6] Going forward, we will also use the updated NSER to ensure, with the support of international partners, a well-targeted expansion of the BISP beneficiary base and design of new programs.

c. ***Fostering financial inclusion and development.*** In October 2021 we launched the KPP—our flagship initiative which is designed to transform the lives of the marginalized segments of the society and ensure their financial empowerment—to promote SME, agriculture, and low-cost housing financing. Initially the program will be piloted in Balochistan, Khyber Pakhtunkhwa, Gilgit Baltistan, Azad Jammu and Kashmir, and the poorest districts of Sindh and Punjab and it will be extended to the whole of Pakistan after evaluating its successes. We aim to reach 3.7 million households within the first 5 years of the program. We are including the subsidy interest rate component as part of spending and recording the guarantees in our debt statistics.

d. ***Launching a new food subsidy program.*** In November 2021 we unveiled a new subsidy program in order to provide relief to low-income households facing rising food costs during the remainder of FY 2022. The program aims to cover 20 million households across Pakistan by providing PRs 1000 per family per month to cover three food products that account for about 25 percent of food spending by low-income households. Families will be able to access these products through our network of Utility Stores Corporation and Kiryana stores. We estimate the cost of the program to reach PRs 120 billion during FY 2022, which will be shared between the Federal government and provinces.

Monetary and Exchange Policies

13. Our efforts remain centered on entrenching monetary and financial stability by maintaining a market-determined exchange rate, lowering inflation, and building foreign exchange reserves. External conditions worsened in early FY 2022, on the back of a widening trade deficit and higher uncertainty. The strong demand for FX put pressure on the exchange rate, which depreciated by more than 14 percent between May and December 14, 2021, notwithstanding FX

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[4] We revised downward the FY 2021 budget allocation by PRs 5 billion in Spring 2021 to reflect the Economic Coordination Committee's (ECC) decision to reallocate the poverty graduation program from BISP to the Pakistan Poverty Alleviation and Social Safety Fund (PASS).

[5] This includes 4.2 million re-confirmed households, 3.8 million newly eligible households, and 1.9 million exiting households.

[6] To be proposed for cabinet approval by an expert committee within a period of three years from the last update.

sales to prevent disorderly market conditions. At the same time, inflation remained elevated at around 9 percent, reflecting the strong recovery in domestic demand, coupled with higher international commodity prices. To ensure that inflation expectations remain anchored, the SBP raised its key policy rate by 275 basis points since September 2021 to reach 9.75 percent as of mid-December 2021. While the recalibration of the fiscal-monetary policy mix, if effectively implemented, will help ease the external pressures, our actions ahead include:

a. ***Continued commitment to a market-determined exchange rate and bolstering external stability.*** The exchange rate has served as an essential buffer protecting economic activity during this period of heightened uncertainty. In this context, we remain committed to the market determined exchange rate while supporting the smooth function of the market. SBP's interventions will remain guided by market conditions and the objective of rebuilding reserve buffers. Forex sales will be limited to preventing disorderly market conditions (DMCs), while not suppressing an underlying trend.

b. ***Appropriate monetary policy stance*.** Since September 2021, the monetary policy stance has pivoted towards a tapering of the significant monetary stimulus that was provided in the aftermath of the COVID-19 shock. As a result, interest rates have moved close to being mildly positive in real terms on a forward-looking basis. Monetary policy decisions will continue to be guided by the primary goal of safeguarding price stability to ensure the program monetary targets are met and guide inflation to our medium-term objective of 5-7 percent. Consistent with this, in mid-November we raised the average cash reserve requirement (CRR) to 6 percent, with the daily minimum CRR rising to 4 percent. We will continue to provide forward guidance in our monetary policy statement, which was introduced in January 2021, as an important step towards strengthening our communication and monetary policy transmission. We will also continue to publish a 6-month ahead calendar of MPC meetings to give more predictability and transparency to the market and in November 2021 announced a move to 8 meetings per year to enhance the predictability of monetary policy actions.

14. Our temporary support to the housing and construction sector continues. In addition to mandatory targets on banks' lending to this sector, in June 2021 we amended the capital adequacy regulations to lower the applicable risk weight to 100 percent (from 200 percent previously) on bank and development finance institution investments in real estate investment trusts. As of end-September 2021 lending to the construction and housing sector reached PRs 305 billion, or 4.3 percent of private sector credit against the end-December 2021 requirement of 5 percent of banks' domestic private sector lending. Banks have received applications worth more than PRs 185 billion as of end-September 2021 under the government's housing financing scheme, of which PRs 72 billion has already been approved.

15. We have ended the temporary refinancing schemes introduced as part of the emergency COVID-response. As of end-September 2021, the outstanding amount for all facilities was PRs 1,225 billion, of which PRs 322 billion were related to our temporary COVID schemes. In August 2021 we introduced a new refinancing scheme for lending to SMEs without collateral, with a

40-60 percent first loss guarantee provided by the government. While in October 2021 we eased the conditions for renewable energy solution providers under the Refinance Scheme for Renewable Energy. We will undertake a study to assess the Export Refinancing Scheme (EFS) by end-February 2022 and take needed actions to improve its effectiveness. To support the eventual phasing out of the refinance facilities, the Ministry of Finance and SBP jointly will design a plan, in consultation with other stakeholders, by end-April 2022, to establish an appropriate Development Finance Institution (**new end-April 2022 SB**) so that in the future a plan to transfer the refinancing schemes to the government can be developed.

16. We are making good progress toward strengthening the SBP's autonomy, governance, and mandate. In March 2021 we submitted amendments to the SBP Act to parliament. The amendments aim to: (i) establish domestic price stability as the primary objective, with financial stability and growth as secondary objectives; (ii) clearly define the SBP's functions to help achieve these objectives; (iii) strengthen the SBP's financial autonomy, including through statutory mechanisms for sufficient recapitalization and profit retention; (iv) prohibit the extension of direct credits or guarantees to the general government; (v) establish the statutory underpinnings for audits; (vi) secure stronger protection of the personal autonomy of senior officials; (vii) further strengthen collegial decision making at the executive management level; (viii) provide stronger oversight by the Board; and (ix) improve SBP's accountability regarding the conduct of its monetary policy and the achievement of its objectives. As a **prior action** for the review, amendments to the Act will be adopted by the parliament and signed into law by the President. Additionally, we will complete the main outstanding recommendations related to the 2019 safeguards assessment by filling the vacant non-executive director positions on the SBP Board and name additional members to the audit committee by end-January 2022.

17. We continue to closely monitor the health of the financial sector to safeguard its resilience. Regulatory forbearance and relaxation of lending standards introduced as part of the COVID-19 response ended in March 2021 and we have returned to the preexisting loan classification, provisioning rules, and pre-COVID-19 lending standards. Banks remain well capitalized and profitable, with non-provisioned NPLs remaining low at 1.1 percent as of end-June 2021. Since July 2019 we have successfully resolved three banks, however, an additional two non-systemic private sector banks and one public sector banks remain undercapitalized. We have taken several steps as supervisors, including restrictions on fresh lending, capital expenditures, and bonuses to senior management of the private sector banks. In addition, the Board of Directors at one bank has been replaced and both private banks have new CEOs. One private bank accepted the offer from investors for recapitalization in October 2021, but the recapitalization of another private bank is still under discussion. We remain closely engaged with these banks and are committed to ensuring compliance with the minimum capital requirements. To this end, by end-May 2022 the two private sector banks will complete the first stage recapitalization (**new end-May 2022 SB**).[7] We will identify any further capital requirements by end-September 2022 and require the new owners to submit

[7]The first stage recapitalization requires the completion of capital injections, with documentation submitted to, and accepted by, SBP, to fill 50 percent of the capital shortfall calculated as of September 30, 2021, which will result in the banks achieving positive capital.

updated plans by end-December 2022 to achieve the minimum capital requirements. The public sector bank is undergoing a privatization process that is expected to be completed by end-January 2022. However, in case the privatization is not successful, we will consider other resolution options, including liquidation. We completed our self-assessment of the key attributes of an effective resolution regime in May 2021 and assess ourselves to have various gaps, including in the area of recovery and resolution planning. IMF technical assistance is helping us to strengthen our bank resolution and crisis management frameworks, including the deposit insurance scheme's role. We will submit a draft law addressing these gaps to the Federal Government by end-January 2022, with the aim of parliamentary adoption before the end of the program.

18. We remain committed to the full completion of the AML/CFT Action Plans. To this end, we have engaged several capacity development providers, including the IMF, and we have made significant progress towards completion of the 2018 Action Plan. Satisfactory progress has been made across 26 of the 27 action items, with the pending action item related to terrorist financing investigations and prosecutions of senior leaders of UN-designated terrorist groups (Immediate Outcome 9). Given the continuing efforts to enhance capacity and the ongoing challenges presented by the COVID-19 pandemic, we will continue to work on demonstrating substantial effectiveness in the last remaining item of the 2018 Action Plan (**end-June 2021 SB, reset to end-March 2022**). In parallel, we continue to advance in addressing the strategic deficiencies identified by the 2019 Mutual Evaluation Report of the Asia Pacific Group on Money Laundering (APG). We established a Secretariat to centralize and coordinate efforts across agencies to strengthen the AML/CFT regime. We are on track to meet the timelines for the implementation of our 2021 Action Plan, including on the mutual legal assistance framework, AML/CFT supervision, transparency of beneficial ownership information, and compliance with targeted financial sanctions for proliferation financing. In line with our commitments, we are targeting full completion of the 2021 Action Plan by end-January 2023. With respect to the tax amnesty program for the construction sector, the SBP will conduct by end-June 2022 a thematic inspection of banks' compliance with AML/CFT obligations (such as customer due diligence, recordkeeping, and suspicious transaction reporting) on funds received under the program through the designated bank accounts (including random sampling of beneficiaries). By end-September 2022, the key findings and recommendations of the thematic inspection will be shared with the banking sector through the compliance forum and relevant competent authorities through the General Committee under AML Act, and appropriate enforcement actions will be undertaken including changes in regulatory framework, as appropriate.

19. We remain committed to remove exchange restrictions, MCPs, and administrative measures. However, to support our balance of payments and reduce foreign currency outflows we took the following action:

- To discourage the import of some items, in late-September 2021 we extended a 100 percent cash margin requirement on imports to an additional 114 items.[8]

[8] https://www.sbp.org.pk/bprd/2021/CL30.htm

We are aware that this constitutes an intensification of the exchange restriction for balance of payment (BOP) measures but intend to eliminate them when BOP conditions allow within the next 12 months and therefore request approval for all existing measures subject to Article VIII listing such measures.

Energy Sector Policies

20. Notwithstanding efforts in recent years, the financial conditions in the energy sector remain difficult, with arrears accumulating, and the implicit cost to the budget and the economy remaining unsustainably high. The more limited progress than envisaged was partly the result of measures that we had to take in response to the COVID-19 crisis. However, we remain committed to continuing to restructure the power sector, with the objective of ensuring its financial viability and containing additional fiscal costs. Some of the actions we have taken since January 2021 are already having a positive impact:

- ***Circular debt flow.*** Although we accumulated PRs 297 billion in new power payment arrears through FY 2021, this was PRs 57 billion better relative to the updated circular debt management plan (CDMP) that we adopted in March 2021. This mainly is due to a later-than expected coming-on-stream of new generation capacity, stronger-than-expected power demand, and rupee appreciation.

- ***Annual tariff rebasing.*** We implemented the completion of the FY 2021 annual rebasing (AR) by November 5, 2021 (**June 1, 2021 SB**). We estimate that this delay implies lost revenue of about PRs 60 billion, which has not jeopardized our CDMP targets given the CD flow overperformance in FY 2021.

- ***CPPA-G payables.*** In line with renegotiated purchasing power agreements (PPAs) signed in March 2021, we reduced our CPPA-G payables to independent power producers (IPPs) on June 4, 2021 through a first payment of PRs 89.9 billion with one-third in cash and the remainder in debt instruments (**end-May 2021 SB**).[9] This covered 20 IPPs whose tariffs were immediately downward adjusted to reflect the renegotiated PPA terms. We will use a similar contract structure to settle another PRs 311 billion in FY 2022 to continue to reduce our CPPA-G payables. Any additional and future reduction will depend on adequate budget space and implementation progress of the CDMP.

- ***NEPRA Act amendments and quarterly tariff adjustments.*** Parliament adopted key amendments to the NEPRA Act in August 2021, thereby making permanent what had been temporary enacted through presidential ordinance in March 2021. Most importantly, this establishes two crucial powers: (i) the regulator's power to determine and notify quarterly tariff adjustments (QTAs) for capacity payments; and (ii) the government's power to levy surcharges over and above the system's revenue requirements under the NEPRA Act. On this basis, NEPRA implemented the first two QTAs falling under this new regulation for (PRs 0.90 and -0.07 per

[9] The debt instruments were 10-year floating-rate PIBs and 5-year sukuks (in equal parts).

kwh for Q1 and Q2 FY 2021, respectively) in October 2021, together with the last QTA under the old regulation (PRs 0.83 per kwh for Q4 FY 2020 (**end-September 2021 SB**)). We recognize that the regular implementation of tariff adjustments in line with the established formulas for the QTAs and monthly fuel price adjustments (FPAs) is critical for the credibility of our revised CDMP. Against this backdrop, we expect NEPRA to notify the next QTA (covering Q1 in FY 2021) in December 2021.

- ***DISCO governance and efficiency.*** To facilitate the process of appointing board members and CEOs in all DISCOs under competitive and transparent procedures, we have given HR mandates back to the independent boards. This is an important step towards improving the governance and efficiency of the DISCOs. Moreover, we are exploring options for their phased privatization.

21. However, given the continuing challenges in the sector, some of our commitments require recalibration.

- ***Annual tariff rebasing.*** We are on track to implement the FY 2022 AR by February 2022, for which we will ensure DISCOs' submission of their petitions by mid-November 2021.

- ***Subsidy reform.*** In March 2021, our government adopted a comprehensive 3-phased energy subsidy reform plan spanning 2021-24, which however did not yet underpin a better targeting of energy subsidies in the FY 2022 budget adopted in June (**end-June 2021 SB**). Following NEPRA's approval in late-September 2021, we have completed the first reform phase with the implementation of: (i) a more stringent eligibility criterion for protected consumer slabs (based on households' maximum usage from the previous 6-months consumption rather than the average over the previous 12 months); (ii) a lower threshold for protected consumer slabs (of 200 rather than 300 units per month);[10] (iii) a breakdown of the unprotected 301-700 units slabs (into smaller slabs of 100 each); and (iv) an expansion of the definition of lifeline consumers (to also include residential consumers with consumption of 50-100 units per month). However, we need additional time for the second reform phase that seeks to reduce total net subsidies through a reduction in cross-subsidies and increase in the progressivity of the tariff structure, which was previously envisaged for the FY 2022 budget. This will allow us to fully analyze the involved poverty impacts and finalize cabinet approval by end-January 2022 (**new end-January 2022 SB**) to: (i) remove the previous slab benefit (incremental block tariff); and (ii) increase the effective tariff of the unprotected slabs by at least PRs 0.5 per kwh. The remaining reform agenda over the coming years foresees further steps to improve targeting (including to households and the agricultural sector), while protecting the most vulnerable (including through the Ehsaas program).

22. We remain committed to taking action to address both the stock and flow of the sector's arrears:

[10] This covers 46 percent of domestic users, down from 93 percent.

- ***Measures to address the cost side.*** We aim to replicate the success in renegotiating PPAs (¶20) with other groups of power producers,[11] including those owned by the government to achieve a notable reduction in capacity payments. We expect to follow a similar approach by first signing a MoU and then converting them into binding contractual agreements.

- ***Stock of arrears.*** The stock of power sector arrears held by the Power Holding Private Limited (PHPL) stood at PRs 93 billion (about 1.9 percent of GDP) at end-June 2021, down PRs 77 billion since end-June 2020. This mainly reflects the conversion of PRs 72.6 billion in maturing PHPL debt into public debt.

23. We are also committed to undertaking reforms in the gas sector. Based on an ongoing assessment of available data from OGRA and the two gas sector companies (Suis), we currently estimate the circular debt stock[12] in the gas sector to have increased to about PRs 654 billion at end-June 2021 (with PRs 554 billion in system gas arrears and about PRs 100 billion in RLNG arrears). Recognizing this development, we are taking measures to improve the sector's performance:

- ***Updating tariffs.*** Based on the receipt of OGRA's determination of the annual Estimated Revenue Requirement (ERR) for FY 2022 since September 2021,[13] we are now in the process of revising consumer gas prices so that the flow of circular debt and its addition to the existing stock is restricted and/or minimized. This will be the first gas price adjustment since September 2020, as previous determinations were not implemented in view of the COVID-19 shock and high inflation.

- ***Amending the OGRA Act.*** Parliament will adopt amendments to the OGRA Act before end-June 2022 (**end-June 2021 SB, reset to end-June 2022**). This will support timely notification of OGRA determinations in the future.

- ***Reducing unaccounted for gas losses (UFG).*** We published our second UFG monitoring report covering FY 2021 in November 2021, which covers the: (i) progress against benchmarks; (ii) impact of initiatives and measures; and (iii) assessment of contingency measures to address weaknesses. Accordingly, both Sui companies over-performed relative to their annual UFG reduction targets during FY 2021,[14] thus making tangible progress toward the benchmark allowed by OGRA of 7.5 percent. To make further headway in improving their profitability in terms of reducing disallowances in revenue requirements, the Sui companies are taking further

[11] We are already in negotiations with 15 IPPs under the 2006 renewable energy power policy (wind, bagasse) that involve international lenders (PRs 34 billion).

[12] Defined as the accumulated shortfall in revenue from a failure to cover costs due to the 2 SUI companies charging the 'sale price' set by the government rather than the 'prescribed price' by OGRA.

[13] The ERR is demonstrative of the moratorium we have adopted on curtailing further expansion of pipeline network and consolidating the existing system to provide gas to industrial users as a priority.

[14] SSGCL and SNGPL achieved a UFG reduction of 13,087 MMCF and 14,019 MMCF against their respective targets of 10,462 MMCF and 5,700 MMCF.

steps to reduce their UFG, by system revamping,[15] mainly by replacing the under- and over-ground leaking transmission network and curtailing the gas pilferage by consumers through illegal taps and increased vigilance.

Structural Policies

24. **We continue to implement several comprehensive structural reforms in an effort to attract investment and support growth and job creation.** We will continue to focus on policies that: (i) reform state-owned enterprises (SOEs); (ii) improve the overall business environment; and (iii) enhance governance.

25. **We are committed to improving SOEs' governance, transparency, and efficiency as well as limiting their fiscal risks.** Specific actions include:

- ***Advancing privatization and SOE support.*** We are advancing our plans to privatize two RLNG power plants and expect to complete the process by end-June 2022, with proceeds to be channeled to debt reduction and poverty programs. To advance the privatization of two small public banks we will: (i) constitute the board of one bank by end-December 2021 and aim to complete the privatization process by end-June 2022; and (ii) complete the 2018-2020 outstanding annual audits of the other bank by end-June 2022 and the 2021 annual audit by end-August 2022, with the aim to complete the privatization process by end-December 2022. In September 2021, the ECC approved a bailout for Pakistan International Airways (PIA) amounting to PRs 44 billion (of which, half in cash and the remainder in sovereign guarantees) after COVID-related restrictions contributed to a deterioration of PIA's already difficult financial situation.

- ***Increasing transparency.*** The external audit of the Utility Stores Corporation (USC) based on FY 2020 financials is facing delays and data challenges, reflecting a longer period of vocational adjustment after switching to a new international audit firm this year, a more extensive coverage than in previous years, and difficulties in establishing ex-post key data inputs at end-FY 2020 (**end-April 2021 SB**). As these challenges risk delaying the publication of the audit beyond the program period, we request to drop the related SB.

- ***Strengthening the monitoring of SOEs.*** We aim to operationalize a Central Monitoring Unit (CMU) within the MoF by end-May 2022 and have already started the process to hire staff in October 2021. The CMU will centralize SOE monitoring functions and provide better analysis at the aggregate SOE level.

- ***Enhancing the SOE legal and regulatory framework.*** In March 2021, we submitted a new SOE law to parliament for enactment by end-June 2022 (**new end-June 2022 SB**), which will, in line with staff recommendations, (i) define the rationale for state ownership; (ii) ensure that SOE operations are grounded on commercial footing, including by defining what constitutes a

[15] The monetary value of UFG up to the allowed benchmark is passed to the end consumers. Any excess reduces the allowed revenue requirement of the gas companies (termed 'UFG disallowance'), which adds to the circular debt.

commercial SOE; and (iii) regulate oversight and ownership arrangements. Additional work that we will attempt to finalize by end-May 2022 includes:

(i) Cabinet adoption of an SOE ownership policy to help operationalize the principles of the SOE law (once enacted) into a policy that clarifies ownership arrangements and the division of roles within the federal government; and

(ii) Selection of four SOEs and submission of amendments to their Acts to parliament to help ensure that the scope of the SOE law brings governance changes to statutory enterprises.

26. We see improving Pakistan's competitiveness and the business environment as key for supporting medium-term growth, private sector development, investment, and job creation. Going forward, we will:

- ***Continue to implement the approved national tariff policy*,** based on time-bound strategic, infant, and greenfield industry protection. In line with our revenue mobilization strategy, we will rationalize tariffs to boost competitiveness for 'Made in Pakistan' products, including phasing out tariffs on capital goods, intermediate products, and raw materials.

- ***Take steps to improve the business environment*.** In particular, we will: (i) simplify procedures to start a business and eliminate other unnecessary regulations, including the introduction of one portal for all business registrations and integration of federal and provincial entities involved in starting a business; (ii) streamline the approval process for foreign direct investment (FDI); (iii) improve trading across borders by reducing customs-related processing time and reducing hours to prepare import/export documentation; (iv) simplify and harmonize the process of paying taxes through the introduction of a simple and fully automated regime for paying taxes, contributions, and fees; and (v) launch a communication drive to disseminate information regarding the reforms undertaken.

- ***Support the further development of the housing and construction sector by addressing structural impediments.*** We will establish a working group comprised of relevant stakeholders that will produce a strategy paper by end-February 2022 and offer solutions to address the structural impediments to the development of the sector. This will also help increase private sector lending to the sector.

27. Measures to strengthen governance and the control of corruption remain key. Our priorities include:

- ***Strengthening the effectiveness of anticorruption institutions*.** To further advance transparency, accountability, and integrity in the public sector, we will issue regulations to establish an electronic asset declaration system (**end-June 2021 SB, reset to end-January 2022**) that is comprehensive (i.e., covering assets beneficially owned or located abroad), centrally-held with the Federal Board of Revenue, covering federal civil servants of Base Pay

Scale 17 to 22, accessible to entities authorized by law (including banks for the limited purposes of conducting customer due diligence as required for the provision of banking services), and effectively verified. It will also institutionalize public access for annual declarations for all members (elected and unelected) of the federal government cabinet of Pakistan. We are undertaking the 2nd review cycle under the UNCAC implementation mechanism, and will publish the full report, including the findings, analysis, and recommendations for improving the anti-corruption framework. A task force with inputs from reputable international experts and civil society organizations will complete a review of the institutional framework of our anticorruption institutions by end-December 2021 to enhance their independence and effectiveness in investigating and prosecuting corruption cases, with proposals for legislative amendments as appropriate.

- ***Enhancing the use of AML tools to support anti-corruption efforts.*** We continue to support financial institutions and other reporting institutions in improving their capacities to identify politically exposed persons and apply enhanced due diligence measures. We are conducting further outreach and continue enhancing risk-based supervision of financial institutions and other reporting institutions to improve the quality of suspicious transaction reporting, particularly on corruption activities. To strengthen the effectiveness of the Financial Monitoring Unit (Pakistan's financial intelligence unit), we are enhancing its analytical skills through training, and entering into information sharing arrangements with foreign counterparts. We continue to pursue our application for membership in the Egmont Group of Financial Intelligence Units.

- ***Reducing the use of prize bonds.*** In April 2021 we announced the withdrawal of PRs 7,500 and PRs 15,000 prize bonds as we continue to rein in the use of bearer instruments, which have the potential for use in illegal activities and tax avoidance.

Financing and Program Monitoring

28. We have secured adequate long-term financing from our international partners to support our economic reform program. The current projections suggest that with the policies outlined in this MEFP, the gross external financing needs for FY 2022 will amount to US$26 billion, of which about US$10 billion is amortizations to multilateral and bilateral official and commercial creditors. To close this gap, we have secured financing commitments from bilateral and multilateral partners: China US$6.6 billion, UAE US$2 billion, the World Bank US$2 billion, the Asian Development Bank US$1.5 billion, and the Islamic Development Bank US$1 billion. Crucially, key bilateral creditors have maintained their exposure to Pakistan in line with program financing commitments. In addition, we continue to benefit from the temporary suspension of debt service to official bilateral creditors provided under the G-20 DSSI initiative, which will cover US$1.0 billion falling due during July-December 2021 (third round of DSSI).

29. We will also make prudent and transparent use of the policy space created by the recent SDR allocation (US$2.77 billion) and will not use it to support unsustainable policies. We intend to use the allocation to bolster reserves, and if needed to complement other sources of vaccine finance.

30. Implementation of the policies under the program will continue to be monitored through prior actions, quantitative performance criteria, indicative targets, continuous performance criteria, structural benchmarks, and schedule of reviews, as envisaged in our MEFPs dated June 19, December 2, 2019, and March 9, 2021, along with this MEFP. The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria and indicative targets under the program. The quantitative targets for end-December 2021, end-March 2022, and end-June 2022, along with continuous quantitative performance criteria are set out in Table 1. The prior actions and structural benchmarks are set out in Table 2.

