

PAKISTAN DEVELOPMENT UPDATE

October 2021

REVIVING EXPORTS



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Reviving Exports

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Preface

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

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Lists of Abbreviations and Acronyms

ACD	Additional Customs Duties	MOF	Ministry of Finance
BPM6	Balance of Payments Manual 6	MOITT	Ministry of Information Technology and Telecommunication
CAD	Current Account Deficit		
CD	Customs Duties		
CPEC	China Pakistan Economic Corridor	MNFSR	Ministry of National Food Security and Research
CPI	Consumer Price Index		
CPFTA	The China-Pakistan Free Trade Agreement	MSCI	Morgan Stanley Capital International
CRR	Cash Reserve Requirement	NPL	Non-Performing Loans
DDT	Duty Drawback of Taxes	NTB	National Tariff Board
DLTL	Drawback of Local Taxes and Levies	NTP	National Tariff Policy
DSSI	Debt Service Suspension Initiative	PBS	Pakistan Bureau of Statistics
DTRE	Duty and Tax Remission for Exports	PDU	Pakistan Development Update
EFS	Financing Scheme for Exporters	PHPL	Power Holding Power Limited
EM	Emerging Market	PKR	Pakistani Rupee
FBR	Federal Board of Revenue	PPGD	Public and Publicly Guaranteed Debt
FDI	Foreign Direct Investment	PRI	Pakistan Remittance Initiative
FED	Federal Excise Duty	PSDP	Public Sector Development Program
FOB	Free-On-Board	PSEB	Pakistan Software Export Board
FM	Frontier Markets	PTA	Preferential Trade Agreement
FRDLA	Fiscal Responsibility and Debt Limitation Act	RD	Regulatory Duties
FTA	Free Trade Agreement	REER	Real Effective Exchange Rate
FY	Fiscal Year	SAFTA	The South Asia Free Trade Agreements
GDP	Gross Domestic Product	SBP	State Bank of Pakistan
GIDC	Gas Infrastructure Development Cess	SCRR	Special Cash Reserve Requirement
GST	General Sales Tax	SME	Small and Medium Enterprise
HEC	Higher Education Commission	SMEDA	Small and Medium Enterprises Development Authority
ICT	International Trade Center		
IEMP	The Index of Export Market Penetration	STG	Sales Tax on Goods
IMF-EFF	International Monetary Fund- Extended Fund Facility	TDAP	Trade Department Authority of Pakistan
LSM	Large Scale Manufacturing	TFP	Tariff on Firm-Level Productivity
LTFE	Long-Term Financing Facility	USD	United States Dollar
MOC	Ministry of Commerce	WBG	World Bank Group
		y-o-y	Year-on-Year

1. Executive Summary – Reviving Exports

Real GDP growth rebounded in FY21 with effective micro-lockdowns, strong remittance inflows and a supportive monetary policy

Due to low base effects and recovering domestic demand, Pakistan's real GDP growth (at factor cost) is estimated to have rebounded to 3.5 percent in FY21 from a contraction of 0.5 percent in FY20 (Table 1). With effective micro-lockdowns curbing the spread of the pandemic, record-high official remittance inflows, the expansion of the Government's cash transfer program, and an accommodative monetary policy, private consumption and investment are both estimated to have strengthened during FY21, driving the economic recovery. Government consumption is also estimated to have risen, but at a slower pace than in FY20, when the COVID-19 fiscal stimulus package was rolled out. In contrast, net exports are estimated to have contracted in FY21, as imports growth almost doubled that of exports due to strong domestic demand.

Both the industry and services sectors are estimated to have expanded with the easing of mobility restrictions

On the production side, supported by strong large-scale manufacturing, industrial activity is estimated to have bounced back after contracting for two consecutive years. Similarly, the services sector, which accounts for 60 percent of GDP, is estimated to have expanded, as generalized lockdown measures were increasingly lifted. In contrast, agriculture sector growth is expected to have slowed, partly due to an approximate decline of 30 percent in cotton production on account of adverse weather conditions.

Monetary policy remained accommodative throughout FY21

Despite slowing to 8.9 percent in FY21 from 10.7 percent in FY20, headline consumer price inflation remained elevated – mostly because of high food inflation, which is likely to disproportionately impact poorer households that spend a larger share of their income on food than on non-food items. With the policy rate being held at 7.0 percent throughout FY21, real interest rates were negative, supporting the recovery.

The current account deficit in FY21 was the narrowest in a decade, in part due to record-high remittance inflows

The current account deficit (CAD) narrowed from 1.7 percent of GDP in FY20 to 0.6 percent in FY21 as robust remittance inflows offset a wider trade deficit. Foreign direct investment decreased, while portfolio inflows increased with the issuance of USD2.5 billion Eurobonds. Overall, the balance of payments surplus was 1.9 percent of GDP in FY21. Gross official foreign exchange reserves rose to USD20.6 billion as of October 1, 2021, equivalent to 3.7 months of total imports. After gaining ground against the U.S. dollar in FY21, the Pakistani Rupee depreciated by 7.7 percent against the U.S. dollar in Q1 FY22 – partly due to pressures from the rising import bill.

The fiscal deficit improved due to strong revenue growth

In FY21, the fiscal deficit (excluding grants) narrowed to 7.3 percent of GDP from 8.1 percent in FY20, as revenue growth, underpinned by stronger domestic activity, outpaced higher expenditures. Public debt, including guaranteed debt, ticked down to 90.7 percent of GDP at end-June FY21 from 92.7 percent of GDP at end-June FY20.

The economic recovery is estimated to have reduced poverty

Bolstered by the recovery in the industry and services sectors and resultant off-farm employment opportunities, poverty incidence, measured at the international poverty line of USD1.90 PPP 2011 per day, is expected to have declined to 4.8 percent in FY21 from 5.3 percent in FY20. However, this change is not statistically significant, and downside risks arising from lockdown-induced disruptions to employment and high food inflation remain.

Table 1: Projections of Key Economic Indicators

	FY18	FY19	FY20	FY21	FY22	FY23
Real GDP growth, at constant factor prices	5.5	2.1	-0.5	3.5	3.4	4.0
Current Account Balance (% of GDP)	-6.1	-4.8	-1.7	-0.6	-1.9	-2.5
Fiscal Balance (% of GDP), excluding grants	-6.5	-9.0	-8.1	-7.3	-7.1	-7.2
Public Debt, including govt. guaranteed debt (% of GDP)	75.9	89.7	92.7	90.7	90.6	89.3

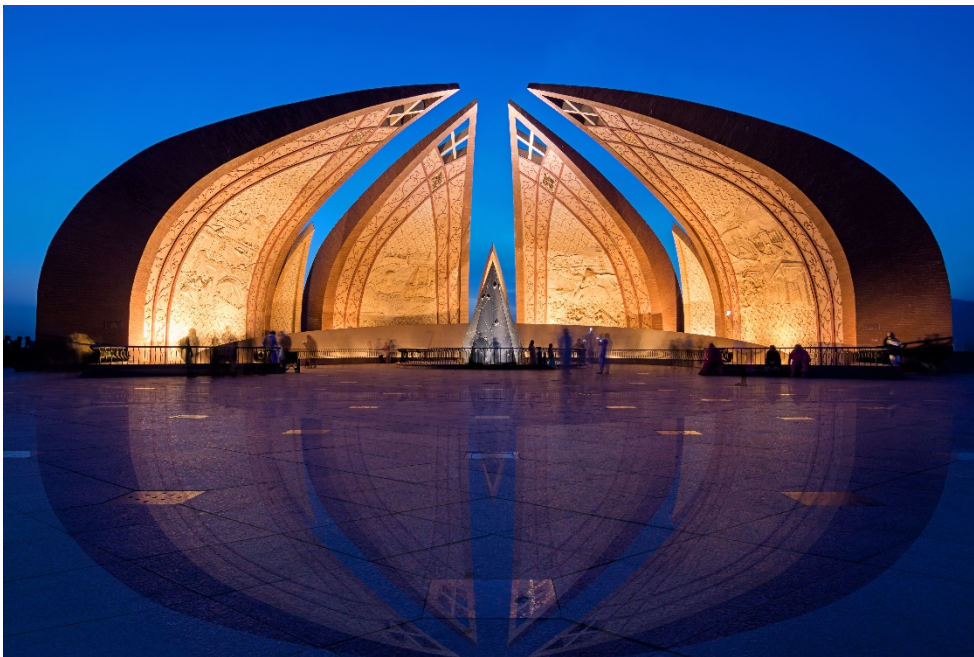
Sources: Data from the official sources, World Bank staff estimates.

Note:

This macroeconomic outlook was prepared by World Bank staff and differs from that of the Government. The Government's preliminary real GDP (at factor-cost) growth estimate for FY21 is 3.9 percent. See footnote 1.

GDP growth is projected to ease in FY22 as fiscal and monetary tightening resumes	In line with the 25-basis point policy rate hike in September 2021, fiscal and monetary tightening are expected to resume in FY22, as the Government refocuses on mitigating emerging external pressures and managing long-standing fiscal challenges. Output growth is therefore projected to ease to 3.4 percent in FY22 but strengthen thereafter to 4.0 percent in FY23 with the implementation of key structural reforms, particularly those aimed at sustaining macroeconomic stability, increasing competitiveness and improving financial viability of the energy sector. Poverty is expected to continue declining, reaching 4.0 percent by FY23.
Inflation is expected to edge up with higher global commodity prices	Inflation is projected to edge up in FY22 with the domestic electricity tariff hikes announced in October 2021, and higher oil and commodity prices before moderating in FY23.
The current account is projected to widen due to rising imports in line with higher global oil prices	The CAD is projected to widen to 2.5 percent of GDP in FY23 as imports expand with higher economic growth and oil prices. Exports are also expected to grow strongly after initially tapering in FY22, as tariff reform measures gain traction, supporting export competitiveness. In addition, the growth of official remittance inflows is expected to moderate after benefiting from a COVID-19-induced transition to formal channels in FY21.
The fiscal deficit is expected to marginally narrow in FY22, before widening in FY23	Despite fiscal consolidation efforts, the deficit (excluding grants) is projected to remain high at 7.1 percent of GDP in FY22 and widen to 7.2 percent in FY23 due to pre-election spending. Implementation of critical revenue-enhancing reforms, particularly the harmonization of the General Sales Tax, will support a narrowing of the fiscal deficit over time. Public debt will remain elevated in the medium-term, as will Pakistan's exposure to debt-related shocks. This outlook assumes that the IMF-EFF program will remain on-track.
Further delays to the IMF-EFF Program and more contagious COVID-19 strains pose severe downside risks	Major downside risks include delays in and the stalling of the IMF-EFF program and the consequent external financing difficulties; exceedingly high domestic demand leading to unsustainable external pressures; more contagious COVID-19 strains requiring widespread lockdowns; and worsening regional and domestic security conditions, including those stemming from the situation in Afghanistan. All of these could delay critical structural reforms.
Declining export competitiveness is a key factor behind Pakistan's persistent trade imbalance	Debates on appropriate policies to reduce the trade deficit have resurfaced with the recent increases in the trade gap. A key factor driving the trade imbalance is the declining export competitiveness. Indeed, the share of exports in GDP has been declining since the turn of the century, from 16 percent in 1999 to 10 percent in 2020. This falling export share has implications for foreign exchange, jobs, and productivity growth. At the firm-level, the decline is consistent with low entry rates into exporting, and exporters that struggle to expand over their life cycle. At the economy level, the lack of a sustained robust growth in exports has resulted in little diversification or sophistication gains for the export bundle.
The special section of this PDU will focus on ways to revive Pakistan's exports	While the causes of the falling export share are manifold, there are three key ones. First, the high effective import tariff rates and limited export market access tend to discourage exports. Second, the supporting services for exporters are inadequate, especially those for long-term financing of capacity expansions and market intelligence services to secure new export contracts. Third, the low productivity of Pakistani firms hinders them from successfully competing in global markets. The special section of this PDU examines these issues in detail and proposes a policy agenda for export revival based on Pakistan's context and on international best practices.

2. Recent Economic Developments



The Pakistan Monument

a. Context

Targeted lockdowns have been effective at containing the spread of infection, while allowing economic activity to continue

With the pandemic, the Government has been focused on managing the recurring waves of COVID-19 infections, implementing a mass vaccination campaign, expanding its cash transfer program, and providing accommodative monetary conditions to sustain economic growth. Grappling with the fourth wave of COVID-19, the Government, as before, implemented micro-lockdowns that successfully limited the spread of the infection, while permitting economic activity to continue and thereby mitigating the economic fallout. While vaccination rates have been increasing, they remain low. As of October 15, 2021, only around 15 percent of the total population has been fully vaccinated.

b. Real Sector

Growth

Real GDP growth is estimated to have rebounded in FY21

Due to low base effects and recovering domestic demand, real GDP growth (at factor cost) is estimated to have rebounded to 3.5 percent in FY21 from a contraction of 0.5 percent in FY20 (Figure 2.1).¹ Buttressed with record-high official remittance inflows and an accommodative monetary policy, private consumption and investment are both estimated to have strengthened during FY21, after registering contractions in FY20. Government consumption is also estimated to have risen, but at a slower pace than in FY20, when the COVID-19 fiscal stimulus package was rolled out. In contrast, net exports are estimated to have contracted in FY21, as imports growth almost doubled that of exports due to strong domestic demand.

A large decline in cotton production weighed on

The agriculture sector's growth is expected to have slowed to 2.2 percent in FY21 from 3.3 percent in FY20. Livestock, which constitutes around 60 percent of the sector, was the main contributor to sectoral growth in FY21. However, the slowdown in the sector's growth was partly due to a decline of approximately 30 percent in cotton production on

¹ World Bank estimate. The Government's preliminary real GDP (at factor-cost) growth estimate for FY21 is 3.9 percent. GDP growth estimates are inherently uncertain, and the level of uncertainty has increased significantly with COVID-19. Given the high level of uncertainty, the World Bank GDP estimate for FY21 and that of the Government's are not materially different. The regular publication of quarterly national accounts data will help improve the precision of such annual GDP growth estimates.

agriculture sector growth...

account of pest attacks and exceptionally heavy monsoon rains – this was lowest cotton production since FY85.² Other major crops largely recovered in FY21, with wheat, rice, and maize reaching historical levels of production, while sugarcane also posted its second-highest output on record.³

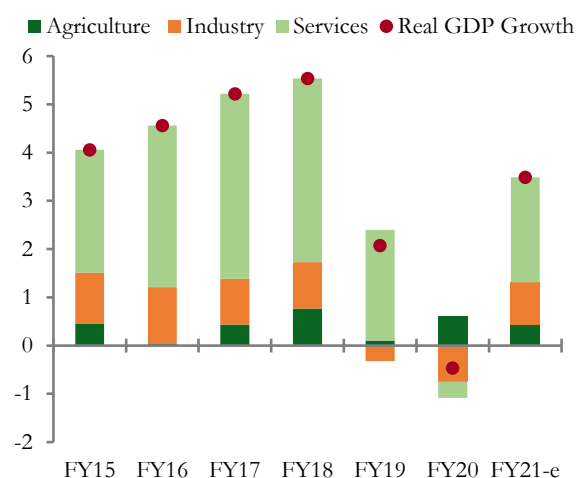
...while the industrial sector recorded a strong recovery

On the production side, industrial activity is projected to have rebounded after contracting for two consecutive years, with the sector estimated to have grown by 4.6 percent in FY21 after a contraction of 3.8 percent in FY20. Large-Scale Manufacturing (LSM), which constitutes approximately half of industry, grew by an average of 14.8 percent y-o-y in FY21, compared to a contraction of 9.8 percent in FY20. The LSM expansion is broad based, reflecting production increases in 10 out of 15 sectors, namely textile, food, beverages and tobacco, coke and petroleum products, pharmaceuticals, chemicals, non-metallic mineral products, automobiles, fertilizers, iron and steel products, and paper and board (Figure 2.2). With the recovery in domestic economic activity, petrol sales increased by 18.0 percent to a record 19.4 million tons in FY21, after a sharp drop of 12.0 percent in FY20 due to COVID-19-related lockdowns.⁴ Similarly, in light of the Government’s supportive construction package, domestic cement sales grew by 20.1 percent during FY21, compared to 2.0 percent in FY20.⁵

The services sector expanded in FY21 after shrinking in FY20 due to mobility restrictions

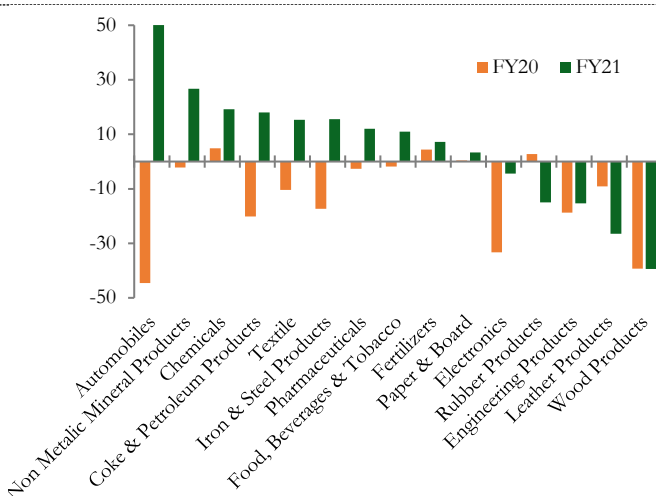
Lockdown restrictions imposed in Q4-FY20 had severely impacted the services sector, which heavily depends on in-person interactions. As a result, the sector—which constitutes almost 60 percent of GDP—contracted by 0.6 percent in FY20. In FY21, as generalized lockdown measures were gradually lifted, activity in the sector resumed, with an estimated expansion of 3.5 percent. Recovery in the sector was driven by wholesale and retail trade, the largest sub-sector in services, which benefitted from positive performance in the goods producing sectors. Credit to wholesale and retail trade increased to a net disbursement of PKR28.6 billion during FY21, compared to a net retirement of PKR51.5 billion during FY20. On the other hand, activity in transport, storage, and communication (the second largest services sub-sector) continued to decline in FY21, as intermittent restrictions on inter-city transport were imposed by the Government in response to multiple waves of COVID-19 infections.⁶ However, the magnitude of the contraction was smaller this year than in FY20.

