4 Fiscal Policy and Public Debt

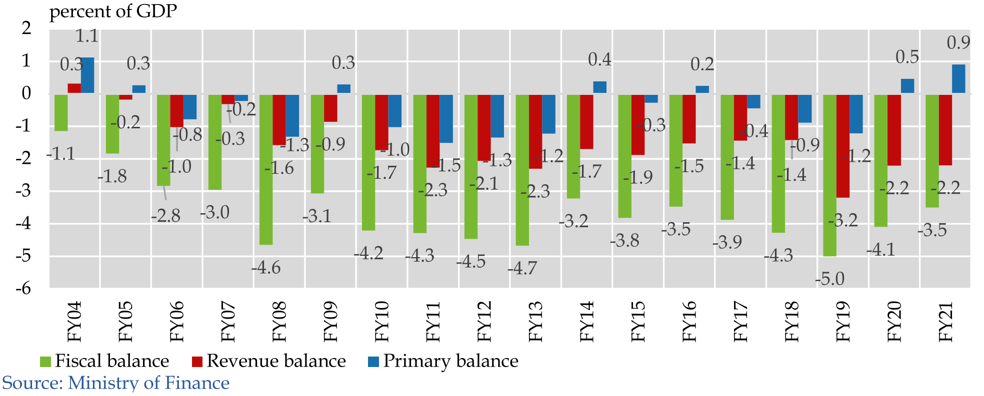
Fiscal indicators witnessed improvement during Jul-Mar FY21. The primary surplus for the period stood higher than the overall target for FY21 in absolute terms and at a 17 year-high in terms of GDP, while the fiscal deficit was also lower compared to last year. This improvement emanated both from rationalization of non-interest spending as well as a notable increase in tax collection. The containment of non-priority outlays also provided room to expand the social safety nets. However, the continued pressures of interest payments constrained the space for other expenditure, including development spending. The reduced deficit financing requirements led to a concomitant slowdown in the pace of public debt accumulation. In addition, PKR appreciation also contributed to a reduction in the external debt burden in Rupee terms. The overall increase in the debt stock emerged from domestic sources, with a larger share of long-term instruments.

4.1 Fiscal Trends and Policy Review

The fiscal deficit for Jul-Mar FY21 declined to 3.5 percent of GDP compared to 4.1 percent in the same period last year **(Figure 4.1)**. The government maintained a prudent policy stance by strengthening tax administration efforts and economizing non-priority current spending. Provinces also delivered on the commitment of fiscal consolidation and the provincial surplus of 0.9 percent of GDP during Jul-Mar FY21 exceeded the annual target of 0.5 percent.[1]

The fiscal deficit stood at 1.1 percent of GDP in Q3-FY21, compared to 1.7 percent in the same period last year. This improvement was helped by a sharp 24.6 percent increase in FBR taxes, which outpaced a nominal 0.3 percent growth in expenditures witnessed in this quarter. The broad-based increase in FBR taxes during Q3-FY21 was helped by the continued expansion in economic activity, FBR's efforts to improve tax administration, the impact of price increase in some categories, as well as a low base from last year associated with the onset of the Covid pandemic.

Fiscal Indicators during Jul-Mar **Figure 4.1**



Source: Ministry of Finance

[1] Provincial surplus during Jul-Mar FY21 stayed at almost last year's level (0.9 percent of GDP during Jul-Mar FY20)

Consolidated Fiscal Indicators **Table 4.1**

billion Rupees, growth in percent

	Jul-Mar FY20	Jul-Mar FY21	YoY growth Jul-Mar FY20	YoY growth Jul-Mar FY21	Q3 FY20	Q3 FY21
1. Total Revenue (a+b)	**4,689.9**	**4,992.6**	**30.9**	**6.5**	**1457.9**	**1641.4**
(a) Tax Revenue	3,365.5	3,765.0	12.5	11.9	1057.7	1309.1
Federal	3,044.3	3,394.9	12.6	11.5	950.9	1184.8
Provincial	321.2	370.1	11.6	15.2	106.8	124.3
(b) Non-Tax	1,324.4	1,227.6	123.9	-7.3	400.3	332.3
Federal	1,244.8	1,145.4	136.6	-8.0	380.6	297.4
Provincial	79.6	82.2	21.9	3.2	19.7	34.9
2. Total Expenditure (a+b+c)	**6,376.1**	**6,644.6**	**15.8**	**4.2**	**2149.4**	**2155.5**
(a) Current Expenditure	5,611.6	6,085.4	16.9	8.4	1890.2	2056.1
Of which : Mark-up Payments	1,879.7	2,103.9	28.8	11.9	598.5	628.7
Defence	802.4	784.0	3.6	-2.3	272.9	297.4
Non-markup expenditure	4,496.4	4,540.7	11.1	1.0	1550.9	1526.8
(b) Development Expenditure & net lending	781.4	722.9	14.2	-7.5	308.1	265.1
(c) Statistical Discrepancy	-16.9	-163.8	--	--	-48.9	-165.7
3.Overall Budget Balance	-1,686.2	-1,652.0	-12.3	-2.0	-691.5	-514.1
percent of GDP	*-4.1*	*-3.5*			-1.7	-1.1
4.Primary Balance	193.5	451.8	-141.8	133.5	-93.0	114.6
percent of GDP	*0.5*	*0.9*			-0.2	0.2
5. Revenue balance	-921.7	-1092.9	-24.1	18.6	-432.2	-414.7
percent of GDP	-2.2	-2.2			*-1.0*	-0.9
6. Financing (a+b)	1,686.2	1,652.0	-12.3	-2.0	691.5	514.1
(a) External (Net)	682.4	562.2	30.1	-17.6	168.8	107.7
(b) Domestic (Net)	1,003.8	1,089.9	-28.2	8.6	522.7	406.4
Non-Bank	402.0	292.1	-34.1	-27.3	-37.4	159.9
Bank	601.8	797.8	-23.6	32.6	560.1	246.5

Source: Ministry of Finance

The restraint on non-interest current spending during Jul-Mar FY21, including running of the civil government and defense, provided fiscal space to the government for continued spending on social safety nets. The expenditure on running of the civil government was contained by limiting non-priority spending through restricting supplementary grants and implementing austerity measures.

The primary balance (the difference between revenues and non-interest expenditures) recorded Rs 452 billion surplus during Jul-Mar FY21 amounting to 0.9 percent of GDP, which not only exceeded the annual target of -0.5 percent but was also the highest in the comparable period since FY04 **(Table 4.1)**. This shows that overall revenues were sufficient to absorb non-interest expenditures, and also partly covered debt servicing payments.[2]

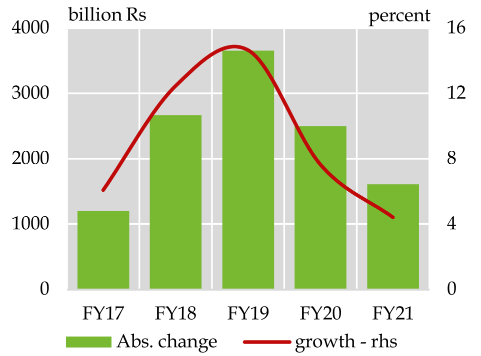
Aside from the improvements in fiscal and primary balances, the revenue balance, which reflects the difference between total revenue and current expenditures,

[2] The primary balance continued to be in surplus in Q3-FY21 and stood at 0.2 percent of GDP (against a deficit of 0.2 percent in Q3-FY20).

remained at a similar level during Jul-Mar FY21 as compared to the corresponding period last year, which indicates continued strain on fiscal space for undertaking development expenditures **(Figure 4.1)**.[3] While the non-interest current spending was contained, a large increase in the interest payment was mainly responsible for the worsening of this ratio. Specifically, the interest payments posted 11.9 percent increase in Jul-Mar FY21, compared to 28.8 percent increase in the same period last year. Despite this relative slowdown, debt servicing claims over FBR taxes rose to 62.0 percent in Jul-Mar FY21 from 61.4 percent in the same period last year.

During Jul-Mar FY21, development expenditures posted an 11.1 percent decline, against 14.6 percent increase in the same period last year. In addition to the budget constraint, the Covid-related execution delays and implementation of Public Financial Management (PFM) Rules 2019, which allocated greater responsibility of undertaking development projects to relevant ministries, also partially contributed to the decline in development spending. It may take some time for PFM reforms to yield desired results, with gradual adaptation of the relevant departments to the new rules of conduct. The process may also entail hiring of new staff with specialized skills to undertake various development expenditures.

Public debt accumulation (Jul-Mar) Figure 4.2



Source: State Bank of Pakistan

The financing mix of the fiscal deficit remained tilted towards domestic commercial banks, whereas the inflows from non-bank and external resources posted a slowdown in this period (**Table 4.1**). In line with the containment in the fiscal and current account deficits, as well as revaluation gains emerging from the appreciation of PKR, the pace of public debt accumulation also slowed down during Jul-Mar FY21 (**Figure 4.2)**. The entire increase in the public debt stock was contributed by domestic debt, while external debt saw a small decline during this period (in PKR terms). With the continued focus on debt management reforms, around 81.6 percent of the increase in domestic debt came from long-term instruments during Jul-Mar FY21 in line with Medium-Term Debt Strategy.

