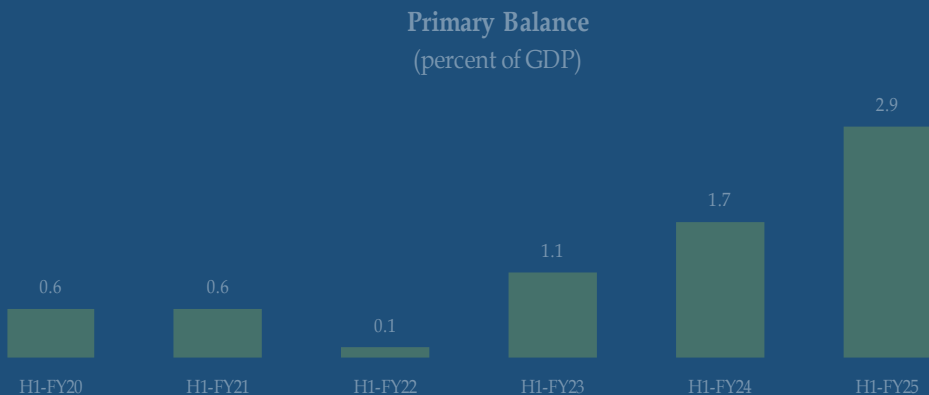


## Fiscal Policy and Public Debt

*The pace of fiscal consolidation steepened in FY25. The overall fiscal deficit was contained to the lowest level since H1-FY05, while primary balance posted a larger surplus. This strong fiscal performance largely owes to higher SBP profits, followed by decent gains in tax revenue and decline in disbursement of power subsidies. The fiscal consolidation slowed the pace of public debt accumulation. Moreover, the overall public debt profile improved in terms of maturity, roll over, and currency risk. For the first time, GoP also conducted buyback auctions of market treasury bills manifesting the easing of liquidity conditions for the government. The improved fiscal performance and foreign exchange earnings slightly boosted the overall debt repayment capacity.*





## 4.1 Fiscal Trends and Policy Review

Fiscal consolidation continued, with primary balance recording a higher surplus in H1-FY25 compared to the same period last year. In the same vein, overall fiscal deficit in H1-FY25 nearly halved compared to the same period last year (Figures 4.1a & 4.1b). This improvement was driven by a significant increase in revenue, as well as a decline in non-interest expenditure as percent of GDP.<sup>1</sup> Meanwhile, contribution of provincial surplus to the primary balance doubled compared to the last year (Table 4.1).

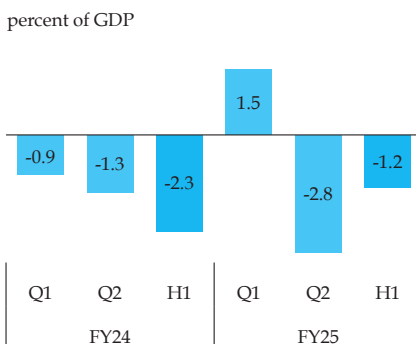
The major contribution to improved revenue performance came from record high SBP profit, followed by modest gains in tax revenue as percent of GDP. Despite the above-target collection of direct taxes, the half-year target for tax revenue was missed by a wide margin. This shortfall was due to underperformance of indirect taxes, notwithstanding the additional revenue mobilization measures introduced

in the FY25 budget. Faster-than-anticipated decline in inflation and relatively muted growth in import values in PKR terms, as well as less than sufficient administrative efforts, constrained the indirect tax collection.

On the other hand, the decline in non-interest expenditure (as percent of GDP) could be attributed to lower-than-budgeted disbursement of power subsidies, austerity measures and pension reforms. While grants increased due to enhanced coverage under the Benazir Income Support Programme (BISP), development spending remained almost unchanged in terms of GDP. In contrast to the non-interest expenditure, mark-up payments continued to increase owing to rising debt stock from persistently high fiscal deficit in recent years. Nonetheless, declining interest rates, stable exchange rate, and slower debt accumulation helped moderate the pace of increase in interest payments.

Fiscal Balance

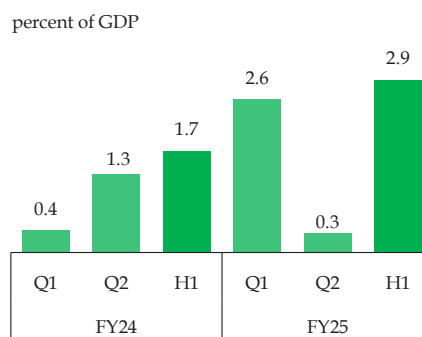
Figure 4.1a



Source: MoF

Primary Balance

Figure 4.1b



<sup>1</sup> Non-interest expenditure excludes the statistical discrepancy. If this discrepancy is included, the non-interest expenditure increases from 4.8 percent of GDP in H1-FY24 to 5.0 percent in H1-FY25.

## The State of Pakistan's Economy, Half Year Report 2024-25

Consolidated Fiscal Indicators

Table 4.1

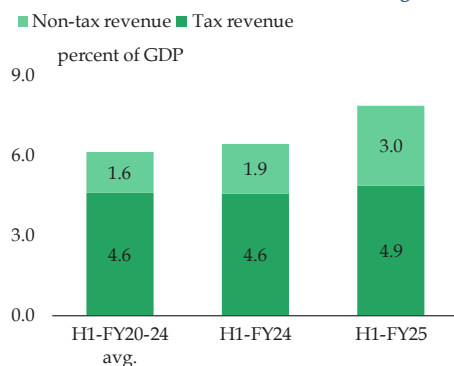
	Values (billion Rupees)				Growth (percent)			
	FY24	FY25			FY24	FY25		
	H1	Q1	Q2	H1	H1	Q1	Q2	H1
<b>Total revenue</b>	<b>6,854</b>	<b>5,827</b>	<b>3,937</b>	<b>9,764</b>	<b>45.9</b>	<b>117.0</b>	<b>-5.6</b>	<b>42.5</b>
Tax revenues	4,834	2,776	3,292	6,067	29.5	25.2	25.8	25.5
FBR taxes	4,469	2,563	3,062	5,625	30.3	25.5	26.1	25.9
Non-tax revenue	2,020	3,051	645	3,696	108.8	550.9	-58.4	83.0
SBP profit	972	2,500	0	2,500	161.9	-	-	157.2
PDL collection*	473	262	288	549	165.9	17.8	14.8	16.2
<b>Total expenditure</b>	<b>9,262</b>	<b>3,931</b>	<b>7,370</b>	<b>11,302</b>	<b>45.1</b>	<b>7.2</b>	<b>31.7</b>	<b>22.0</b>
Current expenditure	8,565	3,537	6,581	10,118	41.3	11.5	22.1	18.1
Mark-up payments	4,220	1,306	3,835	5,142	64.0	-5.3	35.0	21.8
Development expenditure & net lending	661	277	467	744	3.9	-2.0	23.3	12.5
PSDP	673	278	494	772	13.9	-2.8	27.7	14.7
Federal	130	23	110	133	-4.4	-44.5	23.2	1.9
Provincial	543	256	383	639	19.4	4.1	29.0	17.7
Statistical discrepancy	36	117	322	440	-111.4	-44.4	-284.4	1,124.2
<b>Fiscal balance</b>	<b>-2,408</b>	<b>1,896</b>	<b>-3,434</b>	<b>-1,538</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<i>percent of GDP</i>	<b>-2.3</b>	<b>1.5</b>	<b>-2.8</b>	<b>-1.2</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Primary balance</b>	<b>1,812</b>	<b>3,202</b>	<b>401</b>	<b>3,604</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<i>percent of GDP</i>	<b>1.7</b>	<b>2.6</b>	<b>0.3</b>	<b>2.9</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Revenue balance</b>	<b>-1,711</b>	<b>2,290</b>	<b>-2,645</b>	<b>-354</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<i>percent of GDP</i>	<b>-1.6</b>	<b>1.8</b>	<b>-2.1</b>	<b>-0.3</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Financing (net)</b>	<b>2,408</b>	<b>-1,896</b>	<b>3,434</b>	<b>1,538</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
External	608	-157	78	-79	-	-	-	-
Domestic	1799	-1,739	3,356	1,617	-	-	-	-
<b>Memorandum items:</b>					<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Provincial balance	289	360	416	775				
<i>percent of GDP</i>	<i>0.3</i>	<i>0.3</i>	<i>0.3</i>	<i>0.6</i>				
Non-interest expenditure <sup>^</sup>	5,006	2,508	3,213	5,720	-	-	-	-
GDP <sup>#</sup>	106,045	124,150	124,150	124,150	-	-	-	-

\*on petrol/diesel; ^total expenditure minus mark-up payments & statistical discrepancy; #budget estimate for the full year

Source: MoF

While fiscal consolidation continued in the first half of FY25, it is important to assess the sustainability of the underlying trends. The impact of high interest rates, a major factor behind recent gains, has started to taper off, akin to other factors like stable exchange rate and low inflation outturns. This is already reflected in subdued indirect tax collection despite revenue measures introduced in the FY25 budget. Meanwhile, the rise in interest

payments, albeit slowing down, has further squeezed the fiscal space for productivity-linked spending on health, education and PSDP. In this backdrop, it is imperative to implement reforms aimed at broadening of tax base and providing resilience to revenue mobilization. The reforms should also rationalize taxation across sectors and products and reduce indirect taxes, which are inherently regressive, for an equitable distribution of

**Breakdown of Total Revenue** **Figure 4.2**

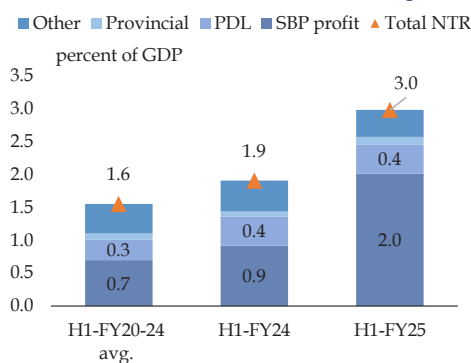
Source: MoF

tax burden.<sup>2</sup> In this regard, amendments to provincial agriculture income tax regimes is a step in the right direction.

