

PAKISTAN

DEVELOPMENT UPDATE

October 2023

Restoring Fiscal Sustainability



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Preface

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

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List of Abbreviations and Acronyms

BISP	Benazir Income Support Programme
BPS	Basis Points
CAD	Current Account Deficit
CAR	Capital Adequacy Ratio
CCI	Council of Common Interests
CIT	Corporate Income Tax
CLL	Concurrent Legislative List
CPI	Consumer Price Index
DMIS	Debt Management Information System
DMO	Debt Management Office
EFF	Extended Fund Facility
FBR	Federal Board of Revenue
FDI	Foreign Direct Investment
FRDLA	Fiscal Responsibility and Debt Limitation Act
FY	Fiscal Year
GDP	Gross Domestic Product
GST	General Sales Tax
HIES	Household Integrated Economic Survey
IMF	International Monetary Fund
Kwh	Kilowatt Hour
LSM	Large-Scale Manufacturing
NEC	National Economic Council
NFC	National Finance Commission
NPL	Non-Performing Loan
OMO	Open Market Operation
PDL	Petroleum Development Levy
PDU	Pakistan Development Update
PFM	Public Financial Management
PKR	Pakistani Rupee
PPP	Purchasing Power Parity
PSDP	Public Sector Development Programme
QTA	Quarterly Tariff Adjustment
SBA	Stand-By Arrangement
SBP	State Bank of Pakistan
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
TSA	Treasury Single Account
UIPT	Urban Immovable Property Tax
Y-o-Y	Year-on-Year

1. Executive Summary

Amid stagnant growth, Pakistan faces exceedingly high economic risks

Pakistan's strong post-pandemic recovery came to a halt in fiscal year (FY)23 with the delayed withdrawal of COVID-19-era policy stimulus leaving large accumulated economic imbalances. Pressures on domestic prices, external and fiscal balances, the exchange rate, and foreign exchange reserves mounted amid surging world commodity prices, global monetary tightening, recent catastrophic flooding, and domestic political uncertainty. Confidence and economic activity collapsed due to import and capital controls, periodic exchange rate controls, creditworthiness downgrades, and ballooning interest payments. Amid shrinking economic activity, price shocks, and the impacts of flooding, poverty increased significantly. The approval of the International Monetary Fund (IMF) Stand-By Arrangement (SBA) in July 2023 unlocked new external financing and averted a balance of payments crisis. However, underlying imbalances and structural constraints remain to be addressed. Short-term macroeconomic stability will depend on the robust implementation of the SBA and continued fiscal restraint and external financing inflows. Without further reforms, risks will remain exceptionally high, economic activity will remain constrained by import controls and weak confidence, while low investment will undermine medium-term growth potential. A more robust medium-term recovery will require the implementation of significant medium-term reforms to improve the quality of expenditures, broaden the tax base (including increased taxes on agriculture, retail, and property, and improved administration), address regulatory constraints to private sector activity, reduce the distortive presence of the state in the economy, and address inefficiencies and high costs in the energy sector. Election-related policy slippages and new domestic or external shocks also pose major risks to the external balance and financial sector stability.

Economic activity contracted in FY23

Economic activity slowed sharply in FY23 with contractions in both industry and services sectors and muted growth in the agriculture sector. Overall, real gross domestic product (GDP) is estimated to have declined by 0.6 percent in FY23 after growing by 6.1 percent in FY22 and 5.8 percent in FY21. Floods caused heavy damage to crops and livestock, while difficulties securing critical inputs, including fertilizers, further slowed agriculture output growth. Supply chain disruptions due to import restrictions and flood impacts, high fuel and borrowing costs, political uncertainty, and weak demand affected industry and service sector activity, and dampened private investment. Public consumption and investment contracted in line with fiscal consolidation. Private consumption also shrank with weakened labor markets and surging inflation.

Monetary policy was tightened in response to a surge in inflation

Headline inflation rose to a multi-decade high in FY23, averaging 29.2 percent year-on-year (y-o-y) compared to 12.2 percent in FY22. Main drivers included flood-related disruptions to agricultural production and supply chains, energy tariff and petroleum price adjustments, and depreciation of the Rupee. In response to rising inflation, the State Bank of Pakistan (SBP) continued to hike the policy rate, increasing it by a cumulative 825 basis points (bps) to reach 22.0 percent in FY23. Despite this, monetary policy remained accommodative with negative real interest rates.

Poverty increased with record high inflation, wide-scale damages from the floods, and weak labor markets

Amid slowing growth and high inflation, the poverty headcount is estimated to have reached 39.4 percent in FY23—more than 5 percentage points higher than in FY22.¹ The record high food and energy prices, lower labor incomes, and the loss of crops and livestock due to the 2022 floods significantly impacted real household incomes. Despite a temporary increase in cash transfers and one-time fuel subsidy, overall mitigation measures were insufficient to protect poor and vulnerable households.

Despite a narrower CAD, the external position weakened

Pakistan's external position weakened in FY23 due to tight global financing conditions, large amortization payments, and loss of investor confidence limiting new foreign inflows. The current account deficit (CAD) narrowed to 0.7 percent of GDP in FY23, from 4.7

¹ Both FY22 and FY23 poverty estimates are based on World Bank projections. The last Household Integrated Economic Survey (HIES) that allowed accurate measurement of poverty took place in 2018. A new survey is needed to update the poverty headcount.

percent of GDP in FY22.² This was primarily due to import management measures, a weaker currency, and muted economic activity that caused imports to decline faster than exports, supporting a narrower trade deficit. Meanwhile, official remittance inflows declined by 13.6 percent y-o-y, partly due to rigidities in the official exchange rate incentivizing the use of informal remittance channels. Amid large amortization payments and capital outflows, the financial account also turned negative driving the overall balance of payments into a slight deficit. The SBP's gross foreign exchange reserves fell to US\$5.7 billion, equivalent to only one month of imports at end-June 2023.³ Given the high external pressures, by end-June 2023 the Rupee had depreciated by 28.6 percent against the US dollar.

High interest payments caused fiscal pressures

Despite significant narrowing of the primary deficit, the consolidated fiscal deficit, excluding grants, declined only marginally to 7.8 percent of GDP in FY23, from 7.9 percent in FY22.⁴ This was due to a substantial increase in interest payments on the back of the higher domestic policy rate and weakening currency. The primary deficit declined to 0.8 percent of GDP in FY23, from 3.1 percent in FY22, supported by lower public spending on subsidies and grants. Muted economic activity and a decline in imports suppressed revenue from indirect taxes, limiting the Government's capacity to increase tax revenue. The Government financed the resulting fiscal deficit primarily through borrowing from commercial banks, further crowding out private sector borrowing. Although the banks' capital adequacy ratio (CAR) at end-FY23 remained largely unchanged in comparison to end-FY22, financial sector risks rose with the larger exposure to the sovereign and a slight increase in non-performing loans. By end-FY23, public debt, including guaranteed debt, rose to 82.3 percent of GDP from 80.7 percent of GDP at end-FY22.

The pace of economic recovery will be limited by external sector constraints, with very high risks

Careful economic management—including exchange rate flexibility, fiscal restraint, and maintaining implementation of the FY24 budget and the IMF-SBA—will be required to ensure macroeconomic stability this fiscal year. Even with these measures, the current economic trajectory is not sustainable without further fiscal adjustment and other reforms. The foreign exchange position continues to erode, despite the new IMF program, rollovers, refinancing, and new inflows from official creditors. The persistent exchange rate depreciation and inflationary pressures continue to weigh on economic activity. Selective import controls will be required to preserve scarce foreign exchange reserves, constraining the pace of economic recovery with continued supply chain disruptions. Confidence remains extremely weak. Economic growth is therefore expected to remain below potential over the medium term with limited improvements in investment and exports. With depleted policy buffers, the economy's capacity to overcome any fresh domestic or external shock remains limited; downside risks to the outlook are therefore very high.

Table ES.1: Projections of Key Economic Indicators

	FY20	FY21	FY22	FY23e	FY24f	FY25f
Real GDP Growth, at factor cost	-0.9	5.8	6.1	-0.6	1.7	2.4
Current Account Balance (% of GDP)	-1.5	-0.8	-4.6	-0.7	-1.4	-1.5
Fiscal Balance (% of GDP), excluding grants	-7.1	-6.1	-7.9	-7.8	-7.7	-7.6
Public Debt, including govt. guaranteed debt (% of GDP)	84.0	77.6	80.7	82.3	72.4	70.3

Sources: Data from the Pakistan Bureau of Statistics, State Bank of Pakistan, Ministry of Finance, and World Bank staff estimates.

Notes: e = estimate; f = forecast. This macroeconomic outlook was prepared by World Bank staff and differs from that of the Government, including real GDP growth estimates for FY23. Indicators are reported as share of World Bank estimated GDP for FY23.

Real GDP growth will remain low over the medium term

Under a baseline scenario, where the fiscal deficit is effectively contained but little progress is made with broader structural reforms, growth will remain sluggish and risks will remain exceptionally high. Real GDP growth is projected to reach only 1.7 percent in FY24 and 2.3 percent in FY25 (Table ES.1). The agriculture sector is expected to recover on the back of higher production of important crops, including cotton and rice.

² The CAD in FY23 is reported as share of World Bank estimated GDP for FY23.

³ Based on World Bank import projections for FY24.

⁴ Primary and fiscal deficits in FY23 are reported as share of World Bank estimated GDP for FY23.

Marginal easing of import restrictions is expected to support some recovery in the industrial sector, particularly large-scale manufacturing. Flow-on impacts from the strengthening agriculture and industrial sectors will support a revival in associated services sectors including wholesale and retail trade, and transport and storage. However, high inflation due to increasing domestic energy prices and continued depreciation is likely to keep economic activity subdued. Recovery in private investment and exports will be marginal in the absence of broader reforms.

The CAD is expected to widen marginally

The CAD is expected to widen to 1.4 percent of GDP in FY24 and further to 1.5 percent in FY25, primarily on account of higher imports. The phased and gradual easing of import restrictions is expected to lift imports, in part due to pent-up demand from the previous fiscal year. Inflows of critical imported inputs will also support major export-oriented sectors, include textiles. Growth in imports is expected to exceed growth in exports, leading to a wider trade deficit. Meanwhile remittances are expected to decline marginally, in part due to slower growth in host countries.

Despite fiscal consolidation, the overall fiscal deficit is expected to remain high due to increasing interest payments

With the slight recovery in revenue partly due to the resumption of growth and imports, and continuation of expenditure restraint, the primary deficit is expected to remain modest, declining to 0.4 percent of GDP in FY24 and further to 0.3 percent in FY25. However, the weaker currency and high domestic policy rates will increase interest payments. Subsequently, the fiscal deficit will decline only marginally to reach 7.7 percent in FY24 and inching down to 7.6 percent in FY25. Gross financing needs will remain sizeable throughout the projection period because of maturing short-term debt (though short-term deposits are expected to be rolled over), multilateral and bilateral repayments, and Eurobond maturities. By end-FY24, total public debt, including guaranteed debt, is projected to decline to 72.4 percent of GDP and further to 70.3 percent by end-FY25.

The path to economic recovery requires a decisive commitment to reforms

Under the current policy framework, Pakistan faces sluggish growth and extremely high macroeconomic risks, even assuming effective implementation of the SBA and a stable political environment. External financing from official creditors and private flows will be critical to strengthening the foreign exchange position, stabilizing local currency, and mitigating inflationary pressures. Gradual and progressive easing of import and capital restrictions will enable some revival of economic activity. Confidence will remain low with growth insufficient to support significant poverty reduction, while soft levels of investment will dampen output as well as future growth potential. A more robust recovery will require an ambitious medium-term reform agenda backed by strong political ownership and commitment. This would include reforms to increase revenues (including from closing exemptions and tapping increased revenue from agriculture, retail, and property), rationalize expenditures (including through reducing wasteful and regressive subsidy spending), and restore private sector confidence (including through business regulatory reform and reforms to state-owned enterprises [SOEs]).

Regaining fiscal and debt sustainability can result in a sustained higher growth path

The Special Focus section of this update indicates that sustained fiscal consolidation is critical to mitigating the rising fiscal and debt sustainability risks. Persistently large budget shortfalls have led to the rapid accumulation of public debt, crowding out private investment, and contributing to macroeconomic volatility. The structural fiscal deficit is an outcome of rigid expenditures, low revenue collections, and macroeconomic and institutional factors, such as the intergovernmental framework and the fragmentation of fiscal institutions. These challenges can be addressed through a comprehensive reform of tax policy, rationalization of public expenditure, and better management of public debt to lower debt costs and risks. Overall fiscal management will also need to be strengthened through improved inter-government coordination within the framework of the 18th Constitutional Amendment and the 7th National Finance Commission (NFC) Award.

2. Recent Economic Developments

a. Context

Pakistan faced major economic disruptions and uncertainties through FY23

Pakistan's strong post-pandemic recovery came to a halt in FY23. Accumulated economic imbalances, including high fiscal deficits and increasing debt, left Pakistan vulnerable to a series of shocks, including catastrophic floods, increasing world commodity prices, and tight global financing conditions. Repeated delays in implementing the IMF Extended Fund Facility (EFF) program and the associated decline in external financing inflows saw foreign reserves fall to critically low levels, amid high inflation and sharp depreciation. To manage these pressures, the authorities introduced exchange rate rigidities, capital flow restrictions, and import controls. These measures further undermined confidence, disrupting local supply chains and driving sharp declines in domestic industrial activity, exports, and remittance flows. Following the expiry of the incomplete EFF program, a new nine-month SBA was approved by the IMF on July 12, 2023. Under the SBA, exchange rate flexibility was restored, import controls were eased, and new measures were introduced to contain the budgeted FY24 deficit. New IMF and bilateral financing drove some recovery in foreign exchange reserves, but inflation remains high, depreciation has continued, and confidence remains depressed. Without further fiscal adjustment and other reforms, the current trajectory remains unsustainable, involving continued low investment and no significant progress with poverty reduction. Risks are very high. Short-term stability depends on remaining on track with the SBA, continued fiscal restraint, and new external financing inflows. Robust economic recovery over the medium term will require the steadfast implementation of much broader fiscal and economic reforms.

b. Real Sector

Growth

Real GDP is estimated to have contracted in FY23

Pakistan's economy is estimated to have contracted by 0.6 percent y-o-y in FY23, after growing by 6.1 percent in FY22 and 5.8 percent in FY21 (Table 2.1).⁵ Import volumes declined sharply on the back of import management measures and a weaker currency. Export volumes also fell but only by around half as much as imports, partly due to domestic supply chain disruptions and a slowdown in global growth. Similarly, private investment decreased to a near decade low with business confidence at its lowest level since the pandemic, amid heightened market uncertainty, tight financing conditions, difficulties in securing inputs, and a steadily depreciating exchange rate. Simultaneously, private consumption declined as persistent high inflation, particularly in food and energy items, impacted households' real income. Government spending and investment also fell sharply as high debt servicing costs eroded fiscal space for non-interest current and development spending.

