ADB

# Report and Recommendation of the President to the Board of Directors

**INTERNAL**

Project Number: 56148-001
September 2022

# Proposed Countercyclical Support Facility Loans Islamic Republic of Pakistan: Building Resilience with Active Countercyclical Expenditures Program



Asian Development Bank

## CURRENCY EQUIVALENTS
(as of 1 September 2022)

| | | |
|---|---|---|
| Currency unit | – | Pakistan rupee/s (PRe/PRs) |
| PRe1.00 | = | $0.00456 |
| $1.00 | = | PRs219.09 |

## ABBREVIATIONS

| | | |
|---|---|---|
| ADB | – | Asian Development Bank |
| BISP | – | Benazir Income Support Programme |
| CARES | – | COVID-19 Active Response and Expenditure Support |
| CDEP | – | countercyclical development expenditure program |
| COVID-19 | – | coronavirus disease |
| DSA | – | debt sustainability analysis |
| EFF | – | Extended Fund Facility |
| FDI | – | foreign direct investment |
| FY | – | fiscal year |
| GDP | – | gross domestic product |
| IMF | – | International Monetary Fund |
| LNG | – | liquefied natural gas |
| M&E | – | monitoring and evaluation |
| MOF | – | Ministry of Finance |
| OP | – | operational priority |
| SBP | – | State Bank of Pakistan |

## NOTES

(i) The fiscal year (FY) of the Government of Pakistan and its agencies ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2023 ends on 30 June 2023.

(ii) In this report, "$" refers to United States dollars.

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[a] Outposted to the Pakistan Resident Mission.

**CONTENTS**

# PROGRAM AT A GLANCE

## 1. Basic Data

**Project Number:** 56148-001

| | | | |
|---|---|---|---|
| **Project Name** | Building Resilience with Active Countercyclical Expenditures Program | **Department/Division** | CWRD/CWPF |
| **Country** | Pakistan | **Executing Agency** | Ministry of Finance |
| **Borrower** | Islamic Republic of Pakistan | | |
| **Country Economic Indicators** | https://www.adb.org/Documents/LinkedDocs/?id=56148-001-CEI | | |
| **Portfolio at a Glance** | https://www.adb.org/Documents/LinkedDocs/?id=56148-001-PortAtaGlance | | |

## 2. Sector

| Sector | Subsector(s) | ADB Financing ($ million) |
|---|---|---|
| ✓ **Public sector management** | Public expenditure and fiscal management | 750.000 |
| | Social protection initiatives | 750.000 |
| | **Total** | **1,500.000** |

## 3. Operational Priorities

✓ OP1: Addressing remaining poverty and reducing inequalities
✓ OP2: Accelerating progress in gender equality
✓ OP3: Tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability
✓ OP5: Promoting rural development and food security
✓ OP6: Strengthening governance and institutional capacity
✓ OP7: Fostering regional cooperation and integration

**Climate Change Information**

| | |
|---|---|
| GHG reductions (tons per annum) | 0 |
| Climate Change impact on the Project | Low |
| **ADB Financing** | |
| Adaptation ($ million) | 268.000 |
| Mitigation ($ million) | 0.000 |
| **Cofinancing** | |
| Adaptation ($ million) | 0.000 |
| Mitigation ($ million) | 0.000 |

**Sustainable Development Goals**

SDG 1.3, 1.5
SDG 2.1
SDG 4.4
SDG 5.5, 5.c
SDG 8.1, 8.3
SDG 9.3
SDG 11.5
SDG 13.a

**Gender Equity and Mainstreaming**

Effective gender mainstreaming (EGM) ✓

**Poverty Targeting**

General Intervention on Poverty ✓

## 4. Risk Categorization: Complex

## 5. Safeguard Categorization

**Environment:** C **Involuntary Resettlement:** C **Indigenous Peoples:** C

## 6. Financing

| Modality and Sources | Amount ($ million) |
|---|---|
| **ADB** | **1,500.000** |
| Sovereign Countercyclical Support Facility Lending (Concessional Loan): Ordinary capital resources | 250.000 |
| Sovereign Countercyclical Support Facility Lending (Regular Loan): Ordinary capital resources | 1,250.000 |
| **Cofinancing** | **0.000** |
| None | 0.000 |
| **Counterpart** | **0.000** |
| None | 0.000 |
| **Total** | **1,500.000** |

**Currency of ADB Financing:** US Dollar

# I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on proposed loans to the Islamic Republic of Pakistan for the Building Resilience with Active Countercyclical Expenditures Program under the countercyclical support facility.[1]

2. **Cumulative exogenous shocks.** At the beginning of fiscal year (FY) 2022, Pakistan was positioned to recover from the adverse socioeconomic effect of the coronavirus disease (COVID-19) pandemic, supported by increasing private consumption, heightened agricultural activity, and strong and broad-based performance in large-scale manufacturing and services. However, post-pandemic global supply disruptions, and more significantly, the Russian invasion of Ukraine on 24 February 2022, have compounded the macroeconomic vulnerabilities caused by long-standing structural constraints. The crises have been further aggravated by severe floods impacting most parts of the country since June 2022.[2] These cumulative exogenous shocks have resulted in macroeconomic and cost-of-living crises that are having a significant adverse impact on businesses and households, especially the poor and vulnerable.[3]

3. **Government response.** A new government, which came into power in April 2022, moved swiftly to provide relief for surging imported food and fuel inflation, while in parallel deploying monetary and fiscal tightening measures to reduce the pressure on the balance of payments and unlock external financing from the International Monetary Fund (IMF) and other development partners.[4] On 30 June 2022, the government announced relief measures in the FY2023 national budget amounting to $2.3 billion in support of (i) increased funding for social protection, (ii) increased funding for food security, and (iii) enhanced support for business entities.[5] These relief measures, all of which are consistent with the IMF's policy advice, comprise the government's countercyclical development expenditure program (CDEP) (para. 20).

4. **Proposed program.** The program will support the government's efforts to provide immediate relief while, in conjunction with other development partners aligned to the government's reform program with the IMF, accelerate the ongoing implementation of structural reforms to improve Pakistan's medium- to long-term macroeconomic prospects.[6] The program is aligned with the government's strategic priorities and the overarching objectives of promoting social inclusion by strengthening the support provided to poor and vulnerable groups, improving economic resilience, and supporting the trade-related sectors.[7] The program is also aligned with Strategy 2030 of the Asian Development Bank (ADB), particularly (i) operational priority (OP) 1: addressing remaining poverty and reducing inequalities, (ii) OP 2: accelerating progress in gender equality, (iii) OP 3: tackling climate change, building climate and disaster resilience and enhancing environmental sustainability, (iv) OP 5: promoting rural development and food security, (v) OP 6: strengthening governance and institutional capacity, and (vi) OP 7: fostering regional cooperation

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1 Asian Development Bank (ADB). 2022. *Enhancing Contingent Disaster Financing and the Countercyclical Support Facility*. Manila.
2 Dawn. 2022. *Pakistan declares emergency in the face of calamitous floods*. 26 August.
3 ADB. 2022. *Asian Development Outlook Supplement: Recovery Faces Diverse Challenges*. Manila (July).
4 State Bank of Pakistan (SBP). 2022. *Monetary Policy Statement July 7, 2022.* Islamabad.
5 Government of Pakistan, Finance Division. 2022. *Federal Budget 2022–23: Annual Budget Statement*. Islamabad.
6 IMF. 2022. Pakistan: *2021 Article IV Consultation: Sixth Review Under the Extended Arrangement Under the Extended Fund Facility, and Requests for Waivers of Applicability and Nonobservance of Performance Criteria and Rephasing of Access. IMF Country Report. No. 22/27.* Washington, DC.
7 Government of Pakistan; Ministry of Planning, Development and Reform; Planning Commission. 2015. *Pakistan 2025: One Nation, One Vision*. Islamabad.

and integration.[8] The program is also aligned with ADB's country partnership strategy for Pakistan, 2021–2025, especially on reducing economic and social disparities, strengthening economic governance, and supporting private sector development.[9]

5. **Access criteria.** Pakistan meets all the criteria required to access ADB's countercyclical support facility (Table 1 and Appendix 4), which include an adverse impact of exogenous shocks, a pro-poor CDEP, public debt levels maintained at sustainable levels, and ongoing implementation of structural reforms.[10]

**Table 1: Compliance with Access Criteria for Countercyclical Support Facility**

| No. | Access Criteria | ADB Assessment |
|---|---|---|
| 1. | Adverse impact of exogenous shocks | The crisis triggered by the post-COVID-19 pandemic surge in international commodity prices and the Russian invasion of Ukraine has several negative spillovers for Pakistan. Fiscal adjustment and monetary tightening are expected to suppress domestic demand and curtail economic activity in FY2023. This demand contraction, together with capacity and input constraints caused by higher import prices and the large depreciation of the Pakistan rupee (by 30% against the United States dollar between February to July 2022), will reduce industrial output and import demand. As the impact of the shocks unfolds, businesses and households have come under significant pressure. The costs of doing business and living have surged in the final quarter of FY2022 with the central bank forecasting inflation at around 18–20% during FY2023 (para. 13). Higher trade costs, a reduction in foreign direct investment, and weakening private consumption are adversely impacting the economy—GDP growth in FY2023 is expected to drop to 3.5% from 6.0% in FY2022 and will be further downgraded due to the social and economic impact of the 2022 floods, which has significantly affected various parts of the country, and could reduce GDP growth by 2.0%.[a] In addition, according to preliminary estimates following the government's rapid assessment of the impact of the floods, public expenditure is likely to increase although the size of the increase, and in turn its impact on the fiscal balance, will become clearer after the multi-donor PDNA is completed in mid-to-late October 2022. |
| 2. | Countercyclical development expenditures program | The government's countercyclical measures, which are in line with the IMF's policy advice, amount to about $2.3 billion. The measures will help to (i) increase funding for social protection, (ii) increase funding for food security, and (iii) enhance support for businesses. The measures predominantly target the poor and vulnerable segment of Pakistan's population, especially women and girls. The CDEP, which utilizes the government's tried and tested mechanisms for crises response, is expected to remain substantially intact despite the 2022 floods. |
| 3. | Pre-shock record of generally sound macroeconomic management | The country loosened monetary and fiscal policies as a countermeasure against the economic impact of the COVID-19 pandemic. These accommodative policies helped mitigate the adverse socioeconomic impacts of the pandemic. Consequently, real GDP rebounded from a contraction of 0.9% in FY2020 and grew by 6.0% in FY2022. At the onset of the pandemic, the government suspended its fiscal consolidation measures under the IMF-supported stabilization program (the 2019 EFF) but remained committed to the medium-term fiscal targets. The implementation of the EFF was revived in FY2022 and accelerated in FY2023 and aims to strike a balance between fiscal sustainability over the long run and continued support for economic stabilization. As corrective measures, the government agreed to discontinue untargeted subsidies on fuel and adopt a FY2023 budget with a small primary surplus backed by non-priority expenditure constraints and tax measures. |
| 4. | Structural reforms | The government is taking credible steps to address structural weaknesses and improve resilience to complex shocks in the economy by undertaking structural reforms in several key sectors, which are supported by ADB's medium-term support (para. 21). In 2019, the IMF approved the $6 billion EFF for Pakistan to help shore up |