Figure 2.1: Contribution to real GDP growth (at factor cost)
(Percentage Points)



Source: Ministry of Finance and World Bank staff estimates.

Figure 2.2: Large Scale Manufacturing growth by sector
(Percent, y-o-y)



Source: Pakistan Bureau of Statistics.

² State Bank of Pakistan (2020d).
³ Ibid.
⁴ Dawn (July 12, 2021).
⁵ Ministry of Finance (2021b).
⁶ State Bank of Pakistan (2020d).

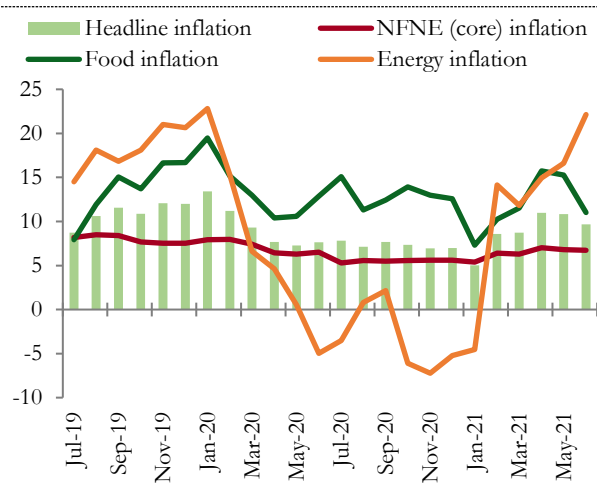
Inflation

While lower than in FY20, headline inflation remained high amid persistent food price inflation...

Headline consumer price inflation declined from an average of 10.7 percent in FY20 to 8.9 percent in FY21, amid broad-based easing of inflationary pressures. Core inflation in both rural and urban areas decreased, in part due to the administrative measures taken to provide economic relief and to support the recovery (Figure 2.3 and Figure 2.4).⁷ In addition to lower food inflation, domestic energy prices were relatively subdued and a halt to gas tariff hikes in FY21 contributed to lower energy inflation.^{8,9} Ten out of twelve product groups exhibited lower inflation in FY21, with alcoholic beverages and tobacco, transport, and education recording the steepest decline.^{10,11} Despite easing, average headline inflation in Pakistan was substantially higher than in other countries in South Asia, with the regional average at 5.2 percent in FY21.

Figure 2.3: Inflation in urban areas

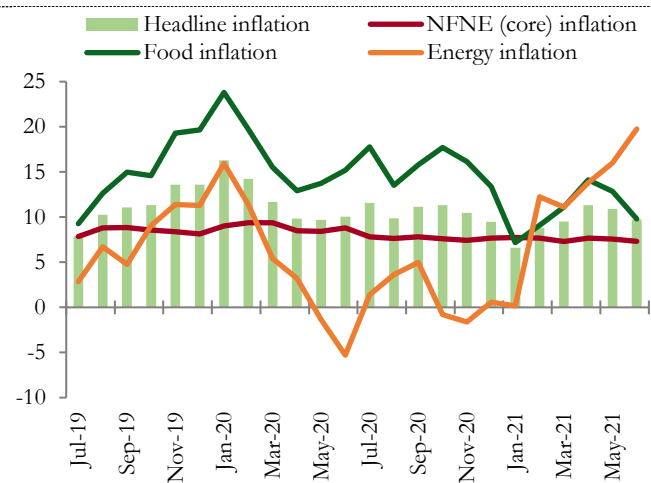
(Percent, y-o-y)



Source: Ministry of Finance and World Bank staff estimates.

Figure 2.4: Inflation in rural prices

(Percent, y-o-y)



Source: Pakistan Bureau of Statistics.

...because of higher food imports due to domestic supply shortages

In FY21, food inflation was recorded at 12.5 percent in urban areas and 13.2 percent in rural areas, compared to 13.6 percent and 15.9 percent in urban and rural areas in FY20, respectively. Domestic food shortages and the subsequent increase in food imports at higher international prices led to higher food prices in the domestic market. For example, increased imports of wheat, sugar, red chilies, palm oil, and soybean oil led to the surge in the prices of food commodities, such as condiments and spices, wheat, cooking oil, and sugar during FY21.

While energy inflation fell during the H1 FY21, a steep rise was recorded from February 2021 onwards

Energy price inflation showed a marked decrease over July 2020–January 2021 due to the high base effects associated with the pre-pandemic energy price hikes in early FY20.¹² However, energy price inflation rose again in the second half of FY21 due to the increase in electricity tariffs announced in February 2021 and the higher prices of petroleum products, including petrol, which were raised in June 2021 to partially pass on the costs of higher international fuel prices.

⁷ The FY21 Budget helped lower inflation through tax relief measures announced by the Government, such as a halt in further tax hikes on motor vehicles and postal services, and tariff concessions on import of raw materials. State Bank of Pakistan (2020c).

⁸ Over July 2020–February 2021, motor fuel prices fell. In addition, the Government kept the prices of petroleum products unchanged from mid-April to mid-June 2021 to manage inflationary pressures. Source: [The Express Tribune](#) (June 01, 2021).

⁹ A 168 percent hike in gas tariffs was approved in July 2019 to pass on energy sector arrears to consumers. However, there has been no further upward adjustment to gas prices since July 2020. State Bank of Pakistan (2020a).

¹⁰ Under the FY20 Budget, the Government increased the Federal Excise Duty (FED) on cigarettes and converted the three-tiered system of tax slabs into a two-tiered one. Although the FED was increased again on imported cigarettes and tobacco substitutes in the FY21 Budget, the effect on the overall price for tobacco was not as pronounced, leading to an overall decline in inflation for the alcoholic beverages and tobacco product category. Ministry of Finance (2021a).

¹¹ In education, several administrative measures helped to restrict hikes in private schools' fees. These include: (i) the Supreme Court's decision in September FY20 to restore private schools' fees to their January 2017 levels and to allow a maximum increase of 5 percent per annum (subject to regulatory approval); (ii) concessions in school fees offered by the Sindh and Punjab Governments in response to COVID-19; and (iii) waiver of the advance tax on tuition fees by some educational institutes. State Bank of Pakistan (2020b).

¹² Energy inflation consists of electricity charges; gas charges; liquefied hydrocarbons; solid fuel and motor fuel.

Core inflation declined in FY21, but remained higher in rural areas compared to urban areas

Core inflation, which excludes the more volatile energy and food components, also declined in FY21.¹³ Rural core inflation declined to 7.6 percent and urban core inflation to 6.0 percent during FY21 from 8.7 percent in rural areas and 7.5 percent in urban areas during FY20. The decline in core inflation was in part due to government administrative measures to support economic recovery. In urban areas, the decline in the prices of motor vehicles, construction inputs,¹⁴ and services of household servants and transport contributed to lower inflation. In rural areas, a marked decrease in the prices of postal services, motor vehicles and associated accessories and taxes,¹⁵ and lower marriage hall costs contributed to lower inflationary pressures.

Poverty

Supported by the economic recovery, poverty is estimated to have declined in FY21

Bolstered by the recovery in the industry and services sectors and resultant off-farm employment opportunities, poverty incidence, measured at the international poverty line of USD1.90 PPP 2011 per day, is expected to have declined to 4.8 percent in FY21 from 5.3 percent in FY20. However, this change is not statistically significant, and downside risks arising from lockdown-induced disruptions to employment and high food inflation remain.

However, the pandemic affected household welfare through the decline in labor incomes...

With the onset of the pandemic, over half of the working population faced either job or income losses associated with the widespread lockdown over April to June 2020, with 74 percent of affected workers belonging to the informal sector. As such, the most vulnerable segments of the labor force were the worst affected, with informal and low skilled workers employed in elementary occupations facing the strongest contraction in income from labor markets. However, subsequent estimates indicate that the labor market had almost fully returned to its pre-lockdown levels by November 2020 (PBS, 2020), which is consistent with the estimated rebound in real GDP growth in FY21.

...and a potential decrease in total remittances...

The Government has been instituting various initiatives to increase the inflow of remittances through official channels.¹⁶ While external accounts report a significant increase in official inflows of remittances for FY21, household survey data show a different picture. Recipient households reported a 35 percent decline in the value of remittances received between the onset of the pandemic and November 2020. Therefore, it is likely that even as official remittances have risen, the overall value of remittances has actually gone down in line with the global recession and disruptions in labor markets.

...was only partly compensated through an increase in public transfers

Around 33 percent of households reported receiving some form of public transfers during the COVID-19 period. Through the scale up of the Ehsaas program, the Government delivered PKR 179.8 billion as a one-time emergency cash assistance to 14.8 million beneficiaries at risk of falling into extreme poverty. Other initiatives included relief to daily wage workers, financial support to MSMEs, and interest free loans.

c. Monetary and financial sector

Monetary

Monetary policy continues to be accommodative to support the ongoing recovery

To preserve financial stability and support economic activity amid the COVID-19 crisis, the SBP maintained the policy rate at 7.0 percent throughout the year. With headline inflation averaging 8.9 percent during FY, real interest rates remained negative. In addition, the SBP also introduced other liquidity support measures, including regulatory relaxations for restructuring debt, principal repayment deferrals, and multiple refinancing facilities to support employment, investment, and setting up of health

¹³ The Pakistan Bureau of Statistics (PBS) does not report core inflation at the national level.

¹⁴ Several tax relief measures were announced for the construction industry in Budget 2020-21, including reduction in Federal Excise Duty on cement from PKR 2/kg to PKR 1.75/kg. State Bank of Pakistan (2020c).

¹⁵ In response to COVID-19, Provincial Governments did not increase motor vehicles tax in FY21 and offered concession on its payment. State Bank of Pakistan (2020c).

¹⁶ See Section 2d External Sector.

facilities. These measures were estimated to amount to PKR 2,067 billion or around 4.4 percent of GDP.¹⁷ Marking the onset of tapering of the accommodative monetary policy, the SBP hiked the policy rate by 25 basis points in September 2021.

Financial Sector

Banks remain heavily invested in government securities, potentially crowding out credit to the private sector

The capital adequacy ratio stood at 18.3 percent at end-June 2021, well above the SBP's minimum requirement of 12.5 percent. Mainly due to the moratorium on government loans from the central bank as part of the IMF program, the financial sector's investment in government securities grew by 28.9 percent in FY21 after expanding by 37.8 percent in FY20. Government securities constituted around 57.4 percent of all the credit extended by the banking sector in June 2021, dominating the banking sector's investment portfolio and reducing its appetite to financially intermediate to the private sector.

Credit to the private sector is concentrated in the corporate sector

Despite the above, private sector credit grew by 10.5 percent in FY21 as compared to 1.5 percent in FY20. This significant increase can be attributed to the liquidity measures introduced by the SBP, under which existing loans were often retired and refinanced under the more favorable terms offered under the COVID-19 response relief measures. However, bank credit (advances) is concentrated in the corporate sector, which accounts for 69.2 percent of the lending portfolio of banks, whereas bank credit to the riskier SME sector currently amounts to only 4.6 percent of total advances.

The sovereign-bank nexus has adverse implications for private sector credit

With the recent roll back in the SBP's liquidity measures and the upward movement of interest rates, there is a risk of a credit squeeze and rising non-performing loans (NPL). Thus far, the banking sector has not reported a deterioration in asset quality, with gross NPLs standing at 8.9 percent at end-June 2021, lower than 9.7 percent at end-June 2020. Thus, NPLs are well provisioned (with a provision coverage ratio of 88.8 percent at end-June 2021) with limited immediate stability concerns. More concerning is the banks' increasing reliance on risk-free government securities, which not only continues to crowd out private sector credit but exposes banks to higher sovereign risk.

d. External sector

Pakistan's CAD narrowed to a 10-year low in FY21, as record-high remittance inflows outweighed a wider trade deficit

During FY21, the current account recorded a deficit of 0.6 percent of GDP (USD1.8 billion), narrower than the FY20 deficit of 1.7 percent of GDP (USD4.4 billion), the smallest since 2011 (Table 2.1). Strong imports on the back of rebounding domestic demand, especially in May and June, led to a wider trade deficit during the year. However, record levels of official remittance inflows helped mitigate the trade gap, leading to an overall narrower current account deficit in FY21.

Even though exports reached a record high, imports grew more strongly, leading to a larger trade deficit

The overall trade deficit grew to USD30.0 billion in FY21 from USD24.4 billion in FY20, as total imports jumped by 17.5 percent, outstripping the 12.8 percent increase in total exports. The wider overall trade deficit also reflected a larger goods trade deficit, primarily due to the surge in goods imports amidst recovering domestic economic activity. In contrast, the services trade deficit shrank, as imports of key services, including tourism and transport, continued to be adversely impacted by the pandemic. The large increase in goods imports was driven by the recovery in domestic consumption and industrial activity, and the Government's efforts to address supply-side inflationary pressures focused on food.¹⁸ Goods exports also saw a substantial increase, albeit smaller than that of good imports, as textiles particularly value-added apparel exports, expanded sharply in FY21.¹⁹ Goods imports continued to surge in July and August 2021, expanding by 67.8

¹⁷ As of May 27, 2021. State Bank of Pakistan (2020d).

¹⁸ The main contributors to import growth in FY21 were: (i) machinery and mechanical appliances, (ii) vegetable products, (iii) textiles, primarily due to cotton imports, (iv) base metals, driven by iron and steel imports, and (v) vehicle imports, particularly cars.

¹⁹ Mainly U.S.A., U.K., China, and Germany. Note that while Pakistan's apparel exports to U.S.A and U.K. increased, the overall apparel imports of these markets, including those from some of Pakistan's major competitors decreased. This substantiates anecdotal evidence that Pakistan's apparel exports benefited from orders deflected from competitor countries whose export industries were more adversely impacted by COVID-19. State Bank of Pakistan (2020d).

percent y-o-y and consequently, the current account deficit widened sharply to USD2.3 billion over the 2 months.

Robust remittance inflows supported a wider income account surplus

The income account surplus increased to USD28.2 billion during FY21, relative to USD20.0 billion in FY20. The improvement was a result of the sustained growth in official remittances in the secondary income account (largest contributor to this account). The primary income account recorded a narrower deficit, in part due to the reduction in interest payments on external debt due to debt service relief under the G20 Debt Service Suspension Initiative (DSSI).²⁰

Table 2.1: Balance of payments summary¹
USD million unless mentioned otherwise

	FY18	FY19	FY20	FY21
i. Current account (A+B+C+D)	-19,195	-13,434	-4,449	-1,827
A. Good trade balance	-30,903	-27,612	-21,109	-28,163
Goods Exports	24,768	24,257	22,536	25,632
Goods Imports	55,671	51,869	43,645	53,795
B. Services Trade Balance	-6,426	-4,970	-3,316	-1,836
C. Balance on primary income²	-5,437	-5,610	-5,459	-4,669
D. Balance on secondary income²	23,571	24,758	25,435	32,841
of which remittances	19,914	21,740	23,131	29,370
ii. Capital account	376	229	285	238
1. Balance from current and capital accounts (i+ii)³	-18,819	-13,205	-4,164	-1,589
2. Financial accounts⁴	-13,611	-11,759	-9,313	-8,194
of which:				
Direct investment	-2,772	-1,436	-2,652	-1,762
Portfolio investment	-2,257	1,274	409	-2,776
Net acquisition of financial assets	273	-67	-127	350
Net incurrence of financial liabilities	8,855	11,530	6,935	4,010
3. Errors and omissions	-933	-58	150	-1,052
Overall balance (-1+2-3)	6,141	1,504	-5,299	-5,553
Gross SBP reserves (incl. CRR, SCRR)	11,341	9,301	13,724	18,716
Memorandum items				
Current account balance (percent of GDP) ⁶	-6.1	-4.8	-1.7	-0.6
Goods Trade Balance (percent of GDP) ⁶	-9.8	-9.9	-8.0	-9.7
Goods export growth (percent, y-o-y)	12.6	-2.1	-7.1	13.7
Goods import growth (percent, y-o-y)	16.0	-6.8	-15.9	23.3
Remittance growth (percent, y-o-y) ⁶	2.9	9.2	6.4	27.0
Financial account (percent of GDP) ⁶	4.3	4.2	3.5	2.8
Overall Balance (percent of GDP) ⁶	2.0	0.5	-2.0	-1.9

Source: State Bank of Pakistan, 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

6: Calculated using World Bank FY21 GDP estimates.

