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Policy Research Institute of Market Economy
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PRIME PLUS

A Quarterly Review and Briefing of Economic, Institutional and Policy Environment in Pakistan

January -March 2022

Policy Research Institute of Market Economy

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Prime Plus

Prime Plus is a quarterly report that aims at analyzing policies by the government or the regulators, and then discussing possible consequences or developments on the economy. The report would hence include federal level economic policies on a range of policies such as taxation, trade, and investment which influence business climate. Businesses can analyze and modify their planning scenarios in the light of government policies, reduce risk and improve their plans for investment and sales targets after reviewing this report.

What this Report is about?

In the first section of the report, we bring to you the News Review for the third quarter (Jan-March) of FY 22'. Starting from agricultural schemes for farmers to relief packages introduced by the former government, the section gives you a closer look at the mix of policies formed in Pakistan during January – March 2022.

Section 2 discusses a deeper impact of some main policy reforms in context of National Bank of Pakistan, State Bank of Pakistan, and mainly by the Ministry of Information Technology and Telecom and Ministry of Industries on the business climate specifically and economy. It is pertinent to mention how the various reforms introduced in this quarter bring in investment opportunities for the private sector and transparency and accountability. Unfortunately, the institutional system lacks on implementation of these policies. The significant risks associated with the economy - subsequent current account deficit, inflationary pressure and external debt, pose skepticism on the long run effect of these reforms.

In Section 3 we present economic data on major macro indicators including Inflation, Current Account, Public Debt, Foreign Direct Investment, Government borrowing and a general trend of how the economy is behaving, where we reach to the conclusion that Pakistan's economy is currently not performing at its potential level.

The last Section summarizes the economic outlook of the country. Pakistan is experiencing severe inflationary pressures from distortions in the supply chain emanating from the pandemic and the outbreak of war between Russia and Ukraine; therefore, the international commodity and petroleum prices, and freight costs have spiraled out of control thus stemming the economic recovery. The economic activity, especially the output of the manufacturing sector, will experience a slowdown due to higher costs of inputs. However, proactive measures at the fiscal and monetary policy fronts may help to mitigate the slowdown. Furthermore, policy reforms are needed to ensure the sustainability of the energy sector.

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Policy Review

In this document, the policy analysis for the third quarter of FY 22' starts with discussion on fine imposed by the US authorities on National Bank of Pakistan (NBP) on non-compliance with anti-money laundering (AML) laws.

The report proceeds with discussion on State Bank of Pakistan's (SBP) revised Indicative Credit Limits for the agriculture sector in a move to facilitate small agriculture farmers. The revised scheme that enables farmers to avail loans at subsidized rates, poses an impact on the overall production of 5 major crops and reduces production losses.

Further this report analyses a welcoming $500 million investment by the OKTA Exploration & Production Ltd.in the Oil and Gas sector of Pakistan. Considering Pakistan's dependency on imported oil, the new investment by OKTA group can help mitigate energy demand-supply gap in Pakistan using indigenous resources.

The revised National SME Policy 2021 has brought reforms in trade and taxation. From the introduction of a unanimous SME definition to the adoption of new regulatory and tax framework in the sector, the revised SME Policy has tried to address the demand and supply-side issues in the sector.

The report also scrutinizes 10 years of Reko Diq case and the impact of its settlement in form of $900 million penalty. Also it analyses the renewal of agreement between the Government of Balochistan and Barrack Gold while discussing its relevance in terms of the national interests of the country.

Pakistan may no longer remain under European Union's GSP Plus trade preferential status after 2023. The status that has helped Pakistan improve its trade performance especially in textiles – needs an extension. This document further examines results from a report "Pakistan and European Union under GSP Plus" and assesses the impact of the absence of GSP Plus on textile exports of Pakistan.

Lastly, the policy analysis sheds light on the foreign loan profile of Pakistan that stands at $15 billion for nine months of FY 22' versus $10.8 billion reserves. Proliferation in foreign borrowings and depleting foreign currency reserves is a major challenge for Pakistan in the upcoming months.

Section 2: POLICY ANALYSIS

1. US authorities impose $55 million fine on NBP

The Central Bank of the US – Federal Reserve Bank of New York (NY) and New York State Department of Financial Services (NYSDFS), after a recent examination of the National Bank of Pakistan's (NBP) branch operating in the NY, have imposed a collective fine on NBP worth US $55 million. As per the Federal Reserve System's announcement, the Central Bank of the US has imposed $20.4 million fine whereas, NYSDFS has charged the NBP branch in NY a penalty worth $35 million.

Earlier on 14th of March 2016, NBP and its branch in the NY already entered into a written agreement with the Central Bank of the US and NYSDFS as a means to correct deficiencies related to the NY branch of NBP's compliance with laws related to anti-money laundering (AML).

On March 4, 2021, the aforementioned US authorities found significant deficiencies related to the Branch's risk management and compliance with AML laws and Bank Secretary Act (BSA). According to the order, the NBP's NY branch could not maintain an adequate BSA/AML compliance program. As a result of which, soon after the penalty, NBP's shares dropped by more than 7% during the trading session in the Pakistan Stock Exchange (PSX).

It is pertinent to mention that NBP is one of the largest commercial banks in Pakistan of which 75.2% is owned by the government[1]. Earlier in 2017, Pakistan's largest bank; Habib Bank Ltd (HBL) was fined US $630 million by the US authorities for non-compliance of AML laws. HBL was liable to pay the amount within 14 days but settled to pay a third of the total amount fined by the US authorities i.e. US$ 225 million yet faced repercussions in form of contesting the initial order from the US authorities and winding up operations in the NY city where the branch was operational since 1978[2]. A year before the penalty, HBL declared after-tax profit of US $327 million.

Following the US authorities' order against the NBP's NY branch, both parties have agreed to an out-of-court settlement; however, a Civil Money Penalty (after settlement) worth US $20.4 million (as per the documented order) remains in place. The penalty, in any case, have to be paid by the NBP, in case it fails to, the State Bank of Pakistan (SBP) which is also the Central bank of Pakistan, is liable to pay back the amount to the concerned US authorities.

According to NBP's Financial Statement for the year ended December 31st 2021, the total profits (after tax) of the bank have decreased from US $173 million in 2020 to US $162.9 million in 2021[3]. Considering this, a fine of US $20.4 million would certainly have an impact on NBP's profitability and hence, operations.

[1] https://www.dawn.com/news/1676998

[2] https://www.dawn.com/news/1354474

[3] Business Recorder, March 31st, 2022

However, in case NBP fails to pay off the imposed penalty, the Central Bank i.e. SBP is liable to pay. As of 1st April 2022, total reserves with the SBP stood at US $11.3 billion[4].

With that, the global AML watchdog, the Financial Action Task Force (FATF), has already placed Pakistan on its "grey list" for the deficiencies in the laws pertaining to AML. The country therefore needs to work on its compliance with the AML laws.

The US authorities have come to an out-of-court settlement following a set of resolutions that includes;

- Within 60 days of the order, a written plan on compliance with AML laws has to be submitted by the NBP NY branch's management to the Central Bank of the US that shall include measures to improve the management information systems' reporting with the branch's compliance with AML laws, tracking of issues, and allocation of adequate resources in a move to improve compliance.
- Within 60 days of the order, NBP's branch in NY shall submit a revised compliance program that shall include a system of internal controls, comprehensive risk assessment, and effective training for branch personnel.
- Within 60 days of the order, NBP's branch in NY shall submit a revised customer diligence program to the Central Bank of the US that shall include policies and procedures that ensure collection of accurate customer information, periodic reviews and evaluation of customers and their account information and measures that ensure appropriate documentation.
- Within 60 days of the order, a Transaction Monitoring System to be adopted that shall engage an independent third party with an aim to validate the effectiveness of the Branch's transaction monitoring system and prepare a written report on findings and conclusions.
- Within 10 days of the order, an officer to be designated who shall be responsible for the coordination and submitting written plans to the Central Bank of the US.
- An immediate transfer of funds to the Central Bank of the US under the civil money penalty worth US $20.4 million.

Pakistan needs to address a few immediate challenges within a couple of months. The current account deficit as per the SBP's data for the 8 months of FY 22' (Jul-Feb 22') stands at US $12 billion which is even greater than the amount of reserves the country is holding at the moment. The current account deficit (CAD) might hit $18 billion in the current FY if follows the same pace considering rising trade deficit in the next few months with a very high oil import bill. With that, according to the Public Debt Bulletin Jul-Dec 2021, almost $24 billion of external debt is maturing in 2022 (principle amount $21 billion plus interest rate). The immediate need of the hour is to tackle these fiscal challenges. But what more important is to identify the adequate mix of monetary and fiscal policy that can sustain the foreign reserves of the country for necessary payments.

[4] Domestic Markets & Monetary Management Department

2. Indicative Credit Limits and Eligible Items for Agriculture Financing

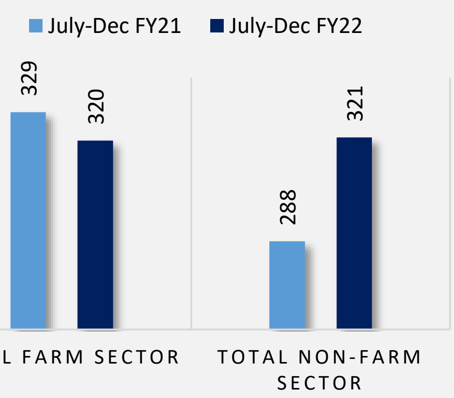
Agriculture being an important sector for the economy of Pakistan, contributed about 19.8% to the GDP[5] and employed around 42.3% of the country's total labor force in 2016.[6] Almost 65% to 70% of the total population in Pakistan depends upon agriculture for its livelihood.

In order to ensure uninterrupted food supply through managing the risks associated with farmers, SBP has enhanced the indicative credit limits by banks for agriculture financing in a move to facilitate small agriculture farmers by aligning the amount of financing with the input requirements.

Figure 1 shows the total agriculture loan disbursement to farm and non-farm sectors in the first six months of FY 21' and FY 22'. As per the data, loans to the total farm sector have reduced from Rs.329 billion (Jul-Dec FY21') to Rs.320 billion (Jul-Dec FY22') as compared to the non-farm sector where loan disbursement has shown an increase from Rs.288 billion to Rs.321 billion in the same time period. Also according to the Federal Budget for FY 2021, the estimated development expenditure for agriculture was Rs.77 billion out of which Rs.53 billion was actually spent in FY21'. For FY 2022, new estimated development expenditure for agriculture stands at Rs.102 billion.

The revised indicative credit limit by the SBP (2022), acts as a means to assess the credit requirements of agricultural borrowers by offering adequate collateral to banks for getting loans. Banks can further decide the amount being disbursed on the basis of prices of inputs, repayment capacity of the borrowers and current market conditions.

Figure 1: Agriculture Loan Disbursement in Billion Rs.
Source: SBP



A number of agricultural schemes are already in place by commercial banks in Pakistan. List of banks and the schemes offered by them are listed in Table 1 below. Despite the availability of numerous agri-credit schemes by commercial banks, small farmers remain deprived of access to credit. As per Governor SBP's statement, 90% of the total farmers are small growers and 40% of them are able to

[5] Pakistan Economic Survey 2021

[6] ZTBL Financial Report 2016

avail credit facility[7]. From SBP data for FY 21', total number of borrowers (both farm and non-farm) who received credit facility were 1,354,196 against the total outstanding borrowers i.e. 3,559,563, more than double of farmers who availed the facility. Same data reveals that a total of Rs.617 billion (farm and non-farm) credit was disbursed out of which Rs.542 billion was recovered. Although the recovery rate has been sustainable, many farmers could not access the agri-credit schemes due to the maturity period and other documentation issues.