[8] ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.
[9] ADB. 2020. *Country Partnership Strategy: Pakistan, 2021–2025—Lifting Growth, Building Resilience, Increasing Competitiveness*. Manila.
[10] Government's Countercyclical Expenditure Measures (accessible from the list of linked documents in Appendix 2).

| No. | Access Criteria | ADB Assessment |
|---|---|---|
| | | the balance of payments and facilitate improved macroeconomic management. Although there have been challenges such as the waivers for nonobservance for missed quantitative and continuous policy conditions that were granted in August 2022, the government remains committed to addressing structural reforms as evidenced by the corrective actions highlighted in para. 9 and the new structural benchmarks that have been introduced. ADB and other development partners have aligned and coordinated their support with the objectives of the EFF and, consequently, major structural reforms are underway to address poor export performance, low-savings investment rates, low tax yields, rising power sector circular debt, and high indebtedness. |
| 5. | Debt sustainability | Both the IMF and ADB debt sustainability analyses conclude that Pakistan's public and external debts are projected to remain sustainable against the backdrop of policy reforms and fiscal adjustments envisaged under the 2019 EFF. The public debt-to-GDP ratio is projected to decline from 77.9% in FY2021 to 60.7% by FY2027, while external debt is projected to decline from 34.9% in FY2021 to 30.2% in FY2027. The analyses, however, emphasizes that, while the debt is assessed as sustainable, higher interest rates, a larger-than-expected growth slowdown, pressures on the exchange rate, and a rise in contingent liabilities from loss-making state-owned enterprises pose significant risks to debt sustainability. The government should, therefore, remain committed to fiscal consolidation and macroeconomic stability to avoid debt distress. The debt sustainability analyses confirmed that Pakistan's overall public debt position was sustainable even after factoring in the impacts of the surge in international commodity prices and additional borrowings in particular the $1.5 billion under the proposed program. |
| 6. | Coordination with the IMF | Ongoing ADB coordination and collaboration with IMF was instrumental in the preparation of the BRACE program. This included frequent discussions and information sharing on the macro-fiscal impact of the crisis and the appropriateness of the government's response. The IMF supports the program and believes its focus is correct and timely. The IMF published its 2022 staff review report covering the seventh and eight reviews of the EFF on 1 September 2022 and confirmed on 2 September 2022 that the report could serve as the IMF assessment letter. The IMF board approval allowed disbursement of $1.1 billion, bringing total disbursement under the EFF to $3.9 billion, in addition to an extension of the EFF to June 2023 and an increase in the access amount to $6.5 billion. This continuous dialogue with the IMF has been extended to include the impact of the floods. |
| 7. | Monitoring and evaluation | The monitoring and evaluation framework for the program is embedded in the government's existing mechanism for monitoring countercyclical expenditure measures. The Ministry of Finance will monitor, publish, and submit to ADB quarterly progress reports on the execution and utilization of the CDEP, which will highlight measures implemented, beneficiaries targeted, and the impact on women and poor and vulnerable people (in line with recommendations from the forthcoming Pakistan COVID-19 Active Response and Expenditure Support Program completion report). An independent third-party survey of the beneficiaries of the CDEP will be conducted 3 months after program completion in June 2023. |

ADB = Asian Development Bank, CDEP = countercyclical development expenditure program, COVID-19 = coronavirus disease, EFF= Extended Fund Facility, FY = fiscal year, GDP = gross domestic product, IMF = International Monetary Fund, PDNA = post-disaster needs assessment.

Note: The FY of the Government of Pakistan and its agencies ends on 30 June. "FY" before a calendar year denotes the year in which the fiscal year ends, e.g., FY2023 ends on 30 June 2023.

[a] Flooding that began in August 2022 due to excessive monsoon rain and other factors has adversely affected the low-income households in the affected areas because of a further surge in inflation and is expected to further aggravate food insecurity. While the initial impact analysis is still being carried out, the economic fallout from the floods could reduce GDP growth up to 2% mainly because of the direct impact on the agriculture sector (about 3.6 million acres of crop area have also been damaged throughout the country), with the hit to rural wealth and incomes likely to spread to the industry sector. According to the National Disaster Management Authority, about 1.7 million houses have been damaged or destroyed countrywide as of 5 September 2022.

Sources: Government of Pakistan, Ministry of Finance; ADB. 2022. *Asian Development Outlook Supplement: Recovery Faces Diverse Challenges*. Manila (July); and IMF. 2022. *Seventh, and Eighth Reviews of the Extended Arrangement Under the Extended Fund Facility, Requests for Waivers of Nonobservance of Performance Criteria, and for Extension, Augmentation, and Rephasing of Access*. *IMF Country Report.* No. 22/288. Washington, DC.

# II. PROGRAM AND RATIONALE

## A. Background and Development Constraints

### 1. The Economic Context

6. **Macroeconomic context.** Since the 1980s, a pattern of recurring spurts of high economic growth followed by episodes of economic crisis has held back Pakistan's sustained economic development. The root cause of this episodic growth lies in faltering investment and Pakistan's structural trade gaps, emerging whenever domestic demand grows too fast.

7. **Macroeconomic performance.** In July 2019, Pakistan embarked on an ambitious stabilization and structural reform agenda under the IMF's Extended Fund Facility (EFF) to address structural imbalances in the economy. This was interrupted by the large social and economic shock caused by the COVID-19 pandemic. Although the economy was severely hit by the pandemic in 2020, the government's response was quick and effective, and the adverse impact of the pandemic was substantially mitigated. Pakistan's real gross domestic product (GDP) growth rebounded from the pandemic-induced contraction of 0.9% in FY2020 to 5.7% in FY2021 to 6.0% in FY2022. However, macroeconomic vulnerabilities quickly arose as a sharp expansion in domestic demand and a steep rise in global oil and commodity prices caused imports to rise much faster than exports, and consumer price inflation to rise to an average of 12.1% year-on-year in FY2022 from 8.9% in FY2021. The current account deficit registered $17.4 billion (4.6% of GDP) during FY2022 compared to a deficit of $2.8 billion (0.8% of GDP) in FY2021 and $1.9 billion (0.5% of GDP) in FY2020. About 75% of the increase came from a widening in the merchandise trade deficit to 10.5% of GDP during FY2022 from 8.2% in FY2021. Further, depreciation of the Pakistan rupee accelerated in FY2022, which increased the cost of imports. The fiscal deficit in FY2022 remained high at 7.9% of GDP, up from 6.1% in FY2021, reflecting decreased levies on petroleum products and increased petroleum subsidies in the wake of the global oil price shock. Continued challenges from the lingering impact of the pandemic, sociopolitical pressures, and the surge in commodity prices yielded uneven implementation of the EFF in FY2022 with progress on several structural reforms slowing down.

8. **Macroeconomic policy response.** Following the worsening of macroeconomic imbalances, the government and the State Bank of Pakistan (SBP), the central bank, acted to reduce inflation to support macroeconomic stability and sustain growth consistent with the government's medium-term budget framework. With persistently high inflation and mounting pressure on the domestic currency, the SBP began tightening monetary policy in September 2021, raising its policy interest rate by a cumulative 800 basis points to 15%. The government's expansionary fiscal policy was partially reversed in January 2022 with the passage of a supplementary finance bill that targeted an underlying primary balance of 0% of GDP.

9. **Implementation of the 2019 EFF.** The IMF reports that overall compliance has remained weak since the completion of the sixth review.[11] Several quantitative criteria were missed and gaps in implementation arose, particularly in the fiscal and structural reform agenda, amid challenging circumstances, including domestic political turmoil and spillovers from the Russian invasion of Ukraine. However, the government has renewed its commitment to the EFF's medium-term objectives, as shown through the implementation of four prior actions that are critical to

[11] IMF. 2022. *Seventh and Eighth Reviews of the Extended Arrangement Under the Extended Fund Facility, Requests for Waivers of Nonobservance of Performance Criteria, and for Extension, Augmentation, and Rephasing of Access*. *IMF Country Report*. No. 22/288. Washington, DC.

achieving program fiscal objectives and financial viability of the power sector: (i) parliamentary approval of the FY2023 budget, including a personal income tax reform in June 2022; (ii) the signing of memoranda of understanding with provincial governments in July 2022 to deliver their individual commitment to spend less than their annual revenue collections and deliver fiscal surpluses; (iii) reversal of the February 2022 energy price relief package during May–July 2022; and (iv) catch-up on overdue power tariff adjustments during July and August 2022, i.e., implementation of overdue annual electricity tariff rebasing. The IMF board approved the seventh and eighth reviews of the EFF on 29 August 2022, enabling disbursement of $1.1 billion and bringing total disbursement under the EFF to $3.9 billion. In addition, the EFF was extended to June 2023 and the access amount was increased to $6.5 billion (footnote 11).

10. **Political context.** Pakistan has faced continuous political instability, compounding the economic and policy uncertainty. The general elections in 2013 and 2018 marked the completion of term and the transfer of power between two civilian governments. The current government took power after a no-confidence vote against the former Prime Minister. While the political situation remains complex, the present government has expressed its intention to complete its term (footnote 11). Moreover, there is consensus among key political stakeholders that sustained commitment to macroeconomic stability and fiscal consolidation is key to avoiding debt distress and improving the country's macroeconomic outlook. Therefore, implementation of structural reforms will continue, despite a moderate risk of delays given the challenging political and economic climate. The implementation of targeted countercyclical support is, however, unlikely to be affected.

### 2. The Crisis and Its Transmission Channels

11. The crisis exacerbated by the surge in international commodity prices and the Russian invasion of Ukraine is having severe negative spillover effects on Pakistan. These include (i) soaring inflation, (ii) a worsening current account deficit, (iii) declining foreign exchange reserves, (iv) rapid currency depreciation, (v) significant pressure on the fiscal position, and (vi) rising food insecurity and poverty. Higher trade costs, a reduction in foreign direct investment (FDI), and weakening private consumption are adversely impacting the economy—pre-2022 floods, GDP growth in FY2023 was expected to drop to 3.5% from 6.0% in FY2022, while the fiscal deficit expectation for FY2022 was revised from 6.3% to 7.9% of GDP. The 2022 floods are expected to further impair the macroeconomic and fiscal outlook with GDP growth rate worsening by possibly another 2.0% and an even larger fiscal deficit.[12]

12. **Worsening trade deficit.** Pakistan's direct trade linkages with the Russian Federation and Ukraine are limited, with bilateral trade amounting to just $0.8 billion (about 1.0% of total trade volume) in 2020.[13] However, Pakistan is exposed to the impacts of the Russian invasion of Ukraine through a surge in import costs because of rising global commodity prices, in particular fuel. Pakistan's import share of oil and gas is one of the highest among the 15 net energy importers in Asia.[14] This mainly stems from Pakistan's energy sector's heavy dependence on imported fuel (oil and liquefied natural gas [LNG]), increasing the country's vulnerability to

[12] On the back of high base effects, recent and expected macroeconomic adjustment measures and stronger inflation, real GDP growth is expected to moderate to 3.5% in FY2023. (ADB, August 2022). While the initial impact analysis is still being carried out, the revised estimates for GDP growth and fiscal balance will be updated after the completion of multi-donor post-disaster needs assessment.