The 2022 floods heavily impacted crop production

The devastating floods in 2022 substantially impacted crops, livestock, grain storage facilities, and other critical agriculture infrastructure, leading to an estimated agriculture output growth of just 1.0 percent y-o-y in FY23—substantially below the 4.3 percent rise in FY22. With about 4.4 million acres of crops damaged, crop output contracted in FY23. The impact of floods also spilled over into the subsequent Rabi crop season by delaying the plantation of wheat due to slow dissipation of water from fields. In addition, difficulties in securing critical inputs, such as fertilizers and tractors due to substantial price increases, further weighed on agriculture sector growth.⁶

Import restrictions and higher

In line with high borrowing and input costs, import restrictions, and supply chain disruptions from the floods, industrial sector output contracted by 2.9 percent y-o-y in

⁵ FY23 real GDP growth is based on World Bank staff estimates. The Government's provisional FY23 GDP growth estimate is 0.3 percent.

⁶ Fertilizer off-take was lower by 15 percent y-o-y during July–March FY23. Source: Ministry of Finance (2023b) *Pakistan Economic Survey FY2022–23*. Production and sale of tractors reduced by 46.1 percent and 47.5 percent, respectively. Source: Ministry of Finance (2023a) *Monthly Economic Update & Outlook*.

production costs weighed down industrial sector activity FY23, after growing by 6.8 percent in FY22. Out of four sub-sectors, outputs of i) mining and quarrying, ii) manufacturing, and iii) construction contracted, whereas only the iv) electricity, gas, and water supply sector grew. The Large-Scale Manufacturing (LSM) index, a key indicator for manufacturing activity, contracted by 10.3 percent in FY23 compared to 11.8 percent growth in FY22. Of the 22 sectors in the LSM index, 18 sectors reported lower production during the year, including textile, food, coke and petroleum products, chemicals/fertilizers, and pharmaceuticals.

Slower agriculture and industrial sector activity also weakened the services sector The slowdown in agriculture and industrial sectors spilled over onto the services sector, leading to an estimated contraction of 0.5 percent in FY23 from growth of 6.6 percent in FY22. Sluggish activity in the commodity producing sectors combined with lower imports impacted wholesale and retail trade (the largest service sub-sector), leading to an estimated contraction of 4.5 percent. Similarly, high fuel costs, damaged transport infrastructure due to the floods, and sluggish agriculture and industrial production is also estimated to have led to a contraction of 2.9 percent in the transport and storage sector.

Table 2.1: Real GDP Growth

	FY18	FY19	FY20	FY21	FY22	FY23e
Real GDP Growth (at factor cost)	6.1	3.1	-0.9	5.8	6.1	-0.6
Agriculture	3.9	0.9	3.9	3.5	4.3	1.0
Industry	9.2	0.2	-5.7	8.2	6.8	-2.9
Services	6.0	5.0	-1.2	5.9	6.6	-0.5
Real GDP Growth (at market price)	6.2	2.5	-1.3	6.5	4.7	-0.6
Private consumption	7.2	5.6	-2.8	9.4	6.7	-1.0
Government consumption	5.5	-1.6	8.5	1.8	-1.3	-7.2
Investment	9.9	-9.7	-6.1	4.0	5.5	-15.4
Gross fixed capital formation	10.3	-11.1	-6.7	3.7	5.7	-17.8
Public	18.5	-33.0	-12.9	11.8	12.1	-15.4
Private	7.1	-1.7	-4.9	1.5	3.8	-18.5
Exports of goods and non-factor services	10.0	13.2	1.5	6.5	5.9	-8.6
Imports of goods and non-factor services	15.7	7.6	-5.1	14.5	11.0	-17.8

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

Notes: e = estimate. FY23 macroeconomic estimates were prepared by World Bank staff and differ from that of the Government. The Government's preliminary real GDP (at factor cost) growth estimate for FY23 is 0.3 percent.

Inflation

Inflation reached a multi-decade high in FY23 Pakistan's headline consumer price inflation rose from an average of 12.2 percent y-o-y in FY22 to a multi-decade high of 29.2 percent in FY23—the highest since FY74. The jump was partly due to supply side factors including the floods, higher government administered energy prices, and a substantially weaker exchange rate. The increase in inflation was broad-based, with double digit inflation in 10 out of 12 product categories in the Consumer Price Index (CPI). In addition to supply side factors, the rapid growth in monetary base also contributed to inflationary pressures (see Box 2.1).

Food inflation rose sharply, in part due to flood-related damages Food inflation surged in FY23 primarily due to the 2022 catastrophic floods, domestic fuel price increases, and currency depreciation. In urban areas, food inflation jumped from 13.4 percent in FY22 to 37.3 percent in FY23, while in rural areas it tripled from 13.0 percent to 40.8 percent during the same period (Figure 2.1 and Figure 2.2). The sharp increase in food inflation was partly due to the extensive flood-related damages to crops, livestock, and agriculture infrastructure. Grain storage facilities carrying wheat stocks were also destroyed, while market uncertainty rose regarding timely plantation of wheat for the subsequent crop season.⁷ As reliance on food imports increased amid domestic shortages, the substantially weaker exchange rate further escalated domestic food prices.⁸ Furthermore, the high transport and fertilizer costs also increased agriculture producers' operational costs.

⁷ State Bank of Pakistan (2023d) *The State of Pakistan's Economy*.

⁸ In FY23, the quantum of wheat import increased by 23.7 percent y-o-y, soybean oil by 58.4 percent, and pulses by 48.3 percent. Source: Pakistan Bureau of Statistics. External Trade Statistics.

Higher energy prices added further to inflationary pressure

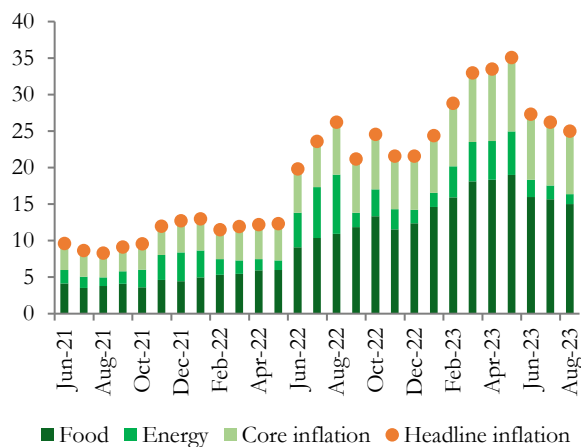
Energy prices rose in rural and urban areas during FY23, partly due to higher taxes on fuel, the weaker currency, and tariff adjustments in the energy sector.⁹ Energy inflation reached 40 percent in urban areas and 40.1 percent in rural areas during FY23, compared to 25.5 percent and 24.7 percent, respectively, during FY22. Price hikes in motor fuel dominated energy inflation, primarily due to cumulative increases in the petroleum development levy (PDL) from zero at end-June 2022 to PKR 50 per liter by start of November 2022. Despite global oil prices easing from an average of US\$89.2 per barrel in FY22 to US\$84.3 per barrel in FY23, the weaker exchange rate maintained inflationary pressures in domestic fuel prices. Likewise, the annual rebasing of electricity tariffs and quarterly tariff adjustment in FY23 led to hikes in electricity prices.¹⁰ In parallel, the end-user gas prices were adjusted by an average of 75 percent in line with amendments in the pricing structure, including an updated gas tariff slab system, changes in fixed charges, and the introduction of the category of protected consumers.¹¹

Higher food and energy inflation impacted core inflation

Core inflation doubled in rural and urban areas in FY23, reflecting import management measures including higher regulatory duties, the effects of high energy and food inflation on wages and prices, and exchange rate depreciation. Urban core inflation rose to an average of 16.1 percent in FY23 from 8.1 percent in FY22. Similarly, rural core inflation increased to 20.4 percent in FY23 from 9.0 percent in FY22. Broad-based increases in production costs and import restrictions through controls on letters of credit and higher regulatory duties increased prices and constrained the availability of raw material for industry.¹²

Figure 2.1: Contribution to Headline Inflation in Urban Areas

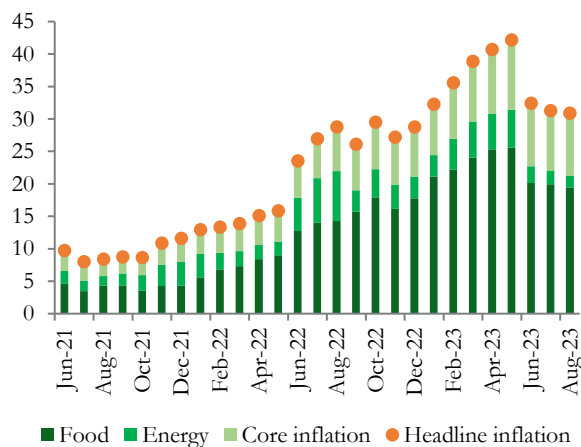
(Percentage points)



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

Figure 2.2: Contribution to Headline Inflation in Rural Areas

(Percentage points)



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

Headline inflation moderated slightly in June–August 2023 on account of base effects

After peaking at 38.0 percent y-o-y in May 2023, monthly headline inflation declined steadily for three consecutive months, reaching 27.4 percent in August 2023. This is primarily due to high base effects, despite significant increases in domestic energy prices. In August 2023, energy inflation fell to 9.4 percent in urban areas and 12.0 percent in rural areas in comparison to 80.7 percent and 67.8 percent in August 2022, respectively. Food and core inflation also moderated, but to a lesser extent.

⁹ Energy inflation consists of electricity charges, gas prices, liquefied hydrocarbons, solid fuel, and motor fuel.

¹⁰ The combined annual rebasing of PKR 7.91/kilowatt hour (kwh) for FY22 and FY23 were implemented in three phases in July 2022 (PKR 3.5/kwh), August 2022 (PKR 3.5/kwh), and October 2022 (PKR 0.91/kwh). The delayed quarterly tariff adjustment (QTA) for Q2–Q4 FY22 was implemented in July 2022 (PKR 1.55/kwh), August 2022 (PKR 0.51/kwh), and October 2022 (PKR 3.21/kwh). Subsequently, the Q1 FY23 QTA was implemented in February 2023 (PKR 1.49/kwh to PKR 4.5/kwh) and the Q2 FY23 QTA was implemented in April 2023 (PKR 0.47/kwh). Source: IMF (2023) *Staff Report for Stand-By Arrangement*; and National Electric Power Regulatory Authority notifications.

¹¹ IMF (2023) *Staff Report for Stand-By Arrangement*; and National Electric Power Regulatory Authority notifications.

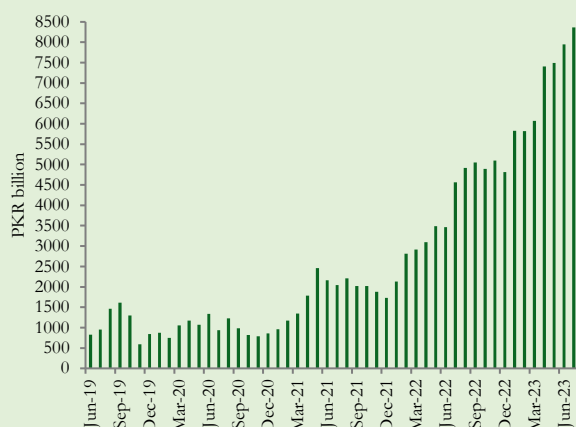
¹² State Bank of Pakistan (2023d) *The State of Pakistan’s Economy*.

Box 2.1: Pressing the Brake and Accelerator at the Same Time!

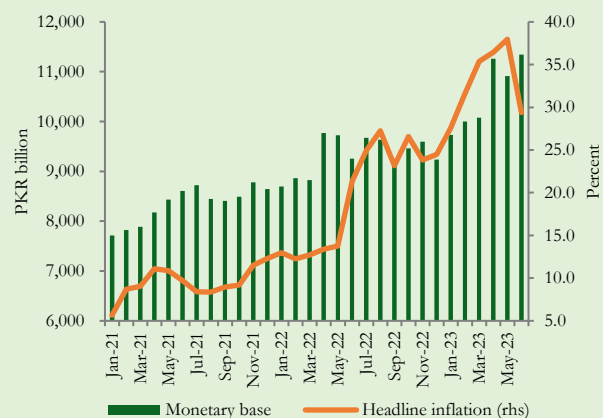
With loss of access to external capital markets, the Government relied heavily on domestic borrowing to finance the fiscal deficit in FY23. Government domestic borrowing from commercial banks increased by 76.4 percent in FY23. Banks increasingly relied on the liquidity injected by the SBP through Open Market Operations (OMOs) to meet the Government's growing financing needs. As a result, the size of the SBP's outstanding OMOs more than doubled in FY23, leading to a 62.2 percent growth in the outstanding aggregate bank borrowing from the SBP (Figure B.2.1).

Financing the fiscal deficit through bank borrowing has led to a rapid growth in monetary base, contributing to inflationary pressures. In FY23, reserve money and currency in circulation grew by 23 and 21 percent, respectively, exceeding the growth of the monetary base during COVID-19. As a result, despite weak economic conditions, money supply grew by 14.2 percent, higher than the 13.6 percent growth of money supply in FY22 when real GDP growth expanded by 6.1 percent. The record high inflation of 29.2 percent in FY23 is therefore partly explained by the rapid growth of the money supply (Figure B.2.2).