Table 1: Per Acre Indicative Agriculture Credit Limits for Crops

(Rs./Acre)			
Major Crops	**Existing (2019)**	**Revised (2022)**	**% increase**
Rice	45,000	70,000	55.56
Wheat	40,000	60,000	50.00
Cotton	52,000	75,000	44.23
Sugarcane	73,000	105,000	43.84
Maize (Hybrid)	55,000	78,000	41.82
Maize	45,000	65,000	44.44
Source: Indicative Credit Limits and Eligible Items for Agriculture Financing 2022			

Under the revised scheme, SBP aims to facilitate provincial planning departments in estimating total financial and credit requirements of respective provinces for both farm and non-farm sectors. The indicative credit limits (per acre) for the five major crops have been listed in Table 4, which can be used by the banks as a tool to estimate the credit requirements of each borrower. Also, these limits could be used by banks for the claims of Crop Loan Insurance Scheme (CLIS)[8].

Revision of the indicative limits has led to an increase in the per acre credit limits of the five major crops (table 2) which indicates a major increase in rice by almost 56% followed by wheat, cotton, sugarcane and maize. According to the Economic Survey 2021, cotton production decreased by 22.8% due to agricultural challenges including declining profitability of growers. The revised credit scheme can facilitate in addressing the issue to some extent by extending credit facility to cotton producers and mitigating their issues related to finance and crop storage.

As per Pakistan Economic Survey 2021, although these major crops grew by 4.65%, a 15% to 20% of the total production of the aforementioned crops is wasted due to lack of maintenance of warehouses[9].

Table 2: List of banks providing agricultural loans in Pakistan

Habib Bank ltd	Hari Bhari agricultural revolving credit
	Tractor financing
	Agriculture finance for dairy farming
	Agricultural finance for poultry farming and allied activities
	Running Finance Farm Production

[7] https://www.aboutpakistan.com/news/sbp-to-provide-unlimited-loans-for-agri-warehouse-projects-at-6-markup/

[8] SBP's scheme aims to mitigate the risk of losses of farming community due to natural calamities. It is applicable and mandatory for all agricultural production loans of banks for five major crops i.e. wheat, maize, sugarcane, cotton and rice.

[9] https://www.aboutpakistan.com/news/sbp-to-provide-unlimited-loans-for-agri-warehouse-projects-at-6-markup/

HBL	Dairy and Livestock Finance
	Poultry Finance
	Fisheries Finance
	Tractor Finance
JS Bank	Zarkhez Agri Finance
NBP	**Famous products offered by NBP for agri-sector:**
	Poultry farming in a controlled environment
	Dairy farming
	Off-season vegetable farming in tunnels
	Floriculture in Pakistan
	Kinnow processing plant
	Dehydrated fruits and vegetable plant feasibility
	Dates processing plant
Soneri Bank Ltd.	Farm Production Loan
	Farm Development Loan
	Non-Farm Working Capital or Development Loan for dairy farming
	Non-Farm Working Capital or Development Loan for poultry farming
	Non-Farm Working Capital or Development Loan for fish farming
	Non-Farm Working Capital or Development Loan for cattle farming
	Mustaqeem Tractor Loan
	Mustaqeem Murabaha Non-Farm Working Capital Loan for Poultry Farming
	Kisan Dost Scheme
	Sada Bahar Scheme
ZTBL	Warehouse Receipt Financing Scheme
	Tahafuz-e-Ajnas Scheme
	Soghat-e-Shireen Scheme
	Tobacco Barn Financing Scheme
	Khushk Ratab Scheme
	Rural Development Scheme for AJK
Source: Zameen.com blog	

Considering the crop storage related problems, new scheme by the SBP provides loans for agri-warehouse infrastructure at a 6% markup. For the purpose, indicative rates have been given in the revised agri-scheme that include proposed rates by the SBP of Rs. 27,000 for cold storage (per sq yard), Rs.65,000 for silos construction (per sq yard), and a cumulative amount of Rs.1,150,000 for tunnel farming for vegetable crops (per acre)[10].

Because of the unavailability of storage houses, farmers previously forced to sell their crop at lower price during harvesting season can now reduce their losses. The scheme can therefore promote less wastage of crops which can further lead to better price discovery. Also this would improve food security by minimizing post-harvest losses. In addition to that, SBP has also launched an Electronic Warehouse Receipt Financing Facility that would be issued by the approved collateral management companies. The receipts from here would be further used as collateral to avail financing from the banks on the basis of the value of the stored harvest marked on the electronically issued warehouse receipts. The system is a win-

[10] Indicative Credit Limits 2022 by SBP

win situation for both farmers and banks because of the documentation. Also this would promote optimal utilization of resources in a way that the most deserving farmers get a chance to receive the credit facility. Since the system is developed through collaborative efforts of the SBP, Security and Exchange Commission Pakistan (SECP), Federal and Provincial Governments and commercial banks, it caters the interests of all stakeholders and improves documentation and accountability.

Table 3: Total Farm and Non-Farm Sector Jul-Dec 2020

	No. of Disbursed borrowers	No. of Outstanding Borrowers
Punjab	1,127,148	2,928,720
Sindh	185,774	521,796
Khyber Pakhtunkh	30,782	72,520
Blochistan	2,948	7,763
Azad Kashmir	4,221	18,425
Gilgit Baltistan	3,323	10,339
All Pakistan	**1,354,196**	**3,559,563**
Source: SBP		

The credit requirements for the farm sector vary with farm size and cropping patterns. Under the new scheme by the SBP, banks can assess the credit requirement through an assessment of cost of production for various products. As per this scheme, large farmers have low credit requirements as compared to small farmers who mainly rely on credit facilities to meet their 90% to 100% financial needs. At the same time, the data shows only 40% of these small farmers have an access to credit. Since the provincial departments will be estimating the credit requirements and then disbursing loans accordingly, this might help cater the demand-supply gap as the number of small farmers vary from province to province.

Table 3 indicates that almost double the disbursed borrowers in Punjab fall under the head of outstanding borrowers. For other provinces, the trend is even worse. Therefore, an estimation of credit risk carried out by provincial departments can help mitigate the problem.

For FY 22', SBP has set an all-time high agri-credit target of Rs.1.7 trillion. The revised credit facility if manages to extend credit to small farmers is ultimately going to improve the agricultural production mainly for the major crops.

These strategic crops involve livelihood of millions of farmers and strategic industries. Since cotton crop is a raw material to the textile industry of Pakistan and also adds 3.1% value addition to the total agriculture in the country[11], it is in dire need of seed and fertilizer credit as the crop faces serious threats in form of increased competition and decreasing production. Other crops like Gram, Bajra, and Jower have also shown a decline in their production because of the decrease in the area of cultivation.

Despite the provision of agricultural subsidies by the government in form of cheap natural gas (Rs.865 per bag of urea), subsidized LNG for the production of urea (Rs.479 per bag) and cash subsidy for fertilizers (Rs.500 per bag), many minor crops show a decreasing growth.

[11] Pakistan Economic Survey 2021

3. Pakistan's Oil and Gas sector to receive $500 million investment through OKTA Exploration & Production Ltd. (OKTA EPL)

Oil and Gas being the most impactful sectors of Pakistan's economy, constitute 80% of the total energy mix in the country. Other sources of energy include Liquefied National Gas (LNG), Liquefied Petroleum Gas (LPG), and coal. But, Oil and Gas – the primary energy supply, amounts to over 70 Million Tonnes of Oil Equivalent (TOE). Also, the total demand for crude oil for the refineries is around 400,000 barrels where 20% of it is being supplied by local exploration and production companies[12].

OKTA Exploration and Production Limited – aims at unlocking the oil and gas reserves in Pakistan through exploration and providing sustainable solutions to the prevailing energy crisis through technological innovation in the field. In a recent development, OKTA EPL group has planned to invest $500 million in the coming years in Pakistan's Oil and Gas sector and $1 billion in the country for the next 10 years.

Previously in January 2021, through a bidding process under Ministry of Energy, OKTA group won two exploration blocks –

1. Block-28 North - situated in Balochistan already surrounded by gas discoveries. With the confirmation of the presence of hydrocarbons, the area is expected to be $1/10^{th}$ the size of Sui Field.
2. D.I. Khan West Block - situated in KPK province has multiple petroleum reservoirs and is surrounded by numerous gas fields.

The new expected investment by the group in Pakistan's oil and gas sector can impact different areas and related stakeholders. The energy mix in Pakistan as per World Bank is shown in Figure 2. Pakistan so far has discovered 1.15 billion barrels of oil where all the major discoveries were made until 1980s. In a move to increase oil discoveries, Pakistan needs to tap into the frontier and unexplored areas of KPK, Sindh and Balochistan. But considering huge investment and rising cost of such projects, private companies are unwilling to invest without any substantial benefits. On the other hand, the public sector companies like Oil and Gas Development Company Limited (OGDCL) and Pakistan Petroleum Limited (PPL), have to cut down their costs on exploration due to security issues and the continuously rising circular debt that stands at Rs.650 billion for the gas sector as of February 2022.

With the growing economy, Pakistan's reliance on energy has been increasing. According to the Pakistan Economic Survey 2021, domestic production of crude oil was 4.3 million metric tonnes of crude oil during FY 19' which could only meet 20% of the total petroleum demand in the country. The gap is always filled through an annual import of crude oil and refined petroleum (from Gulf countries mainly Saudi Arabia) of almost US $16 billion. Pakistan's indigenous resources of oil are not sufficient enough to meet the energy

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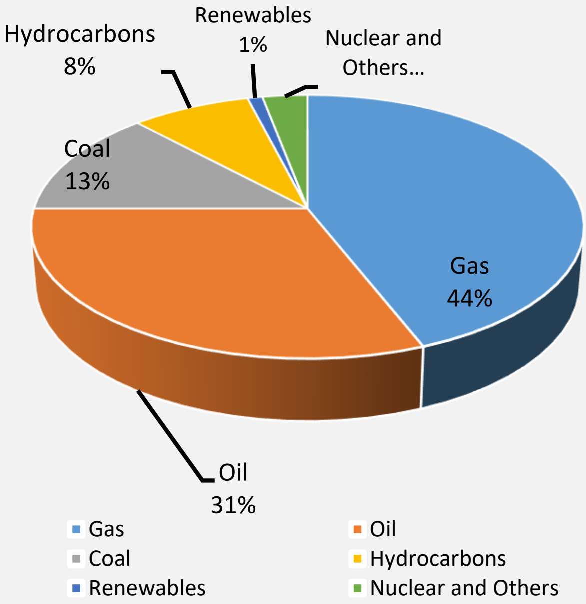
[12] https://www.icap.org.pk/paib/pdf/Oil&GasSector-Post-WebinarPaper.pdf

demand. Total imports of Petroleum Group stood at US $11.3 billion for FY 21' i.e. a 9% increase since FY20'[13]. Table 4 indicates Brent crude oil international price per barrel. As of 14th April 2022, the price per barrel has increased to US $107.5 due to the ongoing Russian-Ukraine conflict.

Figure 2: Energy Mix in Pakistan



This continuous increase in international oil prices will further put pressure on the current account deficit which currently stands at US $12 billion for the period July21'-Feb 22'.

