March 28, 2024

A RAGING FIRE

PAKISTAN’S DEBT CRISIS

TABADLAB

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Table of Contents

1 PAKISTAN'S PUBLIC DEBT PROFILE

PUBLIC DEBT

EXTERNAL DEBT

DOMESTIC DEBT

DEBT MATURITIES

DEBT OWED PER CITIZEN

SOVEREIGN GUARANTEES

WHAT DOES THIS MEAN?

Key terms & concepts

GROSS PUBLIC DEBT
The sum of domestic debt, external public debt, and IMF debt

EXTERNAL DEBT
Owed to foreign creditors, in foreign currency, mostly used to gap the current account deficit (CAD)

DOMESTIC DEBT
Owed to domestic creditors in local currency, mostly used to gap the fiscal deficit

CURRENT ACCOUNT DEFICIT (CAD)
When a country's total inflows (goods and services) exceed its total outflows (exports, remittances, and foreign direct investment (FDI))

FISCAL DEFICIT
When a country's total government expenditure exceeds its total revenue (excluding borrowings)

GROSS DOMESTIC PRODUCT (GDP)
The combined economic output of a country
The GDP formula is: C+I+G+(X−M),
C = Consumption, I = Investment,
G = Government Spending,
X = Exports, M = Imports

GDP PER CAPITA
Economic output per citizen (GDP divided by population)

DEBT-TO-GDP RATIO
Compares a country's total debt to its GDP, which is one of the global indicators of fiscal health and the viability of the debt portfolio

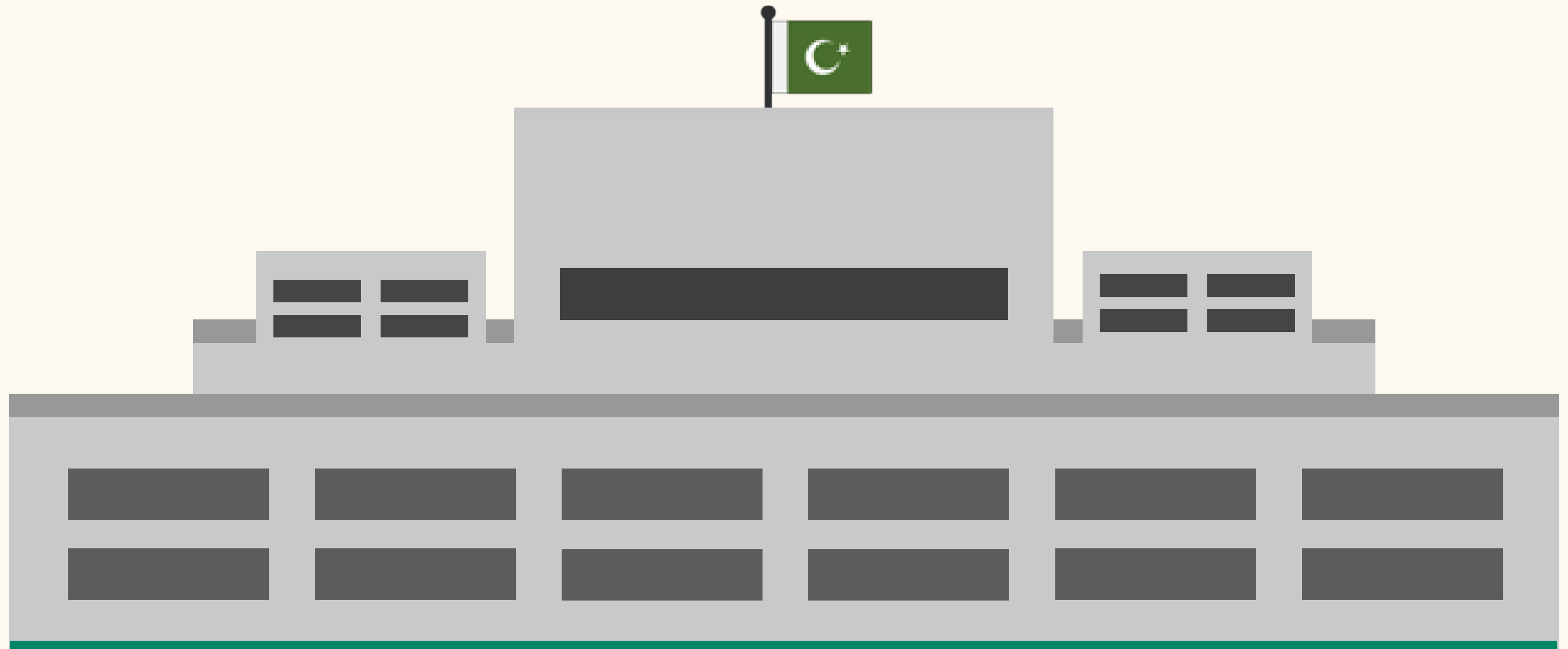
FISCAL YEAR
The government's twelve-month financial period for reporting and budgeting (e.g. 2023 means July 2022 to June 2023)

DEBT MATURITY
Length of time during which a borrowed sum must be repaid along with all applicable interest

SOVEREIGN GUARANTEES
Promises made by the government to cover the debt of a person, company, and/or project if they are unable to pay themselves

SOEs
State-owned enterprises, businesses in which the government holds ownership

PSEs
Public-sector enterprises, principally engaged in non-financial activities, owned and/or controlled by public authorities



Total Debt and Liabilities

when conducting global comparisons or quantifying external debt and liabilities, this document will use foreign currency values

Total External Debt and Liabilities

when conducting domestic comparisons or quantifying domestic debt and liabilities, this document will use the Pakistani Rupee

Total Domestic Debt and Liabilities

TABADLAB

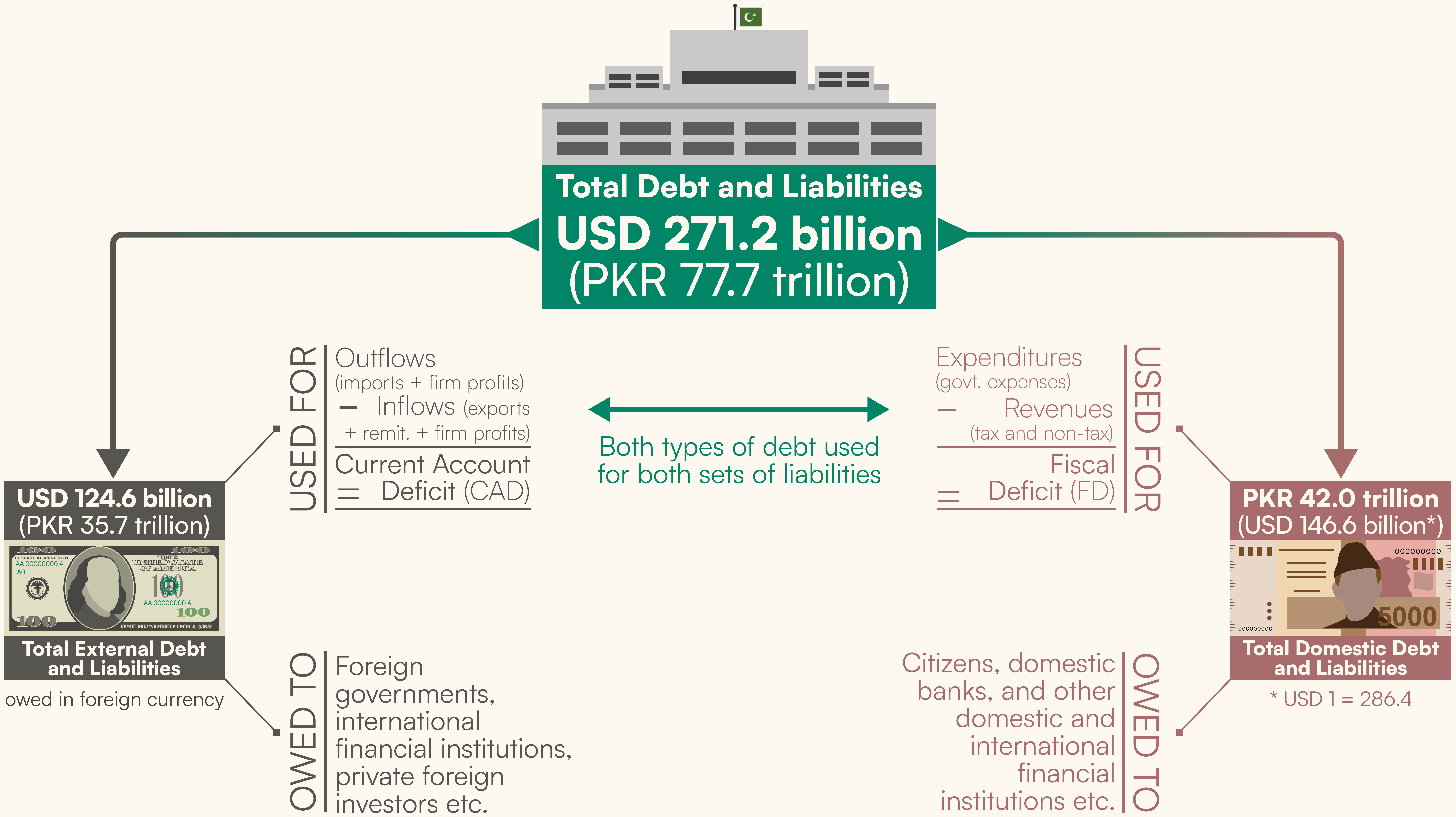
How the State Bank of Pakistan (SBP) Reports and Categorises Debt and Liabilities - 2023

No.	Category	PKR trillion	USD billion
I.	Government Domestic Debt	38.8	135.5
II.	Government External Debt	22.03	76.9
III.	Debt from IMF	2.04	7.1
IV.	External Liabilities	3.10	10.8
V.	Private Sector External Debt	5.22	18.2
VI.	PSEs' External Debt	2.15	7.5
VII.	PSEs' Domestic Debt	1.69	5.9
VIII.	Commodity Operations	1.49	5.2
IX.	Intercompany External Debt	1.14	4.0
	Total	**77.66**	**271.2**

Total Debt & Liabilities

TABADLAB

Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.



TABADLAB

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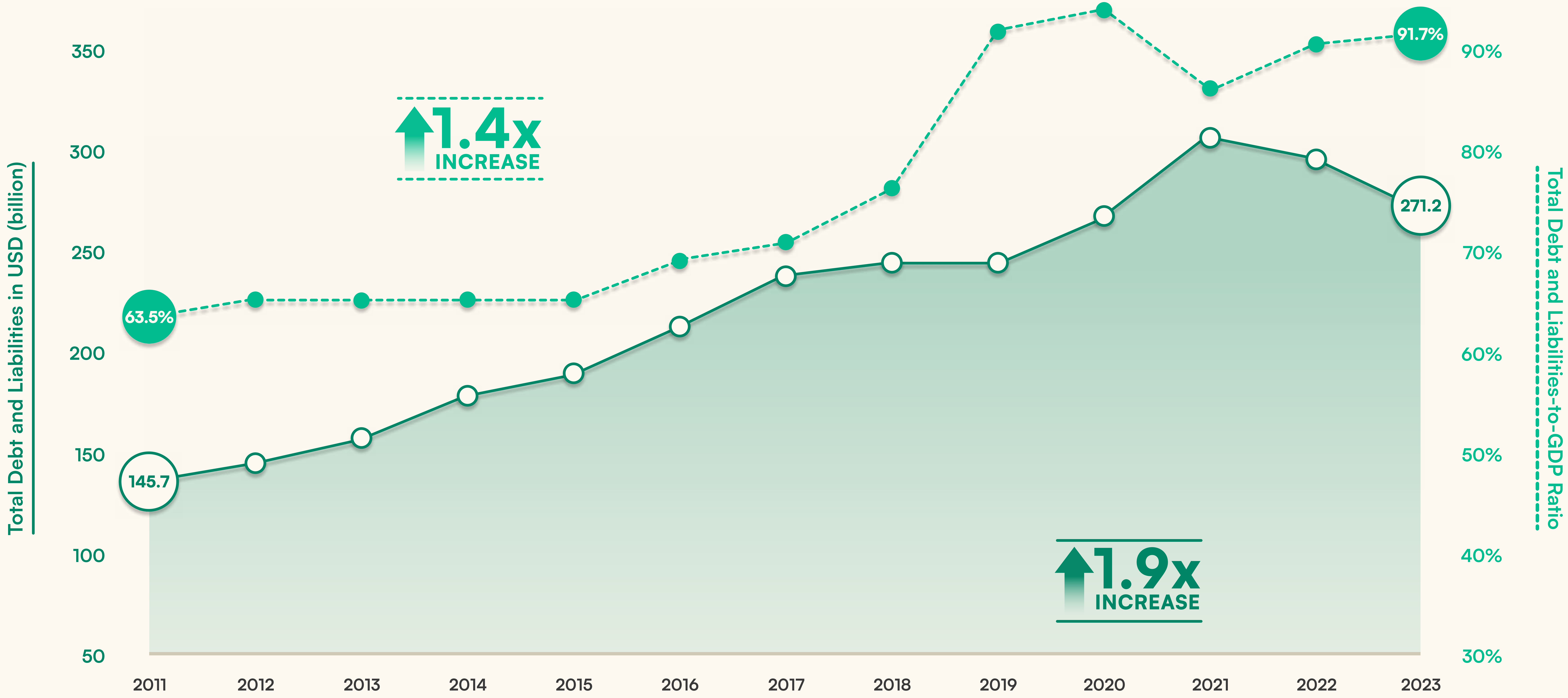
Pakistan's Total Debt and Liabilities



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VII.	PSEs' Domestic Debt	1.69	5.9	
VIII.	Commodity Operations	1.49	5.2	
IX.	Intercompany External Debt	1.14	4.0	
	Total	**62.87**	**219.6**	