Policy inconsistency has constrained the effectiveness of monetary policy in curbing inflation. The current policy framework is inconsistent, with attempts to curb inflation through increases in the policy rate partly undermined by the simultaneous expansion in the monetary base. Higher policy rates are increasing government borrowing costs, driving higher financing needs. These financing needs are—in turn—being met through increasing borrowing from the domestic banking system, necessitating increasing liquidity injections through OMOs. Any sudden stop to OMO injections could leave banks unable to extend further loans to the Government. The only sustainable solution is therefore to reduce the Government's primary deficit, reducing financing needs and borrowing from the domestic banking sector, and thereby alleviating the requirement for new liquidity injections.

Figure B.2.1: Stock of Outstanding OMOs

Source: State Bank of Pakistan.

Figure B.2.2: Monetary Base and Inflation

Source: State Bank of Pakistan monetary survey.

Poverty

Poverty is estimated to have increased in FY23 due to record high food inflation, weak labor markets, and devastating floods

The poverty headcount using the global lower-middle-income poverty line (US\$3.65/day 2017 purchasing power parity [PPP] per capita) is projected to reach 39.4 percent in FY23—more than 5 percentage points higher than in FY22 (see Annex 2.1 for projection methodology).¹³ The significant increase in poverty is due to reduced economic activity and incomes, record high food and energy prices, and disruption to services and loss of crops and livestock during the catastrophic 2022 floods. More than 80 percent of poor workers rely on agriculture, manufacturing, construction, and trade sectors for employment.¹⁴ Muted economic activity in these sectors has had negative impacts on job quality and labor incomes for poor households and for those at risk of falling into poverty. The real value of remittances from abroad has also fallen. At the same time, food inflation nearly tripled, reaching an average of 38.7 percent in FY23. As a result, households' real incomes and purchasing power declined. This is particularly true for poor and vulnerable households, which spend roughly half their budgets on food, with households in the poorest decile experiencing a 7-percentage point higher inflation rate than the richest decile.

¹³ World Bank staff estimates. The last Household Integrated Economic Survey (HIES) which allowed accurate measurement of poverty took place in 2018. A new survey is needed to update the poverty headcount.

¹⁴ World Bank staff calculations based on the HIES 2018–19.

Expansion of targeted cash transfers was sought to mitigate the negative welfare shocks experienced by the poor

In an effort to assist households at the lower end of the income distribution facing these challenging conditions, the Government expanded the flagship social protection program, the Benazir Income Support Programme (BISP). The number of beneficiary households increased from 7.7 million in FY22 to 9.0 million in FY23 (as of March 2023),¹⁵ and the BISP cash transfer amount was increased by 25 percent with effect from January 2023.¹⁶ Other pro-poor initiatives included a one-time targeted fuel subsidy—the Sasta Petrol/Sasta Diesel Scheme—introduced in June 2022, and a cash relief package rolled out in flood-affected districts in August 2022.¹⁷ While these efforts are likely to have supported many low-income households, they were short term in nature. Overall, these increased transfers were not sufficient to compensate for the significant increase in food and energy prices.

c. Monetary and Financial Sector

Monetary

In response to persistent inflation, the SBP continued to hike interest rates

With rising inflationary pressures, the SBP continued to hike the policy rate throughout FY23, a trend that started in the second half of 2021. Since July 2022, the SBP has increased the policy rate by a cumulative 825 bps to reach 22.0 percent by end-FY23. Additionally, the gap between the policy rate and the interest rate on two concessionary financing facilities—Export Finance Scheme and Long-Term Financing Facility—was reduced from 500 bps to 300 bps to strengthen monetary policy transmission.¹⁸ However, the real interest rate remained negative with inflation averaging 29.2 percent in FY23. Given the persistent inflationary pressures and slight uptick in inflation expectations,¹⁹ monetary policy is expected to remain tight in the near term.

Financial Sector

Private sector borrowing remained low and concentrated as bank lending to the public sector grew significantly

In June 2023, bank credit to the public sector was 73.7 percent of the total credit extended. Credit to the private sector paled in comparison, standing at 26.2 percent and declining from 30.3 percent of total bank credit in June 2022.²⁰ The private sector's access to credit continued to shrink in FY23 due to the Government's increasing reliance on financing from commercial banks amid limited external financing inflows. Additionally, the private sector's demand for credit was also low due to the high cost of borrowing and general economic slowdown. Within the limited private sector borrowing, bank credit was largely concentrated in the manufacturing sector, which constituted 56 percent of total loans to the private sector in June 2023, and more than 18 percent of private sector credit was through SBP development finance schemes. Bank lending to small and medium enterprises (SMEs) had also steadily fallen to 5.3 percent of total domestic private sector credit in March 2023, the lowest in over a decade. This is partly due to deterioration in the asset quality of banks' SME portfolios.

Banks' capital buffers have eroded and mask significant risks to the sector

While banks' profitability is increasing in the context of rising interest rates, underlying risks are increasing. The deepening sovereign–bank nexus, continuing macroeconomic instability, and deteriorating asset quality continue to negatively impact banks' capital position. The aggregate commercial banks' CAR stood at 16.3 percent in March 2023, dropping from 17 percent in December 2022. While this is still well above the minimum regulatory requirement (11.5 percent), several smaller banks remain undercapitalized.

¹⁵ Ministry of Finance (2023b) *Pakistan Economic Survey FY2022–23*.

¹⁶ BISP (2023) Press Release.

¹⁷ The fuel subsidy involved an additional cash transfer of PKR 2,000, disbursed to existing and new BISP beneficiaries that were made eligible by relaxing the Proxy Means Testing score cut-off. Under the flood relief program, immediate cash relief of PKR 25,000 per family was offered in flood-affected regions notified by National Disaster Management Authority.

¹⁸ State Bank of Pakistan (2022b) Circular No. 13.

¹⁹ State Bank of Pakistan (2023a) *Consumer Confidence Survey*.

²⁰ State Bank of Pakistan (2023b) "Credits/Loans Classified by Borrowers."

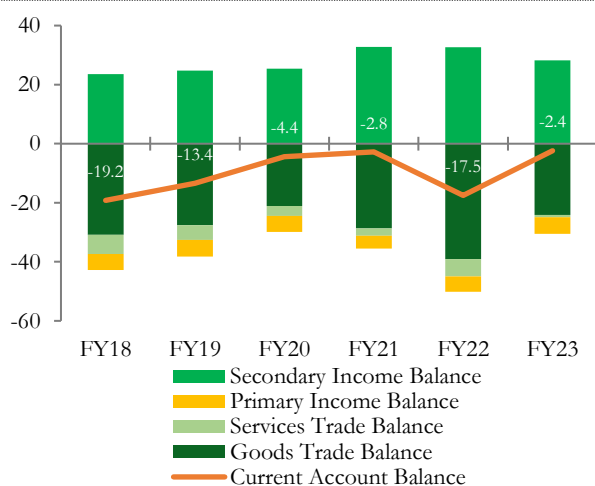
Additionally, the CAR does not adequately reflect the risks of banks' exposure to the Government, which receives a zero-risk weight. The economic slowdown is further impacting the asset quality of banks. The ratio of non-performing loans (NPLs) to total lending has increased marginally to 7.8 percent in March 2023 from 7.5 percent in June 2022. While 90.7 percent of NPLs are provisioned for, risks are fast emerging, with many banks showing an accelerated rise in NPLs.²¹

d. External Sector

Pakistan's external position weakened in FY23

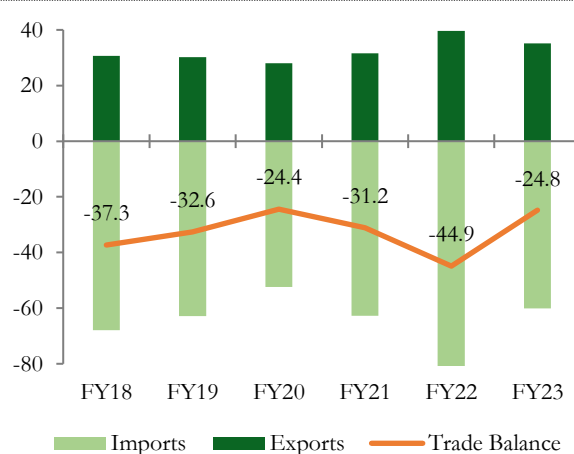
Despite narrowing of the CAD, Pakistan's external position weakened significantly in FY23, reflecting low international financial inflows and sizable external debt servicing payments. The drop in imports was in large part due to import management measures aimed at preserving scarce international reserves. Exports also fell due to unavailability of imported inputs and slow global growth. Meanwhile, remittances were partly diverted towards informal channels due to exchange rate rigidities introduced by the Government. Amid high debt repayments, the financial account saw a deficit for the first time in nearly 20 years. The broader loss of confidence due to the Government's distortive policies on imports, the exchange rate, and capital repatriation further discouraged fresh disbursement and investment inflows. The resulting large balance of payments deficit led to a significant decrease in international reserves in FY23. In line with the mounting external pressures and loss of confidence, the Rupee depreciated sharply against the major global currencies.

Figure 2.3: Annual Current Account Balances
(US\$ billion)



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

Figure 2.4: Annual Trade Balances
(US\$ billion)



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

The CAD narrowed to a 10-year low in FY23

The CAD decreased from US\$17.5 billion (4.7 percent of GDP) in FY22 to US\$2.4 billion (0.7 percent of GDP) in FY23, the narrowest since FY13 (Figure 2.3 and Table 2.2). The smaller CAD was largely due to a contraction of 28.9 percent in imports of goods and services, reflecting the impact of administrative measures, lower global commodity prices, a depreciated currency, and reduced domestic economic activity. Meanwhile, exports also fell by 11.1 percent on account of lower agriculture output due to the floods, shortage of inputs from import controls,²² and slower global growth. As a result, the total trade deficit narrowed by 44.7 percent from US\$44.9 billion in FY22 to US\$24.8 billion in FY23 (Figure 2.4).

²¹ State Bank of Pakistan (2023c) *Statistics of the Banking System*.

²² State Bank of Pakistan (2023d) *The State of Pakistan's Economy*.

Table 2.2: Balance of Payments Summary¹
(US\$ million unless mentioned otherwise)

	FY19	FY20	FY21	FY22	FY23	Percent of GDP in FY22	Percent of GDP in FY23
i. Current Account (A+B+C+D)	-13,434	-4,449	-2,820	-17,481	-2,387	-4.7	-0.7
A. Good trade balance	-27,612	-21,109	-28,634	-39,050	-24,076	-10.4	-7.2
Goods exports	24,257	22,536	25,639	32,493	27,903	8.7	8.3
Goods imports	51,869	43,645	54,273	71,543	51,979	19.1	15.5
B. Services trade balance	-4,970	-3,316	-2,516	-5,840	-761	-1.6	-0.2
Services exports	5,966	5,437	5,945	7,102	7,302	1.9	2.2
Services imports	10,936	8,753	8,461	12,942	8,063	3.5	2.4
C. Balance on primary income²	-5,610	-5,459	-4,400	-5,248	-5,732	-1.4	-1.7
D. Balance on secondary income²	24,758	25,435	32,730	32,657	28,182	8.7	8.4
of which remittances	21,740	23,131	29,450	31,279	27,027	8.3	8.1
ii. Capital Account	229	285	224	205	374	0.1	0.1
1. Balance from current and capital accounts (i+ii)³	-13,205	-4,164	-2,596	-17,276	-2,013	-4.6	-0.6
2. Financial accounts⁴	-11,759	-9,313	-8,768	-11,261	1,781	-3.0	0.5
of which:							
Direct investment	-1,436	-2,652	-1,648	-1,702	-316	-0.5	-0.1
Portfolio investment	1,274	409	-2,774	55	1,012	0.0	0.3
3. Errors and omissions	-58	150	-619	-303	-425	-0.1	-0.1
Overall balance (-1+2-3)	1,504	-5,299	-5,553	6,318	4,219	1.7	1.3
Gross SBP reserves⁵	9,301	13,724	18,716	11,090	5,669		
Memorandum items							
<i>GDP (US\$, million)</i>	<i>321,834</i>	<i>300,832</i>	<i>348,933</i>	<i>374,697</i>	<i>334,458</i>		
<i>Export growth (percent, y-o-y)</i>	<i>-1.3</i>	<i>-7.4</i>	<i>12.9</i>	<i>25.4</i>	<i>-11.1</i>		
<i>Import growth (percent, y-o-y)</i>	<i>-7.6</i>	<i>-16.6</i>	<i>19.7</i>	<i>34.7</i>	<i>-28.9</i>		
<i>Remittance growth (percent, y-o-y)</i>	<i>9.2</i>	<i>6.4</i>	<i>27.3</i>	<i>6.2</i>	<i>-13.6</i>		

Source: State Bank of Pakistan and World Bank staff calculations

Notes:

¹ As per Balance of Payments Manual 6 (BPM6).

² In BPM6, the income account has been renamed "primary income" and current transfers, "secondary income."

³ A negative balance shows that the economy is a net borrower from the rest of the world.

⁴ A negative balance highlights a net increase in the incurrence of foreign liabilities.

⁵ Includes Cash Reserve Requirement and Special Cash Reserve Requirement.

Higher interest payments and lower remittance inflows weighed on the income account balance

The income account surplus narrowed due to reduced remittance inflows and higher interest payments on government external debt. The income account surplus shrank to US\$22.5 billion in FY23 from US\$27.4 billion in FY22, with a 9.2 percent y-o-y increase in the primary income deficit and a 13.7 percent decline in the secondary income surplus. The primary income deficit widened on rising interest payments on external debt, partly due to tightening global financial conditions. Under secondary income, worker remittances fell by 13.6 percent from a record high of US\$31.3 billion in FY22 to US\$27.0 billion in FY23. The economic slowdown in the high-income host countries contributed to the decline in remittances, combined with the large and varying spread between open market and official rate, incentivizing the use of informal channels.

The financial account recorded a deficit reflecting large amortization payments

The financial account swung to a deficit for the first time since FY04 as amortization payments and capital outflows surpassed international inflows. Net external financial outflows amounted to US\$1.8 billion in FY23, compared to net inflows of US\$11.3 billion in FY22.²³ Pakistan faced rising debt distress resulting in credit rating downgrades and loss of investor confidence, which were further compounded by the Government's

²³ The FY23 financial account reflects repayment of US\$5.2 billion in commercial loans, US\$1.0 billion maturing international bond repayments, and repayment of multilateral and bilateral debts.

policies that discouraged private investment and capital flows.²⁴ Net foreign direct investment (FDI) fell to US\$0.3 billion in FY23, with FDI declining in most of the sectors including power, financial, telecom, and trade sectors.²⁵ Net portfolio investment saw outflows of US\$1.0 billion in FY23, reflecting the maturing Sukuk bond repayment.

