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PAKISTAN
DEVELOPMENT UPDATE

Fiscal Impact of Federal State-Owned Enterprises

April 2024

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Preface

The World Bank Pakistan Development Update (PDU) provides an update on the Pakistani economy, its economic outlook, the development challenges the country faces, and the structural reforms that should be considered.

This edition of the PDU was prepared by Macroeconomics, Public Sector, Trade, and Investment Global Practice under the guidance of Najy Benhassine (Country Director, SACPK), Mathew Verghis (Regional Director, ESADR), Shabih Ali Mohib (Practice Manager, ESAC1), Ximena Del Carpio (Practice Manager, ESAPV), and Tobias Akhtar Haque (Lead Country Economist and Program Leader, ESADR). The core PDU team was led by Sayed Murtaza Muzaffari (Economist, ESAC1) and Derek H.C. Chen (Senior Economist, ESAC1), and includes Adnan Ashraf Ghumman (Senior Economist, ESAC1), Aroub Farooq (Economist, ESAC1), Mukhtar Ul Hasan (Economist, ESAC1), Lucy Pan (Senior Economist, ESAC1) Fahad Hasan (Financial Sector Specialist, ESAF1), Maria Qazi (Economist, ESAPV), Moritz Meyer (Senior Economist, ESAPV), Christina Wieser (Senior Economist, ESAPV), Florian Blum (Senior Economist, EECM2), Qurat ul Ain Hadi (Financial Management Specialist, ESAG1), Arsianti (Consultant, ESAC1), and Ali Shahid (Team Assistant, SACPK). The report benefited from detailed inputs from Shabih Ali Mohib (Practice Manager, ESAC1), Tobias Akhtar Haque (Lead Country Economist and Program Leader, ESADR), and Manoj Jain (Lead Governance Specialist, ESAG1). The report was edited by Andrea Scheibler.

Sections 1, 2, and 3 of the report were prepared by Sayed Murtaza Muzaffari, Derek Chen, Aroub Farooq, Mukhtar Ul Hasan, Fahad Hasan, Teuta Kacaniku, Minahil Raza, Moritz Meyer, and Maria Qazi. Section 4 was prepared by Qurat ul Ain Hadi and Derek Chen, with inputs from Sayed Murtaza Muzaffari, Aman Mangrio, Ishrat Hussain, Teuta Kacaniku, Hasan Afzal Zaidi, Dr. Zafar Hayat (Senior Economist, IMF), Lai Tora (Country Economist, ADB), and was reviewed by Manoj Jain.

The findings, interpretations, and conclusions expressed in this report do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent. The World Bank does not guarantee the accuracy of the data included in this work. The data cut-off date for this report was March 8, 2024. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of the World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

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To receive the PDU and related publications by email, please email ashahid2@worldbanko.org. For questions and comments, please email smuzaffari@worldbank.org.

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List of Abbreviations and Acronyms

ADR	Advances to Deposit Ratio
BISP	Benazir Income Support Programme
BOP	Balance of Payments
CAD	Current Account Deficit
CAR	Capital Adequacy Ratio
CDL	Cash Development Loan
CMU	Central Monitoring Unit
CPI	Consumer Price Index
DISCO	Distribution Company
FDI	Foreign Direct Investment
FRDLA	Fiscal Responsibility and Debt Limitation Act
FY	Fiscal Year
GDP	Gross Domestic Product
GST	General Sales Tax
HIES	Household Integrated Economic Survey
IFSWF	International Forum of Sovereign Wealth Funds
IMF	International Monetary Fund
ITC	Infrastructure, Transport, And Communication
LSM	Large-Scale Manufacturing
NBP	National Bank of Pakistan
NHA	National Highway Authority
NPL	Non-Performing Loan
OGDCL	Oil and Gas Development Company Limited
OMO	Open Market Operation
PDU	Pakistan Development Update
PHPL	Power Holding Private Limited
PIACL	Pakistan International Airlines Corporation Limited
PKR	Pakistani Rupee
PPL	Pakistan Petroleum Limited
PPP	Purchasing Power Parity
PSDP	Public Sector Development Programme
PSM	Pakistan Steel Mills
PSO	Public Service Obligation
RE	Renewable Energy
RHS	Right Hand Side
SBA	Stand-By Arrangement
SBP	State Bank of Pakistan
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
US$	United States Dollar
Y-o-Y	Year-on-Year

1. Executive Summary

Pakistan's economy has stabilized with improved economic management and new external inflows

Pakistan faced an imminent economic crisis at the start of fiscal year (FY)24, reflecting the impacts of inadequate macroeconomic management, surging world commodity prices, global monetary tightening, catastrophic flooding in 2022, and political uncertainty. Amid high inflation and weak confidence, and with reserves at dangerously low levels, the International Monetary Fund (IMF) approved a new Stand-By Arrangement (SBA) program in July 2023.[1] Steadfast implementation of the program—including through continued fiscal restraint, energy tariff adjustments, and the continued high policy rate—enabled new official external inflows early in the fiscal year, allowing a loosening of import management measures, and some recovery in confidence. The broad-based but still nascent recovery has been inadequate to reduce poverty, with growth expected to reach only 1.8 percent in FY24; the poverty rate is expected to stagnate at current high levels of around 40 percent (Table ES.1).

A sustained recovery, with improved growth prospects, and poverty reduction will require deep reforms

A clearly articulated, ambitious, and credible economic reform agenda is required to reduce uncertainty and restore confidence. Risks remain very high, and key policy constraints to sustainable economic growth remain unaddressed. Policy buffers to manage any shocks remain depleted, with high levels of debt and tightly constrained foreign exchange reserves. Under current policy settings, and unless a major structural reform program is durably implemented, growth is expected to remain muted amid continued very low investment, persistent external imbalances (likely necessitating continued import and capital management measures), distortionary fiscal policies, and a large state presence in the economy. Without major reforms, no significant poverty reduction is expected over the medium term. Financial sector stress, looming policy uncertainty with potential policy slippages, climate change-induced shocks and natural disasters, and external headwinds all pose very high risks to the outlook. A more robust medium-term recovery will require the implementation of significant medium-term reforms to:

- Improve the quality of expenditures and reduce the distortive presence of the state in the economy including SOE reforms and privatizations, reduced untargeted subsidies, and reduced federal expenditures in areas devolved to provinces.
- Broaden the tax base including increased taxes on agriculture, retail, and property, reduced tax exemptions and loopholes, and improved administration, particularly via digitalization.
- Address regulatory constraints to private sector activity including cutting red tape and removing barriers to foreign investment.
- Removing the anti-export bias in trade policy including tariff rationalization and reform of export subsidy schemes.
- Address inefficiencies and high costs in the energy sector including continued tariff reform and increased private sector participation in distribution and transmission.

Table ES.1: Projections of Key Economic Indicators

	2020/21	2021/22	2022/23	2023/24e	2024/25f	2025/26f
Real GDP Growth, at constant factor prices	5.8	6.2	-0.2	1.8	2.3	2.7
Current Account Balance (% of GDP)	-0.8	-4.7	-0.7	-0.7	-0.6	-0.6
Fiscal Balance (% of GDP), excluding grants	-6.1	-7.9	-7.8	-8.0	-7.4	-6.6
Public Debt, including govt. guaranteed debt (% of GDP)	77.6	80.7	81.4	73.1	72.3	72.5

Source: Data from the official sources, World Bank staff estimates.
Note: e = estimate; f =forecast. 2020/21 corresponds to FY20–21, which runs from July 1, 2020, to June 30, 2021. This macroeconomic outlook was prepared by World Bank staff and differs from that of the Government.

[1] IMF. July 12, 2023. "IMF Executive Board Approves US$3 Billion Stand-By Arrangement for Pakistan."

Economic activity recovered over the first half of FY24

After contracting for two consecutive quarters, real gross domestic product (GDP) at factor cost rose by 2.1 percent year-on-year (y-o-y) over July to September 2023 (Q1 FY24) on the back of strong agricultural output and some improvement in confidence. Agricultural output expanded by 5.1 percent in Q1 FY24, the highest quarterly growth on record, as conducive weather conditions contributed to strong yields. With continued import management measures, high input and borrowing costs, and weak domestic demand, the industrial sector's activity remained weak. Meanwhile, the wholesale and retail trade sub-sector benefited from the agriculture sector rebound and supported 0.8 percent growth in the overall services sector output.

Poverty reduction stalled amid anemic growth and rising prices

The poverty headcount is expected to remain stagnant at FY23 levels.[2] The poor and vulnerable are likely to have benefited from the windfall gain in agricultural output in Q1 FY24. However, these gains would have been partially offset by continued high inflation and limited wage growth in other sectors that employ many of the poor.

The CAD narrowed in H1 FY24 as imports of goods contracted sharply

The current account deficit (CAD) narrowed to US$0.8 billion in July–December 2023 (H1 FY24) from US$3.6 billion in H1 FY23 largely due to a substantially smaller trade deficit on account of reduced domestic demand, import management measures, and lower global commodity prices. Meanwhile, official remittances decreased by 6.8 percent y-o-y in H1 FY24 due to exchange rate rigidities earlier in the year. Reflecting fresh multilateral and bilateral inflows, the financial account ran a substantial surplus leading to a balance of payments (BOP) surplus of US$3.0 billion in H1 FY24, compared with a deficit of US$4.2 billion in H1 FY23. Consequently, international reserves increased to US$9.4 billion at end-December 2023, equivalent to 1.7 months of imports. With the BOP surplus and regulatory reforms in the foreign exchange market, the rupee appreciated modestly (1.2 percent) against the US dollar over H1 FY24.

Inflationary pressures have remained elevated amid rising domestic energy prices

Headline consumer price inflation rose to a multi-decade high of an average of 28.8 percent y-o-y in H1 FY24, up from 25.0 percent in H1 FY23, reflecting higher domestic energy prices, continued liquidity injections into the banking sector through open market operations (OMOs), and domestic supply chain disruptions. Food inflation remained high, particularly impacting poor and vulnerable households that spend half of their budgets on food. Transportation costs rose faster in rural areas, increasing the cost of accessing markets, schools, and health centers for the rural poor. To mitigate the high inflation rates, the policy rate was held at 22.0 percent, implying negative real interest rates throughout H1 FY24.

The primary balance registered a surplus in H1 FY24, reflecting fiscal consolidation efforts

With fiscal consolidation efforts, the primary fiscal surplus doubled to PKR 1.8 trillion in H1 FY24. Supported by higher direct taxes and the petroleum development levy hikes, total revenue rose by 17.1 percent after adjusting for consumer price index (CPI) inflation. Meanwhile, although non-interest expenditure rose by 24.6 percent nominally, mainly due to higher subsidy spending, it declined by 4.2 percent in CPI inflation-adjusted real terms. The overall fiscal deficit registered at PKR 2.4 trillion for H1 FY24.

Tight macroeconomic policies, continued external headwinds, and domestic policy uncertainty are expected to weigh on economic growth in the medium term

Pakistan is expected to continue facing foreign exchange liquidity issues due to the persistent trade deficit and limited access to external financing. Even with the recent successful completion of the IMF-SBA and continued rollovers, reserves are projected to remain low. Import management measures are expected to continue disrupting domestic supply chains, while tight macroeconomic policies will mute aggregate consumption and investment. In the absence of a credible and ambitious economic reform agenda, uncertainty is expected to linger, affecting confidence and growth. Economic activity is therefore expected to remain subdued with real GDP projected to grow at 1.8 percent in FY24. As confidence improves, output growth is expected to recover to an average of 2.5 percent over FY25 and FY26, remaining below potential in the medium term.

[2] Poverty projections are based on microsimulations using Household Integrated Economic Survey (HIES) 2018–19 microdata and macroeconomic indicators such as sectoral GDP and inflation. See Annex 2.1 for projection methodology.

Inflation is expected to remain elevated in FY24 due to higher domestic energy prices

Inflation is projected to remain elevated at 26.0 percent in FY24 due to higher domestic energy prices. With high base effects and lower projected global commodity prices, inflation is expected to moderate over the medium term. With lower domestic demand and continued import management measures, the CAD is expected to remain low at 0.7 percent of GDP in FY24 and to further narrow to 0.6 percent of GDP in FY25 and FY26.

The fiscal deficit is expected to increase in FY24 due to higher debt servicing

The fiscal deficit is projected to increase to 8.0 percent of GDP in FY24 due to higher interest payments. It will then gradually decline over the medium term as interest payments decrease and fiscal consolidation measures take hold. The primary deficit is expected to decline to 0.1 percent of GDP in FY24, reflecting the recent fiscal consolidation measures. It is expected to grow to 0.3 percent of GDP in FY25–26. A deeper fiscal consolidation over the medium term will be necessary to restore fiscal and debt sustainability.

Multiple factors pose risks to the economic outlook

With a tax-to-GDP ratio of only about 10.0 percent of GDP[3], Pakistan has been heavily reliant on domestic borrowing for fiscal financing. Growing exposure to the sovereign is exposing the banking sector to risks. Additional downside risks include growing policy uncertainties that could lead to weaker than expected business confidence, even more limited external financing, and therefore more pronounced macroeconomic vulnerabilities. Potential increases in world energy and food prices in the context of intensification of regional geopolitical conflicts, slower global growth, and tighter than expected global financing conditions pose additional risks to the macroeconomic outlook.

Urgent SOE reforms are necessary to mitigate the large and growing fiscal drain and risks

Pakistan's economic structure includes a significant number of state-owned enterprises (SOEs) operating across most sectors of the economy. These SOEs have been consistently making losses since 2016, and the Government has been providing them with significant financial support through subsidies, grants, loans, and guarantees, leading to large and growing fiscal exposure. The Special Focus section of this Development Update discusses the fiscal drain and risks of the federal SOEs and the critical reforms needed to improve their performance, efficiency, and governance. The Government has initiated reforms to improve the financial discipline of SOEs and strengthen oversight under the new State-Owned Enterprises (Governance and Operations) Act 2023 and the SOE Ownership and Management Policy 2023. Full and effective implementation of these reforms is now critical, along with accelerating privatizations and implementing the SOE Triage exercise completed in 2021. The Government should move to eliminate the practice of covering SOE operating losses with transfers from the federal budget and implement measures to manage fiscal risks associated with explicit and implicit obligations, such as holding SOEs accountable for performance and responsible for fiscal risks arising from their operations.

[3] The tax-to-GDP ratio was 10.0 percent in FY23.

2. Recent Economic Developments

a. Context

Pakistan has moved away from the brink of economic crisis, showing some fragile signs of recovery

Pakistan's economy contracted by 0.2 percent y-o-y in FY23 due to inadequate macroeconomic management, surging world commodity prices, global monetary tightening, catastrophic flooding in 2022, and political uncertainty. Persistent fiscal and external imbalances led to pressures on domestic prices, increasing debt, depreciation, and sharp reductions in foreign reserves. To preserve scarce foreign exchange, import and capital management measures were imposed which disrupted domestic supply chains, leading to further inflationary pressures, and weakening economic activity. Poverty increased by an estimated 4.5 percentage points in FY23, with 10 million people just above the poverty line at risk of falling into poverty in face of shocks.