## 4.2 Revenue

Total revenue collection increased to 7.9 percent of GDP in H1-FY25, up from 6.5 percent last year. In continuation of last year's trend, most of this increase came from non-tax revenue (NTR) (**Figure 4.2**).

Non-tax revenue increased from 1.9 percent of GDP in H1-FY24 to 3.0 percent in H1-FY25 (**Figure 4.3**). This increase was mainly on account of transfer of record SBP profit, which resulted from SBP's money market operations at elevated

**Breakdown of Non-tax Revenue** **Figure 4.3**

Source: MoF

interest rates, as well as net exchange gains amid stronger PKR during FY24.<sup>3,4</sup> Another factor that supported higher non-tax revenue was PDL collection, backed by recovering POL sales.<sup>5</sup> However, as the PDL rate remained unchanged, its contribution to NTR growth declined compared to last year.<sup>6</sup> Moreover, Punjab's income from investments also contributed to total non-tax revenue.

## Tax Revenue

Tax revenue increased from 4.6 percent of GDP in H1-FY24 to 4.9 percent in H1-FY25, with direct taxes being the major contributor (**Table 4.2**). Income tax from banks and withholding taxes played a key role. The rise in banks' tax payments could

<sup>2</sup> For instance, there has been a sharp rise in share of income tax paid by salaried individuals, as well as banks, in the tax revenue over the last few years. In comparison, share of agriculture income tax collected by provinces has remained very low and stagnant. In case of products, domestic sales tax collection has been majorly contributed by electrical energy during recent years; having about one-third share in total domestic sales tax collection.

<sup>3</sup> The annual profit of SBP is transferred to the government after publication of the audited balance sheet, usually in the first half of the following fiscal year.

<sup>4</sup> SBP recorded net exchange gains of Rs 186 billion in FY24, compared to a considerably high net exchange loss of Rs 875 billion in FY23. Source: SBP Annual Financial Statements 2023-24

<sup>5</sup> POL sales increased by 7.3 percent in H1-FY25, compared a decline last year. Source: OCAC

<sup>6</sup> PDL on petrol and diesel was last increased to Rs 60 per liter each on September 01, 2023 and November 01, 2023, respectively.

## The State of Pakistan's Economy, Half Year Report 2024-25

**Tax Revenue in H1** Table 4.2  
value in billion Rupees; growth in percent

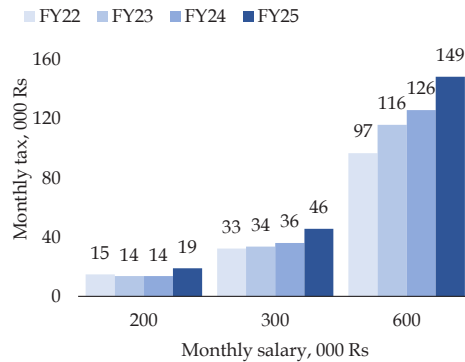
	Value		Growth		Percent of GDP	
	FY24	FY25	FY24	FY25	FY24	FY25
Direct taxes	2,149	2,782	40.9	29.4	2.0	2.2
Indirect taxes	2,320	2,843	21.9	22.5	2.2	2.3
Sales tax	1,515	1,898	19.1	25.3	1.4	1.5
Customs	541	599	15.8	10.7	0.5	0.5
FED	265	347	61.0	31.0	0.2	0.3

Source: FBR

be attributed to increase in the minimum tax rate from 39 percent to 44 percent.<sup>7</sup> Moreover, there was a considerable increase in banks' profit-before-tax, driven by investment in government securities at higher interest rates.<sup>8</sup> In case of withholding taxes (WHT), the major boost came from personal income tax (PIT), helped by a significant uptick in progressive tax rates introduced in the FY25 budget (Figure 4.4).<sup>9</sup>

It is pertinent to highlight that the contribution of direct taxes to growth in tax revenue, which has remained quite robust in FY23 and FY24, somewhat waned in H1-FY25. A key factor behind this trend is declining interest rate environment, which has impacted the interest-sensitive components of the direct taxes. This is particularly evident in slower growth of WHT on the income earned by individuals on their profit-bearing bank accounts and

**Personal Income Tax in Recent Years** Figure 4.4



Source: taxcalculator.pk

investment in government securities, and banks' income tax (Figure 4.5).

Indirect taxes inched up from 2.2 percent of GDP to 2.3 percent of GDP, in contrast to a decline last year (Table 4.2). The muted performance of indirect taxes was despite a reasonable growth in sales tax and federal excise duty (FED). Upward revision in electricity tariffs largely drove the increase in sales tax.<sup>10</sup> Moreover, the government announced new revenue mobilization measures in the FY25 budget to strengthen tax collection. For instance, it rationalized the list of goods subject to exemptions or concessional rates, like tractors, leather and textile products, local supply of poultry feed, stationery items, and DAP.<sup>11</sup> Similarly, the tax on mobile phone (worth less than US\$ 500) was

<sup>7</sup> Simultaneously, advances to deposit ratio (ADR) tax on banks was abolished. Source:

[www.pakistancode.gov.pk/english/UY2FqaJw1-apaUY2Fqa-apaUY2Npa5pqbw%3D%3D-sg-jjjjjjjjjjjj](http://www.pakistancode.gov.pk/english/UY2FqaJw1-apaUY2Fqa-apaUY2Npa5pqbw%3D%3D-sg-jjjjjjjjjjjj)

<sup>8</sup> Banks' markup earnings from investments, heavily concentrated in government securities, rose by 10.5 percent in H1-FY25; in comparison, loans and advances yielded 9 percent lower returns in H1-FY25 than the same period last year. Consequently, banks' profit-before-tax was up 4.7 percent in H1-FY25. Source: Financial Soundness Indicators, State Bank of Pakistan

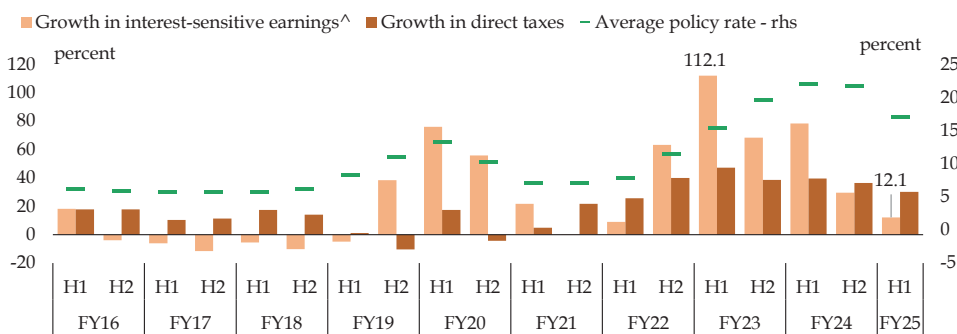
<sup>9</sup> PIT grew by 16.2 percent in H1-FY25, compared to the 58.8 percent last year.

<sup>10</sup> See Chapter 3 for more details on electricity tariffs.

<sup>11</sup> For instance, 18 percent sales tax on DAP was imposed. Initially, tractors, which were earlier exempt, were subjected to 10 percent in the FY25 budget; the rate was later raised to 14 percent.

**Policy Rate and Income Tax on Interest-sensitive Earnings**

**Figure 4.5**



<sup>^</sup> means sum of income tax paid by banks and WHT on 'bank interest & securities' (interest earnings of individuals)  
Sources: Staff calculations based on data from various FBR Biannual Reports, MoF, SBP, and Haver Analytics

changed from per unit to standard ad valorem tax (18 percent).<sup>12</sup> In case of FED, a duty of Rs 15/kg was levied on the supply of sugar to food manufacturers, among other measures.

Notwithstanding these measures, the target for indirect taxes was missed, resulting in a shortfall of about Rs 384 billion in the overall tax revenue. In part, this is due to the economic factors – mainly GDP, inflation, imports, and LSM – turning out to be less favorable compared to the FBR projections for FY25 (Table 4.3).<sup>13</sup> For instance, subdued imports (in

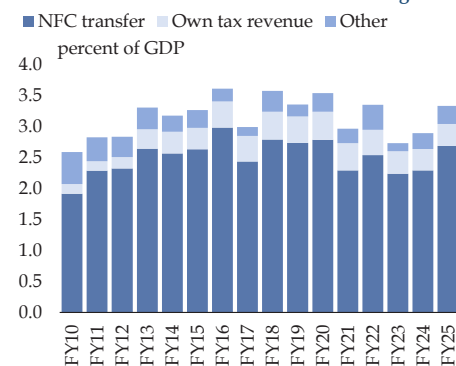
PKR) had a direct bearing on sales tax collected at import stage, as well as customs duties. Moreover, other reasons for missing the target could be the insufficient administrative efforts to mobilize revenue. This is evident from lower number of sales tax filers added to the active taxpayer list: 1.18 million during

**Economic Indicators in FY25** Table 4.3  
growth in percent

	Annual Projections	Actual (H1-FY25)
Imports	16.9	3.3
Inflation	15.6	7.2
Real GDP	3.7	1.5
LSM	3.5	-1.9

Source: FBR Evidence Based Revenue Forecasting FY25

**Provincial Revenue in H1** Figure 4.6



Source: MoF

<sup>12</sup> For example, smart phones (CBUs) worth US\$ 100 to US\$ 200 were earlier subject to Rs 1,680/- per unit. Now, all mobile phones below US\$ 500 are subject to standard GST rate of 18 percent. It may be noted here that multiple slabs below US\$ 500 have been reduced to only one, where the sales tax is 18 percent regardless of the origin of manufacturing, local or foreign.

