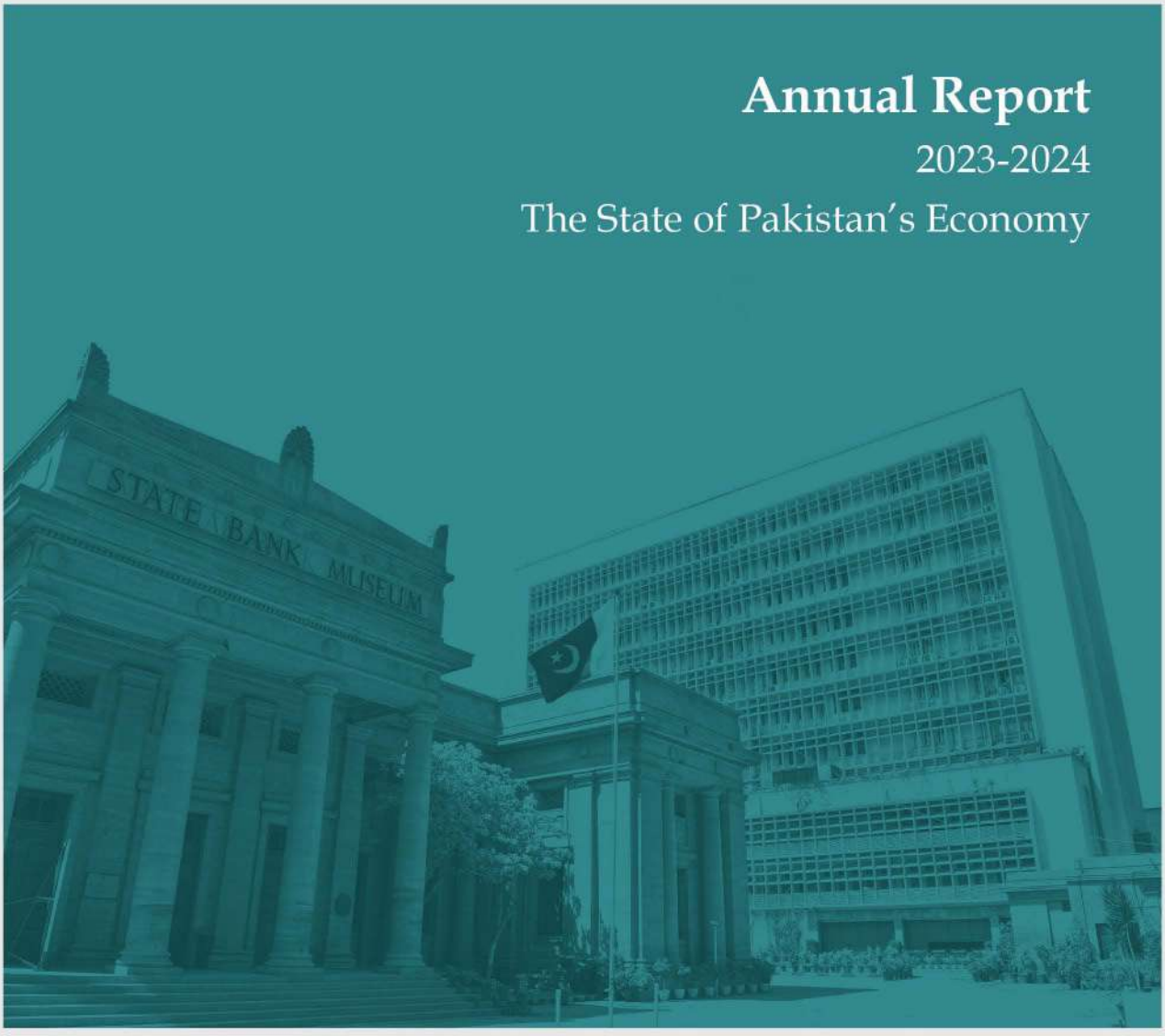
State Bank of Pakistan

Annual Report

2023-2024

The State of Pakistan's Economy



The State of Pakistan's Economy 2023-2024

October 17, 2024

State Bank of Pakistan

The State of Pakistan's Economy

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For the year 2023-2024
of the Board of Directors of State Bank of Pakistan

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LETTER OF TRANSMITTAL

State Bank of Pakistan
Karachi.
October 17, 2024

Dear Mr. Chairman,

In terms of Section 39(2) of the State Bank of Pakistan Act, 1956, the Annual Report of the Board of Directors of State Bank of Pakistan on the State of Economy for the year 2023-24 is hereby enclosed for submission to the Majlis-e-Shoora (Parliament).

With warm regards,

Yours sincerely,

(Jameel Ahmad)
Governor
Chairperson, Board of Directors

Syed Yousaf Raza Gilani
Chairman
Senate of Pakistan
Islamabad

LETTER OF TRANSMITTAL

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Karachi.
October 17, 2024

Dear Mr. Speaker,

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With warm regards,

Yours sincerely,

(Jameel Ahmad)
Governor
Chairperson, Board of Directors

Sardar Ayaz Sadiq
Speaker
National Assembly of Pakistan
Islamabad

LETTER OF TRANSMITTAL

State Bank of Pakistan
Karachi.
October 17, 2024

Dear Finance Minister,

In terms of Section 39(2) of the State Bank of Pakistan Act, 1956, the Annual Report of the Board of Directors of State Bank of Pakistan on the State of Economy for the year 2023-24 is hereby submitted.

With warm regards,

Yours sincerely,

(Jameel Ahmad)
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1

Economic Review

1 Economic Review

1.1 Overview[1]

Macroeconomic conditions improved during FY24, supported by stabilisation policies, successful engagement with the IMF, reduced uncertainty, and ease in global commodity prices. The real economic activity recovered led by agriculture, while inflation came down significantly particularly in the second half of the year. The current account deficit further narrowed and financial inflows improved, helping in build-up of FX reserves and reducing pressures on exchange rate. The fiscal consolidation continued with the primary balance posting a surplus for the first time in 17 years, which contributed to a considerable reduction in debt-to-GDP ratio (**Table 1.1**).

At the start of FY24, the economy was grappling with a host of macroeconomic challenges. Although on a declining path, inflation was still hovering around 30 percent. The aggressive adjustments in energy tariffs, which were started in FY23 and continued into FY24, somewhat slowed the pace of disinflation during the year. On the other hand, artificial wheat shortages added to price pressures in the domestic market, despite increase in its production in FY23. Although the Stand-By Arrangement (SBA) with the IMF in June 2023 had addressed near-term challenges, declining but elevated uncertainty and speculative activity maintained pressures in the FX market during initial months of FY24.

In view of the domestic macroeconomic challenges, the SBP and the government continued with the macroeconomic stabilization measures during FY24. A persistently elevated level of inflation and its expectations during the first half and increased uncertainty about the global commodity prices amid rising tension in the Red Sea region, led the SBP to continue with the tight monetary policy stance. However, almost a consistent declining trend in headline and core inflation in H2-FY24 amid improving external account position, provided the SBP some room to cut the policy rate by 150 basis points (bps) to 20.5 percent in June 2024.[2] Furthermore, fiscal consolidation remained on

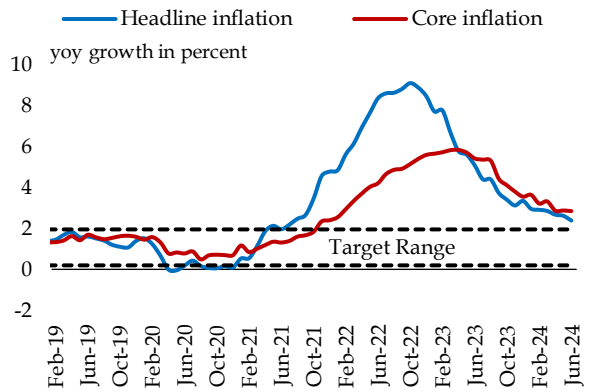
Selected Economic Indicators **Table 1.1**

	FY22	FY23	FY24
Growth rate (percent)*			
Real GDP [a]	6.2	-0.2	2.5
Agriculture	4.2	2.2	6.4
Industry	7.0	-3.7	-1.1
o/w LSM	11.9	-9.8	1.1
Services	6.7	0.0	2.2
National CPI (period average) [a]	12.1	29.2	23.4
National CPI (yoy, June)	21.3	29.4	12.6
Private sector credit [b]	17.4	2.3	4.0
Money supply (M2)[b]	13.6	14.2	16.1
Exports [b]	26.7	-14.2	11.6
Imports [b]	31.8	-26.3	0.9
Tax revenue – FBR [c]	28.9	16.7	29.9
Exchange rate (end-period) (+app/dep%) [b]	-23.1	-28.4	2.7
Policy rate (end-period) [b]	13.75	22.0	20.5
million US dollars			
SBP's reserves (end-period) [b]	9,815	4,445	9,390
Workers' remittances [b]	31,279	27,333	30,251
Current account balance [b]	-17,481	-3,275	-665
percent of GDP			
Fiscal balance [c]	-7.9	-7.8	-6.8
Fiscal primary balance	-3.1	-1.0	0.9
Gross public debt	73.9	74.9	67.4
Current account balance	-4.7	-1.0	-0.2
Investment [a]	15.6	14.1	13.2

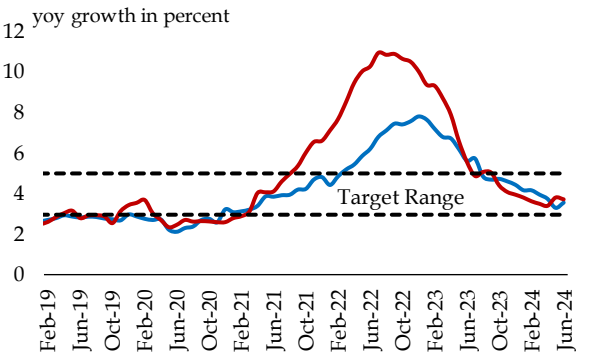
* The numbers relating to real GDP for FY22, FY23 and FY24 are on constant basic prices of 2015-16 and represent final, revised, and provisional estimates respectively.
Sources: [a] Pakistan Bureau of Statistics; [b] State Bank of Pakistan; [c] Ministry of Finance

[1] The analysis and projections presented in this report were prepared on data outturns for FY24 and finalized in September 2024, using data and developments as of then.
[2] SBP reduced the policy rate further by 100 bps in July and 200 bps in September 2024 to 17.5 percent.

Inflation Trends in Advanced Economies (AEs)* Figure 1.1a



Inflation Trends in Emerging Market & Developing Economies (EMDEs)* Figure 1.1b



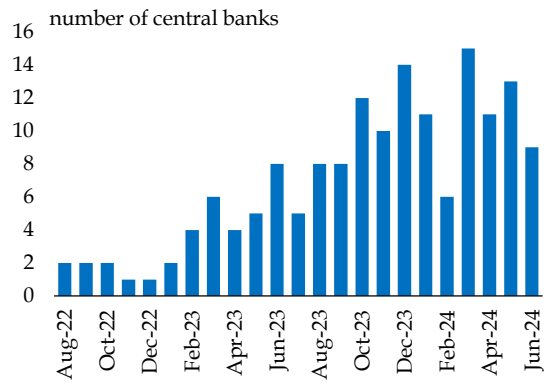
Note: Samples comprise 30 AEs in Figure 1.1a and 43 EMDEs in Figure 1.1b; *median inflation
Sources: Haver Analytics and World Bank

track, with primary surplus turning out to be higher than envisaged in the FY24 budget.

A relatively conducive global economic environment, somewhat eased the impact of domestic challenges during FY24. Particularly, the global commodity prices continued the downtrend witnessed since FY23, which was mainly led by decline in energy prices. A notable expansion in crude supplies from non-OPEC+ countries, cushioned the impact of output cuts by the OPEC members and the geopolitical tensions in the Middle East. Similarly, the prices of natural gas also softened as favourable weather and subdued industrial activity in Europe led to reduced demand. These developments had positive spillover on inflation in both advanced economies (AEs) and emerging market and developing economies (EMDEs).

Inflation in AEs and EMDEs started returning to pre-pandemic levels in FY24 (**Figures 1.1a & 1.1b**). Core inflation also moderated in both AEs and EMDEs. However, relatively stubborn inflation in services slowed the pace of moderation in core inflation. In view of the sticky underlying inflationary pressures, the central banks in major AEs adopted a cautious approach and maintained the contractionary monetary policy stance during FY24. However, the central banks in many EMDEs transitioned to monetary easing during FY24 (**Figure 1.2**). These developments helped maintain global growth momentum.

Interest Rate Cuts by Central Banks in EMDEs Figure 1.2

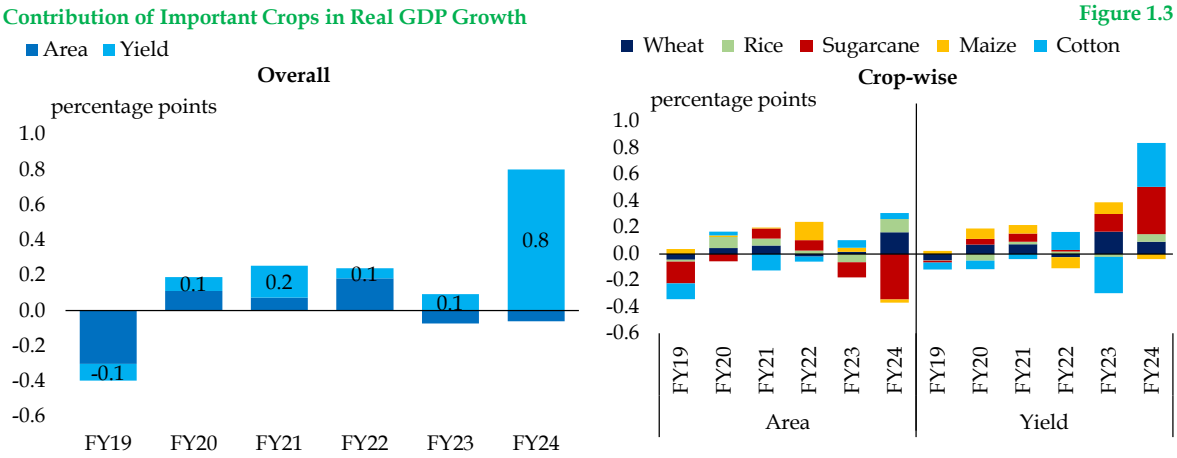


Note: Sample comprises 43 EMDEs
Source: Haver Analytics

At the same time, domestic macroeconomic conditions also started to show early signs of recovery. The real GDP posted a moderate growth in FY24, compared to a contraction in the preceding year. The growth was led by agriculture sector, mainly on account of a rebound in the production of important crops; in particular, record wheat and rice harvests, and more than doubling of cotton production. Although area under cultivation of these crops expanded, improvement in crop yields predominantly contributed, accounting for about one-quarter of real GDP growth in FY24 (**Figure 1.3**). A range of supportive factors,

Contribution of Important Crops in Real GDP Growth

Figure 1.3



Sources: Ministry of National Food Security and Research; SBP staff calculations

including favourable weather conditions, better availability of inputs, and timely announcement of support price(s) explain the recovery in important crops in FY24.

The government had announced a significant increase in the Minimum Support Price (MSP) for wheat during FY23, which was maintained at that level in FY24. In addition, the government also announced support price for cotton in March 2023, right before the start of the sowing season. This encouraged farmers to increase area under cultivation of these crops during FY24. Similarly, better export prospects served as an incentive to enhance crop area under rice cultivation. In anticipation of higher profits, the farmers employed better crop management practices, such as greater use of certified seeds and fertilizer. Meanwhile, water availability remained satisfactory almost throughout FY24. Although somewhat erratic, the rainfall was close to the average of past ten years during most part of the year. Canal water withdrawals also increased compared to FY23. In addition, enhanced credit disbursement under *Kissan Package* further supported crop production during FY24. The confluence of these factors enhanced yields of wheat, rice and sugarcane to their historic levels, whereas cotton yield also recovery sharply from the decline in FY23 (**Figure 1.3**).

The strong performance of agriculture, however, did not translate into a concomitant recovery in industry during FY24. Within industry, Large Scale Manufacturing (LSM) saw a marginal increase of 1.1 percent in FY24, recovering from a sharp contraction of 9.8 percent in FY23. Although this moderate increase in LSM was relatively broad based, with ten (10) out of twenty-two (22) sub-sectors reporting expansion in output, compared to only four (4) in FY23; yet, most of those sectors could not reach the average production levels seen during FY21-22. Petroleum products, wearing apparel and pharmaceutical mainly contributed to the modest recovery in LSM.

Better export opportunities and improved liquidity position encouraged the refineries to increase production, despite declining domestic sales of petroleum products during the year. On the other hand, deregulation of drug prices, incentivised pharma industry to expand production to meet local demand. However, continued slack in two large sectors, automobiles and textile, prevented a sizeable recovery in LSM production. In particular, production of cotton yarn and cloth dipped to its lowest level since FY06, despite a substantial improvement in domestic cotton output during FY24.

A host of factors kept industrial activity subdued during FY24. These included an upward adjustment in energy prices; elevated inflation that dampened households' purchasing power; high borrowing cost; and, deceleration in development spending amid continued political uncertainty. The unwinding of government support in the form of energy subsidies to export-oriented industries, as well as weak external demand, also weighed on textile production during FY24. Moreover, the automobile industry was additionally affected by tightened macro-prudential regulations and increase in vehicle prices in the last two years.

The increase in agriculture production and a slight recovery in LSM, together with increase in import volumes, spilled over to *wholesale and retail trade* and *transport and storage* services. Meanwhile increased provincial spending, also boosted the value addition by *education* services. However, subdued demand and elevated operational cost constrained services sector growth during FY24.

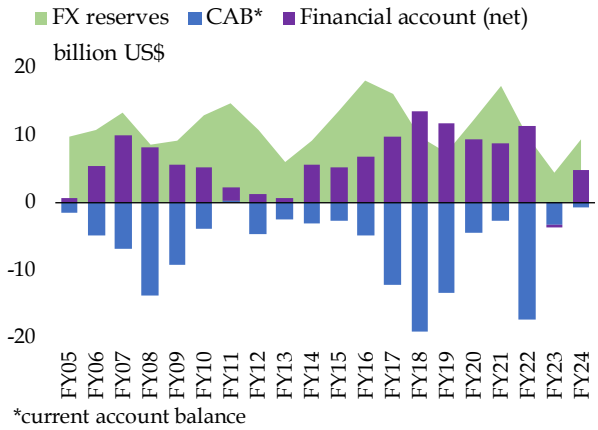
The composition of real GDP from the expenditure side shows that private consumption remained the predominant contributor, whereas investment declined for the second consecutive year in FY24. The challenging political and business environment affected private sector's incentives to add capacities in manufacturing industries during the year. However, agriculture sector continued to attract private investment, which bodes well for addressing climate-related challenges, such as fast melting glaciers (see **Box 2.1**). However, increased policy attention, as well as investment, is needed for sustainability of the sector and reducing risks related to food security.

The increase in agriculture production also reflected positively on current account balance during FY24. A substantial increase in crop output, alongside subdued domestic demand and softening global commodity prices, helped keep imports contained close to the FY23 level. Specifically, the rebound in domestic cotton production reduced the import bill by US$ 1.2 billion during FY24. In the same vein, higher production of food commodities led to a notable volume-driven recovery in exports. The upturn in rice production, which enabled exporters to capitalize on the opportunity created in the wake of the export ban by India, spurred rice exports by US$ 1.3 billion to a record US$ 3.9 billion in FY24. Besides, ICT exports contributed significantly in services exports **(Box 6.2)**. The combined effect of these factors, along with a sizeable recovery in workers' remittances, underpinned a substantial reduction in CAD, which fell to a thirteen-year low of 0.2 percent of GDP in FY24.

A host of domestic and global factors drove a notable growth in workers' remittances, with inflows from all corridors reporting increase during FY24. In particular, declining headline inflation and strong labour markets in AEs, alongside better employment opportunities in the GCC countries, facilitated increase in remittances from these corridors. In addition, the governments' administrative measures and exchange company reforms introduced by the SBP calmed sentiments in FX market. This narrowed the spread between the interbank and open markets, which encouraged remittances through formal channels during FY24. The improvement in trade balance and robust growth in remittances overshadowed the widening of primary income deficit, amid surge in interest payments and repatriation of profits and dividends during FY24.

The substantial reduction in CAD, together with the improvement in net financial inflows, helped build-up of SBP's FX reserves (**Figure 1.4a**), and induced stability in FX market during FY24. The successful completion of the SBA with the IMF was instrumental in catalysing official inflows from other multilateral and bilateral external creditors. In this vein, the country also had continued access to Saudi oil facility, and managed to mobilize deposits from friendly countries. Moreover, net FDI increased in FY24, reaching the average level of FY21-22, after a sharp decline in FY23. The inflows in NPCs also edged up during the year, primarily encouraged

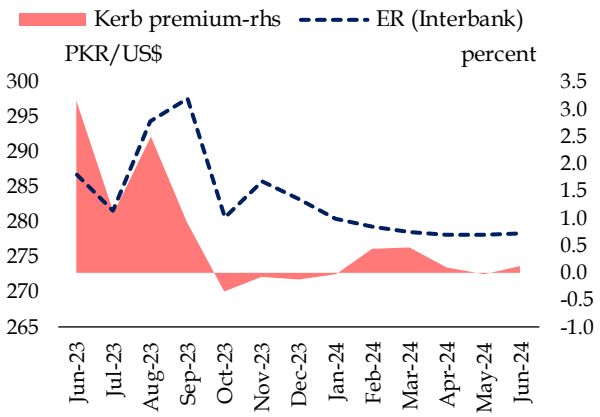
Pakistan's Balance of Payments **Figure 1.4a**



*current account balance

Source: State Bank of Pakistan

Exchange Rate and Kerb Premium in FY24 **Figure 1.4b**

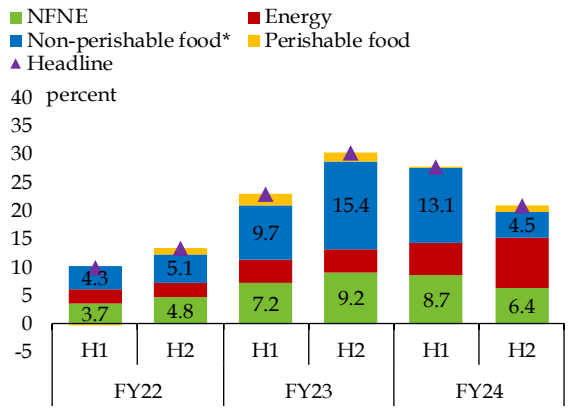


by increase in rate of return, after net outflows seen during FY23. These, along with the improved sentiments in the FX market, led to a 9.8 percent PKR appreciation during September 2023 to June 2024 (**Figure 1.4b**), with the kerb premium dropping to around one-fifth of the level seen in FY23.

The combined effect of the improved supply of food commodities, appreciation of PKR, declining global commodity prices of food and continued contractionary monetary and fiscal policies led to a rapid decline in inflation in H2-FY24. The YoY inflation fell to a two-year low of 12.6 percent in June 2024, from a high of 38.0 percent in May 2023. Nevertheless, a significant increase in energy tariffs, especially the gas charges, impeded the pace of decline in inflation during the year. Specifically, the contribution of energy group in urban inflation increased from around one-fifth in the first half to, nearly one-half in H2-FY24 (**Figures 1.5a & 1.5b**). The hike in administered energy prices and artificial shortages of key food commodities had kept inflationary pressures relatively high during the first half of FY24. However, the government's administrative efforts, wheat imports and increase in crop production eased supply situation of food commodities and considerably unwound food price pressures in the latter half of FY24.

In overall terms, the average National CPI (NCPI) inflation came down to 23.4 percent in

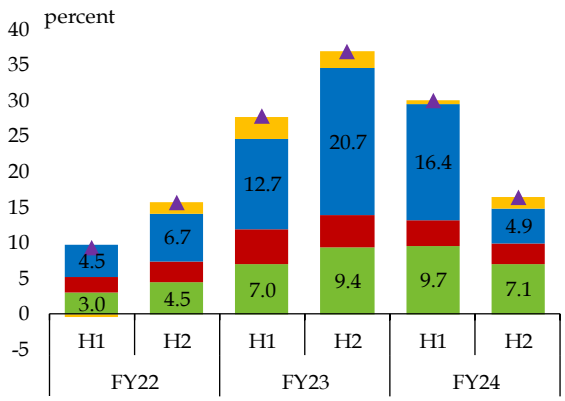
Composition of CPI Inflation - Urban **Figure 1.5a**



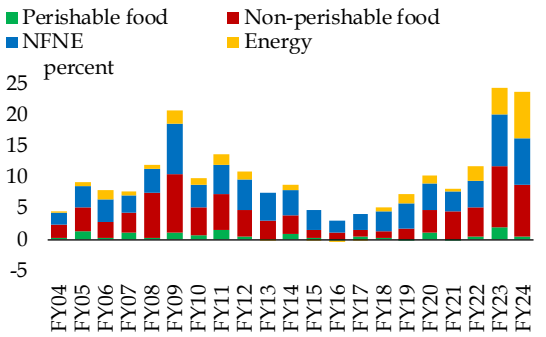
*inclusive of alcohal beverges and readymade food

Sources: State Bank of Pakistan; SBP staff calculations

Composition of CPI Inflation - Rural **Figure 1.5b**



Long-term Composition of CPI Inflation (Urban) **Figure 1.6**



Note: FY02-09 numbers are on base year FY00, FY09-17 numbers are on FY08, and FY17-23 numbers are on FY16
*urban indices are used from FY17 onwards
Sources: PBS and SBP staff calculations

FY24, from a high of 29.2 percent in FY23. The contribution of energy rose to a multi-decade high in FY24 due to large adjustments in administered energy prices (**Figure 1.6**). The escalating energy prices also seeped into underlying inflation through increased operational costs and elevated inflation expectations. This slowed the pace of decrease in core inflation relative to headline inflation during FY24.

The longstanding inefficiencies in energy sector have resulted in a substantial accumulation in power and gas circular debt (see **Box 3.1**). The government initiated adjustments in electricity prices in FY19 to align power tariffs with the cost recovery levels and reduce the stock of circular debt. Continuing these efforts, the government introduced a sizeable increase in gas charges during FY24. These price adjustments, though slowed the pace of disinflation, helped to curtail the fiscal burden through a decline in energy subsidies during the year.

The reduction in subsidies and development spending, together with a notable increase in revenue in terms of GDP, helped the government to achieve higher-than-envisaged fiscal consolidation during FY24. The primary balance posted a surplus of 0.9 percent in FY24, first time since FY07, against the budget target of 0.4 percent of GDP. The interest payments, on the other hand, continued to surge, accounting for more than two-thirds of government tax revenue.

On the revenue side, while tax collection saw a notable expansion during FY24, the major impetus came from non-tax revenue. A surge in SBP profit was the major contributor to non-tax revenue during FY24. In addition, the government further increased petroleum development levy (PDL) rate during FY24, which spurred collection notwithstanding decline in POL sales. Within the tax collection, while direct taxes continued to grow sharply, indirect taxes also recovered during FY24. The tax measures, increase in tax rates and elimination of certain tax exemptions; a modest recovery in economic activity; declining but still elevated inflation; and high interest rates, all aided the expansion in tax collection during FY24. However, despite an accelerated growth in tax collection, the FBR taxes increased only marginally in terms of GDP. This underpins the need to widen the scope of tax policy efforts to achieve a sizeable and sustainable increase in tax collection.

The fiscal consolidation and substantial revaluation gains due to exchange rate appreciation led to a notable decline in public debt in terms of GDP during FY24. This was majorly contributed by a decline in external debt, primarily explained by revaluation gains stemming from the appreciation of US dollar against major international currencies, as well as the strengthening of PKR against US dollar. The domestic debt also declined in terms of GDP. However, lower-than-budgeted availability of external finance resulted in government's increased reliance on banks to meet its financing requirements. In view of the market's increased interest in long-term securities, the government met its financing needs mainly through long-term securities, which improved the maturity profile of domestic debt. Whilst the decline in debt-to-GDP ratio is an encouraging development, bringing it further down is imperative from the macroeconomic stability standpoint. This reinforces the need for

expediting fiscal reforms to help maintain primary surplus over the medium term.
The increase in the government's budgetary borrowing inflated Net Domestic Assets (NDA) of the banking system. Moreover, amid a moderate recovery in economic activity and elevated input costs, the growth in private sector credit also inched up in FY24. Meanwhile, the improvement in external account contributed to expansion in the Net Foreign Assets (NFA) of the banking system, driving an uptick in broad money growth in FY24. However, consistent with the tight monetary policy stance, growth in monetary aggregates remained considerably lower than the nominal GDP growth. Also, deposits grew sharply amid attractive rates of return, whereas currency-in-circulation (CiC) remained almost unchanged at the previous year's level in FY24. As a result, the currency-to-deposit ratio has improved to 33.6 percent at end June 2024 from 41.1 percent at end June 2023.

Notwithstanding the improvement in macroeconomic conditions during FY24, the perennial structural issues facing the economy continued to pose risks to macroeconomic stability. In view of the challenging business conditions, investment declined for the second consecutive year, falling to the lowest level in FY24. Consistently low and stagnant investment, constrained by low savings, has stifled country's potential to sustain higher growth – without pressures on external account – by limiting the pace of industrialization (see **Box 2.2**). Given low productivity and increasing vulnerability to climate change, agriculture sector, despite its considerable share in GDP, cannot consistently spearhead the economic growth.

In this context, the need for creating a conducive environment for investment can hardly be overemphasised. In particular, investment in physical as well as human capital is needed to support technology-based industries and encourage export diversification to generate stable and sustainable phase of high economic growth, and to absorb burgeoning labour force. Moreover, a robust expansion in export earnings also requires a supporting business environment, removing administrative bottlenecks, enforcing intellectual property rights and enhancing R&D in export oriented industries (see **Box 6.1**).

Creating an enabling environment, however, requires sustainable stream of government resources. Although, the country saw a large increase in tax revenues during FY24, this mostly came from cyclical factors, such as higher interest rate and inflation. Efforts to boost tax revenue through efficient use of tax policy and administration, and broadening of tax base have remained wanting (see **Box 4.1 and 4.2**).

At the same time, there is a need to urgently address the long-standing agenda to rationalize government expenditures. This includes ending redundant and overlapping functions within the government; bringing efficiency-seeking reforms in government operations; and leaner organizational structures. In addition, there is a need to reduce poorly targeted energy and commodity subsidies, and roll out the necessary reforms in state-owned enterprises (SOEs). These do not only have a huge fiscal burden, but also undermine the country's growth potential by offering poor service delivery; discouraging competition; and inhibiting the role of market forces in efficient resource allocation. In this context, power sector, which is one of the largest contributors to loss-making SOEs, presents a basket case at the nexus of sectoral policy issues and SOEs' losses.

The untargeted energy (power and gas) subsidies, delayed tariff adjustments and slow pace of reforms, especially those related to privatisation and deregulation of prices, have exacerbated the impact of poor operational efficiency of the energy sector. In addition, excess power generation capacity that does not commensurate with the dilapidated state of transmission and distribution system, and huge capacity payments that drove a sharp increase in circular debt, have had implications on fiscal

performance, inflation dynamics and industrial production.

In view of these challenges the government has introduced significant price adjustments since FY23 to align tariffs with cost recovery levels. However, there is a need to widen the scope of these efforts for improvement in operational efficiency in the transmission and distribution segment. Furthermore, in view of the key contribution of capacity payments in power sector circular debt, there is a need to monitor capacity utilization of Independent Power Producers to ensure transparency.

Addressing such sector-specific policy and regulatory issues lies at the heart of SOE reforms that need to be resolved across both loss and profit making SOEs. These, however, need to be accompanied by proper implementation of recently introduced SOEs' legal and policy frameworks to strengthen their corporate governance, followed by adequate reforms of SOEs' business operations. In consideration of SOE's impact on Pakistan's economy, this report includes a special chapter on Reforming SOEs in Pakistan. The chapter sheds light on Pakistan's experiences with historical and ongoing SOE reforms in light of global best practices and outlines key ingredients for successful reforms including adequate management of SOEs' labour concerns and garnering of political consensus, failures to both of which have derailed the SOE reform efforts several times in the past.

1.2 Economic Outlook

The latest data on high-frequency indicators points to further improvement in macroeconomic conditions in FY25. This, combined with the approval of the Extended Fund Facility (EFF) program by the IMF Board in September 2024, is expected to boost investor confidence and further upgrade Pakistan's credit rating.[3] These developments could make way for external inflows from multilateral creditors, as well as from private investors. Moreover, global commodity prices are maintaining a downtrend while global growth is expected to remain steady, as per the IMF's latest World Economic Outlook. These developments have improved Pakistan's near-term macroeconomic outlook (**Table 1.2**). However, inherent volatility in global energy prices may pose some risks to this outlook.

Macroeconomic Targets and Projections for FY25 **Table 1.2**

	Target	SBP Projections
Growth rate (percent)		
Real GDP [a]	3.6	2.5-3.5
CPI (average) [a]	12.0	11.5-13.5
billion US$		
Remittances [a]	30.3	32.0-33.0
Exports (fob) [a]	32.3	30.5-31.5
Imports (fob) [a]	57.3	56.5-57.5
percent of GDP		
Fiscal deficit [b]	5.9	5.5-6.5
Current account deficit	0.9	0.0-1.0

Sources: [a]Annual Plan 2024-25, [b]Federal Budget 2024-25

Amid receding inflationary pressures, the SBP has already started to lower the policy rate, after maintaining the tight monetary policy stance for the longest period in recent past. Lower borrowing costs, combined with improving external position and fall in global commodity prices, are expected to support expansion in industry and services sectors during FY25. Meanwhile, the FY25 budget envisages a notable increase in development spending that may further boost economic activity. The high-frequency demand indicators also continue to show signs of bottoming out, whereas LSM saw almost consistent improvement since December 2023. However, the latest information about *kharif* crops suggest that agriculture sector may not sustain its growth momentum into FY25. According to the preliminary estimates as of 1st September 2024, cotton arrivals reported a 59.7 percent decline compared to the same period last year. In view of these developments, the real GDP growth is expected in the range of 2.5 – 3.5 percent in FY25.

[3] Moody's upgraded Pakistan's local and foreign currency ratings from Caa3 to Caa2 in August 2024.

Despite reduction in the policy rate, the real interest rates remain significantly positive. The tight monetary policy stance and continued fiscal consolidation, as envisaged in FY25 budget, are expected to keep inflation significantly contained during FY25. Moreover, the headline inflation has maintained a general downtrend since June 2023, falling to 6.9 percent in September 2024, whereas core inflation has also declined considerably in recent months. In view of the recent outturns, the average inflation in FY25 may even fall below the earlier projected range of 11.5 – 13.5 percent. However, volatility in international oil prices, fiscal slippages and unplanned subsidies pose significant risks to this projection.

The SBP projects fiscal deficit in the range of 5.5 – 6.5 percent in FY25, compared to 6.8 percent of GDP in FY24. This improvement is expected to come from a sharp increase in both tax and non-tax revenues. While direct taxes are expected to continue the uptrend witnessed since the last year, the continuing momentum in economic activity, which is anticipated to be led by industry and services sectors in FY25, and an uptick in imports are likely to further boost indirect taxes.

On the other hand, expenditures are also expected to continue to grow. The FY25 budget envisages notable increase in expenses for social protection. In addition, the government has announced increase in salaries and pensions of government employees in view of the heightened inflation. Similarly, to give a boost to economic growth, the budget envisages substantial increase in development spending during FY25.

In line with the moderate expansion in industry and services sectors, imports are likely to increase in FY25. Moreover, while there are upside risks to global commodity prices due to rising geo-political tensions, commodity prices continue to be low. On the other hand, both the exports and workers' remittances are holding the trends observed in FY24. Incorporating these trends and expected future developments, the SBP expects the CAD to remain contained in the range of 0 – 1.0 percent of GDP in FY25. On the other hand, the approval of US$ 7 billion EFF program and the realization of external inflows from multilateral and bilateral creditors are expected to further strengthen the external buffers.

2

Economic Growth

Real GDP moderately grew in FY24 after a slight contraction in the previous year. The agriculture sector led the recovery with bumper harvest of major crops. Increase in area under cultivation, improved yields, conducive weather conditions, and better availability of inputs all supported the higher crop production. The services sector also made a notable contribution, while industry posted contraction for the second consecutive year. The stabilisation policies, together with lingering structural issues, continued to restrain the industrial activities. Nonetheless, output of large scale manufacturing posted a slight increase, after a sharp decline in FY23, with improved availability of both domestic and imported raw materials. The industrial employment also closely followed the trends in LSM. Moreover, business and consumer sentiments about employment prospects somewhat improved. However, investment declined for the second consecutive year, falling to the lowest level, in FY24. This does not bode well for achieving higher growth and creating employment opportunities in the economy over the medium-term.

2 Economic Growth

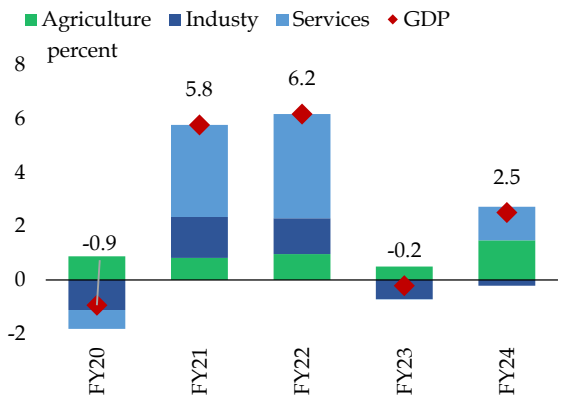
2.1 GDP Growth

Pakistan's real economic activity moderately recovered in FY24, after a slight contraction in the previous year (**Table 2.1**). The recovery was led by agriculture, followed by the services sector. The industry, however, showed a slight decline (**Figure 2.1**). While agriculture production benefited from post-flood diluvial soil enrichment and other supporting factors, the decline in industry reflects the impact of continued contractionary macroeconomic policies, high inflation, domestic economic uncertainty, and tight global financial conditions.

The growth in agriculture sector was mainly driven by record harvest of wheat and rice, together with significant increase in cotton production. While both the area under cultivation and yields improved, the major impetus came from favourable weather conditions, better availability of irrigation water, greater use of certified seeds and fertilizer, and increased credit disbursements to the agriculture sector.

A significant contraction in *electricity generation, gas & water supply* mainly underpinned the decline in industry. The sharp increase in power tariffs and gradual shifting of domestic and industrial users to off-grid solar power that dampened electricity consumption, and lower subsides contributed to a notable decline in value addition

Contribution to GDP Growth - Supply Side **Figure 2.1**



Source: Pakistan Bureau of Statistics

by the sector. Moreover, *construction sub-sector* also contributed negatively during FY24 due to deceleration in development spending and increased construction cost amid tight monetary policy and fiscal consolidation. However, Large Scale Manufacturing (LSM) saw a slight recovery in FY24 after showing a large decline in FY23.

Better availability of raw materials, supported by increase in agriculture production, relaxation in import restrictions and lower global commodity prices, were the key contributors to the nascent recovery in LSM during FY24. Nevertheless, a host of factors continued to weigh on manufacturing activity, including elevated input

GDP Growth **Table 2.1**

percent

	FY23R					FY24P					Contribution to GDP Growth*	
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	FY23R	FY24P
GDP	**1.5**	**2.5**	**-1.1**	**-3.6**	**-0.2**	**2.7**	**2.0**	**2.4**	**3.1**	**2.5**	**-0.2**	**2.5**
Agriculture	0.0	3.3	3.9	1.7	2.2	8.6	6.1	3.9	6.8	6.4	0.5	1.5
Important crops	-11.8	9.1	9.2	-7.9	0.5	30.2	14.0	2.0	27.0	17.0	0.0	0.7
Industry	-0.2	1.7	-6.6	-9.2	-3.7	-2.7	-1.2	2.8	-3.6	-1.1	-0.7	-0.2
LSM	-1.3	-1.9	-14.5	-19.5	-9.8	-0.6	-0.7	1.6	4.2	1.1	-0.9	0.1
Services	2.7	2.4	-1.2	-3.7	0.0	2.0	1.3	1.6	3.7	2.2	0.0	1.3

R: Revised, P: Provisional

*may not necessarily match due to rounding-off

Source: Pakistan Bureau of Statistics

Composition of Aggregate Demand **Table 2.2**

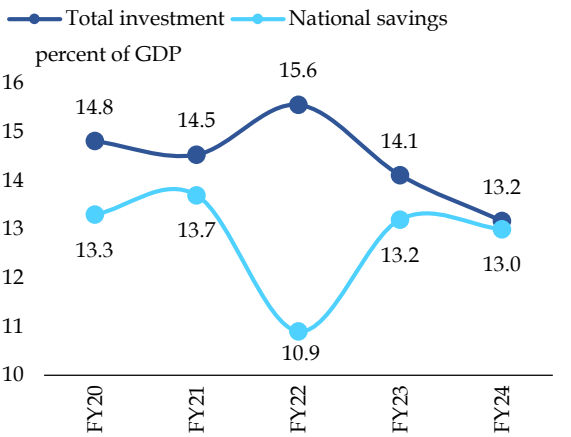
as percent of GDP

	FY20	FY21	FY22	FY23	FY24
Total consumption	93.3	94.4	96.4	93.5	93.4
Household*	81.5	83.5	85.9	83.2	84.6
Government	11.8	10.9	10.5	10.3	8.7
Investment	14.8	14.5	15.6	14.1	13.2
Net exports	-8.1	-8.9	-12.0	-7.6	-6.5
Exports	9.3	9.1	10.5	10.5	10.4
Imports	17.4	18.0	22.5	18.1	16.9
Memorandum item					
National Savings	13.3	13.7	10.9	13.2	13.0

*including non-profit institutions serving households

Sources: Pakistan Economic Survey 2023-24; Pakistan Bureau of Statistics

Saving-Investment Gap **Figure 2.2**



Source: Pakistan Bureau of Statistics

costs, particularly due to increase in energy prices; subdued domestic demand amidst inflationary pressures; and high cost of borrowing.

The improved performance of services sector mainly reflects the spillover from robust agriculture production, and slight recovery in LSM. The major contribution to the services sector growth came from *wholesale and retail trade, other private services* and *education*. The value addition by *finance and insurance* and *general government* services, however, contracted for the second consecutive year in FY24.

The labor market developments, as depicted by industrial employment, mirrored the trends observed in manufacturing activity. This is also evident from a slight improvement in both business and consumer sentiments about current and future employment generation. The wages, on the other hand, improved albeit at a slower pace than the previous year.

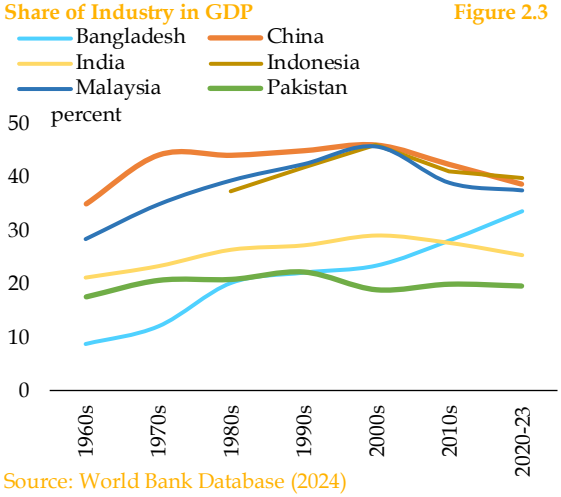
The demand-side measure of GDP shows that consumption expenditure, notwithstanding slower growth, continued to dominate with over 90 percent share in GDP. On the other hand, investment declined for the second consecutive year, falling to the lowest level of 13.2 percent of GDP in FY24 **(Table 2.2)**. This, despite a slight decrease in savings, has resulted in the saving-investment gap to almost disappear (**Figure 2.2**). However, these trends do not bode well for medium to long-term growth trajectory and employment generation for want of expansion in the country's productive capacity.

The experiences of advanced and leading emerging economies suggest that accelerated economic growth cannot be achieved without substantially increasing savings and investment.[1] In fact, low and stagnant investment stifles economic expansion, especially by limiting the pace of industrialization.

As shown in **Figure 2.3,** share of industry in Pakistan's GDP is not only the lowest in the region, it has also been trending downward in recent years. This is in contrast to the experiences of regional economies such as China, where a sustained increase in investment from 25.6 percent of GDP during 1960s to 43.1 percent in 2022, pushed the share of industry from around 35.0 percent during 1960s to around 40 percent of GDP in 2022. In this backdrop, increasing investment is crucial for revitalizing the industrial sector for a sustainable and inclusive growth in Pakistan. This, however, hinges on economy-wide reforms, including but not limited to reducing political uncertainty, improving security situation, strengthening rule of law, creating competition

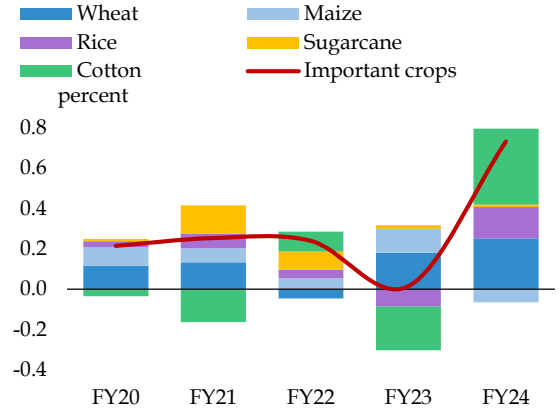
[1] ADB (2020). Asia's Journey to Prosperity, Policy, Market, and Technology over 50 Years, Asian Development Bank

Share of Industry in GDP **Figure 2.3**



Source: World Bank Database (2024)

Contribution of Important Crops to GDP Growth **Figure 2.4**



Source: Pakistan Economic Survey 2023-24

through deregulation and privatisation of SOEs, reducing cost of doing business and creating overall conducive business environment.

2.2 Agriculture

Agriculture growth accelerated in FY24, after remaining subdued in the previous year due to flood-related damages (**Table 2.3).** This acceleration in growth was led by record production of wheat and rice, and rebound in cotton, offsetting the decline in maize and sugarcane production **(Figure 2.4).**

The production of cotton and rice rebounded in the backdrop of flood-related damages in FY23.

Both the increase in area under cultivation and improved yields contributed to high crop production. Higher prices in the previous year as well as timely policy interventions like announcement of support prices, especially for cotton, encouraged farmers to expand area under important crops. Whereas, favourable weather conditions and better availability of inputs including seed, fertilizer, water, and credit improved crop yields. In addition, enhanced agriculture credit disbursement target, and *Kissan* package[2] also supported the agriculture output. Although water availability met requirements, irregular rainfall patterns, caused by climate change, remained a source of concern.

Growth in Agriculture Sector **Table 2.3**

percent

	FY23R					FY24P					Contribution	
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	FY23R	FY24P
Agriculture	**0.0**	**3.3**	**3.9**	**1.7**	**2.2**	**8.6**	**6.1**	**3.9**	**6.8**	**6.4**	**2.2**	**6.4**
Crops	-8.2	4.0	3.1	-4.7	-1.2	16.0	9.6	2.6	14.0	10.3	-0.4	3.5
Important crops	-11.8	9.1	9.2	-7.9	0.5	30.2	14.0	2.0	27.0	17.0	0.1	3.2
Other crops	-2.1	-1.3	-1.5	-0.6	-1.4	-2.0	-1.0	-0.4	-1.5	-1.2	-0.2	-0.2
Cotton ginning	-22.4	-30.2	-26.9	-10.7	-22.8	25.7	53.4	61.8	49.4	47.2	-0.3	0.5
Livestock	4.0	2.4	3.9	4.3	3.7	5.3	3.7	4.8	4.0	4.5	2.3	2.8
Forestry	14.2	18.5	18.7	15.1	16.6	8.3	3.7	0.9	-0.4	3.0	0.4	0.1
Fishing	0.6	0.6	0.6	0.6	0.6	0.7	0.8	0.8	0.9	0.8	0.0	0.0

R: Revised, P: Provisional

Source: Pakistan Bureau of Statistics

[2] *Kissan* Package offered subsidies and technological advancements to support agriculture. Source: Pakistan Economic Survey 2023-24, MoF

Inputs

Seed

The availability of quality seeds in Pakistan has remained a persistent issue. Use of hybrid maize seeds has been a successful domestic example of obtaining substantial gains in yield. During FY24, the use of better quality seeds for rice, pest-resilient varieties for cotton, and certified seeds for wheat helped in attaining better yields.

The farmers' access to certified seeds increased for maize and wheat during FY24, however, it remained short of requirements for all major crops except for paddy/rice (**Table 2.4**).[3] In *Rabi* FY24, the availability of certified seeds for wheat increased, commensurate with the increase in area under cultivation. The seed shortages are typically met via seeds acquired through informal sources, which are of low quality and prone to pest attacks, consequently hampering the agricultural productivity.[4]

Seed Availability and Requirement **Table 2.4**

availability in 000' MT

	FY23		FY24	
	Avail.	% of Req.	Avail.	% of Req.
Paddy	67.3	147.5	57.1	125.1
Maize	28.0	84.9	32.2	97.4
Cotton	42.2	84.2	25.4	50.8
Wheat*	511.4	46.4	529.1	46.3

*FY24 numbers are provisional

Source: Federal Seed Certification and Registration Department

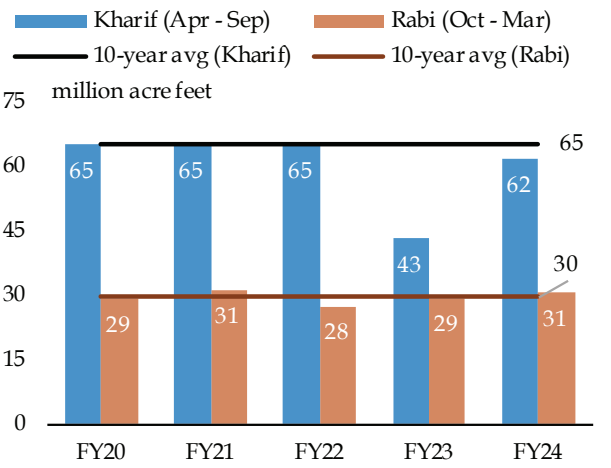
Water

Flow of canal water remained generally satisfactory during FY24. The overall canal withdrawals were greater than the previous year, when the floods had reduced the requirement for irrigation purpose **(Figure 2.5)**. Season-wise breakdown indicates the flow of irrigation water during *Kharif* FY24 was 42.9 percent higher than the previous year. These releases, conforming to the rainfall patterns, were lower than 10-year average before the flood year.[5] However, rainfall patterns were irregular, an increasing manifestation of climate change in Pakistan during FY24.

Rainfall remained above average or close to the average for the most part of the *Kharif* season except for a dry spell in August 2023, which came after June 2023 that was second wettest June in the last sixty-three years.[6] Likewise, weather was dry and cold in December and most of January, whereas March experienced above normal rainfall, accompanied by hailstorms and gusts, damaging the standing crops in some regions.[7]

Another worrying element of climate change in Pakistan is the accelerated melting of the Himalayas Karakoram Hindukush (HKH) glaciers – a major upstream source of water for Indus basin irrigation system. In this context, **Box 2.1** briefly highlights the issue, its implication for Pakistan, and possible remedial measures.

Irrigation Water Releases **Figure 2.5**



Source: Indus River System Authority

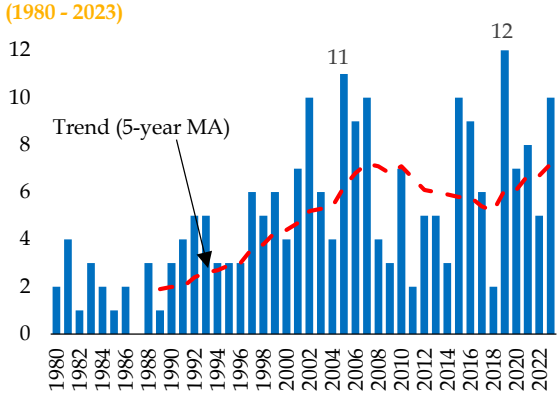
[3] Specifically, the certified seed availability exceeded for paddy by 25.1 percent, but fell short by 2.6 and 49.2 percent for maize and cotton, respectively. In *Rabi* FY24, the availability of certified seeds for wheat increased, commensurate with the increase in area under cultivation.
[4] Evaluation of Seed Industry: Way Forward. Pakistan Institute of Development Economics, 2024.
[5] Average irrigation water flows during *Kharif* FY13-22 were 65 million acre feet. Source: IRSA
[6] Source: Pakistan Monthly Climate Summary, issues from April to September 2023, Pakistan Meteorological Department
[7] Source: Pakistan Monthly Climate Summary, issues from October 2023 to March 2024, Pakistan Meteorological Department

Box 2.1: Climate Change and Accelerated Melting of Glaciers in Pakistan

Climate change is one of the most pressing global issues, profoundly affecting the earth and its inhabitants.[1] Pakistan ranks very high among the countries most vulnerable to climate change, despite contributing only 0.9 percent of the total global greenhouse gas emissions.[2] As per Germanwatch's, long-term climate risk index focusing on extreme weather events such as floods, storms, and heatwaves, Pakistan is the *eighth* most affected country.[3]

The country is increasingly experiencing extreme weather events such as flash floods, prolonged dry spells followed by irregular rainfall patterns, and frequent heatwaves **(Figure 2.1.1)**. The situation is expected to worsen in the coming years. World Bank (WB) forecasts 18 to 20 percent GDP loss to be caused by climate change in Pakistan by 2050.[4] Floods alone are estimated to cost around US$ 3.3 billion per year in Pakistan depending upon intensity and frequency.[5] For example, floods in 2022 caused an estimated loss of around US$ 15.2 billion.[6]

Number of Natural Disasters in Pakistan (1980 - 2023) **Figure 2.1.1**



Note: Disasters include floods, cyclones, extreme temperature, and droughts

Source: Financial Risk Statement 2024 - 25, MoF

Another climate event gradually unfolding in the northern parts of Pakistan is the accelerated melting of glaciers that can greatly worsen the flood situation and water availability. These rapidly melting glaciers may not only disrupt the life and agricultural activities in the northern region, but also have wider implications for downstream agriculture sector of the country. Specifically, global warming between 1.5 to 2°C may cause the glaciers in the Himalayas Karakoram Hindukush (HKH) mountain ranges to lose around 30 to 50 percent of their volume by 2100.[7]

To put this in perspective, Pakistan is home to over seven thousand glaciers. As per projections, expected increase in temperature in Pakistan is likely to surpass the world average, with a 1.4 to 3.7°C rise by the 2060s and 6°C by 2090s, possibly increasing snowmelt from glaciers.[8] Due to rising temperature, these glaciers in HKH region are already melting at a faster rate, leading to formation of around three thousand glacial lakes. Out of these, thirty-three lakes are prone to glacial lake outburst flood (GLOF)—massive releases of millions of cubic meters of water in case of a breach.[9]Attabad lake, created because of earthquake induced land-sliding, is an important example of a lake that is at risk of bursting due to increased flow from accelerated glaciers melting.[10]

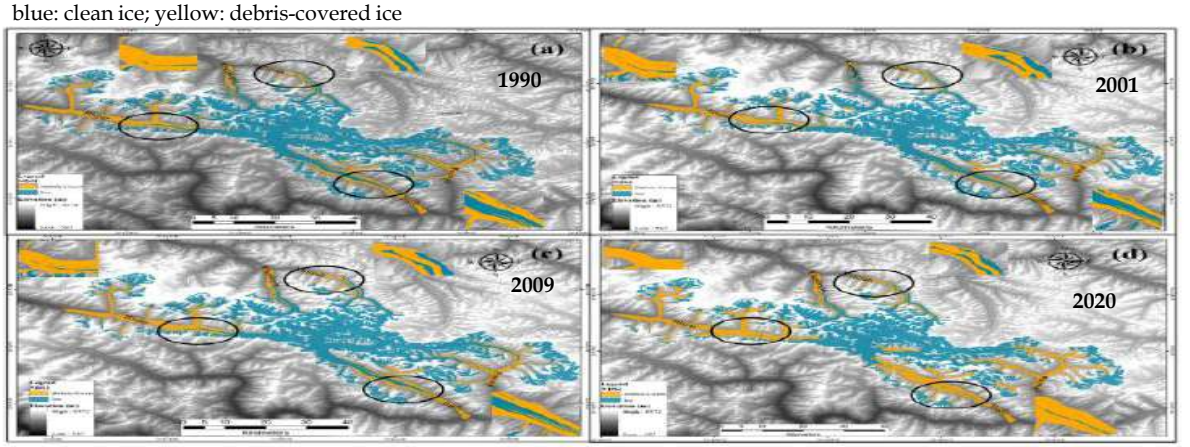
As evident from **Figure 2.1.2**, the glacier mass is visibly decelerating over the years. The blue portion signifying the clean ice, has significantly decreased in 2020 as compared to 1990, whereas, the yellow portion indicating debris covered ice formed as a result of melting glaciers has increased.[11]

Glaciers/snowmelt from HKH mountain ranges is the main source of water supply in Indus Basin Irrigation System, which irrigates millions of hectares of agricultural land in Pakistan.[12] However, glaciers in these mountain ranges have melted at a 65 percent faster pace than anticipated during 2011-2022.[13] Besides floods, this could also deplete water resources in the longer run pushing Pakistan further towards water stress and scarcity. As per WB forecast, the water shortages could lead to an overall decline in GDP by more than 4.6 percent per year and the delayed climate action can cause a 7-8 percent decrease in the agriculture sector by 2030 in Pakistan.[14] Furthermore, the western Himalayas glaciers are anticipated to retreat over the next fifty years, initially increasing the Indus River System's water supply, but as these glacial reservoirs deplete, flows may decrease by a substantial 30 to 40 percent in next fifty years.[15]

To prepare and delay the impact, Pakistan has taken certain initiatives such as a collaborative project with United Nations Development Program (UNDP) with the objective to identify and manage risks related to GLOF events.[16] The fiscal risk statement FY25 of Pakistan, released by MoF, has called for a holistic approach with a combination of proactive planning, diversified funding sources, and targeted policy interventions for managing climate issues. These

Glacier Inventory of Central Karakoram National Park (CKNP)* **Figure 2.1.2**

blue: clean ice; yellow: debris-covered ice



*adopted from Moazzam et al. (2022)

efforts are suggested to include: incentives for renewable energy projects, encouraging climate-resilient agricultural practices, budget allocations for disaster preparedness and response, exploring collaboration with international organizations and donors, and combining climate and disaster risk management mechanism. Notwithstanding these efforts, Pakistan currently ranks 30th on Climate Change Performance Index(CCPI), enlisting it among medium performers despite being amongst the most vulnerable.[17] Considering that global efforts on climate action across all fronts are also lagging, the situation calls for implementing the agreed interventions, domestically and globally, such as minimizing carbon emissions by transitioning from fossil fuels to renewable energy sources.[18]

Other measures could include sustainable use of land by protecting glacial watersheds while minimizing human influence in areas saturated with glaciers, developing water management strategies including storage and distribution to manage the changes in water supply as the glaciers recede, and regulating tourism and ensuring sustainable mountaineering practices to prevent damages to glaciers, and exploring innovative technologies such as artificial glaciers and ice sheets to slowdown the glacial melting.[19]

References

[1] There is a sixty-six percent probability that annual average near surface level global temperature will be more than 1.5°C between 2023-27. Whereas, a 98 percent likelihood that at least one of the next five years will be warmest on record. Source: World Meteorological Organization

[2] Source: Ministry of Finance (2024), Pakistan Economic Survey 2023-24. Islamabad: MoF.

[3] Eckstein, D., Künzel, V., & Schäfer, L. (2021). The global climate risk index 2021. Bonn: Germanwatch.

[4] Source: WB Group, Pakistan – Country, Climate, and Development Report, November 2022.

[5] Source: Government of Pakistan, Updated Nationally Determined Contributions, 2021.

[6] Source: Ministry of Finance (2024), Pakistan Economic Survey 2023-24. Annex III: Pakistan Floods 2022 Impact Assessment.

[7] ICIMOD. (2023). Water, ice, society, and ecosystems in the Hindu Kush Himalaya: An outlook. (P. Wester, S. Chaudhary, N. Chettri, M. Jackson, A. Maharjan, S. Nepal, & J. F. Steiner [Eds.]). ICIMOD. https://doi.org/10.53055/ICIMOD.1028

[7] Source: Ministry of Finance (2024), Pakistan Economic Survey 2023-24. Islamabad: MoF.

[9] Source: UNDP, Scaling-up of Glacial Lake Outburst Flood (GLOF) risk reduction in Nothern Pakistan.

[10] Noor, S., Mahmood, S., & Habib, W. (2024). Risk Assessment of Attabad lake Outburst Flooding using integrated Hydrological and Geo-Spatial Approach. Advanced Geomatics, 4(1), 57-67.

[11] Moazzam, M. F. U., Bae, J., & Lee, B. G. (2022). Impact of Climate Change on Spatio-Temporal Distribution of Glaciers in Western Karakoram Region since 1990: A Case Study of Central Karakoram National Park. Water, 14(19), 2968.

[12] Simons, G. W. H., et al. "A novel method to quantify consumed fractions and non-consumptive use of irrigation water: Application to the Indus Basin Irrigation System of Pakistan." Agricultural Water Management 236 (2020): 106174.

[13] Source: International Centre for Integrated Mountain Development (ICIMOD), Nepal.

[14] Source: WB Group, Pakistan – Country, Climate, and Development Report, November 2022.

[15] Source: Asian Development Bank, Climate Change Profile of Pakistan, 2017.

[16] Source: Scaling-up of Glacial Lake Outburst Flood (GLOF) risk reduction in Northern Pakistan | UNDP (undp.org)

[17] Source: Ranking, Climate Change Performance Index (ccpi.org).

[18] Source: United Nations Framework Convention on Climate Change (UNFCC), COP28: What was achieved and What Happens Next?, November – December 2023.
[19] Saidakbarovich, M. M., & Ogli, R. B. D. S. (2023). Glacier Melting: Control and Mitigation Strategies. Western European Journal of Linguistics and Education, 1(3), 26-33.

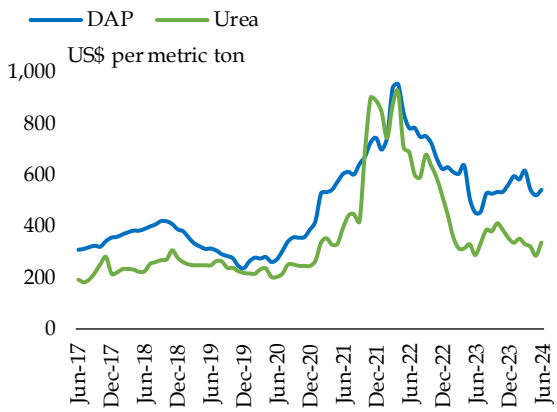
Fertilizer

Fertilizer offtake, despite higher prices, increased during FY24, compared to the previous year.[8] The increase largely emanated from better crop situation and expansion in area under cultivation **(Figures 2.6a and 2.6b).**

The urea offtake increased by 5.8 and 1.6 percent during *Kharif* and *Rabi* FY24; whereas DAP offtake increased by 54.2 and 21.7 percent, respectively. However, in comparison to 10-year average, DAP offtake remained lower during *Kharif* FY24, due to historically high prices.[9]

While fertilizer prices decreased in international market in FY24 from their peak in FY22 **(Figure 2.7)**, the domestic prices remained higher. The decline in international fertilizer prices was initially due to lower demand because of erosion in farmers' affordability, and latter due to a reduction in global prices of raw materials, primarily gas.[10,11]

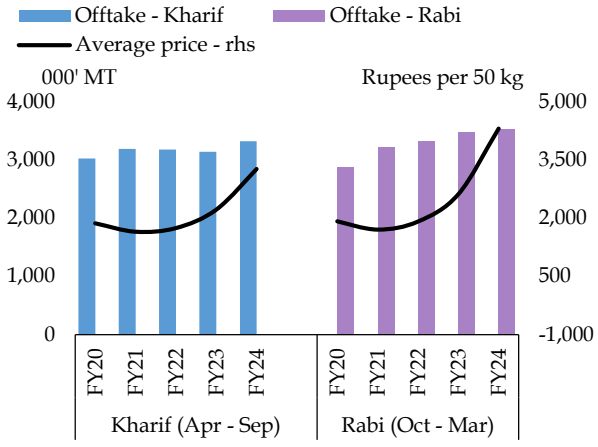
Global Urea and DAP Prices — Figure 2.7



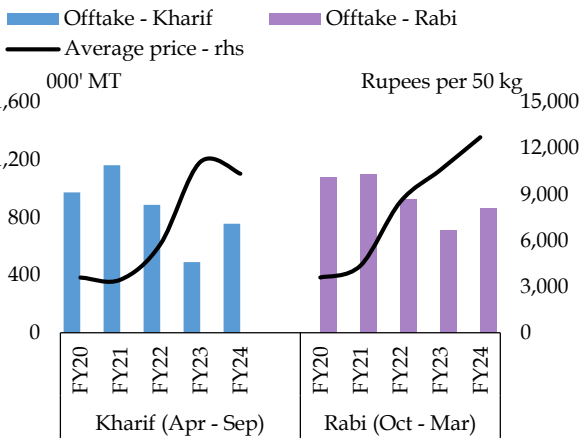
Source: World Bank

Given that DAP is largely imported, the decline in international DAP prices during *Kharif* FY24 was reflected in reduced domestic prices as well. However, the international DAP prices increased in Q3-FY24 mainly due to export restrictions by China and Russia on phosphate and ammonia,

Urea Offtake and Prices — Figure 2.6a



DAP Offtake and Prices — Figure 2.6b



Source: National Fertilizer Development Centre

[8] Efforts are being made in collaboration with provincial governments to eliminate hoarding. Source: PR No. 259, Press Information Department, GoP April 2024.
[9] Average DAP offtake during *Kharif* FY13-FY22 was 792.8 thousand tons, whereas it was 757.0 thousand tons in FY24. Source: NFDC
[10] Source: WB – Commodity markets outlook, October 2023
[11] Source: WB – Commodity markets outlook, April 2024

Agricultural Credit Disbursement **Table 2.5**

billion Rupees

	FY22	FY23	FY24
Farm Sector (Production)			
All crops	374.7	438.8	483.0
Horticulture	34.4	36.6	45.4
Corporate farming	57.0	110.6	156.4
Others	220.8	331.1	392.8
Subtotal	**686.9**	**917.1**	**1,077.6**
Farm Sector (Development)			
Tractor	10.7	10.9	48.3
Farm machinery	0.7	2.5	6.6
Tube well	0.5	1.7	9.5
Sprinkle and trickle irrigation	0.0	-	0.3
Others	30.1	34.7	69.2
Subtotal	**42.0**	**49.7**	**133.9**
Non-Farm Sector (Working Capital)			
Livestock/Dairy	349.0	394.7	485.9
Poultry	222.9	261.0	313.8
Others	48.4	70.4	131.0
Subtotal	**620.3**	**726.0**	**930.7**
Non-Farm Sector (Fixed Investment)			
Livestock/Dairy	41.2	58.8	42.3
Poultry	19.9	15.4	21.3
Others	8.7	8.9	9.9
Subtotal	**69.7**	**83.1**	**73.5**
Grand Total	**1,418.9**	**1,776.0**	**2,215.7**

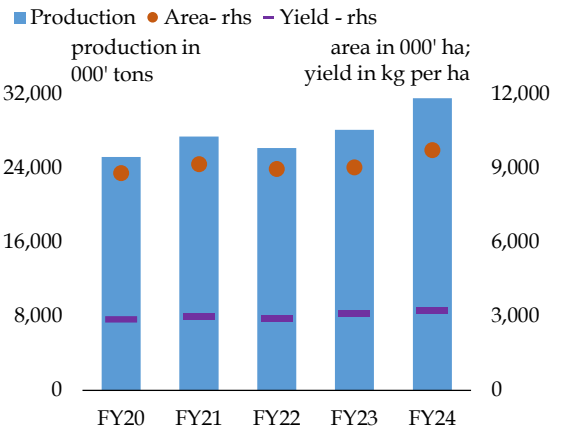
Source: State Bank of Pakistan

respectively.[12] This increased the domestic prices by 20.2 percent in *Rabi*.[13]

Agriculture Credit Disbursement

Credit disbursement to the agriculture rose by 24.8 percent during FY24 **(Table 2.5)**. The increase was in line with upward revision in the target set by the SBP to Rs 2,250 billion in wake of rising input costs.[14] Besides, SBP increased efforts to raise awareness about various financing schemes among the farming community.[15] Livestock/dairy and crops remained the largest borrowers. Loans for purchase of tractors, under farm sector development, increased significantly, which is also reflected by 47.0 percent growth in tractor sales during FY24.[16]

Wheat Crop **Figure 2.8**



Source: Pakistan Bureau of Statistics

The major chunk of farm sector developmental loans falls under the 'others' category, which almost doubled in FY24. These loans include borrowings for cold storage, farm transportation, fruits orchids, silos, green houses, tunnel farming, land improvement, high quality seed processing units, and disbursement to NGOs for farm development. In addition, *Kissan* Package, crop loan insurance, and electronic warehouse receipt and livestock insurance schemes for borrowers also contributed to higher loan disbursement.[17]

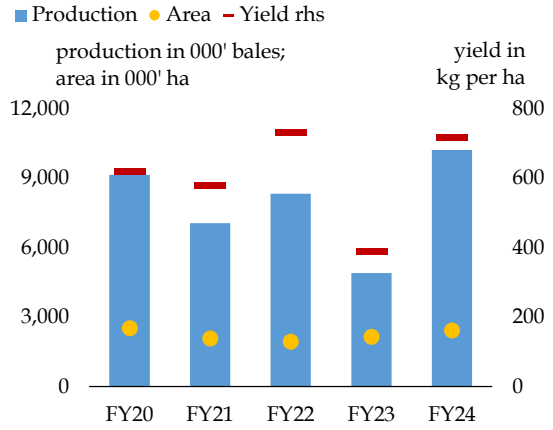
Output

Wheat

Wheat crop witnessed a record harvest of 31.6 million tons in FY24, compared to 28.2 million tons in FY23 **(Figure 2.8).** This increase in production came from a combination of increase in area under cultivation and better yields. This

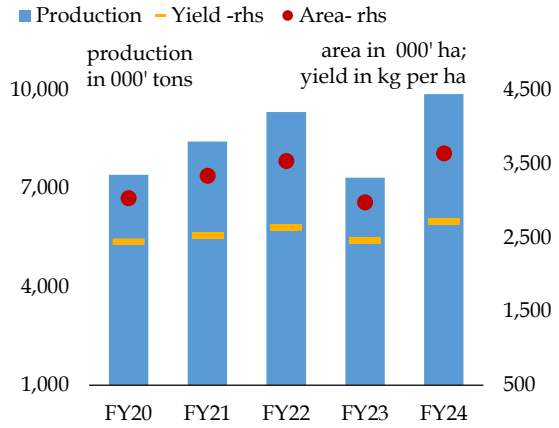
[12] Ibid.
[13] The average price of DAP during *Rabi* 2024 (Oct-Mar) was Rs 12,736 per 50kg compared to Rs 10,599 during *Rabi* 2023. Source: PBS.
[14] As per Agriculture Market Information System, the cost of production increased by 51.7, 46.5, 61.2, and 42.0 percent for cotton, maize, sugarcane, and wheat respectively in FY24.
[15] Source: SBP press release (ECD/M&PRD/PR/01/2023-84), September 18, 2023
[16] Source: PAMA, Production and Sales Report
[17] Markup Waiver Scheme, GoP Markup Subsidy Scheme, Markup Subsidy, Interest Free Loans and Risk Sharing Scheme for Landless Farmers, and Risk Sharing Scheme for Farm Mechanization. Source: AC&MFD Circular No. 03 and 04 of 2022, SBP

Cotton Crop — Figure 2.9



Source: Pakistan Bureau of Statistics

Rice Crop — Figure 2.10



Source: Pakistan Bureau of Statistics

could be linked to greater use of fertilizer and quality seeds amid adequate availability of irrigation water.[18] Use of rust-resistant seeds combined with less rainfall during *Rabi* lowered the incidence of the rust disease during FY24 crop.[19] Moroever, the government maintained MSP for FY24 at Rs 3,900/40 Kg, which was sufficient to cover the cost of production.[20,21] Rainfall patterns in *Rabi* FY24 were, however, erratic. A dry spell in December 2023 continuing till the third week of January 2024 induced drought-like conditions in rain-fed areas.[22] Though, rains at the end of January compensated for this dry spell, the rains in March accompanied by hailstorms and gust damaged the crop in a few areas.[23] Nevertheless, better input utilization and higher yields helped achieve the record harvest.

Cotton

Cotton output rebounded in FY24, after experiencing sizeable damages from floods in the previous year. Both increase in area under cultivation and yield contributed to higher cotton production (**Figure 2.9**). A timely announcement of the support prices in March 2023, well before the sowing season, incentivized farmers to allocate more area for cotton cultivation.[24] Further, the use of pest-resilient seeds, favorable weather conditions and flood-induced regeneration of soil, resulted in improved yield.[25]

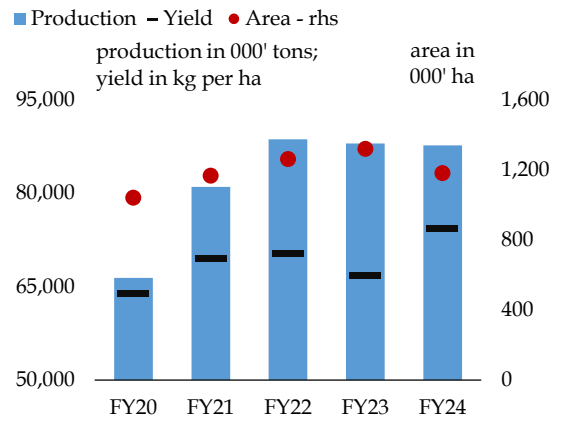
Even though cotton production increased to 10.2 million bales in FY24 from 4.9 million bales in FY23, it fell short of the target for the year. The shortfall can be linked to lower than targeted yield in Punjab, that suffered from whitefly attacks and uneven rain patterns.[26] In Sindh, dry weather during picking season and lower pest attacks benefitted the crop.