The IMF approved a new SBA program in July 2023. Steadfast implementation of the program—including through continued fiscal restraint, energy tariff adjustments, and the continued high policy rate—enabled new official external inflows early in the fiscal year, allowing a loosening of import management measures and some recovery in confidence. The broad-based but still nascent recovery has been inadequate to address poverty, as wages for unskilled labor have not kept up with inflation.

b. Real Sector

Growth

Economic activity recovered in H1 FY24

After contracting for two consecutive quarters, real GDP at factor cost rose by 2.1 percent y-o-y over July to September 2023 (Q1 FY24) on the back of strong agricultural output (Figure 2.1).[4] Agricultural output expanded by 5.1 percent in Q1 FY24, the highest quarterly growth on record, as conducive weather conditions contributed to strong yields. Meanwhile, industrial output remained weak reflecting the impact of continued import management measures, lower demand, and high cost of borrowing. With the wholesale and retail trade sub-sector benefiting from the rebound in agricultural output, service sector output increased by 0.8 percent after contracting for the two preceding quarters.

Favorable weather conditions supported higher crop production

After the devastating floods in June–October 2022, conducive weather conditions and availability of critical inputs supported higher production of important crops such as cotton and rice. Partly due to the greater availability of agricultural inputs, provisional estimates suggest that rice production is expected to increase by 18 percent y-o-y whereas cotton production is likely to be twofold higher in H1 FY24.[5]

Industrial sector output declined, partly due to lower aggregate demand

Continued import management measures, high input and borrowing costs and weak economic conditions dampened industrial sector growth, particularly in manufacturing. The Large-Scale Manufacturing (LSM) Index shows a contraction of 1.2 percent y-o-y in Q1 FY24, followed by a marginal recovery of 0.4 percent over Q2 FY24 (Figure 2.2).[6]

The services sector strengthened on

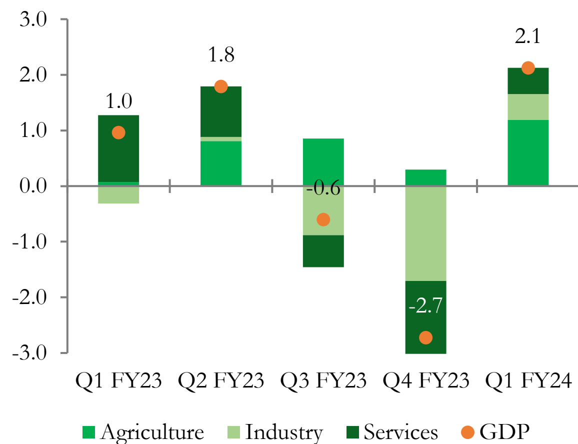
The recovery in the services sector was driven by wholesale and retail trade, the largest sub-sector in services, which benefited from higher agriculture output. Similarly, the

[4] The Pakistan Bureau of Statistics published their quarterly GDP series for the first time in November 2023, including GDP for Q1 FY24. The quarterly national accounts data included production side GDP only. The update for Q2 FY24 has not yet been published.
[5] Ministry of Finance (2023c) *Monthly Economic Update & Outlook: October 2023*. The availability agricultural inputs such as fertilizers, agricultural credits, and farm machinery improved in H1 FY24. Additionally, the credit disbursement for agriculture rose by 31.3 percent (Source: Ministry of Finance (2024) *Monthly Economic Update & Outlook: February 2024*). The fertilizer off-take during both the Kharif season (April–September) and early Rabi season (October–December) in 2023 also picked up (Sources: Ministry of Finance, Monthly Economic Update and Outlook, Dec 2023 to Feb 2024. Pakistan Space & Upper Atmosphere Research Commission (January 1, 2024) "Satellite Based Crop Monitoring System."). The production of tractors grew by 67.5 percent in H1 FY24 with sales doubling (Source: Pakistan Automotive Manufacturers Association, Monthly Production & Sales Data of Vehicles dataset).
[6] State Bank of Pakistan (February 16, 2024) *Production of Selected Large-Scale Manufacturing*. World Bank staff calculation.

account of positive spillover effects from agriculture

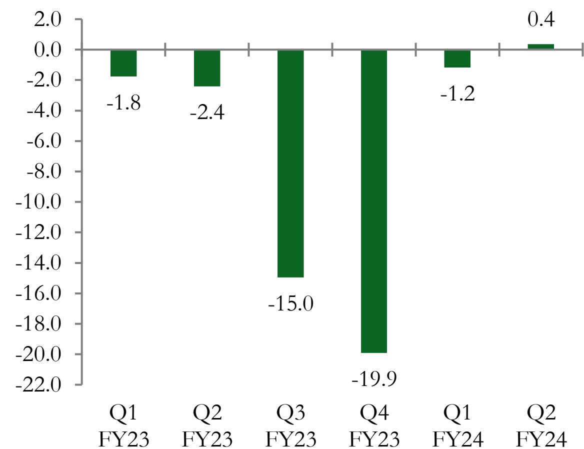
second largest sub-sector, transport and storage, also benefited from the rebound in agriculture sector. Overall, the business confidence index has been steadily improving since September 2023, turning optimistic in December 2023–January 2024.

Figure 2.1: Contribution to GDP Growth by Sector
(y-o-y, percentage points)



Source: Pakistan Bureau of Statistics and World Bank staff calculations.

Figure 2.2: Large-Scale Manufacturing Index
(y-o-y, percentage change)



Source: Pakistan Bureau of Statistics and World Bank staff calculations.

Inflation

Inflationary pressures remained elevated

The headline CPI increased by 28.8 percent y-o-y in H1 FY24 compared to 25.0 percent in H1 FY23, the highest inflation in the first half of the fiscal year since FY74 (Figure 2.3; Figure 2.4). Despite easing global commodity prices, higher domestic crop production, and stability in exchange rate,[7] inflation pressures increased due to higher domestic energy prices and money supply growth. Upward revisions in electricity and gas prices have substantially increased the overall cost of production. Meanwhile, the rapid increase in money supply in FY23 continues to exert inflationary pressures.[8] During FY23, to help banks cope with the Government's large financing needs, the State Bank of Pakistan (SBP) injected substantial liquidity into the banking sector through Open Market Operations (OMOs). By end-FY23, the size of outstanding stock of OMOs had more than doubled, leading to a 62.2 percent growth in the outstanding bank borrowing from the SBP. As a result, despite weak economic conditions, money supply (M2) grew by 14.2 percent in FY23. Since then, the outstanding stock of OMOs has continued to increase, reaching PKR 8.7 trillion by end-December 2023 compared to PKR 7.9 trillion at end-June 2023, while money supply has grown by 4.5 percent over H1 FY24.

Energy prices rose in urban areas, largely due to increases in administrative gas prices

In urban areas, energy inflation increased from 40.6 percent y-o-y in H1 FY23 to 50.6 percent in H1 FY24 due to significant increases in domestic energy prices. In rural areas, however, energy inflation slowed from 41.9 percent in H1 FY23 to 27.8 percent in H1 FY24 due to the exclusion of gas from the commodity basket of the rural CPI.[9] After the Government updated end-user gas prices and changed the tariff structure in February 2023,[10] gas tariffs were again raised in November 2023[11] and February 2024.[12] In parallel, the Government also maintained timely upward adjustments of quarterly and monthly

[7] The PKR/US$ exchange rate appreciated by 1.2 percent over H1 FY24.
[8] Kemal (2006) "Is Inflation in Pakistan a Monetary Phenomenon?"; Asghar, Jaffri, and Asjed (2013) "An Empirical Investigation of Domestic and External Determinants of Inflation in Pakistan."; State Bank of Pakistan, "Learning Resources."
[9] Energy inflation in urban areas consists of electricity charges, gas prices, liquified hydrocarbons, solid fuel, and motor fuel. In rural areas, energy inflation includes all the same items except for gas prices.
[10] To improve progressivity in gas prices and protect vulnerable households.
[11] End-user gas prices were adjusted by an average of 75 percent in February 2023 and again by an average of 65 percent in November 2023. In February 2023, a new gas tariff slab system was also approved by the Cabinet to improve cost recovery, affordability, and efficiency. Source: IMF (2024) *Pakistan: First Review Under the Stand-By Arrangement*.
[12] Oil and Gas Regulatory Authority, "Consumer Gas Price Notification."

electricity tariffs to improve cost recovery and limit energy subsidies, further fueling energy inflationary pressures.[13]

Core inflation increased substantially

Core inflation has continued to increase in both rural and urban areas, reflecting second round effects of persistently high energy prices (electricity, gas, and motor fuel) onto higher overall costs of production. In urban areas, core inflation rose from 14.1 percent y-o-y in H1 FY23 to 18.4 percent in H1 FY24. In rural areas, core inflation is even higher and rose from 17.4 percent in H1 FY23 to 25.9 percent in H1 FY24.

Food inflation remained broadly stable

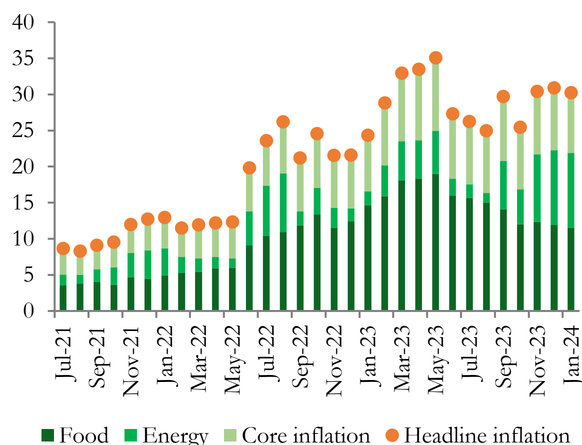
Food inflation remained high but steady over H1 FY24. On average, during H1 FY23 food inflation was 30.7 percent in urban areas and 33.5 percent in rural areas. It rose to only 33.4 percent and 34.0 percent in urban and rural areas, respectively, in H1 FY24. The relatively smaller increase was partly due to a higher output of domestically produced food items combined with a decline in global food prices.[14]

Monthly y-o-y inflation edged downward in January and February 2024

On a monthly basis, headline inflation fell from 28.3 percent in January to 23.1 percent in February 2024. The high base effect, particularly in energy prices, contributed to the decline in inflation in both rural and urban areas. Similarly, food and core inflation also continued declining over January to February 2024.

Figure 2.3: Contribution to Headline Inflation in Urban Areas

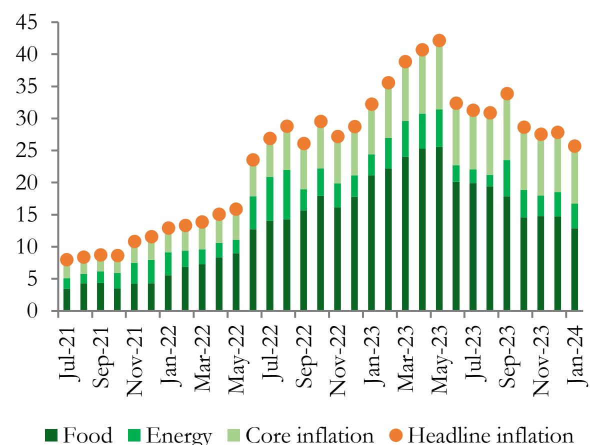
(Percentage points)



Source: Pakistan Bureau of Statistics and World Bank staff calculations.

Figure 2.4: Contribution to Headline Inflation in Rural Areas

(Percentage points)



Source: Pakistan Bureau of Statistics and World Bank staff calculations.

Poverty

Economic growth was inadequate to sustain poverty reduction

The poverty headcount is expected to remain stagnant at FY23 levels.[15] The poor and vulnerable are likely to have benefited from the windfall gain in agricultural output in Q1 FY24. However, these gains were offset by continued high inflation and limited wage growth in other sectors that employ many of the poor, such as construction, trade, and transportation, in which the wages of daily laborers increased by only 5 percent in nominal terms during H1 FY24.[16] Meanwhile, the decline in official remittances during H1 FY24

[13] FY24 annual rebasing was implemented in July 2023 (PKR 5.75 per unit on average across consumer slabs). In addition, Q3 and Q4 FY23 quarterly tariff adjustment was also notified in July and October 2023, respectively. The Q3 FY23 tariff adjustment was PKR 1.25 per unit on average and the Q4 FY23 adjustment was PKR 3.28 per unit on average across consumer slabs. Source: IMF (2024) *Pakistan: First Review Under the Stand-By Arrangement*.
[14] The World Bank estimated global food price index recorded average deflation of 6.7 percent in H1 FY24 compared to an average inflation of 7.6 percent in H1 FY23. Source: World Bank Commodity Markets Outlook dataset.
[15] Poverty projections are based on microsimulations using HIES 2018–19 microdata and macroeconomic indicators such as sectoral GDP and inflation. See Annex 2.1 for projection methodology.
[16] Wage rates from the Pakistan Bureau of Statistics Weekly Sensitive Price Indicator dataset (Appendix B). Estimates are averages based on data collection from 17 major cities across the country.

indicates a likely reduction in transfer incomes and economic security, especially for vulnerable and middle-class households.

Rising prices continue to have negative impacts on the poor

Food inflation remained high, particularly impacting poor and vulnerable households that spend half their budgets on food, leading to significant inflation inequality across households. Transportation costs rose faster in rural areas, thereby increasing the cost of accessing markets, schools, and health centers, particularly for the rural poor.

Increased food insecurity, declining affordability of education and health services, and poor air quality undermine household wellbeing

The persisting cost-of-living crisis coupled with rising transportation costs could potentially lead to an increase in out of school children and delayed medical treatments, particularly for worse off families. At the same time, food security remains a concern in parts of the country. Among 43 rural districts across Khyber Pakhtunkhwa, Sindh, and Balochistan, many of which were impacted by the 2022 floods, the prevalence of acute food insecurity is projected to increase from 29 to 32 percent in Q2–Q3 FY24.[17] Finally, chronic poor air quality and smog during the autumn and winter months remains a public health concern, affecting 71 percent of the population across the country with wide-ranging impacts on health outcomes.[18]

Fiscal consolidation measures negatively impacted the poor, while BISP transfers are not enough to protect the poorest

The consolidation of the Public Sector Development Programme (PSDP) in real terms likely reduced public spending on construction, which employs many poor and vulnerable. In addition, federal public pensions grew while Benazir Income Support Programme (BISP) spending declined[19] (with the phasing out of flood response spending) in H1 FY24, contributing to rising inequality. To mitigate the negative impacts of declining real household incomes, the Government approved a 20 percent increase in the benefit amount paid out as unconditional cash transfers under the BISP *Kafalat* scheme, effective January 2024. With inflation averaging 28.8 percent during H1 FY24, this is not sufficient to cover the rising cost of living.

c. Monetary and Financial Sector

Monetary

As inflation remains elevated, the SBP has maintained a tight monetary policy with the policy rate at a historical high

In response to the persistently high inflation, the SBP has maintained a tight monetary policy, keeping the policy rate at 22 percent—the highest since October 1996—over July to February FY24. With an inflation rate higher than the policy rate, the real interest rate nevertheless remained negative. Repeated massive injections of liquidity into the banking sector through OMOs have, however, negated the effectiveness of the monetary policy in curbing inflation.[20]

Financial Sector

Bank credit to the public sector continues to crowd out lending to the private sector, while demand for credit has declined due to weak economic conditions

As of December 2023, bank credit to the private sector stood at PKR 9.1 trillion, comprising 24.3 percent of total credit, down from 26.3 percent in June 2023. In contrast, credit to the public sector was 75.6 percent of the total bank credit, up from 73.7 percent in June 2023,[21] which is among the highest in the world. The Government's dependence on financing from the domestic financial sector has increased amid limited external financing inflows. Meanwhile, borrowing by the private sector remains clustered within the manufacturing sector, accounting for two-thirds of total loans to the private sector in December 2023. Additionally, more than 19 percent of private sector credit was extended through SBP subsidized development finance schemes, which can distort the market. Bank lending to small and medium enterprises (SMEs) has also steadily fallen to 5.2 percent of total domestic private sector credit in September 2023, the lowest in over a decade. This is partly due to deterioration in the asset quality of banks' SME portfolios.