The new investment by OKTA group can help mitigate energy demand-supply gap in Pakistan using indigenous resources. Cumulative hydrocarbon reserve discoveries in Pakistan for less than 25% on shore land area have been increasing. These field include Halini Makhori East Mamikhel, Adhi South, and Jhandial[14]. OKTA group, which is also

Table 4: Brent crude oil price per barrel

Date	USD
3/14/2022	106.9
3/17/2022	106.64
3/22/2022	115.48
3/23/2022	121.6
3/25/2022	120.65
4/1/2022	104.39
4/4/2022	107.53
4/7/2022	100.58
4/8/2022	102.78
4/11/2022	98.48
4/14/2022	107.5
Source: businessinsider.com	

working on hydrocarbon exploration, also intends to install a petrochemical plant that helps separating other chemicals from hydrocarbon extracted reserves. Considering Pakistan's dependency on oil, insufficient indigenous production, huge import bill for crude and refined oil, the current investment from the company can help mitigate the energy crisis in the long-run and also create new jobs keeping in view incoming investment and induction of new plant.

Although this investment opportunity would act as a stimulus to the stagnant E&P sector of Pakistan, it is very important to tap the unexplored potential in the country that also includes frontier areas. Not to disagree with the importance of huge investment and related costs, the government shall make policies that include incentives for investing in these areas and therefore can help attract multinational companies in the sector. It is pertinent to mention that OKTA group is already intending to bring international investors from Russia and Saudi Arabia to Pakistan's Oil and Gas

[13] Pakistan Annual Trade Performance Jul-June 2021 - TDAP

[14] https://www.icap.org.pk/paib/pdf/Oil&GasSector-Post-WebinarPaper.pdf

sectors, hence stimulating investment and restoring the sector. Pakistan is looking forward for this development and its long-run impact on the sector.

4.National SME Policy 2021

Small and Medium Enterprises (SMEs) are considered to be one of the most important pillars for economic growth which help alleviate poverty and promote creation of jobs. In the case of Pakistan, SMEs contribute a 40% share to the country's GDP[15] and 25% to exports[16]. During FY21', the manufacturing sector recorded an 8.7% growth on account of Large Scale Manufacturing(LSM), SMEs and Slaughtering[17]. Small and Medium Enterprise Development Authority (SMEDA) is an SME policy advisory body of the Government of Pakistan that supports and promotes SMEs in Pakistan through various initiatives including business development services, infrastructure development, human capital development and providing support for SMEs' productivity enhancement. According to the estimates, there are over 5.2 million SMEs in Pakistan[18] and 72%[19] of the non-agriculture labor force employed in the informal sector is attributable to SME employment. Considering these numbers, a strong sustainable SME policy is the need of the hour.

The Federal Government has launched the long-awaited SME Policy 2021 which is based on two central pillars;

1. Reforming the current SME policy and regulatory environment in Pakistan.
2. Addressing the demand and supply gaps in the SME market.

The policy with an aim to generate countrywide employment, improve business competitiveness, and promote exports, intends to provide fiscal and monetary benefits while recommending all stakeholders to adopt a unanimous definition for SMEs. According to the policy, SMEs in Pakistan have access to limited amount of invested capital and most of these enterprise comprise of the unskilled labor force. Also, the connection between SMEs and vocational training institutions is weak which does not allow SMEs to come out of the low end of the value chain in local markets. Moreover, because of the high cost of tax compliance, most SMEs remain informal and unregistered. Another hurdle identified by the Policy is the inability of the SMEs to scale up and diversify. Most of the export-oriented SMEs focus on less sophisticated and low-value-added products due to the business and policy environment in Pakistan that does not support inter-firm collaboration. Adding to that, the Policy has also identified inadequate infrastructure as a constraint in SME development.

[15] SMEDA Annual Report 2019-20
[16] SME Policy 2021
[17] Pakistan Economic Survey 2020-21
[18] SME Policy 2021
[19] Labor Force Survey 2018-19

Table 5: Targets of National SME Policy 2021

1	Increasing Economic contribution of SMEs	Sustaining a growth rate of 9% per annum for small scale manufacturing	Was 8.31% for 2020-21
		Sustaining a growth rate of 10% per annum for service sector SMEs.	Was 4.3% for 2020-21
		Increasing average SME sector employment by 5% per annum	Was 2.43% for last three years
		Growing SME sector exports by 10% per annum.	Overall export growth rate was 7.13% (2020-21)
2	Making SMEs more competitive and productive	Aiming to increase SME credit from PKR 437.57 billion to PKR 800 billion	
		Number of SME borrowers to increase from 172,893 to 700,000	
3	Enhancing formalization and increasing the number of SMEs	Number of new registered businesses to grow by 10% per year.	
		Launching SME Registration portal	
4	Improving networking of SMEs	A target of public sector procurement from SMEs shall be secured during the first year. It will increase to attain a maximum of 30% in 5 years.	
5	Increasing start-up Enterprises	Launching sector-specific SME programs for preferred sectors.	
		Public and Private incubators, accelerators and co-working spaces to increase by 20% in 5 years.	

National SME Policy 2021 focuses on the achievement of four performance indicators by 2025. Table 5 lists them in detail.

The first feature of the Policy is the unanimous adoption of SME definition with the purpose to define enterprise categories and to collect and organize data in a systematic way. The revised SME definition considers an enterprise with an annual sales turnover up to Rs.150 million as a Small Enterprise (SE). Any enterprise with an annual sales turnover between Rs.150 million to Rs.800 million is a Medium Enterprise (ME). However, a small enterprise or a medium enterprise up to 5 years old will be considered as Start-up SE or Start-up ME as compared to the previous SME Policy 2007 where an enterprise with an employment size of 250 and annual sales up to Rs.250 million was considered as an SME. The idea of disaggregating the definition of SME into SE, ME and start-ups is appreciated since the 5.2 million SMEs actually include micro, small and medium enterprises. Also as per the SME Action Plan 2020, it was suggested to define an SME based on the annual sales turnover rather the number of employees since many enterprises in Pakistan falling under the definition of SMEs as per number of employees (up to 250 employees) might not be even 2 years old and in case they are, might still be struggling to survive.

Revised SME policy also introduces new regulatory and tax framework under which an enterprise (under certain industries) would not require a No Objection Certificate (NOC) for setting up an establishment. The policy divides SMEs in three categories as low risked businesses that include transportation sector, wholesale and services. The other category is medium-risk enterprises including auto parts and leather industry. While the last category is high-risk businesses that include explosives. According to the revised policy, a low-risk business would not require an NOC, whereas, a medium-risk business will get an approval within 30 days even if the NOC is not provided within this duration. However, a high-risk business would be needing an approval.

Moreover, an E inspection portal will be introduced at federal and provincial regulatory departments for verification and validation of SMEs. The policy also highlights some major developments under FBR that includes a facilitative SME tax regime for selected sectors including IT and ITES. Also, FBR will consider a gradual reduction in withholding tax parallel to an increase in sales and income tax receipt. In 2021, the total tax to GDP ratio in Pakistan was 11.1% whereas the FBR tax to GDP ratio was 9.9%. 0ut of the FBR's 9.9% collection, the ratio of direct tax as a percentage of total tax was 36.5%, and 72% of which was withholding tax. Contrary to that, the proportion of indirect tax collection by the FBR in the same year was 62.6% of total tax out of which sales tax was 65.9% and custom duties stood at 24.8% of the indirect taxes[20]. Keeping in view these figures, reducing withholding tax can improve the liquidity of entrepreneurs while increasing income/sales tax receipt collection will bring more SMEs into the tax net. The problem is that many SMEs are not even registered with Security and Exchange Commission Pakistan (SECP) which makes it even more difficult for the government to maintain documentation and accountability. Those enterprises which are registered, might be understating their incomes in a move to evade tax. The magnitude of tax evasion in Pakistan can be justified by the total number of filers increasing from 1,414,519 in 2015 to 3,198,746 in 2019 while the average tax decreasing from Rs. 23,640 (2015) to Rs.10,914 (2019). The solution lies within the problem. Business entities evade tax due to high rate of taxation in the country. Also, in Pakistan, tax payers have to deal with a number of tax agencies that ultimately increase their cost of doing business. Rather taxing entities through different means, a unanimous flat and broad-based tax should be introduced[21]. There's a need to reform existing tax system through identifying structural and operational weaknesses in the system at federal level.

The policy also embodies incentives supporting women-led SMEs under which women entrepreneurs get a 25% tax exemption on applying for loans. Although the idea of supporting women-led businesses is the need of the society, tax exemptions alone might not be able to achieve the required target. Many SMEs are located in the rural side of Pakistan. Ensuring that women located in rural areas actually come forward to set up their businesses, will actually make a difference.

With that, the Policy promotes cascading[22] to make imported raw material, machinery and intermediate goods less costly for the SMEs. According to a survey[23], most of SMEs are unable to afford innovation due to prevailing high costs. The survey further revealed that a huge chunk of non-exporting firms was SMEs whereas, the export-oriented firms were far ahead in innovation as compared to non-exporting firms. Cascading, hence can reduce the input cost of the export-oriented SMEs that can facilitate them in competing among other

[20] Business Recorder

[21] https://primeinstitute.org/towards-low-flat-broad-and-predictable-taxes-2020/

[22] National Tariff Policy of Pakistan is based on the principle of cascading which means that import duty on raw material shall be charged at a lower rate, whereas, final goods are subject to a higher rate.

[23] Innovation and Technology Center, Lahore School of Economics.

firms. The Trade and Development Authority (TDAP) will also support SME participation ensuring their inclusion in trade.

Access to finance is one of the major supply side constraints for SMEs. As per SBP's data, the total lending to SMEs is Rs.525 billion in March 2022 i.e. only 2.5% of the total private sector lending in the month while these enterprises contribute 40% to the GDP. Moreover, the financing target set by the SBP for CY 23' is Rs.800 billion[24]. Revised SME aims at providing excess to credit worth Rs.10 million at a 9% rate that can facilitate 30,000 SMEs in the country under the SAAF Finance Scheme introduced by the SBP. Under this scheme, SBP will encourage banks to lend to the SMEs based on their size and sector. The SAAF scheme will facilitate SMEs since it will encourage banks that intend to specialize in lending to SMEs. The problem here is that banks usually do not intend to specialize in SME financing due to their lack of capacity. Since the probability of SME default remains high, banks rather concentrate on their profitability and lend to other less risky businesses. The point can be validated with the fact that despite the presence of the National SME Policy 2007 and numerous schemes offered by the SBP, the proportion of SME lending in the total private sector is not even 3% for the month of March 2022. Also, SBP in past has been inaugurating schemes such as the Rozgaar Scheme in a move to facilitate SMEs during the pandemic. The government disbursed more than Rs.212 billion to mitigate the risks associated with SMEs that ultimately prevented 382,673[25] employees of SMEs from layoff.

It is quite evident that inadequate infrastructure acts as a constraint to SME productivity. Under the revised Policy, relevant authorities in collaboration with SMEDA will set up SME industrial estates through a land lease model in an attempt to lower costs. An allocation of 4200 acres i.e. 19,500 plots has been promised for the SMEs. The attempt to provide land on an installment basis to the prioritized SMEs would yield results in the long-run. Assuming the revised policy is based on the duration of 2021-25, provision of land through the plug and play model can be sustainable.

To make the outcome of National SME Policy 2021 more pragmatic, structural reforms in the institutions of the country including FBR, SECP and SBP, with their implementation is crucial. SMEs in Pakistan are not growing. As per a study from the World Bank[26], most of the small businesses in Pakistan die out due to a number of factors that hinder their survival. Moreover, bringing all the SMEs in the tax net is another challenge. Also, the tax system in Pakistan lacks any approach that can actually trace tax evaders. Lastly, in the presence of numerous schemes, the proportion to private sector lending for SMEs still remains very low which signals high risks associated with small businesses.