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets

(Billions of Pakistani rupees, at program exchange rates, unless otherwise indicated)

	FY 2020/21								FY 2021/22					
	end-March				end-June				end-September		end-December		end-March	end-June
	Program (PC) CR 21/73	Adjusted Prog.	Actual	Status	Program (PC) CR 21/73	Adjusted Prog.	Actual	Status	Program (IT) CR 21/73	Est.	Program (IT) CR 21/73	Proposed (PC)	Proposed (PC)	Proposed (PC)
Performance Criteria														
Floor on net international reserves of the SBP (millions of U.S. dollars)	-10,238	-10,198	-7,836	Met	-8,676	-8,041	-4,434	Met	-8,518	-2,303	-7,677	-5,450	-6,000	-5,100
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees)	9,655	9,650	9,044	Met	10,173	10,083	9,290	Met	9,947	8,793	10,190	9,850	10,233	10,792
Ceiling on SBP's stock of net foreign currency swaps/forward position (negative, millions of U.S. dollars)	5,200	...	4,285	Met	5,200	...	4,870	Met	4,900	4,870	4,600	4,900	4,300	4,000
Ceiling on general government primary budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 2	-230	-350	-505	Met	246	412	462	Not met	-130	-137	-96	-300	-389	25
Ceiling on net government budgetary borrowing from the SBP (stock, billions of Pakistani rupees)	6,908	...	5,127	Met	6,618	...	5,274	Met	6,333	4,973	6,049	6,049	6,049	6,049
Ceiling on the amount of government guarantees (stock, billions of Pakistani rupees) 3/	2,715	...	2,682	Met	2,715	...	2,626	Met	2,735	2,649	2,765	2,797	2,954	2,956
Continuous Performance Criteria														
Zero new flow of SBP's credit to general government 8/	0	...	0	Met	0	...	475	Not met	0	0	0	0	0	0
Zero ceiling on accumulation of external public payment arrears by the general government	0	...	0	Met	0	...	0	Met	0	0	0	0	0	0
Indicative Targets														
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees) 7/	114	...	76	Not met	199	...	194	Not met	48	6	102	86	199	250
Cumulative floor on general government budgetary health and education spending (billions of Pakistani rupees)	975	...	1,006	Met	1,567	...	1,583	Met	356	336	752	783	1,287	2,014
Floor on net tax revenues collected by the FBR (cumulative, billions of Pakistani rupees)	3,394	...	3,395	Met	4,691	...	4,764	Met	1,181	1,397	2,585	2,852	4,343	6,100
Ceiling on net accumulation of tax refund arrears (billions of Pakistani rupees) 4/ 5/	65	...	112	Not met	65	...	-30	Met	0	17	0	11	5.5	0
Ceiling on power sector payment arrears (cumulative flow, billions of Pakistani rupees) 4/	319	...	269	Met	354	...	297	Met	-166	114	-154	67	184	166
Gross issuance of PIBs, Sukuks, and Eurobonds (cumulative, billions of Pakistani rupees) 6/	2,850	...	2,341	Not met	4,250	...	3,496	Not met	1,000	1,443				

Sources: Pakistani authorities; and Fund staff estimates.

1/ Fiscal year runs from July 1 to June 30. All definitions as per the attached Technical Memorandum of Understanding.

2/ Cumulative from the start of each fiscal year. "-" means surplus. End-June 2019 actual measured from above the line.

3/ Definition changed at the time of the second review. Applicable for end-March 2021 targets onward.

4/ Data for December 2018/June 2019 is an actual/projected stock as of the end of the month. Quarterly targets are cumulative flows for each fiscal year.

5/ The projected end-June 2019 figure included only sales tax arrears, while the actual end-June 2019 tax arrears includes all tax arrears and adheres to the TMU definition.

6/ Added at the time of the second through the fifth EFF review. Applicable for end-March 2021 onward. This applies to the cumulative gross issuance of Pakistan Investment Bonds (PIBs) and GoP Ijara Sukuks, and Eurobonds starting from the beginning of the fiscal year. This is defined as the cumulative sum—since the start of the fiscal year—of the total acceptance of the bids of each auction of PIBs, GoP Ijara Sukus across all maturities (both at fixed and floating rate), and that of Eurobonds evaluated at the program exchange rate.

7/ Excludes spending by the Poverty Alleviation Fund amounting to PRs 5 billion that was originally programmed to be executed in FY 2021/22 by BISP.

8/ On November 18, 2021 the SBP on-lent PRs 475 billion (SDR 1.947 billion equivalent) to the government of Pakistan amounting to 100 percent of the SDR allocation received on August 23, 2021.

Table 2. Pakistan: Structural Conditionality

Actions				
Prior Actions	**Rationale**			
1 National assembly adoption of a supplementary finance bill (GST reform), which the President signs into law, in line with staff agreement together with supporting measures (published list of expected guarantees).	Critical to ensure achievement of fiscal objectives.			
2 Petroleum development levy on gasoline and diesel raised by PRs 8/liter.	Critical to ensure achievement of fiscal objectives.			
3 Adoption by parliament, and signed into law by the President, of the amendments to the State Bank of Pakistan Act, prepared in consultation with the IMF staff, aimed at strengthening the SBP independence, decision making structure, and mandate.	Critical for central bank independence.			
4 Publication of key information on all COVID-related awarded procurement contracts on the Public Procurement Regulatory Authority's website.	Critical for transparency, governance, and tackling corruption.			
5 Auditor General of Pakistan will conduct an ex-post audit of the procurement of COVID-related supplies and social payments made during FY 2020. The full audit report will be published on the website of the Ministry of Finance.	Critical for transparency, governance, and tackling corruption.			
Structural Benchmarks	**Date**	**Revised Date**	**Status**	
Fiscal				
1 Commit to not grant further tax amnesties.	Continuous		Met.	
2 Avoid the practice of issuing new preferential tax treatments or exemptions.	Continuous		Not met.	
3 Ministry of Finance will establish and make functional the TSA-1.	end-May 2021		Not met. Implemented with delay in September 2021.	
4 Reintroduce and roll out the track-and-trace systems for tobacco products.	end-Jun. 2021		Not met. Reintroduced and rolled out only in one company out of 16 in October 2021.	
Social Protection and Gender				
5 Finalize the update of the BISP beneficiaries' database (National Socio-Economic Registry).	end-Jun. 2021		Not met. Implemented with delay in October 2021 with a coverage of 33 million households.	
Monetary and Financial				
6 Adopt measures to strengthen the effectiveness of the AML/CFT framework to support the country's efforts to exit the Financial Action Task Force list of jurisdictions with serious deficiencies.	end-Jun. 2021	end-Mar. 2022	Not met.	
Energy Sector, State-Owned Enterprises, and Governance				
7 Reduction in CPPA-G payables to power producers through a payment up to PRs 180 billion with no more than 1/3 in cash and the remainder in debt instruments.	end-May 2021		Not met. Implemented with delay on June 4 through a payment of PRs 89.9 billion, with 1/3 in cash and the remainder in debt instruments.	
8 Completion of the FY 2021 annual rebasing (AR).	Jun. 1, 2021		Not met. Implemented with delay on November 5, 2021.	
9 Notification of FY 2020 Q4 electricity tariff adjustment for capacity payments.	end-Sep. 2021		Not met. Implemented with delay on October 1, 2021.	
10 Finalization of the energy cross-subsidy reform for the FY 2022 budget.	end-Jun. 2021		Not met. To be implemented through a new SB #4.	
11 Adoption by parliament of amendments to the OGRA Act.	end-Jun. 2021	end-Jun. 2022	Not met.	
12 Conduct and publish external audit of the Utility Stores Corporation (USC) based on FY 2020 financials.	end-Apr. 2021		Not met.	
13 Publication of awarded COVID-spending related contracts and beneficial ownership information of bidding and awarded legal persons in a centralized and publicly accessible website.	end-Apr. 2021		Not met. To be partially implemented through PA #4, with beneficial ownership transparency addressed with a delayed but broader reform (new SB#6) that covers all large contracts (not just COVID-related spending).	
14 Auditor General of Pakistan will conduct an ex-post audit of the procurement of urgently needed medical supplies related to Covid-19. Audits results will be published on the website of the Ministry of Finance.	end-Apr. 2021		Not met. To be implemented through PA #5.	
15 Establish a robust asset declaration system with a focus on high-level public officials (including elected and unelected members of the Federal Cabinet).	end-Jun. 2021	end-Jan. 2022	Not met.	
New Structural Benchmarks				
1 Preparation of draft personal income tax (PIT) legislation.	end-Feb. 2022			
2 Preparation of a plan by Ministry of Finance and State Bank of Pakistan, in consultation with other stakeholders, to establish an appropriate Development Finance Institution to support the eventual phasing out of SBP refinance facilities.	end-Apr. 2022			
3 Completion of the first stage recapitalization of the two private sector banks that are undercapitalized.	end-May 2022			
4 Cabinet decision on the second step of the energy subsidy reform for residential consumers.	end-Jan. 2022			
5 Parliamentary approval of new SOE law in line with staff recommendations.	end-Jun. 2022			
6 Issuance of regulations by the Public Procurement Regulatory Authority to require collection for publication of beneficial ownership information from companies which are awarded public procurement contracts for PRs 50 million and above.	end-Mar. 2022			

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out the understanding between the Pakistani authorities and the IMF staff regarding: (i) the ***definitions*** of quantitative performance criteria (and their adjustment mechanisms), indicative targets, and—if needed—prior actions and structural benchmarks in Section A below; and (ii) the respective ***reporting requirements*** used to monitor developments—for the economic program under the Extended Arrangement under the Extended Fund Facility (EFF)—as described in the authorities' latest Letter of Intent (LOI) dated December 17, 2021 and the attached Memorandum of Economic and Financial Policies (MEFP, notably its Tables 1 and 2) in Section B below. To this effect, the authorities will provide the necessary data to the IMF as soon as it becomes available. The definitions used in this TMU will be adjusted to reflect any changes in program design and accounting classifications introduced during the program period.

2. For the purposes of **monitoring under the program**, all assets and liabilities as well as debt contracted, denominated in Special Drawing Rights (SDRs) or in currencies other than the U.S. dollar, are converted into U.S. dollars at the program exchange rate. Net external budget financing and external cash grants are converted into Pakistani rupees (PRs) at the program exchange rate. The program exchange rate of the Pakistani rupee to the U.S. dollar is set at PRs 141.3172 per U.S. dollar. The corresponding cross exchange rates for other foreign currencies are provided in Text Table 1.

Text Table 1. Pakistan: Program Exchange Rates
(Units of currency per U.S. dollar) 1/

Currency	Rate	Currency	Rate
EUR	0.896456	THB	32.035948
JPY	111.699717	MYR	4.141502
CNY	6.741081	SGD	1.362695
GBP	0.769292	INR	69.267944
AUD	1.428981	SDR	0.723019
CAD	1.346196		

1/ As of May 3, 2019 except for: JPY and CNY (as of April 30, 2019), and CAD (as of May 2, 2019).

A. Quantitative Targets

3. The program sets performance criteria and indicative targets for defined test dates (MEFP Table 1) as well as defines continuous performance criteria that apply throughout the program period. The program sets the following performance criteria:

Performance Criteria

- Floor on the net international reserves (NIR) of the State Bank of Pakistan (SBP) (millions of U.S. dollars);
- Ceiling on the net domestic assets (NDA) of the SBP (stock, billions of Pakistani rupees);
- Ceiling on SBP's stock of net foreign currency swap/forward position (millions of U.S. dollars);
- Ceiling on the general government primary budget deficit excluding grants (cumulative flows, billions of Pakistani rupees);

- Ceiling on net government budgetary borrowing from the SBP (including provincial governments) (stock, billions of Pakistani rupees); and
- Ceiling on the amount of government guarantees (stock, billions of Pakistani rupees).

Continuous Performance Criteria

- No new flow of SBP's credit to general government
- Zero ceiling on the accumulation of external payment arrears by the general government; and
- Other (see ¶25).

Indicative Targets

- Floor on targeted cash transfers spending (BISP) (cumulative, billions of Pakistani rupees);
- Floor on general government budgetary health and education spending (cumulative, billions of Pakistani rupees);
- Floor on net tax revenues collected by the Federal Board of Revenue (FBR) (cumulative, billions of Pakistani rupees);
- Ceiling on net accumulation of tax refund arrears (flow, billions of Pakistani rupees);
- Ceiling on power sector payment arrears (flow, billions of Pakistani rupees).

Floor on the Net International Reserves (NIR) of the SBP

Definition

4. The general government is defined as the central (federal) government and local (provincial) governments, excluding state-owned enterprises. The definition of the general government includes any new funds, or other special budgetary or extra-budgetary entities, that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2001. The authorities will inform IMF staff on the creation of any such entities without delay.

5. Net international reserves (stock) of the SBP are defined as the U.S. dollar value of the difference between usable gross international reserve assets and reserve-related liabilities, evaluated at program exchange rates. On April 16, 2019, the NIR of SBP are estimated at negative US$15,557 million.

6. Usable gross international reserves of the SBP are readily available claims on nonresidents denominated in foreign convertible currencies and controlled by the monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes. Gross official reserves include: (i) holdings of foreign currencies; (ii) holdings of SDRs; (iii) the reserve position in the IMF; and (iv) holdings of fixed and variable income instruments. Excluded from usable reserves, inter alia, unless there is also a reserve-related liability associated with it, are: (i) claims on residents; (ii) assets in nonconvertible currencies; (iii) precious metals; (iv) illiquid assets; (v) assets that are pledged or collateralized; (vi) any reserve assets that are not readily available for intervention in the foreign exchange market because of lack of quality or liquidity that limits marketability at the book price; and (vii) balances held at foreign branches of non-investment rated domestic banks.

7. **Reserve-related liabilities of the SBP** include all foreign exchange liabilities to residents (except general government) or nonresidents, including: (i) foreign currency liabilities, excluding liabilities to the general government, with remaining maturity of one year or less; (ii) any foreign exchange liabilities of SBP and general government arising from derivatives positions (such as futures, forwards, swaps, and options) on a net outstanding basis (defined as the long position minus the short position); (iii) outstanding IMF credits to Pakistan; and (iv) foreign exchange deposits with the SBP of foreign governments, foreign central banks, foreign deposit money banks (excluding regulatory capital deposits of foreign banks with the SBP), international organizations, and foreign nonbank financial institutions, as well as domestic financial institutions (excluding regulatory capital deposits of domestic financial institutions with the SBP). The reserve-related liabilities of the SBP exclude SDR allocations and accrued interest on reserve-related liabilities.

8. **Aggregate net position in the foreign exchange derivatives** is defined as the aggregate net positions in forwards and futures in foreign currencies of the SBP and general government vis-à-vis the domestic currency (including the forward leg of currency swaps). At end-April 2019, the SBP's aggregate net derivative position was negative US$8,055 million.

9. **Gross sale of foreign exchange** includes outright and swap sales of foreign exchange by the SBP to banks in the foreign exchange interbank market by using foreign exchange market intervention. The swap sale of foreign exchange and maturities of the forward transactions will be measured on a net daily basis.

10. **Net purchase of foreign exchange** is defined as outright and swap purchases of foreign exchange minus outright and swap sales of foreign exchange by the SBP from/to banks in the foreign exchange market by using foreign exchange market intervention. The net purchase of foreign exchange will be measured on a net daily basis.

Adjustment mechanism

11. The floor on NIR will be **adjusted** upward (downward) by the cumulative excess (shortfall) in:

a. ***cash inflows from multilateral and bilateral creditors, commercial borrowing, and bond issuance*** relative to the projected inflows (Table 1). Cumulative cash inflows are defined as external disbursements (including grants) from official multilateral creditors (including, but not limited to the Asian Development Bank, Islamic Development Bank, and

World Bank), official bilateral creditors (including, but not limited to bilateral oil facilities, China, Saudi Arabia, UAE, DFID-UK, and USAID), external bond placements and other commercial borrowings that are usable for the financing of the central government budget;

b. the ***actual stock of NIR*** at end-June 2019 relative to the projected amount. The stock of NIR of SBP at end-June 2019 is projected at negative US$17,743 million; and

c. the ***use by the SBP of the foreign assets related to commercial consortium loan*** to make import payments relative to the amounts expected under the baseline (Text Table 2).

Text Table 2. Pakistan: Use by SBP of Foreign Assets Related to Commercial Consortium Loan
(Cumulative flows from the start of the fiscal year; millions of Renminbi)

End-Dec 2021	End-Mar 2022	End-Jun 2022
0	0	0

d. The floor on NIR will also be adjusted downward by the cumulative amount of purchase of the government from the central bank of ***foreign exchange for financing of the purchase of COVID-19 vaccines imports***, as reported by the State Bank of Pakistan as being sold to the NDMA, Ministry of Health or any other institution designated by the government for the import of COVID-19 vaccines. The adjustor cumulates from October 1, 2021.

Ceiling on the Net Domestic Assets (NDA) of the SBP

Definition

12. **Net domestic assets of the SBP** are defined as the difference between reserve money (as defined below) minus the NIR of the SBP (as defined above). For the purposes of computing the NDA target, the NIR is valued at the program exchange rate (¶2) and expressed in Pakistani rupee.

13. **Reserve money (RM)** is defined as the sum of: (i) currency outside schedule banks (deposit money banks); (ii) schedule banks' domestic cash in vaults; (iii) schedule banks' required and excess rupee and foreign exchange deposits with the SBP; and (iv) deposits of the rest of the economy with the SBP, excluding those held by the federal and provincial governments and the SBP staff retirement accounts.

Adjustment mechanism

14. Consistent with the NIR target adjustment mechanism (as defined above), the ceiling on the NDA will be **adjusted** downward (upward) by the cumulative excess (shortfall) in:

a. ***cash inflows from multilateral and bilateral creditors, and commercial borrowings and bond issuances*** relative to the projected inflows (Table 1) and evaluated at the program exchange rate

b. the ***actual stock of NIR at end-June 2019*** relative to the projected amount (see above) and evaluated at the program exchange rate; and

c. the ***use by the SBP of the foreign assets related to commercial consortium loans to make import payments*** relative to the amounts expected under the baseline (Text Table 2) and evaluated at the program exchange rate

d. The ceiling on NDA will also be adjusted upward by the cumulative amount of purchase of the government from the central bank of ***foreign exchange for financing of the purchase of COVID-19 vaccines imports*** to the government, as reported by the State Bank of Pakistan as being sold to the NDMA, Ministry of Health or any other institution designated by the government for the import of COVID-19 vaccines. The adjustor cumulates from October 1, 2021 and is evaluated at the program exchange rate

e. The ceilings on the NDA of the SBP will also be adjusted upward by PRs 166.6 billion to account for the increase in the average cash reserve ratio (CRR) on November 12, 2021. They will be similarly adjusted upward (downward) by the amount of banks' Pakistani rupee reserves seized (freed) by any increase (reduction) of the average CRR according to the following formula: $\Delta NDA = \Delta r B_0$, where Δr is the change in the average CRR; and B_0 denotes the level of demand and time liabilities on which the reserve requirement applies. On November 12, 2021 the ΔNDA = 1% * PRs 16,664.2 billion = PRs 166.6 billion.

Ceiling on SBP's Stock of Net Foreign Currency Swap/Forward Position

15. The **stock of net foreign currency swap/forward positions** is defined as the aggregate net positions in forwards and futures in foreign currencies of the SBP vis-à-vis the domestic currency (including the forward leg of currency swaps). It will be evaluated at the program exchange rate. At end-April 2019, the SBP's aggregate net FX derivative position was negative US$8,055 million.

Ceiling on the General Government Primary Budget Deficit Excluding Grants

Definition

16. The **general government primary budget deficit (excluding grants)** is monitored quarterly as the general government's overall budget deficit (excluding grants) minus the consolidated interest bill of the federal and provincial budgets.

17. The **general government overall budget deficit (excluding grants)** is measured as the cash deficit from below the line, defined as the sum of:

a. ***net external budget financing***, excluding valuation changes

b. ***change in net domestic credit from the banking system (cash basis)***, excluding valuation changes from deposits denominated in foreign currency and government securities bought by non-residents (notably T-bills, Pakistan Investment bonds (PIBs), Naya Pakistan Certificates, and Banao Certificates)

c. ***change in the net domestic nonbank financing***, excluding valuation changes. These comprise: (i) privatization receipts (either received directly or transferred from the privatization accounts to the general government budget, including from abroad and in foreign currency); (ii) change in the stock of issued government securities held outside the general government and the banking system, net of valuation changes; (iii) change in net deposits and reserves received by the general government (public accounts deposits); (iv) any other government borrowing from domestic nonbank sources net of repayments; minus (v) the change in general government deposits with nonbank financial institutions; and

d. ***total external grants to the federal and provincial governments***, which are defined as the sum of project grants, cash external grants for budgetary support, capital grants reflecting the principal amounts of external debt cancellation or swaps, and other grants.

18. **Net external budget financing** (excluding valuation changes and all external financing counted as reserve liabilities of the SBP, as defined above) is defined as the sum of:

a. ***external budget loans*** to the general government, including those on-lent to financial institutions and companies (public or private) and external emergency relief lending. It comprises those with: (i) medium- and long-term maturity from official multilateral sources (including IMF budget support), official bilateral sources, and private sector sources (e.g., bonds and non-residents' purchases of PIBs, Naya Pakistan Certificates, and Banao Certificates); and (ii) short-term maturity, net of foreign portfolio investment excluding non-residents' purchases of Naya Pakistan Certificates and Banao Certificates but including non-residents' purchases of domestic T-bills; and

b. ***net external debt amortization flow*** of the general government, which is the change in its stock of external debt service arrears net of the debt amortization due on its external budget loans (with the latter accounting for the impact of any rescheduled, relieved, or accelerated amortization, including that related to debt swaps or debt cancellation recorded as capital grants).

Adjustment mechanism

19. The ceiling on general government primary budget deficit (excluding grants) will be **adjusted** on a cumulative basis since the beginning of the fiscal year:

a. downward (upward) by any shortfall (excess) in ***external project financing*** relative to the program projections evaluated in Pakistani rupee terms at actual average exchange rates (see Table 1). External project financing is defined as disbursements from bilateral and multilateral creditors to the general government for specific project expenditure

b. downward by any underexecution in the ***targeted cash transfers (BISP)*** relative to their indicative program target

c. downward by any excess in the flow of ***power sector payment arrears*** above the respective indicative program targets, excluding non-recoveries and excess line losses (see Text Table 4)

d. downward by any increase in the ***stock of budgetary arrears on social payments*** (such as wages, pensions, social benefits) accumulated since the beginning of the fiscal year

e. downward by any excess in the flow of ***tax refund arrears*** (as defined below) relative to their respective indicative program targets

f. ***for SBP profit transfers:***

(i) *until the amended SBP Act is approved and enacted by the National Assembly*, downward (upward) for any excess (shortfall) in the actual interim SBP profit transfers to the general government budget relative to its programmed SBP level (Text Table 3); and

(ii) *after the amended SBP Act is approved and enacted by the National Assembly*, upward by any shortfall in actual interim SBP profit transfer to the general government budget relative to its programmed level (Text Table 3).

Text Table 3. Pakistan: Fiscal Program: Selected Projections
(Cumulative flows from start of fiscal year; billions of Pakistani Rupees)

	End-Dec 2021	End-Mar 2022	End-Jun 22
SBP profit transfers to the budget	349	437	550

g. upward by up to PRs 311 billion for the ***clearance of CPPA arrears to IPPs*** in FY 2021/22; and

h. upward by up to PRs 352 billion for the ***purchase of COVID-19 vaccines*** in FY 2021/22.

Ceiling on Net Government Budgetary Borrowing from the SBP

Definition

20. **Net government budgetary borrowing from the SBP** (including provincial governments) is defined as SBP claims on the general government minus general government deposits with the SBP. Those claims include government securities, treasury bills, treasury currency, and debtor balances, whereas those claims exclude accrued profits on government securities. Government deposits with the SBP exclude the Zakat Fund (Table 2).

Adjustment mechanism

21. The ceiling on net government budgetary borrowing from the SBP will be adjusted upward by the amount of local currency on-lending by the SBP to the Ministry of Finance of the SDR allocation. This adjustor is cumulative and is capped at PRs 457 billion for FY 2022.

Ceiling on the Amount of Government Guarantees

22. The **ceiling on the amount of government guarantees** applies to the stock of publicly guaranteed debt for which guarantees have been issued by the central government. It includes both domestic and external government guarantees. Beginning with the end-March 2021 test date, the external government guarantees will be converted into Pakistani rupees at the program exchange rate. This ceiling excludes guarantees issued by the Ministry of Finance for the SBP borrowing from the IMF. The stock of issued guarantees at end-September 2019 was PRs 2,580 billion.

No New Flow of SBP's Credit to General Government—Continuous Performance Criterion

23. To protect the capability of the central bank to pursue its price stability objective, there should be no new flow of **SBP's direct credit to the general government**, including in the form of purchases of public debt securities on the primary market. The performance criterion applies on a continuous basis throughout the program period.

Zero Ceiling on the Accumulation of External Payment Arrears by the General Government—Continuous Performance Criterion

24. **External payment arrears** are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) of the general government (federal and provincial government, SBP, and state-owned enterprises) to nonresidents arising in respect of public sector loans, debt contracted or guaranteed (including unpaid penalties or interest charges associated with these obligations that are beyond 30 days after the due date). The definition of debt, for the purposes of the EFF, is set out in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Executive Board Decision No. 6230-(79/140), last amended by Executive Board Decision No. 14416-(09/91), adopted August 31, 2009). The ceiling on the accumulation of external payment arrears is set at zero. The performance criterion applies on a continuous basis throughout the program period.

Other Continuous Performance Criteria

25. During the program period, **Pakistan will not**:

a. impose or intensify ***restrictions on the making of payments and transfers*** for current international transactions

b. introduce or modify ***multiple currency practices (MCPs)*** excluding though MPCs arising from the introduction and/or modifications of the multiple-price foreign exchange auction system operating in line with IMF staff advice with the objective of supporting flexible market-determined exchange rate

c. conclude ***bilateral payment agreements*** that are inconsistent with Article VIII of IMF Articles of Agreement; and

d. impose or intensify ***import restrictions*** for balance of payments purposes.