The consistent strain on fiscal resources posed by debt servicing payments has constrained public investment and is not favorable for the country's economic growth prospects. In this regard, the continuation of ongoing reforms aiming at broadening the tax base, careful management of spending, structural reforms in Public Sector Enterprises (PSEs), reforms in energy sector and better

[3] The revenue balance slightly improved to -0.9 percent of GDP in Q3-FY21, compared to -1.0 percent in last corresponding period.

FBR Tax Collection **Table 4.2**

billion Rupees, growth in percent

	Jul-Mar		Q3		Growth			Growth Cont.	
					Jul-Mar		Q3	Jul-Mar	Q3
	FY20	FY21	FY20	FY21	FY20	FY21	FY21	FY21	FY21
Direct taxes	**1,142**	**1,246**	**362**	**415**	**14.5**	**9.1**	**14.8**	**3.4**	**5.2**
Indirect taxes	**1,917**	**2,149**	**589**	**770**	**12.3**	**12.1**	**30.7**	**7.6**	**19.9**
Customs duty	481	541	146	203	-5.2	12.5	39.2	2.0	6.7
Sales tax	1,250	1,416	384	498	19.3	13.3	29.8	5.4	12.5
Import	675	791	229	301	15.3	17.1	31.6	3.8	8.0
Domestic	575	625	155	197	24.4	8.7	27.1	1.6	4.5
FED	186	192	60	69	22.7	3.2	15.6	0.2	0.9
Total taxes	**3,060**	**3,395**	**951**	**1,185**	**13.2**	**10.9**	**24.6**	**10.9**	**24.6**

Source: Federal Board of Revenue

targeting of subsidies are expected to introduce sustained improvement in the fiscal account in the medium term.

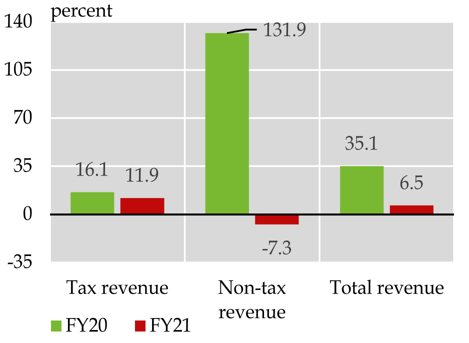
4.2 Revenues

The total revenues went up by 6.5 percent during Jul-Mar FY21, compared to 35.1 percent increase in the same period last year. This growth is entirely explained by 11.9 percent increase in tax revenues, while non-tax revenues showed 7.3 percent decline in this period (**Figure 4.3**).

FBR Collections

The improvement in economic activities, higher imports, FBR tax administrative efforts, a low base from last year, and inflationary impact in some categories led to a decent 10.9 percent increase in tax receipts during Jul-Mar FY21, compared to 13.1 percent increase in same period last year **(Table 4.2)**.[4,5] Importantly, this increase was witnessed despite higher payment of tax refunds and the absence of any major increase in tax rates during this period.[6,7]

Growth in Overall Revenues during Jul-Mar **Figure 4.3**



Source: Ministry of Finance

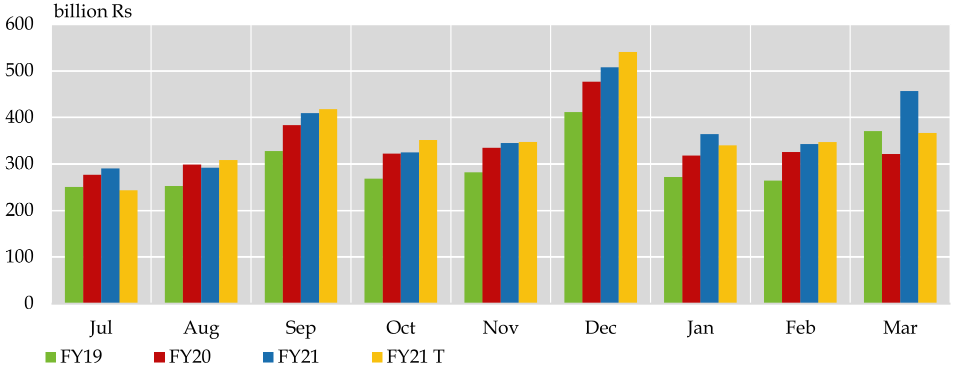
[4] Sugar prices posted 23.9 percent YoY increase during Jul-Mar FY21, over same period last year, while electricity prices were revised upward by 7.7 percent in this period.

[5] This number may not tally with number provided in Figure 4.3, as Figure 4.3 represents tax revenue reported by MoF.

[6] With the exception of beverages, for which FED rates were increased in FY21.

[7] FBR issued higher refunds of Rs 235.5 billion in Jul-Mar FY21 compared to Rs 130.9 billion last year. This was because of the introduction of an IT module named Fully Automated Sales Tax e-Refund (FASTER) that was introduced in FY20. The system was further improved at the start of FY21 by addressing some technical glitches.

Monthly FBR Tax Collection **Figure 4.4**



Source: Federal Board of Revenue

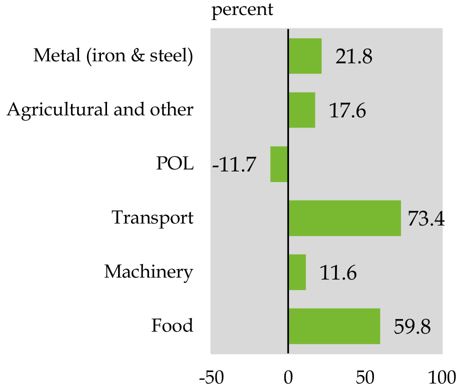
The quarterly analysis shows that FBR taxes posted a significant YoY growth of 26.4 percent in Q3-FY21 compared to 6.5 percent last year. This rise reflects the impact of low base of last year, amid Covid-led lockdowns in the month of March 2020. Specifically, the FBR tax collection posted 5.1 percent YoY increase during Jul-Feb FY21. However, the 41.9 percent YoY surge seen in March FY21, pushed the overall growth to 10.9 percent for the overall Jul-Mar FY21.

The annual target for FBR tax collection was revised down to Rs 4.7 trillion from Rs 4.9 trillion in March 2021, amid the third wave of Covid.[8] The FBR taxes surpassed the revised target by around Rs 100 billion in Jul-Mar FY21 (**Figure 4.4**).

Indirect Taxes Recorded a Broad Based Increase during Jul-Mar FY21

Around half of the entire increase in tax collection was contributed by import related taxes, namely GST on imports and custom duties during Jul-Mar FY21. This increase was seen despite tariff rationalization measures and decline in global oil prices, and mainly reflects the impact of revival in economic activity, which led to higher imports of various capital and consumer goods and raw materials (**Figure 4.5**). Specifically, receipts from iron and steel, vehicles, food items

Growth in Import Value during Jul-Mar FY21 (sector-wise) **Figure 4.5**



Source: State Bank of Pakistan

[8] IMF country report (2021), "Second, Third, Fourth, and Fifth Reviews Under the Extended Arrangement Under the Extended Fund Facility and Request for Rephasing of Access-Press Release; Staff Report; Staff Supplement, and Statement by the Executive Director for Pakistan".

Import Related Taxes in Jul-Mar **Table 4.3**

billion Rupees; growth in percent

	FY20	FY21	Growth	Growth Cont.
Sales tax	**675.4**	**791.2**	**17.1**	
POL	192.2	175.3	-8.8	-2.5
Iron and steel	63.4	85.6	35	3.3
Vehicles	33.1	53.3	61.2	3
Edible oil	39.2	52.3	33.6	1.9
Plastic	42.8	51.4	20.1	1.3
Machinery	47.2	54.4	15.3	1.1
Semiconductor devices	39.4	40.6	3.1	0.2
Custom Duty	**481.5**	**541**	**12.4**	
Vehicles	43.6	70.7	62.1	5.6
POL	68.1	63.1	-7.4	-1
Iron and steel	35.1	42.4	20.7	1.8
Machinery	24.7	30.1	22.1	1.1
Edible oil	23.3	25	7.4	0.4
Semiconductor devices	44.7	46.2	3.4	0.3

Source: Federal Board of Revenue

and machinery witnessed a sharp YoY increase during Jul-Mar FY21, whereas collection from POL declined amid softening import prices (**Table 4.3)**.[9]

GST collection from domestic sales also witnessed a decent expansion. Receipts from electrical energy had the most prominent share in the overall increase, which was led by both upward revision of electricity tariffs and increase in sales (**Table 4.4**).[10] Similarly, collection from sugar also surged amid sharp increase in domestic prices, whereas the revival in vehicle and POL sales during Jul-Mar FY21 also contributed positively to the overall collection. Moreover, intensified crackdown against the illegally imported

Sales Tax (domestic) during Jul-Mar **Table 4.4**

billion Rupees, growth in percent

	FY20	FY21	Growth	Growth Cont.
Electrical energy	78.6	105.7	34.5	4.3
POL	211.8	228.2	7.8	2.6
Sugar	26.8	43.8	63.2	2.7
Cement	16.0	26.5	65.7	1.7
Cotton yarn	24.5	34.1	39.1	1.5
Motor cars	3.0	12.1	305.2	1.4
Beverages	14.3	23.1	61.9	1.4
Cigarettes	13.9	18.2	30.8	0.7
Iron and steel	6.2	7.8	26.0	0.3
Textile	9.0	9.8	9.5	0.1
Others	230.8	271.5	17.6	6.4
Gross	**634.8**	**780.8**	**23.0**	**-**
Net	**578.8**	**624.6**	**7.9**	**-**

Source: Federal Board of Revenue

cigarettes made these brands more expensive in the local market. Resultantly, the consumption of local substitutes of these products increased, which led to higher collections from cigarettes at domestic stage.[11]

Collections from FED ticked up slightly during the period under review, with major share from cigarettes and beverages. As discussed earlier, collections from cigarettes increased due to the switching of demand to local brands amid anti-smuggling drive by FBR.