[17] IPC (June 5, 2023) "Pakistan: Acute Food Insecurity Situation for April–October 2023 and Projection for November 2023–January 2024."
[18] Gallup (January 30, 2024) "Nearly 3 out of 4 Pakistanis (71%) Report Being Affected by Fog or Smog in the Previous Month."
[19] The budget for BISP spending in H1 FY23 included one-off payments in the context of the devastating floods in summer 2022.
[20] See the inflation section for a detailed discussion on the impact of OMOs.
[21] State Bank of Pakistan (2024a) "Credit/Loans Classified by Borrowers."

Beyond SMEs, the broader financial inclusion agenda is at risk as the capital adequacy ratio of the microfinance banks fell to 7.6 percent in December 2023 from 9.3 percent in June 2023. As a result of weak economic conditions and the strong shift toward financing the sovereign, the commercial bank advances to deposit ratio (ADR) fell to 41.8 percent in December 2023 from 45 percent in June 2023, with a significant reduction in ADR of the top five largest banks.[22] The supply side access to finance constraints are compounded by weaker demand on account of the macroeconomic situation, resulting in steadily falling loan applications since Q2 FY23.

Conventional financial soundness indicators mask the vulnerabilities of the banking sector

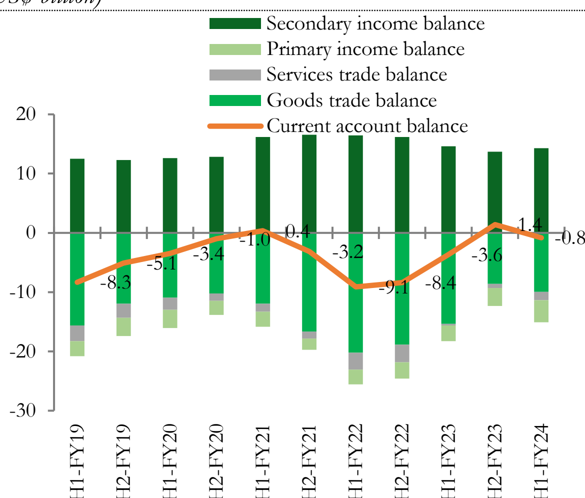
Commercial banks' earnings continue to grow on the back of larger investments in government securities in the high interest rate environment. However, underlying risks continue to increase with rising macroeconomic instability and asset quality issues that are not captured by conventional soundness indicators. The aggregate commercial banks' capital adequacy ratio rose to 19.7 percent in December 2023 from 17.5 in June 2023, significantly above the minimum regulatory requirement of 11.5 percent. However, this indicator does not adequately depict the risks of commercial banks' exposure to the Government, which receives a zero-credit risk. The ratio of non-performing loans (NPLs) to total lending was at 7.6 percent in December 2023, marginally up from 7.4 percent in June 2023; however, 92.7 percent of NPLs are provisioned for. This slight increase in delinquency was driven by rising NPLs in the corporate sector.[23]

d. External Sector

The CAD narrowed in H1 FY24…

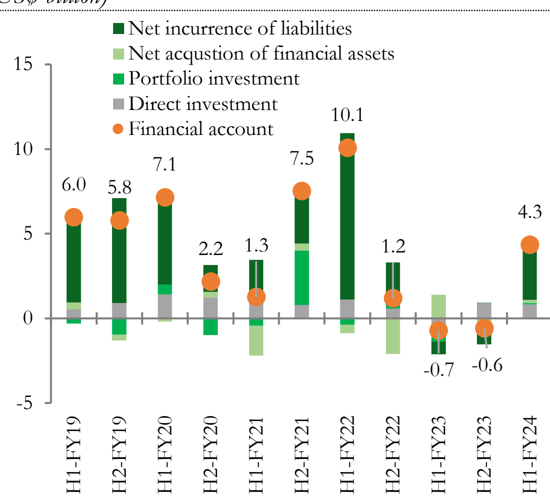
The current account recorded a deficit of US$0.8 billion during H1 FY24, narrowing from a deficit of US$3.6 billion in H1 FY23 (Figure 2.5). The narrower CAD was led by a significantly smaller trade deficit more than offsetting a narrower income account surplus. The narrower trade deficit was due to a strong contraction in goods imports, reflecting the impact of lower domestic demand, import management measures, and lower global commodity prices. Exports rose largely due to higher rice exports, benefiting from higher global rice prices as well as the rice export ban by India.[24] Meanwhile, official remittances fell in H1 FY24 in part due to exchange rate rigidities earlier in the year. The lower remittances coupled with the increased primary income deficit reduced the income surplus in H1 FY24. Despite the decline, remittances financed the entire of the trade deficit in H1 FY24.

Figure 2.5: H1 Current Account Balances
(US$ billion)



Source: State Bank of Pakistan and World Bank staff calculations.

Figure 2.6: H1 Financial Account Inflows
(US$ billion)



Source: State Bank of Pakistan and World Bank staff calculations.
Note: A positive financial account balance represents inflows.

[22] State Bank of Pakistan (September 2023) *Quarterly Compendium: Statistics of the Banking System*.
[23] State Bank of Pakistan (December 2023) *Quarterly Compendium: Statistics of the Banking System*.
[24] U.S. Department of Agriculture (September 19, 2023) "Rice Export Prices Highest in More Than a Decade as India Restricts Trade."

…as goods imports contracted sharply amid weak domestic demand and import management measures

The overall goods and services trade deficit decreased from US$15.6 billion in H1 FY23 to US$11.4 billion in H1 FY24 as imports declined and exports increased. Goods exports increased by 7.5 percent y-o-y in H1 FY24, while goods imports fell by 14.7 percent. Food exports grew sharply due to a significant increase in the export of rice, but exports of most other commodities contracted. The contraction in imports was broad based with all major product groups declining (except for machinery), owing to overall weak economic conditions, import management measures lower global prices, and better agricultural outputs. As a result, the goods trade deficit declined to US$10.0 billion in H1 FY24. Services exports declined by 2.7 percent while services imports increased by 25.0 percent, with the latter mainly driven by increases in the import of passenger transport and travel services. As a result, the services trade deficit widened to US$1.4 billion in H1 FY24.

The income account recorded a lower surplus due to reduced remittance inflows and increased interest payments

The income account surplus decreased to US$10.5 billion in H1 FY24 from US$12.0 billion in H1 FY23, mainly due to increased interest payments on external debts and reduced remittance inflows. The primary income account deficit increased by 42.1 percent y-o-y due to higher interest payments on external debt and increased profit repatriation by foreign companies.[25] Under secondary income, remittance inflows declined by 6.8 percent due to a misaligned official exchange rate during Q1 FY24 and weaker labor market conditions in all key remitting countries.

The financial account recorded a surplus, reflecting fresh financial inflows

The financial account ran a surplus of US$4.3 billion in H1 FY24 compared to a deficit of US$0.7 billion in H1 FY23, reflecting fresh financial inflows (Figure 2.6). These inflows included US$1.2 billion of the IMF loan under the stand-by arrangement, US$3 billion of bilateral loans and deposits at the central bank, and around US$1.0 billion of multilateral loans. Portfolio flows recorded a small net inflow of US$72.0 million, while foreign direct investment (FDI) also saw a net inflow of US$0.8 billion in H1 FY24, largely owing to investments from Hong Kong, the UK, and China.[26]

The current account moved into deficit in January 2024, offset by net financial account inflows

After recording a current account surplus of US$404 million in December 2023, the current account turned to a deficit of US$303 million in January 2024, reflecting a significant increase in trade deficit. Cumulatively, the CAD in July–January FY24 declined to US$1.1 billion compared to a deficit of US$3.8 billion in the same period in FY23. With financial account recording a substantial surplus over this period, the BOP surplus reached US$2.4 billion compared to a deficit of US$6.5 billion in July–January FY23. As a result, the external position slightly improved, with foreign exchange reserves standing at US$9.1 billion at end-February 2024, equivalent to 1.7 months of total imports (Figure 2.7).[27]

Higher international reserves helped to ease pressures on the exchange rate

After depreciating by 28.7 percent against the US dollar over FY23, the rupee stabilized at around PKR 280 to the US dollar, recording a slight appreciation of 1.2 percent in H1 FY24 (Figure 2.8). A BOP surplus, higher levels of international reserves, and implementation of regulatory measures and reforms[28] (addressing the illegal activity in foreign exchange markets) eased the pressure on the exchange rate. The rupee saw a 10 percent appreciation in the real exchange rate in part due to the high inflation rates.[29]

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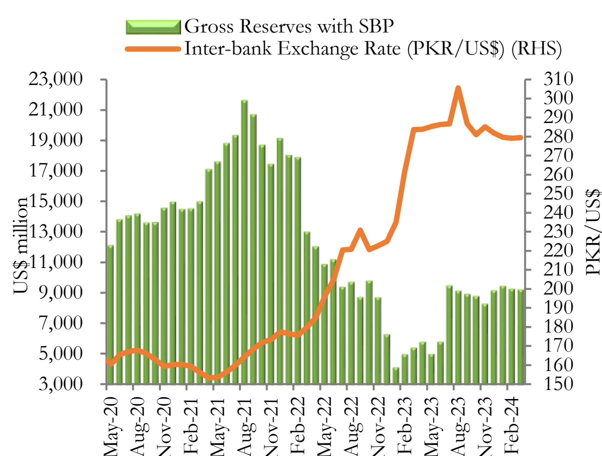
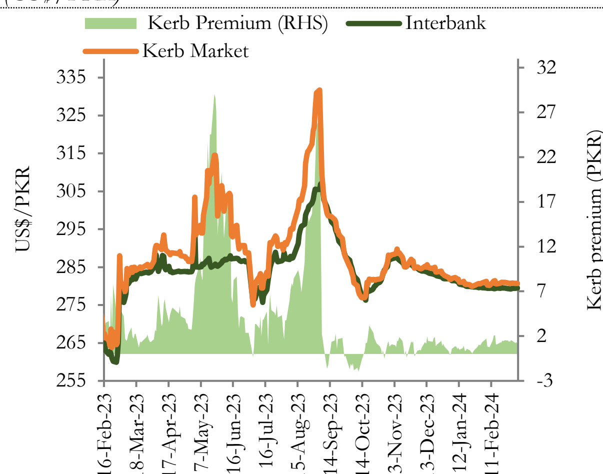
[25] State Bank of Pakistan (2024d) "Repatriation of Profit/Dividend by Country on Foreign Investment."
[26] Ministry of Finance (2023d) *Monthly Economic Update & Outlook: December 2023*.
[27] Based on World Bank staff projections for the next 12 months of imports.
[28] State Bank of Pakistan (September 6, 2023) "Reforms in the Exchange Companies Sector."
[29] Real effective exchange rate, based on CPI. Source: IMF, International Financial Statistics dataset.

Figure 2.7: Gross Official SBP Reserves and Exchange Rate
(US$ million)



Source: State Bank of Pakistan and World Bank staff calculations.
Note: RHS=right hand side.

Figure 2.8: Domestic Exchange Rate Movements
(US$/PKR)



Source: State Bank of Pakistan and World Bank staff calculations.
Note: RHS=right hand side.

Table 2.1: Balance of Payments Summary[1]
(US$ million unless mentioned otherwise)

	FY21	FY22	FY23	H1 FY22	H1 FY23	H1 FY24
i. Current Account (A+B+C+D)	**-2,820**	**-17,481**	**-2,235**	**-9,112**	**-3,629**	**-824**
A. Good trade balance	**-28,634**	**-39,050**	**-23,955**	**-20,194**	**-15,366**	**-9,965**
Goods exports	25,639	32,493	27,879	15,242	14,223	15,285
Goods imports	54,273	71,543	51,834	35,436	29,589	25,250
B. Services trade balance	**-2,516**	**-5,840**	**-969**	**-2,874**	**-270**	**-1,403**
C. Balance on primary income[2]	**-4,400**	**-5,248**	**-5,671**	**-2,506**	**-2,631**	**-3,738**
D. Balance on secondary income[2]	**32,730**	**32,657**	**28,360**	**16,462**	**14,638**	**14,282**
of which, remittances	29,450	31,279	27,333	15,808	14,418	13,436
ii. Capital Account	**224**	**205**	**375**	**116**	**317**	**88**
1. Balance from current and capital accounts (i+ii)[3]	**-2,596**	**-17,276**	**-1,860**	**-8,996**	**-3,312**	**-736**
2. Financial accounts[4]	**-8,768**	**-11,261**	**1,312**	**-10,070**	**726**	**-4,335**
of which:						
Direct investment	-1,648	-1,702	-590	-1,115	329	-833
Portfolio investment	-2,774	55	1,012	374	1,033	-72
Net acquisition of financial assets	1,345	2,613	-1,029	504	-1,387	-196
Net incurrence of financial liabilities	5,691	12,226	-1,928	9,832	-757	3,234
3. Errors and omissions	**-619**	**-303**	**-1,046**	**-286**	**-246**	**-593**
Overall balance (-1+2-3)	**-5,553**	**6,318**	**4,218**	**-788**	**4,284**	**-3,006**
Gross SBP reserves (incl. CRR, SCRR)[5]	18,716	11,090	5,669	19,058	6,159	9,443
Memorandum items						
Current account balance (percent of GDP)	*-0.8*	*-4.7*	*-0.7*	-	-	-
Goods trade balance (percent of GDP)	*-8.2*	*-10.4*	*-7.2*	-	-	-
Goods export growth (percent, y-o-y)	*13.8*	*26.7*	*-14.2*	*29.0*	*-6.7*	*7.5*
Goods import growth (percent, y-o-y)	*24.4*	*31.8*	*-27.5*	*49.0*	*-16.5*	*-14.7*
Remittance growth (percent, y-o-y)	*27.3*	*6.2*	*-12.6*	*11.4*	*-8.8*	*-6.8*
Financial account (percent of GDP)	*2.5*	*3.0*	*-0.4*	-	-	-
Overall balance (percent of GDP)	*-1.6*	*1.7*	*1.3*	-	-	-