[13] Pakistan Business Council. 2022. *Potential for a Pakistan–Russia Free Trade Agreement*. Karachi (January).

[14] United Nations Comtrade Database (accessed 8 February 2022); and Observatory of Economic Complexity (accessed 25 February 2022).

commodity price shocks.[15] In FY2022, Pakistan's merchandise trade deficit widened to $39.6 billion from $28.6 billion in FY2021, with the deficit in petroleum accounting for about 80% of the overall deterioration. The sharp increase in merchandise trade deficit resulted in a more than fivefold jump in the current account deficit to $17.4 billion (4.6% of GDP) between FY2021 and FY2022, resulting in a sharp reduction of foreign exchange reserves and significant depreciation of the Pakistan rupee.

13. **Higher inflation.** As the Russian Federation and Ukraine are global players in agri-food markets,[16] the regional supply disruptions because of the war in Ukraine and subsequent sanctions on the Russian Federation escalated global food prices. Energy prices also skyrocketed on prospects of a reduction in the global supply of energy products because of sanctions on the Russian Federation.[17] The surge in global prices of food and fuel, along with increased logistics and transport costs because of lingering global supply disruptions, resulted in higher imported inflation for Pakistan. To support food security and incentivize the production of wheat by domestic farmers, the government raised the public sector procurement price for wheat from domestic farmers from PRs1,950 to PRs2,200 per 40 kilogram in March 2022. This triggered about a 10% price hike for wheat flour during March–June 2022. As a prior condition to resume the ongoing EFF, the government abolished the untargeted subsidy on petroleum products that was announced in February 2022, and agreed on phased increases in electricity tariffs to cost recovery levels. These interventions are pushing costs up, further compounding the impact of the external shock on low-income households. Consumer price index inflation in Pakistan averaged 14.4% from January to June 2022, with a sudden spike to 21.3% in June, its highest level since 2008, because global oil prices affected domestic fuel and electricity prices. As a result, average headline inflation for FY2022 increased to 12.2% from 8.9% in FY2021. The surge in inflation was broad-based, with food and nonfood price indices both recording double-digit increases. Prices of essential commodities are expected to increase further because almost one-third of the country, and domestic supply chains in particular, have been affected by the floods.[18] The SBP had aimed to bring inflation within single digits by FY2023 but revised its inflation projection for FY2023 to 18%–20% in July 2022 (footnote 4).

14. **Food insecurity.** As of mid-2022, about 4.7 million people in Pakistan were classified as acutely food insecure, with high levels of malnutrition across all provinces in Pakistan.[19] In some districts, the incidence of poverty and food insecurity in rural areas is more than 2.5 times that in urban areas.[20] Risks to Pakistan's agriculture and food markets from the ongoing war are multifold and cover all areas of agriculture value chains, including trade, price, logistics, energy, production, and exchange rate. A considerable shortfall in global supply of grains, oilseeds, and vegetable oils is already taking place because of the Russian Federation's invasion of Ukraine. Pakistan has limited capacity and options to fill the gap because of a lack of alternative suppliers. The Food and Agriculture Organization anticipates this supply gap to push food and feed prices up by 8%–22% globally in 2022. This rise in global prices will impact local food prices and access to food, especially for low-income groups. In Pakistan, 15% of people already cannot access basic food

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[15] Pakistan started LNG imports in 2015 and has become the world's ninth-largest LNG importer in just 7 years.

[16] Together, the Russian Federation and Ukraine represent 53% of the share of global trade in sunflower oil and seeds, and 27% of the share of global trade in wheat.

[17] The Russian Federation is the second-largest oil exporter in the world, selling about 5 million barrels of oil daily. The country is also a major global supplier of chemical products (including fertilizers), as well as metals and wood products.

[18] The Economist. *Pakistan has been hit by its worst floods in recent memory*. 30 August.

[19] Integrated Food Security Phase Classification. *Pakistan: Acute Food Insecurity Situation October 2021 - March/April 2022 and Projection for April/May - June 2022*.

[20] ADB. 2020. *COVID-19 Impact on Farm Households in Punjab, Pakistan*. *ADB Briefs*. No. 149. Manila (August).

needs and 67% of people cannot access a healthy diet.[21] Before the war started, Pakistan was expected to import most of its required 2.0 million metric tons of wheat from Ukraine. In 2021, Pakistan imported wheat worth $813 million, out of which 58.8% was imported from Ukraine and 18.5% from the Russian Federation. Climate change impacts and low domestic wheat productivity, exacerbated by the effects of the conflict, are expected to increase Pakistan's wheat import requirement for FY2023 to 3.0 million metric tons, which equates to about $1.0 billion at current prices.[22] This is a drastic change for a country that was self-sufficient in its staple food until 2020. Food insecurity is further compounded by the severe damage to all major crops during the recent floods. Moreover, farms remain inundated impeding the preparation for the upcoming sowing season, particularly of the wheat crop.[23]

15. **Fiscal pressure.** The fiscal deficit remained high at 7.9% of GDP in FY2022, up from 6.1% in FY2021 (footnote 5). The consolidated fiscal deficit of the federal and provincial governments stood at 3.8% of GDP during the first 9 months of FY2022, 0.8% higher than in the comparable period of FY2021, reflecting decreased levies on petroleum products and increased petroleum subsidies in the wake of the global oil price shock. The primary balance posted a deficit equivalent to 3.1% of GDP during FY2022, up from a deficit of 1.2% in FY2021. Revenue collection slipped by 0.4% to 12.0% of GDP in FY2022 as a large decline in nontax revenue outweighed strong tax collections. Total expenditure increased to 19.9% of GDP during FY2022 from 18.5% of GDP in FY2021, owing to the aforementioned subsidies and development spending. The fiscal stress will compound further due to the floods as economic activity and government revenues decline, while government spends more on relief and recovery operations.

16. **Low market confidence.** Moody's Investors Service revised Pakistan's outlook from "stable" to "negative" in June 2022, and Fitch Ratings and Standard & Poor's did the same in July 2022. The rating agencies maintain that the revision of the outlook to "negative" reflects a significant deterioration in Pakistan's external liquidity position because of higher commodity prices, Pakistan rupee depreciation, and tighter financing conditions since early 2022. External resources are likely to remain under pressure in a challenging economic and political climate.

17. **Decline in remittances.** Workers' remittances are an important and growing source of foreign exchange for Pakistan, nearly matching Pakistan's merchandise export receipts in FY2022. With more than 9 million Pakistanis (or more than 4.0% of Pakistan's population) residing in 115 countries around the world, remittances, which account for about 8.2% of GDP, play a major role in stabilizing Pakistan's external sector and helping to alleviate poverty by enhancing recipient households' income. [24] This supports higher private consumption, and real estate investment. The Russian Federation's invasion of Ukraine has weakened expectations for global growth in 2022 and 2023.[25] Consequently, the remittance inflow to Pakistan is expected to come under pressure as the global economy weakens, which will reduce personal consumption and adversely affect demand for construction and real estate, posing a risk to 6.4 million employed in the construction sector.[26]

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[21] Food and Agriculture Organization of the United Nations. 2022. *Possible impacts of conflict between Russian Federation and Ukraine on food and agricultural markets in Pakistan.* Rome.

[22] Government of the United States, United States Department of Agriculture, Foreign Agricultural Service. 2022. *Pakistan Grain and Feed Annual*. Islamabad (March).

[23] Dawn. 2022. *Floods Inflict $10bn Losses Across Pakistan.* 30 August.

[24] Migrant Resource Centre. Remittances.

[25] The baseline forecast is for growth to slow from 6.1% in 2021 to 3.2% in 2022, 0.4% lower than in the IMF's April 2022 World Economic Outlook, partially reflecting spillovers from the war in Ukraine and tighter monetary policy. IMF. 2022. *World Economic Outlook Update: Gloomy and More Uncertain*. Washington, DC (July).

[26] Construction provided jobs to 9.5% of total 67.3 million employed in FY2021. Government of Pakistan, Finance Division. 2022. *Economic Survey of Pakistan 2021–22*. Islamabad.

18. **Lower foreign direct investment.** Given its fragile balance of payments position and urgent need to boost industrial production, Pakistan needs to significantly increase its mobilization of foreign resources. Pakistan's FDI is low, and the country is stuck in a low-savings, low-investment trap that is hampering its growth potential.[27] In FY2022, FDI in Pakistan stood at $1.9 billion, marginally up from FY2021, with roughly half of it concentrated in the energy sector. The tightening of global financing conditions because of increased uncertainty of the global economic outlook, along with a downgrade in Pakistan's outlook to "negative" from "stable" by rating agencies (para. 16), is expected to also reduce FDI inflows from other countries.

19. **Exacerbating poverty.** The poverty rate fell from 50.4% in 2006 to 24.3% (about 48 million people) in 2015. Another 19.9% (about 20 million people) are near-poor and vulnerable to shocks that could pull them below the poverty line.[28] The country's multidimensional poverty head count ratio is estimated at 39.0%, with the greatest contribution to poverty stemming from educational deprivation (42.8%), living standards (31.5%), and health care (25.7%). The rural poverty head count ratio of 30.7% is more than double the urban ratio of 12.5%. Women, who dominate the informal labor market, and girls from poor families are disproportionately affected in times of economic crises. The government's decision in June 2022 to reduce fuel subsidies, increase electricity and gas prices, introduce additional tax policy measures, and tighten monetary policy is leading to a sharp and prolonged increase in inflation. In addition, deceleration of economic activities is expected to trim job creation and increase financial hardship for poor and vulnerable groups. Simultaneously, a slowdown in remittances will also affect the income of dependent households. More than 3 million self-employed women, who are mainly engaged in agriculture, handicrafts, textile products, and housekeeping, may be affected by sluggish economic growth and a reduction in households' income. Further, modeling of the impact of the macroeconomic crisis on poverty levels in Pakistan concluded that headline poverty ($3.2 per day per person) is projected to increase from 38.0% in FY2021 to 42.8% in FY2023, an increase of more than 10 million people since FY2021. Poverty levels are likely to further worsen as early estimates indicate that the 2022 floods have affected 33 million people while half a million have been rendered homeless.[29] Current and future climate risks such as the floods will increase macroeconomic vulnerabilities and impact the poor and vulnerable first. Without expanded social and economic support to counter high inflation, a decline in remittances, as well as reduced job opportunities, it is expected that lost household income, from including for women, will worsen poverty in Pakistan.