TABADLAB

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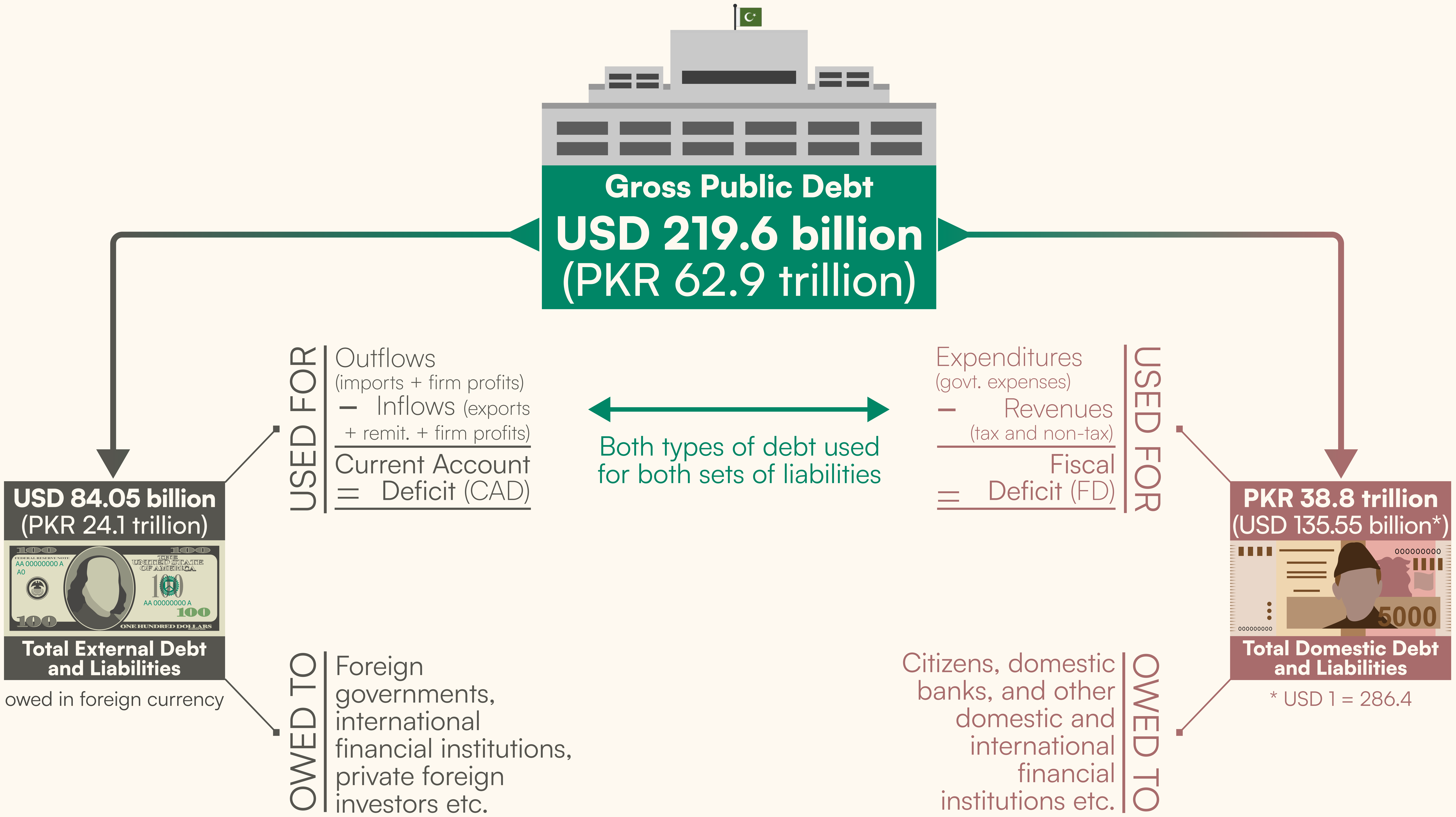
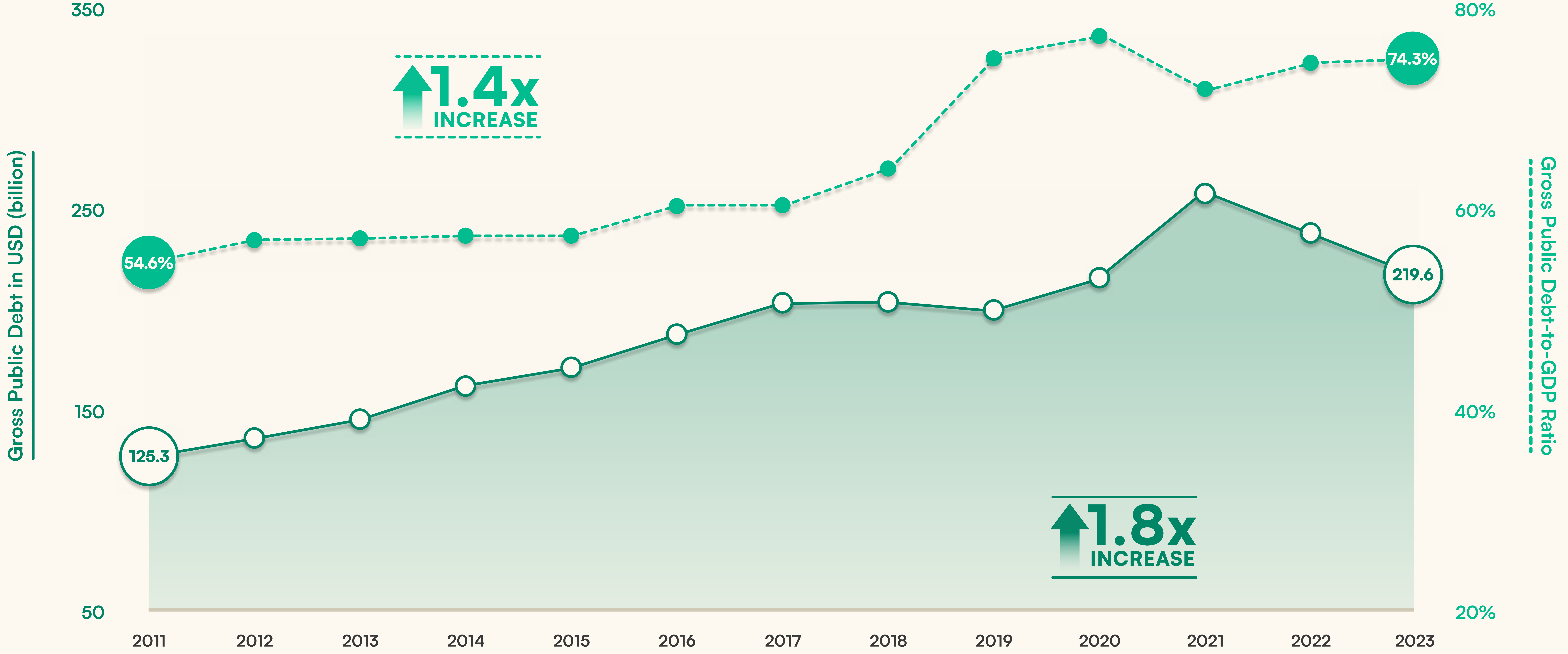


TABADLAB

Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

Pakistan's Gross Public Debt

Government Domestic Debt, External Debt, and IMF Debt
as delineated by the State Bank of Pakistan (SBP)



TABADLAB

Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls).

Debt-to-GDP Ratio Global Comparison 2023

*IMF calculates the 76.6% ratio as debt/GDP (PKR 64.8 trillion/ PKR 84.7 trillion). The former figure comprises of the gross government debt (government internal and external debt, and IMF debt), and another PKR 1.9 trillion, likely to be PSE debt.

If we were to include all of Pakistan's debt and liabilities in this calculation, they would account for an alarming 91.7% of the GDP.

TABADLAB

Source: International Monetary Fund, Data Mapper 2024, via https://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/OEMDC/ADVEC/WEOWORLD/GHA.

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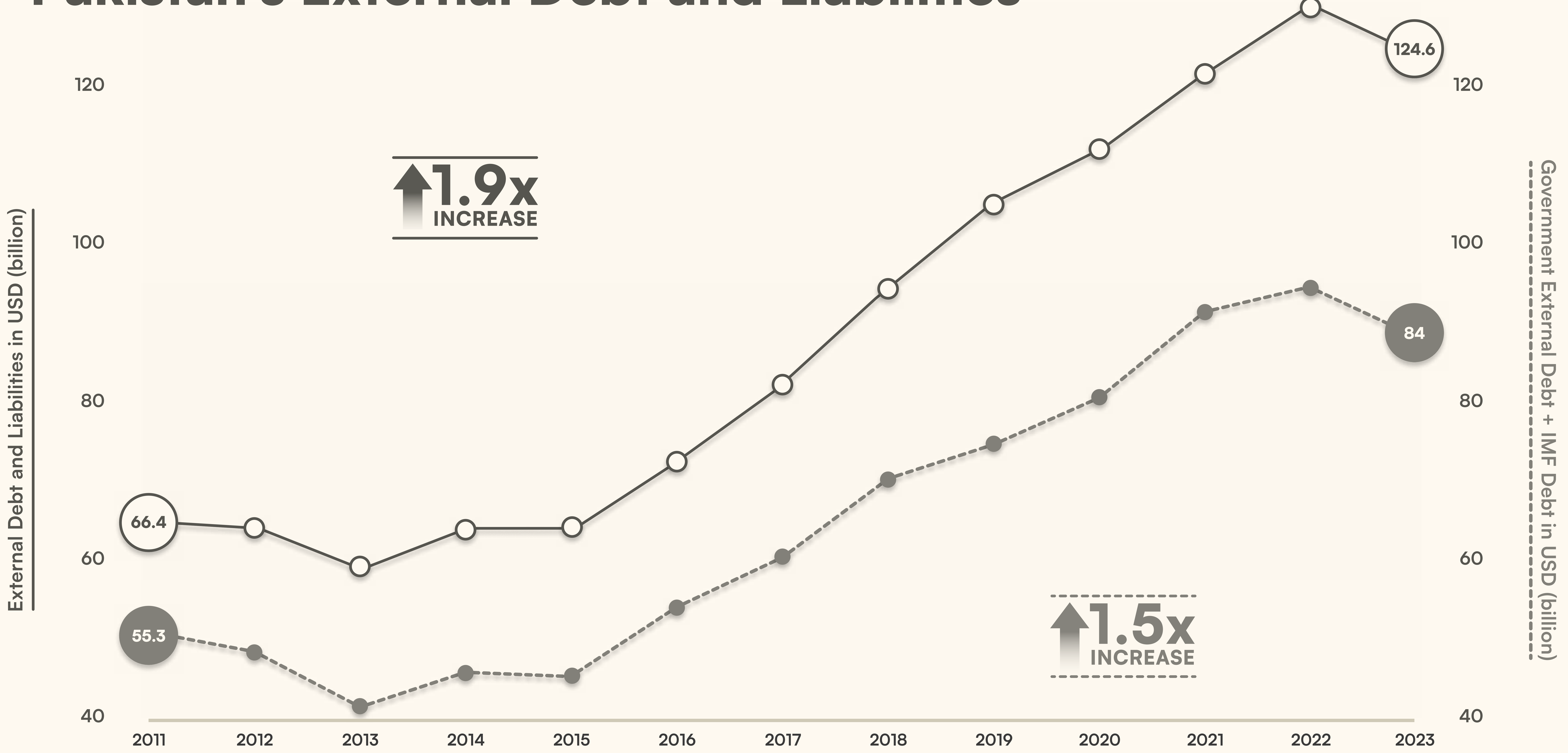
VII.	PSEs' Domestic Debt	1.69	5.9
VIII.	Commodity Operations	1.49	5.2
IX.	Intercompany External Debt	1.14	4.0
	Total	**35.68**	**124.6**

Total External Debt & Liabilities

TABADLAB

Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

Pakistan's External Debt and Liabilities



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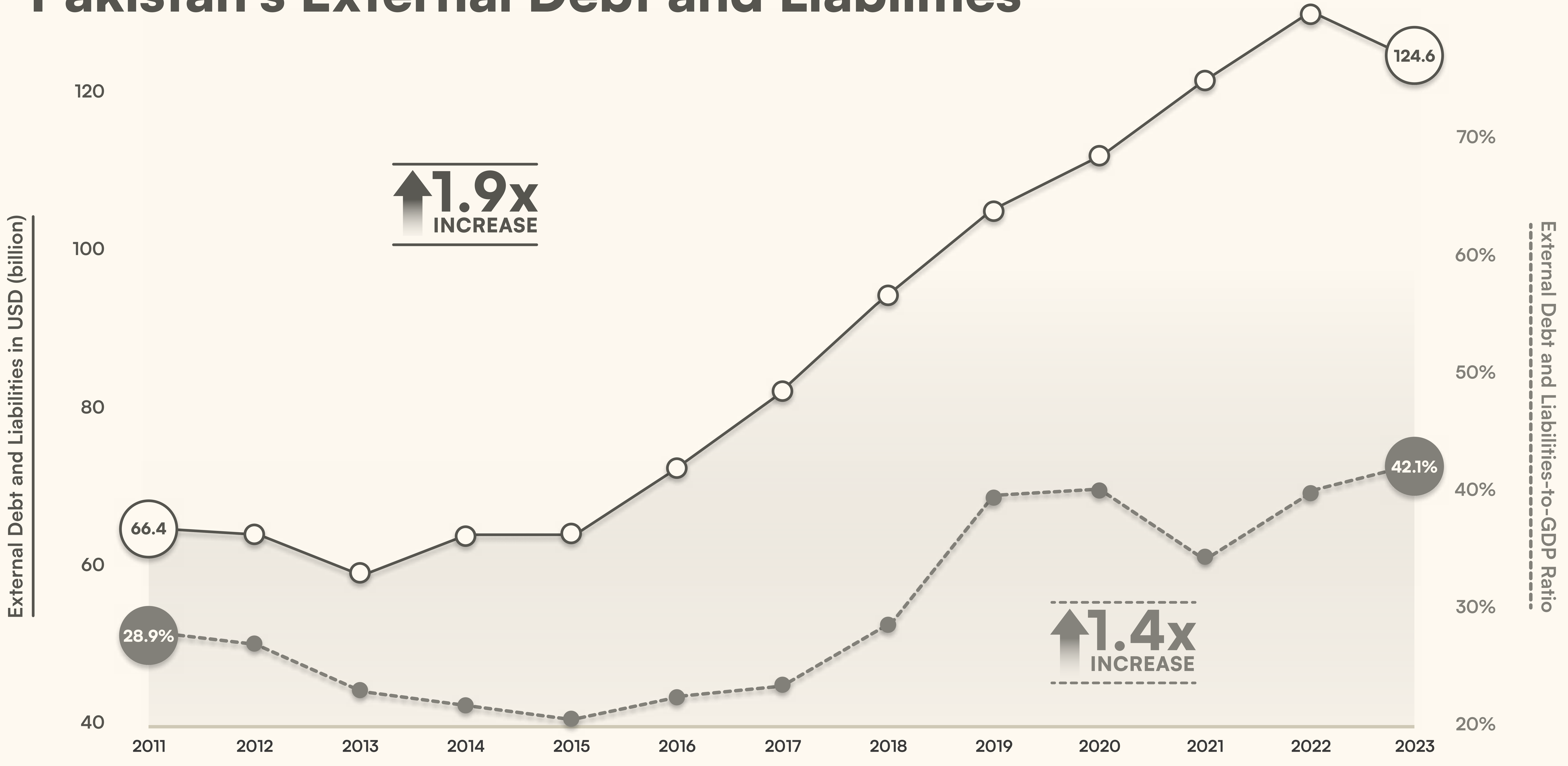
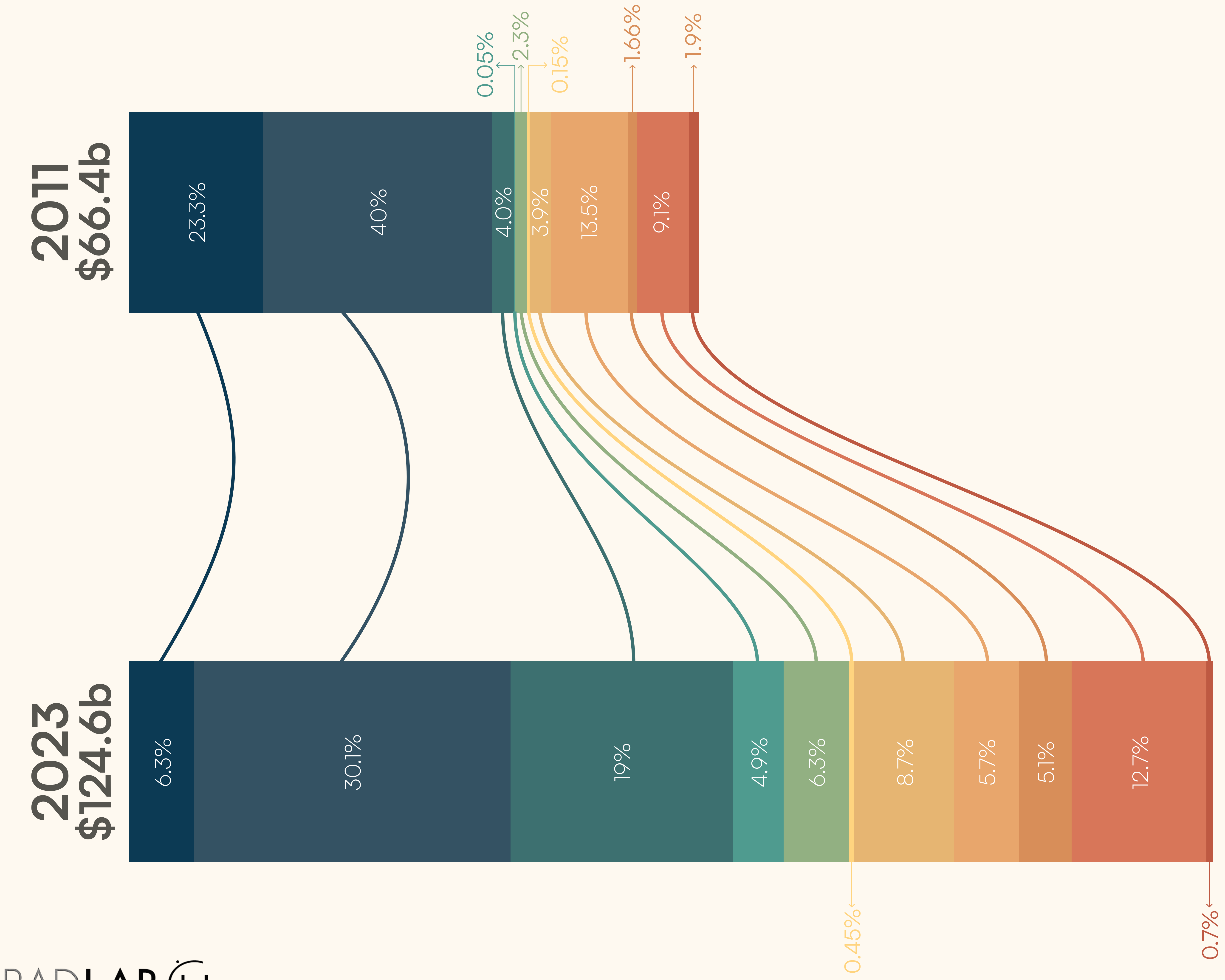
Pakistan's External Debt and Liabilities



TABADLAB

Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

Pakistan's External Debt and Liabilities Category Breakdown



Paris Club: An informal group of creditor governments that lends and finds rescheduling solutions for debt-stressed countries

Multilaterals: Financing from institutions formed by three or more countries to achieve a certain objective, such as, World Bank, Asian Development Bank, Islamic Development Bank, Asian Infrastructure Investment Bank etc.