Floor on Targeted Cash Transfers Spending (BISP)—Indicative Target

26. The floor on **targeted cash transfers spending (BISP)** applies to the cumulative targeted cash transfers spending by the Benazir Income Support Program (BISP).

Floor on General Government Budgetary Health and Education Spending—Indicative Target

27. The floor on the **general government budgetary health and education spending** will apply to the cumulative budgetary spending on health and education by the federal and provincial governments.

Floor on Net Tax Revenues Collected by the Federal Bureau of Revenue (FBR)—Indicative Target

28. **Net tax revenues collected by the FBR** are defined as the sum of revenues collected from: (i) general sales tax (GST) on goods (including GST on services collected in Islamabad Capital Territory); (ii) customs duties, customs registration fees and levies; (iii) excise duties on imported products; (iv) excise duties on domestic products; (v) levies (toll) on oil derivatives; (vi) other proceeds and fees; (vii) sales tax; and (viii) unclassified revenues minus the tax refunds. Net revenue collection is defined, for each test date, as the cumulative sum of net revenues collected since the beginning of the respective fiscal year. The floor on the collection of net revenues by the FBR is measured quarterly based on cumulative end-of-quarter data.

Ceiling on Net Accumulation of Tax Refund Arrears—Indicative Target

29. The ceiling on the **net accumulation of tax refund arrears** applies to the cumulative flow of tax refund arrears. The stock of tax refund arrears is defined as the amount of tax refund claims that have not been settled (through a cash refund, netting out against obligations of taxpayers, payment with a government bond/promissory note or an official decision to reject the claim) within a specified time period after the tax refund claim has been submitted to the FBR. The stock of tax refund arrears as of end-December 2020 was PRs 499 billion.

Ceiling on Power Sector Payment Arrears—Indicative Target

30. **Power sector payment arrears** are defined as power sector payables in arrears that arise from: (i) non-recoveries from supply to Azad Jammu and Kashmir (AJ&K), industrial support package, other federal and provincial governments including FATA, private consumers, and Baluchistan Tube Wells; (ii) accrued markup from the servicing of PHPL; (iii) line losses and non-collections that are not recognized by NEPRA; (iv) GST non-refunds,; (iv) late payment surcharges; (v) delays in subsidy payments; and (vi) delays in tariff determinations.

31. Monitoring mechanism to track the stock and flow of payables. The stock of payment arrears includes the payables of PRs 2,280 billion (of which PRs 930 billion held at PHPL) as of end-FY 2020/21. The projected evolution of the stock and the flow of payables, including measures (policy and surcharges) and its components are given in Text Table 4.

Text Table 4. Pakistan: Flow of Power Sector Payment Arrears
(Cumulative flows from start of fiscal year; billions of Pakistani Rupees)

	FY2021/22		
	end-Dec	end-Mar	end-Jun
	Target	Target	Target
Total flow	**67**	**184**	**166**
Operational part	**126**	**174**	**244**
DISCOs' losses and inefficiency	40	54	77
DISCOs' under-recoveries	86	120	167

Source: Pakistani authorities.

B. Program Reporting Requirements

32. To effectively monitor the program performance, the authorities will provide all the needed data to the IMF in line with Article VIII, Section 5 of the IMF Articles of Agreement as deemed necessary. Performance under the program is monitored from data supplied to the IMF by the SBP, Ministry of Finance, FBR, Pakistan Bureau of Statistics, Ministry of Water and Power, and other agencies as outlined in Table 3 below. The authorities will transmit promptly to IMF staff any data revisions as well as other information necessary to monitor the arrangement with the IMF.

Table 1. Pakistan: Projected Disbursements

(Millions of U.S. dollars)

	FY 2021/22			
	Jul-Sep 2021	Oct-Dec 2021	Jan-Mar 2022	Apr-Jun 2022
		Proj.		
Multilateral and bilateral disbursements	2,230	1,550	3,848	2,991
of which: in cash 1/	2,124	1,389	3,695	2,734
of which: Saudi oil facility and IDB commdity loans	325	325	775	775
of which: project support	256	420	393	654
International bond issuance	1,200	1,700	200	1,200
Commercial borrowing	450	450	2,732	650
Other	0	0	0	0
Gross inflows	3,880	3,700	6,780	4,841
of which: in cash	3,774	3,539	6,627	4,584

1/ Assumes that 65 percent of project loans and 50 percent of project grants were received in cash.

Table 2. Pakistan: Government Sector (Budgetary Support)

(End-of-period stocks, millions of Pakistani Rupees)

ITEM	30-Jun-19	30-Sep-19	31-Dec-19	31-Mar-20	30-Jun-20	30-Sep-20	31-Dec-20	31-Mar-21	30-Jun-21	30-Sep-21
A. Central Government	**12,586,952**	**12,933,003**	**13,118,407**	**13,939,638**	**14,972,589**	**15,301,056**	**15,650,396**	**16,110,338**	**16,894,192**	**17,246,761**
1. Scheduled Banks	**5,753,677**	**7,461,389**	**6,697,593**	**7,259,336**	**8,222,465**	**8,767,130**	**9,254,690**	**10,250,249**	**11,181,917**	**11,458,935**
a) Government Securities	2,568,289	3,319,899	3,552,790	3,581,969	4,441,763	5,498,121	6,115,941	6,400,843	6,790,862	7,081,073
b) Treasury Bills	4,413,731	5,316,079	4,348,498	4,934,845	5,152,667	4,643,369	4,528,674	5,268,909	6,050,056	6,128,777
c) Government Deposits	-1,228,344	-1,174,589	-1,203,695	-1,257,478	-1,371,965	-1,374,360	-1,389,926	-1,419,503	-1,659,001	-1,750,914
2. State Bank	**6,833,275**	**5,471,615**	**6,420,814**	**6,680,302**	**6,750,124**	**6,533,926**	**6,395,706**	**5,860,089**	**5,712,275**	**5,787,826**
a) Government Securities	7,189,745	7,189,745	7,189,745	7,189,740	7,189,740	6,904,745	6,904,745	6,904,740	6,620,740	6,335,745
b) Accrued Profit on MRTBs	2,909	259,192	109,331	285,953	83,618	167,834	68,278	161,295	58,537	147,020
c) Treasury Bills	570,158	570,148	285,170	285,191	2,816	3,270	3,270	3,169	6,133	53,501
of which: MTBs created for replenishment of cash balances	569,000	569,000	284,000	284,000	0	0	0	0	0	0
d) Treasury Currency	9,569	9,569	9,789	9,789	9,789	9,788	9,789	9,401	9,797	9,806
f) Government Deposits (Excl. Zakat and Privatization Fund)	-967,305	-2,584,405	-1,202,341	-1,119,397	-565,997	-577,503	-616,694	-1,240,886	-1,016,725	-784,477
B. Provincial Governments	**-990,484**	**-1,180,548**	**-1,335,318**	**-1,376,713**	**-1,224,280**	**-1,267,549**	**-1,464,836**	**-1,619,932**	**-1,520,728**	**-1,796,571**
1. Scheduled Banks	**-849,079**	**-813,920**	**-865,864**	**-907,882**	**-1,012,953**	**-990,486**	**-1,022,026**	**-1,047,915**	**-1,140,944**	**-1,128,494**
a) Advances to Punjab Government for Cooperatives	1,024	1,024	1,024	1,024	1,024	1,024	1,024	1,024	1,024	1,024
b) Government Deposits	-850,103	-814,944	-866,888	-908,906	-1,013,977	-991,510	-1,023,050	-1,048,939	-1,141,968	-1,129,519
2. State Bank	**-141,405**	**-366,628**	**-469,454**	**-468,831**	**-211,327**	**-277,063**	**-442,810**	**-572,017**	**-379,784**	**-668,077**
a) Debtor Balances (Excl. Zakat Fund)	0	0	0	0	0	0	0	0	0	0
b) Government Deposits (Excl.Zakat Fund)	-141,405	-366,628	-469,454	-468,831	-211,327	-277,063	-442,810	-572,017	-379,784	-668,077
C. Net Govt. Budgetary Borrowings From Banking System	**11,596,468**	**11,752,456**	**11,783,089**	**12,562,925**	**13,748,309**	**14,033,507**	**14,185,560**	**14,490,407**	**15,373,463**	**15,450,190**
Through SBP	6,691,870	5,104,987	5,951,360	6,211,471	6,538,797	6,256,863	5,952,896	5,288,072	5,332,490	5,119,749
Through Scheduled Banks	4,904,598	6,647,469	5,831,730	6,351,454	7,209,512	7,776,644	8,232,664	9,202,335	10,040,973	10,330,440
Memorandum Items										
1. Accrued Profit on SBP & BSC holding of MRTBs & MTBs	2,912	259,201	109,341	285,997	83,618	167,834	68,278	161,295	58,537	147,020
2. Scheduled banks ' deposits of Privitization Commission	-2,979	-2,516	-3,272	-2,289	-2,410	-2,438	-3,448	-3,227	-3,807	-3,376
3. Outstanding amount of MTBs (Primary market; discounted value)	4,363,090	5,243,197	4,259,110	4,803,332	4,956,617	4,497,227	4,429,945	5,205,372	5,979,180	6,044,578
Net Govt. Borrowings (Cash basis) From Banking System	**11,545,893**	**11,422,889**	**11,587,632**	**12,147,705**	**13,471,051**	**13,721,969**	**14,022,001**	**14,268,802**	**15,247,857**	**15,222,347**
(i) From SBP	**6,688,958**	**4,845,786**	**5,842,019**	**5,925,475**	**6,455,179**	**6,089,030**	**5,884,619**	**5,126,777**	**5,273,953**	**4,972,729**
(ii) From Scheduled Banks	**4,856,935**	**6,577,103**	**5,745,614**	**6,222,230**	**7,015,872**	**7,632,939**	**8,137,383**	**9,142,025**	**9,973,904**	**10,249,617**

Table 3. Pakistan: Monitoring and Reporting Requirements				
Reporting Agency	**Type of Data**	**Description of Data**	**Frequency**	**Timing**
State Bank of Pakistan (SBP)	SBP balance sheet	Summary	Weekly	First Thursday of the following week
	SBP balance sheet	Summary at program exchange rates; and by official exchange rates	Monthly	Within 15 days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks at actual official exchange rates	Monthly	Within the first 30 days of each month.
	International reserves	By (i) program exchange rates; and (ii) at actual official exchange rates.	Daily	The following working day
	Foreign exchange market	Market exchange rates (buying and selling); weighted average customer exchange rate; monthly trade volume, and high and low exchange rate of the interbank, the KERB market.	Daily/ Monthly	Within one day/ monthly within five working day
	Foreign exchange market	SBP foreign exchange operations, and intervention (volume), distinguishing within spot transactions the outright purchase/sale and purchase/sale related to forward contract	Daily	Within one day
	Foreign exchange market	SBP operation against the domestic currency in swap/forwards by (volumes)	Daily	Within one day
	Foreign exchange market	SBP operations against the domestic currency in swap/forwards (including all legs of transactions): for each day, the initial outstanding FX swap/forward position, summary of transactions during the day, the end-of-day position	Daily	Within one day
	Foreign exchange market	Breakdown of short, long, counterparts, of the swap/forward contracts	Monthly	Third working day of the following month
	Foreign exchange market	Outstanding swap/forward positions by maturity buckets, and counterparties.	Monthly	Third working day of the following month
	Net International Reserves	Net International reserves at program exchange rates as defined in TMU, including a breakdown by currency and specification of *nostro* balances with foreign branches of National Bank of Pakistan.	Quarterly	Seventh working day after quarter end
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash.	Quarterly	Within 15 days of the end of each quarter
	Interbank money market	Daily interbank repo volume and interest rate of trades	Daily	Within one day
	SBP operations	Repo (reverse repo) operations, open market operations	Weekly	First Monday of the following week
	Bank liquidity	Excess reserves, in local currency	Bi-weekly	With a lag of 15 days

Table 3. Pakistan: Monitoring and Reporting Requirements (continued)				
Reporting Agency	**Type of Data**	**Description of Data**	**Frequency**	**Timing**
	T-bill and coupon bond financing, SBP securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Fortnightly	Last working day of the fortnight
	Banking data	Sectoral distribution of loans and deposits; loans and deposits by local and foreign currency; deposit and lending rates, disaggregated between new operations and outstanding stock	Monthly	Within 25 working days of the end of each month.
	Banking data	Loan maturities	Quarterly	Within 45 days of the following quarter
	Banking data	Regularity capital deposit requirement deposits of foreign and domestic schedule banks with the SBP (account numbers 33052 and 330506)	Monthly	Within 15 days of the end of each month
	Banking indicators	Core Financial Stability Indicators (FSIs), including but not limited to capital adequacy; asset composition and quality; profitability; liquidity; open FX positions – in aggregate and bank-by-bank (without names)	Quarterly	Within 45 days of the following quarter
	Banking indicators	Liquidity data and deferred/restructured loans	Weekly	Within 5 days of the end of each week
	Banking data	Banks' net open foreign exchange positions split between total foreign assets and foreign exchange liabilities: in aggregate for the system and bank by bank (without names)	Monthly	Within five days of the end of each month
	Banking data	Holdings of government securities – in aggregate and bank-by-bank (without names)	Monthly	Within 7 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Quarterly	Within 60 days
	Transfers	Workers' remittances.	Monthly	Within 25 days of the following month
	Other monetary data	The SBP survey, ODCs and DCs published in IFS.	Monthly	Within 45 days of the end of each month
	SBP refinance schemes	Outstanding position under SBP refinance schemes (by program)	Monthly	Within 25 days of the end of each month
	Balance of payments	Detailed export and import data Detailed balance of payments data	Monthly	Within 28 days of the end of each month
	Privatization receipts	Balance on the PC Fund account; gross inflows into and outflows from the PC Fund account during the month, specifying the nature of each transaction	Quarterly	Within seven days of the end of each quarter
Ministry of Finance (MOF)	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the SBP, and state-owned companies; any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears.	Monthly	Within 25 days of the following month

Table 3. Pakistan: Monitoring and Reporting Requirements (continued)				
Reporting Agency	**Type of Data**	**Description of Data**	**Frequency**	**Timing**
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash and in kind.	Quarterly	Within 15 days of the end of each quarter
	Domestic debt	Domestic debt composition	Monthly	Within 25 days of the end of each month
	Domestic debt	T-Bill and PIB Bid sheet from domestic debt auctions	Daily	Within 1 day of each T-Bill and PIB auction
	Federal government	State budget	Monthly	Within 30 days of the end of each month
	Federal government	Government guarantees - issued and executed (reported separately). Name of entity receiving the guarantee and the value of the guarantee.	Quarterly	Within 15 days of the end of each quarter
	Consolidated general government	Federal and provincial governments	Quarterly	Within 45 days of the end of each quarter
	Consolidated general government	Federal and provincial governments	Annual	Within 180 days of the end of each year
	Federal government	Fiscal financing sources: Detailed quarterly financing plan for the coming 12 months including projections for domestic public securities (issuance and maturities), external financing, SBP profits, short-term borrowing, other financing schemes, and borrowing from the SBP.	Monthly	One month in advance
	General government	Total general government budgetary spending on health and education broken down into spending by the federal and provincial governments	Monthly	Within 15 days of the end of each month
	Federal government	Stock of government borrowing from the SBP	Quarterly	Within the first five days of each quarter.
Pakistan Bureau of Statistics (PBS)	SPI, CPI, WPI	Detailed monthly price indices	Monthly	Within five days of the following month
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
Federal Board of Revenue (FBR)	Revenue collection Tax credits	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions.	Monthly	Within seven days of the end of each month
	Tax arrears	By category	Monthly	Within seven days of each month
		By type of tax	Monthly	Within seven days of the end of each month
	All tax refund claims in arrears	Itemized by tax category (GST, income, customs duties, etc.)	Monthly	Within seven days of the end of each month

Table 3. Pakistan: Monitoring and Reporting Requirements (continued)				
Reporting Agency	**Type of Data**	**Description of Data**	**Frequency**	**Timing**
	Automated GST refunds	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Quarterly	Within seven days of the end of each month
		Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Quarterly	Within seven days of the end of each month
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large taxpayer units (LTUs)	Quarterly	Within seven days of the end of each month
	Import data	Total value of recorded imports Total value of duty-paid recorded imports; Number of total transactions involving recorded imports; Number of total transactions involving nonduty free recorded imports	Quarterly	Within 30 days of the end of each quarter
	Audits	Percentage of selected companies and identified revenue from audits	Quarterly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
Ministry of Water and Power		Key Power Sector Statistics (Please see the attached template) Cumulative Monthly Subsidy Position (Rs. Billion) PEPCO Month End Payables and Receivables Positions And Aging Schedule, Rs. Billion Receivables Positions - Total and DISCO-wise Break-up CPPA/PEPCO Month-wise Consolidated Cash Flow AT&C Statistics Monthly TDS Claims by DISCOs and Total Inter Corporate Circular Debt Sheet Prepared by Ministry of Finance DISCOs Consolidated Income Statement Net Electrical Output & Power Purchase Price by Source, GWh Generation, Demand and Shortfall for FY 2010 to date Net Electrical Output (MkWh) Plant and Fuel-wise Detail Working Capital Loans For each loan type	Quarterly	Within 30 days
	Quantitative target on performance of DISCOs	Quarterly quantitative targets for each DISCO for technical and distribution losses, collection form current consumers and recoveries of arrears.	Quarterly	Within 30 days from the end of the quarter

Table 3. Pakistan: Monitoring and Reporting Requirements (concluded)

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	Domestic expenditure arrears	Energy arrears (stock) Flow of arrears by source	Quarterly	Within 45 days of the end of each month for government arrears
		Determined and Notified Tariff's for each User and User Group (Please see template)	Annual	Within 30 days of determination and notification
Ministry of Petroleum and Natural Resources		Gas supply Gas prices Gas sales by consumers	Quarterly on monthly frequency	Within 30 days from the end of the quarter
		UFG losses	Quarterly	Within 30 days from the end of the quarter
BISP	Targeted cash transfers	Coverage (number of beneficiaries paid) and payment by conditional and unconditional transfers.	Quarterly	Within 30 days from the end of the quarter
Ministry of Finance	Financial statements	Financial statements (cash flow, income statement, and balance sheet) and operational indicators for Pakistan Railways, Pakistan Steel Mills and Pakistan International Airline	Quarterly	Within 30 days from the end of the quarter

INTERNATIONAL MONETARY FUND

PAKISTAN

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION, SIXTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, AND REQUESTS FOR WAIVERS OF APPLICABILITY AND NONOBSERVANCE OF PERFORMANCE CRITERIA AND REPHASING OF ACCESS—INFORMATIONAL ANNEX

December 22, 2021

Prepared By

Middle East and Central Asia Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(as of October 31, 2021)

Membership Status

Joined July 11, 1950; Article VIII.

General Resources Account

	SDR Million	Percent Quota
Quota	2,031.00	100.00
Fund Holdings of Currency	7,051.21	347.18
Reserve Position	0.12	0.01

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	2,935.19	100.00
Holdings	2,186.89	74.51

Outstanding Purchases and Loans

	SDR Million	Percent Allocation
Emergency Assistance	1,015.50	50.00
Extended Arrangements	4,004.83	197.19

Latest Financial Commitments

Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	Jul 3, 2019	Oct 2, 2022	4,268.00	1,394.00
EFF	Sep 4, 2013	Sep 30, 2016	4,393.00	4,393.00
Stand-By	Nov 24, 2008	Sep 30, 2011	7,235.90	4,936.04

Outright Loans:

Type	Date of Commitment	Date Drawn	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RFI	Apr 16, 2020	Apr 20, 2020	1,015.50	1,015.50

Projected Payments to the Fund

	Forthcoming (SDR Million)				
	2021	**2022**	**2023**	**2024**	**2025**
Principal	210.00	702.17	986.04	1,263.92	769.21
Charges / Interest	23.47	74.71	46.13	28.68	16.59
Total	**233.47**	**776.88**	**1,032.18**	**1,292.60**	**785.80**

Implementation of HIPC Initiative

Not applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI)

Not applicable.

Safeguards Assessment

The latest safeguards assessment for the State Bank of Pakistan (SBP) was completed in December 2019. The assessment found that the SBP has maintained a broadly strong safeguards framework since the last assessment in 2013, except for its legal framework, in particular with regards to autonomy and governance. The financial reporting, external and internal audit mechanisms, and an enterprise-wide risk management framework all highlight sound practices. However, the SBP's involvement in quasi-fiscal activities needs to be phased-out in the medium-term, and staff is engaging with the authorities to strengthen SBP's autonomy and governance arrangements through legislative reforms. Previous assessments were completed in December 2013, March 2010, March 2009, and February 2001.

Exchange Arrangement

On May 19, 1999, the dual exchange system was unified, with all international transactions conducted at the interbank market exchange rate (FIBR). The de jure and de facto exchange rate arrangements are floating. The exchange rate is determined by the market forces, that is demand and supply of foreign exchange. The SBP does not explicitly or implicitly commit to an exchange rate target or path. The SBP intervenes in the market to curb speculative pressures for ensuring smooth functioning of the markets. In June 2019 the SBP announced that (i) the SBP moves to a flexible market-determined exchange rate with a focus on price stability; (ii) interventions are limited to safeguarding financial stability and preventing disorderly market conditions (DMC); and (iii) banks are free to quote and trade at any exchange rate. The volume and frequency of FX intervention and other administrative measures have been increased to manage the FX market as current expansionary macroeconomic policies led to heightened depreciation pressure on PKR in 2021. The SBP does not publish data related to market interventions, being more transparent and strengthened communications should improve the functioning of the floating FX regime. Pakistan has accepted the obligations of Article VIII, sections 2, 3, and 4 of the Fund's Articles of Agreement. Pakistan maintains an exchange restriction and multiple currency practice (MCP) subject to Fund approval under Article VIII 2(a) and 3 arising from imposing a 100 percent cash margin requirement on imports of certain goods originally imposed in February 2017. In September 2021, the margin requirement was extended to an additional 114 items, taking the total number of items to 525. Pakistan also maintains an exchange restriction arising from a limitation on advance payments for imports against letters of credit and advance payments up to the certain amount per invoice (without LCs) for the import of eligible items, imposed in July 2018.

Last Article IV Consultation

Concluded on July 13, 2017 (IMF Country Report No. 17/212).

FSAP Participation

Pakistan participated in the Financial Sector Assessment Program (FSAP) in September 2008, however, the report was not published. The previous FSAP was conducted in February and April 2004. The Financial System Stability Assessment was published in July 2004 (IMF Country Report No. 04/215).

Technical Assistance since last Article IV consultation (July 2017)

Department	Timing	Purpose	Receiving Agency[1/]
FAD	March/September-November 2021	Compliance Risk Management	FBR
FAD	January 2021	Cash Management and TSA Implementation	MOF
FAD	August 2020	Revenue Mobilization	FBR
FAD	June 2020	Tax policy responses to Covid-19, Sales Tax Harmonization	FBR/MOF
FAD	February 2020	Sustainable Development Goals (SDG) costing	MOF
FAD	October 2019	Tax policy	FBR/MOF
FAD	September 2019	Cash management and PFM reform	MOF
FIN	September 2019	Safeguards assessment	SBP
LEG/MCM	July 2021	Bank Resolution Framework	SBP
LEG	March 2020/ October 2019	AML/CFT risk-based supervision and legal drafting	MOF
LEG	January 2020	SOE governance	MOF
LEG	January 2020	Central bank reform	MOF
MCM	May 2020	Cyber risks	SBP
MCM	January 2020	Debt Management	MOF

MCM	May 2018	Islamic banking liquidity and Sukuk market development	SBP/MOF
STA	January 2022	National Accounts rebasing	PBS
STA	April 2019	Price statistics	PBS
STA	September 2018	e-GDDS	SBP/MOF/PBS

[1/]Ministry of Finance (MOF), Ministry of Interior (MOI), Federal Board of Revenue (FBR), State Bank of Pakistan (SBP), and Pakistan Bureau of Statistics (PBS).

Resident Representative

Ms. Esther Pérez Ruiz replaced Ms. Teresa Daban-Sanchez as the Resident Representative in December 2021.

COLLABORATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

As of October 31, 2021, Pakistan has collaborations with the World Bank Group and the Asian Development Bank (ADB).

International Financial Institution	Hyperlink
The World Bank Group	https://www.worldbank.org/en/country/pakistan
The Asian Development Bank (ABD)	https://www.adb.org/countries/pakistan/main

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance

General

Data provision is broadly adequate for surveillance with some key data shortcomings in the government finance and national accounts statistics.

National Accounts

The Pakistan Bureau of Statistics (PBS) disseminates annual national accounts statistics using the 2005/06 benchmark estimate as the base year, which is broadly in line with the concepts and definitions of the 2008 System of National Accounts. The current GDP and component series go back to 1999/00. The PBS is in the process of rebasing national accounts to 2015/16. The rebasing has been delayed due to difficulties in conducting an Integrated Agriculture Census (IAC). STA technical assistance (TA) is planned for FY 2022 to support the rebasing exercise as well as the development of quarterly national accounts, both of which are critical improvements for surveillance purposes. The PBS is releasing quarterly employment/unemployment data and is investigating the feasibility of disseminating data on wages/salaries.

Price Statistics

The PBS produces three price indices: the CPI, the wholesale price index (WPI), and the sensitive price indicator (SPI). The CPI and WPI are compiled on a monthly basis. The SPI is compiled on a weekly basis and consists of 53 essential commodities. The concepts and definitions of the CPI attempt to follow international guidelines. There is a need to replace the WPI with a producer price index (PPI). PBS introduced the Classification of Individual Consumption by Purpose (COICOP) with the August 2011 index, along with updated weights and expanded item and geographic coverage. In September 2019 PBS released an updated CPI with base year 2015–16, which now covers both rural and urban areas.