<sup>13</sup> FBR, in its *Evidence Based Revenue Forecasting* reports, uses assumptions for various economic indicators to project revenue collection for the year ahead.

## The State of Pakistan's Economy, Half Year Report 2024-25

## Consolidated Expenditure in H1

Table 4.4

values in billion Rupees; growth in percent

	Values		Growth		Percent of GDP	
	FY24	FY25	FY24	FY25	FY24	FY25
<b>Total expenditure</b>	<b>9,226</b>	<b>10,862</b>	<b>37.7</b>	<b>17.7</b>	<b>8.7</b>	<b>8.7</b>
<b>Current expenditure</b>	<b>8,565</b>	<b>10,118</b>	<b>41.3</b>	<b>18.1</b>	<b>8.1</b>	<b>8.2</b>
<b>Federal</b>	<b>6,529</b>	<b>7,643</b>	<b>50.2</b>	<b>17.1</b>	<b>6.2</b>	<b>6.2</b>
Mark-up payments	4,220	5,142	64.0	21.8	4.0	4.1
Domestic	3,718	4,675	63.5	25.7	3.5	3.8
Foreign	502	467	67.6	-7.1	0.5	0.4
Defence	758	890	18.6	17.5	0.7	0.7
Pension	404	450	25.9	11.2	0.4	0.4
Running of civil government	302	339	33.4	12.1	0.3	0.3
Subsidies	375	237	90.9	-36.8	0.4	0.2
Grants to others	469	585	20.6	24.6	0.4	0.5
<b>Provincial</b>	<b>2,035</b>	<b>2,475</b>	<b>18.6</b>	<b>21.6</b>	<b>1.9</b>	<b>2.0</b>
<b>Development expenditure &amp; net lending</b>	<b>661</b>	<b>744</b>	<b>3.9</b>	<b>12.5</b>	<b>0.6</b>	<b>0.6</b>
<b>Total development expenditure</b>	<b>673</b>	<b>772</b>	<b>13.9</b>	<b>14.7</b>	<b>0.6</b>	<b>0.6</b>
PSDP	673	772	13.9	14.7	0.6	0.6
Federal	130	133	-4.4	1.9	0.1	0.1
Provincial	543	639	19.4	17.7	0.5	0.5
<b>Net lending PSE's</b>	<b>-12</b>	<b>-28</b>	<b>-126.2</b>	<b>136.4</b>	<b>-</b>	<b>-</b>
<b>Memorandum items:</b>						
Non-interest (total) expenditure	5,006	5,720	21.4	14.3	4.7	4.6
GDP	106,045	124,150*	26.4	17.1	-	-

\* Budget estimate

Source: Ministry of Finance

first six months of FY25 compared to 1.33 million in the same period of FY24.<sup>14</sup>

The provincial taxes, on the other hand, increased only slightly in terms of GDP, mainly on account of sales tax on services. The provincial tax to GDP ratio has hovered around 0.4 percent of GDP since H1-FY16 (Figure 4.6). The lackluster performance of provincial own tax collection could be linked to less-than-required efforts amid huge revenue transfers from the federal government under the NFC award.<sup>15</sup>

### 4.3 Expenditure<sup>16</sup>

In contrast to increase in revenue, total expenditure stood unchanged (in terms of GDP) in H1-FY25, with a decline in non-interest expenditure offsetting the slight increase in interest payments (Table 4.4).

#### Non-interest Expenditure

Continuing the last year's trend, the non-interest expenditure declined in terms of GDP in H1-FY25. Almost the entire decline could be attributed to lower disbursement of subsidies, mainly to power sector, which

<sup>14</sup> FBR<sup>15</sup> For more details, see Box 4.4 in *The State of Pakistan's Economy, Annual Report FY17*.<https://www.sbp.org.pk/reports/annual/arFY17/Chapter-04.pdf><sup>16</sup> This section excludes statistical discrepancy, consistent with previous reports. Due to the large discrepancy reported for H1-FY25, the trends vary by including it.

account for around 90 percent of total subsidies. During H1-FY25, there were no disbursements to the IPPs on account of clearance of circular debt arrears, unlike last year when about half of the budgeted amount was disbursed (Table 4.5).<sup>17</sup> However, there was an increase in inter-disco tariff differential subsidy (TDS)<sup>18</sup>, partly due to the staggered distribution of the annual tariff rebasing.<sup>19</sup>

Furthermore, there was a sharp fall in other subsidies as well. The government's decision to abolish gas subsidy to fertilizer plants, an untargeted subsidy which did not serve the intended purpose of lowering the urea prices for farmers, helped rationalize the subsidy spending.<sup>20</sup> This policy pivot followed the rationalization of gas subsidies to the industrial sector last year.<sup>21</sup>

While subsidies declined, growth in spending on the running of civil government and pension decelerated, keeping it almost unchanged in terms of GDP. This is partly on account of the austerity measures announced by the government in September 2024, in continuation of the measures introduced in February 2024. These measures included ban on the government's purchase of all

Breakup of Subsidies and Grants Table 4.5

	H1 (P)		Percent of Annual BE	
	FY24	FY25	FY24	FY25
	billion Rupees			
<b>Subsidies</b>				
<b>Power subsidies</b>	<b>331.0</b>	<b>214.0</b>	<b>17.1</b>	<b>21.1</b>
IPPs	131.0	0.0	50.0	0.0
Tariff differential	193.6	161.2	50.1	35.0
Inter disco	49.1	156.3	32.8	56.6
KE	116.4	3.0	68.1	1.7
Tube-wells	3.1	1.9	31.1	18.8
AJK	24.9	0.0	45.3	0.0
Other	6.0	52.3	8.2	33.5
<b>Non-power subsidies</b>	<b>44.7</b>	<b>23.8</b>	<b>27.7</b>	<b>10.0</b>
Fertilizer plants	10	0.0	40.0	0.0
Wheat	5.7	6.2	34.4	22.7
Others	29.0	17.6	65.0	0.0
<b>Total subsidies</b>	<b>375</b>	<b>237</b>	<b>35.3</b>	<b>17.4</b>
<b>Grants</b>				
<b>Grants to provinces</b>	<b>54.0</b>	<b>59.0</b>	<b>58.9</b>	<b>52.5</b>
<b>Grants to others</b>	<b>469.0</b>	<b>585.0</b>	<b>35.7</b>	<b>35.2</b>
BISP	183.7	232.3	39.4	39.2
AJK and GB	68.1	100.3	55.9	58.0
Contingent liability	67.4	39.8	28.5	14.7
DIII*	-	20.0	0.0	100.0
Others	150.3	192.8	30.5	31.7
<b>Total grants</b>	<b>524</b>	<b>644</b>	<b>37.2</b>	<b>36.3</b>

\*Digital Information Infrastructure Investment;

P: provisional

Source: MoF

types of non-essential vehicles and machinery/equipment, creation of new and ad-hoc posts, and non-obligatory visits abroad.<sup>22</sup> In addition, the government also introduced the much-needed reforms to

<sup>17</sup> The subsidy under this subhead (Rs 215 billion) is expected to be disbursed in H2-FY25.

<sup>18</sup> TDS is the difference between the uniform tariff notified by the government and distribution company-wise tariff determined by NEPRA.

<sup>19</sup> Initially, the government had announced lump sum annual rebasing for both protected and non-protected categories of consumers. Later, to give relief to the consumers, the government decided to stagger the increase over a period of four months, Jul-Oct 2024. This alone raised the TDS by Rs 50 billion. Source: NEPRA Notification dated July 11, 2024

<sup>20</sup> IMF (2024). Pakistan: 2024 Article IV Consultation and Request for an Extended Arrangement under the Extended Fund Facility-Press Release; Staff Report; and Statement by the Executive Director for Pakistan, International Monetary Fund, Washington, D.C.

<sup>21</sup> The government had disbursed Rs 25 billion and Rs 730 million to the fertilizer plants and industrial sector in FY24, while there was no LNG subsidy. In FY23, these subsidies cumulatively stood at about Rs 53 billion.

<sup>22</sup> MoF Notification dated September 04, 2024

## The State of Pakistan's Economy, Half Year Report 2024-25

**Provincial Fiscal Accounts in H1** Table 4.6  
values in billion Rupees; growth in percent

	Values		Growth		Percent of GDP	
	FY24	FY25	FY24	FY25	FY24	FY25
<b>Total revenue</b>	<b>3,071</b>	<b>4,140</b>	<b>33.9</b>	<b>34.8</b>	<b>2.9</b>	<b>3.3</b>
NFC transfer	2,435	3,339	29.5	37.1	2.3	2.7
Own revenue	444	585	18.9	31.8	0.4	0.5
Taxes	365	443	20.5	21.2	0.3	0.4
GSTS*	230	261	23.4	13.6	0.2	0.2
Non-tax	79	143	12.0	80.4	0.1	0.1
Fed. transfers	191	216	386.1	12.7	0.2	0.2
Loans (net)	115	125	-477	8.1	0.1	0.1
Grants	76	91	9.0	19.7	0.1	0.1
<b>Total expenditure</b>	<b>2,782</b>	<b>3,365</b>	<b>26.9</b>	<b>21.0</b>	<b>2.6</b>	<b>2.7</b>
Current	2,074	2,524	19.7	21.7	2.0	2.0
Development	543	639	19.4	17.7	0.5	0.5
Statistical	165	202	-	-	-	-
<b>Overall balance</b>	<b>289</b>	<b>775</b>	<b>186.1</b>	<b>167.9</b>	<b>0.3</b>	<b>0.6</b>

\*general sales tax on services

Source: MoF

reign in rising pension bill. This is a welcome development from the sustainability standpoint, however, there are significant gaps that still remain unaddressed (**Box 4.1**).