WHT and Collection on Demand (CoD) Helped Increase the Direct Taxes

Direct taxes posted a growth of 9.1 percent during Jul-Mar FY21, compared to 15.0 percent increase in the same period last

[9] The price of crude oil per barrel declined by 17.6 percent during Jul-Mar FY21 compared to last year.
[10] Electricity generation posted 4.8 percent increase during Jul-Mar FY21, compared to 1.0 percent in the same period last year.
[11] This can be seen from 17.8 percent increase in cigarettes production during Jul-Mar FY21, compared to 31.5 percent decline in the same period last year.

Direct Taxes during Jul-Mar **Table 4.5**

billion Rupees, growth in percent

	FY20	FY21	Growth	Growth Cont.
Collection on demand	**41.5**	**64.9**	**56.6**	**2.1**
Voluntary payments	**324.7**	**356.3**	**9.7**	**2.8**
Withholding taxes	**827.2**	**876.5**	**6.0**	**4.3**
Imports	155.0	157.3	1.5	0.2
Salaries	89.7	105.1	17.2	1.4
Dividends	38.5	41.0	6.5	0.2
Bank interest and securities	100.8	105.7	4.9	0.4
Contracts	173.9	180.3	3.7	0.6
Export	29.7	30.3	2.1	0.1
Cash withdrawals	12.6	11.5	-8.6	-0.1
Electricity bills	35.8	36.4	1.8	0.1
Telephone	41.3	46.9	13.6	0.5
Other WHT	150.0	161.9	7.9	1.0
Net Direct Taxes	**1,142.3**	**1,246.4**	**9.1**	**9.1**

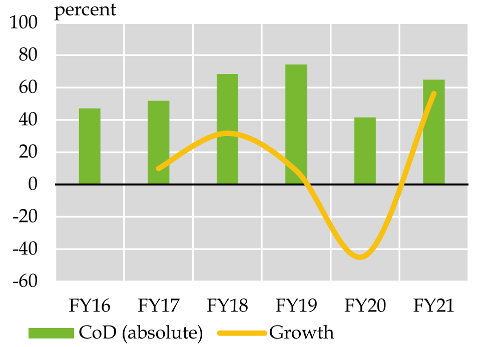
Source: Federal Board of Revenue

year. The growth during the review period was contributed by all the three sub-heads in this category namely, WHT, Voluntary payments and CoD (**Table 4.5**).

The increase in WHT was mainly driven by the sub-heads of contracts, bank interest and securities and telecom services. The boost in construction activity, uptick in saving deposits,[12] increasing usage of telecom services (due to virtual meetings and online educational activities, etc., amid Covid) helped the WHT grow during Jul-Mar FY21.

Meanwhile, the CoD showed a strong growth during the period when compared with last year. In fact, the growth in CoD was the highest in past five years (**Figure 4.6**). This improvement can be traced to administrative efforts of FBR, which

Collection on Demand during Jul-Mar of Last Five Years **Figure 4.6**



Source: Federal Board of Revenue

included: targeted audits of big revenue-yielding corporates and multi-nationals, and issuance of higher demand notices to the potential taxpayers.[13] Also, FBR has established two dedicated offices in Multan and Islamabad to facilitate large taxpayers to improve tax facilitation system. Furthermore, the FBR has also launched *Maloomat Tax-Ray*, under which it collects the information of individuals' assets and withholding deductions from third-party sources (such as banks) and shares the same with the individuals. The use of third-party data sources helps the FBR to better determine the tax liability of high net-worth individuals (and issue demand notices).[14]

Federal Non-tax Revenue Declined on Account of Lower SBP and PTA Profits

Non-tax revenues declined in Jul-Mar FY21 compared to last year due to lower SBP and PTA profits (**Table 4.6**). In fact, the contraction in these two heads alone led to

[12] Saving deposits increased by around 14 percent in Jul-Mar FY21.
[13] Source: Monthly Economic Update & Outlook April 2021 available at: www.finance.gov.pk/economic/economic_update_april_2021.pdf
[14] www.fbr.gov.pk/pr/pakistan-banks-association-and-fbr-agrees-to/152491 (dated: September 24, 2020)

Federal Non-Tax Revenue during Jul-Mar **Table 4.6**

billion Rupees, percent

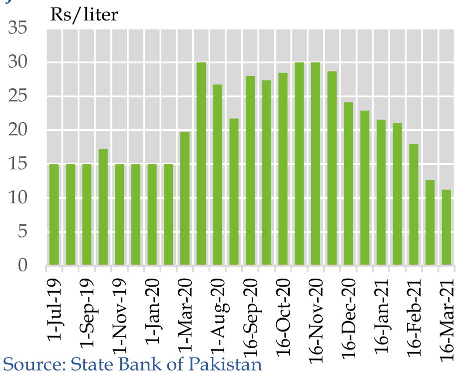
			Growth	
	FY20	**FY21**	**FY20**	**FY21**
Mark-up	70.0	53.2	387.3	-24.0
Dividends	26.6	19.6	-17.4	-26.3
PTA profits	113.2	20.0	599.4	-82.3
SBP Profits	635.5	497.5	359.8	-21.7
Passport Fee	16.3	10.2	0.0	-37.2
Royalties on Oil Gas	65.6	53.3	6.2	-18.7
Petroleum Levy	198.3	369.2	40.3	86.2
GIDC	6.2	15.4	-64.7	147.4
NGDS	7.9	17.2	64.7	117.8
Others	60.2	55.6	27.5	-7.7
Total	**1,262.7**	**1,165.6**	**134.4**	**-7.7**

Source: Ministry of Finance

Rs 231.2 billion reduction in total non-tax revenues in the period under review. However, this impact was partially offset by Rs 170.9 billion increase in collections from Petroleum Development Levy (PDL) in Jul-Mar FY21.

The transfer of SBP profits to the government marked a sharp 21.7 percent YoY reduction during Jul-Mar FY21. This mainly reflects the impact of lower interest rates, and a decline in the government debt stock with the SBP.[15] In the case of PTA, the decline in profits reflects the impact of one-off payment of GSM license renewal fee last year. It may be recalled that last year the telecom companies had paid 50 percent of their license renewal fee, while the remaining amount had to be paid in tranches over the next five years. PTA transferred Rs 20 billion to the government

PDL Rates on Petrol during Jul-Mar **Figure 4.7**



Source: State Bank of Pakistan

during Jul-Mar FY21 in this head, compared to Rs 113 billion last year.

PDL levy, on the other hand, showed a robust growth in Jul-Mar FY21 compared to last year. The government raised PDL rates on gasoline and diesel during Jul-Feb FY21 compared to last year, which reached a historic high of Rs 30/liter during the months of July and November 2020 (**Figure 4.7**). On the other hand, led by the economic recovery, the consumption of these POL products also witnessed 14.3 percent YoY increase during the period under review.[16] The combination of higher rates and consumption led to 86.2 percent YoY increase in collection from PDL during the entire Jul-Mar FY21, compared to the same period last year. However, in Q3-FY21 the government reduced the PDL rates amid rising international oil prices, which slowed down the pace of collection from the levy compared with the previous quarters of this year.

[15] The government retired Rs 0.3 trillion to the SBP during Jul-Mar FY21.
[16] Source: OCAC

4.3 Federal Expenditures[17]

Federal expenditures grew by 4.9 percent during Jul-Mar FY21, compared to 21.0 percent increase in Jul-Mar FY20. Major contribution came primarily from growth in domestic markup payments and grants and subsidies which covered Covid related expenditures and social spending under Ehsaas program. However, non-interest expenditures (including running of civil government, pension, defence, and federal development expenditures) declined by 0.4 percent as compared to 15.8 percent increase in the same period last year. Specifically, the expenditures for the running of the civil government showed consistent YoY declines in the last two quarters, after witnessing an increase in Q1-FY21.