Other Bilateral: These include sovereign entities that loan directly to Pakistan, and do not fall under the Paris Club

Commercial Banks and T-Bills: Financing raised through commercial banks, and issuance of T-Bills to foreign investors

Eurobonds and Sukuks: Financing raised from capital markets through issuance of Eurobonds, Sukuks, or other financial instruments

Naya Pakistan Certificate (NPC): Financing raised from Pakistani citizens through the Naya Pakistan Certificate

FX Liabilities: Central Bank liabilities, foreign exchange deposits, and any swap positions to supplement overall foreign exchange position

IMF: Financing available from the International Monetary Fund

Banks: Non-resident deposits and liabilities of banks

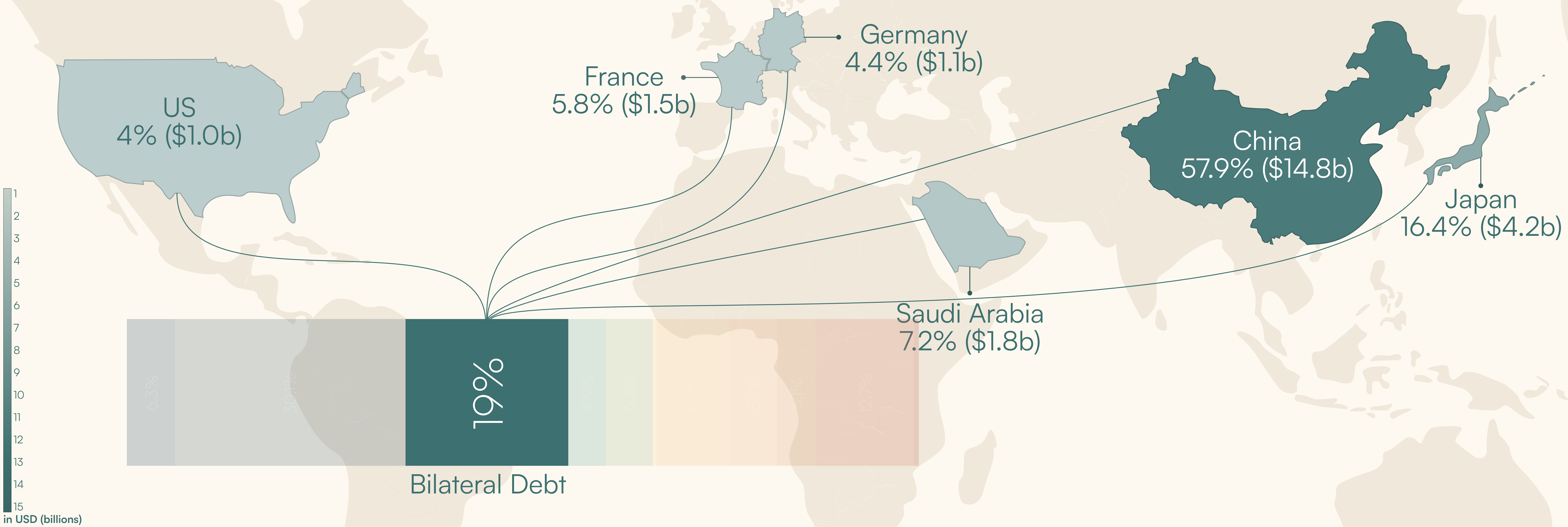
Private Sector & Inter-company Liabilities: Debt and inter-company liabilities of the private sector, that is brought into Pakistan and marked as repatriable debt

Others: Any other categories that do not fit in the above disaggregation

TABADLAB

Source: State Bank of Pakistan, External Debt Outstanding, via https://www.sbp.org.pk/ecodata/pakdebt_Arch.xls.

Pakistan's External Debt and Liabilities Bilateral Breakdown
(not including Paris Club)



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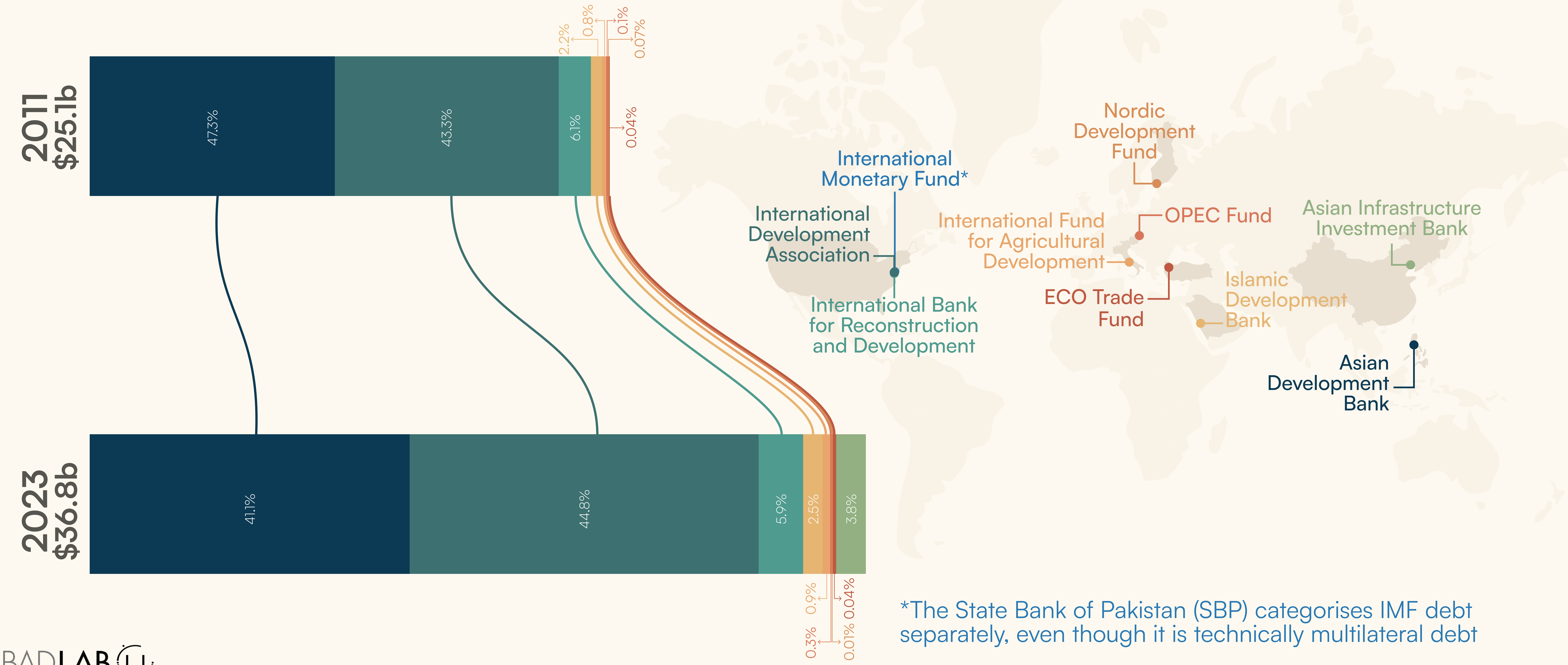
Source: Finance Division, Economic Survey of Pakistan (June 8, 2023; data from March 2023), via https://www.finance.gov.pk/survey_2023.html.

Pakistan's External Debt and Liabilities Multilateral Breakdown



*The State Bank of Pakistan (SBP) categorises IMF debt separately, even though it is technically multilateral debt

TABADLAB

Source: Finance Division, Public Debt section of the Economic Survey of Pakistan for respective years, via https://www.finance.gov.pk/survey_2022.html.

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VIII.	Commodity Operations	1.49	5.2
IX.	Intercompany External Debt	1.14	4.0
	Total	**41.98**	**146.6**

Total Domestic Debt & Liabilities

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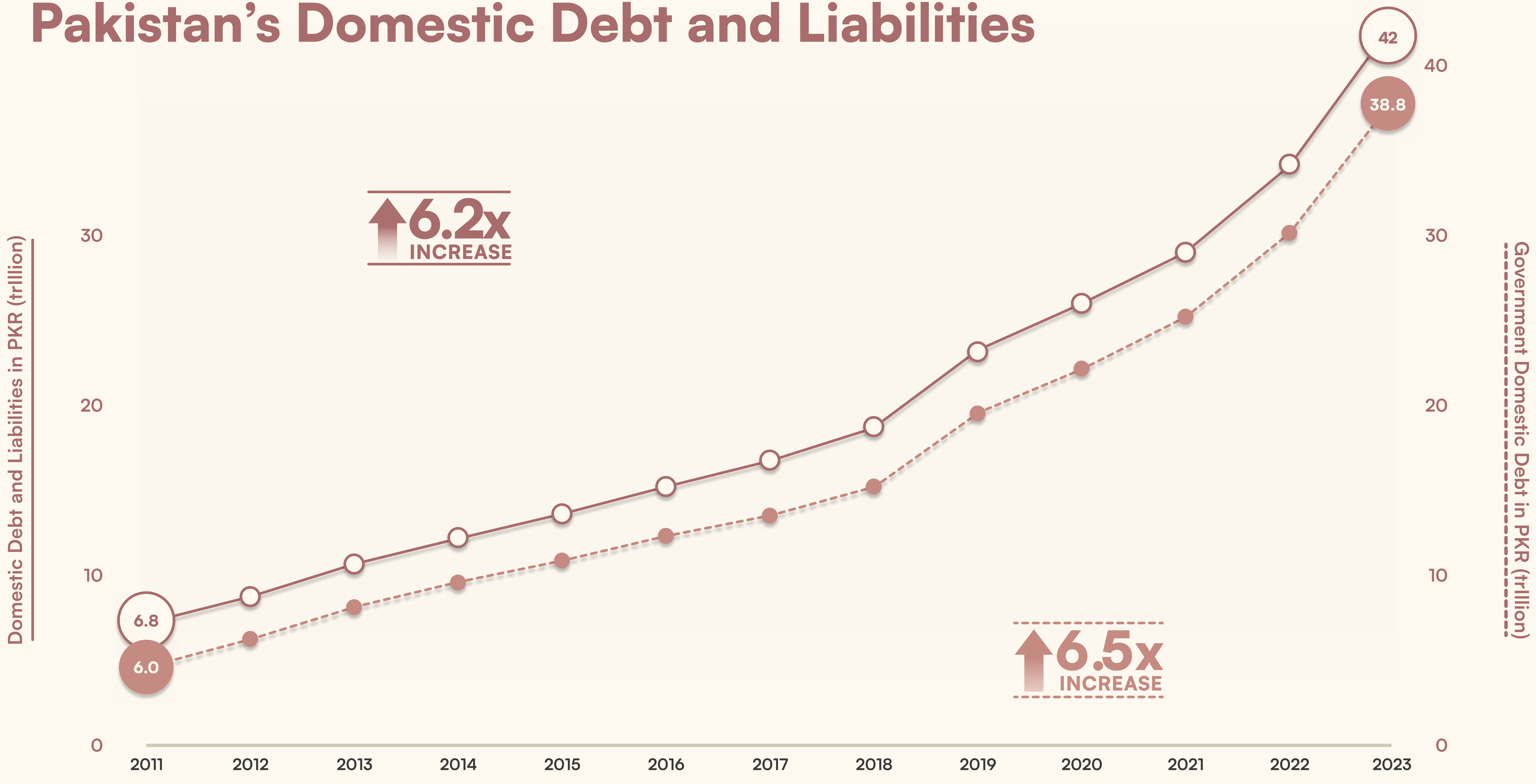
Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

Pakistan's Domestic Debt and Liabilities



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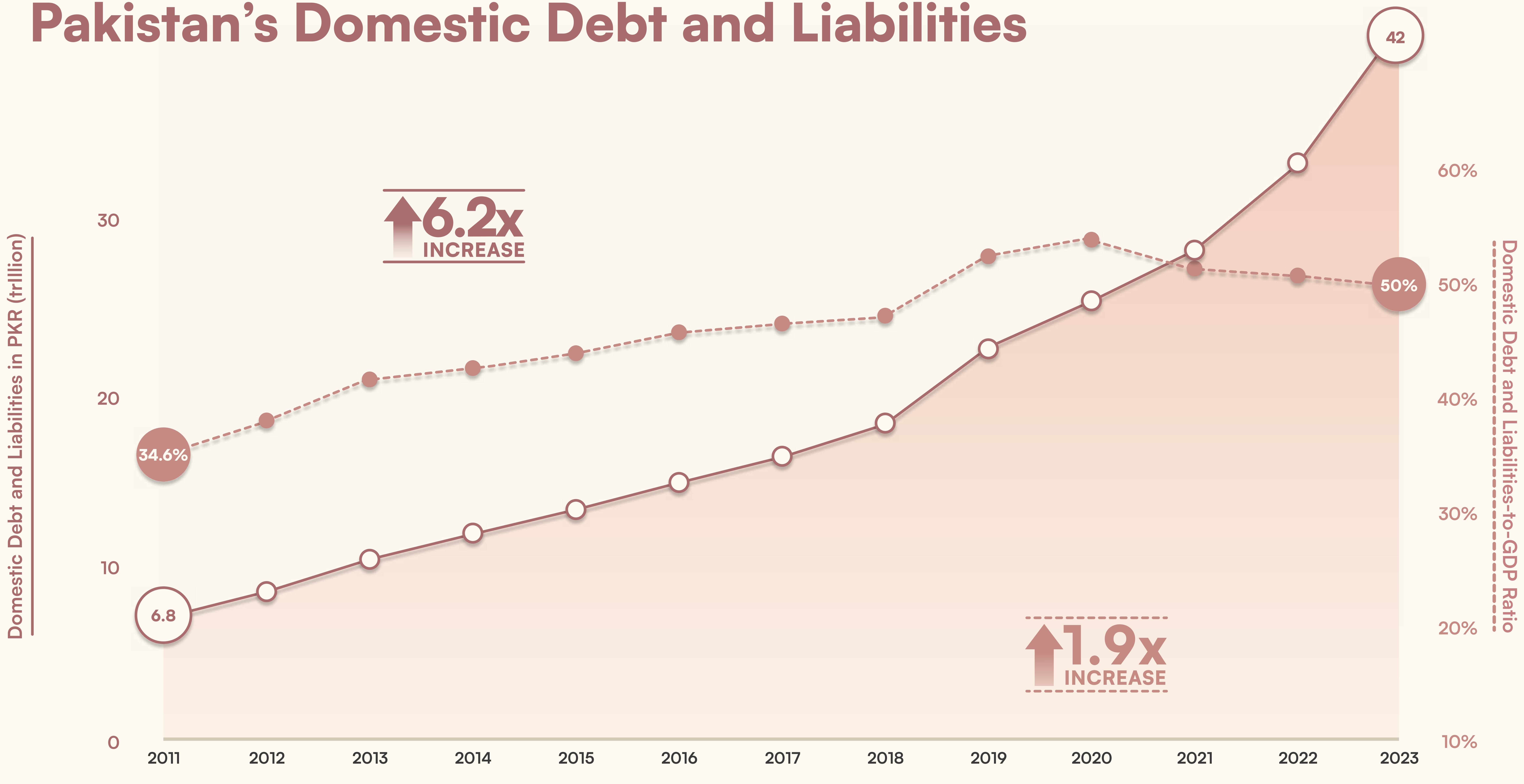
Source: State Bank of Pakistan. Government Domestic Debt & Liabilities, via https://www.sbp.org.pk/ecodata/DDArchive.xls.