External Sector Statistics

Starting from September 2013, the SBP reports regularly quarterly balance of payments (BoP) statistics with data beginning with Q1 2005 in line with the Balance of Payments Manual sixth edition (BPM6). In October 2015, the SBP also started reporting to the STA BPM6 based annual and quarterly international investment position (IIP) with data beginning with Q1 2014. Some issues of consistency between BoP and IIP remain to be addressed. Pakistan also participates in the Coordinated Direct Investment Survey (CDIS) and the Coordinated Portfolio Investment Survey (CPIS).

Government Finance Statistics

The concepts and definitions used in compiling government finance statistics are broadly based on the GFSM 1986. The scope of central government data is further limited as it does not cover the activity of extra budgetary funds. The classification of expenditure deviates from GFSM 1986 methodology because the economic and functional classifications are mixed in reporting, in particular, with defense and government administration expenditures not clearly identified according to economic classification. Moreover, the wage bill is not reported separately. The basis of recording GFS is on, or close to, a cash basis with transactions recorded on a gross basis.

No data are provided on transactions in nonfinancial and financial assets and liabilities. Data provided include revenues, and expenditure by economic nature and functions of the government. However, tax revenue does not have a comprehensive breakdown, lacking taxes on income, profits, and capital gains paid by corporations; and the quality of the expenditure data, both in COFOG and in expense by nature, is not consistent.

Areas for improvement include: (i) moving to GFSM 2014 for concepts, definitions, and presentation; (ii) improving the timeliness of annual and quarterly data; (iii) reviewing revenue and expenditure classification; (iv) improving the availability of data on transactions in nonfinancial and financial assets and liabilities; and (v) expanding coverage from the budgetary central government to general government.

Monetary and Financial Statistics

The SBP reports the standardized report forms (SRFs) for central bank (1SR), other depository corporations (2SR), and monetary aggregates (5SR) to the Fund, which are published in the IMF's IFS website. In 2017, STA has conducted a technical assistance for expanding the compilation of MFS and compilation of OFC survey (4SR). However, the SBP has not yet started reporting 4SR.

Pakistan reports data on all series and indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

Financial Surveillance

Pakistan reports all core financial soundness indicators (FSIs) for deposit takers (DT) and 12 out of 28 FSIs of the encouraged set for DT, non-financial corporations, and real estate prices. These FSIs are disseminated on the IMF's FSI website.

II. Data Standards and Quality

Participant in the IMF's enhanced General Data Dissemination System (e-GDDS), Pakistan began implementing the e-GDDS on January 11, 2019 by launching a National Summary Data Page.

A ROSC report on Fiscal Transparency was published in April 2008.

Table 1. Table of Common Indicators Required for Surveillance

(As of December 2, 2021)

	Date of latest observation	Date received	Frequency of data [4]	Frequency of reporting [4]	Frequency of publication [4]
Exchange rates	Dec 2, 2021	Dec 2, 2021	D and M	D and M	D and M
International reserve assets and reserve liabilities of the monetary authorities [1]	Nov 19, 2021	Dec 2, 2021	D	D	M
Reserve/base money	Oct 31, 2021	Nov 25, 2021	W and M	W and M	W and M
Broad money	Oct 31, 2021	Nov 30, 2021	W and M	W and M	W and M
Central bank balance sheet	Oct 31, 2021	Nov 25, 2021	M	M	M
Consolidated balance sheet of the banking system	Oct 31, 2021	Nov 30, 2021	M	M	M
Interest rates [2]	Nov 2021	Nov 24, 2021	M	M	M
Consumer price index	Nov 2021	Dec 1, 2021	M	M	M
Revenue, expenditure, balance and composition of financing – general government	Sep 2021	Oct 5, 2021	M	M	M
Revenue, expenditure, balance and composition of financing – central government	Sep 2021	Oct 5, 2021	M	M	M
Stocks of central government and central government-guaranteed debt [3]	Sep 2021	Nov 24, 2021	M/Q	M/Q	M/Q
External current account balance	Oct 2021	Nov 26, 2021	M	M	M
Exports and imports of goods and services	Oct 2021	Nov 26, 2021	M	M	M
GDP/GNP	FY2020/21	Jun 10, 2021	A	A	A
Gross external debt	Sep 2021	Nov 24, 2021	Q	Q	Q
International investment position [5]	Q2 2021	Oct 4, 2021	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds. Central government-guaranteed debt is available on a quarterly basis.
[3] Including currency and maturity composition.
[4] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Semi-annually (SA), Annually (A), Irregular (I), or Not Available (NA).
[5] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

PAKISTAN

January 28, 2022

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION, SIXTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, AND REQUESTS FOR WAIVERS OF APPLICABILITY AND NONOBSERVANCE OF PERFORMANCE CRITERIA AND REPHASING OF ACCESS—SUPPLEMENTARY INFORMATION, REVISED PROPOSED DECISIONS, AND SUPPLEMENTARY LETTER OF INTENT

Approved By
Thanos Arvanitis and Kenneth Kang

Prepared by the Middle East and Central Asia Department

This supplement provides an update on recent developments and the status of the prior actions (PAs), since the issuance of the report on December 23, 2021. The update does not alter the thrust of the staff appraisal.

1. Recent economic developments. Economic activity remains broadly in line with the macroeconomic framework underlying the review. Inflation increased to 12.3 percent in December (y-o-y), and although the authorities' policy adjustment is expected to gradually bring inflation down in the coming months, persistently high commodity prices might keep it somewhat higher than anticipated at the time of issuance of the report.

2. COVID-19 situation. Since end-December 2021, COVID-19 cases have been on the rise, and the test positivity rate has increased markedly in various cities. In response, on January 20, 2022, the authorities introduced bans on indoor gatherings as well as capacity limits for cities with a test positivity rate above 10 percent. The vaccination campaign has been progressing, albeit as of mid-January 2022, only 36 percent of the population are fully vaccinated.

3. The authorities have met all five PAs for the review:

- ***Supplementary budget***. The National Assembly adopted a supplementary finance bill (with the GST reform) broadly in line with staff agreement on January 13, 2021, which the President signed into law on January 15, 2021 to take effect immediately. The Ministry of Finance also published a Statement of Contingent Liabilities with all guarantees expected to be issued during the remainder of the current fiscal year on January 11, 2022, which was laid before the National Assembly on January 21, 2022.

- ***Fuel taxes***. The authorities raised the development levy on gasoline and diesel by PRs 8/liter in two equal steps on November 5 and December 1, 2021 (PA) and by another PRs 4/liter on January 1, 2022.

- ***Central bank legislation***. Parliament adopted the amendments to the State Bank of Pakistan (SBP) Act, prepared in consultation with the IMF staff, which the President signed into law on January 28, 2022.

- ***Governance and transparency I***. The authorities are publishing key information on COVID-related awarded procurement contracts on the Public Procurement Regulatory Authority's website.

- ***Governance and transparency II***. The Auditor General of Pakistan conducted an ex-post audit of the procurement of COVID-related supplies and social payments made during FY 2020. The full audit report was published on the website of the Ministry of Finance on November 19, 2021.

4. Given the delay in the Executive Board meeting, information has become available on:

- ***one PC proposed to be set for end-2021***. As the information on the ceiling on the SBP's stock of net foreign currency swaps/forward position for the end-December 2021 is already available,[1] in line with Fund policy, staff proposes that this performance criterion (PC) be set only for end-March and end-June 2022 (Attachment II).[2] The Proposed Decision 2 has been revised accordingly (Attachment I).

- ***two structural benchmarks (SBs) proposed to be set for end-January 2022***. The cabinet adopted the second step of the energy subsidy reform for residential consumers on December 16, 2021, thereby meeting the related SB. However, given delays arising from capacity constraints in establishing a robust asset declaration system with a focus on high-level public officials (including elected and unelected members of the Federal Cabinet), staff supports the authorities' request to reset the related SB to end-March 2022.

5. Against this backdrop, staff continues to recommend the completion of the review as set forth in the main staff report, the authorities' December 2021 LOI and the attached MEFP and TMU.

[1] The information shows that the end-December 2021 indicative target has been met.

[2] In line with Fund policy, the Executive Board may only set PCs retroactively subject to two conditions: (i) the Letter of Intent/MEFP is signed and circulated to the Board before the relevant test date, and (ii) the data on those PCs is not yet available at the time of the Board meeting.

Appendix I. Supplementary Letter of Intent

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431
USA

Islamabad, January 28, 2022

Dear Ms. Georgieva:

1. This letter updates our Letter of Intent dated December 17, 2021, as subsequently corrected. Importantly, we have completed all prior actions required for the review:

- The National Assembly adopted a supplementary finance bill on January 13, 2022, which included a GST reform in line with IMF staff agreement. On January 15, 2022, the President signed this into law, with it immediately coming into effect. Separately, we presented to the National Assembly on January 21, 2022, a Statement of Contingent Liabilities with all guarantees expected to be issued during the remainder of the current fiscal year.

- We raised the petroleum development levy (PDL) on gasoline and diesel by PRs 8/liter in two equal steps on November 5 and December 1, 2021, and by an additional PRs 4/liter effective from January 1, 2022.

- On January 13, 2022, the National Assembly approved amendments to the State Bank of Pakistan (SBP) Act, aimed at strengthening SBP’s independence, decision making structure, and mandate. Subsequently the Senate approved the amendments and the President signed this into law on January 28, 2022.

- We are publishing key information on COVID-related awarded procurement contracts on the Public Procurement Regulatory Authority's website, with information available here: https://www.ppra.org.pk/pcontract.asp.

- The Auditor General of Pakistan conducted an ex-post audit of the procurement of COVID-related supplies and social payments made in FY 2020. The full audit report was published on November 19, 2021, and is available here: https://www.agp.gov.pk/SiteImage/Policy/53.%20Covid-19%20Audit%20Report%2008.06.2021.pdf.

2. Due to the timing of the Executive Board meeting falling after the end-December 2021 test date, the information on the ceiling on the net foreign currency swaps/forward position of the SBP for end-December 2021 is already available. Based on this information (position of negative

US$4,382 million), we met the end-December indicative target that was set at the time of the 2nd-5th reviews. As a result, we confirm our understandings that this performance criterion will be set for end-March and end-June 2022. A revised QPC table is included in Table 1.

3. On the same basis, we need to update some of our structural conditionality commitments. On December 16, 2021, we adopted a cabinet decision for the second step of the energy subsidy reform for residential consumers, thereby completing this structural benchmark (SB) proposed for end-January 2022. However, we have requested to establish a robust asset declaration system with a focus on high-level public officials (including elected and unelected members of the Federal Cabinet) by end-March 2022 to permit sufficient time to complete this important SB. A revised table of structural conditionality is included in Table 2.

Sincerely yours,

/s/	/s/
Shaukat Tarin	Dr. Reza Baqir
Minister for Finance and Revenue	Governor of the State Bank of Pakistan

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets

(Billions of Pakistani rupees, at program exchange rates, unless otherwise indicated)

	FY 2020/21								FY 2021/22					
	end-March				end-June				end-September		end-December		end-March	end-June
	Program (PC) CR 21/73	Adjusted Prog.	Actual	Status	Program (PC) CR 21/73	Adjusted Prog.	Actual	Status	Program (IT) CR 21/73	Est.	Program (IT) CR 21/73	Proposed (PC)	Proposed (PC)	Propose (PC)
Performance Criteria														
Floor on net international reserves of the SBP (millions of U.S. dollars)	-10,238	-10,198	-7,836	Met	-8,676	-8,041	-4,434	Met	-8,518	-2,303	-7,677	-5,450	-6,000	-5,100
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees)	9,655	9,650	9,044	Met	10,173	10,083	9,290	Met	9,947	8,793	10,190	9,850	10,233	10,792
Ceiling on SBP's stock of net foreign currency swaps/forward position (negative, millions of U.S. dollars) 9/	5,200	…	4,285	Met	5,200	…	4,870	Met	4,900	4,870	4,600	…	4,300	4,000
Ceiling on general government primary budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 2/	-230	-350	-505	Met	246	412	462	Not met	-130	-137	-96	-300	-389	25
Ceiling on net government budgetary borrowing from the SBP (stock, billions of Pakistani rupees)	6,908	…	5,127	Met	6,618	…	5,274	Met	6,333	4,973	6,049	6,049	6,049	6,049
Ceiling on the amount of government guarantees (stock, billions of Pakistani rupees) 3/	2,715	…	2,682	Met	2,715	…	2,626	Met	2,735	2,649	2,765	2,797	2,954	2,956
Continuous Performance Criteria														
Zero new flow of SBP's credit to general government 8/	0	…	0	Met	0	…	475	Not met	0	0	0	0	0	0
Zero ceiling on accumulation of external public payment arrears by the general government	0	…	0	Met	0	…	0	Met	0	0	0	0	0	0
Indicative Targets														
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees) 7/	114	…	76	Not met	199	…	194	Not met	48	6	102	86	199	250
Cumulative floor on general government budgetary health and education spending (billions of Pakistani rupees)	975	…	1,006	Met	1,567	…	1,583	Met	356	336	752	783	1,287	2,014
Floor on net tax revenues collected by the FBR (cumulative, billions of Pakistani rupees)	3,394	…	3,395	Met	4,691	…	4,764	Met	1,181	1,397	2,585	2,852	4,343	6,100
Ceiling on net accumulation of tax refund arrears (billions of Pakistani rupees) 4/ 5/	65	…	112	Not met	65	…	-30	Met	0	17	0	11	5.5	0
Ceiling on power sector payment arrears (cumulative flow, billions of Pakistani rupees) 4/	319	…	269	Met	354	…	297	Met	-166	114	-154	67	184	166
Gross issuance of PIBs, Sukuks, and Eurobonds (cumulative, billions of Pakistani rupees) 6/	2,850	…	2,341	Not met	4,250	…	3,496	Not met	1,000	1,443				

Sources: Pakistani authorities; and Fund staff estimates.

1/ Fiscal year runs from July 1 to June 30. All definitions as per the attached Technical Memorandum of Understanding.

2/ Cumulative from the start of each fiscal year. "-" means surplus. End-June 2019 actual measured from above the line.

3/ Definition changed at the time of the second review. Applicable for end-March 2021 targets onward.

4/ Data for December 2018/June 2019 is an actual/projected stock as of the end of the month. Quarterly targets are cumulative flows for each fiscal year.

5/ The projected end-June 2019 figure included only sales tax arrears, while the actual end-June 2019 tax arrears includes all tax arrears and adheres to the TMU definition.

6/ Added at the time of the second through the fifth EFF review. Applicable for end-March 2021 onward. This applies to the cumulative gross issuance of Pakistan Investment Bonds (PIBs) and GoP Ijara Sukuks, and Eurobonds starting from the beginning of the fiscal year. This is defined as the cumulative sum—since the start of the fiscal year—of the total acceptance of the bids of each auction of PIBs, GoP Ijara Sukus across all maturities (both at fixed and floating rate), and that of Eurobonds evaluated at the program exchange rate.

7/ Excludes spending by the Poverty Alleviation Fund amounting to PRs 5 billion that was originally programmed to be executed in FY 2021/22 by BISP.

8/ On November 18, 2021 the SBP on-lent PRs 475 billion (SDR 1.947 billion equivalent) to the government of Pakistan amounting to 100 percent of the SDR allocation received on August 23, 2021.

9/ The QPC for end-December 2021 is not proposed as the information became available before the Executive Board meeting for the sixth review.

Table 2. Pakistan: Structural Conditionality (Revised)

Actions				
Prior Actions	**Rationale**			
1 National assembly adoption of a supplementary finance bill (GST reform), which the President signs into law, in line with staff agreement together with supporting measures (published list of expected guarantees).	Critical to ensure achievement of fiscal objectives.			
2 Petroleum development levy on gasoline and diesel raised by PRs 8/liter.	Critical to ensure achievement of fiscal objectives.			
3 Adoption by parliament, and signed into law by the President, of the amendments to the State Bank of Pakistan Act, prepared in consultation with the IMF staff, aimed at strengthening the SBP independence, decision making structure, and mandate.	Critical for central bank independence.			
4 Publication of key information on all COVID-related awarded procurement contracts on the Public Procurement Regulatory Authority's website.	Critical for transparency, governance, and tackling corruption.			
5 Auditor General of Pakistan will conduct an ex-post audit of the procurement of COVID-related supplies and social payments made during FY 2020. The full audit report will be published on the website of the Ministry of Finance.	Critical for transparency, governance, and tackling corruption.			
Structural Benchmarks		**Date**	**Revised Date**	**Status**
Fiscal				
1 Commit to not grant further tax amnesties.		Continuous		Met.
2 Avoid the practice of issuing new preferential tax treatments or exemptions.		Continuous		Not met.
3 Ministry of Finance will establish and make functional the TSA-1.		end-May 2021		Not met. Implemented with delay in September 2021.
4 Reintroduce and roll out the track-and-trace systems for tobacco products.		end-Jun. 2021		Not met. Reintroduced and rolled out only in one company out of 16 in October 2021.
Social Protection and Gender				
5 Finalize the update of the BISP beneficiaries' database (National Socio-Economic Registry).		end-Jun. 2021		Not met. Implemented with delay in October 2021 with a coverage of 33 million households.
Monetary and Financial				
6 Adopt measures to strengthen the effectiveness of the AML/CFT framework to support the country's efforts to exit the Financial Action Task Force list of jurisdictions with serious deficiencies.		end-Jun. 2021	end-Mar. 2022	Not met.
Energy Sector, State-Owned Enterprises, and Governance				
7 Reduction in CPPA-G payables to power producers through a payment up to PRs 180 billion with no more than 1/3 in cash and the remainder in debt instruments.		end-May 2021		Not met. Implemented with delay on June 4 through a payment of PRs 89.9 billion, with 1/3 in cash and the remainder in debt instruments.
8 Completion of the FY 2021 annual rebasing (AR).		Jun. 1, 2021		Not met. Implemented with delay on November 5, 2021.
9 Notification of FY 2020 Q4 electricity tariff adjustment for capacity payments.		end-Sep. 2021		Not met. Implemented with delay on October 1, 2021.
10 Finalization of the energy cross-subsidy reform for the FY 2022 budget.		end-Jun. 2021		Not met. To be implemented through a new SB #4.
11 Adoption by parliament of amendments to the OGRA Act.		end-Jun. 2021	end-Jun. 2022	Not met.
12 Conduct and publish external audit of the Utility Stores Corporation (USC) based on FY 2020 financials.		end-Apr. 2021		Not met.
13 Publication of awarded COVID-spending related contracts and beneficial ownership information of bidding and awarded legal persons in a centralized and publicly accessible website.		end-Apr. 2021		Not met. To be partially implemented through PA #4, with beneficial ownership transparency addressed with a delayed but broader reform (new SB#6) that covers all large contracts (not just COVID-related spending).
14 Auditor General of Pakistan will conduct an ex-post audit of the procurement of urgently needed medical supplies related to Covid-19. Audits results will be published on the website of the Ministry of Finance.		end-Apr. 2021		Not met. To be implemented through PA #5.
15 Establish a robust asset declaration system with a focus on high-level public officials (including elected and unelected members of the Federal Cabinet).		end-Jun. 2021	end-Mar. 2022	Not met.
New Structural Benchmarks				
1 Preparation of draft personal income tax (PIT) legislation.		end-Feb. 2022		
2 Preparation of a plan by Ministry of Finance and State Bank of Pakistan, in consultation with other stakeholders, to establish an appropriate Development Finance Institution to support the eventual phasing out of SBP refinance facilities.		end-Apr. 2022		
3 Completion of the first stage recapitalization of the two private sector banks that are undercapitalized.		end-May 2022		
4 Cabinet decision on the second step of the energy subsidy reform for residential consumers.		end-Jan. 2022		Met.
5 Parliamentary approval of new SOE law in line with staff recommendations.		end-Jun. 2022		
6 Issuance of regulations by the Public Procurement Regulatory Authority to require collection for publication of beneficial ownership information from companies which are awarded public procurement contracts for PRs 50 million and above.		end-Mar. 2022		

INTERNATIONAL MONETARY FUND

PAKISTAN

SELECTED ISSUES

December 22, 2021

Approved By
Middle East and Central Asia Department

Prepared by Kerstin Gerling, Tannous Kass-Hanna, and Christine Richmond (all MCD); and Fernanda Brollo, Emine Hanedar, and Sébastien Walker (all FAD)

CONTENTS

FIGURES

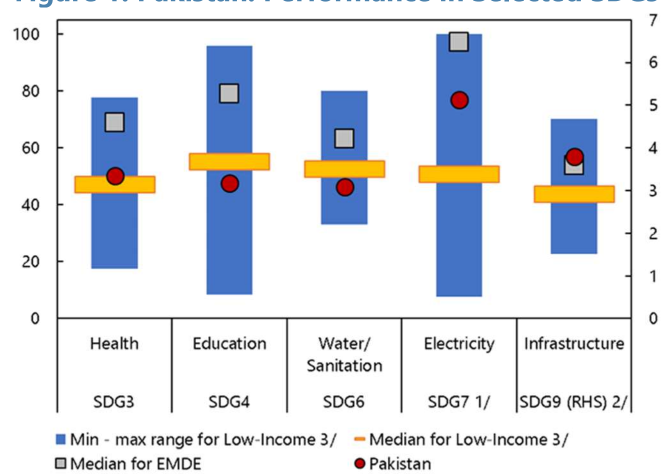
SPENDING NEEDS FOR REACHING THE SUSTAINABLE DEVELOPMENT GOALS[1]

Pakistan has made some progress towards meeting the Sustainable Development Goals (SDGs) in recent years, but additional spending is required. Spending in the areas of health, education, water and sanitation, electricity, and road infrastructure needs to increase gradually, reaching an additional 16.1 percent of GDP in annual spending by 2030, with about two-thirds corresponding to education and health. In the education sector, the priority is to increase enrollment rates and the quantity and quality of teachers, as well as to improve essential infrastructure. In health, additional spending should be geared towards increasing the number of medical personnel and reducing the share of "out of pocket" spending. Regarding electricity, roads, and water and sanitation, the challenge is to enhance both infrastructure access and quality. The substantial additional spending calls for multiple sources of financing, including by creating fiscal space through revenue mobilization and greater spending efficiency. Beyond resources, strengthening governance, capacity, and coordination among various stakeholders would help to increase spending efficiency and will be essential for achieving the SDGs.

A. Background

1. Pakistan has integrated the SDGs into its national development agenda. Pakistan committed to the 2030 Agenda for Sustainable Development in 2015 and adopted the SDGs as part of its national development agenda in 2016. Pakistan has designed a comprehensive national SDG framework to identify and prioritize goals in different areas and guide the design of development strategies. The national and provincial assemblies have established taskforces to monitor progress towards the SDGs and Pakistan underwent a Voluntary National Review (VNR) in 2019 to take stock of its progress.

Figure 1. Pakistan: Performance in Selected SDGs



Sources: Sachs et al. (2019) and IMF staff calculations.
1/ Access to electricity (percentage of population).
2/ Quality of overall infrastructure.
3/ Countries with GDP per capita below US$3,000.

2. While Pakistan has made progress in some areas, its current performance in critical SDG sectors lags that of its peers. The 2019 VNR highlighted progress in several areas, including poverty and child stunting, transparency and accountability, and gender equality and women's empowerment. However, Pakistan's current performance in education, health, electricity, and water

[1] Prepared by Fernanda Brollo, Emine Hanedar, and Sébastien Walker (all FAD). The information for this analysis was current as of March 2020 and reflects comments from the authorities that were taken on board during the consultative process. An expanded version of this paper with more details on the methodology was published as IMF Working Paper *Pakistan: Spending Needs for Reaching Sustainable Development Goals (SDGs)*.

and sanitation—as measured by the SDG indices of each sector—is below the median for Emerging Market and Developing Economies (EMDEs) (Figure 1). Pakistan's performance in education and water and sanitation is also below the median for countries with GDP per capita below US$3,000. In the context of rapid population growth, Pakistan needs to redouble its efforts to make further progress towards meeting the SDGs.

3. This Selected Issues Paper (SIP) assesses the additional spending required to make substantial progress towards achieving the SDGs. The SIP focuses on critical areas of human (education and health) and physical (electricity, roads, and water and sanitation) capital. For each sector, the SIP documents the progress to date, assesses where Pakistan stands relative to its peers, highlights key challenges, and estimates the additional spending required to make substantial progress. The estimates for the additional spending are derived using the IMF SDG costing methodology.[2]

4. The IMF methodology to estimate the additional spending needs assumes that development outcomes are a function of a mix of inputs. For a particular country, the methodology for health and education assigns the level of key inputs (such as the number of doctors and teachers) and its unit costs at the values for countries with a similar GDP per capita that perform well in the SDG index scores.[3] For electricity, roads, and water and sanitation, the estimates consider the additional investment required to support economic growth and expand coverage following the SDG targets. We summarize the results as additional spending in 2030 as a share of GDP.[4]

B. Human Capital

Education

5. Despite improvements during recent decades, education outcomes in Pakistan lag those of its peers, especially in secondary and tertiary education. The primary gross enrollment rate has increased significantly over the last 15 years (from 73 percent in 2003 to 94 percent in 2018), but 23 million children aged 5 to 16 are estimated to be out of school (about 40 percent of students aged 5 to 16) (ABD, 2019). While gross enrollment rates in pre-primary education are above peers,

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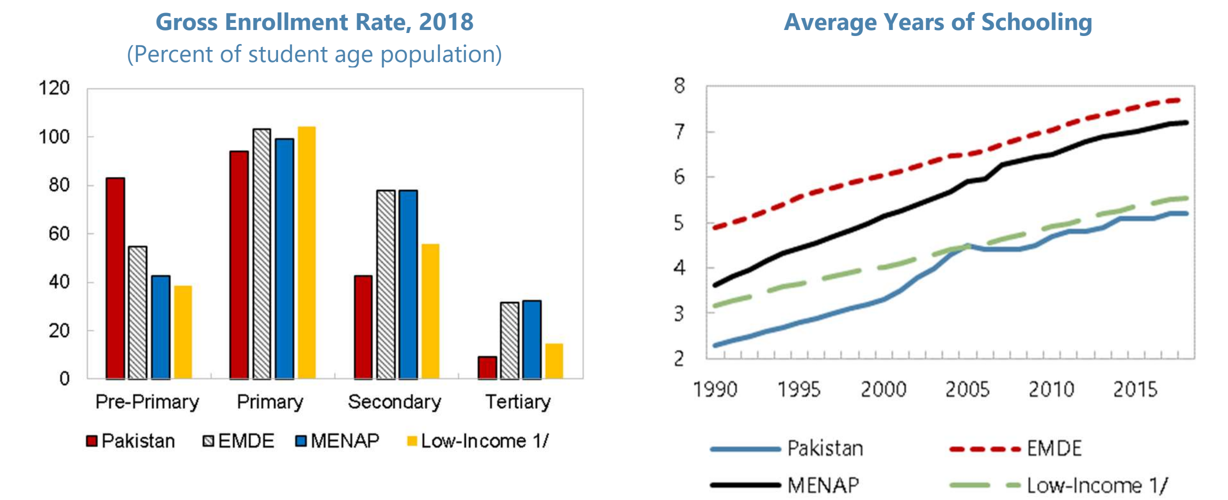
[2] The costing follows the methodology developed by Gaspar et al. (2019) and is laid out in Brollo et al. (2021).