In contrast to subsidies and other expenditure, grants rose mainly due to increase in the number of BISP beneficiaries (**Table 4.5**). The government had targeted to add 0.7 million beneficiaries to the social net in FY25, while simultaneously meeting the half year target set in the EFF.<sup>23</sup>

Moreover, the government disbursed the whole-year budgeted amount (Rs 20 billion) for the Digital Information Infrastructure Initiative (DIII) that is meant to enhance cybersecurity of government's

ICT infrastructure. In addition to grants, provincial current expenditure increased notably, led by spending on the general public service (**Table 4.6**).<sup>24</sup>

Lastly, PSDP remained stagnant in terms of GDP, as well as in growth terms. This follows the lowering of the annual federal and provincial PSDP targets under the EFF.<sup>25</sup>

### Interest Expenditure

Interest payments maintained the rising trend in H1-FY25 (**Table 4.7**). The increase was in tandem with the upsurge in debt stock due to persistently large fiscal deficit, as well as higher interest rates in recent years. However, the pace of increase in interest payments considerably decelerated amid falling interest rates, stable exchange rate, and improved fiscal indicators. The impact was particularly pronounced in case of domestic interest payments (**Figure 4.7**).

**Mark-up Payments as Percent of Major Fiscal Variables and GDP in H1** Table 4.7

	FY20-24 Avg.	FY24	FY25
<b>Total expenditure</b>	<b>35.1</b>	<b>45.7</b>	<b>47.3</b>
Current expenditure	38.8	49.3	50.8
PSDP	393.1	626.8	666.0
Non-interest expenditure	55.6	84.3	89.9
<b>Total revenue</b>	<b>47.3</b>	<b>61.6</b>	<b>52.7</b>
FBR tax	69.4	94.4	91.4
Net FBR tax*	163.5	207.5	225.0
<b>GDP</b>	<b>2.9</b>	<b>4.0</b>	<b>4.1</b>

\* FBR tax revenue adjusted for NFC transfers to provinces

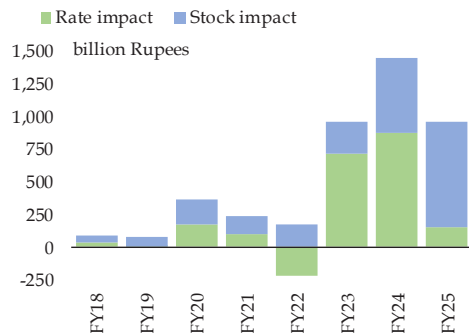
Sources: MoF; SBP staff calculations

<sup>23</sup> IMF Staff Report October 2024

<sup>24</sup> General public service mainly includes expenditure on account of executive, legislative, and fiscal organs of the provincial governments.

<sup>25</sup> Federal PSDP target was lowered from Rs 1.4 trillion to Rs 983 billion, and provincial target, from Rs 2.5 trillion to Rs 1.9 trillion. Source: IMF Staff Report October 2024 and Ministry of Finance

**Breakdown of Absolute Change in Domestic Interest Payments in H1** Figure 4.7



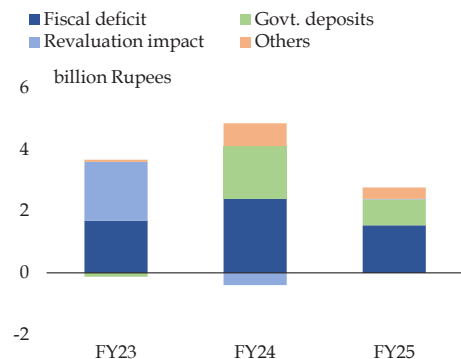
Source: Staff calculations based on MoF and SBP data

### 4.4 Public Debt

Significant fiscal consolidation achieved in H1-FY25 slowed the pace of public debt accumulation to 3.9 percent in H1-FY25, from 7.1 percent in the same period last year (Figure 4.8). A stable exchange rate and lower accumulation in government deposits also contributed to the slower growth in public debt (Figure 4.9).

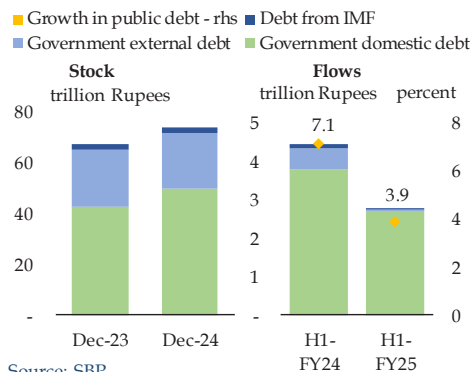
Both the domestic and external debt contributed to slower pace of debt accumulation during H1-FY25.

**Sources of Change in Public Debt in H1** Figure 4.9



Source: SBP

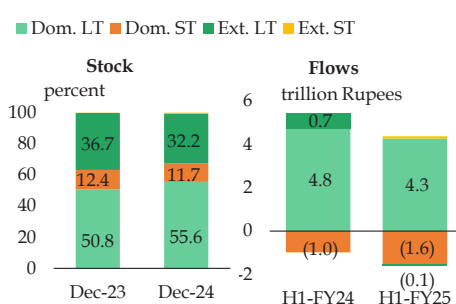
**Public Debt - Stock and Flows** Figure 4.8



Source: SBP

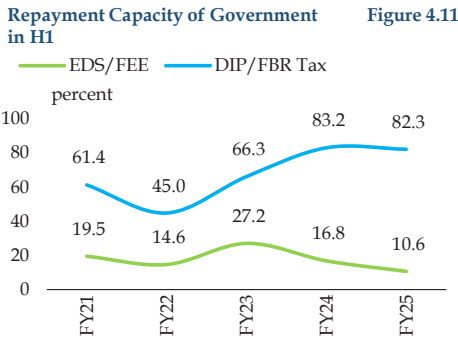
Nonetheless, 98 percent of the increase in public debt during H1-FY25 was sourced domestically, mainly through long-term instruments, while government retired short-term domestic and long-term external debt during the period under review (Figure 4.10). As a result, the overall public debt profile in terms of average time to maturity, rollover risk, and currency risk improved in H1-FY25. Moreover, a notable increase in revenue collection, increase in foreign exchange earnings and build-up in foreign exchange reserves boosted the overall debt

**Composition of Public Debt** Figure 4.10



Dom.= Domestic Debt, Ext. = External Debt, ST= Short-term, LT= Long-term

Source: SBP



Note: EDS: External Debt Servicing; FEE: Foreign Exchange Earnings; DIP: Domestic Interest Payments  
Sources: MoF and SBP

repayment capacity of the country (Figure 4.11).

### Domestic Debt

Growth in domestic debt almost halved compared to the same period last year (Table 4.8). To contain the roll-over and interest rate risk and improve the maturity

profile of domestic debt, the government mobilized a substantial amount from long-term securities, while making net retirements in T-bills. The improved liquidity position, supported by a lower fiscal deficit, allowed the government to conduct buyback auctions of T-bills amounting to Rs 1.0 trillion in H1-FY25 (Box 4.3).

Furthermore, the falling interest rate environment benefitted the government as most of the debt was raised through variable rate instruments.<sup>26</sup> During H1-FY25, the average coupon payment rate on variable rate instruments decreased from 21.4 percent to 20.5 percent.<sup>27</sup>

In terms of institution-wise holding, the increase in domestic debt stock was primarily due to non-bank entities, particularly corporates, as ADR-based additional tax constrained the banks from

**Government Domestic Debt and Liabilities**  
billions Rupees, growth and share in percent

Table 4.8

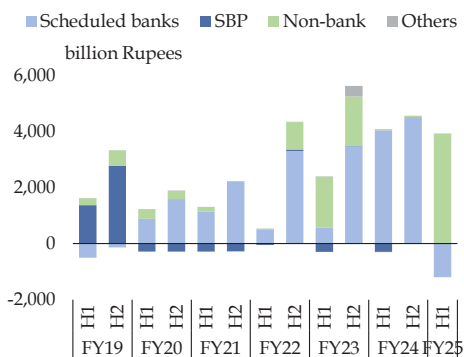
	Stock		Flows		Share in debt stock		Growth over end-June	
	Dec-23	Dec-24	Jul-Dec FY24	Jul-Dec FY25	Dec-23	Dec-24	Dec-23	Dec-24
<b>Government Domestic Debt</b>	<b>42,594.8</b>	<b>49,883.3</b>	<b>3,785.0</b>	<b>2,723.1</b>	<b>100.0</b>	<b>100.0</b>	<b>9.8</b>	<b>5.8</b>
GOP Ijara Sukuk	4,419.0	5,709.3	1,268.4	943.1	10.4	11.4	40.3	19.8
Pakistan Investment Bonds	25,608.7	31,216.2	3,599.5	3,190.4	60.1	62.6	16.4	11.4
Prize Bonds	382.6	394.3	0.1	9.2	0.9	0.8	0.0	2.4
Treasury Bills (T-bills)	8,288.4	8,602.0	-980.8	-1,565.3	19.5	17.2	-10.6	-15.4
National Saving Schemes (NSS)	2,748.9	2,785.8	-69.7	78.0	6.5	5.6	-2.5	2.9
Naya Pakistan Certificates (NPCs)	118.7	81.0	-24.0	-3.1	0.3	0.2	-16.8	-3.7

Source: SBP

<sup>26</sup> By the end of June 2024, around 55 percent of the stock of government securities (excluding PIBs held by SBP) was on floating rate. It increased to around 60 percent at the end of December 2024. This may help reduce interest payments in the declining interest rate scenario, lowering government's cost of borrowing.