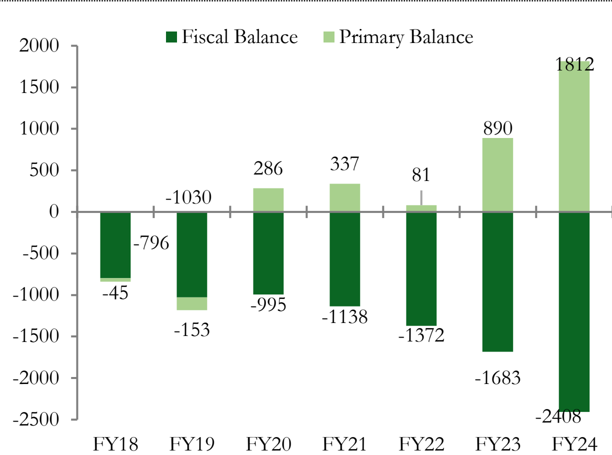
Source: State Bank of Pakistan and World Bank staff calculations.
Notes:
1 As per Balance of Payments Manual 6 (BPM6).
2 In BPM6, the income account has been renamed "primary income" and current transfers, "secondary income."
3 A negative balance shows that the economy is a net borrower from the rest of the world.
4 A negative balance highlights a net increase in the incurrence of foreign liabilities.
5 CRR=cash reserve requirement; SCRR=special cash reserve requirement.

e. Fiscal and Debt Sustainability

The primary surplus in H1 FY24 doubled with fiscal consolidation efforts, while the overall deficit continued to widen

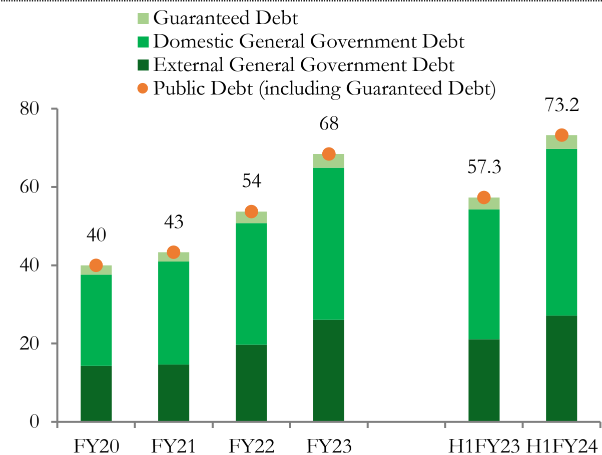
The consolidated fiscal deficit widened to PKR 2.4 trillion in H1 FY24, substantially higher than the PKR 1.7 trillion deficit in H1 FY23 (Figure 2.9). The widening was primarily due to larger debt servicing costs, which grew the fastest in six years due to higher domestic and international interest rates. Meanwhile, in line with fiscal consolidation efforts, the primary fiscal surplus more than doubled to a historic high of PKR 1.8 trillion, with total revenues growing faster than total expenditures.

Figure 2.9: Consolidated Fiscal and Primary Balance (excluding grants) in H1 FY18–24
(PKR billion)



Source: Ministry of Finance and World Bank staff calculations.

Figure 2.10: Public and Publicly Guaranteed Debt
(PKR trillion)



Source: Ministry of Finance and World Bank staff calculations.

Total revenue increased by 17.1 percent in real terms in H1 FY24

Total revenue for H1 FY24 increased by a nominal 45.9 percent y-o-y to reach PKR 6.9 trillion compared to PKR 4.7 trillion in H1 FY23 (Table 2.2). After adjusting for CPI inflation, the increase implies real growth of 17.1 percent. This rise was mainly due to the growth in tax revenue, which increased by 35.2 percent to PKR 5.3 trillion (6.4 percent in real terms) in part due to high inflation but also due to tax policy changes. These measures included an increase in personal income tax on salaried individuals, the imposition of a "super tax" on high-net-worth individuals, and the increase in petroleum development levy from PKR 50 to PKR 60 per liter. Furthermore, revenues from federal excise duty grew by 60.1 percent (31.3 percent in real terms) mainly due to increases in tax rates on fertilizers, cement, and beverages. In line with fiscal consolidation efforts, the sales tax rate on goods was increased from 17 percent to 18 percent, resulting in a 19.1 percent increase (-9.7 percent in real terms) in goods sales tax revenues compared to a contraction of 0.2 percent in H1 FY23.

Non-tax revenues increased by 72.4 percent in real term in H1 FY24

Non-tax revenue doubled to PKR 1.5 trillion in H1 FY24, which is more than the amount collected for the entire FY23. The 101.2 percent y-o-y (72.4 percent in real terms) increase was mainly due to a surge in SBP surplus profit, the Government's interest receipts from lending to public sector enterprises, and royalties on oil and gas. However, the revenue generated from the Pakistan Telecommunication Authority declined sharply by 88.5 percent (59.7 percent in real terms).

Current expenditures increased on account of higher interest payments

Total expenditure in H1 FY24 increased by 45.1 percent y-o-y to PKR 9.3 trillion, implying a CPI inflation adjusted real growth rate of 16.3 percent. This increase was mainly due to higher current expenditure, which rose by 41.3 percent (12.5 percent in real terms) to PKR 8.6 trillion in H1 FY24, primarily on account of higher interest payments and subsidies. With 72 percent of domestic debt stock comprised of floating rate instruments at end-June 2023, the high policy rate of 22 percent directly impacted

domestic debt servicing by increasing interest payments on domestic debt, which grew by 63.5 percent (34.7 percent in real terms) in H1 FY24.[30]

Table 2.2: Summary of Fiscal Operations
(PKR billion unless mentioned otherwise)

	FY22	FY23	H1 FY22	H1 FY23	H1 FY24	H1 FY23 Growth y-o-y	H1 FY24 Growth y-o-y
Total revenue	**8,035**	**9,634**	**3,956**	**4,699**	**6,854**	**18.8**	**45.9**
Tax revenue[1]	**6,947**	**8,441**	**3,294**	**3,938**	**5,325**	**19.6**	**35.2**
Federal	6,335	7,791	3,023	3,635	4,960	20.2	36.5
Provincial	612	650	271	303	365	11.8	20.5
Non-tax revenue	**1,088**	**1,193**	**662**	**760**	**1,529**	**14.8**	**101.2**
Total expenditure	**13,295**	**16,155**	**5,328**	**6,382**	**9,262**	**19.8**	**45.1**
Current expenditure	11,521	14,448	4,676	6,061	8,565	29.6	41.3
of which:							
Interest payments	3,182	5,696	1,453	2,573	4,220	77.1	64.0
Non-interest expenditure	8,339	8,752	3,223	3,488	4,345	8.2	24.6
Defense	1,412	1,586	520	639	758	22.9	18.6
Subsidies	1,530	1,080	313	197	375	-37.1	90.4
Development expenditure and net lending	**1,657**	**1,953**	**571**	**637**	**661**	**11.6**	**3.8**
of which:							
PSDP	1,617	1,893	565	591	673	4.6	13.9
Statistical discrepancy	116	-246	81	-315	36		
Fiscal balance (excl. grants)	**-5,260**	**-6,521**	**-1,372**	**-1,683**	**-2,408**		
Primary balance (excl. grants)	**-2,077**	**-826**	**81**	**890**	**1,812**		
Public debt (incl. guaranteed debt)	**53,745**	**68,422**	**46,708**	**57,328**	**73,216**	**22.7**	**27.7**
Domestic debt	31,085	38,810	26,746	33,178	42,588	24.0	28.4
External debt	19,677	26,092	17,408	21,069	27,133	21.0	28.8
Guaranteed debt	2,983	3,520	2,553	3,080	3,495	20.6	13.5
Memorandum items							
Fiscal balance (excl. grants) as percent of GDP	*-7.9*	*-7.8*	-	-	-		
Primary balance (excl. grants) as percent of GDP	*-3.1*	*-1.0*	-	-	-		
Public debt (incl. guaranteed debt) as percent of GDP[2]	*80.7*	*81.4*	*70.1*	*68.2*	*68.0*		
GDP (PKR billion)	*66,640*	*84,069*	-	-	*107,666*		

Source: Ministry of Finance and World Bank staff calculations.
Notes:
1 From FY21 onwards, the Ministry of Finance has included revenue from Gas Infrastructure Development Cess, natural gas development surcharge, and petroleum levy in non-tax revenue. For consistency of analysis across years, these taxes have been included in tax revenue.
2 Public debt (including guaranteed debt) in H1 FY24 is reported as share of World Bank estimated nominal GDP provided in the last row of the table.

Non-interest current expenditures remained high due to power subsidies and grants

During H1 FY24, non-interest current expenditures increased by 24.6 percent y-o-y to PKR 4.3 trillion (but declined by 4.2 percent in real terms), three times higher than the nominal 8.2 percent increase that was seen during H1 FY23. The increase was mainly due to higher spending on subsidies and grants. There was a significant increase of 90.9 percent (62.1 percent in real terms) in subsidies amounting to PKR 375 billion, primarily to the power sector (Box 2.1).[31] At the same time, federal grants increased by 20.6 percent (-8.2 percent in real terms) due to higher social protection and election-related spending. In addition, provincial current spending increased by 18.6 percent (but declined by 10.2

[30] Debt Management Office (2023) Annual Debt Review & Public Debt Bulletin FY 2022–23.
[31] This includes spending on tariff differential subsidies, including independent power producers, K-Electric, and inter-DISCO tariff differential. Source: Ministry of Finance (2023a) *Federal Budget 2023–24: Budget in Brief.*

percent in real terms), partly due to the Government of Punjab's repayment of PKR 115 billion to clear its uncollateralized commodity debt.

Development expenditures increased nominally, but decreased in real terms

In line with fiscal consolidation efforts, development expenditures increased modestly by 3.9 percent (a -24.9 percent decrease in real terms) in H1 FY24. Consolidated PSDP spending grew by 13.9 percent (a -14.8 percent decrease in real terms), reflecting a significant decline in federal PSDP.

Public debt remained high amid sizeable financing needs

External financing flows saw net inflows in H1 FY24 compared to net outflows in H1 FY23 due to fresh bilateral inflows under the IMF-SBA commitments.[32] However, the Government continued to rely primarily on domestic financing sources during this period. Amid significant financing needs, the total public and publicly guaranteed debt increased to PKR 73.2 trillion (68.0 percent of GDP[33]) by the end of December 2023, compared to PKR 68.4 trillion (81.4 percent of GDP) at the end of June 2023 (Figure 2.10). Of the total public debt, the share of external debt was 39.8 percent, implying an ongoing substantial exchange rate risk, whereas short-term debt was 8.6 percent at end-December 2023.

Box 2.1: Rising "Circular Debt" of the Energy Sector

Structural issues, poor planning, and substantial subsidies have resulted in huge inefficiencies across the power sector, affecting the reliability of supply and generating huge deficits (referred to as "circular debt"). Pakistan has the highest subsidies on energy products in South Asia. Energy subsidies in the current fiscal year are estimated at PKR976 billion (0.9 percent of GDP[34]), two-thirds of which were for electricity consumption.[35] While the gap has been recently reduced, the notified tariff remains below the cost recovery level. A total of 62 percent of residential and all agriculture consumers remain subsidized (this rate has declined from 92% in 2021)[36]. While the progressivity of subsidies to residential consumers has improved with recent tariff notifications (July 2022 and July 2023), the subsidy to electric tube wells continues to be regressive, benefiting primarily large and wealthy farmers. As a result of the absence of cost-reflective tariffs, together with operational and technical inefficiencies within the state-owned electricity distribution companies (DISCOs), revenue collection does not fully cover the cost of electricity supply, which leads to accumulating deficits ("circular debt"). Inefficiencies in the DISCOs include outdated metering practices, low collection rates, high technical losses, and rampant theft.

While the pace of accumulation has slowed since FY23, the power sector circular debt has continued to grow. As of the end of January 2024, the circular debt stock stood at PKR 2,635 billion (2.4 percent of GDP[37]), including an additional flow of PKR 463 billion since end-June 2023. Recent large accumulations began in 2018 with the signing of "take-or-pay" contracts for large, imported coal and imported gas power plants. These have increased capacity payments by 50 percent and increased the country's exposure to international fossil fuel price volatility—as witnessed over 2022.

Circular debt on gas has emerged as another challenge for the sector. As of January 2024, gas circular debt stood at PKR 2,866 billion (2.7 percent of GDP[38]) compared to PKR 2,391 billion in June 2023. While consecutive gas tariff increases have contributed to containing growth, the accumulation is a result of delays in tariff adjustment (three years of no tariff increase), inefficiencies in the sector (i.e. unaccounted for gas); and increasing diversion of expensive RLNG to domestic consumers during winter months.

The Government has engaged in comprehensive power sector reforms to contain the accumulation of circular debt, but more needs to be done. Timely tariff increases in the last two years, coupled with subsidy rationalization reforms, have narrowed the historical gap between tariffs and the costs of supply while protecting vulnerable consumers. Although these increases were substantial, they were necessary to avoid further accumulation of debt that contributed to fiscal sustainability and sector viability risks. The ongoing large-scale anti-theft campaign has helped to improve collections, with an additional PKR 76 billion of recovery recorded as of January 2024.[39]

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[32] IMF (January 11, 2024) IMF Executive Board Completes First Review of the Stand-By Arrangement for Pakistan.
[33] Calculated as percentage of World Bank's estimated GDP for FY24.
[34] Calculated as percentage of World Bank's estimated GDP for FY24.
[35] IMF, Fossil Fuel Subsidies dataset (data from 2023). Only includes "explicit subsidies." Total energy subsidies, including both explicit and implicit, are estimated at 8.0 percent of the country's GDP for 2023. See Parry, Black, and Vernon (2021) "Still Not Getting Energy Prices Right: A Global and Country Update of Fossil Fuel Subsidies."
[36] Data from Power Division, Ministry of Energy.
[37] Calculated as percentage of World Bank's estimated GDP for FY24.
[38] Calculated as percentage of World Bank's estimated GDP for FY24.
[39] Data from Power Division, Ministry of Energy.

The Government should maintain its commitment to comprehensive reforms of the sector, including transition away from fossil fuels. This requires addressing inefficiencies within DISCOs by concessioning to the private sector, reducing the cost of generation and overdependence on imported fossil fuels through increasing the share of renewable energy (RE), bringing end-consumer tariffs closer to the cost recovery level, improving supply side efficiency and collections while strengthening regulatory capacity. Pakistan has large untapped hydro, solar, and wind power potential. Large variations in seasonal peak demand create challenges for deployment of RE, which requires simultaneous expansion and strengthening of the transmission grid. Mobilizing renewable capacity will require: i) competitive bidding for new power generation projects and ending the old practice of direct contracting and cost-plus tariffs that have led to high power costs and an over-reliance on fossil fuels; and ii) strengthening and expanding the transmission network, including through private sector participation together with building capacity for integrative system planning. A programmatic approach on expansion of RE that would be followed by annual rounds of procurement to meet the Government's targets should be adopted. This model has proven successful in other countries.