The overall balance remained negative resulting in a reduction of international reserves

Despite the narrow CAD, the balance of payments registered an overall deficit of US\$4.2 billion (1.3 percent of GDP) in FY23 compared to a deficit of US\$6.3 billion (1.7 percent of GDP) in FY22. As a result, the SBP's gross reserves, including the Cash Reserve Requirement and cash holdings, fell to a new low of US\$5.7 billion, equivalent to only one month of imports at end-June 2023,²⁶ the lowest in the last two decades. The Rupee depreciated by 28.6 percent against the US dollar over FY23, with a 9 percent depreciation in real exchange rate.

In July 2023, the current account registered a deficit

After four months of consecutive current account surpluses during March–June 2023, the current account turned to a deficit in July 2023 as import restrictions were partially relaxed. In line with the CAD, the trade deficit—which had been declining for four consecutive months—increased again in July as imports grew by around 30 percent month-on-month whereas exports remained stable. However, the CAD remained lower y-o-y than in July FY22, due to a smaller trade deficit.

e. Fiscal and Debt Sustainability

Pakistan's large fiscal deficits persist due to high interest payments

Despite a lower primary deficit, Pakistan's overall fiscal deficit remained broadly unchanged in FY23 due to an increase in interest payments. The consolidated fiscal deficit fell marginally to 7.8 percent of the GDP in FY23 from 7.9 percent in FY22 (Figure 2.5 and Table 2.3).²⁷ The rise in domestic and international interest rates and the depreciation of the Rupee resulted in debt servicing costs consuming almost one-third of tax revenues. Nevertheless, the Government's efforts to lower subsidies and grants combined with higher revenue from direct taxes and the PDL led to a substantially lower primary deficit of 0.8 percent of GDP in FY23 compared to 3.1 percent in FY22. However, the revenue balance, which measures the overall revenues' capacity to finance current expenditures, deteriorated in FY23 compared to the previous year due to substantial growth in interest payments (Figure 2.6).

Overall revenues declined with lower revenue from indirect taxes

Total revenue fell to 11.6 percent of GDP in FY23 from 12.1 percent of GDP in FY22 with both tax and non-tax revenue declining by 0.2 percentage points. Within tax revenue, revenue from indirect taxes—including sales tax on goods and services, custom duties, and excise duties—fell to 5.2 percent of GDP in FY23 from 6.3 percent of GDP in FY22. This was largely due to a decline in imports, which lowered revenue from sales tax and custom duties on imported goods. Conversely, revenue from direct taxes and the PDL rose during the year. The hike in the PDL from zero to PKR 50 per liter increased PDL revenues to PKR 580 billion, almost 4.5 times higher than in FY22.²⁸ In addition, revenue from direct taxes grew in part due to changes in tax policy measures, including revisions in income tax rates, super tax on banks and non-bank firms, and higher property taxes.²⁹ Non-tax revenue declined on account of lower profits of the SBP and the Pakistan Telecommunication Authority.

²⁴ For instance, the foreign currency control measures decreased repatriated profits and dividends on foreign investment to US\$331 million in FY23 from US\$1,680 million in FY22. Source: State Bank of Pakistan.

²⁵ There were also FDI outflows in the form of disinvestment from the mining sector. Source: State Bank of Pakistan (2023d) *The State of Pakistan's Economy*.

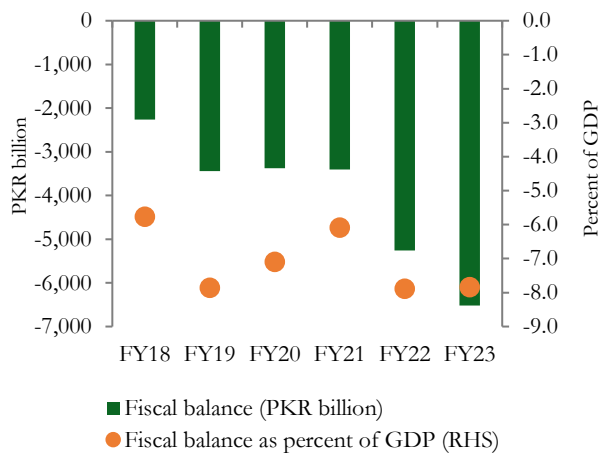
²⁶ Based on World Bank staff projections for next 12 months of imports.

²⁷ In this section, FY23 fiscal outcomes are reported as share of World Bank estimated GDP for FY23.

²⁸ After remaining at zero between mid-March 2022 to June 2022, the PDL was increased to PKR 10 per liter at the start of July 2022 and gradually hiked to PKR 60 per liter between July 2022 and September 2023. The Government now considers tax on petroleum products as part of non-tax revenue; however, for consistency against historical years these are included in tax revenue.

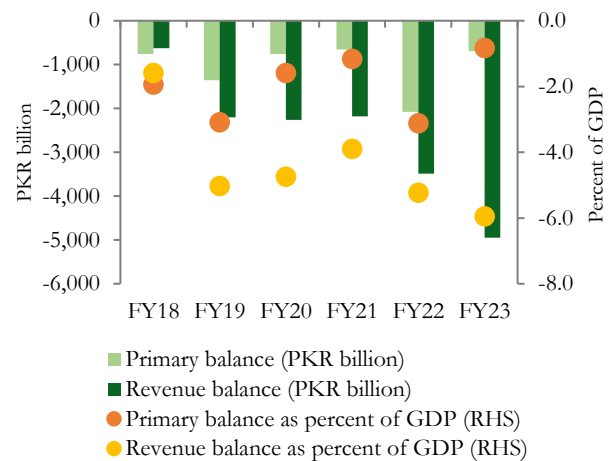
²⁹ Revenue mobilization measures introduced in the Finance (Supplementary) Act 2022 and Finance Act 2022 include revisions in income tax rates, imposition of super tax on high-earning persons, and measures to widen the tax base—for example tax on deemed rental income from property and removal of domestic General Sales Tax (GST) exemptions helped increase tax revenue. Further, increase in government salaries also cushioned tax collections and rising interest rates pushed up returns on government securities, saving deposits, saving certificates, banks' profitability, and income taxes. Source: State Bank of Pakistan (2023d) *The State of Pakistan's Economy*.

Figure 2.5: Consolidated Fiscal Balance (excluding grants)
(PKR billion and percent of GDP)



Source: Ministry of Finance and World Bank staff calculations.
RHS: Right hand side

Figure 2.6: Primary and Revenue Balance (excluding grants)
(PKR billion and percent of GDP)



Source: Ministry of Finance and World Bank staff calculations.
Note: Revenue balance is the difference between current expenditure and revenue. RHS: Right hand side

Interest payments rose substantially due to macroeconomic shocks

Total expenditure decreased to 19.4 percent of GDP in FY23 from 20 percent in FY22, as the decline in development spending was partially offset by the increase in current expenditure. The large interest payments, reaching 7.0 percent of GDP in FY23, were the main driver of increased current expenditure, which rose to 17.5 percent of GDP in FY23 from 17.3 percent in FY22. On external debt, interest payments more than doubled due to the Rupee's weakening against major currencies. At the same time, increases in the SBP policy rate saw interest payments on domestic debt grow by 79.3 percent in FY23, with 68 percent of the domestic debt stock consisting of floating rate instruments at the end of December 2022.³⁰

Non-interest current expenditure fell in line with fiscal consolidation efforts

Non-interest current expenditure fell to 10.5 percent of GDP in FY23, from 12.5 percent of GDP in FY22. The decline was largely due to lower spending on subsidies and grants. Subsidies fell as the Government curtailed spending on power sector subsidies and reversed last year's subsidy on electricity and petroleum prices. Similarly, grants declined with lower spending on COVID-19-related programs, railways, contingent liabilities, and the Higher Education Commission. This created some fiscal space for the Government to provide subsidized electricity and re-gasified liquefied natural gas for selected export-oriented industries and increase spending under BISP in the wake of the 2022 floods.

Development expenditure also declined on account of lower provincial spending

Development expenditure and net lending fell to 2.4 percent of GDP in FY23 from 2.5 percent in FY22 largely due to a drop in provincial development spending. In comparison, the spending under the federal Public Sector Development Programme (PSDP) rose with higher spending on infrastructure projects, including the construction of roads, dams, and bridges, as well as programs for social and regional development.

Fiscal deficit was financed primarily from domestic sources

The Government relied predominantly on domestic sources to finance the fiscal deficit as external repayments exceeded inflows. With the net external inflows turning negative, financing from domestic sources rose by 76.4 percent. Out of total domestic financing, bank financing constituted 49 percent and remained stable in level terms. However, financing from non-bank institutions rose three-fold, making up 51 percent of domestic financing.³¹ Historically, non-bank institutions have held around 20 percent of annual domestic financing.

³⁰ Ministry of Finance (2023c) *Public Debt Bulletin*.

³¹ Non-bank financing consists of mutual funds, insurance companies, non-bank financial institutions, and the Employees' Old-Age Benefits Institution.

Public debt remains elevated with high liquidity risks

By the end of FY23, total public and publicly guaranteed debt had reached PKR 68.4 trillion (82.3 percent of estimated GDP), increasing from PKR 53.7 trillion (80.7 percent of GDP) at the end of FY22. Of the total public debt, the share of external debt was 40.9 percent whereas short-term debt was 13.7 percent. Liquidity risks remain high amid sizeable external financing needs and low foreign reserves. Large revaluation losses due to the weakening of the domestic currency and an increase in gross financing needs with large amortization payments contributed to the rise in public debt. In addition, new debt was largely sourced through long-term domestic debt instruments carrying floating interest rates, which improved the overall maturity profile but also increased debt servicing costs and interest rate risks.

Table 2.3: Summary of Fiscal Operations*(PKR billion unless mentioned otherwise)*

	FY19	FY20	FY21	FY22	FY23	Percent of GDP in FY22	Percent of GDP in FY23
Total Revenue	4,901	6,272	6,903	8,035	9,634	12.1	11.6
Tax revenue¹	4,477	4,751	5,760	6,947	8,441	10.4	10.2
Federal	4,075	4,337	5,251	6,335	7,791	9.5	9.4
Provincial	402	414	508	612	650	0.9	0.8
Non-tax revenue	424	1,521	1,144	1,088	1,193	1.6	1.4
Total Expenditure	8,346	9,648	10,307	13,295	16,155	20.0	19.4
Current expenditure	7,104	1,813	9,084	11,521	14,583	17.3	17.5
<i>of which:</i>							
Interest payments	2,091	742	2,750	3,182	5,831	4.8	7.0
Defense	1,147	1,213	1,316	1,412	1,586	2.1	1.9
Subsidies ²	-	-	425	1,530	1,080	2.3	1.3
Development expenditure and net lending	1,219	1,204	1,316	1,657	1,953	2.5	2.4
<i>of which:</i>							
PSDP	1,008	1,090	1,211	1,617	1,893	2.4	2.3
Statistical discrepancy	22	-87	-93	116	-381	0.2	-0.5
Fiscal Balance (excl. grants)	-3,445	-3,376	-3,403	-5,260	-6,521	-7.9	-7.8
Primary Balance (excl. grants)	-1,354	-2,634	-654	-2,077	-690	-3.1	-0.8
Public Debt (including guaranteed debt)	35,569	39,949	43,349	53,745	68,421	80.7	82.3
External debt	12,869	14,323	14,676	19,677	26,092	29.5	31.4
Domestic debt	20,732	23,283	26,265	31,085	38,809	46.7	46.7
Guaranteed debt	1,969	2344	2407	2983	3520	4.5	4.2
Memorandum items							
GDP (PKR billion)	43,798	47,540	55,836	66,624	83,097		

Source: Ministry of Finance and World Bank staff calculations.

Notes:

¹ From FY21 onwards, the Ministry of Finance has included revenue from Gas Infrastructure Development Cess, natural gas development surcharge, and petroleum levy in non-tax revenue. For consistency of analysis across years, these taxes have been included in tax revenue.

² Prior to FY21, subsidies data was not reported in the fiscal operations data published by the Ministry of Finance.

f. Medium-Term Outlook**Limited by external sector constraints, GDP growth is projected to remain below potential in the medium term**

Under a baseline scenario, political conditions will remain stable and the fiscal deficit will be effectively contained, including through limited new expenditure and revenue measures. With little progress against structural reforms, however, confidence will remain low, growth sluggish, and risks exceptionally high. Even with the completion of the IMF-SBA, associated bilateral financing inflows, and continued rollovers, reserves are projected to remain low, averaging less than one month of total imports over FY24–25. Given the large amortization payments and limited private inflows, the Government will be forced to maintain import controls, constraining the viable pace of economic recovery.