## B. Countercyclical Expenditure Package and ADB's Value Addition

20. **Countercyclical development expenditure program.** To respond to the substantial adverse impact of the cumulative shocks on the economy, the government introduced the CDEP in the FY2023 national budget, which amounted to about $2.3 billion. The CDEP is summarized in Table 2. The measures prioritize and increase funding for (i) social protection (through the Benazir Income Support Programme [BISP]),[30] (ii) food security, and (iii) enhanced support for business. While the CDEP was finalized and budgeted prior to the 2022 floods, it is expected to

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[27] ADB. 2020. *Pakistan: Reviving Growth through Competitiveness*. Manila.

[28] Government of Pakistan; Ministry of Planning, Development and Reforms. 2018. *National Poverty Report 2015–2016*. Islamabad.

[29] The Guardian. 2022. *UN chief appeals for 'massive' help as flood-hit Pakistan puts losses at $30bn*. 9 September.

[30] BISP is the flagship social protection program of the government and is one of the most extensively evaluated program in the public sector. Its expansion has been accompanied by key developments such switching from community-based targeting to more effective targeting using proxy means test-based poverty scorecards, and developing one of the largest databases of poor households (the National Socio-Economic Registry). BISP identifies each beneficiary household through its oldest female member and transfers the income support in her name.

remain substantially intact and will be implemented as described (paras. 28–30) as the need for social protection, food security, and support for employment have become even more pronounced. The proposed program will provide timely liquidity support to moderate the adverse economic impact of the exogenous shocks while also allowing the government to focus on immediate relief efforts for the flood victims.

**Table 2: Countercyclical Expenditure Measures**

| Expenditure Items | Cost ($ million)[a] |
|---|---|
| **Social protection measures include** | **1,688** |
| Benazir Income Support Programme, comprising: | 1,662 |
| *Unconditional cash transfer to 9 million heads of the poorest families* | *1,096* |
| *Fuel subsidy scheme to 2 million vulnerable households* | *219* |
| *CCTs for education* | *161* |
| *National socioeconomic registry* | *8* |
| *Undergraduate scholarship program* | *42* |
| *CCTs for health and nutrition for pregnant and lactating mothers and children under 2 years* | *98* |
| *Employee-related expenses, administration, and other program expenditure* | *37* |
| Bait-ul-Maal (charity and social welfare organization) and Pakistan Poverty Alleviation Fund | 26 |
| **Food security measures include** | **324** |
| Subsidy for PASSCO for availability and price uniformity of wheat | 32 |
| Subsidy for Utility Stores Corporation to enable poor households to afford basic food commodities such as edible oil, flour, and pulses (beans, peas, and lentils) | 78 |
| Fertilizer plant subsidy for plants operating on LNG to reduce the prices of fertilizers | 68 |
| Subsidy for import of urea or fertilizer to supply imported fertilizer at uniform prices | 27 |
| Agriculture relief initiatives to promote smart agriculture for increase in agriculture productivity | 46 |
| Sales tax exemptions on import of seeds and tractors for increase in agriculture productivity | 73 |
| **Measures for support for business include** | **320** |
| Entrepreneurship and employment schemes | 46 |
| Support for export-oriented industries through subsidy for electricity and RLNG | 274 |
| **Total** | **2,331** |

CCT = conditional cash transfer, LNG = liquefied natural gas, PASSCO = Pakistan Agricultural Storage & Services Corporation Ltd., RLNG = regasified liquefied natural gas.
[a] Numbers may not sum precisely because of rounding.
Source: Asian Development Bank estimates.

21. **Structural reforms.** Persistent structural weaknesses continue to pose risks to Pakistan's growth in the medium term. They frequently disrupt macroeconomic stability and sustainable economic development, therefore hindering any serious effort toward poverty reduction. Restoring macroeconomic stability in the short term through fiscal constraint and improving domestic resource mobilization, market-determined exchange rates, and a proactive and prudent monetary policy remains key. In 2019, following the adoption of the EFF, ADB and other development partners aligned and coordinated their support for macroeconomic management with the objectives of the EFF. Consequently, the government is implementing major structural reforms to address poor export performance, low-savings investment rates, low tax yields, heavy reliance on external finance, rising power sector circular debt, and high indebtedness. ADB and other development partners' support for these reforms is highlighted below:

(i) the energy sector, to address financial, technical, and governance deficits in the sector that adversely impact sector sustainability and affordability such as circular debt;
(ii) social protection, to support institutional strengthening of BISP and enhance and expand conditional cash transfer programs in support of education, health services, and nutritional supplies for women and girls from the poorest of the poor families as well as building resilience to climate shocks through climate responsive targeting;
(iii) domestic resource mobilization, to address major binding constraints to mobilize larger resources to enhance productive investment through reforms to tax administration and

compliance, cash and public debt management, and the mobilization of greater domestic savings and FDI;

(iv) public–private partnerships, to improve the enabling environment for infrastructure financing and public–private partnerships at the federal level and, in doing so, to attract private finance for infrastructure investments in priority sectors such as roads, housing, health, education, water and sanitation, and technology; and

(v) women's inclusive finance, to address challenges related to women's access to finance in Pakistan through a combination of women-centered policy reforms, along with de-risking and unlocking liquidity to mobilize finance to women beneficiaries.

The government's appetite for sustaining structural reforms is high and there is strong, broad-based, support for completing the IMF program and ongoing development partner-supported structural reforms. ADB is also integrating climate risk management measures across its portfolio to strengthen Pakistan's resilience to complex shocks.

22. **ADB's value addition.** ADB has been in dialogue with the government since the post-COVID-19 pandemic surge in international commodity prices and the Russian Federation's invasion of Ukraine. The dialogue has centered around the impact of these shocks, possible countercyclical expenditure measures, the financing gap, and development partner coordination in support of the government's immediate relief and response effort. In providing this support, ADB builds on its experience of effective partnership with the government through several program loans and crisis response operations, including the special policy-based loan for the Economic Stabilization Program in 2019 and the COVID-19 Active Response and Expenditure Support (CARES) Program in 2020.[31] This has enabled a strong policy dialogue for development of the CDEP, as well as support for its monitoring and evaluation (M&E). ADB has also played an important role in strengthening BISP's cash transfer programs, including strengthening fiduciary systems and processes.[32] ADB, the World Bank, and other development partners are supporting the government to accelerate critical structural reforms that are aligned with the EFF. From 2019 to 2021, ADB supported trade competitiveness and exports, revenue mobilization, capital markets development, tax policy and administration, and state-owned enterprise development.

23. **Lessons.** Because exogenous shocks can disrupt economic growth and put significant pressure on the fiscal position, mitigating such adverse impacts is in line with ADB's institutional mandate. The preparation of this program draws from ADB's past and recent engagement in similar programs as well as related lessons in Pakistan and elsewhere in the region; this most recently includes the 2020 CARES Program (footnote 31). Important lessons from the CARES Program that have been incorporated into the scope and design of the proposed program include the following: (i) it is important to rapidly deploy countercyclical support to counteract the impacts of the crisis; (ii) regular dialogue between the government team and the ADB team is essential to building trust and confidence, data and information collection, and cross-verification of analyses; (iii) the immediate focus should be on increasing funding for social protection programs such as BISP's Kafaalat program, which provides unconditional cash transfers that help to cushion the

[31] ADB. 2019. *Recommendation of the President to the Board of Directors: Proposed Special Policy-Based Loan to the Islamic Republic of Pakistan for the Economic Stabilization Program*. Manila; and ADB. 2020. *Report and Recommendation of the President to the Board of Directors: Proposed Countercyclical Support Facility Loan to the Islamic Republic of Pakistan for the COVID-19 Active Response and Expenditure Support Program*. Manila.

[32] ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Islamic Republic of Pakistan for the Social Protection Development Project*. Manila; ADB. 2019. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Additional Financing to the Islamic Republic of Pakistan for the Social Protection Development Project*. Manila; and ADB. 2020. *Report and Recommendation of the President to the Board of Directors: Proposed Results-Based Loan, Grant, and Administration of Grant to the Islamic Republic of Pakistan for the Integrated Social Protection Development Program*. Manila.

impact of shocks on the poorest of the poor (in the absence of support under the CARES Program, Pakistan's progress toward achieving the Sustainable Development Goals would have been rolled back or even halted); (iv) the government's response should also account for the implementation capacity of relevant agencies, meaning priority should be given to crisis response that builds on ongoing, tried, and tested programs such as the Kafaalat program and BISP's conditional cash transfer programs in education and health; and (v) crises can create the political space for structural reforms that would be challenging in normal times. Therefore, the government or development partners may initiate policy dialogue for the development or implementation of difficult medium- to long-term structural reforms. [33]

24. **Debt sustainability analysis.** According to the debt sustainability analysis (DSA) published by the IMF in September 2022, Pakistan's public and external debt is projected to remain sustainable. The EFF has provided much-needed fiscal space to accelerate structural reforms, thereby laying the foundation for strong and sustainable growth in the medium term. The IMF September 2022 DSA projects the public debt-to-GDP ratio to decline from 77.9% in FY2021 to 60.7% by FY2027, and the external debt from 34.9% to 30.2% over the same period. The government's FY2023 budget consolidation is based on sharp spending cuts. The FY2023 national budget targets an underlying primary surplus of 0.4% of GDP, a consolidation of more than 2.0% of GDP. ADB's DSA, which includes a post-floods stress test to mimic the macroeconomic and fiscal impacts of the floods, corroborates these findings and projects the public and external debt to remain sustainable over the medium-to long-term. The ADB analysis, however, points out that the debt trajectory remains vulnerable to macro-fiscal shocks. If the key variables—real GDP growth, interest rate, inflation, and primary balance—deteriorate significantly, the public debt-to-GDP ratio will breach the debt threshold. Likewise, exchange rate depreciation and a rise in the current account deficit have the potential to jeopardize external debt sustainability. Both the IMF and ADB DSAs, however, confirmed Pakistan's debt sustainability under the impacts of the pandemic and after factoring in the additional borrowings, including the proposed $1.5 billion program.

25. **Coordination with the International Monetary Fund and other development partners.** ADB coordination and collaboration with the IMF is ongoing and includes consultations with the IMF regarding the crisis assessment and ADB's support through the program and other structural reforms, as well as, more recently, dialogue to assess the macroeconomic and fiscal impact of the floods. For the crises, ADB coordinated closely with the IMF on data and analysis, most specifically on the macro-fiscal framework and DSA. In addition to confirming that the focus of the program was timely and appropriate, the IMF agreed with ADB that BISP was the most effective and efficient mechanism for social protection support. The IMF also confirmed Pakistan's sound macroeconomic management and fiscal and debt position following the successful conclusion of the seventh and eighth reviews of the EFF. Alongside the focus on the crisis, ADB, IMF, and other development partners continue to support and monitor progress on key structural reforms.[34] ADB is also coordinating with other development partners to prepare a comprehensive post-disaster

[33] ADB. Forthcoming. Completion Report: COVID-19 Active Response and Expenditure Support Program in Pakistan. Manila.