[24] National SME Policy 2021
[25] Pakistan Economic Survey 2021
[26] Trade Outlook, October 2021

5. 10 years of legal battle ends – Reko Diq reaches settlement by paying $900 million

Having gold reserves amounting 20.9 million ounces and 10.3 million tons of copper, Reko Diq is one of the largest copper and gold mines in the world that is located in Balochistan, Pakistan. An Australian company, Tethyan Copper Company Limited (TCC) held a 75% share in the exploration license for the Reko Diq mine through an agreement with the Government of Balochistan in 2006, while the remaining 25% was held by the provincial authority – Balochistan government. TCC was jointly owned by two companies; Antofagasta PLC (a Chilean Multinational) and Barrick Gold Corporation (a mining company headquartered in Canada). This resulted in a 37.5% interest of Antofagasta PLC in Reko Diq (RD). The total mineral resources were estimated at 5.9 billion tonnes in RD, hence, Antofagasta's attributable share in the resources amounted to 2.2 billion tonnes.

The TCC in 2010 submitted a feasibility study to the Government of Balochistan in respect of the RD project and in 2011, the company submitted another application with reference to a mining lease in the area. Later the Government of Balochistan rejected the application for mining lease as a result of which TCC commenced two international arbitrations. According to TCC, the Government of Balochistan entitled it to the mining lease back in 1998, reversing the agreement has caused the company to bear huge costs. Therefore, TCC in 2011 claimed $8.5 billion from the Government of Balochistan and the latter terminated the agreement. Since 2006, TCC had invested $220 million in RD mines.

In 2012, TCC sought help from the World Bank's tribunal of the International Centre for Settlement of Investment Disputes (ICSID) while claiming the amount of damages in form of assumed profits the company might have earned if granted the mining lease. However, on July 17th, 2019, the ICSID declared Pakistan a violator under the Pakistan-Australian Bilateral Investment Treaty and therefore, charged a $5.8 billion fine plus interest rate against Pakistan. With that, the London Court of Arbitration (LCA) also charged Pakistan with a penalty of $4 billion.

The Chilean company, Antofagasta decided to exit the project while claiming its reward of $3.9 billion out of the $5.8 billion penalty. Since then, numerous meetings on the settlement have been carried out between the two companies – Antofagasta and Barrick and the Attorney General of Pakistan (AGP).

In March 2022, the terms of settlement were approved by the Economic Coordination Committee (ECC) under the latest version of Antofagasta exit deed with a decision on tax exemptions as suggested by the FBR. While the huge penalty of almost $11 billion was successfully waived off by the World Bank tribunal, Pakistan agreed on paying $900 million to Antofagasta under the settlement deed. The FBR observed that the settlement money was taxable in Pakistan depending upon the structure of the transaction. The settlement deed includes the Government of Pakistan issuing a standby letter of credit (SBLC) worth $397 million to Antofagasta not later than 31st March 2022, however, funds won't be released until the completion of legal formalities. Also, $337.5 million would be paid to Antofagasta on behalf of the Government of Balochistan. A collective $900 million has to be paid no later than 31st March 2022, in case of non-compliance till 30th June 2022, a late payment surcharge would be charged to the Government of Pakistan.

In a significant development, the Government of Pakistan restored the contract with the Canadian company - Barrick Gold Corporation which was also in dispute since 2011. In March 2021, the Balochistan government and the Barrick Gold have finally re-signed the agreement after three long years of negotiations. As opposed to the previous deal, the new agreement assigns Barrick as an operator of the project and the company will be allowed licensing on mining lease, exploration lease, surface rights along with a mineral deal. The new RD agreement is a partnership between Barrack and Pakistan where 50% of the project would be owned by the company and the remaining 50% shall be equally divided among the Federal Government and the Provincial Government of Pakistan. The 25% share of the Federal government would be divided among the State-Owned Enterprises (SOEs) which include Oil & Gas Development Corporation Limited (OGDCL), Pakistan Petroleum Limited (PPL) and Government Holdings Pakistan Limited (GHPL) while the remaining 25% share would be held by a company owned and controlled by the Balochistan Provincial Government. As per the agreement, the Balochistan government will not be held responsible for managing any development expenses in RD rather the expenses will be borne by the Federal Government.

Being one of the largest copper and gold mining projects in the world, the new RD agreement would bring in investment worth $10 billion in Balochistan hence making the province the largest recipient of FDI in Pakistan. Moreover, according to the former Prime Minister of Pakistan, Imran Khan, the project would be creating additional 8000[27] jobs in the country. During peak construction times, the project might facilitate the country with 7500 plus jobs however once the production starts, creation of around 4000 jobs is expected by the company itself[28].

According to the company, it is planning a two-phase construction approach while taking a start with a 40 million tonne per annum plant. The company anticipates the capital investment to double within 5 years and the first production to take place in five to six years of duration. Barrack claims RD to be a multi-generational mine that would last for 40 years and the exploration license holds additional deposits in the land package with immense future potential[29]. In addition to the gold mining project, Barrack plans to introduce and

[27] https://tribune.com.pk/story/2348876/reko-diq-to-liberate-pakistan-from-crippling-debt-says-pm-imran

[28] https://www.barrick.com/English/news/news-details/2022/true-partnership-will-deliver-reko-diq-project/default.aspx

[29] https://www.barrick.com/English/news/news-details/2022/true-partnership-will-deliver-reko-diq-project/default.aspx

implement a range of social development programs in Balochistan in form of improvement in education, healthcare, food security and access to water in a move to facilitate the people of Balochistan and the employees under the mining project. An additional $1 billion would be invested by the company to uplift the social projects associated with Reko Diq[30]which are much needed in the province.

The RD settlement although is a favorable development for Pakistan, poses a few threats on the fiscal side of the country. Despite the fact that Pakistan managed to escape a $5.8 billion penalty that was as much large as the IMF loan program itself, it is of great need to realize that the country is already lacking sufficient reserves. Since the deadline for payment (March 31st, 2022) has already passed, Pakistan is now liable to pay the settlement amount with a late payment surcharge till June 30th, 2022 which would be greater than $900 million. As per the former PM's statement, the settlement money will be paid by the three aforementioned SOEs which in return get a 25% share in the Reko Diq project. Since SOE have been given a significant share, OGDCL that represents 43% of the country's total area under exploration[31] is itself a loss making enterprise, where the circular debt hits Rs. 708 billion in 2021 (principle amount is Rs. 531 billion plus Late Payment Surcharge (LPS))[32] and the profits have fallen from Rs. 124 billion (2014) to Rs. 100 billion (2020). Moreover, the intercorporate circular debt in the petroleum sector has increased to Rs.1.5 trillion in 2021 which includes Pakistan State Oil (PSO), Sui Northern Private Limited (SNGPL), Sui Southern Gas Company Limited (SSGC), Oil and Gas Development Company Limited (OGDCL), Pakistan Petroleum Limited (PPL), and Pakistan LNG Limited (PLL)[33].

One good aspect of the revised agreement is the reduction in the proportion of share of partner company from 75% in 2006 to 50% in 2022. However, in the previous agreement, TCC brought in just Rs.220 million investment but in case of a disagreement with Pakistan, Antofagasta claimed $3.9 billion from the country. If Barrrack Gold plans to bring in billions of investment, there would always be a probability of them claiming even more. The government in this agreement needs to maintain a mechanism in order to avoid such events in the future. Moreover, details of the project have not been shared with the general public. Although Barrack is getting half of the project, there is no information on whether there is going to be a cap/limit on the quantity of minerals excavated by the company annually. Furthermore, no information is provided on the investment share of the company and Pakistan. If both parties have equal shares in the project, are they going to share investments equally? If yes, how would Pakistan finance $5 billion (half of $10 billion) in the project? The government of Pakistan needs to provide details for further Cost and Benefit Analysis of the Reko Diq project.

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30 https://www.thenews.com.pk/print/943365-pakistan-gives-reko-diq-project-to-canadian-firm

31 OGDCL Annual Report 2021

32 https://propakistani.pk/2021/09/15/ogdcls-circular-debt-hits-rs-701-billion/#:~:text=701%20Billion,-By%20Aleena%20Haroon&text=Oil%20and%20Gas%20Development%20Company,Senate%20Standing%20Committee%20on%20Petroleum.

33 https://www.thenews.com.pk/print/880300-inter-corporate-circular-debt-in-petroleum-sector-hikes-to-rs1-505-bn

6. Pakistan needs EU's GSP Plus extension to sustain $3 billion of its textiles exports

Pakistan was awarded the GSP Plus status on 1st January 2014, which serves as an impetus for boosting the country's economy. The status eliminates tariffs over 66% of product categories exported by the vulnerable countries to the EU market and is based on the effective implementation of the 27 International Conventions on human and labor rights, environmental protection, and good governance.

Over the years, European Union (EU) has been the largest export destination for Pakistan following the USA. In 2020, exports to the EU market constituted almost 34.08% of Pakistan's total exports. Among the EU countries, the United Kingdom has been the leading export destination (pre-Brexit) and competes among the top three export destinations for Pakistan.

In the past 14 years, the EU has remained a major component of export earnings for Pakistan. This can be justified through Table 6 below, in FY18' out of a total of USD 24.7 billion exports, Pakistan's exports to the EU were almost USD 8 billion i.e. about 32.14% of the total exports of Pakistan. The main exports to the EU include Textile and Agricultural products, where the share of textiles in total exports in 2021 has been almost 61%[34].

Table 6: Pakistan's Top Export Destinations

Exports in USD Billion

	EU 28	USA	China
2006-07	4.47	3.8	0.5
2007-08	5.1	3.7	0.67
2008-09	4.8	3.5	0.66
2009-10	4.9	3.56	1.2
2010-11	6.02	4.1	1.6
2011-12	5.9	3.94	2.08
2012-13	5.7	3.88	2.69
2013-14	6.6	3.95	2.68
2014-15	6.9	3.96	2.3
2015-16	6.7	3.71	1.9
2016-17	7.03	3.68	1.6
2017-18	7.97	3.86	1.75
2018-19	8.1	4.04	1.85
2019-20 (incl UK)	7.7	3.9	1.66
2020-21[35]	6.7		

Source: Author's Estimations, State Bank of Pakistan Economic Data

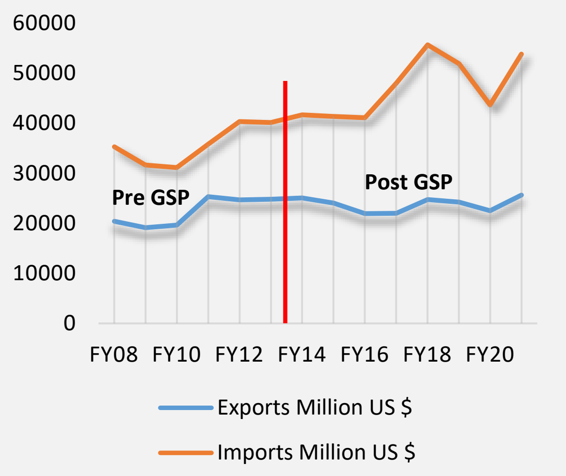
As per a draft report, **"Pakistan and European Union under GSP Plus",** Pakistan's exports to the EU since 2013 have increased by almost 35% (FY 13' to FY 20') and stand at USD 6.7 billion in 2021 (excluding the UK) however, the country's compliance with and performance of the 27 mandatory conventions remain inconsistent. The analysis in this report disaggregates Pakistan's bilateral trade with the EU in two eras – 2007-2013 and 2014-2021 and concludes that Pakistan's exports to the EU have increased from an aggregate USD 37 billion (2007-13) to an aggregate USD 57.8

[34] Economic Survey of Pakistan 2020-21

[35] Excluding exports to the UK i.e. almost USD 2 billion in 2021 (following Brexit)

billion (2014-2021) as compared to its exports to the world i.e. from an aggregate USD 150 billion to USD 192 billion in the same period.