Rice

Rice crop witnessed a record production of 9.9 million tons in FY24 **(Figure 2.10)**. This was an

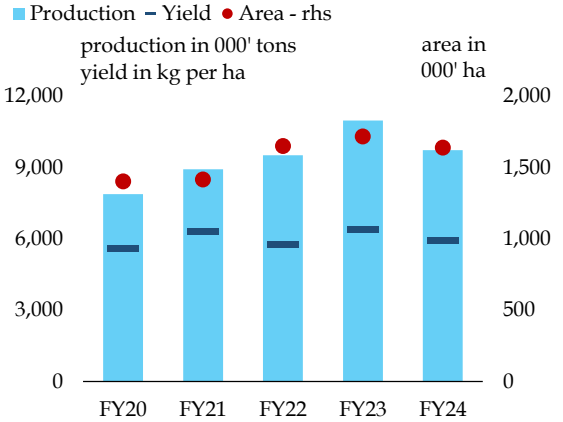
[18] Farmers have used certified seeds for 46 percent of wheat crop in FY24. Source: USDA, Grain and Feed Annual Report, April 2024.
[19] Source: USDA, Grain and Feed Annual Report, April 2024.
[20] Source: Ministry of Finance (PR No. 510 – December 30, 2023)
[21] Cost of production of an average farmer for wheat in FY24 is estimated to be Rs 3,303.5/40Kg and 3,075.2/40Kg in Punjab and Sindh respectively. Source: Wheat Policy Analysis for 2023-24 Crop.
[22] Source: Monthly Agromat Bulletin, National Agromat Centre, Pakistan Meteorological Department, Vol:12-2023 and Vol: 01-2024, December 2023 and January 2024.
[23] Source: Monthly Agromat Bulletin, National Agromat Centre, Pakistan Meteorological Department, Vol:03-2024, March 2024.
[24] ECC fixed the intervention price of cotton (Phutti) at Rs 8,500/40Kg. Source: Ministry of Finance (PR No. 325 - March 14, 2023),
[25] Source: Monthly Economic Update and Outlook, August 2023, Finance Division, Economic Advisor's Wing, Government of Pakistan.
[26] Source: PAK SCMS Bulletin, SUPARCO, volume XIII, Issue 10, Serial No. 154, October 2023

Sugarcane Crop **Figure 2.11**



Source: Pakistan Bureau of Statistics

Maize Crop **Figure 2.12**



Source: Pakistan Bureau of Statistics

outcome of a combination of 22.2 percent increase in the area under cultivation and a 10.3 percent rise in yield. Higher prices and better export prospects remained the major reasons behind the increase in area under cultivation, while favourable monsoon rains and use of new high-yielding non-basmati varieties boosted yield.[27] Moreover, rice output has been trending upward for the past few years reflecting greater profitability and export potential. The FY24 also marked a milestone in terms of rice exports **(see Chapter 6).**

Sugarcane

Production of sugarcane fell slightly by 0.4 percent in FY24, primarily due to 10.5 percent decline in the area under cultivation, while yields improved by an impressive 11.3 percent **(Figure 2.11)**. The decline in area under cultivation, despite an increase in support price, was on account of shift to other competing crops like cotton and rice.[28]

Maize

Maize production declined by 11.3 percent as both area and yield fell in FY24 (**Figure 2.12).** Moreover, maize prices also declined because of lower demand emanating from poultry feed.[29, 30] Consequently, farmers shifted to more profitable options in FY24 such as cotton and rice, contrasting the trend of past decade.

Other Crops

The output of *other* crops slightly declined in FY24. This was mainly because of lower area under cultivation, as farmers switched area under cultivation to more profitable important crops. The production of gram and green fodder witnessed a fall for the second consecutive year due to both lower yields and decline in area under cultivation (**Table 2.6**). However, production of *Kharif* pulses, particularly moong and mash, rebounded in FY24. This was despite a fall in area under cultivation, which points towards better yields.

Production of oilseed saw a significant increase in FY24, primarily on account of better yields as the area under cultivation declined. This is an important development in the context of dependence of domestic cooking oil and ghee industry on imported raw materials. The growing import volumes have motivated policy efforts to

[27] Source: USDA, Grain and Feed Annual Report, April 2024.
[28] Indicative price for sugarcane increased to Rs 400/40Kg in KPK and Punjab in FY24 from Rs 300/40Kg in FY23. Whereas, in Sindh the price increased to Rs 425/40Kg in FY24 from Rs 302/40 Kg in FY23. Source: Pakistan Bureau of Statistics.
[29] Source: USDA, Grain and Feed Annual Report, April 2024.
[30] Price of maize decreased by 6.7 percent in FY24 in comparison to FY23. Source: Pakistan Bureau of Statistics.

Other Crops **Table 2.6**

area in 000' hectares (ha); production in 000' tons; growth in percent

	Area		Growth		Production		Growth	
	FY23R	FY24P	FY23	FY24	FY23R	FY24P	FY23	FY24
Chilli	47.9	49.6	-17.7	3.6	109.6	120.6	-23.9	10.0
Bajra	240.6	237.8	6.2	-1.2	256.4	294.4	13.3	14.8
Gram	842.7	797.0	-2.2	-5.4	243.6	209.1	-22.9	-14.2
Potato	340.6	338.7	8.4	-0.5	8,319.8	8,434.4	4.8	1.4
Moong	217.9	201.0	-27.8	-7.7	135.0	153.4	-48.8	13.6
Oilseeds	2848.6	2819.0	21.5	-1.0	2,245.0	2,728.0	-18.9	21.5
Onion	135.5	142.7	-3.8	5.3	1,843.5	2,304.2	-10.6	25.0
Mash	7.0	7.0	-13.4	0.0	4.2	5.6	-30.7	31.9
Green fodder	3,830.7	3,598.2	0.3	-6.1	190,020.5	176,881.3	-1.9	-6.9

R: Revised, P: Provisional

Sources: Pakistan Economic Survey 2023-24, Pakistan Bureau of Statistics

reduce country's reliance on imported oilseed. To this end, the National Oilseed Enhancement Program (FY20–24) has been encouraging growers by providing subsidies on seeds, inputs, and machinery.[31]

Livestock

The value addition by livestock grew by 4.5 percent in FY24, compared to 3.7 percent in FY23. Major impetus came from poultry, which, despite challenges, registered steady growth (**Table 2.7**).[32] Main challenges faced by the poultry sector include lower feed quality, disease outbreaks, a ban on GE soybean import – an important component of feed - and higher operational cost.[33]

Poultry Products **Table 2.7**

million numbers

	FY22	FY23	FY24
Day old chicks	1,651	1,813	1,991
Poultry birds	1,725	1,887	2,065
Eggs	22,512	23,819	25,212
Poultry meat*	1,977	2,160	2,362

*000' tons

Source: Pakistan Economic Survey 2023-24

Meanwhile, milk production increased to 70.1 million tons in FY24, up from 67.9 million tons last year.[34] Moreover, meat production has increased in recent years in response to a steady rise in its export. Within the meat production, beef holds the major share followed by poultry, while mutton falls far behind in terms of annual production.[35]

2.3 Industry

The industrial GDP saw a lower contraction of 1.1 percent in FY24, compared to a decline of 3.7 percent in FY23. This improvement mainly came from a slight recovery in mining & quarrying and manufacturing (**Table 2.8**). Specifically, LSM production posted increase in H2-FY24, after a consistent decline in the previous one and half years. Nevertheless, the overall industrial activities remained constrained by subdued domestic demand amid tight monetary policy stance and fiscal consolidation, higher input costs and increase in wages.

In view of the key role of manufacturing as main driver of industrial growth, the recovery in manufacturing is an encouraging development

[31] Source: Ministry of National Food Security and Research, Pakistan Oilseed Development, National Oilseeds Enhancement Program.

[32] Poultry birds and meat registered a growth of 9.4 percent each in FY24. Source: Pakistan Economic Survey 2023-24

[33] Source: Ministry of Finance (2024), Pakistan Economic Survey 2023-24. Islamabad: MoF.

[34] Ibid.

[35] Out of total meat production of 5.8 million tons in FY24, beef amounts for 45.3 percent followed by 40.6 percent share of poultry, whereas, mutton accounts for remaining 14.1 percent. Source: Pakistan Economic Survey 2023-24.

Growth in Industrial Production **Table 2.8**

percent

	FY23R					FY24P					Contribution	
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	FY23R	FY24P
Industry	**-0.2**	**1.7**	**-6.6**	**-9.2**	**-3.7**	**-2.7**	**-1.2**	**2.8**	**-3.6**	**-1.1**	**-3.7**	**-1.1**
Mining & quarrying	-17.6	-1.1	6.9	1.2	-3.2	15.4	4.3	0.6	-5.3	3.5	-0.3	0.3
Manufacturing	1.1	0.7	-9.2	-12.3	-5.3	2.3	2.1	3.4	4.8	3.1	-3.4	2.0
Large scale	-1.3	-1.9	-14.5	-19.5	-9.8	-0.6	-0.7	1.6	4.2	1.1	-4.8	0.5
Small scale	8.6	8.9	9.3	9.9	9.2	10.5	10.2	8.9	6.8	9.1	1.0	1.1
Slaughtering	6.1	6.2	6.5	6.9	6.5	7.5	7.4	6.6	5.1	6.6	0.4	0.5
Electricity, gas & water supply	8.3	24.0	0.5	9.1	9.9	-32.7	-21.2	17.2	-35.5	-23.1	1.2	-3.3
Construction	-4.8	-5.9	-5.6	-20.5	-9.2	8.0	-3.3	-9.0	-0.5	-1.5	-1.2	-0.2

R: Revised, P: Provisional

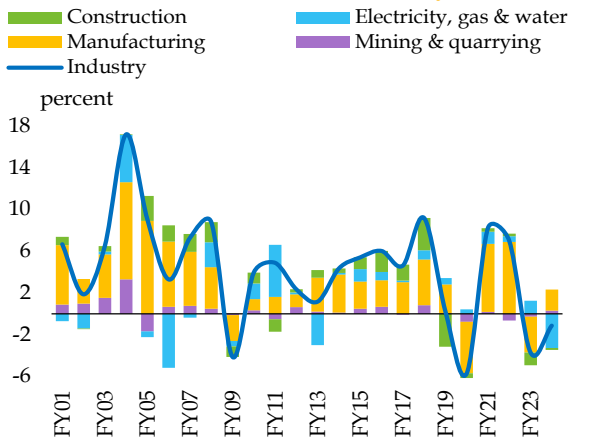
Source: Pakistan Bureau of Statistics

(**Figure 2.13**). The LSM recorded a slight increase in FY24 after showing a large contraction of about 10 percent in FY23. Looking at the monthly trends, LSM output gradually recovered to post an increase in the last three months of FY24, after recording contraction for 21 consecutive months.

This slow and gradual recovery in LSM is attributable to both demand and supply side challenges. Domestic demand remained contained amid continued contractionary policies and high inflation, which further eroded consumers' purchasing power. On the supply side, while the availability of raw materials improved with the ease in import restrictions and a decline in international commodity prices, input costs increased substantially on account of adjustments in energy prices. Moreover, political uncertainty also affected the industrial activity.

Nonetheless, the growth in manufacturing in recent years has remained well below the long-term average. In this context, **Box 2.2** discusses impediments and constraints based on WB Enterprise Surveys, underlying the performance of manufacturing in Pakistan.

Sectoral Contribution to Growth in Industry **Figure 2.13**



Source: Pakistan Bureau of Statistics

Box 2.2: Obstacles to Manufacturing Activities in Pakistan: Evidence from World Bank Enterprise Surveys (WBES)

The WBES, provide insights into different factors influencing businesses environment, including access to finance, access to land, political instability, electricity supplies, courts, and trade regulations. These surveys are conducted with different time lags across different countries. The survey lists down fifteen selected impediments for seeking firms' view on the biggest obstacle they face at that point in time.

For Pakistan, the surveys are available for 2007, 2013 and 2022. The latest survey identifies political instability as the most cited factor constraining business activity, followed by access to finance, tax rate, electricity shortfall, corruption, crimes, and tax administration (**Table 2.2.1**). However, a difference between the initial two surveys and the latest one is that the responses have highlighted more factors, reducing the skewness of responses substantially

from fewer to a more boarder spectrum of factors. For example, electricity remained the top ranked obstacle in 2007 and 2013, with 73.4 percent and 46.7 percent responses, but has ranked down to number 5 in the latest survey with around 10 percent responses. On the flip side, customs and trade regulations, for example, has gained more prominence when compared to the 0.7 percent and 1.4 percent responses in the last two surveys, which is also the case in almost all other factors as well.

A possible interpretation could be that: factors like electricity shortfall and corruption were so intense at the time of the 2007 and 2013 surveys that they overshadowed the possible interplay of other factors. Nonetheless, a more important aspect is that other elements have gained notable weight indicating that the issues have intensified over time, both in terms of magnitude and manifestation.

A comparison of the findings of the latest surveys for Pakistan, South Asia, and the rest of the world reveals almost similar situation. For instance, firms in Pakistan and South Asia rank precisely similar factors as the top five obstacles, except for the difference in ranking sequence due to little deviation in the scale of responses. However, the combined response of 73.0 percent for the top five factors in Pakistan is relatively higher compared to 63.0 percent in South Asia and 61 percent for all economies. This signifies the intensity of these factors in Pakistan compared to the South Asian region.

These findings offer an opportunity to formulate evidence-based policy to nurture a resilient industrial sectors in the country. The highlighted issues are structural in nature and can only be addressed through close coordination and cooperation among various stakeholders. Political instability is the leading constraint in the latest survey with possible adverse implications for economic growth, investment and business confidence. To overcome this challenge, it is imperative to ensure policy consistency in the country over the medium to long run. Similarly, access to finance, another major challenge, calls for enhancing financial inclusion and literacy. To this end, for instance, jointly designing entrepreneurial literacy programs, tackling informal credit channels, and reducing the role of few big borrowers could help businesses, especially SMEs, to have better access to financing. Last but not the least, fiscal and taxation reforms aiming at improving tax administration are critical for harmonization of tax policies and rates as well as facilitation across national and sub-national governments.

World Bank Enterprise Surveys for Pakistan **Table 2.2.1**

Biggest Obstacle	Pakistan						South Asia		All Economies	
	2022		2013		2007					
	Rank	% firms	Rank	% firms	Rank	% firms	Rank	% firms	Rank	% firms
Political instability	1	25.9	3	9.4	7	0.9	2	16.6	4	11.2
Access to Finance	2	14.6	8	2.4	4	3.7	1	16.9	1	15.8
Tax rates	3	11.8	6	4.4	5	3.1	3	11.0	2	12.4
Corruption	4	10.4	2	19.1	2	9.3	5	9.0	7	6.5
Electricity	5	10.2	1	46.7	1	73.4	4	9.3	6	7.4
Access to land	6	7.3	14	0.2	6	1.9	7	5.9	13	3.2
Customs and trade regulations	7	6.6	10	1.4	9	0.7	8	5.6	9	3.7
Business licensing and permits	8	3.1	12	0.4	15	0.0	12	2.5	14	3.0
Labor regulations	9	2.9	11	0.9	14	0.1	9	4.8	8	3.9
Transportation	10	2.1	7	3.3	10	0.6	10	4.1	11	3.6
Inadequately educated workforce	11	1.8	9	1.5	12	0.5	11	3.6	3	11.2
Informal sector	12	1.6	15	0	13	0.3	6	6.6	5	10.3
Courts	13	0.7	13	0.3	11	0.5	15	0.3	15	0.8
Crimes	14	0.5	4	5.5	3	4.3	13	2.0	12	3.5
Tax administration	15	0.4	5	4.5	8	0.8	14	1.4	10	3.6

Source: World Bank

Mining and Quarrying

Mining and quarrying recovered sharply from the contraction of previous year. This growth was led by higher extraction of coal, gypsum, limestone, iron ore and marble (**Table 2.9**).[36] The increase in production of these minerals mainly reflects activity in the allied industries. For example, increasing use of domestic coal in power generation, gypsum in case of fertilizer, limestone for cement, and iron ore for steel production. The increase in coal production, in particular, partially compensated for the decline in gas production due to continuous depletion of existing reserves and limited new explorations.[37, 38]

Production of Important Minerals **Table 2.9**

production in 000' MT; growth in percent

	Production		Growth	
	FY23	FY24	FY23	FY24
Coal	15,069.8	20,319.3	55.7	34.8
Natural gas*	1,189.5	1,140.6	-9.0	-4.1
Crude oil**	25.4	25.8	-9.7	1.8
Chromite	155.6	213.0	-20.2	36.9
Magnesite	5.0	6.7	-15.8	34.4
Dolomite	544.3	532.7	11.7	-2.1
Gypsum	1,639.7	2,094.9	-29.5	27.8
Lime stone	58,941.3	63,628.9	1.0	8.0
Rock salt	2,907.4	3,212.4	7.0	10.5
Sulphur	11.7	9.3	-28.2	-20.3
Barytes	141.0	125.6	10.5	-10.9
Iron ore	377.0	617.8	-47.4	63.9
Soap stone	164.2	212.3	-45.5	29.3
Marble	5,714.4	7,041.3	-13.8	23.2
Ocher	92.0	69.2	1.4	-24.8

*production in 000' MMCFT

**production in million barrels

Source: Pakistan Bureau of Statistics

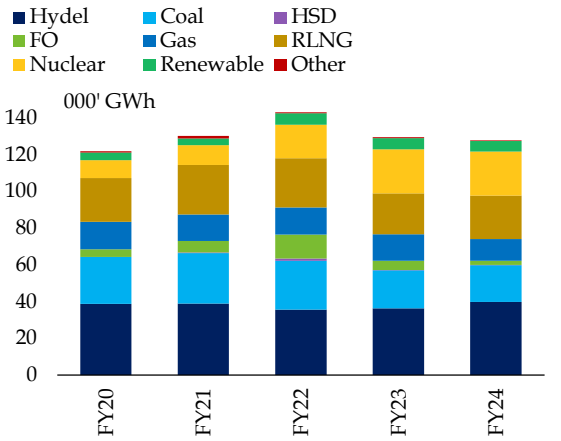
Electricity, Gas and Water supply

The electricity, gas and water supply, on the contrary, witnessed a contraction in FY24, dragging the industrial growth by 3.3 percentage points. This contraction was largely due to decline in electricity generation amid low demand (**Figure 2.14**), as well as reduced gas distribution during FY24.

Subdued domestic demand, amid households and businesses increasingly shifting to solar, as anecdotal evidence suggests, has likely decreased the reliance on system generated electricity. Moreover, reduction in government subsidies partly explains the contraction.[39]

In a bid to attain cost efficiency, the use of domestic energy sources has been gradually increasing. Importantly, the share of green fuels such as hydel, natural gas, renewables, has increased substantially.[40] Nonetheless, use of coal offers a tradeoff to choose between short-term cost

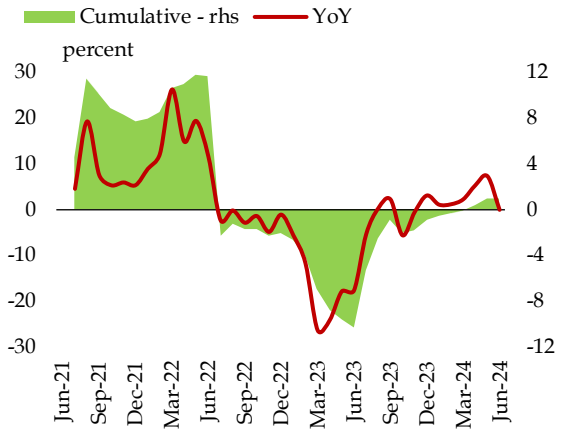
Electricity Generation **Figure 2.14**



Sources: NEPRA; SBP Easy Data

[36] FDI in mining and quarrying increased to US$ 103.1 million in FY24, compared to a net outflow of US$ 220.3 million in FY23.
[37] Gas reserves in Pakistan depleted from 1,458,936 million CFt in FY18 to 1,189,515 million CFt in FY23. Source: Pakistan Energy Year Book, 2023.
[38] Gas supplies are accounted for in the calculation of value-added in electricity, gas and water supply, while its production is part of value-added of 'mining and quarrying' (Source: Pakistan Bureau of Statistics, National Accounts of Pakistan, 2015-16 Base Year).
[39] While calculating GVA of electricity, subsidies are treated as income of the power generation and distribution companies. As government reduced subsidies during FY24, the GVA and thus the value addition by electricity declined.
[40] Hydel holds the highest share (31.1 percent), followed by natural gas (27.8 percent) and coal (15.7 percent) in electricity generation in FY24. The use of renewable source, including solar, wind and bagasse, was only 4.5 percent.

Growth in Quantum Index of LSM **Figure 2.15**



Source: Pakistan Bureau of Statistics

Number of LSM Groups Showing Increase and Decrease in Production **Figure 2.16**

Source: Pakistan Bureau of Statistics

efficiency versus limiting environmental concerns in medium to long-term.

Construction

The value addition by construction sub-sector declined by 1.5 percent in FY24, lower than the decline of 9.2 percent in FY23. High borrowing cost in the wake of tight monetary policy; deceleration in development spending; and declining but still high domestic uncertainty have been the main factors constraining construction activities during the last two years. In addition, escalating cost of construction materials amid increase in taxes/duties and wages also weighed on construction activities.[41]

Manufacturing

Manufacturing grew by 3.1 percent during FY24, against a sharp contraction in the previous year. The growth was mainly due to LSM, which posted a slight increase in FY24 against a sharp contraction in the previous year.

Large Scale Manufacturing[42]

The LSM grew by 0.9 percent during FY24 against a sharp contraction of 10.3 percent in FY23 **(Table 2.10).** Monthly data shows that the LSM output steadily improved during FY24, after showing contraction throughout FY23 **(Figure 2.15)**. Almost half of the LSM groups with 48 percent weight in the index saw an increase in production during FY24 **(Figure 2.16).**

The recovery in LSM output is mainly attributable to improved availability of raw materials in FY24. However, heightened uncertainty and increased cost of inputs, despite a decline in imported input prices, slowed the pace of recovery. The continued contractionary policies and subdued consumer demand amid squeezed consumers' real income given high inflation were the major factors constraining domestic demand.

The LSM performance is also reflected by improved business confidence, including the Purchasing Managers Index (PMI). The business confidence index (BCI) has substantially improved since May 2023 (**Figure 2.17**). Moreover, businesses' assessment of capacity utilization also improved during FY24.

Food, beverages and tobacco

Production of food group increased by 1.7 percent in FY24, compared to a contraction of 7.1 percent in FY23. The growth was relatively broad-based as four out of six categories, led by cooking oil,

[41] The average price of cement and steel products, increased by 16.7 percent and 11.2 percent respectively in FY24, compared to 34.7 percent and 25.1 percent in the same period last year.
[42] This section is based on disaggregated data released by the PBS in August 2024.

Cumulative Growth of LSM Sectors — Table 2.10

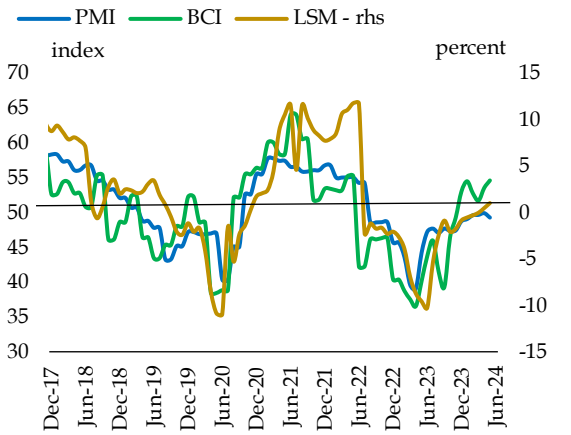
	Weight	Growth		Contribution	
		FY23	FY24	FY23	FY24
LSM	78.4	-10.3	0.9	-10.3	0.9
of which					
Food	10.7	-7.1	1.7	-1.2	0.3
Beverages	3.8	-6.6	-2.1	-0.3	-0.1
Tobacco	2.1	-28.4	-23.0	-0.7	-0.4
Textile	18.2	-18.7	-5.2	-3.7	-0.9
Wearing apparel	6.1	25.7	8.2	2.7	1.2
Leather products	1.2	1.5	5.7	0.0	0.0
Wood products	0.2	-59.8	11.8	0.0	0.0
Paper & board	1.6	-8.6	-0.4	-0.2	0.0
Coke & petroleum	6.7	-13.4	9.8	-0.9	0.6
Chemicals	6.5	-6.9	5.3	-0.5	0.4
Pharmaceuticals	5.2	-28.8	15.7	-1.8	0.8
Rubber	0.2	-3.8	-1.5	0.0	0.0
Non-metallic mineral	5.0	-12.1	-5.3	-0.8	-0.4
Iron & steel	3.4	-5.1	-4.4	-0.2	-0.2
Fabricated metal	0.4	-16.1	-7.8	-0.1	0.0
Computer, electronics, optical	0.0	-30.3	-12.4	0.0	0.0
Electrical equipment	2.0	-15.4	-9.5	-0.5	-0.3
Machinery and equipment	0.4	-45.3	45.5	-0.3	0.2
Automobiles	3.1	-50.0	-25.0	-2.2	-0.6
Other transport equipment	0.7	-40.8	-4.0	-0.3	0.0
Furniture	0.5	46.5	15.0	0.7	0.4
Other manufacturing	0.3	20.6	7.6	0.1	0.0

Source: Pakistan Bureau of Statistics

registered increase in production (**Figure 2.18**). The growth in cooking oil mainly emanated from low international palm oil prices.[43] Increase in sugar production by 1.3 percent, despite the decline in sugarcane output and delayed start of crushing, reflects high sucrose recovery rate during FY24. Wheat and rice milling, representing around 34 percent of the food group, improved (showing lower contraction) on the back of record wheat and rice production

The production of beverages and tobacco declined for the second consecutive year in FY24. Anecdotal evidence suggests that the decline in production of beverages is mainly due to reduced demand amid boycotts. In case of tobacco, it is the

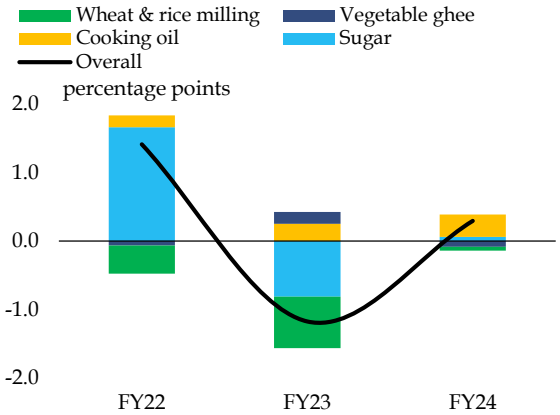
LSM Growth and Purchasing Managers Index — Figure 2.17



Sources: State Bank of Pakistan; Pakistan Bureau of Statistics

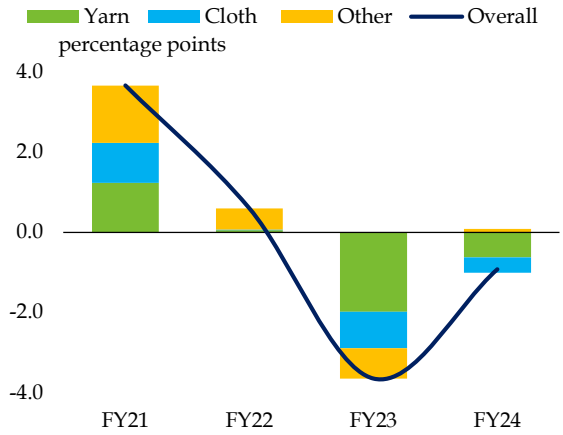
[43] On average, the international palm oil prices declined to US$ 860.8 per MT in FY24, compared to US$ 949 per MT in FY23 and US$ 1404 per MT in FY22. Source: World Bank.

Contribution to Growth in Food Production — Figure 2.18



Source: Pakistan Bureau of Statistics

Contribution to Growth in Textile — Figure 2.19



Source: Pakistan Bureau of Statistics

increase in federal excise duty over the last couple of years that may have led to under reporting of the production.

Textile

The output of textiles declined by 5.2 percent in FY24, much lower compared to the decline of 18.7 percent in FY23. This bottoming out in textile output was somewhat supported by increase in export volumes, especially of cotton yarn, hosiery, bed-wear, and towels, during FY24 (**Figure 2.19**).[44] The recovery in production notwithstanding higher export volumes and increased availability of raw materials (**Chapter 6**), was somewhat constrained by high input costs.

Higher interest rates and withdrawal of energy subsidy for export oriented industries have particularly increased the overall cost of production. Moreover, the minimum wage was increased by 28.0 percent to Rs 32,000 per month, adding to the cost of production.

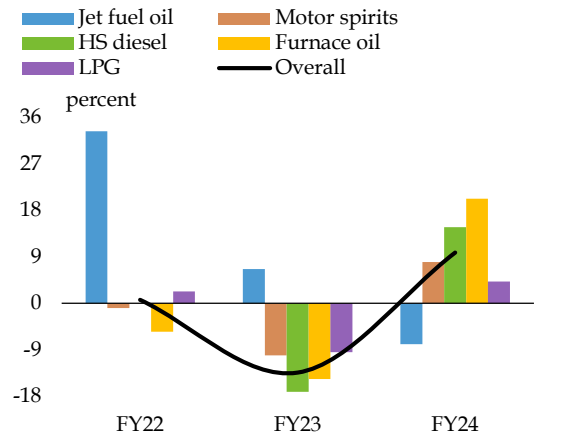
Petroleum Products

Production of petroleum products rebounded, registering 9.8 percent growth in FY24 compared to the contraction of 13.4 percent in the previous year (**Figure 2.20).** The increase in production of POL products, despite sluggish domestic sales, can be attributed to decline in imports of POL products as well as government's decision to allow export of furnace oil (**Chapter 6).**[45,46]

Pharmaceuticals

The production of pharmaceuticals grew sharply by 15.7 percent in FY24, against a substantial decline of 28.8 percent in the previous year. Production of syrups and tablets, constituting

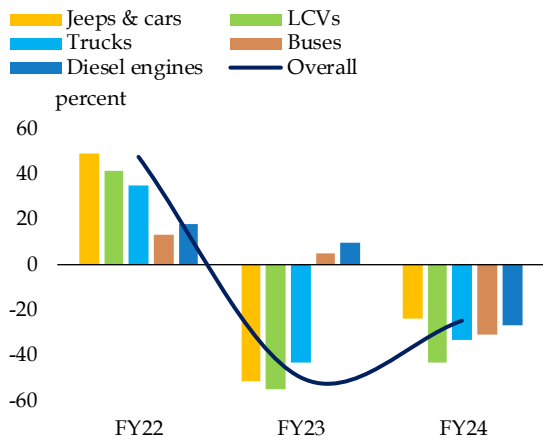
Growth in Output of POL Products — Figure 2.20



Source: Pakistan Bureau of Statistics

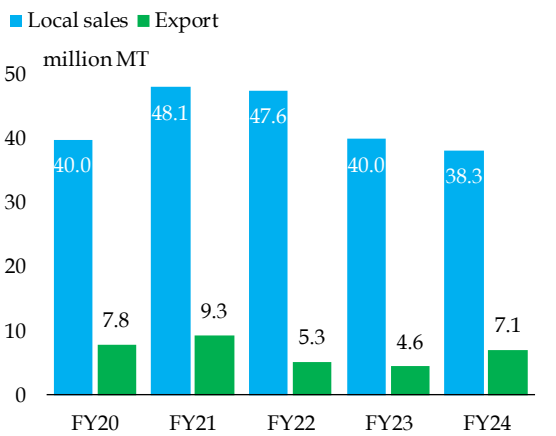
[44] Yarn and cloth, with 8.9 percent and 7.3 percent weights, form around 90 percent of the total textile weight.
[45] The import volume of POL products in FY24, declined by 12.9 percent, while crude increased by 11.8 percent.
[46] It is worth mentioning that domestic refineries have a build-in capacity to produce furnace oil. However, given reduced demand from power sector, the refineries were left with excess furnace oil. Allowing export of surplus furnace oil has cleared way for increased capacity utilization by the refineries.

Growth in Automobile Production **Figure 2.21**



Source: Pakistan Bureau of Statistics

Cement Dispatches **Figure 2.22**



Sources: Pakistan Bureau of Statistics; APCMA

around 84 percent of the pharma production, remained the principal product lines contributing almost entirely to the growth.

A number of factors supported production of pharmaceuticals during FY24. These include, increased availability of raw materials, deregulation of drugs' prices by DRAP amidst rising cost of imported raw materials,[47] and increase in exports.[48]

Automobile

Production of automobile continued to remain lackluster, showing a decline of 25.0 percent during FY24 compared to a decline of 50.0 percent in the previous year. The decline was broad-based as all categories registered double digit decline, with biggest decline in the production of LCVs, cars and jeeps (**Figure 2.21**).

The auto industry has been facing multiple challenges since the start of FY23, including issues in the availability of raw materials and lack of consumer demand amid economic slowdown, higher vehicle prices, and increased cost of financing. Except for the production and sales of tractors, other categories of vehicles show a marked decline in the number of units produced and sold in FY24 - the lowest volumes recorded after FY20, a year affected by Covid-19.[49, 50]

Construction-allied Industries

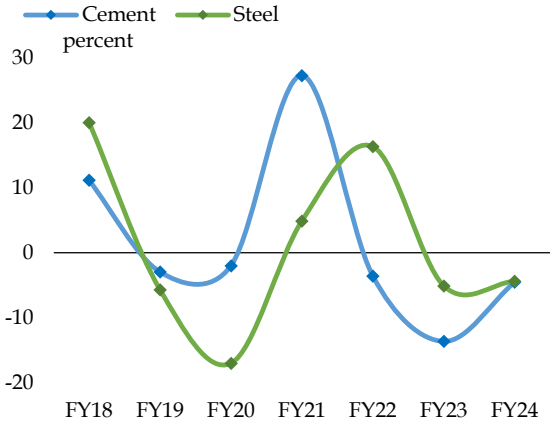
In line with the performance of construction sector, the output of allied industries also remained subdued during FY24. Production of cement and steel, the two key construction materials, posted decline in FY24. Besides lacklustre construction activities, hike in energy prices also discouraged the production of these energy-intensive industries.

Cement

Production of cement declined by 4.5 percent in FY24, significantly lower than 13.7 percent in FY23. The decline was largely due to fall in domestic cement dispatches, which could be associated with rising prices (**Figure 2.22**). Export of cement, on the other hand, experienced a

[47] In February 2024, the federal government allowed pharmaceutical companies to set prices of around 146 medicines, which are not included in the National Essential Medicine List.
[48] The export of pharmaceutical products increased during FY24, mainly to the African countries. While FDI in the *Pharmaceuticals and OTC Products* has increased from US$ 7.3 million in FY23 to US$ 38.0 million in FY24.
[49] In LSM data, the production of tractors is classified under *machinery and equipment*.
[50] Credit disbursement for purchase of farm tractors under the farm sector development has increased to Rs 48.3 billion in FY24, compared to Rs 10.9 billion in FY23.

Growth in Cement and Steel Production Figure 2.23



Source: Pakistan Bureau of Statistics

notable increase from 4.6 million MT in FY23 to 7.1 million MT in FY24 (**Chapter 6**).

Steel

Steel production declined by 4.4 percent during FY24, compared to a contraction of 5.1 percent last year (**Figure 2.23**). The decline is mainly attributed to weak demand amid higher steel prices. Moreover, subdued production in the complementary industries such as automobile, heavy machinery and equipment, sewing, and sugarcane machinery also weighed on the production in the steel industry, especially on the production of flat steel.

2.4 Services

In line with the increase in agriculture production and a slight recovery in LSM, the services sector grew by 2.2 percent, after remaining flat in FY23 **(Table 2.11).** The growth was mainly driven by *wholesale and retail trade, other private services* and *education*. However, *general government* and *finance and insurance*, posted contraction largely due to high inflation and stabilisation measures.

Wholesale and retail trade, the largest component of services sector, posted a sub-average increase with major impetus coming from recovery in important crops, LSM, and increased import volumes. However, lacklustre LSM performance, high borrowing costs, and sharp increase in energy prices partially offset the positive spillover from higher agriculture output.

Transport and storage expanded by 1.9 percent in FY24, mainly due to positive value addition by railways, water transport, and postal services **(Table 2.12)**. Improvement in overall trade, exports and imports, handled by ports and

Growth in Services Sector Table 2.11

percent

	FY23R					FY24P					Contribution	
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	FY23R	FY24P
Services sector	**2.7**	**2.4**	**-1.2**	**-3.7**	**0.0**	**2.0**	**1.3**	**1.6**	**3.7**	**2.2**	**0.0**	**2.2**
Wholesale & retail trade	0.2	0.7	-6.4	-9.8	-4.0	3.4	2.6	2.9	4.8	3.4	-1.3	1.1
Transport & storage	3.6	4.4	5.3	1.9	3.8	2.4	2.2	0.9	2.1	1.9	0.7	0.3
Accommodation and food services activities (hotels & restaurants)	3.9	4.0	4.1	4.3	4.1	4.7	4.6	4.1	3.2	4.1	0.1	0.1
Information and communication	-0.3	4.4	-1.5	-5.5	-0.7	4.0	-4.5	-5.6	7.9	0.3	0.0	0.0
Finance & insurance activities	0.2	-3.5	-13.8	-21.8	-10.0	-15.9	-15.2	-7.4	-2.5	-10.7	-0.3	-0.3
Real estate activities	3.6	3.6	3.7	4.0	3.7	4.2	4.2	3.7	2.9	3.7	0.4	0.4
Public administration and social security (general government)	4.5	-3.1	-11.1	-17.0	-7.0	-10.0	-10.5	-7.6	-0.2	-7.3	-0.6	-0.6
Education	5.7	5.2	4.9	4.7	5.1	8.1	8.3	8.7	9.0	8.5	0.2	0.4
Human health and social work activities	8.5	9.0	9.1	8.8	8.8	5.6	5.1	5.6	5.9	5.6	0.2	0.2
Other private services	4.5	4.3	4.2	3.9	4.2	3.9	3.8	3.3	3.4	3.6	0.6	0.5

R: revised, P: provisional

Source: Pakistan Bureau of Statistics

Growth in Transport and Storage **Table 2.12**

percent

	FY23	FY24
Railways	27.2	10.3
Water transport	-23.7	15.2
Air transport	27.3	4.4
Road transport	4.3	1.2
Postal services	-11.9	14.8
Pipeline transport	-18.9	-7.4
Storage	-4.1	3.4

Source: Pakistan Bureau of Statistics

container terminals mainly explains the increase in water transport. Growth in road transport, on the other hand, remained weak as indicated by declining trend in auto sales. This is also reflected in reduced POL sales to the transport sector **(Figure 2.24)**.

The value addition by *information and communication* services grew in FY24 against a contraction in the previous year. Increase in mobile cellular and broadband subscribers amid increasing use of digital financial services partly explains this increase **(Figure 2.25)**.[51]

On the contrary, *finance and insurance* activities

Growth in Finance and Insurance **Table 2.13**

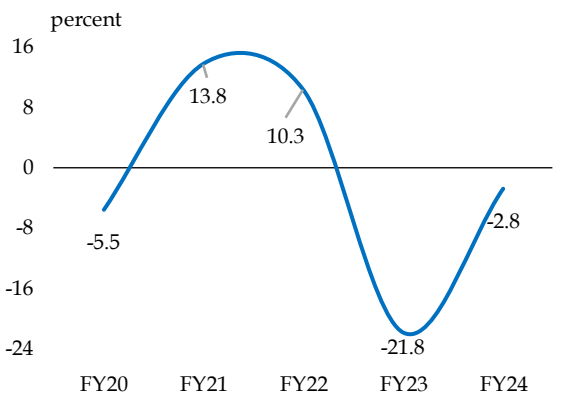
percent

	FY23	FY24
Central banking	-10.3	-22.8
Other monetary intermediation	-12.9	-6.8
Scheduled banks	-12.7	-7.3
Non-scheduled banks	-25.1	23.2
Insurance, reinsurance, and pension funding	60.3	-58.2
Other financial services	-12.5	-20.7
Auxiliary activities	-19.5	8.1

Source: Pakistan Bureau of Statistics

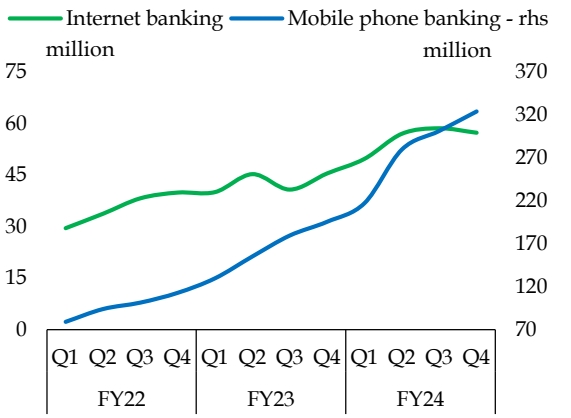
continued to deteriorate for the second year in FY24 **(Table 2.13)**. The sector was impacted by high interest rates and inflation.[52] Even though the profitability of scheduled banks increased, the value addition turned negative due to relatively sharper increase in deposits than in advances during FY24.[53, 54] Further, majority of the investments were in government securities, that are not included in value addition, as these provide minimum risks and higher returns due to lucrative interest rates.[55] In addition, the output of insurance companies, which had a healthy growth in FY23, declined in FY24 possibly due to reduced incomes amidst high inflation.

Growth in POL Sales to the Transport Sector **Figure 2.24**



Source: Oil Companies Advisory Council

Volume of Internet Banking and Mobile Banking Transactions **Figure 2.25**



Source: State Bank of Pakistan

[51] Cellular subscribers increased to 192.5 million in FY24 from 190.9 million in FY23, whereas, broadband subscribers increased to 138.3 million in FY24 from 127.6 million in FY23. Source: Pakistan Telecommunication Authority

[52] Policy rate remained all time high at 22.0 percent for most part of FY24. It was reduced by 150 basis points in June 2024. Source: SBP.

[53] Source: SBP (2024), Quarterly Compendium: Statistics of Banking System.

[54] Value addition in finance & insurance is computed using FISIM method by PBS, which may not necessarily reflect the actual profitability of financial institutions.

[55] Ibid.

The *general government services* continued to show contraction, albeit at slower pace. This is in line with fiscal consolidation achieved during FY24 (**Chapter 4**).[56] Other services such as *accommodation and food services, real estate activities,* and *other private services* maintained their FY23 growth momentum into FY24 as well. While, *education* grew substantially in line with 23.7 percent increase in provincial spending on education in FY24.[57]

2.5 Labor Market

Reflecting the performance of LSM during FY24, the sentiments about employment prospects, captured through the business confidence survey (BCS) and consumer confidence survey (CCS) also somewhat improved. On the other hand, the employment data showed relatively lower deterioration in industrial employment, mainly originating from automobile and textile.

Punjab

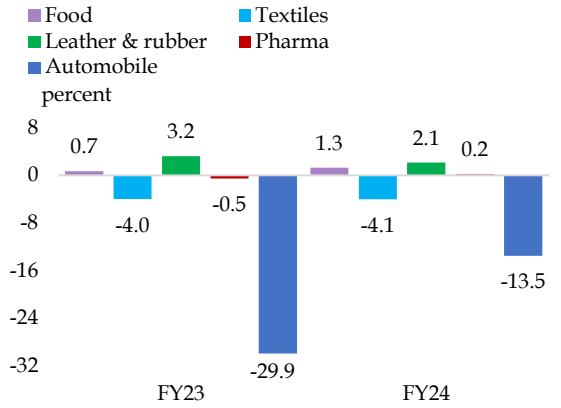
Employment in Punjab declined by 1.8 percent in FY24, compared to a decline of 2.2 percent last year. The decline was driven by lower employment in major industries, including textile – the leading employer, and automobile (**Figure 2.26)**. The employment in leather and rubber industries increased but at a slightly slower pace. However, employment in food and pharmaceuticals registered a notable improvement, largely in line with the production trends in these sectors.

Within the food, vegetable ghee and cooking oil, dairy products, and soft drinks remained the major contributors to growth in employment.

Sindh[58]

Employment in Sindh, has declined by 1.4 percent during Jul-Dec FY24. Overall, 8 out of 18 industries showed increase in employment,

Punjab: Employment Growth in Major Sectors **Figure 2.26**



Source: Punjab Bureau of Statistics

compared to 12 industries during the corresponding period of the previous year. The major drag came from textiles, pharmaceutical and automobiles. While food and wearing apparel provided substantial support to employment in Sindh, these remained relatively restrained compared to last year.

However, employment improved in other key industries, especially in beverages and rubber & plastic industries recording 34.0 and 24.5 percent growth respectively during Jul-Dec FY24.

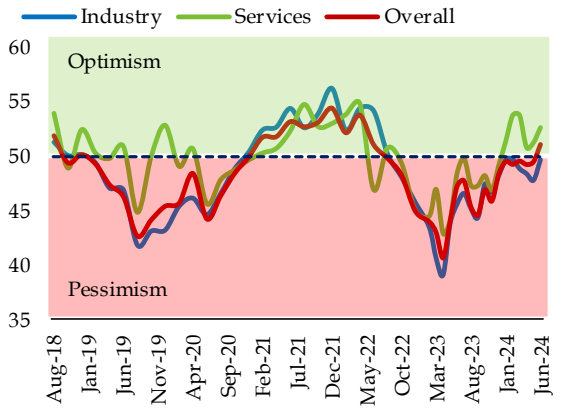
Business Confidence Survey

The overall business confidence in the country, on average, has improved with 48.1 percent of the respondents in the SBP Business Confidence Survey (BCS) showing optimism about employment generation over the past six months' horizon, compared to 45.9 percent in FY23 **(Figure 2.27)**. This improvement manifests across activities in the services as well as industrial sectors.

The index of job creation in the past six months in the services sector increased to 50.2 in FY24 from 46.6 in the previous year. The index for employment in the manufacturing also improved, though slightly below the optimistic level, at 47.7

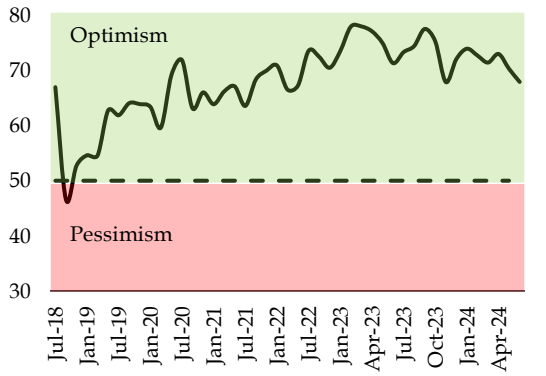
[56] Source: Ministry of Planning Development and Special Initiatives (2024), Annual Plan 2024-25.
[57] Source: Provincial Fiscal Operations, Ministry of Finance (2024).
[58] The employment data for Sindh is for Jul-Dec FY24.

Business Confidence Surveys: Employment Indices **Figure 2..27**



Source: State Bank of Pakistan

Consumer Confidence Surveys: Unemployment Index (Next Six Months) **Figure 2.28**



Source: State Bank of Pakistan

in FY24, up from 45.6 in FY23. The index about the future job creation in services and manufacturing also showed notable improvement indicating better job prospects.

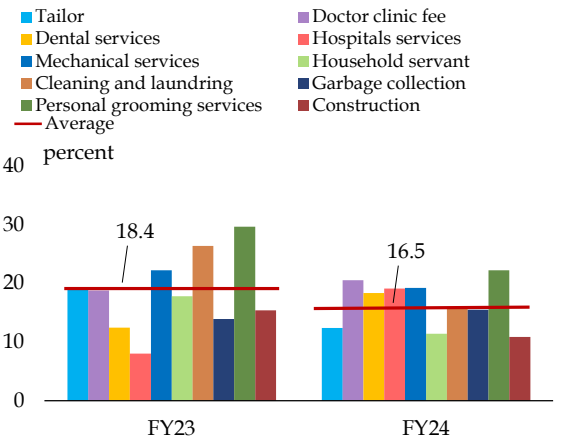
Consumer Confidence Survey

According to the SBP Consumer Confidence Survey (CCS), consumer confidence regarding the prospects of job creation over the next six months was slightly less optimistic in FY24 compared to last year. On average, the consumer confidence index has declined to 72.6 in FY24, compared to 74.4 in FY23. Similarly, according to the June 2024 wave of CCS, consumers were relatively less optimistic about job creation as 68.0 percent of respondents showed positive response compared to 71.4 percent in June 2023 (**Figure 2.28)**.

Wages

Growth in the wages of different services portrays a mixed picture in FY24. According to CPI, the pace of increase in wages across different occupations has slightly slowed down compared to FY23 (**Figure 2.29)**. Specifically, growth in the wages of most of the medical related services and waste collection has accelerated, while in other services, including tailoring, mechanical services construction and personal grooming, growth has decelerated in FY24.

Growth in Wages of Services Sector **Figure 2.29**

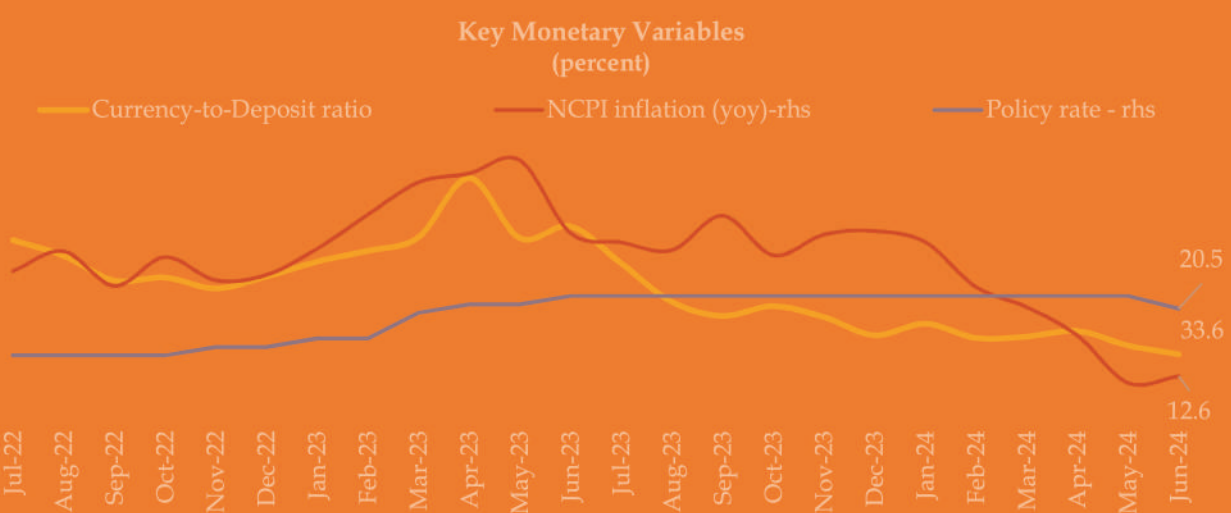


Source: Pakistan Bureau of Statistics

3

Monetary Policy and Inflation

The average NCPI inflation declined to 23.4 percent in FY24 from 29.2 percent in FY23. On year on year basis, the headline inflation came down sharply from 29.4 percent in June 2023 to 12.6 percent in June 2024. The combined effect of contractionary monetary and fiscal policies, the government's administrative measures to address artificial shortages of food commodities and improved agriculture output underpinned a sharp decline in inflation in H2-FY24. A significant increase in energy tariffs, especially gas charges, though impeded the pace of decline in inflation. Some of the above-mentioned measures also helped in further narrowing of current account deficit during FY24 and stability in foreign exchange market. A sustained decline in inflation during H2-FY24 and improved external position allowed the Monetary Policy Committee to reduce the policy rate by 150 basis points to 20.5 percent in June 2024. The build-up of SBP's FX reserves contributed to expansion in net foreign assets of the banking system. This, together with a sharp increase in the government's budgetary borrowing that inflated net domestic assets of the banking system, scaled up the broad money growth relative to the previous year. Moreover, amid a moderate recovery in economic activity and elevated input costs, the growth in private sector credit also inched up in FY24. Consistent with a tight monetary policy stance, growth in monetary aggregates remained lower than nominal GDP growth.



2 Monetary Policy and Inflation

3.1 Policy Review

The average National CPI (NCPI) inflation eased to 23.4 percent in FY24, close to the lower bound of the SBP's revised inflation projection range of 23.0 – 25.0 percent.[1] While adjustments in administered food and energy prices kept the NCPI inflation elevated in H1-FY24, it declined sharply during H2-FY24 reflecting the lagged impact of monetary tightening, continued fiscal consolidation, improved supply of food commodities, ease in global commodity prices, and a high base from the previous year.

The Monetary Policy Committee (MPC) followed a cautious approach and kept the policy rate unchanged through most part of the year. However, an almost consistent downtrend in both NCPI and core inflation during H2-FY24, softening inflation expectations of consumers and businesses, and improved external account position allowed the MPC to put an end to its thirty-three months' long monetary tightening cycle – that began in September 2021 – in the last MPC meeting of FY24. Precisely, the MPC reduced the policy rate by 150 basis points (bps) to 20.5 percent in its June 2024 meeting. The MPC viewed that the stance was adequately tight to bring inflation down to the medium-term target of 5.0 – 7.0 percent during FY26.

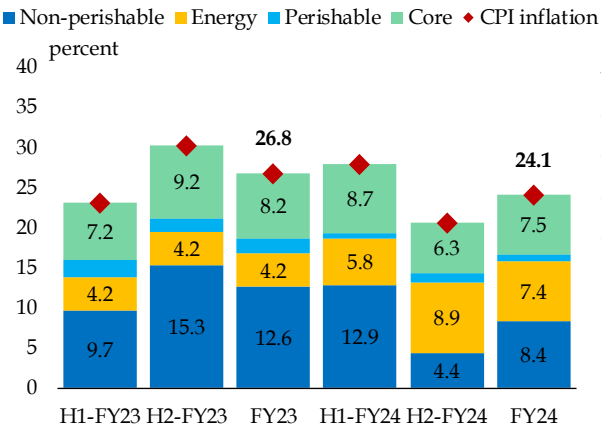
The macroeconomic outlook had noticeably improved, when the MPC met in July 2023. The US$ 3.0 billion Stand-By Arrangement (SBA) with the IMF in June 2023 did not only mitigate near-term challenges to the external account, but also lowered the prevailing economic uncertainty. Moreover, the lagged impact of the accumulated monetary tightening since September 2021 coupled with the budgeted fiscal consolidation in FY24 was expected to keep domestic demand in check. In addition, a favourable outlook for global commodity prices reflected positively on inflation outlook. Further, the NCPI inflation had dropped significantly in June 2023 from its peak in May 2023. Accounting for these trends and developments, the MPC anticipated inflation to follow a declining trajectory during FY24, falling in the range of 20.0 – 22.0 percent. These projections were, however, subject to upside risks emanating from climate change, unfavourable global developments, and unanticipated hike in energy prices.

The MPC expected the real GDP growth to post an agriculture-led moderate recovery in the range of 2.0 – 3.0 percent in FY24. Although the removal of import prioritisation guidance from June 2023 was anticipated to ease supply bottlenecks faced by the industry, the continuation of tight monetary policy and fiscal consolidation was expected to keep GDP growth range bound. In view of an anticipated moderate expansion in economic activities led by agriculture, current account deficit (CAD) was projected to remain in the range of 0.5 to 1.5 percent of GDP during FY24.

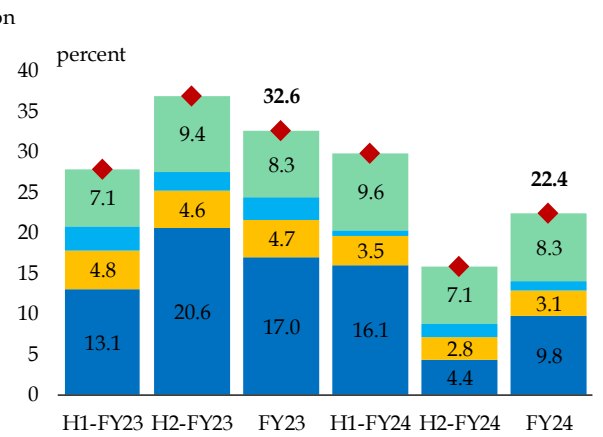
In line with the MPC's expectations, the real GDP grew by 2.1 percent during Q1-FY24.[2] Reflecting the tepid improvement in economic activity, the current account balance slipped into a small deficit during Jul-Nov 2023, after witnessing a surplus in the last four months of FY23, whereas fiscal indicators improved during Q1-FY24. Meanwhile, an increase in crop production, government's administrative efforts to address artificial shortages of food commodities, and curb speculation in foreign exchange (FX) market contributed positively to inflation outlook. Notwithstanding these favourable trends, the NCPI inflation remained

[1] The MPC's initial inflation forecast range in July 2023 was 20.0 - 22.0 percent.
[2] According to the revised estimates released in September 2024, the real GDP grew by 2.7 percent during Q1-FY24.

Contributors of Urban CPI Inflation **Figure 3.1a**



Contributors of Rural CPI Inflation **Figure 3.1b**



Sources: Pakistan Bureau of Statistics; SBP staff calculations

persistently higher in H1-FY24 than the same period of the previous year.

Large unanticipated hikes in energy prices (specifically gas charges) were mainly behind higher inflation outturns in H1-FY24. Aside from its direct impact, the increase in energy tariffs also seeped into underlying inflation through higher operational and transportation costs, and elevated inflation expectations of households and businesses.

The confluence of the second round effects of frequent adjustments in energy prices, along with the hike in tax rates, increase in wages, and PKR depreciation[3] kept the core inflation at elevated levels during H1-FY24, compared to the same period last year. Moreover, the volatility in global commodity prices and deteriorating geopolitical situation in the Middle East and shipping bottlenecks in the Red Sea region also posed upside risks to the inflation outlook. In view of these risks, and to keep inflation on the projected downward trajectory, the MPC maintained the policy rate unchanged at 22.0 percent in all its meetings held during H1-FY24.

Going into H2-FY24, the MPC noted that significant adjustments in energy prices had impeded the pace of expected decline in inflation and its expectations. To stem the accumulation of circular debt, the government introduced significant hikes in gas tariffs for all categories in November 2023 and February 2024. With these adjustments, the contribution of energy group in headline inflation in urban areas significantly increased in H2-FY24 **(Figures 3.1a and 3.1b)**.

These developments partly neutralized the impact of contractionary monetary and fiscal policies and favourable food supply conditions, having a strong bearing on near-term inflation outlook. Moreover, the geopolitical tensions continued to pose considerable risks in the form of disruption in trade flows, elevated freight charges and increase in global commodity prices. In light of these developments and potential risks, the MPC revised its inflation forecast range upward to 23.0 – 25.0 percent in its January 2024 meeting.

From January 2024 onward, inflation began its anticipated downward trend on year-on-year basis. Both food and core inflation started to ease. However, increase in administered energy prices continued to contribute to inflation directly and indirectly. Considering these

[3] On average, mark-to-market exchange rate depreciated by 12.4 percent during FY24.

developments, alongside the growing uncertainty surrounding global commodity prices and rising geo-political tension, the MPC kept the policy rate unchanged at 22.0 percent in the meetings convened in March and April 2024. In its policy deliberations, the committee also took into account the cautious monetary policy stance adopted by central banks in major advanced economies (AEs), and emerging market and developing economies (EMDEs).

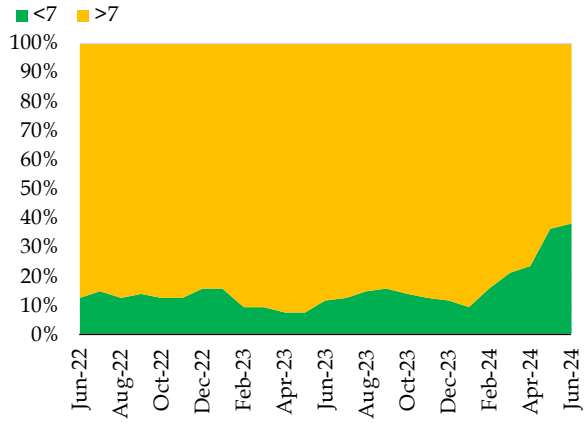
Around the time the MPC met in June 2024, the macroeconomic conditions were broadly in line with the MPC's earlier expectations. According to the provisional estimates, the real GDP showed a moderate increase of 2.5 percent in FY24, against a 0.2 percent contraction in FY23. Despite substantial debt repayments and weak official inflows, a steep reduction in CAD underpinned increase in FX reserves and strengthening of the PKR,[4] which also had positive implications for inflation outlook.

Moreover, year-on-year inflation in May 2024 more than halved to 11.8 percent from 28.3 percent in January 2024. Importantly, the YoY increase in the prices of nearly 25 percent of the CPI items was below the upper bound (7 percent) of the medium-term inflation target range in both the rural and urban baskets during H2-FY24 (**Figures 3.2a and 3.2b)**. The impact of accumulated monetary tightening, fiscal consolidation, improvement in food supply, softening underlying inflation and a high base from last year, mainly explain this decline. Considering these developments, the MPC decided to reduce the policy rate by 150 basis points to 20.5 percent in June 2024.

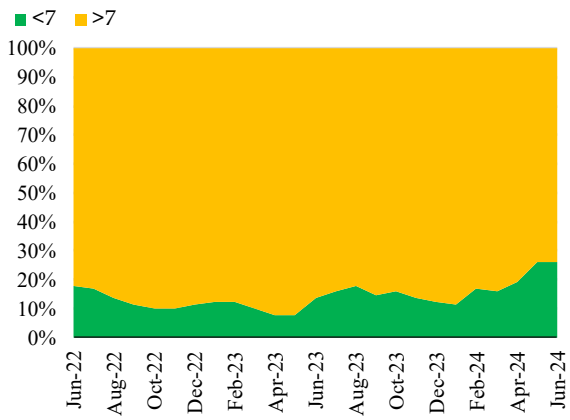
Furthermore, the MPC in its various meetings also highlighted the importance of tackling structural issues in the context of achieving and maintaining price stability. The Committee emphasized on continuation of stabilization measures, which included maintaining fiscal prudence, broadening tax base, reducing untargeted subsidies, and expediting reforms of loss-making Public Sector Enterprises (PSEs), for achieving macroeconomic stability and bringing inflation within the medium-term target range.

The monetary policy response in Pakistan during FY24 was in line with the developments in domestic economic conditions as well as the global economic trends.

Frequency Distribution of Urban CPI **Figure 3.2a**



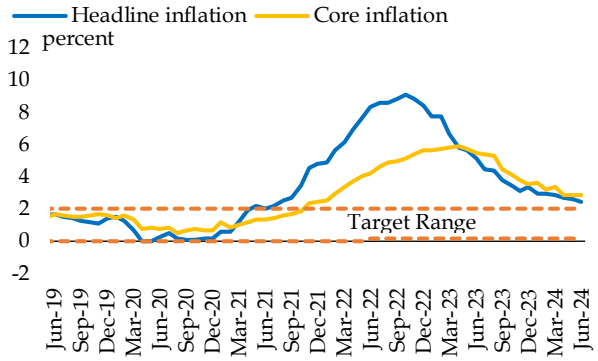
Frequency Distribution of Rural CPI **Figure 3.2b**



Sources: Pakistan Bureau of Statistics; SBP staff calculations

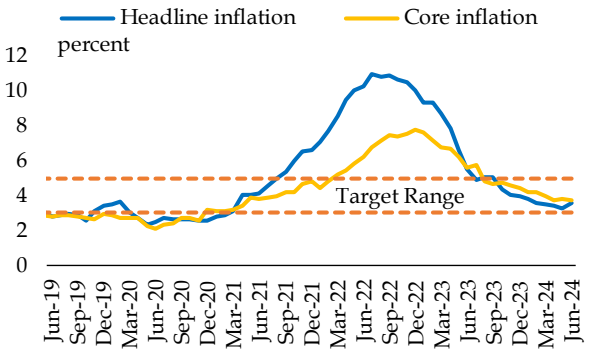
[4] The improvements in external account translated into a 2.3 percent appreciation in the PKR against the US dollar during Mar-Jun 2024 over the same period of the previous year.

Inflation* Trends in Advanced Economies (AEs) **Figure 3.3**



Note: The sample contains 30 advanced economies
*median inflation and target range
Source: Haver Analytics

Inflation* Trends in Emerging Market and Developing Economies (EMDEs) **Figure 3.4**



Note: The sample contains a group of 43 countries
*median inflation and target ranges.
Source: Haver Analytics

3.2 Global Inflation and Monetary Policy Responses

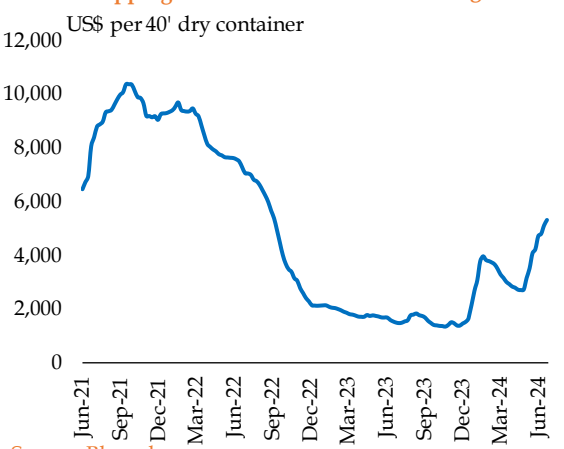
The headline inflation in many EMDEs and AEs[5] nearly returned to pre-pandemic levels in FY24 **(Figures 3.3 and 3.4)**. Albeit elevated compared to the AEs, inflation in EMDEs started returning to the target range. This decline reflects the impact of fading price shocks and subdued demand amid tight monetary policies.

With substantial increase in energy supply, the price pressures in energy group receded more quickly than anticipated. The resolution of pandemic-era supply chain disruptions led to improved delivery times, which also had a favorable impact on transportation costs. However, the attacks on commercial shipping in the Red Sea region spurred global transportation costs[6] in the latter half of the fiscal year (**Figure 3.5**).

Core inflation, albeit higher than the headline inflation, also moderated gradually in both the AEs and EMDEs. Most of this decline came from softening core goods inflation.[7] While services inflation also decreased, relatively stubborn demand and higher wages kept it at elevated levels (**Figure 3.6**).

Following a cautious approach, many central banks in the AEs and EMDEs maintained tight monetary stance in the first half of FY24. However, as underlying inflationary pressures began to unwind, the central banks, specifically in the EMDEs, started easing monetary policy stance. This policy shift became more evident in the second half of FY24 **(Figure 3.7).**

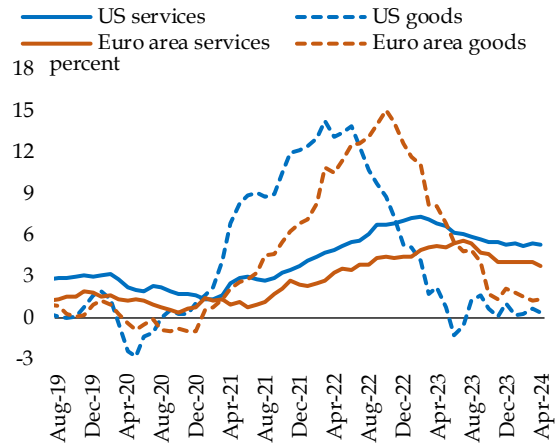
Global Shipping Cost **Figure 3.5**



Source: Bloomberg

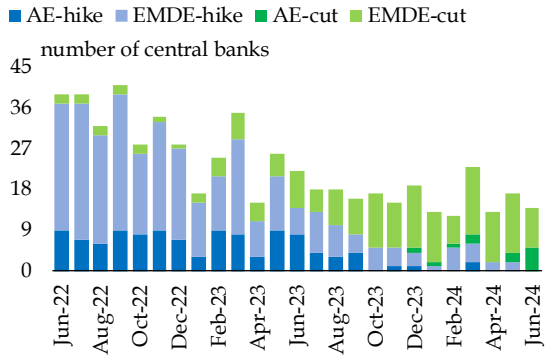
[5]AEs mainly include Canada, France, Germany, Italy, Japan, the United Kingdom and the United States; whereas EMDEs consists of a group of 83 countries.
[6] With Red Sea region shipping accounting for 12-15 percent of global trade and 20 percent of global container shipping, repercussions can be expected to become more severe if uncertainties continue. Source: World Economic Forum
[7] Goods inflation in the US was 0.54 percent in FY-24 (July-April) compared to 2.46 percent in the Euro Area. In contrast, services inflation was 5.53 percent in the US and 4.4 percent in the Euro Area during the same period.

Goods and Services Inflation Figure 3.6



Source: World Bank

Monetary Policy Decisions in Advanced and Emerging Market and Developing Economies Figure 3.7



Note: The sample contains 30 advanced and 43 emerging economies. *median inflation.

Source: Haver Analytics

3.3 Pakistan's Monetary Aggregates

The broad money (M2) growth ticked up to 16.1 percent in FY24 from 14.2 percent in the previous year (**Table 3.1**). Nonetheless, the tight monetary stance kept the M2 growth significantly lower than the nominal GDP growth, which boded well for inflation outlook. Further, the composition of M2 also improved as Net Foreign Assets (NFA) of the banking system expanded, reflecting the improvement in external account position during FY24. The Net Domestic Assets (NDA) of the banking system also increased, albeit at a slower pace compared to the previous year, driven by the government's increased reliance on budgetary borrowing from commercial banks (**Table 3.1**).

Although external financing inflows saw a notable increase during FY24, large retirements in non-bank borrowing increased government's reliance on commercial banks to finance the deficit. Furthermore, in line with a moderate recovery in economic activity and increase in input costs, private sector credit slightly improved during FY24. However, net

Monetary Aggregates Table 3.1

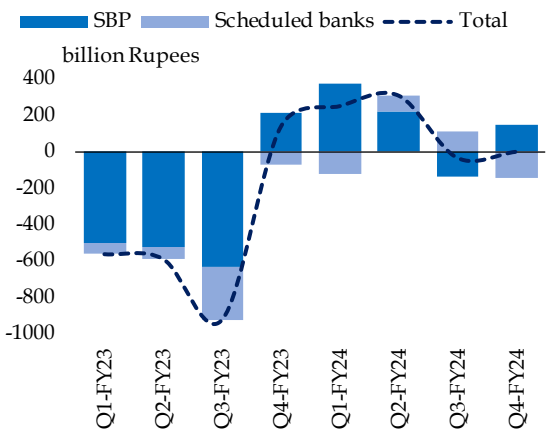
flows in billions; growth in percent; contribution in percentage points

	Change in Stock		Growth		Contribution to M2 Growth	
	FY23	FY24	FY23	FY24	FY23	FY24
NFA	-1,934.5	530.7	-	-	-7.0	1.7
NDA	5,855.1	4,531.0	20.6	13.2	21.2	14.4
Budgetary borrowing	3,747.9	7,478.0	20.3	33.6	13.6	23.7
SBP	108.7	-715.0	2.1	-13.6	0.4	-2.3
Scheduled banks	3,639.3	8,192.9	27.2	48.2	13.2	26.0
Commodity operations	352.3	-107.6	31.1	-7.2	1.3	-0.3
Credit to private sector	208.3	364.2	2.3	4.0	0.8	1.2
Credit to PSEs	293.7	18.5	21.5	1.1	1.1	0.1
Other items net	1,108.1	-3,155.3	-	-	-	-
Broad money (M2)	3,920.6	5,061.7	14.2	16.1	14.2	16.1
Total Deposits	2,327.6	5,002.1	11.7	22.5	8.4	15.9
Currency in circulation	1,576.3	4.4	20.82	0.0	5.7	0.0
Other deposits with SBP*	16.8	55.2	17.6	49.3	0.1	0.2
Reserve money	2,093.2	297.5	22.4	2.6	7.6	0.9

*Other deposits with SBP include deposits of NBFIs, DFIs and MFBs.

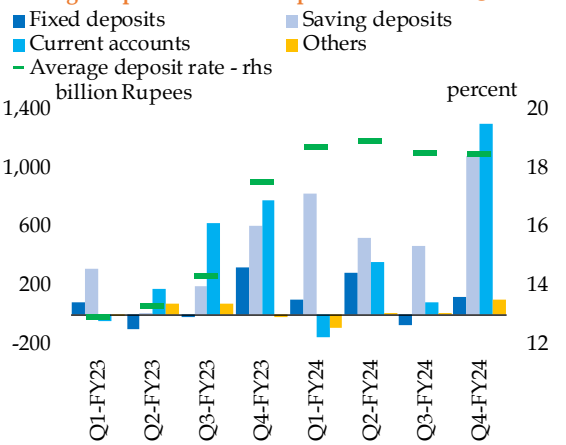
Source: State Bank of Pakistan

Quarterly Flows of NFA **Figure 3.8**



Source: State Bank of Pakistan

Average Deposit Rate and Deposit Flows **Figure 3.9**



Source: State Bank of Pakistan

retirements in commodity financing, a sizeable slowdown in loans to PSEs, and a large contraction in other items net (OIN) partly offset the impact of higher budgetary borrowings on NDA during the year.

The expansion in NFA of the banking system was led by the SBP, mirroring the build-up of external buffers **(Figure 3.8)**. Particularly, the SBA with the IMF in June 2023 was instrumental in unlocking financing from other bilateral and multilateral lenders, leading to a significant increase in inflows in FY24. In addition, narrowing of CAD provided the SBP an opportunity to build FX reserves.

On the liabilities side, the currency-in-circulation (CiC) remained almost unchanged, showing a meagre increase of Rs 4.4 billion in FY24 compared to a huge expansion of Rs 1.6 trillion in the previous year. Attractive rates of return on deposits and SBP's digitalization efforts explain the trends in CiC. In addition, decrease in uncertainty and relatively lower inflation also partly contributed to the slowdown in CiC. Based on anecdotal evidence, crackdown on smuggling and hoarding of foreign currencies may also have discouraged CiC.

Commodity Financing **Table 3.2**

flows in billion Rupees

	FY23	FY24
Total	**352.3**	**-107.6**
Wheat	299.1	-177.2
Sugar	39.9	0.5
Cotton	0.2	-1.8
Seeds	1.7	0.7
Fertilizer	11.2	70.4

Source: State Bank of Pakistan

Meanwhile, growth in bank deposits accelerated to 22.5 percent in FY24 from 11.7 percent in FY23. This growth was led by saving deposits in line with the tight monetary policy stance **(Figure 3.9)**.

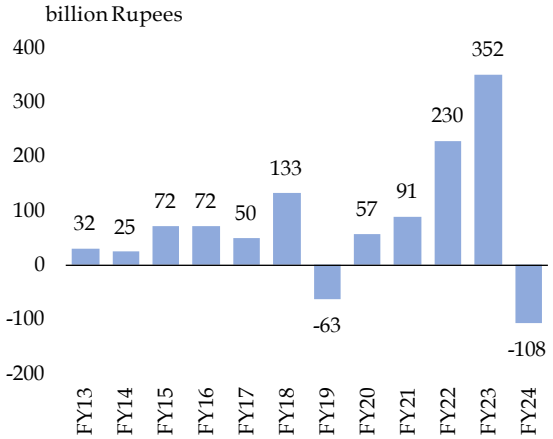
Commodity Financing

Financing for commodity operations posted a net retirement in FY24 as compared to a substantial offtake in the previous year (**Table 3.2**). This was the first time since FY19 that commodity financing saw a net retirement (**Figure 3.10**). This indicated improved cash position of wheat procuring agencies, higher borrowing cost and lower wheat procurement during FY24.