[34] Development Coordination (available from the list of linked documents in Appendix 2). The IMF is expected to capture the macro-fiscal impact of the floods in the framework of their ninth review of the EFF in December 2022. In addition, ADB is working on a multipronged approach to support the government's relief and recovery efforts amid widespread floods across the country, including: $3.0 million grant, financed from Asia Pacific Disaster Response Fund, for 2022 Flood Emergency Response to fund the immediate purchase of food supplies, tents, and other relief goods to support flood victims across the country; and concerted support across various infrastructure sectors through repurposing of existing loans and reprioritizing future investments for rehabilitation and reconstruction needs.

needs analysis which will guide Government's recovery efforts, as well as further development partner support to Pakistan.

## C. Expected Outcomes of the Program

26. The program is aligned with the following impacts: macroeconomic management strengthened, and sustained and inclusive growth supported, which are in line with Pakistan's Vision 2025 (footnote 7). The program will have the following outcomes: adverse socioeconomic effects of the crisis mitigated, and resilience of poor and vulnerable groups enhanced.[35] The program outputs are aligned with the CDEP and are detailed in paras. 28–30:

27. **Output 1: Increased social protection measures implemented.** The following measures aim to cushion the impact of shocks on poor and vulnerable households: (i) increasing the number of beneficiary families identified through the National Socio-Economic Registry from the current 7.9 million to 9.0 million, with cash benefits paid only through the female head of poor families; (ii) providing financial assistance for primary and secondary school education, health services for poor children, nutritional supplements for children under 2 years, and antenatal and postnatal care for pregnant and lactating women belonging to the poorest families; and (iii) providing monthly direct cash transfers of PRs2,000 each as a fuel subsidy to 2 million households with a monthly income below PRs40,000. The design and monitoring framework of the National Socio-Economic Registry guarantees quick and transparent targeting of the poorest households of the population, including low-income families with children requiring education and health services (footnote 30). In addition, ADB supported reforms are underway to introduce climate smart measures like the climate smart National Socio-Economic Registry and management information systems, which will improve targeting of beneficiaries that have been impacted by climate shocks (footnote 32).[36]

28. **Output 2: Increased food security measures implemented.** Aimed at ensuring adequate supply of essential food items at stable prices, interventions under this output include the following: (i) providing a freight subsidy on the transportation of wheat to different parts of the country through Pakistan Agricultural Storage & Services Corporation Limited; (ii) offering financial support to the Utility Stores Corporation for the provision of basic commodities to the general public at prices lower than those in the open market; and (iii) offering tax relief and a subsidy on agricultural inputs, including fertilizers, urea, seeds, and tractors, to enhance crop yields. These measures will be complemented by an increased allocation for food security initiatives by the provincial governments of Punjab and Sindh.

29. **Output 3: Enhanced support for business implemented.** Measures planned under this output aim to promote self-employment and entrepreneurship opportunities for youth, and support export growth. Measures include (i) allocating PRs10 billion for the government's entrepreneurship and employment schemes, including disbursing subsidized loans through commercial banks to eligible borrowers (encompassing women borrowers, and trade-related small and medium-sized enterprises); and (ii) providing targeted and time-bound subsidies on electricity and gas prices to five export-oriented sectors to support price competitiveness and safeguard employment (footnote 11).[37]

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[35] The design and monitoring framework is in Appendix 1.
[36] Global Centre for Adaptation. 2019. *Climate Resilience through Social Protection.* Rotterdam.
[37] The government also reaffirmed that it would limit power subsidies to PRs570 billion.

30. This program will benefit the general population with more stable food prices and adequate supply of wheat flour. In particular, the following groups will benefit: (i) the poor and vulnerable population, including low-income families, the elderly, the disabled, pensioners, and the unemployed, who will benefit from stable prices of food and essential commodities; (ii) the poor and vulnerable population, women-led businesses, and youth entrepreneurs, who will benefit from one-time social assistance and skills development training for improved employment prospects, and financing support for establishing businesses; (iii) exporters, who will benefit from improved liquidity position with the release of delayed refunds; (iv) businesses in food and retail, which will benefit from stability in prices of essential items and the resulting increased demand; (v) employees of export companies and food and retail businesses, who will benefit from business sustainability and stable job opportunities; (vi) public servants, who will benefit from increased capacity for crisis management, including M&E and reporting; and (vii) women and girls, who are the beneficiaries in all the outputs, included targeted support under BISP.[38]

## D. Development Financing Needs and Budget Support

31. The government's budget deficit for FY2023 is estimated at $17.6 billion (or 4.9% of GDP), while the gross financing needs amount to $84.2 billion. The external financing is expected to be $27.9 billion, which includes IMF ($3.8 billion), ADB ($2.3 billion), World Bank ($1.9 billion), commercial borrowings and/or bonds ($6.3 billion), and short-term borrowings ($13.3 billion).[39] The balance will be financed from domestic sources.[40] ADB's $1.5 billion loan for the program will provide 5.5% of the gross external financing needs and support the CDEP of $2.3 billion. ADB is also exploring cofinancing with other development partners.

32. The government has requested (i) a regular loan of $1.25 billion from ADB's ordinary capital resources; and (ii) a concessional loan of $250 million from ADB's ordinary capital resources to help finance the program. The regular loan will have a 7-year term, including a grace period of 3 years; an interest rate determined in accordance with ADB's Flexible Loan Product plus 75 basis points; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan agreement. Based on the straight-line method, the average maturity is 5.5 years, and there is no maturity premium payable to ADB. The concessional loan will have a 25-year term, including a grace period of 5 years; an interest rate of 2.0% per year during the grace period and thereafter; and such other terms and conditions set forth in the draft loan agreement.[41]

## E. Implementation Arrangements

33. **Implementation.** The Ministry of Finance (MOF) will be the executing agency. The implementing agencies will be the MOF, BISP, the Ministry of Industries and Production, the Ministry of National Food Security and Research, and SBP. The program's implementation period is from 1 July 2022 to 30 June 2023. The loan closing date is 31 December 2023.

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[38] Program Economic Assessment (accessible from the list of linked documents in Appendix 2).

[39] ADB's $2.3 billion projected support in FY2023 consists of the proposed Building Resilience with Active Countercyclical Expenditures Program ($1,500 million), Improved Domestic Resource Mobilization Reform Program, Subprogram 1 ($150 million), Sustainable Infrastructure Financing and Public–Private Partnership Program, Subprogram 1 ($175 million), Women Inclusive Finance Program, Subprogram 1 ($75 million), and Energy Sector Reforms and Financial Sustainability Subprogram 3 ($400 million).

[40] ADB estimates based on information received from the Government of Pakistan, Ministry of Finance (MOF). The estimates do not capture the impact of the 2022 floods on the projected budget deficit, as the impact will become clearer after the multi-donor post-disaster needs assessment is completed.

[41] The loan is included in the latest commitment projections and reflected in the assessment of ADB's risk bearing capacity in the Quarterly Risk Management Report for the first quarter of 2022.

34. **Monitoring and evaluation.** The government, through the MOF, will monitor budget execution and flow of funds. The MOF will set up a steering committee comprised of the secretary for finance (chair), the secretary for economic affairs, the secretary for industries and production, the secretary for national food security and research, the secretary for BISP, and the executive director for SBP. A working group led by the joint secretary (external finance), as the program coordinator, will support the steering committee with M&E and reporting of program performance indicators, and drafting of progress reports for the MOF and ADB. The progress reports will be submitted and published on the MOF website on a quarterly basis. The M&E framework will (i) support regular and systematic reporting on the CDEP announced in the FY2023 national budget, with particular focus on priority expenditure items outlined in program design and monitoring framework; (ii) provide a platform for coordinated and informed discussions between the government and development partners on the implementation of the CDEP; and (iii) continue the monthly policy dialogue with the government to address longstanding structural constraints. An independent third-party survey of the countercyclical expenditure measures will be conducted 3 months after the end of the program in June 2023.

35. The proceeds of the loan will be withdrawn in a single disbursement in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

## III. DUE DILIGENCE

36. **Poverty and social considerations.**[42] The poor and vulnerable are most at risk to the impact of exogenous shocks, have the least means to respond, and may find it difficult to finance basic needs if already low incomes are further reduced (para. 19). The impact on the poor will be compounded by the 2022 floods. Government initiatives supported by the proposed program will help mitigate price and income shocks, especially for vulnerable groups such as the poor and women and girls, most of whom have also been affected by the 2022 floods. Measures targeted at poor households include social protection initiatives that will provide additional social assistance transfers to 9 million poor households. Food security measures supported by the program will help low-income farmers and growers increase their agricultural production and will ensure that the prevalence of severe food insecurity in the total population does not increase above the pre-pandemic level. Tax exemptions and cost control measures will be applied to food and other items to lower the net cost, which will benefit poor households.

37. **Gender.** The program is categorized *effective gender mainstreaming* and focuses on mitigating negative effects of crises caused by macroeconomic vulnerabilities coupled with cumulative exogenous shocks on women and girls through the CDEP. The program supports distribution of fuel subsidies to the poor, with at least 20% of the targeted population being female. The program also supports the provision of cheaper financing to women through the government's entrepreneurship and employment schemes, as at least 15% of the borrowers under these schemes are targeted toward companies owned by women. This will mitigate the loss of income for companies led by women,[43] as well as help maintain employment. CDEP measures build upon ADB support for gender empowerment through deep diagnostic work and technical assistance, concerted policy dialogue, and several projects and program loans that have helped to ensure the government's gender equality measures are (i) well developed, designed, and targeted (short-term response); and (ii) focused on improved access for women and girls to primary and secondary school education, health services, nutritional supplies, and financial services—human

[42] Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).
[43] Companies led by women are defined as companies with a female founder and/or at least one female cofounder and/or a female chief executive officer.

capital development measures that help to reduce intergenerational poverty and enhance improved employment and livelihood prospects (para. 21).[44]

38. **Safeguards.** In compliance with ADB's Safeguard Policy Statement (2009), the program is classified category C for environment, involuntary resettlement, and indigenous peoples. The program is not expected to have any adverse environmental or social safeguard impacts, and no category A or B activities are envisaged. An assessment of the program's potential impacts on safeguards is provided as a supplementary document.[45] The program will confirm such exclusions through the MOF's quarterly reporting on consolidated expenditures.

39. **Governance.** A governance risk assessment was conducted in line with the Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan.[46] No major fiduciary risks and mismanagement of public resources at the federal level have been identified.[47] ADB is (i) supporting reforms to improve cash management practices; (ii) issuing administrative rules assigning all debt management functions to the debt management office; (iii) ensuring efficient management and control of special purpose funds; (iv) establishing a cash forecasting unit to improve cash planning and management; and (v) adopting an integrated fiscal risk framework to mitigate, manage, and integrate fiscal risks into the national budget process. In addition, ADB support for BISP under its 2021 Integrated Social Protection Development Program has four disbursement-linked indicators amounting to $173 million that support the strengthening of fiduciary systems and processes (footnote 32). Other development partners such as the IMF and the World Bank are supporting reforms to improve public expenditure efficiency, improve procedures for supplementary grants, disclose fiscal risks and contingent liabilities in the national budget, and improve the efficiency of public investments. M&E arrangements (para. 35) will also include financial audits of the CDEP.

40. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

41. **Risk mitigating measures.** Major risks and mitigating measures are summarized in Table 3 and described in detail in the risk assessment and risk management plan.[48]

**Table 3: Summary of Risks and Mitigating Measures**

| Risks | Mitigation Measures |
|---|---|
| The crisis continues beyond projected time frames, resulting in increased hardship, employment and income losses, and poverty. | The government has set up a dedicated institutional framework for monitoring and responding to the crisis with appropriate countermeasures as it evolves. Monitoring and evaluation of the ADB is embedded in the government's institutional coordination mechanism. ADB and the government will be jointly monitoring the program and its impact. ADB will also work with the International Monetary Fund and other development partners to support the government as the situation evolves. |

[44] ADB. 2019. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan to the Islamic Republic of Pakistan for Subprogram 1 of the Trade and Competitiveness Program*. Manila; and ADB. 2020. *Report and Recommendations of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loans to the Islamic Republic of Pakistan for Subprogram 1 of the Third Capital Market Development Program*. Manila.
[45] Safeguard Assessment Matrix (accessible from the list of linked documents in Appendix 2).
[46] ADB. 2008. *Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.
[47] The approval of amendments to the Public Finance Act 2019 in June 2020 strengthened the credibility and transparency of the fiscal and fiduciary arrangements.
[48] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

| Risks | Mitigation Measures |
|---|---|
| Compounded crises, including the recent floods, strain government capacity for timely implementation of its programs. | ADB will coordinate closely with the government and other development partners to support the implementation of the countercyclical development expenditure program. Where necessary, ADB will repurpose ongoing technical assistance (TA) and mobilize new TA resources to strengthen (i) the Ministry of Finance's capacity for program execution, monitoring and evaluation, and improved data collection and reporting; and (ii) the availability of sex-disaggregated data. ADB will also strengthen government capacity to manage complex shocks, including climate shocks through its broader Paris aligned investments in Pakistan. |
| Prolonged economic slowdown and political tensions shift the government's focus away from implementing key structural reforms related to macroeconomic management, gender equality and women's empowerment, domestic resource mobilization, public financial management, state-owned enterprise governance, and public–private partnerships. | Coordinated efforts by ADB and other development partners will promote continuity of structural reforms through (i) policy dialogue, (ii) the provision of targeted support to new programs and/or projects and the monitoring of existing ones, and (iii) capacity building TA. |

Source: ADB.

## IV. ASSURANCES

42. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement, as described in detail in the draft loan agreements.

## V. RECOMMENDATION

43. I am satisfied that the proposed countercyclical support facility loans would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve:

(i) the loan of $1,250,000,000 to the Islamic Republic of Pakistan for the Building Resilience with Active Countercyclical Expenditures Program, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's Flexible Loan Product plus 75 basis points; for a term of 7 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board; and

(ii) the loan of $250,000,000 to the Islamic Republic of Pakistan for the Building Resilience with Active Countercyclical Expenditures Program, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 2% per year during the grace period and thereafter; for a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa
President

28 September 2022

## DESIGN AND MONITORING FRAMEWORK

| **Country's Overarching Development Objectives** |
|---|
| Macroeconomic management strengthened, and sustained and inclusive growth supported (Pakistan 2025: One Nation, One Vision)[a] |

| Results Chain | Performance Indicators with Targets and Baselines | Data Sources and Reporting Mechanisms | Risks and Critical Assumptions |
|---|---|---|---|
| **Outcomes**<br>Adverse socioeconomic effects of the crisis mitigated, and resilience of poor and vulnerable groups enhanced | a. By June 2024, inflation declines to the State Bank of Pakistan's target range of 5%–7% (June 2022 baseline: 12.2%) (OP 6.1.3)<br><br>b. By June 2024, number of female heads of poor families that have received unconditional cash transfers have increased by 15%. (June 2022 baseline: 7.8 million) (OP1.1, 1.1.3, 2.5) | a.–b. State Bank of Pakistan and MOF quarterly macroeconomic and fiscal reports | A: The surge in global prices of essential commodities eases<br><br>R: The crisis continues beyond projected time frames, resulting in increased hardship, unemployment and income losses, and poverty |
| **Outputs**<br>1. Increased social protection measures implemented | 1.1 By June 2023, unconditional cash transfers are provided to an additional 1 million female heads of poor families, with total female beneficiaries reaching 9 million[b] (June 2022 baseline: total beneficiaries: 7.8 million households) (OP 1.1, 1.1.3, 2.5.4, 3.2)<br><br>1.2 By June 2023, an additional 10,000 students are provided BISP undergraduate scholarships, of which at least 50% students are female (June 2022 baseline: NA) (OP 1.1, 1.1.3, 2.5.4)<br><br>1.3 By June 2023, conditional cash transfers for health and nutrition are extended to 159 districts nationwide for pregnant and lactating mothers and children under 2 years of age (June 2022 baseline: coverage restricted to 14 districts) (OP 1.1, 1.1.2, 1.1.3, 2.5.4) | 1.1–1.4 MOF quarterly progress reports and BISP annual reports | A: Government sustains implementation of its fiscal reform commitments under the Extended Fund Facility<br><br>R: Delays in the execution of the countercyclical development expenditure program are caused by increasing fiscal difficulties as the crisis continues beyond projected time frames or new crises emerge such as the September 2022 floods<br><br>R: Prolonged economic slowdown and political tensions shift the government's focus away from implementing key structural reforms related to macroeconomic management, gender equality and women's empowerment, domestic resource |

| Results Chain | Performance Indicators with Targets and Baselines | Data Sources and Reporting Mechanisms | Risks and Critical Assumptions |
|---|---|---|---|
| | 1.4 By June 2023, an additional 2 million children are enrolled in conditional cash transfer for education at the primary, secondary, and higher secondary levels (June 2022 baseline: 6 million enrolled) (OP1.1, 1.1.3) | | mobilization, public financial management, state-owned enterprise governance, and public–private partnerships |
| 2. Increased food security measures implemented | 2.1 By June 2023, the government has provided a subsidy of at least PRs17 billion for the Utility Stores Corporation (June 2022 baseline: PRs6 billion allocation) (OP 1.1.3)<br><br>2.2 By June 2023, the government has provided a subsidy on the import of urea and fertilizer of PRs6 billion (June 2022 baseline: NA) (OP 5.1)<br><br>2.3 By June 2023, the import of all seeds is exempted from the application of sales tax (June 2022 baseline: NA) (OP 5.1) | 2.1–2.3 MOF quarterly progress reports | |
| 3. Enhanced support for business implemented | 3.1 By June 2023, commercial banks disburse loans worth PRs45 billion under the government's employment and entrepreneurship schemes to companies, of which at least 15% are led by women[c] (March 2022 baseline: PRs25 billion, 11.6% companies led by women) (OP 2.1.3)<br><br>3.2 By June 2023, the government has provided PRs60 billion in fuel and power subsidies to export-oriented sectors (June 2022 baseline: PRs36 billion allocation) (OP 7.2) | 3.1–3.2 MOF quarterly progress reports | |

| |
|---|
| **Key Activities with Milestones**<br>Not applicable<br><br>**Budget Support**<br>Asian Development Bank: $1,500,000,000 ($1,250,000,000 ordinary capital resources and $250,000,000 concessional ordinary capital resources) |

A = assumption, BISP = Benazir Income Support Programme, GDP = gross domestic product, MOF = Ministry of Finance, NA = not applicable, OP = operational priority, R = risk.

[a] Government of Pakistan; Ministry of Planning, Development and Reform; Planning Commission. 2015. *Pakistan 2025: One Nation, One Vision*. Islamabad.

[b] Poor households are identified through the National Socio-Economic Registry, that is, a household is defined as "people living and dining together." Hence, a single household may comprise multiple families (nuclear families). But BISP defines "family" as having an "ever-married woman" in the household, i.e., a married woman with or without children, or a widow or divorcée with or without children. Hence, while eligibility is based on households, benefits are paid to all ever-married women in the identified poor households.

[c] Women-led companies are defined as companies with a female founder and/or at least one female co-founder and/or a female Chief Executive Officer.

**Contribution to Strategy 2030 Operational Priorities**

OP indicators to which this operation will contribute results are detailed in Contribution to Strategy 2030 Operational Priorities (accessible from the list of linked documents in Appendix 2).

Source: Asian Development Bank.

## LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=56148-001-3

1. Loan Agreement: (Ordinary Operations)
2. Loan Agreement: (Ordinary Operations [Concessional])
3. Contribution to Strategy 2030 Operational Priorities
4. Development Coordination
5. International Monetary Fund Assessment Letter[1]
6. Summary Poverty Reduction and Social Strategy
7. Program Economic Assessment
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items
10. Debt Sustainability Analysis
11. Monitoring and Evaluation Framework

**Supplementary Documents**

12. Gender Monitoring Matrix
13. Safeguards Assessment Matrix
14. Government's Countercyclical Expenditure Measures

[1] The International Monetary Fund confirmed that the attached International Monetary Fund Country Report No. 22/288 dated 1 September 2022 may serve as the International Monetary Fund assessment letter.

# DEVELOPMENT POLICY LETTER

No. 415(1)-FM/2022

Miftah Ismail
Minister for Finance and Revenue

ISLAMABAD

September 14, 2022

Dear Mr. President,

**Subject: <u>Building Resilience with Active Countercyclical Expenditures Program</u>**

On behalf of the Government of the Islamic Republic of Pakistan, I would like to thank the Asian Development Bank (ADB) for its trusted partnership to Pakistan over the years, and in particular the support for structural reforms aimed at addressing macroeconomic imbalances and improving Pakistan's medium-to long-term economic growth prospects.

We are also grateful for the unprecedented and timely support that ADB extended during the pandemic through the COVID-19 Active Response and Expenditure Support Program (CARES) and in augmenting support with IMF Extended Fund Facility in 2019 through Economic Stabilization Program (SPBL).

Pakistan's economy was poised to recover from the COVID-19 pandemic but has been subjected to cumulative shocks from sharply rising international commodity prices due to global supply disruptions and the Russian invasion of Ukraine. Not only is the high inflation, currency depreciation, depleting foreign exchange reserves, rising food insecurity, and poverty impacting millions of Pakistan, but the market conditions have also led to limited access to financial markets for the government. The situation is further exacerbated by flooding in various parts of the country, which will not only result in a loss of agricultural productivity and economic growth but also compound the issue of food insecurity in some provinces.