Figure 3: Pakistan's Import Export Trend
Source: State Bank Economic Data



The report further reveals that cumulative exports to EU between these two eras have increased by almost 56% (as compared to growth in exports to the world in the same period i.e. by almost 27%) whereas Pakistan's exports to the EU since FY13' (start of GSP+) have risen by almost 35% (FY20').

The proportion of Pakistan's exports to the EU in total exports has also increased from 24.6% (2007-13') to 30.1% (2014-21') as compared to other major export destinations including China (6.5% to 8.2%) and USA (17.6% to 16.7%) in same eras.

Pakistan has a higher Revealed Comparative Advantage (RCA) in textiles[36] as compared to other product categories. Also, country's top 10 exports to the EU include mostly textile, textile made-ups, footwear, and leather products. **Out of a total of USD 14.5 billion of textile exports in 2021, almost USD 7 billion textile products were exported to the EU under GSP Plus.**

Pakistan Readymade Garments Manufacturers and Exporters Association (PRGMEA) has been urging the Government of Pakistan for pushing the EU for an extension/renewal of GSP Plus status that expires in December 2023 since the exporters fear that they might start experiencing the destructive effects in the absence of GSP Plus right from the beginning of 2023. Due to the fact that orders are placed before time, international start looking for alternative regional suppliers. PRGMEA is of the view that in case Pakistan loses GSP Plus, the textile industry would undergo an export loss of $3 billion.

Table 7: Pre and Post GSP+ Outlook

		2007-13	**2014-21[37]**
Pakistan's Exports in USD billion	To World	150	192
	To EU	37	57.8
	Proportion in total exports	24.6	30.1
	Growth in exports to EU %	26.6	35.08[38]
Pakistan's Imports in USD billion	From World	280	327
	From EU	33.8	33.5
	Proportion in total imports	12.07	10.24

Source: Author's Estimations, State Bank Economic Data

[36] World Integrated Trade Solutions (WITS)
[37] For 2021 figures, UK has been excluded
[38] This growth figure is till 2020

GSP Plus has positively impacted Pakistan's garments exports to the EU (11%) as compared to its exports to the world (1.5%)[39]. However, a number of factors can hinder the continuity of the scheme and the most important one is Pakistan's ineffective implementation of the 27 International Conventions that fall under the categories of Human Rights, Labor Rights, Environment and Governance. Recent events in Pakistan including child marriages, honor killings, domestic violence, child abuse, child labor, threat to wildlife, corruption and drug trafficking have raised a question on constructive adoption of these conventions.

In November, 2021, an official from the EU delegation's visit to Pakistan apprised the country of its performance on women and minority rights and press freedom and that Pakistan has been making absolutely 'no progress' in a move to sustain the trade status beyond 2023[40]. Also, the EU's ambassador to Pakistan has asked the latter to 're-double' its efforts in context of effective implementation of international rights convention.

Pakistan's total exports to EU in the past 14 years have been around USD 100 billion. On average in the past 9 years, it has been USD 6.5 billion. Out of total exports to the EU, the proportion of exports under GSP+ has been 93.6%, 93.7% and 93.6% in 2019, 2020 and 2021[41]. These numbers authenticate Pakistan's need for and reliance on the EU's preferential scheme.

In case Pakistan fails to receive an extension in the aforementioned status for the next 10 years; the country would experience a loss of preferential status in form of duty-free access as well as a loss of around USD 3 billion of textile exports. Pakistan must start prepping itself for the GSP Plus 2023-33 status. For the purpose, it needs to effectively implement 27 conventions and try to fill the gaps mentioned in the latest assessment report by the European Commission[42]. With that, the country to expand its exports further, must exploit its textile potential and try negotiating on tariff lines not covered under GSP Plus status.

7. Incentive package for the IT sector proposed

Telecom sector is considered as catalyst for growth in all other sectors. During the pandemic and afterwards, the world has seen a dramatic transformation towards the adoption of technology. It is safe to say that telecom sector has precipitated the restoration of economic activity post pandemic. In Pakistan, Information Technology (IT) and IT-enabled services (ITeS) sectors, are two of the few fastest growing sectors and collectively contribute 1% to the GDP i.e. USD 3.5 billion.

[39] https://www.theigc.org/blog/gsp-plus-status-improved-pakistans-garments-export/

[40] https://www.arabnews.pk/node/1963581/pakistan

[41] Pakistan and European Union under GSP Plus, 2022

[42] The EU GSP+ Assessment of Pakistan covering the period 2018-2019 – European Commission

And as per the experts, this figure must grow to USD 7 billion in the upcoming 3 to 4 years.

In past 3 years, IT sector exports have risen by 70% where Pakistan recorded highest IT exports of USD 1.067 billion in FY 2017-18[43]. The appetite for IT/ITeS sector can be validated by the fact that 60% of the total population of Pakistan lies between the age of 15 to 29 years which is the major customer for the sector, and the country is producing more than 20,000 IT graduates and engineers each year. Furthermore, more than 2000 IT companies and call centers are operating in Pakistan which indicates country's rapid move towards digitization and technological revolution.

In a move to facilitate freelancers and startups, former government approved a number of financial and non-financial incentives for IT and ITeS sectors to incorporate into the upcoming Finance Bill. One of the major incentives includes an income tax holiday on export income or revenue receipts of the freelancers registered with the Pakistan Software Export Board (PSEB) till 2030. This relief is subject to income receipts generated through formal banking channels in specific purpose codes as assigned by SBP. Under section 154A of the Income Tax Ordinance 2001, all the export receipts are subject to a 1% income tax deduction[44] that shall be charged on the gross value on clearance of goods exported. The rate shall increase to 2% if a person is not on the Active Tax Payer List (ATL). As per the latest ATL list issued by the FBR, there are around 2.88 million active taxpayers. This implies, on every Rs. 1 million export income, the ATL exporters are liable to a tax worth Rs. 10,000 however people not on the active taxpayer list, shall have to pay Rs. 20,000. This sales tax will be due on invoices not older than 2 months.

In order to facilitate freelancers in getting themselves registered with the PSEB, the proposal contains recommendations on incentivized registration fee package by the PSEB that would also provide subsidized training and provide office space at the Software Technology Parks (STPs) across the country. Earlier in 2021, the MoIT&T announced the establishment of 40 STPs by the end of 2022 all over the country including Bannu, Swat, Quetta, Faisalabad, Karachi and Sukkur, and Rs 44 billion were assigned to develop such parks in Karachi and Islamabad[45]. In addition to that an IT park in Islamabad worth Rs. 13.72 billion[46] in a partnership with Exim bank, Korea is under development that would financially facilitate ICT companies. This can help mitigate IT sector infrastructure shortages and can also facilitate in technological transfers.

It is also proposed for the Security and Exchange Commission (SECP) to provide a 20% registration fees discount for the PSEB registered freelancers. According to data, freelancers earn $1.2 million of exports which are not documented by the SBP since these freelancers are not registered. Also there is another $600 million of IT exports from the

[43] Sector Profile Tech (IT and IT enabled Services) by Board of Investment (BOI)

[44] https://invest.gov.pk/node/1550

[45] https://www.techjuice.pk/40-software-technology-parks-in-the-works-under-public-private-partnerships/

[46] https://moitt.gov.pk/TopStoryDetail

companies that do not intend to bring revenues to Pakistan [47].

The proposed policy will incentivize exporters to get themselves registered with PSEB and get their export income documented. Hence can also avail associated benefits including income tax holiday, and registration discounts.

Pakistan was ranked at 4th position for freelance development in world and its IT exports have increased by 70% during the last 3 years. According to former Prime Minister of Pakistan, Imran Khan, Pakistan has a capacity to extend IT-related exports to $50 billion in the coming years[48].

Moreover, registered freelancers would also get private and government's home loan facilitations at subsidized rates given that the freelancers must have a minimum of 5 years record on freelancing export remittance of more than $10,000.

The other incentive under the package for IT sector is the fast-tracked and simplified opening up of foreign currency (FCY) bank accounts for the PSEB registered freelancers as a means of promoting ease of doing business. Easy inflow/outflow of foreign currency has been a long outstanding issue of the IT companies. With the opening up of FCY accounts, freelancers can retain 100% of their remittance directly through proper banking channels. Prior this policy, freelancers had to cope with issues related to smooth inflow of remittance for an international project, which usually was channeled through indirect means such as jazz cash. As a result of which, even when the payments were in Dollars, freelancers received them in Rupees. Opening up of FCY accounts are going to mitigate such issues and reduce cost of doing business.

Furthermore, recommendations on Pakistan Technology Startup were also approved by the government which is going to be a public-private partnership fund. In 2021, 83 Pakistani startups have already raised a total of $352 million, which accounts for two-thirds of all investments raised during 2015 to 2021. The five major startup fundings were provided to Airlift ($85 million), QisstPay ($15 million), TAG ($12 million), Tajir ($17 million) and Bazaar ($30 million)[49]. Startups in Pakistan are growing at a high pace. Careem, Daraz, Zameen.com and Rozee.pk are a few examples of success which have been attracting investment to Pakistan. This is also evident through the recent acquisition of Easypaisa by Alibaba. If such policies are formulated and implemented, then the Digital Policy of Pakistan's agenda of growing the IT industry to $20 billion by 2025 can be achieved.

[47] Sector Profile Tech (IT and IT enabled Services) by Board of Investment (BOI)

[48] https://www.brecorder.com/news/40155976

[49] https://www.aljazeera.com/economy/2022/3/16/pakistans-startups-take-center-stage#:~:text=The%20five%20largest%20disclosed%20startup,%2C%20and%20TAG%20(%2412m).

8. Pakistan's Debt Profile

Pakistan since its inception has been relying on foreign assistance both bilateral and multilateral. The historic dependency interestingly corroborates to the governance in Pakistan. The main reason for continuously rising debt is of course the ever-dwindling foreign exchange reserves.

According to the SBP and Ministry of Economic Affairs data, the gross foreign loans taken by the former government of Pakistan Tehreek – i- Insaaf in the first nine months of FY 22' stood at $15 billion, that brings the total gross foreign borrowings by the former government to $57 billion during its tenure[50].

The $15 billion breakdown includes - $13.5 billion from international creditors, and $1.4 billion from overseas Pakistanis in form of Naya Pakistan Certificates[51].

Whereas, the breakdown of $57 billion borrowing during 3.5 years include $2 billion from UAE, $1.5 billion form Chinese currency swaps, $26 billion outflow in form of repayments, while the remaining $31 billion figure was added to the external public debt figure.

Table 8: Source wise External Public Debt Composition in USD million

	Dec 20'	% of total	Dec 21'	% of total
External Public Debt = A+B+C	82,406	100	90,633	100
A. Multilateral	41,219	50	42,434	47
World Bank	17,308	21	18,420	20
Asian Development Bank	13,665	17	13,947	15
IMF	7,479	9	6,732	7
Others	2,768	3	3,334	4
B. Bilateral	26,149	32	28,075	31
Paris Club	11,547	14	10,146	11
Non-Paris Club	14,602	18	17,929	20
C. Commercial	15,039	18	20,124	22
Commercial Loans	9,009	11	10,218	11
Euro/Sukuk Global Bonds	5,300	6	7,800	9
Naya Pakistan Certificates	129	0	1,414	2
Local Currency Sect (T-Bills & PIBs)	532	1	629	1
NBP/BOC deposits/PBC	69	0	63	0

Source: Public Debt Bulletin Jul-Dec 2021, Ministry of Finance

These foreign loans were used to finance the mushroom growth in budget deficits

[50] https://tribune.com.pk/story/2353665/foreign-loans-swell-to-15b-in-jul-mar Foreign Debt Bulletin July-March 2022

[51] Foreign Debt Bulletin July-March 2022

accompanied by plunging foreign exchange reserves – standing now at $10.8 billion.