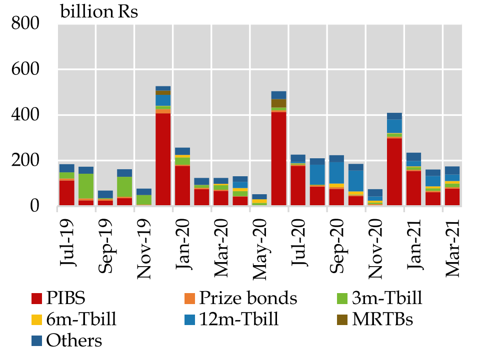
Federal Current Expenditures

Within current spending, major increase was observed in markup payments, which grew by 11.9 percent during Jul-Mar FY21 as compared to 28.8 percent in the same period last year. This deceleration mainly came from a decline in foreign markup payments during the period.

Interest payments on domestic & external debt

The interest payments on domestic debt posted 17.5 percent increase during Jul-Mar FY21. According to quarterly details, the YoY growth in interest payments slowed down to 8.4 percent in the past two quarters, after showing a large 29.8 percent increase in Q1-FY21. The surge seen in Q1-FY21 was mainly contributed by the coupon payments on PIBs, which inflated the overall interest payments during Jul-Mar FY21 (**Figure 4.8**).

Instrument-wise Interest Payments **Figure 4.8**



Source: State Bank of Pakistan

On the other hand, interest payments on external debt declined by 27.4 percent during Jul-Mar FY21, compared to the same period last year. This decline was primarily due to the debt relief provided under DSSI. In addition, a 10.0 percent appreciation of PKR against the US$ during the period and a drop in foreign interest rates (Libor), which favorably repriced the floating debt contracts, also contributed to this decline.[18]

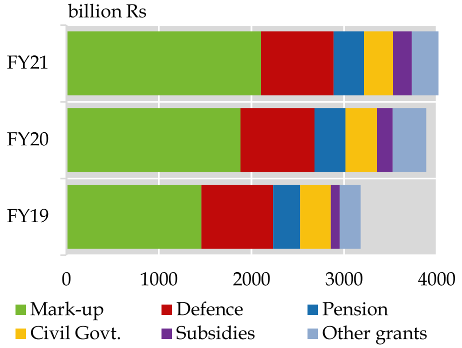
Curtailment in Non-Interest Current Expenditures

The slowdown in non-interest current spending was mainly led by contraction in the outlays for running of civil government, defense and pensions **(Figure 4.9)**. The expenditure for running of the civil government was contained by limiting

[17] The discussion in this section is based on federal expenditures excluding statistical discrepancy

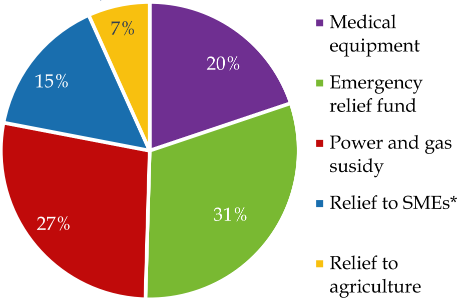
[18] See Chapter 5 for detail.

Composition of Federal Current Expenditures during Jul-Mar **Figure 4.9**



Source: Ministry of Finance

Covid-related Spending under Fiscal Stimulus Package (Up to March 2021) **Figure 4.10**



Source: Ministry of Finance

non-priority spending, restricting supplementary grants and implementing austerity measures.[19] These included restraints on protocols (traveling-related, etc.), better accounting practices under PFM Act (2019), ban on vehicle purchases (such as cars and vans, etc.), suspension of new vacancies, and rationalization of other operational expenditures.[20]

Economic Stimulus Package continued

The government announced Rs 1.2 trillion Economic Stimulus Package in FY20 to provide relief and mitigate the impact of Covid. Out of this amount, 56.5 percent was spent last year, and a further 12.0 percent was utilized during Jul-Mar FY21. Around half of these disbursements during Jul-Mar FY21 catered to Covid management requirements i.e., medical equipment and lockdown administration in the virus hotspots and emergency relief (such as purchase of vaccines, hospital services, awareness campaigns, etc.). The remaining amount was spent for providing incentives to revive growth in various sectors of the economy **(Figure 4.10)**.

Social Protection Programs remained robust

The government launched Ehsaas Emergency Cash (EEC) transfer program in April 2020, to save the vulnerable families from the recessionary impact of Covid. Under this program, immediate one-time cash assistance amounting to Rs 12,000 per household was provided to eligible families identified with the help of the provinces and communication campaigns. By end-June 2020, the authorities had reached 12.5 million families and disbursed Rs 133 billion from the fiscal stimulus package. This support continued until end-September 2020, by including 2.3 million additional households. From Q2-FY21, this support was reverted to the regular Benazir Income Support Program

[19] Ministry of Finance (2021). Mid-year Budget Review Report, 2021. Islamabad: Budget Wing, Ministry of Finance.
[20] Circular No. 7(1) Exp. IV/2016-430, dated August 6, 2020, Expenditure Wing, Finance Division.

(BISP) beneficiaries.[21] According to details, the BISP disbursements witnessed Rs 8.6 billion YoY increase during Jul-Mar FY21. However, the entire increase (Rs 38.3 billion) came in H1-FY21, while the Q3-FY21 disbursements stood at Rs 4.5 billion, against Rs 34.2 billion in the same period last year.

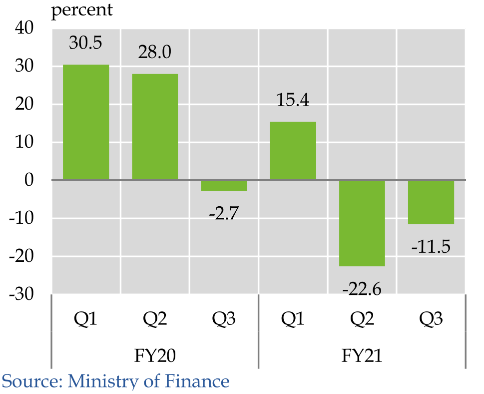
Furthermore, government is gearing its efforts to broaden the scope of social welfare spending. In this regard, some of the major efforts include: (i) increase in the coverage and stipend to support children's education under various programs, announced during Jul-Mar FY21;[22] and (ii) opening shelter homes *(Panagahs)* across different parts of the country in Q3-FY21.[23]

Federal Development Expenditures

The federal government development expenditures saw a 17.7 percent contraction during Jul-Mar FY21 as compared to 9.3 percent increase seen in the same period last year. In fact, after witnessing increase during Q1-FY21, the development expenditure edged down in the past two quarters **(Figure 4.11)**.

As per the PFM guidelines of 2019, a strategy for the fund allocation was introduced in order to streamline disbursements under PSDP spending.

YoY Growth in Federal PSDP **Figure 4.11**



Source: Ministry of Finance

Accordingly, about 80.0 percent of the budgeted PSDP target ought to be spent up to March of every year.[24] However, only 54.3 percent of the budgeted PSDP has been spent up to March 2021.

This sluggishness is partly attributable to the government's efforts to contain fiscal deficit. This can also be seen from the reduction in FY21 budgetary allocation of federal PSDP to Rs 650 billion, from Rs 700 billion a year earlier. However, according to official sources, a number of other factors also explain this reduction:

(i) The PFM rules of 2019 require involvement of relevant ministries to execute the identified projects. However, the relevant government departments may take some time to adapt to these changes as

[21] IMF country report (2021), "Second, Third, Fourth, and Fifth Reviews Under the Extended Arrangement Under the Extended Fund Facility and Request for Rephasing of Access-Press Release; Staff Report; Staff Supplement, and Statement by the Executive Director for Pakistan".

[22] Under the Conditional Cash Transfers (CCT) program, the stipend for boys and girls was doubled to Rs 1500 and RS 2000, respectively from August 2020, and the coverage was expanded to all 154 districts of the country. Furthermore, Ehsaas steering committee approved expansion of Waseela-e-Taleem Digital for secondary education stipends.

[23] Source: Monthly Economic Update & Outlook, April 2021. Finance Division, Government of Pakistan.