3. Outlook and Risks

a. Medium-Term Outlook

In the absence of major reforms and continued trade deficit, external financing constraints are expected to slow the pace of recovery

In the absence of major and sustained economic reforms, Pakistan is expected to continue to face foreign exchange liquidity issues due to the persistent trade deficit and limited access to external financing, especially from the private sector. Even with the recent successful completion of the IMF-SBA[40] and continued rollovers, reserves are projected to remain low, hovering around 1.3 months of total imports over FY24–26. Continued import management measures and tight monetary and fiscal policies are expected to disrupt domestic supply chains and mute aggregate consumption and investment. In the absence of an ambitious and credible economic reform plan, confidence and investment are likely to remain muted, with real GDP projected to grow at 1.8 percent in FY24. As confidence improves with the expected implementation of a new IMF program, output growth is expected to gradually recover to an average of 2.5 percent over FY25 and FY26 but remaining below potential in the medium term.

Pakistan's growth prospects are expected to remain constrained over the medium term

Reflecting a recovery from the 2022 floods in FY23, agricultural output is expected to grow rapidly by 3.0 percent in FY24, largely supported by a higher estimated output of major crops, particularly of cotton and rice. The agriculture sector is expected to grow at an average rate of 2.5 percent over FY25–26. With easing import management measures and spillovers from strong agriculture performance, industry is expected to recover, growing at 1.8 percent in FY24. Despite improved confidence, the growth of the industrial sector is projected to remain muted at an average of 2.3 percent over the medium term, mainly due to tight macroeconomic policies and continued import management measures. With spillover from the recovery in the agriculture and industry sectors, the services sector is expected to grow marginally at 1.2 percent in FY24. As inflationary pressures ease, the growth of the services sector is expected to strengthen over the medium term to an average of 2.7 percent over FY25–26.

Tight policy and import management measures will drag on aggregate demand in the near term

Growth in private consumption is projected to decline to 1.7 percent in FY24, due in part to erosion in real incomes because of high inflation and in part to administrative measures, including the import management measures. As inflationary pressures dissipate, private consumption is expected to grow at an average rate of 2.3 percent over FY25–26. Total investment is expected to further contract in FY24, reflecting policy uncertainty, tight macroeconomic policy, and the high cost of borrowing, before gradually recovering in FY25–26. Constrained by high interest expenditures, government consumption is projected to grow marginally in FY24. With interest expenditure declining and gradual expansion of fiscal space, government consumption is expected to see some recovery over the medium term.

Inflation is expected to remain elevated in FY24 due to higher domestic energy prices

Consumer price inflation is projected to remain elevated at 26.0 percent in FY24. The increase in prices is driven by domestic gas, electricity, and fuel tariff adjustments resulting in significant increase in domestic energy prices. In view of the persistently high inflationary pressures, the SBP is expected to maintain a tight monetary policy stance in FY24. Inflation will gradually moderate in FY25–26 due to a high base effect and as global commodity prices ease.

The CAD is expected to remain low as import management measures continue

Imports growth is expected to be muted reflecting weak domestic demand and continued import management measures aimed at preserving the scarce foreign reserves. As a result, the CAD is expected to remain low at 0.7 percent of GDP in FY24 and to further narrow to 0.6 percent of GDP in FY25 and FY26. Pakistan's external financing needs will remain significant throughout the projection period, due to IMF repayments and maturing

[40] IMF (March 20, 2024) Pakistan: IMF Reaches Staff-Level Agreement of the Second and Final Review of the 9-Month Stand-By Arrangement.

Eurobonds. Despite a low CAD, the reserve position is therefore projected to further weaken, reflecting limited external financing.

The fiscal deficit is expected to increase in FY24 due to higher debt servicing

The fiscal deficit is projected to increase to 8.0 percent of GDP in FY24 due to higher interest payments but to gradually decline over the medium term as interest payments decrease over time and fiscal consolidation and revenue mobilization measures take hold. Meanwhile, the primary deficit is expected to narrow to 0.1 percent of GDP in FY24 reflecting fiscal consolidation measures, before slightly growing to 0.3 percent of GDP in FY25–26. The continuation of bold fiscal consolidation measures over the medium term is necessary to restore fiscal and debt sustainability.

Public debt-to-GDP ratio is projected to marginally decline over the medium term

Pakistan is expected to continue facing liquidity pressures over the medium term. Gross financing needs will remain sizeable throughout the projection period, because of maturing short-term domestic debt, multilateral and bilateral repayments, and Eurobond bullet maturities. With continuation of fiscal consolidation measures, public debt as a share of GDP is projected to decline to 73.1 percent in FY24 and gradually to 72.5 percent in FY26, indicating limited solvency risks.

No poverty reduction is expected over the medium term because of weak growth and continued high inflation

Poverty reduction is projected to stall in the medium term due to weak growth, low real labor incomes, and persistently high inflation. The poverty headcount rate, measured at the lower-middle-income country poverty line of US$3.65/day 2017 purchasing power parity (PPP), is expected to remain around 40 percent over FY24–26. The lower than potential growth and high inflationary pressures due to continued import management measures, and potential reduction in public spending on social sectors, are expected to worsen human development outcomes. These effects will be especially compounded for poorer households with already depleted savings and reduced incomes. Chronic inflation in the absence of substantial growth, along with policy uncertainty, could cause social discontent and have negative welfare impacts. Increased targeted transfers will play a vital role to protect the poorest from these risks.

Table 3.1: Pakistan Macroeconomic Outlook (FY24–26)
(Annual percent change unless indicated otherwise)

	2020/21	2021/22	2022/23	2023/24e	2024/25f	2025/26f
Real GDP Growth, at constant factor prices	5.8	6.2	-0.2	1.8	2.3	2.7
Agriculture	3.5	4.3	2.3	3.0	2.2	2.7
Industry	8.2	6.9	-3.8	1.8	2.2	2.4
Services	5.9	6.7	0.1	1.2	2.4	2.9
Real GDP Growth, at constant market prices	6.5	4.8	0.0	1.8	2.3	2.7
Private consumption	9.4	7.1	2.4	1.7	2.2	2.5
Government consumption	1.8	-1.3	-4.9	0.9	1.4	2.0
Gross fixed capital formation	3.7	3.3	-16.3	-0.5	1.2	2.0
Exports, goods, and services	6.5	5.9	2.4	2.1	3.2	3.7
Imports, goods, and services	14.5	11.0	-0.3	0.3	1.2	1.6
Inflation (CPI)	8.9	12.1	29.2	26.0	15.0	11.5
Current Account Balance (% of GDP)	-0.8	-4.7	-0.7	-0.7	-0.6	-0.6
Net FDI (% of GDP)	0.5	0.5	0.2	0.3	0.3	0.4
Fiscal Balance (excluding grants, % of GDP)	-6.1	-7.9	-7.8	-8.0	-7.4	-6.6
Debt (% of GDP)	77.6	80.7	81.4	73.1	72.3	72.5
Primary Balance (excluding grants, % of GDP)	-1.2	-3.1	-1.0	-0.1	-0.3	-0.3

Source: Pakistan Bureau of Statistics, State Bank of Pakistan, and World Bank staff estimates.
Note: FY21 corresponds to fiscal year 2020–21, which runs from July 1, 2020, to June 30, 2021. This macroeconomic outlook uses the re-based national accounts data in 2015–16 prices. It was prepared by World Bank staff and differs from that of the Government.

b. Risks and Priorities

Rising government borrowing poses further risks to financial sector stability

In the absence of international capital market access, Pakistan has been heavily reliant on expensive domestic borrowing for fiscal financing,[41] leading to an intensifying sovereign bank nexus.[42] The rising demand for expensive domestic private credit by the sovereign increases the Government's interest expenditures, crowds out financing from the private sector, while also adding stress to the balance sheet of commercial banks. As a result, the underlying risks to financial sector continue to increase with asset quality issues that are not captured by conventional soundness indicators, as lending to the Government receives zero-credit risk.

Further policy uncertainty will pose downside risks to the outlook

Policy uncertainty remains elevated. Potential policy slippages, reform reversals or political instability would further weigh on the medium-term outlook through lower business confidence, even more limited external financing, and more pronounced macroeconomic vulnerabilities. In the absence of a strong national political consensus on an ambitious and credible economic reforms plan, policy slippages and delays in implementation of critical structural reforms (such as fiscal consolidation or energy reforms) are likely. This prospect poses significant downside risks on the medium-term economic outlook.

Liquidity risks remain high due to low reserves and high external payments

Pakistan has sizeable upcoming domestic and external payments in the near to medium term. With limited fiscal space and foreign reserves amounting to only US$9.1 billion at end-February 2024 (equivalent to 1.7 months of FY25 imports), any delays in the disbursement of planned external financing could pose substantial liquidity risks. Capacity to meet the high gross and external financing needs depends heavily on achieving necessary fiscal consolidation, the materialization of expected rollovers of regional bilateral loans and deposits and refinancing of commercial loans.

External headwinds and climate vulnerabilities also pose risks to macroeconomic stability

Global inflationary pressures, though moderating, are at risk of remaining elevated amid potential extensions of production cuts by oil producing countries, continuation of export bans on food items by large global exporters, and the continued war in Ukraine. Any escalation of the conflict in the Middle East and the associated disruptions in the energy supply chain would pose additional risks. Weaker global demand due to continued tight monetary policy will affect demand for Pakistan's exports and inflow of remittances. Similarly, tighter than expected financing conditions will further limit access to external financing, potentially leading to exchange rate and external instability. Pakistan remains heavily exposed to climate change impacts, and macroeconomic stability could be imperiled by increasing temperatures, increased flooding, and more frequent droughts.

Structural reforms remain critical to improve confidence and boost investment

The current macroeconomic outlook projects below potential growth with little poverty reduction and continued erosion of living standards. The projected weak domestic and foreign investment over the medium term will further reduce future growth potential. A more robust economic recovery will require the steadfast implementation of an ambitious, broad and credible reform program to improve confidence and boost investment (Box 3.1 provides a list of potential economic reforms). Rapid reforms are required to: i) improve the quality of expenditures and reduce the distortive presence of the state in the economy including SOE reforms and privatizations, reduced untargeted subsidies, and reduced federal expenditures in areas devolved to provinces; ii) broaden the tax base including increased taxes on agriculture, retail, and property, reduced tax exemptions and loopholes, and improved administration, particularly via digitalization; iii) address regulatory constraints to private sector activity including cutting red tape and removing barriers to foreign investment; iv) removing the anti-export bias in trade policy including tariff rationalization and reform of export subsidy schemes; and v) address inefficiencies and high costs in the energy sector including continued tariff reform and increased private sector participation in distribution and transmission.

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[41] The weighted average yield of six months' treasury bills was at 20.39 percent in auction held on February 21, 2024. Source: State Bank of Pakistan (2024b) Government of Pakistan Market Treasury Bills (MTBs) Auction Result.
[42] State Bank of Pakistan (2024a) Credit/Loans Classified by Borrowers.

Box 3.1: Recommended Economic Reform Priorities

1. Debt management reforms

To optimize the debt portfolio to achieve an appropriate balance between cost and risk.

Reform	Description
Establish a unified debt management office (DMO)	Establish an appropriately staffed-up unified debt management office, with responsibility for all debt management systems and functions to the DMO (currently fragmented across SBP, EAD, and MOF), as mandated by FRDLA.
Develop debt management strategy	Implement a credible and consistent medium-term debt management strategy, including the publication of a credible annual borrowing plan.
Develop credit risk assessment framework	Utilize a credit risk assessment framework to manage the issuance, valuation, and monitoring of loan guarantees to SOEs and use it to guide analysis of fiscal risks and risk management strategies.

2. State-Owned Enterprise Reform

Reduce the fiscal costs of SOEs, reduce state presence for overall economic efficiency through selective privatization.

Reform	Description
Divest, restructure, and privatize SOEs	Implement the SOE Triage (2021) and move forward with selective divestment of high-profile State-Owned Enterprises as per the Federal Government's plan.
Limit government exposure to SOEs	Immediately implement policies to limit government fiscal support to SOEs and ensure compliance with loan contracts; establish and enforce overall loan limits to SOEs at the aggregate level and as a share of SOE assets.
Address SOEs governance and fiscal discipline issues	Implement corporate governance and fiscal discipline requirements in accordance with the SOE Act, including competitive selection of Boards, establishment of performance agreements, application of Public Service Obligation Framework and effective SOE oversight and regular reporting by Central Monitoring Unit, within MoF.

3. Trade Reform

Move towards increased economic openness and integration by removing the current anti-export bias in trade policy.

Reform	Description
Rationalize trade tariffs	Develop, publicize, and begin implementing a tariff rationalization strategy, with the goal of reducing average tariffs and reducing the anti-export bias of existing trade policy.
Phase out import duty exemptions	Phase out import duty exemptions under the 5th schedule of the tariff code to level the playing field and reduce tax expenditures.
Open export financing schemes to firms in all sectors and simplify the process	Open export financing schemes (EFS, LTFF) to firms in all sectors, focusing on new firms or those exporting new products or to new markets. Gradually link interest rates with market rates to increase cost-effectiveness and financial sustainability. Simplify requirements and documentation for firms to access the Export Facilitation Scheme (EFS). Digitize and automate EFS processes and verification checks through the Pakistan Single Window to allow risk-based audits.

4. Expenditure Reform

Reduce wasteful government expenditure and achieve long-term fiscal sustainability.

Reform	Description
Implement Treasury Single Account	Fully implement the Treasury Single Account to reduce the government's cash holdings, reducing interest costs (estimated PKR 424 billion savings annually).
Reduce energy and commodity subsidies	Reduce subsidy expenditure including tube-well, gas, wheat, and fertilizer subsidies (estimated PKR300+ billion savings annually). It is critical to shield against any negative impacts on the poor through enhanced social protection.
Reform pensions	i) Introduce immediate parametric reforms to reduce the fiscal liability arising from federal and provincial public sector pensions. ii) Develop and take initial steps to implement a longer-term pension reform plan to ensure fiscal affordability over the long-term. iii) Take initial steps under a reform plan to rationalize public sector compensation, including through simplification and monetization of benefits.

5. Private Sector Reform

Remove unnecessary regulatory constraints to private sector activity and investment.

Reform	Description

Simplify the business environment	i) Immediately revise the Investment Act and align it with the new Investment Policy, addressing arbitrary legal barriers to foreign investment, and clearly signaling commitment to investment climate reform. ii) Establish a National Regulatory Delivery office with all responsibilities for leading wholesale business environment regulatory reforms, including the Pakistan Regulatory Modernization Initiative. This office should work with the private sector to identify and address unnecessary regulatory constraints and red tape. Equivalent offices should be established at the provincial level. iii) Establish a unified electronic portal for all regulatory approvals at the federal and provincial level.

6. Financial Sector Reform

Strengthen financial sector stability safeguards and expand inclusion.

Reform	Description
Improving financial sector stability	Enhance financial sector safety net measures—including establishing a resolution authority at SBP, developing standard operating procedures SOPs of the National Financial Stability Council, and strengthening capacity of Deposit Protection Corporation.
Increase financial inclusion	Improve the National Financial Inclusion Strategy (NFIS) targets and develop a stronger roadmap for action items on inclusion, account opening, agriculture and SME finance, and digitization.