Remittances in FY21 likely benefited from a COVID-19-induced

Overall remittances grew by 27.0 percent to reach a record high of USD29.4 billion in FY21. Remittances from the Gulf Cooperation Countries (GCC) constituted 58.2 percent of total remittances (down from 65.4 percent in FY20) whereas those from the United

²⁰ On May 1, 2020, the Government requested its G20 creditors to activate the Debt Service Suspension Initiative, which allows for all official debt service obligations to G20 creditors to be suspended from May 1, 2020 to December 31, 2020. The DSSI has been extended till December 31st, 2021. This initiative helped reduce external financing needs by approximately USD2.5 billion over FY20–FY21. Ministry of Finance (2021d).

transition to formal channels

States, United Kingdom, and European Union accounted for 32.4 percent of inflows (up from 26.3 percent in FY20). The unexpected sustained growth in remittances observed over the FY is in part due to: (i) cross-border air travel restrictions due to COVID-19, which may have helped channelize inflows toward formal banking channels as opposed to the informal channels used previously (via family members travelling, hawala/hundi agents);²¹ (ii) air travel restrictions, including curbs on religious travel, which likely contributed to a build-up in savings with the overseas diaspora and as a result, expatriates were able to remit back additional funds; (iii) domestically, policy measures undertaken by the Government, including incentivizing banks to introduce digital products to facilitate migrants in sending remittances under the Pakistan Remittance Initiative; (iv) policy support in the host destinations (especially advanced economies) via unemployment benefits, rent and loan deferrals, and direct cash handouts, which likely increased the ability of migrants to remit higher amounts back home; and (v) favorable cross-currency movements against the U.S. dollar, which have also played an important role in driving up remittances in USD terms.²²

With a decline in FDI and other Government inflows, the financial account surplus narrowed in FY21

The financial account surplus narrowed in FY21 with net inflows declining to USD8.2 billion from USD9.3 billion received during FY20. Weak global trends, combined with a lack of lucrative opportunities to attract fresh investment, led to lower net foreign direct investment (FDI). Inflows to the telecommunications sector decreased, while those to the power sector (particularly thermal) increased. Overall, FDI inflows from most countries, including China, declined during the fiscal year. Net portfolio investment saw net inflows of USD2.8 billion compared to net outflows of USD0.4 billion FY20, as the Government raised USD2.5 billion from a Eurobond issuance in March 2021.²³ The net inflow of external loans into the country amounted to USD4.0 billion in FY21, compared to USD6.9 billion in FY20. During FY21, the financial account also benefitted from inflows of USD1.6 billion under the Roshan Digital Account, a scheme introduced by the Government to allow non-resident Pakistanis to participate in investment (including in Government securities), payment, and banking activities in Pakistan.²⁴

The Balance of Payments recorded an overall surplus in FY21

Aided by the sizable financial account surplus and a narrower current account deficit, the overall balance of payments recorded a surplus of 1.9 percent of GDP (USD5.6 billion) in FY21, slightly narrower than the 2.0 percent surplus in FY20. The SBP's gross reserves, including the Cash Reserve Requirement and cash holdings, increased to USD18.7 billion – the highest since January 2017. In July 2021, Pakistan raised an additional USD1.0 billion in Eurobonds and in August 2021, received USD2.8 billion from the IMF as per new SDR allocation. These inflows helped shore gross official foreign exchange reserves to USD20.6 billion by October 1, 2021, equivalent to 3.7 months of imports, compared to USD13.7 billion or 2.7 months of imports at end-June 2020.²⁵

Supported by the narrower current account deficit and higher remittance inflows, the Rupee appreciated in FY21

In FY21, the Pakistani Rupee appreciated by 5.8 percent against the US dollar.²⁶ The strengthening of the Rupee in FY21 reflected the overall positive sentiments in the economy after the successful conclusion of the IMF-EFF review in March 2021 and the country's subsequent re-entry into international capital markets, the surge in remittances, and effective domestic management of COVID-19 spread through targeted lockdowns.²⁷

²¹ However, there is no evidence of these unobserved remittances inflows in the balance of payments prior to the pandemic, with annual net errors and omissions being small and averaging negative USD132 million or 0.1 percent of GDP over 2010-2019.

²² In this regard, the substantial 58.3 percent growth in remittances to Pakistan from the United Kingdom during FY21 stands out, given that the British Pound (GBP) has appreciated by over 10 percent against the USD during Jul-Mar FY21. Ibid.

²³ As per the press release of the Finance Division ([Ministry of Finance \(2021c\)](#)), the Government of Pakistan raised USD2.5 billion from the international capital market on March 30, 2021. This is Pakistan's first international capital market transaction since November 2017. The Government contracted USD1.0 billion 5-year bonds at an interest rate of 6.0 percent, another USD1.0 billion of 10 years at 7.375 percent and about USD0.5 billion of 30-year bonds at a cut-off yield of 8.875 percent.

²⁴ State Bank of Pakistan (2021). <https://www.sbp.org.pk/RDA/Progress.html>.

²⁵ Based on next 12 months' projected imports of goods & services. Import coverage ratio may change with the change in import projections.

²⁶ Calculated using end period exchange rates (average for June 2021 and June 2020).

²⁷ State Bank of Pakistan (2020d).

The accommodative monetary policy stance of the United States also helped the Pakistani Rupee strengthen against the dollar, similar to the other emerging markets.²⁸ However, after rallying strongly in Q3 FY21, the Rupee has lost ground against the U.S. dollar, largely due to the surge in imports (Box 2.1). Meanwhile, the Real Effective Exchange Rate (REER) appreciated by 10.4 percent in FY21, partly due to high domestic inflation relative to the inflation in Pakistan’s trading partners.

Box 2.1: Potential Drivers of the Recent Depreciation of the Pakistani Rupee²⁹

The Pakistani Rupee (PKR) reached a more than two-year high of PKR 152.2 against the U.S. dollar (USD) on May 7, 2021. However, the Rupee has subsequently been depreciating, losing more than 10 percent of its value against the greenback in just under five months, to a record low of PKR171.1 on October 14, 2021 (Figure 2.1.1). The relatively sharp decline in the Rupee can be attributed to a few significant global, regional, and Pakistan-specific developments that have occurred in recent months.

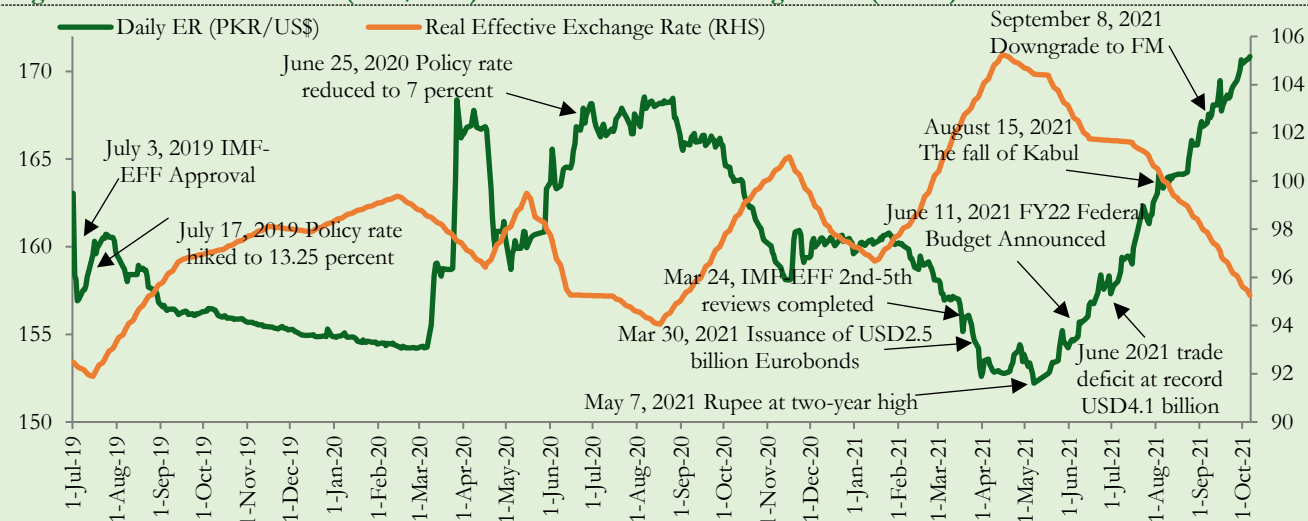
Widening trade deficit. With domestic demand continuing to be supported by the accommodative monetary policy, record-high remittance inflows, and the expectations of an expansionary fiscal policy set out in the FY22 fiscal budget (Box 2.2), imports surged over April-June 2021, coinciding with the turnaround in the trajectory of the Rupee exchange rate. The strength in imports has carried over to the first quarter of the current fiscal year. Total imports in August 2021 jumped 85.8 percent y-o-y, leading to a monthly trade deficit of USD4.0 billion, slightly lower than the record-high trade deficit of USD4.1 billion in June 2021. The growing trade deficit, and consequently wider current account deficit, has increased the demand for the USD, contributing to the depreciating PKR.

MSCI downgrade. In line with the market expectations, Morgan Stanley Capital International (MSCI) announced on September 8, 2021, that Pakistan will be notched down from the MSCI Emerging Market (EM) Index into the Frontier Markets (FM) index with effect from December 1, 2021.³⁰ The downgrade is likely to have led investors to divest away from Pakistani equities as they rebalanced investment portfolios, contributing some additional downward pressure on the Rupee, at least in the short-term.

Increasing likelihood of global monetary policy tightening. Amid signs of robust economic recoveries and hiking inflation, central banks in advanced economies are expected to begin tapering asset purchases and/or raising interest rates in the near future. Generally, monetary policy tightening by major central banks causes emerging market currencies, including the Rupee, to lose value as investors rebalance their portfolios away from developing economies to take advantage of the higher yields with lower risk in developed nations.

The Afghan crisis. Pakistan’s goods exports values to Afghanistan have been sizeable, amounting to USD870.5 million (4 percent of total Pakistan goods exports) in calendar year 2020. However, with the Afghanistan crisis, shipments from Pakistan to Afghanistan have declined significantly, by around 40 percent y-o-y in July and August 2021. In sharp contrast, goods imports values from Afghanistan to Pakistan in August 2021 have jumped by about 30 percent y-o-y. These developments have reduced Pakistan’s USD earnings and led to an increased outflow of USD, contributing to the dollar’s scarcity relative to the PKR.

Figure 2.1.1: Pakistan Nominal (PKR/USD) and Real Effective Exchange Rates (REER)



Source: State Bank of Pakistan, JP Morgan, Haver Analytics.

Note: Daily ER based on SBP - weighted average customer exchange rate. REER based on JP Morgan Real Broad Effective Exchange Rate Index, CPI Based (2010=100) (Daily series was derived from the monthly data series by linearly interpolation).

²⁸ In the past, the U.S. monetary policy easing has generally been transmitted to Emerging Market and Developing Economies through domestic currency appreciation, lower bond yields, higher equity prices, and increased capital inflows. World Bank (2021).

²⁹ As of October 15, 2021, which is the data cut-off date for this Update.

³⁰ Pakistan was classified in the leading EM index since May 2017 when the benchmark KSE-100 Index hit an all-time high of 53,000 points. However, the index failed to sustain at that level and has yet to recover since.

**Box 2.2: The FY2022 Federal and Provincial Budgets:
An expansionary fiscal stance underpinned by strong growth and higher revenues^{1,2}**

The Federal Budget for FY22 anticipates that the consolidated fiscal deficit will narrow to 6.3 percent of GDP in FY22 from 7.1 percent in FY21 (Table 2.2.1). This assumes a cumulative provincial surplus of 1.1 percent of GDP, significantly higher than the 0.7 percent surplus recorded for FY21. The Budget projects the Federal fiscal deficit for FY22 at 7.4 percent of GDP, narrower than the shortfall of 7.8 percent in FY20. After the 21.1 percent increase in FY21, total Federal revenue is expected to grow by 26.1 percent - of which tax revenues are projected to increase by 26.5 percent. The increase in tax revenues is on the back of a projected real GDP growth of 5.0 percent (buoyancy factor) as well as tax administration/policy measures. Similarly, Federal non-tax revenues are expected to increase by 24.4 percent. In line with the budget's overall objective of promoting economic recovery, total Federal expenditure is budgeted to increase by 17.2 percent, up from a muted growth of 4.1 percent in FY20. Federal current expenditure is projected to grow by 18.5 percent, whereas Federal development spending (and net lending) is slated to expand by 22.2 percent.

In line with higher Federal revenues in FY22, the provinces expect federal transfers to grow by 33.4 percent. In addition, provincial own-source tax revenues are also expected to increase by 28.8 percent, while provincial non-tax revenues are expected to jump by 189 percent. Provincial expenditure also shows an expansionary trend, with current expenditures budgeted to rise by 25.9 percent and development expenditures by 94.4 percent. Cumulatively, the provincial budgets indicate a provincial deficit of 0.8 percent of GDP.

Therefore, there is a sizable discrepancy in the expected provincial surplus assumed by the Federal Government and the fiscal balances projected by the Provincial Governments themselves. If the consolidated provincial fiscal deficit from the provincial budget documents were to materialize, the national fiscal deficit could reach 8.2 percent of GDP in FY22 – 1.9 percentage points above the Federal Government's projections.

Table 2.2.1: Key Fiscal Indicators – FY22 Federal and Provincial Budgets
(Share of GDP (unless mentioned otherwise))

	FY17	FY18	FY19	FY20	FY21	FY22BE ² Federal Budget	FY22BE ³ Federal and Provincial Budgets
Total Federal Revenue	14.3	13.6	11.6	13.9	13.1	14.7	14.7
Federal Tax Revenue	11.4	11.8	10.7	10.4	11.0	12.3	12.3
Federal Non-Tax Revenue	2.8	1.8	0.9	3.5	2.1	2.4	2.4
Transfer to Provinces	6.2	6.4	6.3	6.0	5.7	6.3	6.3
Net Federal Revenue	8.1	7.2	5.4	7.9	7.4	8.3	8.3
Total Federal Expenditure	13.7	13.6	14.7	16.4	15.2	15.8	15.8
Federal Current Expenditure	10.9	11.0	12.6	14.7	13.3	14.0	14.0
Federal Dev. Expenditure	2.7	2.6	2.1	1.7	1.7	1.8	1.8
Statistical Discrepancy	0.0	0.0	0.0	0.0	0.2	0	0.0
Federal Fiscal Balance	-5.6	-6.4	-9.4	-8.5	-7.8	-7.4	-7.4
Estimated Provincial Balance³	-0.5	-0.1	0.4	0.2	0.7	1.1	-0.8
Statistical Discrepancy	-0.2	0.0	0.1	-0.2	0.0	0.0	0.0
Consolidated Fiscal Balance (excl. grants)	-5.8	-6.5	-9.0	-8.1	-7.1	-6.3	-8.2
Consolidated Primary Balance (excl. grants)	-1.6	-2.2	-3.6	-1.8	-1.4	-0.7	-2.5
Nominal GDP (PKR billion)	31,922	34,616	38,086	41,556	47,709	53,867	53,867

¹Growth rates for FY22 Budget Estimates have been calculated using FY21 Fiscal Operations data, published by the Ministry of Finance.

²Based on Government GDP estimates for FY21 and projections for FY22. World Bank GDP estimates and projections vary.

³Using the FY22 Federal Budget, Ministry of Finance.

⁴Using Federal and Provincial Budgets for FY22. Provincial balance is calculated by aggregating the revenue and expenditure of all Provincial Governments.

Source: Fiscal Operations, Ministry of Finance; Budget documents, Federal and Provincial Finance Departments; World Bank staff estimates

e. Fiscal and Debt Sustainability

The fiscal balance improved in FY21 with stronger revenues amid the economic recovery

The consolidated fiscal deficit narrowed to 7.3 percent of GDP in FY21 from 8.1 percent of GDP in FY20 (Table 2.2). The fiscal balance improved on the back of the economic recovery and buoyant tax revenues, with indirect taxes being the dominant driver of total revenue growth.