The Government has adopted various countercyclical expenditure and relief measures under (i) social protection, (ii) food security, and (iii) business support especially to the entrepreneurs and export-oriented sectors such as textile, leather, carpets, surgical goods, and sports goods. These measures build on existing crisis response platforms such as the Benazir Income Support Program for social protection and entrepreneurship and employment schemes. You will note that gender mainstreaming is a central theme in the social protection and relief measures.

Please refer to the Table below for details:

**Table : Countercyclical Development Expenditure Plan (FY2023)**

| | PR millions |
|---|---|
| **Social Protection** | **369,778** |
| Benazir Income Support Program | 364,078 |
| *Unconditional cash transfer* | *240,100* |
| *Fuel subsidy scheme* | *48,000* |
| *Conditional cash transfer for education* | *35,320* |
| *National Socio-economic registry* | *1,703* |
| *Undergraduate scholarship* | *9,270* |
| *Conditional cash transfer for health and nutrition* | *21,480* |
| *Employee related expenses* | *3,578* |
| *Administration and other program expenditure* | *4,627* |
| Bait-ul-Maal | 3,700 |
| Pakistan Poverty Alleviation Fund | 2,000 |
| | |
| **Food Security** | **71,000** |
| PASSCO | 7,000 |
| Utility Stores Corporation | 17,000 |
| Fertilizer plant subsidy | 15,000 |
| Subsidy for import of urea or fertilizer | 6,000 |
| Agriculture relief initiatives | 10,000 |
| Sales tax exemptions on import of seeds and tractors | 16,000 |
| | |
| **Support for Businesses** | **70,000** |
| Entrepreneurship and employment schemes | 10,000 |
| Support for export-oriented industries | 60,000 |
| *Subsidy for electricity* | *20,000* |
| *Subsidy for RLNG* | *40,000* |
| | |
| **Total** | **510,778** |

While the above countercyclical development expenditure plan was prepared before the ongoing floods in the country, the plan remains valid as it utilizes the government's tried and tested mechanisms for crises response and social protection. The planned expenditures may need to be increased once the impact of the floods and damage assessment is completed.The measures above are being taken in conjunction with tightening fiscal and monetary measures, that is, while the government has increased the funding and outreach for targeted countercyclical measures as above, it has also withdrawn general and non-targeted fuel and power subsidies. Moreover, the central bank has increased interest rates by 800 basis points since September 2021 to control inflation.

As you are aware, the government is under an IMF program since 2019, and is committed to complete the ongoing program successfully by June 2023. The structural reforms under the IMF program have financial implication in the form of adjustment cost which requires support from other development partners not only to maintain the momentum of ongoing structural reforms but also to create fiscal space to effectively execute the anti-crisis package.

We request ADB's participation in supporting Pakistan's countercyclical measures. The government appreciates ADB's \$1.5 billion assistance for the BRACE Program to partly finance the countercyclical expenditure plan outlined above. The plan is already under implementation, thus showing high readiness to receive funds. The program implementation follows high governance standards based on an established reporting system. The government remains fully committed to its development agenda of the above program.

Yours sincerely,

(MIFTAH ISMAIL)

Mr. Masatsugu Asakawa
President
Asian Development Bank
Manila - Philippines

## ASSESSMENT OF COMPLIANCE WITH THE ACCESS CRITERIA FOR THE COUNTERCYCLICAL SUPPORT FACILITY

| Access Criteria | Asian Development Bank Assessment |
|---|---|
| 1. Adverse Impact of Exogenous Shocks. | The crisis triggered by the post- COVID-19 pandemic surge in international commodity prices and the Russian invasion of Ukraine has several negative spillovers for Pakistan. Fiscal adjustment and monetary tightening are expected to suppress domestic demand and curtail economic activity in FY2023. Fiscal adjustment and monetary tightening are expected to suppress domestic demand in FY2023 and add more stress to businesses and households. The key policy rate has been raised by more than 800 basis points since September 2021, reflecting continued monetary tightening underway since late last year, which aims at ensuring a soft landing of the economy amid an exceptionally challenging and uncertain global environment. This demand contraction, together with capacity, and input constraints caused by higher import prices and the large depreciation of the Pakistan rupee, will reduce industrial output and import demand, alleviating some of the pressure from the current account deficit. Inflationary pressures had been accumulating since the second quarter of FY2022. A steep rise in inflation occurred in the last quarter from the pass-through effects of fuel and electricity subsidy removal, significant rupee depreciation, and the surge in international commodity prices from geopolitical tensions. As a result, inflation spiked to 21.3% year-on-year in June 2022, its highest level since 2008, lifting average headline inflation for FY2022 to 12.2% from 8.9% a year earlier. Inflation continued to accelerate to 24.9% in July and 27.3% in August. The surge in inflation was broad-based, with food and non-food price indices both recording double-digit increases. Prices of essential commodities are expected to increase further because almost one-third of the country has been affected by the floods and domestic supply chains are affected. Food insecurity is further compounded by the severe damage to all major crops during the recent floods. Moreover, farms remain inundated impeding the preparation for the upcoming sowing season, particularly of the wheat crop. The consolidated fiscal deficit of the federal and provincial governments stood at 3.8% of GDP during the first nine months of FY2022, 0.8% higher than in the comparable period of FY2021, reflecting decreased levies on petroleum products and increased petroleum subsidies in the wake of the global oil price shock. The primary balance posted a deficit equivalent to 3.1% of GDP during FY2022, up from a deficit of 1.2% in FY2021. Revenue collection slipped by 0.4% to 12.0% of GDP in FY2022 as a large decline in non-tax revenue outweighed strong tax collections. Total expenditure increased to 19.9% of GDP during FY2022 from 18.5% of GDP a year earlier, owing to the aforementioned subsidies and development spending. The fiscal stress will compound further due to the floods as economic activity and government revenues decline, while government spends more on relief operations. The government continues to face fiscal constraints with the aggravation of the crisis in FY2023. The current account deficit as a percent of GDP jumped more than fivefold from the previous year. The current account deficit registered $17.4 billion (4.6% of GDP) during FY2022 compared to a deficit of $2.8 billion (0.8% of GDP) in FY2021. About 75% of the increase came from a widening in the merchandise trade deficit to 10.5% of GDP during FY2022 from 8.2% in FY2021. Furthermore, the Pakistan rupee depreciation accelerated since the beginning of 2022, which increased the cost of imports. The currency depreciated against the US dollar by about 30% since January 2022, exceeding PRs240 per the dollar on 1 August 2022. Since then, the Pakistan rupee has strengthened slightly. On 31 August 2022, the exchange rate was recorded as PRs218.8 per dollar. Moody's revised Pakistan's outlook from Stable to Negative in June, followed by Fitch and S&P's downgrading of the same in July 2022. The rating agencies maintain that the revision of the outlook to Negative reflects a significant deterioration in Pakistan's external liquidity position due to higher commodity prices, rupee depreciation, and tighter financing conditions since early 2022. Even though Fitch and S&P assume IMF board approval of the 7th and 8th review of the EFF program in September, which has eventuated, they see considerable risks to its implementation. External resources are likely to remain |

| Access Criteria | Asian Development Bank Assessment |
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| | under pressure in a challenging economic and political climate. Businesses and households are under significant pressure. The costs of doing business and living have surged in FY2023. Higher LNG prices increased by 76% and added $1.7 billion to the current account deficit in the first 10 months of FY2022. The increase in the prices of edible oil and fertilizer added $1.25 billion to Pakistan's imports in the same period. In June 2022, household utility prices increased by 13.5% (year-on-year [y-o-y]), transport prices increased by 62.2% (y-o-y) and food prices increased by 25.9% y-o-y. Modeling of the impact of the macroeconomic crisis on poverty levels in Pakistan concluded that headline poverty ($3.2 per day per person) is projected to increase from 38% in FY2021 to 40% in FY2022, and further to 42.8% in FY2023, an increase of more than 10 million people since FY2021. Poverty levels are likely to further worsen as early estimates indicate that the 2022 floods have affected 33 million people while half a million have become homeless. Without expanded social and economic support to counter high inflation, decreasing economic activity, and reduced job opportunities, including for women, poverty in Pakistan will worsen. GDP growth in FY2023 is expected to drop to 3.5% from 6.0% in FY2022, and will be further impacted due to the social and economic impact of the 2022 floods, which has significantly affected various parts of the country.[a] In addition, according to the preliminary estimates following the government's rapid assessment, public expenditure is likely to increase although the size of the increase will become clearer after the multi-donor PDNA is completed in mid-to-late October 2022. |
| 2. Countercyclical Development Expenditures Program | The government introduced targeted measures and reprioritized expenditures to help cushion the impact of the cumulative exogenous shocks to the economy, businesses, and households. A total allocation of $2.3 billion was allocated for countercyclical expenditure measures. Of this amount, $1.1 billion was allocated for increasing the number of beneficiaries for cash transfer programs under the BISP, Pakistan's flagship social protection program and $219 million to fund PRs2,000 (around $10) per month to 2 million families with monthly income of PRs40,000 (around $85) per month. $324 million was allocated for food security measures including: (i) subsidies for PASSCO to ensure availability and price uniformity of wheat, fertilizer plants that are operating on LNG to reduce the price of fertilizer, and imports of urea to supply imported fertilizer at uniform prices, (ii) PRs17 billion ($78 million) to USC to enable poor households to afford basic food commodities such as edible oil, flour, and pulses (beans, peas, and lentils), and (iii) agriculture relief package to promote smart agriculture, provide quality seeds, and increase agriculture exports. In addition, $46 million was allocated for the entrepreneurship and employment schemes of the government, and $274 million to subsidize RLNG and electricity for exporters in five export-oriented sectors. The CDEP utilizes the government's tried and tested mechanisms for crises response, is expected to remain substantially intact, and will be implemented as the need for increased social protection, food security, and support for business will be even more pronounced in the face of the 2022 floods. |
| 3. Pre-shock Record of Generally Sound Macroeconomic Management | The country loosened monetary and fiscal policies as a countermeasure against the economic impact of the COVID-19 pandemic. These accommodative policies supported allowed economic activity to continue, expansion of the national cash transfer program, deployment of a mass vaccination campaign, and, overall, helped mitigate the adverse socio-economic impacts of the pandemic. Consequently, the economy registered a robust 6.0% growth rate in FY2022. This followed a strong rebound from a contraction of 0.9% in FY2020 to growth of 5.7% in FY2021. Growth in agriculture increased to 4.4% in FY2022 from 3.5% a year earlier. Complementing the performance in agriculture was continued robust growth in industry, led by strong, and broad-based growth in large-scale manufacturing. Services also grew strongly, led by wholesale, and retail trade and transport and storage. Private consumption expanded by 10% in FY2022, reflecting improved employment conditions, and household incomes. Investment growth decelerated during FY2022, despite a noticeable increase in public investment associated with government efforts to expand infrastructure and affordable housing. The fiscal deficit widened |