[3] Countries that perform well have higher spending efficiency, and therefore, the estimates presented in this SIP assume that Pakistan's spending is as efficient as the high-performer peers. If efficiency does not improve towards the level of efficiency of high-performing peers, the spending required to achieve the SDGs would be larger.

[4] For education and healthcare, we report additional spending, corresponding to the difference between the spending consistent with high performance in 2030 as a share of GDP and the current level of spending as a share of GDP. For physical capital, additional spending corresponds to the annualized spending required to close infrastructure gaps between 2020 and 2030 as a share of GDP.

enrollment rates in secondary and tertiary education remain below (Figure 2).[5] Gross enrollment rates for female student are even lower than for male students, particularly at the pre-primary and primary levels. Average years of schooling have gradually increased, from 3.3 in 2000 to 5.2 in 2018-though they remain below MENAP and EMDE averages. These improvements have resulted in increases in the adult literacy rate, which has improved from 55 percent in 2011 to 59 percent in 2017.

Figure 2. Pakistan and Peers: Education Outcomes

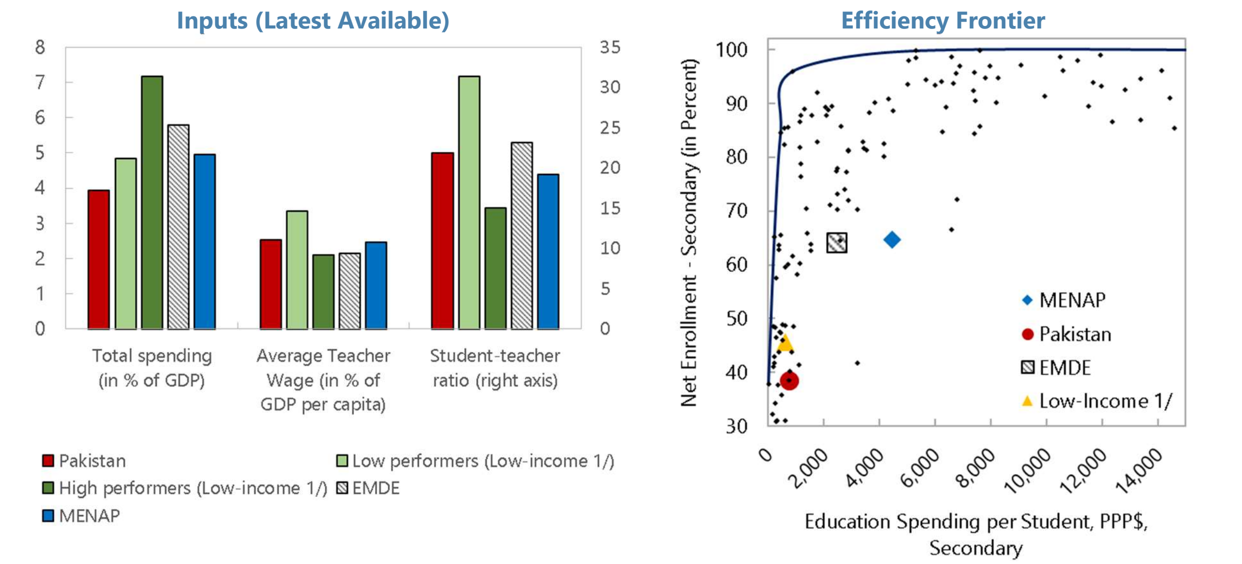


Sources: World Bank WDI (2020), and IMF staff calculations.
1/ Countries with GDP per capita below US$3,000.

6. **The weak performance in education is mainly driven by a low level of spending, but there is also room to increase spending efficiency**. Pakistan's total education spending (public and private) reached about 4 percent of GDP in 2018, below its peers (Figure 3). The student-teacher ratio (22) is above that of high-performing countries with similar income per capita (15 on average). Moreover, the student-teacher ratio differs significantly across education levels, reaching over 40 for primary education and only 13 for secondary and tertiary education. There is also room to increase spending efficiency, as suggested by Pakistan's low secondary net enrollment rate compared to countries with similar spending per student. Spending efficiency could notably be raised by tackling the issue of "ghost" teachers who are on the teacher's payroll but are not actually working as teachers. Teacher absenteeism has been historically high in Pakistan, but recent initiatives have reduced it from 24 percent in 2009 to 12 percent in 2016 (ADB, 2019). Minimum qualifications for public school teachers have been increased, but there is still ample room for improving teacher quality.

[5] The gross enrollment rate is the number of students enrolled in a given education level (primary, secondary, or tertiary), regardless of age, divided by the population of the age group that officially corresponds to that level. Therefore, gross enrollment rates could be higher than 100 percent. This is as opposed to the net enrollment rate, which is the number of students enrolled in a given level who belong to the age group that officially corresponds to that level, divided by the total population of the same age group.

Figure 3. Pakistan and Peers: Education Sector



Sources: Pakistani authorities, Gaspar et al. (2019), IMF FAD Expenditure Assessment Tool (EAT) and staff calculations.
1/ Countries with GDP per capita below US$3,000.

7. Demand- and supply-side factors further constrain improvements in education outcomes. While shortfalls in education spending hinder improvements in enrollment rates, reluctance by parents to send their children to school is an additional obstacle. This reluctance may reflect demand-side factors, including a preference for having children engaged in activities which are more "productive" in the short run and cultural norms and security concerns, such as a view that girls' education is not worth investing in or that is not safe for girls to travel to a school too far from the home.[6] The reluctance to send children to school could also mask several supply-side issues that households do not articulate clearly (ABD, 2019), including lack of, or poor, basic facilities in schools, poor quality of education, and teacher absenteeism (Ailaan, 2017). In some provinces, the high dropout rates at middle and high school levels are explained by the lack of availability of schools.

8. Pakistan's education spending would need to increase markedly to meet the SDG targets. To that end, annual total (public and private) education spending would need to increase by about 5.7 percent of GDP (from 3.9 percent in 2018 to 9.6 percent in 2030) (Table 1). The higher spending needs reflect both an increase in the teacher wage bill, given the need to bring on board more teachers to support higher enrollment and reduce class size, and higher capital spending.

- ***Increasing enrollment rates and improving essential infrastructure***. Pakistan needs to increase enrollment rates significantly, particularly in secondary and tertiary education. In line with the SDG targets, the estimates assume that by 2030 gross enrollment rates will reach 50 percent in pre-primary education, 100 percent in primary and secondary education, and 50

[6] Schools in Pakistan are mostly segregated by gender, with girls' schools requiring female teachers.

percent in tertiary education.[7] Increasing enrollment rates requires addressing the barriers to enrollment described above. This will also require building more schools, particularly in rural areas, and improving school infrastructure, such as the availability of bathrooms, electricity, drinking water, and the existence of boundary walls.[8]

- ***Increasing the quantity and quality of teachers***. Pakistan needs to reduce its student teacher ratio to 15 in order to match the current ratio of high performing countries. Teacher qualifications, as well as attendance, should be further improved. Teacher wages relative to GDP in Pakistan are slightly above those of high-performing countries, and therefore do not necessarily have to increase to attract more and better-qualified teachers.

Table 1. Pakistan: Additional Spending Required in Education by 2030

	GDP per capita US$ 0 - US$ 3,000	Pakistan	
	High performers	2018	2030
Main factors			
Students per teacher ratio	15	22	15
Teacher wages (ratio to GDP per capita)	2	3	2
Other current and capital spending (percent of total spending)	55	30	55
Student-age population (percent of total population)	39	42	39
Enrollment rate (preprimary to tertiary)	59	57	80
Private share (percent of total spending)	20	39	20
Results			
Education spending (percent of GDP)	7.2	3.9	9.6
Public	5.7	2.4	7.7
Private	1.5	1.5	1.9
Spending per student (US$ 2018)	674	244	570
SDG4 index	86	47	>80

Source: IMF staff estimates.

Health

9. Pakistan has made steady strides in health outcomes. Between 1990 and 2018, infant mortality rates decreased from 106 to 58 deaths per 1,000 live births and the mortality rate of children under 5 by about 50 percent.[9] Despite these improvements, Pakistan's health outcomes lag

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[7] The estimates assume a gross enrollment rate in pre-primary education by 2030 that is below the current level of 83 percent. Maintaining this high pre-primary enrolment rate would increase the 2030 annual spending needs by 1 percentage point of GDP.

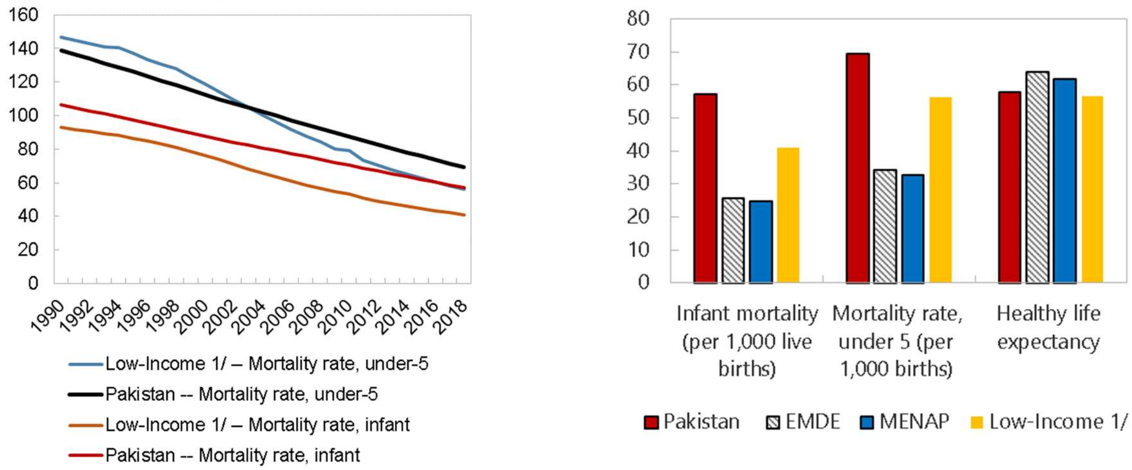
[8] A recent study on the availability of school facilities has revealed that only 52 percent of public schools in Pakistan have all four components of essential infrastructure, i.e., boundary walls, electricity, drinking water, and toilets. Furthermore, 11 percent of all public schools do not have any of these four elements (ADB, 2019).

[9] Other health indicators also show improvements in recent years, including the proportion of children aged 1-2 years covered by all vaccines (which increased from 54 percent in 2013/14 to 66 percent in 2015/16) and the proportion of births attended by skilled personnel (from 52 percent in 2013/14 to 69 percent in 2015/16). Demographic and Health Survey 2012–2013 and 2017–2018 and Pakistan's Voluntary National Review.

those of peers, with infant mortality rates and under-5 mortality rates about twice as high as the EMDE and MENAP averages and life expectancy at birth somewhat below peer averages.

Figure 4. Pakistan and Peers: Health Outcomes

Infant and Child Mortality (Mortality rate per 1,000 live births) | **Health Outcomes** (Latest available)

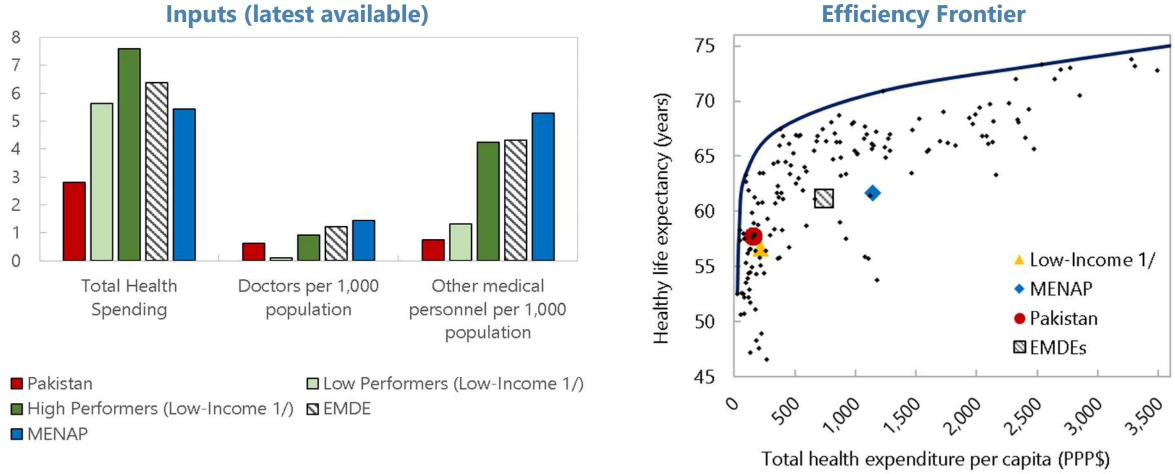


Sources: World Bank WDI (2020) and IMF staff calculations.
1/ Countries with GDP per capita below US$3,000.

10. Spending on healthcare is low and there is room to improve efficiency. Pakistan spends only 3 percent of GDP on healthcare, below its peers that spend around 5.5 to 7.5 percent of GDP (Figure 5). The "out of pocket" share of spending on healthcare is high at 65 percent, compared to 35 percent for EMDEs on average. This leads to greater vulnerability of poor households to health shocks. In part reflecting low spending, healthcare inputs in terms of number of doctors and particularly other medical personnel are below peer levels. While spending efficiency is better than in countries with GDP per capita below US$3,000, there is still room to improve efficiency as Pakistan remains far from the health efficiency frontier.

Figure 5. Pakistan and Peers: Health Sector

Inputs (latest available) | **Efficiency Frontier**



Sources: Pakistani authorities, Gaspar et al. (2019), IMF FAD Expenditure Assessment Tool (EAT) and staff calculations.
1/ Countries with GDP per capita below US$3,000.

11. Healthcare spending would need to increase significantly by 2030 to meet the SDG targets. Pakistan would need to almost triple its healthcare spending in terms of GDP-from the current 2.8 percent to 8.2 percent by 2030-to meet the SDG targets and perform at a commensurate level with high-performing peer countries (Table 2). This would require increasing public healthcare spending almost five-fold in terms of GDP, from 0.9 percent in 2018 to 4.3 in 2030.

- ***Increasing the number of doctors and medical personnel***. Pakistan needs to substantially increase the number of medical service providers. The number of doctors per 1,000 inhabitants should increase from its current level of 0.6 to 0.9. The number of other medical personnel such as nurses and midwives should be increased to almost six times its current level. The wages of doctors are slightly higher than in high-performing peer countries, thus there is room to increase the number of doctors while allowing salaries to increase by less than GDP per capita.

- ***The public and private share of total health spending could be more balanced***. Private spending represents two-thirds of total health spending in Pakistan, significantly above the level in high-performing peer countries. Increasing the public share of spending would increase the access of poor households to healthcare.

Table 2. Pakistan: Additional Spending Required in Healthcare by 2030

	GDP per capita US$ 0 - US $3,000	Pakistan	
	High performers	2018	2030
Main factors			
Doctors per 1,000 population	0.9	0.6	0.9
Other medical personnel per 1,000 population	4.3	0.7	4.3
Doctor wages (percent of GDP per capita)	10	11	10
Other current and capital spending (percent of total spending)	62	62	62
Private share (percent of total spending)	48	69	48
Results			
Health spending (percent of GDP)	7.6	2.8	8.2
Public	3.9	0.9	4.3
Private	3.7	1.9	4.0
Per capita spending (US$ 2018)	165	41	151
SDG3 index	75	50	>70

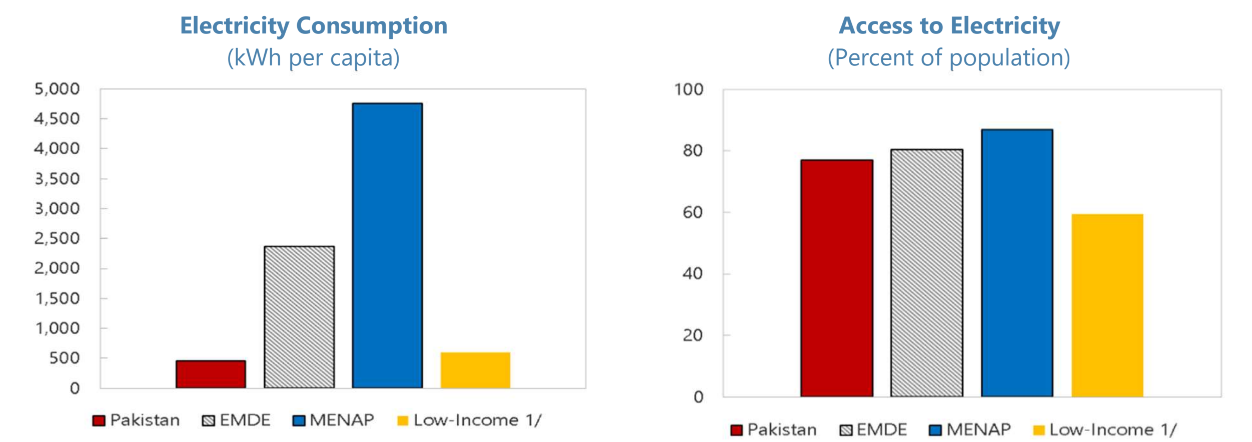
Source: IMF staff estimates.

C. Physical Capital

Electricity

12. Electricity consumption in Pakistan lags its peers and electricity access is still limited, particularly in rural areas. Per capita electricity consumption reached 452 kWh in 2018, equivalent to about 10 percent of the average for other countries in the MENAP region and 19 percent of the average for EMDEs (Figure 6). Electricity access is still limited, with 77 percent of the population having access to on-grid electricity, slightly below the average for EMDEs, but above the average for countries with a GDP per capita below US$3,000. About 32,300 villages-accounting for 8.8 million households-remain without grid access. These villages tend to be in remote and sparsely populated areas, making expanding the grid to reach them technically challenging and costly.[10]

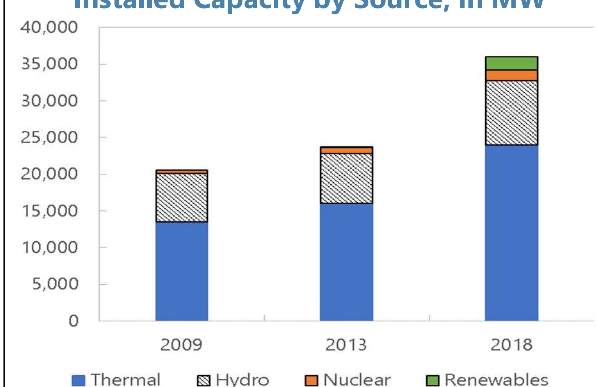
Figure 6. Pakistan and Peers: Electricity Sector



Sources: IEA World Energy Statistics (2020), World Bank WDI (2020), and IMF staff calculations.
1/ Countries with GDP per capita below US$3,000.

13. **Installed capacity has increased significantly over the last decade, but generation capacity remains underutilized due to limitations in transmission and distribution**. Pakistan increased its generation capacity by 52 percent in the last 5 years, from 23,663 megawatt (MW) in 2013 to 36,010 MW in 2018 (Figure 7). Most of the additional capacity comes from thermal and hydro plants, with an increasing share of renewable energy sources. Generation capacity is underutilized given limitations and inefficiencies in transmission and distribution systems. According to government estimates, the average capacity utilization factor is around 43 percent. Transmission and distribution losses in Pakistan average about 20 percent, among the highest in the region.

Figure 7. Pakistan: Electricity Generation Installed Capacity by Source, in MW



Sources: NEPRA and IMF staff calculations.

14. **Pakistan has embarked in an ambitious plan to increase the use of renewable energy sources**. To achieve SDG7 and cope with expected increases in electricity consumption, the government plans to significantly increase generation capacity from hydro, nuclear, and renewable sources over the next ten years. In addition, the government plans to rely on renewable energy

[10] Electricity access is universal in the provinces of Punjab and two autonomous territories (Azad Jammu and Kashmir, Gilgit-Baltistan), but limited in Balochistan (44 percent), Khyber Pakhtunkhwa (96 percent), and Sindth (95 percent).

sources to provide access to electricity in areas that are not connected to the grid and where extending the grid might not be economically feasible.[11]

15. Providing electricity access to all by 2030 would require significant investments. Total electricity consumption is expected to increase by 78 percent between 2019 and 2030, reflecting population growth as well as higher per capita consumption, due to the expansion of the electricity grid to achieve universal coverage and economic growth. To keep up with this higher consumption, Pakistan will need to invest an aggregate amount of US$24.5 billion by 2030, equivalent to spending 0.7 percent of GDP every year from 2020 to 2030 (Table 3).[12]

Table 3. Pakistan: Additional Investment in Electricity Generation, Transmission, and Distribution Required by 2030

Change in total consumption 2019-2030 (kWh)	109,183,957,844
Change in consumption 2019-2030 that cannot be met by current installed capacity (kWh)	61,423,117,980
Required change in installed capacity (incl. generation, transmission and distribution) (KW)	16,255,365
Additional required change in transmission and distribution capacity (KW)	13,630,377
Assumptions	
Coefficient (electricity consumption to GDP per capita)	0.95
Plant capacity factor	43%
Unit cost of installed capacity (incl. generation, transmission and distribution) (US$ per KW)	1,059
Unit cost - only transmission and distribution capacity (US$ per KW)	530
Depreciation per year	5%
Investment required by 2030 (US$ billion)	**24.5**
Annual spending 2020-2030 (percent of GDP)	**0.7**

Source: IMF staff estimates.

Roads

16. Road length in Pakistan has not increased during the last two decades and road density lags its peers. Since 2000, Pakistan has added 19,000 kilometers to its road network (from 250,000 kilometers in 2000 to 269,000 in 2018).[13] Most of the road network (124,442 kilometers) is composed of provincial roads, while federal highways and motorways represent 5 percent of total road length. Road density in Pakistan is equivalent to 66 percent of the average for other countries in the MENAP region and 58 percent of the average for EMDEs (Figure 8). The government of Pakistan has ambitious plans to increase road density to 0.45 kilometers per square kilometer by 2025, which would imply expanding the existing road network by 38 percent (Government of Pakistan, 2014).

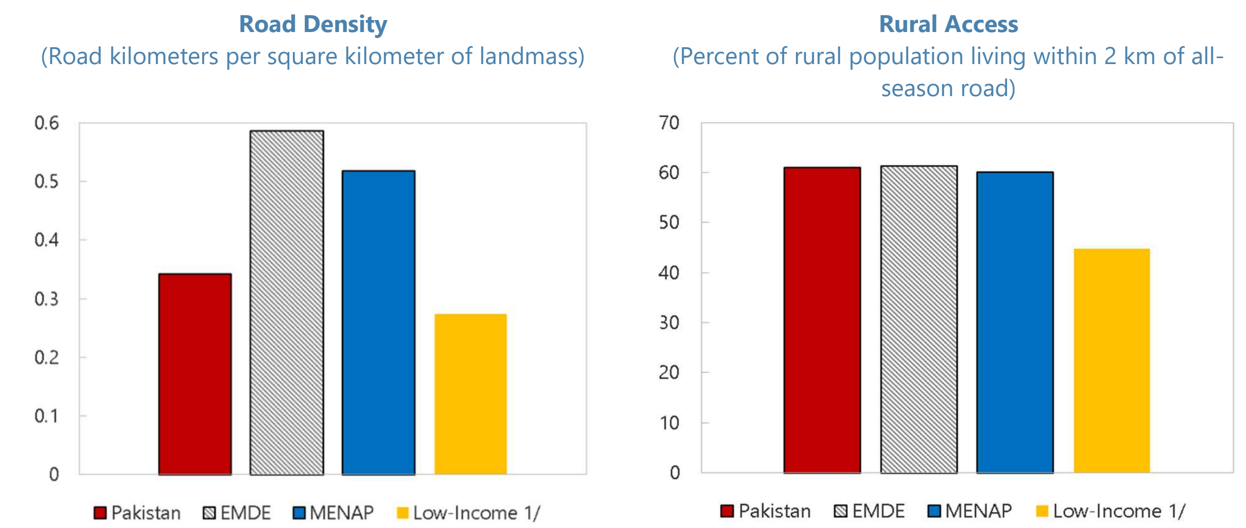
[11] The government plans to extend access on-grid to 97 percent of the population. The remaining 3 percent would have access off-grid.