Government spending also saw a smaller increase	Another contributing factor to the fiscal consolidation was the lower growth in the Federal Government recurrent spending, partly due to a smaller increase in debt servicing costs. The Federal fiscal deficit narrowed from 8.5 percent of GDP (PKR3,541 billion) in FY20 to 8.0 percent of GDP (PKR3,717 billion) in FY21. The improvement in the national consolidated fiscal balance was further aided by surpluses posted by all Provincial Governments, who recorded a cumulative provincial balance of 0.7 percent of GDP (PKR314 billion), up from a surplus of 0.2 percent of GDP (PKR77 billion) in FY20. Together with the lower national fiscal deficit, the consolidated primary deficit also narrowed to 1.4 percent of GDP (PKR654 billion) from 1.8 percent (PKR757 billion) in FY20.
Total consolidated revenues grew on account of higher tax revenues	Total revenues increased by 10.1 percent in FY21, smaller than the 28.0 percent jump in FY20. The smaller increase was largely due to a decline in non-tax revenues. However, tax revenues grew in line with rebounding economic activity and higher imports, which outweighed the decline in non-tax revenues. Specifically, total tax revenues posted a growth of 21.2 percent as opposed to the muted growth of 6.1 percent observed in FY20, and both Federal and Provincial Governments contributed to the increase. Non-tax revenues, in contrast, declined mostly on account of high base effects as they were atypically high in FY20. ³¹
The growth in tax revenues came largely from indirect taxes	In FY21, there was a 24.8 percent y-o-y growth in revenues from indirect taxes, which include stamp duties and taxes on goods and services, international trade, motor vehicles, and petroleum products. Receipts from the sales tax on goods and services grew by 23.0 percent as domestic consumption increased. As global merchandise trade rebounded and Pakistan's goods imports saw double-digit growth, tax revenues from international trade increased by 22.2 percent. Indirect tax revenues from the Gas Infrastructure Development Cess (GIDC), natural gas development surcharge, petroleum levy, and motor vehicle tax collected by the Provinces ³² also increased significantly, registering a cumulative growth of 35.3 percent in FY21, up from a 17.7 percent growth in FY20. In FY20, growth in indirect tax revenues was considerably lower at 6.4 percent, in part due to the adverse effects of COVID-19 on economic activity.
However, direct taxes also increased	The revenues from direct taxes, however, grew by 13.6 percent in FY21, up from 5.4 percent in FY20. The efforts of the Federal Board of Revenue (FBR) to improve tax administration ³³ partly supported the growth observed in direct tax revenues. The largest share of direct taxes (72 percent) is withholding taxes, of which the highest growth was recorded from taxes on salaries, dividends, telephone use, contract processing, and electricity.
Growth in total expenditures was low due to a smaller increase in Federal Government current expenditures	Registering the lowest growth since FY15, total Government expenditure grew by 6.8 percent y-o-y in FY21 compared to 15.6 percent in FY20. This was largely on account of low growth in Federal current spending, which fell to 4.1 percent from 26.0 percent in FY20. This was partly due to a smaller increase in debt servicing payments on account of lower domestic interest rates and the DSSI. The Federal Government also reduced non-interest current expenditures, including pensions and non-provincial grants. ³⁴ In contrast, defense expenditures growth rose in FY21.

³¹ Non-tax revenues were exceptionally large in FY20 because of one-off 4G license renewal fees paid by the telecommunication companies and large transfers from the State Bank of Pakistan due to substantial profits on account of high interest rates.

³² A large increase in sale of vehicles in FY21 led to the surge in revenue from motor vehicle tax. Source: Pakistan Automotive Manufacturers Association; [Motor vehicle tax collection grows 50% in FY21](#). Bol News (August 28, 2021).

³³ FBR undertook multiple measures to improve tax administration. These included targeted audits of large multi-national organizations, increase in issuance of demand notices to potential taxpayers, establishment of two separate offices in Multan and Islamabad for taxpayers, and use of systems that allow integration of third-party data sources to collect and verify information on individuals' wealth and assets. State Bank of Pakistan (2020d).

³⁴ Expenditure on grants declined due to the Government's efforts for restrict supplementary grants. Only additional funds approved through supplementary grants were the unutilized funds from the COVID-19 Economic Stimulus Package approved in FY20. Ministry of Finance (2021c).

Table 2.2: Summary of Pakistan's Fiscal Operations

PKR billions (unless mentioned otherwise)

	FY17	FY18	FY19	FY20	FY21	FY20 Growth YoY (%)	FY21 Growth YoY (%)
Total Revenue¹	4,937	5,228	4,901	6,272	6,903	28.0	10.1
Tax Revenue	3,969	4,469	4,477	4,751	5,760	6.1	21.2
Federal	3,647	4,068	4,075	4,337	5,251	6.4	21.1
Provincial	322	401	402	414	508	2.9	22.9
Non-Tax Revenue	967	759	424	1,521	1,144	259.1	-24.8
Federal	888	612	337	1,419	993	320.6	-30.0
Provincial	79	147	86	102	150	18.6	46.8
Expenditure	6,801	7,488	8,346	9,648	10,307	15.6	6.8
Current Expenditure	5,198	5,854	7,104	8,532	9,084	20.1	6.5
<i>of which:</i>							
Interest	1,348	1,500	2,091	2,620	2,750	25.3	5.0
Defense	888	1,030	1,147	1,213	1,316	5.8	8.5
Dev. Expenditure & Net Lending	1,681	1,622	1,219	1,204	1,316	-1.3	9.3
<i>of which:</i>							
Total PSDP	1,578	1,456	1,008	1,090	1,211	8.1	11.2
Other Dev. Expenditure	116	128	170	65	27	-61.5	-58.3
Net Lending to PSEs	-13	38	41	49	77	19.1	58.5
Statistical Discrepancy	-78	12	22	-87	-93		
Fiscal Balance (excl. grants)	-1,864	-2,260	-3,445	-3,376	-3,403		
<i>Percent of GDP²</i>	<i>-5.8</i>	<i>-6.5</i>	<i>-9.0</i>	<i>-8.1</i>	<i>-7.3</i>		
Primary Balance (excl. grants)	-515	-760	-1,354	-757	-654		
<i>Percent of GDP²</i>	<i>-1.6</i>	<i>-2.2</i>	<i>-3.6</i>	<i>-1.8</i>	<i>-1.4</i>		

Source: State Bank of Pakistan, World Bank Staff calculations.

Notes: 1. For FY21, the Ministry of Finance switched the GIDC, natural gas development surcharge, and petroleum levy from tax to non-tax revenue. For consistency of analysis across years, these taxes have been included in tax revenue. 2. Calculated using WB FY21 GDP estimates. Based on Government estimates, the fiscal deficit in FY21 was 7.1 percent of GDP and the primary deficit was 1.4 percent of GDP.

However, Provincial recurrent spending expanded at a faster rate in FY21 than in FY20

Consolidated Provincial current expenditures increased by 12.1 percent y-o-y in FY21, larger than the 8.1 percent increase in FY20, and contributed the most toward total expenditure growth. This was largely due to a significant increase in recurrent spending by Sindh on account of COVID-19-related expenditures and an increase in the salaries and pensions of Government employees. Khyber Pakhtunkhwa (KP) also posted high growth in current spending, although only marginally higher than the previous fiscal year.³⁵

Development expenditures and net lending rebounded after contracting for two consecutive fiscal years

After contracting in both FY19 and FY20, development expenditures and net lending grew by 9.3 percent in FY21 on the back of higher growth in the Provincial Public Sector Development Program's (PSDP) spending and net lending. Total PSDP expenditures grew by 11.2 percent, of which Provincial PSDP spending expanded by 23.8 percent y-o-y whereas the Federal PSDP declined by 5.7 percent. Net lending, however, increased by 58.5 percent, reflecting the payments made by the Federal Government to the Power Holding Private Limited (PHPL) for absorption of its loans into general government debt.³⁶

The fiscal deficit was financed largely

In FY21, 61 percent of the fiscal deficit was financed through domestic sources. Overall, external financing flows grew by 49 percent y-o-y over the FY, whereas domestic

³⁵ The increase in current spending by KP was due to large unspent resources from the FY20 budget that were carried forward in the FY21 budget. State Bank of Pakistan (2020d).

³⁶ In FY21, PHPL loans amounting to PKR72 billion were absorbed by the Federal Government as general government debt.

though domestic sources. financing flows declined by 17 percent, largely due to lower non-bank financing and a narrowing of the fiscal deficit, which helped reduce the Government's financing needs.

Although public debt as a share of GDP declined in FY21, it remains high and vulnerable to shocks Public and publicly guaranteed debt declined to 90.7 percent of GDP in end-June FY21, down from 92.7 percent in end-June FY20.³⁷ In end-June FY21, external debt accounted for 33.9 percent of the total public debt, whereas short-term debt accounted for 16.2 percent – indicating low rollover risks. Nonetheless, this debt level is in breach of the Fiscal Responsibility and Debt Limitation Act (FRDLA) 2005 (amended in 2017) that stipulated a reduction of total public debt to 60 percent of GDP by end-FY18. Moreover, growing arrears in the power sector and liabilities from commodity operations pose further risks to debt sustainability.

f. Medium-Term Outlook

GDP growth is projected to slightly taper in FY22 before strengthening in FY23 In line with the 25-basis point policy rate hike in September 2021, fiscal and monetary tightening are expected resume in FY22, as the Government refocuses on mitigating emerging external pressures and managing long-standing fiscal challenges (Table 2.3). The SBP's accommodative monetary stance supported the economic recovery in FY21, but with looming external pressures and the high likelihood of major central banks turning more hawkish soon, the space for continued expansionary monetary policy is limited. Output growth is therefore projected to ease to 3.4 percent in FY22 but strengthen thereafter to 4.0 percent in FY23, predicated on implementation of key structural reforms. These reforms include those aimed at sustaining macroeconomic stability, increasing competitiveness, and improving the financial viability of the energy sector. Inflation is projected to edge up in FY22 with the expected domestic energy tariff hikes and higher oil and commodity prices, before moderating in FY23.

Table 2.3: Pakistan's Macroeconomic Outlook (FY21-23)

(Annual percent change unless indicated otherwise)

	2017/18	2018/19	2019/20	2020/21 e	2021/22 f	2022/23 f
Real GDP growth, at constant market prices	5.8	1.1	-0.9	3.5	3.4	4.0
Private Consumption	6.2	3.1	-4.1	4.2	3.9	4.1
Government Consumption	8.6	0.8	6.8	2.2	2.7	5.8
Gross Fixed Capital Investment	11.2	-12.5	-1.0	5.7	4.5	4.7
Exports, Goods and Services	12.7	14.5	2.5	4.8	3.7	4.2
Imports, Goods and Services	17.6	4.3	-7.9	8.1	6.0	5.7
Real GDP growth, at constant factor prices	5.5	2.1	-0.5	3.5 ^a	3.4	4.0
Agriculture	4.0	0.6	3.3	2.2	3.2	2.7
Industry	4.6	-1.6	-3.8	4.6	3.8	4.3
Services	6.3	3.8	-0.6	3.5	3.4	4.4
Inflation (Consumer Price Index)	4.7	6.8	10.7	8.9	9.0	7.5
Current Account Balance (% of GDP)	-6.1	-4.8	-1.7	-0.6	-1.9	-2.5
Net Foreign Direct Investment (% of GDP)	0.9	0.5	1.0	0.6	0.8	0.9
Fiscal Balance (% of GDP), excluding grants	-6.5	-9.0	-8.1	-7.3	-7.1	-7.2
Debt (% of GDP)	75.9	89.7	92.7	90.7	90.6	89.3
Primary Balance (% of GDP), excluding grants	-2.2	-3.6	-1.8	-1.4	-1.3	-1.6

Sources: Pakistan Bureau of Statistics, State Bank of Pakistan, World Bank staff calculations.

Notes:

e: estimate, f: forecast.

a. World Bank estimate. The Government's preliminary real GDP (factor cost) growth estimate for FY21 is 3.9 percent. See footnote 1.

The current account deficit is expected to widen over the medium-term The current account deficit is projected to widen to 2.5 percent of GDP in FY23 as imports expand with higher economic growth and oil prices. Exports are also expected to grow strongly after initially tapering off in FY22, as tariff reform measures gain traction, supporting export competitiveness. In addition, the growth of official remittance inflows

³⁷ Public debt includes general government debt and public guarantees, defined as guarantees to State-Owned Enterprises. Guaranteed debt was recorded at 5.2 percent of GDP at end-June FY21 (calculated using WB FY21 GDP estimates).

is expected to moderate after benefiting from a COVID-19-induced transition to formal channels in FY21.

Fiscal pressures are expected to remain elevated, especially with national elections on the horizon

Despite fiscal consolidation efforts, the deficit (excluding grants) is projected to remain high at 7.1 percent of GDP in FY22 and widen to 7.2 percent in FY23 due to pre-election spending. Implementation of critical revenue-enhancing reforms, particularly General Sales Tax harmonization, will support a narrowing of the fiscal deficit over time. Public debt will remain elevated in the medium-term, as will Pakistan's exposure to debt-related shocks. This outlook assumes that the government continues to implement reforms agreed with the IMF under the-EFF program.

g. Risks and Priorities

External pressures have increased in recent months, increasing the risks associated with an external imbalance

External pressures have recently increased notably. Compared to a surplus of USD0.8 billion in July–August 2020, the current account recorded a deficit of USD2.3 billion for the same period in 2021, largely due to strong domestic demand leading to a wider trade deficit. During this period, exports of goods and services increased by 33.6 percent y-o-y whereas total imports jumped by 62.2 percent. With limited external buffers and elevated financing needs, the rapidly growing imports and wider trade deficit have heightened external risks and resulted in pressures on the exchange rate. The Rupee has already depreciated by 7.7 percent against the U.S. dollar over the first quarter of FY22. Given that external public debt is a third of the total public debt stock, the depreciation of the currency has implications for public debt, which is already above 90 percent of GDP.

Further waves of COVID-19 and variants continue to pose severe risks

Moreover, critical structural reforms could be delayed by more contagious COVID-19 strains requiring widespread lockdowns, and a worsening of regional and domestic security conditions, including those stemming from the Afghanistan situation. These could pose additional downside risks to the outlook.

Revenue mobilization reforms are urgently required

With elevated risks for fiscal and debt sustainability, fiscal consolidation efforts are necessary. In particular, the Government needs to focus on increasing domestic revenue collections by implementing structural reforms such as a harmonized General Sales Tax (GST) regime. In the absence of such reforms, the fiscal space available to increase spending in the event of additional shocks is limited.

The Government should remain committed to its IMF-EFF-supported reform program

A major downside risk to Pakistan's macroeconomic outlook is a further delay or stalling of the IMF-EFF program and the consequent external financing difficulties, such as access to international financial markets and the roll-over of bilateral debt from non-traditional donors. With elevated external financing needs over the medium-term, Pakistan's already limited reserves could come under additional pressure. Thus, a successful and timely conclusion of the sixth review of the IMF-EFF program, and implementation of critical structural reforms will strengthen Pakistan's fiscal position in the medium-term and improve fiscal and debt sustainability. Critical reforms include those aimed at sustaining macroeconomic stability, domestic revenue mobilization, increasing competitiveness, and improving the financial viability of the energy sector.

3. Special Focus – Reviving Exports



The Port of Karachi.

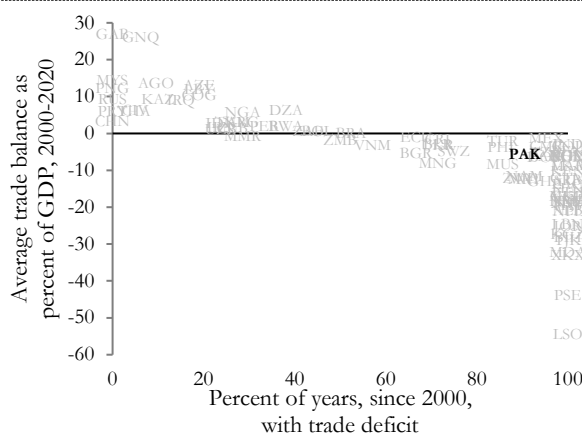
a. Introduction & Motivation

Underlying Pakistan’s persistent and large trade deficit are the export competitiveness challenges that the country faces. Exports have been growing slowly since the beginning of the century. As a result, the economy has become more inward oriented, as the share of exports in GDP declined from 16 percent in 1999 to 10 percent in 2020. This inward focus has had implications for the country’s foreign exchange, employment, and productivity growth. With some exceptions on the services front, the stagnant export competitiveness over the years shows in the lack of diversification into higher value-added activities. Firm-level analysis hints at substantial barriers for firms to enter exporting, and to scaling up once they have entered. The causes of Pakistan’s export challenge are manifold. However, three factors can be identified as crucial: First, the marked anti-export bias of tariff policy in the form of the world’s highest levels of effective protection to domestic industries that makes exporting only a residual option—that is, protection granted with the objective of substituting imports has substituted exports instead; second, the inadequate support services for exporters, particularly long-term finance (key for plant expansions) and market intelligence provision (key to lowering the information costs of exporting); third, the structurally low productivity of Pakistani firms. To make export revival a priority, a policy reform agenda needs to be designed and implemented in a coordinated manner by federal and provincial authorities, along with the broadest support from civil society.

The increase in Pakistan’s trade deficit has sounded the alarm for the country’s external vulnerabilities

Pakistan’s trade balance in goods and services reached a cumulative deficit of USD7.4 billion in the first two months of FY22 and shows a persistent negative trend. The trade deficit increased from USD24.4 billion in FY20 to almost USD30 billion in

Figure 3.1: Persistence and levels of trade deficits, cross-country comparison



Source: World Development Indicators; World Bank staff calculations. Note: the scatter plot includes countries lower-middle income, upper-middle income, and South Asian countries with population greater than 1 million. Timor-Leste is not shown in the plot for scale reasons.

FY21.³⁸ Although running trade deficits is not inherently negative, the fact that they have been systematic and large (Figure 3.1) invites the question of how they can be narrowed.

