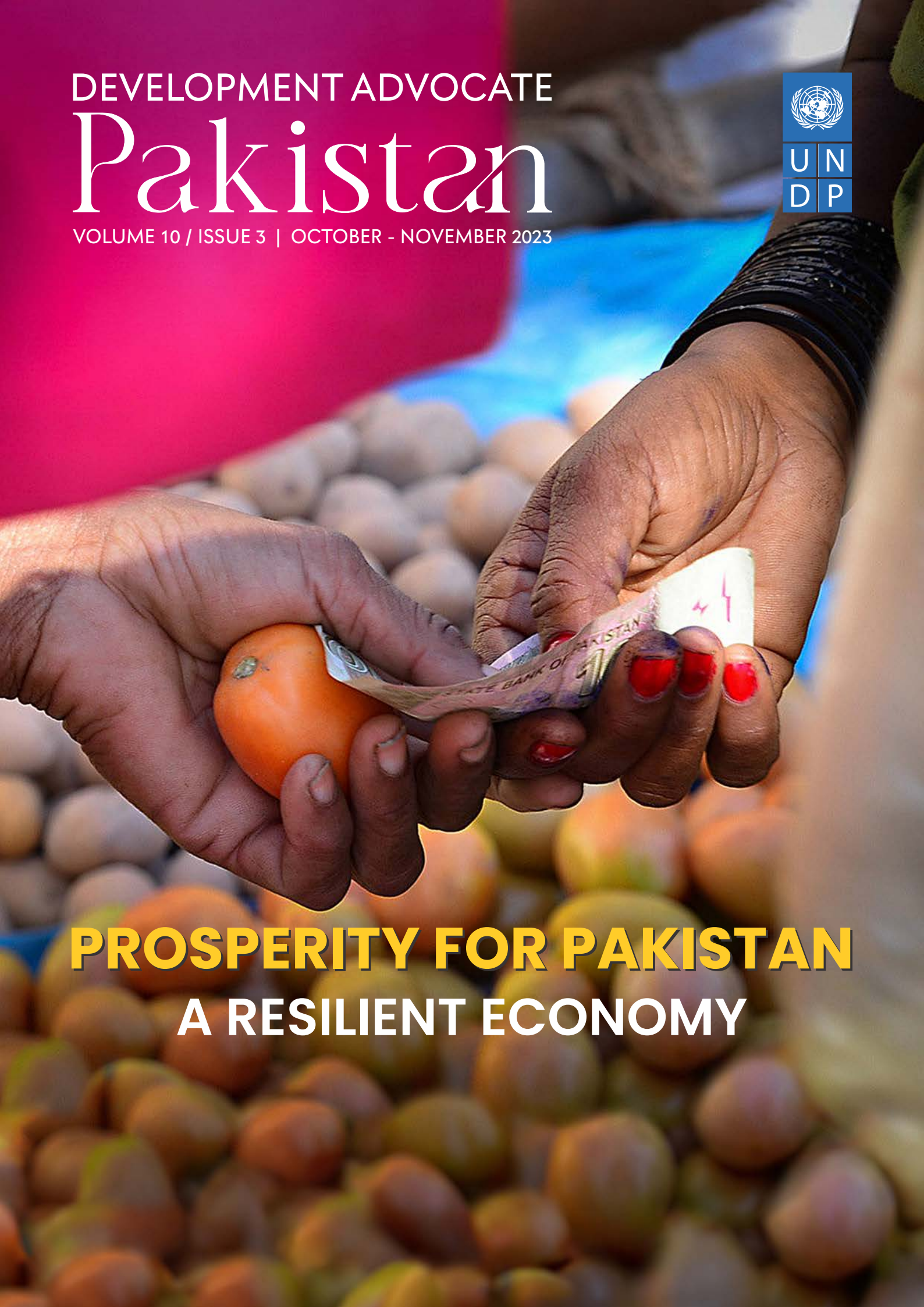


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PROSPERITY FOR PAKISTAN
A RESILIENT ECONOMY



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Development Advocate Pakistan provides a platform for the exchange of ideas on key development issues and challenges in Pakistan. Focusing on a specific development theme in each edition, this quarterly publication fosters public discourse and presents varying perspectives from civil society, academia, government and development partners. The publication makes an explicit effort to include the voices of women and youth in the ongoing discourse. A combination of analysis and public opinion articles promote and inform debate on development ideas while presenting up-to-date information.