	Real GDP growth is therefore expected to recover only marginally to 1.7 percent in FY24 (Table 2.4). Low investment and continued import controls will constrain real GDP growth below potential in the medium term, reaching only 2.4 percent in FY25.
Recovery in crop production and industrial sector will support economic growth over FY24–25	Recovery from the 2022 floods is expected to see 2.2 percent agriculture growth in FY24, partly supported by the higher estimated output of major crops, including cotton and rice. Agriculture sector growth is projected to further strengthen to 2.4 percent in FY25 as inflationary pressures and supply chain challenges gradually dissipate. Phased and gradual easing of import restrictions will also support industrial sector activity over the medium term, with sectoral growth increasing to 1.4 percent in FY24 and further to 2.3 percent in FY25. Together, the improvements in the agriculture and industrial sectors will spill over to the services sector, led by recovery in the largest sub-sectors of wholesale and retail trade, and transport and storage. Collectively, services sector activity is expected to remain muted but grow marginally at 1.5 percent in FY24 and 2.4 percent in FY25.
External financing pressures will remain high, leading to only marginal increase in CAD	The CAD is forecasted to widen to 1.4 percent of GDP in FY24 and further to 1.5 percent in FY25, with a widening trade deficit and weak remittance inflows. With the IMF-SBA financing and associated new bilateral inflows from regional partners, ³² import controls will be gradually eased. Total import values are therefore expected to increase by 8.5 percent in FY24. With the greater availability of imported critical inputs for export-oriented sectors and higher expected crop production, particularly of rice, total export value is forecast to grow by 6.0 percent in FY24. With imports projected to grow faster than exports, the trade deficit is expected to widen. Meanwhile, worker remittances are expected to decline due to slower growth in host countries. Pakistan’s external financing needs will remain high in the medium term, exerting pressure on foreign exchange reserves and making the complete removal of all import restrictions unlikely over FY24–25.
Inflationary pressures will remain elevated	Consumer price inflation is projected to moderate to 26.5 percent in FY24 and to 17.0 percent in FY25. Inflation will moderate due to high base effects and the gradual dissipation of domestic supply chain disruptions, despite the weak currency and upward adjustments to administered domestic energy prices.
Resumption of growth will support gradual decline in poverty	Poverty reduction is projected to be gradual in the medium term, owing to weak growth and lower labor income, persistent inflation (especially for food and energy), and lower remittances. The poverty headcount rate, measured at the lower-middle-income country poverty line of US\$3.65/day 2017 PPP, is expected to decline to 37.2 percent in FY24 and further to 35 percent in FY25 on resumption of growth and economic activity. However, the higher energy prices will maintain domestic price pressures and may contribute to growing social and economic insecurity. Protracted and elevated food and energy price inflation, in the absence of substantial growth, could cause social dislocation and have negative welfare impacts, especially on the worse-off households with already depleted savings and reduced incomes. Increased targeted transfers will play a vital role to protect the poorest from these risks.
Fiscal consolidation will remain critical due to high liquidity risks	Revenues are expected to recover to 11.9 percent of GDP in FY24 and rise further to 12.3 percent of GDP in FY25 due to the resumption of economic growth and expansion in imports. Non-tax revenues are also expected to increase on account of temporary higher profits from the SBP. However, expenditure pressures will remain high due to large interest payments on the back of the depreciated exchange rate, tight global financing conditions, and the high domestic policy rate. Total expenditures are expected to reach 19.6 percent of GDP in FY24 and increase further to 19.8 percent in FY25. As a result, the overall fiscal deficit (excluding grants) is expected to narrow marginally to 7.7 percent of GDP in FY24 and further decline to 7.6 percent of GDP in FY25. Given the persistent fiscal pressures, the Government is expected to rationalize non-interest expenditure and the primary deficit is projected to narrow to 0.4 percent of GDP in FY24 and further to 0.3 percent of GDP in FY25. Gross financing needs will remain sizeable

³² SBP gross reserves increased to US\$9.0 billion (equivalent to 1.6 months of imports) at end-August 2023, up from US\$5.7 billion (equivalent to one month of imports) at end-June 2023. The higher level of foreign reserves has enabled the gradual easing of import restrictions.

throughout the projection period because of maturing short-term debt (though short-term deposits are expected to be rolled over), multilateral (including IMF) and bilateral repayments, and Eurobond maturities. Public debt, including guaranteed debt, is expected to reach 72.4 percent of GDP in FY24 and decline further to 70.3 percent of GDP in FY25.

Table 2.4: Pakistan Macroeconomic Outlook (FY20–25)

(Annual percent change unless indicated otherwise)

	2019/20	2020/21	2021/22	2022/23e	2023/24f	2024/25f
Real GDP Growth, at constant factor prices¹	-0.9	5.8	6.1	-0.6	1.7	2.4
Agriculture	3.9	3.5	4.3	1.0	2.2	2.4
Industry	-5.7	8.2	6.8	-2.9	1.4	2.3
Services	-1.2	5.9	6.6	-0.5	1.5	2.4
Real GDP Growth, at constant market prices	-1.3	6.5	4.7	-0.6	1.7	2.4
Private consumption	-2.8	9.4	6.7	-1.0	1.9	2.6
Government consumption	8.5	1.8	-1.3	-7.2	1.9	2.8
Gross fixed capital formation	-6.7	3.7	5.7	-17.8	0.8	2.2
Exports, goods, and services	1.5	6.5	5.9	-8.6	0.7	2.0
Imports, goods, and services	-5.1	14.5	11.0	-17.8	1.7	3.2
Inflation (CPI)	10.7	8.9	12.2	29.2	26.5	17.0
Current Account Balance (% of GDP)	-1.5	-0.8	-4.7	-0.7	-1.4	-1.5
Financial and Capital Account Balance, (% of GDP)	3.2	2.6	3.1	-0.4	1.9	1.8
Fiscal Balance (excluding grants, % of GDP)	-7.1	-6.1	-7.9	-7.8	-7.7	-7.6
Debt (% of GDP)	84.0	77.6	80.7	82.3	72.4	70.3
Primary Balance (excluding grants, % of GDP)	-1.6	-1.2	-3.1	-0.8	-0.4	-0.3

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

Notes: e=estimate; f=forecast.

¹ The Government's provisional estimates for real GDP growth at factor prices in FY23 is 0.3 percent. World Bank estimates differ from the Government's.

g. Risks and Priorities

Liquidity risks are extremely high with low foreign reserves and large external payments

Pakistan has sizeable upcoming domestic and external payments for the remainder of FY24. With limited fiscal space and foreign reserves amounting to only US\$9.0 billion at end-August 2023, the country faces substantial liquidity risks. Capacity to meet the high gross and external financing needs depends heavily on achieving necessary fiscal consolidation, the materialization of expected rollovers and refinancing of regional bilateral deposits and commercial loans, and remaining on track with the IMF-SBA program.

Political and social risks are high due to the upcoming elections

Political and social pressures during the run-up to elections may impact implementation of required fiscal consolidation, including pressures for energy price relief through new subsidies. Weak investment confidence partly reflects continuing uncertainties regarding the election timing and process, with most investors citing political instability as the primary constraint to investment in Pakistan.

External factors pose further risks to macroeconomic stability

Tighter global financing conditions, potential increases in world energy and food prices, and slower global growth pose additional risks for the macroeconomic outlook. Global inflationary pressures, though moderating gradually with weaker demand, are at risk of remaining elevated amid the extension of production cuts by oil producing countries, export bans on food items by large global exporters, and the continued war in Ukraine impacting fertilizer, wheat, and corn prices.³³ Subdued global demand, tighter financing

³³ i) In August 2023, Saudi Arabia announced the extension of production cuts of 1 million barrels per day for another month; ii) amid continued bombing of Ukrainian ports and grain silos, the Russian Federation announced on July 17, 2023 that it would not renew the United Nations-brokered deal enabling Ukrainian grain and oilseed shipments; and iii) in July, India (which accounts for 40 percent of global rice exports) announced an export ban on non-basmati rice. Source: World Bank (2023a). *Global Economic Prospects*.

conditions and persistent inflationary pressures will weigh on Pakistan's economic growth and current account balance, which will in turn affect the country's ability to meet its external financing requirements.

Structural reforms remain critical to improve confidence and boost investment

The current macroeconomic outlook represents slow growth, marginal progress with poverty reduction, continued erosion of living standards, and extremely high external risks. Continued weak domestic and foreign investment will undercut future growth potential. A more robust economic recovery will require the steadfast implementation of a broad reform program, including: i) reduction of protectionist trade policies to increase competitiveness and exports; ii) reduction of distortive subsidies, especially in agriculture and energy sectors; iii) drastic reduction of tax exemptions and expansion of the tax base to increase progressive taxation of agriculture income, property, and retail; iv) measures to cut red tape and ease the business environment; v) improving the financial viability of the power sector by lowering generation costs, raising cost recovery, and reducing inefficiency and losses in distribution; vi) broader measures to introduce private participation in the SOE sector, including through selective privatization of SOEs operating in sectors open to competition; and vii) reforms and increased public investments to improve human development outcomes, including addressing child stunting and poor educational outcomes. These reforms need to be complemented by a coherent fiscal and monetary policy mix and market determined exchange rate. Critical priorities for fiscal reform are outlined in the Special Focus section.

3. Restoring Fiscal Sustainability

a. Introduction

Pakistan's fiscal policies pose risks to macroeconomic sustainability and long-term growth

Fiscal issues are at the heart of many of Pakistan's current economic challenges. Pakistan's large and persistent fiscal deficits have led to public debt accumulation, crowding out private sector borrowing and posing macroeconomic risks. The tax structure is distortionary and inequitable, providing insufficient resources to pay for critical government services, while contributing to the misallocation of resources within the economy. Because public expenditures are rigid and focused on consumption rather than investment, government spending drives inflation and imports, rather than expanding the productive base of the economy. Periods of high spending therefore necessitate subsequent remedial cooling policy measures to resolve the resulting fiscal and external imbalances, creating recurrent boom–bust cycles that deter investment and slow economic growth.

Institutional challenges exacerbate risks

Pakistan's existing fiscal institutions and intergovernmental coordination arrangements are constraining effective management of the Government's finances and contributing to the fiscal sustainability challenge. Fiscal policy making is fragmented across numerous bodies, resulting in institutional gaps that contribute to the lack of focus on achieving sustainable fiscal outcomes at the national level. In parallel, current approaches to debt management, partly arising from the weaknesses of debt management institutions, have led to higher debt risks and costs.

This Special Focus provides a roadmap to restore fiscal sustainability

This Special Focus topic highlights weaknesses in current fiscal policies and institutional arrangements and presents a reform roadmap to address these challenges. The remainder of this Special Focus is divided into **Six Sections**. **Section b** briefly covers stylized facts about Pakistan's fiscal deficits and debt accumulation. **Section c** provides an overview of the key challenges in domestic revenue mobilization and analyzes avenues through which revenues can be enhanced. **Section d** analyzes the structure of public expenditures and explores options for expenditure rationalization. **Section e** discusses the financing of fiscal deficits and Pakistan's public debt issues. **Section f** describes Pakistan's architecture of fiscal federalism and its implication for fiscal outcomes. Finally, **Section g** presents a detailed roadmap of recommendations based on the preceding analysis.

b. Pakistan's Fiscal Deficits and Debt Accumulation

Pakistan's fiscal deficits have been large and are increasing

Fiscal deficits in Pakistan have been persistently large. In FY23, the general government fiscal deficit stood at 7.8 percent of GDP, just marginally lower than the 22-year high deficit of 7.9 percent of GDP in FY22 (Figure 3.1 and Figure 3.2).³⁴ Over the past decade, the deficit averaged 6.2 percent of GDP, a notch below the South Asia regional average of 6.3 percent (Figure 3.2).³⁵ The fiscal sustainability challenge is also inter-linked with the constitutionally defined fiscal arrangements between federal and provincial governments that have created persistent structural deficits. The 18th Constitutional Amendment in 2010 and the 7th NFC Award have resulted in significant vertical fiscal asymmetry leading to larger (total) fiscal and primary fiscal deficits. According to the 7th NFC Award, approximately three-fifths of the consolidated revenues accrue to the provinces,³⁶ while the Federal Government assumes responsibility for two-thirds of total general government expenditures. As a result, the large recurrent budget shortfalls have led to rapid accumulation of public debt (including guaranteed debt), which reached 82.3 percent of GDP in FY23, slightly lower than the record high public debt of 84.0 percent

³⁴ In this section, FY23 fiscal outcomes are reported as share of World Bank estimated GDP for FY23.

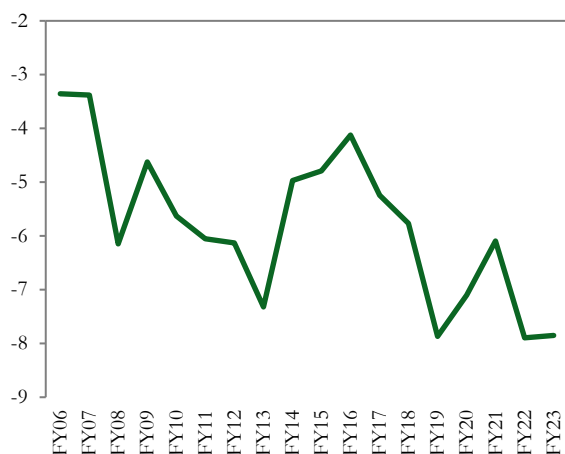
³⁵ Due to the pandemic and recent surges in commodity prices, fiscal deficits across the region have trended higher, most acutely in major oil-importing countries, such as Pakistan.

³⁶ 7th NFC Award sets vertical share of provinces in federal divisible pool at 57.5 percent, up from 46.5 percent in the previous award. As per the 18th Constitutional Amendment, the share of the provinces in subsequent awards cannot be less than their share in the previous award.

of GDP in FY20. Accordingly, both the deficit and debt levels are in breach of the fiscal rules stipulated by the Fiscal Responsibility and Debt Limitation Act (FRDLA).³⁷

Figure 3.1: Pakistan: General Government Budget Balance

(Percent of GDP)



Source: Ministry of Finance and World Bank staff calculations.

Figure 3.2: South Asia: General Government Budget Balance

(Percent of GDP)



Source: World Bank, 2023b.

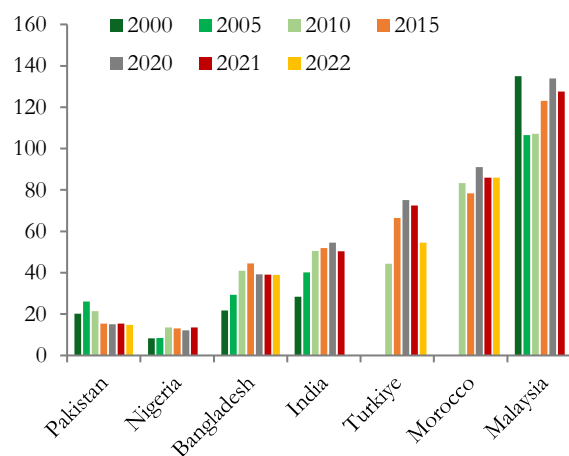
Note: SAR = South Asia Region.

High public debt has crowded out private investment, leading to lower potential growth in the extended term

Extensive credits from the financial sector to the Government have crowded out private sector lending. Credit extended by the banking sector to the Government has risen by more than 400 percent over FY11–21.³⁸ Meanwhile, private sector credit in Pakistan has fallen to 14.8 percent of GDP in 2022, one of the lowest among emerging economies (Figure 3.3). The reduced access to credit is one of the main contributing factors for the low levels of private investment and hence low productivity growth in Pakistan,³⁹ in turn leading to lower potential growth over the medium and long term.