<sup>27</sup> The effect of cut in policy rate has not been fully translated into reduced interest rates due to semiannual revision of coupon rate. As most of the maturing coupon payments in H1-FY25 were based on the prevailing interest rates in H2-FY24, the downward revision in interest rate during H1-FY25 will significantly affect the bi-annual coupon payments PFL, albeit, in H2-FY25.

**Institution-wise Flows in Domestic Debt** Figure 4.12



Source: SBP

making investments in government securities. This also helped the government to make a net retirement to scheduled banks, for the first time since FY19 (Figure 4.12). Consequently, the share of banks' holding of government securities declined from 76.2 percent at end-June to 67.4 percent by the end-December 2024, while the share of non-banks/corporates nearly doubled from 17.7 percent to 32.6 percent.

Other debt instruments, such as National Saving Schemes (NSS) and Prize Bonds also witnessed net inflows during H1-FY25, reflecting increased interest of retail investors. The NSS (net of prize bonds) showed net inflows, reversing the trend of net outflows observed during the past three years. Relatively higher return on bank deposits and government securities, especially PFLs and T-bills, could have been a possible reason for net outflows during the past few years.<sup>28</sup> However, reduced differential between the rate of returns on bank deposits and government

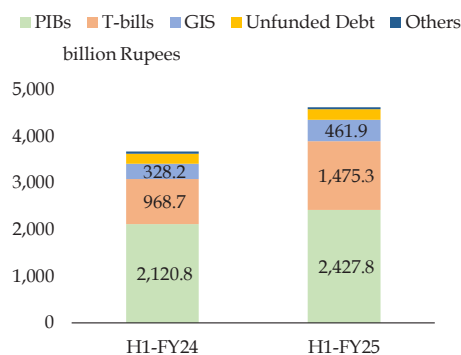
securities and profit rates on NSS instruments led to lower outflows from NSS in H1-FY25.

### Domestic Debt Servicing

Interest payments on domestic debt during H1-FY25 were predominantly against PIBs and T-bills owing to higher stock as well as interest rates (Figure 4.13). In the case of unfunded debt, significant interest payments were associated with the Behbood Saving Scheme. Nonetheless, the domestic debt repayment capacity based on the ratio of Domestic Interest Payments (DIP) to FBR Taxes slightly improved as a result of relatively higher growth in FBR taxes (Figure 4.11).

Overall, the government's strategy in H1-FY25 effectively lengthened debt maturities, reduced rollover and currency risks, diversified the investor base (by engaging more non-bank participants), and lowered interest costs.

**Interest Payments on Domestic Debt** Figure 4.13



Source: SBP

<sup>28</sup> The average rate of return on NSS during H2-FY21 - FY24 was 14.47 percent, while return on PFLs and T-bills was 14.63 percent and 15.74 percent, respectively.

## Public External Debt

Table 4.9

million US\$; growth in percent

	Stock				Flows		Growth	
	Jun-2023	Dec-2023	Jun-2024	Dec-2024	H1-FY24	H1-FY25	H1-FY24	H1-FY25
<b>Public external debt</b>	<b>84,050.1</b>	<b>87,761.8</b>	<b>86,525.1</b>	<b>86,621.4</b>	<b>3,711.7</b>	<b>96.3</b>	<b>4.4</b>	<b>0.1</b>
<b>Government external debt</b>	<b>76,926.2</b>	<b>80,165.5</b>	<b>78,147.4</b>	<b>78,128.6</b>	<b>3,239.3</b>	<b>-18.8</b>	<b>4.2</b>	<b>0.0</b>
<b>Long term (&gt;1 year)</b>	<b>76,765.9</b>	<b>80,066.2</b>	<b>77,387.6</b>	<b>77,016.3</b>	<b>3,300.3</b>	<b>-371.3</b>	<b>4.3</b>	<b>-0.5</b>
Paris club	7,901.1	7,541.1	6,474.4	5,745.8	-359.9	-728.6	-4.6	-11.3
Multilateral	37,363.1	38,813.6	39,248.0	39,663.7	1,450.5	415.7	3.9	1.1
Other bilateral	17,572.3	19,644.1	18,552.4	17,908.9	2,071.9	-643.5	11.8	-3.5
Euro Sukuk global bonds	7,800.0	7,800.0	6,800.0	6,800.0	0.0	0.0	0.0	0.0
Commercial loans/credits	5,563.8	5,611.3	5,490.3	5,774.7	47.5	284.4	0.9	5.2
Naya Pakistan Certificates	534.3	628.3	783.9	1,054.8	93.9	270.9	17.6	34.6
<b>Short term (&lt;1 year)</b>	<b>160.3</b>	<b>99.3</b>	<b>759.8</b>	<b>1,112.2</b>	<b>-61.0</b>	<b>352.5</b>	<b>-38.1</b>	<b>46.4</b>
Multilateral	160.3	99.3	250.0	389.6	-61.0	139.6	-38.1	55.8
<b>From IMF</b>	<b>7,124.0</b>	<b>7,596.3</b>	<b>8,377.6</b>	<b>8,492.8</b>	<b>472.4</b>	<b>115.1</b>	<b>6.6</b>	<b>1.4</b>
<b>Foreign exchange liabilities</b>	<b>10,831.2</b>	<b>11,938.6</b>	<b>11,731.2</b>	<b>11,709.5</b>	<b>1,107.5</b>	<b>-21.6</b>	<b>10.2</b>	<b>-0.2</b>
Central bank deposits	2,700.0	3,700.0	3,700.0	3,700.0	1,000.0	0.0	37.0	0.0
Other liabilities (SWAP)	4,224.9	4,271.0	4,169.6	4,181.0	46.0	11.4	1.1	0.3
Allocation of SDR	3,904.0	3,966.6	3,860.8	3,827.9	62.6	-32.9	1.6	-0.9

Source: State Bank of Pakistan

## External Debt and Liabilities

Public external debt grew marginally by 0.1 percent during H1-FY25. Net repayment of long-term Paris club and other bilateral debt mainly contributed to the slowdown in external debt accumulation. Moreover, appreciation of US dollar against other international currencies together with a decrease in net external disbursements also contained expansion in external debt.<sup>29</sup>

The slight increase in external debt during H1-FY25 was mainly on account of inflows in NPCs and commercial loans (Table 4.9). Higher rate of return was instrumental in case of the former, while the latter reflects government's efforts to plug the financing

gap due to lower-than-planned realization of long-term external financing. Another reason to avail short term financing could be to avoid relatively higher cost on long-term commitments amid prevailing higher global interest rates.

## External Disbursements

External disbursements remained lower at US\$ 3.6 billion compared to US\$ 5.5 billion in H1-FY24 (Table 4.10). Only 18.6 percent of the budgeted inflows of US\$ 19.6 billion for FY25 were realized during H1-FY25, which was considerably lower than the corresponding period of FY24.

The share of multilateral inflows decreased to 51.7 percent during H1-FY25, from 62.3 percent in the same period last year.

<sup>29</sup> The appreciation of US dollar against other currencies lowered the stock of external debt by US\$ 1.3 billion during H1-FY25.

Summary: External Disbursements

Table 4.10

million US\$

Sources	Grants		Loans		Total	
	H1-FY24	H1-FY25	H1-FY24	H1-FY25	H1-FY24	H1-FY25
<b>Multilateral</b>	25.6	22.0	2,219.7	1,841.9	2,245.3	1,863.9
ADB	8.0	3.5	581.4	905.5	589.4	909.0
AIIB	-	-	287.0	51.0	287.0	51.0
IBRD	5.4	14.7	111.9	125.5	117.4	140.3
IDA	10.9	-	1,029.7	-	1,040.6	-
<b>Bilateral</b>	58.0	71.4	665.1	240.3	723.1	311.7
China	2.0	2.4	40.2	96.8	42.2	99.2
France	-	-	20.1	100.3	20.1	100.5
USA	25.1	-	-	-	-	39.4
Japan	13.6	9.9	-	-	17.3	-
Saud Arabia	-	-	595.4	-	595.4	-
<b>Commercial banks</b>	-	-	-	500.0	-	500.0
NPC	-	-	491.5	927.6	491.5	927.6
<b>Time deposits</b>	-	-	2,000.0	-	2,000.0	-
<b>Total</b>	83.6	93.5	5,376.3	3,509.9	5,459.9	3,603.3

Source: EAD

Among the multilateral institutions, the major disbursements were made by Asian Development Bank (ADB), followed by International Bank for Reconstruction and Development (IBRD) and Asian Infrastructure Investment Bank (AIIB). Regarding bilateral disbursements, its share markedly declined to 8.7 percent from 20.1 percent in H1-FY24 with the largest inflows coming from China, France and USA (Table 4.9).