As of 1st April 2022, total reserves with the SBP stood at US $11.3 billion[52]. These foreign reserves mainly constitute safe deposits from countries including China. According to data, cash-strapped Pakistan has gone deeper into debt as shown in Table 8 - total external public debt of the country increased from almost US $82 billion in December 2020 to US $91 billion in December 2021. The multi-lateral sources of debt include the World Bank, the IMF and the Asian Development Bank. Table 9 indicates that by June 2021, total safe China deposits increased to US $4 billion i.e. also 5% of the total external public debt.

Under the maturity profile for external debt 2022 i.e. almost US $24 billion, China safe deposits constituted US $4 billion whereas, US $3 billion were deposits from Saudi Arabia[53]. As per sources[54], China on repeated requests of Pakistan agreed to roll out US $4.2 billion facility in March 2022, that was also maturing in the same month.

The external debt profile of Pakistan which was at $75.3 billion by the end of June 2018, proliferated to $102.3 billion as of December 2021[55]. For the year 2019-20, Pakistan has borrowed $10.6 billion excluding $6 billion from IMF[56].

Pakistan's immediate challenge is to finance maturing debts ($24 billion including interest payment for 2022) and current account deficits (i.e. $13.1 billion (July-March 22') – 4.45% to GDP) for the upcoming couple of months which pushes the country into another challenge of debt trap. With just $10.8 billion of foreign exchange reserves what Pakistan can do next is – borrow to repay, get its repayments rescheduled or in other cases, remission.

Table 9: Maturity Profile of External Public Debt in USD million

	June 20'	% of total	June 21'	% of total
External Public Debt = A+B	**77,949**	**100**	**86,415**	**100**
A. Short Term Debt	12,382	16	14,295	17
i. Safe China Deposits	3000	4	4000	5
ii. Commercial and Others	141	0		0
ii. IDB Short Term	814	1	506	1
iv. Local Currency Securities	586	1	352	0
v. Long Term Debt*	7,841	10	9,437	11
B. Long Term Debt	65,612	84	72,120	83

***Remaining Maturity of less than a year**
Source: Debt Policy Statement Jan 22' Ministry of Finance

[52] Domestic Markets & Monetary Management Department
[53] Public Debt Bulletin Jul-Dec 2021, Ministry of Finance.
[54] https://www.business-standard.com/article/international/cash-strapped-pakistan-says-china-agreed-to-rollover-4-2-bn-debt-122032301444_1.html
[55] https://tribune.com.pk/story/2353665/foreign-loans-swell-to-15b-in-jul-mar
[56] https://pakistan-sports.com/pakistans-debt-maturity-profile-shortens/

Section 3: ECONOMIC ANALYSIS

Economic Analysis

The countries around the globe were not over from the disruptions caused by the pandemic, and the onset of war between Russia and Ukraine has further deteriorated the global economic recovery. In a globalized world, Pakistan is no exception and is among the countries strongly affected by disruptions caused by recent developments. The rising international commodity and petroleum prices along with the exponential rise in freight costs have significantly increased the costs of doing trade and subsequently, the developing world is more vulnerable to fiscal and balance of payment crises.

Inflation, a decline in purchasing power, remained the biggest concern of the government, as the cost of living has significantly increased and remained outside the government's set target. Average YoY CPI stood at 13 percent in the first quarter of CY2022 while MoM CPI was 0.4 percent in January, 102 percent in February, and 0.8 percent in March. The YoY SPI averaged 17.5 percent in the first quarter of CY2022; whereas, MoM SPI stood at -0.8, 1.3 and 0.6 percent in January, February and March respectively. Moreover, the WPI averaged 24 percent in the first quarter of CY2022; whereas, MoM WPI stood at 0.6, 1.9 and 3.9 percent in January, February and March respectively. The underlying reasons for the inflation are depreciation of the rupee, supply chain hurdles, higher demand after the resumption of economic activity, and high energy prices.

The public debt has increased by Rs.1.2 trillion in the first two months of the first quarter of CY 2022 from Rs.41.6 trillion at the end of December to Rs.42.7 trillion at the end of February. Domestic debt increased by Rs.960 billion while external debt increased by Rs. 250 billion in the period under review.

The total credit to the government stood at Rs. 16.5 trillion in February from Rs. 16.6 trillion in December, a decline of Rs. 145 billion in the first two months of CY2022. The decline in credit to the government comes from a drop in the government's borrowing from the State Bank of Pakistan from Rs. 5.2 trillion in December to Rs. 4.8 trillion. However, the commercial banks' credit to the government showed an increase from Rs. 11.3 trillion in December to Rs. 11.6 trillion in February. The legislation on the State Bank of Pakistan's autonomy resulted in the drop in direct borrowing of government from the State Bank.

The private sector borrowing (LTFF) showed an increase of Rs.34 billion in the first two months of the first quarter from Rs. 519 billion to Rs.552 billion at the end of February. The manufacturing sector borrowing comprises 90 percent of the private sector borrowing, which stood at Rs.512 billion at the end of February 2021.

The output of the manufacturing sector posted a growth of 8.4 percent and 6.6 percent in February and January 2022 on a YoY basis while posted a growth of 7.9 and -2.3 percent in January and February 2022 on a MoM basis. The growth in the manufacturing sector compared to the previous year is due to higher demand emanating from the resumption of businesses and economic activity, while the decline on monthly basis is due to soaring input costs and supply chain bottlenecks.

The globally high international commodity and petroleum prices have contributed to a significant build-up of the current account deficit, which cloaked at $12 billion during July- February FY2022.

The exports showed a growth of 24 percent in the first three months of CY 2022 and recorded at $8.1 billion compared to $6.5 billion last year. Similarly, imports posted a growth of 21 percent and stood at $18.1 billion compared to $15 billion last year. The remittances play a cardinal role in the management of the external account and are cloaked at $7.14 billion in first quarter of CY2022 compared to $7.2 billion in the corresponding period last year.

The net FDI stood at $200 million in Jan-Feb 2022 compared to $305 million last year. The inflow of FDI stood at $335 million against the outflow of $133 million.

In the forex market, a surge in demand for dollars and higher spending on foreign goods resulted in the depreciation of local currency from Rs.177.7 in December 2021 to Rs.180.1 in March 2022. Furthermore, the foreign exchange reserves of the State Bank of Pakistan declined by $5.6 billion from $17.6 billion in December 2021 to $12 billion at the end of March 2022.

The first quarter of CY 2022 saw a significant rise in political uncertainty in the country in the form of no confidence motion submitted by opposition parties against the government. The KSE-100 Index stood at 44,983 points at the end of December 2021 and declined to 44,866 points at the end of March 2022, a decline of 117 points. Moreover, the market capitalization of the stock market declined by Rs. 141 billion from Rs. 7.6 trillion in December 2021 to Rs. 7.4 trillion at the end of March 2022.

Box 1: PTI Government's Welfare Program

The PTI government's allocation for the Benazir Income Support program later converted into Ehsaas program, was Rs. 180 billion in 2020, Rs. 194 billion in 2021 and Rs. 246 billion in 2022. Moreover, Rs. 5 billion were disbursed for Naya Pakistan Housing Authority in 2021, and Rs. 30 billion are allocated for 2022.

- **Ehsaas Kafaalat Program** is a cash handout program of the government in which Rs.14,000 is paid to registered needy people. In FY2021, four hundred thousand people (4,144,164) received cash handouts from government which cost Rs. 100 billion. Moreover, in July-Dec 2021, two hundred thousand people (2,242,862) received money from the government costing Rs. 27 billion.

- **Sehat Sahulat Program** is a health insurance program in which provincial governments in collaboration with Pakistan State Life Insurance Corporation will provide treatment to patients in any government and private hospitals in Pakistan. Punjab government will allocate Rs. 85 billion and the KPK government will allocate Rs. 21 billion for FY2022.

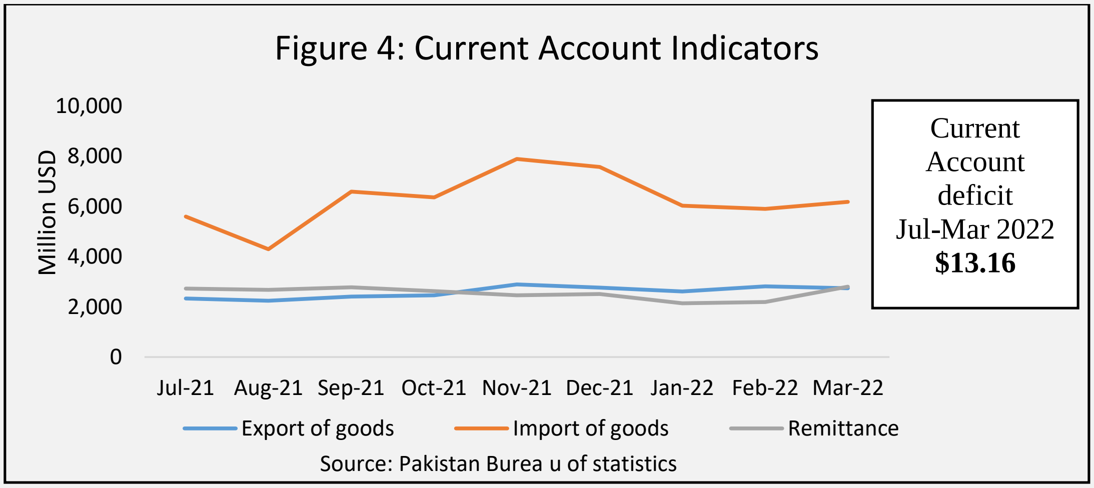
- **Kamayab Jawan Program** is a program in which capital is provided to young entrepreneurs to start their businesses. In this program, 27,900 loans have been approved with the sanctioned amount of Rs. 44.3 billion. However, loans of Rs. 37.1 billion have been disbursed to 22,919 people and the total job creation as a result of these businesses is 51,038.

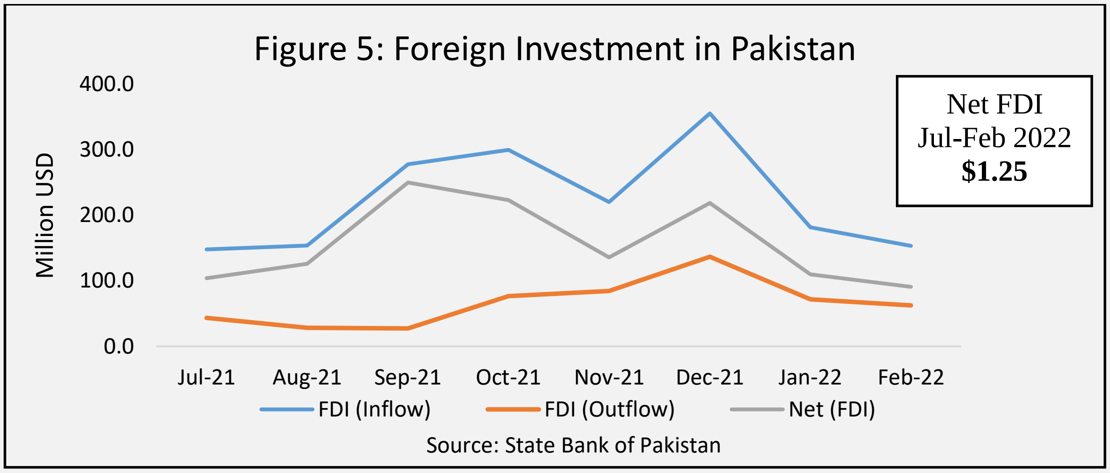
- **Mera Pakistan Mera Ghar Scheme** is a housing facility for lower and middle-income people to provide them with affordable accommodation. Banks are mandated to give at least 5% of their loans to the housing sector. Till February 2022, Rs. 338 billion has been requested while Rs.148 billion has been approved and Rs.53 billion has been disbursed.