[12] The unit cost of investment per KW (including generation, transmission, and distribution costs) is estimated at US$1,059 based on data from the National Electric Power Regulatory Authority in Pakistan and Ministry of Power.

[13] National Transport Research Centre, 2019.

17. There are gaps in rural road connectivity. Road connectivity is key for rural development-roads promote access to economic and social services, with potentially positive effects on agricultural and non-agricultural employment and productivity. In Pakistan, 61 percent of the rural population live within 2 km of an all-season road, similar to the EMDE and MENAP averages but above the average for low-income countries (Figure 8).[14] To achieve the SDGs, investment plans should focus on improving rural road infrastructure.

Figure 8. Pakistan and Peers: Roads



Sources: Pakistani authorities, World Bank Rural Access Index, IMF WEO and staff calculations.
1/ Countries with GDP per capita below US$3,000.

18. Spending requirements to expand the road network and improve connectivity are sizeable. Increasing rural access from the current 61 percent to 75 percent by 2030 will require about 94,146 additional kilometers of all-season roads-a 36 percent increase in road length. This will require investing an aggregate amount of US$76 billion by 2030, equivalent to spending 2.3 percent of GDP every year from 2020 to 2030 (Table 4).[15]

Table 4. Pakistan: Additional Investment in Roads Required by 2030

Required change in road length 2019-2030 (km) 1/	94,146
Unit cost (US$/Km)	808,098
Depreciation per year	5%
Investment required (US$ billion)	**76.1**
Annual spending 2020-2030 (percent of GDP)	**2.3**

Source: IMF estimates.
1/ Required change to improve the rural access to 75 percent.

Water and Sanitation

19. Pakistan has made remarkable progress in improving basic sanitation provision but still lags its peers. The share of the population relying on open defecation decreased from 40 percent in

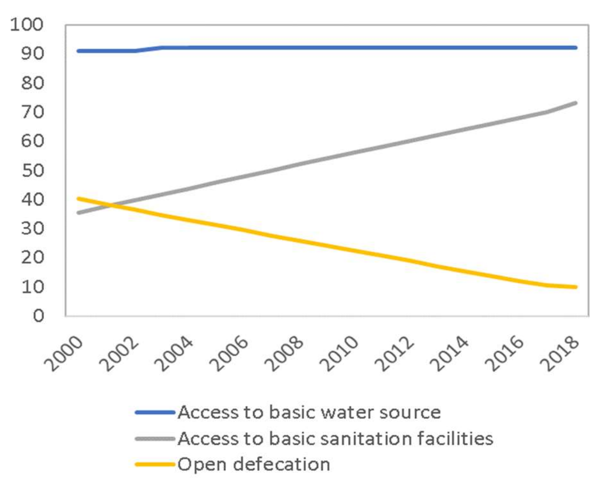
[14] Rural access data come from Mikou et al. (2019).

[15] Construction costs vary by road type (e.g., number of lanes, type of surface, etc.) and region. Based on data from the Pakistan Planning Commission, we estimate an average cost of US$808,000 per kilometer.

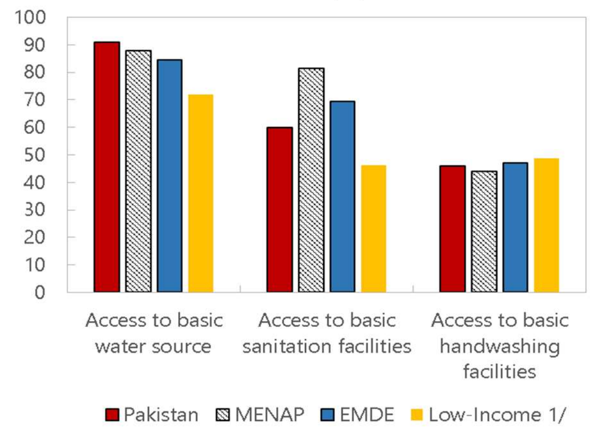
2000 to 10 percent in 2018 (Figure 9). Access to basic sanitation facilities, such as flush toilets or latrines with a slab, also improved significantly over this period, with 73 percent of the population having access to these facilities in 2018, compared to 36 percent in 2000. The bulk of this improvement came from rural areas, where the share of the population with access to basic sanitation increased almost four-fold, from 16 percent in 2000 to 60 percent in 2018. Despite this improvement, access to basic sanitation facilities in Pakistan is still below the average for EMDEs and other countries in the MENAP region. Access to basic water sources and to basic handwashing facilities in Pakistan is similar to the average for EMDEs and MENAP.

Figure 9. Pakistan and Peers: Water and Sanitation

Water and Sanitation Access in Pakistan
(Percent of total population)



Water and Sanitation Access, International Comparison, Latest Available
(Percent of total population)



Sources: World Health Organization and United Nations Children's Fund Joint Monitoring Programme for Water Supply, Sanitation and Hygiene (JMP) (2017), Pakistan Living Standards Management Survey (latest available), and IMF staff calculations.
1/ Countries with GDP per capita below US$3,000.

20. Substantial efforts to increase access to non-contaminated drinking water and safely managed sanitation facilities are needed. To achieve the SDGs by 2030, Pakistan must expand access to safely managed water and sanitation to the entire population. This will require significant efforts as currently only 44 percent of the population has access to non-contaminated drinking water and only 46 percent has access to safely managed sanitation facilities on household premises, where excreta are safely disposed of in situ or treated off-site. The Planning Ministry is working closely with provincial governments to formulate an integrated water resource management strategy to meet the SDGs.

21. Spending needs to meet SDG targets in water and sanitation are also sizable. To achieve universal coverage by 2030, Pakistan would need to expand access to safely managed water and sanitation facilities to an additional 168 million and 184 million people, respectively (Table 5). It would also need to expand access to basic handwashing facilities with soap and water to 131 million people. This will require investing an aggregate amount of US$55 billion by 2030, equivalent to spending 2 percent of GDP every year from 2020 to 2030.[16]

Table 5. Pakistan: Additional Investment in Water and Sanitation Required by 2030

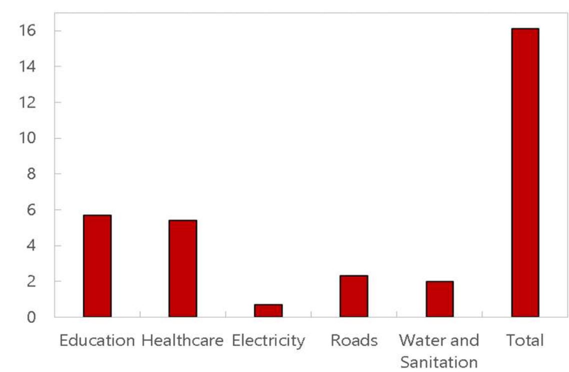
	Water		Sanitation		Hygiene		Total
	Rural	Urban	Rural	Urban	Rural	Urban	
Total target population (million)	96	71	114	69	94	37	
Population unserved in 2017 (million)	79	42	97	40	76	8	
Population growth 2017-2030 (million)	18	29	18	29	18	29	
Cost (per capita, US$)	200	178	146	83	5	8	
Investment required by 2030 (US$ billion)	19.27	12.63	16.73	5.74	0.50	0.29	**55.2**
Annual spending 2020-2030 (percent of GDP)							**2.0**

Source: IMF staff estimates.

D. Policy Recommendations and Conclusions

22. Making substantial progress in critical SDG sectors will require additional annual spending of about 16 percent of GDP by 2030 (Figure 10). Additional spending needs for education and healthcare in Pakistan are especially large. While the estimates refer to spending requirements for 2030, given the size of the spending needs and the challenges that must be addressed to achieve a high performance in SDGs, the scaling-up of spending should start well before 2030.

Figure 10. Pakistan: Additional Spending Required by 2030 to Meet SDG Targets
(Percent of GDP, 2030)



Source: IMF staff estimates.

23. Financing the SDGs will be challenging and requires a multifaceted approach. The high fiscal deficit and the need for fiscal consolidation to reduce public debt limit the availability of resources to move towards achieving the SDGs in the short run. The substantial additional spending required to meet the SDGs underlines the urgency of creating considerable fiscal space and calls for multiple and stable sources of financing. Pakistan's tax-to-GDP ratio is low compared to its peers. A medium-term revenue strategy could help boost revenues. Private financing is also critical while development assistance may also be needed to fill remaining gaps. Structural reforms to boost growth and increase efficiency have a role to play to mobilize these financing sources and ensure their optimal use in achieving high SDG performance.

24. Beyond resources, institutional and capacity constraints need to be addressed in order to increase spending efficiency. The estimates assume that Pakistan will be able to combine

[16] The investment costs for each service are based on the estimates for Pakistan in Hutton and Varughese (2016).

different inputs efficiently to deliver across the sectors analyzed. This would require important reforms. For example, in education, reducing class sizes in primary education and increasing enrollment in secondary and tertiary education would require a higher number of qualified teachers. In health, in addition to raising the quantity and quality of inputs (health workers and facilities), it is critical to address the financial vulnerability to healthcare shocks of disadvantage groups in the population by lowering out of pocket expenses. In infrastructure, raising institutional and technical capacity remains key, particularly in rural areas.

25. Strengthening coordination between the federal and provincial governments will be critical for meeting the SDGs. The eighteenth amendment of 2010 to the Constitution of Pakistan devolved a range of responsibilities to Pakistan's four provinces, including those related to health, education, and water and sanitation. As such, the provinces have discretion over public spending that is key for achieving the SDGs. The national SDG framework prepared by the federal government is based on targets set at the provincial level. SDG support units have been established to support coordination between the different levels of government. However, coordination needs to be further strengthened, notably in collecting data to monitor progress towards the SDG targets.

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TRADE AS A SOURCE OF GROWTH AND ECONOMIC DEVELOPMENT[1]

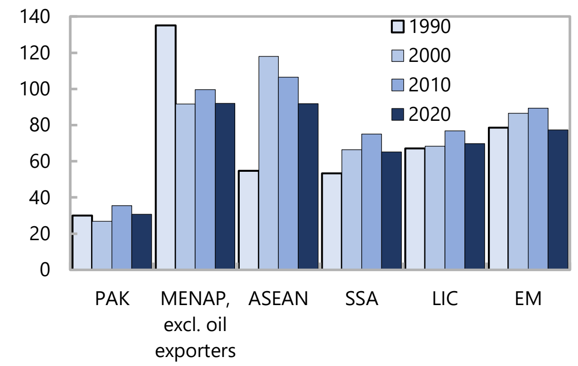
Pakistan is a very closed economy compared to other emerging and developing economies, with net exports often acting as a drag on growth. Complicating the outlook is that only a small number of firms export, primarily of low value-added textile products, while the country has also relied heavily on import tariffs to boost tax revenue, undermining trade integration and further weakening export competitiveness. Comprehensive reforms will be needed to boost competitiveness and support exports.

A. Stocktaking

1. Pakistan is a very closed economy. Openness—as measured by the sum of exports and imports—is very low compared to other regions as well as other emerging and developing economies (EMDEs). Moreover, compared to 1990, Pakistan's openness has barely changed, standing in stark contrast to EMDEs which have experienced large gains in the degree of openness.[2]

Figure 1. Openness

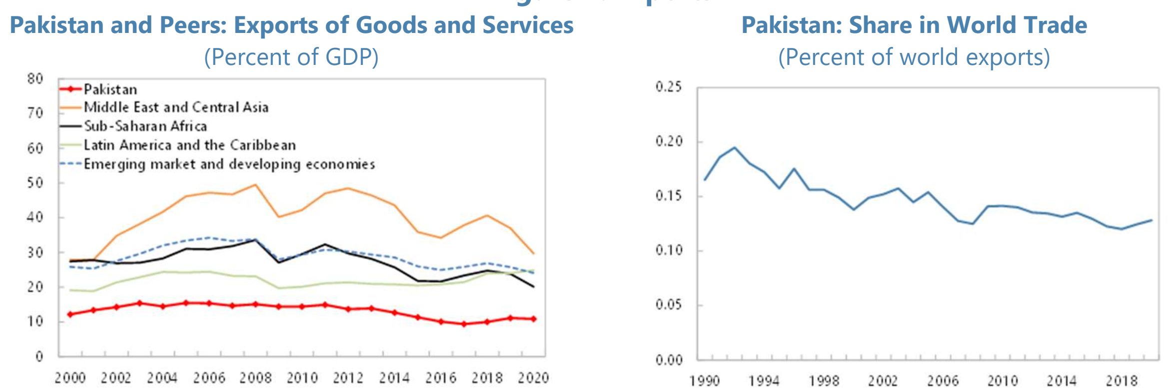
(Share of imports and exports in percent of GDP)



Source: IMF WEO and staff calculations.

2. This is mirrored in Pakistan's level of exports and share of world exports (Figure 2). Pakistan's exports, which peaked at about 15 percent of GDP in 2003, have been on a declining trend since 2011 and currently stand at about 11 percent of GDP, which is much lower than peer countries. At the same time, export volume growth has stagnated since FY 2007 amid de-industrialization, resulting in a widening export volume growth gap compared to EMDEs. This has contributed to Pakistan's share of global exports declining by almost 40 percent since the early-1990s to only 0.13 percent of world exports in 2020.

Figure 2. Exports



Sources: IMF WEO, Direction of Trade Database, and IMF staff calculations.

[1] Prepared by Christine Richmond (MCD).

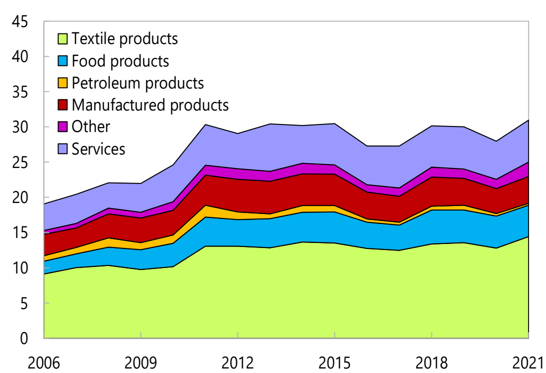
[2] The World Economic Forum's 2019 Competitiveness Index ranked Pakistan as 138 (out of 141 countries) in terms of trade openness, with weaknesses in trade tariff rates, border clearance efficiency, and prevalence of non-tariff barriers.

3. At the same time, Pakistan's export product mix has stagnated (Figure 3). In terms of broad export product categories, Pakistan's main exports are textiles and clothing, agriculture (vegetables, food products, animal hides), and services, which have all seen limited growth in value during the last decade. The current export basket lacks technological sophistication—products are concentrated in primary products or low-tech undifferentiated products that entail a low level of technology to produce and are on the lowest rungs of the value chains.[3] Simultaneously, the number of unique products exported has declined. Measured at a HS 6-digit level, Pakistan exported 2,824 unique products in 2019 compared to 2,987 unique products in 2009. This contrasts with many other countries (e.g., Sri Lanka, Vietnam) that have expanded the number of products they are exporting while also moving up the quality and sophistication ladders. While Pakistan is showing some nascent signs of growing its non-traditional exports since 2020-21, they remain a small share of overall exports.

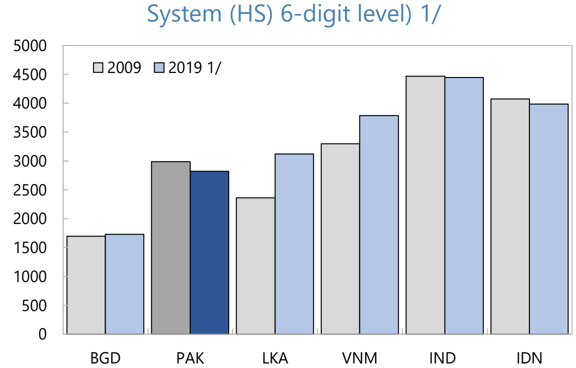
4. Consequently, net exports have frequently been a drag on growth. This has contributed to Pakistan's weak medium-term growth prospects, due to the current unsustainable model's over-reliance on consumption and debt-financed investment. Pakistan's low level of economic complexity suggests that low growth rates will continue unless the country is able to create an environment where a greater diversity of productive activities and more complex activities can prosper, including through exports.

Figure 3. Export Products

Products Exported
(US$ billions)



Products Exported (2019)
(Total number of traded products at the Harmonized System (HS) 6-digit level) 1/

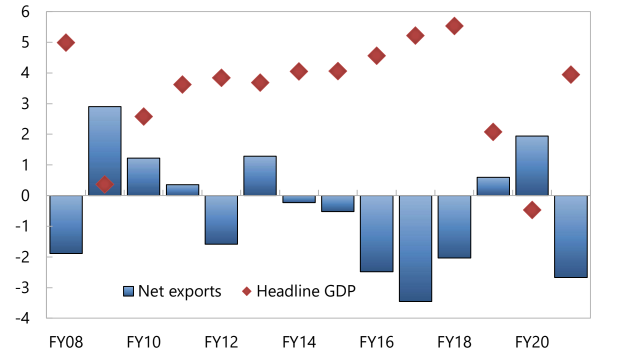


Sources: SBP, WITS, and IMF staff calculations.
1/ LKA value is from 2017, and BGD value from 2015.

[3] Note that cascading taxes will deter firms from producing more complex products that require more stages of production due to a high tax burden. The high taxes translate into higher export prices and hinders their price competitiveness.

5. Although the exchange rate is now broadly in line with fundamentals, due to a challenging external environment it is unlikely to have a very large impact on exports in the short run. Historical experience in advanced and EMDEs suggests that exchange rate movements typically have sizable effects on export (and import) volumes. IMF (2015) found that a 10 percent real effective depreciation in an economy's currency is associated with a rise in real net exports of 1.5 percent of GDP, on average, with much of the effect materializing in the first year. However, the benefits accrue mainly when there is slack in the economy and the financial sector is operating normally. Yet, the benefits accruing to Pakistan are likely to be less, largely due to weak global demand and structural bottlenecks: (i) global trade remains weak, raising price competition, particularly for primary products and low-tech undifferentiated products; (ii) presently only a limited number of firms have export experience, with small and/or potential exporters unsure of how to access new markets; (iii) some input prices have risen as part of the government's stabilization plan (e.g., energy prices); and (iv) many firms are also financially constrained and credit is scarce (limited trade credit), which makes it costly for firms to expand production or to begin exporting.

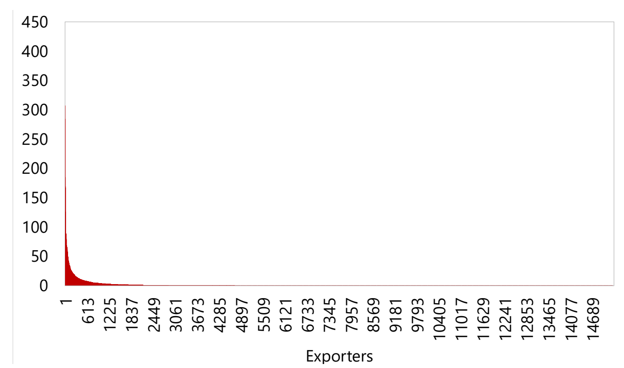
Figure 4. Net Export Contribution to GDP Growth
(Percent)



Sources: PBS and IMF staff calculations.

6. Exported values tend to be small, but concentrated. In FY 2021, the number one exporting firm exported goods valued at less than US$450 million, or 1.6 percent of total exports. At the same time, exports were concentrated with 198 firms contributing 50 percent of total exports. Less than 3000 firms exported more than US$1 million of goods and services, while the median value of exports by a firm were only about US$105,000.

Figure 5. Value of Exports by Firm
(US$ millions)

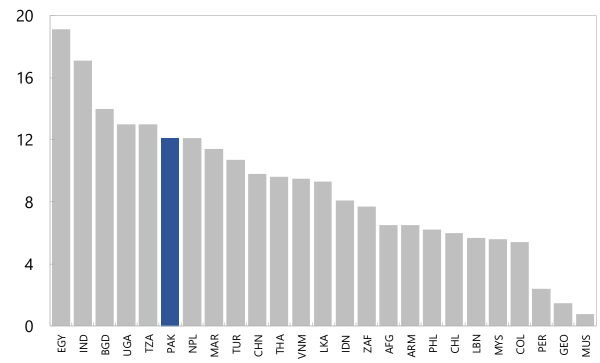


Sources: Pakistani authorities and IMF staff calculations.

7. Export financing has long been available. The State Bank of Pakistan has operated an export finance scheme (EFS) with the objective to boost exports since 1973. The EFS provides short-term financing to exporters via banks (commercial and Islamic) for exports of manufacturing goods under two separate facilities: (i) transaction-based facility; and (ii) revolving facility based on the previous year's exports. The financing is offered at highly concessionary fixed interest rates, for up to 180 days. However, the lending is a commercial decision made by the banks, which are assuming the credit risk. In FY 2021, PRs 700 billion was allocated to EFS—with an additional PRs 90 billion also allocated toward export-oriented investment under the Long-Term Financing Facility—with PRs 565 billion outstanding as of end-June 2021.

8. Pakistan has relied heavily on import tariffs to boost tax revenue, undermining trade integration and further weakening export competitiveness. With limited revenue mobilization and weak tax administration capacity, the government has relied on import duties and related taxes to raise revenue. As a result, tax revenue collected at import stages stands at about ½ of total tax revenue. Although Pakistan has reduced tariffs during the last decade, its tariffs remain relatively high compared to most EMDEs. The high effective protection has resulted in long-protected "infant" industries preventing their development, reducing the incentive to compete with imports and need to export given their protected, privileged domestic market position.

Figure 6. Import Tariff
(Percent, simple average of most favored nation)



Sources: Fenochietto et al. (2019).

9. Pakistan has only signed a limited number of free trade agreements (FTAs). While Pakistan has signed FTAs with China, Sri Lanka, and Malaysia, has preferential trade agreements with Iran, Indonesia, and Mauritius, and is part of the South Asian Association for Regional Cooperation (SAARC), a number of FTAs remain under negotiation or consultation. However, most of Pakistan's exports are to countries with whom Pakistan does not currently have a FTA. For example, in FY 2021 trade with the United States[4], United Kingdom, Afghanistan, and Germany[5] (Pakistan's first, second, fourth, and fifth most important export destinations, respectively) comprised about 37 percent of total merchandise exports, while exports to Pakistan's 3 FTA markets were about 10 percent.[6] The absence of permanent FTAs with the major export market destinations hurts Pakistani exporters' competitiveness as they face higher tariffs than other exporters.[7]

B. Policy Recommendations and Conclusions

10. External trade has not been a significant driver of growth in Pakistan due to limited trade integration, weak export competitiveness, and a low-tech product mix. Pakistan's exports as a share of GDP have declined over the past decade as exports volume growth has stagnated amid considerable de-industrialization. Consequently, Pakistan's share in global trade has steadily

[4] Pakistan is a beneficiary of the United States' GSP scheme for developing countries. However, most textiles and apparel are excluded from these benefits.

[5] Under GSP Plus, a 10-year preferential trade arrangement with the European Union (EU) in effect since 2013, certain products can be imported by the EU at zero duty.

[6] IMF staff calculations based on SBP export receipts by all countries.

[7] New FTAs are being negotiated with Turkey, Thailand, Uzbekistan, and Afghanistan.

declined. The export basket lacks technological sophistication, concentrated on primary goods at the lowest rungs of the value chain. Pakistani exports are moreover susceptible to high volatility from terms of trade shocks and face growing competition from lower-cost economies. Exports are hampered by multiple factors, including the legacy of an overvalued exchange rate, an unsupportive tax and business environment, and a restrictive and non-transparent trade regime. High levels of protection have contributed to an anti-export bias, undermining trade integration and stifling the development of export-oriented and viable import competing industries.

11. Some actions that should be considered in the short- and medium-term are:

- ***Continue to work to further rationalize the tariff structure as part of implementing the approved national tariff policy, based on time-bound strategic protection***. As domestic tax revenue mobilization strengthens, there will be space to rationalize tariffs in line with international practices, which should aim for low tariffs at uniform rates.
- ***Support new and small exporters***. A key supporting mechanism would be for the government to facilitate market discovery and entry because a major cost for exporters is learning about markets and demand. This is where a well-developed country strategy supported by embassies and a strengthened Trade Development Authority can help. Financing for new and small exporters is also important and consideration should be given to develop new export financing instruments, while also reevaluating existing financing instruments. The authorities should also advance their efforts to establish the Ex-Im Bank.
- ***Facilitate integration into the global supply chains***. Including through improving product quality, reliability of the firm, and registering the firm with all necessary entities for tax and business purposes.
- ***Negotiate new Free Trade Agreements (FTAs)***. Pakistan's exporters are facing higher tariffs in Pakistan's major export markets compared with competing economies, which restricts Pakistani exporters' competitiveness. While some FTAs are already in effect (including China, Malaysia, and Sri Lanka), Pakistan would benefit from pursuing high-standard, permanent FTAs with large, important trading partners to secure market access.
- ***Invest in education and human capital***. Raising the average skill level of employees will be crucial to support the production of more complex products.
- ***Reduce red tape and improve the overall business environment***. This is needed to reduce uncertainty, simplify the complicated tax and business environment, and support private sector investment. In particular, a disproportionate GST burden falls on exporting manufacturing industries compared to those in peer countries.
- ***Remove exchange restrictions to facilitate trade***. The authorities should remain committed to phasing out existing exchange measures-when conditions permit-and eliminate them by the end of the current EFF (September 2022).
- ***Develop an export strategy***. This would allow the authorities to articulate and expand on many of the recommendations listed here in greater detail.

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STATE-OWNED ENTERPRISES IN PAKISTAN: FOOTPRINT, PERFORMANCE, FISCAL RISKS, AND GOVERNANCE[1]

SOEs in Pakistan—and the Middle East, North Africa, and Central Asia region more broadly—are prominent, yet their role and contribution to the economy is ambiguous. They are used for a range of purposes, including the supply of basic goods and services, advancing strategic interests, addressing market inefficiencies, and meeting social objectives. They are also involved in a wide range of activities that are often carried out by private firms in other regions, and often act as an employer of first and last resort. While Pakistan has recently embarked on a reform process, it will be important to follow through with its plans to improve the performance, governance, and economic contribution of SOEs.