Unlike H1-FY24, more than 50 percent of the external disbursements were meant for non-project financing/BOP support while the share of project financing was lower than last year. The decline in external financing, despite a positive external outlook and the ongoing IMF program, points to efforts needed to further improve the country's risk perception.<sup>30</sup>

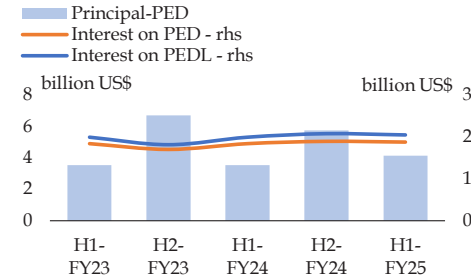
### External Debt Servicing

The overall external debt servicing increased to US\$ 6.2 billion during H1-FY25 compared to US\$ 5.5 billion in H1-FY24 (Figure 4.14). This increase mainly emanated from relatively higher principal repayments to multilateral and bilateral creditors, IMF and NPC holders. The interest payments amounted to US\$ 2.04 billion, slightly higher compared to US\$ 2.0 billion in the corresponding period of last year.

Major interest expense was incurred on long-term debt, which constituted around 90 percent of the total interest on public external debt. However, a decline in the long-term debt stock helped contain interest expense at US\$ 1,518.0 million during H1-FY25, marginally lower than

<sup>30</sup> During H1-FY25, Moody's Ratings raised Pakistan's outlook position to positive from stable.

**External Debt Servicing - Principal and Interest** Figure 4.14



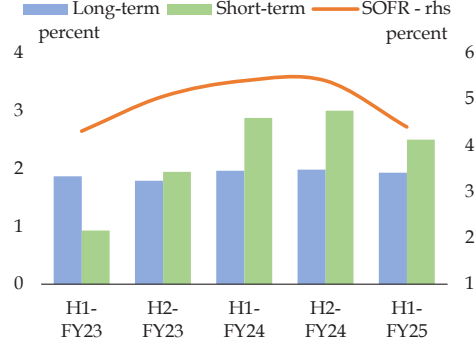
PED: Public External Debt (govt. debt + debt from IMF)  
 PEDL: Public External Debt and Liabilities (PED + liabilities)  
 Source: SBP

US\$ 1,521.0 million in the same period last year. In contrast, the interest payments on debt from the IMF and external liabilities registered an increase, notwithstanding a decreasing global interest rate environment.<sup>31</sup>

The composition of debt servicing depends on interest rate charged on various categories. Historically, the average effective interest rates on long-term loans has remained lower than on the short-term debt.<sup>32</sup> Although both are concessional in nature, the interest rates on short term debt follow the dynamics of global financial markets (Figure 4.15).<sup>33</sup>

Furthermore, the average effective interest rate on debt from multilateral (excluding IMF) and bilateral creditors seem to be fixed and concessional in nature, carrying interest rates substantially lower compared to that on NPCs, commercial loans and Euro bonds (Figure 4.16).

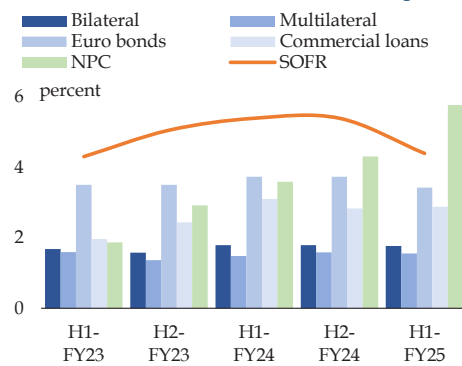
**Tenor-wise Effective Interest Rates on External Debt** Figure 4.15



Source: SBP

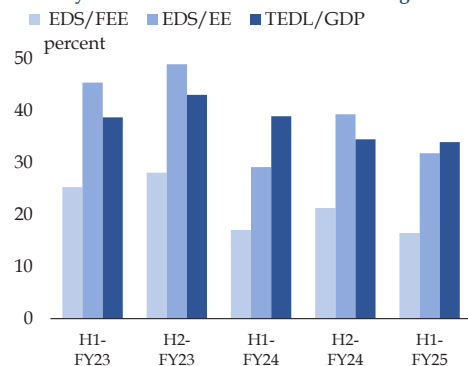
Amongst the other categories, external financing through NPCs stayed relatively more expensive, followed by Euro bonds and commercial bank loans. In addition, with the exception of debt extended by multilateral and bilateral creditors, the costs of raising external funds through NPCs, Euro bonds and commercial loans are driven by global market conditions.

**Effective Interest Rates on External Debt** Figure 4.16



Source: SBP

<sup>31</sup> Interest cost on IMF debt increased due to relatively higher effective interest rate and higher stock during H1-FY25.  
<sup>32</sup> The average effective interest rate is calculated as the ratio of interest payments of current period to the average debt stock of the previous two periods.  
<sup>33</sup> The Secured Overnight Financing Rate (SOFR) is the benchmark rate for dollar-denominated derivatives.

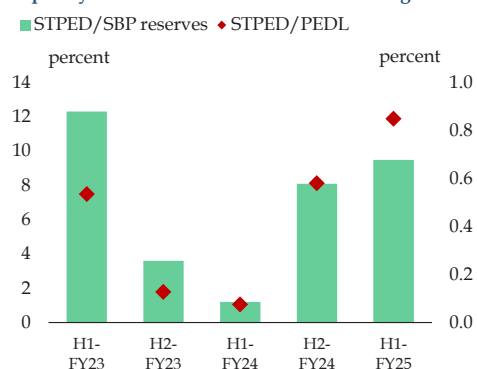
Solvency Indicators for External Debt **Figure 4.17**

Source: SBP

### External Debt Sustainability

Ease in external borrowing constraints, after entering into IMF program, along with surplus in current account balance are the major factors leading to an improvement in Pakistan's external debt sustainability. Moreover, a stable PKR against US dollar and gains owing to US dollar appreciation against other international currencies also helped in strengthening the sustainability position of external debt.

The solvency indicators carried forward their positive momentum from the previous year. The assessment based on Total External Debt & Liabilities (TEDL) to GDP ratio, External Debt Service (EDS) to Foreign Exchange Earnings (FEE) ratio and EDS to Exports Earning (EE) ratio depict enhancement in the country's capacity for

Liquidity Indicators for External Debt **Figure 4.18**

Source: SBP

the repayment of external debt (**Figure 4.17**).

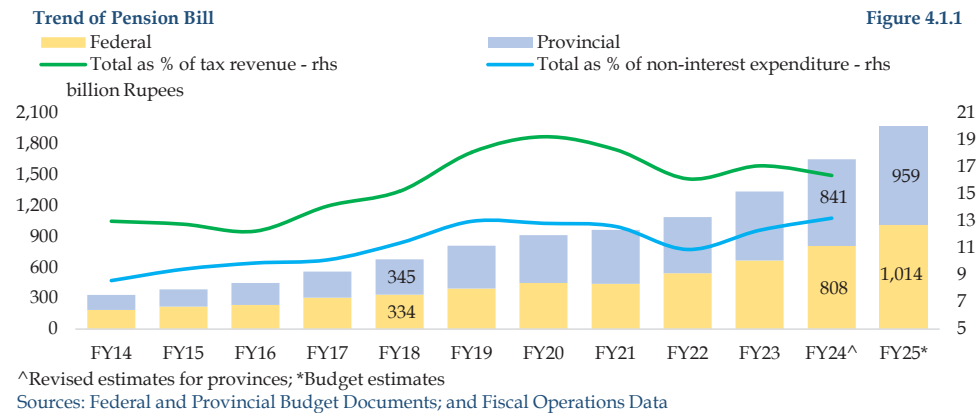
Unlike the solvency indicators, liquidity indicators deteriorated due to increase in short-term external debt during H1-FY25. The ratios of Short-term External Public Debt (STEPD) to SBP reserves and STEPD to Public External Debt & Liabilities (PEDL) slightly deteriorated during H1-FY25 (**Figure 4.18**). Despite an increase in the SBP's foreign exchange reserves, the increase in short-term external debt was the major factor causing deterioration in liquidity indicators. In the backdrop of rising external debt stock and debt servicing, there is a need to explore innovative solutions from sustainability perspective. In this regard, **Box 4.2** makes a recommendation, which also help address the climate vulnerability – another key issue facing the country.

**Box 4.1 Rising Pension Bill and the Recent Reforms**

Pakistan's pension bill has increased at the compound annual growth rate (CAGR) of 17.3 percent from Rs 333 billion in FY14 to Rs 1,649 billion in FY24 (Figure 4.1.1). In comparison, the CAGR of tax revenue was 14.7 percent, while that of non-interest expenditure was 12.4 percent. Moreover, the pension bill is about two to three times the consolidated federal and provincial spending each on education, health and social protection. These trends, if continue, could create challenges for fiscal sustainability.

In this context, the provincial governments had established pension funds in the 2000s to mitigate future pension risk. However, these funds have proven far from sufficient to meet the sharply rising pension payouts, especially in the last few years.<sup>34</sup> For instance, in FY03, the size of Khyber Pakhtunkhwa's (KP) pension fund was almost three times its pension bill; by FY25, the pension liabilities have reached more than four times the size of the fund. In light of this, the federal and provincial governments have implemented key reforms in the past three years.

These reforms include: i) shift from Defined Benefit (DB) Model to Defined Contribution (DC) Pension Schemes for new recruits, requiring both employees and the government to contribute to a pension fund;<sup>35,36</sup> ii) setting a minimum service age by KP, while Sindh and the federal government imposed pension reductions for those retiring before 60 in order to discourage early retirements;<sup>37</sup> iii) abolished multiple pensions, limiting individuals to draw only one pension at a time; iv) tightened family pension rules, restricting eligibility and setting time limits;<sup>38</sup> v) started to use the average of the last 24 months'



<sup>34</sup> As per the budget documents, the federal government has set aside Rs 10 billion a year for the *Federal Pension Fund* in FY23 through FY25. These funds generate profits through various investment avenues. However, there is no publicly available information on the modalities of the fund, or even if government actually spent the earmarked budget.