[24] Revised Release Strategy for Funds Allocated for the Public Sector Development Programme (PSDP) 2019-20, Budget Wing, Finance Division

Provincial Fiscal Operations **Table 4.7**

billion Rupees; growth in percent

	Jul-Mar				Growth			
	FY20	FY21	Q3-FY20	Q3-FY21	Jul-Mar FY20	Jul-Mar FY21	Q3-FY20	Q3-FY21
A. Total revenue	2,467.36	2,584.29	783.95	925.99	12.2	4.7	7.92	18.12
a. Provincial share in fed. revenue	1,931.61	1,985.76	605.79	705.70	8.57	2.80	4.47	16.49
b. Fed. loans and transfers	134.91	146.26	51.66	61.09	N-A	8.41	386.02	18.25
c. Provincial own revenue	400.84	452.27	126.50	159.20	13.55	12.83	-6.97	25.85
Taxes	321.22	370.12	106.81	124.27	11.65	15.22	6.88	16.34
Non-taxes	79.62	82.15	19.69	34.93	21.92	3.18	-45.38	77.43
B. Total expenditure (a+b+c)	2,073.25	2,171.58	738.28	768.41	8.74	4.74	4.26	4.08
Expenditures (a+b)	2,123.82	2,338.35	764.08	829.70	11.43	10.10	12.08	8.59
a. Current	1,741.80	1,948.39	601.42	667.39	6.86	11.86	4.88	10.97
b. Development	382.02	389.96	162.66	162.31	38.41	2.08	50.21	-0.21
c. Statistical discrepancy	-50.57	-166.77	-25.81	-61.29	N-A	229.81	-197.83	137.50
Overall balance (A-B)	394.11	412.71	45.67	157.59	35.15	4.72	148.67	245.02
Financing	-394.11	-412.71	-45.67	-157.59	35.15	4.72	148.67	245.03

*Negative sign in financing means surplus.

Source: Ministry of Finance

the process may entail hiring of new staff with specialized skills to undertake various development expenditures. In this regard, Pakistan's experience is not different from other developing countries that experienced both technical and non-technical issues while implementing PFM rules (Haque et al., 2012).[25] As explained in the literature, the pace of PFM reforms in various countries should be matched with the level of technical capabilities of the relevant departments, while policy efforts should also aim at capacity building of staff (Welham et al., 2013).[26]

(ii) A part of the overall decline in PSDP spending can also be attributed to Covid-related execution delays, emerging from the implementation of smart lockdowns in various parts of the country as required from time to time.

However, some fast moving projects such as 10 Billion Tree Tsunami, Karachi Transformation Plan, projects related to National Commission for Human Development, housing, interior division, and IT related projects were given more funds by re-appropriation from slow moving projects.

4.4 Provincial Fiscal Operations

Provinces remained committed to fiscal consolidation and posted a combined surplus of Rs 412.7 billion during Jul-Mar FY21 against Rs 394.1 billion in the same period last year **(Table 4.7)**. In terms of

[25] Haque, T., Knight, D., and Jayasuriya, D. (2012). Capacity Constraints and Public Financial Management in Small Pacific Island Countries: Capacity Constraints and PFM. Asia & the Pacific Policy Studies.

[26] Welham, B., Krause, P., and Hedger, E. (2013). Linking PFM Dimensions to Development Priorities. Working Paper 380, Results of ODI research presented in preliminary form for discussion and critical comment.

GDP, the provincial fiscal surplus stood at 0.9 percent in Jul-Mar FY21 as compared to 0.9 percent in Jul-Mar FY20 (last 5-year average is 0.7 percent) and budget target of 0.5 percent of GDP.

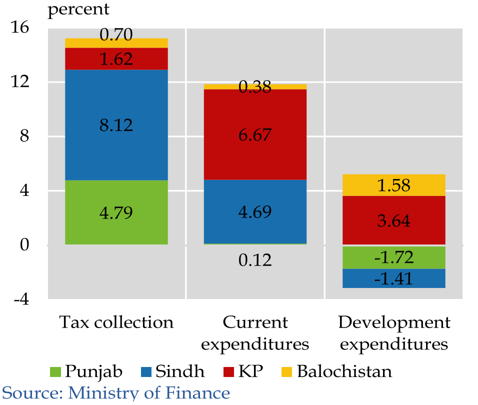
This improvement was contributed by both an increase in revenues and a slowdown in spending. In the wake of Covid situation, there was a shift of preference towards current expenditures, whose growth almost doubled during Jul-Mar FY21 as compared to same period last year. On the other hand, development expenditures posted a nominal growth of 2.1 percent during this period, against 38.4 percent increase in the same period last year.

During Q3-FY21, provincial surplus stood at 0.3 percent of GDP against a nominal 0.1 percent in the same period last year. This improvement was contributed by a large 18.1 percent YoY increase in revenues, while expenditure growth remained muted in this quarter. The expansion in revenues was broad based including all sub-heads, namely federal transfers under the NFC, provincial own tax and non-tax resources, and federal loans and grants. While on the expenditure side, the overall growth stemmed from an increase in current expenditures, whereas development expenditures showed a slight YoY decline in Q3-FY21.

Provincial tax revenues grew strongly

Provincial revenues posted a 4.7 percent increase during Jul-Mar FY21, compared to 12.2 percent increase in the same period

Province-wise Growth Contribution in Tax Collection and Expenditures for Jul-Mar FY21 **Figure 4.12**



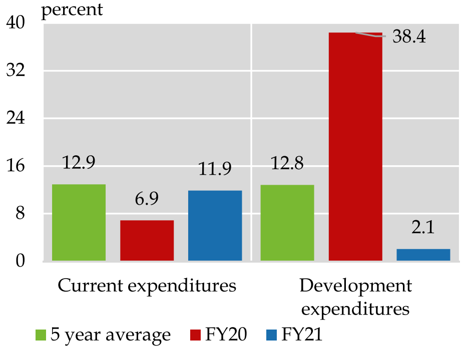
Source: Ministry of Finance

last year. This slowdown emanated from reduction in the pace of NFC transfers to provinces, deceleration in federal loans and transfers as well as non-tax revenue (due to lower profits from hydroelectricity) during Jul-Mar FY21.[27] However, provincial tax revenues showed a sharp 15.2 percent YoY increase during Jul-Mar FY21, which was mainly helped by increased GST collection on services.

In terms of province-wise performance, tax collection by Sindh had the highest contribution in growth, followed by Punjab (**Figure 4.12**). In the case of Sindh, this growth mainly stemmed from two factors: (i) a rise in import activity which led to an uptick in collections from ports and shipping services; and (ii) resumption of GST collection on telecommunication services. In the case of Punjab, most of the YoY increase in tax collection was seen in Q2-FY21, which was mainly on account of

[27] The NFC transfers to provinces, posted an average 25.7 percent YoY increase in the past two quarters, after showing a 29.4 percent YoY decline during Q1-FY21.

Growth in Current and Development Expenditures during Jul-Mar FY21 **Figure 4.13**



Source: Ministry of Finance

cross-input tax adjustment between FBR and the Punjab Revenue Authority.[28]

Provinces prioritized current spending

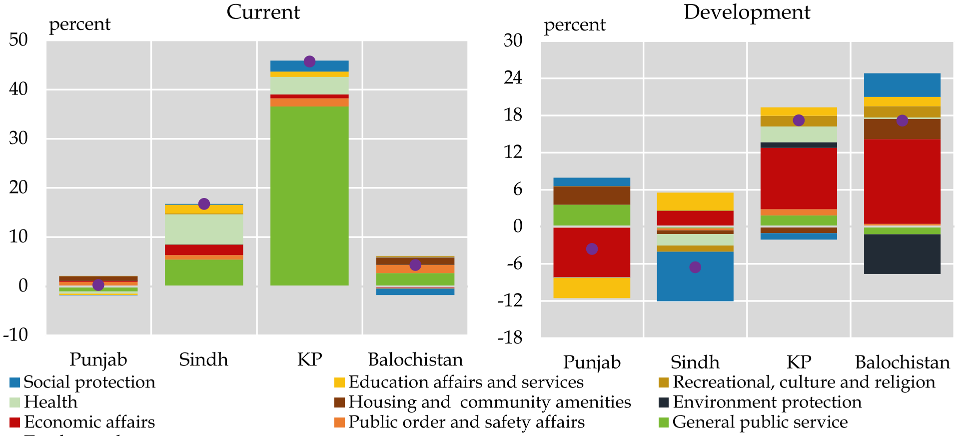
Provincial spending maintained the growth momentum seen last year, as expenditures grew by 10.1 percent during Jul-Mar FY21 compared to 11.4 percent increase in the same period last year. However, unlike last year, most of the increase came from current expenditures, whereas development spending witnessed only a marginal increase **(Figure 4.13)**. Specifically, current spending in KP witnessed a sharp 45.7 percent increase during Jul-Mar FY21, compared to a nominal 0.8 percent expansion in the same period last year (**Figure 4.13**). According to the provincial authorities, a large sum from the last year's allocated budget for operational expenditures under the head of *General Government Services* remained unspent because of prevailing lockdown. This amount was included in the FY21 Budget and was used during Jul-Mar FY21.

Current spending in Sindh posted 16.8 percent increase during Jul-Mar FY21, against 4.4 percent increase in the same period last year. This growth mainly stemmed from Covid-related spending by the health department as well as an increase in salaries and pensions of government employees. For Punjab, current expenditures remained almost at the same level during Jul-Mar FY21 as last year.

As for development expenditures, the marginal increase observed during Jul-Mar FY21 was contributed by increased spending in the sub-head of *Economic Affairs* by KP and Balochistan **(Figure 4.14)**. This category mainly includes spending on projects related to construction and transport, agriculture, food, irrigation, forestry and fishing, etc. Development spending by Punjab fell by 3.6 percent during Jul-Mar FY21 against 53.7 percent increase in the same period last year. This decline was led by lower spending on construction, transport and education sector. Similarly, Sindh also recorded a decline of 6.5 percent during Jul-Mar FY21, compared to 4.4 percent increase in the same period last year.