Pakistan's Domestic Debt and Liabilities



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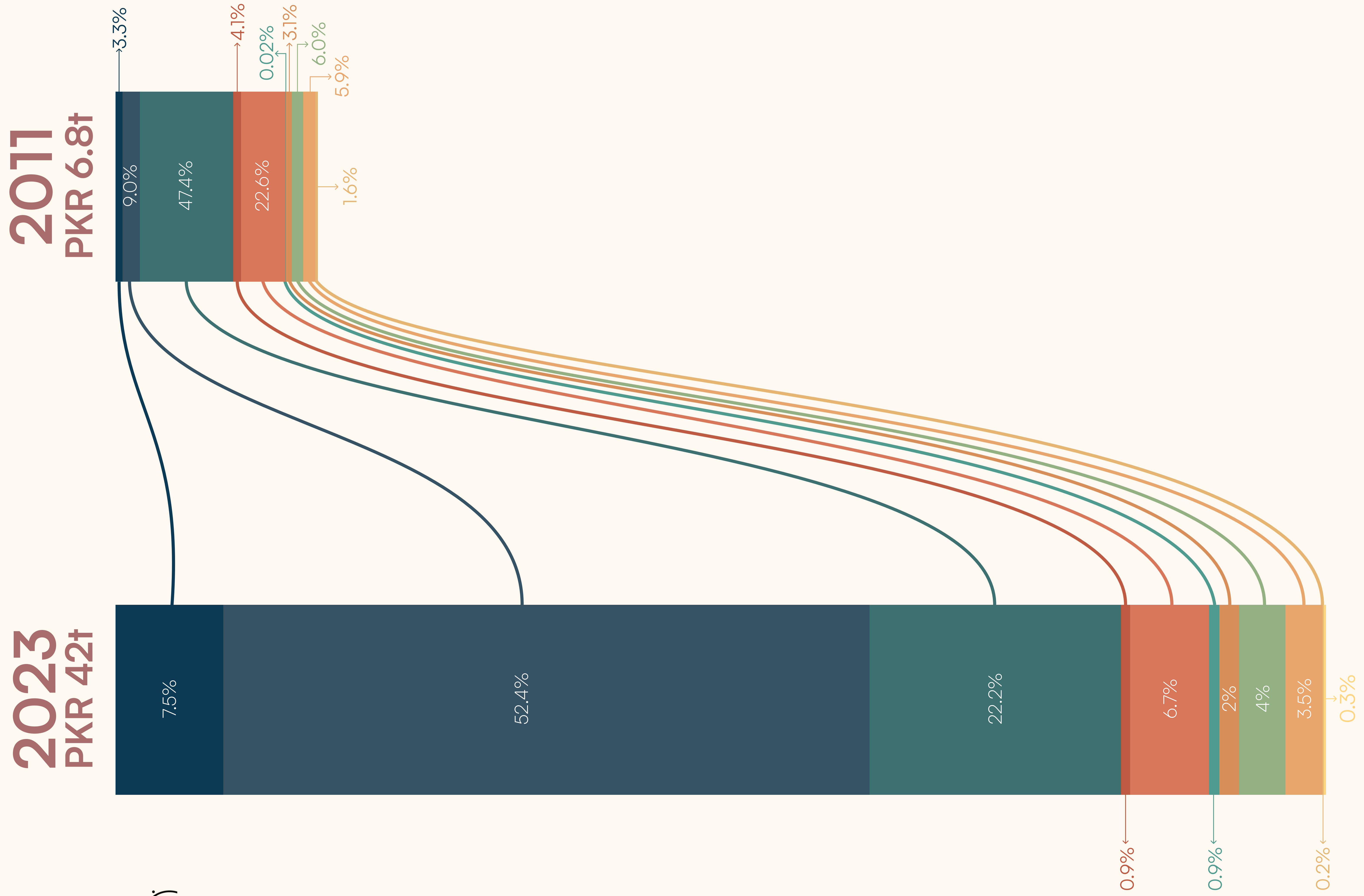
Pakistan's Domestic Debt and Liabilities Category Breakdown



Ijara Sukuk: Financing raised through shariah-compliant debt instruments

Pakistan Investment Bonds: Financing raised through long-term debt instruments with varying maturities

Treasury Bills: Financing raised through short term debt instruments with maturity of less than one year

Prize Bonds: Financing raised through issuance of prize bonds

National Savings Schemes: Financing raised through different National Savings Scheme products

Foreign Currency Loans: Old loans with a long tail (a very small component of domestic debt)

Government Domestic Liabilities: Reflects provincial governments' borrowings from banks for commodity operations

PSE Debt: Public sector enterprises debt

Commodity Operations: Debt raised to conduct operations in commodity markets to support government intervention

Others: Anything else that does not fall into the other categories

Naya Pakistan Certificates: Financing raised through Naya Pakistan Certificates with different maturities

TABADLAB

Source: State Bank of Pakistan, Government Domestic Debt & Liabilities, via https://www.sbp.org.pk/ecodata/DDArchive.xls.

Debt Maturities

What Are Debt Maturities?

Debt maturities refer to the dates on which a borrower is obligated to repay the principal amount of a debt instrument to the lender.

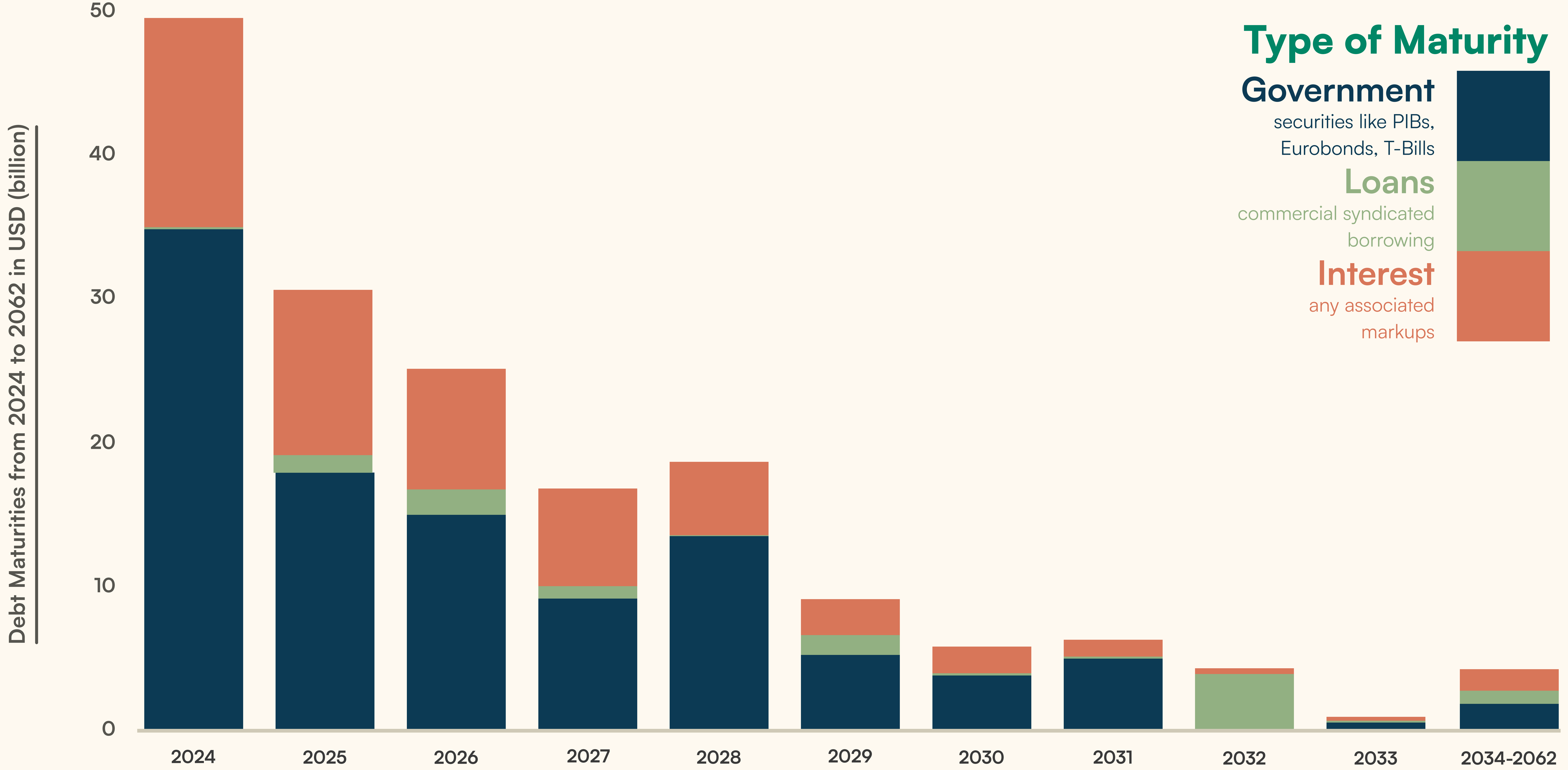
Dataset and Disaggregation

The following graph uses data from Bloomberg, and does **not** include IMF and bilateral loans. It is disaggregated into **government** (securities: PIBs, Eurobonds, T-Bills), **loans** (commercial syndicated borrowing), and **interest**.

Additional Considerations

All values are in USD billion. This data does **not** include bilateral debt. 97.35% of all debt will mature by 2034, whereas 2.65% will mature between 2034 and 2062.

Pakistan's Debt Maturities



Snapshot taken December 20, 2023

Source: Bloomberg, Pakistan's Debt Maturities.

Total Debt and Liabilities Owed per Citizen

2011

Total debt & liabilities:	USD 145.7 billion
GDP (USD 1 = PKR 86):	USD 229.4 billion
Population:	177.1 million
Debt/Capita:	USD 823
GDP/Capita:	USD 1,295

2023

Total debt & liabilities:	USD 271.2 billion
GDP (USD 1 = PKR 286.4):	USD 295.6 billion
Population:	241.5 million
Debt/Capita:	USD 1,123
GDP/Capita:	USD 1,224

What does this mean?

1. Pakistan’s debt per capita has grown from USD 823 in 2011 to USD 1,122 in 2023; a 36% increase.
2. In the same period, Pakistan’s GDP per capita has declined from USD 1,295 in 2011, to USD 1,223 in 2023, a 6% decrease.
3. This means that Pakistan’s debt is growing at a much faster rate than its income, widening the financing gaps, necessitating further borrowing.
4. Another way to think about it is that a child in 2011 had a debt of PKR 70,778 at birth. However, a child in 2023 has a debt of PKR 321,341. This is a 4.5x increase.

TABADLAB

Source: Population figures via www.pbs.gov.pk/sites/default/files/population/2023/Press%20Release.pdf. Missing Population figures interpolated on the basis of population growth rates as published by PBS.

What are Sovereign Guarantees?

Guarantees are made by a government to cover the debt of a person, company, or project if they are unable to pay.

It is the government saying: “If they can’t pay, we will.”

Technically not considered part of sovereign debt, this is a financial liability.

State Owned Enterprises (SOEs)

Pakistan International Airlines (PIA) is a major beneficiary of sovereign guarantees, as all of its debt is secured by sovereign guarantee.

Food Procurement Programmes

Various food procurement programmes executed by the government through its various agencies, which have also raised debt facilities from financial institutions backed by sovereign guarantees.

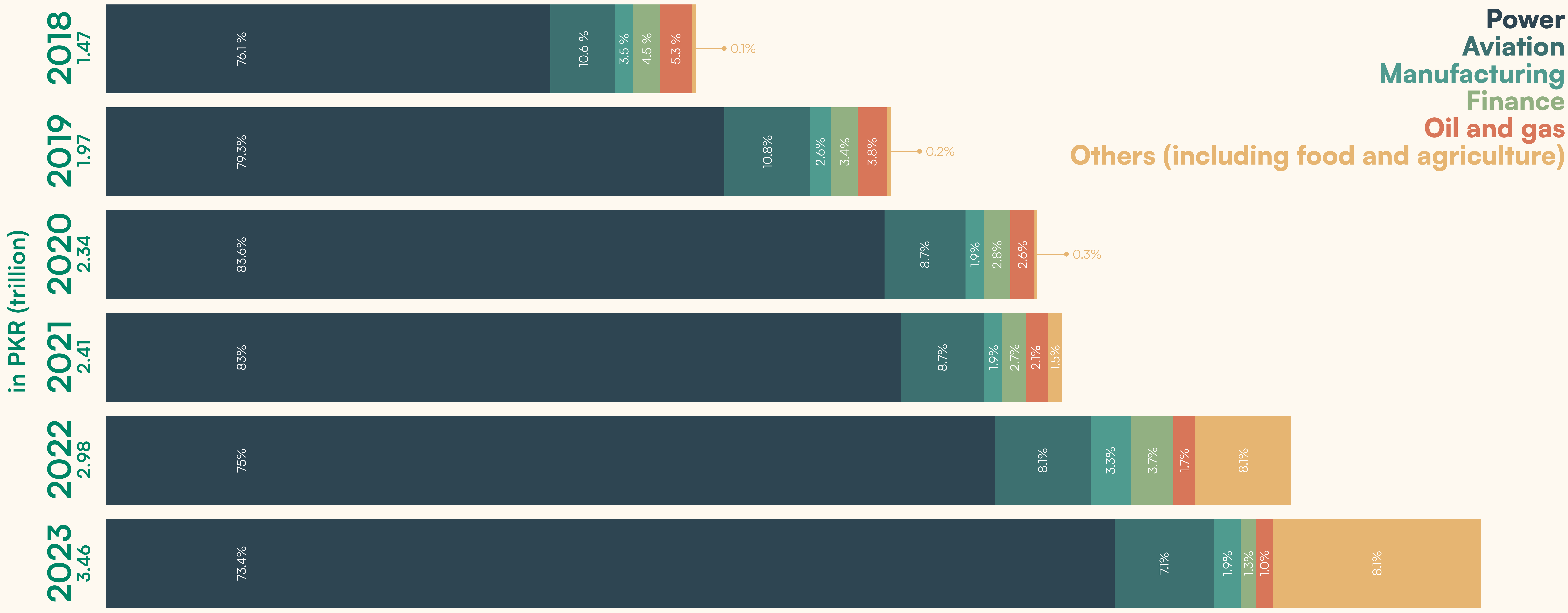
Power Sector

Power projects under the China Pakistan Economic Corridor (CPEC), which account for the greatest proportion of the surge. Accumulated circular debt in the power sector, to the tune of PKR 2,500 billion. Power sector debt in Pakistan is largely secured by sovereign guarantees.