A. Introduction

1. **In comparison with most Middle East, North Africa, and Central Asia (ME&CA) countries, SOEs in Pakistan hold sizable assets, yet their share of employment in the economy is relatively low**. The total assets of non-financial SOEs in the country stood at 44 percent of GDP in 2019 (up from 31 percent of GDP in 2015), whereas the sector employed only 0.7 percent of total formal employment. Based on a comprehensive report published by the Ministry of Finance in 2021, as of end-June 2019 there were 213 federal-level SOEs operating in various economic sectors, out of which 67 were commercial non-financial federal SOEs, excluding health and education institutions and non-commercial operations.

2. **Recently, the authorities embarked on a reform process—with the support of the IMF and World Bank—to improve the performance and governance of the SOE sector**. Consistent with international trends, Pakistan witnessed an active privatization drive in the 1990s and 2000s, that subsequently slowed, with only 5 transactions taking place over the past decade compared to 167 transactions completed over the 1991-2010 period.[2] A triage exercise to examine the functions and financial performance of individual SOEs was undertaken in 2020 to identify the SOEs that should be privatized, as opposed to those that should be only restructured or retained by the federal government. The authorities are planning to establish a Central Monitoring Unit with a central database and analysis of all the SOEs, as part of a broader reform to strengthen their corporate governance framework and limit fiscal risks stemming from their operations.

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[1] Prepared by Tannous Kass-Hanna (MCD). The analysis draws on the recently published MCD Departmental Paper "State-Owned Enterprises in Middle East, North Africa, and Central Asia: Size, Role, Performance, and Challenges"

[2] http://privatisation.gov.pk/Detail/NTU0ZjE1NGQtNmYzNC00NWZjLWIxZTEtYWMzMzliYzFhNzk4

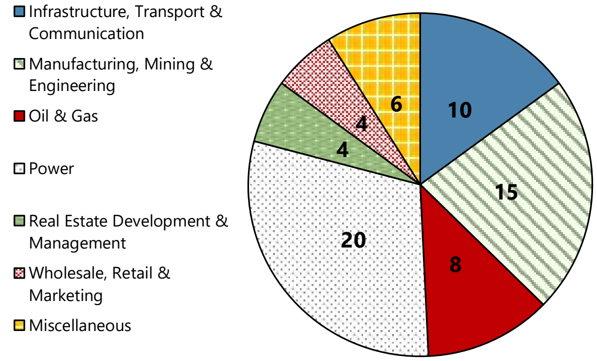
B. Footprint and Performance

3. The SOE footprint in the power and oil and gas sectors is particularly large. Out of 67 non-financial commercial SOEs, 28 are in the power or oil and gas sectors, while an additional 15 are in the manufacturing sector.

4. The financial performance of the SOE sector in Pakistan is relatively weak when compared to ME&CA countries, despite their important role in the economy. Almost half of the SOEs operated at loss in 2019 (Figure 2), including one-third of commercial SOEs that are consistently generating losses (NHA, power sector distribution companies (DISCOs), Pakistan Railways, and Pakistan International Airlines that owns the Roosevelt Hotel in New York and the Scribe Hotel in Paris are among the major ones). Commercial SOEs recorded losses of PRs 143 billion in FY 2019. The average return on assets for SOEs in the country is among the lowest in the ME&CA region, at –1.4 percent (Figure 2.B). A recent work published by the World Bank (Melecky, 2021) estimates the liabilities of loss-making SOEs in Pakistan in the range of 14–18 percent of GDP, posing considerable potential fiscal costs.[3]

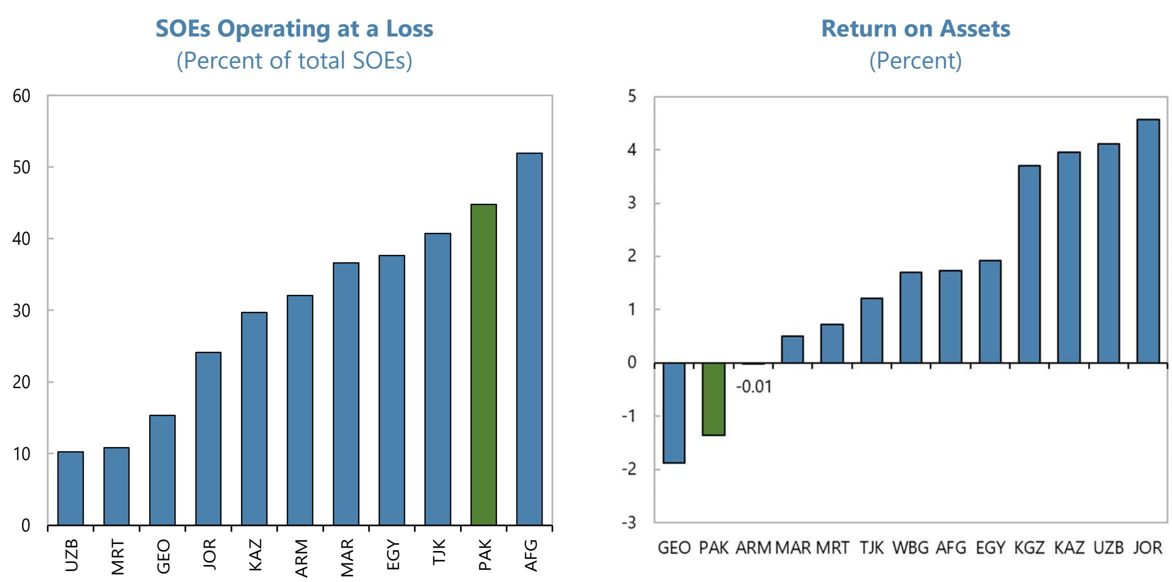
Figure 1. Portfolio of Non-Financial Commercial SOEs, FY 2019

(Number of SOEs)



Source: Finance Division, Government of Pakistan (2021).

Figure 2. SOE Performance Indicators, 2019 or Latest Available



Sources: Finance Division, Government of Pakistan (2021); Ramirez Rigo and others (2021).

[3] Note that liabilities are being measured from the balance sheet, of which debt is only one component.

C. Corporate Governance

5. A survey on SOE corporate governance practices in ME&CA countries sheds light on (i) ownership policy, (ii) financial oversight, and (iii) fiscal and policy interactions with the government. During Winter 2021 staff in the IMF's Middle East and Central Asia Department conducted a survey with ME&CA countries on SOE corporate governance practices, using the World Bank Corporate Governance Toolkit (World Bank, 2014) and the OECD guidelines (OECD, 2015) as a benchmark. The responses of 16 ME&CA countries reflect stated or de jure corporate governance policies of SOEs in the region, as opposed to de facto practices which may somewhat differ.

D. Ownership Policy

6. Best international standards require the state to exercise centralized operational and fiscal oversight over all SOEs and to communicate its rationale and objectives for state ownership to market participants, and the public more broadly. Governments need to first know what they own, by establishing consolidated SOE lists with full coverage of SOEs owned at the national and subnational levels. Second, they should determine the rationales for state ownership and clearly communicate them to the public, the market, and to relevant government entities that exercise ownership rights or are otherwise involved in the implementation of the state's ownership policy. Multiple and contradictory rationales for state ownership can lead to either a very passive conduct of ownership functions, or conversely result in the state's excessive intervention in the management of the enterprise and its governance organs. Lastly, governments need to establish centralized, merit-based, and transparent board nomination processes, independent from political interference.

7. Pakistan reports having decentralized coverage and oversight over SOEs, with an ownership policy that is not communicated to the public. While the government has visibility over all SOEs in Pakistan, their coverage and oversight are fragmented among line ministries for SOEs owned at the federal level, or among provincial governments for SOEs owned at the subnational level. However, the Finance Division within the Ministry of Finance has the financial and fiscal oversight function over all federal SOEs, particularly those with significant fiscal costs. Similarly, the selection of board members is decentralized between the cabinet, sectoral ministries, and other agencies, depending on the SOE, with legislative requirements for independent board member representation across all SOEs, and requirements of certain competencies only for a subset of SOEs. Based on the survey responses, Pakistan's rationale for state ownership is associated with the objectives of (i) supporting national economic and strategic interest, (ii) supplying specific public goods and services, (iii) performing business operations in a natural monopoly situation, and/or (iv) supporting social objectives. And although these objectives and an overall ownership policy is laid out in a document, the latter is not publicly available, and its substance is not well-communicated to the public.

E. Financial Oversight

8. **Best international practices call for regular target-setting and performance evaluation, as well as disclosure and transparency in financial reporting**. Oversight authorities should set operational and financial targets for SOEs and evaluate their performance. To support this and to enhance transparency, annual financial statements of individual SOEs should follow international accounting standards and be audited by external independent auditors, published, and reviewed by the oversight authority. More broadly, an aggregate SOE report—providing an overview of the sector, along with performance and risks assessments, financial transactions with the government, disclosure of individual SOE mandates, and ownership policy assessment—should be produced and published on a regular basis by a centralized oversight authority.

9. **Pakistan reports having systematic operational and financial oversight over SOEs, with norms to audit and make public their annual financial statements**. The relevant authorities appear to set operational and financial targets for SOEs, evaluate their performance, and make them accountable for the quality of service provided. While it is a common practice for annual financial statements to be audited by independent external audit firms and reviewed by the oversight authority, only a subset of SOEs follow international audit and accounting standards and make their financial statements publicly available on their website or the website of the relevant oversight unit. Moreover, there are often significant lags between the end of the fiscal year and completion of audits. Given the decentralized nature of oversight, there is also an absence of an aggregate SOE document evaluating the annual operational and financial performance of the sector as a whole.

F. Fiscal and Policy Interactions

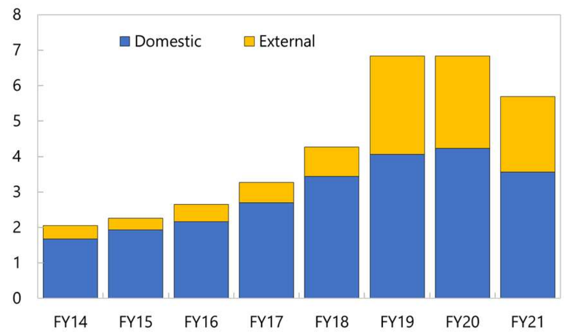
10. **Best practices call for establishing clear rules for fiscal support, maintaining competitive neutrality as well as preserving budgetary transparency and sustainability**. The authorities should strengthen the legal and institutional framework for an efficient and timely management of fiscal risks stemming from SOEs. This requires an effective legal framework and capacity building to empower the oversight authority, typically located in the Ministry of Finance, to assess, measure, and monitor SOE fiscal risks. The legal framework should also have an explicit dividend policy outlining the magnitude and conditions associated with the transfer of SOE dividends to the government budget. In its dealings with SOEs, the government should have an arms-length relationship regarding in terms of financing to maintain a level-playing field between SOEs and the private sector. For instance, SOEs should not receive budget or quasi-fiscal support when conducting their business operations. As for non-commercial SOE operations mandated by the government, public sector obligations (PSOs) should be explicitly spelled out in legislation.

11. **The government of Pakistan has room to improve its management of fiscal risks stemming from SOEs**. SOEs in Pakistan often have a mandate to undertake investment or social spending on behalf of the government to meet PSOs. Such non-commercial mandates are explicitly laid out in legislation, ensuring the obligation of the government to compensate SOEs for any losses associated with such activities. Budgetary support—in the form of transfers, subsidies, or cash

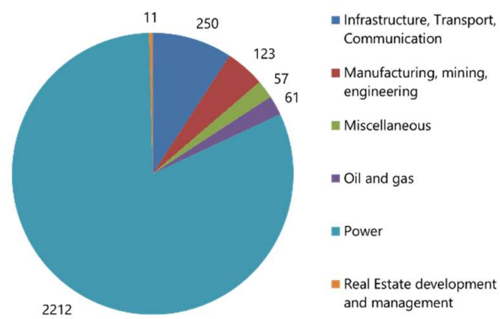
injections, as well as quasi-fiscal support—in the form of guarantees or budgetary loans—are submitted to the parliament and available in public as part of the federal budget, but documents have yet to include guarantees expected to be issued in the forthcoming year. While there are limits on government exposure to SOEs—including limits to public guarantees, SOE risk is not integrated in the overall fiscal risk management framework. For instance, beyond explicitly publicly guaranteed SOE debt—amounting to almost 6 percent of GDP in FY 2021 and mostly concentrated in the power sector (see Figures 3.a and 3.b)—SOE losses and liabilities are not included in the headline fiscal indicators.

Figure 3. Publicly Guaranteed SOE Debt

Evolution of Guaranteed SOE Debt[1]
(Percent of GDP)



Composition of Issued Guarantees to SOEs
(PRs billion, FY 2021)

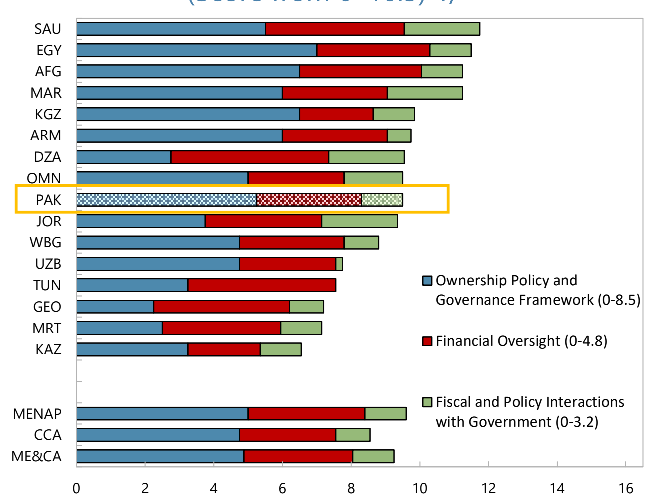


Sources: Pakistani authorities; and IMF staff calculations.
1/ Beginning FY 2019 reporting is on issued guarantees.

G. SOE Corporate Governance Index

12. Pakistan's overall corporate governance index is comparable to the median ME&CA country, indicating that there is room to better align its corporate governance standards to high performers in the region and to international best standards. A composite index of SOE governance practices is constructed for cross-country comparison in the ME&CA region (see Figure 4). While the index covers survey responses from country authorities (de jure policies on ownership policy, financial oversight, and fiscal and policy interactions), it does not reflect the de facto policies. This snapshot of stated policies in

Figure 4. SOE Corporate Governance Index
(Score from 0–16.5) 1/



Source: Ramirez Rigo and others (2021).
1/ Higher values denote closer adherence to OECD guidelines and greater fiscal transparency. See Annex 8 in Ramirez Rigo and others (2021) for a full description of the methodology.

place in late-2020 helps provide a rough comparison of the legal and institutional framework vis-à-vis OECD guidelines. Pakistan scores 9.5 out of a maximum of 16.5, which is weak when compared to the maximum score in the ME&CA region of 11.8. However, this is comparable to the median country in the region, particularly the median MENAP country that also scores 9.5. This suggests that Pakistan has room to improve its governance measures, especially in the areas of financial oversight and fiscal and policy interactions.

13. Consistent with survey results, an IMF technical assistance mission in early 2020 noted that the corporate governance of SOEs in Pakistan was weak, which may explain—at least in part—the performance of the SOE portfolio, displaying low productivity and efficiency levels.[4] The IMF TA mission observed that the ownership model in place in 2020 was fragmented, with blurred roles between line ministries and regulatory authorities in various sectors while a marginal role was played by the Ministry of Finance. For instance, it was observed that the Ministry of Energy has the final say on power tariff adjustments, the regulator of the aviation sector owns the civil aviation infrastructure, and the regulator of the financial sector is the majority shareholder of a systemic state bank. Contrary to de jure policies as reported by the authorities in the survey, political interference in the selection of members of SOE boards seems to be prevalent. Moreover, the mission observed that internal audit functions lack capacity, accounting and auditing standards are weak, and financial reporting is riddled with numerous accounting exemptions that may have a significant bearing on the evaluation of the actual financial performance of the overall SOE sector. Finally, performance target setting, and evaluation seem to be lacking due to the absence of an efficient performance monitoring system. These shortcomings have in turn brought about unanticipated fiscal risks from SOE operations.

H. SOE Sector Reform

14. In early 2021, the Pakistani government submitted to the parliament an SOE Governance and Operations Act that aims at enhancing the governance framework, management, and financial efficiency of SOEs in the country, and limit the fiscal risks stemming from their operations. The Act lays the groundwork for a gradual move towards a more centralized model, whereby a newly created SOE unit in the Ministry of Finance would assume the functions of ownership and oversight. The oversight functions of the Ministry of Finance have already started to improve with the publication of the "Federal Footprint—SOE Annual Report" to assess SOE portfolio risks in a more structured and more transparent way. With respect to the selection of SOE board members, the Act proposes a "nomination committee" headed by the minister of the line-ministry in charge of the SOE along with four other members: the secretary of the division in charge, the finance secretary or his/her nominee, and two private sector experts with at least 20 years of experience. Under this new model, the majority of the SOE board members would be independent directors, while the governance functions of the SOE would be separated from its management.

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[4] The IMF technical assistance was conducted by Pasquale Di Benedetta and Mia Pineda (both IMF Legal Department)—in collaboration with the World Bank and the Asian Development Bank.

Moreover, the Act intends to separate the regulatory and policy making functions of the state with regards to its SOEs.

15. With regards to ownership policy reforms, SOEs will have to set company mandates and strategies through a publicly available statement of corporate intent. An ownership policy document will subsequently integrate this framework and will clarify the processes for developing strategy and negotiating performance agreements as well as the respective roles of all involved institutions. The reforms proposed by the new Act are also expected to strengthen the central role of the board in its oversight of SOE operations, hence strengthening internal and external controls as well as reporting and disclosure standards. In that respect, the new Act provides a timeline for compliance with IFRS accounting standards and requires the disclosure of non-financial information (for example, details of a PSO agreement) and the aggregate reporting on an annual basis at a minimum. Under the new Act, the board of each SOE will be expected to adopt a three-year business plan every financial year, laying out targets, strategic direction, and operational and financial performance measures. This business plan mandated by the new Act is envisaged to serve as the performance agreement between the government and the SOE.

I. Policy Recommendations and Conclusions

16. Considerable fiscal cost and risks emanate from the weak performing SOE sector in Pakistan, particularly from the power sector. As of 2020, SOE corporate governance standards in Pakistan showed significant gaps against international best practices (for example, OECD guidelines) and against top performers in the region and in the world. The authorities need to retain strong political commitment to the recently introduced structural reforms aiming at restructuring and privatizing some SOEs as well as enhancing both the SOE corporate governance framework and the fiscal risk management framework.

17. An immediate priority of the authorities should be passage of the SOE Governance and Operations Act. Some additional actions that should be considered in the short- and medium-term to help strengthen SOE corporate governance and contribute to improving performance are:

- A consolidated list of all SOEs—owned by the federal government, provincial governments, or other SOEs—should be produced and published on an annual basis to provide a comprehensive picture of the SOE sector in Pakistan.

- Publish the ownership policy document, to communicate the ownership objectives, financial and public policy targets, reporting guidelines, and guidelines for boards of directors to the markets and the public.

- SOE performance should be assessed on an annual (or quarterly) basis, supported by timely audited annual financial statements following the best international standards. This should include an evaluation against public policy and individual SOE objectives as well as private sector comparators.

- The Ministry of Finance should be empowered by strengthening the legal and institutional framework, as well as by building its capacity to assess and monitor fiscal risks stemming from SOEs. Faced with capacity constraints, the initial focus could be on the sectors generating the most fiscal risk in Pakistan, namely the power and transport sectors.

- Greater transparency and disclosure of SOE debt including both explicitly and implicitly guaranteed debt are warranted to adequately monitor and reduce fiscal risks.

- The Government of Pakistan should incorporate into its balance sheet information such as the state holdings in SOEs, as well as government's receivables from and payables to SOEs.

- The government should condition financial support to a commitment by the SOE to improve its corporate governance practices and audit procedures as well as enhance reporting, disclosure, and transparency.

- SOE board composition requirements should be improved to support objective and independent decision making, while avoiding potential conflicts of interest.

- Beyond the legal reforms to the institutional framework in Pakistan, attention and commitment should be placed on the implementation corporate governance standards.

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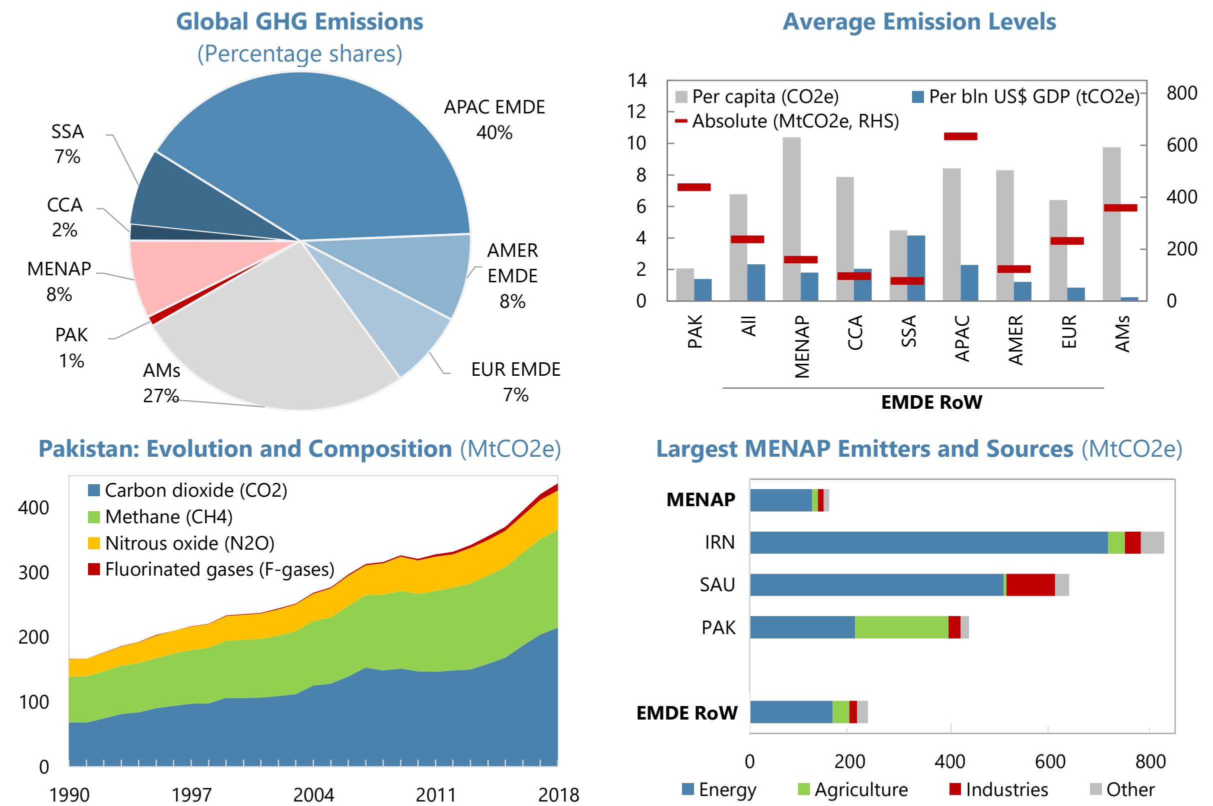
CLIMATE MITIGATION IN PAKISTAN[1]

Pakistan is a relatively small emitter of greenhouse gases (GHG) in per capita terms, but still ranks among the largest 20 GHG emitters worldwide in absolute terms.[2] The main sources are carbon dioxide in the energy sector and methane in agriculture. While mitigation is a focus of the Pakistani authorities, they need to accelerate their efforts to keep their international GHG reduction commitments within reach. Key measures should include reforming energy prices, subsidies, and taxes (which could also help mobilize significant and easily collected revenues, e.g., to help finance the Sustainable Development Goals); implementing technology-based measures for green and inclusive development; and garnering more external support in the form of financing and know-how transfer.

A. Emission Stocktaking

Figure 1. Pakistan and Peers: Greenhouse Gas (GHG) Emissions, 2018



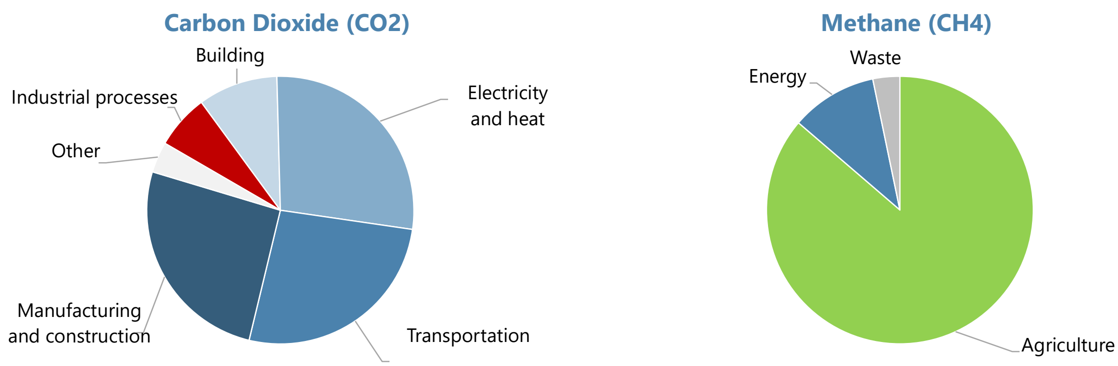
Sources: CAIT, WB WDI, IMF WEO and staff calculations.
All GHGs are converted to CO2-equivalents to account for their different warming potential. This is important as, for instance, methane is more than 25 times as potent as carbon dioxide at trapping heat in the atmosphere and thus at contributing to global warming (EPA 2021; IPCC 2021; IEA 2021). See WRI (2015) for more information on the CAIT GHG data.