| Access Criteria | Asian Development Bank Assessment |
|---|---|
| | in FY2022—from 6.1% of GDP in FY2021 to 7.9% of GDP in FY2022.[b] The consolidated fiscal deficit of the federal and provincial governments stood at 3.8% of GDP during the first nine months of FY2022, 0.8% higher than in the comparable period of FY2021, reflecting decreased levies on petroleum products and increased petroleum subsidies in the wake of the global oil price shock. The primary balance posted a deficit equivalent to 0.8% of GDP during July–March FY2022, reversing an equivalent surplus during the same period last year. Revenue collection slipped by 0.2 percentage points to 8.8% of GDP in the first nine months of FY2022 as a large decline in non-tax revenue outweighed strong tax collections. Total expenditure increased to 12.6% of GDP during July–March FY2022 from 11.9% of GDP a year earlier, owing to increases in fuel and electricity subsidies and development spending. Domestic borrowing financed 61.7% of the fiscal deficit, with 41.0% from the banks and 20.7% from non-bank sources. External borrowing financed the remaining 38.3%. However, the significant fiscal stimulus and delayed monetary tightening have fueled domestic demand to unsustainable levels.[c] Worsening external conditions, due to spillovers from Russian invasion of Ukraine, are compounding domestic challenges (refer point 1, above). Fiscal adjustment and monetary tightening in response to worsening macroeconomic imbalances and soaring inflation are expected to suppress domestic demand, and demand contraction, together with capacity and input constraints caused by higher import prices from the large depreciation of the Pakistan rupee, will slow business activity and reduce output in the industry. |
| 4. Structural Reforms | Longstanding structural weaknesses in the economy can be traced back to import substitution policies that have kept trade tariffs high but which, over time, have undermined export competitiveness, and performance. Consequently, economic growth has been characterized by decades of boom-and-bust cycles. These weaknesses have compounded the impact of exogenous shocks to the economy. In 2019, the IMF approved a $6.0 billion EFF for Pakistan to help shore up the balance of payments and facilitate improved macroeconomic management. ADB and other development partners have aligned and coordinated their support for macroeconomic management with the objectives of the EFF and, consequently, major structural reforms are underway to address poor export performance, low-savings investment rates, low tax yields, heavy reliance on external finance, rising power sector circular debt, and high indebtedness. Between 2022–2023, ADB has policy-based loans and sector development programs in support of (i) energy sector reforms to address financial, technical, and governance deficits in the energy sector that adversely impact sector sustainability and affordability such as circular debt; (ii) social protection reforms to support institutional strengthening of BISP and enhance and expand conditional cash transfer programs in support of education, health services and nutritional supplies; (iii) domestic resource mobilization reforms to address major binding constraints to mobilize larger resources to enhance productive investment through reforms to tax administration and compliance, cash and public debt management, and mobilizing greater domestic savings and foreign direct investment; (iv) public–private partnership reforms to improve the enabling environment for infrastructure financing and public–private partnerships at the federal level and, in doing so, attract private finance for infrastructure investments in priority sectors such as roads, housing, health, education, water and sanitation, and technology; (v) state-owned enterprise reforms to improve corporate governance and commercial performance through improvements to the legal, policy, and institutional environment, as well as accelerate state-owned enterprise transformation (from restructuring to management contracts to privatization); (vi) trade and investment competitiveness reforms to recover Pakistan's current account deficit in a sustained manner and promote macroeconomic stability by facilitating improved trade competitiveness and exports; (vii) women's inclusive finance reforms to address women's access to finance challenges in Pakistan through a combination of women centered policy reforms, along with de-risking and unlocking liquidity to mobilize finance to women beneficiaries; and (viii) capital markets development reforms to broaden and deepen the financial system in Pakistan and |

| Access Criteria | Asian Development Bank Assessment |
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| | ground it in a strong legal and regulatory framework. Government appetite for sustaining structural reforms is high and, unlike previous similar situations, there is strong, broad-based, support for completing the IMF program and ongoing development partner-supported structural reforms in order to unlock concessional development partner financing, restore market confidence, create the fiscal space needed to provide targeted social protection measures, and staying the course on structural reforms to improve medium-to long-term economic growth prospects. |
| 5. Debt Sustainability | According to DSA published by IMF in September 2022, Pakistan's debt is assessed as sustainable.[d] Pakistan's public debt continues to be judged as sustainable with strong policies and robust growth, but with greater uncertainty, in part because the fiscal relaxation in the second half of FY2022 prevented the debt ratio reduction projected at the time of the sixth review. The debt-to-GDP ratio is now projected to rise from 77.9% at end-FY2021 to 78.9% at end-FY2022 before falling to around 60% by end-FY2027, assuming the adjustment efforts in the context of the EFF program are fully carried out. While GFN remain elevated over the near term amid sizeable fiscal deficits and limited progress in lengthening maturities, GFNs are projected to decline over the medium term—reflecting programmed fiscal consolidation and efforts to enhance cash and debt management—reaching 17.2% of GDP by FY2027. Higher interest rates, a larger-than-expected growth slowdown due to policy tightening, pressures on the exchange rate, renewed policy reversals, slower medium-term growth, and contingent liabilities related to SOEs pose significant risks to debt sustainability. The report also highlights that as foreign exchange reserves have fallen to about 1.5 months of imports at the end of June 2022, the government remains committed to rebuilding reserves to more prudent levels through greater exchange rate flexibility, imposing import bans on luxury and nonessential items, building reserve buffers, and maintaining commitment to the EFF, which will help build market confidence and resolve external imbalances. ADB's DSA corroborates these findings and projects the public and external debt to remain sustainable. The analysis, however, points out that the debt trajectory remains vulnerable to macro-fiscal shocks. If the key variables: real GDP growth, interest rate, inflation, and primary balance, deteriorate significantly, the public debt-to-GDP ratio will breach the debt threshold. Likewise, exchange rate depreciation and rise in the current account deficit has the potential to jeopardize the external debt sustainability. The DSA confirmed that Pakistan's overall public debt position was sustainable even after factoring in the impacts of the surge in international commodity prices and additional borrowings including the $1.5 billion under the proposed program. |
| 6. Coordination with the International Monetary Fund | ADB is consulting and coordinating closely with IMF. ADB held several consultations with the IMF regarding the assessment of the crisis and the proposed ADB support through the proposed program and other ongoing structural reforms. In addition, ADB has coordinated closely with the IMF on data and analysis, most specifically on the macro-fiscal framework and DSA. In addition to confirming that the focus of the proposed program was correct and appropriate, the IMF agreed with ADB that BISP was the most effective and efficient mechanism for social protection support. The IMF also confirmed Pakistan's sound macroeconomic management and fiscal and debt position following successful conclusion of the seventh and eighth reviews of the EFF, which allowed Pakistan to draw about $1.1 billion. While the focus of the program is to help the government respond to the current crisis rather than driving structural reforms, ADB is coordinating closely with the IMF and other development partners to ensure that progress on key structural reforms continues. ADB is also coordinating with other development partners to prepare a PDNA based on the impact of the floods. |
| 7. Monitoring and Evaluation | The main objective of the M&E framework is to (i) ensure regular and systematic reporting on countercyclical expenditure measures announced in the fiscal year FY2023 national budget, with particular focus on priority expenditure items outlined in the design and monitoring framework of the proposed program, (ii) provide a platform for coordinated and informed discussions between the government and development partners on the implementation of the countercyclical expenditure |

| Access Criteria | Asian Development Bank Assessment |
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| | measures, and (iii) continue the ongoing policy dialogue with the government on its program to address longstanding structural constraints. The M&E framework for the BRACE Program will be anchored in the ongoing M&E mechanism established by the government and strengthened in 2020 under Asian Development Bank's (ADB) COVID-19 Active Response and Expenditure Support (CARES) Program. The government, through the MOF, will monitor budget execution. The M&E framework builds on the CARES Program and is also based on the recommendations made by the Auditor General of Pakistan in its audit report on expenditure incurred for the government's COVID-19 pandemic response. The report emphasizes that strict monitoring and early identification of problem areas is critical to ensure aid effectiveness. To mitigate these challenges, it is critical that ADB maintain close ties with the MOF (executing agency) and the overall coordination group. This is more relevant when transfer payments are planned for a large group spread across the country, such as with the "Kafaalat Program" of BISP, which are unconditional cash transfers to women from the poorest families. Targeting is based on the National Socio-Economic Registry and other databases of the government, and payments will require biometric identification. The MOF will set up a Steering Committee comprised of the Secretary for Finance (Chairperson), the Secretaries for Economic Affairs, Industries and Production, Food Security and Research, and BISP, and the Executive Director for State Bank of Pakistan who will engage in high-level policy dialogue with ADB. A working group led by the Joint Secretary (External Finance), as the program coordinator, will support the Steering Committee with monitoring, evaluating, and reporting of program performance indicators, and drafting progress reports for the MOF and ADB. The progress reports will be submitted and published on the MOF website on a quarterly basis. An independent third-party survey of the countercyclical expenditure measures will be conducted 3 months after the program in June 2023. |

ADB = Asian Development Bank, BISP = Benazir Income Support Program, BRACE = Building Resilience with Active Countercyclical Expenditures, COVID-19 = coronavirus disease, DRM = domestic resource mobilization, DSA = debt sustainability analysis, EA = executing agency, EAD= Economic Affairs Division, EFF = Extended Fund Facility, FY = fiscal year, GDP = gross domestic product, GFN = gross financing needs, IA = implementing agency, IMF = International Monetary Fund, LNG = liquefied natural gas, M&E = monitoring and evaluation, MOF = Ministry of Finance, PDNA = post-disaster needs assessment, PASSCO = Pakistan Agricultural Storage & Services Corporation Ltd, PRs = Pakistan Rupee, RLNG = regasified liquefied natural gas, SBP = State Bank of Pakistan, S&P = Standard and Poor's, USC = Utilities Stores Corporation.

[a] Recent flooding in 2022 due to the excessive monsoon rain has adversely affected the low-income households in the affected areas due to a further surge in inflation and is expected to further aggravate food insecurity. While the initial impact analysis is still being carried out, the economic fallout from the floods is likely to reduce GDP growth to 2% mainly due to the direct impact of agriculture sector (approximately 3.6 million acres of crop area has also been damaged throughout the country), with the hit to rural wealth and incomes likely to spread to the industrial sector. According to the National Disaster Management Authority, approximately 1.7 million houses have been damaged or destroyed countrywide, as of 5 September 2022.

[b] Ministry of Finance. 2022. Pakistan: Summary of Consolidated Federal and Provincial Fiscal Operations, 2021-22. Islamabad. https://www.finance.gov.pk/fiscal/July_June_2021_22.pdf.

[c] FY2020 growth was negative, but due to the pandemic countermeasures, the economy recovered in FY2021 and FY2022. During the pandemic, the Pakistan government successfully negotiated the external debt rollover to G20 and "friendly" non-Paris club members. One of the external debt restructurings was to make debts medium- to long-term.

[d] https://www.imf.org/en/Publications/CR/Issues/2022/02/04/Pakistan-2021-Article-IV-Consultation-Sixth-Review-Under-the-Extended-Arrangement-Under-the-512715

Source: ADB.