- **Ehsaas Education Stipend Program** is a program in which financial assistance is given to Kafaalat eligible families for the education of their children aged 4- 22 years at primary, secondary, and higher secondary levels. Primary school going boys get a quarterly stipend of Rs. 1,500 and girls Rs. 2,000; secondary school boys receive Rs. 2,500 and girls Rs. 3,000; and at the higher secondary level, boys get Rs. 3,500 and girls Rs. 4,000.

- **Ehsaas Undergraduate Scholarship Program** is a program in which students from low income families will be awarded a scholarship for 4-5 years of undergraduate degree programs. In this program, 200,000 scholarships will be awarded and the allocated budget for this 4 year program is Rs. 24 billion.

Macroeconomic Indicators





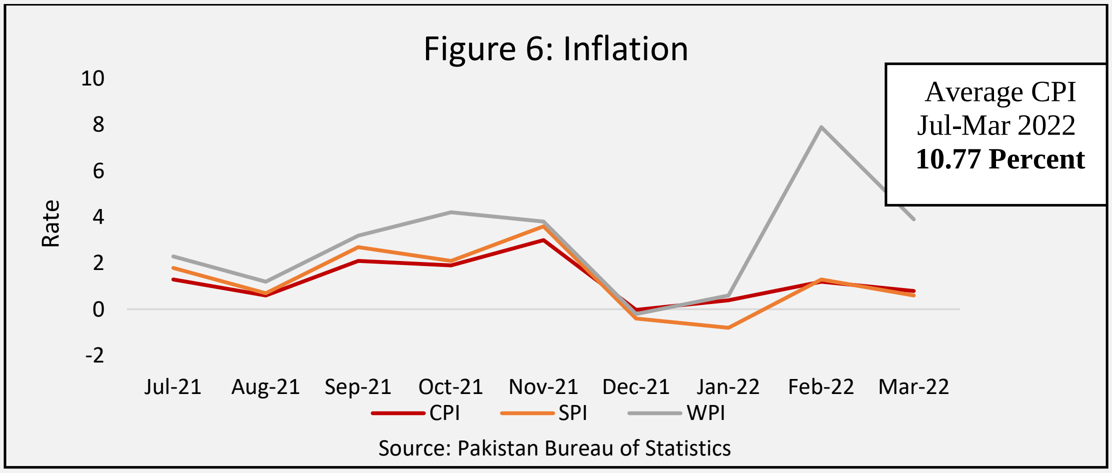
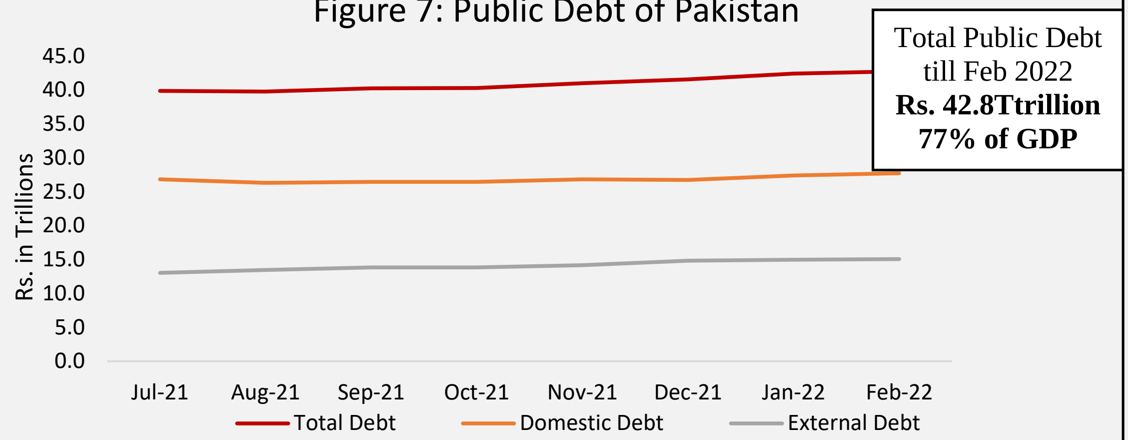
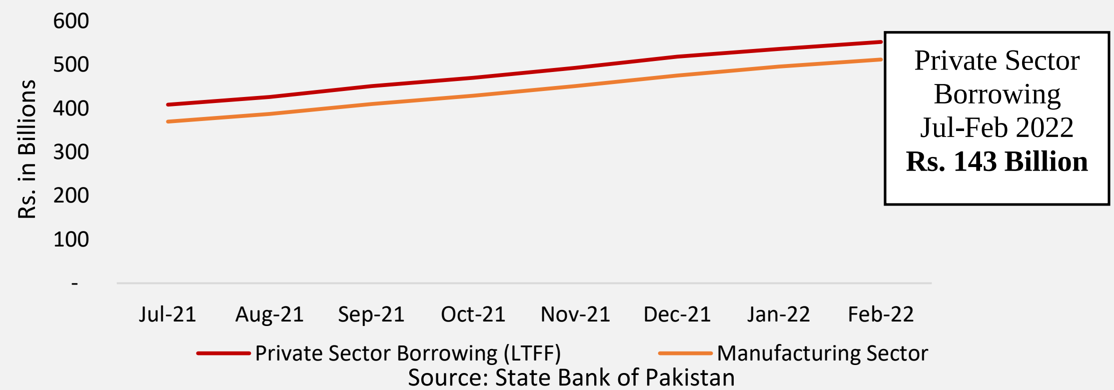