TABADLAB

The Story of Sovereign Guarantees

Sovereign guarantees are used to support project-based/SOE level debt, but they are not factored in when calculating total debt.



TABADLAB

Source: Finance Division, Fiscal Risk Statement FY23-24, via https://www.finance.gov.pk/publications/Fiscal_Risk_Statement_FY2023_24.pdf.

What does this mean?

Since 2011, in nominal terms Pakistan's external debt has near doubled, and domestic debt has increased by sixfold.

In FY-2024, Pakistan will need to pay back an estimated USD 49.5 billion in debt maturities (30% of which is interest, and none of which is a bilateral or IMF loan).

Debt accumulation has been overwhelmingly used to continue fostering a consumption-focused, import-addicted economy, without investment in productive sectors or industry.

Pakistan's debt profile is alarming, and its borrowing and spending habits are unsustainable.

Increasing demands of a growing population require more money for social protection, health, education, and climate change related disasters, adaptation strategies, and the green transition.

Pakistan’s climate and debt vulnerability exacerbate one another, but there is an opportunity to synergise and mitigate both existential crises at the same time.

2 RELIANCE ON DEBT & INCREASING INTEREST EXPENSES

TOTAL
DEBT SERVICING

EXTERNAL
INTEREST SERVICING

DOMESTIC
INTEREST SERVICING

COUNTRY
COMPARISON

TAX COLLECTED AS
PERCENTAGE OF GDP

WHAT DOES
THIS MEAN?

Key terms & concepts

TOTAL SERVICING

Repayment of all borrowed money (interest amount and principal debt amount)

TOTAL EXTERNAL SERVICING

Repayment of all borrowed money (interest amount and principal debt amount) to foreign creditors

TOTAL DOMESTIC SERVICING

Repayment of all borrowed money (interest amount and principal debt amount) to domestic creditors

INTEREST SERVICING

Paying back the interest on the principal amount

FLOATING RATE BASIS

Interest rate that can change based on macroeconomic market conditions, thereby changing the amount of interest owed

INTEREST PAYMENTS AS PERCENTAGE OF GDP

Share of a country's GDP used to cover the cost of paying interest on its debts

DOMESTIC SERVICING AS PERCENTAGE OF FEDERAL REVENUE

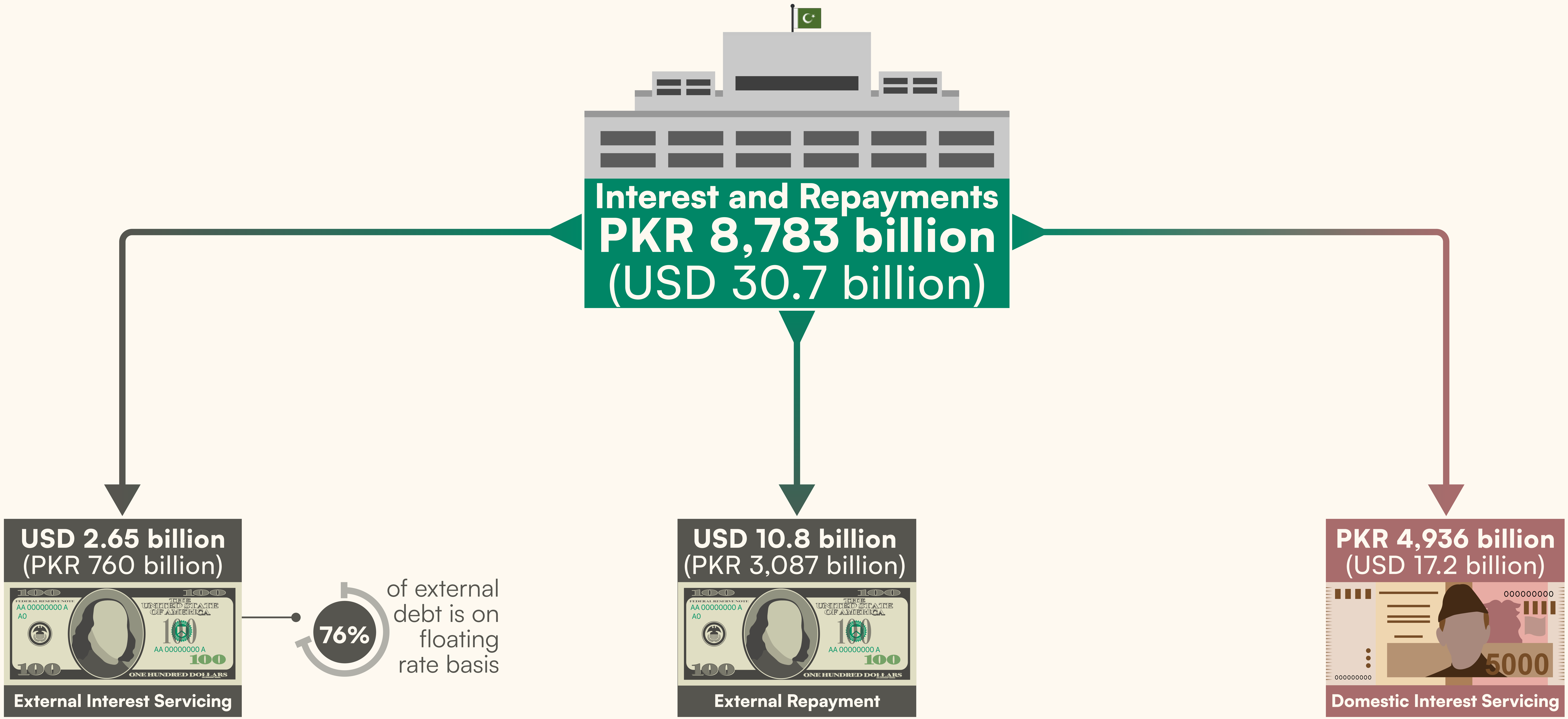
Local currency income gauged against local currency debt servicing, as a measure of fiscal sustainability

EXTERNAL SERVICING AS PERCENTAGE OF DOLLAR REVENUE

Foreign currency income gauged against foreign currency debt servicing, as a measure of fiscal sustainability

MACROECONOMIC VOLATILITY

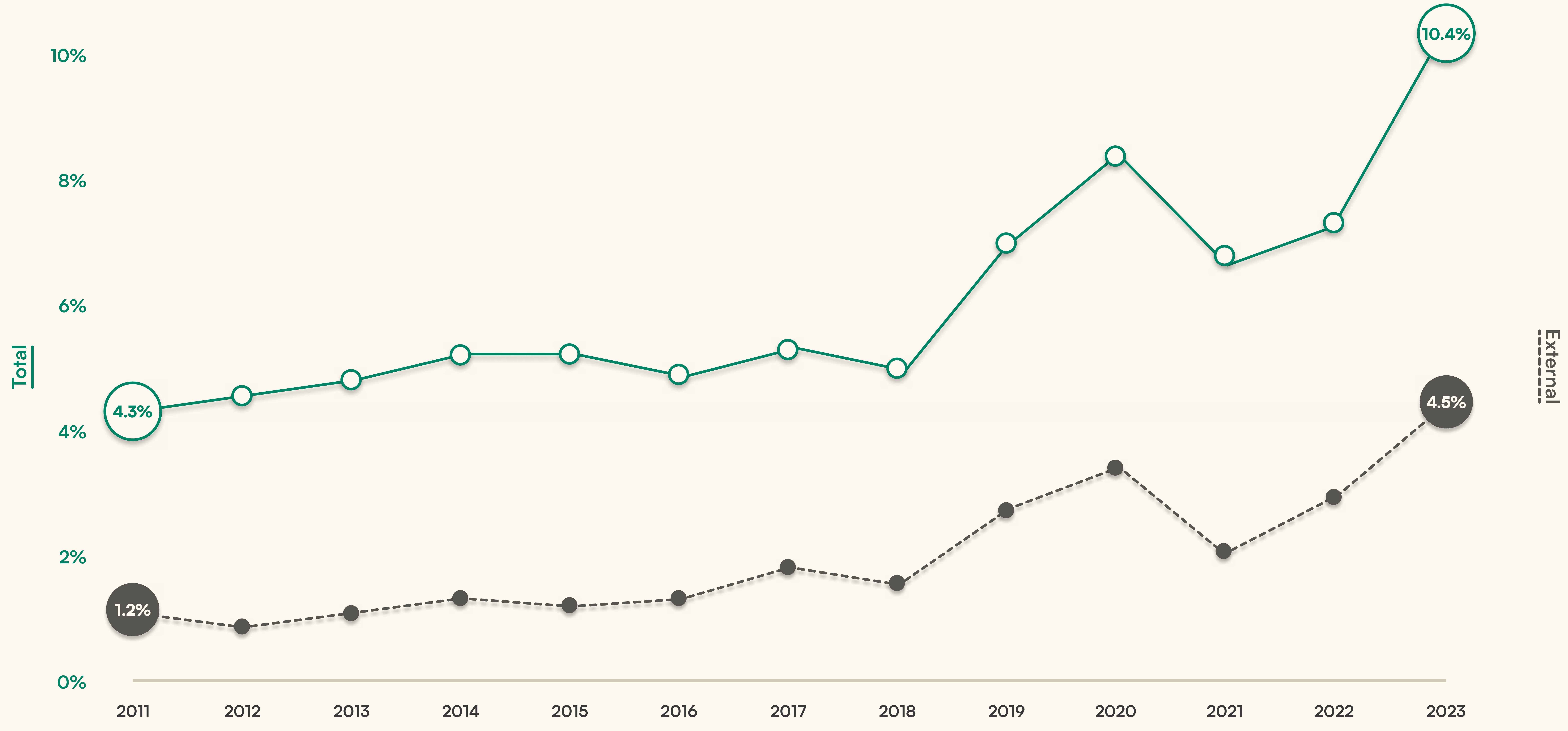
Unpredictable and undesirable changes in the economic conditions of a country (inflation, unemployment, economic growth, financial market upheaval, exchange rate volatility etc.)



TABADLAB

Source: Budget Documents, Budget 2023-24, via https://www.finance.gov.pk/budget/Budget_2023_24/Budget_in_Brief.pdf. Budget 2011-12, via https://www.finance.gov.pk/survey/chapters_16/04_Fiscal_Development.pdf.

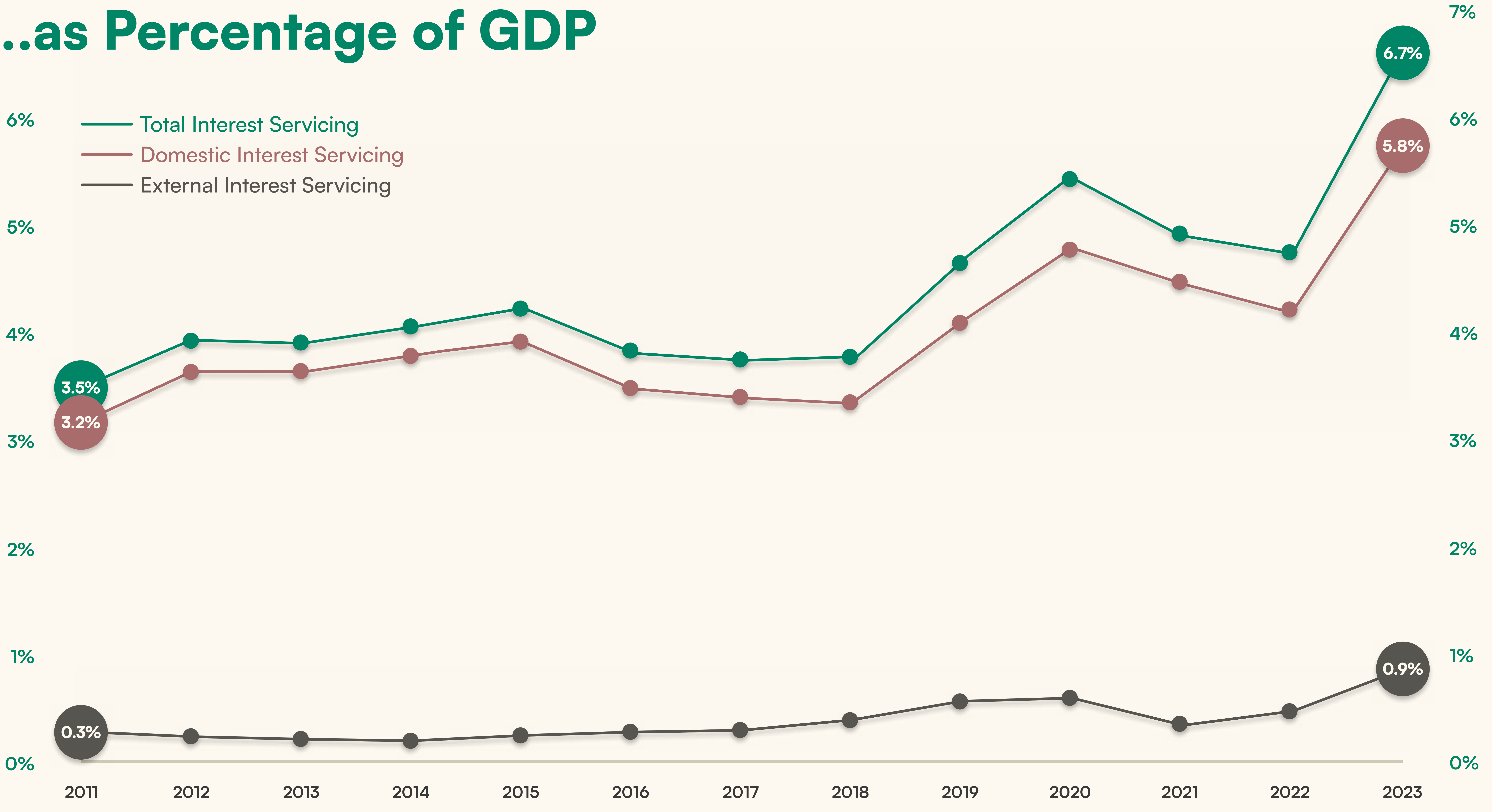
Interest Servicing and Repayment as Percentage of GDP



TABADLAB

Source: Finance Division, Statistical Appendix and Fiscal Development Chapter (Economic Survey of Pakistan) for respective years.