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From Debt Crisis to Solvency: Mid-Term Outlook for Pakistan

A well thought out, well planned, and effectively implemented set of structural reforms is the only option for solvency in Pakistan.



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One of the primary drivers of Pakistan's debt challenges arises from the ineffective handling of public finances.

The debt crisis at hand

The likelihood of Pakistan's debt crisis worsening in medium term is high. The country is in a sovereign debt trap due to upcoming debt repayments, low foreign exchange reserves, high interest rates, and inadequate non-debt external inflows. This situation makes it difficult for the country to meet the principal as well as the interest payments during the next two to three years.

The external debt reached around USD 124.3 billion in June 2023, which is 42.5 percent of the GDP.¹ The overall debt-to-GDP ratio has also been rising over the last decade, reaching 78 percent in 2022. From 2000 until 2007, there was some drop in the debt-to-GDP ratio, whereas after 2007 it started to rise again and in fact skyrocketed from 2015 onwards.²

Putting problems into context

Political uncertainty, lowering of trust with global lenders, challenges in keeping the programme with International Monetary Fund (IMF) on track, and subdued overall economic activity has accentuated Pakistan's debt crisis. The short-tenor debt and its repayments are making the task of overall debt management difficult for the federal government. The country has to make repayments of USD 77.5 billion by June 2026. It is more than one fifth, 22 percent to be exact, of the country's GDP.

This challenge is rooted in the structures of economy and economic governance. One of the primary drivers of Pakistan's debt challenges is the ineffective handling of public finances. The government's weak capacities to allocate and utilise its resources efficiently have resulted in fiscal imbalances. This mismanagement frequently necessitates excessive borrowing to bridge budget shortfalls. Moreover, the absence of transparency and accountability in public financial administration exacerbates the issue, creating difficulties in monitoring how funds are allocated and utilised at the national and sub-national level.

Another substantial contributor to Pakistan's debt difficulties is the persistent problem of generating adequate revenue. Pakistan has struggled to enhance its tax revenue collection, and tax evasion remains a widespread issue. A significant portion of the population operates within the informal economy, making it challenging for the government to levy taxes on their income. This constrained revenue collection compels the government to rely on borrowing to finance its operations, consequently amplifying the national debt burden.

Pakistan's debt dilemma is aggravated by a deficiency in fiscal discipline, marked by a noticeable lack of oversight over government expenditures. Frequently, governments embark on costly initiatives without conducting thorough evaluations of their financial feasibility or taking into account their implications on the national debt. This absence of fiscal restraint in handling government spending leads to the accrual of debt without simultaneous economic growth. Consequently, Pakistan grapples with the predicament of escalating debt burdens that do not align with its objectives for economic expansion and development as often envisaged by the Planning Commission. The parliament's role in providing the oversight of government public finances is crucial but often missing.

As of now, Pakistan's debt crises can only be managed rather than solved completely. Fresh borrowing and the rollover of past debts are the main options in the immediate- to short-run. Pakistan will be relying mainly on China and the Gulf countries for these rollovers. We have seen Beijing rolling over USD 2.4 billion in July 2023 for another two years. Similarly, friendly cash deposits from Gulf countries have been rolled over in the past.

The country is also working on additional borrowing to finance its existing debt payments. But this will require not only the successful completion of the ongoing Standby Agreement (SBA) of the IMF, but another fresh programme of three years. This is essential, as we have seen external bilateral



A broker at the Karachi Stock Exchange.

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The adoption of modern financial management systems and the reinforcement of government capabilities can play a substantial role in advancing public finance management.

and multilateral finance contingent upon Pakistan's engagement with the fund. Unseen earlier, China and the Gulf lenders in 2022 and 2023 also pushed the then governments to fulfil commitments with IMF before seeking any new assistance in the form of further friendly deposits and rollovers.

Solvency will require work on economic fundamentals

While opinion is divided, the government formed after the elections of 2024 may have to make a serious assessment of its options for debt management. Short-term rollovers will not release the pressures on the fast-piling debt burden for current and future generations. They will only provide, at best, a breathing space for one to two quarters. But expectedly, the new government is likely to be hesitant on a large-scale debt restructuring for political reasons. The IMF, however, will encourage the government to design the new programme facility, keeping debt levels sustainable. This

design phase could take some time, but it is advised that to give markets the right confidence, the waiting period before which a new programme is signed with the fund should be kept as short as possible.