[28] Cross input tax adjustment refers to adjustments of input tax across provincial and federal tax jurisdictions. When tax on goods used as input (i.e. input tax) for a particular services is collected by the FBR, and taxpayers only pay GST on that service to provincial revenue authorities, the tax for goods used as input for these services becomes a receivable from FBR for provincial revenue authorities. The same is true for vice versa, where services are used as input for goods, and the tax on such services becomes payable to FBR by the provincial revenue authorities.

Province-wise Gorwth Contribution in Current and Development Expenditures **Figure 4.14**

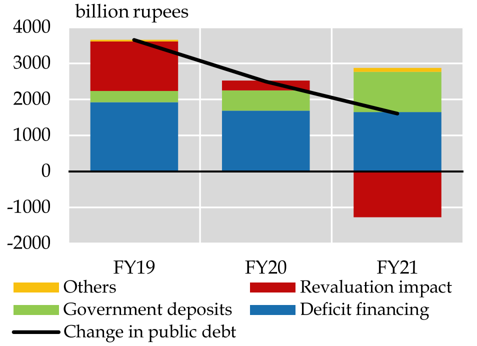


Source: Ministry of Finance

4.5 Public Debt

With the addition of Rs 1.6 trillion during Jul-Mar FY21, Pakistan's public debt reached Rs 38.0 trillion on end-March 2021 (**Table 4.8**). The growth in accumulation of debt slowed down to 4.4 percent during Jul-Mar FY21, compared to 7.6 percent in the same period last year. This slowdown is attributed to: (i) reduction in fiscal deficit, which was partially contributed by the debt relief under DSSI; and (ii) higher revaluation gains on existing debt stock due to appreciation of PKR (**Figure 4.15**).

Source of Change in Public Debt (Jul-Mar) **Figure 4.15**



Source: State Bank of Pakistan

While government external debt (including debt from IMF) posted a Rs 0.7 trillion decline in PKR terms in this period, [29] the entire increase in public debt during Jul-Mar FY21 emanated from domestic debt, which increased by Rs 2.3 trillion during the period under review. This increase came from both a slight increase in the deficit financing requirements from domestic sources as well as the increase in

[29] The entire decline in government external debt was due to PKR appreciation, excluding the impact of 10.0 appreciation of PKR against the US dollar, government external debt (including debt from IMF) actually increased by almost Rs 0.6 trillion.

Public Debt Composition - Jul-Mar (Rs Billion) **Table 4.8**

	Stock			Absolute change			
	Jun-20	Mar-21	Jul-Mar FY20	Jul-Mar FY21	Q1	Q2	Q3
I. Government Domestic Debt	23,282.5	25,552.2	1,745.9	2,269.7	420.0	611.6	1,238.1
II. Government External Debt	11,824.5	11,288.6	603.0	-535.9	162.2	-28.9	-669.2
III. Debt from IMF	1,291.5	1,164.9	150.3	-126.5	-30.8	-67.2	-28.6
Gross Public Debt (sum I to III)	36,398.6	38,005.8	2,499.2	1,607.2	551.4	515.6	540.3

Source: State Bank of Pakistan

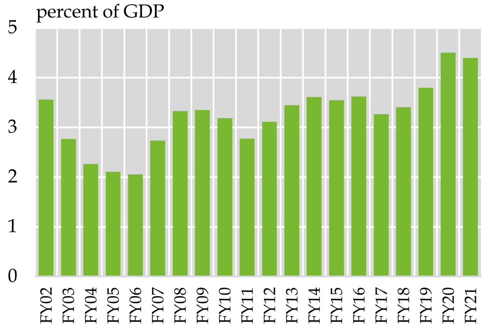
government deposits during Jul-Mar FY21.[30]

Quarterly analysis of public debt composition shows that the rise in public debt was almost equally distributed across the three quarters (**Table 4.8**). While the external debt (in Rupee terms) recorded a YoY decline during Q3-FY21, domestic debt witnessed a sharp Rs 1.2 trillion expansion in Q3-FY21. This was led by an increase in the deficit financing requirements from domestic sources and increase in government deposits with the banking system.

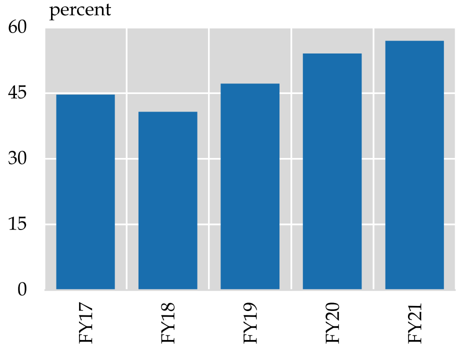
While there is a slowdown in the pace of public debt accumulation, significant additions in the country's public debt during the past few years have pushed up the markup expense to substantially high levels (**Figure 4.16a**), whereas the interest payments to FBR tax ratio has also seen a large increase for the past few years (**Figure 4.16b**).[31] To address these concerns, the government has introduced various reforms in public debt management in the past few years, which aim at improving the composition and risk exposure of public debt. In this regard, some of the important highlights of the debt management operations included:
(i) continued focus on lengthening of maturity profile of domestic debt; (ii) diversification of the debt instruments and investor base by introducing new instruments; (iii) imposing a ban on institutional investments in National Saving Schemes to ensure institutional investment in long-term debt market; (iv) zero fresh borrowing from the SBP for deficit financing; (v) withdrawal of Rs 25,000 denomination prize bond to improve the documentation of the economy; (v) re-profiling of the existing stock of the SBP debt from short-term (6 months) to medium to long-term (1 to 10 years) with the target to retire it completely over a period of ten years; and (vi) diversification of external borrowing sources by mobilizing US$ 2.5 billion through a multi-tranche transaction of dollar-denominated Eurobonds in the international capital market.

[30] The overall deficit financing requirements declined to Rs 1.65 trillion during Jul-Mar FY21, from Rs 1.69 trillion in the same period last year. However, while the financing from external sources posted 17.6 percent YoY decline in Jul-Mar FY21, the domestic financing increased by 8.6 percent YoY in this period.
[31] In this regard, it should be noted that the increase in the public debt level in the past few years was partly contributed by higher mark-up cost.

Interest Payments during Jul-Mar **Figure 4.16a**



Interest payments as percent of Tax Revenues during Jul-Mar **Figure 4.16b**



Source: Ministry of Finance

Composition of Domestic Debt

Government domestic debt increased by Rs 2.3 trillion during Jul-Mar FY21, reaching Rs 25.6 trillion on end-March 2021. On cumulative basis during Jul-Mar FY21, almost 80 percent of the increment in domestic debt was sourced through long-term instruments (**Table 4.9**).

From institutional perspective, the government adhered to its commitment of zero fresh borrowing from the SBP. In fact, the government retired Rs 0.3 trillion to the SBP during the period under review. Fund mobilization through National Saving Schemes (NSS) recorded net outflows, with the government's decision to impose ban on institutional investment in these schemes. Prize bonds also recorded net outflows during the period under review, as the government discontinued the sale of Rs 25,000 denomination bond in December 2020.[32]

Absolute change in Domestic Debt during Jul-Mar **Table 4.9**

billion Rupees

	FY20	FY21
I. Permanent Debt (1+2+3)	**1,164.3**	**1,852.4**
of which		
GOP Ijara Sukuk	-	438.1
Pakistan Investment Bonds (PIBs)	1,321.3	1,488.5
Prize Bonds	(157.0)	(74.2)
II. Floating Debt	**270.8**	**421.7**
of which		
Market Treasury Bills	555.8	421.3
III. Unfunded Debt	**310.6**	**(22.0)**
of which		
Saving Schemes (Net of Prize Bonds)	317.9	(11.4)
IV. Foreign Currency Loans	**0.2**	**(0.6)**
V. Naya Pakistan Certificates	**-**	**18.2**
Domestic Debt (I+II+III+IV+V)	**1,745.9**	**2,269.7**

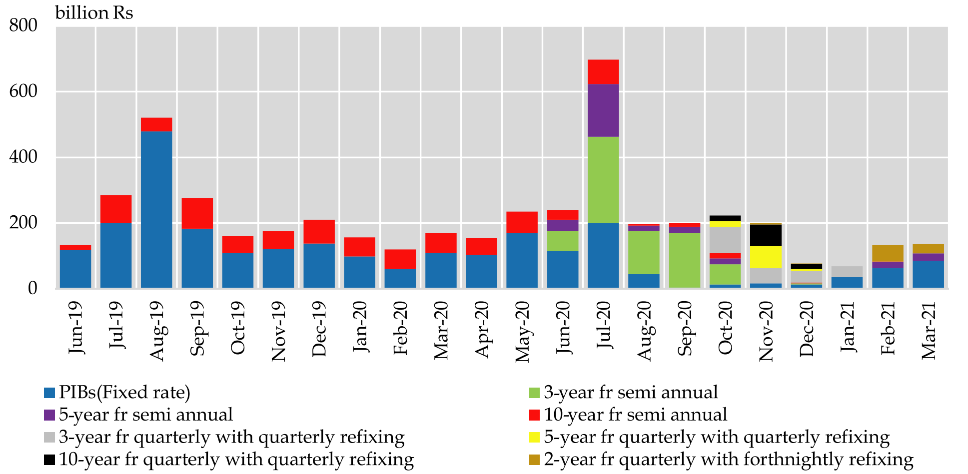
Source: State Bank of Pakistan

Lengthening maturity profile of domestic debt

The share of permanent debt in government domestic debt increased to

[32] The holders were provided three options in this regard: (i) convert to premium prize bond; (ii) replace with Special Savings Certificates (SSC)/Defence Savings Certificate (DSC); and (iii) encash at face value. However, most of the holders opted for the encashment of these bonds, as the rise in sales of the premium prize bonds and the SSC/DSC was marginal.