The Government of Pakistan has recently increased import barriers to curb the trade deficit

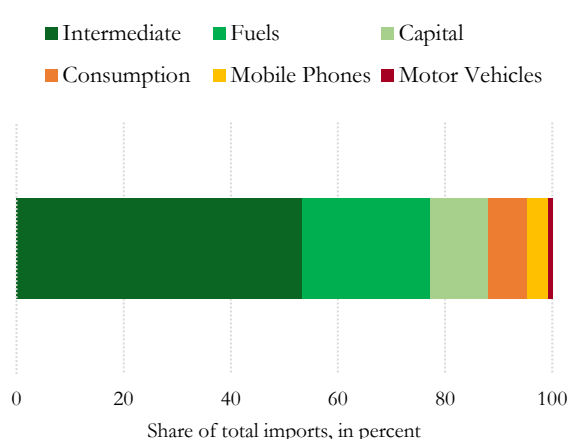
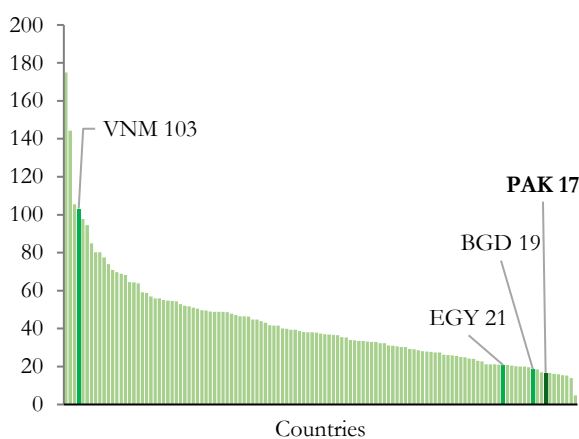
The SBP has recently added 114 items to the list of import products that require a “100 percent cash margin.” This measure mandates importers to hold deposits of a value equivalent to the import order at the time of placing it.³⁹ This increases firms’ financial costs and acts as a non-tariff barrier to imports. In addition, the Ministry of Finance has announced increases in regulatory duties on “non-essential, luxury” imports. Yet, these measures are unlikely to curb the deficit for three reasons. First, the share of imports of non-essential or luxury goods is too small to have an impact. Second, these items are already facing very high import duties and further increases will not curb their consumption substantially, as demand is relatively inelastic. Third, the import content of domestically produced substitutes is high, and therefore any substitution away from imported and into domestic luxury goods will likely lead to an increase in imports of parts and components to produce the domestic versions. Thus, instead of achieving the intended goal, these measures exacerbate the already pronounced anti-export bias of Pakistan’s trade policy and add uncertainty by increasing the likelihood of sudden policy changes that affect firms’ cost structures.

The challenge with the trade deficit is not the import bill, but rather the low export receipts

Pakistan’s import bill is not particularly large when benchmarked against comparator countries, nor is its composition tilted towards luxury or even consumer goods. As a percentage of GDP, imports of goods and services stood at 17 percent in 2020, below Bangladesh’s 19 percent, Egypt’s 21 percent, or Vietnam’s 103 percent, all Pakistan’s peers in the size of economy (Figure 3.2). In terms of composition, Pakistan’s merchandise imports are mainly for industrial or commercial use. In FY21, imports of intermediate inputs accounted for 53 percent of the total, fuels for 24 percent, and capital goods for 11 percent. Consumer goods accounted for only 7 percent of imports, while mobile phones accounted for 4 percent (Figure 3.3). On the services front, imports have been similarly tilted towards production use: transport (mainly sea-freight) and business services typically account for approximately 69 percent of services imports.

Figure 3.2: Imports of goods and services as a percentage of GDP, 2020

Figure 3.3: Composition of Pakistan’s goods imports by type of good, FY21
(Share of total imports, in percent)



Source: World Development Indicators; World Bank staff calculations. Source: State Bank of Pakistan; World Bank staff calculations.

Pakistan’s exports are substantially below potential

A more sustainable way of addressing the trade deficit challenge is by boosting exports. Pakistan exported USD188 per working-age person in 2020, approximately half of Bangladesh’s amount, and more than 20 times less than Vietnam’s (Figure 3.4). As previously mentioned, Pakistan’s exports are low because they have been stagnant for an

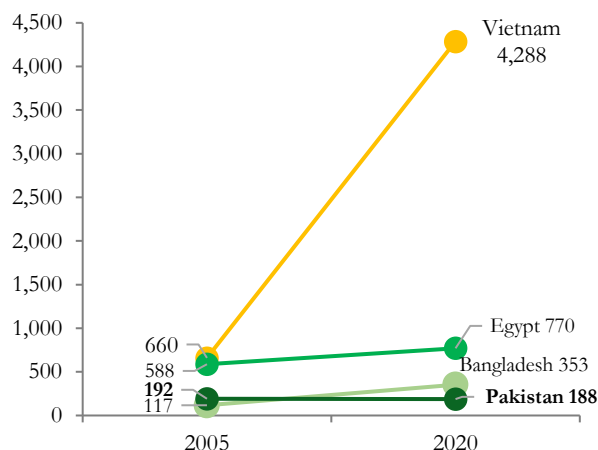
³⁸ The current account balance in FY21 was, however, the narrowest in a decade, in part because of high remittances inflows.
³⁹ See State Bank Pakistan’s BPRD Circular Letter No. 30 of 2021 for the list of the 114 items.

extended period. In 2020, exports were only 47 percent greater than they had been in 2005, in current prices, whereas Vietnam’s were 700 percent greater.

Pakistan has turned more inward oriented since the turn of the century. As a share of GDP, Pakistan’s exports fell from 16 percent in 1999 to 10 percent in 2020 (Figure 3.5). Increased inward orientation poses a problem because greater integration into the global marketplace is closely linked with faster productivity growth (Box 3.1). Moreover, Pakistan’s increasingly inward orientation is not the consequence of a structural lack of export potential. A recent study reveals that considering its characteristics (including size, level of development, location, and factor endowments), Pakistan should be exporting around USD88.1 billion worth of merchandise, almost four times its current level.⁴⁰ While there are several challenges that Pakistani firms face related to the business environment, there are export-specific challenges that prevent the realization of this potential. This special section examines in detail the challenges for Pakistan’s export competitiveness, its drivers, and potential policy levers to boost it.

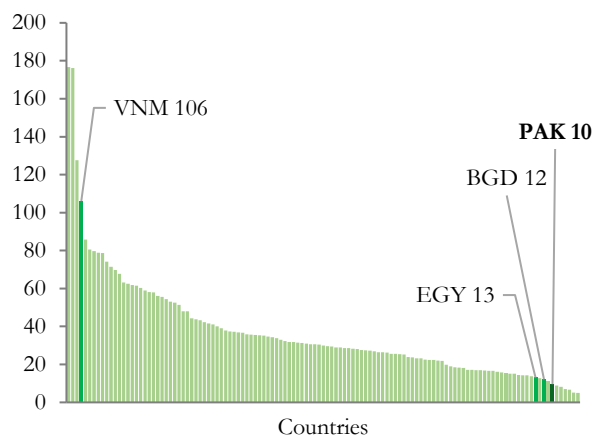
Figure 3.4: Exports of goods and services per capita, 2005 vs. 2020

(Exports in current \$ / Population aged 15-64)



Source: World Development Indicators; World Bank staff calculations.

Figure 3.5: Exports of goods and services as a percentage of GDP, 2020



Source: World Development Indicators; World Bank staff calculations.

Box 3.1: Trade and productivity in Pakistan. What do we know?

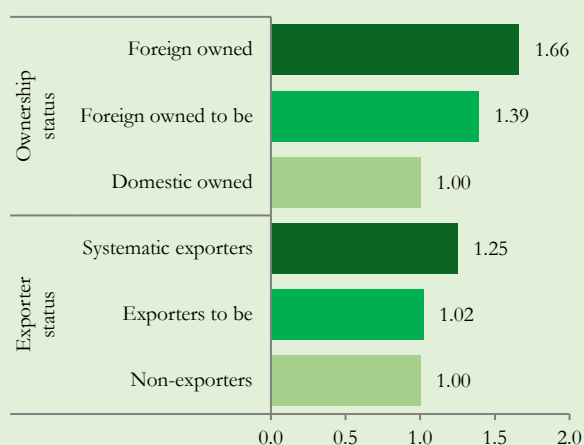
Pakistan’s increasing inward orientation is a challenge because of the close links between integration into the global marketplace and productivity. A [recent paper](#) examines how publicly listed firms in Pakistan fare in terms of productivity, focusing on the links between integration and productivity. Two key findings are worth highlighting.

First, internationally linked firms are exceptional performers. As documented for other countries, Pakistani firms that export and those that are partially or wholly foreign owned tend to perform (much) better than those that are oriented to the domestic market or wholly domestically owned. Firms that systematically export are 25 percent more productive than those that have never exported (Figure 3.6). This is mostly because exporters become more productive as they export more systematically, suggesting a process of learning-by-exporting.¹ A similar learning occurs for foreign-owned firms (although with some distinct features), and they are 66 percent more productive than domestically owned firms. This difference is due to two factors. First, foreign investors tend to “cherry pick” and invest in the more productive firms (selection). Indeed, domestically owned firms that are set to become foreign owned in the following period are 39 percent more productive than those that are not. Second, the productivity of firms that are acquired by multinationals tends to increase after the acquisition (learning).

⁴⁰ See Box 3.1 in World Bank (2021). *Pakistan Development Update*. April 2021. The analysis relies on the estimation of a gravity model of trade, focusing on countries with at least 5 million inhabitants and covering 80 percent of international trade flows. For a detailed description of the methodology, see Mulabdic, A. and P. Yasar (2021). “Gravity Model-Based Export Potential: An Application to Turkey”. Policy Research Working Paper No. 9557. World Bank, Washington.

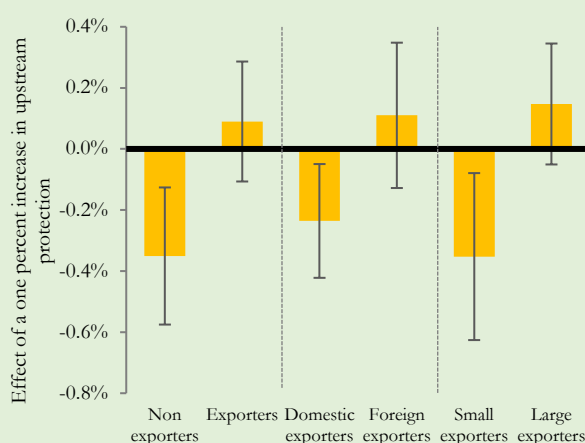
Second, increased import duties – particularly, but not only, on intermediates – reduce firms’ productivity. This common finding across countries is also the case for Pakistan. Accessing intermediates at world prices is crucial to expanding the set of options available to firms when choosing how to produce and increase efficiency. Results show that reductions in import duties for intermediate inputs help firms in downstream sectors to increase their productivity. This is because they import more of the same intermediates but also new varieties that may help them produce more efficiently. The results also suggest that, while import duty exemption schemes are in place for exporters (for example, the Duty and Tax Remission for Exports, DTRE) that allow duties paid on intermediates to be refunded when used to produce exportables, these schemes do not work seamlessly. Results from a pilot survey among exporters conducted in Pakistan reveals that, despite some progress, the system to claim exemptions remains complex, inducing some exporters – particularly the smaller ones – to opt out of it. In addition, indirect exporters face substantial challenges in securing duty exemption schemes. The high costs of inputs due to high import duties (Pakistan’s import duties on intermediates and on capital equipment are among the highest in the world) prevents many firms (often small or indirect exporters) from making the jump to global markets. The results indeed show that the firms that are most affected by increases in import duties on inputs are domestic-oriented and relatively small exporters, whereas foreign-owned and large exporting firms are relatively immune to input duty changes – as they are likely better positioned to access duty exemption schemes (Figure 3.7). Thus, improving exemption schemes such as the DTRE and an across-the-board tariff rationalization reform are both policy imperatives.

Figure 3.6: Productivity by exporting and ownership status in Pakistan
(Productivity index)



Source: Lovo and Varela (2020). Note: the categories “domestic owned” and “non-exporters” are set as benchmarks, with productivity equal to one. Foreign-owned corresponds to firms that were foreign-owned over the entire period of analysis (2012-2017), whereas systematic exporters are firms that exported in every year between 2012 and 2017. Exporters and foreign owned “to be” are firms that change status to exporter/foreign-owned in the following year.

Figure 3.7: Estimated effects of increases in intermediate input import duties on firm’s productivity, by type of firm



Source: Lovo and Varela (2020). Note: graph shows regression coefficients (and 95% confidence intervals) of input tariffs on firm-level productivity (TFP) by type of exporter. The coefficient shows the effect of a 1 percentage point increase in input tariffs on TFP.

b. The state of Pakistan’s export competitiveness

Pakistan has been losing ground in export markets

The export market share of Pakistani firms has declined since 2000 – particularly over the last decade. In 2000, USD13 out of every USD10,000 worth of goods and services exported worldwide originated in Pakistan. This has fallen to only USD11 in 2020. In contrast, Vietnam increased its export market share from USD21 to USD127 over the same period (Figure 3.8). The decline in Pakistan’s export market shares is generalized across sectors. Pakistan’s share in the global market for hides and skins, for example, shrank from 1.5 percent in the early 2000s to 0.8 percent in 2020. The share of Pakistan’s flagship export sector, textile and apparel, shrank from 2.3 percent to 1.8 percent over the same period. The services sector also showed stagnation, with only modern services (that include exports of computer and professional services), has shown dynamism. Overall, Pakistan’s presence in global markets shrank since the turn of the century, while global trade almost tripled.⁴¹

⁴¹ Global trade increased from USD7.9 trillion to USD22.6 trillion between 2000 and 2020. However, global trade growth has not been continuous over the past two decades and has been substantially lower after the 2008 global financial crisis.

Merchandise export diversification has been elusive

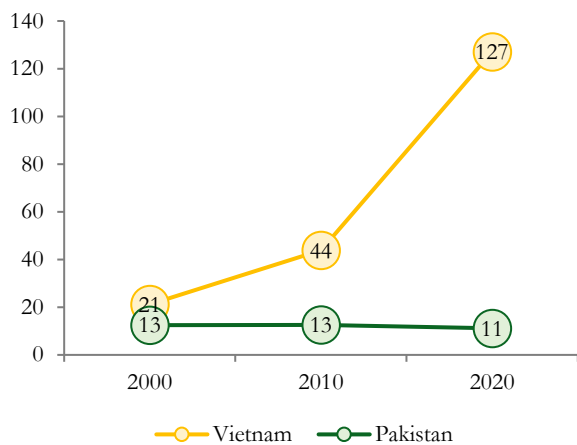
Pakistan has struggled to diversify its exports, falling behind the rest of the world, in terms of both products and destinations (Figure 3.9). This matters for two reasons: first, diversifying the export bundle hedges against product- or destination-specific shocks; second, the ability to diversify export destinations is correlated with a sector’s competitiveness.

At the product level, Pakistan’s merchandise export bundle (four-fifths of total exports) has not changed substantially in the past decade. Textile and apparel account for almost 60 percent, while the animal, vegetable, and foodstuff sectors combined account for 20 percent. Indeed, the number of product varieties exported by Pakistan fell over the past decade, from an average of 3,167 in 2007–09, to an average of 2,894 in 2017–19.⁴² This implies that in the last decade, Pakistan fell in the world ranking of product varieties exported, from the 38th percentile to the 45th percentile.

In terms of destinations, despite some progress, Pakistan has improved at a slower pace than its peers. A straightforward way of measuring destination diversification is to count the number of markets reached. By this metric, Pakistan fell from the 22nd percentile in 2007–09 to the 29th percentile in 2017–19. The Index of Export Market Penetration (IEMP) is an alternative measure of destination diversification. For all product varieties a country exports, it measures the share of active importers it reaches. Export powerhouses, such as China or Germany, show an IEMP above 60 percent; meaning their export products reach more than 60 percent of the potential destinations. In 2019, Pakistan reached 8 percent of the pool of potential importers, up from the 7.4 percent observed a decade ago, and while it has made progress, it is still far from countries such as Vietnam, Malaysia, or Indonesia (Figure 3.10). This relatively low destination reach contributes to keep exporting firms small, limiting their ability to tap into economies of scale (Box 3.2).

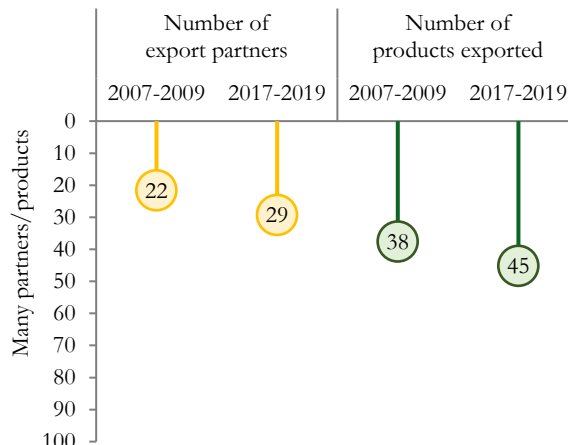
Finally, product and destination diversification (or the lack thereof) can serve as an indicator of competitiveness. For example, Pakistani firms sell cotton towels to clients across 132 different countries, but electric smoothing irons only to Afghanistan. Pakistan has a consolidated comparative advantage in the export of textiles and can therefore successfully sell in distant or nearby markets alike. Instead, its competitiveness to export more sophisticated items, such as household appliances, is less consolidated and relies on advantages related to low transport costs (due to proximity) or common preferences between domestic and export markets (due to similar cultures, levels of development, or acceptance of certain standards).