For the past four years, the provincial governments were not able to retire these loans due to non-payment of subsidies by the federal government. To address this issue, the government made a partial payment of overdue subsidies to provincial food departments, which

Commodity Financing Flows **Figure 3.10**

billion Rupees



Source State Bank of Pakistan

enabled them to retire a part of outstanding commodity debt during FY24.[8]

Government Borrowing

A higher fiscal deficit, in absolute terms, a notable decline in non-bank financing, and retirements to the SBP contributed to increased government borrowings from scheduled banks in FY24. The net budgetary borrowings from commercial banks increased by Rs 8.2 trillion during FY24, compared to an increase of Rs 3.6 trillion in FY23. The government met the bulk of its financing requirements through floating rate PIBs (PFLs) in FY24 (**Table 3.3**). To contain the rollover and interest rate risk, the government assigned higher auction targets to PFLs, followed by fixed-rate PIBs. Similarly, for T-bills, the government allocated higher targets for 6-month and 12-month papers, while the targets for 3-month bills were set below the maturities.

Although on a declining path, inflation was hovering close to the multi-decade peak at the start of the year. This, together with a sustained increase in government borrowing requirements from commercial banks, drove increase in cut-off rates during Q1-FY24. Also, the market appetite for 3-month T-bills and PFLs increased during this period. However, in line with its objective to reduce rollover risk, the government

Auction Summary - FY24 **Table 3.3**

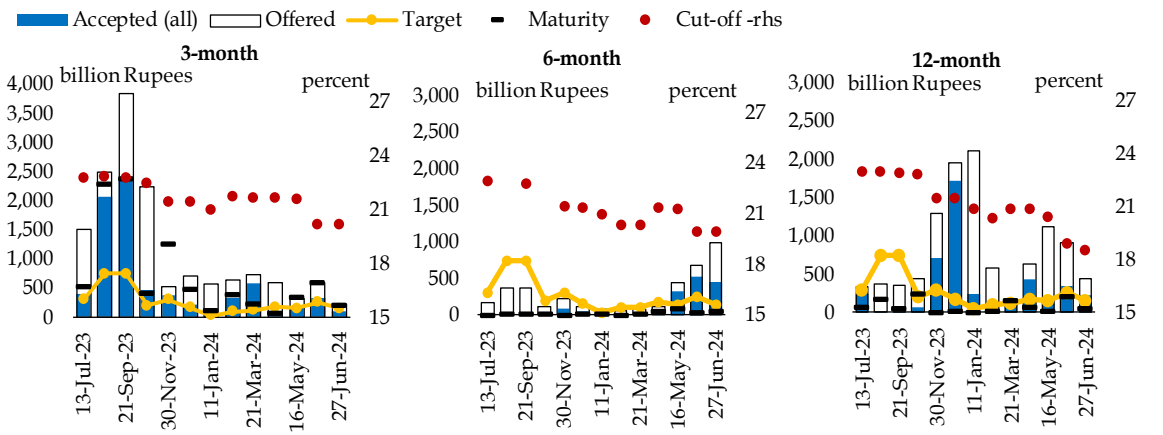
billion Rupees

	Target	Maturity	Offered (competitive)	Accepted (all)
Treasury Bills				
Q1-FY24	8,700.0	8,754.8	14,624.4	8,309.2
Q2-FY24	7,635.0	8,948.2	24,729.2	9,273.5
Q3-FY24	1,670.0	1,880.2	8,668.2	2,124.4
Q4-FY24	3,090.0	2,311.1	10,163.3	4,473.7
Total	**21,095.0**	**21,894.3**	**58,185.2**	**24,180.9**
Pakistan Investment Bonds				
Fixed Rate				
Q1-FY24	480.0	859.7	716.5	189.1
Q2-FY24	510.0	-	1,644.7	763.6
Q3-FY24	505.0	3.2	936.9	303.4
Q4-FY24	570.0	3.6	595.5	235.1
Total	**2,065.0**	**866.5**	**3,893.7**	**1,491.2**
Floating Rate				
Q1-FY24	1,360.0	475.4	3,407.9	2,168.4
Q2-FY24	2,280.0	1,515.6	6,556.7	2,999.7
Q3-FY24	1,280.0	-	2,400.6	901.6
Q4-FY24	1,860.0	-	4,374.6	1,628.7
Total	**6,780.0**	**1,991.0**	**16,739.9**	**7,698.4**

Source: State Bank of Pakistan

[8] Source: Punjab Debt Bulletin, September 30, 2023, Government of Punjab

Auction Summary of T-bills During FY24 **Figure 3.11**



Source: State Bank of Pakistan

mobilized most of the financing through PFLs during the first quarter.

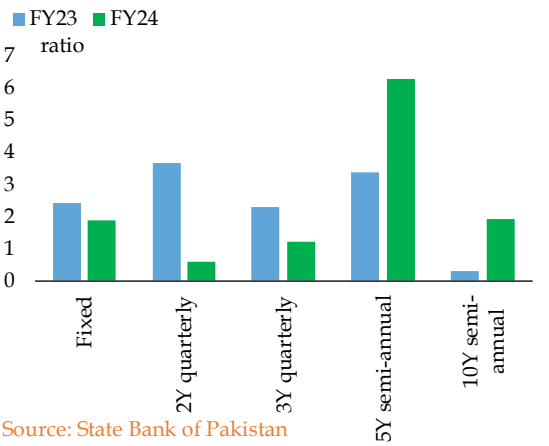
Anticipating inflation to start tapering off from the second half of FY24, the market began pricing in a cut in the policy rate, as evidenced by the decline in secondary market yields and auction cut-off rates from Q2-FY24 onwards, barring an uptick in the third quarter. Less than expected moderation in inflation due to a hike in gas prices and upward revision in SBP's inflation forecast range temporarily increased the cut-off rates in Q3-FY24.

Besides decrease in secondary market yields and cut off rates, offers for 3-month T-bills also declined in the latter half of FY24, reflecting the market's waning interest in short-term papers (**Figure 3.11**). The market stepped up offers for 6-month and 12-month T-bills in H2-FY24, specifically as the June 2024 MPC meeting drew closer, when the decision was in line with the market sentiments. In view of the market's keen interest, and soaring deficit financing requirements, the government accepted large amounts in 6-month T-bills, followed by 12-month bills on net of maturity basis during FY24, and retired 3-month T-bills.

Longer-tenor securities attracted market interest throughout the year. In particular, offers for semi-annual 5-year coupon increased manifold in the latter half of FY24. In overall terms, the offer-to-target ratio for semi-annual 5-year bonds increased to 6.3, more than twice that of T-bills during FY24 (**Figure 3.12**). Resultantly, the government met its financing needs mainly through these long-term securities. In the case of fixed-rate PIBs, the market offers were nearly double the target amount. However, in view of higher cost of borrowing, the government accepted only 38.9 percent of the offered amount.

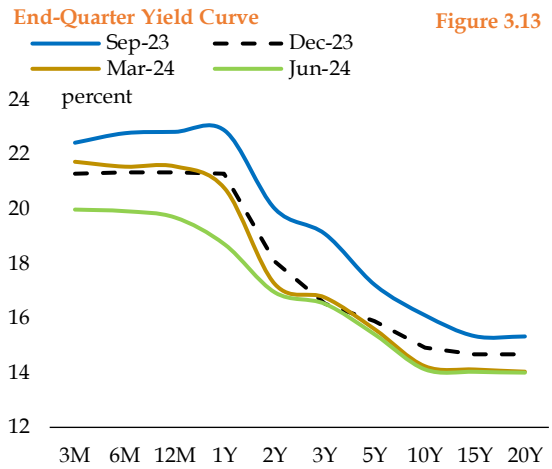
Against the backdrop of lower inflation expectations, the availability of external financing flows, and a stabilizing macroeconomic outlook, the secondary market yield curve shifted downwards. This depicted a decrease in the spread between secondary

Offer-to-Target Ratio - Fixed & Floating PIBs **Figure 3.12**



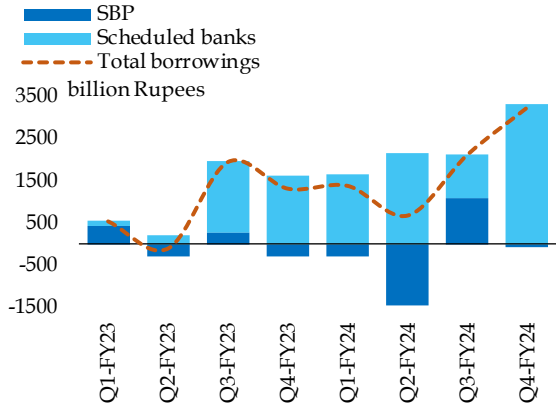
Source: State Bank of Pakistan

End-Quarter Yield Curve — Figure 3.13



Source: Financial Markets Association Pakistan

Government Borrowings from the Banking System — Figure 3.14



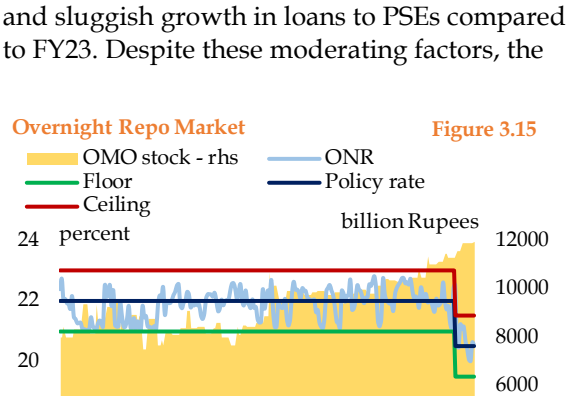
Source: State Bank of Pakistan

market yields and the policy rate. However, yields for short-term papers experienced a sharper decline than the yields for long-term securities (**Figure 3.13**).

Interbank Liquidity

Liquidity conditions in the interbank market remained strained during FY24. This was despite improved NFA of the SBP, strong growth in deposits and stagnation in CiC in FY24, net retirements in commodity financing, and sluggish growth in loans to PSEs compared to FY23. Despite these moderating factors, the government's increased budgetary borrowing requirements from commercial banks and a moderate increase in private sector credit maintained liquidity pressure in the interbank market **(Figure 3.14**). Given its objective to keep the overnight rate (ONR) aligned with the policy rate, the SBP had to inject a considerably higher amount in the interbank market via open market operations (OMOs). As a result, the average outstanding stock of OMOs rose by about 62 percent to Rs 9.4 trillion in FY24, from Rs 5.8 trillion in FY23 (**Figure 3.15).**

Overnight Repo Market — Figure 3.15



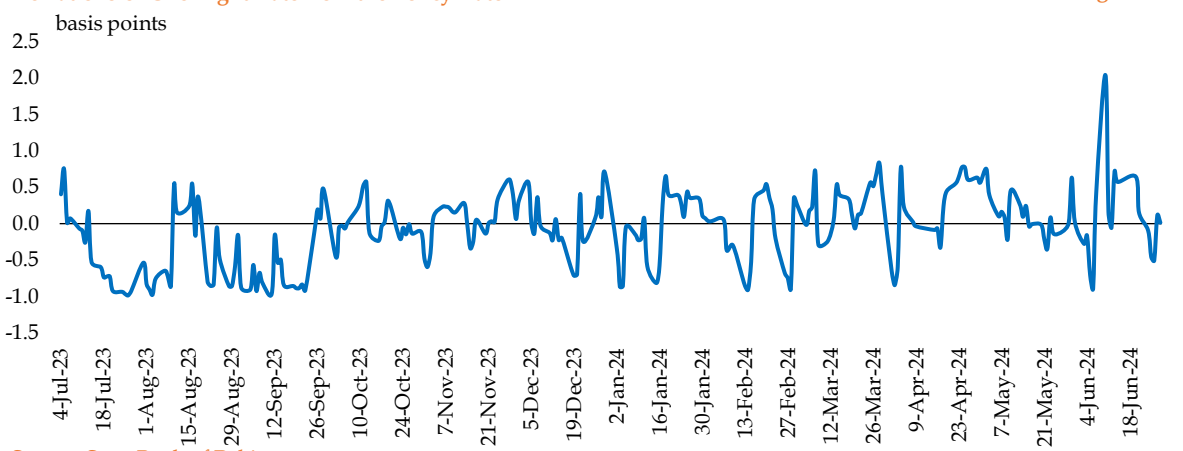
Source: State Bank of Pakistan

In Q1-FY24, the SBP employed longer-tenor OMOs. This, together with higher deposit flows, created ample liquidity in the system thus pushing the ONR below the policy rate (**Figure 3.16**). This resulted in greater utilization of the SBP's floor facility during Q1-FY24, as compared to the same period last year.[9]

However, in the remaining quarters of FY24, expectations of monetary easing drove market preferences towards shorter-tenor OMOs, as this offered the least opportunity cost in the case of future rate reductions. The SBP managed interbank liquidity through shorter-tenor OMOs, which served to move the ONR closer to the policy rate. In overall terms, the share of 7-

[9] The market used SBP repo facility 425 times in Q1-FY24, and parked Rs 24.3 trillion, compared to Rs 4.4 trillion in 102 instances in Q1-FY23.

Deviations of Overnight Rate from the Policy Rate Figure 3.16



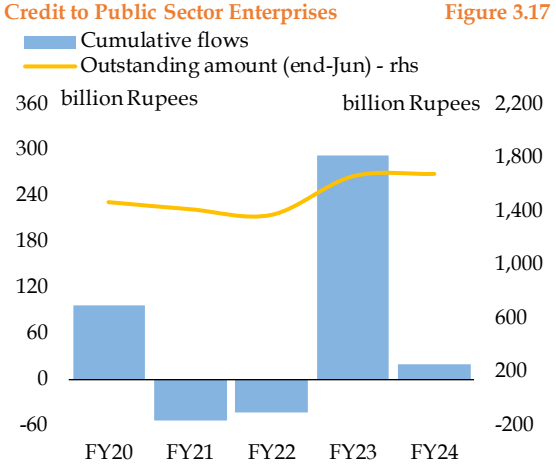
Source: State Bank of Pakistan

day OMOs rose to 59.8 percent in FY24, compared to 10.7 percent in FY23, while 28-day OMOs made up 34.9 percent of overall OMOs conducted in FY24.

In the last quarter, a sharp increase in the government borrowing from commercial banks, some recovery in private sector credit, increase in loans for commodity financing, and a spike in currency in circulation increased liquidity demand. Although total deposits also showed a notable growth, as reflected by the increasing spread between the ONR and the policy rate **(Figure 3.16)**, this was not sufficient to meet the overall liquidity needs of the market. Hence, the SBP scaled up liquidity injections, causing the average outstanding stock of OMOs to rise to Rs 10.9 trillion in Q4-FY24, compared to Rs 9.8 trillion in Q3-FY24. Nonetheless, the impact of increase in stock of OMOs in FY24 was partially offset by the net retirement in government borrowing from the SBP and reduction in stock of SBP refinance schemes. Resultantly, the reserve money growth remained significantly lower in FY24.[10]

Liquidity requirements of Islamic Banking Institutions also increased in FY24. Overall, Rs 7.4 trillion was injected in FY24, as compared Rs 4.1 trillion in FY23. The average amount per injection increased to Rs 102.5 billion in FY24 as compared to Rs 58.6 billion in FY23.

Credit to Public Sector Enterprises Figure 3.17



Source: State Bank of Pakistan

Credit to Public Sector Enterprises

Credit uptake by the PSEs tapered off to only Rs 18.5 billion in FY24, after posting a steep increase of Rs 293.7 billion last year (**Figure 3.17**). Significant retirements by the Pakistan State Oil (PSO) and an oil refinery mainly explain this slowdown in the loans to PSEs.

PSO retired a part of its outstanding debt owed

[10] Higher SBP profit in FY24 also had a contractionary impact on reserve money through other items (net).

to banks during FY24. An expansion in its marketing and distribution network shored up the company's sales revenue, which contained its dependency on bank loans.[11,12] This was in contrast to FY23, when increase in outstanding receivables from the Sui Northern Gas Pipelines Ltd. (SNGPL), together with the company's net losses resulting from flood-related slack in sales had led to an overall rise in the company's borrowings.

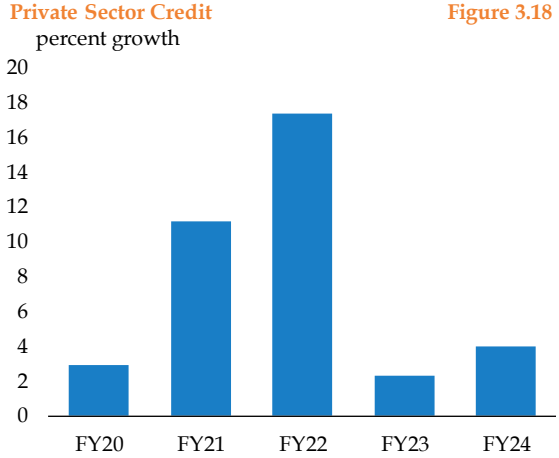
Similarly, export of furnace oil, and an uptick in capacity utilization, improved cash flow position of one of the large refineries, which reduced its reliance on bank borrowings.[13] The gas distribution companies SNGPL and Sui Southern Gas Co. Ltd. (SSGC), on the other hand, have seen a notable increase in bank loans since last year.[14] Large overdue receivables from the government on account of delayed payment of subsidies and tariff adjustment have undermined the cash flow position of these companies, leading to increased reliance on commercial borrowing to clear outstanding dues.

3.4 Private Sector Credit

Private sector credit (PSC) grew by 4.0 percent in FY24 as compared to 2.3 percent in FY23 (**Figure 3.18**). After remaining depressed during the first quarter, credit demand picked up from the second quarter onwards. A moderate expansion in economic activity, alongside persistent cost pressures in some industries, mainly explain the increase in PSC.

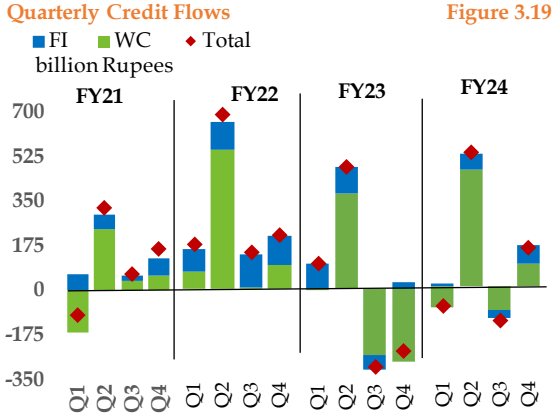
Nonetheless, tight monetary stance along with large financial needs from domestic sources continued to be the key factors behind subdued credit demand in FY24.[15] Furthermore, commercial banks exhibited a strong preference for risk-free investment in government securities, enticed by significant increase in government's borrowing requirements amid higher interest rates.[16] This was demonstrated

Private Sector Credit **Figure 3.18**



Source: State Bank of Pakistan

Quarterly Credit Flows **Figure 3.19**



Note: FI: Fixed Investment; WC: Working Capital

Source: State Bank of Pakistan

[11] Source: PSO's third quarterly financial report, March 2024

[12] According to PSO's third quarterly financial report 2024, it increased its outreach by establishing 37 new retail outlets, bringing the total number of locations nationwide to 3,555.

[13] The country exported 630,174 MT of furnace oil during FY24 as compared to 20, 600 MT in FY23.

[14] The loans to SNGPL and SSGC rose by Rs 29 billion and 18 billion respectively in FY24, after witnessing a Rs 76 billion and Rs 16 billion increase in FY23.

[15] Policy rate remained unchanged in FY24 till June 2024, when MPC reduced the policy rate by 150 bps.

[16] Government raised about twice the budgeted financing of Rs 3.5 trillion (on cash basis) from scheduled banks in FY24, registering a growth of 48.0 percent over FY23 borrowing.

Loans to Major Private Sector Businesses **Table 3.4**

flow in billion Rupees

	Total		Working Capital*		Fixed Investment		Construction Finance**	
	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
Private Sector Businesses	31.1	458.6	-145.0	363.6	173.8	119.3	2.3	-24.4
Manufacturing	89.4	298.0	-39.9	336.6	128.8	-33.4	0.6	-5.3
Textile	95.1	36.8	55.9	46.5	40.3	-10.5	-1.0	0.8
Cement, lime & plaster	36.5	-39.8	9.9	-22.1	27.0	-16.7	-0.1	-0.9
Refined petroleum	47.2	-21.2	45.4	-21.0	1.9	-0.3	0.0	0.0
Paper & paper products	3.9	30.5	-15.9	20.5	19.7	10.0	0.0	0.0
Basic iron and steel	-35.5	33.5	-37.6	39.6	2.3	-5.9	-1.0	0.0
Motor vehicles	-12.8	-0.9	-13.0	2.4	1.2	-3.3	-1.0	0.0
Basic pharma. products	17.3	4.5	15.7	1.3	1.9	3.6	-0.3	-0.3
Fertilizers	-8.4	-4.4	-6.1	6.0	-2.3	-10.4	0.0	0.0
Veg. & animal oils & fats	1.9	0.2	0.8	1.0	1.1	-0.5	0.0	-0.3
Rice Processing	3.3	3.2	4.7	2.9	-1.4	0.4	0.0	-0.1
Sugar	-12.3	131.0	-1.2	138.6	-11.4	-7.5	0.3	-0.1
Telecommunications	63.2	66.6	14.9	3.5	48.3	63.0	0.0	0.0
Construction	1.9	2.6	9.4	8.1	1.0	-1.3	-8.5	-4.2
Agri., forestry & fishing	17.9	56.5	-6.2	-17.8	24.2	74.5	-0.1	-0.2
Mining & quarrying	14.4	10.8	16.9	11.8	-2.5	-1.1	0.0	0.0
Real estate activities	-0.8	1.5	0.7	1.1	-2.3	3.5	-1.0	0.0
Transportation & storage	-8.4	4.8	-2.3	1.6	-6.1	3.5	-0.1	-0.3
Power gen, trans & dist.	-47.6	-56.0	-41.8	-22.6	-5.8	-33.2	0.0	-0.2
Wholesale & retail trade	-79.8	88.1	-81.4	62.1	-11.1	27.5	12.8	-1.4

* includes trade finance

** in terms of IH&SMEFD Circular Letter No. 28 of 2020, the data on credit/loans has been revised since June 2020 due to inter-sectoral adjustment in private sector business.

Source: State Bank of Pakistan

by the markedly higher bids compared to the auction targets and the maturities.[17]

Disaggregated data indicates that businesses scaled up working capital requirements from Q2 onwards, whereas loans for fixed investment remained sluggish throughout FY24 (**Figure 3.19**). Low capacity utilization in many industries, high interest rate environment, and persistent economic and political uncertainty dented firms' appetite for fixed investment loans (**Table 3.4**).

On the other hand, gradual phasing-out of SBP's concessionary financing schemes (EFS and LTFF) may also have led to some switching towards conventional financing for working capital.[18] As a result, the outstanding stock of loans under EFS and LTFF fell by 11.3 percent during FY24.

Surge in input costs underpinned increased credit demand in some industries

A significant growth in loans to private sector businesses largely emanated from the industries struggling with soaring overhead costs, along with the rise in input prices (**Table 3.5**). In particular, sugar industry accounted for around

[17] Banks offers to maturity ratio was more than double for T-bills, more than 4 times and 8 times of the maturity of both the fixed rate floating PIBs, respectively.

[18] As a condition of the IMF, the SBP will end its operational involvement in the two largest refinancing schemes (EFS and LTFF) after a five-year transition period started in July 2023.

Key Input Price Components **Table 3.5**

growth in percent

	FY23	FY24
Mark-to-market average exchange rate (PKR/US$)	-28.2	-12.4
Mark-up rate (1Y average KIBOR)	18.6	21.9
Wholesale price index	32.8	20.2
Furnace oil	14.3	22.9
LNG	7.7	61.1
Electrical energy	39.9	40.0
Steel products	23.3	41.4
Plastic products	15.7	33.2
Capacity utilization (%)	63.8	64.8

*exchange rate depreciated by around 15% in Q1-FY24 but appreciated from Q2-FY24 following the exchange companies' reforms and administrative actions taken by government

Sources: SBP, PBS, IMF

38.1 percent of the total increase in working capital loans during FY24. Despite a slight dip in sugarcane production in FY24 as compared to the previous year,[19] a significant increase in minimum support prices (MSP) of sugarcane augmented cost of production for the industry, enhancing its working capital needs.[20]

Likewise, wholesale trade sector also registered a large increase in credit offtake. The major beneficiaries were *food and beverages*, *electronics and communication equipment*, *solid, liquid and gaseous fuels, agriculture machinery and equipment,* and *fertilizers and agrochemicals.* The high credit demand of these sub-sectors was also driven by increase in input costs (**Table 3.6**).

Rising input and operational costs amplified credit appetite for energy-intensive sectors

Iron and steel sector has been struggling since the beginning of the year. Depreciation of local currency in Q1-FY24, and rise in global prices of iron fueled cost of production, raising working capital requirements during H1-FY24.[21]

Wholesale Price Index **Table 3.6**

growth in percent

	FY23	FY24
Food Group		
Meat of animals	17.5	22.1
Dairy products	33.0	37.9
Sugar refined	5.1	47.0
Sugar confectionary	8.9	13.9
Spices	-23.6	67.9
Beverages	33.2	41.7
Electronics and Machinery		
Engines and motors	3.8	42.2
Fridge, washing, sewing machines, fans, iron	21.5	32.0
Radio and television	28.7	36.7
Fuels		
Natural gas liquefied	7.7	61.1
Furnace oil	14.3	22.9
Agriculture Machinery and Agrochemicals		
Cultivators	45.4	56.7
Pesticides	8.4	16.6
Insecticides	5.9	27.9

*bank floating average exchange rates

Sources: SBP, MoF, PBS, PAMA, World Bank

A significant rise in gas and electricity tariffs that amplified operational expenses of the industry during H2-FY24, further increased working capital demand for the sector.

A modest recovery in economic activity and strong agriculture production provided some boost to credit growth

In addition to rising input cost for few industries, increase in agricultural production and an uptick in LSM output[22] increased the demand for private sector credit. For instance, increased production levels led various industries such as leather, chemical and rubber and plastic to increase borrowing from the banking sector. Similarly, strong agriculture production (wheat, cotton and rice) in FY24 also

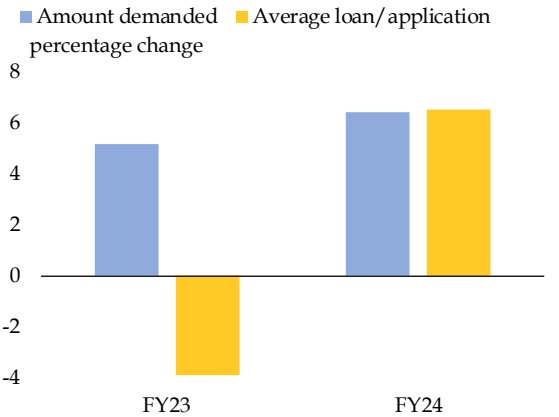
[19] Sugarcane production registered 0.4 percent decline in FY24 as compared to 0.8 percent decline last year.

[20] For Punjab and KPK, the price was raised to Rs 400/maund in FY24 as compared to Rs 300/maund last year whereas for Sindh, it was raised to Rs 425/maund from Rs 302/maund last year (Source: Economic Survey 2023-24).

[21] As per the World Bank pink sheet data, global iron prices rose by 8.5 percent during FY24 as compared to a decline of 20.8 percent last year. The electricity and gas in WPI increased by 40.0 percent (39.9 percent in FY23) and 61.1 percent (7.7 percent in FY23), respectively in FY24.

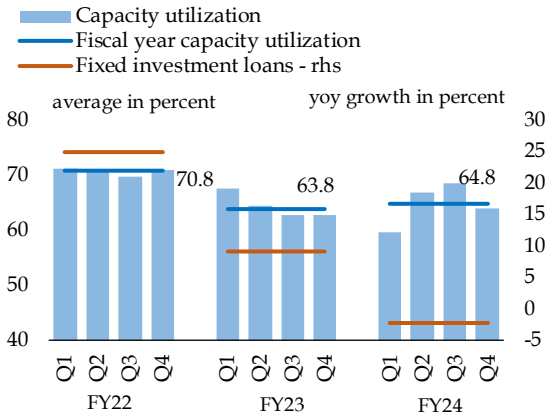
[22] LSM increased by 1.1 percent in FY24 as compared to contraction of 9.8 percent in FY23.

Private Sector Businesses' Demand for Working Capital Loans **Figure 3.20**



Source: State Bank of Pakistan

Capacity Utilization and Fixed Investment Loans - Manufacturing **Figure 3.21**



Source: State Bank of Pakistan

raised credit requirements of grain milling and allied industries.

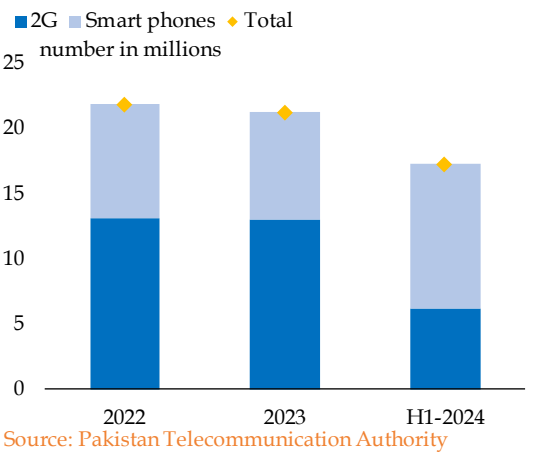
The number of industries witnessing increase in working capital uptake in FY24, almost doubled as compared to FY23. Moreover, the total amount demanded for working capital and the loan demand per application also increased during FY24 **(Figure 3.20)**.

Tight macroeconomic policies and economic and political uncertainty impacted fixed investment loans

The fixed investment loans decelerated for the second consecutive year, registering a growth of 4.6 percent in FY24 compared to 7.1 percent last year. The combined effect of contractionary policy environment, political and economic uncertainty, and a sluggish increase in capacity utilization in manufacturing sector, were the major factors behind the slowdown in fixed investment loans during FY24. Specifically, one-third of the total capacity of manufacturing sector still remained unutilized in FY24, which dented firms' incentives to add further capacity **(Figure 3.21).**

However, *agriculture and forestry* and *telecommunication* sector continued to avail fixed investment loans in FY24. Telecommunication was the only sector witnessing an increase in fixed investment for the fifth consecutive year. The sector saw expansion in both wired and wireless communication, including infrastructure as well as in manufacturing of mobile phones. The subscriber base grew to 194.6 million, achieving a tele-density of 80.7 percent, while, the mobile manufacturing already reached about 85 percent of CY2023 production in H1-CY2024 (**Figure 3.22**).[23]

Mobile Phone Manufacturing/ Assembling in Pakistan **Figure 3.22**



Source: Pakistan Telecommunication Authority

[23] The broadband subscriptions increased to 135.4 million, corresponding to a penetration rate of 56.1 percent. The ICT services exports increased by 24.1 in FY24, compared to a contraction of 0.8 percent in FY23. Source: Economic Survey 2023-24; State Bank of Pakistan.

Consumer Financing **Table 3.7**

flows in billion Rupees

	FY22	FY23	FY24
Total Consumer Financing	**192.2**	**-40.4**	**-57.4**
Credit cards	17.7	21.0	28.5
House building	97.1	11.6	-8.7
Personal loans	16.4	1.2	-14.0
Consumers durable	1.2	0.0	0.1
Auto loans	59.7	-74.1	-63.2

Source: State Bank of Pakistan

Consumer financing remained on a downtrend for the second consecutive year

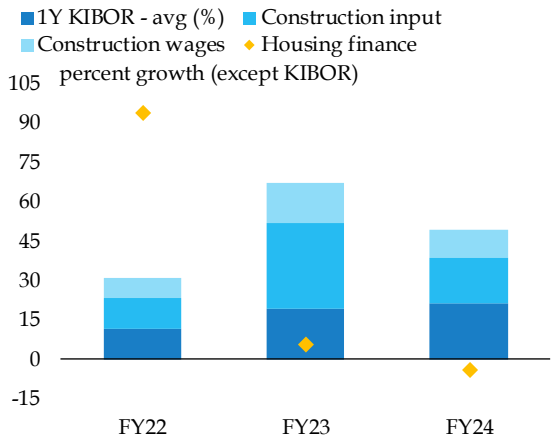
Consumer loans continued the declining trend and witnessed net retirement of Rs 57.4 billion in FY24, compared to Rs 40.4 billion in FY23 (**Table 3.7**). Amid the tight monetary stance, interest rates remained at their highest levels almost throughout FY24. Moreover, elevated inflation continued to constrain demand for consumer durables.

While all segments of consumer finance, barring credit cards, saw retirement, the major drag came from auto loans. Alongside the elevated borrowing cost, tightened prudential regulations, and a notable increase in car prices in the last two years, made it difficult for many customers to avail the auto-finance due to higher monthly installments.[24] This is also evident from a marked, 20.2 percent, decline in the sales of cars, jeeps and vans during FY24, reflecting lackluster consumer demand.

Since the end of the government's concessional housing finance scheme, house-building loans have also been on a downward trajectory. In addition to the higher mark-up rates, elevated construction cost also discouraged credit uptake **(Figure 3.23)**. The only category in consumer finance witnessing expansion for the last two years is credit card loans, which rose 30.4 percent in FY24. The growing adoption of digital technologies by both consumers and merchants, given the ease and convenience of transactions, has significantly boosted credit card usage. This is evident from the rise in both credit card based transactions volume as well as their value **(Figure 3.24).**

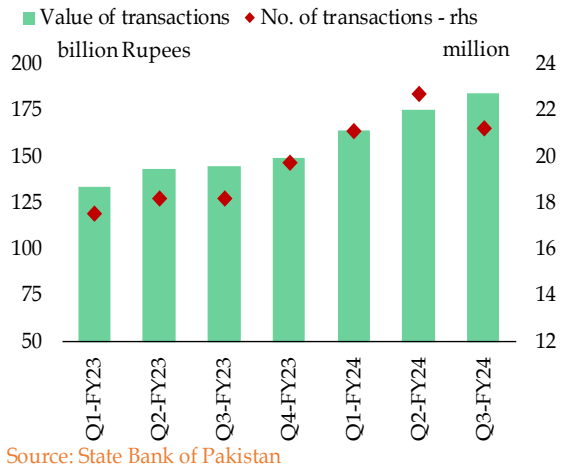
The number of point of sale (POS) machines has also risen during the Jul-Mar FY24 period compared to the same period last year.[25] Lesser preference of consumers to carry cash, rise in price levels and the discounts and offers on

Housing Finance and Construction Cost **Figure 3.23**



Sources: Pakistan Bureau of Statistics and State Bank of Pakistan

Credit Card Transactions **Figure 3.24**



Source: State Bank of Pakistan

[24] Despite some reduction announced by several companies for particular models in FY24, the car prices have increased by more than 50 percent compared to FY22 levels. SBP had introduced several amendments to the Prudential Regulations (PRs) for consumer financing (September 2021, May 2022) aiming to moderate the auto loans by limiting the per customer exposure; increasing the down-payment requirement and reducing the maximum tenure of auto financing.

[25] Number of POS machines increased to 120,641 at the end of Q3-FY24, compared to 112,302 POS machines at the end of Q3-FY23 as per SBP's "Payment System Review" for Q3-FY24.

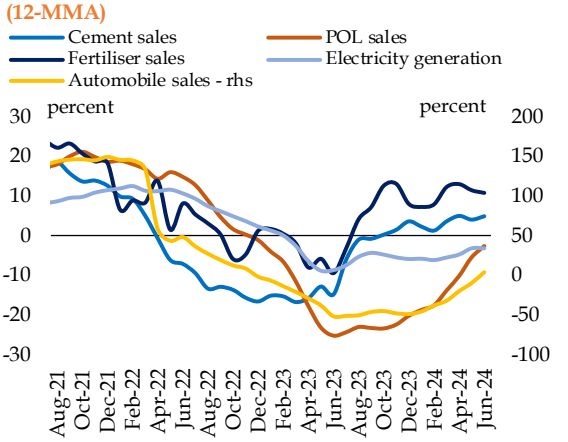
credit card based transactions are also contributing to the overall rise in credit card loans.

3.5 Inflation

The average NCPI inflation came down to 23.4 percent in FY24, from the recent high of 29.2 percent in FY23 **(Table 3.8)**. The core inflation remained almost at the previous year's level, whereas energy inflation spiked to a multi-decade peak in FY24 amid the continued price adjustments in the energy sector. The monthly data shows that disinflationary trends gained traction during H2-FY24, with the YoY inflation falling to a two-year low of 12.6 percent in June 2024, from a high of 38.0 percent in May 2023.

A substantial increase in administered food and energy prices added to inflationary pressures during H1-FY24, compared to the same period last year. In addition, PKR depreciation that pared the gains from easing global commodity prices, and increase in tax rates, levies and wages announced in the FY24 budget also contributed to higher inflation during this

Trends in High Frequency Indicators (12-MMA) **Figure 3.25**



Sources: APCMA, OCAC, NFDC, PAMA, & NEPRA

period. These developments partly neutralized the impact of policy-induced slack in domestic demand (**Figure 3.25**) and improved supply of food commodities **(Figure 3.26)**

The increase in gas prices alone contributed around one-fifth of urban headline inflation during FY24, compared to its negligible 0.4 percent contribution in FY23. Longstanding inefficiencies in the energy sector have resulted in piling up of a huge stock of circular debt in

Average CPI Inflation and Contribution **Table 3.8**

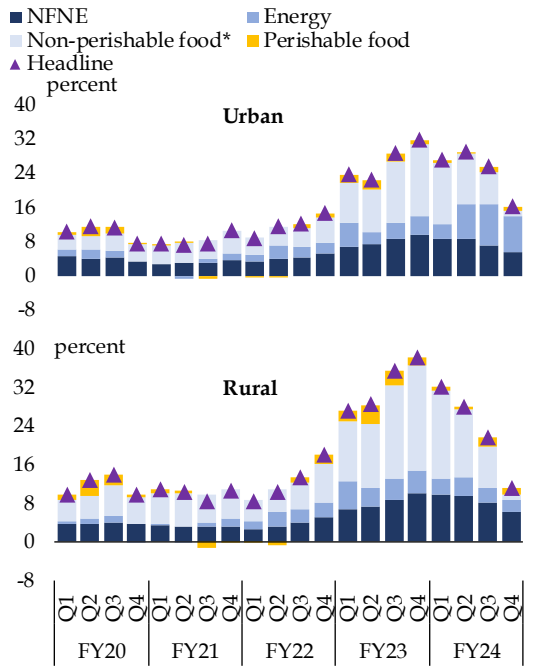
percent

Items	Average Inflation							Contribution		
	Wt.*	H1-FY23	H2-FY23	FY23	H1-FY24	H2-FY24	FY24	H1-FY24	H2-FY24	FY24
NCPI	**100**	**25.0**	**33.0**	**29.2**	**28.8**	**18.7**	**23.4**	**28.8**	**18.7**	**23.4**
Urban										
CPI	**100.0**	**23.1**	**30.4**	**26.8**	**28.0**	**20.7**	**24.1**	**28.0**	**20.7**	**24.1**
Food	**36.8**	**30.7**	**44.0**	**37.6**	**33.2**	**12.9**	**22.1**	**13.5**	**5.5**	**9.2**
Perishable	4.4	48.3	36.0	41.9	7.5	25.0	16.2	0.4	1.1	0.8
Non-perishable	32.4	28.5	45.0	37.1	37.0	11.5	22.9	13.1	4.4	8.4
NFNE	**53.7**	14.1	18.2	16.2	18.4	13.9	16.1	8.7	6.3	7.5
Energy	**9.5**	25.1	38.0	38.4	47.9	76.1	62.6	5.8	8.9	7.4
Rural										
CPI	**100.0**	27.9	37.0	32.6	30.0	16.5	22.4	30.0	16.5	22.4
Food	**45.9**	33.6	48.0	41.1	33.7	12.9	21.6	16.8	6.7	11.3
Perishable	5.7	52.0	41.3	46.4	7.7	29.9	17.7	0.5	1.7	1.1
Non-perishable	40.3	31.3	48.9	40.4	37.8	10.7	22.1	16.3	4.9	10.2
NFNE	**42.6**	17.4	23.5	20.6	25.9	19.3	22.7	3.5	6.9	8.1
Energy	**11.4**	41.0	37.4	39.1	27.2	23.3	24.9	9.6	2.9	3.1

*wt. = weight, Cont.= Contribution

Source: Pakistan Bureau of Statistics

Composition of CPI Inflation **Figure 3.26**

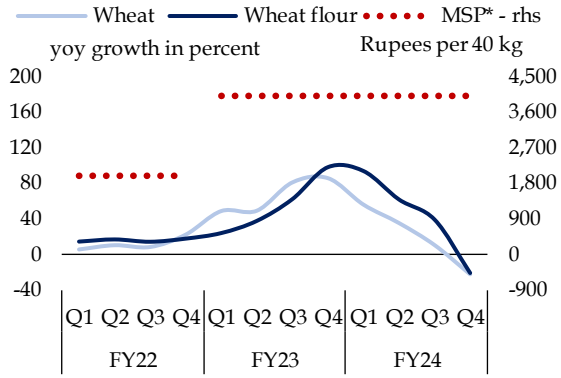


*inclusive of alcohol beverages and readymade food
Sources: Pakistan Bureau of Statistics; SBP staff calculations

power and gas sectors.[26] To stem the pace of accumulation in circular debt, the government has initiated aggressive price adjustments in the energy sector since FY19.[27,28] In the same vein, the government introduced sizeable and broad-based increase in gas charges during FY24, which amplified energy inflation during the year **(Box 3.1)**. Moreover, the steep increase in gas prices pushed the urban inflation above rural inflation in FY24.[29]

The impact of escalating energy inflation seeped into prices of core goods and services as well as higher inflation expectations of consumers and businesses. However, subdued domestic demand and strengthening of the PKR amid

Trends in Wheat Prices **Figure 3.27**



*minimum support price of Sindh was Rs 4,000 per 40 kg in FY23 & FY24
Source: Pakistan Bureau of Statistics

improved external account position, moderated the pace of core inflation during H2-FY24.

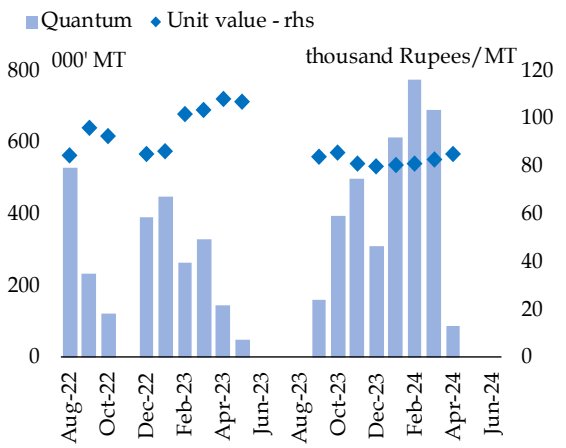
Improved supply situation eased price trends in major food commodities

Food inflation in urban areas decreased to 22.1 percent in FY24, from 37.0 percent in FY23. Increase in crop output, administrative measures and declining global commodity prices mainly explain receding prices of major food items, particularly of wheat, during FY24. After rising significantly in the first half, wheat prices declined sharply in the latter half of FY24 **(Figure 3.27)**. The government introduced a large increase in MSP of wheat in FY23 to incentivize its production that fuelled increase in market prices of wheat and wheat products during H1-FY24.

Besides, artificial shortages further escalated price increases in the first half. To address these issues, the government initiated administrative actions in Q1-FY24.[30] Meanwhile, the

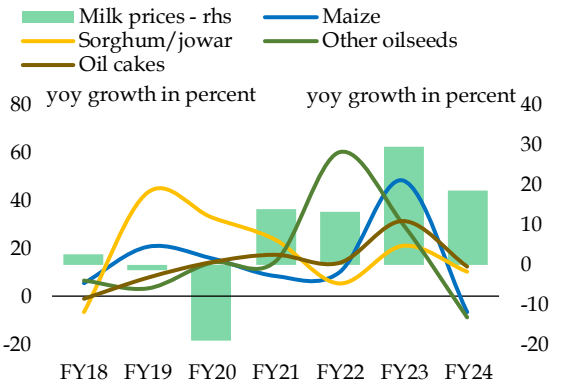
[26] IMF (2024). Second and Final Review under Stand-By Arrangement, published in May 2024
[27] IMF (2019). Staff Report under Request for an Extended Arrangement under the Extended Fund Facility, published in July 2019
[28] However, the tariff adjustments were delayed during the pandemic. Source: IMF (2021). Staff Report under Second, Third, Fourth, and Fifth reviews under the Extended Arrangement under the Extended Fund Facility and Request for Re-phasing of Access, published in April 2021
[29] The CPI basket of the rural areas does not include gas in energy group due to non-availability of piped gas in many parts of rural areas.
[30] Source: Press Release: Second session of the 5th APEX committee of SIFC on September 9, 2023

Wheat Imports **Figure 3.28**



Source: Pakistan Bureau of Statistics

Trends in Prices of Feed Inputs* and Milk Fresh **Figure 3.29**



*wholesale prices of feed inputs

Source: Pakistan Bureau of Statistics

government also allowed the private sector to import wheat, which shored up supply and reversed the price trend in the domestic market **(Figure 3.28)**.[31] In addition, record production of wheat also added to the downtrend in domestic wheat prices especially during Q4-FY24. [32]

Lower input prices allayed price pressures in milk

After witnessing a strong uptrend during FY23, milk prices stabilized albeit at elevated levels during FY24. This may be attributed to a significant reduction in feed prices, including oilseeds and maize during FY24 compared to the preceding year. A significant supply shock in the form of floods had fuelled large increase in milk prices during FY23, on account of shortages of feed inputs and loss of large number of animals.[33] However, during FY24 some important animal feed products including oilseeds witnessed sizeable increase in production, leading to lower prices.[34,35] Furthermore, an overall slowdown in maize (corn) demand from the poultry industry dragged its prices down in FY24,[36] despite a reduction in its production during the year **(Figure 3.29)**. In addition, stringent administrative measures to enforce price controls also contributed to stability in milk prices during FY24. The provincial governments ensured adherence to the announced administered prices of milk that reduced the pace of increase in milk prices in FY24.[37]

[31] Wheat import volume rose by 29.6 percent in FY24 to 3.5 MMT compared to 2.7 MMT in FY23.

[32] Wheat production grew by 12.2 percent to 31.4 MMT in FY24 as compared to a growth of 7.4 percent with a production of 28.2 MMT in FY23. Source: Pakistan Bureau of Statistics

[33] For details, see Chapter 3 of SBP's Half Year Report FY23 on The State of the Pakistan's Economy

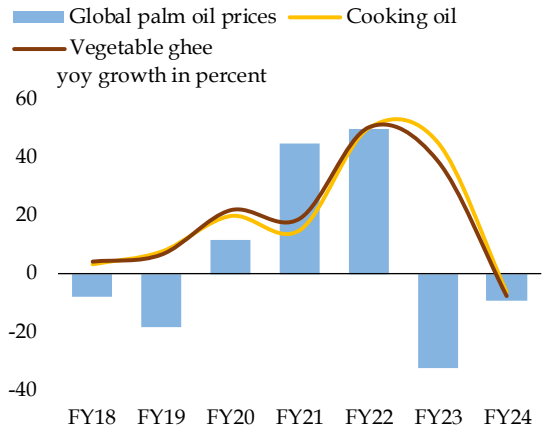
[34] Oilseed crops include cottonseed, sorghum, and mustard, which are used in the composition of dairy feed. Sources: Pakistan Economic Survey and Pak Dairy Info, available at (Pak Dairy Info - concentrates in dairy animal nutrition)

[35] The production of oilseeds significantly increased by 21.5 percent in FY24 reaching 3.2 million tonnes as compared to 2.7 million tonnes in FY23. Source: Pakistan Bureau of Statistics

[36] The demand for maize as poultry feed decreased drastically in FY24 amid the dismal performance of the poultry sector due to rising input costs and the ban on genetically engineered (GE) soybean imports. Traditionally, poultry feed constitutes about 65 percent of corn consumption, while wet milling and dairy feed account for about 15 and 10 percent, respectively. Source: USDA (2024). Report on Grain and Feed Annual, published in April 2024

[37] Under Sindh Essential Commodities Price Control and Prevention of Profiteering and Hoarding Act 2005 (Amended in 2008 and 2023), the Commissioner Office Karachi set the retail milk prices at Rs 200 per liter.
Source: Notification No. CK/AC(HQ)/865/2023, published on October 3rd, 2023.
Likewise, the Deputy Commissioner Office (Lahore) also announced milk prices at Rs 160 per liter. Source: Notification No. DO(IPWM)/LHR/34, published on March 8th, 2024

Trends in Global and Domestic Oil Prices **Figure 3.30**



Sources: Pakistan Bureau of Statistics and World Bank

Lower global palm oil prices induced declines in edible oil prices

The drop in prices of vegetable ghee and cooking oil collectively accounted for more than one-quarter of the decline in food inflation during FY24. Mirroring the falling trend in international palm oil prices amid stable exchange rate, domestic prices of edible oil decreased substantially during FY24, compared to an uptrend in the previous year **(Figure 3.30)**.

Substantial hike in gas prices pushed energy inflation to multi-decade peak

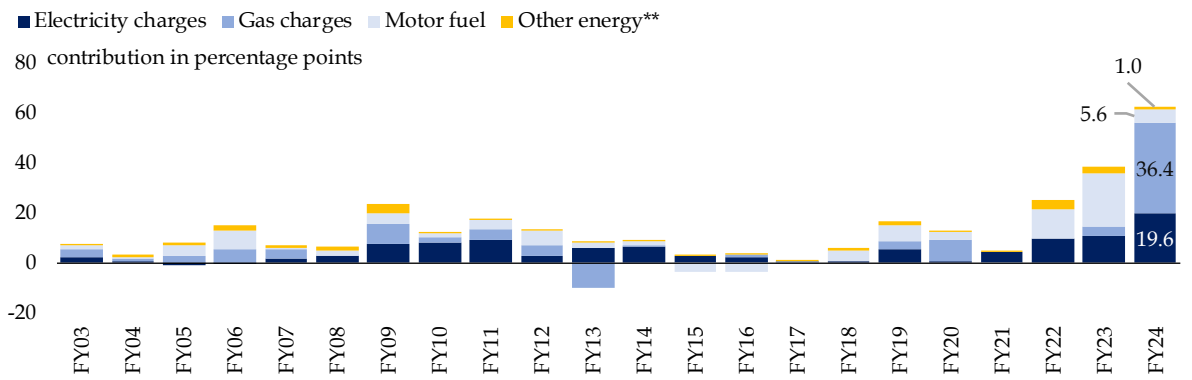
Energy inflation nearly doubled to 62.6 percent in urban areas in FY24 from 38.4 percent in the preceding year. The power and gas price adjustments, especially a significant increase in gas charges, pushed the energy inflation to a multi-decade high level in FY24 **(Figure 3.31)**.

In a bid to shield domestic consumers from the impact of rising global oil and LNG prices, the government had kept the prices of natural gas unchanged since FY20. However, persistent fiscal constraints did not allow the government to pay overdue subsidies to gas distribution companies, which severely affected cash position of these entities leading to accumulation of inter-corporate circular debt in the gas sector.

To stem the flow of circular debt, the government initiated gas price adjustments from January 2023, with a view to align gas charges with cost recovery levels. Continuing these measures, the government significantly scaled up both variable and fixed gas charges for protected and non-protected domestic consumers in November 2023 and February 2024 **(Table 3.9)**. Gas charges for the non-domestic sector, including commercial and captive users, and CNG stations, almost doubled from previous rates, further contributing to inflation in urban areas.

Conversely, in rural areas energy inflation exhibited an opposite trend, falling to 24.9 percent in FY24 from 39.1 percent in FY23. This

Composition of Energy Inflation* **Figure 3.31**



Note: Inflation indices are based on following base years: FY02-09 on base year of FY00, FY09-17 on FY08, and FY17-23 on FY16; *inflation indices for urban areas are used from FY17 onwards; **includes firewood, kerosene oil, bulbs, match box

Sources: Pakistan Bureau of Statistics; SBP staff calculations

Gas Charges Increased Manifold during FY24 **Table 3.9**

Rupees per MMBTU

	Jan-23	Nov-23	Feb-24
Variable charges			
Protected category			
Up to 0.25 hm^3	121	121	200
Up to 0.5 hm^3	150	150	250
Up to 0.6 hm^3	200	200	300
Up to 0.9 hm^3	250	250	350
Non-protected category			
Up to 0.25 hm^3	200	300	500
Up to 0.6 hm^3	300	600	850
Up to 1 hm^3	400	1,000	1,250
Up to1.5 hm^3	600	1,200	1,450
Up to 2 hm^3	800	1,600	1,900
Up to 3 hm^3	1,100	3,000	3,300
Up to 4 hm^3	2,000	3,500	3,800
Above 4 hm^3	3100	4000	4200
Fixed charges			
Protected category	10	400	400
Non-protected category	460	1,000 (<= 1.5 hm^3) 2,000 (>1.5 hm^3)	1,000 (<= 1.5 hm^3) 2,000 (>1.5 hm^3)

Source: Oil & Gas Regulatory Authority

Fuel Charges Adjustment - FY24 **Figure 3.32**

May-23	----●1.9	Jul -23
Jun-23	---● 1.81	Aug -23
Jul-23	--● 1.46	Sep-23
Aug-23	---● 1.71	Oct-23
Sep-23	-● 0.4	Nov-23
Oct-23	------● 3.08	Dec-23
Nov-23	--------● 4.13	Jan-23
Dec-23	---------● 4.57	Feb-23
Jan-24	----------● 7.05	Feb-23
Feb-24	----------● 4.92	April-24
Mar-24	----● 2.84	May-24
Apr-24	---------● 3.33	Jun-24
May-24	---------● 3.32	Jul-24

Note: LHS indicates months for which FCA was charged; indicative months on RHS are months in which FCA was actually billed. FCA is collected with a two-month lag

Source: National Electric Power Regulatory Authority

Quarterly Adjustments in Electricity Tariffs for Residential Consumers **Table 3.10**

Rupees per KWh

Quarter	Unit	Billing period
Q1-FY23	1.49 to 3.21	Feb- Mar 2023
Q2-FY23	0.5	Apr-Jun 2023
Q3-FY23	1.25	Jul-Sep 2023
Q4-FY23	3.28	Oct 2023-Jan 2024
Q1-FY24	1.15	Jan-Mar 2024
Q2-FY24	2.75	Apr-Jun 2024
Q3-FY24	1.9	Jun-24

Source: National Electric Power Regulatory Authority

is because gas is not part of the rural basket, and hence gas price increases did not translate into higher energy inflation. However, electricity prices along with solid fuel contributed dominantly to inflation due to higher prices of firewood and coal across rural segments.

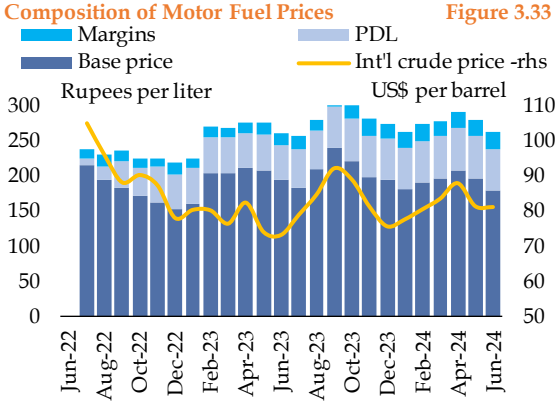
Hikes in electricity tariffs also continued to contribute to inflation during the year, accounting for around one-third of the increase in urban energy inflation during FY24. Effective July 01, 2023, the government introduced an annual adjustment to variable electricity charges across all consumer slabs. Similarly, regular quarterly power tariff adjustments were also implemented throughout the year **(Table 3.10)**. Additionally, fuel charge adjustments (FCAs), typically collected due to variation in actual and reference fuel cost for a particular month, also contributed to the cost of electricity **(Figure 3.32)**.

This was despite a declining trend in global oil prices during the year. The weaker local currency, especially during the first half, exacerbated the fuel cost, leading to higher electricity prices even as global oil prices fell.

Furthermore, the petrol prices, on cumulative basis, increased in FY24 relative to last year on account of higher Petroleum Development Levy (PDL). The government increased the PDL from Rs 50 per litre in July 2023 to Rs 60 per litre from September 2023 **(Figure 3.33)**.[38]

[38] Similarly, PDL on Diesel was raised from Rs 50 per litre to Rs 55 per litre in October 2023, and Rs 60 per litre in November 2023. Source: OGRA

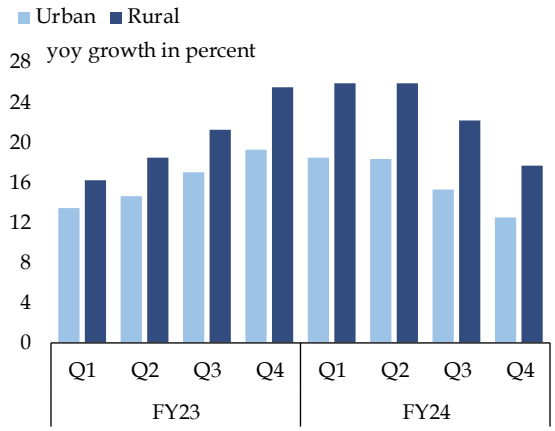
Composition of Motor Fuel Prices **Figure 3.33**



Note: The effect of subsidies and sales tax remained zero during the review period

Source: Oil & Gas Regulatory Authority

Trends in Core Inflation **Figure 3.34**



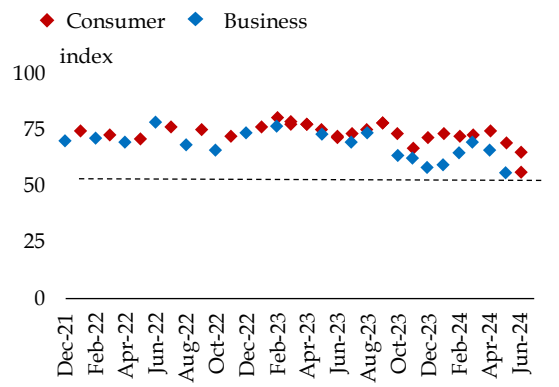
Source: Pakistan Bureau of Statistics

The underlying inflationary pressures started to ease from the start of H2-FY24

Average core inflation in urban areas during FY24 remained almost at the last year's level.[39] This indicated the combined impact of hike in tax rates, levies and wages introduced in the FY24 budget, the lagged impact of PKR depreciation up till September 2023, and second round effects of adjustments in administered prices of food and energy.[40] However, after plateauing at an elevated level, core inflation showed a gradual decline almost throughout H2-FY24 **(Figure 3.34**).

Soaring energy and food prices kept inflation expectations of households elevated in the first half. However, as food inflation began to fall sharply in H2-FY24, consumer expectations also somewhat eased during the second half, which partly effected a slowdown in wage growth during this period **(Figures 3.35 and 3.36)**. In addition, strengthening PKR alongside the policy induced slack in domestic demand that relieved price pressures on input costs also played a role in taming core inflation during the second half of FY24**.** More **s**pecifically, inflation

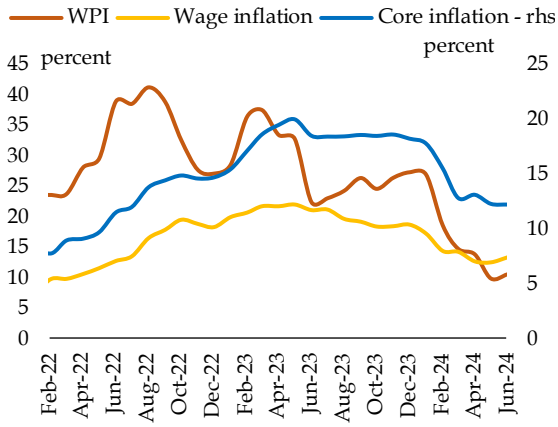
Inflation Expectations **Figure 3.35**



Note: The values exceeding 50 indicates that high inflation views are more than low inflation views.

Source: State Bank of Pakistan

Input Costs, Wages, and Core Inflation **Figure 3.36**

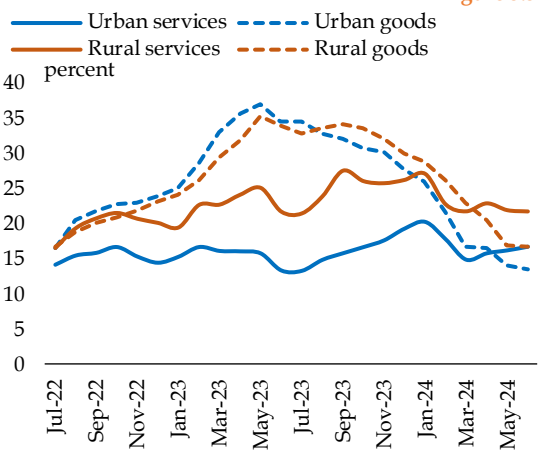


Source: Pakistan Bureau of Statistics

[39] Core inflation in FY24 was 16.1 as compared to 16.2 in FY23.

[40] Wages include charges/wages for tailoring, household servants, cleaning and laundering, construction workers, garbage collection, dental services, doctor fees, mechanical services, and personal grooming services.

Trend in Goods and Services Inflation **Figure 3.37**



Source: Pakistan Bureau of Statistics

in core goods fell more swiftly than in services (**Figure 3.37**).

The elevated inflation in services is explained by slower adjustment of wages and contracts, which do not immediately reflect changes in raw material and energy costs. This lag results in services inflation trailing goods inflation as well as the headline inflation during periods of high inflation.[41] Furthermore, higher taxes on services, including additional tax on marriage halls and caterers introduced via the Finance (Supplementary) Act in November 2023 also raised prices of these services.[42] In addition, increased fuel levies contributed to higher transport service charges, including elevated fares. However, the house rent index, the largest component of core inflation, remained stable in urban areas, but experienced a rise in rural areas.

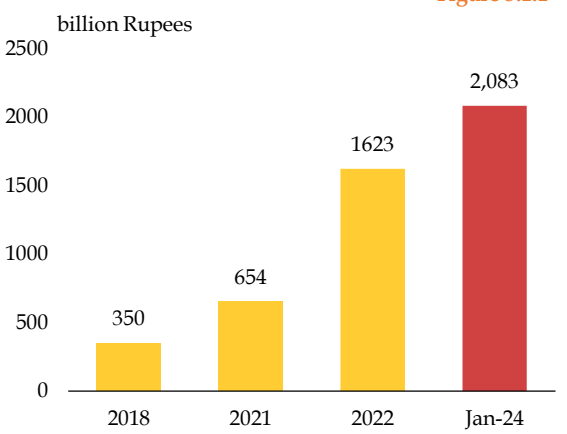
Core inflation in the rural basket increased slightly, rising from 20.6 percent last year to 22.7 percent in FY24. Despite declining headline inflation in rural areas, core inflation remained persistent, although it weakened as the year progressed. The rural basket saw a slight increase in the contribution from services, with marriage hall charges being the main contributor to this rise.

Box 3.1: Factors Underpinning Increase in Gas Prices

A significant hike in gas prices was the major driver of inflation in FY24. These price adjustments were part of the pricing policies pursued by the government since FY19 to stem the pace of increase in energy sector circular debt. The circular debt in the gas sector reached Rs 2.1 trillion in early 2024, around 2.0 percent of GDP **(Figure 3.1.1)**. There are three major interrelated issues underpinning the increase in gas prices. First, political considerations in determination of gas tariffs and extension of gas distribution network which have led to freezing gas tariffs below cost recovery levels. The cheaper availability of the fuel has stoked its demand, which also amplified the government's fiscal burden. However, scarcity of fiscal resources constrained timely payment of subsidies by successive governments, leading to accumulation of circular debt. Second, in the face of diminishing domestic gas reserves, the government has resorted to import costlier LNG since 2015, which has further exacerbated the debt stock. Third, the inability of gas distribution companies to contain transmission and distribution losses has further worsened the gas sector circular debt.

Cross-subsidization distorts price signals to domestic consumers. On account of political considerations, successive governments have extended protection to domestic gas consumers, at the expense of industries. A subsidized price for

Circular Debt of Gas Sector in Pakistan **Figure 3.1.1**

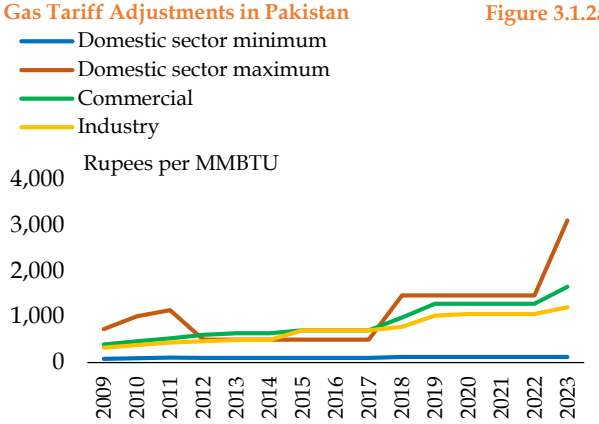


Sources: IMF and Finance Division

[41] Bańbura, M., Bobeica, E., & Martínez Hernández, C. (2023). What drives core inflation? The role of supply shocks. ECB Working Paper Series, 2875

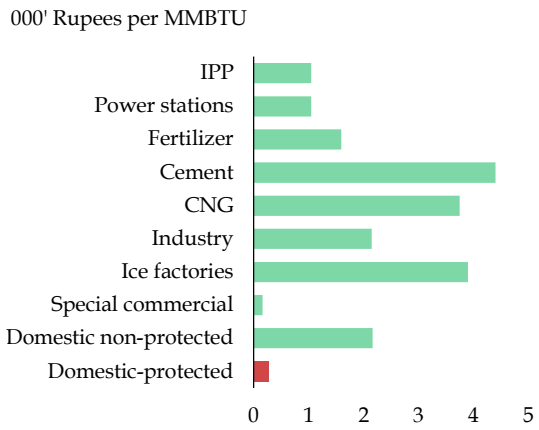
[42] Advance tax of 10 percent has been announced in supplementary finance bill in addition to 15 percent sales tax on marriage halls/lawns/clubs/caterers.

Gas Tariff Adjustments in Pakistan Figure 3.1.2a



Source: Pakistan Energy Year Book and Pakistan Economic Survey (various issues)

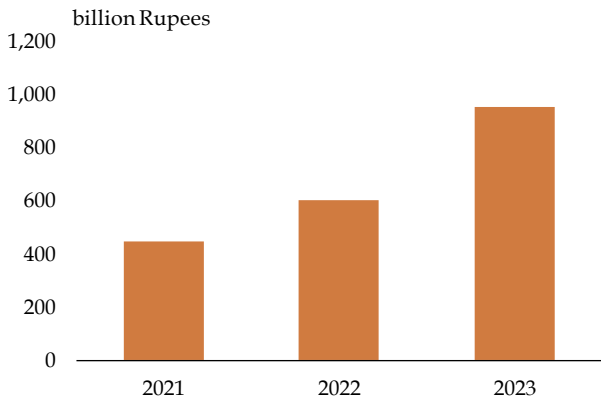
Sector-wise Gas Tariffs Figure 3.1.2b



Source: Oil & Gas Regulatory Authority

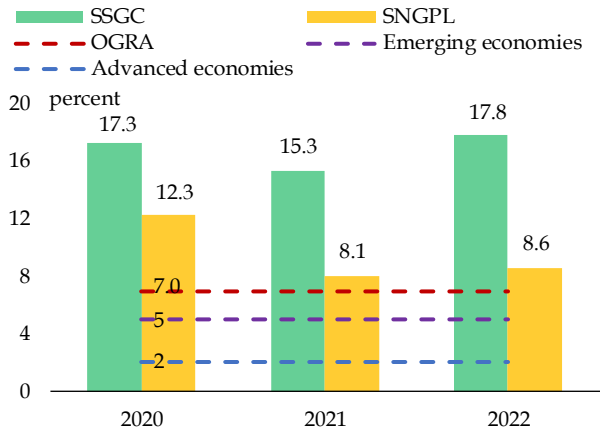
the domestic sector distorts price signals by protecting households at the cost of other sectors **(Figure 3.1.2a and 3.1.2b)**. This encouraged consumption amid diminishing gas reserves. The Oil and Gas Regulatory Authority (OGRA) determines the tariff schedule by incorporating full cost recovery of the distribution companies including SNGPL and SSGC pertaining to sales of gas, transmission and distribution (T&D) costs, and unaccounted for gas (UFG) cost. However, the government intervenes in the price adjustment process by providing subsidies to shield the domestic sector. In addition, the government also absorbs the LNG delivery cost[43] thereby keeping the gas tariff unchanged for a prolonged period. The initial cost differential is borne by the distribution companies which is reimbursed by the government in the form of a subsidy. However, delays in the timely disbursement of the subsidy, erodes the liquidity position of these companies and gives rise to accumulation of intercorporate debt. SNGPL – one of the major gas distribution companies – has reported a substantial increase in pending receivables from the government on account of delayed gas tariff adjustments since past few years **(Figure 3.1.3)**.

SNGPL Receivables on Account of Delayed Tariff Adjustment Figure 3.1.3



Source: SNGPL Annual Reports (various issues)

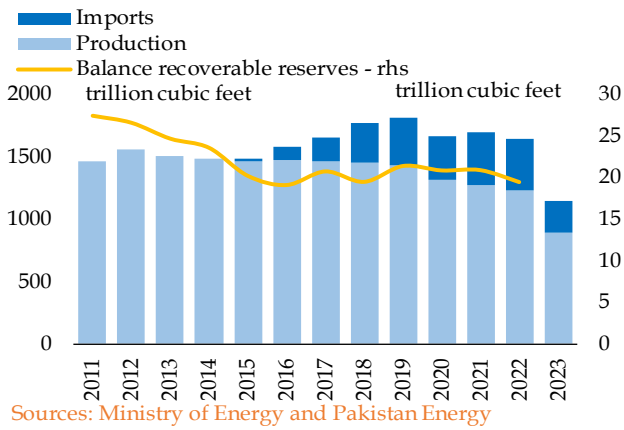
UFG Losses of Distribution Companies Figure 3.1.4



Sources: SSGC & SNGPL Annual Reports; KPMG

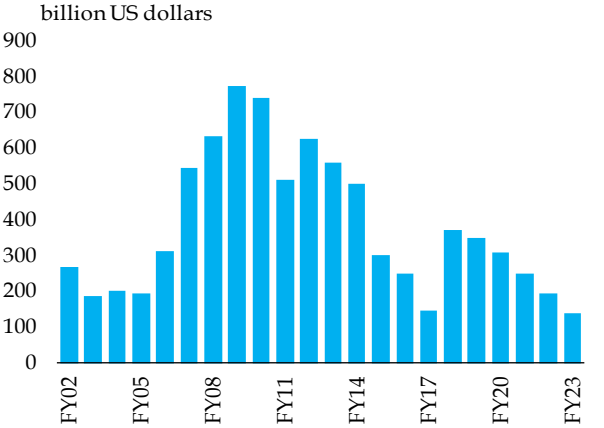
[43] The substantial variance between the LNG basket price and the natural gas price is the amount paid by the government in the form of a subsidy when imported LNG is provided to domestic consumers at the price of natural gas. The government has initiated the process of passing on the entire delivered cost of LNG to the consumers. However, the pace of this shift needs to be expedited (Saad et al. 2023).

Availability of Gas Resources



Sources: Ministry of Energy and Pakistan Energy Yearbook (various issues)

Figure 3.1.5 Foreign Direct Investment in Pakistan



Source: Pakistan Bureau of Statistics

Figure 3.1.6

Operational inefficiencies of the gas sector lead to large unaccounted-for-Gas (UFG) losses. UFG is the difference between metered gas volume injected into the T&D network and the metered gas delivered to the end consumers. OGRA has set the UFG allowance as 6.98 percent **(Figure 3.1.4)**. The amount that exceeds the UFG allowance is treated as a disallowance and negatively impacting gas prices.[44] A number of factors contribute to high UFG losses including aged infrastructure, law and order issues, and theft of gas. Old infrastructure together with poor maintenance of distribution pipelines and utility networks lead to gas leakages from the system. Old gas meters also hinder efforts to accurately estimate UFG losses and identify domestic gas theft. The magnitude of UFG is higher in areas where law and order situation obstructs the operations of gas companies.[45] Gas theft is also higher in such areas as the practice of installing illegal connections is more common. This further impacts the company's ability to repay their dues and circular debt is generated. As an example, SSGC has been running losses from 2016-2022 due to high UFG disallowances that eroded the company's revenues. On account of these operational bottlenecks, gas distribution companies report higher UFG losses than their counterparts in developing and advanced economies **(Figure 3.1.4)**. The mounting inter-corporate circular debt has hampered the ability of the companies to fix issues in the gas distribution and transmission network, which has further augmented the gas sector circular debt.

Depletion of natural gas reserves has led to growing reliance on costlier LNG imports. The country's gas reserves have been declining, which has increased RLNG imports over the past few years **(Figure 3.1.5)**. Government's involvement in price fixation is one of the primary reasons behind the lower gas reserves, which has discouraged foreign direct investment in the oil and gas exploration sectors (**Figure 3.1.6**). In addition, mounting burden of inter corporate circular debt has also dented the pace of the gas exploration activities by the domestic sector. Thus, since 2015, the government has been importing costly LNG to meet demand, which has increased the country's vulnerability to adverse movements in the global commodity prices.

Conclusion: The settlement of the huge stock of circular debt requires bringing gas tariffs to cost-recovery levels, aligning domestic gas charges with imported LNG prices and phasing out politically motivated preferential treatments. These pricing policies will go a long way in correcting price signals, which is required to rationalize gas demand in the country. This will, however, entail regular adjustments in energy prices, which will escalate energy inflation. Furthermore, there is also a need to focus on introducing improvements in gas transmission and distribution network to lower UFG losses. Similarly, extension of gas exploration activities by encouraging domestic and foreign investment also has a potential to reduce requirements on expensive LNG imports, which may ease price pressures in the gas sector.