Auction of Pakistan Investment Bonds (Accepted Amount) **Figure 4.17**



*fr= floating rate

Source: State Bank of Pakistan

62.1 percent by end-March FY21, from 60.2 percent as of end-June 2020.[33] To improve the maturity profile of domestic debt and to diversify the investor and instrument base, a number of new instruments were introduced during Jul-Mar FY21, including: (i) availability of Shariah Compliant Sukuks of longer tenors (5-years) with fixed and variable returns; and (ii) introduction of new long-term instruments (including 3- and 5-year floating rate PIBs). In addition, the government also imposed a ban on institutional investments in NSS with effect from July 1, 2020, to enhance institutional participation in competitive primary and secondary markets of long-term debt. Due to these above-mentioned steps, the government was able to diversify the investor base and mobilize funds across long-term instruments (**Figure 4.17**). From the demand side also, market participants seemed keen to invest in these instruments due to the embedded coupon re-fixing feature.

The introduction of the 5-year Ijara Sukuk (both fixed and variable-rate rental options), helped the government to mobilize Rs 0.4 trillion during the period under review. This instrument not only helped diversify the domestic debt portfolio, but also improved the maturity profile and provided an investment avenue to Islamic banks.

Shift towards floating debt in the third quarter

Short-term securities contributed around 77.3 percent to the increase in domestic debt during Q3-FY21. This can be

[33] The share of permanent debt in domestic debt on end December was 64.1 percent. A shift towards short-term debt (MTBs and MRTBs categorized as floating debt) during Q3-FY21 lowered the share of permanent debt slightly on end March 2021 to 62.1 percent.

Auction Summary of Market Treasury Bills **Table 4.10**

billion Rupees

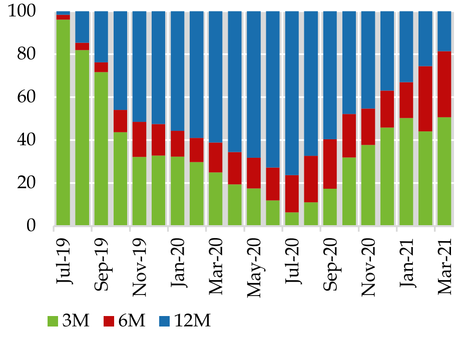
	Target	Target Net of Maturity	Maturity	Offered(all)	Accepted (all)
Q1-FY20	6,800	1,620.4	5,179.6	8,290.2	6,124.2
Q2-FY20	3,300	-1,137.2	4,437.2	8,210.7	3,340.2
Q3-FY20	2,750	359.1	2,390.9	8,299.6	2,978.1
Q4-FY20	2,200	221	1979	6,139.6	1,806.7
Q1-FY21	1,800	-903.8	2,703.8	5,143.1	1,981.4
Q2-FY21	2,750	-743.9	3,493.9	4,909.9	3,188.0
Q3-FY21	4,025	116.4	3,908.6	6,887.2	4,711.8

Source: State Bank of Pakistan

explained by lower targets set for floating-rate PIBs (PFL). In addition, in response to higher yield demanded by the market on PIBs, the government increased the net of maturity targets of MTBs (**Table 4.10**) during Q3-FY21.

From demand side, the market started to invest in short-term papers (3M-Tbills) from Q2-FY21 as the market expected bottoming out of interest rate. However with the rise in term premium, the market's interest shifted towards 6M-Tbills in the third quarter (**Figure 4.18**).[34] The average term premium between 6M and 3M T-bills increased to 23 bps in Q3-FY21 compared to 8bps in Q2-FY21. During Q3-FY21, the market placed bids of Rs 2.3 trillion for 6M-Tbills compared to Rs 0.4 trillion in the preceding quarter. [35]

Share in outstanding stock of MTBs **Figure 4.18**



Source: State Bank of Pakistan

Inclusion of Naya Pakistan Certificates in Domestic Debt

Naya Pakistan Certificates held by residents were included in the category of domestic debt. Naya Pakistan Certificates (NPCs) are USD, PKR, Euro and GBP-denominated sovereign instruments issued by the Government of Pakistan. NPCs offer attractive risk-adjusted returns over different maturities. They are available in both conventional and Shariah compliant versions and are administered by the SBP.[36]

[34] The cut-off rates for 6M T-bills on average remained 36 bps higher during Q3-FY21 compared to Q2-FY21.

[35] See Chapter 3 for detail.

[36] Naya Pakistan Certificate (NPC) is a fixed income security offered digitally by Government of Pakistan under NPC Rules 2020 framed under Public Debt Act, 1944. It is a sovereign security denominated in US Dollars, and Pak Rupees issued with full faith and credit of the Government of Pakistan. The NPCs are available in five maturities, namely, 3-month, 6-month, 12-month, 3-year and 5-year. Non-resident Pakistanis having National Identity Card for Overseas Pakistanis (NICOP) or Pakistan Origin Card (POC)

Absolute Change in Government External Debt during Jul-Mar **Table 4.11**

billion US$

	FY20	FY21	Q1-FY21	Q2-FY21	Q3-FY21
A. Public external debt (1+2)	**3,049.2**	**3,611.7**	**1,912.6**	**2,499.5**	**-800.4**
1. Government external debt	**2,259.9**	**3,657.8**	**1,988.0**	**2,625.3**	**-955.5**
i) Long term(>1 year)	**835.0**	**4,366.5**	**2,358.1**	**2,881.4**	**-872.9**
Paris club	-449.2	-486.2	278.4	343.9	-1,108.5
Multilateral	1,072.4	1,823.3	1,487.3	779.9	-443.9
Other bilateral	646.2	1,294.7	984.0	190.5	120.2
Euro/Sukuk global bonds	-1,000.0	0.0	0.0	0.0	0.0
Commercial loans/credits	498.6	1,092.2	-425.5	1,366.3	151.4
Local Currency Securities	41.0	251.9	23.3	73.0	155.6
Naya Pakistan Certificates	0.0	382.1	0.5	128.0	253.5
Others	26.0	8.6	10.0	-0.2	-1.2
ii) Short term (<1 year)	**1,424.9**	**-708.7**	**-370.0**	**-256.1**	**-82.6**
Multilateral*	**279.8**	**-363.4**	**-303.7**	**64.9**	**-124.6**
Local Currency Securities	**1,345.4**	**-203.8**	**-39.9**	**-206.0**	**42.1**
Commercial loans/credits	-200.3	-141.5	-26.5	-115.0	0.0
2. From the IMF	**789.3**	**-46.2**	-75.4	-125.8	155.1
i) Federal government	1,424.9	581.5	65.6	67.3	448.5
ii) Central bank	-635.5	-627.7	-141.1	-193.1	-293.5
B. Foreign exchange liabilities	**-617.1**	**-1,212.8**	-859.3	228.9	-582.3

Source: State Bank of Pakistan

The government mobilized funds worth Rs 18.2 billon through NPCs during Jul-Mar FY21. [37]

Public External Debt & Liabilities

Pakistan's public external debt reached US$ 81.6 billion by end-March 2021, with 4.6 percent increase over its end-June 2020 position.[38] Improvement in the current account balance amid strong remittances and debt relief provided under the DSSI kept the external financing needs relatively lower in FY21 (**Box 4.1)**. Revaluation losses of almost US$ 1.1 billion due to depreciation of US dollar against other international currencies inflated the external debt in dollar terms. One half of the revaluation losses were due to appreciation of Special Drawing Rights (SDR) against the US dollar. Excluding the revaluation impact, the increase in external debt would have been much lower.

Quarterly breakup shows that the stock of public external debt declined by US$ 0.8 billion during Q3-FY21 after recording an

and resident Pakistanis having declared assets abroad, are eligible to invest in NPCs through Foreign Currency Value Account (FCVA) and Non Resident Pakistanis Rupee Value Account (NRVA) account being marketed by agent banks as Roshan Digital Accounts (RDAs). Opening a Roshan Digital Account with one of the 11 agent banks is a pre-requisite for investment in NPCs. NPCs held by residents are part of domestic debt while NPCS held by non-residents are part of external debt.