7. Benazir Income Support Program

Invest in the BISP program to protect poor households, including from the impacts of tax and energy reforms.

Reform	Description
Ensure effectiveness of benefits	i) Recalibrate payment amounts in alignment with global best practices to ensure effectiveness of benefits in improving consumption. ii) Introduce indexation of payment amounts, in line with inflation, to retain purchasing power of benefits for poor households.
Keep the beneficiary list updated	Pursue administrative measures to ensure appropriate inclusion and exclusion of BISP beneficiaries based on regularly updated data.

8. Revenue Reform

Broader the tax base, improve progressivity, and ease compliance.

Reform	Description
Close tax exemptions	Review and close existing corporate and sales tax exemptions, including tax exemptions for real estate, the energy sector, COVID response, and some basic household goods. Compensate poor households from negative impacts through enhanced social protection.
Improve compliance	Address constraints delaying the rollout of the track and trace system to all sectors to improve compliance.
Simplify the tax structure	i) Reform the personal income tax system to reduce complexity by aligning schemes for salaried and non-salaried workers. ii) Reform personal income tax schedules to increase equity by eliminating privileged treatment of specific income sources and by harmonizing rate structures across taxable income sources.
Increase taxes on socially harmful goods	Increase taxes on socially harmful goods, including increased taxation of tobacco, other unhealthy products, and environmentally damaging goods.
Eliminate withholding charges to protect the poor	Eliminate personal income tax "withholding" charges on consumption of energy products, telecommunications, financial services, and others to reduce the total tax burden among poor and vulnerable households.

9. Energy Reform

Improve system efficiency and sustainability.

Reform	Description
Improve performance and efficiency of the sector	i) Privatize or otherwise introduce private participation in electricity distribution companies to improve performance and reduce financial and technical losses. ii) Initiate private sector participation in the transmission grid enhancement/strengthening critical for integration of RE (note:

	approval by NEPRA of the Transmission System Expansion Plan (TSEP) and updated IGCEP are the first step).
Tariff reforms	Continue electricity and gas sector tariff reform to align tariffs with the cost of supply to constrain mounting gas and electricity sector circular debt. Protect the poor through enhanced social protection.
10. Federal-Provincial Fiscal Management Move towards a coherent national fiscal policy, align spending with constitutional mandates, and mobilize under-utilized provincial revenue sources.	
Reform	Description
Align spending with constitutional mandates	Implement the new Fiscal Responsibility and Debt Limitation Acts at the federal and provincial levels, including through development and implementation of a national medium-term fiscal framework through the FY25 budget process.
Reduce federal government spending on devolved areas	Develop, publicize, and take decisive measures to implement a plan to reduce federal government spending on provincial mandates, including federal ministry, project, and vertical program funding on provincial mandates.
Progress GST harmonization	Work with provinces to progress GST harmonization, including through roll-out of the GST portal, move towards rate harmonization to facilitate tax compliance and the provision of input tax credits; to reduce administrative complexity, consider consolidation of all GST collection responsibilities with a single agency which could then distribute revenues in accordance with constitutional provisions.
Mobilize revenues from under-utilized sources	i) For Urban Immovable Property Tax (UIPT): apply harmonized valuation tables (currently rental-value based) to be updated annually based on observed variables such as inflation, insurance valuation, sales records; equalize rates between owner occupiers and rentals; harmonize and reduce exemptions such as area-based exemptions or owner occupier exemptions or for non-residents; unify federal deemed income tax and UIPT. ii) For Agricultural Income Tax: make consistent the definition of land area and reconsider exemptions based on the size of land holdings; set common minimum rates based on crop acreage or production estimates; incorporate irrigation and/or constructed buildings to differentiate per hectare minimum rates. iii) For capital gains tax: unify treatment of builders, property developers, REITs and others; simplify the types of taxes related to capital gains and transfers (CGT, CVT, stamp duty, withholding); remove years-held based differential rates and simplify the rate structure.

4. Fiscal Impact of Federal State-Owned Enterprises[43]

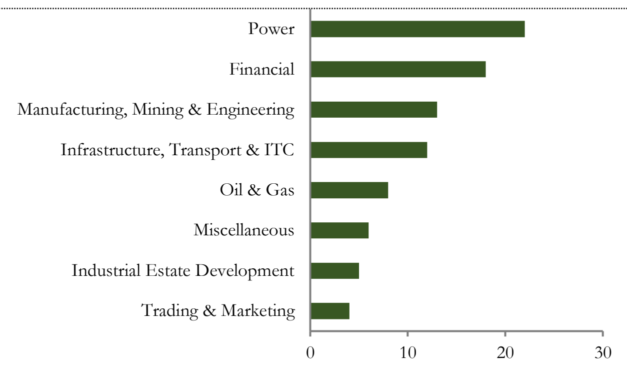
a. Introduction

Pakistan has a significant number of commercial SOEs at the federal level operating in key sectors of the economy. The SOE portfolio has been consistently making losses since 2016. The Federal Government provides significant financial support to SOEs through subsidies, grants, loans, and guarantees, leading to growing fiscal costs and risks. Urgent action is necessary to mitigate the fiscal pressures. The Government has implemented some reforms to improve the financial discipline of SOEs and strengthen ownership and oversight function. These reforms include a triage exercise that was conducted in 2021 to identify the SOEs that should be privatized, restructured, or retained by the Government. The implementation of this SOE Triage 2021 including selected privatization or concessioning of SOEs is critical to limit the fiscal drain. In addition, the Cabinet Committee on SOEs, Ministry of Finance, sector ministries, and SOE boards should ensure the full implementation of the SOE Act and Policy to all federal SOEs (including those covered under Sovereign Wealth Fund, 2023) to improve SOE efficiency, governance, and transparency. The Government should move to eliminate the practice of covering SOE operating losses with transfers from the federal budget and implement measures to manage fiscal risks associated with explicit and implicit obligations, such as holding SOEs accountable for performance and responsible for fiscal risks arising from their operations.

SOEs operating in commercial sectors account for a large proportion of the assets, revenues, and losses across the overall federal SOE portfolio

SOEs play a large role in Pakistan's economy. As of FY22[44], the Federal Government's SOE portfolio comprised a total of 206 firms, including 88 commercial entities. (Figure 4.1).[45] These commercial SOEs span a variety of sectors, including energy, finance, manufacturing, infrastructure and transport, and trade. Ten of these enterprises are publicly traded on the Pakistan Stock Exchange, adhering to all the listing regulations. In addition, the non-commercial SOE portfolio in FY22 was made up of 45 entities. In FY22, commercial SOEs accounted for 99 percent of the total SOE portfolio in terms of asset and revenue base. Commercial SOEs are responsible for all the SOE portfolio's net losses. Non-commercial SOEs are largely financially self-sustaining entities and are established to implement government policy roles that the private sector is unable to undertake.[46]

Figure 4.1: Federal Commercial SOEs by Sector, FY22



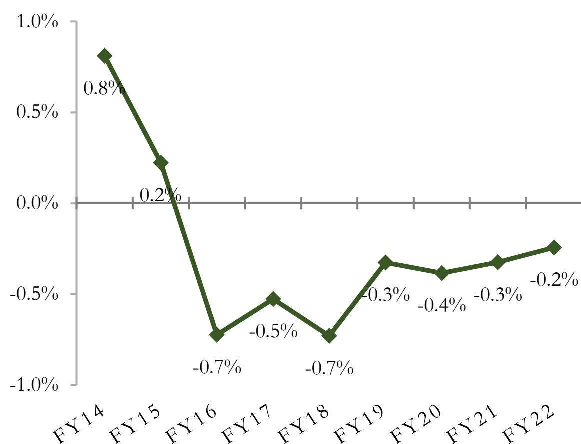
Source: Ministry of Finance.

While federal commercial SOE losses have been declining over time, they remain unprofitable overall

Since FY16, federal commercial SOEs in Pakistan have been persistently making losses. Aggregate net losses decreased from 0.3 percent of GDP in FY21 to 0.2 percent of GDP in FY22 due to increasing revenues (11.6 percent of GDP in FY21 to 15.4 percent of GDP in FY22). At the same time, the aggregate profitability of these SOEs has deteriorated since FY14, when the aggregate profit was 0.8 percent of GDP, to a loss of 0.2 percent of GDP in FY22 (Figure 4.2).

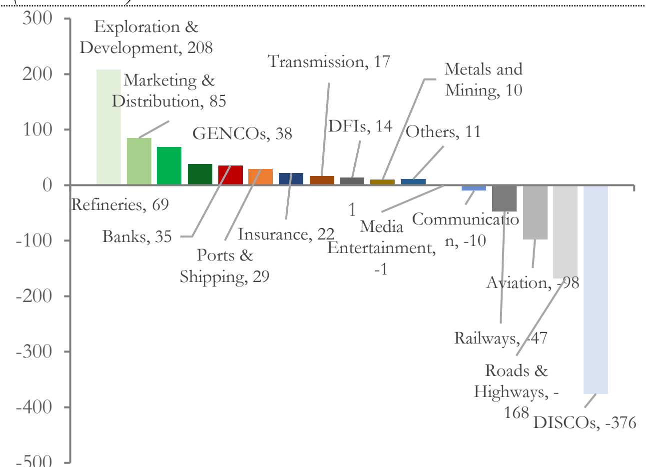
[43] The analysis and recommendations of this section are mostly related to federal commercial state-owned enterprises.
[44] Latest year for which financial information is available.
[45] Ministry of Finance (2023b) *Federal Footprint: State Owned Enterprises Annual Report 2020-22: Volume I – Commercial SOEs*. The Annual Report of FY18–19 report mentioned total of 73 subsidiaries of commercial SOEs. However, no aggregate subsidiary count is mentioned in the FY20–22 report.
[46] Ministry of Finance (2021) *State-Owned Enterprises Triage: Reforms and Way Forward*.

Figure 4.2: Federal Commercial SOEs – Net Profit
(% of GDP)



Source: Ministry of Finance.

Figure 4.3: Federal Commercial SOEs – Net Profit/Loss by Sub-Sectors in FY22
(PKR billion)



Source: Ministry of Finance.

Profitability varies by sector

The power sector is the largest loss-making sector for federal commercial SOEs, followed by the infrastructure, transport, and communication sectors. The oil and gas sector accounts for the largest share of profit (Figure 4.3).

In FY22, the combined losses of the power and infrastructure, transport and communication sectors were 0.9 percent of GDP

SOE losses were concentrated in the power and the infrastructure, transport, and communication (ITC) sectors. Losses in power sector DISCOs increased from 0.2 percent of GDP in FY21 to 0.5 percent of GDP in FY22, largely due to electricity theft, transmission and distribution losses due to old infrastructure, and lags in revising regulated consumer tariffs. Efforts to adjust the tariffs more frequently in FY23–24 have helped limit energy sector losses. After the power sector, the ITC sector accounted for the second largest proportion of losses, totaling 0.4 percent of GDP in FY22. Pakistan Railways reported a loss of 0.1 percent of GDP, fully covered by an equal amount of grant from the Government. Pakistan International Airlines Corporation Limited (PIACL) doubled its revenue in FY22, yet the net losses increased due to high debt finance costs. In the transport sector, the National Highway Authority (NHA) faced high public service obligation (PSO) costs as the Government sought to improve transportation and access to remote areas.

Oil and gas SOEs account for a large share of SOE profits

The oil and gas sector accounts for a large share of federal commercial SOE profit. The sector showed remarkable performance and profitability, contributing the highest net profit among SOEs at 0.5 percent of GDP, with profits and assets increasing in FY22 (Table 4.1). Despite overall profitability, the sector struggles with working capital challenges due to high unpaid bills from customers—often from government agencies—impacting cashflow and ability to pay debts and leading to circular debt accumulation.

Table 4.1: Oil and Gas SOE Performance

Sub-Sector	Net Profit (% of GDP)		Assets (% of GDP)	
	FY21	FY22	FY21	FY22
Exploration & Development	0.33	0.31	3.45	3.56
Refineries	0.01	0.10	0.31	0.42
Marketing & Distribution	0.08	0.13	3.46	4.45
Total Oil and Gas Sector	**0.42**	**0.54**	**7.22**	**8.43**

Source: CMU (2023) Federal Footprint: SOE Consolidated Report.

b. Fiscal Cost

Government support to SOEs was equal to 18 percent of the federal budget deficit

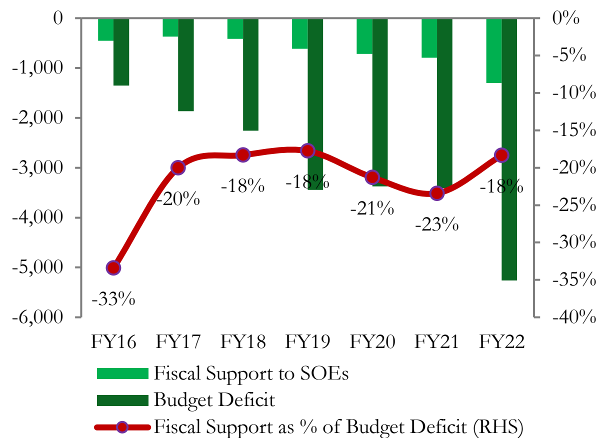
SOE losses have been imposing increasing fiscal costs on the Federal Government. In FY22, direct government support to SOEs in the form of subsidies, loans, and equity investments accounted for 18 percent of the federal budget deficit (Figure 4.4) and 2 percent of GDP, which is more than the total expenditure on health at 1.4 percent of

and 2 percent of GDP in FY22

GDP[47] (Figure 4.5). Such direct support was provided to SOEs for various reasons, such as providing price support, bailouts from creditors, divestments, subsidized service, or undertaking new development projects. Subsidies are typically for current activities, including specific public service obligations. Grants and loans are typically for operational support and capital investment.[48]

Figure 4.4: Fiscal Support to SOEs vs Fiscal Deficit

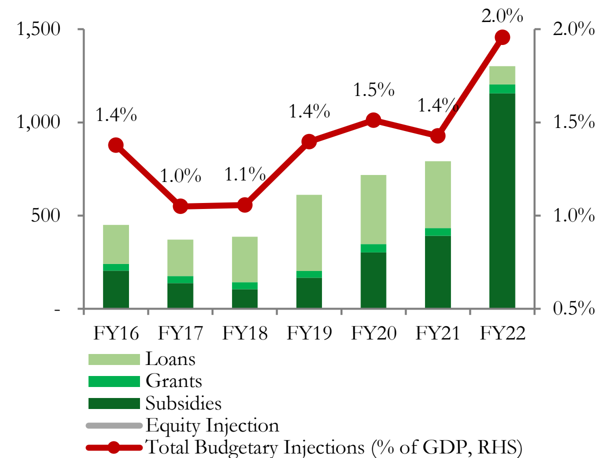
(PKR billion, % of budget deficit)



Source: Ministry of Finance.