<sup>35</sup> To be applied on new recruits in KP from June 07, 2022; in Sindh from July 01, 2024; in Punjab from November 14, 2024; in federation, from July 1, 2024 for civilians, and from July 1, 2025 for armed forces.

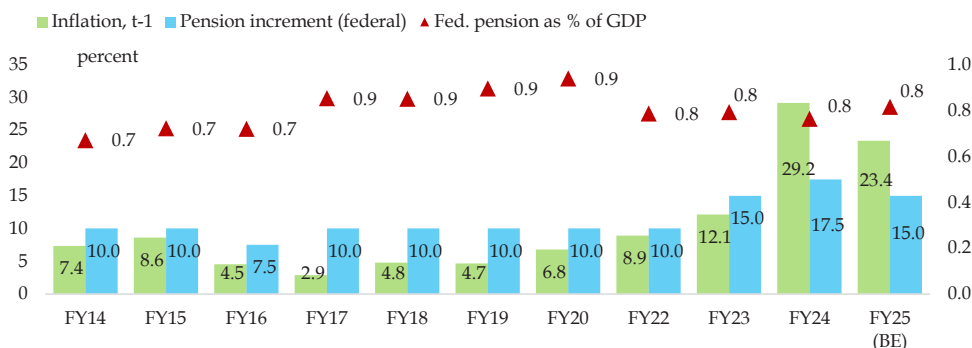
<sup>36</sup> It may be noted that these funds shall be maintained through employee-government contributions, unlike the existing pension funds in provinces, which are government-funded.

<sup>37</sup> Earlier, the federal employees would see a reduction in their post-retirement benefits if they retired before completing 30 years of service. However, the rules were silent in case of an employee who would complete 30 years of service before reaching the age of 60, hence encouraging the trend of early retirements.

<sup>38</sup> For instance, family members of civilians in the federal government can avail ordinary family pension for a maximum period of 10 years. In KP, the long list of beneficiaries has been reduced to the pensioner's widow/widower, dependent children and parents.

Trend in Net Pension Increase and Inflation

Figure 4.1.2



Sources: PBS and Ministry of Finance's various circulars

salary instead of the last drawn pay as base to calculate pension; and vi) future pension increases of the federal employees to be based on a fixed baseline pension.<sup>39</sup>

While these reforms are welcoming, there are still some important issues that need to be addressed in order to make pension bill sustainable. These are discussed as follows:

**i. Indexation of pension increments:** Pension increments in Pakistan are ad-hoc in nature, and not indexed to some variable, like CPI inflation, wage growth, or growth in nominal GDP, as per the international best practices. This has two major implications for Pakistan. One, the pension bill often increases in nominal terms, as well as in percent of GDP. If increments were indexed to inflation, these would have been mostly lower than the ad hoc increments announced in recent years (Figure 4.1.2). Two, it makes difficult for the policymakers to assess future pension risks and design an appropriate coping strategy. In this backdrop, indexing will not only help in devising a proper strategy, it will also facilitate in lowering the gross replacement rate (Figures 4.1.3).<sup>40</sup> Furthermore, other ad-hoc increments, like medical allowances, may also be reconsidered.

**ii. Abolishing carried-forward increments:** Under the current plan, the increments are applied to existing as well as future pensioners, leading to a very high gross replacement rate (Figures 4.1.3 & 4.1.4). For example, an increment of 15 percent announced at the start of FY23 was admissible to the existing pensioners as of June 30, 2022, as well as to those who would retire on or after July 01, 2022. Such increments remain in effect until the government decides to discontinue a particular increment. Moreover, these retrospective increments are applied to the commuted amount at the time of restoration as well.<sup>41</sup>

Admissibility of the carried-forward increases creates double jeopardy for policymakers, as the basic pay scale, an integral part of the total emoluments, are revised from time to time (mainly to maintain real

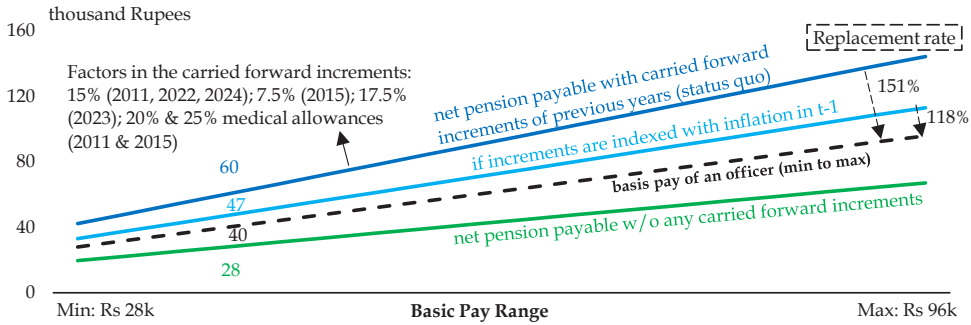
<sup>39</sup> From January 01, 2025, net pension (gross minus commuted portion) calculated at the time of retirement will be termed as baseline pension; for existing pensioners, current pension shall be deemed as baseline pension; any increase in pension shall be granted on this base

<sup>40</sup> Gross replacement rate is the ratio of the net pension payable to pre-retirement total emoluments.

<sup>41</sup> This means that the commuted amount is automatically inflated over the commutation period. Commutation is the post-retirement option of getting a lump-sum portion of future pension payments in advance. Pensioners can commute up to 35 percent of their gross pension in Pakistan.

Scenario Analysis of Pension of an Officer Retiring in December 2024

Figure 4.1.3



Note: 1) It is assumed that total emolument is equal to the basic pay, the most conservative scenario. Actual base for pension calculation includes different allowances, like special allowance.

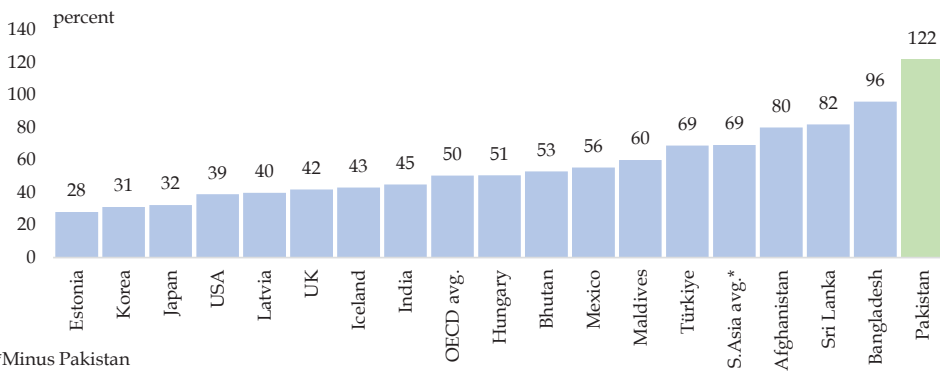
Sources: Staff calculations based on Ministry of Finance's various circulars, and SBP

wages), leading to increase in government's expenditure, as well as expansion of the base on which pension is calculated. The carried-forward pension increments, applied on the expanding base, then have a compounding effect on the pension payouts of the government.

**iii. Rationalization of the federal government contribution:** In the new contributory pension scheme, the federal government contributes 20 percent of the basic pay, double the contribution by the employees. Meanwhile, the Punjab government contributes 12 percent, which is slightly more than the 10 percent share of employees.<sup>42</sup> Peer country comparison also suggests that the governments usually contribute more; however, the difference is smaller. For instance, in Maldives, both parties contribute 7 percent

Gross Replacement Rate

Figure 4.1.4



\*Minus Pakistan

Sources: World Bank (2020); OECD

<sup>42</sup> Source: Punjab Defined Contribution Pension Scheme Rules. Other provinces are yet to roll out similar rules for their DC schemes.

apiece; in India, government and employee contribute 10 percent and 14 percent, respectively;<sup>43</sup> and in Sri Lanka, employee contributes 8 percent of the wage, and employer, 12 percent.

Moreover, given the new DC scheme applies to only new recruits in Pakistan, the government's expense might increase in the short to medium term, as it has to set aside contributions for the new employees, as well as pay out the existing employees/retirees from its revenue as per the defined benefit scheme.

*\* The contribution of Muhammad Farhan Akber is acknowledged in writing this box.*

#### **Box 4.2: Debt-for-climate Swaps\***

Debt-for-climate swap is a type of climate financing that lowers a country's debt obligation in exchange for using the freed fiscal resources to counter or adapt to climate change. It is executed in bilateral and tripartite settings, with the latter being more common.<sup>44</sup> It is especially useful for the countries that are afflicted by high indebtedness, climate vulnerability, and limited fiscal space to manage both of these risks. This is usually true of low- and middle-income countries.

Ecuador, a middle-income country, has secured the largest deal to date, in which it bought back its US\$ 1.6 billion debt at a 60 percent discount in 2023, while committing to use the debt relief for protecting and nourishing its Galapagos Islands (one of the world's most valuable ecosystems). Moreover, Belize, a Caribbean country, was able to pare its external debt by 10 percent of GDP in 2021, in exchange for commitment to conserving its coral reef.<sup>45</sup>

In the past, these swaps have delivered tangible climate outcomes. For instance, America's Tropical Forest and Coral Reef Conservation Act (TFCCA) has helped conserve more than 68 million acres of tropical forests, equal to an area larger than New Zealand, in different countries including Brazil, Peru, Indonesia, and the Philippines.<sup>46</sup>

#### **Feasibility for Pakistan**

On the demand side of swaps, Pakistan is among the countries most exposed to climate risk (95<sup>th</sup> percentile in a group of 107 developing countries). At the same time, its public external debt to GDP ratio is also moderately high (41<sup>st</sup> percentile) among the peer countries (**Figure 4.2.1**). Secondly, Pakistan is one of the most biodiverse countries in the world.<sup>47</sup> It could use debt-for-climate swaps, among other climate financing modalities, to protect its biodiversity, which is considered a global public good.