[37] Source: State Bank of Pakistan, available at: www.sbp.org.pk/ecodata/D-Debt-Liabilities.pdf

[38] Foreign exchange liabilities of the country reached US$ 8.7 billion by end-March 2021, a decline of 12.3 percent over its end June 2020 position.

increase during the first two quarters.[39] The stock of both long-term and short-term loans declined during the quarter mainly due to repayments to multilateral donors. This decline neutralized the impact of the increase emanating from inflows received against NPCs and foreign investment in government securities during Q3-FY21 (**Table 4.11**).

Maturity profile of external debt improved

Composition of external debt shows that the entire increase in external debt stock during Jul-Mar FY21 was sourced through long-term debt (**Table 4.11**). In addition, the country repaid its short-term debt worth US$ 0.7 billion during the period under review, which improved the maturity profile.

Foreign investment in long-term government securities also saw an uptick, which bodes well in terms of diversifying the investor base. Fund mobilization through NPCs held by non-residents stood at US$ 0.4 billion during the period under review. Most of the inflows under NPCs came in Q3-FY21.[40]

Overall, gross disbursements were recorded at US$ 7.4 billion during Jul-Mar FY21, compared to US$ 6.7 billion during the same period last year.[41,42] A large part of these disbursements (42 percent) was in the form of commercial borrowings to repay maturing foreign commercial loans. Meanwhile, budgetary support and project assistance for the ongoing development projects constituted 18 percent and 20 percent share in the overall loan inflows. Multilateral and bilateral sources disbursed around US$ 3.3 billion during the period under review with major contribution coming from the ADB and the World Bank (**Table 4.12**). Another important development was Pakistan's re-entry in the international capital market after a gap of more than three years. [43]

Donor-wise Disbursements during Jul-Mar **Table 4.12**

billion US$

	FY20	FY21
1. Commercial Sources	**1.8**	**3.1**
2. Multilateral & Bilateral Sources	**4.8**	**3.3**
of which		
ADB	2.2	1.2
World Bank	0.3	0.9
IDB	0.8	0.5
Other multi & bilateral	1.5	0.7
3. Others	**0.1**	**1.0**
Total disbursements (1+2+3)*	**6.7**	**7.4**

*Excluding inflows from IMF, Pakistan Banao Certificates, Naya Pakistan Certificates and non-resident investment in government securities

Source: Economic Affairs Division

[39] Foreign exchange liabilities declined by US$ 0.6 billion during Q3-FY21.
[40] www.sbp.org.pk/NPC-/page-npc.html
[41] Ministry of Economic Affairs available at: www.ead.gov.pk/SiteImage/Publication/BulletinMarch2020-21with%20Annexure1.pdf
[42] This amount excludes inflows from IMF, Pakistan Banao Certificates, Naya Pakistan Certificates and Non-resident investment in government securities.
[43] Actual proceeds from the issuance arrived during early April 2021, and were therefore not reflected in the external debt data in Q3-FY21.

Pakistan's External Debt Servicing -Principal **Table 4.13**

million US$

	Jul-Mar FY20	Jul-Mar FY21	Q1-FY21	Q2-FY21	Q3-FY21
1. Public debt (a+b)	**4,839.9**	**4,402.4**	**1,423.5**	**1,381.1**	**1,597.9**
a. Government debt	**4,302.3**	**3,624.2**	**1,170.2**	**1,078.5**	**1,375.5**
Paris Club	371.3	4.7	0	4.7	0
Multilateral	1,148.8	1,216.2	442.7	319.1	454.4
Other Bilateral	386.5	85.7	70	4.7	11.1
Euro/Sukuk global bonds	1,000.0	0.0	0	0	0
Commercial loans /credits	1,395.0	2,317.5	657.5	750.0	910.0
b. To the IMF	**537.6**	**778.0**	**253.3**	**302.6**	**222.4**
2. Foreign exchange liabilities	**500.0**	**3,000.0**	**1,000.0**	**1,000.0**	**1,000.0**
Memorandum Items					
Short-term government debt	**696.6**	**744.9**	**272.3**	**154.5**	**318.1**

Source: State Bank of Pakistan

Repayment of sovereign debt

The country repaid its sovereign debt worth US$ 5.1 billion during the period under review (**Table 4.13**).[44] While external debt servicing to multilateral sources remained almost at last year's level, repayments to bilateral sources recorded a slowdown during Jul-Mar FY21 mainly due to the debt relief provided under the DSSI. Furthermore, a net reduction of US$ 3.0 billion was recorded in stock of foreign exchange liabilities. The country repaid US$ 1.0 billion in each quarter.

Box 4.1: Debt Service Suspension Initiative - Implications for Pakistan's Fiscal Sector and Debt Sustainability Indicators

The World Bank and the IMF urged G20 countries to establish the Debt Service Suspension Initiative (DSSI) in April 2020 with the objective of helping developing countries to manage the adverse impact of Covid pandemic. In all, 73 countries are eligible for a temporary suspension of debt-service payments owed to their official bilateral creditors. The suspension period, originally set to end on December 31, 2020, has been extended through December 2021.[45] Under this initiative, the debt repayments are postponed for the short-term, instead of the actual cancellation of debt obligations. The repayment period for the restructured principal and interest amounts is 4-6 years.

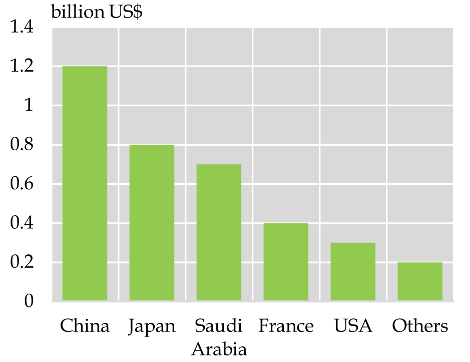
Pakistan was also eligible for a deferment of both interest and principal repayments on bilateral official debt on repayments falling due between May 2020 and December 2020.[46] In absolute terms, the DSSI has provided a temporary relief of around US$ 3.7 billion to Pakistan, of which one-third of the relief is

[44] Including government short-term debt.
[45] Source: worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative
[46] According to the October 2020-dated joint IMF-WBG staff note, titled "Implementation and Extension of the Debt Service Suspension Initiative", the bilateral official creditors had committed to "suspend payments on all principal and interest coming due between May 1 and December 31, 2020." The scope of the initiative was later extended to cover debt payments for eligible countries till June 2021. (Source: worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative)

sourced from China (**Figure 4.1.1)**. The relief amount under first two phases (May-December 2020) and (January-June 2021) was around US$ 2.7 billion;[47] under the third phase (July-December 2021), it is expected to be around US$ 1.0 billion. As percent of GDP, potential savings of 0.9 percent are provided under the DSSI.

Importantly, the DSSI has positive implications for the country's fiscal accounts as well as external debt sustainability indicators. First, with the deferment in markup payments on external debt, fiscal deficit is likely to be reduced by around 0.09 percent of GDP during H1-FY21 and a further 0.08 percent in FY22.[48]

Creditor-wise relief under DSSI **Figure 4.1.1**



Source: World Bank - IDS

This entails reduction in the government's gross financing needs and hence public debt burden by the same amount. Second, the pressure on FX reserves has also subsided due to this temporary relief. This can be seen from improvement in the external debt servicing to exports ratio to 34 percent (**Table 4.1.1**). In the absence of this relief, external debt servicing would have claimed 49 percent share of the country's export earnings. In the same manner, the ratio of external debt servicing to FX earnings has improved during H1-FY21 due to the relief provided under the DSSI.

Impact of DSSI on debt sustainability indicators **Table 4.1.1**

	Unit	H1-FY19	H2-FY19	H1-FY20	H2-FY20	H1-FY21*
Interest payments on government external debt	billion US$	1.0	1.1	1.1	0.9	0.7
**External debt servicing/FX earnings	Ratio (percent)	13.3	20.6	18.6	22.4	12.7
**External debt servicing/exports	Ratio (percent)	31.1	46.5	42.3	57.7	33.7

* First phase of DSSI **Including principal repayments

However, the repayment of the deferred payments will fall due after 2024. It is imperative to pace up structural reforms aiming at diversification of the country's export base and strengthening of non-debt related capital inflows to ensure stable stream of FX inflows for servicing external debt payments in the medium term. In this regard, the inflows from Roshan Digital Account (RDA) bode well for external debt sustainability.

[47] Economic Affairs Division (EAD) press release titled 'Government of Pakistan signs Memorandum of Understanding with Paris Club countries for 2nd round of Debt Suspension Initiative', available on the EAD website.

[48] Under the DSSI, Pakistan's markup payments on external debt have been deferred. These markup payments were estimated to be around Rs 29 billion during H1-FY21. If the country had paid this amount during FY21, country's overall expenditures and consequently fiscal deficit would have increased by 0.09 percent of GDP. However due to this relief, the deficit is estimated to be reduced by 0.09 percent of GDP.