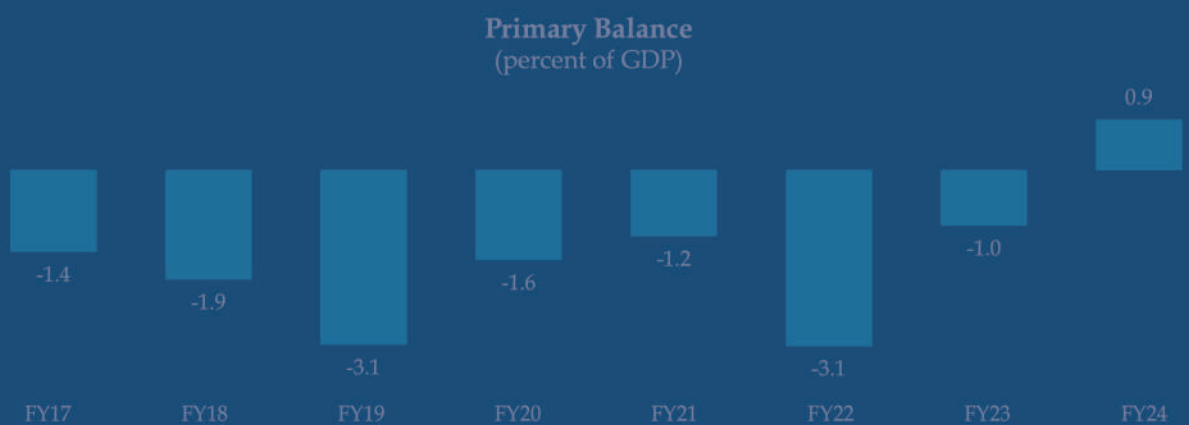
[44] OGRA determines prices by equating revenue requirements of the companies with costs of selling gas. OGRA computes the average prescribed gas price by taking the ratio of total revenue requirement (TRR) to the sales volume of gas for each company. The TRR includes the revenue of gas sales at the current prices and the demand-supply shortfall. While the gas sales volume covers the cost of gas sold, T&D losses, UFG allowance/disallowance, return on assets, and depreciation. [OGRA (2022)].

[45] SSGC cited 53 percent UFG losses in Baluchistan.

4

Fiscal Policy

Fiscal consolidation continued in FY24, as primary balance posted a surplus for the first time in 17 years. Overall fiscal deficit as well as revenue deficit also decreased by about one percent of GDP. Increase in total revenue largely explains the improvement in fiscal balances. The major contribution to total revenue came from non-tax revenue, supported by higher SBP profit and PDL collection. Meanwhile, tax revenue also recorded a modest increase in terms of GDP. In case of expenditure, a slight decline in terms of GDP was primarily due to non-interest spending on account of lower subsidies and development spending, more than offsetting the increase in interest payments amid high debt stock and elevated interest rates. In this context, sustaining the fiscal consolidation is imperative to contain debt servicing and create fiscal space for social and development spending to support growth over medium to long term. This could only be achieved through reforms aimed at broadening the tax base, and reducing untargeted subsidies and grants by addressing structural issues, particularly in the energy sector, and privatisation of state owned enterprises.



4 Fiscal Policy

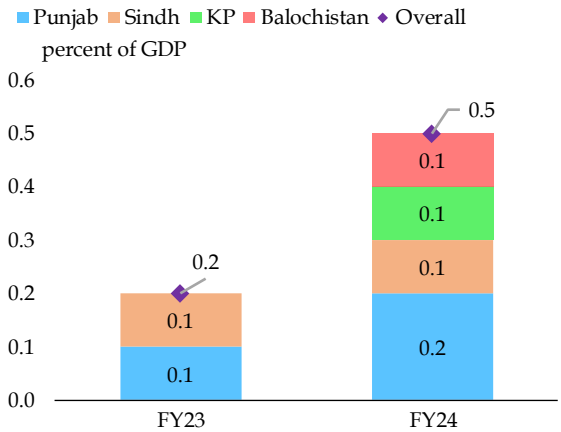
4.1 Fiscal Trends and Policy Review

Robust growth in total revenue helped the government in achieving desirable fiscal consolidation during FY24. The fiscal deficit decreased by one percent to 6.8 percent of GDP in FY24, while primary balance recorded a surplus of 0.9 percent—first time since FY07 (**Figures 4.1a & 4.1b, Table 4.1**). The provinces contributed 0.5 percent to the consolidated surplus, compared to 0.2 percent in the previous year (**Figure 4.2**). Meanwhile, revenue balance posted a lower deficit compared to the previous year, as increase in total revenue outpaced the increase in current expenditure (**Figure 4.1c**).

The major thrust to revenue growth came from non-tax revenue (NTR), which contributed 80 percent of the increase in total revenue in terms of GDP. Higher SBP profit, petroleum development levy (PDL) collection, and federal mark-up receipts on loans to PSEs/provinces were the major contributors to the substantial increase in the NTR during FY24.

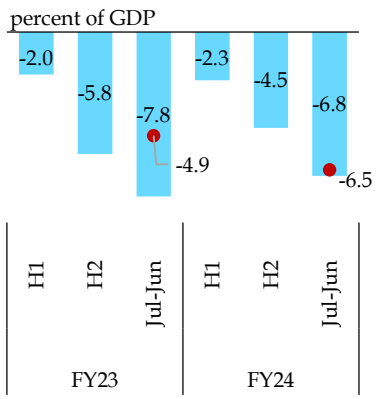
By comparison, tax revenue accounted for only 20 percent of the increase in total revenue. This was despite a substantial growth in tax revenue. Both economic factors and revenue mobilization measures contributed to this growth. Major economic factors included high interest rates and inflation, as well as PKR depreciation compared to the previous year.[1] These were supported by a host of tax measures, like widening the scope of super tax, increase in withholding tax (WHT) and general sales tax rates (GST), and rationalization of tax expenditure to some extent.

Provincial Fiscal Balance **Figure 4.2**

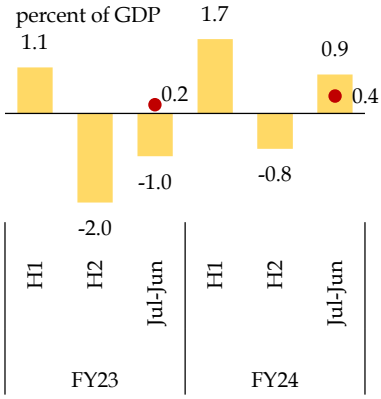


Source: Ministry of Finance

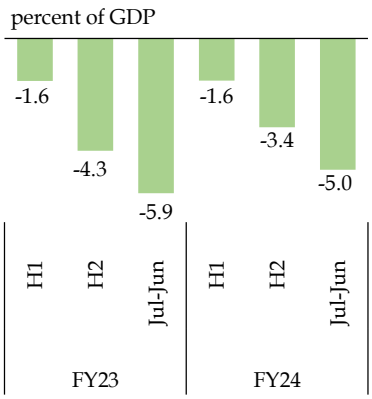
Fiscal Balance **Figure 4.1a**



Primary Balance **Figure 4.1b**



Revenue Balance **Figure 4.1c**



Note: Maroon dots represent respective Budget Estimates
Source: Ministry of Finance

[1] On average, PKR depreciated by 12.4 percent against USD during FY24.

Consolidated Fiscal Position **Table 4.1**

	Values (billion Rupees)				Growth (percent)			
	FY23	FY24			FY23	FY24		
	Jul-Jun	H1	H2	Jul-Jun	Jul-Jun	H1	H2	Jul-Jun
1. Total revenue (a+b)	**9,634**	**6,854**	**6,415**	**13,269**	**19.9**	**45.9**	**30.0**	**37.7**
(a) Tax revenue	7,819	4,834	5,251	10,085	15.7	29.5	28.5	29.0
o/w FBR taxes	7,169	4,469	4,842	9,311	16.7	30.3	29.4	29.9
(b) Non-tax	1,815	2,020	1,164	3,184	41.8	108.8	37.3	75.4
2. Total expenditure (a+b+c)	**16,155**	**9,262**	**11,214**	**20,476**	21.5	**45.1**	**14.8**	**26.7**
(a) Current expenditure	14,583	8,565	10,006	18,571	26.6	41.3	17.4	27.3
o/w Mark-up payments	5,696	4,220	3,940	8,160	79.0	64.0	26.2	43.3
(b) Development expenditure & net lending	1,953	661	1,417	2,078	17.8	3.9	7.7	6.4
o/w PSDP	1,893	673	1,354	2,027	17.1	13.9	4.0	7.1
(c) Statistical discrepancy	-381	36	-209	-173	-	-	-	-
3. Fiscal balance	**-6,521**	**-2,408**	**-4,799**	**-7,207**	-	-	-	**-**
percent of GDP	*-7.8*	*-2.3*	*-4.5*	*-6.8*	-	-	-	-
4.Primary balance	***-826***	***1,812***	***-859***	**953**	-	-	-	**-**
percent of GDP	*-1.0*	*1.7*	*-0.8*	*0.9*	-	-	-	-
5. Revenue balance	**-1,464**	**-1,711**	**-3,591**	**-5,302**	-	-	-	**-**
percent of GDP	*-5.9*	*-1.6*	*-3.4*	*-5.0*	-	-	-	-
5. Provincial balance	**155**	**289**	**229**	**518**	-	-	-	**-**
percent of GDP	*0.2*	*0.3*	*0.2*	*0.5*	-	-	-	**-**
6. Financing (a+b)	**6,521**	**2,408**	**4,799**	**7,207**	-	-	-	-
a) External (net)	-680	608	-288	321	-	-	-	-
b) Domestic (net)	7,201	1,799	5,087	6,886	-	-	-	-

Note: *Fiscal balance* is total revenue minus total expenditure; *primary balance* is fiscal balance excluding interest payments; *revenue balance* is total revenues minus total current expenditures

Source: Ministry of Finance

At the same time, total expenditure decreased slightly in terms of GDP. The decline was primarily due to a fall in non-interest expenditure, led by subsidies and development spending. Reduction in subsidies was on account of lower disbursement to Pakistan State Oil (PSO), as well as government decision to restrict gas subsidies to the industrial sector.[2] However, power subsidies continued to remain elevated. In case of development spending, both the federal public sector development program (PSDP) and provincial development expenditure witnessed a decline in terms of GDP. This could be traced to tight fiscal space and caretaker governments in place till elections in February 2024.[3] In contrast to non-interest expenditure, interest payments rose considerably due to elevated debt stock amid high interest rate environment.

While it is encouraging to see significant fiscal consolidation continuing in FY24, it is important to look at its contributory factors from the standpoint of sustainability. The major sources of revenue gains included SBP profit, the PDL collection, and cyclical factors like interest rate and inflation, rather than broadening of tax base. Measures to boost tax revenue through efficient use of tax policy and administration, both at federal and provincial levels, remained insufficient. This is reflected in only a marginal increase in the tax-to-GDP ratio.[4]

Furthermore, within the tax revenue, though direct taxes posted a reasonable increase in terms of GDP, GST on goods and services either

[2] Unlike last year, government did not have to pay subsidy on account of valuation losses on FE-25 loans of PSO during FY24.
[3] As per constitution, the caretaker governments have limited powers in terms of spending decision.
[4] Subdued growth in non-agriculture GDP in FY24 also explains this phenomenon, to some extent.

deteriorated or remained unchanged, notwithstanding increase in the standard GST rate on goods in the latter half of FY23.

On the expenditure side, interest payments overshot the budget estimate for the second year in a row. Amid fiscal constraints, overall development spending as percent of GDP decreased, which has negative repercussions for economic growth and thus, future revenue generation capacity.[5] Moreover, provincial social spending on health and education also decreased in terms of GDP in FY24, which has implications for availability of skilled labor force and productivity in the economy.[6]

In view of these factors, it is imperative to implement reforms aimed at increasing tax revenue through broadening of the tax base and rationalizing non-interest expenditure, particularly subsidies. These reforms are particularly important in the context of sustaining fiscal consolidation needed to reduce debt levels, as well as stimulate social and development spending to support inclusive growth.

4.2 Revenue

Total revenue rose by one percent to 12.5 percent of GDP in FY24, edging above the average of last five years (**Table 4.2**). While non-tax revenue predominantly contributed to this increase, the tax revenue also increased, both in terms of GDP and growth.

Breakup of Consolidated Revenue **Table 4.2**

	Values (billion Rupees)			Percent of GDP			Growth (percent)			Contribution to Growth (ppts)*		
	FY19-23 avg.	FY23	FY24	FY19-23 avg.	FY23	FY24	FY19-23 avg.	FY23	FY24	FY19-23 avg.	FY23	FY24
Total Revenue (a+b)	**7,149**	**9,634**	**13,269**	**12.1**	**11.5**	**12.5**	**13.6**	**19.9**	**37.7**	-	-	-
a) Tax revenue	**5,698**	**7,819**	**10,085**	**9.6**	**9.3**	**9.5**	**13.5**	**15.7**	**29.0**	**10.4**	**13.2**	**23.5**
Federal	**5,181**	**7,169**	**9,311**	**8.7**	**8.5**	**8.8**	**13.8**	**16.7**	**29.9**	**12.5**	**15.2**	**27.4**
Direct taxes	2,051	3,272	4,531	3.4	3.9	4.3	17.7	43.5	38.5	6.5	16.1	17.6
Indirect taxes	3,130	3,897	4,780	5.3	4.6	4.5	11.6	0.9	22.7	7.3	0.6	12.3
Sales tax	2,035	2,592	3,099	3.4	3.1	2.9	12.3	2.4	19.5	5.0	1.0	7.1
Federal excise duty	290	370	577	0.5	0.4	0.5	12.5	15.2	56.2	0.7	0.8	2.9
Customs	804	935	1,104	1.4	1.1	1.0	10.2	-7.4	18.1	1.6	-1.2	2.4
Provincial	**517**	**650**	**774**	**0.9**	**0.8**	**0.7**	**10.5**	**6.1**	**19.2**	**1.0**	**0.6**	**1.6**
Sales tax on services	300	417	505	0.5	0.5	0.5	14.0	17.2	21.0	7.8	10.0	13.5
b) Non-tax revenue	**1,451**	**1,815**	**3,184**	**2.5**	**2.2**	**3.0**	**30.8**	**41.8**	**75.4**	**3.2**	**6.7**	**14.2**
Federal	**1,325**	**1,649**	**2,961**	**2.3**	**2.0**	**2.8**	**35.3**	**43.1**	**79.6**	**30.7**	**38.8**	**72.3**
SBP profit	489	371	972	0.9	0.4	0.9	1,439.7	-21.6	161.9	19.0	-8.9	36.4
PDL	326	580	1,019	0.5	0.7	1.0	77.4	354.7	75.8	9.0	39.3	26.6
Mark-up receipts	90	145	355	0.1	0.2	0.3	37.5	64.8	145.4	2.0	4.9	12.8
Provincial	**127**	**166**	**223**	**0.2**	**0.2**	**0.2**	**7.8**	**29.3**	**34.5**	**0.1**	**2.9**	**3.2**
Net hydel profit	26	5.5	24	0.05	0.01	0.02	-14.5	-76.4	334.0	-5.9	-13.9	11.1
Memorandum Items												
Nominal GDP	59,542	83,875	106,045	-	-	-	-	-	-	-	-	-

Note: 1) Tax revenue numbers reported by FBR and Ministry of Finance may not tally
* 'contribution to growth' measures contributions of the components in percentage points to growth of the immediate aggregate
Sources: Ministry of Finance; SBP staff calculations

[5] Federal government had set the PSDP target of Rs 950 billion in the FY24 budget, with the aim "to accelerate growth and generate employment", but fell short of the target by almost 33 percent. Similarly, overall provincial development spending was shy of the target by 10 percent, with Punjab—the province with the largest development portfolio— witnessing a decline in spending by about 6 percent. Source: Budget in Brief FY24, Ministry of Finance

[6] Provincial development spending on health and education stood unchanged at 0.2 percent of GDP, while current spending decreased from 1.4 percent in FY23 to 1.3 percent in FY24. To put in perspective, mark-up payments were 7.7 percent of GDP in FY24, up from 6.8 percent in the previous year.

i. Tax Revenue

Total tax collection grew by 29 percent in FY24, compared to 15.7 percent in the previous year. In terms of GDP, it inched up slightly from 9.3 percent in FY23 to 9.5 percent in FY24. The tax-to-GDP ratio remained low both in comparison to the recent peak of 12.6 percent achieved in FY16, as well as the average of 13.5 percent in peer countries.[7] In this regard, **Box 4.1** lays down key tax reforms to enhance tax revenue in Pakistan.

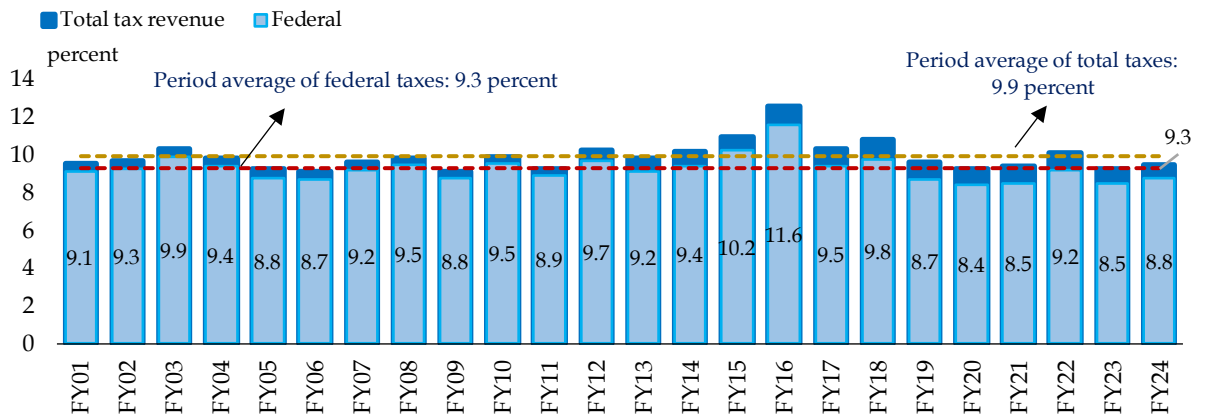
Box 4.1: Tax Reforms in Pakistan

Pakistan's tax-to-GDP ratio has stagnated close to 10 percent in the last two and a half decades (**Figure 4.1.1**). This is significantly lower than the country's capacity, which is estimated at 22.3 percent of GDP.[8] The tax-to-GDP ratio in Pakistan is also one of the lowest compared to the emerging and developing economies, as well as the regional peers. Given federal tax collections constitute about 90 percent of the total tax revenue, this box provides recommendations for federal tax reforms, drawing from the best international practices, with the goal of raising Pakistan's tax-to-GDP ratio.[9]

1) Proper implementation of the value added tax (VAT): VAT, one of the most widely implemented consumption-based taxes around the world, is not fully embedded in the tax system of Pakistan.[10] The environment of skepticism between the taxpayers and the tax authorities weighs on proper functioning of refund and input tax credit process, which is pivotal to VAT's success. Moreover, the VAT tax base is narrow, necessitating rate increases every now and then, as well as delays in refunds by the tax authorities, to maintain or achieve higher revenue.[11] To optimize VAT, Pakistan should focus on streamlining the refund process through digital solutions that minimize human intervention and establish a broad-based, low, and uniform VAT on goods and services across all jurisdictions. This approach would strengthen VAT's role as a vital indirect tax.

2) Rationalization of the corporate income tax (CIT): At 29 percent, Pakistan is among the countries with high standard corporate income tax rates in the world (**Figure 4.1.2**), with certain sectors such as the banking sector subject

Breakup of Pakistan's Total Tax Revenue as Percent of GDP **Figure 4.1.1**



Source: Ministry of Finance

[7] The average refers to 33 select peer countries, including Vietnam, Thailand, Egypt, Myanmar, Central Asian Republics (CARs), South Africa, Iran, among others. It is based on the latest available data for these countries, spanning from 2018 to 2021. Data source: IMF WoRLD Database (2024)

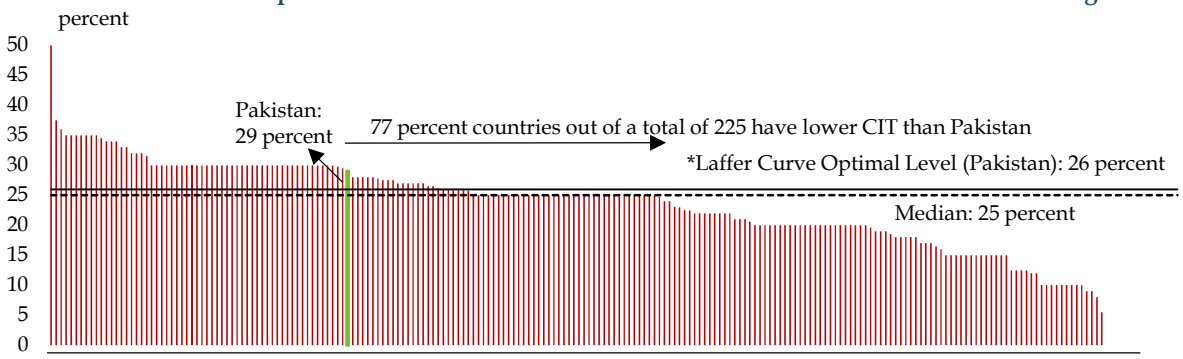
[8] a) Fenochietto, M. R., & Pessino, M. C. (2013). Understanding countries' tax effort (No. 13-244). International Monetary Fund; b) World Bank (2023). *Strengthening Government Revenues. Towards an Equitable, Efficient, and Sustainable Tax System*. Policy note 6. Reforms for a Brighter Future. World Bank Group: Washington DC

[9] These suggestions are based on the SBP Staff Note, *Federal Tax Reforms in Pakistan: Lessons from the Best International Experience* (forthcoming).

[10] In Pakistan, general sales tax and VAT are used interchangeably.

[11] See Box 4.2 for details on efficiency of VAT as a tax instrument.

Pakistan's Standard Corporate Tax Rate **Figure 4.1.2**



Note: Around 15 countries have no corporate income tax in the list of 225 countries
*Mehmood et al. (2022). *Does Laffer Curve Exist in Tax Structure of Pakistan? A Threshold Regression Analysis*. Journal of Economic Impact, Science Impact Publishers
Data source: Tax Foundation

to even higher rate. When additional taxes, such as super tax, are taken into account, the effective CIT rate turns out to be much higher. Such kind of taxation distorts economic incentive structure, as well as fosters opportunities for tax fraud, tax evasion, and misreporting. In Pakistan, there are different effective rates for businesses that have led to the resource misallocation and the slowing down of economic growth (Alm and Khan 2015).[12] Moreover, based on his review of 79 empirical studies, Jacob (2021) found that higher corporate tax rates adversely affect corporate investment, foreign direct investment, innovation, and aggregate growth.[13] In this background, improving CIT efficiency and lowering the standard and effective corporate rates could stimulate economic growth, increase revenue collection, and curb tax-related corrupt practices.

3) Rationalizing tax expenditure: Tax expenditure is the tax forgone due to exemptions, concessional rates, tax credits, and tax holidays. Pakistan's tax expenditure, estimated at 4.6 percent of GDP for FY23, is high compared to the average of 3.2 percent in low-middle income countries.[14] As international experiences suggest, preferential treatment does not usually yield intended results. Therefore, all tax expenditures, except those on account of exporters, need to be rationalized and gradually eliminated after carrying out cost-benefit analysis. Moreover, concessions and exemptions granted via statutory regulatory orders instill ad-hocism into tax policy, making it unreliable and unpredictable, with serious consequences for economic incentives. This ad-hocism is often influenced by powerful business lobbies, leaving SMEs and small taxpayers at disadvantage.

4) Simplification of the entire tax system: The tax system is complex and fragmented in Pakistan. Complex tax laws tend to lead to multiple interpretations of tax statutes, giving way to appeals and litigation by taxpayers, as well as rent-seeking opportunities for tax administrators. Fragmented tax bases, such as VAT on goods versus services and tax on agricultural versus non-agricultural incomes, raise compliance and administrative costs, hindering revenue mobilization. Such a system also causes inter-jurisdictional frictions, as well as non-uniform taxation. A promising step towards simplification includes the recent implementation of Single Sales Tax Portal/Return system for the telecommunication sector by the FBR in collaboration with World Bank. This has reduced the number of returns filed by the sector; however, the sales tax rates still vary across jurisdictions. A broader effort to simplify tax laws and harmonize tax rates across sectors and regions is critical for lowering costs and developing a more efficient revenue system.

5) Efficient use of federal excise taxes (FED): As per the international experience, FED can serve as a complementary tool to aid revenue mobilization, especially as other types of long-term reforms develop and mature

[12] Alm, J. & Khan, M.A. (2015). Assessing and Reforming Enterprise Taxation in Pakistan. Working Papers 1513. Department of Economics. Tulane University. Louisiana
[13] Jacob, M. (2021). *Real Effects of Corporate Taxation: A Review*. SSRN Electronic Journal
[14] Sources: Federal Board of Revenue; Global Tax Expenditures Database (GTED) Flagship Report 2023

to fruition. However, Pakistan's FED collection as percent of GDP is low and falling. To increase FED collection, the country should remove distortions caused by varied tax rates and implementation challenges.

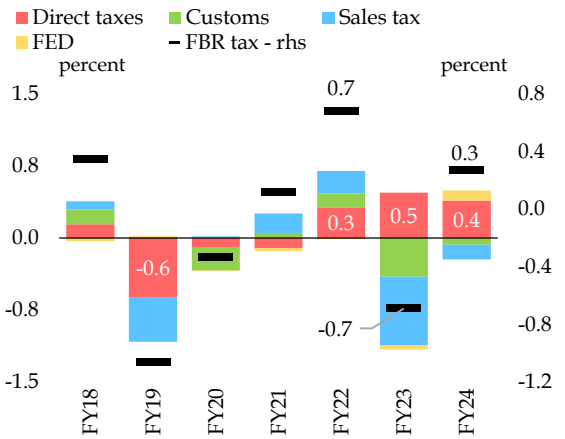
6) Improving tax administration: Use of information and communications technology (ICT) can play a key role in improving enforcement and compliance. There is a need to boost FBR's spending on ICT as percent of total operational expenditure that is currently low. Digital solutions applied so far, like Track and Trace System and FASTER Plus, are facing operational headwinds. There are issues of integration among these solutions as well, not to mention lack of data governance policies. Further, initiatives like Single Sales Tax portal, SWAPS, Track and Trace System, need to be applied comprehensively across all sectors of the economy. The cost of adoption of digital gadgets, like point of sale (POS) machines, also needs to be rationalized such that the users are not burdened. These interventions can help formalize economy, as well as expand revenue.

Additionally, risk-based audits, introduced only recently in 2019, are yet to apply across-the-board at all functional levels of the tax apparatus. Currently, regional offices are still carrying out manual interventions that may be phased out gradually over time. Furthermore, effectiveness of audits is undermined by poor recovery rates, requiring stronger enforcement strategies. Finally, across-the-board ownership of all these reforms is imperative for their success.

Federal taxes

Growth in federal taxes accelerated to 29.9 percent in FY24 compared to 16.7 percent in the previous year. In terms of GDP, federal taxes rose to 8.8 percent in FY24 from 8.5 percent in FY23. Consistent with the previous year's trend, direct taxes led the increase in federal taxes, more than offsetting the slight decline in indirect taxes in terms of GDP (**Figure 4.3**). Within the direct taxes, withholding taxes and voluntary payments made major contributions, while collection on demand declined. In case of indirect taxes, FED increased, while sales tax and customs, in continuation of the previous year, decreased further in FY24.

Breakup of Change in FBR Tax-to-GDP Ratio **Figure 4.3**

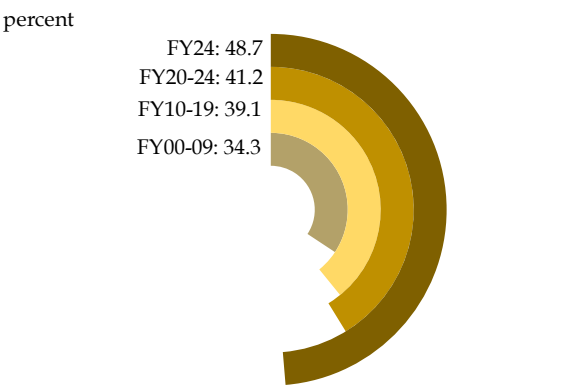


Source: Ministry of Finance

In nominal terms, despite a slight deceleration, growth in direct taxes stayed robust at 38.5 percent in FY24, pushing their share in total federal taxes to the highest level (**Figure 4.4**). WHT dominated the mix with about 60 percent share (**Figure 4.5**). Share of voluntary payments in direct taxes edged up in FY24, mainly supported by income tax paid by banks that has increased considerably in recent years (**Figure 4.6**). Meanwhile, growth in indirect taxes accelerated to 22.7 percent, compared to 0.9 percent in the previous year.

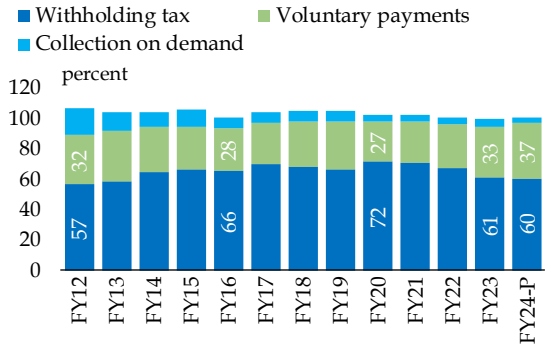
The economic factors – elevated interest rates and inflation, and the PKR depreciation – played a major role in accelerated growth of tax

Share of Direct Taxes in Total Federal Taxes **Figure 4.4**



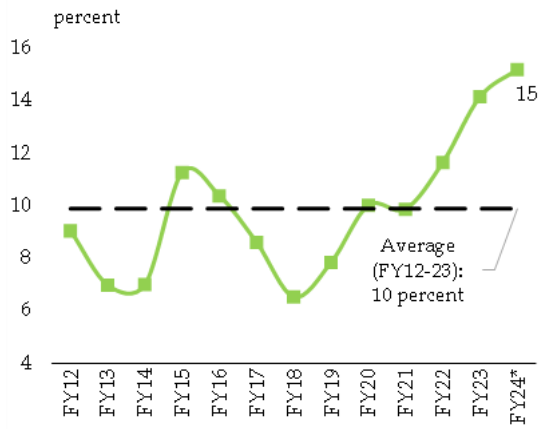
Source: Federal Bureau of Revenue

Share of Major Components of Direct Taxes **Figure 4.5**



Note: These shares may add to more than 100 percent as these are calculated in relation to direct taxes net of refunds and other direct taxes.
Source: Ministry of Finance

Share of Banks' Income Tax in Direct Taxes **Figure 4.6**



Sources: Federal Board of Revenue; State Bank of Pakistan

revenue. At the same time, revenue mobilization measures taken by the government amplified the impact of economic factors.[15]

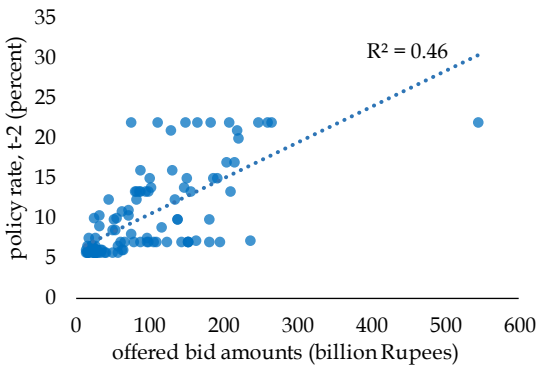
a) Economic factors

High interest rates contributed considerably to the increase in FBR taxes during FY24. This is reflected in income tax paid by banks, and withholding taxes collected on individuals' earning from bank deposits and investment in government securities. During FY24, the banks earned record profits amid increased government borrowing at higher interest rates, translating into sizeable tax payments.[16]

In case of withholding taxes, increase in collection under the head of 'bank interest and securities' could be traced to higher profits earned by individuals from their profit-bearing accounts with the banks, as well as their investment in government securities. These profits could be attributed to both attractive returns (price effect), and increased tendency to save and invest in risk-free government securities among individuals (volume effect), as a hedge against inflation.[17] The historical data shows that individuals tend to invest in government securities during high interest rate environment (**Figure 4.7**).[18]

Elevated inflation, albeit decelerating, continued to contribute to tax collection, especially to

Non-Competitive Bids and Interest Rate **Figure 4.7**



Note: The scatter plot refers to data spanning from July 2015 to June 2024
Source: State Bank of Pakistan

[15] It needs to be highlighted that all these factors, separately or in combination, led to growth in almost all types of direct and indirect taxes.
[16] Banks' net investment increased by 41.4 percent in CY23, compared to 26.4 percent increase in CY22, with investments in government securities constituting the bulk. Their net interest income as percent of gross income rose from 79.8 percent in CY22 to the new high of 82.9 percent in CY23. Source: Financial Soundness Indicators, State Bank of Pakistan
[17] Growing public awareness of the risk-free investment avenues also likely enabled higher investment in government securities.
[18] Remunerative customer deposits (fixed, savings, and remunerative current) with banks rose by 21.6 percent (the highest growth during last 15 years) to Rs 16.4 trillion in CY23, compared to an increase of 8.4 percent in CY22. Source: Financial Soundness Indicators, State Bank of Pakistan

indirect taxes, in FY24. For instance, around half of the 26.8 percent increase in domestic sales tax collection was due to substantial increase in electricity prices.[19] Similarly, increase in prices of sugar, cement, cigarettes, and other commodities also supported higher sales tax and FED collection. Additionally, better prices also lifted profitability of non-financial firms—in some cases through improved net profit margins.[20] Rise in corporate profits also meant higher dividend payments for the shareholders, which led to increase in WHT collection.[21]

Lastly, the PKR depreciation during FY24, and increase in import volumes helped offset the impact of lower unit values on import-related taxes.[22] Imports, which fell by 0.8 percent in dollar terms, rose by 14.9 percent in PKR terms.[23] As a result, taxes collected at import stage increased by 20.2 percent, compared to a decline in the previous year.[24]

b) Tax measures

Implementation of revenue mobilization measures by the government, including increase in rates and rationalization of some tax expenditures, also enabled higher tax collection in FY24. In case of direct taxes, one of the changes was broadening the scope of the super tax on persons earning over Rs 150 million annually, by applying it across-the-board, in an attempt to ensure horizontal equity.[25,26] Super tax cap was also increased from four to ten percent for FY23 and onwards.[27] This, along with the regular income tax regime and large corporate profits, greatly helped the direct tax collection. Another change was revision in income tax slabs for salaried and non-salaried individuals and association of persons (AOPs) to ensure progressivity. In case of non-salaried individuals and AOPs, minimum threshold was also raised from Rs 0.4 million to Rs 0.6 million, bringing it at par with the threshold of salaried individuals to remove distortions.

Furthermore, various rate increases provided boost to WHT collection. Some of these included: increase in the WHT on commercial importers of goods from 5.5 to 6.0 percent; two to three percent increase on the sale and purchase of immovable property, respectively[28]; one to two percent increase in tax on sale contracts of goods and services for individuals, AOPs, and companies; resumption of 0.6 percent tax on cash withdrawal on the amount exceeding Rs 50,000 per day by a non-filer. The government also took measures related to indirect taxes, particularly sales tax and FED. The standard sales tax rate on goods was increased from 17 percent to 18 percent in February 2023, and from 18 percent to 25 percent on locally manufactured cars and import of over 800 tariff lines covering non-

[19] Electricity tariffs were revised up through annual rebasing, quarterly tariff adjustments, and fuel charge adjustments (see Chapter 3 for details).
[20] It reflected in a 38 percent jump in profit-after-tax earned by the top 58 KSE-100 companies in CY2023. Data source: KSE 100 Index Profitability CY23. February 2024. Arif Habib Limited: Karachi
[21] Withholding tax collection from dividends increased by 65.5 percent to Rs 87.1 billion in FY24.
[22] Quantum index of imports rose by 25.0 percent during FY24, compared to a decline of 17.9 percent in the same period of the previous year. Source: Pakistan Bureau of Statistics
[23] Source: Pakistan Bureau of Statistics
[24] These taxes include custom duties, advance income tax, sales tax on goods, and FED.
[25] Earlier this tax applied to 16 kinds of businesses only.
[26] Super tax ranging from two to four percent was imposed on incomes of high-earning persons via section 4B in FY16 with the goal to provide for rehabilitation of temporarily displaced persons. Later, in FY23, section 4B was replaced by new section 4C, "Super tax on high earning persons". For more details on the graduated new tax rates introduced under section 4C, see Chapter 4, The State of Pakistan's Economy Annual Report FY23
[27] Earlier, under the Finance Act 2022, the 10 percent super tax was applied only on non-banking and banking firms with over Rs 300 million annual income for fiscal years 2022 and 2023, respectively. For non-banking firms, the rate was capped at 4 percent for FY23. However, under the Finance Act 2023, graduated rates from one percent to 10 percent were applied across-the-board.
[28] WHT is 200 percent and 350 percent more for non-ATL sellers and buyers of property, respectively.

Tax Expenditure Relative to Actual FBR Tax Collection **Table 4.3**

values in billion Rupees

	Tax Expenditure				Actual Collection					
	Values		Percent of GDP		Values			Percent of GDP		
	FY22	FY23	FY22	FY23	FY22	FY23	FY24 (P)	FY22	FY23	FY24 (P)
Direct taxes	424	477	0.6	0.6	2,285	3,271	4,531	3.4	3.9	4.3
Sales tax*	1,294	2,859	1.9	3.4	2,532	2,591	3,099	3.8	3.1	2.9
Customs	522	544	0.8	0.7	1,011	932	1,104	1.5	1.1	1.0
Grant total	**2,240**	**3,879**	**3.4**	**4.6**	**6,148**	**7,164**	**9,311**	**9.2**	**8.5**	**8.8**

*Excludes computation of tax expenditure on account of services

Source: FBR Tax Expenditure Report 2024 (latest available)

essential items in March 2023.[29,30] The government also rationalized the tax expenditure by increasing concessional GST for tier-1 retailers of different types of goods from 12 percent to 15 percent, and by imposing 5 percent GST on DAP fertilizer, which was exempt earlier.[31] In case of FED, the duty on sugary fruit juices was doubled to 20 percent, while new duty at 5 percent was imposed on fertilizer.

Nevertheless, it is worth highlighting that the overall tax expenditure was 4.6 percent of GDP based on FY23 data, up from 3.4 percent in FY22 (**Table 4.3**). It was also higher than the average of peer countries.[32] Moreover, it is likely that it remained high during FY24 as well.[33] Higher tax expenditure impacts efficiency of tax instruments. In particular, this could be seen in a decline in the efficiency of GST on goods and services in FY24, reflected by the worsening of the C-efficiency ratio (CER) and much lower effective GST rate in the country (**Box 4.2**).

Box 4.2: C-efficiency Ratio (CER) and Effective GST Rate in Pakistan in FY24

C-efficiency (CER) is the ratio of actual sales tax revenues to the product of the standard GST rate and final consumption. A low ratio generally indicates base erosion either by exemptions and concessional rates or by inadequate enforcement. Conversely, a ratio of 100 percent means perfectly enforced VAT at a uniform rate across a broad base, with no concessions or exemptions. CER is mostly below 100 percent, as every country has indeed some kinds of concessions or exemptions available in its tax structure; for instance, exclusion of basic foodstuffs from GST goods basket to protect the poor households. Furthermore, there are enforcement snags, as well, that keep the CER low 100 percent. At around 90 percent, New Zealand has one of the highest CERs in the world. Its exempted items include only donated goods-services, financial services, penalty interest, and supply of fine metals.

In case of Pakistan, CER works out at 20.7 percent in FY24, down from 22.6 percent in FY23, showing further worsening of its GST yield (**Figure 4.2.1a**). As a result of low CER, its effective GST rate was just one-fifths of the actual weighted GST rate on goods and services in FY24 (**Figure 4.2.1b**). Alternatively, low CER and effective rate also meant application of GST on goods and services on a squeezing tax base, as well as gaps in enforcement and compliance. Although government had taken some corrective measures to broaden the base in the Finance Act 2023, these have yet to deliver desired results.

[29] These items included completely built units (CBUs) of cars and appliances; confectionery; articles of jewelry; juices and aerated water, among others.

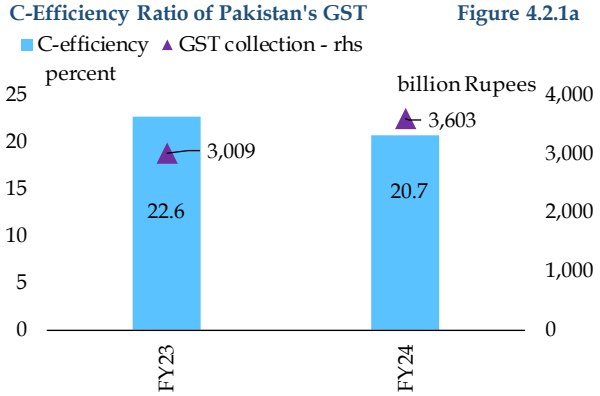
[30] Sales tax on motor vehicles collected domestically and at import stage rose by 161 percent to Rs 13.4 billion and 45 percent to Rs 110.9 billion in FY24, notwithstanding a decline in auto sales.

[31] Goods receiving concessional rate included finished fabrics, locally manufactured finished articles of textile, textile made-ups, leather and artificial leather, among others.

[32] Tax expenditure in low middle-income and upper middle-income countries (27 countries each) is 3.2 percent and 3.7 percent of GDP, respectively. Source: Global Tax Expenditures Database (GTED) Flagship Report 2023; gted.taxexpenditures.org/wp-content/uploads/2023/10/von-Haldenwang-et-al-2023-_-TEs-in-an-era-of-transformative-change.pdf

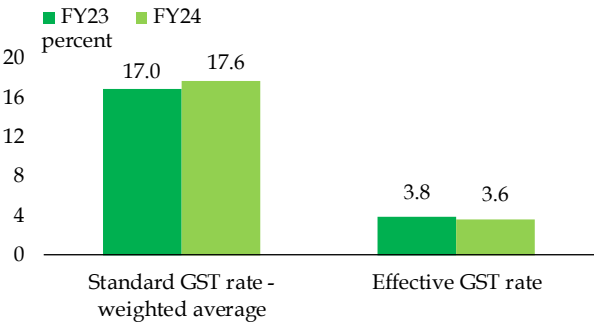
[33] Some budgetary measures taken in FY24, like imposing GST on fertilizers—albeit at a concessional rate, might have lowered the sales tax expenditure (FBR's tax expenditure report for FY24 not available yet); however, the impact might be limited, given many other concessions and exemptions were still in place in FY24—the major one being exemption of POL products.

C-Efficiency Ratio of Pakistan's GST **Figure 4.2.1a**



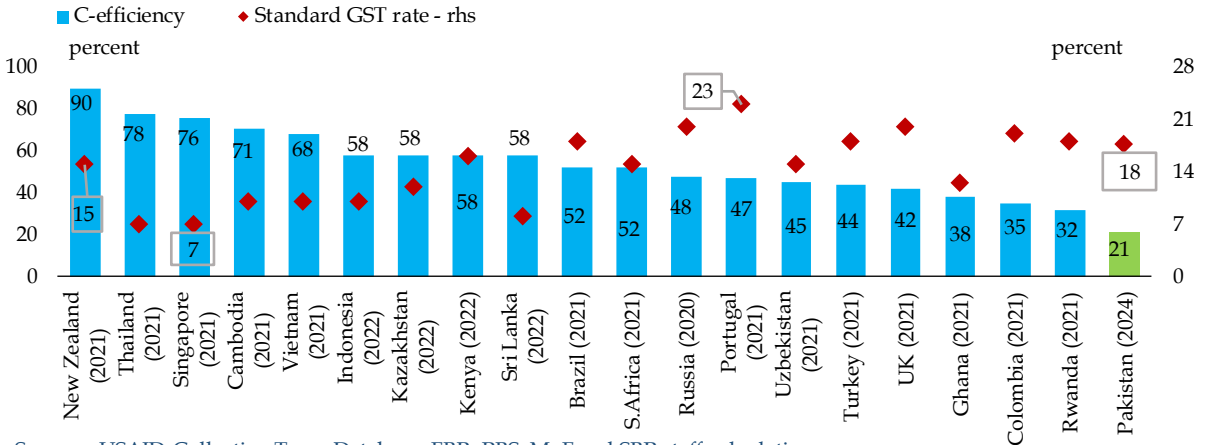
Note: 1) CER is calculated for GST on both goods & services. 2) GDP data used here is based on FY16 base
Sources: FBR, PBS, MoF and SBP staff calculations

Standard and Effective GST Rates in Pakistan **Figure 4.2.1b**



Note: 1) Standard GST is weighted average of GST on both goods & services across all tax jurisdictions. 2) Effective GST rate is calculated by assuming CER=1
Sources: FBR, MoF and SBP staff calculations

Cross-country Comparison of C-efficiency Ratios and Standard GST Rates **Figure 4.2.2**



Sources: USAID Collecting Taxes Database, FBR, PBS, MoF and SBP staff calculations

In the Finance Act 2024, the government took more measures to rationalize sales tax expenditure in order to broaden the tax base, which is an encouraging development.[34] However, elevated standard GST rates on goods and services are still a source of concern from the perspectives of tax burden and compliance, alongside issues related to enforcement. International best practices suggest that properly enforcing a broad-based, uniform and low sales tax may support higher yields. In this connection, cross-sectional comparison depicts an inverse relationship between CER and GST rates (**Figure 4.2.2**).[35,36]

Sensitivity analysis of the impact of CERs on the collections in Pakistan suggests that if the C-efficiency ratio improves through broadening of tax base and better enforcement, the revenue collection may increase (**Table 4.2.1**).

[34] Some of these include: withdrawal of zero rating and exemptions on stationary items, tractors, oil cake and other solid residue, local supply of farm feed, and others; such items are now taxed at the reduced rate of 10 percent. Additionally, exemption on edible fruits and vegetables imports from Afghanistan has been removed, as these are now subject to the standard 18 percent rate. Similarly, milk has been brought under the standard GST regime. Moreover, impact of these measures on CER, effective GST rate, and GST collections will be evaluated by the end of FY25.

[35] However, this may not be considered as a rule in all cases.

[36] Higher CER means broader tax base and better enforcement/compliance. There is a whole body of literature that supports the notion of a broader-base, low-tax rate system. For instance: 1) OECD (2010), *Choosing a Broad Base – Low Rate Approach to Taxation*, OECD Tax Policy Studies, No. 19, Paris: OECD Publishing; 2) Huzaima Bukhari & Dr. Ikramul Haq (2016), *Towards Flat, Low-rate, Broad and Predictable Taxes*, Islamabad: PRIME Institute

In this case, even if the GST rate on goods and services is homogenized and lowered to say 13 percent or 15 percent, Pakistan would see collection rise at least 1.5 times the current level to Rs 5.4 trillion. In a scenario where CER and GST rates are brought at par with the respective medians of the select group of countries (52 percent and 15 percent respectively), Pakistan would see collection increase 2.1 times to Rs 7.7 trillion. This analysis highlights that improved tax efficiency may not only lead to substantial revenue gains, but also allow the government to decrease the standard GST rates without compromising its higher revenue targets.

Impact on Revenue Collection by Changing CER and Standard GST Rate **Table 4.2.1**

Alternate Scenarios of GST Collection - billion Rupees				
		CER (percent)		
		21	**42**	**52**
GST rate (percent)	**17.6**	3,603 (Current scenario)	7,302	9,041
	15	3,063	6,223	7,705
	13	2,654	5,393	6,678
Impact on GST Collection – multiples of current collection				
		CER (percent)		
		21	**42**	**52**
GST rate (percent)	**17.6**	Current collection (C)	2.0 * C	2.5 * C
	15	0.8 * C	1.7 * C	2.1 * C
	13	0.7 * C	1.5 * C	1.9 * C

Note: 1) The sensitivity analysis is run on consumption of Rs 98,782 billion (FY24); 2) 52% CER & 15% GST rate are the medians in the group of select countries from Figure 4.2.2
Sources: FBR, PBS, USAID, SBP staff calculations

Provincial taxes

Provincial tax revenue-to-GDP ratio decreased to 0.7 percent in FY24, compared to 0.8 percent in the previous year (**Table 4.2**). This decrease came despite an acceleration in growth in nominal terms to 19.2 percent, almost three times the previous year. Indirect taxes led this growth on the back of sales tax on services and some other indirect taxes, like infrastructure development cess.[37]

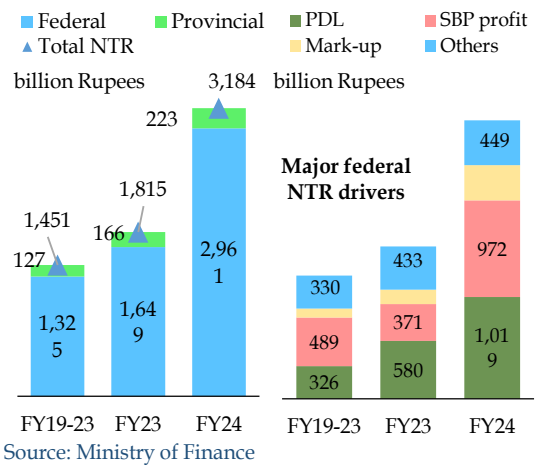
Sales tax on services received a boost from inflation, similar to the case of sales tax on goods.[38] For instance, communication services (call and internet charges) and readymade food served at hotels and restaurants saw a price hike of 7.8 percent and 23.7 percent, respectively, in FY24. However, it may be highlighted here that the sales tax on services to GDP ratio remained unchanged at 0.5 percent in FY24 for the sixth consecutive year, which primarily reflects provincial government's efforts to raise own revenue.

ii. Non-tax Revenue

Non-tax revenue (NTR) grew by 75.4 percent, reaching 3.0 percent of GDP in FY24, up from 2.2 percent the previous year (**Table 4.2**). The entire increase came from federal sources, while provincial collection remained unchanged, in terms of GDP. The increase in federal NTR could be traced to SBP's profit, PDL collection, and federal mark-up receipts on loans to provinces and PSEs during FY24 (**Figure 4.8**).

Sharp increase in SBP's profit is attributed to revaluation gains, due to exchange rate appreciation, and net interest income that grew considerably following large liquidity injections into banking sector at elevated interest rates.[39]

Breakup of Total Non-tax Revenue **Figure 4.8**



Source: Ministry of Finance

[37] Infrastructure development cess is levied on transportation of goods to maintain and repair the infrastructure needed to cater to the load of goods traffic, among other things.
[38] Services inflation was 16.5 percent in FY24. Source: PBS
[39] For details on liquidity injections, see Chapter 3 – Monetary Policy and Inflation

Breakup of Consolidated Expenditure **Table 4.4**

	Values (billion Rupees)			Percent of GDP			Growth (percent)		
	FY19-23 avg.	FY23	FY24	FY19-23 avg.	FY23	FY24	FY19-23 avg.	FY23	FY24
Total expenditure	11,608	16,401	20,649	19.5	19.6	19.5	17.3	24.4	25.9
1. Current expenditure (a+b)	10,138	14,448	18,571	17.0	17.2	17.5	20.0	25.4	28.5
(a) Federal	7,239	10,785	13,970	12.0	12.9	13.2	23.7	29.1	29.5
Mark-up payments	3,268	5,696	8,160	5.4	6.8	7.7	32.9	79.0	43.3
Domestic	2,912	5,071	7,164	4.8	6.0	6.8	33.0	79.3	41.3
Foreign	383	760	996	0.6	0.9	0.9	42.2	114.7	31.1
Defence affairs and services	1,335	1,586	1,859	2.3	1.9	1.8	9.0	12.3	17.2
Pension	498	666	808	0.8	0.8	0.8	15.2	23.0	21.2
Running of civil government	544	634	784	0.9	0.8	0.7	8.5	16.0	23.7
Subsidies	718	1,080	1,067	1.1	1.3	1.0	80.8	-29.4	-1.2
Grants to others	850	988	1,292	1.4	1.2	1.2	25.9	-13.5	30.8
(b) Provincial	2,926	3,798	4,601	5.0	4.5	4.3	13.0	19.9	21.1
2. Development expenditure/ net lending (c+d)	1,470	1,953	2,078	2.5	2.3	2.0	5.4	17.8	6.4
(c) Total development expenditure	1,416	1,893	2,027	2.4	2.3	1.9	5.5	17.1	7.1
PSDP	1,364	1,893	2,027	2.3	2.3	1.9	7.8	17.1	7.1
Federal*	493	652	635	0.9	0.8	0.6	5.6	62.8	-2.6
Provincial	871	1,241	1,392	1.4	1.5	1.3	12.8	2.0	12.1
(b) Net lending to PSEs	53	59.9	52	0.1	0.1	0.0	17.3	48.3	-13.7
Memorandum items:									
Non-interest (total) expenditure	8,340	10,704.8	12,490	14.1	12.8	11.8	12.7	7.1	16.7
GDP	59,542	83,875.0	106,045	-	-	-	16.6	25.8	26.4

Note: Tax revenue numbers reported by FBR and Ministry of Finance may not tally exactly

Sources: Ministry of Finance; SBP staff calculations

High interest rates also increased federal mark-up receipts on loans to provinces and PSEs. Meanwhile, the PDL collection maintained the last year's momentum, following revision of the levy to Rs 60 per liter on petrol and diesel in H1-FY24.[40] The impact of increase in prices was large enough to compensate for the drag from lower POL sale volumes during FY24.[41]

In contrast to the federal NTR, provincial NTR stood almost unchanged at 0.2 percent of GDP, although it grew notably by 34.5 percent in FY24. This growth is attributed to higher extraordinary receipts and net hydel profits (NHP) collected by the provinces.[42]

4.3 Expenditure

Total expenditure declined slightly to 19.5 percent of GDP in FY24, from 19.6 percent in the previous year (**Table 4.4**). This was mainly due to non-interest expenditure, while mark-up payments increased considerably on account of both higher interest rates, as well as debt stock. All the components of non-interest expenditure either declined or remained stagnant in terms of GDP.

[40] PDL on petrol was raised from Rs 50 to Rs 55 per litre on July 01, 2023, and Rs 60 on September 01, 2023. Likewise, PDL on diesel was hiked to Rs 55 on October 16, 2023, and Rs 60 on November 01, 2023. The latest round of PDL revisions had begun at the start of FY23. Sources: Oil and Gas Regulatory Authority (OGRA); Pakistan State Oil (PSO)

[41] POL sales declined in 8 out of 12 months in FY24, with the annual sales falling by 3.5 percent compared to the previous year.

[42] Extraordinary receipts include payments by the United Nations in lieu of services rendered by the Pakistani troops contributing in various peacekeeping operations around the world.

Non-interest expenditure

The non-interest expenditure, despite acceleration in growth to 16.7 percent in FY24 from 7.1 percent in the previous year, declined in terms of GDP by one percent (**Table 4.4**). This decline is traced to decrease in subsidies, development spending, defence affairs, and provincial current spending, while spending on grants, pensions, and running of civil government remained unchanged in terms of GDP.

Total disbursement of subsidies declined slightly by 1.2 percent to Rs 1.1 trillion in FY24, with a fall in non-power subsidies offsetting the marginal growth in power subsidies. At 1.0 percent of GDP in FY24, subsidies have declined sizably from the peak of 2.3 percent in FY22, followed by 1.3 percent in FY23. While still higher than the average of 0.5 percent during FY17-FY21, slight decrease in FY24 for the second year in a row is encouraging.

Non-power subsidies, about 16 percent of total subsidies, decreased from Rs 210 billion in FY23 to Rs 174 billion in FY24, mainly due to lower petroleum subsidies. Unlike last year, there was no disbursement on account of exchange losses on FE-25 loans of PSO that helped reign in petroleum subsides. It was probably the outcome of reduced exchange rate volatility during FY24 compared to FY23.[43] Moreover, the government had restricted gas subsidy to the industrial sector, in view of its revised policy on energy subsidies to the sector.[44]

In contrast to non-power subsidies, power subsidies rose by 2.6 percent from Rs 870 billion in FY23 to Rs 893 billion in FY24 (**Table 4.5**). The share of power subsidies in total subsidies increased further, continuing to pose challenges amidst scarce resources. The breakup of power subsidies indicates increase in disbursements to the Independent Power Producers (IPPs) as the major factor. These disbursements, in line with the budget target, were part of the Circular Debt Management Plan (CDMP) FY24, which requires government to earmark subsidies for power producers every year, as well as increase power tariff regularly, to stem circular debt accumulation.

Furthermore, the government disbursed subsidies of Rs 562 billion to power distribution companies. In particular, K-Electric received Rs 298 billion in view of uniform tariff adjustment, which was 11.7 percent higher than the

Breakup of Subsidies **Table 4.5**

estimates, values, & change in billion Rupees

	Budget estimates		Actual values		Change
	FY23	FY24	FY23	FY24	FY24
Total	**664**	**1,064**	**1,080**	**1,067**	**-13**
Power subsidies	**535**	**894**	**870**	**893**	**23**
IPPs	180	262	93	262	169
K-Electric (TDS)	60	171	267	298	31
AJK (TDS)	-	-	-	105	105
Inter-disco TDS	225	150	213	149	-64
KE for ISP	20	7.0	5.0	-	-5.0
Zero-rated industries	20	-	79	-	-79
PERF	-	48	53	30	-23
Tube-wells	7.0	10	9.0	10	1.0
Non-power subsidies	**129**	**170**	**210**	**174**	**-36**
Petroleum	**71**	**51**	**128**	**51**	**-77**
Exchange Losses (PSO)	-	-	35	-	-35
RLNG to industry	-	-	31	1.0	-30
LNG to industry	40	-	6.5	-	-6.5
Credit Facility (KPC)	-	-	27	-	-27
Others	**58**	**120**	**82**	**124**	**41**
Fertilizer plants	15	25	15	25	10
NPHFS	1.0	12	8.0	23	15
USC	17	35	33	35	1.8

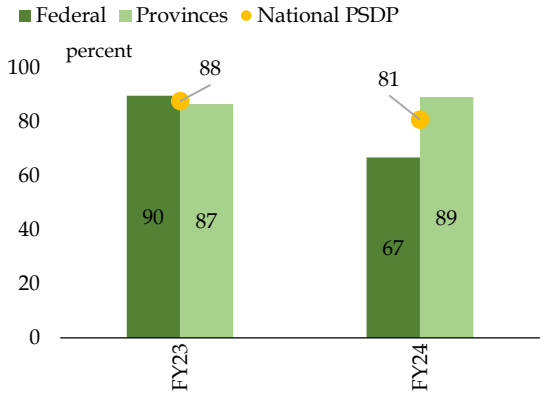
Note: 1) TDS: tariff differential subsidy; ISP: industrial support package; PERF: Pakistan Energy Revolving Fund; PSO: Pakistan State Oil; KPC: Kuwait Petroleum Corporation; NPHFS: Naya Pakistan Housing Finance Scheme; USC: Utility Stores Corporation

Source: Ministry of Finance

[43] In contrast to FY23, PKR appreciated between September 7, 2023 and June 30, 2024. Source: State Bank of Pakistan

[44] Subsidy on LNG supply to industry was almost nil in FY24 against Rs 6.5 billion in the previous year. While subsidy on RLNG to industry was negligible at Rs 730 million in FY24, against Rs 31.1 billion in the previous year.

Actual PSDP Spending as Percent of Budget Estimates **Figure 4.9**



Source: Ministry of Finance

previous year.[45] In addition, the government also issued unbudgeted subsidies – about 14 percent of the budgeted subsidies.[46] Among these, the largest was tariff differential subsidy of Rs 105 billion to Azad Jammu Kashmir (AJK). On the other hand, in an effort to rationalize subsidies, the government ended power subsidy to zero-rated (export-oriented) industries, which had received around Rs 80 billion in FY23 – four times the budgeted amount of the year.[47]

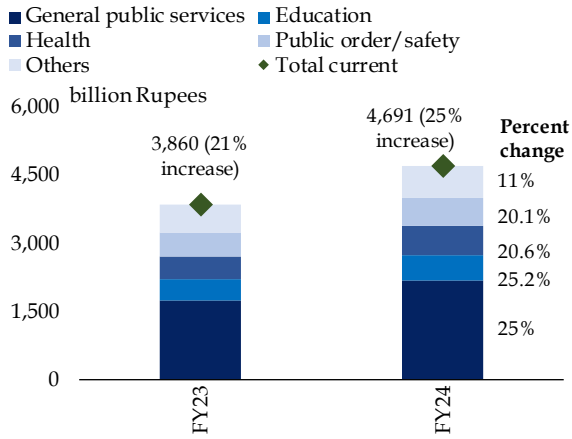
In case of development spending, national PSDP, federal plus provincial, fell short of the target by a larger margin than the previous year (**Figure 4.9**). Decline in federal PSDP, compared to a strong growth in the previous year, mainly explains this phenomenon. In terms of budget utilization, the federal government spent only 72.8 percent of the annual allocation during Jul-May FY24, compared to 98.5 percent same period last year.[48,49]

This could be attributed to limited fiscal space, squeezed by rising interest payments. Moreover, given longer than usual tenure of caretaker federal as well as provincial governments, there was a slowdown in the authorization and thus disbursement of funds for development projects.[50] This reflected in the government prioritizing the ongoing national projects nearing completion rather than the new ones, particularly infrastructure projects in the energy, transport and communication, water resources, and physical planning and housing.[51]

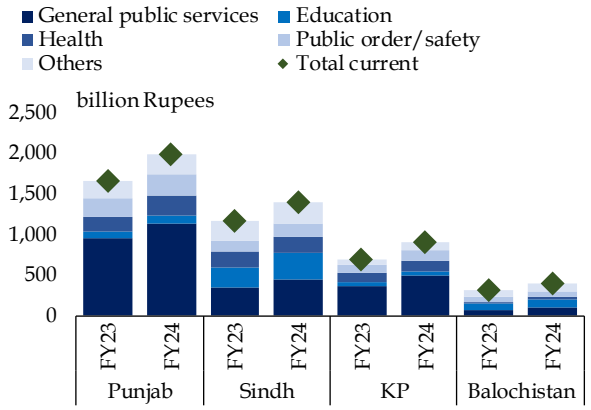
In line with the trend in federal PSDP, provincial PSDP also recorded a decline in terms of GDP, despite growing by 12.1 percent compared to 2.0 percent in the previous year. Sindh led this acceleration, followed by Balochistan and Khyber Pakhtunkhwa, while Punjab witnessed a slump in development expenditure. Sindh's development expenditure, which was 49 percent higher compared to FY23, was partly in response to the 2022 floods. In particular, it spent around 74 percent and 21 percent higher on social protection projects and economic affairs, respectively. One of the social protection development projects included *Strengthening Social Protection Delivery System in Sindh*, in collaboration with the World Bank.[52]

[45] In order to ensure uniform tariff application across all Ex-WAPDA DISCOS (XWDISCOS) and K-Electric, government picks up the positive tariff differential between K-Electric tariffs based on its revenue requirements and tariffs determined for XWDISCOS by NEPRA.
[46] Unbudgeted subsidies here refer to those for which no resources were earmarked in the FY24 budget, but were subsequently disbursed through the course of the year.
[47] Although it did not result in lowering of power subsidies in FY24, it was still a positive development from the perspective of rationalizing subsidies expenditure
[48] Source: Summary of PSDP Jul-May 2024 (latest available). Ministry of Planning, Development & Special Initiatives
[49] These statistics may or may not tally with the MoF numbers on PSDP spending.
[50] In FY18, the previous election year, there was a sharp dip in the ratio of actual federal development spending to the budgeted target: 58 percent compared to 91 percent the previous year. Similarly, in FY24, this ratio declined to 67 percent compared to 90 percent in the previous year. Data source: Various Budgets in Briefs and Fiscal Operations Reports. Ministry of Finance
[51] Source: Pakistan Economic Survey 2023-24
[52] World Bank—Government of Sindh funded five-year Conditional Cash Transfers (CCT) program, covering 65 percent of the total flood-affected union councils in the province to help alleviate flood impacts, especially food insecurity, and monetary constraints for continuous utilization of maternal and children health services. For more details, visit: https://www.worldbank.org/en/news/factsheet/2022/12/19/factsheet-strengthening-social-protection-delivery-system-in-sindh

Breakup of Provincial Current Spending **Figure 4.10a**



Province-wise Currrent Spending **Figure 4.10b**



Source: Ministry of Finance

In case of provincial current spending, there was a decline in terms of GDP, despite notable growth in nominal terms. General public services led most of this growth, followed by public order and safety, health and education (**Figures 4.10a & 4.10b**).

Federal grants, another major component of non-interest expenditure, stood unchanged at 1.2 percent of GDP, despite growing by 30.8 percent in FY24, as opposed to a decline in the previous year. This growth could mainly be traced to higher disbursements on account of contingent liabilities of PSEs, Benazir Income Support Program (BISP), and reimbursement of T.T charges for remittances. Uptick in budgetary allocation in tandem with the broadening social net of the program explains higher BISP disbursements.[53] Meanwhile, grants in respect of T.T charges reimbursement, aimed at incentivizing formal remittance inflows, increased following higher remittances from Saudi Arabia (the volume effect). In the same vein, the reimbursement rate on inflows from Saudi Arabia was increased from SAR 20 to SAR 30 in September 2024 (the price effect).[54]

Mark-up Payments as Percent of Major Fiscal Variables and GDP **Table 4.6**

	FY19-23 avg.	FY22	FY23	FY24
Total expenditure	27	24	35	40
Current expenditure	31	28	39	44
PSDP	234	197	301	403
Non-interest expenditure	38	32	53	65
Total revenue	45	40	59	61
FBR tax	62	52	79	88
Net FBR tax*	155	125	193	202
GDP	5.4	4.8	6.8	7.7

* FBR tax revenue adjusted for NFC transfers to provinces
Sources: Ministry of Finance; SBP staff calculations

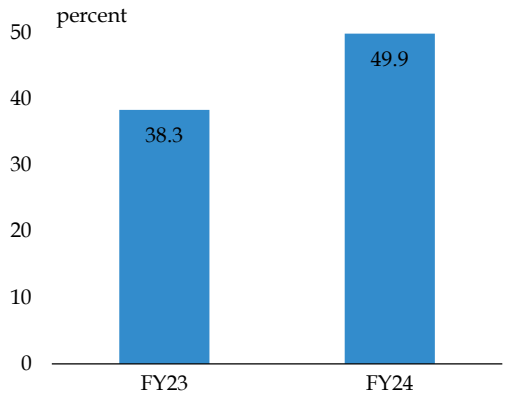
Interest Expenditure

Interest expenditure rose by 43.3 percent to Rs 8.2 trillion, from Rs 5.7 trillion in the previous year, leading to a substantial increase in terms of GDP (**Table 4.4**). As a result, the mark-up payments as percent of major fiscal variables has considerably increased during FY24 **(Table 4.6)**. For instance, interest payments rose to 202 percent of the FBR tax revenue, adjusted for National Finance Commission (NFC) transfers to provinces. Similarly, interest payments were about 50 times the provincial spending on health and education (**Figure 4.11**). These trends

[53] Number of eligible beneficiary families increased from 7.6 million in CY2022 to 9.0 million in CY2023. Quarterly stipend under Benazir Kafaalat Program saw a raise of 25 percent to Rs 8,750 per family. Similarly, the number of children receiving Benazir Taleemi Wazaif scholarships almost tripled from 2.6 million in 2022 to 7.52 million in 2023. Source: BISP Press Release dated August 02, 2024; https://bisp.gov.pk/SiteImage/Misc/files/Aug%202%2c%2024.pdf

[54] Source: EPD Circular Letter No. 14 of 2023, dated September 21, 2024 (effective 30 days later); https://www.sbp.org.pk/epd/2023/FECL14.htm

Ratio of Interest Expenditure to Cumulative Provincial Spending on Health & Education **Figure 4.11**

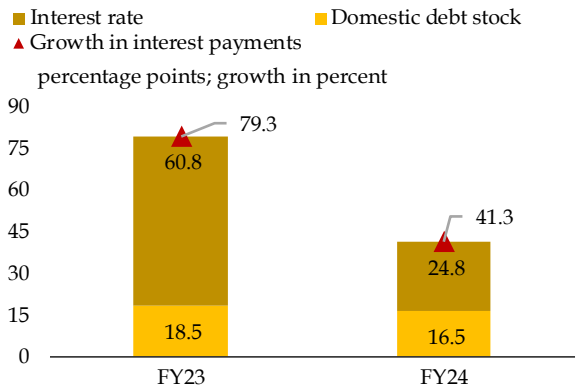


Source: Ministry of Finance

reflect accumulation in public debt due to large fiscal deficits in recent years, as well as the elevated interest rates.[55]

Although growth in interest payments decelerated in FY24, it still remained considerably high. The slight deceleration is explained, in part, by the slowdown in domestic interest payments as the policy rate remained almost unchanged during the year, albeit elevated (**Figure 4.12a**).[56] Moreover, the pace of foreign mark-up payments also decreased due to stable exchange rate, particularly in the second half of FY24 (**Figure 4.12b**)

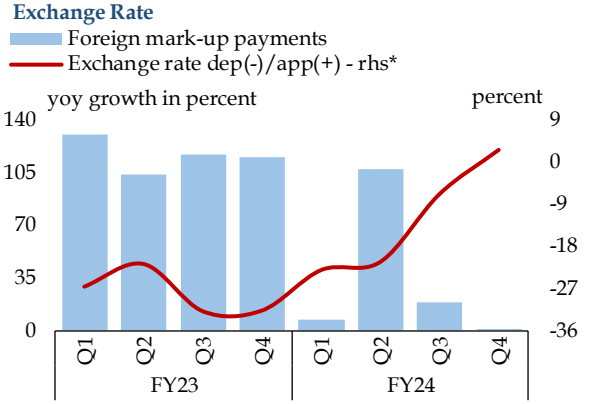
Estimated Contribution to Growth in Domestic Interest Payments **Figure 4.12a**



Note: FY21 is taken as the base year

Source: Ministry of Finance; SBP staff calculations

Foreign Mark-up Payments and Exchange Rate **Figure 4.12b**



*this change is relative to same period year ago

Source: Ministry of Finance; Pakistan Bureau of Statistics

[55] While fiscal deficit declined to 6.8 percent of GDP in FY24, it was still quite large. Moreover, in absolute terms, it saw an increase of 10.5 percent to Rs 7.2 trillion in the year under review.

[56] For details, see Chapter 5 – Domestic and External Debt

5

Domestic and External Debt

Fiscal consolidation and revaluation gains considerably slowed down the pace of debt accumulation during FY24. As a result, the public debt to GDP ratio fell to 67.4 percent in FY24 from 74.9 in FY23. While both domestic and external debt contributed to this decline, the major contribution came from external debt. The external debt recorded a contraction in absolute terms, primarily on account of revaluation gains amid exchange rate appreciation, which more than offset the accumulation in external debt in dollar terms. On the other hand, growth in domestic debt also decelerated. The domestic debt was primarily sourced from commercial banks, predominantly mobilised through long-term government securities that lengthened the debt maturity profile during FY24. Moreover, while the liquidity indicators for external debt deteriorated, the repayment capacity and solvency indicators improved.

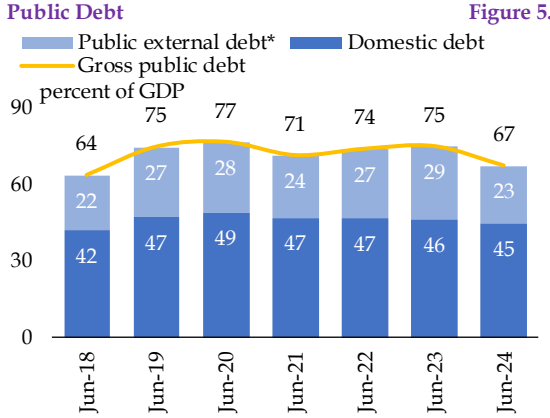
5 Domestic and External Debt

5.1 Public Debt

Pakistan's total debt and liabilities grew by 11.0 percent during FY24, slower than 29.1 percent increase in the previous year. Likewise, growth in public debt decelerated to 13.3 percent during FY24 compared to 27.7 percent in the previous year. As a result, the public debt to GDP ratio dropped to 67.4 percent at end-June FY24, the lowest since FY18 **(Figure 5.1).**[1] This decrease largely emanated from a contraction in external debt, while domestic debt also decreased in terms of GDP **(Table 5.1 & Figure 5.1)**.

The decline in external debt primarily stemmed from a favorable revaluation impact of 0.7 percent of GDP (Rs 694.3 billion) due to exchange rate appreciation, which more than offset the increase in external debt in dollar terms during FY24 **(Figure 5.2).** The decrease in domestic debt in terms of GDP, on the other hand, mainly reflects lower fiscal deficit.[2] More specifically, it was due to a primary surplus recorded in FY24 after 17 years.[3] Notwithstanding the slowdown, the share of domestic debt increased during FY24 **(Figure 5.3)**.

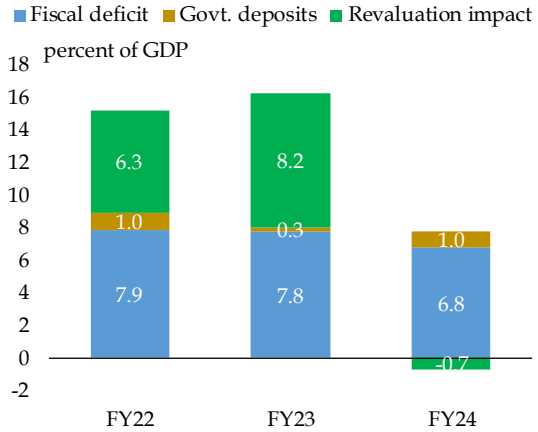
Public Debt **Figure 5.1**



*Including debt from IMF

Source: State Bank of Pakistan

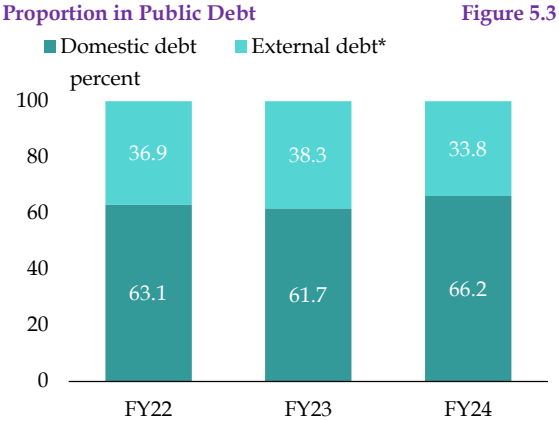
Composition of Change in Public Debt **Figure 5.2**



Source: State Bank of Pakistan

The domestic debt was almost entirely sourced from commercial banks during FY24. This may be attributed to lower-than-budgeted external financing, retirement in National Savings Schemes (NSS) and repayment of maturing Pakistan Investment Bonds (PIBs) to the SBP. Moreover, suspension of higher tax in connection with maintaining minimum advances-to-deposit ratio for FY24 encouraged banks' investment in government securities. In

Proportion in Public Debt **Figure 5.3**



*Including debt from IMF

Source: State Bank of Pakistan

[1] In addition to reduction in external debt in PKR terms, a sharp growth of 25.9 percent in nominal GDP also lowered the debt to GDP ratio.
[2] Although fiscal deficit decreased in terms of GDP during FY24, it increased in absolute terms compared to the previous year.
[3] The primary balance showed a surplus of Rs 952.9 billion during FY24, against a deficit of Rs 825.5 billion in FY23.