Figure 3.8: Global market shares 2000-2020
(Exports per \$10,000 of world’s exports)



Source: World Development Indicators; World Bank staff calculations.

Figure 3.9: Market and product diversification
(Pakistan’s normalized ranking)



Source: World Integrated Trade Solution; World Bank staff calculations.
Note: rankings calculated based on period averages.

⁴² These “export varieties” are defined following the classification of the “Harmonized System” at six digits of disaggregation.

Pakistan’s pattern of export specialization focuses mostly on the low-quality segment

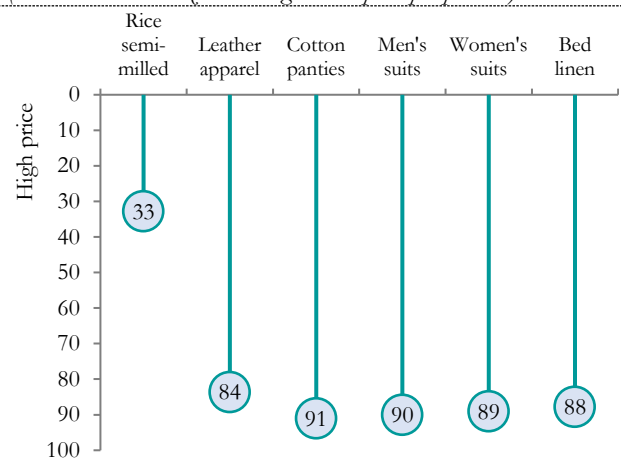
The quality of Pakistan’s export products is another indicator of export competitiveness. If exporters specialize in high-quality segments of the market, they create more value added and better paid jobs. However, the prices fetched by Pakistan’s exporters, for narrowly defined products in the textile and apparel sector, are lower than that of competitors. This suggests that Pakistan’s exporters specialize in more standard, low-quality items. For example, in the market for men and women’s suits, which are among Pakistan’s top 10 export products, Pakistani exporters rank 90th and 89th, respectively, in terms of prices (Figure 3.11). In the case of rice, where Pakistan sells a well-established product (basmati rice), Pakistani exporters fare substantially better: they rank 33rd in terms of the price fetched. This suggests that there is substantial scope for value addition in agricultural exports through, for example, branding, compliance with standards, and appropriate certification.

Figure 3.10: Index of Export Market Penetration (IEMP) in selected countries 2009-2019



Source: World Integrated Trade Solution; World Bank staff calculations.

Figure 3.11: Quality ladders (Pakistan’s normalized ranking in unit price per product)



Source: World Integrated Trade Solution; World Bank staff calculations.

Note: based on average prices of exports to the EU. For each product line, only countries with exports over USD100,000 were considered. A value of 1 implies that Pakistan is fetching the highest unit price for that product, a value of 100 the lowest. HS codes of the products shown (from left to right): 100630, 420310, 611592, 620342, 620462, 630232.

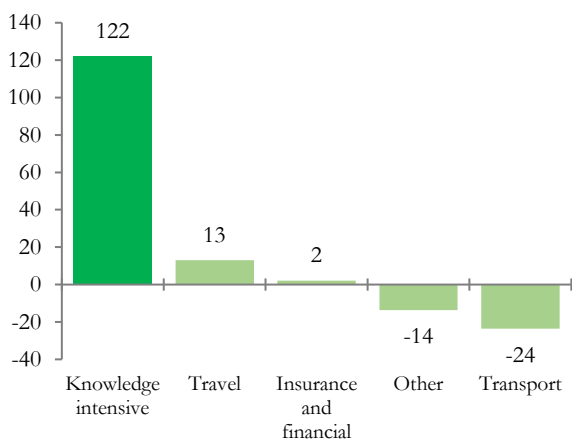
In services, a transformation into knowledge-based exports is taking place

Export quality upgrading is notable in the services sector. During the past decade, services exports have been stagnant in the vicinity of USD6 billion. However, within services, knowledge-intensive sectors such as computer and professional business services have grown relatively fast, at rates above 10 percent annually. A decomposition of export growth of the different subsectors within services shows knowledge-intensive services accounting for almost all the growth, compensating for the contraction of transport and other services exports (Figure 3.12). The global trend of internationalization of business services facilitated this transformation, as Pakistani freelancers and SMEs embraced it. The trend has been amplified by an increase in remote working, fueled by the COVID-19 pandemic.⁴³ The share of knowledge-intensive services exports in total services exports grew from 10 percent in 2010 to 50 percent in 2020 (Figure 3.13). The sector’s current exports receipts are almost equal those of Pakistan’s vegetable sectors combined. Moreover, the sector’s relevance in exports is likely to be underestimated in the available data. Industry experts believe that approximately USD1.5 billion of exports (roughly 50 percent of total services exports) are not reported. This is because some of the exporters are small freelancers who register their receipts as remittances for taxation reasons. Further, given that Pakistani firms face challenges transferring foreign currency to another

⁴³ While most of the growth in knowledge-based services exports in recent years is accounted for by software development, there is a wide diversity of professional services being exported. For example, during the COVID-19 pandemic, with gyms closed in most countries, a group of Islamabad-based personal trainers started selling personalized training programs to clients across the Gulf countries.

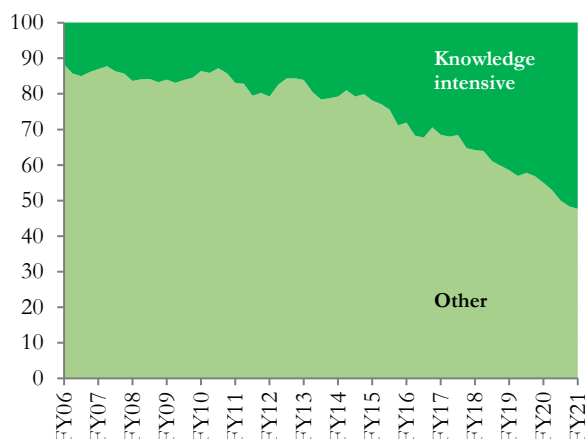
country (often needed to pay foreign suppliers), some firms choose to hold accounts in foreign banks and receive the payments in those accounts instead of within Pakistan.⁴⁴

Figure 3.12: Contributions to growth of services exports, FY06-FY21



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

Figure 3.13: Composition of service exports, FY06-FY21 (In percent)



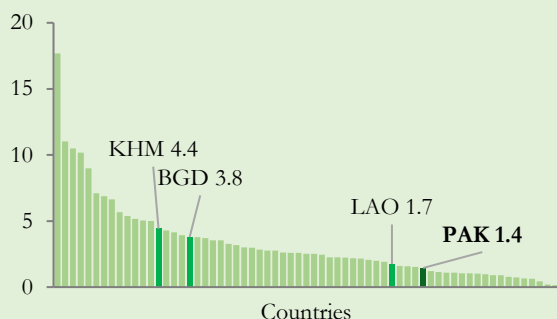
Source: State Bank of Pakistan; World Bank staff calculations.

Box 3.2: Firm export dynamics

Countries do not export. Firms do. Therefore, analyzing exporter-level data is crucial to better understand export competitiveness patterns in Pakistan. To this end, Pakistan’s exporter-level data for the three latest available years (FY15-17) is analyzed and the results benchmarked against relevant comparators.¹ Two related questions are examined: (1) how large are Pakistani exporters? and (2) what are the dynamics of entry and exit?

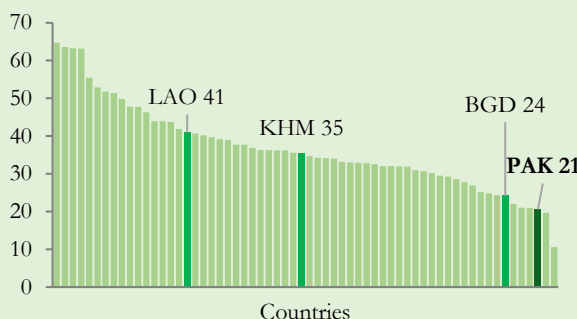
Pakistani exporters are relatively small. On average, they export USD1.4 million per year, almost one-third of the average Bangladeshi exporter (Figure 3.14).¹ The comparison with Bangladesh is particularly informative since the sector’s composition of Bangladesh’s merchandise export bundle is similar to Pakistan’s. The fact that exporters are small is also consistent with a feature of Pakistan’s private sector: firms struggle to grow.¹ An alternative explanation is that entering export markets for Pakistan is relatively easy and therefore, even small firms can succeed at it. However, if that were the case, we would expect to see many exporters, something that is not observed for Pakistan. There are approximately 14,000 active exporters in Pakistan, which, normalized by population, places Pakistan in low levels, almost on par with Bangladesh and Nepal.¹ Rather, the prevalence of small exporters is more likely to be related to frictions that prevent firms from scaling up

Figure 3.14: Exporter size
(Average level of exports per year by exporting firm (USD millions), last available year)



Source: Pakistan exporter microdata (FY15 to FY17) and Exporter Dynamics Database; World Bank staff calculations. Note: the dataset covers 1997-2014. We considered only countries with data from 2009 or more recent.

Figure 3.15: Exporter entry rate
(Percent)

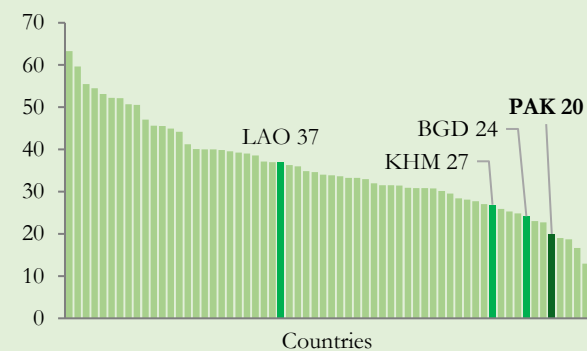


Source: Pakistan exporter microdata (FY15 to FY17) and Exporter Dynamics Database; World Bank staff calculations. Note: the dataset covers 1997-2014. We considered only countries with data from 2009 or more recent.

⁴⁴ See Box 4.2 “Pakistan’s ICT Services Boom” in “At Your Service? The Promise of Services-Led Development.” World Bank, 2021.

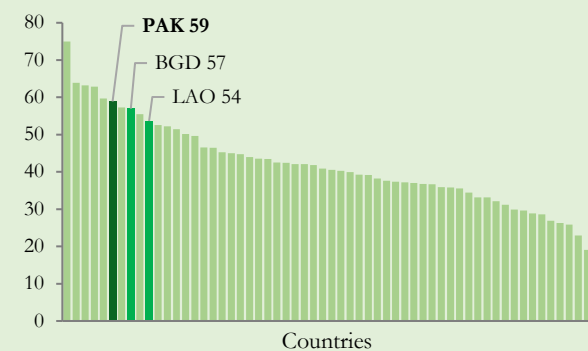
Low entry and exit rates into exporting are revealing of frictions that discourage firms from exporting in Pakistan.⁴⁵ Entry and exit rates in Pakistan are low compared to the rest of the world (21 and 20 percent, respectively), and in line with Bangladesh’s (Figure 3.15 and Figure 3.16). Low entry rates are suggestive of an environment with entry frictions in export markets. These frictions reduce the scope for churning, typically associated with improvements in allocative efficiency. These may be related to the set of incentives in place that reward incumbents rather than innovators (such as the Duty Drawback of Taxes or DDT and the Drawback of Local Taxes and Levies or the DLTL schemes, summarized in Section c). Low exit rates imply high survival rates (Figure 3.17), further consistent with incentives prizing incumbents rather than innovators.

Figure 3.16: Exporter exit rate
(In percent)



Source: Exporter Dynamics Database; World Bank staff calculations. Note: the dataset covers 1997-2014. We considered only countries with data from 2009 or more recent.

Figure 3.17: Survival rate
(Entrant first year survival rate, in percent)



Source: Exporter Dynamics Database; World Bank staff calculations. Note: the dataset covers 1997-2014. We considered only countries with data from 2009 or more recent.

c. The drivers of the export challenge

There are 3 key reasons for the stagnation of Pakistan’s exports

The stagnation of Pakistan’s exports can be explained by examining three key elements: (i) the incentives firms face when choosing whether to export or sell locally; (ii) the supporting services they have once they decide to export, and (iii) the underlying productivity of Pakistani firms, which constitutes a key determinant of success in demanding global markets.⁴⁶ These elements are discussed in turn.

High import duties act as export taxes

High import duties discourage firms from exporting. Domestic firms have a natural advantage in their home market because of low transport costs and deep knowledge about consumer preferences relative to foreign suppliers. Further, the Government actively encourages selling domestically at the expense of exports. Although Pakistan does have a large domestic market, the global market is 318 times larger. High import duties imply high effective rates of protection of domestic industries, making profits of selling domestically artificially large by deterring import-competition. Import duties, intended to incentivize import substitution, instead incentivize export substitution.⁴⁷

Pakistan’s tariff policy creates a high

Import duties in Pakistan are high, have been increasing, and follow a “cascading” scheme.⁴⁸ These three features have resulted in a marked and increasing anti-export bias. The country’s average import duties are among the highest in the world (Figure 3.18),⁴⁹

⁴⁵ The entry rate in year T is the percentage of exporters present in T that were not present in T-1. The exit rate in T is the ratio of “exitors” (firms that were present in T-1 and that are not present in T), over the number of exporters in T, times one hundred. The entrant first year survival rate in a given year T is the ratio of first year surviving entrants (firms that exported in T and T-1, but not in T-2) over the entrants of the previous year (firms that exported in T-1, but not in T-2).

⁴⁶ There are many factors that constrain private sector growth in Pakistan. Both exporters and non-exporters are affected by many of these challenges, such as energy costs and availability, transport and logistics challenges, infrastructure conditions (such as internet connectivity and availability of fiber optics, for the knowledge-intensive, tourism or transport-related sectors), the conduciveness of the investment climate, general taxation frictions, or the exogenously determined soaring freight costs. This PDU section focuses on the challenges or policies that disproportionately affect export decisions or export activity and that can be affected by public policy or public investment decisions.

⁴⁷ Systematic evidence on the link between output tariffs and “missing exports” (the difference between potential and actual exports) and between effective rates of protection and missing exports is presented in “Pakistan’s Export Potential: Some Estimates and Implications”, World Bank. Islamabad.

⁴⁸ In a cascading tariff scheme, the more processed and “closer” to the consumer the good is, the higher the tariff it faces. Final consumer goods face the highest tariffs, followed by processed intermediates, while raw materials face relatively low tariffs.

⁴⁹ Pakistan ranks among the top decile of countries with the highest average import duties. It also ranks among the top decile of countries with the highest duties on consumer goods, on capital goods, and on intermediates.

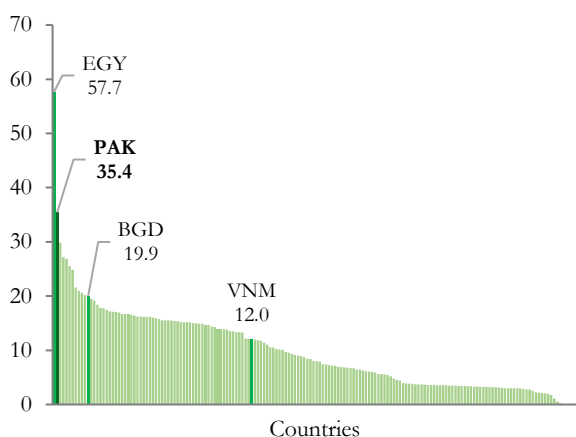
and increasing anti-export bias

and have also increased over the past five years (Figure 3.19). While customs duties (CDs) have slightly declined during the past decade, two new import duties were introduced (additional customs duties, ACDs, and regulatory duties, RDs). Their introduction more than compensated for the decline of CDs. As a result, total import duties increased from slightly less than 15 percent in FY15, to 20 percent in FY21. The introduction of ACDs and RDs increased the anti-export bias of tariff policy and also tariff policy uncertainty. While changes in CDs require the Parliament’s approval, changes in ACDs and RDs only require the Cabinet’s approval, making ad-hoc duty changes more likely to be passed.