Figure 3.3: Credit to the Private Sector

(Percent of GDP)



Source: World Development Indicators and World Bank, 2022.

c. Revenue Mobilization Challenges

Despite various reform efforts, revenue collection remains low in international comparison

In FY23, Pakistan's aggregate revenue stood at 11.6 percent of GDP, with 92 percent of revenues collected at the federal level and remaining at the provincial level (Figure 3.4). The tax-to-GDP ratio reached just 10.2 percent in FY23. Although Pakistan's tax revenue performance improved between FY11–18, rising from a low of 8.6 percent of GDP in FY11 to a high of 11.4 percent in FY18, it still falls short of 15 percent of GDP, which is considered the minimum required tax revenue by developing countries to fund basic

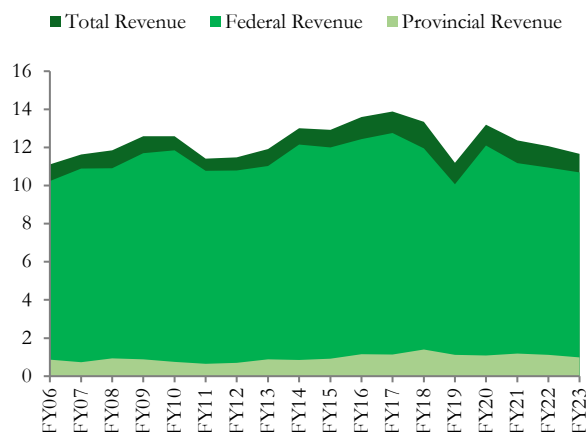
³⁷ The FRDLA stipulates a fiscal deficit ceiling of 3.5 percent of GDP and a debt ceiling of 60 percent of GDP. However, the fiscal deficit has consistently exceeded 3.5 percent of GDP since FY06, and the public and publicly guaranteed debt-to-GDP ratio has remained above 60 percent since FY16.

³⁸ Includes investments in government securities, direct lending for commodity operations, and lending to SOEs.

³⁹ World Bank (2022) *Pakistan Development Update*.

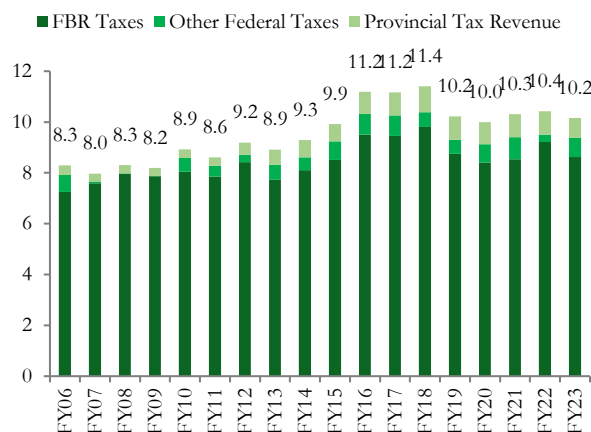
government functions.⁴⁰ It also falls below the tax collections of middle-income and low-income countries, and—more importantly—the level needed to reduce the country’s budget shortfalls and create fiscal space for public spending on infrastructure, education, and health.

Figure 3.4: Total Revenue, by source and year
(Percent of GDP)



Source: Ministry of Finance and World Bank staff calculations.

Figure 3.5: Tax Revenue, by source and year
(Percent of GDP)



Source: Ministry of Finance and World Bank staff calculations.

Federal tax collection relies primarily on indirect and withholding taxes, while provincial tax collection remains critically low

Federal tax revenues, mainly collected by the Federal Board of Revenue (FBR, Figure 3.5), increased between FY06–23 but with significant fluctuations. The share of direct taxes (income and corporate taxes) in FBR revenues averaged 38.4 percent between FY06–23, whereas the remaining 61.6 percent came through indirect taxes, namely excise duties, sales tax on goods, and customs duties. In addition, income tax receipts come from a small number of taxpayers; in FY22 the number of taxpayers that filed tax returns was just 3 million (1.2 percent of the total population). In the same fiscal year, 67 percent of income tax receipts were collected by withholding agents such as banks and telecom and utility companies.⁴¹ Income tax collected in this manner essentially becomes an indirect tax and is regressive as some of these taxes can be passed on to consumers. For instance, advance tax on imports and contracts is a major contributor to the withholding taxes and gets added to the final price of a good or service. Similar to federal tax revenue, provincial tax revenue has increased over the years but remains significantly low. Since the 18th Constitutional Amendment, provincial tax revenues increased from 0.3 percent of GDP in FY10 to 1.0 percent of GDP in FY18, largely on account of GST on services, but since then have declined to 0.8 percent of GDP in FY23. Provincial tax revenue accounted for only 7.7 percent of overall tax revenue collection in FY23.

Weak revenue performance reflects the structure of the tax system

Pakistan’s tax system is complex, has a narrow tax base, and high tax rates. The tax system has numerous special provisions, concessional rates, exemptions, and, to some extent, unorthodox approaches to tax policy. Many of these policy choices were implemented to balance the provision of fiscal support to certain groups or industries with the need to maintain a minimum level of revenue collection. This has resulted in a complex system with many vested interests and has come at the cost of losing economic efficiency and revenue.

Tax exemptions result in significant revenue loss

The GST base definition is narrow, with multiple exemptions permitted. The sales tax system allows for concessional rates below the standard 18 percent for select products and sectors. It also allows certain domestic supplies to be zero-rated, which further narrows the tax base. A value-added tax gap analysis based on 2019 data reveals that concessional tax rates, exemptions, and zero ratings for non-exported products cost

⁴⁰ United Nations Committee of International Experts on International Cooperation in Tax Matters (2018) *The Role of Taxation and Domestic Resource Mobilization in the Implementation of the Sustainable Development Goals*, p.3; Gaspar, Jaramillo, and Wingender (2016) *Tax Capacity and Growth*, p.30.

⁴¹ State Bank of Pakistan (2022a) *Annual Report 2021–22*.

Pakistan 15 percent of its revenue potential.⁴² In FY22, Pakistan lost a total of 2.6 percent of GDP to tax concessions, 0.2 percentage points more than in FY20. Between FY20 and FY22, Pakistan annually lost an average of 26, 18, and 30 percent of sales tax on goods, income tax, and customs duty revenue potential, respectively, to concessionary rates and exemptions. Moreover, due to the challenges associated with having a large informal and undocumented economy, retailers are largely able to avoid taxation despite having an annual turnover exceeding the legal threshold for sales tax registration.

The corporate income tax is complex and features numerous preferential schemes

Corporate income tax (CIT) rates differentiate between three different regimes with different tax rates and special provisions applied to standard companies, small firms, and SMEs in the manufacturing sector. These differentiations generate incentives for firms to split or stay small. Additionally, Pakistan provides certain firms access to a simplified turnover tax regime, which is both financially lucrative for the firms and reduces incentives for them to invest in accounting systems, business formalization, and expansion. The CIT regime also provides for various tax incentives. These include outright tax holidays, reduced rates, credits, and exemptions granted by sector, investment type, and location. Pakistan's thin-cap provisions only have limited coverage, opening opportunities for firms to reduce their tax liabilities.⁴³

Federal excise duty collection on cigarettes lies below its potential

Pakistan collected 0.5 percent of GDP in federal excise duty revenue in FY21. The taxation of cigarettes was the main contributor to this and accounted for 0.19 percent of GDP, which has remained relatively steady in recent years. Cigarettes are taxed through a dual rate. A substantial revenue gain of 0.4 percent of GDP could be achieved if the current rate on premium cigarettes (PKR 16.50 per cigarette) was also applied to standard cigarettes.

Potential provincial revenue sources remain underutilized, including agriculture and property taxation

Pakistan's provinces are assigned three significant sources of revenue: sales tax on services, agricultural income taxation, and property taxation. The World Bank's and the IMF's respective tax policy reviews⁴⁴ have analyzed agricultural income taxation and have highlighted the resulting fractionalization of the income tax base due to the split between federal and provincial governments⁴⁵ and the exceptionally low revenue performance,⁴⁶ despite the agricultural sector's substantial contribution to GDP. Property taxation, which is a shared responsibility between provincial, district, and town governments, has low collection rates driven by valuation tables⁴⁷ that understate current market values and/or the potential income from property, especially for self-occupied property.⁴⁸ More recent academic literature on provincial property taxation has highlighted that property tax collectors face few incentives to raise revenue.⁴⁹

Pakistan's fiscal sustainability hinges on revenue reforms

Priority reforms to address the challenges identified above include: i) drastic reduction of tax exemptions; ii) expansion of the tax base to increase progressive taxation of agriculture income, property, and retailers; and iii) increasing excise taxes on tobacco products and other socially harmful products.

d. Expenditure Management Challenges

Pakistan's prevailing structure of public

Pakistan relies heavily on liability-financed expenditure to meet recurrent spending obligations and to achieve short-run policy objectives. Rigidities in government

⁴² World Bank (2023b) *Pakistan Federal Public Expenditure Review*.

⁴³ Thin-cap provisions regulate firms that are financed by a relatively high portion of debt compared to equity. In such circumstances, interest expenditure is high, which reduces firms' tax liability. Thin-cap provisions limit the amount of interest that can be deducted in calculating the taxable profits, thereby preventing companies from avoiding tax liabilities through excessive debt.

⁴⁴ World Bank (2018) *Pakistan Tax System – Tax Policy Review*; IMF (2019) *Redesigning Pakistan's Tax System*.

⁴⁵ The FBR estimates that the fractionalization of the tax base cost the Federal Government more than PKR 69 billion in foregone revenues in 2020. Source: Federal Board of Revenue (2020) *Tax Expenditure Report 2020*.

⁴⁶ Nasim (2012) "Agricultural Income Taxation."

⁴⁷ With the support of the World Bank Resilient Institutions for a Sustainable Economy development policy operations, federal and provincial property valuations were recently adjusted higher to better reflect market valuations.

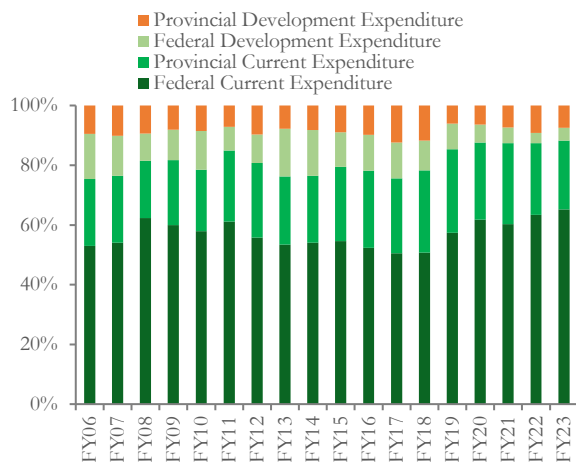
⁴⁸ World Bank (2017) "Annual Report 2016–17. Sindh Annex 6 – Property Tax Study"; World Bank (2018) *Pakistan Tax System – Tax Policy Review*.

⁴⁹ Khan, Khwaja, and Olken (2016) "Tax Farming Redux."; Khan, Khwaja, and Olken (2019) "Making Moves Matter."

expenditure poses risks to fiscal sustainability

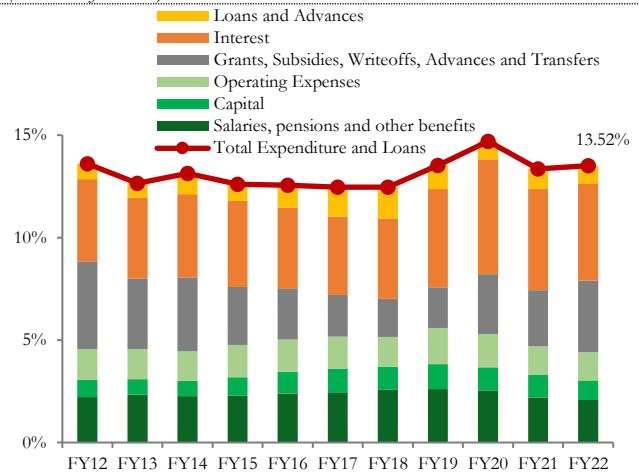
expenditures constrain efforts to reprioritize public spending towards development targets. The share of recurrent expenditure in total general government expenditure has increased from 79.5 percent of total consolidated expenditure in FY15 to 88.2 percent in FY23 (Figure 3.6). Meanwhile, the share of development expenditure has significantly dropped from 20.5 percent of total outlays to 11.8 percent over this period. Consisting mostly of rigid expenditures such as debt servicing, pensions, and wages, recurrent expenditure has increased at both the federal and provincial level as a share of total outlays (Figure 3.7). As a result, spending does not lead to a significant growth dividend and instead risks perpetuating a cycle of increasing debt and debt service expenditure.

Figure 3.6: Recurrent and Development Expenditure
(Percent of total general government spending)



Source: Ministry of Finance and World Bank staff calculations.

Figure 3.7: Federal Government Spending, Economic Classification
(Percent of GDP)



Source: Government of Pakistan and World Bank staff calculations. Note: Due to unavailability of accurate data, similar disaggregation has not been provided for provincial governments.

Interest payments are increasingly accounting for the largest share of current spending

Interest payments to service the country’s public debt are the primary driver of the Government’s current spending.⁵⁰ Over the last 10 years, interest spending averaged 4.7 percent of GDP per year and jumped to 7.0 percent of GDP in FY23 from 4.8 percent in FY22. The share of interest payments in total current spending reached 40 percent in FY23—the highest in the last 10 years. The burden of interest payments falls primarily on the Federal Government as it relies heavily on borrowing from domestic commercial banks and more recently, on external commercial loans and Eurobonds and International Sukuk. The recent hike in domestic policy rates combined with the weaker currency has significantly increased interest payments for the Federal Government. Conversely, provinces have predominantly relied on concessional financing from multilateral development institutions. As a result, provincial borrowing costs have remained low, but increased recently with the weakening currency.

Together, the wage bill and pension expenses are one of the largest spending drivers

Spending on public sector staff, including on salaries and pensions, accounts for around 2.0 percent of GDP per year and 15 percent of total spending in FY22.⁵¹ Fiscal costs for Pakistan’s civil servants’ pension schemes have dramatically grown over the past several years and risk further increase over the coming years driven by ad hoc indexation that is much higher than inflation, historical growth in civil service headcount, and liberalization of the eligibility requirements for benefits such as the survivorship benefits. In comparison to South Asian peers, Pakistan’s pension expenditure as share of GDP at 1.7 percent is estimated to be the highest in the region. Bangladesh has the lowest pension bill at 0.6 percent of GDP whereas Sri Lanka has the second highest pension expense, after Pakistan, at 1.4 percent of GDP.⁵² A comprehensive review of Pakistan’s compensation structure is critical to identify the necessary reform measures to achieve sustainability and fairness.