Figure 4.5: Direct Fiscal Support to SOEs

(PKR billion, % of GDP)



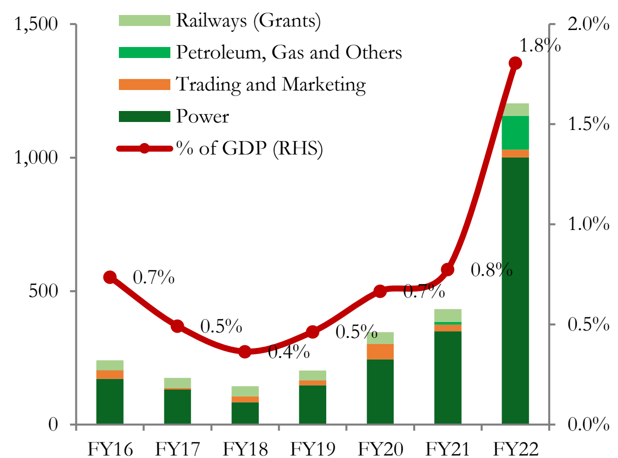
Source: Ministry of Finance.

Federal commercial SOE support exceeds taxes and dividends paid to the treasury

Direct support to federal commercial SOEs exceed their financial contributions. Fiscal inflows to the Federal Government from SOE taxes and dividends were 0.6 percent of GDP in FY22, significantly lower than government transfers to the SOEs, which were 2 percent of GDP in FY22 (Table 4.2).[49] In FY22, the net fiscal gap between the government financial support and financial return from SOEs has further widened despite an increase in corporate tax flows from federal commercial SOEs. Financial support from the Federal Government to SOEs is mainly in the form of subsidies and grants (1.8 percent of GDP in FY22), especially to power and petroleum marketing companies to cover persistent gaps between tariffs and supply costs (Figure 4.6).

Figure 4.6: Subsidies and Grants to Federal Commercial SOEs by Sector

(PKR billion, % of GDP)



Source: Ministry of Finance.

[47] Pakistan Healthcare Expenditure was 1.4 percent of GDP in FY22, much lower than what is spent to support Federal Commercial SOEs.
[48] The Government can decide to allocate additional subsidies to the SOEs during the fiscal year, with post-facto approval through the cabinet. In contrast, grants and loans are approved annually.
[49] The flow of foreign relent loans for FY22 was not available at the time of assessment, hence the actual annual transfers from the Government to the SOEs in FY22 was more than 2 percent of GDP.

Table 4.2: Transactions between the Government and Federal Commercial SOEs
(PKR billion)

	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Fiscal Outflows							
Subsidies	204	138	105	166	302	392	1,156
Grants	37	37	38.5	37	45	40	47
Equity Injection	1	2	27	-	-	5	2.2
Domestic Loans	168	205	204	103	133	165	98
Foreign Re-lent Loans	41	-9	39	306	239	195	Not available
Total Outflows	451	373	414	612	719	797	1,303
Total Outflows (% of GDP)	1.4	1	1.1	1.4	1.5	1.4	2.0
Fiscal Inflows							
Dividend Payments	63	70	57	60	41	44	44
Corporate Tax – Aggregate	77	108	127	154	135	157	376
Interest on Domestic Loans	Not available	Not available	Not available	Not available	23	16	Not available
Interest on Foreign Re-lent Loans	Not available	Not available	Not available	Not available	22	10	Not available
Total Inflows	140	178	184	214	221	227	421
Total Inflows (% of GDP)	0.4	0.5	0.5	0.5	0.5	0.4	0.6
Net Impact (% of GDP)	-0.9	-0.6	-0.6	-0.9	-1.0	-1.0	-1.4

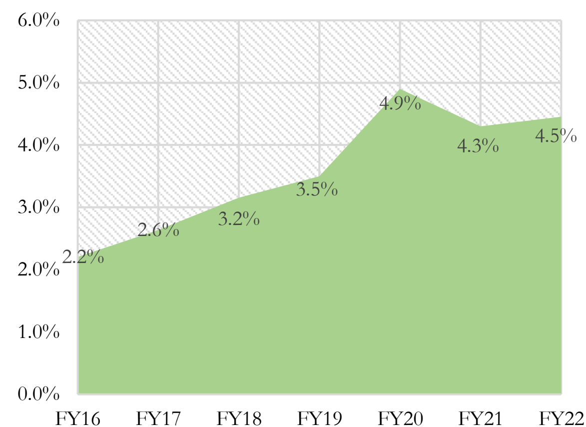
Source: Ministry of Finance.

c. Fiscal Risk

Fiscal risks emanating from federal commercial SOEs include non-payment of debt and contingent liabilities, which doubled between FY16 and FY22

Fiscal risks refer to potential government losses; those emanating from federal SOEs include non-payment of domestic and/or foreign debt and realization of contingent liabilities,[50] such as guarantees. Government guarantees are aimed at supporting SOEs borrowing, usually on favorable terms, from commercial banks. In addition, government guarantees can be preconditions for concessional loan approvals for SOEs from bilateral or multilateral agencies. The stock of outstanding guarantees from the Government to federal commercial SOEs has increased from 2.2 percent of GDP in FY16 to 4.5 percent of GDP in FY22 (Figure 4.7).[51] Annual issuance of total new government guarantees[52] has been averaging 0.9 percent of GDP over the FY16–22 period but remains below the ceiling of 2 percent of GDP stipulated by the

Figure 4.7: Outstanding Guarantees to SOEs (excl. commodity operations)
(% of GDP)



Source: Ministry of Finance.

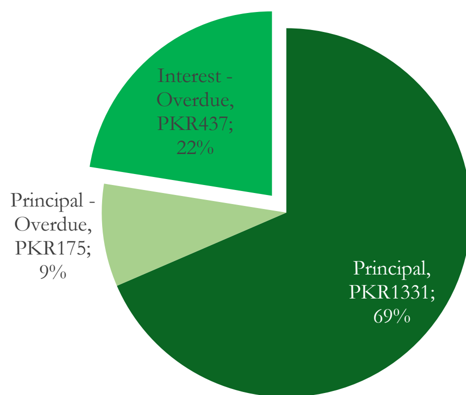
[50] Obligations triggered by an uncertain event include both explicit liabilities—those defined by law or contract, e.g., debt guarantees—and implicit liabilities— moral or expected obligations for the Government, based on public expectations or pressures, e.g., bailouts or unfunded pension liabilities.
[51] For example, the PIACL, a major beneficiary of government guarantees, has outstanding guarantees of PKR 268 billion (0.4 percent of GDP) in FY22. The guarantees were provided primarily for bailout support, as the PIACL has been borrowing from commercial banks to finance its negative operating margins.
[52] Any rollover of existing guarantees will count as a new guarantee.

Fiscal Responsibility and Debt Limitation Act 2005 (FRDLA).[53] Over 75 percent of the stock of guarantees is against the power sector for financing the circular debt.

SOEs have poor repayment track records

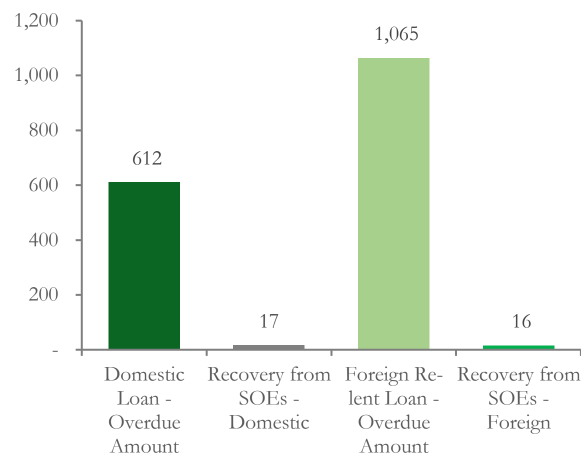
Out of the stock of outstanding domestic loans to federal commercial SOEs in FY21, overdue principal and interest payments accounted for nearly one-third (Figure 4.8). In the same year, SOEs only paid PKR 17 billion, equivalent to 2.8 percent of the total overdue domestic loan amount of PKR 612 billion. Similarly, SOEs only repaid PKR 16 billion, or 1.5 percent of the stock of overdue foreign re-lent loans (Figure 4.9). Despite being overdue on loan obligations, SOEs continue to receive guarantees from the Federal Government. Many SOEs are the beneficiaries of government guarantees but do not have a financially viable means to repay the guaranteed loans.

Figure 4.8: Domestic Loans, Outstanding Amount as of FY21
(PKR billion, % share)



Source: Details of CDLs, Ministry of Finance.

Figure 4.9: Loan Recovery from SOEs in FY21
(PKR billion)



Source: Details of CDLs, Ministry of Finance; foreign loan details, Economic Affairs Division.

The NHA has benefitted from large government loans but has limited capacity to meet repayment obligations

The National Highway Authority (NHA) of Pakistan is fully financed by the Government through Cash Development Loans (CDLs).[54] Loans have been provided for projects that do not demonstrate economic viability, such as in remote, underdeveloped areas. Lending for loss-making projects has contributed to high levels of debt (4 percent of GDP in FY22) and high debt servicing costs. Without sufficient revenues, the NHA repays its loan through mandatory deduction from its budgetary project allocation, which results in financing shortfalls, project delays, and cost overruns.[55] As part of the NHA reform plan, the Executive Committee of National Economic Council has suspended NHA's CDL interest payments on the condition of financial restructuring and a shift towards corporatization.

d. Government Response to Fiscal Challenges

The Government is seeking to improve the performance and governance of the federal SOE portfolio

A triage exercise to review the functions and financial performance of individual SOEs was undertaken by the Ministry of Finance in 2020–21 to identify the SOEs that should be privatized, restructured, or retained by the Federal Government.[56] The 14 top loss-making federal commercial SOEs, which accrue a large share of the fiscal costs to the Federal Government, were recommended to be either privatized or retained and restructured. These SOEs include the 10 electricity DISCOs (which together incur an annual fiscal cost of 0.5 percent of GDP), PIACL, Pakistan Steel Mills (PSM), and

[53] In addition, the FRDLA Amendment Act of 2022 mandates that the stock of outstanding government guarantees be capped at 10 percent of GDP. The Act also mentions that guarantees will be rated at risk-weighted values for the purpose of measuring the utilization of the limit. However, the risk-weighted method has not been clarified in the Act.
[54] CDLs are concessional loans with long tenures.
[55] Cost overrun results from delays in project implementation.
[56] Ministry of Finance (2021) *State-Owned Enterprises Triage: Reforms and Way Forward*.

Pakistan Railways. The PIACL frequently receives government bailout support. The PSM closed its operations in 2015 but has yet to shut down and causes a fiscal drain in the form of grants and loans (Box 4.1). The losses of the Pakistan Railways are covered by annual government grants. Lastly, the Power Holding Private Limited (PHPL), though classified to be retained without restructuring, incurs high fiscal cost and is exposed to fiscal risk. The PHPL has not borrowed since 2021; however, it continues to benefit from substantial guarantees.

Box 4.1: Pakistan Steel Mills—Defunct but Incurring Significant Carrying Costs

The PSM commenced operations in 1985. Since FY08–09, the PSM has consistently faced financial challenges, accruing an average loss of 0.03 percent of GDP on an annual basis. The Government has been providing funds for the net salaries of PSM employees since 2013. Since June 2015 when operations were shut down, the company has been incurring fixed costs such as depreciation, utilities, plant maintenance costs, and staff salaries. Accumulated losses amounted to 0.3 percent of GDP in June 2023, equivalent to PKR 224 billion. Aiming to reduce the operational costs, the Government laid off 5,679 employees, reducing the work force to approximately 3,100 and cutting monthly wage expenses from PKR 360 million to approximately PKR 104 million. The fiscal cost to the Government, which has been subsidizing the PSM through CDLs is on average 0.03 percent of GDP.[57] The Government's total fiscal exposure due to outstanding loans and sovereign guarantees is 0.23 percent of GDP.[58] The PSM has also not been current on its payments on the loans. Additionally, the Government may be subject to certain additional obligations, such as unfunded pension liabilities. Multiple privatization attempts have failed in the past, with the most recent auction in 2023 being canceled due to a lack of qualified buyers, as reported by the Privatization Commission.[59] On October 30, 2023, the care-taker federal Cabinet, following a decision taken by the Special Investment Facilitation Council, approved a proposal to delist the PSM from active privatization. Consequently, the Privatization Commission transferred the PSM to the Ministry of Industries and Production to consider other viable options for the PSM in consultation with relevant stakeholders.[60] Whatever option is eventually pursued, urgent action to stem continued losses is recommended.

Source: PSM FY23 Annual Audited Financial Statements.

Potential annual fiscal savings from reforming the top 14 loss-making SOEs are estimated at 0.8 percent of GDP

The Government is taking steps to expedite decision-making to improve performance of the loss-making SOEs and has formed the Cabinet Committee on SOEs to drive the reform agenda. Nevertheless, concrete outcomes for the implementation of the SOE Triage have yet to materialize. The delays in enacting these and other reforms resulted in the Federal Government bearing a fiscal cost of 0.8 percent of GDP in FY22 (Table 4.3).

Table 4.3: FY22 Fiscal Impact of SOEs Identified for Reform in Triage Report

SOE		Annual Fiscal Cost		Fiscal Exposure***		Triage Outcome Updated based on Ongoing Reforms
		Grants/ Subsidies	Loans Disbursed**	Outstanding Loans	Outstanding Guarantees	
Electricity DISCOs[61]	PKR billion	337*	-	69.4[62]	-	Triage Report suggests privatization in the medium term. To improve immediate performance, introduce private sector participation (PSP) through concessioning and preparing bankable opportunities to attract credible bidders. Successful PSP would most importantly require cost reflective tariffs.
	% of GDP	0.51	-	0.10	-	

[57] During FY23, the Government granted loans of PKR 2.1 billion (2022: PKR 8 billion) that were released for the payments of net salaries, retirement benefit, provident fund, gratuity, and leave encashment of employees of the PSM, and for gas charges.
[58] In FY23, the total outstanding loan and interest payable to the Government stood at PKR 157 billion, which includes overdue principal of PKR 39 billion and accrued interest of PKR 54 billion. The PSM has defaulted on commercial loans secured by government guarantees amounting to PKR 38.1 billion.
[59] Naeem (November 26, 2023) "Is Pakistan Steel Mills Stuck in a Time-Loop or are we Going Crazy?"
[60] Cabinet decision of Case No. 174/21/2023 dated October 30, 2023, as referred in PSM Audited Financial Statements, FY23.
[61] Electricity DISCOs include the following 10 SOEs: Islamabad Electric Supply Company (IESCO), Lahore Electric Supply Company (LESCO), Faisalabad Electric Supply Company (FESCO), Gujranwala Electric Power Company (GEPCO), Multan Electric Power Company (MEPCO), Peshawar Electric Supply Company (PESCO), Tribal Electric Supply Company (TESCO), Sukkur Electric Power Company (SEPCO), Hyderabad Electric Supply Company (HESCO), and Quetta Electric Supply Company (QESCO).
[62] Outstanding loan for DISCOs is as of June 30, 2021. Consolidated information for DISCO loan stock is not available.