Summary of Pakistan's Debt and Liabilities **Table 5.1**

stock and flows in billion Rupees, growth in percent

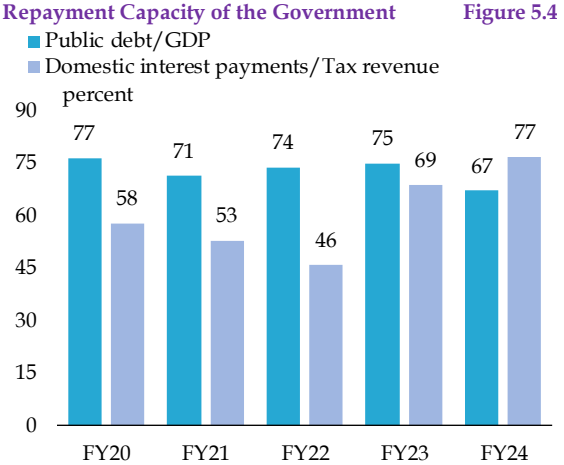
	Stock			Flows		Growth	
	FY22	FY23	FY24	FY23	FY24	FY23	FY24
Total Debt & Liabilities	**59,260.8**	**76,511.5**	**84,906.9**	**17,250.7**	**8,395.4**	**29.1**	**11.0**
Gross Public Debt (I+II+III)	**49,242.0**	**62,881.0**	**71,245.9**	**13,639.0**	**8,364.9**	27.7	13.3
I. Government domestic debt	31,085.4	38,809.8	47,160.2	7,724.4	8,350.4	24.8	21.5
II. Government external debt	16,747.0	22,030.9	21,753.6	5,283.9	-277.3	31.6	-1.3
III. Debt from IMF	1,409.6	2,040.2	2,332.1	630.7	291.8	44.7	14.3
IV. External liabilities	2,275.6	3,101.9	3,265.6	826.3	163.6	36.3	5.3
V. Private sector external debt	3,697.7	5,503.3	5,540.2	1,805.6	36.9	48.8	0.7
VI. PSEs external debt	1,667.1	2,147.9	2,162.2	480.8	14.3	28.8	0.7
VII. PSEs domestic debt	1,393.4	1,687.2	1,705.6	293.7	18.5	21.1	1.1
VIII. Commodity operations	1,133.7	1,485.9	1,378.3	352.3	-107.6	31.1	-7.2
IX. Intercompany external debt	837.6	1,301.4	1,273.7	463.8	-27.7	55.4	-2.1
Percent of GDP							
Gross public debt	73.9	74.9	67.4	-	-	-	-
Government domestic debt	46.6	46.2	44.6	-	-	-	-
Government external debt	25.1	26.2	20.6	-	-	-	-
Total external debt and liabilities	40.0	43.0	34.4	-	-	-	-

Source: State Bank of Pakistan

addition, the expectation of lower interest rate amid falling inflation might have increased banks' appetite for long-term instruments **(see Chapter 3)**.

Within the borrowing from banks, the government mainly relied on long-term instruments, GoP Ijara Sukuks and floating rate PIBs, whereas significantly lower funds were raised through T–bills. This improved the maturity profile of the domestic debt, and reduced the rollover risk.[4] Further, higher debt in floating rate PIBs is likely to benefit the government in declining interest rate environment through repricing at lower rates. Conversely, the maturity profile of external debt slightly deteriorated due to increase in the proportion of short-term loans during FY24.[5] Furthermore, the indicators for repayment capacity of the government show a mixed picture during FY24. The ratio of public debt to GDP improved, while the ratio of domestic interest payments to FBR tax deteriorated. The improvement in the former mainly owes to slower growth in public debt, as well as higher nominal GDP. The deterioration in the latter, despite significant growth of nearly 30 percent in FBR taxes, can be attributed to relatively higher share of domestic debt **(Figure 5.4)**. In addition, both the indicators are still higher than

Repayment Capacity of the Government **Figure 5.4**



Sources: Ministry of Finance and State Bank of Pakistan

[4] As per the latest report by MoF, average time to maturity (ATM) of domestic debt increased to 3.0 years from 2.8 years at the end of FY23.

[5] According to MoF, the ATM of external debt decreased to 6.3 years in H1-FY24 from 6.4 years at end the of FY23.

Government Domestic Debt **Table 5.2**

billion Rupees; share and growth in percent

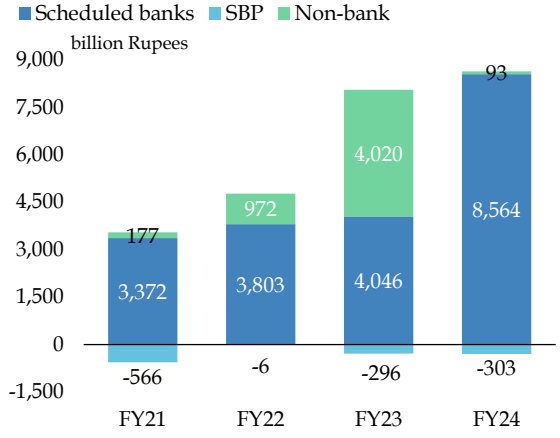
	Stock			Flows		Share		Growth	
	FY22	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
Government Domestic Debt (I+II+III+IV+V)	**31,085.4**	**38,809.8**	**47,160.2**	**7,724.4**	**8,350.4**	**-**	**-**	**24.8**	**21.5**
I. Permanent debt, *of which*	20,843.7	26,021.5	33,656.2	5,177.8	7,634.7	67.0	71.4	24.8	29.3
GoP Ijara Sukuk	2,279.8	3,150.6	4,766.2	870.8	1,615.6	8.1	10.1	38.2	51.3
PIBs	17,687.0	22,009.3	28,025.8	4,322.3	6,016.5	56.7	59.4	24.4	27.3
Prize bonds	374.6	382.5	385.1	7.9	2.6	1.0	0.8	2.1	0.7
II. Floating debt, *of which*	6,804.1	9,335.3	10,247.6	2,531.2	912.4	24.1	21.7	37.2	9.8
Market treasury bills	6,752.4	9,269.2	10,167.3	2,516.8	898.1	23.9	21.6	37.3	9.7
III. Unfunded debt, *of which*	3,336.0	2,926.5	2,798.7	-409.5	-127.8	7.5	5.9	-12.3	-4.4
NSS (Net of prize bonds)	3,208.3	2,818.5	2,707.8	-389.8	-110.7	7.3	5.7	-19.0	-3.9
IV. Foreign currency instruments	8.7	383.8	373.6	375.1	-10.3	1.0	0.8	4315.4	-2.7
V. Naya Pakistan Certificates (NPCs)	92.9	142.7	84.1	49.8	-58.6	0.4	0.2	53.6	-41.1

Source: State Bank of Pakistan

the international thresholds proposed by the World Bank and the IMF.[6]

While the improvement in debt indicators during FY24 is encouraging, sustaining these trends is imperative from the macroeconomic stability standpoint. In this regard, the need for continued fiscal consolidation can hardly be overemphasized. This requires streamlining policy efforts to widen the tax base for steady increase in government revenue over the medium term. Similarly, expediting SOE reforms is a must to reduce unnecessary burden on fiscal accounts and slow accretion in debt.

Institution-wise Domestic Debt - Flows **Figure 5.5**



Source: State Bank of Pakistan

5.2 Domestic Debt

Domestic debt maintained the momentum, albeit at a slightly slower pace **(Table 5.2)**. It rose by 21.5 percent during FY24, compared to 24.8 percent increase in the previous year. In terms of GDP, however, it decreased by 1.6 percent to 44.6 percent due to fiscal consolidation as well as significant growth in nominal GDP during FY24

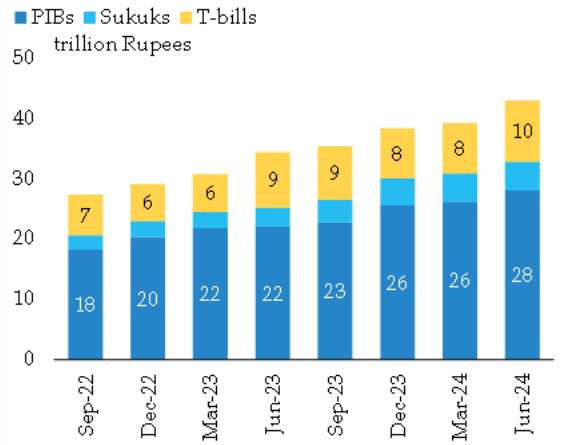
The accumulation in domestic debt was primarily sourced from scheduled banks during FY24. The funds mobilized from banks more than doubled to Rs 8.6 trillion in FY24 from Rs 4.0 trillion in FY23. This is in contrast to FY23, when government had borrowed almost equally from banks and non-bank sources **(Figure 5.5)**.

This shift is attributable to the suspension of higher tax on the banks' investment in government securities for FY24, which was linked to Advances to Deposits Ratio (ADR).[7] In addition, relatively higher returns on bank

[6] As suggested by the World Bank and the IMF, public debt-to-GDP ratio is the most relevant in measuring the degree of indebtedness and government's solvency capability. The optimum threshold for this indicator is 25 to 30 percent for emerging economies. Moreover, the proposed range for interest payments-to-tax revenue ratio is 7 to 10 percent. (Source: GUID-5250-Guidance-on-the-Audit-of-Public-Debt-Appendix-1-Debt-Indicators.pdf (issai.org)

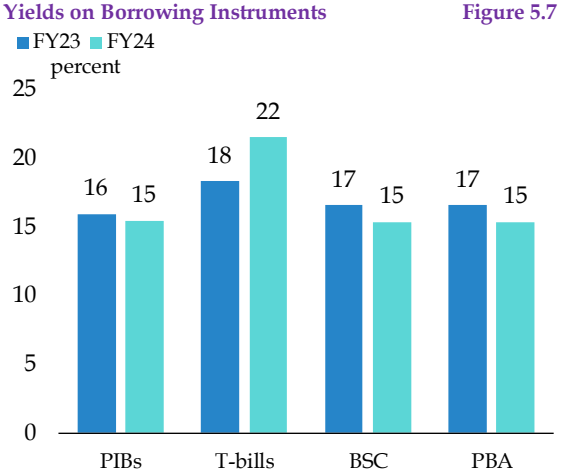
[7] Source: FBR SRO No. 226(I)/2023.

Outstanding Stock of Government Securities Figure 5.6



Source: State Bank of Pakistan

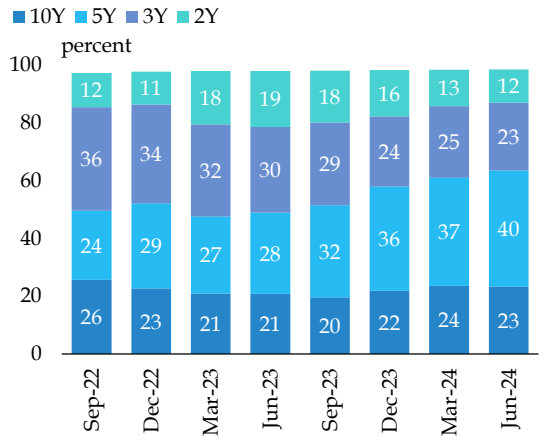
Yields on Borrowing Instruments Figure 5.7



Sources: State Bank of Pakistan and National Savings

deposits enticed individuals to place their funds in bank deposits instead of investing in relatively low yielding alternates, including NSS instruments.[8,9] Besides, lower than expected inflows from external sources also increased government reliance on scheduled banks **(Figure 5.5)**.

Tenor-wise Shares in Outstanding PIBs Figure 5.8



Source: State Bank of Pakistan

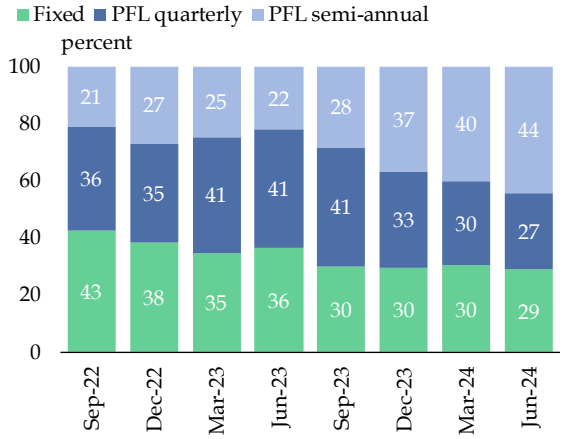
Permanent Debt

In order to reduce the cost of borrowing, the government raised more funds through long-term securities, primarily floating-rate PIBs (PFLs), amid the expectation of reduction in the policy rate during FY24. In particular, the government borrowing through PIBs and Sukuk increased by Rs 6016.5 and Rs 1615.6 billion respectively, during FY24 compared to Rs 4322.3 and 870.8 billion in the last fiscal year **(Figures 5.6 & 5.7)**. As a result, the share of PIBs and Sukuk in the stock of domestic debt increased to 65.2 and 11.0 percent respectively, at end-June 2024 from 63.9 and 9.2 percent in the previous year.

Within the permanent debt, the investors were more inclined towards 5-year papers during FY24 **(Figure 5.8)**.[10] Amid expected decrease in the interest rates, the government raised more funds through semi-annual PFLs to reduce the cost of funding and rollover risk.[11,12] Consequently, their share surged to 44.1 percent

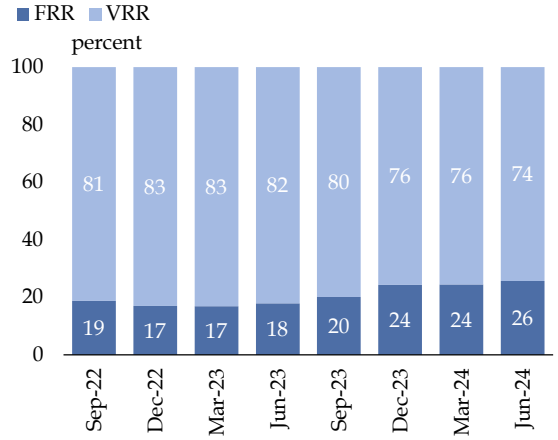
[8] NBFIs' deposits with banks increased to Rs 484 billion during FY24, against the withdrawal of Rs 148.3 billion in the previous year.
[9] For example, the bank balances of NBP Government Securities Liquid Fund, UBL Retirement Savings Fund and NBP Islamic Money Market Fund increased to Rs 1570.1 million, Rs 1458.5 million and Rs 8560.4 million respectively, during Jul-Mar FY24 (the latest available) from Rs 194.4 million, Rs 1333.7 million and Rs 7703.3 million at end-June 2023. Moreover, the rates on these balances ranges from 10 to 22.5 percent during July-Mar FY24.
[10] The categorization is based on tenor at the time of issuance. The share of 5-year and 10-year PIBs increased to 40.2 and 23.4 percent respectively at end-June FY24 from 28.2 and 20.8 percent the previous year. Whereas, the share of 2-year PIBs decreased to 23.4 percent at end-June FY24 from 29.6 percent at end-June FY23.
[11] The share of floating-rate PIBs (PFLs) increased to 71.1 percent at end- June FY24 from 63.6 percent the previous year.
[12] The weighted average yield on funds raised through PIBs decreased to 15.4 percent during FY24 from 16.8 percent in the last year.

Share in PIBs - Fixed and Floating **Figure 5.9**



Source: State Bank of Pakistan

FRR and VRR Shares in Sukuks **Figure 5.10**



Source: State Bank of Pakistan

at the end of FY24, from 22.1 percent recorded at the end of FY23 **(Figure 5.9)**.

In order to diversify the existing investors' base, the government initiated issuance of Shariah compliant debt securities through Pakistan stock exchange from December 2023. This initiative, together with sufficient liquidity with the Islamic banks, resulted in significant higher mobilization through GoP Ijara Sukuk; Rs 1615.6 billion during FY24 compared to Rs 870.8 billion raised in the previous year. Like PIBs, most of the funding was raised through Variable Rental Rate (VRR) GoP Ijara Sukuk.

However, due to expected decline in interest rates, the investors remained more inclined to invest in Fixed Rentals Rate (FRR) instruments. As result, their share in government securities increased to 25.6 percent at end-June 2024, from 17.9 percent in the previous year **(Figure 5.10)**.

Prize bonds, a major component of permanent debt, saw net inflow of only Rs 2.6 billion during FY24 against a net inflow of Rs 7.9 billion in the previous year. This was because of three reasons. First, the government announced extension in encashment/replacement or conversion of major denomination bonds from June 2023 to June 2024 that may have led to higher encashment. Second, the government required to purchase bonds through bank account, which may have discouraged prospective investors due to fear of registration. Third, lucrative rate of return on saving accounts particularly, Sarwa Islamic Saving Account (SISA) may also have resulted in some switching away from prize bonds.[13]

Floating Debt

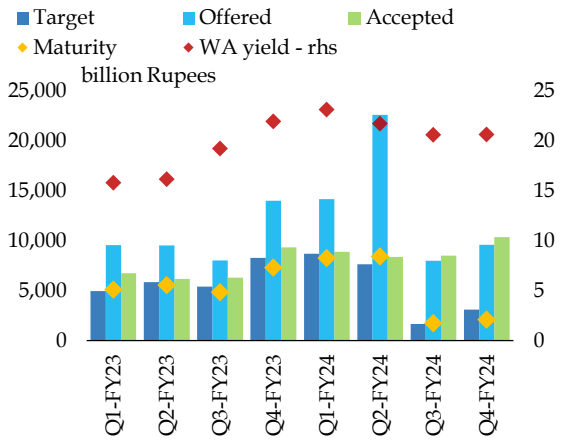
Under the prevailing higher interest rate environment, relatively lower amount of funds were raised through short-term instruments like T-bills, especially in the first two quarters of FY24. The funds raised through T-bills decreased to Rs 898.1 billion in FY24 against Rs 2,516.8 billion in the previous year. Owing to higher bid rates, the government set the auction targets close to the maturities during the first two quarters of FY24. However, consequent upon higher financing needs amid lower-than-expected external inflows, the government raised more funds than the announced targets in the last two quarters of FY24 **(Figure 5.11)**.

Moreover, the quarterly auction summary shows that the realized amount was largely

[13] Source: Circular No. CMD/GSSAD/PBU/PB-1/48397/2023, Link: C_15.pdf (sbp.org.pk)

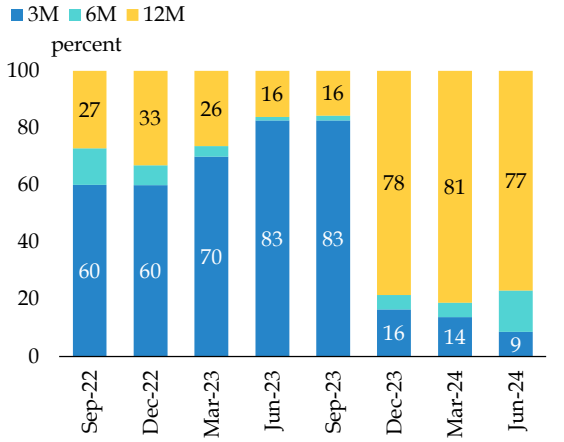
[14] The weighted average yield on T-bills on the average remained 21.5 percent during FY24, compared with 18.3 percent in the previous year.

Auction Summary T-bills **Figure 5.11**



Source: State Bank of Pakistan

Tenor-wise Shares in Outstanding T-bills **Figure 5.12**



Source: State Bank of Pakistan

concentrated in 12-month T-bills during the last three quarters of FY24 **(Figure 5.12)**. With the expectation of decrease in interest rates, the concentration of borrowing in 12-month T-bills reflects the government's strategy of reducing rollover risk.

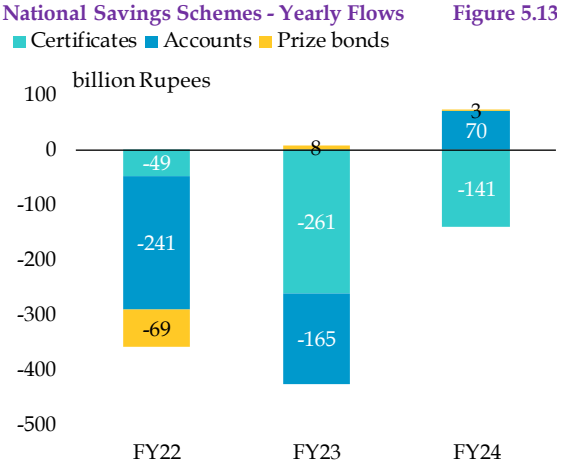
Unfunded Debt[15]

The outflows from unfunded debt – mostly from NSS – declined to Rs 127.8 billion during FY24 compared to an outflow of Rs 409.5 billion in the previous year. The sizeable decrease in outflows could be attributed to higher inflows in SISA on the back of lucrative returns. Nonetheless, Regular Income Certificates (RIC) and Defense Savings Certificates (DSC) mainly led the outflows from NSS.[16] While, Behbood Saving Certificate (BSC), together with all categories of short-term savings certificates, observed moderate inflows during FY24.[17]

The decline in investment in National Savings Certificates (NSCs) is mainly attributed to downward revision in the rate of return on most of the national saving schemes during FY24. Relatively higher returns on bank deposits together with the government's efforts to curb unregistered investment, especially in prize bonds, appears to have diverted investment away from NSS.[18]

Contrary to the NSCs, the Savings Accounts (SAs), the second largest component of the unfunded debt, recorded a net inflow of Rs 70.3 billion during FY24 against an outflow of Rs 164.7 billion in the previous year (**Figure 5.13**). This was mainly because downward adjustment in rates of return on most of the national saving accounts was relatively lower compared to that on saving certificates. The net inflow in SAs was mainly driven by mobilization of Rs 68.9 billion

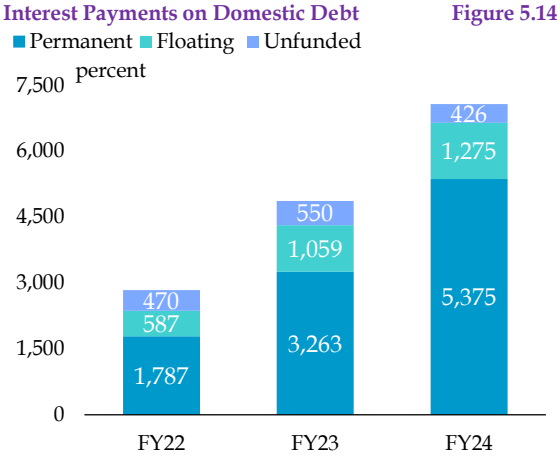
National Savings Schemes - Yearly Flows **Figure 5.13**



Source: State Bank of Pakistan

[15] The unfunded debt, comprising saving certificates and saving accounts, is funded directly by the people.
[16] The average profit rate on RIC remained 15.0 percent during FY24 compared with 12.36 percent in FY23.
[17] The category of short-term comprises on 3-month, 6-month and 12-month certificates.
[18] The investment in registered (premium) bonds increased by Rs 54.7 billion during FY24.

Interest Payments on Domestic Debt **Figure 5.14**



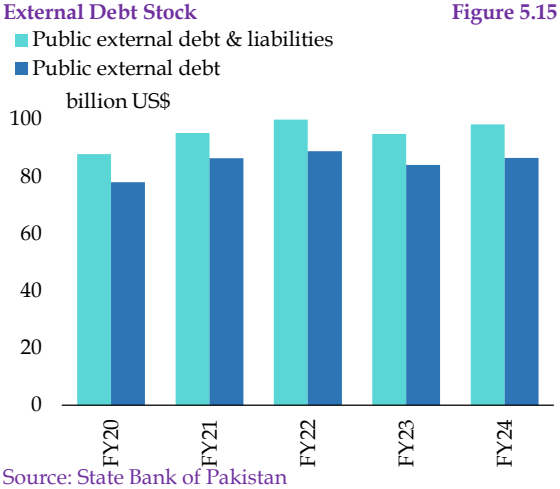
Source: State Bank of Pakistan

through SISA, which may be attributed to attractive profit rate of 19.5 percent during current review period. In addition, Pensioners' Benefit Account (PBA) recorded a net inflow of Rs 29.6 billion compared to Rs 13.8 billion in the last year.

Naya Pakistan Certificates

During FY24, residents' investment in Naya Pakistan Certificates (NPC) declined by Rs 58.6 billion against an expansion of Rs 49.8 billion in the previous year (**Table 5.2**). One of the possible factor could be investors' increased inclination towards locking funds in SISA during FY24.

External Debt Stock **Figure 5.15**



Source: State Bank of Pakistan

Domestic Debt Servicing

Consequent upon rising debt stock amid high interest rate environment, interest payments remained on an upward trajectory.[19] The interest payment on domestic debt surged to Rs 7.1 trillion during FY24 from Rs 4.9 trillion in the previous year (**Figure 5.14)**. This is despite increased mobilization of funds through long-term securities, mostly the PFLs and GoP Ijara Sukuks, at relatively lower rates. At the same time, the stock of short-term debt, mainly T-bills, declined during FY24.[20] In addition, amid investors' declining interest in NSS instruments other than SISA, the interest expenses associated with the unfunded debt declined by 22.6 percent during FY24, against 17.0 percent increase in the previous year. Moreover, cut-off rates also declined in the auctions of government securities held in the last quarter of FY24, as market started to price in a possible reduction in the policy rate amidst falling inflation.[21]

5.3 Public External Debt & Liabilities

The stock of public external debt & liabilities increased by US$ 4.4 billion during FY24, against a decline of US$ 4.2 billion in the previous year. Similarly, the public external debt increased by US$ 2.5 billion during FY24, against a decline of US$ 4.8 billion in the previous year **(Table 5.3 & Figure 5.15)**. The external debt accumulation during FY24 reflects lower Principal repayment and revaluation gains due to appreciation of US dollar against other international currencies.[22]

[19] The interest expenses rose further by 45.6 percent during FY24, after 71.7 percent increase in the previous year.
[20] The interest payments on T-bills increased by 20.4 percent during FY24 compared to 80.5 percent in FY23.
[21] The contribution of interest rate in the growth of interest payments decreased to 29.1 percent during FY24 from 56.0 percent in the last year.
[22] The appreciation of the US Dollar against Euro, Japanese Yen, Pound Sterling and Special Drawing Right (SDR) during fiscal year FY24 resulted in a gain of $635.7 million on external debt.

Public External Debt **Table 5.3**

million US$; share and growth in percent

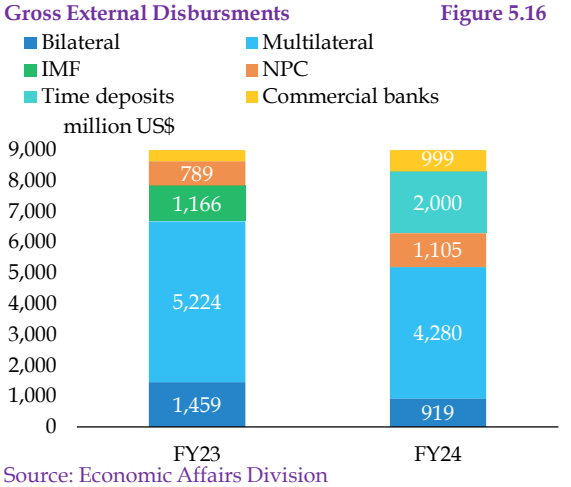
	Stock			Flows		Share		Growth	
	FY22	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
Public external debt (1+2)	**88,837.8**	**84,050.1**	**86,525.1**	**-4,787.7**	**2,474.9**	**-**	**-**	**-5.4**	**2.9**
1. Government external debt	**81,941.0**	**76,926.2**	**78,147.4**	**-5,014.9**	**1,221.3**	**91.5**	**90.3**	**-6.1**	**1.6**
i) Long term (>1 year)	**80,591.9**	**76,765.9**	**77,387.6**	**-3,826.1**	**621.8**	**91.3**	**89.4**	**-4.7**	**0.8**
Paris club	9,231.8	7,901.1	6,474.4	-1,330.7	-1,426.7	9.4	7.5	-14.4	-18.1
Multilateral	34,022.8	37,363.1	39,248.0	3,340.3	1,884.8	44.5	45.4	9.8	5.0
Other bilateral	18,053.3	17,572.3	18,552.4	-481.0	980.1	20.9	21.4	-2.7	5.6
Euro/Sukuk bonds	8,800.0	7,800.0	6,800.0	-1,000.0	-1,000.0	9.3	7.9	-11.4	-12.8
Commercial loans/credits	9,481.2	5,563.8	5,490.3	-3,917.4	-73.5	6.6	6.3	-41.3	-1.3
Naya Pakistan Certificates	953.0	534.3	783.9	-418.7	249.6	0.6	0.9	-43.9	46.7
ii) Short term (< 1year)	**1,349.1**	**160.3**	**759.8**	**-1,188.8**	**599.5**	**0.2**	**0.9**	**-88.1**	**374.0**
Multilateral	1,327.1	160.3	250.0	-1,166.8	89.7	0.2	0.3	-87.9	56.0
2. From IMF	**6,896.8**	**7,124.0**	**8,377.6**	**227.1**	**1,253.7**	**8.5**	**9.7**	**3.3**	**17.6**
Foreign exchange liabilities	**11,134.3**	**10,831.2**	**11,731.2**	**-303.2**	**900.0**	**-**	**-**	**-2.7**	**8.3**
Central bank deposits	2,700.0	2,700.0	3,700.0	0.0	1,000.0	-	-	0.0	37.0
Other liabilities (SWAP)	4,535.3	4,224.9	4,169.6	-310.3	-55.4	-	-	-6.8	-1.3
Allocation of SDR	3,897.3	3,904.0	3,860.8	6.7	-43.2	-	-	0.2	-1.1

Source: State Bank of Pakistan

External Disbursements

The total external loan disbursements amounted to US$ 9.8 billion during FY24, slightly lower from US$ 10.8 billion in the previous year. The overall disbursements also fell short of the budget estimates.[23] The decline may be attributed to tight global financial condition, low sovereign credit rating, and domestic uncertainty. The disbursements were largely from multilateral and bilateral sources. The major disbursements from bilateral sources included time deposits of US$ 2 billion from Saudi Arabia and US$ 1 billion from UAE as deposit with the central bank **(Figure 5.16)**.

Gross External Disbursments **Figure 5.16**



Source: Economic Affairs Division

IMF's Stand-By Arrangement (SBA) supported disbursements from multilateral sources. The major disbursements included US$ 2.2 billion from the World Bank, US$ 1.3 billion from the ADB, and US$ 345 million from the AIIB **(Table 5.4)**.

Moreover, against outflows in FY23, there were net inflows in NPCs during FY24. This mainly reflected increase in profit rates, as well decrease in Pakistan's risk premium with improved external buffers. However, commercial loans continued to show retirement for the second year in FY24.

[23] The government had budgeted US$ 22.8 and US$ 17.6 billion for FY23 and FY24, respectively.

Gross External Disbursements **Table 5.4**

million US$

	FY22	FY23	FY24
Multilateral	4,828.8	5,224.2	4,279.9
ADB	1,625.9	2,266.1	1,327.7
AIIB	41.6	558.9	345.0
IDB	1,406.8	177.8	317.5
IMF	-	1,166.2	-
WB	1,579.0	2,099.5	2,218.3
Bilateral	708.1	1,459.0	919.4
China	162.6	128.0	69.1
Saudi Arabia	401.1	1,182.3	661.5
USA	69.8	31.1	40.2
Japan	20.6	35.2	36.5
France	15.5	33.8	49.6
Commercial banks	4,863.3	2,206.0	999.0
NPCs^	-	789.0	1,104.6
Bonds	2,041.7	-	-
Time deposits *	3,000.0	-	2,000.0
Total disbursements	15,441.9	10,844.3	9,811.3

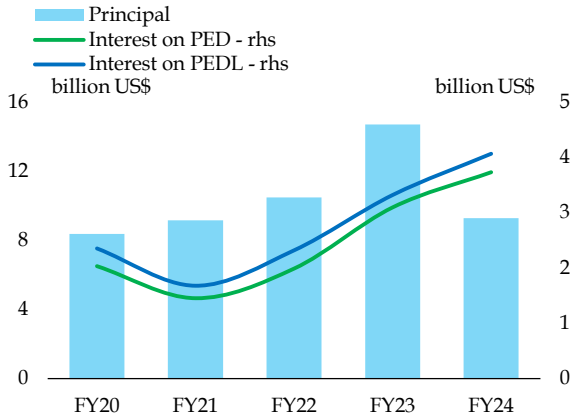
^ NPCs became part of external disbursements for the first time in FY23; * not included in public external debt as these are part of external liabilities.

Source: Economic Affairs Division

External Debt Servicing

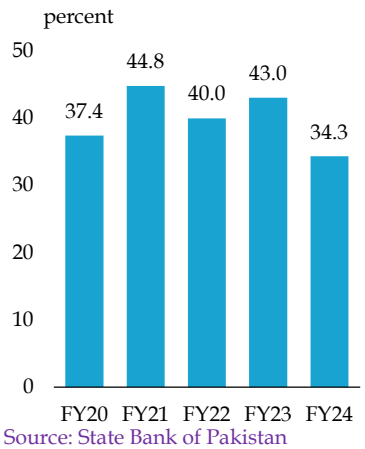
Debt servicing, including interest payments and repayment of principal, declined to US$ 13.5 billion during FY24 compared to US$ 18.0 billion in the last year. The decrease is mainly attributed to lower repayment of principal amount due in FY24. Interest payments, including interest expenses on liabilities, rose to US$ 4.1 billion during FY24, up from US$ 3.3 billion in the previous year **(Figure 5.17)**.[24] The interest payments on long-term loans increased, while declined on short-term loans during FY24.[25,26] The increase in interest payments can be ascribed to rising debt stock, as well as increase in interest rates as indicated by

External Debt Servicing - Principal and Interest **Figure 5.17**



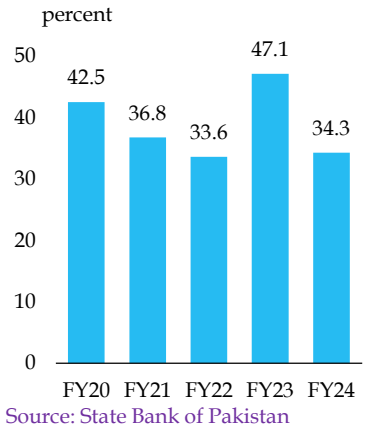
Source: State Bank of Pakistan

TEDL as Percent of GDP **Figure 5.18**



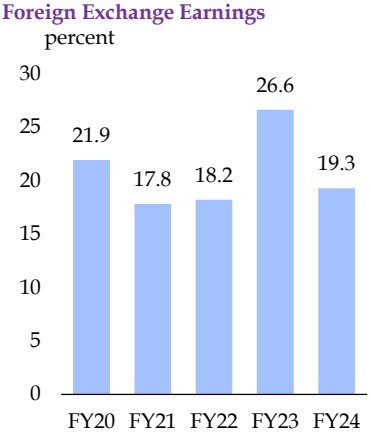
Source: State Bank of Pakistan

EDS as Percent of Exports Earnings **Figure 5.19**



Source: State Bank of Pakistan

EDS as Percent of Foreign Exchange Earnings **Figure 5.20**



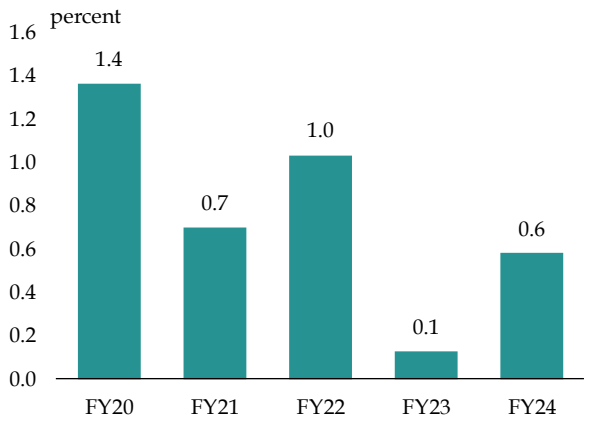
Source: State Bank of Pakistan

[24] Interest payments on liabilities registered US$ 334 million during FY24 compared to US$ 224.1 million in FY23.

[25] The interest expenses on long-term debt rose to US$ 3.1 billion from US$ 2.6 billion in the previous year. Similarly, the interest payments on foreign exchange liabilities and IMF loans increased to US$ 334.0 and US$ 619.1 million respectively, during FY24 compared to US$ 224.1 and US$ 402.2 million in FY23.

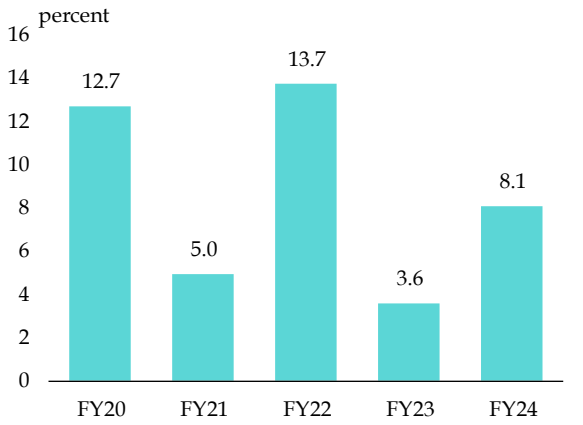
[26] The mark-up expenses on short-term loans marginally declined to US$ 38.0 million during FY24 from US$ 44.0 million in FY23

STPED as Percent of PEDL **Figure 5.21**



Source: State Bank of Pakistan

STPED as Percent of SBP Reserves **Figure 5.22**



Source: State Bank of Pakistan

trends in Secured Overnight Financing Rate (SOFR) during FY24.[27]

External Debt Sustainability[28]

The SBA with the IMF, that partially eased external borrowing constraints, along with noteworthy reduction in current account deficit, resulted in improving sustainability of external debt. Moreover, appreciation of PKR against US dollar and the gains due to appreciation of US dollar against other international currencies also contributed in improving the country's capacity to repay foreign debt. In addition, increase in foreign exchange earnings and SBP's FX reserves supported the sustainability position during FY24.

The debt solvency indicators also depict improvement in the country's ability to repay external debt during FY24. This is indicated by decrease in the ratios of Total External Debt & Liabilities to GDP ratio (TEDL/GDP), External Debt Servicing (EDS) to Foreign Exchange Earnings (FEE) and EDS to Exports Earnings (EE) **(Figures 5.18, 5.19 & 5.20)**.

However, the liquidity indicators—the ratios of Short-Term Public External Debt (STPED) to Public External Debt and Liabilities (PEDL) and STPED to SBP reserves somewhat deteriorated **(Figures 5.21 & 5.22)**. The major reason behind this deterioration is the increase in short-term debt to US$ 759.8 million at the end of FY24 from US$ 160.3 million in the last year.

Despite improvement in the solvency indicators, the external debt profile remained at modest risk during FY24. Based on the IMF' risk assessment benchmarks, the ratio of foreign currency debt to total public debt, though decreased to 34 percent, still lies in the range of modest risk of 20 to 60 percent **(Figure 5.3)**.[29]

[27] SOFR is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities. The average SOFR increased to 5.33 percent in FY24 from 3.81 percent in the previous year. Source: SOFR Averages and Index Data - FEDERAL RESERVE BANK of NEW YORK (newyorkfed.org)

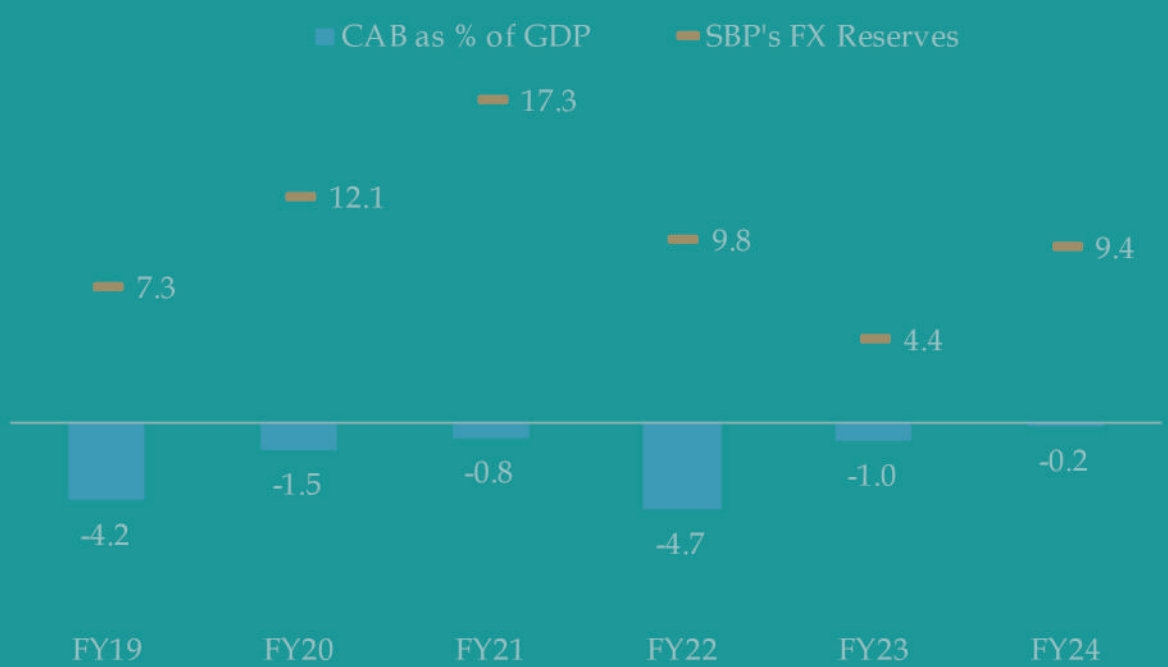
[28] Solvency indicators measure the capacity of a country to repay the external debt on an ongoing basis. The liquidity indicators, measuring the ability to service short-term liabilities, comprise on short-term debt to foreign exchange reserves ratio and short-term debt to total external debt ratio.

[29] According IMF's benchmarks, a country deemed to be at modest risk when the ratio of public debt in foreign currency to total public debt lies between 20 and 60 percent. Below 20 and above 60 percent indicate low and high risk respectively.

6

Balance of Payments

Pakistan's external account position improved during FY24, supported by stabilization policies, reforms in exchange companies, and successful completion of the IMF Stand-By Arrangement. The current account deficit narrowed further with increase in exports and remittances, as well as muted growth in imports. The financial account also saw net inflows in FY24, against net outflows in FY23, from both multilateral and bilateral creditors. The resulting improved liquidity in foreign exchange market offset the impact of higher interest payments and increased repatriation of profits and dividends. With these favorable developments, the country's liquid foreign exchange reserves almost doubled along with the reduction in outstanding forward/ swap liabilities; and the PKR stabilized, with Kerb-market premium plummeted since September 2023.

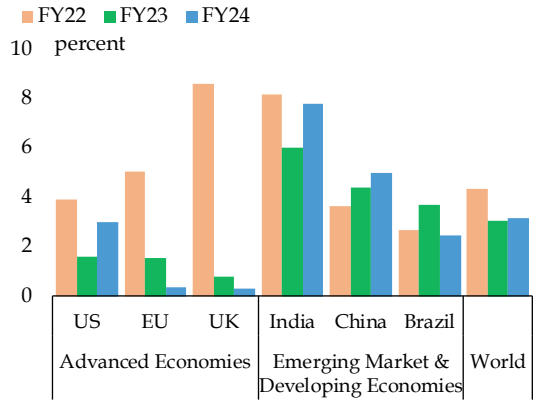


6 Balance of Payments

6.1 Global Economic Review

Global economic activity improved, driven by increase in private consumption and higher public spending, an uptick in services activity, and robust technological exports.[1] Accordingly, the global GDP grew by 3.2 percent in FY24 – only marginally higher than 3.1 percent in FY23 (**Figure 6.1)**. Meanwhile, the pace of global disinflation decelerated due to persistently high services inflation. As a result, monetary policy stance remained tight in most of the advanced economies (AEs) and some of the emerging market and developing economies (EMDEs) during FY24.[2]

Real GDP Growth in Major Economies* **Figure 6.1**



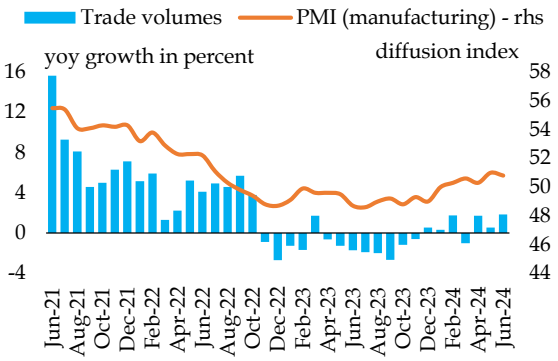
*average of 4 quarters

Source: Bloomberg

After experiencing a near stagnation in 2023, global trade volumes improved towards the end of FY24 in line with global GDP growth pattern as shown by the trend in manufacturing purchasing managers' index (PMI) (**Figure 6.2**).[3] However, the growth in trade volume still remains below its historical average mainly due to rising cross-border trade restrictions amid increased geopolitical concerns.[4] Additionally, global transportation costs increased after attacks on commercial shipping in the Red Sea region. This has caused severe container shortages as vessels remained stuck due to rerouting of cargoes. On balance, these challenges were largely offset by the ease in global supply chain pressures, reflected by decline in global commodity prices in FY24 (**Figure 6.3)**.

The decline in global commodity prices was mainly driven by falling energy and food prices. Energy prices declined due to a sharp fall in gas prices as stocks piled up amid mild winter temperatures, slower industrial activity in Europe, and adequate supplies of liquefied natural gas (LNG). Compared to natural gas, the oil price witnessed a marginal decline as the concerns of sluggish demand and sufficient spare capacity due to an increase in supply from non-OPEC+ countries were more than

Global Trade Volumes and PMI **Figure 6.2**



Note: Monthly PMI is used as a proxy for GDP growth due to its leading indicator characteristics and historical correlation with economic activity.

Sources: CPB World Trade Monitor; Bloomberg

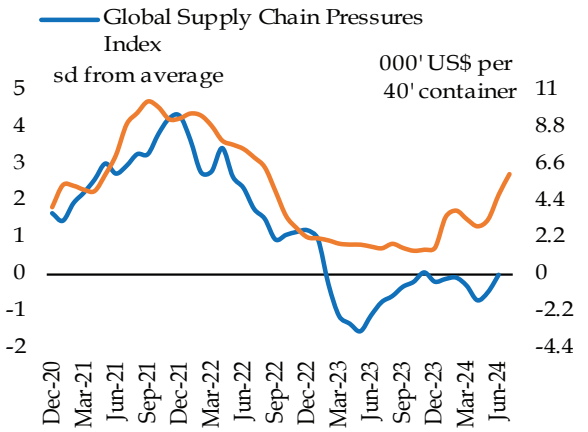
[1] Private consumption improved in US and China, services activity enhanced in Euro Area, while technological exports remained strong in major emerging economies. In addition, public spending, as measured by structural fiscal balance, became more expansionary than initially projected in US and Euro Area.

[2] See discussion on inflation and global monetary policy responses in **Chapter 3**.

[3] Monthly PMI is used as a proxy for GDP growth due to its leading indicator characteristics and historical correlation with the economic activity.

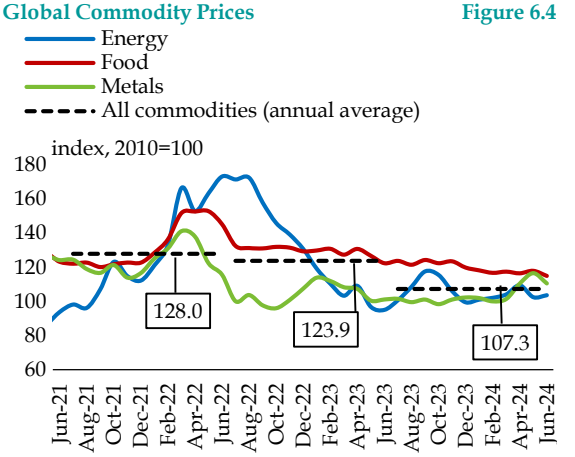
[4] Global Trade Alert reports there were about 3000 new trade restrictions in 2023.

Global Supply Chain Pressures **Figure 6.3**



Note: sd means standard deviation
Source: Newyork Fed and Bloomberg

Global Commodity Prices **Figure 6.4**



Source: World Bank

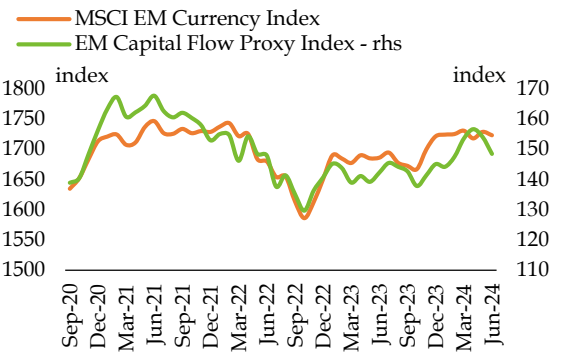
counterbalanced by output restrictions from OPEC+ (**Figure 6.4**). Moreover, global food prices have fallen, largely driven by a drop in vegetable oil prices, due to a seasonal increase in production as well as reduced import demand.

On the other hand, the prices of metals increased, before edging down towards the end of FY24. The rise was fueled by supply disruptions coupled with stronger-than-expected demand from China.[5] Nonetheless, prices of major commodities, which have strong bearing for EMDEs, declined in FY24.[6] The ease in global commodity prices had a favorable impact on inflation dynamics. The headline inflation seems to be on course to fall in the target range, albeit at a slower pace in AEs compared to the EMDEs. Accordingly, the central banks in EMDEs lowered the interest rates, while the central banks in AEs remained cautious.

As a result, funding cost continued to remain elevated as the delay in monetary policy easing in the US and other AEs exacerbated financial market volatility. Consequently, EMDEs witnessed net capital outflows lately, leading to increased pressures on their currencies (**Figure 6.5)**.

In addition, market expectations indicated the tight monetary policy stance in AEs to prolong, as shown by market-implied path for federal funds rate (**Figure 6.6**).[7] This has stressed fiscal position of EMDEs, burdened by higher debt servicing. Interest payments, as a share of total revenues, have increased in most of the EMDEs

Capital Flows and Currency Index **Figure 6.5**



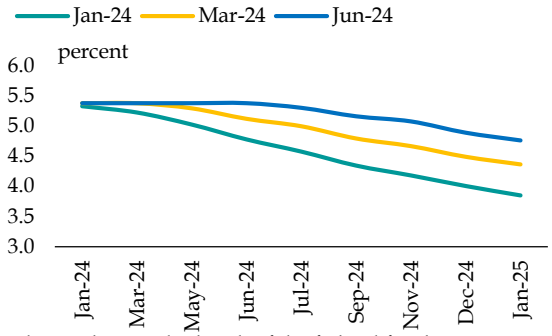
Note: The MSCI Emerging Markets (EM) Currency Index tracks the performance of twenty-five emerging-market currencies relative to the US Dollar.
Source: Bloomberg

[5] Supply disruptions arose following the ban on Russian-origin metals, including aluminum and copper, by major commodity exchanges in the United States and the United Kingdom. The reduction in copper and zinc supplies occurred as key producers scaled back their production in reaction to previous price declines

[6] Most of the EMDEs rely on import of commodities such as wheat, fertilizer, cotton, edible oil and crude oil. The prices of these commodities declined in FY24 over FY23 (**Figure 6.35)**.

[7] In June 2024, market expectations suggest federal funds rate to decline to 4.75 percent by January 2025. However, after a cut of 50 bps in September 2024 FOMC meeting, market expects the federal funds rate to decline to 3.75 percent by January 2025.

Market Implied Fed Funds Rate* **Figure 6.6**

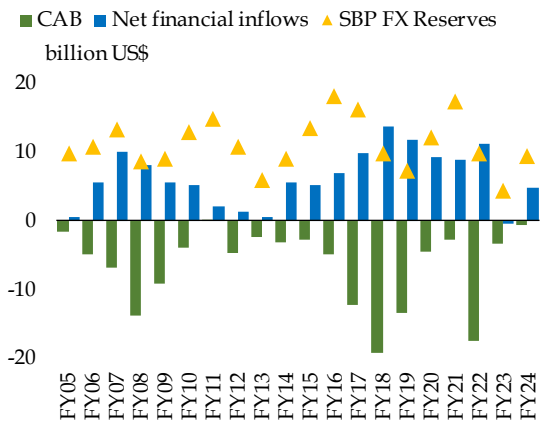


*The market-implied path of the federal funds rate is a prediction of the future path of the federal funds rate based on the prices of financial instruments.
Note: x-axis denotes monetary policy meeting months
Source: Bloomberg

(**Figure 6.7**). The resulting erosion in fiscal buffers is creating difficulties for many emerging economies to make necessary capital spending to cope with frequent adverse supply shocks, adopt to climate change, accelerate digital transformation, and ensure energy security.

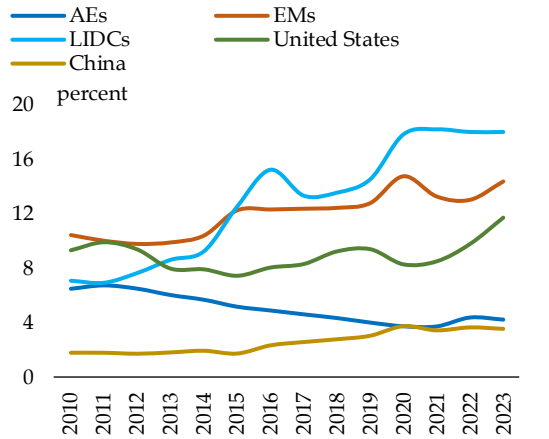
While global growth has stabilized, the pace of growth is still modest compared to the historical standards. Importantly, the growth remains notably weak in countries with high rates of inflation. The headline inflation is falling towards central bank targets, however, core

Pakistan's Balance of Payments **Figure 6.8**



Source: State Bank of Pakistan

Interest Payments as Percent of Revenue **Figure 6.7**



Source: IMF Fiscal Monitor

inflation continues to persist. This has led the central banks in AEs to adopt a cautious monetary policy stance.

These developments, especially the modest GDP growth, coupled with the cautious monetary policy stance adopted by AEs is affecting the growth prospects of EMDEs, including Pakistan. Moreover, it also creates volatility in their currency markets and affects capital flows. To some extent, this is contributing to inflationary pressures as weaker currency makes imports costlier.[8] Given these challenges, the medium-term growth prospects of EMDEs appear less sanguine.

6.2 Pakistan's Balance of Payments

Pakistan's balance of payments improved with further narrowing of current account deficit (CAD) and increase in net financial inflows, supported by IMF's Stand-By Arrangement (SBA). Consequently, by end June 2024, the SBP's gross FX reserves more than doubled from the end June 2023 level (**Figure 6.8 & Table 6.1)**. These developments, accompanied by administrative actions and reforms in the exchange companies, contributed to a modest exchange rate appreciation during FY24.

[8] Some of the emerging economies like Moldova, Ukraine, Sri Lanka witnessed a slight upturn in their inflation readings of June 2024 on YoY basis.

Pakistan's Balance of Payments **Table 6.1**

million US$; growth in percent

	FY23	FY24		FY24	FY24	
		H1	H2		Abs. Change	Growth
Current account balance	-3,275	-922	257	-665	2,610	-79.7
Trade balance	-24,819	-10,152	-11,913	-22,065	2,754	-11.1
Exports	27,876	15,276	15,825	31,101	3,225	11.6
o/w Textile exports	16,633	8,214	8,087	16,301	-332	-2.0
Non-textile exports	11,243	7,062	7,738	14,800	3,557	31.6
Imports	52,695	25,428	27,738	53,166	471	0.9
o/w Energy imports	18,882	7,354	7,808	15,162	-3,720	-19.7
Non-energy imports	33,813	18,074	19,930	38,004	4,191	12.4
Services balance	-1,042	-1,156	-1,150	-2,306	-1,264	121.3
Primary income balance	-5,765	-3,899	-4,724	-8,623	-2,858	49.6
o/w interest payments	4,612	2,899	2,788	5,687	1,075	23.3
Secondary income balance	28,351	14,285	18,044	32,329	3,978	14.0
o/w Workers' remittances	27,333	13,436	16,814	30,250	2,917	10.7
Capital account balance	375	88	87	175	-200	-
Financial account balance*	468	-4,523	-131	-4,654	-5,122	-1,094.4
Direct investment (net)†	-670	-834	-801	-1,635	-965	144.0
Portfolio investment (net)†	1,012	-71	448	377	-635	-62.7
o/w Eurobonds/Sukuk	-1,000	0	-1000	-1000	-	-
Build-up in FX assets abroad	-964	-215	95	-120	844	-87.6
FX loans & liabilities	-1,099	3,403	-127	3,276	4,375	-
Banks	1,241	151	588	739	-502	-40.5
General government	-2,085	2,138	-593	1,545	3,630	-174.1
Disbursements	9,891	2,896	3,136	6,032	-3,859	-39.0
Amortization	11,660	2,851	3,884	6,735	-4,925	-42.2
Other liabilities (net)	-316	2,093	155	2,248	2,564	-
Other sectors	-255	115	-122	-7	248	-97.3
Disbursements	398	644	1,768	2,412	2,014	506.0
Amortization	1,663	788	1,135	1,923	260	15.6
Other liabilities (net)	1,010	259	-755	-496	-1,506	-
Net Errors and Omissions	-850	-683	-619	-1,302	-452	-
Overall Balance	4218	-3006	144	-2862	-	-
SBP's liquid reserves (end-period)	4,445	8,233	9,390	9,390	4,944	-
PKR app(+)/dep(-) in percent (end-period)	-28.4	1.5	1.3	2.7	-	-

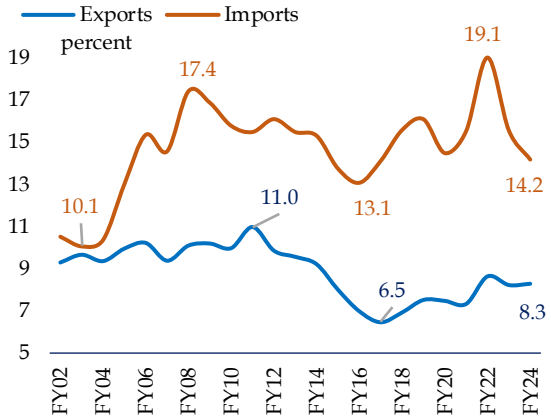
*as per BPM6, negative sign means net FX inflow into Pakistan and vice versa; net investment abroad minus net investment in Pakistan

Source: State Bank of Pakistan

The CAD fell to 0.2 percent of GDP in FY24 – the lowest in last 13 years. This significant reduction can be attributed to improved trade balance and increase in workers' remittances. The improvement in trade balance was mainly due to quantum-driven growth in exports, as imports also slightly increased. A muted growth in imports is attributed to a moderate recovery in economic activity, ease in global commodity prices, and lower food and raw cotton imports. Nonetheless, the primary income deficit has widened substantially due to increased interest payments and repatriation of profits and dividends. Similarly, the trade in services balance also deteriorated largely due to an increase in passengers traveling abroad.

The financial account witnessed net inflows in FY24, against net outflows in the previous year. This reversal is mainly due to official inflows, supported by IMF's SBA disbursements. There was also an uptick in foreign investment in

Pakistan's Exports and Imports as Percent of GDP **Figure 6.9**



Source: State Bank of Pakistan

Pakistan, both in equity and debt, attributable to relatively higher returns. As a result, external buffers improved during the year.

The SBP's FX reserves rose by US$ 4.9 billion during FY24 to reach US$ 9.4 billion at end June 2024. The reserves are sufficient to finance 1.6 months of next year's imports of goods and services.[9] Further, narrowed current account deficit, improved financial inflows and reforms in the foreign exchange companies led to strengthening of PKR against US$ since September 2023. As a result, the exchange rate has remained broadly stable in the second half of FY24 after gradual appreciation from mid of September to December 2023. The real effective exchange rate (REER) also appreciated, largely due to rising inflation differential amid sharp decline in trading partners' inflation vis-à-vis domestic inflation. This may have implications for competitiveness of Pakistan's exports.

Notwithstanding the improvements in external account during FY24, Pakistan's exports-to-GDP ratio has stagnated below 10 percent in the last decade (**Figure 6.9)**. This can be attributed to lack of competitiveness, diversification, value addition, research and development (R&D); and limited penetration of Pakistani firms in global markets (**Box 6.1**). Addressing these challenges would support growth, both via development of manufacturing base and reduction in country's reliance on external borrowing over the medium to long term.

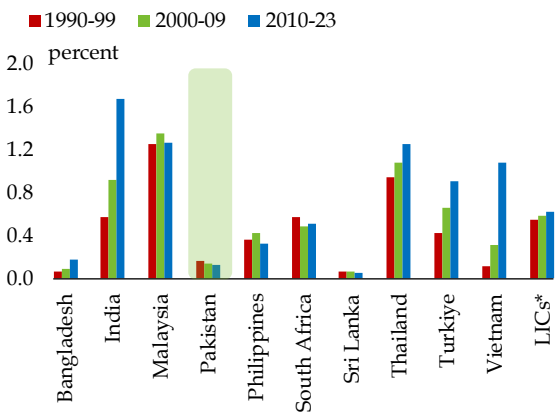
Box 6.1: Addressing Structural Challenges to Pakistan's Exports

Pakistan's exports have averaged around 8 percent of GDP since 2010 and its share in global markets has been on a decline in contrast to peer countries (**Figure 6.1.1**). These trends have increased country's susceptibility to balance of payment pressures, accumulation in foreign debt, and exchange rate volatility, amongst other macroeconomic issues.[10]

In this regard, SBP's (forthcoming) Thematic Report on Exports has analyzed the key structural issues underpinning Pakistan's weak export performance, and made recommendations based on international best practices. It is important to note that most of these issues are interrelated, hence the recommendations for one issue may serve as a catalyst in addressing the other. This box summarizes the key findings of the report as follows:

Removing anti-export bias in trade policies: Pakistan's anti-export bias and protectionist measures incentivize allocation of resources away from exports to domestic markets, encouraging inefficiencies and high cost.[11] This protectionism

Countries' Export Share of Global Exports **Figure 6.1.1**



*low-income Countries

Source: UNCTAD

[9] Source: IMF available at; https://www.imf.org/en/News/Articles/2024/09/27/pr-24343-pakistan-imf-concludes-2024-aiv-consultation-pakistan-approves-37-mo-extended-arr

[10] 'What are the factors making Pakistan's exports stagnant? Insights from literature review'; PIDE Knowledge Brief; March 2023

[11] IMF (2022). Pakistan: Selected Issues, IMF Staff Country Reports, Vol. 2022, No. 27.

shields local producers from competition, fostering rent-seeking behavior.[12] As a result, Pakistan is largely disconnected from the global value chain, leading to an inward-oriented economy.

In this regard, the tariff policy needs to be revisited with the objective of simplifying and lowering import duties to remove anti-export biases. Additionally, there should be a long-term aim to phase out protectionism as a policy and create the requisite supply conditions to enable a graduation towards low and uniform tariffs. Moreover, the government's approach must permanently shift away from using tariffs as revenue measures with the removal of para-duties. These reforms can be supplemented by maintaining exchange rate flexibility, curtailing smuggling and bolstering international trade agreements. These steps will serve to increase incentives to export by lowering costs and tariffs, enhancing international competitiveness, and reducing market distortions.

Improving aggregate productivity: Long-term productivity growth in Pakistan has been stagnant across agriculture, manufacturing, and services.[13] It is specifically hampered by scarce skilled human capital, limited female labor force participation and inadequate investment.[14] This is further exacerbated by low foreign direct investment and limited presence of multinational companies which results in lack of technological transfer and development of human skills.[15]

To address these issues, efforts should be diverted towards the development of human capital and encourage female employment through; (a) imparting skills keeping in view the industry's demand, (b) equipping the existing vocational and training institutions with the latest machines, systems and staff trainings, (c) arranging awareness sessions for marginalized sectors like SME and agriculture, and (d) gender-blind hiring and improving workplace harassment legislation. In addition, firms should be incentivized to boost productivity by upgrading machinery and technology including digital solutions.

Strengthening institutional and business environment:[16] Pakistan's institutional environment is characterized by weak contract enforcement, inefficiency, and policy uncertainty. This undermines export prospects by creating distortions, increasing business costs, and adding administrative burdens, which impedes the development of a dynamic and competitive landscape. In addition, weak quality infrastructure owing to lack of standardization and testing facilities, and weak accreditation raise costs for exporters, as they must obtain various certifications for different countries. Informal producers also undercut the market with inferior products, preventing compliant firms from achieving cost efficiencies in an environment where enforcement of standards is weak and policies tend to favor low price over quality.

Accordingly, there is a need for institutional reforms aimed at streamlining regulations and procedures. These include, but not limited to, reducing organizational entities with overlapping jurisdictions, revitalizing the e-office suites in the ministries, introducing public finance management, strengthening the secretaries' committees for ministerial coordination.[17] On the issue of quality infrastructure, government needs to facilitate in obtaining global equivalence as well as get the domestic institutions accredited with international bodies. Further, digitization of government services like the issuance of licenses, approvals, no-objection certificates and other public goods will not only reduce the cost of doing businesses but will foster a competitive export sector as well.[18]

[12] For example, government intervention such as protectionism may have the unintended consequence of making domestic profits abnormally high. Consequently, this leads to inward looking firms which devote all business and resources locally. Anti-export bias is thus an umbrella term for such distortions.
[13] WBG (2021). Pakistan Development Update, Reviving Exports: World Bank
[14] Source: World Development Indicators, World Bank.
[15] Amjad, R., & Awais, N. (2016). Pakistan's productivity performance and TFP trends 1980-2015: Cause for real concern. Khan, S. U. K.
[16] World Development Indicators, World Bank.
[17] Volume –I. Institutional Reforms in the Federal Government August 2018-August 2021. Reports on Reorganizing the Federal Govt.; Civil Services Reforms, Business Process Re-Engineering and Restructuring Key public sector Institutions. Available at: ishrathusain.iba.edu.pk/pdf/icr-volume-i.pdf
[18] South Korea's UNI-PASS e-system automates all customs procedures without requiring service users to pay in-person, enhancing the country's export efficiency. Source: Jones, D. S. (2008). Comparative Governance Reform in Asia: Democracy, Corruption, and Government Trust Research in Public Policy Analysis and Management, Volume 17, 111–134

Enhancing research and development (R&D): Low R&D in Pakistan hinders innovations and productivity. This is evident from Pakistan's low scores in the Global Innovation Index 2023 in areas like patents, creative goods exports, and knowledge-intensive jobs.[19] One of the major hurdles behind low levels of R&D and innovation is insufficient funding. Globally, pooling of funds and technical collaboration is done by sectoral trade organizations (TOs), unlike Pakistan where it is typically relied upon government.[20]

This can be addressed by pooling of government funds with the private sector (export development fund/sectoral levies) and establish dedicated research institutes to conduct R&D projects. An oversight body may be established to ensure effective utilization of R&D funds. Research commercialization should also be a key end-product of every sectoral R&D framework.[21] In addition, the country's TOs needs to be reformed along with fiscal incentives for private sector R&D, where sectoral R&D frameworks' integration along global value chain also needs to be in place.

Addressing the issue of Intellectual Property Rights (IPRs): Despite signing major IPR treaties and having a legal framework and regulator, Pakistan struggles with poor implementation of IPRs. For example, there is a dearth of IP tribunals leading to significant delays in IPR violation cases. There is also low awareness of IPRs in the country and weak penalties for its violations. These problems harm exports by discouraging R&D, complicating branding, and preventing innovators from scaling up.

To overcome this, specialized IPRs government bodies need to educate businesses about the value of protecting IPRs, facilitate firms in IPR protection, and ready them for international markets. This may be done in coordination with other public sector bodies, such as SMEDA and private sector trade associations. Domestically, it is vital to expand and strengthen specialized IPR courts as well as IPR training to judges and legal practitioners for better IPRs enforcement in Pakistan.

Increasing outreach to new markets for exports: Pakistan's exports have remained concentrated in a few sectors and destinations. For instance, the textile and food constitute major portion of exports, with little change to this pattern.[22] Similarly, most of Pakistan's exports between FY06 and FY23, went to USA, UK, select EU economies and China. Due to the lack of diversification in export markets, exports are susceptible to destination-specific and sectoral shocks. The ability to expand export destinations is also constrained by weak levels of competitiveness and poor trade infrastructure.[23]

To tap new export markets, public and private sector stakeholders need to extensively engage in conducting market research, localized marketing, forging partnerships and leveraging e-commerce platforms.[24] Further, assessment of Pakistan's comparative advantage in difference sectors and analysis of top traded global commodities in new or non-traditional sectors is also warranted to diversify exports.[25] The trade missions abroad can facilitate Pakistani exporters by maintaining an up-to-date list of relevant information, such as key markets, quality standards, safety protocols, non-tariff barriers, key contacts in relevant government institutions, product-specific trade bodies and their key staff, buying agents and other local agents.

[19] GII is calculated on basis of a country's state of institutions, human capital and research, infrastructure, market sophistication, business sophistication, knowledge and technology outputs and creative outputs. Some of the metrics analyzed for this table include sub-metrics of Business sophistication including knowledge intensive employment and the sub-metrics of the metric Creative Outputs including creative goods exports as percent of total trade. It also includes the sub-metrics of Knowledge and Technology Outputs including Patents by origin and high-tech exports as a percent of total trade. The rank is out of 211 economies. Source: WIPO

[20] For instance, the Barcelona Chamber of Commerce developed the Knowledge Innovation Market with the objective of promoting innovation through technology evaluation and collaborations with universities, research centers, technology parks and public administrations.

[21] South Korea's heavy R&D investment in semi-conductor sector and the subsequent commercialization of high-quality semiconductor products helped it in becoming one of the world's leading exporters of semiconductors.

[22] For instance, textile and food exports combined accounted for 74.2 percent of total exports in FY06, which increased marginally to 77.6 percent in FY23.

[23] *WBG (2021). Pakistan Development Update, Reviving Exports: World Bank*

[24] *International Trade Council website: https://tradecouncil.org/export-market-diversification/*

[25] SBP estimates suggest, other than textile, Pakistan has comparative advantage in vegetable products, footwear and live animals.

To facilitate logistics and trade infrastructure, government needs to develop a rail cargo system to improve the efficiency of goods transportation within Pakistan and potentially extend it across borders. While these projects are long-term in nature, government may consider subsidizing international air cargo flights in the interim to support exports to new and far-flung regions. Lastly, commercial banks may be taken on board to open operations in potentially new markets to facilitate exporters.

6.3 Current Account

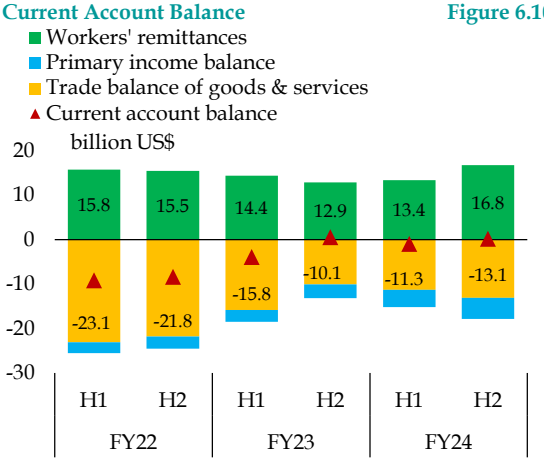
The CAD narrowed by 79.7 percent to $0.7 billion in FY24, from US$3.3 billion in FY23. This significant reduction in the CAD is attributed to improved trade balance and policy-driven growth in workers' remittances, which partially offset the widening in primary income deficit (**Figure 6.10**). Workers' remittances were particularly strong in the second half of FY24, driven reduced kerb premium, and various incentives announced by the government and the SBP.[26]

The narrowing of the trade deficit was primarily due to increase in exports, as imports also grew moderately by 0.9 percent in FY24 against the contraction of 26.3 percent in FY23. The key factors that contained growth in imports included increase in domestic crop output, improved electricity generation mix, and decline in global commodity prices.[27]

Exports grew by 11.6 percent, largely supported by increased volumes as unit values witnessed decline. Also, the growth in exports was majorly attributed to non-textile groups, especially food group, which was the first time since FY18. Food exports surged by 49.5 percent in FY24 on the back of record rice exports, supported by bumper harvest and India's ban on rice export.[28] Excluding rice, overall exports posted a growth of 6.4 percent.

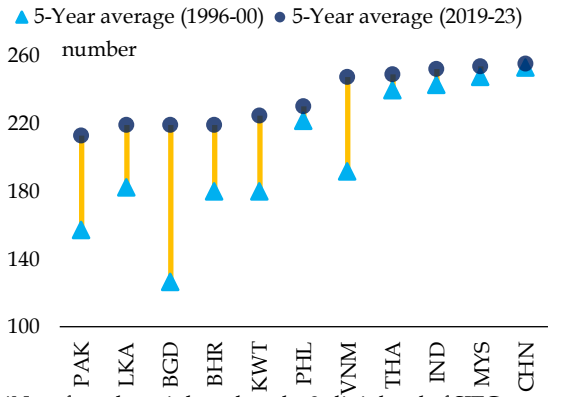
Notwithstanding improved export performance in FY24, occasional spurts in exports have remained mostly concentrated to a particular group or an item. This is because the country has a limited export basket, which does not bode well for sustained increase in exports. **Figure**

Current Account Balance **Figure 6.10**



Source: State Bank of Pakistan

Change in Number of Export Products* **Figure 6.11**



*No. of products is based on the 3-digit level of SITC, Revision 3. The maximum number of products is 261

Source: UNCTAD

[26] SBP and GoP introduced a number of policy measures including; Reforms in the Exchange Companies Sector (www.sbp.org.pk/epd/2023/FEC3.htm); Enhancement in the Reimbursement of TT Charges (www.sbp.org.pk/epd/2023/FECL14.htm); and Incentive Scheme for Marketing of Home Remittances (www.sbp.org.pk/epd/2023/FECL15.htm) to encourage the flow of remittances through formal channels.