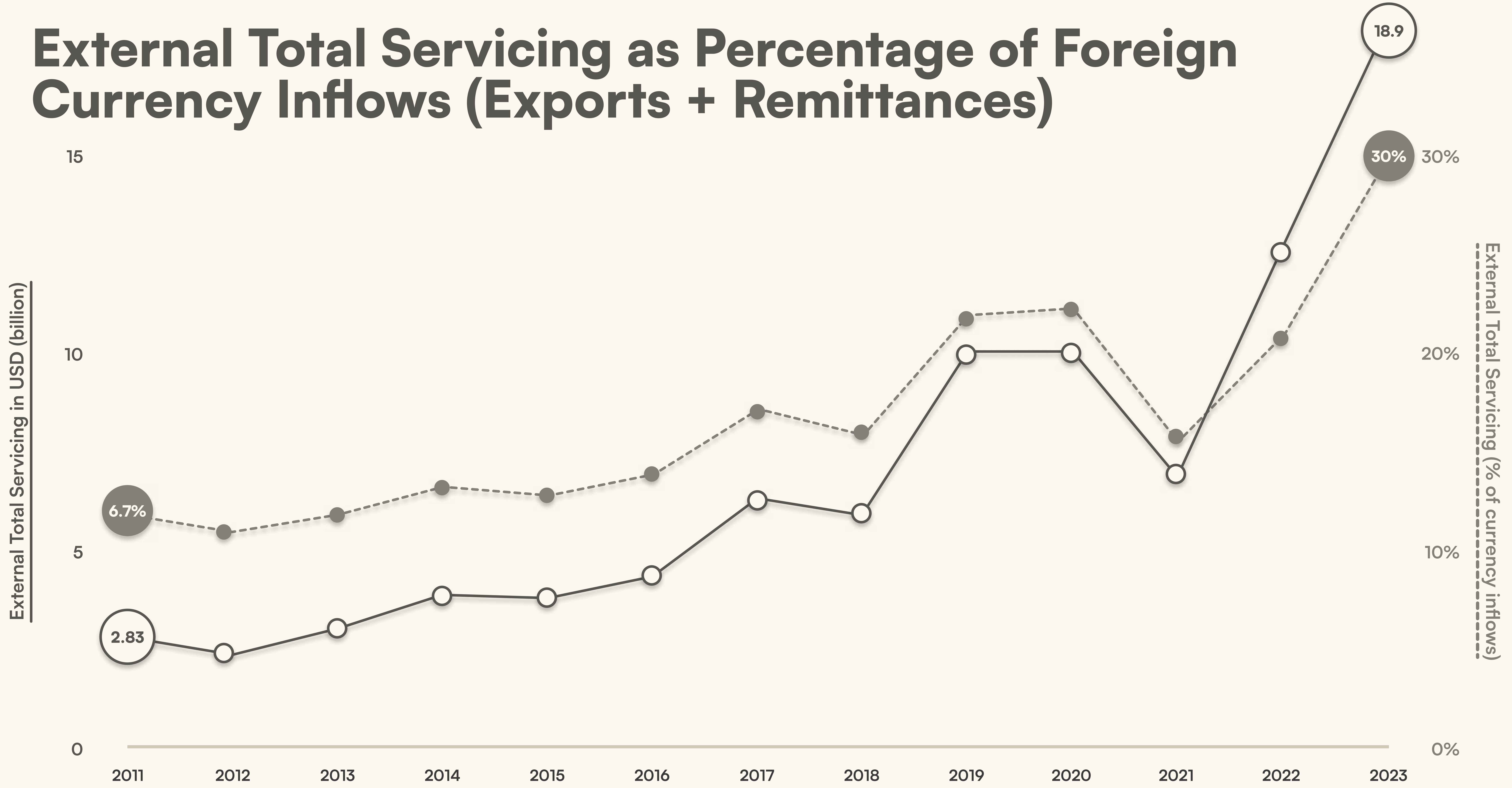
...as Percentage of GDP



TABADLAB

Source: Finance Division, Statistical Appendix and Fiscal Development Chapter (Economic Survey of Pakistan) for respective years.

External Total Servicing as Percentage of Foreign Currency Inflows (Exports + Remittances)



TABADLAB

Source: Finance Division, Statistical Appendix and Fiscal Development Chapter (Economic Survey of Pakistan) for respective years.

What does this mean?

Externally

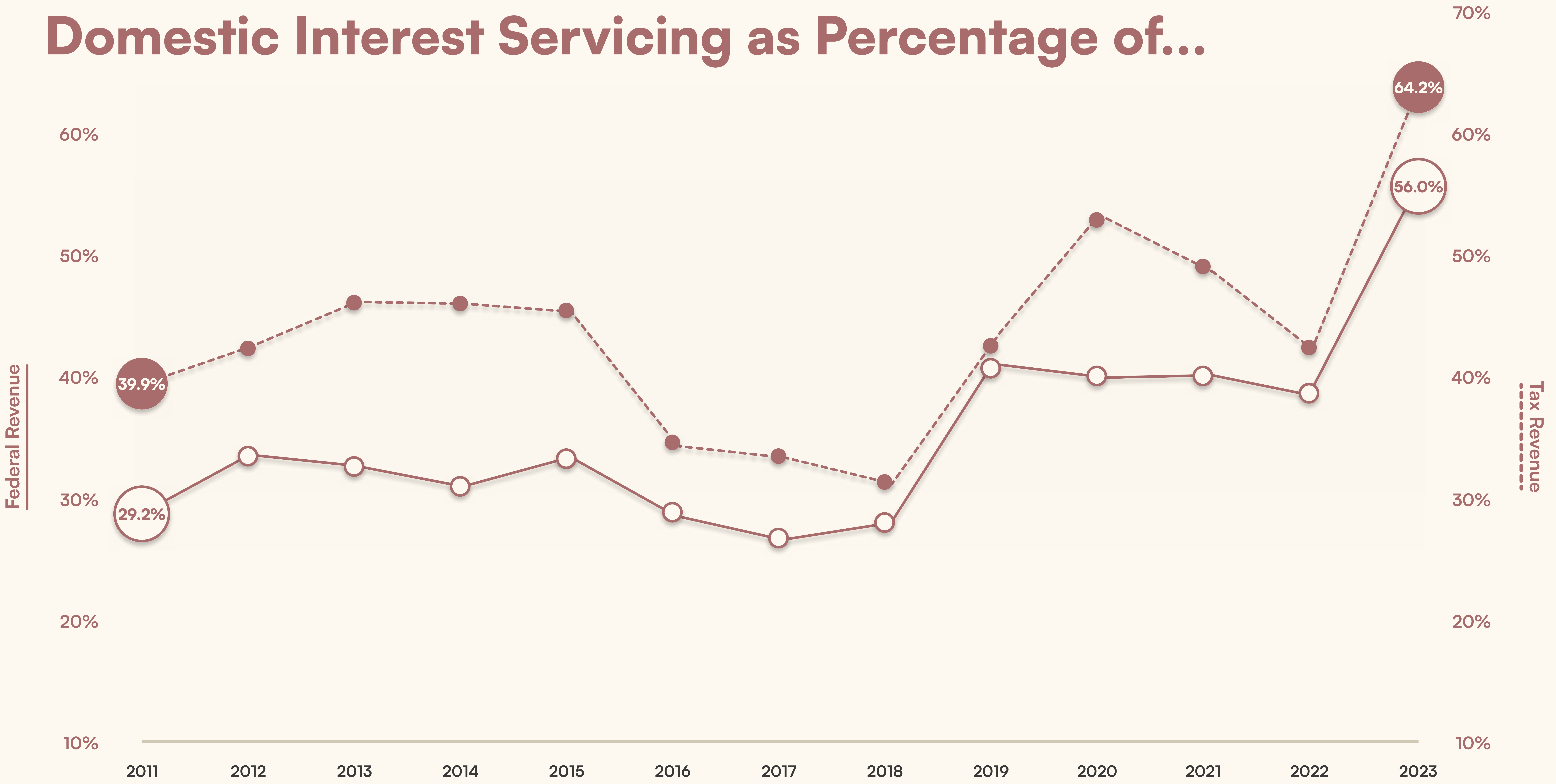
Vulnerable to external shocks or macroeconomic volatility → Financial market instability
Example: PKR devaluation against USD

Heavy reliance on external programmes → Debt trap
Example: 23 IMF programs (24th inevitable)

Reputational damage → Inability to borrow money in the future
Example: PIA unable to refinance or pay interest on its debt due to the current crisis

Climate financing strains borrowing needs, requiring more capital to meet growing needs

Domestic Interest Servicing as Percentage of...



Source: Finance Division, Statistical Appendix and Fiscal Development Chapter (Economic Survey of Pakistan) for respective years.

What does this mean?

Domestically

Government loses autonomy over policy and decision-making
Example: IMF conditions

Reduced focus/spending on social services, as debt servicing is prioritised
Example: Pakistan's deteriorating education system

Political and social upheaval
Example: the political, constitutional, and institutional crisis from February 2022 onwards

Climate financing takes a back seat to domestic debt servicing, further deteriorating climate vulnerability profile

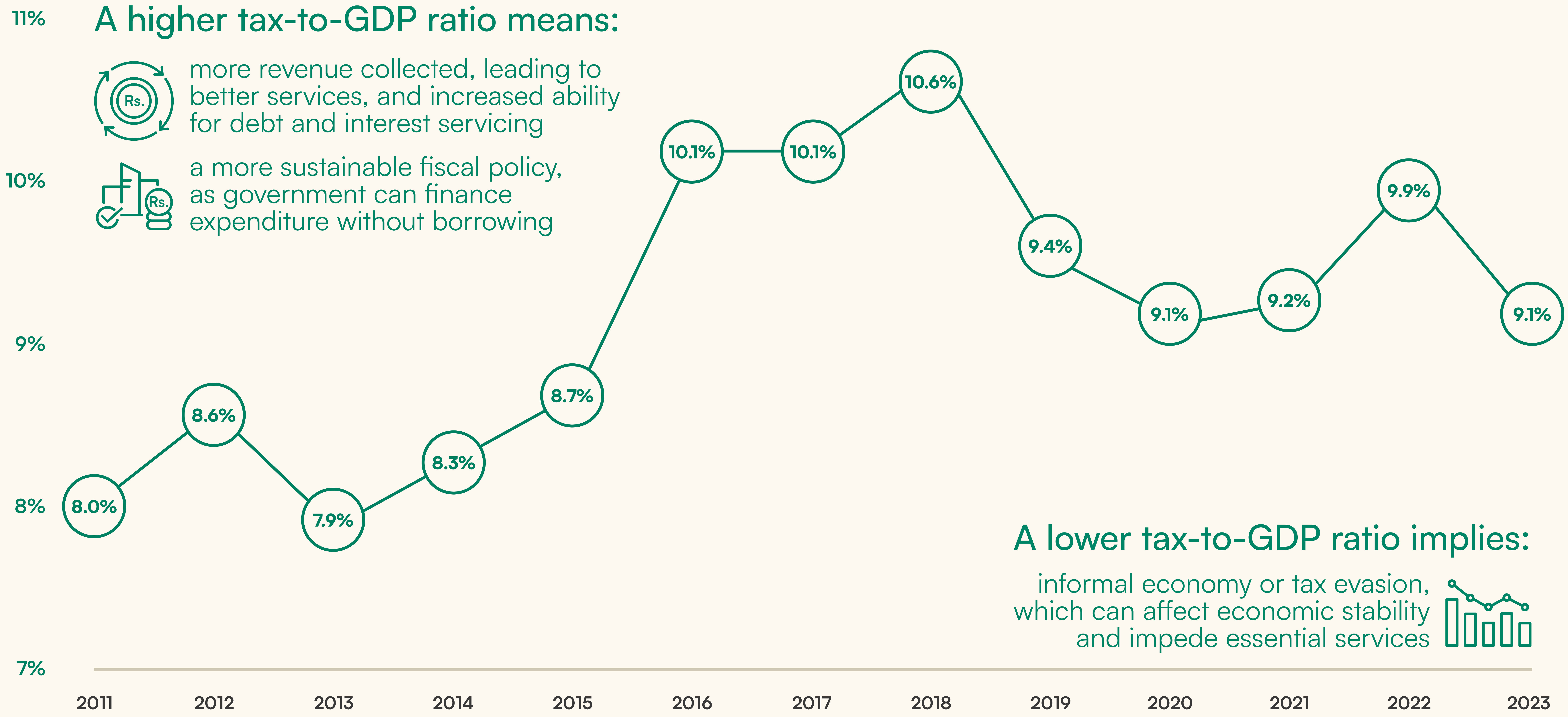
Country Comparison: Interest Servicing as Percentage of Federal Revenue

*With 40% of Pakistan's revenue allocated to interest payments, the government's capacity to invest in essential areas such as social protection — including health and education — and fulfilling the country's climate commitments, is directly hampered.

TABADLAB

Source: *The World Bank, Interest Payment as % of Revenue, via https://data.worldbank.org/indicator/GC.XPN.INTP.RV.ZS.*

Total Tax Collected as Percentage of GDP



TABADLAB

Source: Statistical Appendix and Fiscal Development Chapter (Economic Survey of Pakistan for respective years)

3 HOW AND WHY IS DEBT GROWING SO RAPIDLY?

BOOM AND BUST CYCLES

FISCAL BALANCE & DEFICIT

CURRENT ACCOUNT BALANCE & DEFICIT

FISCAL DEFICIT SPIRAL

CYCLE OF CONSUMPTION

WHAT DOES THIS MEAN?

Key terms & concepts

BOOM AND BUST CYCLE

A repetitive pattern of economic growth (boom) followed by contraction (bust), showing periods of growth and recession

CURRENT ACCOUNT DEFICIT (CAD)

When a country's total imports (goods, services, and transfers) exceed its total exports

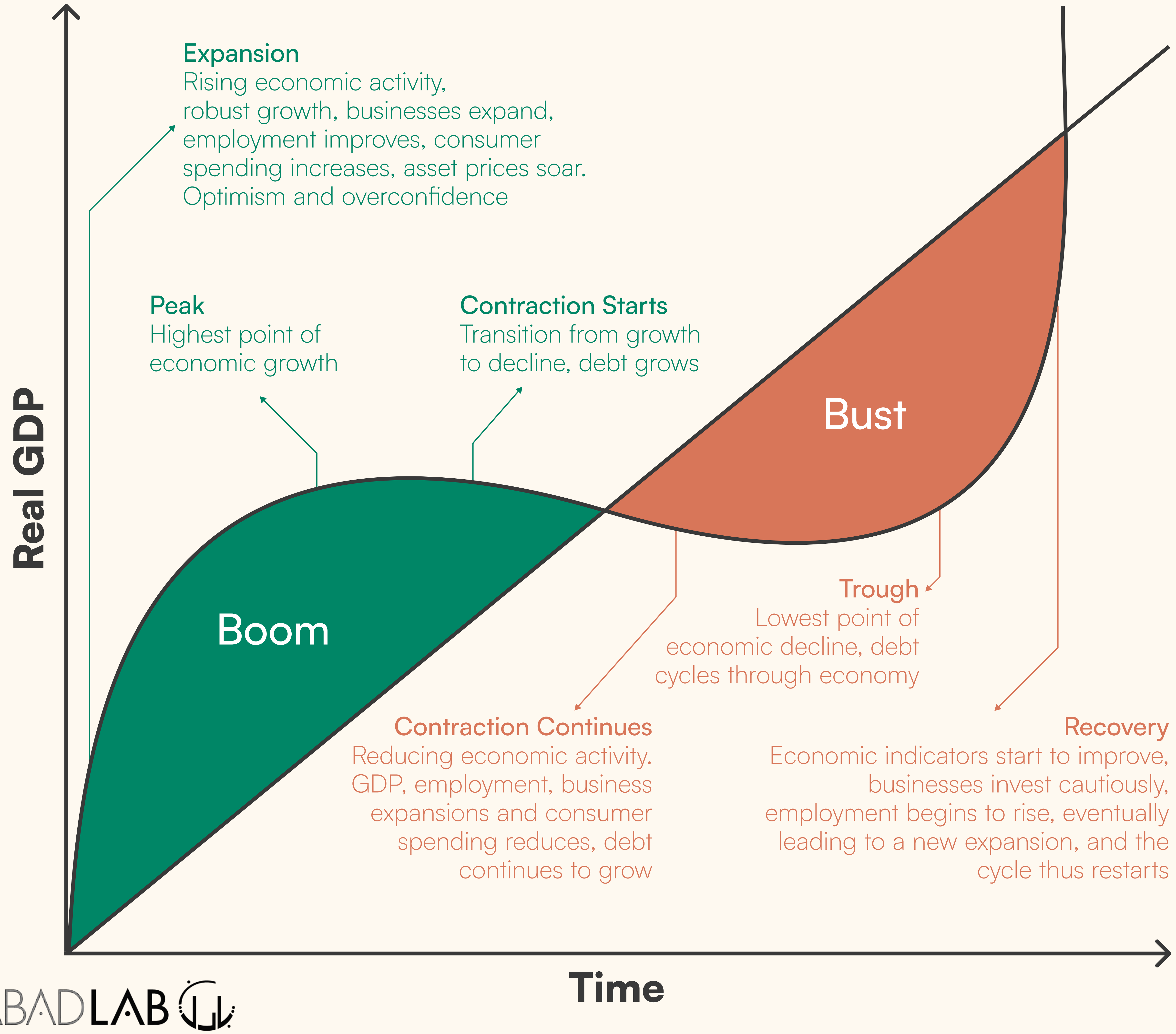
US DOLLAR LIQUIDITY

Availability and ease of obtaining USD in financial markets

CURRENCY DEVALUATION

Decrease in value of a country's currency relative to other currencies

Boom and Bust Cycles



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In Pakistan, the boom and bust cycles are shortening.