Pakistan International Airlines Corporation	PKR billion	-	22	109	268	Initially planned to retain and restructure in Triage Report; however, the Government revisited its plan and now pursuing privatization.
	% of GDP	**-**	**0.03**	**0.16**	**0.4**	
Pakistan Steel Mills Corporation (Private) Limited	PKR billion	-	8	145	-	Immediate privatization.
	% of GDP	-	**0.01**	**0.22**	-	
Pakistan Railways	PKR billion	47	-		-	Retain and restructure.[63]
	% of GDP	**0.1**	-		**-**	
Power Holding Private Limited	PKR billion	132	-	-	800	Retain. The Government has agreed to absorb the existing debt into public debt and clears portion of it every year (as certain debt mature). In addition, the IMF has imposed increasing the surcharge for power consumers to clear the markup under PHPL loans.
	% of GDP	**0.20**	**-**	**-**	**1.2**	
Total for 14 SOEs	PKR billion	**546**		**1,391**		
	% of GDP	**0.8**		**2.1**		

Source: Details of CDLs, Ministry of Finance; foreign loan details, Economic Affairs Division; outstanding guarantees data from the Public Debt Bulletin of FY22, Debt Wing, Ministry of Finance.
Note: *Includes tariff differential subsidies from budget document. **Includes domestic loans only. ***Exposure includes domestic and foreign re-lent loans.

The new SOE Act and Policy seeks to improve financial discipline, strengthen governance, and enhance institutional oversight

The Government has taken some foundational reforms to develop a legal framework to improve SOE financial discipline, strengthen governance, and enhance institutional oversight. This includes introducing the State-Owned Enterprises (Governance and Operations) Act 2023[64] and operationalizing it through the SOE Ownership and Management Policy, 2023.[65] The Government has amended dedicated SOE laws for some SOE—NHA, Pakistan Post Office, Pakistan National Shipping Corporation and Pakistan Broadcasting Corporation[66]—to fully align them with the key fiscal and corporate governance reforms introduced in the new SOE Act.

The SOE Act provides strategic direction to improve performance, financial discipline, and profitability

One of the key objectives of the SOE Act and Policy is to effectively manage SOE fiscal support by introducing measures to improve financial discipline and profitability. The Act requires SOEs to prepare a three-year business plan to strategize their operations and develop financial and non-financial performance measures showing how they will achieve their policy objectives. Such business plans require SOEs to adequately plan for both commercial and non-commercial activities. Non-commercial activities undertaken by SOEs at the direction of the Government must be fully and transparently financed through PSO subsidies. Business plans are approved by SOE boards, which will be held accountable for results.

The Public Service Obligation (PSO) framework requires PSOs to be identified and costed, mitigating a key channel of inefficiencies among SOEs

Several key SOEs, including the NHA, DISCOs, oil and gas marketing firms, and Utility Stores Corporation, face major costs in delivering PSOs (Table 4.4). In instances where SOEs are not paid on a timely basis for undertaking PSOs, cash deficits and arrears are generated. The Federal Government is then required to pay off SOE debt or issue sovereign guarantees to SOEs to borrow from commercial banks—a commonly observed practice in the power sector.[67] To rectify this, the SOE Act requires all PSOs to be identified, costed, and contracted through a performance-based contract. The framework determines that PSOs can only be undertaken if agreed to by the SOE board and if they are consistent with the SOE's commercial mandate. The PSO framework will help to

[63] Pakistan Railways should be restructured into a commercially oriented entity. To enhance financial viability, there is a need to develop private sector participation models for railways in track access and warehousing to attract credible private investment.
[64] Government of Pakistan. 2023b. The State-Owned Enterprises (Governance and Operations) Act, 2023.
[65] Ministry of Finance. 2023e. *State-Owned Enterprises (SOEs): Ownership and Management Policy, 2023*.
[66] The NHA, PPO, and Pakistan Broadcasting are loss-making SOEs and the PNSC is identified for reforms and to be privatized in the medium term.
[67] Guarantee exposure of the power sector is 3.375 percent of GDP. However, no breakdown is available to determine public service obligation share.

rationalize and improve the transparency of government subsidies, equal to approximately 2.4 percent of GDP in FY22 (Table 4.4).

Table 4.4: Annual Public Service Obligation Expenditure

(PKR million)

Subsidies	FY21	FY22
Power Sector		
Independent power producers - settlement	-	434,000
PHPL	-	130,000
Tariff differential subsidy	191,830	184,000
Others - Prime Minister package, Merged Areas	158,520	153,000
Coal power plants	-	100,000
Petroleum Sector		
Liquefied natural gas subsidy to industry	10,000	81,000
Pakistan State Oil, Asia Petroleum Limited, and others	2,000	10,000
Domestic gas consumers	-	36,000
Pakistan Agriculture Storage and Services Co.	7,000	7,000
Utility Stores Corporation	8,000	21,000
Total to SOEs	**377,350**	**1,156,000**
Other Subsidies		
Petroleum subsidy (fixation of petrol price) given to oil marketing companies	-	250,000
K-Electric	16,000	83,000
Other heads	36,650	37,900
Flood related	-	-
NHA (annual fiscal loan flow)	100,575	61,466
Total PSO, including Private Sector Utility and NHA (CDLs)	**530,575**	**1,588,366**
Subsidies as percentage to GDP	1%	2.4%

Source: Government of Pakistan Annual Budget Statements FY22–23.

Box 4.2: Pakistan Sovereign Wealth Fund and its Effect on Federal Commercial SOEs Portfolio

In August 2023, the Federal Government set up a Sovereign Wealth Fund (SWF) to support long-term economic growth. It aims to manage assets of large profit-making SOEs by using the best global practices to ensure such assets grow and benefit the people over the medium to long term.[68] There are seven entities that have been transferred to the SWF under SWF Act, 2023, all of which are profit-making SOEs or the subsidiaries of SOEs: Oil and Gas Development Company Limited (OGDCL), Pakistan Petroleum Limited (PPL), National Bank of Pakistan (NBP), Pakistan Development Fund, Government Holdings Private Limited, Mari Petroleum Company Limited, and Neelum Jhelum Hydro Power Company Limited.

The formation of the SWF, valued at about US$8 billion, creates governance and public financial management challenges because the SOEs transferred to the SWF are exempted from the SOE Act's best corporate governance practices. Dividends from OGDCL, PPL, NBP, and Government Holding Private Limited have been significant, at around 0.05 percent of GDP.[69] A clearly defined dividend policy for SWF is critical. Further, the transfer of these four SOEs may significantly change the outlook of the SOE portfolio. In FY22, these four SOEs accounted for 42 percent of total profits and 12 percent of total assets in the portfolio.[70]

The SOEs within the SWF should be classified as commercial SOEs and be governed by the SOE Act and Policy. Alternatively, if the Government owns and controls the SWF, the SWF itself could be designated as a commercial SOE to ensure appropriate oversight and alignment with best corporate governance practices. The Government should ensure adequate governance arrangements are introduced for the newly created SWF to safeguard assets and stakeholders' interest. The Government should plan an annual evaluation of the SWF against its mandate. Further, the Government should consider the SWF for membership in the International Forum of Sovereign Wealth Funds (IFSWF) and adopt to IFSWF's performance and reporting standards.

[68] Government of Pakistan (2023) Sovereign Wealth Fund Act, 2023.
[69] The calculation is based on dividends paid by these companies in FY22.
[70] CMU (December 2023) *Federal Footprint: State Owned Enterprises (SOEs) Consolidated Report FY2020–22*.

e. Recommendation

The 2021 SOE Triage should be implemented, including privatizations implementation is critical to reduce fiscal costs and risks

To limit fiscal costs to the Government stemming from federal commercial SOE losses, the implementation of the SOE Triage 2021 is critical and should be expedited, including privatizations. Key steps for its implementation include budgeting for restructuring and transaction advisory costs, developing a performance improvement roadmap for SOEs to be retained, resizing and improving the SOE portfolio by closing insolvent SOEs and restructuring inefficient but economically viable SOEs, while assessing the potential for divestment, where possible. For SOEs identified for privatization, such as PIACL[71] and PSM, financial viability could be improved through debt-to-equity swaps, converting overdue government loans into equity, and revaluation of investment property.

The Ministry of Finance and sector ministries should fully implement the SOE Act and Policy to reduce the state's presence and allow private sector participation

The Ministry of Finance, sector ministries, and the SOE Board of Directors should ensure the full implementation of the SOE Act and Policy, which provide a legal framework for the reform process and allows for private sector participation. The transformation plan for non-strategic and non-essential SOEs by sector ministries[72] will reduce the Government's footprint and allow for different options to transform these SOEs, including but not limited to corporate restructuring, management contracts, joint ventures, public–private partnerships, and listing on stock exchange. For essential SOEs,[73] including the DISCOs, transformation options such as outsourcing, concession models, and management transfers should be explored. These measures will reduce the fiscal burden of SOEs on the public exchequer. Further, SOEs under SWF should remain under the purview of SOE Act to improve financial transparency and corporate governance practices.

The NHA requires immediate financial management reforms and corporatization

The NHA has the largest fiscal impact among commercial SOEs, with a loan stock equal to 4 percent of GDP and an asset base amounting to 9 percent of GDP. It was excluded from the triage exercise due to its unique financing model and the extensive level of services it undertakes on a socioeconomic basis. However, the NHA requires significant financial restructuring. It has a capacity to finance its viable projects from the capital market and to seek credit ratings. Upon becoming a corporate entity, the NHA will have the opportunity to pursue various funding avenues, including self-financing, capital market loans, and public–private partnerships, without sole reliance on government loans or guarantees. Until the transition to corporatization is complete, the NHA should receive funding through PSDP grants for socioeconomic projects. Additionally, the NHA should implement sound financial management practices as mandated through amendments in the NHA Act of 2023, which requires the development of a business plan for commercial activities and costing of public service obligations for socioeconomic activities.

The MoF Central Monitoring Unit should be strengthened for effective SOE oversight

The SOE Act, 2023 requires the establishment of Central Monitoring Unit (CMU) within MoF to strengthen SOE ownership and oversight functions. The CMU was established in September 2022 and became operational in November 2023 with the hiring of a dedicated team. The Central Monitoring Unit (CMU) should access technical assistance to develop computerized mechanisms for generating timely aggregate reports on SOEs for more effective decision-making. The comprehensiveness of these reports should be improved to adhere to OECD guidelines. The reports should provide portfolio-level information and entity-level exposure and performance information. Further, the CMU should bi-annually provide status updates to the Government on SOE law and SOE policy implementation progress. In addition, the CMU should improve transparency regarding SOE debt, including both explicitly guaranteed debt and implicit obligations, and disclose this information in the fiscal risk statement of the Government.

To curb SOE losses, the Government

The Government should eliminate the longstanding practice of covering commercial SOE operating losses with transfers from the federal budget. This preferential treatment distorts

[71] As recently included in the privatization list in 2023.
[72] Clause 11 of the SOE Policy mandates that each sector ministry submit a categorization plan for the SOEs operating within its sector and develop a transformation plan for the non-strategic and non-essential SOEs identified through the process.
[73] Essential SOEs refer to the SOEs that are critical for the execution of government policies (see clause 9 of the SOE Policy).

should tighten financing reviews and strengthen loan agreement enforcement

managerial incentives and the market, particularly when these SOEs are competing with the private sector. With the Government's direct fiscal support to the 14 largest loss-making SOEs at 0.8 percent and support to all SOEs reaching 2 percent of GDP in FY22, the Government should subject all SOE financing requests to a more stringent review processes, including submission of independently audited financial statements and credible business plans to reduce losses, as required in the SOE Act. All boards of commercial SOEs should implement business plans that show a path to profitability and financial sustainability.

The Government should manage fiscal risks with new guarantee issuance rules, credit ratings, IFRS adherence, risk monitoring, and debt transparency

To contain fiscal exposure from SOE support, the Government should implement the following measures, consistent with the SOE Act and SOE Policy:

- Collateralize SOE assets for commercial loans to limit government exposure through guarantees.
- Mandate credit risk ratings for borrowing SOEs, which should be evaluated prior to the issuance of new loans by the Government. Similarly, new domestic or foreign loans should not be considered for SOEs that are not current on their payments for existing loans and debt service charges.
- Require all commercial SOEs to follow the International Financial Reporting Standards (IFRS) as outlined in the SOE Act. This will enhance comparability and transparency with adequately detailed financial and non-financial disclosures, such as sustainability and climate risk related disclosures. Any inconsistencies between the IFRS financial reporting framework and the special enactment Acts for specific SOEs should be addressed.
- Disclose and develop monitoring procedures for implicit obligations to the Government, such as non-guaranteed/unsecured loans, intra-SOE debts, and unfunded pension liabilities of SOE employees. For instance, DISCOs and Pakistan Railways have significant pension liabilities with inadequate pension funds.
- Improve the comprehensiveness of the Public Sector Financial Statement by incorporating into its balance sheet information regarding the state holdings in SOEs, as well as the Government's receivables from and payables to SOEs.

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Annex

Annex 2.1

The latest official poverty rates are available for FY19, which was the year of the previous HIES. Since then, Pakistan has undergone several major crises, including the global COVID-19 pandemic, devastating floods in 2022, and a macroeconomic crisis made more precarious by increased political uncertainty. It is expected that these shocks had a profound impact on household welfare and poverty rates in the country, but recent survey data is not available to quantify these. In this context, welfare levels for Pakistan can be estimated using a micro simulation tool that models the path of household welfare based on macroeconomic indicators. The underlying assumption for this approach is that macroeconomic indicators, such as sectoral GDP growth, inflation, and changes in the real value of private and public transfers, directly influence households' real labor and non-labor incomes, which in turn has a direct bearing on consumption levels and poverty.[74]

World Bank poverty projections come from a model that is based on the 2018–19 HIES data and projects each household's consumption over time by simulating the evolution of real labor and non-labor income. The resulting consumption distribution is then used to produce poverty projections for the years FY20 to FY26. More specifically, labor income is modeled using the real growth rates of 11 sectors of the economy in which members of each household work. That is, each household member's projected income is computed by applying the growth rate of the relevant sector to their income at baseline. Total labor income is then calculated as a sum of all household members' projected incomes, weighted by their total contribution to that income component. For non-labor income, remittances and private transfers are assumed to have constant purchasing power over time, whereas public transfers are modeled after BISP payouts, which have stayed constant in nominal terms until very recently. Lastly, household level monthly inflation rates are used to produce real consumption projections. Household level inflation rates are produced using published inflation numbers for each major consumption category, weighted by each household's category-wise budget shares.

Using the 2018–19 baseline, the model projects monthly household consumption. Poverty headcount is then computed using the global lower-middle-income poverty line (US$3.65/day 2017 PPP per capita). The projected poverty headcount rates are outlined in Table A2.1.

Table A2.2: Projected Poverty Headcount

(Percent)

	FY19 (baseline)	FY20	FY21	FY22	FY23	FY24 (nowcast)	FY25	FY26
Poverty headcount, percent	39.8	42.8	39.5	35.5	39.9	40.1	40.0	39.7

[74] For more details, see Caruso et al. (2017) "But…What is the Poverty Rate Today?"; and Barriga-Cabanillas et al. (2024, forthcoming) "Poverty Projections for Pakistan."