[1] Prepared by Kerstin Gerling (MCD).

[2] For cross-country comparisons, this SIP focuses on the 23 emerging and developing economies (EMDEs) in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP). Regional averages are calculated excluding (i) Pakistan for MENAP; and (ii) MENAP for the 131 EMDEs in the rest of the world (RoW) in the Caucasus and Central Asia (CCA), Sub-Saharan Africa (SSA), Asia and Pacific (APAC), Americas (AMER), and Europe (EUR). EMDEs comprise all 190 IMF members except for those classified by the IMF WEO as advanced markets (AMs).

1. Pakistan ranks at the bottom of the 20 largest emitters of greenhouse gases (GHG).[3, 4] In 2018, the country contributed about 1 percent of the world's total GHG emissions (Figure 1a), with represented 438 million tons of GHG.[5] This makes Pakistan feature among the largest 20 GHG emitters worldwide, together with the two largest economies in the MENAP region (Iran and Saudi Arabia). Collectively, they are responsible for more than half of MENAP's GHG emissions. Relative to regional peers worldwide on average, Pakistan emits more GHG in absolute terms, but less both per capita and per unit of output (Figure 1b)—the latter only with the exception of advanced markets as well as American and European EMDEs. Since 1990, Pakistan's GHG emissions have grown by over 160 percent (Figure 1c), roughly below the MENAP country average (175 percent) but well above the world's (50 percent).

Figure 2. Pakistan: Sources of Selected Greenhouse Gas (GHG) Emissions, 2018
(Share of total)



CAIT and IMF staff calculations.

2. However, mitigation and energy-efficient production technologies are crucial in view of the Pakistan's growth potential and large share of methane in its GHG mix. While Pakistan's economy is still relatively small—accounting for about 0.3 of world output but 3 percent of world population—GHG emissions are set to increase with economic growth and development, and the planned expansion of energy production. Together, the energy and agriculture sector already account for more than 85 percent of Pakistan's GHG emissions (Figure 1d). For energy, this is lower than the MENAP average (which includes many oil- and gas-rich countries that predominately source their energy from fossil fuels, Figure 4) and mainly reflects carbon dioxide emissions from electricity and heat production, transportation, as well as manufacturing and construction (Figure 2a). In contrast, Pakistan's GHG emissions in agriculture exceed by far the average of MENAP

[3] The GHG emission data used in this SIP comes from the World Resources Institute's Climate Analysis Indicators Tool (CAIT), which is a comprehensive, cross-country comparable dataset covering all sectors and GHG gases produced by humans. The latter—comprising the four Kyoto gases carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), and fluorinated gases (F-gases)—are widely acknowledged as the primary driver of climate change (Cook et al. 2016).

[4] In 2018, about half of global GHG emissions came from four countries alone (China, the US, India, and Russia) and three quarters from 20 countries. About 5 percent came from the 120 smallest emitters.

[5] Using a different methodology than CAIT, Pakistan itself reported 490 million tons of GHG in 2018 (GoP 2021).

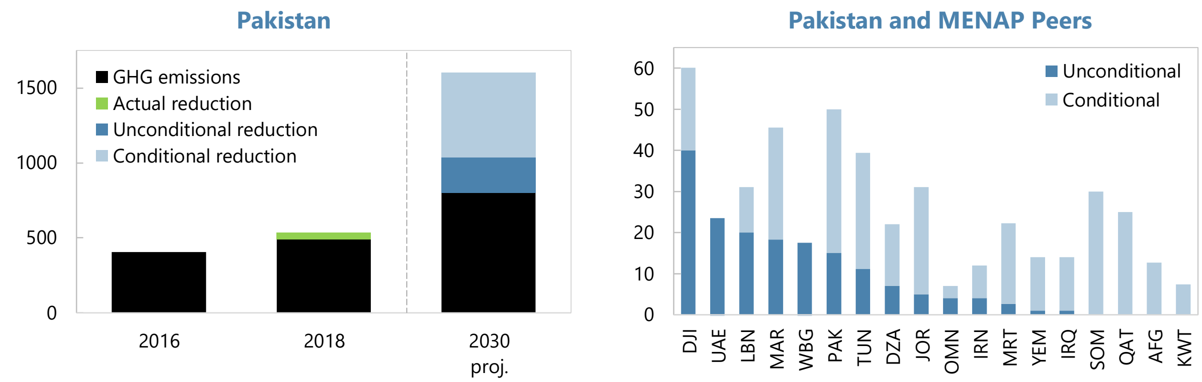
countries' and other EMDEs', and mainly reflect methane emissions (Figure 2b) from enteric fermentation and agricultural soil and (Ijhaz and Goheer 2021).[6]

B. Emission Targets and Policy Actions

3. Pakistan has joined global efforts to contain global warming by committing to cut GHG emissions and helping operationalize the 2015 Paris Agreement. Under its Nationally Determined Contributions (NDC) report in 2021 for the UN Climate Change Conference COP26 in Glasgow in November 2021, Pakistan set an ambitious cumulative GHG reduction target of 50 percent below its projected 2030 emissions under a business-as-usual (BAU) scenario (equivalent to more than 4,000 MtCO2): with an unconditional reduction of 15 percent financed from the country's own resources and a conditional reduction of 35 percent subject to the provision of international grant finance that would require an estimated US$101 billion just for energy transition (GoP 2021) (Figure 3.a). This is a substantial upgrade of Pakistan's ambition relative to its 2016 NDC report for the COP21 in Paris in December 2015. At the time, the country set a conditional reduction target of 20 percentage below its projected 2030 BAU emissions, subject to the availability of international support amounting to US$40 billion (GoP 2016). Within the MEPAP region, Pakistan ranks among the more ambitious countries (Figure 3.b), where emission targets continue to differ widely and remain largely conditional and low, widely reflecting limited fiscal space and weak capacity.

Figure 3. MENAP: Envisaged Nationally Determined Contributions Reduction in Greenhouse Gas Emissions versus 2030 Business as Usual

(Percent)



Sources: Country NDC reports (as publicly available on October 25, 2021) and IMF staff calculations.

In addition, Pakistan joined the global methane pledge launched at the COP26. More than 100 countries—together accounting for more than two thirds of global human-sourced methane emissions—agreed to cut global methane emissions by 30 percent by 2030, which could eliminate over 0.2°C warming by 2050 (EU and USA 2021). This is a potentially huge saving that could

[6] According to Habib and Khan (2018), enteric methane dominates agricultural methane emissions (63 percent), followed by feed production and processing (25 percent), manure management (11 percent), and energy use (1 percent). This reflects a particularly high carbon footprint of milk production, beef, and mutton.

substantially help achieve a reduction in global GHG emissions, in turn curtailing temperature increases happening now, with a powerful impact over the next decades and at a relatively low cost.[7]

4. Pakistan has introduced a number of policy actions focused on mitigating GHG emissions since the 2015 Paris Agreement. According to its own calculations (GoP 2021), these actions helped the country go beyond its original 2016 NCDs by reducing GHG emissions by 8.7 percent between 2016–18 relative to the BAU scenario as reflected in its original 2016 NDCs (GoP 2016).[8] Key efforts—so far mostly financed from own resources and largely still ongoing—include:[9]

- ***Stepping up the legal and institutional framework***. The country adopted the Pakistan Climate Change Act in 2017. It establishes (i) the cross-ministerial Pakistan Climate Change Council responsible for the country's overall climate strategy; and (ii) the Pakistan Climate Change Authority, which is tasked with coordinating climate policy development and implementation, in addition to designing and establishing a national registry and database on GHG emissions.

- ***Stepping up nature-based solutions (NBS)***. Pakistan's nationally-financed flagship project is the Ten Billion Tree Tsunami Program (TBTTP), which is not only an initiative for large reforestation with the aim to plant 10 billion trees in 2021–23 to help mitigate the climate breakdown, but also an initiative for comprehensive ecosystem conservation and management to address decades-long environmental degradation (mainly from illegal timber logging).[10] By mid-2021, more than one billion new trees have been planted, with the engagement of provinces and administrative entities throughout the country. In addition, Pakistan launched the Protected Areas Initiative (PAI), which included increasing the number of national parks from 30 to 45 and projects to enhance the total protected land area from 12 percent to 15 percent by 2023. The country is also working toward becoming a member of the UN's REDD+ program (Reduction of Emissions from Deforestation and Forest Degradation). Those efforts provide multiple co-benefits, including biodiversity conservation, clean air and water, and poverty alleviation.

- ***Increasing the share of renewables in the energy mix and banning coal imports***. Pakistan's primary energy consumption largely depends on fossils: natural gas, oil, and coal account for 85 percent of the mix, but the share of renewables was with almost 11 percent already larger in

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[7] As explained in UNEP (2021) and Borunda (2012), methane is highly potent in absorbing heat (roughly 100 times as much as CO_2) but lasts only a short time in the atmosphere (about a decade, compared to centuries for CO_2). Thus, when methane emissions are reduced, its atmospheric concentration falls relatively quickly.

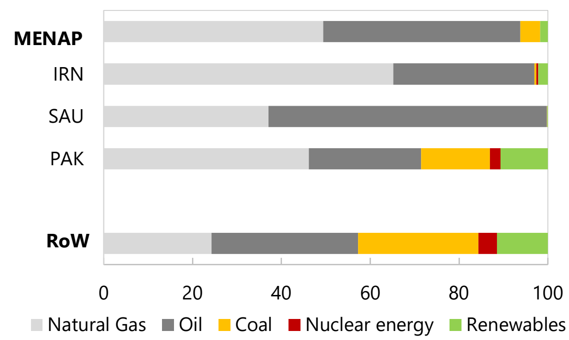
[8] As explained in GoP (2021), Pakistan's 2016 NDC report projected a 300 percent growth in GHG emissions for the period 2015–30, based on annual GDP growth of over 9 percent and increased reliance on fossil fuels. These estimates have been revised downwards in 2021, reflecting the realized GHG reductions from nature-based solutions (NBS, see below), together with increased contributions of renewable energy, energy efficiency, and an updated economic growth outlook in the aftermath of the Covid-19 pandemic.

[9] For details, see ICAP (2021), REN21 (2020), GoP (2021), as well as World Bank and ADB (2021).

[10] As laid out in GoP (2021), the TBTTP has sequestered 8.4 $MtCO_2e$ emissions between 2016–21. At an estimated cost of about US$800 million (financed nationally), the TBTTP is projected to sequester another 149 $MtCO_2e$ emissions over the next 10 years.

2019 than in the rest of MENAP (followed by Morocco and Egypt with 7 and 4½ percent, respectively) and almost in line with the world average (Figure 4).[11] In line with most regional peers, Pakistan builds on renewable energies as a key pillar of its mitigation strategy, targeting a 60-percent share of renewables energies in all energy production by 2030.[12] This requires tapping into Pakistan's large hydropower potential of 60,000 MW, of which only 12 percent is currently developed (IHA 2021).[13] In addition, Pakistan committed in 2020 to refraining from constructing new coal plants beyond those currently in the works and to completely ban imported coal. Concretely, the country already shelved plans for two new coal fired power plants in favor of hydro-electric power and focusing on coal gasification and liquefaction for indigenous coal.

Figure 4. Pakistan and Peers: Primary Energy Consumption by Fuel, 2019
(Percentage shares)



Sources: BP Statistical Review of World Energy (2020), and staff calculations.

- ***Promoting electric vehicles***. In 2020, Pakistan announced a plan to have 30 percent of all vehicles run on electricity by 2030. The government has therefore started to provide fiscal incentives to help bring 500,000 electric motorcycles and rickshaws and more than 100,000 electric cars, buses, and trucks into the transport system by 2025.

- ***Leveraging market-based climate policy instruments***. Like many peers around the world, Pakistan seeks to leverage low-carbon investments and tap into low-cost abatement opportunities. To this aim, the authorities published—supported by the United Nations Framework Convention on Climate Change (UNFCCC) and the Institute for Global Environmental Strategies (GES)—a study on carbon pricing and emission trading system (ETS) in the power and industry sectors. They also launched a National Committee on the Establishment of Carbon Markets in late 2019 to develop recommendations on the development of a domestic ETS and a credit-based trading mechanism linked to international carbon markets.

5. At the same time though, generous energy subsidies persist. Pakistan has tried to remove energy subsidies and align energy prices with their recovery costs. However, progress has been slow, and some energy subsidies were even expanded in response to the COVID-19 pandemic (IMF 2020; IMF 2021). In 2020, Pakistan spent about ½ percent of GDP on explicit energy subsidies, of which almost two thirds on electricity and the remainder on natural gas. This is lower than the

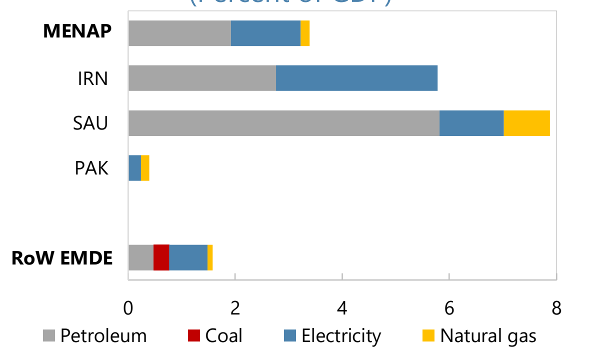
[11] In 2019, about 85 percent of Pakistan's primary consumption of renewables came from hydropower and the remainder mainly from solar.

[12] In 2019, about 85 percent of Pakistan's primary consumption of renewables came from hydropower and the remainder mainly from solar.

[13] Potential remains untapped in the mountainous north along the Indus River (in the provinces of Gilgit-Baltistan and Khyber Pakhtunkhwa), and along the Jhelum River (in the provinces of Punjab, Azad Jammu, and Kashmir).

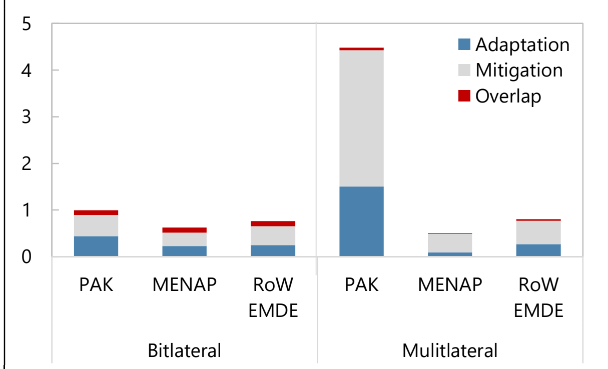
average for the MENAP region (including its largest GHG emitters Iran and Saudi Arabia) and other EMDEs (Figure 5). However, Pakistan's energy subsidies (i) are not well targeted and costly for a tight budget under the pressure of a large public debt burden; and (ii) reduce incentives for investing in much-needed energy-efficient production capacity and technology in the public and private sector alike. Moreover, when also accounting for implicit subsidies (capturing environmental costs), Pakistan's total energy subsidies come closer to some 9½ percent (Parry et al., 2021).

Figure 5. Pakistan and Peers: Explicit Subsidy by Energy Product, 2020
(Percent of GDP)



Sources: Parry and others (2021) and IMF calculations.

Figure 6. Total Climate Financing, 2016–19
(Billions of 2019 US$)



Sources: OECD and IMF staff calculations.

6. Besides, external support has so far remained below the levels needed to meet Pakistan's GHG reduction targets (¶4). The country has received about US$5½ billion for climate projects during 2016–19, of which US$3.4 billion were directed to mitigation. This mainly came from multilateral sources and exceeded the average seen in peers (Figure 6). Recently, Pakistan has also tapped private sources, issuing a green bond in 2021, whose US$500 million are earmarked for projects increasing the share of hydro-energy in the national power generation mix.

C. Policy Recommendations and Conclusions

7. Going forward, Pakistan needs to accelerate its mitigation efforts. Key measures to help meet the COP21 NDC targets and to put the economy on a green, sustainable, and inclusive growth path include:

- ***Ensuring adequate energy pricing and carbon taxation, while better targeting subsidies***. A range of measures can deliver on two fronts: reducing GHG emissions through lower energy consumption and creating fiscal space for investing in much-needed investments in climate technology, infrastructure, and social needs:[14]

[14] Recent examples from the region include Egypt' fuel subsidy reform (that lowered the fiscal burden of fuel subsidies from 3.3 percent of GDP in FY 2016/17 to 0.4 percent in FY 2019/20) or Saudi Arabia's reduction in fossil fuel subsidies (by around 60 percent between 2012–19).

- *Energy price reform*, which seeks to bring electricity and gas prices in line with cost recovery along the prescribed formulas and procedures in the amended NEPRA and OGRA Acts.

- *Energy subsidy reform,* which implies reducing fiscal (and quasi-fiscal) subsidies through a better targeting of energy subsidies to the needs of the most vulnerable.

- *GHG taxation*, which can be readily implemented through a tax on (i) the carbon content of fossil fuels or the carbon dioxide emissions; and (ii) non-carbon GHG emissions based on their CO2-equivalent transformation (i.e., methane, nitrous oxide, and fluorinated gases). Unlike an emissions trading system (ETS) it does not require new capacity,[15] as it is straightforward to administer as an extension of existing fuel taxes (Parry 2021)—either unilaterally or, amid fears for a loss of industrial competitiveness, as part of an international carbon price floor. IMF staff estimates suggest that a carbon tax of US$25 (resp. US$75) per ton could annually yield 1.2 (resp. 2.7) percent of GDP in Pakistan.[16] In addition, World Bank estimates show that a US$20 carbon tax can reduce emissions by more than 1/3 by 2050 (Burns et al, 2021). Redistributive implications could be addressed through compensative measures, such as well-targeted subsidies and improvements in public services. Pakistan could feel pressures to introduce a carbon tax, especially if some of its main trading partners (notably the EU and UK) were to follow through with their recent proposal of border carbon adjustments (BCA)[17] in the absence of an international carbon price floor.[18]

- *Use of revenue-neutral feebates for vehicles*, which are sliding scales of fees on vehicles with above-average emission rates and sliding scale of rebates for vehicles with below-average emission rates. These can provide powerful incentives to buy clean vehicles without a fiscal cost to the government or new tax burden on the average motorist.

- ***Stepping up technology- and know-how-based interventions consistent a with longer-term vision for green and inclusive growth***. Well-identified and prioritized interventions in the public and private sector should focus on: (i) reducing carbon emissions, including by propagating renewable energy, energy conservation and efficiency, and mass transit systems

[15] Such as for monitoring emissions downstream from power/industry smokestacks and trading markets.

[16] As pointed out by Parry (2021), an alternative option can be an emission trading system: firms acquire allowances for each ton of GHG they emit, with the supply of such permits limited by government. Firms can buy and sell allowances, so establishing a price for emissions. This system can be designed to mimic the advantages of taxes through price-stabilizing mechanisms (like price floors) and revenue-raising measures (such as permit auctions).

[17] BCAs are charges on embodied carbon in products imported into a jurisdiction with carbon pricing, potentially matched by rebates for exports. BCAs would be far less effective than an international carbon price floor in scaling up global mitigation, as they only price emissions embodied in traded products and not the bulk of nontraded emissions (e.g., from power generators, domestic manufacturer sales, buildings, and transportation) (Parry 2021).

[18] A well-designed BCA could nonetheless address competitiveness and "carbon leakage" concerns in the interim for countries moving ahead unilaterally with ambitious carbon pricing. However, there is little consensus on the scale of competitiveness or leakage effects of carbon pricing, and there is a risk that without careful design and dialogue with trading partners, BCAs could spur retaliation or disputes that would impact climate and trade policies (IMF 2021b).

(particularly in and between urban areas); and (ii) reducing methane emissions,[19] mainly by updating agricultural production methods to achieve the dual goals of protecting the environment and food security. Mitigation interventions may include improving the efficiency in livestock systems (e.g., through improved animal feed, breeding, and adapted manure storage),[20] better water management and irrigation, reduced crop burning and use of chemical fertilizers and pesticides, and biogas production (IISD et al. 2020; CIAT and World Bank 2017; FAO 2013). Moreover, a payment for ecosystem services (PES) program (such as in Costa Rica) could further promote forest ecosystem conservation and combat land degradation, especially in the context of the REDD+ readiness program.[21]

- ***Garnering more external support***. Given budget and capacity constraints, tangible mitigation progress critically depends on external support, mainly financial and know-how transfer. Pakistan should therefore intensify its collaboration with bi- and multilateral partners, seek more private financing, and facilitate foreign direct investment (particular in green technologies).

[19] See UNEP (2021) for benefits and costs of mitigating methane emissions.

[20] For instance, Habib and Khan (2018) find that improved fodder, herd heath and genetics can reduce methane intensity by up to 43 percent while increasing milk and meat yield by up to 100 and 65 percent, respectively.

[21] It rewards landowners for meeting various environmental objectives including storing more carbon (UNFCC 2021).

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Executive Board Meeting on Pakistan—2021 Article IV Consultation, Sixth Review Under the Extended Arrangement Under the Extended Fund Facility, and Requests for Waivers of Applicability and Nonobservance of Performance Criteria and Rephasing of Access
Mr. Hosseini Speaking Notes
Wednesday, February 2, 2022

Opening Remarks

Thank you Chair for your insightful opening remarks. At this stage, I wish to thank the Executive Directors for their helpful grays, and I will intervene at the end of the meeting to offer some concluding remarks.

Thank you Chair.

Concluding Remarks

1. I thank you Chair for your thoughtful opening remarks and staff for their comprehensive written and oral responses.

2. On behalf of our Pakistani authorities, I would like to thank staff for their engaging consultations, constructive advice, and their hard work. As this is the last meeting of Mr. Ramirez Rigo as Mission Chief on Pakistan, at this juncture, I would like to express my appreciation for his tireless work, dedication, and close partnership since the start of the EFF, including through the unprecedented challenges caused by the Covid pandemic. My authorities have benefited immensely from his wise counsel and we wish him the very best in his next assignment. Let me also take this opportunity to welcome the new mission chief, Mr. Nathan Porter, to the Pakistan team.

3. I am also grateful to my Board colleagues for their support, their very thoughtful comments, recommendations, and policy advice which I will faithfully convey to my Pakistani authorities.

4. As indicated in my Buff statement, Pakistan's economy has been remarkably resilient in the face of the outbreak of the Covid pandemic. Only 9 months before the outbreak of the Covid crisis, Pakistan was in a severe balance of payments crisis. With the support of the EFF, Pakistan was able to make significant progress in addressing the twin deficits that had caused this crisis and rebuilding its fiscal and external buffers. As a result, when Covid hit, Pakistan was in a much better position to withstand the shock without compromising its improved macroeconomic fundamentals.

5. Indeed, the authorities' policy response to the pandemic has been crucial in mitigating its human and economic impact, while ensuring macroeconomic stability. Considering where Pakistan was just 9 months before the Covid outbreak and given its high population density and under-developed health care system, it is a remarkable achievement that the pandemic has been relatively contained in terms of both its health and economic fall-out.

Through the globally recognized Ehsaas cash transfer program and well-coordinated and well-calibrated fiscal and monetary support, the economy was able to rebound from the shock quite quickly. The support received through the RFI during the most acute phase of the Covid outbreak was also extremely timely and appreciated.

6. Looking ahead, our authorities are in broad agreement with the Executive Directors and staff on the priority areas where continued efforts are needed to maintain macroeconomic stability and support the recovery.

7. The authorities would like to stress that the unprecedented challenges created by the pandemic have not weakened their commitment to the program objectives and reforms agreed under the existing EFF. Indeed, there authorities have remained appropriately focused on the key objectives of the program, with FX reserves continuing to rise and public-debt-to GDP continuing to fall despite the Covid shock. The latter outcome stands out in comparison to the rest of the world, where large increases in public debt have been witnessed in the aftermath of Covid. My authorities would like to assure the Executive Directors that with strong policy implementation under the EFF and continued support from multilateral partners and bilateral creditors, Pakistan remains strongly committed to ensuring the sustainability of its public finances, including by raising tax revenues and continuing to lower the public debt-GDP ratio over the medium-term.

8. The SBP’s monetary policy will remain data-driven and forward looking to anchor inflation expectations within the medium-term target range. Monetary policy decisions will continue to be guided by the primary goal of safeguarding price stability. Following the historic transition to a flexible and market-determined exchange rate system in July 2019, the exchange rate flexibility will continue to act as a shock absorber to maintain competitiveness and preserve external buffers. Financial sector policies will be geared towards safeguarding financial stability and promoting financial inclusion, including through digitization and increased participation of women in the financial system.

9. On the structural side, the passage of the amendments to the State Bank of Pakistan Act is a very important milestone. It will help to clarify the objectives of the central bank, ensure greater autonomy in the pursuit of these objectives, and increasing the bank’s accountability. In so doing, the amendments will contribute toward greater macroeconomic stability and sustainable growth in Pakistan. Looking ahead, the authorities are committed to further improving the efficiency of tax system; addressing structural deficiencies in the energy sector to ensure its financial viability; and accelerating structural reforms in the areas of SOEs governance, public financial management, and improving business climate to unlock Pakistan’s growth potential.

10. As noted by many Executive Directors, Pakistan has made good progress on its EFF-supported program. I would like to reassure the Board that the Pakistani authorities remain committed to program objectives and policies under the EFF.

11. Finally, I would like to reiterate the authorities´ complete ownership of reforms and their commitment to the successful completion of the EFF program. They believe the program provides a strong policy anchor for safeguarding macroeconomic stability, supporting a smooth economic recovery, and facilitating inclusive growth over the medium term, while protecting the poor.

12. My Pakistani authorities look forward to continued cooperation and appreciate the support from the Executive Board, Management, and Staff.

Thank you Chair.