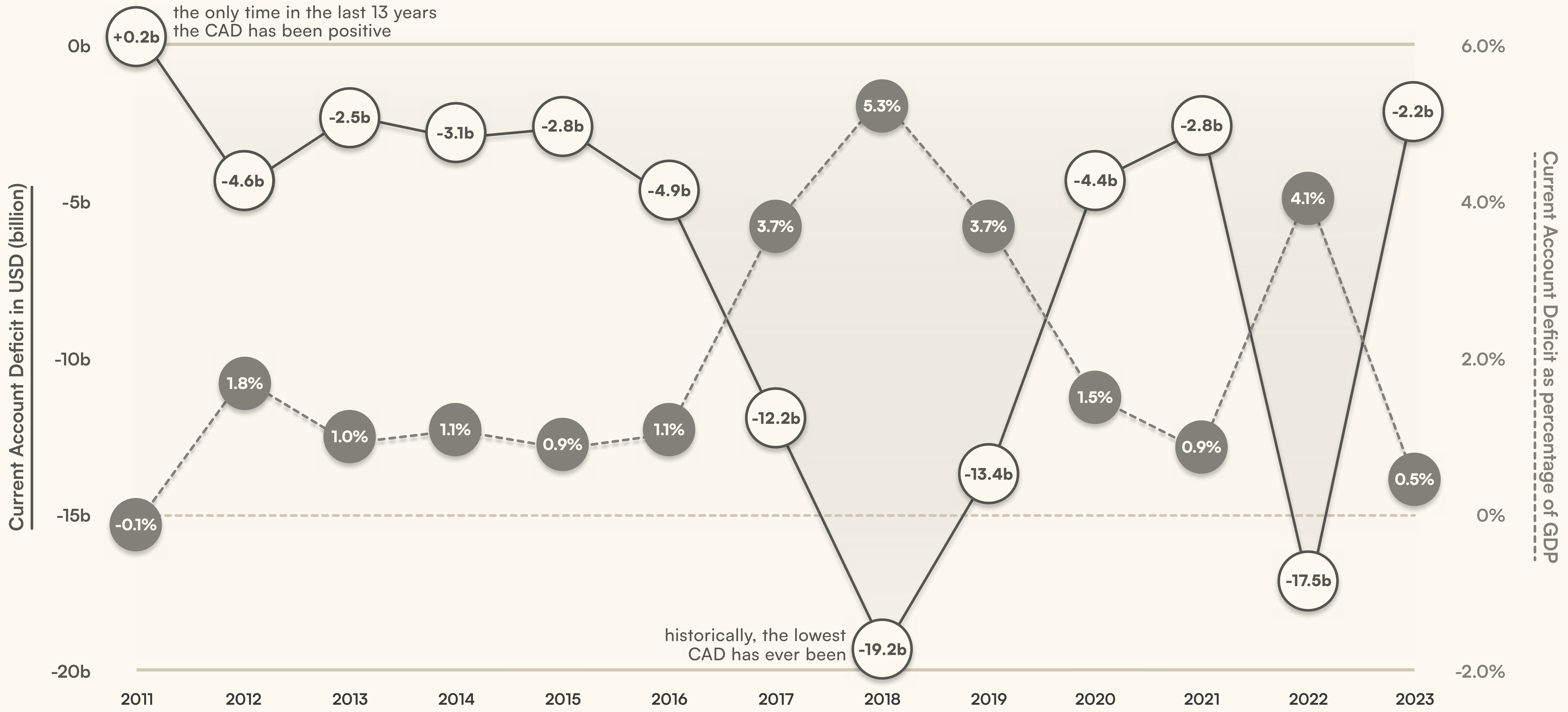
Each boom is accompanied by a consumption-driven burst of growth, followed by a shortage of US dollars to support that consumption, leading to more debt, which ultimately results in a bust.

As the government arranges more US dollar liquidity through friendly countries or multilaterals, it triggers another growth spurt.

Consumption (imports) continues to grow, while exports and remittances remain stagnant, thus shortening the boom cycle, leading to another bust and more inflation.

This cycle repeats ad infinitum.

Pakistan's Current Account Balance



TABADLAB

Source: Finance Division, Statistical Appendix and Fiscal Development Chapter (Economic Survey of Pakistan) for respective years.

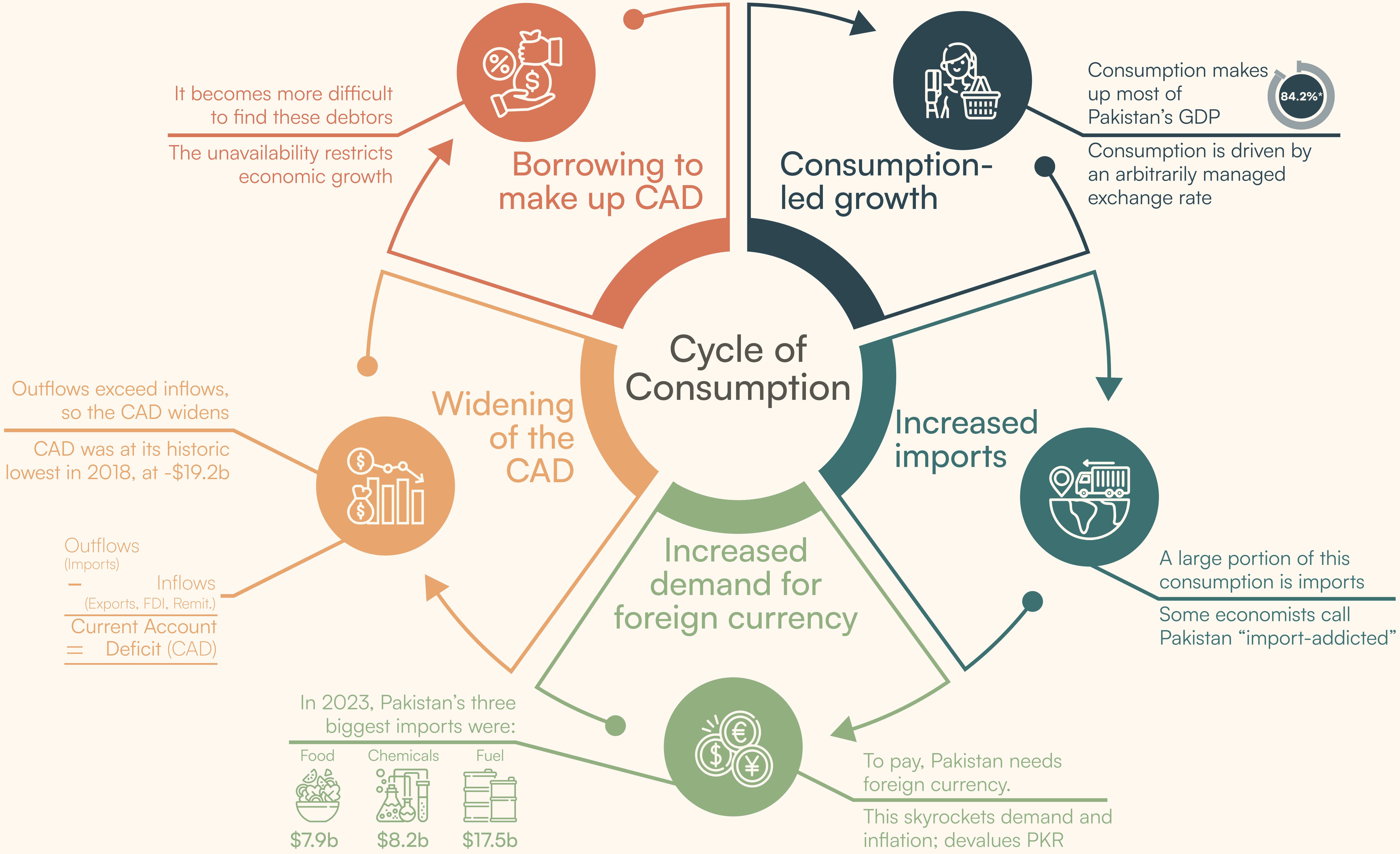
Pakistan's Current Account Balance - Consumption Cycle

Base case scenario:

- Pakistan grows at 3% per annum
- Composition of GDP doesn't change
- USD 9 billion needed annually to grow economy

Bottom line:

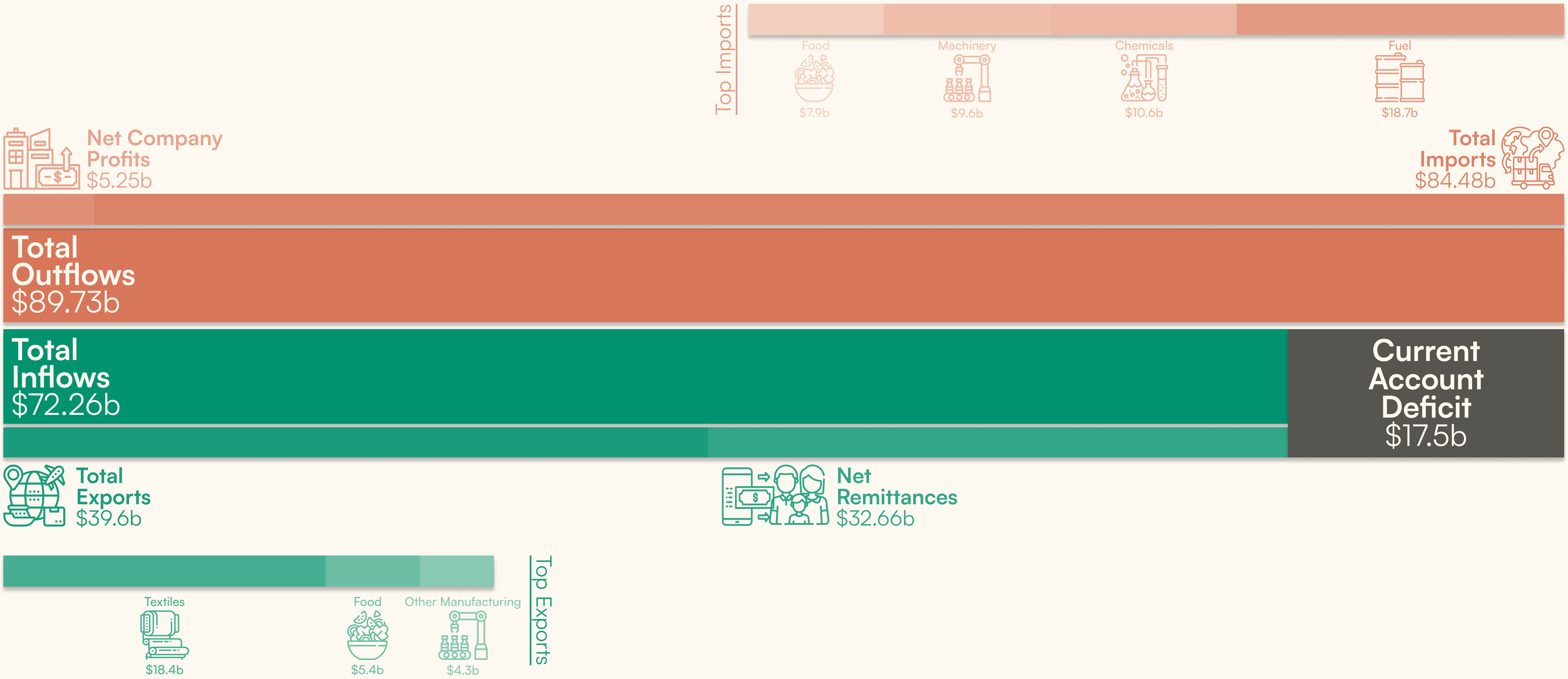
Attaining economic growth by acquiring additional debt without changing composition of GDP will become impossible



TABADLAB

Source: Pakistan Bureau of Statistics, Private Consumption Expenditure and Nominal GDP in PKR, via https://shorturl.at/adyP5.

Pakistan's Current Account Deficit (CAD) - 2022



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Source: State Bank of Pakistan, Import and Exports Payments by Commodities and Groups, via https://www.sbp.org.pk/ecodata/Import_Payments_by_Commodities_and_Groups.pdf.

Fiscal Deficit

Fiscal Debt Formula

A fiscal deficit occurs when a country's expenses outpace its revenues. This is a perennial problem for Pakistan.

Fiscal Deficit = Revenues - Expenses

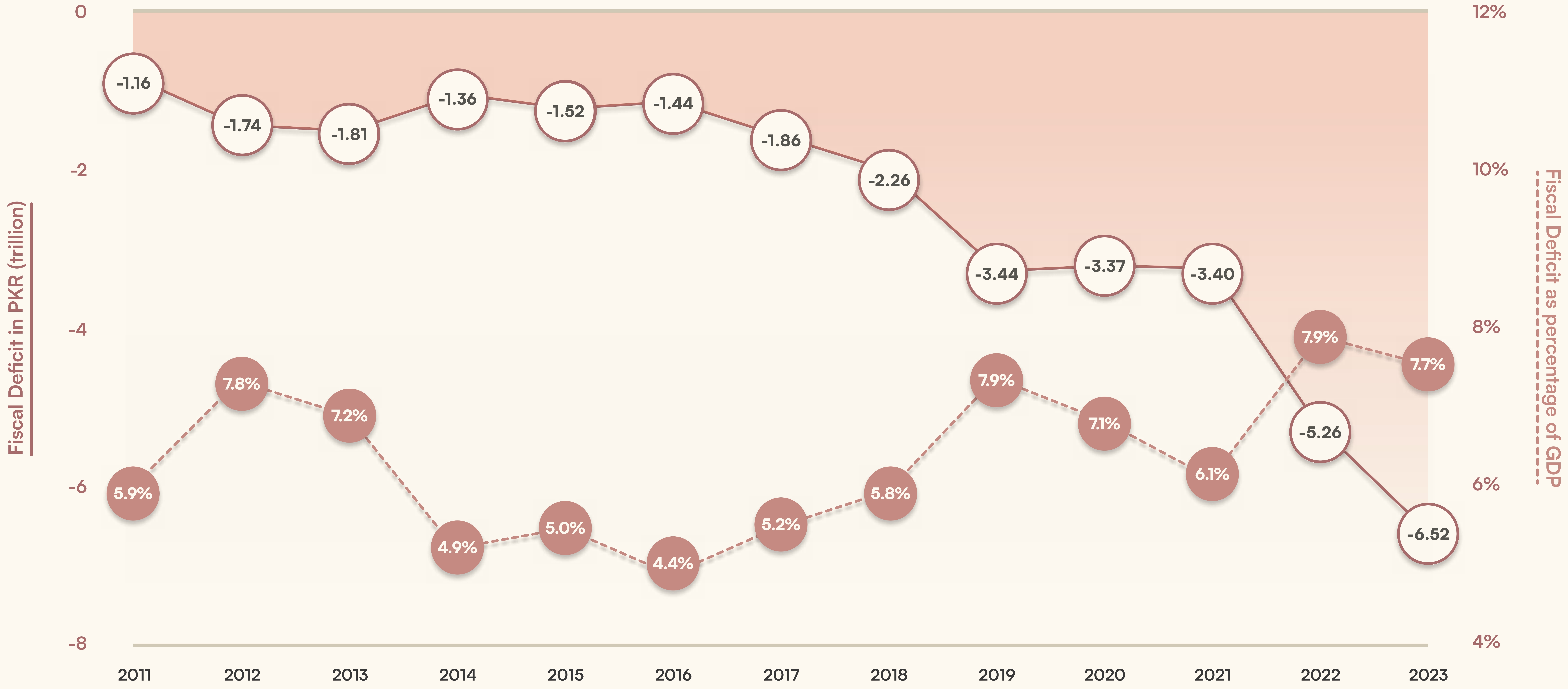
Historical Trend

In the last thirteen years, Pakistan has had a fiscal deficit every year. The only way this deficit has been bridged is by borrowing. The bulk of this borrowing is domestic, though Pakistan sometimes uses external financing to make up for the fiscal deficit.