[27] Disaggregated data reveals that there was a significant increase in non-essential imports like machinery, transport, metals, and raw materials as SBP eased priority guidelines since the start of fiscal year. However, improved domestic crop output coupled with declining global commodity prices led to decline in imports of essential items like food, petroleum and cotton.

[28] Worried over lower output due to the El Nino weather pattern, India banned shipments of non-basmati white rice varieties in July 2023, and imposed curbs on other grades in order to address the concerns over food security and high domestic prices.

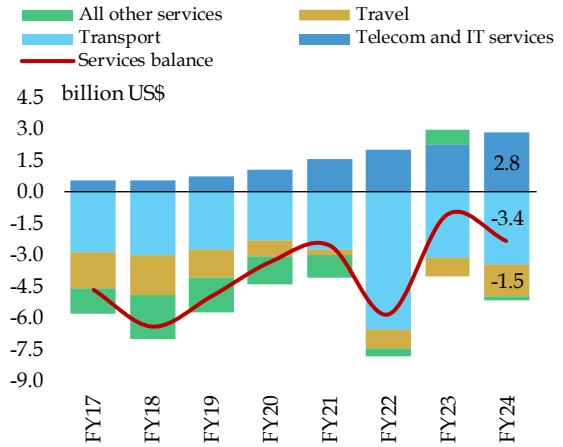
6.11 shows that even after witnessing an improvement over the last two decades, Pakistan's exports basket still has the lowest number of items as compared to the regional peers.

Services Account

The services trade deficit more than doubled in FY24, as growth in services imports outweighed the increase in exports. The import of services increased by 17.0 percent in FY24, against a decline of 33.3 percent in the previous year. This was primarily driven by increased payments for transport, travel, and technical services related to trade and other businesses (**Figure 6.12**).

Almost entire growth in transport payments came on the back of a surge in air travel, which can also be corroborated from the increased personal travel payments.[29] Specifically, these are because of a gradual increase in international air fares as well as higher international traffic,

Services Account Balance **Figure 6.12**



Source: State Bank of Pakistan

particularly from the Asian region, as measured by Revenue Passenger Kilometers (RPK) (**Figure 6.13**).[30,31] On the other hand, sea freight – the major component of goods transport segment – remained almost similar as in the previous year, in line with the lackluster growth in import of goods (**Table 6.2**).

Trade in Services in FY24 **Table 6.2**

million US$

	Import (M)		Export (X)		Balance (X-M)	
	FY24	Absolute Change	FY24	Absolute Change	FY24	Absolute Change
a) Transport	**4,292.0**	**233.8**	**859.0**	**-67.7**	**-3,433.0**	**-301.5**
Sea freight	2,603.3	-29.2	85.8	-58.0	-2,517.5	-28.8
Air passengers	1,164.8	272.3	344.8	-70.3	-820.1	-342.6
Air freight	54.2	-10.6	25.4	-0.4	-28.8	10.2
b) Travel	**2,270.5**	**393.5**	**759.1**	**-212.4**	**-1,511.5**	**-605.8**
Education expenses	519.9	160.6	21.3	9.7	-498.6	-150.9
Other (personal)	1,724.5	223.5	710.6	-235.9	-1,013.9	-459.3
c) ICT Services	**395.6**	**96.6**	**3,222.9**	**626.1**	**2,827.2**	**529.4**
Software consultancy services	166.6	36.8	870.1	109.9	703.5	73.2
Other computer services	28.0	-9.5	1,140.0	409.6	1,112.0	419.1
Export/Import of computer software	120.1	33.2	631.3	33.2	511.2	-0.1
Telecommunications services	74.3	36.8	299.4	34.9	225.0	-1.9
Subtotal (a+b+c)	**6,958.1**	**724.0**	**4,840.9**	**346.0**	**-2,117.2**	**-377.9**
Total services	**10,109.9**	**1,471.3**	**7,802.6**	**207.2**	**-2,307.3**	**-1,264.1**

Source: State Bank of Pakistan

[29] There is also increase in education-related expenditure under travel payments which is likely due to the surge in international education fees.

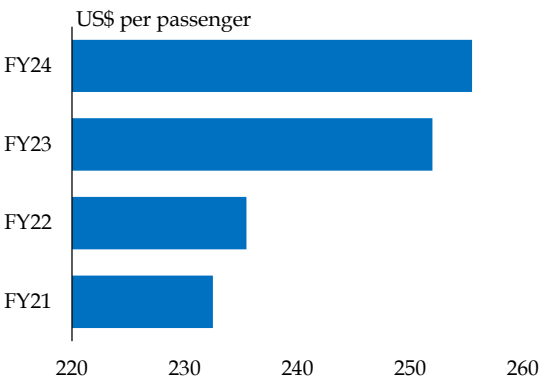
[30] Revenue Passenger Kilometers (RPK) or Revenue Passenger Miles (RPM) is an airline industry metric that shows the number of kilometers traveled by paying passengers. It is calculated as the number of revenue passengers multiplied by the total distance traveled. Since it measures the actual demand for air transport, it is often referred to as airline traffic.

[31] IATA reports that Asia Pacific carriers were the main contributors to the RPK growth followed by European carriers.

Export of services grew by only 2.7 percent in FY24, majorly contributed by robust ICT exports on account of increased demand for software consultancy, call center services, and other computer services. The rising demand for overall IT services is attributable to post-pandemic digitalization drive across the globe.

Among the major categories of IT spending, software segment has recorded the highest growth as companies focused on enhancing productivity, automation, and other software-driven transformation efforts to gain a competitive edge.[32] The recent initiatives by the SBP and the government also contributed to the increase in ICT services exports (**Box 6.2**).

Average Real Return Fare* **Figure 6.13**



*inflation adjusted fares before surcharges and taxes; based on 2018 US$ prices
Source: International Air Transport Association

Box 6.2: Pakistan's ICT Exports in the Context of Containing Services Trade Deficit

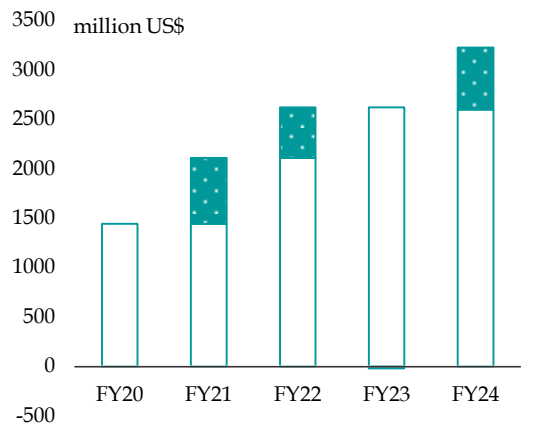
Pakistan's ICT exports grew by 24.1 percent to US$ 3.2 billion in FY24. This represents the highest ever ICT exports, accounting for 8.3 percent of Pakistan's total exports of goods and services in FY24 (**Figure 6.2.1**). Considering the potential and target set of the ICT exports over the medium term, these exports could help in containing the services account deficit, and thus contributing to sustainable current account balance.

ICT services are categorized into three main sub-groups: telecommunication services, computer services, and information services. Computer services is the largest segment, accounting for more than 80 percent of total ICT exports in FY24. Within this category, the highest revenue comes from other computer services including freelancers, followed by software consultancy and software exports (**Figure 6.2.2**).[33]

The significant growth in Pakistan's ICT exports, over the last year, is driven by a host of factors, including enhanced penetration of IT companies in the GCC region, Prime Minister's IT package, relaxation in the permissible retention limit by the SBP, new framework for freelancers, and stability in the exchange rate, which are briefly discussed below:

a) **Enhanced penetration in GCC region**: Pakistani IT companies are actively engaging GCC clients. There is an increasing focus of Gulf countries on diversifying their economies by scaling up digital infrastructure, particularly in sectors such as finance, healthcare, and education.[34] And, with the shared cultural similarities

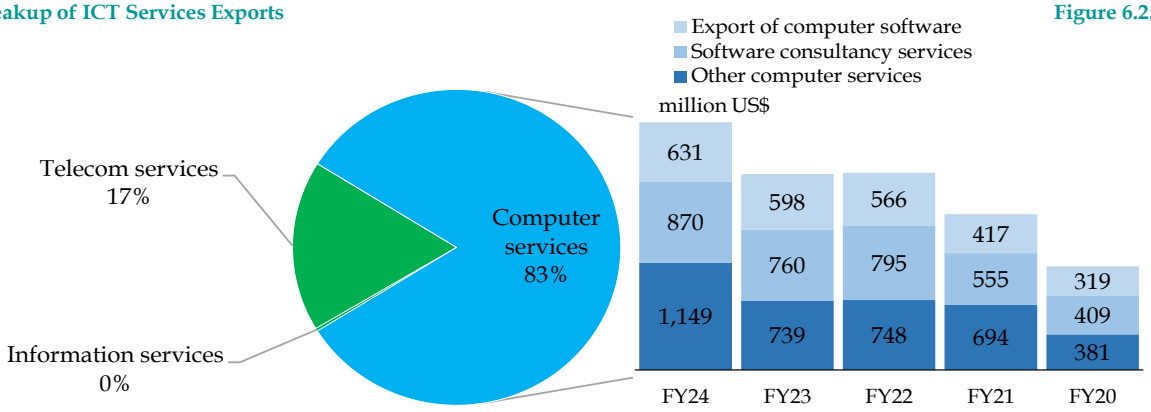
ICT Exports **Figure 6.2.1**



Source: State Bank of Pakistan

[32] Gartner for High Tech (a leading global research and advisory firm that provides insights and analysis for various industries, including high technology) reports that worldwide IT spending grew by 3.3 percent in 2023. The overall IT spending is comprised of Data Center Systems, Devices, Software, IT Services and Communication Services. Among these, only software segment has posted a double-digit growth of 12.4 percent in 2023, followed by data centers (7.1 percent), IT services (5.8 percent) and communication services (1.5 percent), whereas devices declined by 8.7 percent due to changing consumer preferences.
[33] The 'other computer services' category includes various hardware, software, and related services. Industry estimates suggest that Pakistan primarily exports software and software-related services due to its less developed hardware sector.
[34] This is backed by Saudi Vision 2030 (https://www.vision2030.gov.sa/en/overview) which underscores Kingdom's growing demand for technological solutions and services. A similar development plans exists for UAE, Qatar, Egypt and Kuwait.

Breakup of ICT Services Exports **Figure 6.2.2**



Source: State Bank of Pakistan

between Pakistan and GCC nations, Pakistan has taken advantage of this opportunity with several leading companies setting up regional and representative offices in these countries to increase exports of IT services. Further, Pakistani delegations, led by high-level officials from concerned ministries, have been keenly visiting GCC countries in the outgoing year which are making investments to achieve the targets of their mega plans.[35]

b) **Government's IT package**: In FY24 budget, the government announced multiple incentives to promote IT and IT enabled services and boost the foreign exchange earnings.[36] Some of these are:

- A concessional rate of income tax of 0.25 percent will continue till June 30, 2026;
- Reduction in sales tax on IT services from 15 percent to 5 percent;
- A tax concession of 20 percent to banks on earnings from lending to this sector;
- Exemption from sales tax registration and filing of returns to freelancers having export volume up to US$ 24,000 per annum;
- Permission to IT and IT-enabled service to import software and hardware valued at up to one percent of their exports without incurring any tax. The annual cap for these imports is set at US$ 50,000;

c) **Enhancement in the permissible retention limit of IT exporters**:[37] In order to facilitate IT exporters to boost export volumes and expand IT-enabled services, the SBP raised the allowable retention limit for IT exporters in their Exporters' Specialized Foreign Currency Accounts (ESFCAs) from 35 percent to 50 percent of their export earnings in October 2023. This facility has improved liquidity of IT companies and enabled them to procure intermediate inputs required for meeting big-ticket orders. Additionally, the process for using the balances in ESFCAs has been streamlined, allowing IT exporters to make payments directly from these accounts without needing approval from the SBP or banks. Banks have also been instructed to support the issuance of debit cards to IT exporters to make online payments using the funds in their ESFCAs.

d) **Introduction of new Framework for Freelancers:**[38] The SBP introduced a new Framework for Freelancers to simplify the process of opening bank accounts and permit greater retention of funds in their Foreign Currency (FCY) accounts. Freelancers can now open bank accounts either digitally or physically with minimal documentation. Their ESFCAs will be established simultaneously with their primary PKR accounts. Freelancers will be allowed to retain either 50 percent of their export proceeds or up to US$ 5,000 per month, whichever is

[35] In March 2024, a delegation of 38 Pakistani IT companies attended Leading Edge Advancement and Progress (LEAP) event in Saudi Arabia and in May 2024 Prime Minister and IT Minister of Pakistan attended UAE Pakistan Tech Collaboration in Abu Dhabi
[36] There are other measures, as highlighted in https://www.finance.gov.pk/budget/Budget_2023_24/Speech_english_2023_24.pdf, like, Issuance of Automated Exemption Certificate for Exporters of IT and IT Services, Creation of specialized courts to handle IT-related legal disputes and Professional training for 50000 IT graduates; however, their implementation status remains unclear.
[37] https://www.sbp.org.pk/epd/2023/FECL17.htm
[38] https://www.sbp.org.pk/bprd/2023/C5.htm

higher, in their ESFCAs and can make payments from these accounts without needing approval from the SBP or banks.

e) **Exchange rate stability**: The reduced volatility in the exchange rate has encouraged IT exporters to repatriate a larger portion of their profits to Pakistan. Previously, as anecdote suggests, the exporters were holding the proceeds in anticipation of the depreciation in PKR.

It is important to mention that these measures have been introduced in FY24 and their full impact may be reflected in the ongoing fiscal year. At the same time, it is also important to address the challenges IT firms are facing. These include providing seamless internet connectivity, state-of-the-art infrastructure, access to global payment system (like PayPal), reducing cybersecurity risks, data protection, and the development of advanced technical skills.[39]

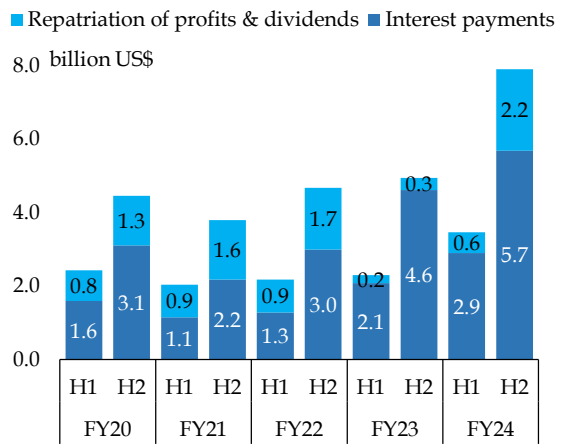
These challenges have already started to weigh on several IT firms and free lancers.[40] Hence, it is important to address these issues to sustain this trajectory and harness the transformative potential of IT. The government must prioritize the digitalization of economy in both public and private sectors. This includes tackling issues of uninterrupted IT service availability and affordability, fostering a supportive environment for start-ups and freelancers, ensuring robust technology by introducing ancillary frameworks, and improving the skillset of human resource through relevant training and equipment.

Primary Income Account

The primary income deficit rose to US$ 8.6 billion in FY24, compared to US$ 5.8 billion the previous year. This surge was mainly driven by a considerable increase in interest payments on external loans and repatriation of outstanding profits and dividends (**Figure 6.14**). The surge in interest payments is attributable to both the increase in external debt stock and global interest rates.[41]

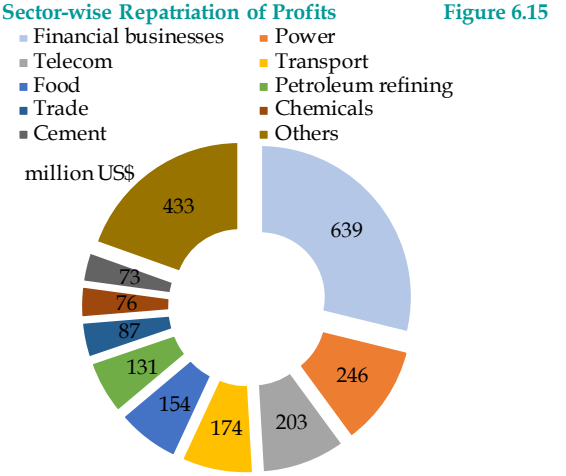
Meanwhile, improved forex liquidity allowed banks to clear the outstanding repatriation of profits and dividends, which increased nearly threefold in the second half compared to the first half, totaling $2.2 billion in FY24. About half of this originated from four key sectors—financial

Payments under Primary Income Account **Figure 6.14**



Source: State Bank of Pakistan

Sector-wise Repatriation of Profits **Figure 6.15**



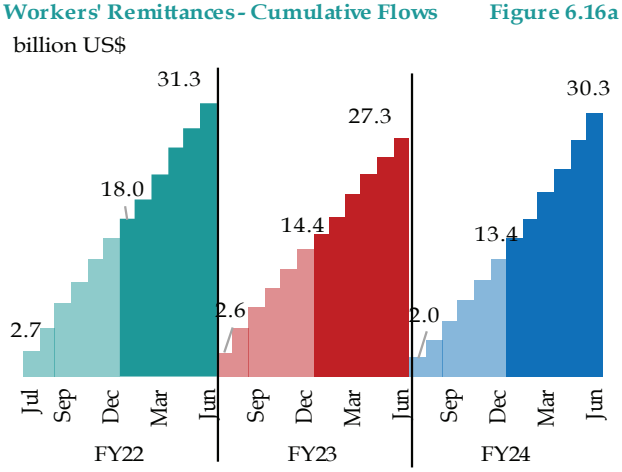
Source: State Bank of Pakistan

[39] As per Ookla's Speedtest Global Index, which measures internet performance of countries by their average internet download and upload speeds, Pakistan ranks at 142 in terms of median internet download speeds, as of June 2024. This is the lowest compared to its regional peers like Sri Lanka (131), Bangladesh (100), India (85) and Nepal (77).

[40] Pakistan Business Council (PBC) reports that most of the IT firms are relocating to other regions due to lack of conducive infrastructure in Pakistan. The key factors contributing to infrastructure include enforcement of contracts, high cost of doing business, political uncertainties, soaring electricity costs, and deteriorating law and order.

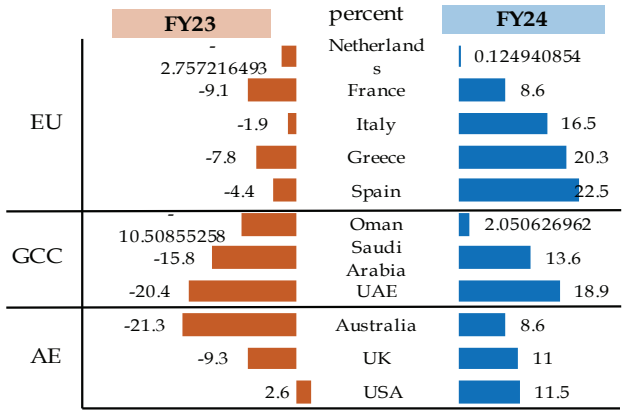
[41] 10-year US sovereign benchmark yield surged from 1.9 percent in FY22 to 3.6 percent in FY23, and 4.3 percent in FY24. A similar pattern was also seen in the yield for UK sovereign bonds.

Workers' Remittances - Cumulative Flows Figure 6.16a



Source: State Bank of Pakistan

Growth in Remittances from Major Destinations Figure 6.16b



Source: State Bank of Pakistan

services, power, telecom, and transport— which highlights the lack of diversification in investment orientation of economy (**Figure 6.15**).

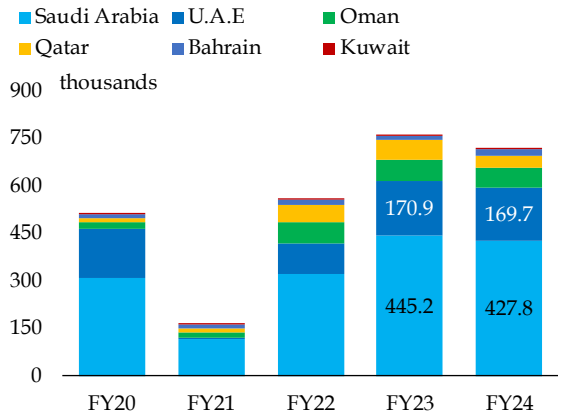
Workers' Remittances

After witnessing a decline in FY23, workers' remittances surged by 10.7 percent to US$ 30.3 billion in FY24. Importantly, the growth was broad-based, with inflows from all the major corridors recording a double-digit growth (**Figures 6.16a & 6.16b**). This increase is attributable to a host of global as well as domestic factors.

Globally, stronger labor markets along with declining inflation in US and Europe, resulted in improved real wages, thereby increasing remittance inflows from these economies.[42] In case of GCC countries, the main factor was robust employment opportunities in Saudi mega-projects, as indicated by increased number of emigrants to GCC (**Figure 6.17**). On the domestic front, policy measures aimed at reducing the kerb premium also facilitated increased remittance inflows through official channels.[43]

It is worth mentioning that several measures introduced by the SBP and the Government are yielding desirable results. The closure of some of the B-category exchange companies is helping in alleviating additional pressure on kerb market premium.[44] Further, most of the large and medium sized banks – actively engaged in foreign exchange business – have announced to establish their subsidiary exchange companies to capture the market. Besides, some of the banks have also introduced various incentives linked to remittance accounts/flows to enhance customer base.[45]

Number of Registered Workers Going Abroad Figure 6.17



Source: Bureau of Emigration & Overseas Employment

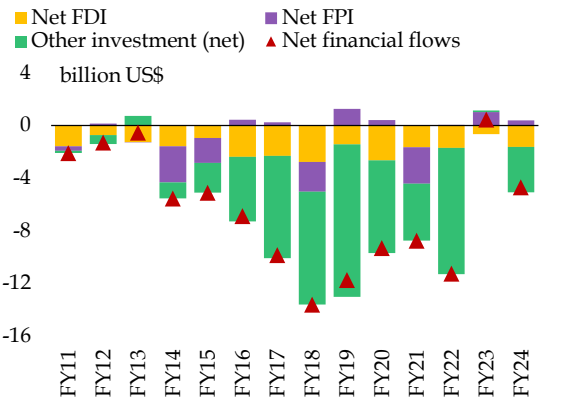
[42] World Bank's Migration and Development Brief 40, June 2024.
[43] Average monthly flow increased from US$ 2.28 billion in FY23 to US$ 2.52 billion in FY24.
[44] SBP press release on authorization of exchange companies dated Feb 13, 2024.
[45] For instance, one of the large-sized banks has offered free life and health insurance, and discounts on lab and medicines associated to its remittance account. Another medium-sized bank has introduced an advanced remittance service to expedite the processing of remittance with competitive exchange rates.

Moreover, the government has made changes in various incentive schemes to enhance their effectiveness and attract more remittance inflows through official channels. For instance, reimbursement of TT charges rate, for eligible home remittance transactions, was enhanced from SAR 20 to SAR 30. Similarly, the rate of cash incentive offered to the financial institutions for any incremental home remittances up to five percent, between five and ten percent, and over ten percent was also increased to Rs 1, Rs 2 and Rs 3 per US$, respectively, for each slab.[46] Lastly, a recent ADB study suggests that higher inflation in Pakistan has been an important factor leading to an increase in remittances as dependents in the host country need more money to cope with the rising cost of living.[47]

6.4 Financial Account

The financial account saw net inflows of US$ 4.7 billion in FY24, against the net outflows of US$ 0.5 billion in FY23 (**Figure 6.18**). This turnaround in financial account was due to both higher inflows and significantly lower debt amortization during the year. In case of private

Financial Account Breakdown **Figure 6.18**



Note: as per BPM6, negative sign means net FX inflow into Pakistan and vice versa

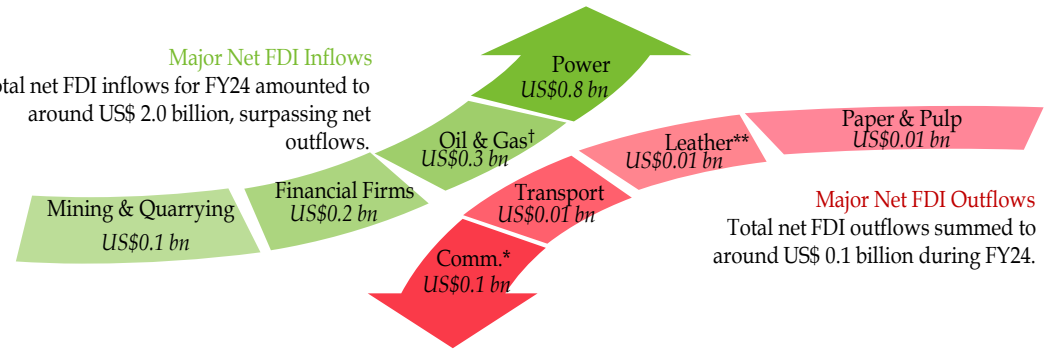
Source: State Bank of Pakistan

inflows, while FDI recovered, foreign portfolio investments saw outflow on account of repayment of Eurobond in April 2024. Further capital transfers also remained lower as per the trend with the exception of FY23.[48]

Foreign Direct Investment in Pakistan

Unlike last year, gross inflows significantly outweighed the gross outflows. As a result, net FDI rose by 16.9 percent to US$ 1.9 billion in FY24. The sectors including power (excluding

Major Sector-wise Net FDI Flows in FY24 **Figure 6.19**



**communications; **leather & leather products; †exploration*

Source: State Bank of Pakistan

[46] Previously, this was Rs 0.5, Rs 0.75 and Rs 1 per US$, respectively, for each slab.

[47] The findings of the study available at https://www.adb.org/publications/understanding-drivers-remittances-pakistan suggest that domestic inflation has a persistent positive impact on remittances, albeit not always statistically significant. This result is also consistent with other studies and indicates that, in line with the altruistic motive to remit, migrants send more money back home when domestic inflation is accelerating and eroding households' real incomes.

[48] In FY23, capital account witnessed a sum of US$ 221 million on account of debt forgiveness via the Reko Diq project.

thermal), oil and gas exploration and mining and quarrying witnessed large gross inflows, compared to significant gross outflows from sectors including communications, thermal power, and financial businesses (**Figure 6.19**).

Major sectors recording gross FDI inflows

The power sector saw significant inflows into coal and hydel projects, largely from China. This included investment by an electric company to connect Thar coal fields by rail.[49] Additionally, inflows came due to a joint venture for a 1,320 MW coal-based power plant. Similarly, Suki Kinari project that is currently underway saw inflows from China.[50] Also, an ongoing solar power project received investment from a Dutch company.[51]

Oil and gas exploration experienced increased inflows due to ARAMCO's acquisition of equity stake in a local Pakistani oil drilling and exploration firm.[52] In the mining and quarrying sector, most inflows were realized in Reko Diq project from Barrick Gold Corporation.[53]

Oil refining saw an uptick in FDI after the government introduced a Brownfield Refinery Policy, aimed to counter eroding foreign investor confidence and stimulating investments in ongoing projects.[54] This policy follows the Greenfield Refinery Policy.

In the trade subsector, there were inflows from a French company that introduced cashless transactions. In the same vein, financial businesses saw inflows from Malaysian investment for the operation of a wholly-owned Exchange Company of a commercial bank. The storage facilities also saw inflows due to the partial acquisition of a terminal company by a Dutch entity. Collaborations with local hospitals also attracted inflows from a Swiss medical innovator.[55]

The miscellaneous sector – oilseeds, grains, and rice – attracted inflows from a Dutch company working on merchandizing and processing, which has a growing presence in Pakistan.[56]

Major sector showing gross FDI outflows

Power sector also witnessed outflows from a coal-based power project. Additionally, the completion of the Uch Power Project also led to outflows from a thermal power project.

The communication sector saw substantial outflows as a major telecom company sold its stakes to a local company, resulting in net outflow of FDI from the sector.[57] Similarly, The chemicals sector observed outflows following the acquisition of a foreign company by a local entity. In petroleum refining, acquisitions led to gross FDI outflows to Luxembourg.

Gross outflows from food and beverages sector were largely due to the divestment of a partial stake in an infant-formula retailing company to a Japanese company. Furthermore, imposition of increased federal excise taxes on carbonated and artificially sweetened beverages appears to have discouraged foreign investment in the sector.[58]

The construction sector saw outflows from the UAE because of the completion of an apartment-

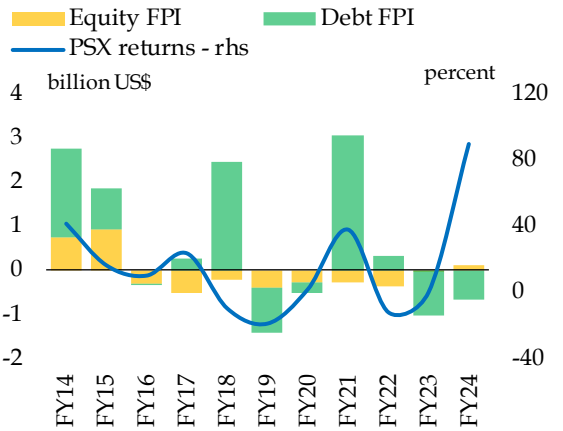
[49] Global Energy Monitor; www.gem.wiki/Port_Qasim_EPC_power_station
[50] CPEC; www.cpec.gov.pk/project-details/15
[51] NEPRA; www.nepra.org.pk/tariff/Tariff/Petitions/2019/December/Tariff%20petition%20-%20Helios%20Web.pdf
[52] Source: www.aramco.com/en/news-media/news/2024/aramco-completes-acquisition-of-stake-in-gas-and-oil-pakistan
[53] Source: www.barrick.com/English/operations/reko-diq/default.aspx
[54] Pakistan Oil Refining Policy for Upgradation of Existing/Brownfield Refineries, 2023; Ministry of Energy (Petroleum Division)
[55] AKUH; www.hospitals.aku.edu/pakistan/AboutUs/News/Pages/akuh-partnership-with-medtronic.aspx#:~:text=Medtronic%2C%20renowned%20for%20its%20prowess,and%20tackle%20global%20health%20challenges.
[56] Louis Dreyfus Company: 2023 Integrated Report
[57] PTCL Press Release, Dec 14, 2023
[58] Circular No.01 of 2023, C.No.3(1)ST-L&P/2019 (Pt-I)/33186-R, Government of Pakistan, Revenue Division, Federal Board of Revenue

Sector-wise Net FPI in FY24 **Figure 6.20**
million US$

**generation & distribution; †exploration & marketing; ^& personal care products*

Source: State Bank of Pakistan

FPI and Stock Market Performance **Figure 6.21**



Sources: SBP and Haver Analytics

building project. There were also outflows from an Emirati company nearing closure. Inflows from a Swiss trade company declined as it gradually winds down its operations in Pakistan.

Foreign Portfolio Investment

Net FPI outflows totaled US$ 0.4 billion in FY24, lower than the net outflows of US$ 1.0 billion in FY23. This was because increased inflows in debt and equity markets during FY24 partly offset the repayment of Eurobond worth US$ 1 billion.

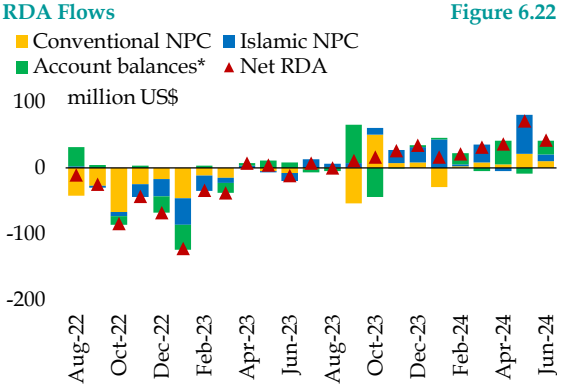
However, despite impressive returns, equity market could only attract inflows of US$ 121 million, mostly concentrated in commercial banks, fertilizer, cement, power, oil and gas, and food sectors (**Figure 6.20**). Economic and political uncertainty, weak growth prospects amid high inflation, and almost unchanged sovereign credit rating after a downgrade in February 2023 are some of the factors that restricted inflows in equity market (**Figure 6.21**).[59]

In debt instruments, it was mainly the Islamic Naya Pakistan Certificates (Islamic NPCs) that attracted significant inflows via Roshan Digital Accounts (RDA). There has been a growing interest in Islamic NPCs as reflected by the rising investments via the RDA in FY24. One of the reasons behind this increase was the upward revision in rates of return on these instruments (**Figure 6.22**).[60]

FX Loans and Liabilities

FX loans and liabilities posted a net inflow of US$ 3.3 billion during FY24. A breakdown of inflows reveals that most of the loan

RDA Flows **Figure 6.22**



*including Roshan equity investments and other liabilities (outstanding position in government securities like T-bills, Sukuk, real estate, mutual funds, etc. but excludes NPCs)

Source: State Bank of Pakistan

[59] Credit rating has remained unchanged during FY24, with upgrading by Fitch in July 2024. The status has been affirmed in December 2023, remaining at CCC. Other credit rating agencies have also kept Pakistan's ratings stable (Caa3 by Moody's and CCC+ by S&P). Sources: Trading Economics; Fitch Ratings

[60] Specifically, US$ rate of return on 3-month NPCs was increased from 7.0 to 8.25 percent, from 7.2 at 8.5 percent on 6-month, and from 7.5 to 9 percent on 12-month NPCs.

Breakdown of Foreign Loan Inflows in Major Projects of FY24 **Table 6.3**

Organization	Project Name	Project Description/Purpose	Amount Disbursed *million US$*
World Bank*	Sindh Flood Emergency Rehabilitation (SFER)	Physical resilience, supporting livelihoods via cash for work programs, institutional strengthening and technical assistance, project management and operational costs, and contingent emergency response.	243.2
	Sindh Flood Emergency Housing (SFEH)	Housing reconstruction grants, institutional strengthening and technical assistance, and project management and implementation support.	250.0
	Second Resilient Institutions for Sustainable Economy (RISE-II) Development Policy Financing	Aims to strengthen fiscal management while promoting competition for inclusive and sustained economic growth.	350.0
Asian Development Bank	Improved Resources Mobilization and Utilization Performance	To aid the government in achieving fiscal consolidation, as part of the Vision 2025.	300.0
	Promoting Sustainable Public-Private Program	Supporting the government in promoting broad-based, inclusive and sustainable economic growth.	250.0
Asian Infrastructure Investment Bank	Second Resilient Institutions for Sustainable Economy (RISE-II) Development Policy Financing	Target of strengthening fiscal management and promoting competitiveness for both sustained and inclusive economic growth.	249.4
Islamic Development Bank	MURABAHA Financing Facility	Islamic short-term financing for purchase of the following: product inventory, raw materials, commodities, agricultural inputs, equipment and machinery, vehicles.	100.0
	ITFC Short Term Financing	Import of oil and LNG.	100.0

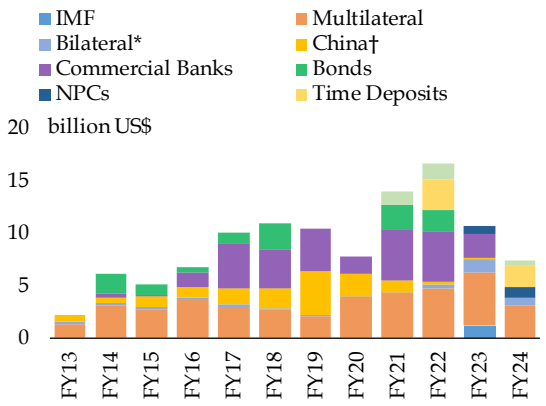
*includes International Development Association (IDA) and International Bank for Reconstruction and Development (IBRD)

Sources: World Bank, ADB, AIIB, IsDB, EAD

disbursements were sourced from multilateral institutions, such as the IMF, the World Bank, and ADB (**Figure 6.23**). The IMF in particular disbursed US$ 3.0 billion in three tranches under the 9-month Stand-By Arrangement. The World Bank disbursed US$ 2.2 billion with a significant portion (US$ 493.2 million) meant for the Sindh Flood Emergency Rehabilitation and Housing Projects (SFER and SFEH). The details about major inflows by project and creditor are given in **Table 6.3**.

Besides multilateral inflows, other bilateral inflows included US$ 595.2 million under Saudi oil facility; US$ 96.3 million for Mohmand Dam Hydro Power Project;[61] and US$ 58.3 million from China for the Phase II of the Karakoram Highway and the Peshawar Karachi Motorway.[62]

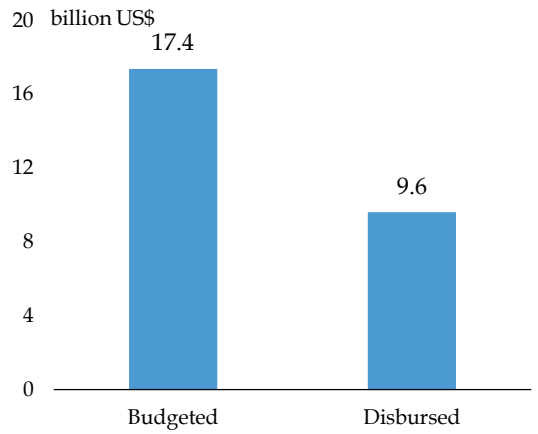
Foreign Loans Disbursement in FY24 **Figure 6.23**



*excluding China; †including deposits

Source: Economic Affairs Division

Total Foreign Loans in FY24 **Figure 6.24**

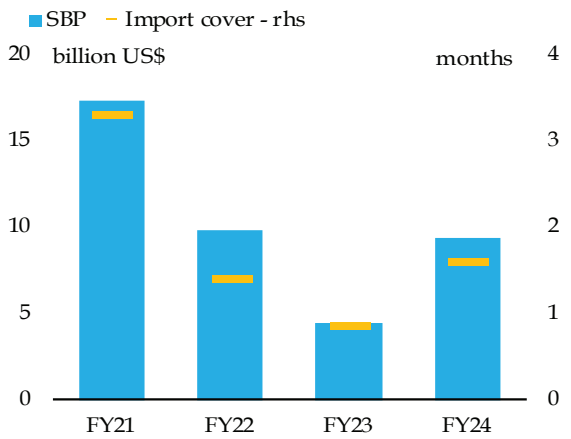


Source: Economic Affairs Division

[61] WAPDA: www.archive.wapda.gov.pk/index.php/projects/water-sector/under-construction/mohmand-dam-hydropower-project

[62] ead.gov.pk

Pakistan's End-Period Forex Reserves **Figure 6.25**



Source: State Bank of Pakistan

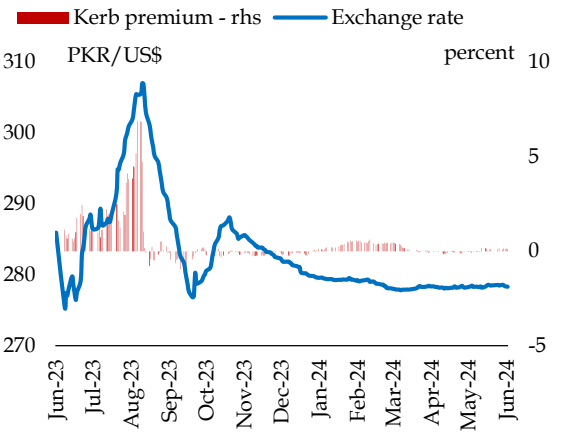
In addition, Pakistan received US$ 2.0 billion from Saudi Arabia (time deposit with the government) and US$ 1.0 billion from UAE (deposits with the central bank), and a guaranteed loan of US$ 508.3 million from China as major foreign liabilities during FY24. Loans from NPCs summed to US$ 1.1 billion during the period under review. Nonetheless, the disbursed amount of FX loans during FY24 was almost half of the budget estimates (**Figure 6.24**).

6.5 Exchange Rate and FX Reserves

The SBP's liquid FX reserves rose to US$ 9.4 billion at end June 2024 from US$ 4.4 billion at end Jun 2023 (**Figure 6.25**). Importantly, the quality of reserves has also improved, with a reduction in the SBP's forward/swap liabilities.[63] Major factors, as discussed above, included improved financial inflows and narrowing of the CAD, which provided the SBP room to build external buffers. Moreover, the amortization of FX loans was also lower in FY24. As a result, the reserve adequacy improved to 1.6 months of next year's imports of goods and services.

The reserve build-up, combined with the introduction of exchange company reforms in

Exchange Rate and Kerb Premium in FY24 **Figure 6.26**

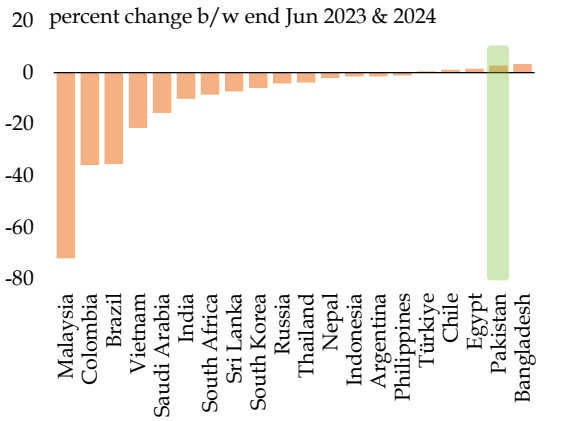


Source: State Bank of Pakistan

September 2023, supported the PKR appreciation by 9.8 percent between end August 2023 and end June 2024. These developments also led to a substantial reduction in the kerb premium, which averaged PKR 1.2 during FY24, down from an average of PKR 5.2 in FY23 (**Figure 6.26**).

Initially, during Jul-Aug 2023, tight global financial conditions, heightened domestic uncertainty, and higher CAD had increased pressures in the foreign exchange market. However, following administrative measures by the government and introduction of reforms in exchange companies by the SBP in September 2023, the PKR started to appreciate.

Cross-Country Currency Changes **Figure 6.27**



Source: State Bank of Pakistan

[63] The outstanding forward/swap liabilities reduced from US$ 4.5 billion at the end of FY23, to US$ 3.4 billion at the end of FY24.

Pakistan's Foreign Trade **Table 6.4**

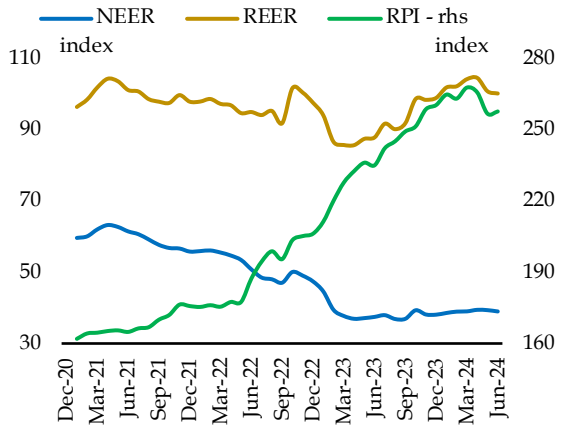
million US$, growth in percent

			Change (FY24)		Volume and Price Effects	
	FY23	FY24	Absolute	Percent	VE	PE
Trade Balance	**-27,474.0**	**-24,121.0**	**3,353.0**	**-12.2**	**-**	**-**
Exports	**27,724.0**	**30,677.0**	**2,952.3**	**10.7**	**-**	**-**
Textile	16,501.8	16,655.9	154.1	0.9	-	-
Apparel	7,928.7	7,971.2	42.5	0.5	1,947.5	-1,905.0
Home textile	3,691.2	3,857.8	166.5	4.5	545.4	-378.8
Cotton yarn	844.3	955.5	111.2	13.2	213.9	-102.7
Non-textile	11,227.4	14,025.8	2,798.4	24.9	-	-
Rice	2,149.1	3,931.9	1,782.6	82.9	1329.9	452.9
Meat	426.7	511.7	85.0	19.9	96.8	-11.8
Vegetables	300.3	430.1	129.8	43.2	11.0	118.8
Oil seeds	188.8	410.1	221.3	117.2	106.9	114.3
Petroleum	220.5	397.7	177.2	80.4	296.9	-119.8
Pharmaceutical	328.2	341.0	12.8	3.9	192.8	-180.0
Cement	189.9	266.5	76.6	40.4	126.8	-50.3
Imports	**55,198.0**	**54,798.0**	**-400.0**	**-0.7**	-	-
Energy	17,014.6	16,910.2	-104.3	-0.6	254.8	-655.4
Non-energy	38,183.2	37,887.7	-295.7	-0.8	-	-
Palm oil	3,640.7	2,778.6	-862.2	-23.7	-80.8	-781.3
Machinery	5,807.9	8,500.6	2,692.7	46.4	-	-
Transport	1,758.2	1,840.0	81.9	4.7	-	-
Cotton	1,679.4	447.9	-1,231.5	-73.3	-1,176.3	-55.2

Source: Pakistan Bureau of Statistics

In November 2023, uncertainty regarding the IMF's SBA tranche briefly increased pressures on PKR resulting in a slight depreciation. Once the tranche was disbursed, the PKR gradually appreciated to around Rs 278 in the start of March 2024 and since then, has remained steady around this level. This stability was further supported by a current account surplus observed during February to April 2024. In fact, the PKR has been one of the better-performing currencies amongst the selected EMs (**Figure 6.27**).

Real and Nominal Effective Exchange Rates **Figure 6.28**



Sources: State Bank of Pakistan

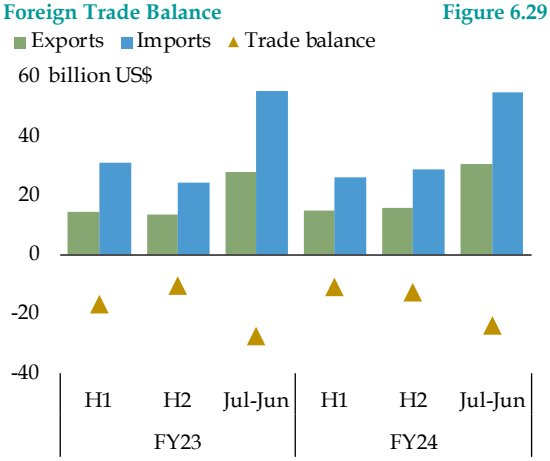
While NEER remained mostly stable during FY24, the REER appreciated amidst rising inflation differential (**Figure 6.28**). The Relative Price Index (RPI) rose 9.6 percent, mainly due to higher domestic inflation vis-à-vis inflation in trading partners. This may not bode well for export competitiveness.

6.6 Foreign Trade[64]

The trade deficit recorded a significant contraction, primarily attributed to a notable increase in exports, as well as a slight decline in merchandise imports (**Table 6.4 & Figure 6.29**). The upturn in exports was supported by higher agriculture production, particularly rice and oil seeds. This, along with the higher global demand and change in trade policy of one of the

[64] This section is based on customs data reported by the Pakistan Bureau of Statistics (PBS). The PBS trade data would not tally with the payments record data, which is reported in Sections 6.2 and 6.3. For details on difference between these two data series, see Annexure on Data Explanatory Notes.

Foreign Trade Balance **Figure 6.29**



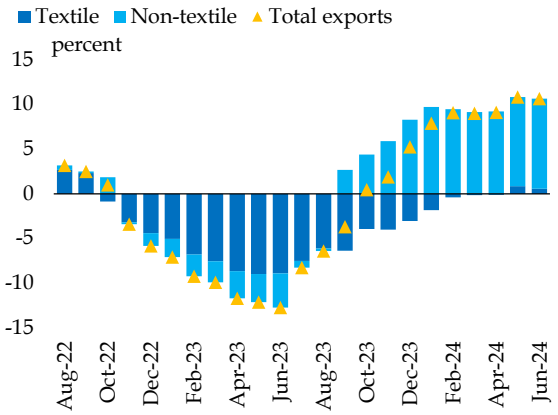
Source: Pakistan Bureau of Statistics

biggest competitors, provided boost to exports of food commodities.

On the other hand, the decline in imports was mainly due to easing global commodity prices, as volumes recovered moderately in line with economic activity since February 2024.

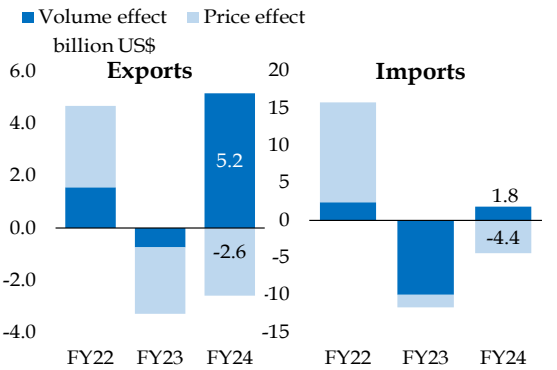
In overall terms, volumes played a significant role in both exports and imports. Within the exports, the decline in unit values of textiles partially offset the gains from increase in volumes (**Figure 6.30**). On the other hand, the declining global prices of crude oil and some food items contributed to decline in import value.

Exports - Contribution in Cumulative Growth **Figure 6.31**



Source: Pakistan Bureau of Statistics

Price and Volume Effects **Figure 6.30**



Note: Exports and imports cover around 84 and 54 percent of total items, respectively

Source: Pakistan Bureau of Statistics

Exports

Pakistan's merchandise exports recovered strongly in FY24 from the previous year's contraction. Total exports rose by 10.7 percent to US$ 30.7 billion in FY24. This growth was underpinned by significant increase in non-textile exports, particularly food and other manufactures, driven by higher production and increased penetration in international market. Textile exports also moderately increased on account of higher export orders from the traditional markets (**Figure 6.31**).

Non-Textile Exports

Food

Food exports continued an upward trajectory throughout the year, with rice and sesame seeds playing pivotal roles. During FY24, Pakistan's rice exports reached a historic high, US$ 3.9 billion, reflecting both volume and price effects (**Table 6.5**). This upturn in rice exports was attributed to two key factors: First, India's export ban due to their concerns about food security, resulted in upward pressure on rice prices in international market (**Figure 6.32a & 6.32b**). Second, there was a record domestic rice production during the year (**Box 6.3**).

Also, the export of sesame seeds more than doubled, reaching US$ 414 million in FY24. The

Non-textile Exports - Volume and Price Effect **Table 6.5**

million US$, volume in 000 MT

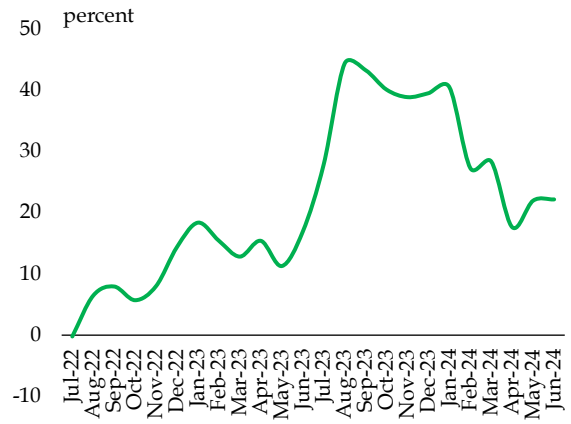
	FY23		FY24		FY24		
	Volume	Value	Volume	Value	Change in Value	Volume Effect	Price Effect
Non-textile exports	**-**	**11,227**	**-**	**14,025**	**2,798**	**-**	-
Of which	-	-	-	-	-	-	-
Food	-	**5,023**	-	**7,370**	**2,347**	-	-
Rice	3,718	2,149	6,019	3,932	1,783	1,330	453
Basmati	595	650	774	877	227	195	32
Others	3,123	1,499	5,245	3,055	1,556	1,019	537
Fruits	526	283	936	344	60	221	-160
Oil seeds	172	189	287	410	221	107	144
Meat	101	427	124	512	85.0	97	-12
Non-food	**-**	**6,205**	**-**	**6,655**	**450**	-	-
POL	338	221	793	398	177	297	-120
Plastic	212	268	379	400	132	213	-80
Pharmaceutical products	54	328	86	341	13	213	-80
Cement	4,248	190	7,087	267	77	127	-50
Sports goods	-	405	-	396	-9	-	-
Leather	-	577	-	546	-32	-	-

Source: Pakistan Bureau of Statistics

trend in exports mirrors domestic production. In view of rising export demand and attractive prices, Pakistani farmers have shifted to sesame production to maximize their returns.[65]

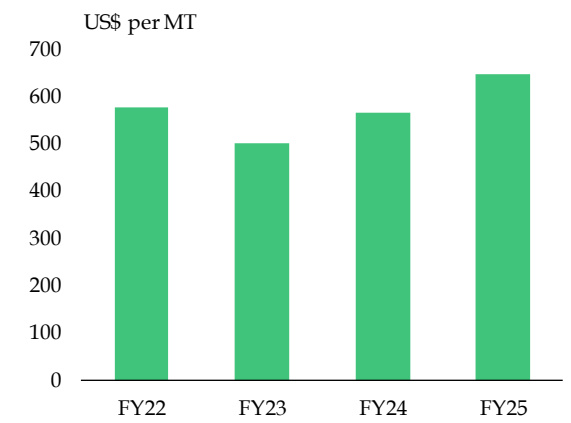
On the demand side, destination-wise analysis shows that the surge in export of sesame seeds was primarily driven by increased shipments to China. Benefiting from duty-free access under the China-Pakistan Free Trade Agreement (CPFTA) Phase II, Pakistan's sesame seeds have established a strong footprint in the Chinese market. Moreover, Pakistan also started exporting sesame to EU and Middle East owing to a significant demand for sesame extracts in their culinary industry.

Growth in Global Rice Prices **Figure 6.32a**



Source: World Bank

Unit Value of Rice **Figure 6.32b**



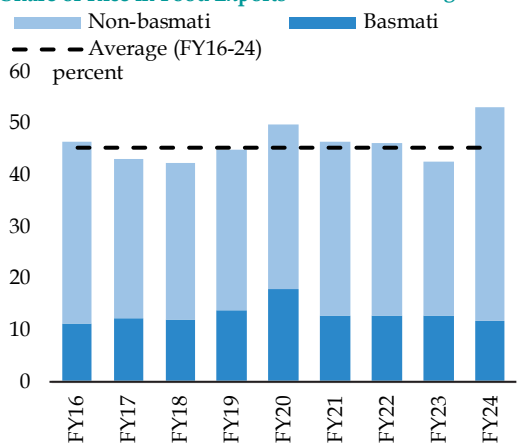
Source: Pakistan Bureau of Statistics

[65] Both the area under cultivation and production increased significantly by 54 and 98 percent during FY24. Source: Pakistan Economic Survey 2023-24

Box 6.3: Sustaining Recent Surge in Pakistan's Rice Exports

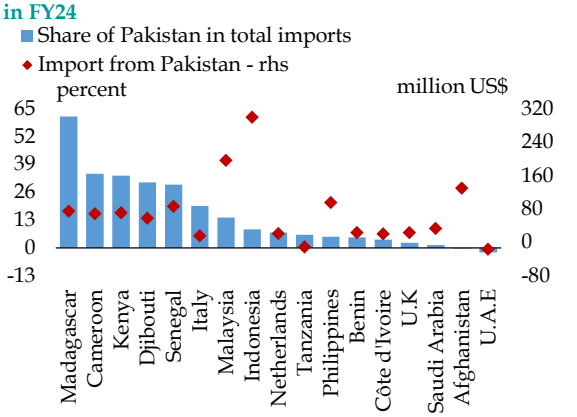
Rice is Pakistan's major export item, accounting for 12.8 percent in total exports and 53.3 percent in food exports in FY24, well above the average of 43 percent (**Figure 6.3.1**). In FY24, Pakistan's rice exports grew by 83 percent to reach a historic high at US$ 3.9 billion. The surge in rice exports contributed almost three-fourth of the growth in food exports during the period.

Share of Rice in Food Exports **Figure 6.3.1**



Source: Pakistan Bureau of Statistics

Imports of Pakistani Rice - YoY Change in FY24 **Figure 6.3.2**



Note: Based on Jul-Mar

Sources: PBS, ITC Trade Map, Country Customs Data

The uptrend in rice exports was supported by both the demand and supply side factors including India's temporary export ban, prompted by their domestic production challenges and concerns about food security. India imposed a ban on white rice exports in July 2023. Later, in August 2023, the country placed an export tax on parboiled rice exports. This move led to supply shortages in the international market, creating an opportunity for Pakistan. Furthermore, the growth was supported by a bumper rice harvest on the back of favorable weather conditions and increased cultivation area, resulting in the production of 9.9 million metric tons of rice. Consequently, rice exports expanded to several new markets such as Madagascar, Cameroon, Djibouti, Senegal by the end of FY24 (**Figure 6.3.2**). Notably, the non-basmati rice segment witnessed a substantial growth, with 68 percent increase in export volumes.

While Pakistan's rice export benefitted from these market dynamics, sustaining this level of exports hinges on retaining the recently acquired export orders, which may be challenged by the potential re-entry of India into the global rice market, following the lifting of its export ban. To sustain and build up on the recent gain, it is pivotal to focus on both demand and supply side factors.

On the demand side, trade missions and diplomatic efforts should be mobilized in order to retain the new markets captured in FY24. In addition, there is a need to proactively explore potential markets with unrealized export prospects for rice to diversify its customer base, and reduce dependence on traditional markets. There is an unrealized export potential of around US$ 500 million for the existing rice products (**Figure 6.3.3**). Furthermore, offering competitive prices may be pivotal to sustain this export momentum, since prices of Indian non-basmati rice remain lower than of Pakistan's, which dampens the comparative advantage of Pakistani rice in international market (**Figure 6.3.4**). One way of achieving this is to focus on reducing input prices.

Pakistan's Rice Export Potential **Figure 6.3.3**

million US$

*others include combined exort potential of Afghanistan, UAE, Kenya, Somalia, Italy, Oman, and Mozambique

Sources: Export Potential Map, ITC

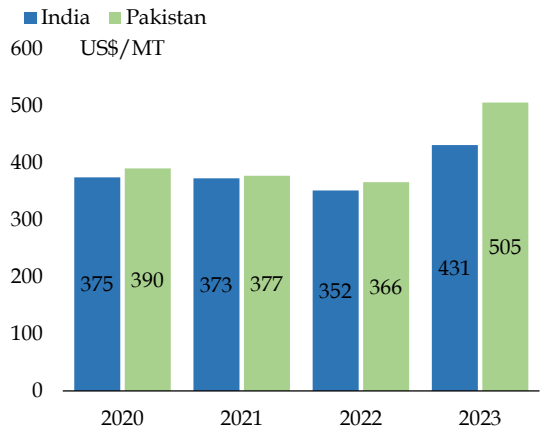
Global Exports of Value-added Rice Products Table 6.3.1

million US$

	2021	2022	2023
Rice noodles			
World	4,480.4	4,979.8	5,395.2
Pakistan	0.0	6.6	0.2
Cereal			
World	2,248.1	2,697.8	2,540.7
Pakistan	4.6	0.8	0.3
Rice oil			
World	2,631.5	2,672.0	2,431.2
Pakistan	0.5	0.8	0.5

Source: ITC Trade Map

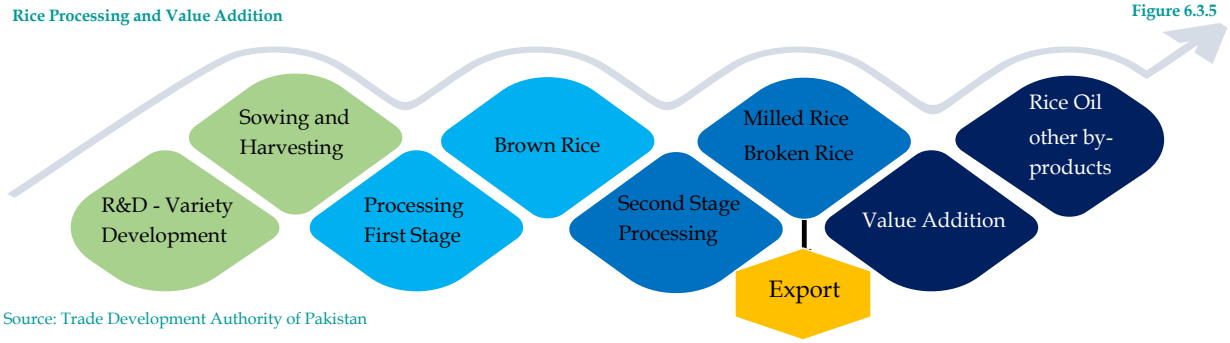
Price Comparison of Non-basmati Rice Figure 6.3.4



Source: Food and Agriculture Organization

On the supply side, addressing low productivity remains crucial particularly in the wake of increasing domestic demand and maintaining sufficient exportable surplus. This can be done by improving per hectare yield through new and advanced seed varieties. Meanwhile, Pakistan maintains a strong Revealed Comparative Advantage (RCA) in rice compared to its main competitors such as Thailand, India and Vietnam. Thereby, a focused fiscal support may be provided to capitalize on this comparative advantage. In addition, diversifying the food export basket with value-added products, such as rice bran oil and rice flour, could provide additional avenues for growth, particularly in region like South-East Asia (**Figure 6.3.5 & Table 6.3.1**). Addressing these challenges will be pivotal to maintaining Pakistan's position in the global rice market and ensuring export momentum.

Rice Processing and Value Addition Figure 6.3.5



Source: Trade Development Authority of Pakistan

Corn is the next major food item that recorded a considerable increase in exports during FY24. Like rice exports, this was mainly driven by higher exportable surplus due to decline in domestic demand from the poultry industry.[66] Vietnam emerged as the largest buyer of Pakistani corn, followed by Malaysia and Sri Lanka.[67]

Meat exports also maintained the rising trend, particularly to Saudi Arabia and the UAE, facilitated by the registration of new exporters and expansion of slaughterhouse facilities, along with the introduction of heat-treated meat exports to China.[68,69]

[66] Lower domestic demand due to high fluctuation in chicken prices in FY24, dented the demand for corn, which is the major input in the chicken feed. Source: USDA

[67] This increase of corn import in Vietnam and Malaysia is primarily due to rise in demand by the poultry and livestock industry, as most corn imports go into animal feed.

[68] Meat exports increased by 19.9 percent in FY24, on top of 25.1 percent in FY23.

[69] Heat-treated meat refers to the meat processed through cooking, pasteurization, or sterilization to ensure its safety and longevity. China's growing demand for heat-treated meat is explained by its preference for ready to eat food products.

Among other food items, export of ethanol was up by 80 percent, reaching US$ 544.9 million in FY24. This growth was entirely driven by higher export volumes, mainly to South Korea and Thailand.[70] Ethanol, produced from sugarcane fermentation as by-product of sugar, is extensively used as a biofuel input in cosmetics and medicinal products globally.[71] On the demand side, South Korea's enhanced use of biofuel domestically has led to higher ethanol import from Pakistan.[72]

Other Manufactures

The export of manufactured goods, including rubber tyres, cement, and plastics, witnessed a substantial growth. The increase in these products was mainly driven by higher volumes on the back of both the supply and demand factors. The establishment of new manufacturing facility in partnership with a Chinese tyre manufacturer, enabled the export of steel-belted rubber tyres for heavy vehicles to the USA, Middle-East and Brazil.

Cement exports rose to US$ 267 million during FY24, compared to US$ 190 million in the same period last year, with increased dispatches to Afghanistan, Bangladesh, Sri Lanka, and Africa. This was mainly due to resumption of construction activity in Afghanistan and Sri Lanka. Moreover, the domestic cement industry has increased its presence in the African and the US market, resulting in the higher export orders.[73]

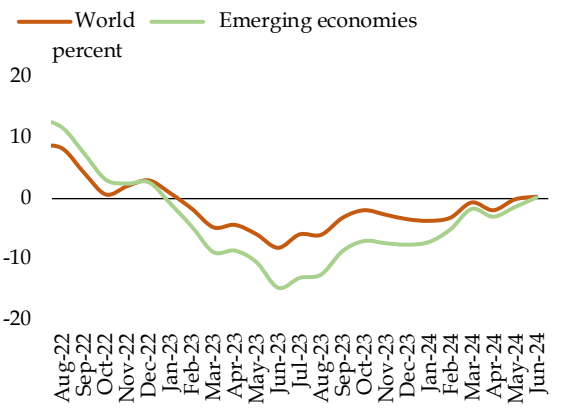
Plastics exports saw a 49 percent increase, amounting to US$ 400 million, mainly to African countries. The plastic manufacturers shifted their focus on exports, as the domestic demand for plastic items remained subdued in the last two years. The industry particularly benefited from exchange rate depreciation over the last few years, which made exports more competitive.[74] Moreover, some of the plastic exporters have met international standards that helped in acquiring new export orders during the period. Meanwhile, the exports of pharmaceutical products also increased significantly, primarily reflecting a volumetric gain resulting from targeting new markets in Africa and Central Asia.

Petroleum exports, mainly furnace oil, also surged during FY24. The uptick was driven by a decreased reliance on furnace oil for electricity generation, as evident from the shift in energy generation mix towards RLNG and other more cost-effective sources. This transition led to excess supply of furnace oil, followed by export permission from the government, resulting in higher export volume.

Textile Exports

Textile sector faced significant challenges throughout FY24. Notwithstanding an increase

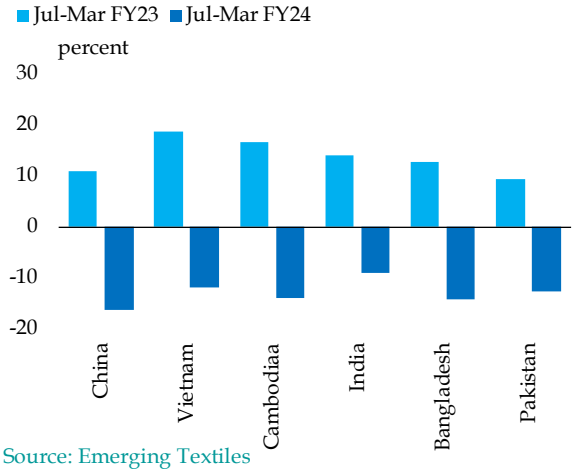
Trend in Emerging Economies Export Prices **Figure 6.33**



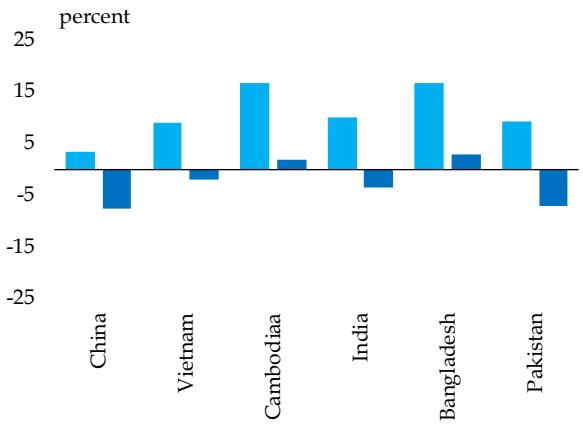
Source: CPB World Trade Monitor

[70] Ethanol is used as bio-fuel in Thailand and South Korea. Sources: Ethanol Use and Gasoline Consumption in Thailand, MPRA, and S&P Global.
[71] The surge in exports is closely linked to the production of sugarcane in the preceding year. Sugarcane production in Pakistan has surged to an average 86.3 MMT in the last four years.
[72] South Korea has been adopting to increase its bio-fuels share by adopting renewable fuel standard (RFS) since January 2024. Source: U.S. Grain Council
[73] Pakistan has started exporting cement to the US, owing to continued increasing demand in the country due to government's higher spending on infrastructure.
[74] The average mark-to-market exchange rate depreciated by 12.4 percent during FY24 compared to the previous year.

EU Apparel Import - Unit Value Change Figure 6.34a



US Apparel Import - Unit Value Change Figure 6.34b



Source: Emerging Textiles

in export volumes, the total textile exports remained stagnant around the previous year's level of US$ 16 billion. This lackluster performance of textile exports was primarily attributed to the declining unit values in traditional markets, such as the EU and US (**Figure 6.33**).

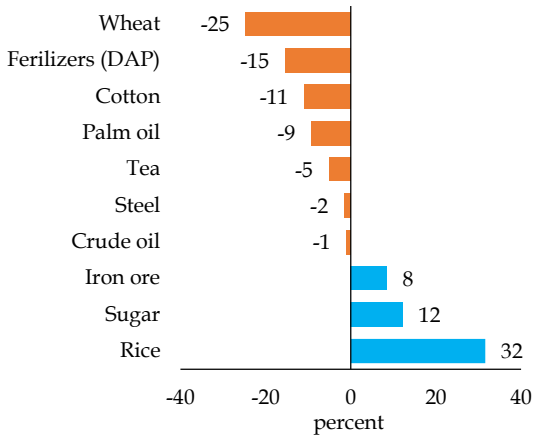
The decline in unit values was mainly driven by lower prices offered by Chinese exporters. China offered textile products at competitive prices by leveraging its ability to minimize production costs mainly on the back of lower wages, falling inflation, and declining borrowing cost.[75,76] This exerted downward pressure on textile prices in major markets. For instance, Pakistan's unit prices for apparel, from major exporters in the EU and the US, fell by 13 percent and 3 percent, respectively, during Jul-Mar FY24 (**Figure 6.34a & 6.34b**).

High value added (HVA) textiles were also affected by the decline in unit values. The impact was noticeable in apparel and home textiles, especially in the EU. In contrast, export volumes of HVA increased, with apparel and home textiles experiencing growth of 15.9 percent and 5.1 percent, respectively, in FY24.

Imports

Overall imports decreased slightly by 0.7 percent during FY24, compared to a 31.1 percent decline in the previous year. The reduction in imports was mainly explained by the decline in global commodity prices, subdued economic activity in the first half of the year, and continuation of contractionary monetary and fiscal policies (**Figure 6.35**).[77] Despite the ease in

Major Commodity Prices in FY24 Figure 6.35



Source: Bloomberg

[75] The headline inflation in China remained flat in FY24 compared to an increase of 1.5 percent in FY23. While, exchange rate depreciated by 3.7 percent in FY24 on top of 7.2 percent in FY23.
[76] In the last two-years, China lost significant apparel export volumes in the US and EU due to the ban on cotton – major input in apparel - produced in its Xinjiang province. This contributed around 90 percent of the total cotton production in China. Since then China gradually substituted it with imported cotton in order to re-gain its market share. With the production from imported cotton, China re-entered the US market, which increased the competition and hence downward pressures on export prices.
[77] GDP grew by 2.4 percent in Q3-FY24 compared to a decline of 1.1 last year.

Import Price and Volume Effects **Table 6.6**

value in million US$, volume in 000 MT

	FY23		FY24		FY24 over FY23		
	Volume	Value	Volume	Value	Change in Value	Volume Effect	Price Effect
Food	-	**8,937.0**	-	**7,903.8**	**-1,033.2**	-	-
Milk	41.6	144.3	34.5	114.2	-30.1	-24.7	-5.4
Wheat	2,729.2	1,072.5	3,536.2	1,031.7	-40.8	317.1	-357.9
Tea	231.4	569.0	260.3	656.6	87.6	70.9	16.7
Soybean oil	227.4	315.5	119.8	129.6	-186.0	-149.2	-36.8
Palm oil	3,064.7	3,640.7	2,996.7	2,778.6	-862.2	-80.8	-781.3
Energy	**18,942.9**	**17,014.6**	**19,406.8**	**16,910.2**	**-104.3**	-	-
POL	11,133.1	7,628.5	10,350.6	6,643.9	-984.5	-533.7	-450.8
Crude	7,809.8	4,947.2	9,054.5	5,531.1	583.9	788.5	-204.6
Textile	-	**3,741.7**	-	**2,713.7**	**-1,028.0**	-	-
Raw cotton	683.9	1,679.4	204.8	447.9	-1,231.5	-1,176.3	-55.2
Agro chemical	-	**8,928.6**	-	**8,508.4**	**-420.1**	-	-
Fertilizer	903.7	604.4	1,374.5	684.7	80.3	314.9	-234.6
Others	-	**868.6**	-	**894.4**	**25.8**	-	-
Rubber crude	347.5	208.9	444.0	254.4	45.6	58.0	-12.4
Rubber*	3,035.4	92.0	4,122.0	101.0	9.0	32.9	-23.9

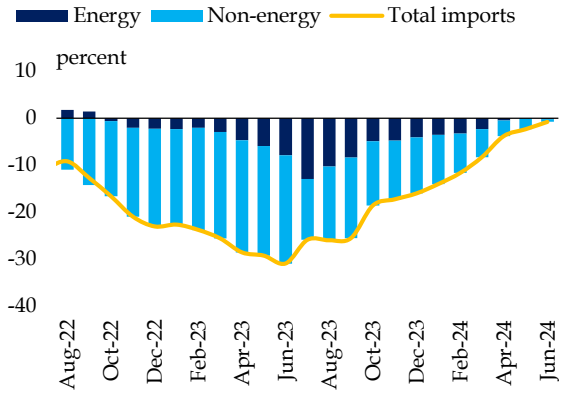
* volume in 000 No.

Source: Pakistan Bureau of Statistics

import priority guidelines, imports fell by 16.0 percent in H1-FY24 compared to last year on the back of slowdown in economic activity. However, imports rebounded strongly in H2-FY24 on account of higher volumes particularly of raw materials, amidst recovering domestic economic activity (**Table 6.6 & Figure 6.36**).

Food and energy imports remained subdued in value terms on the back of declining global prices. On the other hand, a volumetric increase in import of machinery, transport, and metals was recorded during FY24 reflecting the impact of ease in import priority guidelines.

Imports - Contibution in Cumulative Growth **Figure 6.36**



Source: Pakistan Bureau of Statistics

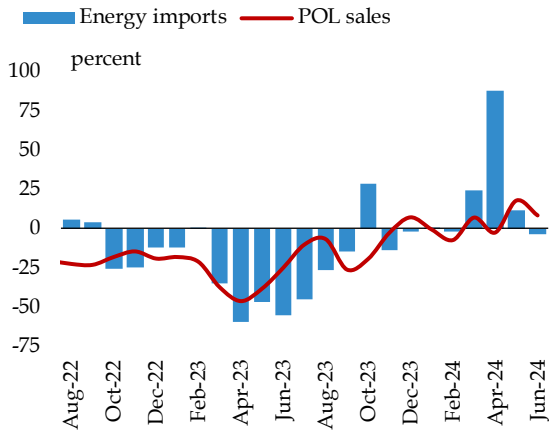
Food

Food imports declined, largely due to fall in import of palm oil, which constitutes the largest share in food imports**.** Import of palm oil was lower by US$ 862.2 million in FY24. This was mainly driven by declining global palm oil prices due to a supply glut mainly from Malaysia and Indonesia, coupled with lower international demand.[78]

In case of wheat, the import decreased by US$ 40.8 million, primarily due to a negative price effect. The dip in prices can be attributed to increased supplies from Russia – a major wheat producer, which experienced higher production. However, the import volume rebounded in H2-FY24 following the government's approval for import by the private sector. Thus, more than 60 percent of the total wheat was imported during second half of FY24.