⁵⁰ Pakistan treats principal repayments on public debt as below-the-line. As a result, principal payments are not included in the expenditure analysis.

⁵¹ World Bank Database on Pensions GP Social Protection. Figures ranged from 2011 to 2018 (latest available).

⁵² Based on data availability, the year of comparison varies for each country.

General subsidies are very costly and distortive	The Federal Government relies on poorly targeted and regressive subsidies to provide social and economic support. Between FY12 and FY22, subsidy spending averaged 1.1 percent of GDP. It increased significantly to 2.3 percent of GDP in FY22 before moderating to 1.3 percent in FY23 as the Government took steps to eliminate new subsidies on fuel and electricity prices and improved targeting and distribution of subsidies on electricity. ⁵³ The misaligned energy subsidies combined with low-cost recovery and poor performance and inefficiency of electricity and gas distribution companies have created a growing financial deficit for the country. In comparison to high public spending on subsidies, the allocation for BISP in the FY24 budget is only 0.6 percent of GDP. ⁵⁴ Provincial government spending on subsidies is primarily on agriculture, including wheat procurement operations, tubewells, and fertilizers. Overall, both federal and provincial subsidies are distortive and regressive, and the benefits largely accrue to the non-poor. ⁵⁵
With operational costs higher than their revenues, loss-making SOEs have been a major drain on fiscal resources	The federal SOE portfolio has been incurring net losses since FY16 that average around 0.5 percent of GDP annually, with the top 14 loss-making SOEs incurring an annual fiscal cost of 0.8 percent of GDP (PKR 458 billion). ⁵⁶ As a result, federal annual fiscal support to the SOEs, in the form of equity injections, subsidies, and loans, has been substantial and growing, reaching 1.4 percent of GDP in FY21. In addition, many government loans to SOEs are overdue and not being serviced. Hence, the stock of outstanding government domestic loans to SOEs stood at 3.5 percent of GDP in FY21, of which nearly one-third was overdue. Moreover, contingent liabilities, in the form of loan guarantees provided by the Federal Government for SOEs to seek commercial loans, have been rapidly rising and were almost 4.5 percent of GDP at end-FY21. Information on tax and dividend arrears is not readily available but taxes and dividends from SOEs averaged just 0.4 percent of GDP during FY16–21—significantly lower than government direct transfers to the SOEs (1.3 percent of GDP).
In contrast, public spending on human capital is low and at risk of being further curtailed given fiscal pressures	Since the 18 th Constitutional Amendment in 2010, public spending on education and health has gradually increased but remains low relative to international norms. Together, Pakistan’s public spending on education and health was 3.4 percent of GDP in FY20, one of the lowest in South Asia and significantly lower compared to the global average of 11.2 percent. ⁵⁷ Public spending on education improved from 1.6 percent of GDP in FY10 to 2.1 percent in FY18, whereas spending on health grew from 0.5 percent to 1.1 percent of GDP during the same period. However, more recently, public spending on the two areas has declined, reaching 1.7 percent of GDP on education and 1.4 percent on health in FY22. ⁵⁸ This partly reflects the impact of high fiscal sustainability pressures, rising predominantly from rigid and increasing current expenditure.
Development expenditure yields limited growth impact and is crowded out by interest payments	Despite the importance of public investment for economic growth, development spending is small and declining, partly due to narrowing fiscal space in the context of increasing interest payments. ⁵⁹ In FY23, spending under the PSDP was equal to only 2.2 percent of GDP, down from 4.4 percent of GDP in FY17. In addition, studies have shown that the growth impact of development spending is limited, due to consistently low levels of development expenditures, weak prioritization, and delays and spending irregularities. ⁶⁰
Urgent reforms are needed to rationalize and improve the	Priority reforms to address the challenges identified above include: i) reducing regressive subsidy spending, especially in energy and agriculture; ii) improving the financial viability of the power sector by lowering generation costs, raising cost recovery, and reducing inefficiency and losses in distribution; iii) applying austerity measures to limit government

⁵³ The Government has created two categories of “protected” and “unprotected” consumers in tariff distribution structure. This should help improve targeting of power sector subsidies with progressively higher tariffs applied on unprotected consumers, based on their consumption.

⁵⁴ Reported as share of government estimated GDP for FY23.

⁵⁵ World Bank (2023b) *Pakistan Federal Public Expenditure Review*.

⁵⁶ Excluding health and education institutions, the federal SOE portfolio comprises 207 enterprises, of which 87 are commercial enterprises operating in various economic sectors, and 47 are non-commercial enterprises. Punjab has 224 SOEs (including 49 public sector companies) and KP has 121 SOEs (including six public sector companies). No information is available regarding the SOE portfolios of Sindh and Balochistan.

⁵⁷ World Development Indicators.

⁵⁸ Ministry of Finance (2023b) *Pakistan Economic Survey FY2022–23*.

⁵⁹ World Bank (2023b) *Pakistan Federal Public Expenditure Review*.

⁶⁰ Ul Haque et al. (2020) *Doing Development Better*.

quality of public spending

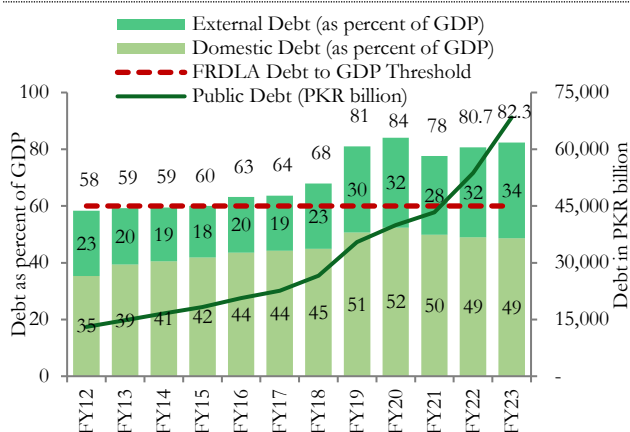
staff and operational costs; iv) reviewing and consolidating PSDP allocations; v) implementing broader measures to introduce private participation in the SOE sector, including through selective privatization of SOEs operating in sectors open to competition; vi) constraining growth of pension spending; and vii) improving public investment management to ensure prioritization of sound public investment projects.

e. Debt Management Challenges

Pakistan’s public debt stock is high and growing, leading to high gross financing needs

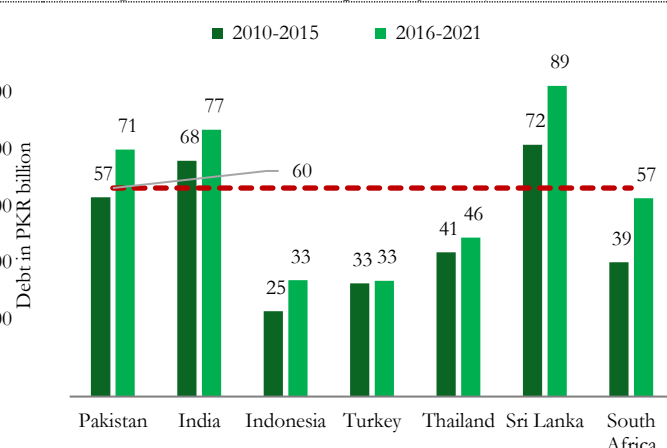
The public debt stock, including guaranteed debt, reached 82.3 percent of GDP at end-FY23, increasing from 58.4 percent of GDP at end-FY12 (Figure 3.8). These debt levels breach the thresholds defined in the FRDLA 2022, which requires public debt to be at most 60 percent of GDP by end of FY23. Pakistan’s general government debt has grown sharply compared to economic peers, including Indonesia, South Africa, Thailand, and Türkiye (Figure 3.9). The growing debt stock imposes high fiscal costs and exposes the country to debt vulnerabilities. The persistent fiscal deficits and debt repayments have maintained high annual gross financing needs, averaging 27 percent of GDP over the last decade—significantly higher than the emerging market threshold of 15 percent.

Figure 3.8: Pakistan’s Public and Publicly Guaranteed Debt



Source: World Bank staff calculations.

Figure 3.9: General Government Debt to GDP
(Average annual GG debt, as a percent of GDP)



Source: IMF 2022 and World Bank staff calculations.

The composition of Pakistan’s public debt exposes it to interest rate and exchange rate shocks

Pakistan’s reliance on floating rate domestic debt instruments and a comparatively high share of external borrowing exposes the country to macroeconomic risks. As a result, between 2013 and 2023, exchange rate depreciation contributed a cumulative 28.9 percentage points of GDP to the public and publicly guaranteed debt, of which 24.3 percentage points occurred over four years in FY19–23 (Figure 3.10). Although the contribution from interest rate changes was negative over the same period—contributing to a reduction of the debt stock—this was more than offset by the revaluation losses due to exchange rate depreciations.

The lack of an integrated debt management function undermines sound debt management and leads to suboptimal borrowing choices

The fragmentation in debt management has resulted in insufficient coordination among the various institutions involved, leading to suboptimal borrowing choices and a disconnect between debt management strategy design and implementation. The Debt Management Office (DMO) remains severely understaffed despite the recent reforms to establish a unified DMO. The lack of a centralized Debt Management Information System (DMIS) underscores how debt management operations are being recorded and managed by four institutions in three different systems (and an Excel database) that are not linked electronically. In addition, critical lagging debt management areas include: i) insufficient information sharing among the SBP, the Budget Wing of the Finance Division, and the DMO on current and future debt transactions, and central government cash flows; ii) lack of effective cash forecasting; iii) the unavailability of business continuity and disaster recovery plans across the entities that register debt records; and iv) lack of in-depth assessment and monitoring of fiscal risks.

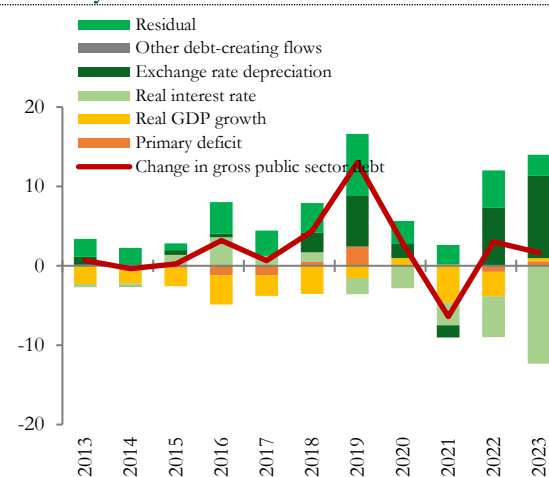
Shallow domestic debt markets have also impacted borrowing choices and sources

Pakistan’s largely under-developed domestic market has constrained borrowing sources and instruments, leading to high debt servicing costs. Despite the increase in domestic debt from 31 percent of GDP in FY11 to 46.7 percent of GDP in FY23, the investor base largely remains limited to commercial banks. In addition, the Government has been increasing the domestic debt issuances of floating rate debt, which has raised the interest burden in recent years. Almost 70 percent of the domestic debt by end-June 2023 was issued on floating interest rates. The development of the domestic debt capital market remains critical in diversifying the investor base, which can help in maximizing long-term domestic borrowing potential.

Debt management reforms are critical to managing rising fiscal costs and risks

Priority reforms to address the challenges identified above include: i) strengthening DMO staffing; ii) improving debt transparency through enhanced debt publications; iii) improving debt recording systems by integrating all existing databases; iv) improving recording and reporting of fiscal risks and contingent liabilities; v) improving cash management and forecasting by implementing the Treasury Single Account (TSA); and vi) developing the domestic debt market through both supply and demand side interventions aimed at expanding the investor base and primary dealership system for auction of government securities, and issuing more debt instruments of varying maturities to meet investor demand.

Figure 3.10: Drivers of Pakistan’s Public and Publicly Guaranteed Debt



Source: Ministry of Finance and World Bank staff calculations.

f. Fiscal Federalism Challenges

The 18th Constitutional Amendment and 7th NFC Award represented major steps forward with the devolution agenda...

The 18th Constitutional Amendment promulgated in 2010 and the 7th NFC Award that preceded it established the framework for fiscal decentralization in Pakistan. Considered to be the most far-reaching reform in the country's constitutional history, it significantly increased the overall share of sub-national governments in the country's revenues and reestablished fiscal autonomy of the provinces in taxing and spending decisions. The 18th Constitutional Amendment abolished the Concurrent Legislative List (CLL),⁶¹ devolving nearly all 47 responsibilities of the CLL to the provinces. It also strengthened the role of key constitutional bodies, including the Council of Common Interests (CCI)⁶² and the National Economic Council (NEC)⁶³ to coordinate intergovernmental relations.

...but resulted in important challenges

The 7th NFC Award was approved before the 18th Constitutional Amendment, with financing arrangements therefore not informed by service delivery responsibilities. As a result, the revenue mobilization and expenditure responsibilities at the federal and provincial level are not aligned and lead to recurrent budget shortfalls. Progress with implementing the devolution agenda has stalled since the 18th Constitutional Amendment, with current arrangements distorting incentives and accountabilities and impeding performance, both at the federal and provincial levels.

- Because formal responsibility for delivering most services resides with the provinces, and around one-half of federal revenues are transferred to provinces, the Federal Government faces weaker incentives to raise revenues.
- Because provinces receive funds from the federal divisible pool regardless of service delivery performance, they face few incentives to bear the political cost of imposing additional taxes or even collecting existing taxes.
- Because the Federal Government continues to devote significant resources to spending in formally devolved areas, there are substantial overlaps and major problems of coordination in service delivery.⁶⁴ Public accountability for service delivery and economic development is weakened at both the provincial and federal levels. Provinces have therefore used additional fiscal space from increased transfers to increase recurrent spending, especially on payroll and pensions, leaving development spending unchanged.
- In the absence of effective coordination, constitutionally fragmented tax bases have further constrained effective tax policy and administration. The sales tax base is fragmented between tax on goods and on services, the former legislated and administered by the Federal Government and the latter under the purview of the provinces. Similarly, the income tax base is fragmented between agriculture income (provincial tax base) and non-agriculture tax (federal tax base).⁶⁵ The constitutional division of taxing powers has impacted authorities' ability to legislate, implement, and reform a coherent tax policy. It has also led to tax arbitrage and tax evasion and an enormous tax compliance challenge for businesses. In addition, the lack of adequate data-sharing protocols between the federal and provincial tax agencies hinders enforcement, creating even more opportunities for tax avoidance, especially in income taxation.