Debt solvency will require a working economy which attracts net positive inflows of foreign currency including exports, foreign investments, and remittances. During 2024-25 and 2025-26, the projected debt servicing is expected to be around USD 25 billion and 23 billion respectively. For this, Pakistan will need a plan that attracts non-debt creating inflows. However, it is doubtful that all three of these sources (exports, foreign investment, and remittances) will be able to keep up with the country's growing import expenses and the mounting pressure of debt repayments. The direction of global oil and commodity prices will also play a role in determining pressures on Pakistan's external account.

Most importantly, the new government has to correct the faultiness underlying the chronic debt problem. A well thought out, well planned, and effectively implemented set

1. <https://www.sbp.org.pk/ecodata/pakdebt.pdf>
 2. <https://www.worlddeconomics.com/GrossDomesticProduct/Debt-to-GDP-Ratio/Pakistan.aspx>

Debt solvency will require a working economy which attracts net positive inflows of foreign currency including exports, foreign investments, and remittances.

of structural reforms is the only option for solvency. To address the challenge of inadequate management of public finances, Pakistan should give top priority to enhancing transparency, accountability, and efficiency in its financial procedures.

The implementation of strict budgetary controls, regular audit practices, and the encouragement of fiscal responsibility can be crucial in ensuring the careful allocation and effective utilisation of public funds. Additionally, the adoption of modern financial management systems and the reinforcement of government institutions' capabilities can play a substantial role in advancing public finance management.

To tackle the revenue challenge, Pakistan should prioritise tax reforms aimed at expanding the tax base and curbing tax evasion. This may entail simplifying the tax code, adopting technology-driven tax collection methods, and providing incentives for informal sector participants to transition into the formal economy. Promoting compliance and discouraging tax evasion through more rigorous enforcement measures can also contribute to the strengthening of government revenue.

Upholding the fiscal responsibility is the most critical driver towards debt solvency. Fiscal accountability will require compliance with the Public Finance Act. Pakistan should implement stringent budget controls and adhere to clearly-defined fiscal targets, which is also in the spirit of the Fiscal Responsibility and Debt Limitation Act. It is crucial to ensure that projects undergo comprehensive assessments of their economic viability and that their funding is sustainable. All projects funded through the Public Sector Development Program or provincial Annual Development Plans should be critically appraised and monitored for timely completion and results. A commitment to fiscal prudence can help avert irresponsible borrowing and the unsustainable accumulation of debt.

In the longer term, to reduce its reliance on external borrowing, Pakistan should explore a range of financing options. This could involve promoting domestic savings, attracting foreign direct investment, and participating in public-private partnerships for infrastructure development. Diversifying funding sources can help mitigate the risks associated with excessive dependence on external loans and grants. A long-term pool of capital for development projects can be set up in the form of a sovereign wealth fund, which will carry and



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A commitment to fiscal prudence can help avert irresponsible borrowing and the unsustainable accumulation of debt.

invest revenues from natural reserves and other sources. Pakistan also needs to quickly move towards accessing funds aimed at addressing climate change and environmental sustainability. These include climate-related grants, loans, and investments from international organisations and funds.

The conclusions

Overall, Pakistan's options to resolve the ongoing debt crisis are very limited. The country is likely to continue relying on short term measures of rollovers, along with additional external borrowing, to ease debt pressure. After the ongoing SBA with IMF, a fresh 3 to 5 year programme will have to be negotiated, which could then unlock longer-term funds from multilaterals. But without correcting the underlying systemic faults producing debt crises, the country will just be delaying the problem rather than solving it.

Pakistan should embrace open budgets and participate in the Open Government Partnership (OGP), as these initiatives promote transparency, accountability, and citizen engage-

ment in public financial management. By adopting open budgets, Pakistan can enhance fiscal transparency, providing citizens with access to detailed information on government revenues, expenditures, and allocation of resources. This empowers citizens to hold the government accountable, fosters trust in public institutions, and reduces corruption. Additionally, OGP membership offers a platform for collaborative efforts with other countries, fostering innovative solutions, sharing best practices, and working towards greater efficiency and effectiveness in governance.

The newly-elected government must have a plan to tackle the debt challenge. It means a reform agenda enhancing financial management, increasing revenue, enforcing fiscal discipline, diversifying funding sources, and effectively managing debt. The parliament should provide regular oversight of treasury operations. By putting these measures into action, Pakistan can work towards achieving fiscal sustainability, diminishing its dependency on external borrowing, and ultimately fostering economic stability and growth.



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