[78] As indicated by a slight deterioration in 2024 compared to last year. For details, see **Figure 6.1**.

Energy Imports and Domestic POL Sales **Figure 6.37**



Sources: PBS and OCAC

Textile

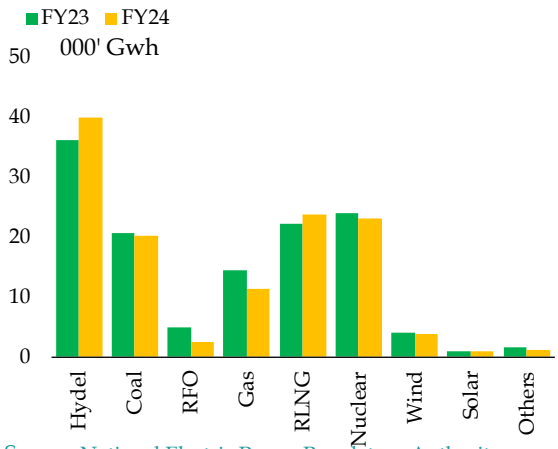
Textile imports posted a decline of 27.5 percent in FY24, largely driven by lower import volumes of raw cotton as well as prices. This decline can be attributed to a higher domestic production leading the textile industry to use locally produced cotton – a major input in textiles. In FY24, the cotton production rebounded after a considerable decline last year amid severe floods **(Chapter 2)**.[79]

Energy

Energy imports shrank by US$ 104 million in FY24, driven by the lower crude oil prices while oil import volumes increased. The disaggregated data shows a notable shift in import of energy products during H2-FY24. In value terms, energy imports increased significantly in the second half, after a 13.8 percent decline recorded in H1-FY24. The revival in economic activity, which is also evident from the recovery in LSM, explains this increase. Meanwhile, the demand indicators also showed a marked improvement during the period, as reflected from higher sales of automobile and POL products in the latter half of the year (**Figure 6.37**).

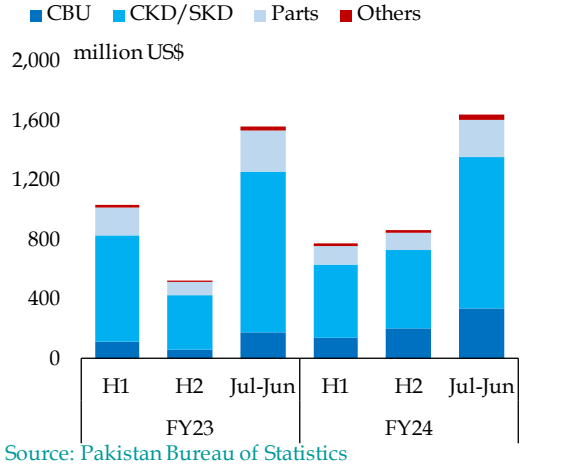
In terms of volumes, the import of crude oil continued to increase throughout the year, partially attributed to recovering economic activity. Although power sector demand for furnace oil dropped due to a change in energy mix, as electricity generation moved from furnace oil to more cost-effective sources such as coal, hydel, and LNG. This shift was prompted by a significant decline in global coal and LNG prices. In addition, the government allowed the export of furnace oil during the period, incentivizing refineries for higher production, which in turn led to a higher import of crude oil. Meanwhile, the decline in global crude oil prices offset the effect of higher import volumes, resulting in reduced import payments during FY24 (**Figure 6.38**).

Source-wise Electricity Generation **Figure 6.38**



Source: National Electric Power Regulatory Authority

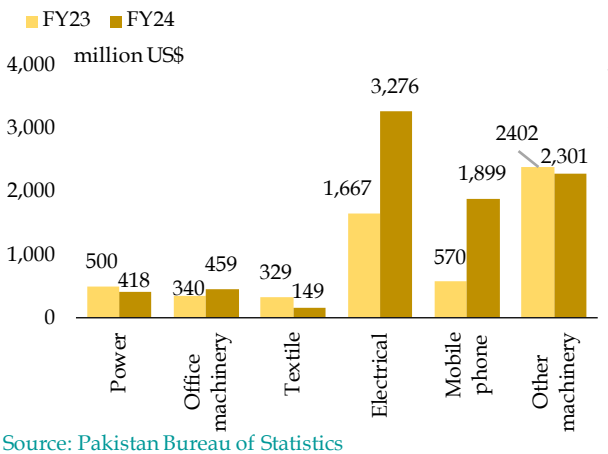
Transport Group Imports **Figure 6.39**



Source: Pakistan Bureau of Statistics

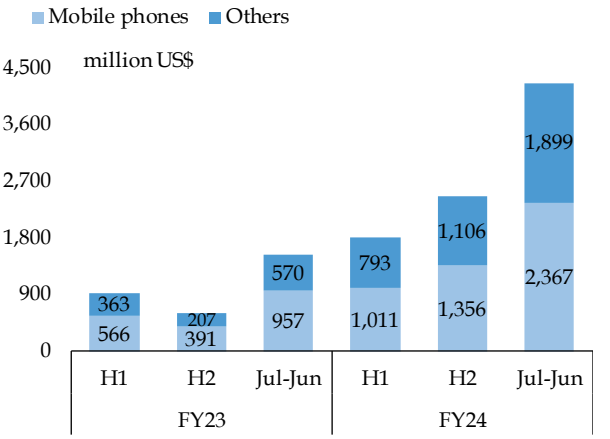
[79] For details, see Chapter 2

Machinery Imports **Figure 6.40a**



Source: Pakistan Bureau of Statistics

Telecom Imports **Figure 6.40b**



Source: Pakistan Bureau of Statistics

Transport

Transport imports witnessed a moderate increase, reaching US$ 1.8 billion in FY24 (**Figure 6.39**). The increase was more prominent in H2-FY24, driven by higher imports of CBU motor cars. While the ease in import constraints supported this increase, import volumes of CBU remained lower than the average of last 5 years. Meanwhile, CKD/SKD vehicle imports contracted owing to a sharp decrease in the sales of domestically produced vehicles particularly in H1-FY24. The domestic production of vehicles declined amid reduced demand, attributed to higher consumer financing cost and increase in vehicle prices. However, with a slight recovery in auto sales since January 2024, import of CKD picked up.

Machinery

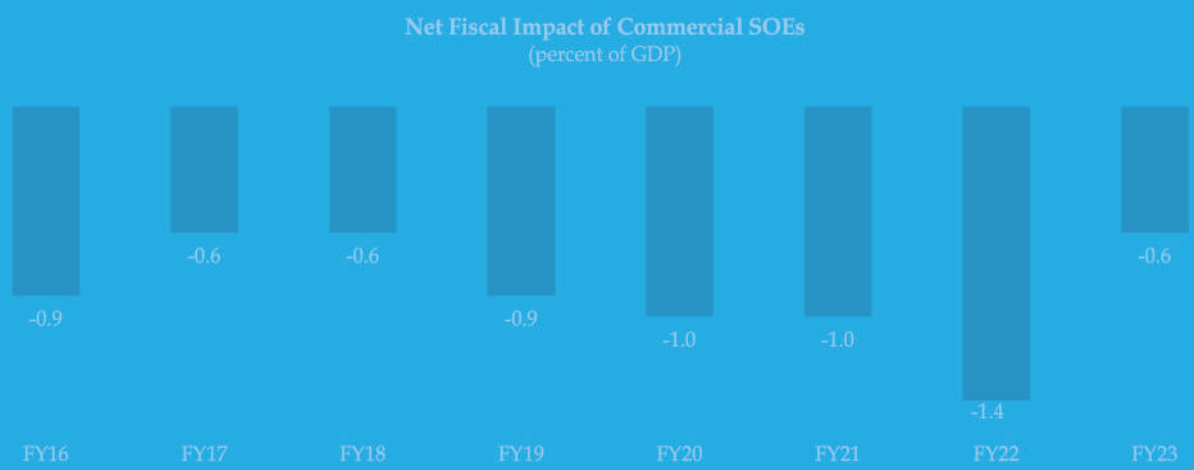
In FY24, contrary to other major imports, the machinery group experienced a marked increase, primarily driven by rise in the import of electrical machinery and mobile phones. Within the electrical machinery, import of solar panels showed a notable growth on account of heightened demand for domestic solar electricity generation units (**Figure 6.40a & 6.40b)**. Amidst increasing electricity cost and the availability of low-priced solar panels from the Chinese market, consumers have increasingly shifted towards in-house solar solutions, resulting in higher imports of electrical machinery.

Meanwhile, significant increase in mobile phone imports to US$ 1.9 billion in FY24 is largely explained by the pent-up demand. As the exchange rate started to stabilize since September 2023, in conjunction with the easing FX constraints, the import of mobile phones increased.

7

Reforming State-owned Enterprises in Pakistan

State-owned Enterprises (SOEs) have been reformed around the world since the 1980s, driven in part by their unsustainable fiscal impact, as well as deteriorating service delivery. In Pakistan, the SOE reform process began in late 1970s, with a focus on privatisation. However, the process remained inconsistent, with short spells of progress punctuated by long periods of stagnation. This was a result of various factors with the biggest hurdle being an overemphasis on change in SOE ownership rather than critical SOE reform components: good corporate governance, strengthening of competition, effective regulation, political consensus and addressing labour concerns. As a result, the country's federal commercial SOEs – that are the focus of this Chapter – continue to burden the government finances, with losses concentrated in two broad sectors: (a) power, and (b) infrastructure, transport & ITC. In recognition of this, the government has recently initiated the first comprehensive set of legal and institutional measures for reforming SOEs' corporate governance, and is in process of taking SOEs' ownership decisions (i.e. whether to privatise or retain entities). Insights from Pakistan's earlier SOE reforms and global best practices suggest that an integrated and well-sequenced approach is needed to achieve desired results from the ongoing efforts. Specifically, it requires necessary focus on sectoral policy, competitive environment and effective regulations, supported by political consensus.



7 Reforming State-owned Enterprises in Pakistan

7.1 Introduction

State-owned enterprises (SOEs) are as old as the state itself. However, with the Great Depression and the post-World War-II developmental needs as the major impetus, SOEs gained significance for accelerated economic development by establishing industrial base and undertaking large infrastructure projects.[1] SOEs were also set up to provide critical services, such as utilities, that the market was unable to deliver universally and sustainably due to limits to private sector's ability to generate funds for large capital expenditure projects.[2]

These trends emerged in the backdrop of a general mistrust of capitalism, and ensuing nationalization in several economies, in part driven by the economic ideology that pursuit of social and other national objectives do not align with profit-maximization of private firms. This was particularly visible in sectors that provided basic public goods. Many industrial SOEs were also set up under import substitution policies with high tariffs, exchange controls and other forms of trade protection. Governments also used SOEs as a tool to meet their social and political objectives, such as job creation.[3]

However, when left in their original set up, SOEs have also been a huge burden on economies, both because of their unsustainable fiscal impact, as well as poor service delivery. This is why SOEs started going out of vogue after the 1980s. Financial statements of SOEs during the 1970s and 1980s suggested that SOEs significantly underperformed compared to private firms, partly because of the difficulty in reconciling their multiple policy goals. There was also a growing realization that some SOEs existed as monopolies, unexposed to market competition, with relatively easier access to finance.[4]

Even in sectors where SOEs were not monopolies, their presence was still a major concern because of their ability to influence policy and competition through their privileged access to government. As a result of this, SOEs remained inefficient, and struggled to offer innovative and quality goods and services. Consequently, the financial performance of many SOEs deteriorated, leading to frequent government bailouts, especially in developing countries, where SOEs became a burden on the national exchequer, a source of fiscal risk, and weakened the financial system. Research suggests that government support to inefficient, loss-making commercial SOEs also adds to inflationary pressures, whereas addressing structural challenges as part of SOE reforms leads to increased competition, which in turn, can reduce inflationary pressure.[5]

In cognizance of these challenges, governments began reforming SOEs since the 1980s. With SOE reforms gaining traction across Advanced Economies (AEs), International Financial Institutions (IFIs) also played a significant role in driving the SOE reform agenda in Emerging Market and Developing Economies (EMDEs). For instance, the International Monetary Fund (IMF) often linked its financial support to SOE reforms, whereas other IFIs supported privatisation and other SOE reforms by helping governments to develop strategies, implementing plans, and appropriate supervisory and institutional frameworks.

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[1] For example, in France, technological modernization and industrial development was led by SOEs like Renault, and Alcatel. In Finland, it was led by SOEs in steel, mining, transport, paper, and chemical industries. Similarly, South Korea's most rapid economic growth was driven by SOEs in steel, oil, gas, electricity, fertilizers and others. Source: Berne, M. & Pogorel, G. (2006); Willner, J. (2006); Rashid (2022).

[2] Bognetti, G. (2020); ADB (2020); Obinger et al. (2016)

[3] Habir, M. (2021)

[4] Roland, G. (2008); Habir, M. (2021)

[5] Campillo, M. & Miron, J. A. (1997)

Three other factors influenced this trend. First, financial crises forced countries to reform SOEs. For instance, the sovereign debt crises of the 1980s led many countries in Latin America, and Eastern Europe to reform their SOEs. From the 1990s onward, the former Soviet Union countries in Central and West Asia reformed their SOEs since they could not sustain them without Soviet-era subsidies. Likewise, following the Asian Financial Crisis of 1997, many East Asian economies carried out SOE reforms to lower their fiscal burden. In China, which still has some of the world's largest SOEs, about two-thirds of the country's total SOEs were privatised between 1995 and 2005.[6]

Second, some governments explicitly pursued policies to promote export-led growth and internationalisation through state capitalism for which they needed to reform SOEs. This, for instance, included exposing SOEs to domestic and international competition, and empowering their boards to make major decisions, such as cross-border mergers and acquisitions. Third, the SOE reform agenda across the world was driven by growing public demand for reliable, cost-effective, and quality delivery of public service. This contributed to corporatisation and retention of SOEs as wholly-owned public firms or as SOEs under public-private partnerships (PPP).[7]

Whilst change of ownership, notably through privatisation,[8] has been the most common instrument of reforms across the diverse global SOE reform experiences, evidence suggests that competitive markets; transparency and monitoring; effective regulation; and sectoral policy reforms, along with good corporate governance are more important than change in ownership. Indeed, there have been several instances where privatisation failed or otherwise did not yield the desired results. At the same time, some of the world's largest companies are effectively under state control, where the trend of cross-border investments by multinational SOEs owned by EMDEs is also notable. These exceptions notwithstanding, research suggests that SOE reforms, which began in the 1980s and peaked in the 1990s, were largely settled by the early mid-2000s in most countries and regions around the world. However, in some countries, including Pakistan, SOE reform is still an unfinished agenda.[9]

The history of SOEs in Pakistan is not very different. Between 1972 to 1977, the country implemented a nationalization program aimed at reversing concentration of wealth developed under the private sector-led growth of 1960s, and driven by then prevailing economic ideology of meeting socio-economic and industrial development through SOEs. In addition to the existing SOEs, several basic industries were nationalized during this period. These included vegetable ghee companies; flour mills; cotton ginning factories; rice husking units; a large number of educational facilities; all domestic private sector banks and insurance companies; and petroleum marketing and shipping companies.[10] Moreover, several new SOEs were established in various sectors including heavy industries, energy and mining.[11]

While some SOEs indeed contributed to industrial, economic and social development, over the years, they started suffering from the classic ills now associated with SOEs around the world. These included production inefficiencies,

[6] Gan, J. (2009); ADB (2020)
[7] Habir, M. (2021).
[8] Privatisation transactions include whole/majority stake sale, minority stake sale with management control, capital market transactions, and others. Retention of SOEs include retention as wholly or majority owned by the government, or under public-private partnership (PPP) models.
[9] Phi et al. (2021); ADB (2008); Majumdar, A. & Ochieng, W. (2003); Mroczek, J. & Bałtowski, M. (2022)
[10] ADB (2008); Jones, D. E. & Jones, R. W. (1977)
[11] Examples of SOEs that existed prior to the nationalisation era include WAPDA, Pakistan International Airlines, Pakistan Industrial Development Corporation, National Bank of Pakistan, whereas examples of those created during the era include DFIs like Pak-Kuwait Investment Company, Peoples Steel Mills, Pakistan State Oil, and Heavy Mechanical Complex.

mismanagement, over-staffing, mounting losses and rising debt. Many enterprises survived only due to preferential policies, such as tariff protection, special access to credit, government guarantees, tax exemptions, and subsidies.[12] These challenges forced policymakers to rethink the role of the state vis-à-vis the private sector in the economy as early as 1978, and rolled out various reform measures including denationalisation, decentralisation, and disinvestment (i.e. privatisation).[13]

The country underwent a major reform process during the 1990s to transform the system from an over-regulated and inward-looking into a more open, deregulated, and market-oriented economy. Consequent to the privatisation program initiated under the Seventh Five-Year Plan (1989-93), a number of SOEs were privatised, a process which continues to date. However, the privatisation process has been punctuated and delayed mainly due to anti-privatisation labour unions; lack of political consensus; and the state's inability to rollout market reforms in several sectors including power, gas, infrastructure and transport.[14]

By the end of FY23, there were 121 federally owned SOEs in Pakistan,[15] of which 73 percent were commercial and the rest were non-commercial for various types of sectoral development needs. The federal commercial SOEs—that are the focus of this Chapter — are mainly categorized in finance; oil and gas; power; infrastructure, transport and Information Technology & Communication (ITC); manufacturing; and trading and marketing sectors. While these entities contribute to government's revenues and generate employment, they also require frequent government assistance, affecting fiscal sustainability. On a net basis, these SOEs had posted consistent losses between FY16 and FY23.[16]

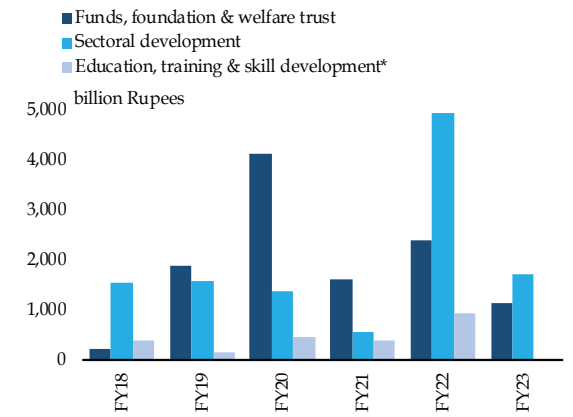
In this backdrop, this chapter underscores the need for urgent SOE reforms in Pakistan, given their large economic footprint, particularly the fiscal impact **(Section 7.2)**. To this end, the government has recently introduced promising measures to reform the SOEs' corporate governance, and is in process of taking decisions on SOEs' ownership. Drawing on lessons from Pakistan's earlier experience of grappling with SOE reforms **(Section 7.3)** as well as insights from global best practices **(Section 7.4)**, the chapter finds that whilst change in SOEs' ownership and improvements in corporate governance are important instruments of successful SOE reforms, the sequencing of the reforms; clear objectives for retaining SOEs; strengthening of competitive environment along with necessary sectoral reforms; and effective regulation are as important as fixing corporate governance and more important than changes in ownership. **Section 7.5** illustrates some of the key findings discussed in Sections 7.3 and 7.4 through brief case studies on major loss making SOEs. **Section 7.6** summarizes and concludes the chapter.

7.2 Economic Footprint of SOEs in Pakistan

Pakistan's federal SOEs are broadly categorized into commercial and non-commercial entities. Commercial entities are expected to be profitable as opposed to non-commercial entities that are made for social and developmental reasons e.g. sectoral development or education

[12] ADB (2008)
[13] Ibid
[14] Faraz, N. & Samad, G. (2022); Jafarey, V. (1992); ADB (2022)
[15] Until FY22, there were 133 SOEs reported in SOEs Federal Footprint (SFF) reports of the Ministry of Finance. However, in FY23, 12 entities, earlier classified as non-commercial SOEs in 'education, training & skill development' sector, were excluded from SFF reporting.
[16] Consolidated data for federal SOEs is only available for the periods FY14-FY19 and FY21-FY23, as published in various SFF reports available at: https://finance.gov.pk/cmu.html. There have also been changes in categories/classifications in these reports over this period. Consolidated data for provincial SOEs is not reported; hence provincial SOEs are not discussed in this chapter.

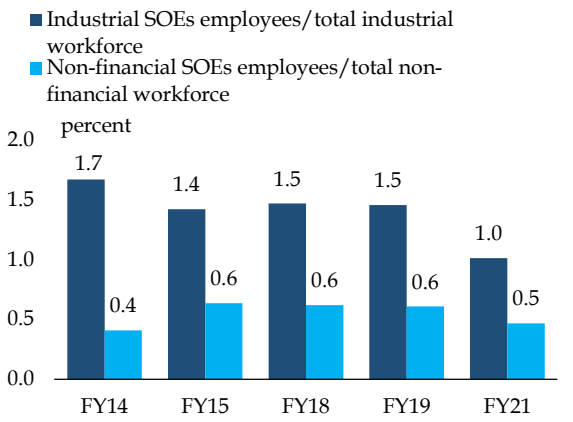
Non-Commercial SOEs' Profits **Figure 7.1**



*sector excluded from reporting in FY23

Source: Ministry of Finance

SOEs' Share in Employment* **Figure 7.2**



*data for certain years not available

Sources: Pakistan Bureau of Statistics; Ministry of Finance

and training. Therefore, greater focus ought to be placed on commercial SOEs, especially considering that they comprise 73 percent of total SOEs; hold 98 percent of SOE assets; and account for nearly all SOE losses.[17] This view is further reinforced by the fact that non-commercial SOEs, have been largely profitable **(Figure 7.1)**.[18]

With the exception of SOEs' share in total employment, the overall economic footprint of federal commercial SOEs is quite high.[19] The share of total employees of non-financial SOEs in Pakistan's non-financial employed workforce was about 0.5 percent in FY21, whereas that of industrial sector SOEs as percentage of total industrial employment in the country was around 1.1 percent —both having witnessed a decline in recent years (**Figure 7.2**). This is much lower than estimates of non-financial SOEs' employment contributions in other countries, such as China (4.3 percent in 2017), and select emerging economies (5 percent during 2014-2016).[20] Similarly, the Organisation for Economic Co-operation and Development (OECD) countries with the highest contribution of SOE to total employment ranged from 2 to 9 percent from 2008 to 2009.[21]

On the other hand, high economic footprint can be seen in total revenues of the 88 commercial SOEs as percentage of GDP. This was about 14 percent in FY23 **(Figure 7.3a)**. By comparison, total revenue of 415 companies (excluding SOEs) listed on the Pakistan Stock Exchange was 17 percent of GDP in FY23.[22] This high footprint is mainly reflected in industrial SOEs in comparison to manufacturing SOEs **(Figure 7.3b & 7.3c)**. This is on account of large-size industrial SOEs in energy exploration & production and power sectors. Despite a decline in recent years, revenues of industrial SOEs as a percentage of industrial GDP is still high at about 58 percent in FY23.[23] Another area of high

[17] MoF (2021); MoF (2023)

[18] The 'profits' in non-profit organisations are usually called surplus income or net assets. However, this chapter uses the term 'profit' in line with the usage in SFF reports.

[19] SBP staff calculations based on various Labour Force Surveys of Pakistan Bureau of Statistics (PBS). Non-financial SOEs includes all SOEs except for the financial sector, whereas industrial SOEs are SOEs in the following sectors: oil & gas, power, industrial estate development and manufacturing, mining and engineering sectors in line with PBS's classifications.

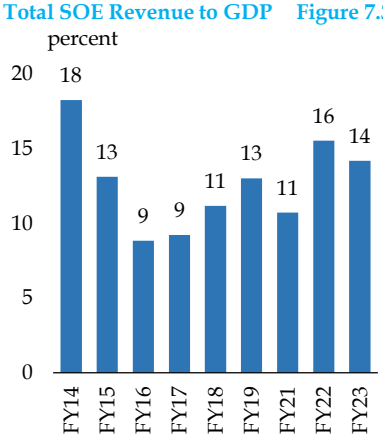
[20] Borkovic, S. & Tabak, P. (2020). The paper categorised the following countries as emerging economies: countries in Central Europe and Baltics, South-eastern Europe, Eastern Europe and Caucasus, Egypt, Kazakhstan and Türkiye.

[21] Borkovic, S. & Tabak, P. (2020); Zhang, C. (2019); OECD (2011)

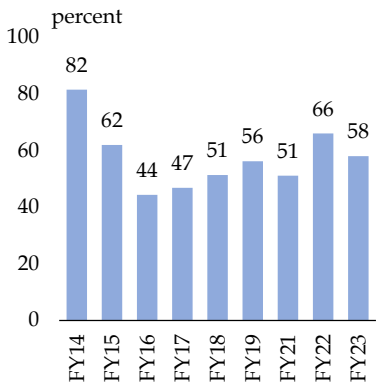
[22] SBP staff calculation based on data available at Capital Stake.

[23] SBP staff calculations based on classification of SOEs as per international definitions of industrial and manufacturing activities adopted by Pakistan Bureau of Statistics (PBS). Industrial sector comprises Mining and Quarrying, Manufacturing, Construction

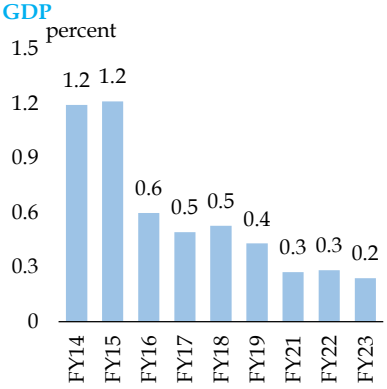
Total SOE Revenue to GDP **Figure 7.3a**



Industrial SOE Revenue to Industrial GDP **Figure 7.3b**



Manufacturing SOE Revenue to Manufacturing GDP **Figure 7.3c**

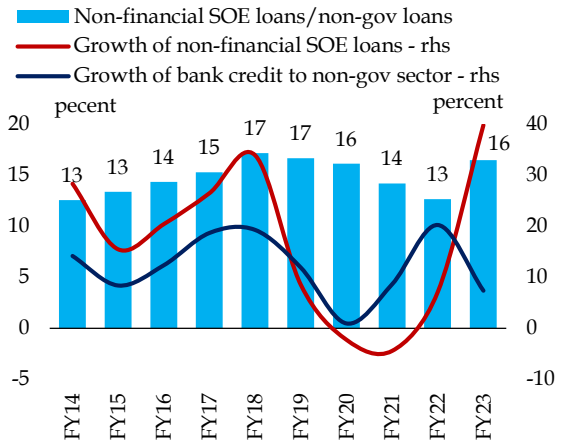


Note: SOE data for FY20 not available
Sources: PBS and Ministry of Finance

footprint is bank financing, where SOEs' share in total bank loans to non-government sector has also remained high at an average of 15 percent between FY14-FY23 **(Figure 7.4)**.

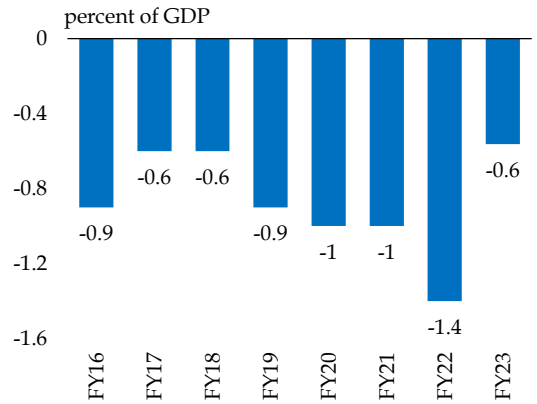
The fiscal impact of SOEs has been quite large. Net losses of commercial SOEs have been increasing in recent years. Net fiscal support to SOEs has generally grown as a percent of GDP, and averaged at around 21 percent of the budget deficits during FY16 and FY23 **(Figure 7.5 and 7.6)**. The fiscal impact of SOEs emanates from their unsustainable, inefficient business operations, as well as politically influenced sectoral policy decisions, such as untargeted subsidies in power sector.[24] Owing to these, many entities rely on the government to provide financial support through subsidies, equity injections, grants and loans. Analysis of federal government's gross outflow to SOEs, and SOEs' payments to the federal government shows that the size of the former more than offsets the latter **(Figure 7.7 and 7.8)**. Moreover, contingent liabilities[25] (e.g. government guarantees) are

Trends in SOE Loans **Figure 7.4**



Source: State Bank of Pakistan

Net Fiscal Impact* of Commercial SOEs **Figure 7.5**



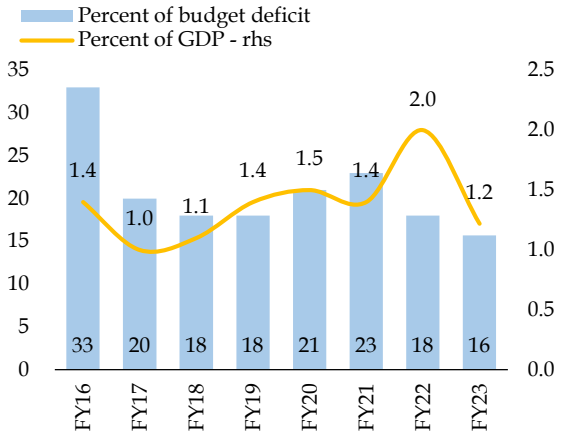
*net fiscal impact is total SOE profits minus losses
Sources: World Bank, FY23 from Ministry of Finance

and Electricity, Gas and Water supply, whereas its manufacturing sub-sector comprises Large Scale Manufacturing, Small Scale Manufacturing and Slaughtering.

[24] Malik, A. (2012)

[25] These liabilities are contingent on one or more uncertain future events. For instance, federal government's guarantee SOEs debt, enabling them to borrow at favourable terms.

Government Support to all SOEs **Figure 7.6**



Sources: World Bank, FY23 from Ministry of Finance

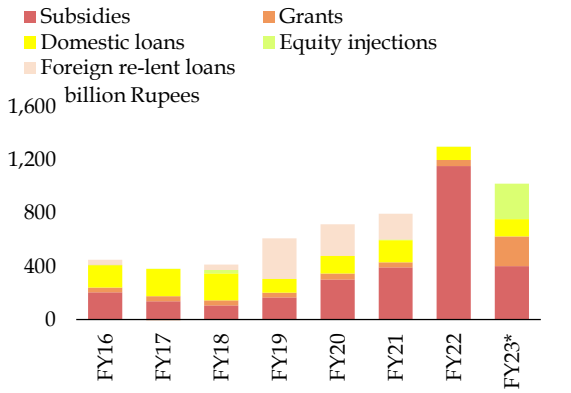
hidden risks that exacerbate these leakages. The extent and recurring nature of these losses coupled with required fiscal support, points to the urgency of course correction.

Sectoral analyses of SOEs reveals that the bulk of losses is concentrated in two main sectors: power, and infrastructure, transport & ITC.[26] Losses in these two sectors have been offsetting profits of other sectors, including the oil & gas sector that contributes the most to total SOE profits. Government outflows to these two sectors are mainly comprised of loans and subsidies (**Figure 7.9 and 7.10**). The power sector alone, which accounted for about 25 percent of total commercial SOEs in FY23, posted combined losses of Rs. 208 billion which is around 29 percent of total SOE losses in FY23 **(Figure 7.11 and 7.12)**. In fact, amongst the highest loss-making entities of FY23, five were power distribution companies (DISCOs) **(Figure 7.13)**. Infrastructure, Transport & ITC sector accounted for 69 percent of SOE losses in FY23, with large losses posted by National Highway Authority (NHA), Pakistan International Airlines (PIA) and Pakistan Railways (PR) **(Figure 7.13)**.

These losses are driven by a number of policy and governance challenges,[27] evidenced by the two biggest loss-making SOE sectors (discussed in detail in **Section 7.5)**. Even profitable sectors like, oil & gas, are susceptible to risks as they may take a hit in profitability after the implementation of relevant international accounting standards.

Furthermore, the unique nature of certain SOEs means that simple financial statement analysis ignores nuances, such as market dynamics and government involvement. For example, many enterprises benefit from sizable contracts from

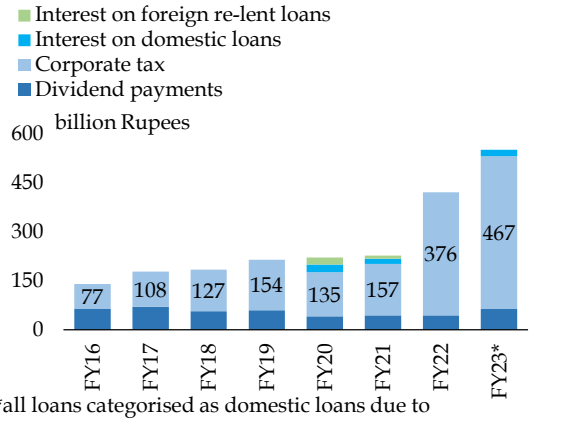
GoP Outflows to Commercial SOEs **Figure 7.7**



*all loans categorised as domestic loans due to unavailability of disaggregated data

Sources: World Bank, FY23 from Ministry of Finance

GoP Inflows from Commercial SOEs **Figure 7.8**



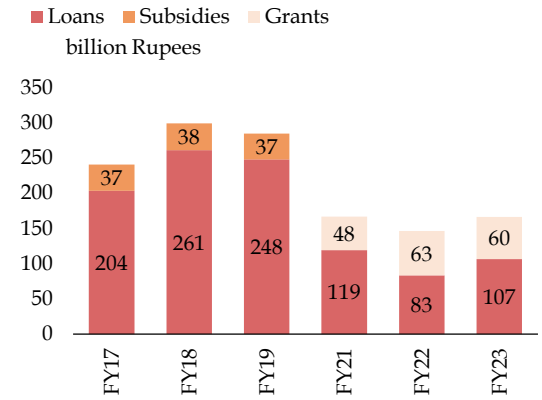
*all loans categorised as domestic loans due to unavailability of disaggregated data

Sources: World Bank, FY23 from Ministry of Finance

[26] As classified by SFF reports, sub-sectors of 'Infrastructure, Transport & ITC' sector include: Ports & Shipping, Railways, Roads & Highways, Aviation, and Communication. Sub-sectors of power sector include: Distribution Companies (DISCOs), Generation Companies, Transmission Companies, and Power Management Companies.

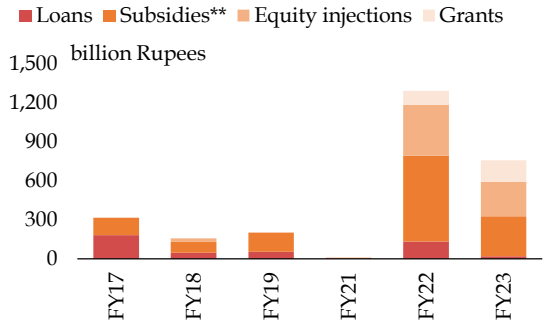
[27] Hussain, I. (n.d).

GoP Outflows to Infrastructure, Transport & ITC sector* **Figure 7.9**



*data for FY20 not available
Source: Ministry of Finance

GoP Outflows to Power Sector* **Figure 7.10**



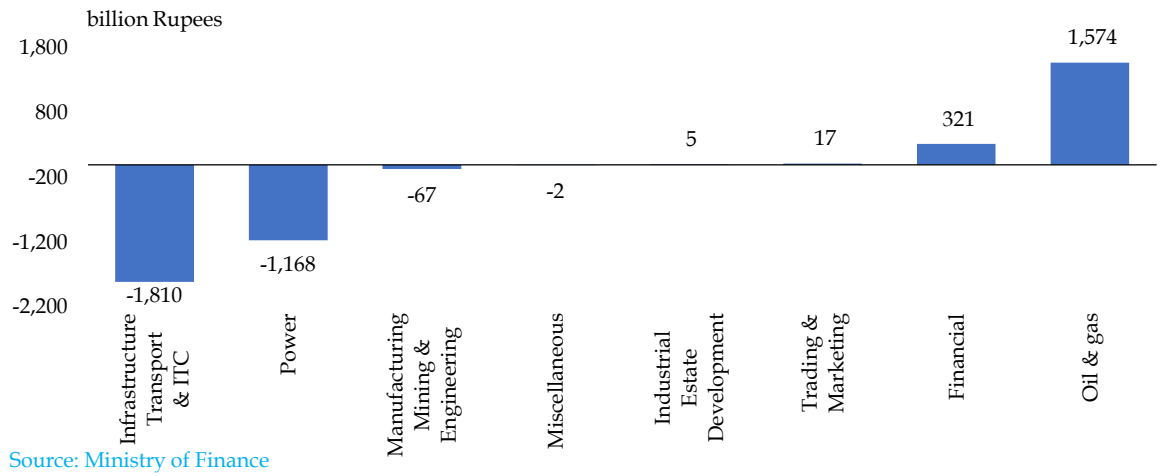
*data for FY20 not available
**tariff differential subsidies are included as outflows to the sector but are not necessarily financial support to power SOEs as they are intended for end consumers
Source: Ministry of Finance

government entities, implying that even profitable entities may not emerge to be truly efficient when tested in competitive markets. Similarly, some SOEs, such as in the petroleum and power sector, operate monopolistically, and there has rarely been any comparative analysis and benchmarking of such companies.[28] These inefficiencies may not necessarily result in financial losses but they do translate into implicit welfare losses for consumers and opportunity costs for the state. On the other hand, these entities may also undertake many actions that fall outside general business considerations. Such public service obligations negatively impact the operations and profits of these entities.

Historical Issues across Commercial SOEs[29]

In addition to the aforementioned sectoral issues, SOEs across the board have also been affected by several other problems, including: (i) lack of corporate governance; (ii) poor business plans and (iii) partial implementation of modern accounting standards and practices. These risks

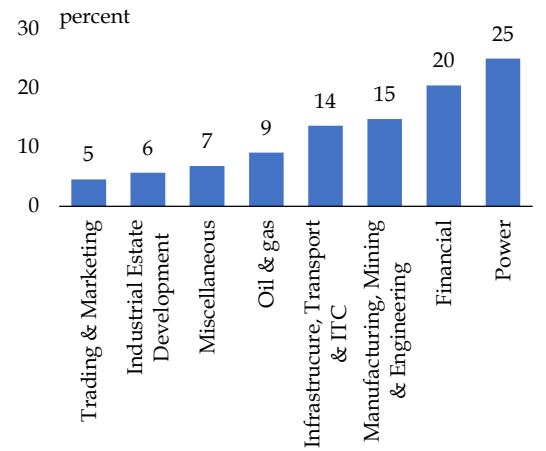
Commercial SOEs Cumulative Profits/Losses (FY18 - FY23) **Figure 7.11**



Source: Ministry of Finance

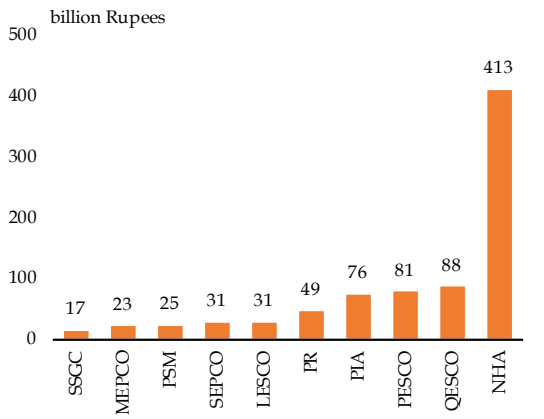
[28] Iftikhar, N (2022).
[29] This sub-section draws on insights from Ministry of Finance's latest report on SOEs, MoF (2023). The report, released on 24th June 2024, summarises problems related to federal SOEs as of FY23. It is the latest available consolidated update on SOEs.

Classifications of Commercial SOEs - FY23 **Figure 7.12**



Source: Ministry of Finance

Top Ten Loss-making SOEs - FY23 **Figure 7.13**



Source: Ministry of Finance

have existed in SOEs in varying degrees, and have long manifested the need to reform the modus operandi of all entities regardless of policy decisions on the ownership of SOEs.

There are multiple issues in SOEs' corporate governance. Amongst the biggest ones, has been the lack of empowerment and independence of the board of directors (BoD). Independent directors formed a minority in the BoD of SOEs, which was exacerbated by the presence of ex-officio members appointed by the government. These boards were further weakened by the presence of government appointed CEOs, breaching corporate governance practices of separation of board and management. There were also problems with monitoring and evaluation (M&E) mechanisms to objectively judge board performances.

SOEs' business plans were found to lack comprehensiveness and did not adequately focus on financial sustainability. Business plans were also found to be unresponsive to changes in the economy or sector, preventing them to take advantageous decisions or mitigate unfavourable circumstances. This was because of two main reasons. Firstly, many entities, such as Pakistan Railways, have relied on government bailouts and support. Secondly, structured and holistic analysis of business threats and opportunities was often not conducted to strategise on future direction.

Moreover, there have been serious lapses in financial reporting in federal SOEs' publications, disclosures, and audits. For instance, audits of some SOEs show material misstatements or departures from accounting standards, highlighting a lack of accuracy or reliability of financial reports. Some SOEs, such as Pakistan Post, Karachi Port Trust and Lahore Electric Supply Company did not prepare audited financial statements for FY23. These issues with data and financial statements reflect a major challenge to data driven decision making for SOE reforms.

In addition, several SOEs had not adopted modern accounting standards, essential to accuracy and transparency. These include International Financial Reporting Standards 9 (IFRS-9) that mandates the use of an expected credit loss (ECL);[30] IFRS-15 for the principles, the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer; International Accounting Standards 19 (IAS-19) for recognition of all employee benefits, including pensions, as liabilities on their balance sheets;[31] and IAS-20

[30] For SOEs with circular debt receivables on its books, for instance, power and gas sector, this means factoring in provisioning for potential defaults into its ECL calculation.
[31] This is in particular important for large employer SOEs, such as Pakistan Railway (PR), which has significant pension obligations.

for recognizing government grants only when there is reasonable assurance that the grants will be received.[32]

The various lapses in SOEs reflect the historical failure of the SOE reform process in Pakistan. Despite several attempts over the past decades, many of these fundamental issues continued to recur. These shortcomings can be rooted in various issues, such as rushed reform processes without the necessary consensus building and due diligence. The following section will analyse the lapses in Pakistan's SOE reform processes across decades and identify common hindrances to past reform programmes.

7.3 Review of SOE Reform Efforts

Reforming SOEs is a complex process. It involves five broad types of reform measures: (a) fiscal and public financial management reforms (e.g. stocktaking of SOEs); (b) strengthening competition and regulation; (c) taking decisions about SOE ownership; (d) corporate governance reforms; and (e) improving business and operations.[33] These measures are not necessarily taken in the sequence listed above, although some literature and global best practices do seem to suggest that. Indeed, there is no single pathway to SOE reform, since much depends on country context. However, global experience suggests that strengthening of competition, regulation, and corporate governance are critical measures, which are advised to be taken before or alongside the decisions on SOE ownership. Similarly, governments also need to take steps to create political consensus, garner public support and manage labour related issues to enhance public buy-in of the reform process **(Figure 7.14)**.

While literature on Pakistan's SOE performance and reforms is scant and dated, a review of the country's historical SOE reform attempts suggests that the reform process has been slow, punctuated and without a well-designed pathway to sustainable SOE reform. The overall policy stance shifted from nationalisation to reforming SOEs as the global trends of privatisation and liberalisation took hold in the 1980s. However, with the exception of some sectors, such as banking and telecom, the country's approach was skewed towards privatisation, rather than implementing wholescale sectoral policy reforms, corporatization, and a robust governance framework to support a competitive economy (**Figure 7.15**). Reforms focusing on corporate governance, and strengthening of competition and regulation was by and large neglected.[34] This has been one of the key reasons why reform efforts failed repeatedly in turning SOEs into profitable entities, improving efficiency, and fixing the fiscal burden problem. This underscores the view that ownership decisions, such as privatisation and retention, are not itself a panacea for the challenges faced by SOEs.

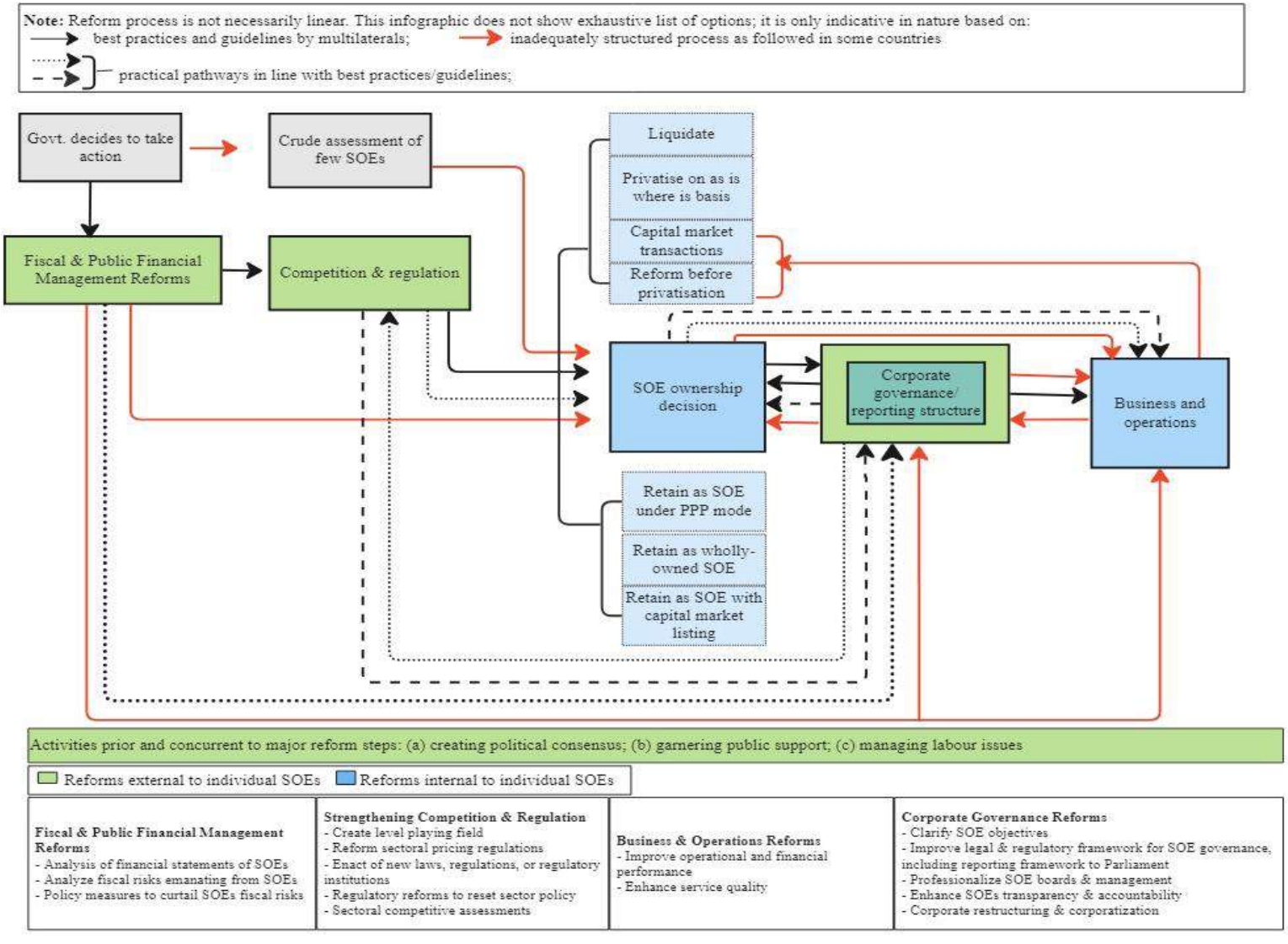
Some attempts at SOE reforms involved improving the business operations of individual SOEs to revive them. Even when such efforts were undertaken with full political support, the lack of good corporate governance and other enabling reforms led to a deterioration of SOEs' business operations, profitability, assets and service delivery, such as in PIA and PR. As a result, bailout packages were provided, and a vicious cycle ensued.[35]

Moreover, the efforts to privatise and other SOE reforms were interrupted by a myriad of underlying challenges, including a lack of political consensus in the absence of which SOE reforms were perceived as the agenda of multilateral agencies. This was because of two

[32] This will effect SOEs like the NHA and PR that are large recipients of government grants.
[33] This chapter excludes discussions on liquidation, which is a one-time transaction, and therefore falls outside the scope of this discussion. SOEs reform in this chapter has been analysed in the context of five broad reform measures mentioned above.
[34] Iftikhar, M. N. (2015).
[35] ADB (2008); PC (2011)[a]; Iftikhar, M.N. (2015).

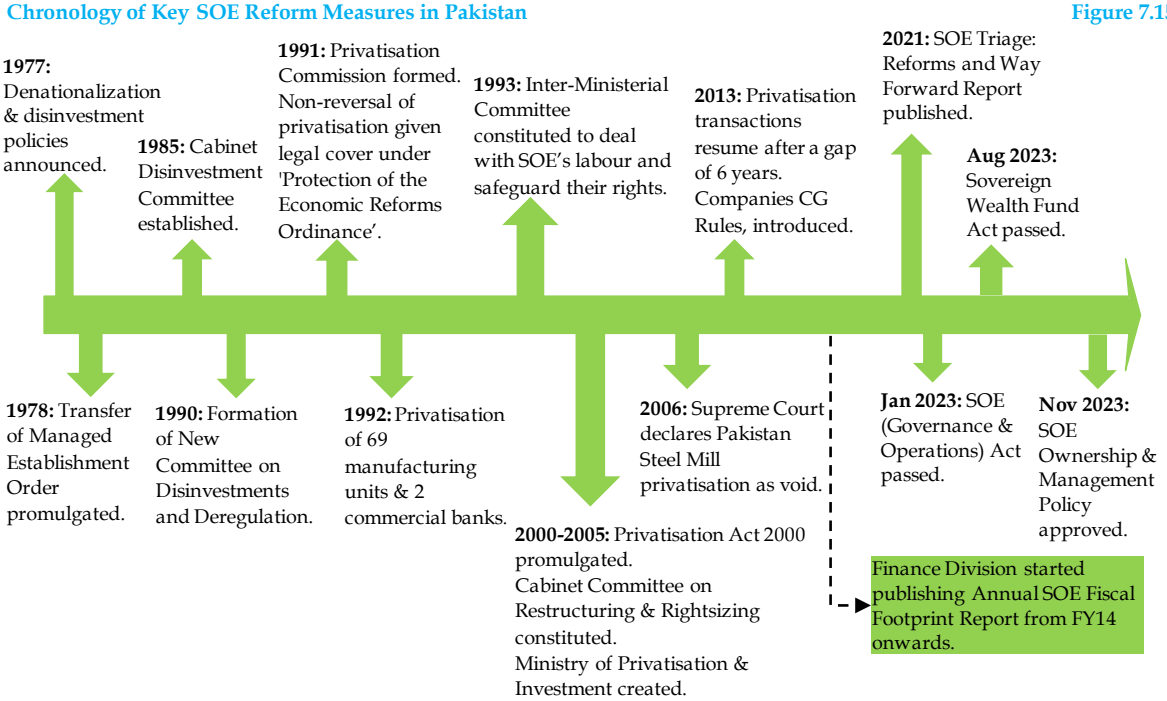
Categories and Sequence of Major Types of SOE Reforms

Figure 7.14



Sources: SBP, based on World Bank (2020), and Kennedy and Jones (2003)

Chronology of Key SOE Reform Measures in Pakistan **Figure 7.15**



Sources: G. Yoganandan (2010); M. Zubair et al. (2022); S. Anwar, (1998).

main reasons. Firstly, clientelism through the management of SOEs continued to undermine SOEs' economic competitiveness. Moreover, political instability and uncertainty stalled both the introduction of required legislation and institutional framework, and privatisation transactions itself. Secondly, during the 1980s and onwards, IMF programs spelled out privatisation as a condition for the multilateral's support. This often hastened the privatisation process, bypassing the recommended phased approach and the legal and institutional reforms needed to reap the benefits of privatisation.[36]

Privatisation

Following global trends, Pakistan has gone through major privatisation since the 1990s. The Privatisation Commission (PC) was established in 1991 as a subsidiary of the Finance Division to implement the privatisation programme. Since then a total of 182 privatisation transactions have been completed. These transactions were mainly concentrated during 1991-95 and 2001-2006 as the process was frequently interrupted due to the aforementioned factors. The 2008 Global Financial Crisis was also a significant setback for the privatisation process in several countries including Pakistan, due to weak investor appetite.[37]

The modalities of privatisation in Pakistan have predominantly involved: (a) the sale of majority stakes with management control in sectors; (b) capital market transactions; and (c) minority stake sale with management control.[38] Other types of privatisation transactions, such as concessions and mutualisation, better suited for low-income countries, have not been executed.[39]

[36] Iftikhar, M. N. (2015); PC (2011)[b]; BTI Index 2024; Bokhari, S.A. (1998); Breen, M., & Doyle, D. (2013); Hussein et al. (2018); Tahir, P. (2014)
[37] IBA speeches (2009); Privatisation Commission website.
[38] Privatisation Commission website.
[39] Concessions involve giving a private company usage rights over SOEs assets (or invest in new assets) to provide certain public services for a specified period, against the right to charge for those services. These arrangements are best suited for privatising SOEs

Sector-wise review of privatisation transactions reveals that the process has been very slow— taking about 6 to 16 years to complete a transaction— even in small sized and less complicated entities such as Roti plants. Further, the large size transactions, mainly related to banks, telecom and energy sectors, were executed through the capital market after 2001 and onwards. This is in line with global experiences, which suggest that privatisation through capital market listing is a better option when the market is relatively developed, whereas whole or majority stake sale is more common when the market is underdeveloped **(Annexure)**.[40]

In some sectors, such as telecom and banking, these transactions were executed alongside efforts to improve competition and strengthen regulation. However, as the ensuing discussion shows, the nature and scope of reforms was not holistic, as the success of SOE reform was seen with a limited yardstick. Moreover, the privatisation process was marked by several legal and institutional weaknesses, whereas some privatisation deals also faced transparency and procedural issues due to which public confidence in the process waned.

Limited criteria of success

One of the major shortcomings of SOE reforms undertaken in Pakistan, is the overemphasis on privatisation as the single most important yardstick of success, with limited focus on strengthening of competition and regulation. Moreover, monitoring and evaluation mechanism for ensuring post privatisation service delivery is weak, which is particularly pertinent for SOEs operating in public goods and services sectors. Also, there have been limited efforts to diagnose and improve the sectoral regulatory frameworks to mitigate such recurring issues.[41]

For instance, the privatisation of Karachi Electric Supply Corporation (now K-Electric), resulted in improvements in service delivery and profitability of the entity. However, its consumers still face high cost of electricity and frequent power outages on account of a host of unresolved sectoral policy and governance issues. Similarly, the capital market transactions of Sui Southern Gas Company (SSGC) and Sui Northern Gas Pipelines Limited (SNGPL) helped the government to raise non-tax revenues amid hopes that stock market listing would enable stronger checks and balances through stringent corporate governance. However, the unresolved sectoral and business policy issues continue to be a burden on these SOEs' operations and finances. This is unlike the banking and telecom sectors, where privatisation of SOEs came alongside a series of policy and governance reforms.[42]

Similarly, it is pertinent to note that while denationalization and privatisation began since the late 1970s and gathered pace during the 1990s, the enabling regulatory environment was not put in place until much later. For instance, several key regulators, such as Securities and Exchange Commission Pakistan (SECP), Pakistan Telecommunication Authority (PTA), National Electric Power Regulatory Authority (NEPRA), Competition Commission of Pakistan (CCP), and Oil and Gas Regulatory Authority (OGRA), were set up more than a decade after the start of the privatisation and reform process.[43]

with monopolistic characteristics, and helps governments mitigate investment/operational risks. Mutualization fosters social cohesion through co-ownership of SOEs by broad group of stakeholders (e.g. employees and customers). Such modalities enhance efficiency and service quality, and also avoid overburdening private sector liquidity. Source: NCP (2022); Jafarey, V.A. (1992)

[40] Megginson, W. L. and Netter, J. M. (1999).

[41] Exceptions include diagnostic study for power sector in 2014 as part of IMF's loan conditionality. However, these were neither made public for stakeholder deliberation, nor implemented. Source: IMF (2014).

[42] SBP (2024); IPS (2023); CCP (2018); Asghar, S. and Mohsin, H. (2023); Kalhoro, S. A. (2022); Hussain, I. (2004); Khan, B. (n.d.)

[43] SECP was set up in 1997. PTA was established as a body corporate in 1996. NEPRA was established in 1997. CCP was formed in 2007. OGRA was formed in 2002. (Source: *Respective websites*)

As a result of this delay and overall regulatory underdevelopment, market dynamics have remained uncompetitive with a weak private sector that undermines broader economic progress. Even the sectors that were privatised in the early years—such as cement, cooking oil/ghee, and fertilizer—are not fully competitive amid recurring instances of cartelization; production inefficiencies; barriers to entry; and low quality standards.[44]

Weak legal and institutional framework

Pakistan's weak legal and institutional framework has affected privatisations in at least four different ways. First, the process of putting the policies and institutions in place took more than a decade. The country introduced policies of denationalization, disinvestment and decentralization in 1978 through the Transfer of Managed Establishments Order (TMEO) 1978. This empowered the government to offer former owners of some of the nationalized industries, the shares of propriety interest in acquiring their formerly owned establishments.

Legal cover was granted under TMEO that the denationalized units would not be nationalized again. Despite this cover, very few nationalized industrial units could be returned to their former owners. This was because the SOEs had deteriorated financially owing to which previous owners had little incentive to invest, especially amid lack of adequate legal provisions to counter the vehement opposition by SOEs' workers and middle and lower management.[45]

The denationalization efforts that began in 1978-1979 soon lost steam and did not advance further until 1985, when a Cabinet Disinvestment Committee (CDC) was set-up to identify units for disinvestment. However, despite setting up this high level ministerial committee which devised the rules and procedures for disinvestment, the overall progress remained negligible for the very same reasons of legal and institutional bottlenecks. In 1988, a National Disinvestment Authority was created with powers wider than the CDC but the institution could not make progress due to a change in government soon after. More than ten years after the start of the process, the PC was eventually established in 1991, along with the Cabinet Committee on Privatisation (CCoP) to institutionalize privatisation efforts. The PC's mandate was initially restricted to industrial transactions. However, by 1993 it had expanded to also include power, oil and gas, transport, telecom, and banking and insurance.[46]

Second, weak stakeholder engagement mechanism has been a major constraint. The mechanisms through which stakeholder interests are aggregated, addressed and mediated are largely absent or limited in their functionality. This undermines the efficacy of the SOE reform process, which requires broad stakeholder ownership. For example, the Pakistan Steel Mills (PSM) was approved for privatisation in 1997 by the Council of Common Interests (CCI), but it was not pursued. However, at the time of privatisation of PSM in 2006, the CCI was not functional, and the government had no active platform to garner a fresh consensus among the federating units.[47]

The third facet of weak institutional capacity revolves around autonomy of regulators. Despite regulatory efforts and the creation of autonomous regulators, elite capture weakens the institutions, whereas the adhocism in decision-making regarding some of the regulators has undermined their autonomy. For instance, the transfer of administrative control of regulatory bodies[48] to their respective line ministries, compromises their independence. Similarly, the lack of consistent capacity

[44] PC (2011)[b]; CCP (2011); CCP (n.d.)
[45] Kennedy, R. M. and Jones, L. P. (2003); ADB (2008); Ramanadham, V.V. (1994).
[46] Bokhari, S.A. (1998); Ramanadham, V.V. (1994); ADB (2008).
[47] BTI Index 2024; Constitution Petition No. 9 of 2006 & Civil Petition Nos. 345 & 394 of 2006, Pakistan Steel Mills Judgment
[48] NEPRA, OGRA, PPRA, PTA and FAB

building of the PC has also acted as a bottleneck for successful privatisation in Pakistan. For example, within a single year in 2006, the PC was under the helm of three different ministers and four different secretaries, whereas the turnover rate of its consultants was also very high. This kind of environment dampens investor confidence.[49]

Lastly, while in 2006, the Supreme Court recognized that it is not the function of the Court to interfere in policymaking domain of the government, many privatisation transactions have been brought before the Court on the broader pretext that they relate to enforcement of fundamental rights. For instance, one of the cases brought for judicial review was whether the privatisation of an entity was undertaken due to IMF's conditionality. Moreover, senior officials of the PC have also frequently faced litigation and investigation from both private citizens and official investigative agencies. These cases deterred them from taking decisive actions, and undermined their willingness to take ownership of crucial decisions, impeding the privatisation process.[50]

Transparency and procedural issues

During the country's history of privatisation, there have been some transactions where due procedures have not been followed amid a lack of transparency. For instance, in the case of PSM's privatisation in 2006, the Supreme Court found that the final terms offered to the buyers' consortium were not in accord with the initial public offering, on the basis of which the court declared the transaction as void. Similar procedural issues have also affected otherwise successful privatisation deals. For instance, in the case of PTCL's privatisation, more than 3000 properties were committed to the buyer, owned by provincial governments and Pakistan Railways,[51] which were never a part of prior consultations before signing the transaction deal. Likewise, in the case of privatisation of a cement sector SOE, the buyer had agreed to a condition on reviving the industrial unit. However, the industrial unit was converted into a housing society, without knowledge of the PC. These instances, albeit few, undermine the transparency and credibility of the privatisation transactions, and damage the prospects of wider public support for the process.[52]

SOE Corporate Governance Reforms[53]

Pakistan's most serious attempts at SOE's corporate governance reforms have been undertaken as recent as 2023. These measures are built on the back of two key fiscal and public financial management reform initiatives: first, the reporting of annual SOEs' financial statements through Federal Footprint reports since FY14; and second, stocktaking of the fiscal impact of SOEs under a 2021 report titled 'SOEs Triage: Reforms & Way Forward'.

Prior attempts at SOEs corporate governance reforms have been few; limited in range and scope; and incomplete. For instance, in 2013, the Public Sector Companies Corporate Governance (PSCCG) Rules were introduced; but they were not effectively implemented. Similarly, in 2012 and in 2019, attempts were made to create a holding company and bring all SOEs under its umbrella. While the 2012 attempt remained mainly at ideation stage despite its hype, the 2019 attempt resulted in the creation of holding company by the name of Sarmaya-e-Pakistan (SEP). However, the SEP did not materially progress beyond incorporation.

PSC Corporate Governance Rules 2013

In response to governance challenges, Pakistan

[49] Naseem, F., & Ghulam, S., (2022); Sherani, S. (2017); ADB (2008).
[50] PC (2023); Hussein et al. (2018).
[51] Naseem, F., & Ghulam, S., (2022).
[52] ADB (2008); Tahir, P. (2014).
[53] This sub-section only sheds light on key corporate governance reforms and its baseline documents. However, the evolving nature of ongoing reforms prevents its exhaustive analyses.

introduced the PSCCG Rules in 2013, later amended in 2017 and 2019. A review of the Rules (as amended up to July 2019) informs that it was a step in the right direction, the first such reform measure in the history of Pakistan's SOEs. Its salient features included the requirement for at least one-third independent directors in SOEs board with competencies relevant to the respective SOEs who are subject to a fit and proper criterion; have a secure term of office;[54] and are appointed under performance contracts. It also mandated the preparation of business plans; internal and external audited reports; publication of annual financial statements as per IFRS on SOEs' website; publication of status report on compliance with the Rules; as well as a penalty for non-compliance or contravention of the Rules.[55]

However, as flagged in **Section 7.2**, these Rules were not effectively implemented, with a compliance rate of a mere 37 percent; incomplete boards; lack of independent directors; improper accounting records; and non-transparent and vague business plans. In fact, the SECP often found it challenging to hold the board, which included government functionaries, accountable. Moreover, the Rules notified were only applicable to SOEs registered under the Companies Ordinance 1984 - later Companies Act 2017 —and not on SOEs established under special enactments or attached departments. This kept several SOEs outside the ambit of corporate governance.[56] However, following the passing of the SOE Policy 2023 under SOE Act 2023, the PSCCG Rules 2013 are no more applicable.[57]

SOE Federal Footprint Reports and the Triage 2021

The Triage report was a review of existing SOEs portfolio, undertaken in consultation with the IMF, the World Bank and the Asian Development Bank to categorize the SOEs for retention, privatisation and liquidation. The Triage report was intended to serve as the foundational policy guideline for all the concerned ministries, divisions and other stakeholders to take appropriate action plans within the detailed timeframe stipulated in the report. Originally initiated in 2019 as a part of the IMF Extended Fund Facility, this was the first comprehensive review of the federal government's existing SOE portfolio to categorize SOEs and to help assess SOEs' fiscal footprint. This was done on the basis of Federal Footprint SOE Performance Review reports by the Ministry of Finance, which mainly collected and compiled the financial statements reported by SOEs after the PSCCG Rules 2013. Beginning with FY14 report, this was the first time that annual financial statements of SOEs were released publicly.[58]

However, like the PSCCG Rules 2013, the Triage has not been effectively implemented. For instance, power sector DISCOs' bidding process for privatisation was slated for 30th June 2024, whereas that of other SOEs was 30th June 2023. But both timelines have lapsed and progress on both accounts has been rather slow. Moreover, the Triage lacked fundamental aspects, such as an unambiguous criterion for retention of SOEs. Furthermore, the Triage did not shed light on the need for essential policy reforms, sectoral competitive assessments, and other actions to reduce market imperfections before initiating

[54] Under Section 13 of the SOE Act, a director cannot be removed unless an inquiry proves non-compliance, misconduct, and other things such as indulging in a professional or personal conflict of interests' situation, receiving gift or other benefits from sources external to the SOEs offered to him.
[55] Public Sector Companies (Corporate Governance) Rules, 2013, amended upto July, 01, 2019
[56] Iftikhar, M.N. (2015).
[57] Unless otherwise notified as an exception. Source: SECP (2024); section 8 SOE Ownership and Management Policy 2023
[58] Whilst the footprint reports offered useful insights, the data in those reports is often patchy because several SOEs did not share data as flagged elsewhere in this section. Moreover, the reported data was often inconsistent with changes in sectoral classifications, data revisions, whereas the data itself was not easily comparable due to non-interactive reporting formats.

privatisation. Whilst the Triage serves as a baseline document, the SOEs are to be re-categorized under the SOE Act and SOE Policy 2023, which spells out a new criteria and process for categorization.

Sovereign Wealth Fund Act 2023

In August 2023, Sovereign Wealth Fund (SWF) Act 2023 came into effect as part of the government's SOE reform process. The objective of the SWF is to contribute to economic development through strategic fund management with capital sourced from the federal government; the SBP; transfer of assets of SOEs; borrowings from financial institutions; and transfer of government shareholding in SOEs. The SWF Act mandated the transfer of ownership of seven entities including several large energy sector SOEs to the Fund.[59] However, this initiative seems to conflict with the SOE Act and Policy, which, as discussed below, emphasize consolidated reporting and independence of SOEs Boards over their actions. The SOE Policy was approved after the SWF Act. However, the SOE Act and the Policy do not align with the SWF, which creates an additional layer of governance framework.

SOE Act & SOE Policy 2023

The recently passed SOE Act 2023 and the SOE Policy 2023 (drafted in accordance with the SOE Act) introduce a broader governance framework for all SOEs including those established under special enactments. It is the most comprehensive corporate governance framework so far in Pakistan and has several important aspects. The SOE policy also spells out specific criteria for categorization of SOEs as strategic or essential for retaining SOEs indefinitely. If a commercial SOE does not meet the criteria for strategic or essential, it will either be (a) privatised without reforms; (b) privatised after restructuring/reforms; or (c) retained in the medium term, after restructuring/reforms. While these decisions are to be proposed by the line ministry in consultation with the SOEs' board, the decision rests with the Cabinet Committee on SOEs (CCoSOEs).[60]

The creation of CCoSOEs with defined responsibilities is another salient feature of the latest SOE legislation; earlier CCoSOEs were not a permanent feature of every cabinet and did not have specific rights and duties defined by any legislation. One such role of CCoSOEs is to review the board of directors of SOEs recommended by the line ministry, before final approval of federal government. The SOE legislation and the SOE Policy also requires a professional board of directors with a majority of independent directors (**Figure 7.16**).[61]

The SOE Act and policy gives autonomy to the SOE boards, with clear provisions that the line ministry shall not micromanage the SOE nor give direction to SOEs to perform public service obligations (PSOs) unless mutually agreed and funded for, and monitored.[62] Moreover, the board is to appoint a CEO on a performance-based contract.[63] The law and policy also requires performance review of its directors under a criteria defined by the Central Monitoring Unit (CMU), set up under Finance Ministry.[64]

The formation of the CMU is another defining feature of the SOE Act, which gives it sufficient powers to monitor and evaluate the

[59] IMF (2023); The seven entities include: Oil and Gas Development Company Limited, Pakistan Petroleum Limited, National Bank of Pakistan, Government Holdings (Private) Limited, Mari Petroleum, Neelum-Jehlum Hydro-Power Company and Pakistan Development Fund Limited

[60] Sections 9, 11, 12, & 13 of the SOE Ownership and Management Policy 2023

[61] Sections 15 & 23 of SOE Ownership and Management Policy 2023

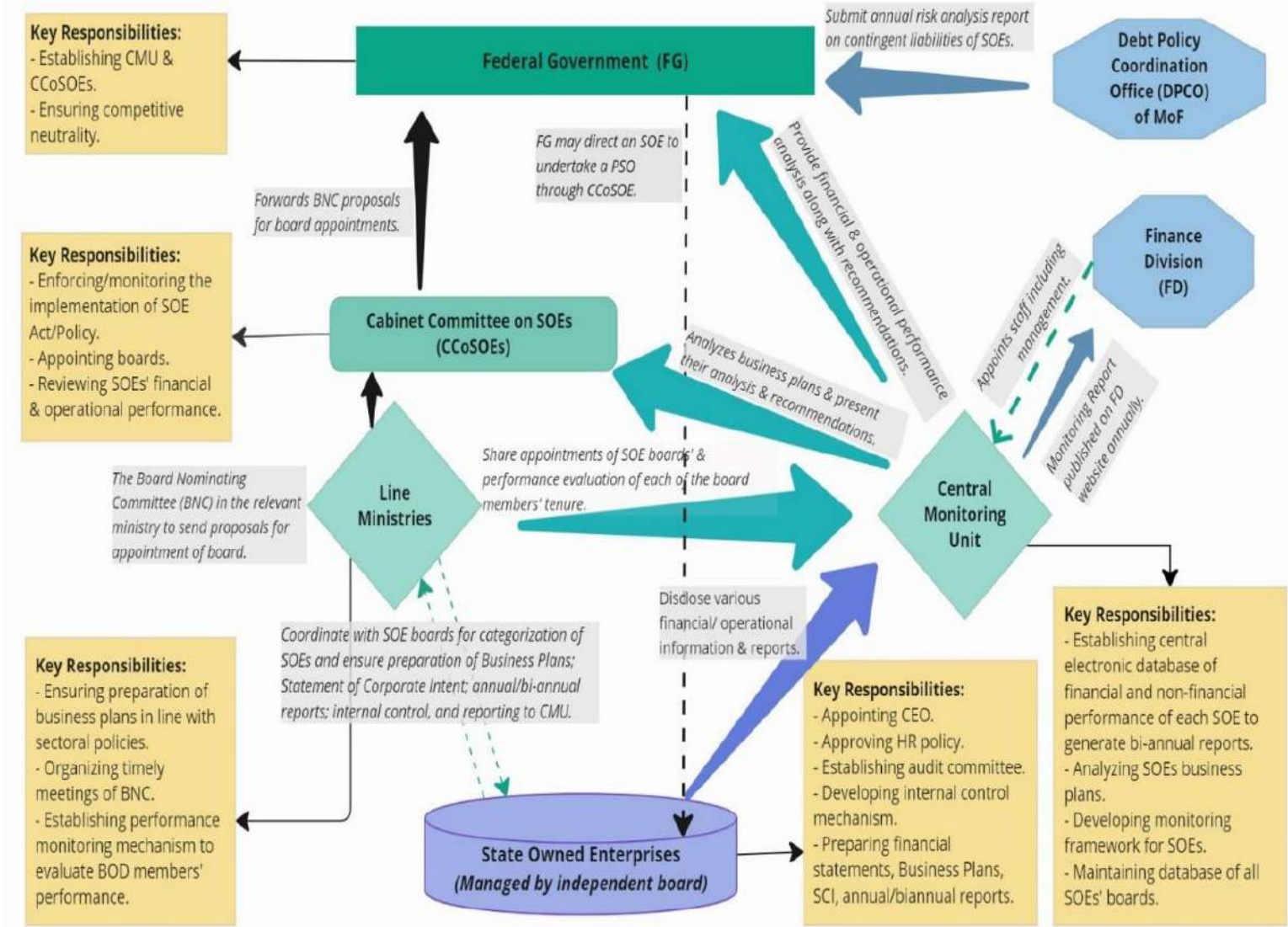
[62] Under section 7(4) of the SOE Act, 2023, the federal government may direct a commercial SOE to undertake a PSO. As per section 32 of the SOE Ownership and Management Policy 2023, the federal government should compensate the SOE appropriately, in case it is directed to undertake a PSO, to the value of services provided.

[63] Section 18 of the SOE Act 2023; and Section 26 of SOE Ownership and Management Policy 2023

[64] Section 18 of the SOE Act 2023; and Section 26 of SOE Ownership and Management Policy 2023

SOE Governance Framework Under SOE Act and Policy 2023

Figure 7.16



Sources: SBP, based on SOE Act 2023 and SOE Ownership and Management Policy 2023

Reforming State-owned Enterprises in Pakistan

performance of SOEs, including their business plans, annual reports, and agreements on PSOs.[65] In addition, the Act also states that each SOE Board is to ensure preparation of annual reports as per IFRS, business plans, statement of corporate intent; as well as other aspects of corporate governance, such as drafting code of conduct; and establishment of an audit committee.[66]

Another key feature of the ongoing reform measures is that the SOE law and policy allows SOEs to have their own HR policy with preference for contract hiring and autonomy over hiring and firing, based on performance evaluation.[67] Moreover, under the new legislation, the SOEs are generally exempt from the Public Procurement Regulatory Authority Ordinance, although exceptions to this may apply.[68] These are important features if retained SOEs are to be run as efficient organizations.