In this connection, Pakistan has already issued Delta Carbon Blue bond to finance protection of mangroves in Sindh. Building on this, biodiversity and climate projects pertaining to ocean conservation

<sup>43</sup> 1) In India, government's contribution was 10 percent till January 30, 2019. 2) Maldives and India had introduced defined contributions plans in 2010 and 2004, respectively.

<sup>44</sup> Tripartite agreements include private entities (like the NGO's and commercial banks), on top of debtor and creditor countries that are the only parties in bilateral agreements.

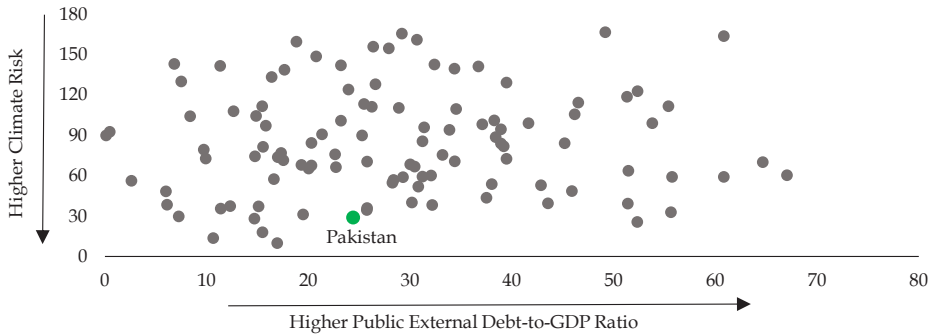
<sup>45</sup> [www.imf.org/en/Publications/fandd/issues/2022/03/Country-cases-meeting-the-future-Belize-Colombia-Ghana#Belize](http://www.imf.org/en/Publications/fandd/issues/2022/03/Country-cases-meeting-the-future-Belize-Colombia-Ghana#Belize)

<sup>46</sup> TFCCA: The US Congress had enacted this Act in 1998, paving the way for many of the debtor countries to enter into debt-climate swaps with the US government. While it initially targeted tropical forests, in 2019, its scope expanded to include coral reefs. It is considered a "highly successful" initiative. Source: <https://www.nature.org/en-us/about-us/who-we-are/how-we-work/policy/tropical-forest-conservation-act/>

<sup>47</sup> [www.cbd.int/countries/profile?country=pk](http://www.cbd.int/countries/profile?country=pk)

External Debt and Climate Risk of Pakistan vis-a-vis the Peer Countries

Figure 4.2.1



Sources: Germanwatch and Haver Analytics

(like protection of coral reefs) and forest management (afforestation) could be negotiated in swaps. Similarly, swaps could be used to redirect fiscal resources towards soil conservation, renewable energy, wastewater management, desalination plants and water storage/transport infrastructure (like canals, barrages, and dams) in water-stressed regions. It is important to note here that V20, of which Pakistan is a member, had issued a communique in 2024, encouraging bilateral partners and the private sector to engage with the V20 on debt-for-climate swaps, among other things.<sup>48</sup>

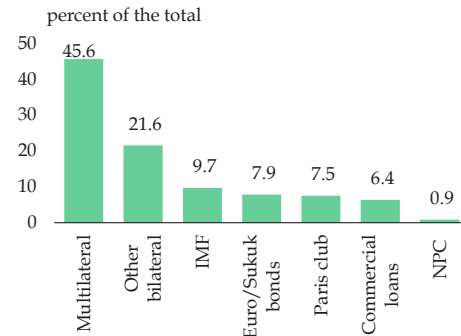
On the supply side, the usage of debt-for-climate swap has gained traction in the last two decades; about 145 deals have been concluded to date. In 2023, eight multilateral development banks and development

finance institutions launched *The Joint Declaration and Task Force on Credit Enhancement of Sustainability-Linked Sovereign Financing for Nature & Climate* at the COP28, with a renewed focus on mobilizing private sector credit through innovative instruments like debt swaps and green bonds.<sup>49</sup> Moreover, NGOs like The Nature Conservancy, which has completed four such deals to date are actively promoting these swaps. In this backdrop, Pakistan can engage these institutions for arranging funds for debt-for-climate swaps at a discounted interest rate, which it can use to buyback debt from bilateral and commercial creditors, as well as work towards fostering climate resilience and adaptation (Figure 4.2.2).

\* The contribution of Muhammad Farhan Akber is acknowledged in writing this box.

Public External Debt\* by Source

Figure 4.2.2



\*excludes FX liabilities; as of end-June FY24  
Source: SBP

<sup>48</sup> It issued this communique, titled "Unlocking Growth and Prosperity through Innovations in Climate Finance and Debt" at the IMF/World Bank Spring Meetings 2024. V20 Finance Ministers is a collaborative initiative of economies (currently 68) systematically vulnerable to climate change. Source: [www.v-20.org/v20-ministerial-dialogue-xii-communiqué](http://www.v-20.org/v20-ministerial-dialogue-xii-communiqué)

<sup>49</sup> [www.iadb.org/en/news/eight-international-organizations-and-development-finance-institutions-join-forces-boost](http://www.iadb.org/en/news/eight-international-organizations-and-development-finance-institutions-join-forces-boost)

**Box 4.3: Buyback Auctions of Market Treasury Bills\***

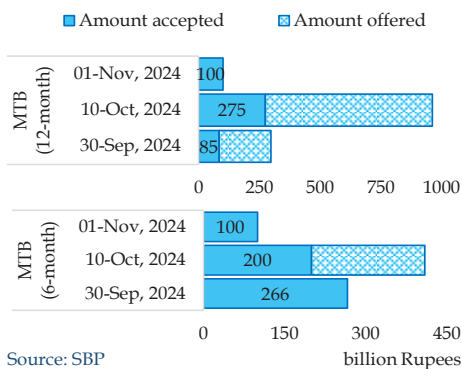
A buyback refers to repurchase of debt instruments by government from the secondary market before their original maturity. The objective of buyback auctions is predominantly *to smooth the redemption profile and to mitigate rollover/refinancing risk*.<sup>i</sup> Besides, the government can save interest cost depending upon the interest rate environment. Developed economies execute buyback operations on both regular and ad-hoc basis, keeping in view the magnitude of available liquidity with them and prevailing interest rate and market dynamics.<sup>ii</sup> However, it is not frequently used in developing economies primarily because of the lack of surplus liquidity available to governments in these economies.<sup>iii</sup>

The motivation for buyback auctions in Pakistan emanated from improved liquidity due to transfer of hefty SBP profit in September 2024. The government found it opportune to gain from buying back the T-bills issued at higher rates and raise the long-term debt at lower rates in falling interest rate environment. Accordingly, the government repurchased four issues of the MTBs maturing in December 2024 with the outstanding amount of around Rs 3.6 trillion at the average yield of more than 20 percent.<sup>50</sup> The process also facilitated in reducing the rollover risk.

These buybacks were conducted through special auctions. GOP announced specific debt security along with the indicative target amount it intended to buy back through competitive bidding process. The auctions were oversubscribed in light of the declining interest rate environment as offers exceeded the targets for both the issues. Thus, government was able to buyback a cumulative of Rs 1.026 trillion – with Rs 566 billion in 6-month and Rs 460 billion in 12-month MTBs – in these auctions.

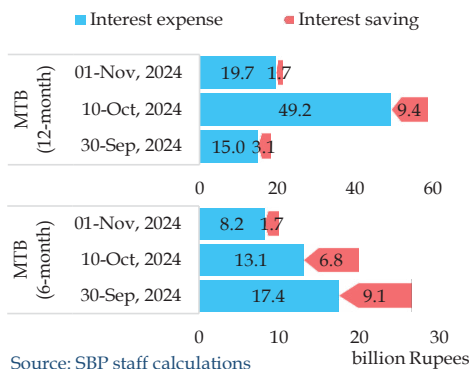
It is worth mentioning that acceptance remained around 73 percent of the target in 6-month tenor and further declined to 34 percent in 12-month tenor. The lower acceptance is mainly because market placed bids at high prices in the subsequent auctions compared to the first auction held on September 30, 2024 (Figure 4.3.1). The overall subscription of these buyback auctions accounted for 27 percent of the maturing MTBs, which reduced the borrowing requirements in subsequent auctions.<sup>51</sup> The estimates

**Bid Pattern of Buyback Auctions**



**Figure 4.3.1**

**Impact on Debt Servicing**



**Figure 4.3.2**

<sup>50</sup> These were 6 and 12 month issues of MTBs maturing on 12-Dec, 2024 and 26-Dec, 2024.

<sup>51</sup> As communicated in the MTB auction calendar for the period of Dec 2024 - Feb 2025, the government has set the target of Rs 1.35 trillion, which is approximately 41 and 24 percent lower than the maturity of auction scheduled on 12-Dec, 2024 and 26-Dec, 2024, respectively.

suggest government saved a total of around Rs 30 billion in debt servicing with these operations (**Figure 4.3.2**).

While government had reduced immediate cost, roll over risk and, improved maturity profile, the literature suggests frequent buybacks run the risk of distorting market expectations, building inflationary pressures and increasing borrowing cost if poorly managed.<sup>iv</sup> Hence, the government should properly communicate the desired objective of buyback in order to avoid aforementioned distortions.<sup>v</sup>

*\* The contribution of Ravi Kumar is acknowledged in writing this box.*

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