Cascading is not unique to Pakistan. Most countries in the world structure their tariffs that way with the intention of incentivizing value addition through effective protection (aiming at import substitution). An unintended consequence of cascading is that it also incentivizes selling at home rather than exporting (resulting in export substitution). And while cascading is not Pakistan-specific, the *extent* to which it is used. Pakistan’s cascading is among the steepest in the world, second only to Egypt (Figure 3.20). Given that tariff cascading incentivizes export substitution, it is no surprise that it is negatively associated with export orientation on a cross-country level (Figure 3.21). Countries with cascading rates in the top quarter of the distribution, which on average have a 13.4 percentage-point difference between tariffs on consumer goods and tariffs on raw materials, show an export to GDP ratio of 25.6 percent on average. In contrast, countries that are in the bottom quarter of the distribution of cascading, which on average have a 1 percentage-point difference between tariffs on consumer goods and raw materials, show double the export to GDP ratio, closer to 50 percent, all else equal.⁵⁰ Indeed, export in Pakistan is portrayed as a residual option for the allocation of production.⁵¹

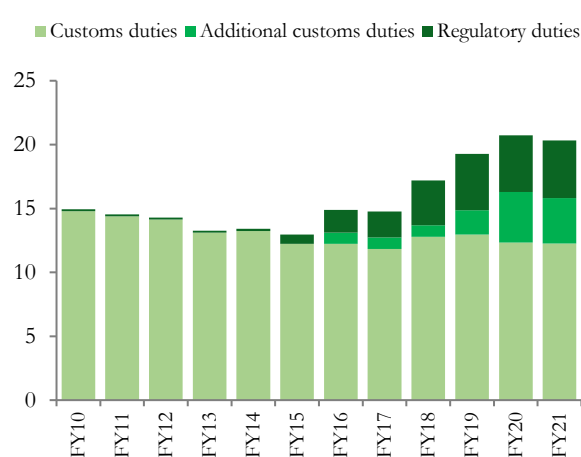
A positive development worth noting is the approval of the first National Tariff Policy (NTP) in FY20, which recognizes tariffs as an instrument for trade facilitation rather than for revenue collection. It set up an institutional framework for tariff policy decisions and initiated a mild process of tariff rationalization. If consolidated, this process could revert the protectionist trends observed in the recent past. Indeed, the slight decline in import duties in FY21 can be attributed to the NTP and the associated improved institutional set up for import duty policy making.

Figure 3.18: Tariffs on consumer goods
(In percent)



Source: Pakistan customs data and World Integrated Trade Solution; World Bank staff calculations.

Figure 3.19: Average tariffs in Pakistan, FY10-FY21
(In percent)

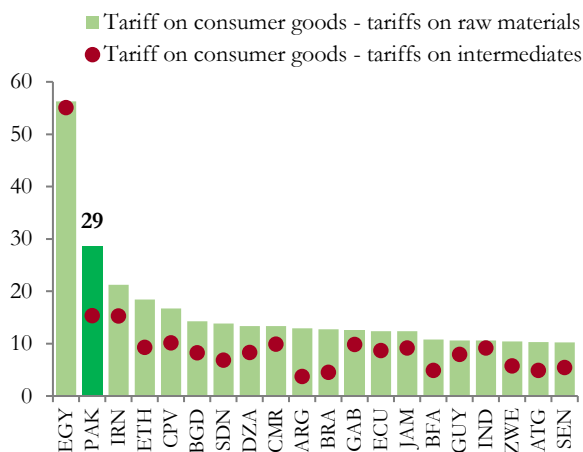


Source: Pakistan customs data; World Bank staff calculations.

⁵⁰ The fact that import duties act as export taxes was introduced by Lerner, A. (1936). More recently, [Varela, G. et al \(2020\)](#) show, in a cross-country setting, that increases in output tariffs are systematically associated with decreases in export orientation, other things being equal.

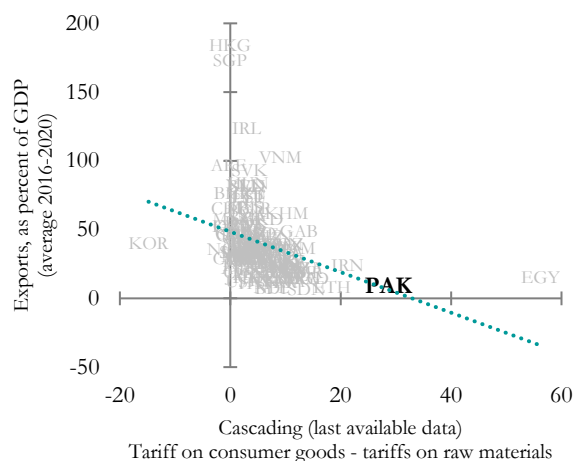
⁵¹ The way the term “export surplus” is used in Pakistan is revealing of exporting being a “residual” option. The Oxford Dictionary defines export surplus as “the amount by which the value of a country’s exports exceeds that of its imports.” The concept is analogous to that of net exports. In Pakistan, however, the term “export surplus” is commonly used as the difference between what is produced at home and sold at home, or the residual that could be sold in international markets.

Figure 3.20: Tariff cascading, top 20 in the world
(Difference between tariff on consumer goods and raw materials)



Source: Pakistan customs data and World Integrated Trade Solution; World Bank staff calculations.

Figure 3.21: Tariff cascading and export orientation



Source: Pakistan customs data, World Integrated Trade Solution and World Development Indicators; World Bank staff calculations. Note: The negative correlation between cascading and export orientation is statistically significant at 5 percent.

Pakistan has few preferential trade agreements and faces implementation challenges in existing ones

The decision to export in Pakistan is further deterred by the country’s limited access to foreign markets. Over the last decades, Preferential Trade Agreements (PTAs) have become a prominent tool used by countries to secure market access and to deepen regional and global integration. They often go beyond lowering trade tariffs and include, for example, harmonization of customs and border procedures, quality standards, and investment integration provisions. Indeed, the number of PTAs worldwide increased from 50 in the early 1990s to roughly 300 in 2019, and their depth – measured by the average number of different provisions they include, also increased. While the average country is signatory to 13 PTAs, Pakistan is only signatory to 4, and only one has been effectively implemented and covers a substantial portion of trade: The China–Pakistan Free Trade Agreement (CPFTA).⁵² Some current progress in this front is commendable, particularly the ongoing negotiations with Turkey (with whom Pakistan already has an agreement in place) and Uzbekistan.

Incentive schemes for existing exporters tend to focus on the well-established sectors

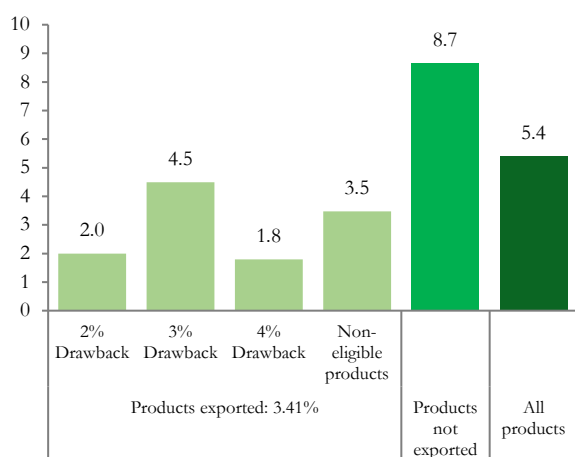
For firms already exporting, the existing export incentives are not conducive to growth or diversification. The Government has in place two duty drawback mechanisms that provide incentives or “rebates” to exporters of eligible products.⁵³ The amount refunded is a percentage (2, 3, or 4 percent) of the exported value. Half of the incentive is, in principle, unconditionally received by the exporter.⁵⁴ The other half is conditional on export growth. However, not all export products are eligible, and, given eligibility, there are different rebate rates. Thus, it is possible to examine whether the eligibility parameters are consistent with the objectives of growth, diversification, or sophistication of exports.

⁵² The South Asia Free Trade Agreement (SAFTA), to which Pakistan is also signatory, is only partially implemented, and faces substantial geo-political challenges that prevent Pakistan from tapping into a market with a potential for exports of USD12 billion. World Bank (2021a) “Pakistan’s Export Potential: Some Estimates and Implications”, World Bank. Islamabad.

⁵³ The mechanism for textiles is the DDT, while for non-textiles it is the DLTL. The export value considered for the calculation is free-on-board (FOB). Strictly, a “drawback” is a refund of duties paid, typically on imported inputs that is subsequently exported or used to produce a product for export. These two schemes, however, can be better understood as export incentives rather than drawbacks. The eligible rebate rate is not determined by how much an exporter paid as duties to produce the exportable product. Rather, they are intended as “liquidity support” for exporters (of some products).

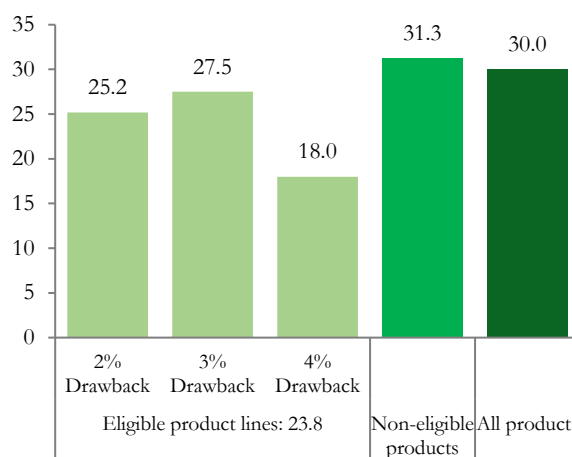
⁵⁴ Although in principle all eligible exporters should receive the incentive, in practice not all do. The agency in charge of running the schemes, the Ministry of Commerce, has not released all the incentive payments in time and, although disbursements have picked up pace in 2020 and 2021, firm level data suggests that it is mainly favoring large firms. This is consistent with both high fixed costs of claiming the incentive (larger the exporter, the lower the average cost of filing a claim) and with the first-come, first-served system of disbursements.

Figure 3.22: Global demand growth (2015-2019) by export incentive eligibility (In percent)



Source: Pakistan customs data and World Integrated Trade Solution; World Bank staff calculations.

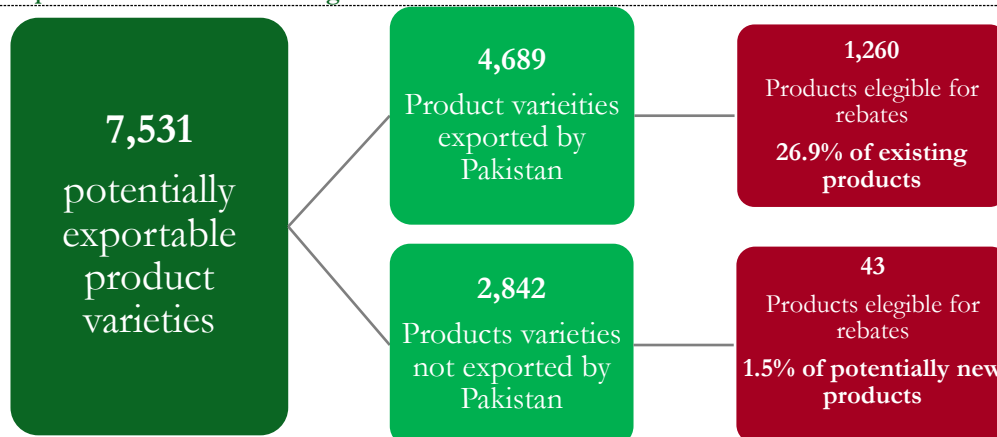
Figure 3.23: Export product sophistication (2015-2019) by export incentive eligibility (Average PRODY)



Source: Pakistan customs data and World Integrated Trade Solution; World Bank staff calculations. Note: PRODY is an outcome-based measure of sophistication: if a product is mostly produced by rich countries, then it is revealed to be a “rich,” or sophisticated, product. PRODY is calculated as a weighted average of per capita GDP of countries producing that product, with weights derived from revealed comparative advantage.

By design, these duty drawback mechanisms reward less dynamic, less sophisticated, and incumbent firms, preserving the current export structure rather than transforming it. First, products eligible for rebates or entitled to higher rebate rates face less dynamic global demand than non-eligible ones (Figure 3.22). Second, eligible products tend to have low sophistication or complexity (Figure 3.23). Within eligible ones, higher rebate rates tend to be applied on less sophisticated products. Third, the schemes have a marked anti-new, pro-incumbent bias. A careful analysis of likelihood of eligibility for rebates suggests that eligibility is more likely for products that are typically exported by relatively larger firms, and for products that are well-established in Pakistan’s export bundle.⁵⁵ In fact, only a handful of targeted products that are not yet exported, with the ratio of targeting of established products to new products being 17.9 to 1 (Figure 3.24). In addition, no services exports are eligible. Yet, the incentives could make a difference precisely to the potentially new export products, as innovative firms venturing in new activities may need additional liquidity to overcome the costs of the innovation. The incentive schemes seem to be designed to preserve the current export structure and dynamism, rather than to transform it.

Figure 3.24: Export incentive schemes target established sectors instead of new sectors



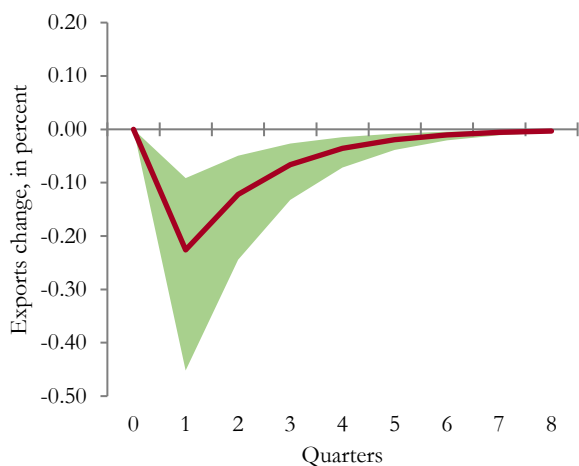
Source: World Bank staff calculations. Note: Exportable product varieties are defined following the classification of the Harmonized System at eight digits of disaggregation.

⁵⁵ See World Bank (2021b) for a detailed analysis of determinants of product eligibility for DDT and DLT.

Exports fall faster than they grow when facing changes in the real exchange rate

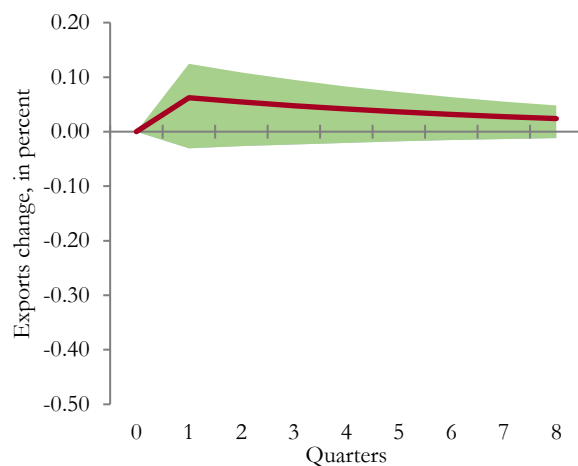
Pakistan’s exports are slow to respond when the real effective exchange rate (REER) depreciates, but fall more rapidly when it appreciates, revealing supply-side constraints. Setting aside the marked anti-export bias of the tariff policy, or incentives that do not favor growth or diversification, REER changes could play a role in the evolution of export competitiveness. In the long run, Pakistan’s exports are sensitive to the REER in the expected direction: a 1-percent depreciation of the REER is associated with a 0.5 percent increase in exports, all else equal. However, the speed at which exports respond to REER movements is asymmetric: exports fall faster after a 1-percent appreciation than they increase after a 1-percent depreciation (Figure 3.25 and Figure 3.26). Results from [recent research](#) focusing on Pakistan ascribes the narrowing of this to two factors related to complementary services to exporting: credit and access to market intelligence. These factors are discussed in turn below.

Figure 3.25: Pakistan’s export response to a 1 percent appreciation



Source: Brun et al. (2020). Note: the chart shows the quarterly adjustment in exports to a real effective exchange appreciation of one percent, along with the confidence interval for the change (shaded green area).

Figure 3.26: Pakistan’s export response to a 1 percent depreciation



Source: Brun et al. (2020). Note: the chart shows the quarterly adjustment in exports to a real effective exchange depreciation of one percent, along with the confidence interval for the change (shaded green area).

Access to credit facilitates the capacity expansion needed to scale up exports after depreciations

The lack of an “exportable surplus” has been identified as the reason for the delayed export responses to REER depreciations in Pakistan. Firms tend to find it difficult to quickly expand capacity and increase production unless they have accumulated retained profits. Indeed, the evidence shows that part of the export response asymmetry disappears for sectors that are structurally less reliant on external finance, or those that have greater access to the SBP’s long-term export finance schemes (For example, the Long-Term Financing Facility, LTFF).⁵⁶ An additional 10 percent in the ratio of loans over exports is related to a 4.7 percent greater export response to REER depreciations.⁵⁷

Improving access to information will also help exporters scale up

Finding new clients after depreciations tends to be more difficult than losing them after appreciations, if finding clients, building relationships, identifying pricing strategies, and tailoring products to the needs of the foreign buyer is costly.

These “information costs” tend to be more relevant for products that are “customized” to the buyer or consumer (or differentiated products) than for products that are standard (homogenous). Data for Pakistan show these patterns. Pakistan’s exports of products such as clothing or surgical products take longer to expand after the REER depreciates than the exports of more standard products such as rice or wheat. This is because the latter are traded in organized markets, which have reference prices, whereas the former require more customization and relationship-building between buyers and sellers, which is not

⁵⁶ Defever et al. (2020) show that the LTFF for capital equipment that SBP runs increased the growth rate of export sales by 8-11 percentage points. While it is costly to run, it is more cost-effective and receives less resources than other mechanisms, such as the working capital financing scheme for exporters (EFS).