Lastly, the latest SOE framework requires the federal government to ensure competitive neutrality of the state, such that no SOE benefits from any unfair competitive market advantage or dominant position by virtue of being an SOE. The SOE policy also directs the federal government to set up accountability mechanisms in place to support and monitor the framework for ensuring competitive neutrality.[69]

7.4 Strategies for Successful SOE Reforms: Lessons from Global Experience

With the introduction of the SOE Act and SOE Policy in 2023, the foundations for comprehensive SOE reforms seem to have been laid. These measures seem broadly in line with global best practices and guidelines on corporate governance that emphasize on professional management of SOEs under an independent board, clarity of objectives, continuous monitoring, competitive neutrality, and legal room for business and operational reforms.[70]

However, the success of the recently launched ongoing corporate governance reforms, as well as the subsequent SOE ownership decisions will depend on their implementation, especially with respect to their alignment with other facets of SOE reforms. In this context, the absence of clearly defined penalties for non-compliance with the SOE Act & Policy is noteworthy.

The success of the ongoing SOE reforms will also depend on the degree to which the gaps in earlier SOE reform efforts are addressed. These gaps, briefly highlighted in **Section 7.3**, include the strengthening and adequate sequencing of competition and regulation; clarity of objectives; effective management of political and labour issues; and further improvements in corporate governance. Accordingly, this section draws on global experience to shed light on: (a) importance of some of these key reforms areas; and (b) different pathways to address those gaps.

Strengthening of Competition and Regulation

Evidence suggests that more than the change in ownership, it is competition that determines quality of service, improved output and efficiency of SOEs. Without ensuring competitive environment, neither retention nor

[65] Section 31 of SOE Act 2023; & Section 19, 20 & 21 of SOE Ownership and Management Policy 2023
[66] Sections 8 & 21 of the SOE Act 2023; and Section 34 and Annexure 1A of SOE Ownership and Management Policy 2023
[67] Sections 29 & 30(d) of SOE Ownership and Management Policy 2023
[68] As per Section 17 of the SOE Act, 2023, SOEs shall maintain independent procurement policies which complies with the Chartered Institute of Procurement and Supply's Global Standards of Procurement and Supply, unless the Federal Government specifically directs a SOE to comply with the provisions of Public Procurement Regulatory Authority Ordinance 2002
[69] Section 5(f) of the SOE Act 2023; and Section 27 of SOE Ownership and Management Policy 2023
[70] For details on good governance of SOEs, see OECD (2015).

privatisation will create adequate incentives to improve services and enhance productivity. Thus, greater attention needs to be paid to promote competition by eliminating barriers to entry.[71]

Literature suggests that there are different pathways to inducing and strengthening competition. One way is to liberalise a sector which is a substitute. This was done in the United Kingdom in the 1980s when bus services were liberalised to increase competition for state-owned rail companies. Another way, which particularly suits sectors with large monopolies, is to make them export-oriented and by virtue of that expose them to competition in international markets. This was seen in the Republic of Korea's Pohang Iron and Steel Company's transformation during late 1960s and 1980s, where exposure to global competition along with good governance enabled it to become one of the most cost efficient producers of low-grade steel in the world.[72]

Moreover, inducing competition does not only include allowing the private sector to compete by removing barriers to entry, but also the government itself can prioritise competition in case the private sector is unable to step up. For example, the Republic of Korea established a new state-owned telecommunication company in the 1980s, albeit with competitive neutrality, to create competition in the provision of international call services.[73]

Aside from increasing competition within and between sectors, the government needs to undertake private sector development as part of long-term SOE reforms to signal a preference for an economy led by the private sector. This was successfully done by the Republic of Korea during the 1980s and 1990s where the government moved from direct and explicit intervention to diminishing its role focusing more on innovation and coordination.[74] Similarly, between 1990 to 1994, Colombia promoted private sector development in monopolistic conditions by permitting open competition between public and private operators in ports. By providing a level playing field, the performance of the public sector entities also improved.[75]

Increasing competition, however, requires effective regulations to encourage new entrants, prevent monopolistic practices, ensure customer protection; enforce quality standards; and promote good corporate governance practices, accountability and investor confidence. These need to be made on the principles of predictability, proportionality, and non-discrimination,[76] which may be facilitated through regulatory sandboxes that facilitate regulatory innovations. For instance, Germany's power sector regulatory transformation is a pertinent case in point.

Germany's electricity sector until the late 1990s was a non-competitive market. Customers had no right to choose their supplier and were bound to regulated tariffs. State authorities controlled electricity prices. However, when Germany liberalized its electricity market, it established an independent regulator, the Federal Network Agency (FNA). A legal framework was established that spelled out clear roles and responsibilities of market participants and the FNA. Procedures were designed by regulator to effectively implement

[71] ADB (2020).
[72] Ibid.
[73] Ibid.
[74] Ibid.
[75] Montenegro, A. (1995).
[76] Non-discrimination implies that regulators do not discriminate between either service providers or within customer categories. Regulations should be fair to all firms with no favouritism and interference from government, neither for any owner of privatised entity nor for managers of retained SOEs. Regulations should be proportional to the nature of business, risk profile, state of competition; minimum level of regulatory control to achieve desired objectives; and should be incentive based where needed. Ensuring level playing field for all stakeholders and encourages competition which subsequently improves the SOE performance.

the regulations, such as rights of information and investigation. Customers rights, such as freedom of choosing suppliers, were strengthened and expanded. Only the electricity grids remained in a regulated natural monopoly. Grid related departments were separated from generation, trading and sales, all of which were now open to competition. This led to a more cost-effective power sector, with a lasting reduction in generation and transmission costs.[77]

Decisions regarding strengthening of competition and regulatory framework require undertaking of competitive sectoral assessments. This provides policymakers an opportunity to develop a comprehensive understanding of the competitive landscape of each sector, its potential challenges and opportunities. It also allows for benchmarking against global best practices, identifying areas for improvement, making informed decisions about SOE ownership, and tailoring regulatory framework for each sector. Moreover, sector-specific competitive assessments allow for targeted interventions for reform failure, recognizing the value of a nuanced approach to regulatory reform, which is important for critical decisions such as deregulation of pricing.

For instance, Germany's privatisation of Deutsche Telecom in the 1990s followed after a detailed sectoral competitive assessment that considered global trends, technical advancements and market changes. The assessment revealed that competition was the preferred mode of market organization due to its ability to adapt to technical and demand shifts, reducing the importance of consideration like economies of scale and sunk costs. The transition included regulatory advancements, ensuring a phased approach to competition addressing the disadvantages the SOE had in the face of competition worldwide in the sector. This had a transformative impact on the German telecom sector demonstrating the efficacy of thorough sectoral assessments in guiding reform decisions.[78]

In this context, the principle of competitive neutrality spelled out in SOE Policy 2023 under guidance of the SOE Act 2023 is a step in the right direction. Under the framework for ensuring competitive neutrality, the SOE Policy states that the federal government shall carry out competitive assessments that identify and revise regulations that restrict competition.[79] However, timelines, policy principles, and institutional responsibilities to this effect also need to be spelled out and followed through as part of the government's commitment to SOE reforms. Pakistan can draw from international best practices to design an effective mechanism for ensuring competitive neutrality; for instance, the Australian Government Competitive Neutrality Complaints Office (AGCNCO). The AGCNCO is a separate unit within the country's treasury department empowered to investigate complaints of unfair competition stemming from non-compliance with competitive neutrality obligations by Australian SOEs, providing unbiased recommendations to the parliament.[80]

Setting Clear Objectives and Performance Benchmarks

Objective setting is indispensable in the SOE reform process as it helps in aligning stakeholder expectations and risk mitigation. It is especially important for the setting of clear goals for the SOE management. Well defined objectives for foreseeable future prevents SOEs' managers from chasing the often multiple and ambiguous government objectives that have the tendency of changing from one administration to another.[81]

[77] Agora Energiewende (2019).
[78] Vogelsang, I. (2003).
[79] Under Annexure 4 of the SOE Ownership and Management Policy 2023
[80] Australian Government Productivity Commission website
[81] Roland, G. (2008).

For instance, the experience of Lithuanian Railways (LR) underscores the importance of clearly defined objectives. For decades, LR's poor performance hid behind the vague objective of fulfilling its social functions. However, the reforms initiated in 2000 centred around well-defined objectives for its freight, passenger transport, and infrastructure operations and ensuing change in ownership structure. This led to creation of three SOEs — each for different LR operation—under a single LR holding company, each having separate books of accounts. This enabled LR to gain efficiencies, and maximise profits in freight carriage operations. LR also continued to fulfil the loss-making passenger transportation obligations in public interest, where the losses were compensated by the government. The clarity of objectives, therefore, helped LR align its operations with public and commercial interests, leading to a successful transformation in a transparent and cost-effective manner.[82]

Objectives are also important for ensuring accountability of management as the performance of the board and management can be better assessed by linking performance evaluation systems with the clearly defined goals. For instance, under the transformation program for its SOEs in 2005, the Malaysian government set objectives to guide and enhance the performance of the SOE's management. It publicly released a guidebook on Key Performance Indicators (KPIs) on financial, organisational, operational as well as non-financial metrics that were benchmarked with comparable international peers and were audited annually. The achievement of KPIs in light of objectives was linked to remuneration of SOEs managers. This enabled benchmarking of the incentives of SOEs management with that in the private sector.

In Pakistan, the primary objective of commercial SOEs under the SOE Act 2023 is to operate in an "efficient manner" and be financially sustainable, achieving the objectives spelled out in their respective Acts or memorandum of association. Moreover, the SOE Policy 2023 also requires the SOEs boards, in coordination with the relevant line ministry, to publish a statement of corporate intent (SCI) for three years. The SCI is to include SOE's objectives along with business goals and performance measures and benchmarks. The latest SOE legislation also requires that the CEO is to be hired on performance-based contracts.[83]

To further cement these positive developments, the government may also consider preparing specific quantitative and qualitative performance evaluation on both financial and non-financial parameters. These may be aligned with the objectives of SOEs in different sectors for better monitoring and evaluation as well as performance assessments of board and management. For instance, financial metrics may include labour productivity, transparency of budget, project cost overruns. Similarly, non-financial parameters may be number of beneficiaries served, compliance with international quality standards, comparisons with industry performance, and timely submission of reports to regulators.[84]

Managing Labour Issues

Labour issues are one of the most complex and politically challenging elements of SOE reforms. This is understandable because the short term human cost of labour rationalisation is often more visible than the potential gains of efficiency, productivity, and competiveness in the medium to long term. Regardless of whether an SOE is privatised, or restructured and retained as a public company, rationalisation of human resources is essential considering that workers' inefficiencies are often one of the key reasons behind the poor performance of SOEs.

[82] ADB (2020); Kikeri et al. (1992).
[83] Sections 7(1), 7(3), and 8(4) of SOE Act 2023
[84] OECD (2016).

Global best practices, therefore, suggest that labour issues can and should be resolved as early in the reform process as possible. This not only helps smooth privatisation or restructuring of SOEs but also allay labour's concerns before they become politically challenging or otherwise become a barrier to reform.[85]

Even if hiring and firing of labour is not done immediately, which is the recommended strategy in some cases—such as in privatisation transactions on 'as is where is basis'—best practices suggest that communication and consultation with labour starts early in the reform process, with openness and transparency as important confidence building measures. This needs to be accompanied by public awareness campaign to help garner wider public support.

Whilst there is no best measure for mitigating labour issues, most instruments of labour management revolve around the following: (a) voluntary retirement scheme including severance and pension payments; (b) worker counselling before and after restructuring; (c) training for new skills that may be utilised within the SOEs or elsewhere in the job market including self-employment schemes; and (d) other benefits, such as unemployment benefits or other social safety nets. Experience suggests that of these options, counselling and training are difficult to manage operationally and do not necessarily have the level of acceptance as much as voluntary retirement which is the costliest option.[86]

In this context, a review of Pakistan's recent SOE legislation and policy suggests that there is room for further reform. While SOE Policy 2023 tasks SOEs' boards to draft regular human resource review mechanism with the view to rationalize workforce, it does not have policy principles and guidelines on labour management framework with its implementation timelines. This, along with clearly stated government commitment to support new managers —of both retained and privatised SOEs— in worker rationalisation is a key gap that the government needs to address in order to prevent derailing of the reform process.[87]

Creating Political Consensus

The lack of political consensus is one of the recurring roadblocks to SOE reforms in Pakistan. While in part this originates from differing economic ideologies, it also stems from labours' concerns, as discussed in the preceding sub-section. Many countries including Pakistan have often backtracked on SOE reform measures due to the public pressure and scrutiny faced by the government, which attempts to extricate itself from the SOE reforms due to political considerations. This stop-start process negatively impacts state credibility, casting doubts on the earnestness of the government's reform efforts. In light of these issues, it is of utmost importance that the government proceeds in a way that maintains political buy in and improves credibility.[88]

There are three major ways through which political roadblocks to SOE reforms may be removed. The first relates to consensus building, where the government can garner support by conducting extensive consultations with multiple stakeholders so that all parties understand the objectives and rationale of the reform process. For instance, lessons may be

[85] ADB (2006).
[86] Jones, L.P. & Kennedy, R.M. (2003).
[87] Government commitment in this regard is critical to increase investor confidence. Despite successful voluntary separation schemes (VSS) such as in the case of PTCL, anecdotal evidence suggests that riots and burning of vehicles outside the head office of KESC (now K-Electric) following its VSS announcement as part of post-privatisation restructuring in 2011, damaged investor confidence. (Source: Nadeem, S. & Aziz, A. (2018); KESC (2012))
[88] The lack of political consensus also originates from the fact that staffing of workers and management of SOEs are often used as endowments by political actors for various types of support provided to them. However, addressing of such issues is usually outside the scope of economic policymaking, hence not discussed in this chapter; Fedrico, Q. (2019); Kuzman, T. (2018).

learnt from institutions like National Social Dialogue Forums, such as in Türkiye. At such forums, the government engages a variety of stakeholders, including workplace representatives, provincial and national authorities as well as private sector participants, trade unions, special arbitrators, civil employers' committees.[89]

Second, clear government communication can play a key role in influencing the outcome of SOE reforms. For example, by illustrating how the state's resources can be better employed in targeted social safety nets rather than poorly performing companies or their few employees. In this context, the shaping of wider public opinion can be carried out through media campaigns that sensitise citizens and emotively appeal to their values.[90]

Third, relates to the right approach to reforms, which depends on the context. For instance, in some cases initiating SOE reform with smaller and relatively easier firms will create the necessary momentum, whereas in other cases starting with the larger and relatively important entities shows the seriousness of the government. In both cases, both political and wider public support for reforms will increase when the public sees tangible improvements in service delivery. For example, in Cote d'Ivoire there was strong support for the overall privatisation programme after there was notable improvements in electricity services post-privatisation.[91]

Improving Corporate Governance

A strong and independent board of competent professionals, free from political pressures, is a crucial success factor in SOEs. As discussed in **Section 7.3**, developments in Pakistan are positive in this regard as the recent SOE legislation has legally enshrined autonomy to SOEs and their boards, and considerably insulated them from potential intervention of line ministry or the federal government. However, two aspects may be explored for further strengthening of SOEs' corporate governance: composition of SOEs' board, and SOE's reporting structure to the government.

In terms of board composition, there are three areas of improvement worth considering. First, while the presence of SOE's CEO on its board under the SOE Act and Policy 2023 is in line with global practices, it is not well aligned with the best practices of separation of board and the management, which requires that the CEO should report to the board. [92]

Second, the recent SOE legal framework warrants a majority of independent directors on SOEs board, it also directs line ministries to select ex-officio board members with relevant expertise who can contribute meaningfully to board deliberations.[93] Considering that line ministries are not necessarily staffed with specialised bureaucracy with subject matter expertise, the government may revise corporate governance framework to allow line ministries to appoint a specialist as their nominee director in place of ex-officio director, if need be. Third, there is a need to expedite the development of a database of prospective board members by the CMU to curate the right mix of professionals with diverse and complementary skill sets, in light of SOE Policy.[94]

In terms of SOEs' reporting structure to the government, the SOE governance framework introduced last year is in line with global experience but not necessarily in line with the most recommended practice. For context, an important step in ensuring SOEs' autonomy is to

[89] ADB (2020); Araújo, S. and Menese, M.P. (2020).
[90] ADB (2020); Rentsch et al. (2020).
[91] Jones, L.P. & Kennedy, R.M. (2003).
[92] Under section 12(1) of SOE Act 2023; Marks, S.G. (1999).
[93] Ibid.
[94] As per SOE footprint report released on Jun 2024, the database of prospective board members was not complete.

create adequate distance between the SOEs and political agents.

Globally, there is a spectrum of ownership models between two broad characteristics of centralised and decentralised ownership. In the centralised model, the ownership is consolidated in a single entity which is either independent or under the authority of a single ministry.[95] In the decentralised model, ownership rests with respective line ministries without any monitoring by any centralised body. This was the case in Pakistan before the introduction of SOE Act & Policy last year. In between this spectrum is a dual or hybrid model, where ownership is vested with the line ministry but another ministry — such as Ministry of Finance — has a central coordinating and monitoring function. After the introduction of SOE Act & Policy 2023, Pakistan falls under the dual/hybrid model **(Figure 7.16)**. Whilst this model offers better monitoring compared to a decentralised model, the monitoring agency lacks capacity and executive authority to roll out reforms as is possible in a centralised model.[96]

There is no one-size-fits-all solution for ownership models. Moreover, these models are somewhat fluid, as there are country arrangements where elements of more than one model have been combined to create a corporate governance system. However, generally, international practices illustrate an inclination of moving towards centralised ownership models, where a single body assumes ownership functions. This preference stems from the fact that line ministries' ownership of SOEs tends to be susceptible to political intervention and relatively lower oversight and accountability since line ministries are both owners of SOEs and their regulator. By comparison, centralisation is considered a better practice because it helps further separate state ownership and regulatory functions - minimising political interference, facilitate uniform corporate governance, improve management and enhance efficiency in administration. Additionally, changing ownership from line ministries minimises political interference and allows ministries to focus on core functions like sectoral development and governance.[97]

In light of this, and the fact that reforms ought not to be a one-time exercise, the government may consider moving towards a centralised model for retained SOEs over the medium term. A centralized model can take different forms. For instance, a central advisory/coordinating body like in India, New Zealand, Norway, South Africa, and Sweden. Another type of central ownership model has central agencies within the government structure, such as in China, France, and Indonesia. The third type of centralised model has holding/investment company that owns and monitors all the SOEs, such as that in Gulf countries, Hungary, Malaysia, Singapore.[98]

The determination of suitability of different centralised models in Pakistan will need to be based on a detailed assessment of the legal framework, political and institutional context, and public deliberations thereof. In the absence of such assessment and deliberations, the acceptability and practicality of attempts toward that model may meet the fate of the now defunct Sarmaya-e-Pakistan or otherwise unnecessarily complicate governance as is being done by the creation of Sovereign Wealth Fund.

Ensuring Appropriate Planning and Sequencing of Privatisation

While privatisation is the logical conclusion for most commercial SOEs operating in an industry that can be easily serviced by private sector, assessing the appropriate sequencing and speed of privatisation is critical. Academic consensus

[95] OECD (2018).
[96] Cheema, F.S. (n.d.).
[97] Aftab, S. & Shaikh, S. (2013); WB (2014); Salem et al. (2023); Jones, L.P. & Kennedy, R.M. (2003); ADB (2020).
[98] Aftab, S. & Shaikh, S. (2013).

on the subject does not exist on account of diversity of context. However, three lessons from global experiences warrant consideration. First, from the perspective of timing of privatisation, there is clear evidence that careful assessment of the industry's market conditions is important. Rapid privatisation in a market that does not have enough liquidity, or sufficient economic growth prospects may not lead to successful transactions or otherwise exhaust the available capital too soon. This risk is especially common in developing economies with weaker capital deepening, which may not be able to cope with simultaneous divestiture of many major SOEs.[99]

Second, interlinkages between industries, where changes in one sector may impact allied sectors, ought to be considered. For instance, if a country's steel industry depends on SOEs for supply of raw materials and machinery, then unplanned privatisation of upstream SOEs, such as iron ore mining and refining, alongside liberalisation of their exports, could affect the entire domestic steel value chain. This underscores the importance of careful sequencing of the privatisation transaction to minimize disruptions and maximize efficiency by considering the backward and forward linkages within the sector.[100]

Third, appropriate sequencing of sectoral regulatory frameworks is critical; it should be undertaken as soon as reform decisions are taken to prevent market inefficiencies. For instance, U.K.'s privatisation of British Telecom in 1984, despite its continued monopolistic position for a number of years after privatisation, was promptly regulated by Office of Telecommunications, ensuring a smooth transition. In contrast, the privatisation of Telmex in Mexico was not accompanied by immediate competition or regulatory reforms. The reorganization of the telecom ministry into a telecom regulatory agency was considerably slow paced which hindered market efficiency.[101]

Implementing Hard Budget Constraints

Hard budget constraints can be found as a feature in a plethora of SOE reforms around the world, with various countries, such as Spain, Peru and Brazil, implementing the concept for improved performance of SOEs. SOEs are often inefficient because of their reliance on state support. By ending this constant support and imposing hard budgets, SOE are forced to be financially disciplined or risk going out of business. In fact, the closure of such firms is an objective of this policy because by driving out inefficient firms, fiscal space is freed up for more productive ventures. Additionally, it also signals the seriousness of the state's SOE reform process.[102]

The existing SOE legislation in Pakistan, which does not explicitly mention hard budget constraints, may benefit from this policy to minimise fiscal risks and improve financial sustainability of SOEs. However, this would need to be enforced carefully. Literature suggests that even if governments attempt to enforce this policy in earnest, SOEs may still default on payments to the government, sell assets, take advantage of underdeveloped financial systems for loans or craft mutually beneficial arrangements with other SOEs. For instance, in Eastern Europe firms overcame hard budget constraints by purchasing on credit from entities which knew that the buyer would default but still continued with the practice because of prior relationships. By selling to these entities, many firms survived longer than they otherwise would have.[103]

[99] Ramanadham, V.V. (1994); Jafarey, V.A. (1992)
[100] Ahuja, G, and Majumdar, S.K. (1998).
[101] Ibid.
[102] Jones, L.P. & Kennedy, R.M. (2003); ADB (2020); Lam, W. R. & Schipke, A. (2017); Musacchio et al. (2015)
[103] Jones, L.P. & Kennedy, R.M. (2003).

7.5 Case Studies on Major Loss-Making SOEs

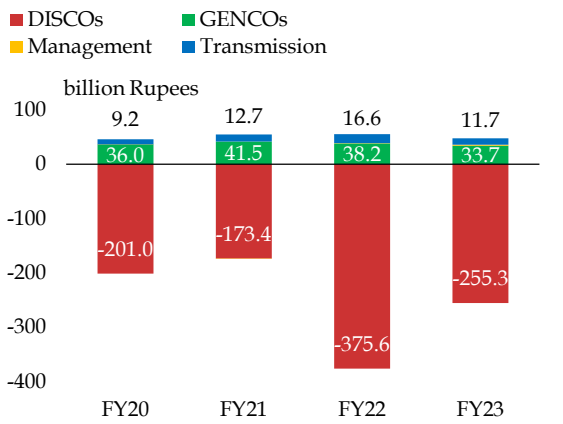
As highlighted in **Section 7.2**, the country's loss making SOEs are concentrated in two sectors: (a) power, and (b) infrastructure, transport and ITC. Losses in the former mainly stems from DISCOs, whereas losses in the latter are driven by PIA, Pakistan Railway and the NHA. Together the losses of these entities accounted for 91 percent of total losses of loss making commercial SOEs in FY23.[104] Moreover, the quality of public services offered by these SOEs has also been substantially poor.

In consideration of these stylized facts, this section sheds light on major sectoral policy and governance issues behind the losses of these SOEs. While the nature of issues faced by these SOEs may differ from one sector to another, there is a common underlying message emerging from these brief case studies: decisions related to ownership (privatisation or retention) and governance of SOEs alone will not address the issue of losses and poor public service in these sectors, as past experience with reforms has shown quite evidently in the case of each of these sectors and SOEs.

Power Sector: Need for Competitive Markets and Effective Regulation

The SOEs in Pakistan's power sector exist in power generation, transmission, distribution, and power management. While power sector losses are concentrated in DISCOs **(Figure 7.17)**, the entire sector faces several challenges ranging from increasing capacity payments to over-reliance on imported fuel, under-utilization of power plants, rising circular debt, transmission constraints, untargeted subsidies by the government, and operational inefficiencies. The primary driver of these challenges is inadequate

Net Profit/Loss of Power Sector **Figure 7.17**



Source: Ministry of Finance

policy direction and weak governance across various stages of planning, operations and accountability.[105]

In the power generation sector, a major issue relates to capacity payments, which stems from power generation policy's 'take or pay' pricing model under which the government, being the single buyer, has to pay capacity charges to producers irrespective of actual purchases of electricity. In other words, the government must pay for unutilized power capacity, which increases the per unit cost of production.

This means that when power demand is lower than generation capacity, the capacity payments are added to the tariffs paid by existing customers. And when tariffs rise, the demand shrinks further, leading to additional increase in capacity payments creating a vicious cycle.[106] Moreover, two other factors have contributed to this cycle. First, the government policy to encourage solar power usage has led to a reduction in power demand from 'paying customers', leading to further rise in capacity payments. Second, capacity payments have also grown substantially in tandem with new

[104] During FY23, NHA posted a loss of Rs 413.5 billion, followed by loss-making power sector DISCOs with a loss of Rs 285.2 billion (Ministry of Finance (2023)
[105] NEPRA (2023)
[106] Ibid.

generation capacity added into the national grid every year.[107]

In addition to capacity payments, there are also several challenges related to operational inefficiencies, such as aging infrastructure due to which several plants are inefficient that raise the cost of power generation. Further, most of the electricity generation in the country is thermal based (mainly oil and gas), which is relatively expensive.[108] These issues are compounded by high operational losses in power generation due to aging infrastructure, whereas several new plants are not connected to the grid.

The challenges weigh on the performance of DISCOs, as higher tariffs due to uncompetitive and inefficient production and transmission system, lead to suppressed demand, high levels of theft and unpaid receivables. In addition, DISCOs also have their own operational inefficiencies, such as old meters, inefficient distribution lines due to which power distribution losses are much more than peer economies. The governance issues at DISCOs affect the overall performance of distribution segment and cost structures. Although power sector SOEs have been established as corporate entities, their governance, accountability, and operational management remains weak.[109]

Moreover, lower revenue collection, reduced affordability of consumers due to high tariffs, and increase in theft and line losses add to the growing circular debt, which remains a critical challenge for the power sector. Delayed payments between power generation companies, DISCOs, and fuel suppliers lead to cash flow crisis, affecting the operational capacity of the entire sector. The growing circular debt placed a significant financial strain on power sector SOEs, limiting the sector's ability to invest in necessary upgrades and maintenance.[110] As a result, public sector DISCOs are particularly cash-strapped, triggering liquidity issues across the supply chain, which necessitates additional financial costs in the form of commercial borrowings and late payment charges.

The DISCOs combined as a sub-sector are the largest employer, compared to all other sectors in which SOEs exist in Pakistan, with more than 139,000 employees as of June 2022.[111] This is part of the historical legacy of unwarranted political interference, overstaffing and bureaucratic delays in handling routine matters in these public utilities, and low quality services, which negatively affected the sector's financial and operational health.[112]

These are some of the reasons why privatisation or improvements in corporate governance alone may not adequately address economic issues stemming from the power sector SOEs in Pakistan. A case in point is the privatisation of KESC (now K-Electric). Although the firm's profitability improved after the privatisation,[113] which included corporate restructuring and worker separation schemes, its customers are still paying high tariffs due to sectoral pricing and purchasing arrangements discussed above. Moreover, while average duration and frequency of power outages of KE is better than several DISCOs, it still frequently breaches regulatory benchmarks.[114]

Apart from the privatisation of KESC, there have been other attempts at power sector reforms, including the amendments to NEPRA Act in 2021, which empowered the regulator to

[107] Capacity payments are projected to reach Rs 2.1 trillion for FY24 (NEPRA (2023))
[108] As of June 30, 2023, around 52 percent of the total electricity generation in Pakistan was thermal based. (NEPRA (2023))
[109] ADB (2021)
[110] Ministry of Finance (2023)
[111] Ibid.
[112] Malik, A. (2015)
[113] K-Electric, annual financial statements FY00-FY23
[114] Source: NEPRA, Performance Evaluation Report of Distribution Companies FY 2020-23

determine and notify quarterly tariff adjustments. However, while there is little disagreement about the types of reforms that are needed in the power sector, their implementation has been wanting. This reflects a lack of broad political ownership, considering that poorly targeted power subsidies still exist.[115]

Therefore, in addition to corporate governance and SOE ownership reforms, there is a need for sectoral policy overhaul and a political consensus for the same. The former includes opening up the power market and fostering competition and efficiency by replacing the existing arrangement of single buyer model with multiple buyer model.[116] In this regard, power wheeling is a part of a larger shift in the power sector of Pakistan that has been underway since the approval of NEPRA's (Wheeling of Electric Power) Regulations in 2016. This shift also entails replacing the existing single buyer model to a competitive, multiple buyer model, supplemented by a transition from the primitive system of fixed pricing formula for capacity payments to capacity auctions.

National Highway Authority: Need for Clarity of Objectives and Corporate Restructuring

The NHA has been in severe financial distress with accumulated losses of Rs 1.5 trillion since FY14 and an outstanding loan portfolio of Rs 3.1 trillion. This hinders the entity's ability to invest in operations and upkeep of roads. In fact, the NHA often features as one of the highest loss-making entities in the SOE space. The entity is largely financed by cash development loans (CDLs) irrespective of commercial viability of projects. These loss-making projects, on the behest of the state, are often necessary for social or developmental reasons, and fall outside the parameter of commercial considerations.[117] As part of the repayment mechanism of CDLs, the federal government makes compulsory deductions at source from NHA's budgetary allocations which have caused further shortfalls, delays and cost overruns.[118]

Moreover, because of the accumulated debts, the NHA has to pay high interest costs to the government of Pakistan. It is also exposed to foreign exchange risks due to the issuance of foreign re-lent loans.[119] Additionally, the high depreciation costs that the NHA bears creates a large non-cash expense that drags down its books. However, these non-cash accounting expenses and CDL loans exaggerate the financial and operational concerns of NHA. As a result of these concerns, NHA was excluded from the Triage Report of 2021 **(See Section 7.3)** and the government has initiated the restructuring process. Potentially the NHA's restructuring may include renegotiation of loan terms, debt refinancing options, and optimization of operational efficiency and revenue diversifications.[120]

The profitability of motorways and national highways can broadly depend on four factors: operation costs, maintenance costs, actual toll traffic, and revenue. Further assessments are also made on metrics such as: projected traffic volume, proposed toll, projected rate of return on a given project, concession period and project financing. Therefore, categorisation of projects is conducted on a case to case basis with comprehensive analysis on financial, technical, ecological, economic and other such grounds.

[115] IMF (2022); IMF (2011)
[116] Competitive Trading Bilateral Contract Market (CTBCM) is a Competitive Wholesale Electricity Market wherein multiple buyers and sellers of electric power can participate by entering into bilateral contracts to purchase and sell electricity at wholesale level (Source: NEPRA website)
[117] CDL is a type of domestic debt given by the federal government to the provincial government, SOEs or any other body, against a mark-up that may be revised every year.
[118] MoF (2023); Hussain, I. (n.d)
[119] Foreign re-lent loans are foreign loans taken by the federal government and re-lent to the provinces, SOEs and other bodies.
[120] Hussain, I. (n.d); MoF (2021); MoF (2023)

Alternatively, some projects may be unsuitable from commercial standpoint and therefore fall under the ambit of developmental projects. Such projects preclude the profit motive with goals, such as increasing market access, infrastructure connectivity and other positive externalities, weighing more heavily.[121]

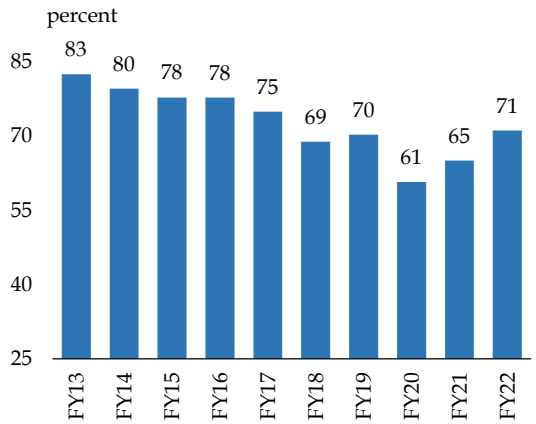
The NHA serves as an example of an entity that requires clear objectives and performance benchmarks – as stated in **Section 7.4**. As in the case of Lithuanian Railways (LR), it may be useful to split NHA's corporate structure into two distinct entities, one which undertakes commercial projects, and the other for developmental and public service obligation projects. Breaking the NHA's into two separate entities will mean that the commercial side can remain a commercial SOE and be accountable to make a profit, whereas the non-commercial section can be classified as a non-commercial entity and can focus on the government's developmental imperatives. Both may report to a NHA holding company that can offer shared services.

The splitting of NHA into two separate entities may also allow the commercial arm to focus on profitable ventures and create alternative means of financing projects on the merit of its balance sheet, for example, capital markets, commercial bank loans, public-private partnerships (PPP) etc. This would be in line with growing trends of private sector participation in road infrastructure projects.[122]

Globally, several countries, including Spain, Portugal, Italy, France, the USA and Latin America, have witnessed increased private sector participation in road infrastructure. This shift has also come about due to public sector's financial difficulties; successful experience with privatisation of other public services like electricity and water; attempts to lower the cost of highway infrastructure; and reverse underinvestment in road network. The involvement of the private sector has some advantages that help in the construction and operation of such infrastructure. For example, the private sector is less prone to political interference, can be more innovative with pricing and construction and have suitable long term financing coupled with long term revenue needs (e.g. insurance and pension funds). However, there are mixed outcomes in terms of efficiency, and there needs to be a strong regulatory and monitoring presence of the public sector to avoid quality lapses and monopolistic pricing concerns.[123]

In this regard, the inclusion of three BOT (build, operate and transfer) projects in NHA's development plan for 2023-24 is promising. In addition to PPP mode, the NHA may also diversify revenues by developing land on the sides of the road as commercial property, as was done successfully in India. This will supplement toll income and right of way charges,[124] to mitigate any losses as a result of lower tolls or vehicle volumes, and attract more private investment. In the absence of detailed financial statements, the falling share of NHA's toll revenue as a percent of its total revenue seems

NHA Toll Revenue as a Percent of Total Revenues* **Figure 7.18**



*data for FY23 not available

Source: Auditor General of Pakistan, various reports

[121] Mohamed et al. (2018)
[122] Hussain, I. (n.d)
[123] Small, K.A. (2009); SBP (n.d)
[124] Right of way charges include charges on petrol pumps, CNG stations, restaurants, sign boards, bill boards, etc.

to indicate a shift in this direction **(Figure 7.18)**.[125]

Lastly, the government may also take a holistic view, and, where possible, create healthy competition between rail, roads and air transport networks to offer more choices, improved service delivery, and better pricing. As discussed in **Section 7.4**, creating competition between substitute industries helps SOEs become more efficient and enhance service delivery.[126]

Pakistan Railways: Need for a Strategic Rethink Beyond Corporate Governance Reforms

The financial and operational performance of PR has been worsening over the last ten years **(Table 7.1)** These losses have had a huge fiscal impact with federal government grants in FY24 alone standing at Rs 55 billion, from Rs 47.5 billion in FY23. However, PR's performance is not a recent phenomenon. The entity has been witnessing consistent losses for the last three decades, with the trend emerging since the 1970s-80s, especially in the wake of the Afghan War when PR starting losing its dominance as the preferred mode of freight transport. [127]

In part, these losses stem from the fact that despite having an extensive rail network, which required funds for its maintenance and upgradation, the government's focus began tilting heavily towards road transport since the 1970s. This preference was reflected in both various policy documents for inter-city and intra-city transport as well as public investment in rail (as percentage of total public investment) reduced by around 70 percent between 1973 to 1993.[128]

The lack of successive governments' commitment and inadequate administrative and budgetary support is also the reason why some multilateral-funded PR reform plans did not bear fruit. These include reform attempts for Open Access Policy (OAP) in 1996, PR's privatisation in 1997, and other operations improvement programs during 1990s. The bias continues even today, with highways and motorways dominating the infrastructure development for supply chain corridor under the China-Pak Economic Corridor and Central

Pakistan Railways: Key Financial Indicators Over the Last Decade **Table 7.1**

	Locomotives (numbers)	Freight Wagons (numbers)	No. of Passengers carried (millions)	Freight Carried (million tonnes)	Freight Tonnes (millions)	Gross Earnings (million Rupees)	Net Loss (million Rupees)	Operational Expenses (million Rupees)	Grants (million Rupees)
FY13	493	16,635	41.9	1.0	419	18,070	30,504	48,535	33,366
FY14	421	16,179	47.7	1.6	1,090	22,800	32,527	39,892	33,500
FY15	458	15,452	52.9	3.6	3,301	31,924	27,247	42,117	37,000
FY16	460	15,164	52.2	5.0	4,773	36,582	26,994	41,944	37,000
FY17	455	16,085	52.4	5.6	5,031	40,065	40,702	50,192	37,000
FY18	478	16,159	54.9	8.4	8,080	49,570	36,622	35,627	38,400
FY19	472	14,327	60.4	8.3	8,304	54,508	32,769	53,851	37,000
FY20	473	14,448	44.3	7.4	7,369	47,584	50,017	37,295	NA
FY21	467	14,448	28.4	8.2	8,179	48,649	47,232	56,413	47,500
FY22	466	13,900	35.7	8.0	8,070	60,257	47,486	67,699	47,064
FY23*	461	13,448	22.6	4.3	4,270	39,950	48,534	74,413	47,500

*provisional. NA: Not Available.
Sources: Ministry of Railways and Finance Division, CMU Reports

[125] MoF (2024); SBP (n.d)
[126] ADB (2020)
[127] Haque, N. and Anwar, S. (2024); Qamar, U. & Saeed (2017); GoP (2024).
[128] Qamar, U. & Saeed (2017); Imran, M. (2009); Tahir, N. & Tahir, P. (2020).

Asia Regional Economic Cooperation.[129] This underscores the importance of conducting sectoral competitive assessments to identify and address the sector's competitive challenges and the under-prioritisation of PR.

Moreover, inconsistent approach to private sector engagement in PR, and abrupt suspension of initiatives like OAP at different points in time, coupled with a dysfunction regulatory framework,[130] highlights the need for appropriate sequencing of privatisation process as discussed in **Section 7.4**. Such an approach would have also encouraged private sector to invest in rail transport. Instead, the private sector has invested in road transport for both passenger services and freight.[131]

The lack of private sector involvement and competition in rail sector and policy focus towards road transport has led to suboptimal outcomes for consumers. For instance, railway's share in Pakistan's freight transport decreased to 6 percent in 2020 from about 86 percent in 1950s. By comparison, freight share of Germany rail was around 19 percent in 2021, while the number stood at over 25 percent in several other European countries. Considering that a single freight train can replace 100 trucks, with rail moving goods at 250 miles per gallon of fuel compared to just 90 miles by road,[132] the overall economy suffers from this policy misalignment.

In addition to these challenges, PR faces four major issues. First of these relates to operations and skewed business priorities. The business model reform of PR may entail adopting a dual-focus model by aligning public and commercial interests, with clarity of objectives to ensure effective reform. Despite the critical role of freight services in railway business, PR has largely remained a passenger-oriented operation, with 70-75 percent of train-km devoted to provision of passenger services. The reliance of cross-subsidization of passenger traffic from freight earnings masks PR's inefficiencies and distorts the economic rationale for effective resource allocation. Inefficient and decaying performance of PR's freight business is reflected in the fact that freight forwarders do not use PR freight services primarily because of the non-reliability of their services.
The cost of using rail is also high due to a lack of competition in contrast to road transport operators. Moreover, PR's freight rates are fixed and not market-oriented which further undermines its competitiveness.[133]

Second, PR has also been burdened by rigid civil service regulations that are incompatible with the demands of an efficient commercially-oriented organization. Some of these are low salary levels, restrictions on hiring and firing processes, and absence of performance-based remuneration, all of which have prevented PR from attracting top-tier managerial and technical talent and have undermined PR's ability to innovate and adapt to the rapidly evolving transport sector. Yet, on an entity level, PR has the highest number of employees among all the federal commercial SOEs in Pakistan— 61,713— whose pay and pensions significantly contribute to the ballooning of PR's operating expenses.[134]

Third, corporate governance challenges have also contributed to PR's weakening performance. For instance, the practice of appointing the senior most BPS-21 officer as the CEO of PR, just months prior to retirement leads to a vacuum of motivation, energy and incentive

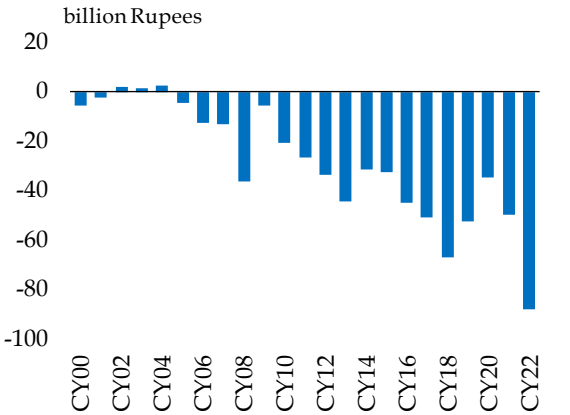
[129] Open access policy (OAP), was introduced for effective utilization of railway infrastructure through "unbundling" railway services. Private sector bids were to be solicited to transport fuel oil by rail on behalf of Pakistan State Oil (PSO) to private power stations. In 1997, to complement the OAP, the government also decided to privatise the PR; WB (1999); PC (2018).
[130] Despite the enactment of Railway Regulatory Authority Ordinance 2002, the Railway Regulatory Authority (RRA) remained dysfunctional, leaving the government as the de facto regulator of the sector. (Source: ADB (2008))
[131] ADB (n.d.); Imran, M. (2009).
[132] Qamar, U. & Saeed (2017). Ministry of Communication (2020); Qanita et al. (2014).
[133] Faiz, A. (1993); Looney, R. E. (1998); Haque, N. and Anwar, S. (2024); CAREC (2021).
[134] Looney, R. E. (1998).

difficult reforms. Similarly, non-monitoring of PR's board performance, and inadequate number of independent board members are also some issues that need resolution, to which end the implementation of recent SOE Act & Policy is of paramount importance.[135]

The lack of effective corporate governance has historically translated into excessive losses, project delays, law suits, and further discouragement of private sector participation in rail transport. Numerous reform attempts have been undertaken to revitalize PR. These include projects relating to procurement of new bogies and carriages; implementation of Track Access Agreements 2010 under Track Access Policy;[136] Restructuring of PR (2001); setting up of project management offices to structure deals with private sector rail operations; and the efforts under National Transport Policy of Pakistan (2018). This serves a pertinent example of how in the absence of good corporate governance, the reforms to restructure the entity and introduce private sector players, have not yielded fruits.[137]

Fourth, PR's legislative umbrella, the Railways Act 1890, and allied legislations are archaic and fails to meet the modern demands of Public-Private Infrastructure partnerships.[138] For instance, PR has struggled to commercialize its vast land holdings, primarily due its outdated legal frameworks and internal inefficiencies. The Railways Act 1890, lacks adequate legal cover for the commercialization and redevelopment of railway land, creating significant barriers to generating market -based revenue streams. Internally, PR is hampered by unprofessional administrative practices, procedural misconduct, and inability to protect its land from encroachment. Unlike global practises, where railways leverage their land to drive economic activity, PR's underutilized assets, such as land leased at suboptimal rates for residential purposes, reflect a missed opportunity to generate significant revenue and revitalize the organization.[139]

PIA - Net Profit/Loss (After Tax) **Figure 7.19**



Sources: PSX, financial statements of PIA (2005-22)

Pakistan International Airlines: Management of Labours' Concerns is Critical

PIA's financial losses have been consistently growing for about two decades **(Figure 7.19)**. These losses stem from a host of business and operational issues, as well as regulatory and policy constraints amid challenges posed by the SOE's labour union.

The airline has encountered a host of business and operational challenges, including mismanagement, operational inefficiencies, alleged corruption, deterioration in quality of

[135] Hussein, I. (2018-2021); CMU (2023).
[136] Track Access Policy was based on private sector involvement in the management and operation of terminal facilities. (Source: Economic Survey of Pakistan (2013)
[137] Various attempts have been made to reform PR. For instance, in 1997, the GoP announced its strategy to privatise PR. In 2001, a report of the Committee on Restructuring & Rightsizing of PR deliberated to engage and regulate private sector rail industry on rail network of Pakistan for freight business and an increased focus was to be placed upon last-mile connectivity to ports, industrial zones and within urban areas. AGP (2023).
[138] ADB (2008).
[139] Aslam, A. M. (2023).

services,[140] aging fleet, and poor safety ratings **(Table 7.2)**. For instance, during a special audit of the PIA, some irregularities were observed in the procurement and contract management, asset utilization, and financial operations of the airline, which led to a substantial loss to the national exchequer.[141] Similarly, due to safety concerns, the European Union (EU) imposed bans on PIA flights to Europe in 2007 and later in 2020, which dented PIA's profitability. Not only did instances like these have a direct impact on revenues from the EU but it also had an indirect impact through reputation losses that led to changes in customer preferences. The airline has also struggled with more than one thousand court cases and stay orders that have consumed its useful financial and managerial resources.[142]

In addition, PIA has one of the highest employees per aircraft ratio, compared to other airlines, as the airline faces the issue of ghost employees, many with fake degrees. A significant increase in human resource burden in PIA is attributed to politically motivated inductions.[143] The government has been cognizant of this, and has been able to somewhat reduce the number of PIA's employees through voluntary separation schemes in recent years. However, addressing of labour concerns remains a major challenge. The activities of PIA's highly organised anti-privatisation labour union and its politics have frequently hampered business and operations reforms aimed at improving the airline's performance. This is both due to their interference in management decisions and general non-cooperative behaviour.[144]

From the perspective of policy challenges, PIA's downturn started after the announcement of open skies policy (OSP) in the 1990s. Although the OSP typically aims to liberalize rules and regulations of the international aviation industry based on reciprocity, in Pakistan's case, unilateral open skies agreements with cities like Dubai, Abu Dhabi, Doha and Istanbul caused considerable damage.[145] This hurt PIA the most, since in the 1990s Pakistan's private sector airlines were in infancy, whereas PIA had the

PIA vis-à-vis Selected Foreign and Local Airlines: Main Operational Indicators **Table 7.2**

average fleet age in years; fleet size and employees per aircraft in number; safety rating out of 7

Airline	Country	Average Fleet Age[a]	Fleet Size[b]	Employees per Aircraft[b]	Safety Rating*[c]
Sri Lankan Airlines	Sri Lanka	10.8	23	237	7
PIA	Pakistan	16.8	34	230	1
Emirates	UAE	10.6	260	192	7
Qatar Airways	Qatar	9.3	284	187	7
Air India	India	15.4	128	94	4
Etihad Airways	UAE	8.3	95	87	7
Turkish Airlines	Türkiye	8.9	440	75	7
Serene Air	Pakistan	14.9	7[a]	NA	NA
AirSial	Pakistan	15.4	5[a]	NA	NA
Fly Jinnah	Pakistan	8.7	5[a]	NA	NA
Airblue	Pakistan	10.2	12[a]	NA	NA

*a rating of 1 is the lowest, and 7 is the highest. NA: Not Available. Data as of August 2024.
Sources: [a]www.planespotters.net; [b]Ministry of Aviation, websites and latest available financial statements of respective airlines; [c] www.airlineratings.com

[140] Senate of Pakistan (2020)
[141] AGP (2018)
[142] MoA (2015).
[143] SBP (2011).
[144] MoA (2015); MoA (2021); MoA (2023)
[145] Asghar, S., & Mohsin, H. (2023)

largest operations, and still has the largest fleet size, translating into a relatively higher fixed cost.

At the same time, the government prioritized PIA while allocating the international traffic rights. This absence of competitive neutrality results into unequal treatment of the airlines, which distorts competition by putting more efficient players at disadvantage, and has led to deterioration of PIA's quality of service due to insufficient competition. For instance, as per policy, user airlines were required to pay navigation charges to the Civil Aviation Authority (CAA) for the services it provides. Despite occasionally defaulting on its payments, PIA continued using the services, which is preferential treatment by the regulator.[146]

PIA is also affected by a number of regulatory issues that directly and indirectly affect the airline's operations and profitability. For instance, while PIA is in competition with the private sector airlines, it is governed by public sector rules, such as Public Procurement Regulatory Authority (PPRA) rules. Such a bureaucratic process in an industry that is increasingly fast, competitive, liberalized and deregulated globally, inhibits efficient working of any airline. This challenge is particularly pronounced when the management cannot capitalise on an opportunity and make prompt business and operational decisions.[147]

In particular, two regulatory challenges stand out: airport regulation, and taxes. In Pakistan, a single authority, the CAA, has had three roles until 2023: (i) it served as the regulatory body responsible for certification and oversight of all air carriers in Pakistan; (ii) it was owner and operator of airports, and (iii) it was responsible for the provision of air navigation services.[148] This left users of airport infrastructure, PIA and other private domestic airlines, unprotected from the CAA's role as monopoly operator while being a regulator at the same time. In terms of taxation, high levels of taxes on domestic flights have contributed to higher airline ticket prices, leading to suppressed demand for air travel, which affects the profitability of both PIA and other airlines.[149]

A critical part of reforming PIA, therefore, would entail reforming the aviation sector as well. To this end, lessons may be learnt from the success of Turkish Airlines. Since 2000s, Turkish Airlines has seen host of reforms including deregulation of domestic market and fostering competition; liberalization of ticket prices; improving international competitiveness of Turkish Airlines; and increasing the number of international civil aviation agreements. In addition to increased air traffic, these measures improved the quality of service and lowered fares.[150] To this end, the rolling out of National Aviation Policy 2023, is a step in the right direction, whereby Pakistan aims to rectify several issues including the unilateral open skies policy.[151]

In the context of entity level reforms, however, immense efforts will be needed for the implementation of frameworks for management of labour issues (as discussed in **Section 7.4**), in the absence of which PIA's reform process may be at risk. The government has made several unsuccessful attempts to introduce reforms in PIA in the past. For instance, in 2015, the government endeavoured to introduce reforms. However, PIA employees made a Joint Action Committee and went to strike resulting in

[146] WB (2019).
[147] Asghar, S., & Mohsin, H. (2023); MoA (2015)
[148] The CAA had three roles until the passing of the Pakistan Civil Aviation Act 2023, and Pakistan Airports Authority Act 2023 that separate the roles of regulatory functions from commercial and operational aspects of airports Source: PCAA (2023); PCAA (2023); CCP (2012);
[149] Senate of Pakistan (2020); CCP (2016)
[150] Asghar, S., & Mohsin, H. (2023). Dursun et al. (2014)
[151] National Aviation Policy 2023

withdrawal of reforms in 2016.[152] This, alongside lack of political will, structural inefficiencies and poor financial health of the airline, created obstacles to PIA's privatisation efforts in past.[153]

These kind of challenges are not unique to Pakistan's state-owned carrier. For instance, in the case of Türkiye's aviation reform, political interventions, both in consideration of labour union and the historical state subsidy, hindered the reform process[154]. However, with political consensus and effectively addressing of labour's concern, reforms were eventually made possible.

7.6 Final Remarks

In their original form, state-owned enterprises around the world have proved to be inefficient and a burden on government resources. As a result, they have been reformed significantly since the 1980s, alongside transformational shifts in their ecosystem. The foremost lesson that global experience demonstrates, is that SOEs' ownership reforms, frequently done through privatisation, is not a panacea. The success of SOE reforms, whether through privatisation or retention, mainly hinges on foundational reforms to SOE ecosystem with focus on strengthening of competition and deregulation; transparency and accountability; and a robust corporate governance framework.

Pakistan trails far behind other countries in the crucial pursuit of successful SOE reforms. The reforms have followed an intermittent path, with the process either rushed due to external push, or frequently stalled due to lack of political consensus. As a result, it remains a work in progress. At present, the SOEs in Pakistan pose a significant challenge, consistently posting net losses for the last eight years, requiring steady fiscal support from the government. Between FY16 and FY23, the accumulative fiscal support, including subsidies, grants, loans, and equity injections, reached a whopping Rs 5.7 trillion, about an average of 1.4 percent of GDP over this period. Furthermore, contingent liabilities in the form of government guarantees, are creating additional veiled risks to fiscal sustainability.

The untenable nature of this dependency as well as the deteriorating quality of goods and services of several SOEs makes their reform imperative for economic stability. Understandably, reforming SOEs is a long drawn, complex and difficult process, including management of labour issues, such as redundancies, and implementation of hard budgets. However, the daunting challenges that SOEs pose can potentially be a germinating point for garnering political consensus on home-grown push for SOE reforms, especially as potential rationalising of SOEs workforce may not be large given their relatively small share in total employment. To this end, creating awareness, open and transparent deliberations on policy options in parliament and media, can potentially allay public concerns and help remove the roadblocks to reforms.

It is, however, essential that policymakers frame SOE reform within the broader context of ensuring well-functioning competitive markets, effective regulation and improvements to the institutional environment. Conflating stand-alone privatisation with SOE reforms, risks repeating the mistakes of Pakistan's historical reform efforts when the aforementioned essential elements of SOE reforms were ignored in the pursuit of short-term privatisation goals. Indeed, without addressing the foundational reforms to SOE ecosystem reduces SOE reform to a mere ownership swap, leaving end consumers to bear the brunt of continued inefficiencies.

In this regard, the recent government initiatives, namely the enactment of the SOE Governance

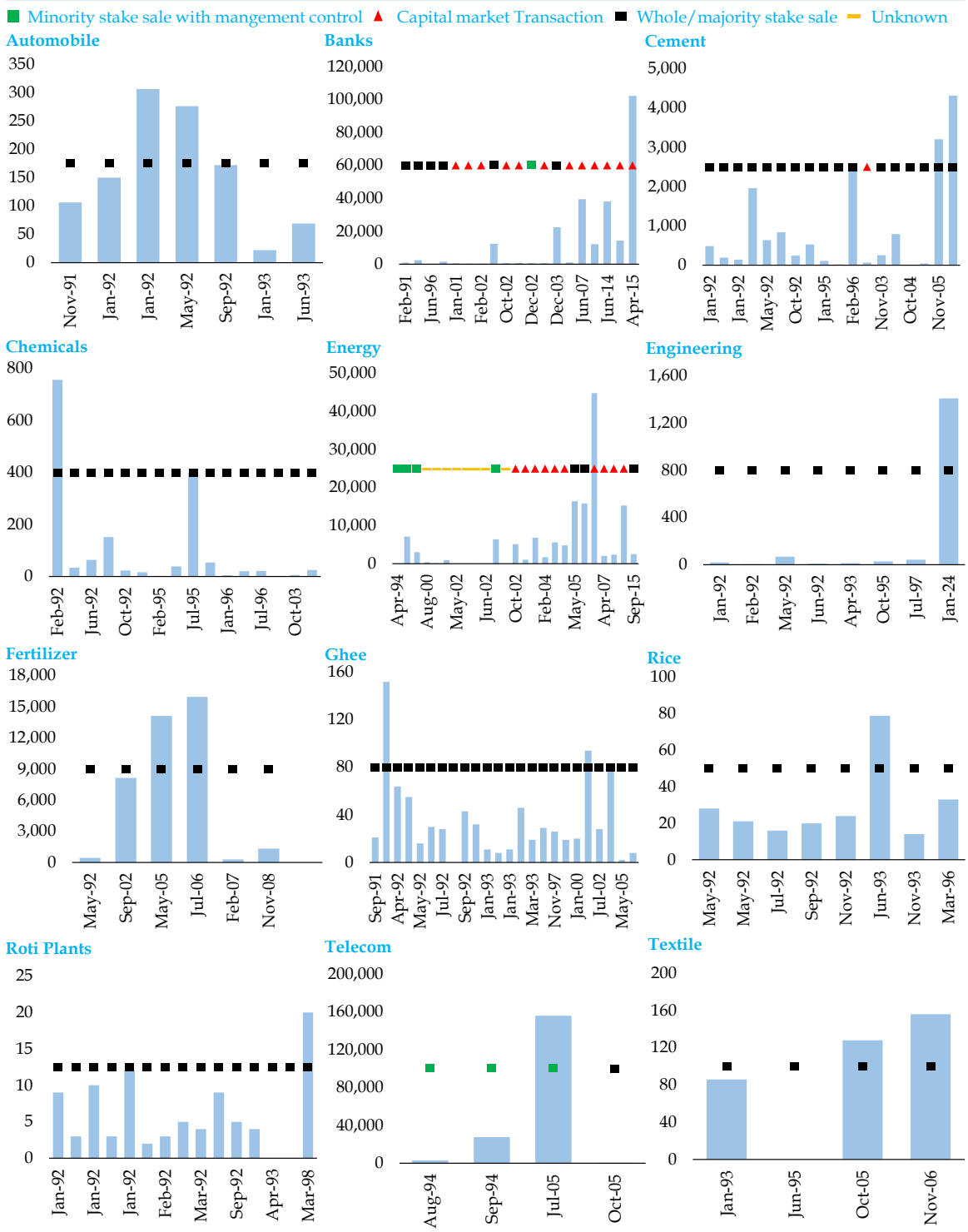
[152] Asghar, S., & Mohsin, H. (2023)
[153] ADB (2008)
[154] Dursun et al. (2014)

and Ownership Act 2023 and SOE Ownership and Management Policy 2023, marks a notable shift from the government's earlier approach to SOE reform efforts. The establishment of a permanent Cabinet Committee on SOEs with clearly defined terms of reference; the formation of a Central Monitoring Unit for evaluating SOEs' performance; the directives to conduct competitive sectoral assessments, ensuring competitive neutrality, mitigating the role of line ministry in micromanaging the SOEs; and adopting best practices for SOEs' corporate governance, are some of the important steps in the right direction.

The impact of these positive measures depend on the degree of commitment with which these are implemented. To this end, adding penalty clauses in SOE Act for non-compliance with the latest SOE legislation and policy may be helpful. In consideration of the fact that reforms are not a one-time affair, the ongoing efforts may be cemented by spelling out policy principles, institutional responsibilities, timelines and right sequencing for strengthening of competition and effective regulation. In addition, instead of existing dual/hybrid governance model where the SOEs are still owned by line ministries, a centralized model may be explored in line with emerging global best practices, to help completely separate SOEs from the influence of line ministries and avoid the mixing of ownership and regulatory roles. Lastly, strengthening institutional arrangements to generate political consensus and wider public support alongside preparation of mitigation framework for managing prospective labour issues are paramount lest the absence of these may stall the SOE reform process again.

Annexure

Privatisation Transactions in Pakistan by Sector and Transaction Type (million Rupees)



Source: SBP staff assessment based on privatisation data for Feb-91 to Jan-24, available on Privatisation Commission website

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Annexure A: Data Explanatory Notes

1) **GDP:** In case of an ongoing year, for which actual GDP data is yet not available, SBP uses the GDP target given in the Annual Plan by the Planning Commission in order to calculate the ratios of different variables with GDP, e.g., fiscal deficit, public debt, current account balance, trade balance, etc. SBP does not use its own projections of GDP to calculate these ratios in order to ensure consistency, as these projections may vary across different quarters of the year, with changing economic conditions. Moreover, different analysts may have their own projections; if everyone uses a unique projected GDP as the denominator, the debate on economic issues would become very confusing. Hence, the use of a common number helps in meaningful debate on economic issues, and the number given by the Planning Commission better serves this purpose.

2) **Inflation:** There are three numbers that are usually used for measuring inflation: (i) period average inflation; (ii) YoY or *yearly* inflation; and (iii) MoM or *monthly* inflation. Period average inflation refers to the percent change of the *average* CPI (national, urban, or rural) from July to a given month of the year over the corresponding period last year. YoY inflation is percent change in the CPI of a given month over the same month last year; and monthly inflation is percent change of CPI of a given month over the previous month. The formulae for these definitions of inflation are given below:

Period average inflation (π_{Ht}) = $\left(\frac{\sum_{i=0}^{t-1} I_{t-i}}{\sum_{i=0}^{t-1} I_{t-12-i}} - 1 \right) \times 100$

YoY inflation (π_{YoYt}) = $\left(\frac{I_t}{I_{t-12}} - 1 \right) \times 100$

Monthly inflation (π_{MoMt}) = $\left(\frac{I_t}{I_{t-1}} - 1 \right) \times 100$

Where I_t is consumer price index in t^{th} month of a year. The CPI can be national, urban or rural.

For detailed information on the methodology, please see: www.pbs.gov.pk/content/methodology-2

3) **Change in debt stock vs financing of fiscal deficit:** The change in the stock of gross public debt does not correspond with the fiscal financing data provided by the Ministry of Finance. This is because of multiple factors, including: (i) the stock of debt takes into account the gross value of government borrowing, whereas financing is calculated by adjusting the government borrowing with its deposits held with the banking system; (ii) changes in the stock of debt also occur due to movements in exchange rates, both PKR and other currencies against US Dollar, which affect the rupee value of external debt.

4) **Government borrowing:** Government borrowing from the banking system has different forms and every form has its own features and implications, as discussed here:

   (a) Government borrowing for budgetary support:

Borrowing from State Bank[1]*:* The federal government may borrow directly from SBP either through the "Ways and Means Advance" channel or through the purchase (by SBP) of Market Related Treasury Bills (MRTBs). Ways and Means Advance allows government to borrow up to Rs 100 million at a time in a year at an interest rate of 4 percent per annum; higher amounts are realized through the purchase of 6-month MTBs by SBP at the weighted average yield determined in the most recent fortnightly auction of treasury bills.

Provincial governments and the Government of Azad Jammu & Kashmir (AJK) may also borrow directly from the SBP by raising their debtor balances (overdrafts) within limits defined for them. The interest rate charged on the borrowings is the three-month average yield of 6-month MTBs. If the overdraft limits are breached, the provinces are penalized by charging an incremental rate of 4 percent per annum. However, the Federal Government has taken over from the State Bank of Pakistan (SBP) the business of direct credit to provincial governments on 29th June 2020. In this regard, the federal government has executed tripartite agreements with four provincial governments and SBP (as executer) for extension of Ways and Means loans on account of Federal Government Central Account No.I (non-food) on 29th June 2020.

Borrowing from scheduled banks: This is mainly through (i) fortnightly auction of 3, 6 and 12-month Market Treasury Bills (MTBs); (ii) monthly auction of 3, 5, 10, 15, 20 and 30 year fixed rate Pakistan Investment Bonds (PIBs); (iii) fortnightly auctions of 2, 3, 5, 10 year floating rate PIBs; (iv) Sukuk and (v) Bai Muajjal of Sukuk (on deferred payment basis). However, provincial governments are not allowed to borrow from scheduled banks.

(b) *Commodity finance:* Both federal and provincial governments borrow from scheduled banks to finance their purchases of commodities e.g., wheat, sugar, etc. The proceeds from the sale of these commodities are subsequently used to retire commodity borrowing.

5) Differences in different data sources: SBP data for a number of variables, such as government borrowing, foreign trade, etc – often do not match with the information provided by MoF and PBS. This is because of differences in data definitions, coverage, etc. Some of the typical cases are discussed below.

(a) **Financing of budget deficit (numbers reported by MoF vs SBP):** There is often a discrepancy in the financing numbers provided by MoF in its quarterly tables of fiscal operations and those reported by the SBP in its monetary survey. This is because MoF reports government bank borrowing on a cash basis, while SBP's monetary survey is compiled on an accrual basis, i.e., by taking into account accrued interest payments on T-bills.

[1] This was applicable before the amendments in the SBP Act in January 2022. According to Section 9C (1) of the SBP Act (as amended up to 28 January, 2022), the SBP "shall not extend any direct credits to or guarantee any obligations of the Government, or any government owned entity or any other public entity."

(b) **Foreign trade (SBP vs PBS):** The trade figures reported by SBP in the *balance of payments* do not match with the information provided by the Pakistan Bureau of Statistics. This is because the trade statistics compiled by SBP are based on banking data, which depends on the actual receipt and payment of foreign exchange, whereas the PBS records data on the physical movement of goods (customs record).

List of Acronyms

A

ADB	Asian Development Bank
ADR	Advances to Deposit Ratio
AE	Advanced Economies
AGCNCO	Australian Government Competitive Neutrality Complaints Office
AGP	Auditor General of Pakistan
AIIB	Asian Infrastructure Investment Bank
AKUH	Aga Khan University Hospital
AJK	Azad Jammu and Kashmir
AOP	Association of Persons
APCMA	All Pakistan Cement Manufacturers Association
ATL	Active Taxpayer List
ATM	Average Time to Maturity

B

BCI	Business Confidence Index
BCS	Business Confidence Survey
BISP	Benazir Income Support Program
BNC	Board Nominating Committee
BOT	Build, Operate and Transfer
BPS	Basic Pay Scale
BSC	Behbood Saving Certificate
BTI	Bertelsmann Transformation Index

C

CAA	Civil Aviation Authority
CAB	Current Account Balance
CAREC	Central Asia Regional Economic Cooperation
CBU	Completely Built Unit
CCI	Council of Common Interests
CCoSOEs	Cabinet Committee on State-owned Enterprises
CCP	Competition Commission of Pakistan
CCPI	Climate Change Performance Index
CCS	Consumer Confidence Survey
CCT	Conditional Cash Transfers
CDC	Cabinet Disinvestment Committee
CDL	Cash Development Loan

	CDMP	Circular Debt Management Plan
	CEO	Chief Executive Officer
	CER	C-efficiency Ratio
	CFt	Cubic Feet
	CIT	Corporate Income Tax
	CKD	Completely Knocked Down
	CMU	Central Monitoring Unit
	CNG	Compressed Natural Gas
	CPEC	China Pakistan Economic Corridor
	CPFTA	China-Pakistan Free Trade Agreement
	CPI	Consumer Price Index
	CTBCM	Competitive Trading Bilateral Contract Market
	CY	Calender Year
D		
	DAP	Diammonium Phosphate
	DC	District Columbia
	DFIs	Development Finance Institutions
	DISCOS	Distribution Companies
	DPCO	Debt Policy Coordination Office
	DRAP	Drug Regulatory Authority of Pakistan
	DSC	Defense Saving Certificate
E		
	ECB	European Central Bank
	ECC	Economic Coordination Committee
	ECL	Expected Credit Loss
	EDS	External Debt Servicing
	EE	Export Earnings
	EFS	Export Finance Scheme
	EMDE	Emerging Market and Developing Economies
	EU	European Union
F		
	FAB	Frequency Allocation Board
	FASTER	Fully Automated Sales Tax e-Refund
	FBR	Federal Bureau of Revenue
	FCA	Fuel Charge Adjustment
	FDI	Foreign Direct Investment

FE	Foreign Exchange
FED	Federal Excise Duty
FEE	Foreign Exchange Earnings
FISIM	Financial Intermediation Services Indirectly Measured
FNA	Federal Network Agency
FO	Furnace Oil
FOMC	Federal Open Market Committee
FPI	Foreign Portfolio Investment
FRR	Fixed Rental Rate
FX	Foreign Exchange
FY	Fiscal Year

G

GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GE	Genetically Engineered
GENCOs	Generation Companies
GII	Global Innovation Index
GLOF	Glacial Lake Outburst Flood
GOP	Government of Pakistan
GST	General Sales Tax
GUID	Guidance on the Audit of Public Debt
GVA	Gross Value Added

H

ha	Hectare
H1	First Half
H2	Second Half
HKH	Himalayas Karakoram Hindukush
hm^3	Cubic Hectometer
HR	Human Resource
HSD	High Speed Diesel
HVA	High Value Added

I

IATA	International Air Transport Association
IAS	International Accounting Standards
IBA	Institute of Business Administration
ICIMOD	International Centre for Integrated Mountain Development

	ICT	Information and Communications Technology
	IDB	Islamic Development Bank
	IFIs	International Financial Institutions
	IFRS	International Financial Reporting Standards
	IH&SMEFD	Infrastructure, Housing, and SME Finance Department
	IMF	International Monetary Fund
	IPPs	Independent Power Producers
	IPR	Intellectual Property Rights
	IPS	Institute of Policy Studies
	IRSA	Indus River System Authority
	ISP	Industrial Support Package
	ITC	Information Technology and Communication
	ITC	International Trade Centre
K		
	KESC	Karachi Electric Supply Corporation
	KIBOR	Karachi Interbank Offered Rate
	KPC	Kuwait Petroleum Corporation
	KPK	Khyber Pakhtunkhwa
	KSE	Karachi Stock Exchange
L		
	LCVs	Light Commercial Vehicles
	LESCO	Lahore Electric Supply Company
	LNG	Liquefied Natural Gas
	LR	Lithuanian Railways
	LSM	Large Scale Manufacturing
	LTFF	Long-Term Financing Facility
M		
	M2	Broad Money
	MAF	Million Acre-Feet
	MEPCO	Multan Electric Power Company
	MFB	Microfinance Bank
	MMA	Monthly Moving Average
	MMBTU	Million Metric British Thermal Unit
	MMCFT	Million Cubic Feet
	MMT	Million Metric Tonnes
	MoA	Ministry of Aviation

MoC	Ministry of Communication
MoF	Ministry of Finance
MPC	Monetary Policy Committee
MSP	Minimum Support Price
MT	Metric Ton
MW	Megawatt

N

N/A	Not Available
NBFIs	Non-Bank Financial Institutions
NBP	National Bank of Pakistan
NCP	National Center For Privatization
NCPI	National Consumer Price Index
NDA	Net Domestic Assets
NEER	Nominal Effective Exchange Rate
NEPRA	National Electric Power Regulatory Authority
NFA	Net Foreign Assets
NFC	National Finance Commission
NFDC	National Fertilizer Development Centre
NFNE	Non-Food Non-Energy
NGO	Non-Governmental Organization
NHA	National Highway Authority
NHP	Net Hydel Profits
NPC	Naya Pakistan Certificate
NPHPS	Naya Pakistan Housing Finance Scheme
NSC	National Savings Certificate
NSS	National Savings Schemes
NTR	Non-Tax Revenue

O

o/w	of which
OAP	Open Access Policy
OCAC	Oil Companies Advisory Council
OECD	Organisation for Economic Cooperation and Development
OGRA	Oil and Gas Regulatory Authority
OIN	Other Items Net
OMOs	Open Market Operations
ONR	Overnight rate

	OTC	Over-the-Counter
P		
	PAAA	Pakistan Airports Authority Act
	PAMA	Pakistan Automotive Manufacturers Association
	PBA	Pensioner's Benefit Account
	PBC	Pakistan Business Council
	PBS	Pakistan Bureau of Statistics
	PC	Planning Commission of Pakistan
	PCAA	Pakistan Civil Aviation Act
	PDL	Petroleum Development Levy
	PED	Public External Debt
	PEDL	Public External Debt and Liabilities
	PERF	Pakistan Energy Revolving Fund
	PESCO	Peshawar Electric Supply Company
	PFL	Floating-rate PIBs
	PIA	Pakistan International Airlines
	PIBs	Pakistan Investment Bonds
	PID	Press Information Department
	PIDE	Pakistan Institute of Development Economics
	PKR	Pak Rupee
	PMI	Purchasing Managers Index
	POL	Petroleum, Oil & Lubricants
	POS	Point of Sale
	PPP	Public-Private Partnership
	PPRA	Public Procurement Regulatory Authority
	PR	Prudential Regulations
	PR	Pakistan Railways
	PR	Press Release
	PRIME	Policy Research Institute of Market Economy
	PSC	Private Sector Credit
	PSCCG	Public Sector Companies Corporate Governance
	PSDP	Public Sector Development Program
	PSE	Public Sector Enterprise
	PSM	Pakistan Steel Mills
	PSO	Pakistan State Oil
	PSX	Pakistan Stock Exchange
	PTA	Pakistan Telecommunication Authority

	PTCL	Pakistan Telecommunication Company Limited
Q		
	Q1	First Quarter
	Q2	Second Quarter
	Q3	Third Quarter
	Q4	Fourth Quarter
	QESCO	Quetta Electric Supply Company
R		
	RDA	Roshan Digital Account
	REER	Real Effective Exchange Rate
	RIC	Regular Income Certificate
	RLNG	Re-gasified Liquefied Natural Gas
	RPK	Revenue Passenger Kilometers
	RRA	Railway Regulatory Authority
S		
	SA	Saving Accounts
	SAR	Saudi Riyal
	SBA	Stand-By Arrangement
	SBP	State Bank of Pakistan
	SCI	Statement of Corporate Intent
	SCMS	Satellite Based Crop Monitoring System
	SDR	Special Drawing Rights
	SECP	Securities and Exchange Commission of Pakistan
	SEP	Sarmaya-e-Pakistan
	SEPCO	Sukkur Electric Power Company
	SFF	SOEs Federal Footprint
	SIFC	Special Investment Facilitation Council
	SISA	Sarwa Islamic Savings Account
	SKD	Semi Knocked Down
	SME	Small and Medium Enterprises
	SMEDA	Small and Medium Enterprises Development Authority
	SNGPL	Sui Northern Gas Pipelines Limited
	SOE	State-owned Enterprise
	SOEFF	State-owned Enterprises' Federal Footprint
	SOFR	Secured Overnight Financing Rate
	SRO	Statutory Regulatory Orders

	SSGC	Sui Southern Gas Company (Limited)
	SSRN	Social Science Research Network
	STPED	Short-term Public External Debt
	SUPARCO	Space and Upper Atmosphere Research Commission
	SWAPS	Synchronized Withholding Administration and Payment System
	SWF	Sovereign Wealth Fund
T		
	T&D	Transmission and Distribution
	T-bills	Treasury Bills
	TDS	Tariff Differential Subsidy
	TEDL	Total External Debt and Liabilities
	TFP	Total Factor Productivity
	TMEO	Transfer of Managed Establishments Order
	TT	Telegraphic Transfers
U		
	UAE	United Arab Emirates
	UBL	United Bank Limited
	UFG	Unaccounted For Gas
	UNDP	United Nations Development Program
	UNFCC	United Nations Framework Convention on Climate Change
	UNIDO	United Nations Industrial Development Organization
	US/USA	United States of America
	USAID	U.S. Agency for International Development
	USC	Utility Stores Corporation
	USD/US$	US Dollar
	USDA	United States Department of Agriculture
V		
	VAT	Value Added Tax
	VRR	Variable Rental Rate
	VSS	Voluntary Separation Scheme
W		
	WBG	World Bank Group
	WAPDA	Water and Power Development Authority
	WB	World Bank
	WBES	World Bank Enterprise Surveys
	WHT	Withholding Tax

	WIPO	World Intellectual Property Organization
	WPI	Wholesale Price Index
X		
	XWDISCOS	Ex-WAPDA Distribution Companies
Y		
	YoY	Year-on-Year