Figure 7: Public Debt of Pakistan



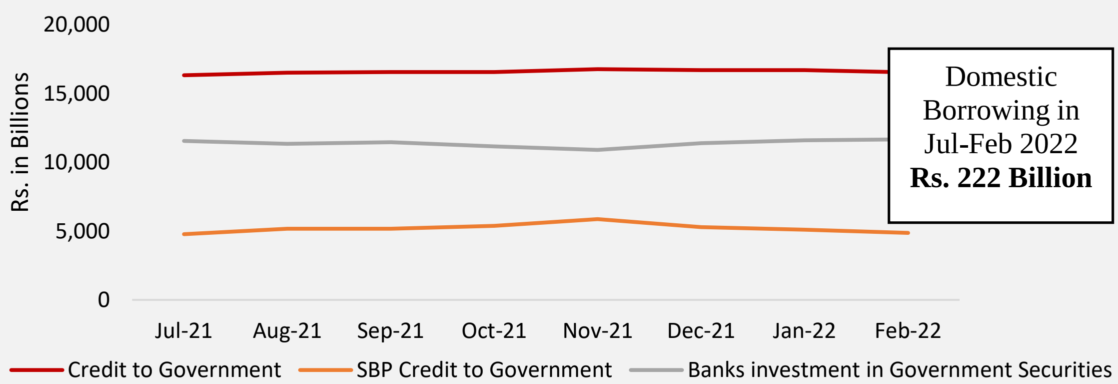
Source: State Bank of Pakistan

Figure 8: Long Term Private Sector Borrowing from Banks



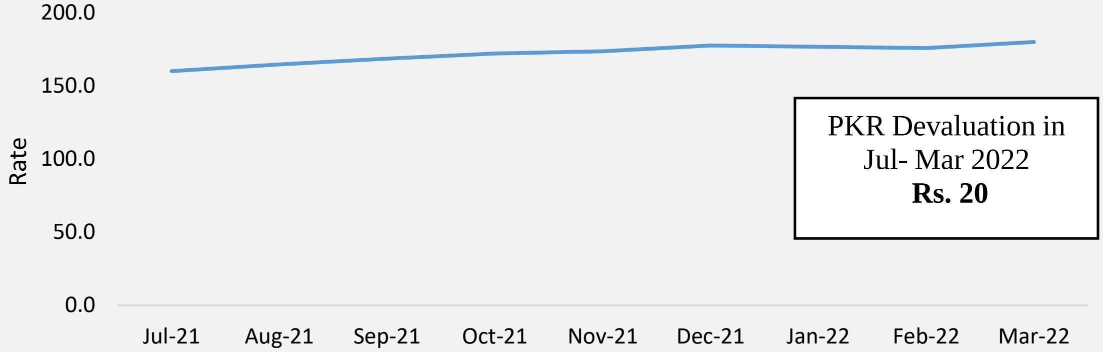
Source: State Bank of Pakistan

Figure 9: Government Domestic Borrowing



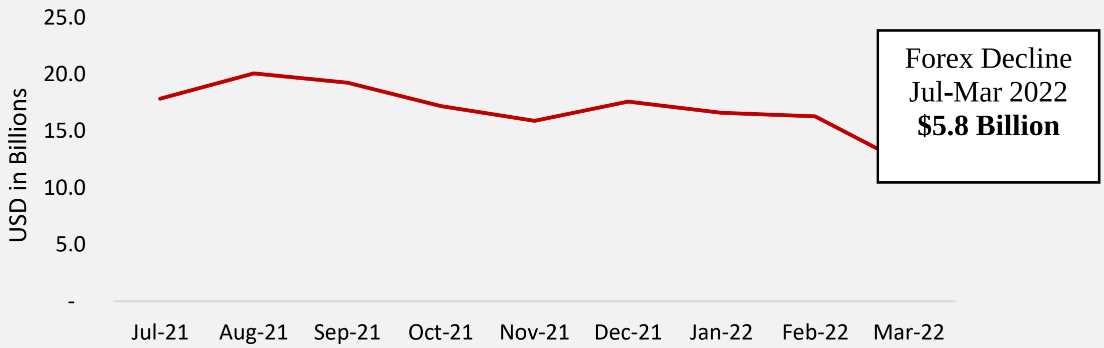
Source: State Bank of Pakistan

Figure 10: Exchange Rate Trend



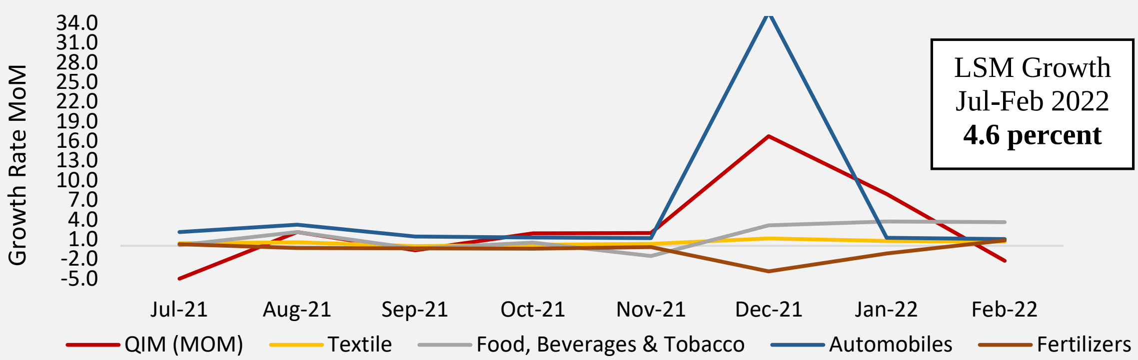
Source: State Bank of Pakistan

Figure 11: Official Foreign Exchange Reserves of Government



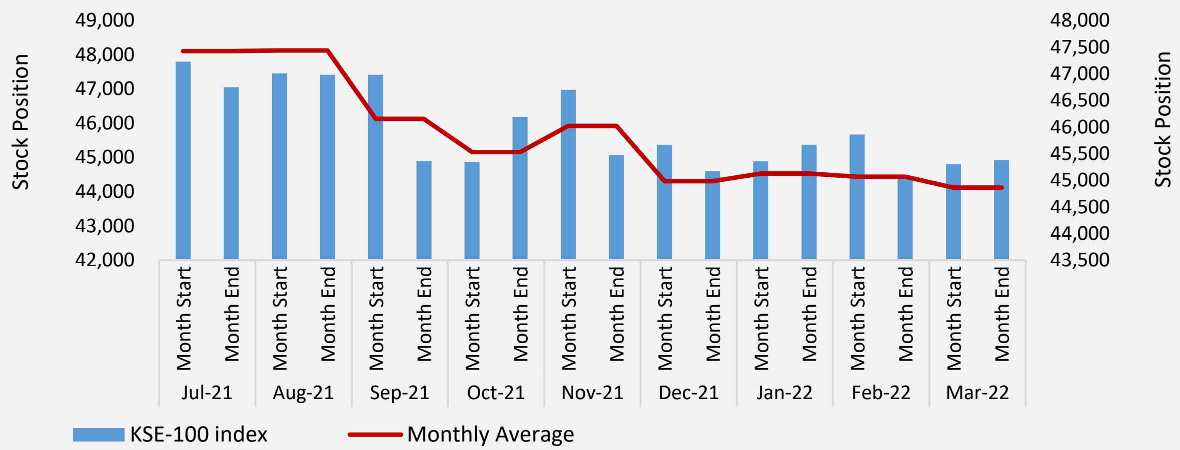
Source: State Bank of Pakistan

Figure 12 : Large Scale Manufacturing Sector Performance



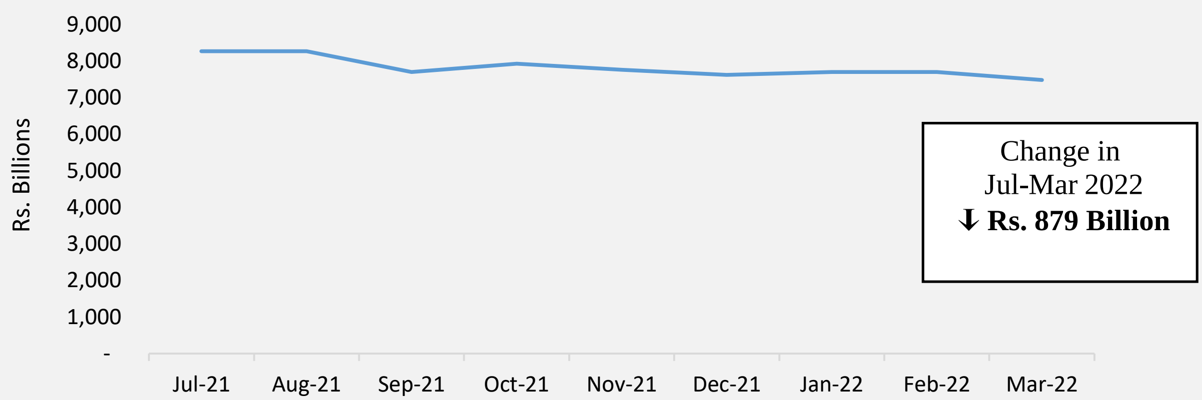
Source: Pakistan Bureau of Statistics

Figure 13 : Stock Market Performance



Source: Pakistan Stock Exchange

Figure 14 : Market Capitalization in Stock Market



Source: Business News, Dawn

Section 4: MACRO ECONOMIC OUTLOOK

Macroeconomic Outlook

The impact of an increase in global energy and commodity prices remains significant and fragile especially after the start of war between Russia and Ukraine, which will overwhelmingly increase the value of imports and translate into domestic inflation. Inflation appears to be the biggest challenge for the previous and new government, as the increase in real and even nominal incomes is not consistent with the inflation.

The higher cost of inputs and supply chain hindrances have resulted in the slowdown of the manufacturing sector and will contribute to stemming the sector from operating at maximum potential in the coming months.

The outgoing government announced a relief package by decreasing the domestic petroleum prices and fixing it till the end of current fiscal year along with decline in the power tariff. This initiative created a huge dent in the recovery of revenues and posted a significant risk of higher fiscal and current account deficits, as the government took initiative against the guidelines of IMF. The government was already failing to recover the budgeted petroleum development levy due to higher petroleum prices during pandemic but this initiative was more of a political motivation and created a huge dent in revenues, which will be financed through a Rs.300 billion cut in development expenditures. Therefore, fiscal deficit is likely to be greater than budgeted Rs. 3.9 trillion.

The external financial obligations of the country are mounting up in the form of soaring debt servicing requirements of $25-30 billion annually, import payments of $55-60 billion, and forex reserves are depleting quickly as manifested by a drop of more than $5 billion in a matter of weeks, which currently stood at $10.8 billion. Therefore, it is imperative to resume talks with the IMF to promote some stability in an already fragile economic environment.

The energy sector of the country remains in hot waters, as the government is struggling to restrict the growth of the circular debt of power sector, which stood at Rs. 2.5 trillion till March 2022. Furthermore, the circular debt is also building up in the gas sector, which stood at Rs. 650 billion till March. The IMF will ask government to raise electricity and gas tariffs to curtail the deficit.

The SBP in its latest monetary policy meeting raised the policy to 12.25 percent to curb inflationary pressure. However, the response from SBP was much delayed and require proactive action in future to keep inflation within the government's set limits.

End Note

Third quarter of FY22' comprised of some major economic challenges accompanied by political instability in Pakistan. Former government of Pakistan Tehreek –e– Insaf that was ousted in the start of April 2022, left the economy in a vulnerable state in context of the twin deficits - budget and current account deficit. The accumulated budget deficit that is reported at Rs. 3.16 trillion (Jul-March 22') i.e. 5.7% and is expected to increase till the end of current fiscal year[57], is going to be the headline challenge for the new government. Moreover, the precarious current account deficit from 2018 has even worsened by 2021 partly due to rising trade deficit and currency devaluation, for July-March 22' which is reported at $13.1 billion i.e. 4.45% of GDP. On monetary side, SBP has gone for monetary tightening through increasing the policy rate by 250 basis points to 12.25% in an emergency meeting, as a means to abate the deteriorating rate of inflation.

However, introduction of a number of welfare schemes remained on its way. Health insurance and scholarship programs were introduced in this quarter. With that, the economy is also moving towards digitalization of payment system. FBR's latest reform on implementation of QR code digital payments will further pull economy into tax net. The quarter has witnessed some major investments in IT sector, Oil and Gas sector and also in Exploration and Production companies. Freelancers and startups in Pakistan are growing at a high pace that also have been attracting investment. Introduction of National SME Policy is expected to bring in long-term benefits to the business climate as a whole.

Pakistan's textile exports are a major dependency for export earnings. The EU's GSP Plus scheme has already brought in desired results however, traders demand further extension of the status for the continuation of these benefits. Energy crisis and Pakistan's dependency on oil import will continue to surge. Depleting foreign exchange reserves and rising deficits have become the tip of the iceberg.

Various policy reforms are undertaken in this review. However, monetary and fiscal challenges remain imperative for discussion in order to sustain any other developmental strategies.

[57] Monthly Economic Outlook - March

Annexure

Table 10: Current Account Indicators of Pakistan			
Month	Exports	Imports	Remittances
	Million USD		
Jul-21	2,340	5,601	2,736
Aug-21	2,247	4,297	2,683
Sep-21	2,410	6,595	2,780
Oct-21	2,464	6,369	2,629
Nov-21	2,901	7,899	2,460
Dec-21	2,764	7,580	2,520
Jan-22	2,614	6,036	2,144
Feb-22	2,820	5,907	2,190
Mar-22	2,740	6,186	2,810

Table 11: Foreign Direct Investment in Pakistan			
Month	Net	Inflow	Outflow
	Million USD		
Jul-21	103.8	147.6	43.7
Aug-21	125.7	153.9	28.2
Sep-21	249.7	277.3	27.6
Oct-21	223.0	299.6	76.6
Nov-21	135.7	220.1	84.4
Dec-21	218.7	355.1	136.5
Jan-22	110.0	181.6	71.6
Feb-22	90.8	153.2	62.4

Table 12: Inflation			
Month	CPI	SPI	WPI
Jul-21	1.3	1.8	2.3
Aug-21	0.6	0.7	1.2
Sep-21	2.1	2.7	3.2
Oct-21	1.9	2.1	4.2
Nov-21	3	3.6	3.8
Dec-21	-0.02	-0.4	-0.2
Jan-22	0.4	-0.8	0.6
Feb-22	1.2	1.3	7.9
Mar-22	0.8	0.6	3.9

Table 13: Public Debt of Pakistan			
Month	Public Debt	Domestic Debt	External Debt
	Rs. in Trillions		
Jul-21	39.9	26.8	13.0
Aug-21	39.7	26.3	13.4
Sep-21	40.3	26.4	13.8
Oct-21	40.3	26.5	13.8
Nov-21	41.0	26.8	14.1
Dec-21	41.6	26.7	14.8
Jan-22	42.4	27.4	15.0
Feb-22	42.8	27.7	15.1

Table 14: Domestic Borrowing of Government			
Month	Total Credit	SBP Credit to Government	Banks Credit to Government
	Rs. in Billions		
Jul-21	16,325	4,767	11,558
Aug-21	16,503	5,167	11,335
Sep-21	16,558	5,167	11,451
Oct-21	16,549	5,392	11,158
Nov-21	16,759	5,870	10,889
Dec-21	16,691	5,298	11,393
Jan-22	16,700	5,108	11,592
Feb-22	16,547	4,877	11,670

Table 15: Long Term Private Sector Borrowing			
Month	Total Credit	Manufacturing	Agriculture
	Rs. in Billions		
Jul-21	409	370	3.76
Aug-21	427	387	3.79
Sep-21	451	410	4.60
Oct-21	470	430	4.49
Nov-21	493	451	3.90
Dec-21	519	475	4.33
Jan-22	536	496	4.34
Feb-22	552	512	4.26

Table 16: Exchange Rate and SBP Reserves

Month	Exchange Rate	SBP Reserves (USD Billions)
Jul-21	160.2	17.8
Aug-21	164.6	20.1
Sep-21	168.6	19.3
Oct-21	172.1	17.2
Nov-21	173.6	15.9
Dec-21	177.7	17.6
Jan-22	176.7	16.6
Feb-22	175.9	16.3
Mar-22	180.1	12.0

Table 17: Large Scale Manufacturing Sector Growth

Month	QIM	Textile	Food & Beverages	Automobiles	Petroleum Products
Jul-2021	-5.0	0.4	0.1	2.1	-0.2
Aug-2021	2.1	0.5	2.1	3.2	0.5
Sep-2021	-0.7	-0.1	-0.5	1.4	0.5
Oct-2021	1.9	0.1	0.5	1.2	0.8
Nov-2021	1.91	0.3	-1.6	1.1	-0.3
Dec-2021	16.7	1.1	3.1	35.7	-0.5
Jan-2022	7.9	0.7	3.7	1.2	0.0
Feb-2022	-2.3	0.6	3.6	1.0	0.3

Table 18: Performance of Stock Market

Month	KSE-100 Index Status		Month Average	Market Capitalization (Rs. in Billions)
	Month Start	Month End		
Jul-2021	47,801	47,055	47,428	8,268
Aug-2021	47,453	47,420	47,436	8,272
Sep-2021	47,413	44,900	46,157	7,701
Oct-2021	44,872	46,185	45,528	7,931
Nov-2021	46,975	45,072	46,024	7,759
Dec-2021	45,369	44,596	44,983	7,622
Jan-2022	44,887	45,375	45,131	7,705
Feb-2022	45,675	44,461	45,068	7,703
Mar-2022	44,804	44929	44,866	7,481