⁵⁷ This result is aligned with vast empirical and theoretical evidence showing how low financial development acts as a barrier to international trade, affecting export decisions. See for example, Kohn et al. (2016) or Kohn et al. (2021)

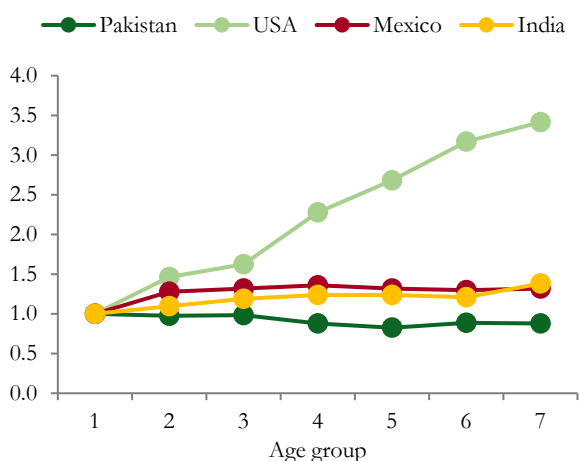
only costly but also takes time. This points to the importance of supporting exporters of these latter types of goods, in securing market intelligence to reduce these costs.⁵⁸

Market intelligence provision in Pakistan is scattered, with the main export promotion agency, the Trade Development Authority of Pakistan (TDAP), being underfunded and having low technical capacity.⁵⁹ A promising recent development in this front is the revamping of Pakistan’s global network of trade attachés, who have been working with TDAP to facilitate the exports. Monitoring and evaluating the results of this revamp is crucial to understand the cost-effectiveness of this instrument.

Increasing firms’ productivity is a long-standing challenge for Pakistan

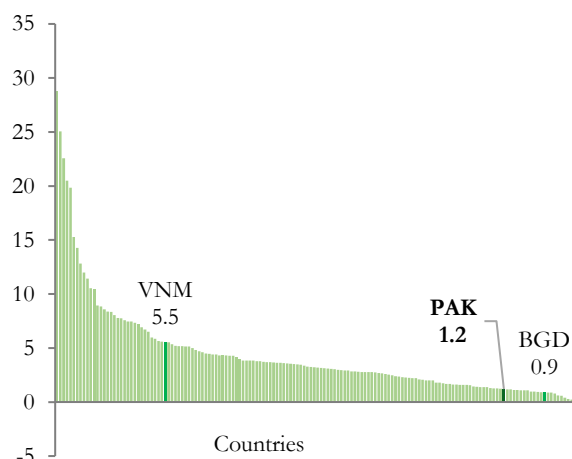
Finally, increasing productivity at the firm level is a major requisite to scale up participation in global markets (Figure 3.27). Pakistani firms’ productivity growth has been sluggish, and while exporters show higher levels of productivity, their growth has been similarly underwhelming.⁶⁰ In addition, Pakistani firms do not grow more productive with time, but rather the opposite: A 40-year-old firm is 87 percent as productive as a young firm of less than 10 years. Instead, in India or Mexico, the older firm is between 30 to 40 percent more productive than the younger one. In the United States, it is 341 percent more productive, on average. This challenge is in part due to the limited integration of Pakistan into the global marketplace: a certain minimum level of productivity is needed to integrate, and productivity, in turn, increases with integration (see Box 3.1). Foreign direct investment, a key driver of productivity spillovers, is low in Pakistan, with net inflows averaging 1.2 percent of GDP during 2010–2020 (Figure 3.28), and the presence of multinationals in export-oriented sectors is particularly low. Security concerns, a complex investment climate, and a highly protectionist Investment Law of 1976, have contributed to this outcome. In addition, firms’ skills, or “capabilities,” strongly associated with productivity, are low, as revealed by recent fieldwork conducted in Punjab and Islamabad. Yet, initiatives by the Small and Medium Enterprise Development Agency to enhance firm capabilities are limited and not subject to rigorous evaluations.

Figure 3.27: Firm’s productivity over their lifecycle, Pakistan and comparators
(TFP index)



Source: Country Economic Memorandum – Country Scan. Mexico, India and USA data come from Hsieh and Klenow (2014), data for Pakistan comes from Lovo and Varela (2020).

Figure 3.28: Foreign direct investment
(Net inflows, in percent of GDP, average 2010-2020)



Source: World Development Indicators; World Bank staff calculations. Note: only countries with population over 1 million are included. Cyprus (77 percent of GDP) is excluded for scale reasons.

⁵⁸ A justification for public investment in this area of market intelligence is the fact that gathering information about the feasibility of selling a given product to a particular new destination is costly for a firm, but that firm may not appropriate all the profits, as other firms may follow suit (without incurring the costs) and also benefit. Therefore, firms may underinvest in market intelligence.

⁵⁹ The International Trade Center (ITC) recently assessed the performance of TDAP at ‘below average’ in its latest benchmarking exercise, pointing to several challenges, including lack of client datasets, client management systems, as well as lack of monitoring and evaluation frameworks for its interventions. Indeed, most of TDAP’s budget is spent on staff remunerations rather than on support to exporters.

⁶⁰ See Lovo and Varela (2020) for a discussion on productivity growth trends, at the firm level, in Pakistan.

d. Fixing the export challenge

Revitalizing export will require a long-term and coordinated policy strategy

To improve export competitiveness, Pakistan needs an integrated and long-term reform strategy. This will require coordination across government agencies at federal and provincial levels to harmonize policy decisions, institutional strengthening to ensure effective implementation, and active public–private sector dialogue to secure the broadest support to reforms. The table below presents key recommendations and indicates whether the recommendation is for the short or long run, as well as the main agencies responsible for their implementation.⁶¹

	Policy Recommendation	Timeframe	Responsible Agencies
Anti-export bias of tariff policy	Design and implement a long-term tariff rationalization strategy. Gradually reduce import duties and tariff cascading. Identify potentially affected sectors and implement time-bound support to displaced workers.	Long run	Ministry of Commerce (MOC), National Tariff board (NTB)
	Phase out regulatory and additional customs duties.	Long run	MOC, NTB
	Digitize and automate duty remission schemes for exporters, with trust-based systems and risk-based audits, and time-bound approval processes.	Short/long run	Federal Board of Revenue (FBR)
	Equip the NTB to make evidence-based policy decisions, building capacity in the National Tariff Commission; strengthen the link between academia and the Government.	Long run	MOC, NTB, NTC
Market access	Negotiate market access with high export potential markets and equip trade negotiators with necessary skills and resources.	Short run	MOC, Private Sector
	Establish foot-and-mouth disease-free zones in partnership with the private sector, to secure beef exports to the fast-growing Chinese market through the China–Pakistan FTA.	Short run	Ministry of National Food Security and Research, MOC, Provincial Govt., Private Sector
	Support exporters to increase destination reach by leveraging market access provided by China-Pakistan FTA and the Generalized System of Preferences.	Short run	MOC, Private Sector, Trade Development Authority Pakistan (TDAP)
FDI promotion	Amend the Investment Act to harmonize it with the Investment Policy of 2013.	Short run	Board of Investment (BOI)
	Simplify processes for registration of paid-up capital in SBP, and profit repatriation of multinationals.	Short run	State Bank of Pakistan (SBP)
	Professionalize the investment promotion agencies and coordinate it with export promotion agencies.	Short/long run	BOI, TDAP
Export subsidies (drawbacks)	Increase eligibility of duty drawback schemes, including services exports; reduce average rate and dispersion; consider the growth of exports as the basis for the subsidy rate rather than the level of exports.	Short run	MOC
	Condition 100 percent of the incentive on export growth, relative to the previous period, automatically making new exporters eligible.	Short run	MOC
	If differential rates are to be applied, consider the following to target products for higher rates: i) new export products, (ii) new exporters, (iii) more sophisticated products, and (iv) products that are not water intensive.	Short run	MOC
	Evaluate the impact of DDT and DLTL.	Long run	MOC
Export Credit	Reallocate resources into the LTFF, away from the EFS.	Short run	SBP
	Reconsider extent of subsidy in LTFF and EFS based on a cost–benefit analysis.	Long run	SBP
Export promotion	Harmonize export intelligence and consolidate it under one agency; consolidate trade portals and keep them under the	Short run	Pakistan Software Export Board (PSEB), TDAP, FBR

⁶¹ Here again, the list of recommendations is not exhaustive but focuses on the most salient policy challenges for reviving exports.

& facilitation	National Single Window, complying with the WTO Trade Facilitation Agreement.		
	Digitalize market intelligence provision support by relying on available international platforms.	Short run	TDAP, PSEB
	Re-consider financial support to firms to participate in trade fairs and exhibitions by evaluating its impact. Focus support on new exporters in the interim.	Short run/long run	MOC, TDAP
	Increase transparency in the use of the Export Development Fund, monitor and evaluate associated expenses.	Short/long run	MOC
	Reduce restrictions to foreign currency outflows. Increase the USD400,000 outflow limit beyond which approvals are required to incentivize firms to register export proceeds in Pakistan.	Short run	SBP
	Allow firms to maintain (greater portions of) export proceeds in foreign currency accounts.	Short run	SBP
	Enhance the e-commerce framework, with focus on regulatory changes to personal data protection.	Short/long run	MOC, Ministry of Information Technologies and Telecommunications
Consider double taxation agreements to reduce the tax burden on exports of modern services.	Long run	MOF, FBR, MOC	
Skills	Collaborate and agree on a curricular update with professional and technical advice.	Long run	Higher Education Commission (HEC), Private Sector, Universities
	Recognize credits from internationally quality-accredited online courses (e.g., focusing on the IT sector, coding courses from Coursera and EdX).	Short run	Higher Education Commission
	Support upgrading of firms' capabilities, focused on new exporters and evaluate its impact.	Long run	Small and Medium Enterprises Development Agency

Source: World Bank Staff elaboration

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Statistical Annex

Annex Table 1: Key Macroeconomic indicators (annual)

	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Real GDP growth, at constant market prices	1.6	2.7	3.5	4.4	4.7	4.7	5.5	5.6	5.8	1.1	-0.9	3.5
Private consumption	2.2	4.6	5.0	2.1	5.6	2.9	7.6	8.5	6.2	3.1	-4.1	4.2
Government consumption	-0.6	0.0	7.3	10.1	1.5	8.1	8.2	5.3	8.6	0.8	6.8	2.2
Gross Fixed Capital Investment	-7.3	-7.7	2.4	2.6	2.5	15.8	7.5	10.3	11.2	-12.5	-1.0	5.7
Exports, Goods and Services	15.7	2.4	-15.0	13.6	-1.5	-6.3	-1.6	-0.6	12.7	14.5	2.5	4.8
Imports, Goods and Services	4.3	-0.1	-3.1	1.8	0.3	-1.6	16.0	21.2	17.6	4.3	-7.9	8.1
Real GDP growth, at constant factor prices	2.6	3.6	3.8	3.7	4.1	4.1	4.6	5.2	5.5	2.1	-0.5	3.5
Agriculture	0.2	2.0	3.6	2.7	2.5	2.1	0.2	2.2	4.0	0.6	3.3	2.2
Industry	3.4	4.5	2.6	0.8	4.5	5.2	5.7	4.6	4.6	-1.6	-3.8	4.6
Services	3.2	3.9	4.4	5.1	4.5	4.4	5.7	6.5	6.4	3.8	-0.6	3.5
Inflation (Consumer Price Index, period average)	10.1	13.7	11.0	7.4	8.6	4.5	2.9	4.8	4.7	6.8	10.7	8.9
Current Account Balance (% of GDP)	-2.2	0.1	-2.1	-1.1	-1.3	-1.0	-1.8	-4.0	-6.1	-4.8	-1.7	-0.6
Fiscal Balance, excluding grants (% of GDP)	-6.2	-6.5	-6.8	-8.2	-5.5	-5.3	-4.6	-5.8	-6.5	-9.0	-8.1	-7.3
General Govt. and Govt. Guaranteed Debt (incl. IMF obligations) (% of GDP)	64.6	61.9	65.8	66.5	65.7	65.7	70.3	70.4	75.9	89.7	92.7	90.7
Primary Balance, excluding grants (% of GDP)	-1.9	-2.7	-2.4	-3.8	-1.0	-0.6	-0.3	-1.6	-2.2	-3.6	-1.8	-1.4

Sources: (i) Pakistan Bureau of Statistics, (ii) Fiscal Operations, Ministry of Finance, (iii) State Bank of Pakistan, and (iv) World Bank staff estimates
 Note: GDP for FY21 is based on World Bank staff estimates. The Government's preliminary real GDP (at factor-cost) growth estimate for FY21 is 3.9 percent.

Annex Table 2: Key Macroeconomic Indicators (quarterly)

	FY20				FY21				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Large Scale Manufacturing Index (growth, y-o-y)	-5.5	0.1	-9.1	-24.6	4.5	10.4	11.5	38.2	
Inflation (Consumer Price Index, period average)	10.1	12.1	12.4	8.4	8.8	8.4	7.8	10.6	
Fiscal and Debt (PKR billion)									
Total Revenue	1/	1,489	1,743	1,458	1,582	1,479	1,872	1,641	1,911
Tax Revenue		1,144	1,323	1,130	1,154	1,277	1,487	1,418	1,578
Non-Tax Revenue		345	420	328	428	202	386	223	333
Expenditure		1,775	2,452	2,149	3,272	1,963	2,526	2,156	3,662
Current Expenditure		1,582	2,139	1,890	2,920	1,813	2,217	2,056	2,999
of which: interest payments		572	710	599	740	742	733	629	646
Development Expenditure & Net Lending		147	326	308	422	215	243	265	593
Statistical Discrepancy		46	(14)	(49)	(70)	(65)	67	(166)	71
Fiscal Balance (excluding grants)		(286)	(709)	(691)	(1,690)	(484)	(654)	(514)	(1,751)
Primary Balance (excluding grants)		286	1	(93)	(950)	258	79	115	(1,105)
General Govt. and Govt. Guaranteed Debt (incl. IMF obligations)	2/	36,209	35,672	36,528	38,538	39,314	39,932	40,707	42,195
External General Govt.		11,591	12,046	12,160	12,911	13,267	13,208	12,742	13,520
Domestic General Govt.		22,650	21,676	22,478	23,283	23,703	24,314	25,555	26,268
Guaranteed	3/	1,969	1,950	1,890	2,344	2,344	2,409	2,410	2,407
Balance of Payments (USD million) 4/									
i. Current Account Balance		(1,719)	(1,728)	(700)	(302)	865	382	(617)	(2,457)
Goods Trade Balance		(5,281)	(5,625)	(4,949)	(5,254)	(5,283)	(6,103)	(7,445)	(9,332)

Goods Exports	5,994	6,414	5,873	4,255	5,354	6,461	6,889	6,928
Goods Imports	11,275	12,039	10,822	9,509	10,637	12,564	14,334	16,260
Services Trade Balance	(1,178)	(892)	(791)	(455)	(533)	(411)	(493)	(399)
Balance on Primary Income 5/	(1,369)	(1,694)	(1,072)	(1,324)	(1,489)	(1,184)	(853)	(1,143)
Balance on Secondary Income 5/ of which: remittances	6,109	6,483	6,112	6,731	8,170	8,080	8,174	8,417
	5,452	5,919	5,637	6,123	7,143	7,060	7,210	7,957
ii. Capital Account	113	85	37	50	77	55	51	55
1. Balance from Current and Capital Accounts (i+ii) 6/	(1,606)	(1,643)	(663)	(252)	942	437	(566)	(2,402)
2. Financial Account 7/	(2,311)	(4,834)	(209)	(1,959)	854	(1,163)	(1,367)	(6,518)
<i>of which:</i>								
Direct Investment	(586)	(822)	(787)	(457)	(410)	(417)	(457)	(478)
Portfolio Investment	(456)	(128)	243	750	179	264	(153)	(3,066)
Net Acquisition of Financial Assets	(129)	316	95	(409)	1,106	467	(264)	(956)
Net Incurrence of Financial Liabilities	1,137	4,199	(244)	1,843	20	1,480	492	2,018
3. Errors and Omissions	373	85	346	(654)	(263)	(143)	(546)	(100)
Overall Balance (-1+2-3)	(1,078)	(3,276)	108	(1,053)	175	(1,457)	(255)	(4,016)
Gross State Bank of Pakistan Reserves (incl. CRR, SCRR) 8/	10,065	13,278	12,861	13,724	13,504	14,886	14,906	18,716

Sources: (i) Pakistan Bureau of Statistics, (ii) Fiscal Operations, Ministry of Finance, (iii) State Bank of Pakistan, and (iv) World Bank staff estimates.

Note:

- For FY21, the Ministry of Finance switched the GIDC, natural gas development surcharge, and petroleum levy from tax to non-tax revenue. For consistency of analysis across years, these taxes have been included in tax revenue.
- Stock, at end-period.
- Guaranteed debt includes Government guarantees issued to public sector enterprises. Where quarterly data is not available, guaranteed debt is assumed to be the same as the last-available estimate.
- As per Balance of Payments Manual 6 (BPM6).
- In BPM6, the income account has been renamed 'primary income' and current transfers, 'secondary income'.
- A negative balance shows that the economy is a net borrower from the rest of the world.
- A negative balance highlights a net increase in the incurrence of foreign liabilities.
- At end-period. CRR: Cash Reserve Requirement, SCRR: Special Cash Reserve Requirement.