⁶¹ The 1973 Constitution introduced a CLL of responsibilities shared by the provinces and the Federal Government with the intention of giving provincial governments time to build capacity to take on these responsibilities. Over time, almost 47 subjects were included in the CLL.

⁶² The CCI is a constitutional body established through the 1956 Constitution for inter-provincial coordination and conflict resolution. Its composition was changed to include the Prime Minister as the Chairperson and the Council is required to meet at least once every 90 days.

⁶³ The NEC is also a constitutional body mandated with oversight of national economic policies. The Council is required to meet at least once every six months.

⁶⁴ Federal expenditure on the devolved areas has increased slightly between FY09—the fiscal year before the 18th amendment was enacted—and FY22, from 0.4 to 0.5 percent of GDP. It primarily includes vertical programs that directly provide services in the provincial domain. Most prominent among these is BISP, for which federal spending has increased consistently since its inception in FY09, peaking at 0.52 percent of GDP during the COVID-19 pandemic in FY20.

⁶⁵ Among direct taxes, the Federal Government is tasked with collecting personal and corporate income tax (except for income derived from agriculture) and capital value tax (excluding immovable property), whereas among indirect taxes it collects custom duties, federal excises, and the GST on goods. The provinces are assigned the following direct taxes: urban immovable property tax (UIPT), agricultural income tax, and capital gains tax (on property). In indirect taxes, provinces have the authority over GST on services, tax on professions, motor vehicle tax, and stamp duty, among others.

Current fiscal federalism arrangements do not provide a framework for a coordinated national fiscal policy

The country's existing fiscal institutions and intergovernmental coordination arrangements have constrained the effective management of the Government's finances. Fiscal policy making is fragmented across numerous bodies,⁶⁶ resulting in institutional gaps that contribute to the lack of focus on achieving sustainable fiscal outcomes at the national level. Pakistan's fiscal legislation, the Fiscal Responsibility and Debt Limitation (Amendment) Act 2022, limits Pakistan's public debt GDP ratio below 60 percent of GDP and makes preparation of a national Medium-Term Fiscal Framework mandatory. However, the law lacks safeguards against the violations of these thresholds. The lack of a consolidated medium-term framework to anchor both federal and provincial budgets and fiscal targets results in incremental budgeting and a lack of coherence between the objectives of the federal and provincial governments, contributing to sizable recurrent fiscal deficits.

Devolution remains an incomplete agenda

To resolve constraints arising from current fiscal institutional arrangements, action is needed to: i) strengthen coordination and coherence between federal and provincial fiscal policies, including through enhanced cooperation on tax policy and administration, service delivery, and fiscal policy; and ii) amend the revenue sharing arrangement to ensure that resources commensurate with responsibilities. Institutions like the CCI and NEC should play a more active role in shaping a common fiscal framework.

Strengthening the fiscal federalism framework is crucial for long-term fiscal sustainability

Priority reforms to address the challenges identified above include: i) resurrecting institutions for fiscal coordination, including the CCI; ii) implementing legal reforms to support a national fiscal policy; iii) limiting federal spending within provincial mandates to reduce federal expenditures and improve accountabilities for service delivery; iv) developing a national tax policy and strengthening federal-provincial coordination on tax policy; and v) revisiting the 7th NFC Award in order to ensure that financing is aligned with functions for provincial and federal governments.

g. Roadmap for Addressing Fiscal Constraints

Pakistan needs a broad-based fiscal reforms agenda to spur sustainable economic growth and strengthen the pace of economic recovery

Pakistan's large and persistent fiscal deficits threaten sustainability, stability, and economic growth. Weaknesses in revenue and expenditure policies have contributed to economic imbalances, distorted resource allocation, and constrained productivity growth. A broad program of policy reforms should be immediately implemented: to i) achieve substantial fiscal consolidation and safeguard macroeconomic sustainability; ii) address systematic resource misallocation arising from distortive tax policies; and iii) improve the quality of spending, with reduced allocations to administrative costs and regressive subsidies. These reforms will ultimately increase fiscal space for pro-growth, pro-poor spending on basic services, social protection, and development needs.

Table 3.1: Policy Recommendations

Priorities	Recommendations
A. Priorities for Improving Revenues	<p>I. Reduce sales tax exemptions and strengthen administration.</p> <p>a. Remove concessional rates: Remove concessional rates on sales tax on goods through the elimination of the 8th schedule of the Sales Tax Act and apply the standard rate on all goods subject to reduced rates.</p> <p>b. Limit zero ratings: Limit the list of goods subject to zero-rating exclusively to exports only. All domestically sold goods mentioned in the 5th schedule of the Sales Tax Act could initially be moved to the exempt list under the 6th schedule before exemptions are also rationalized.</p> <p>c. Limit exemptions: Reduce items included in the 6th schedule of the Sales Tax Act, limiting exemptions only to those considered as basic food, basic public health services, and selected financial transactions.</p>

⁶⁶ Fiscal policy-making institutions at the federal level include the Finance Division, FBR, and Ministry of Planning. At the provincial level, the fiscal policy-making institutions for each province include the Finance Department, Planning Department, Revenue Authority, Board of Revenue and Excise Department. Therefore, there are at least 23 institutions involved with fiscal policy making at the national level.

	<ul style="list-style-type: none"> d. Increase revenue from retailers: Strengthening tax administration to bring retailers with an annual turnover above the legally defined threshold under the Sales Tax Act into the tax system. II. Increase cigarette excise duty. <ul style="list-style-type: none"> a. Collapse the two tiers structure into a single rate and levy the premium excise tax rate, applied on an ad-valorem basis to allow automatic indexation to inflation. III. Reduce import duty exemptions. <ul style="list-style-type: none"> a. Remove import duty exemptions for non-exporters under the 5th schedule of the tariff code. IV. Increase, improve, or implement new taxes on property and agriculture. <ul style="list-style-type: none"> a. Reform agriculture tax: <ul style="list-style-type: none"> i. Reduce or refine the current 12 ½ acre tax exemption threshold to bring more agricultural land into the tax net. ii. Ensure appropriate categorization of land for tax rates, taking into account size, location, and irrigation status (simulations of an acreage-based tax indicated a potential to generate additional provincial revenues of around 1 percent of GDP). This also extends to agricultural land being used for non-agriculture purposes but continues to be taxed under agriculture income tax scheme, leaving opportunities for tax arbitrage. b. Strengthen property tax collection: <ul style="list-style-type: none"> i. Increase property tax rates to match those applied in peer economies (in Punjab, for example, the UIPT rate is currently set at 5 percent of the annual rental value, which translates into a capital value-based tax rate of 0.07 percent, compared to 0.5 percent in many low-income countries). ii. Harmonize the three valuation systems being used for different land-related taxes, with tax rates based on capital values that are reflective of market prices, iii. Continue or complete the establishment of reliable records of land ownership linked to Computerized National Identity Cards (CNICs) and National Tax Number. iv. Improve the policy and legal framework to ensure that sizable and growing peri-urban settlements outside current notified municipal boundaries are also subject to appropriate land taxation.
<p>B. Priorities for Rationalizing Expenditures</p>	<ul style="list-style-type: none"> I. Reduce regressive subsidy spending. <ul style="list-style-type: none"> a. Reduce electricity subsidies: Further improve the targeting of and eliminate electricity subsidies to achieve full cost recovery for non-protected consumers. Reduce power generation and transmission costs of the power sector, while improving cost recovery. b. Reduce natural gas subsidies: Further improve the progressivity of the gas tariffs by reducing subsidies to richer households and compensating poorer households through higher cash transfers under BISP. c. Remove or reduce other distortionary subsidies: Remove or reduce regressive and distortive subsidies on i) petroleum, ii) tube-well, iii) wheat support price, and iv) fertilizers. II. Apply austerity measures to limit government staff and operational costs: The Government could consider implementing government-wide hiring and wage freezes and other measures such as halting vehicle purchases and limiting extra allowances for all staff to manage rapidly growing staff and operational costs. III. Consolidate federal PSDP allocations: Conduct a review of PSDP development expenditure and cancel all projects that have not undergone proper project preparation, selection, and prioritization, as well as delay previously vetted projects that are unlikely to bring any benefits to the poor. IV. Divest or restructure SOEs through increased private participation. <ul style="list-style-type: none"> a. Implement the recommendation of the 2021 triage exercise: Divest loss-making SOEs, especially those in sectors where there is no clear rationale for government involvement. b. Strengthen SOE governance: Strengthen SOE governance through the implementation of the new SOE law, strengthening the capacity of the SOE Central Monitoring Unit for improved financial management and performance, and by institutionalizing performance monitoring. c. Reduce SOE subsidies: Discontinue subsidies to SOEs that do not provide a public good benefit.

	<ul style="list-style-type: none"> d. Cut lending to SOEs: Enforce all SOE loan agreements and establish stringent processes and criteria for evaluating SOE loan requests, including reviews of assets that can be collateralized and repayment capacity. V. Constrain the growth of pension spending through: <ul style="list-style-type: none"> a. Automatic indexation to inflation, subject to a cap. b. Instituting a minimum retirement age to receive benefits. c. Circumscribing dependents eligible for survivorship benefits. VI. Strengthen public investment management: Fully implement the Public Financial Management (PFM) Act of 2019, including a comprehensive economic and risk assessment of development projects. Establish a monitoring and evaluation system for public investment projects and programs.
<p>C. Priorities for Improving Debt Management</p>	<ul style="list-style-type: none"> I. Improve debt management institutions and capacity through strengthening: <ul style="list-style-type: none"> a. DMO staffing: Complete staffing of the DMO as envisioned under the FRDLA 2022. b. Debt publications: Publication of annually updated Medium-Term Debt Management Strategy, annual borrowing plan, annual debt review, and semi-annual debt bulletins by the DMO. c. Debt recording systems: Installation of a DMIS at the DMO that links all databases recording debt related transactions. d. Fiscal risk assessment and contingent liabilities: Analyze and appropriately disclose fiscal risks, including natural disasters and implicit contingent obligations such as circular debt settlements, and commodity operations through a fiscal risk statement. II. Adopt the TSA: Rollout TSA for proper monitoring, accounting, and forecasting of the Government's available cash balance, which can decrease public borrowing requirements. III. Develop the domestic debt market: Development of domestic debt capital market to increase the maturity profile of domestic debt stock and lower the cost of domestic borrowings through: <ul style="list-style-type: none"> a. Enabling a larger investor base to participate in public auction of government securities and their subsequent trading to diversify and expand the current group of primary dealers appointed by the SBP. b. Issuance of broader range of government securities to meet varying demands of a diversified investor base, while improving liquidity management for the Government.
<p>D. Priorities for More Effective Fiscal Federalism</p>	<ul style="list-style-type: none"> I. Resurrect institutions for fiscal coordination: Strengthen the role of the CCI to act as a forum for continuous intergovernmental dialogue. Set up the CCI Secretariat as mandated by the Constitution and phase out the inter-provincial coordination ministry. II. Implement legal reforms to support national fiscal policy: Align federal and provincial fiscal and debt legislations and establish coordination mechanisms for the effective implementation of a national fiscal policy. III. Limit federal spending on devolved areas: Transfer spending responsibilities on devolved areas to provinces, including health, education, and social spending. IV. Develop a national tax policy to facilitate higher provincial own-source revenue to finance expanded priorities. V. Enhance federal-provincial coordination on tax policy: Establish formal and informal mechanisms such as tax policy round tables to foster dialogue between federal and provincial governments on key issues related to tax policy and administration. Use such forums to align tax regulatory regimes where needed and institutionalize data-sharing arrangements to strengthen revenue generation. VI. Revisit the 7th NFC to ensure that financing commensurate with responsibilities. <ul style="list-style-type: none"> a. Revenue sharing arrangements should incentivize higher tax revenue collection, and provincial governments should finance a much larger share of expenditure through own-source revenue. b. Enhance the capacity of the NFC Secretariat to foster dialogue amongst the federating units on matters relating to fiscal transfers, performance grants, and cross-cutting PFM issues.

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Annex

Annex 2.1

The latest official poverty rates available are for FY19, which was the year of the last HIES. Since then, Pakistan has undergone several major crises, including the global COVID-19 pandemic, the devastating floods in 2022, and a macroeconomic crisis made more precarious by increased political uncertainty. It is expected that these shocks had a profound impact on household welfare and poverty rates in the country, but recent survey data is not available to quantify these. In this context, welfare levels for Pakistan can be estimated using a micro simulation tool that models the path of household welfare based on macroeconomic indicators. The underlying assumption for this approach is that macroeconomic indicators, such as sectoral GDP growth, inflation, and changes in the real value of private and public transfers, directly influence households' real labor and non-labor incomes, which in turn has a direct bearing on consumption levels and poverty.⁶⁷

World Bank poverty projections come from a model that is based on the 2018–19 HIES data and projects each household's consumption over time by simulating the evolution of real labor and non-labor income. The resulting consumption distribution is then used to produce poverty projections for FY20–25. More specifically, labor income is modeled using the real growth rates of 11 sectors of the economy in which members of each household work. That is, each household member's projected income is computed by applying the growth rate of the relevant sector to their income at baseline. Then, total labor income is calculated as a sum of all household members' projected incomes, weighted by their total contribution to that income component. For non-labor income, remittances and private transfers are assumed to have constant purchasing power over time, whereas public transfers are modeled after BISP payouts, which have stayed constant in nominal terms until very recently. Lastly, monthly CPI inflation rates are used to produce real consumption projections.

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

Table A2.1: Projected Poverty Headcount

(Percent)

	FY19 (baseline)	FY20	FY21	FY22	FY23 (nowcast)	FY24	FY25
Poverty headcount	39.8	42.7	38.5	34.2	39.4	37.2	35.0

⁶⁷ For more details, see Caruso et al. (2017); and Barriga-Cabanillas et al. (2023, forthcoming).