Root Causes

Low tax-to-GDP and high revenue-to-debt-servicing numbers serve as the root causes for reduced revenues, and increased expenses, both of which contribute to the fiscal deficit.

Pakistan's Fiscal Balance



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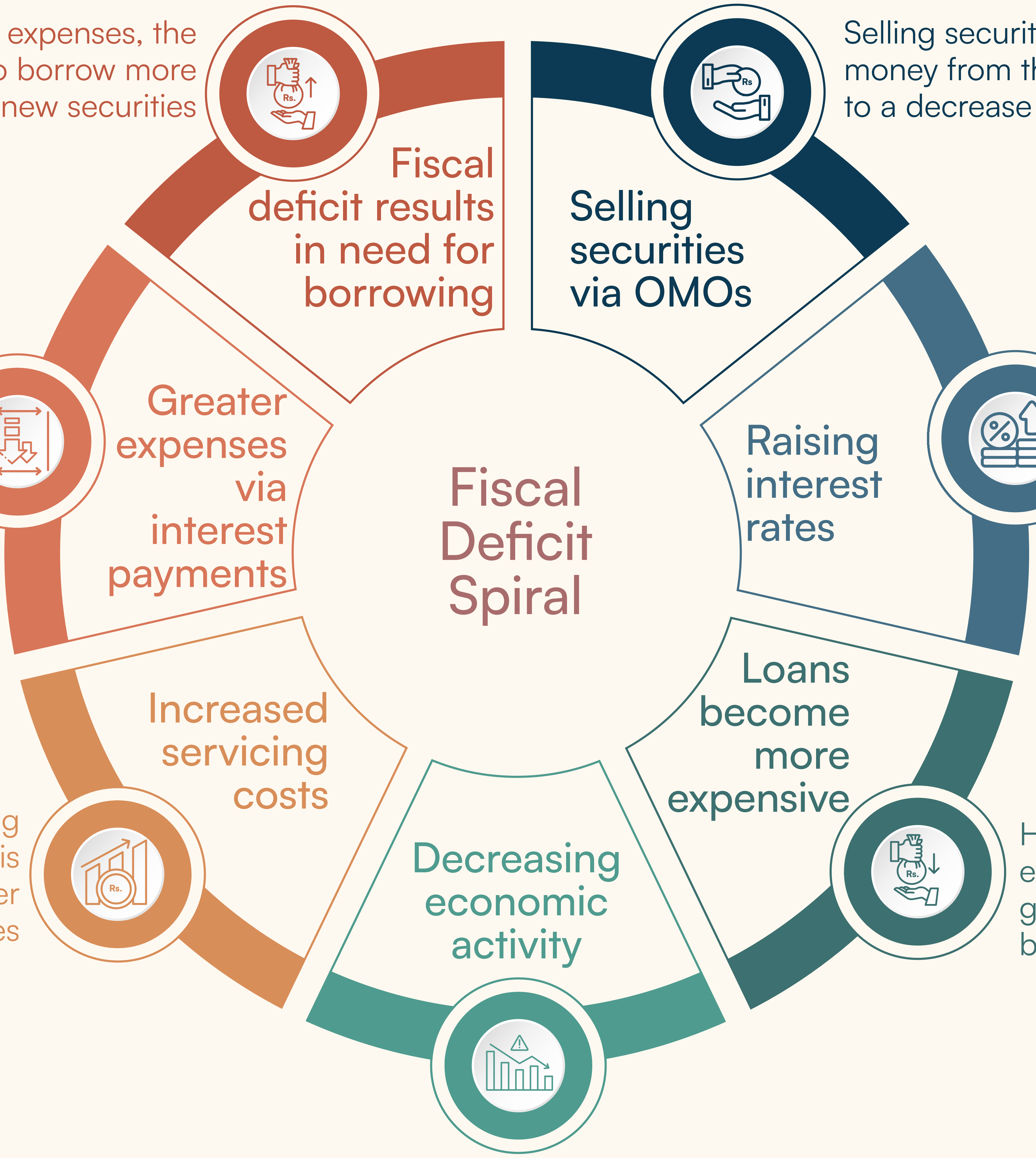
Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

Pakistan's Fiscal Deficit (FD) Spiral



To cover its larger expenses, the government may need to borrow more money by issuing new securities

Selling securities via OMOs removes money from the financial system, leading to a decrease in the money supply

Open Market Operations (OMOs)
- most frequently used instruments for implementing monetary policy
- conducted to manage liquidity in the interbank money market
- ensures availability of sufficient funds for smooth interbank transactions

The reduction in the money supply can contribute to an increase in interest rates, as the cost of borrowing generally rises when money is less abundant

Higher interest rates can make loans more expensive for businesses, consumers, and government potentially slowing down borrowing and spending

The higher cost of borrowing and reduced spending can contribute to a decrease in economic activity

With higher interest rates, the annual servicing cost on existing government debt increases. This is because the government needs to pay higher interest on its outstanding securities

The increased gap between government revenue and expenses, driven by higher interest payments, puts pressure on the government's budget

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What does this mean?

Shortening Boom and Bust

Pakistan's boom and bust cycles are shortening rapidly, disallowing long periods of sustained growth (fuelled by consumption, rather than industrialisation or productive sector enhancement).

Sustained Current Account Deficit

With a small exception, Pakistan's inflows of foreign currency have always been outpaced by its outflows. It is unable to increase remittances, improve the export sector, or restrict imports so that growth and industry expansion are not negatively affected. This results in mostly external borrowing.

Perennial Fiscal Deficit

Domestically, Pakistan has not been able to reconcile its expenses with its revenues, resulting in a fiscal deficit for the national exchequer. This results in mostly domestic borrowing, which has the added disadvantage of crowding out the private sector.

All of this implies that Pakistan needs to borrow to meet most of its needs, including climate change and resilience efforts.

4 AN INEVITABLE GOVERNMENT DEBT CRISIS: PROJECTIONS

SCENARIOS FOR FUTURE PROJECTIONS

PROJECTIONS: CURRENT ACCOUNT BALANCE-TO-GDP RATIO

PROJECTIONS: FISCAL BALANCE-TO-GDP RATIO

PROJECTIONS: PUBLIC DEBT-TO-GDP RATIO

WHAT DOES THIS MEAN?

Key terms & concepts

TAX-TO-GDP RATIO

Proportion of a country's tax revenue compared to its GDP

FISCAL DEFICIT

Total Government Expenditure – Total Government Revenue excluding borrowings

REAL GDP GROWTH

Increase in a country's GDP after adjusting for inflation

DEBT-TO-GDP RATIO

Compares a country's total debt to its GDP, information on its ability to manage debt according to its economy's size

Three Scenarios for Future Projections

Scenario 1: Business As Usual

- Tax-to-GDP stays at 9.5%
- Consumption stays at 85%
- Export-to-GDP remains at 9.2%
- Growth rate stabilises at ~4-5%
- There are no reforms
- Anti-export bias remains

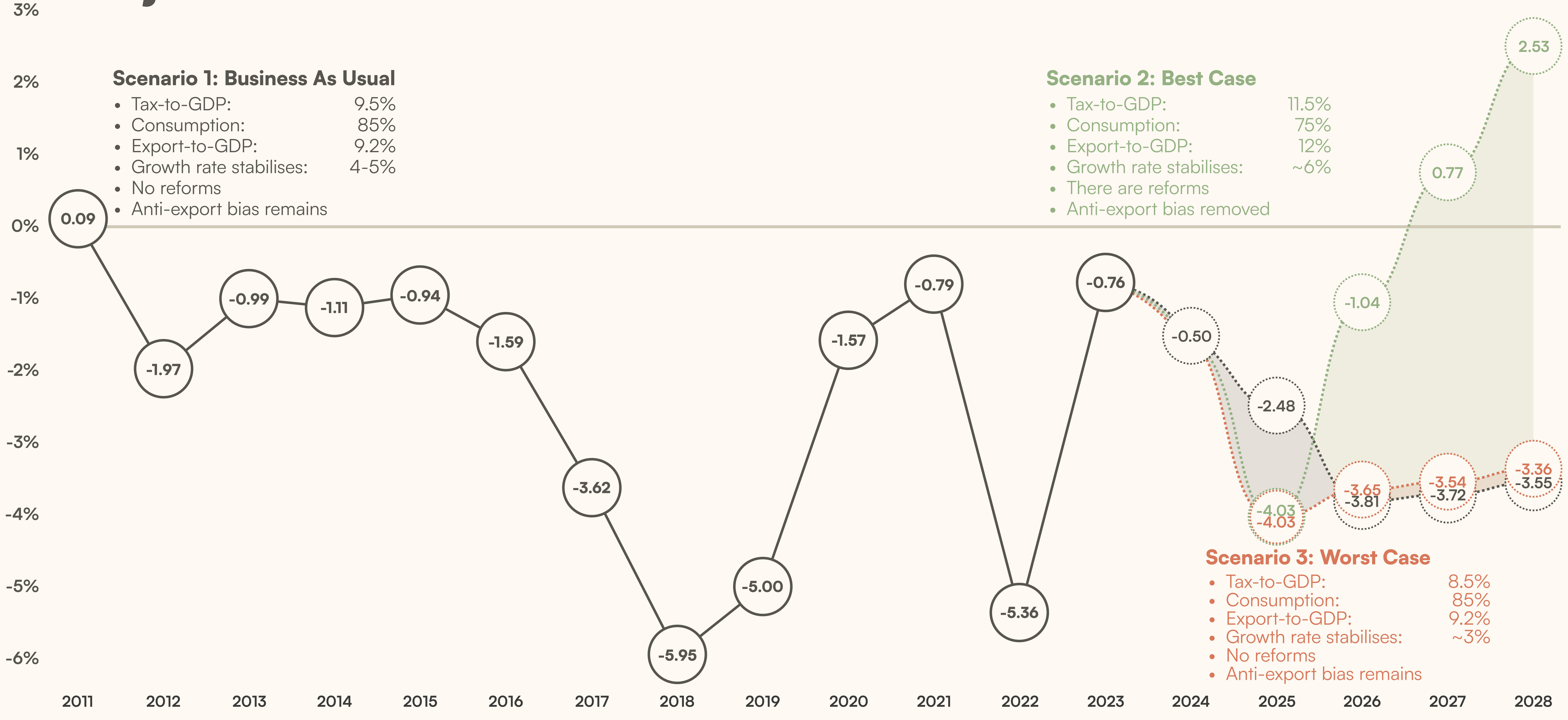
Scenario 2: Best Case

- Tax-to-GDP increases to 11.5%
- Consumption declines, stabilising at 75%
- Export-to-GDP increases to 12%
- Growth rate improves to ~6%
- There are reforms
- Anti-export bias removed

Scenario 3: Worst Case

- Tax-to-GDP reduces to 8.5%
- Consumption remains at historic levels
- Export-to-GDP remains at 9.2%
- Growth rate reduces to ~3%
- There are no reforms
- Anti-export bias remains

Projections: Current Account Balance-to-GDP Ratio



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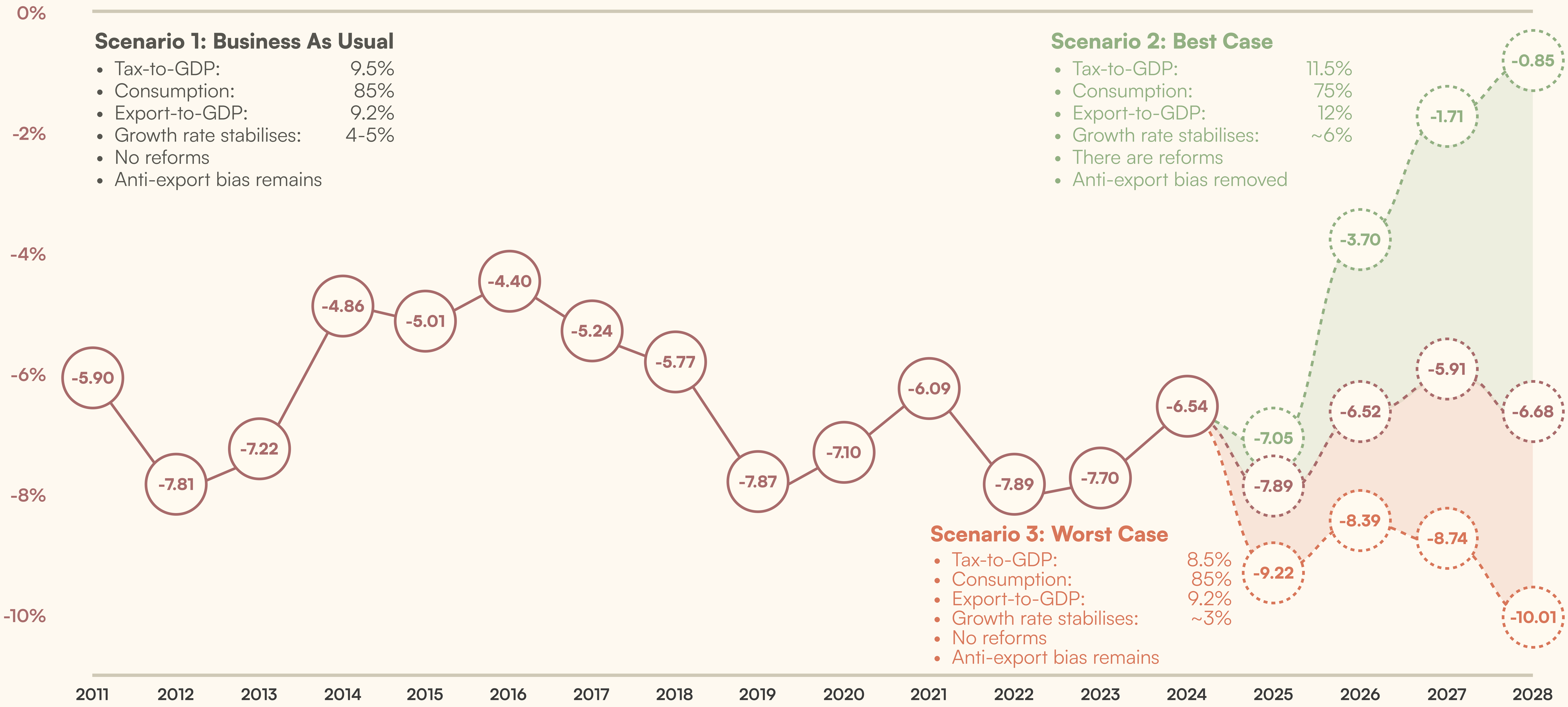
Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

Projections: Fiscal Balance as Percentage of GDP



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Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

For the Public Debt-to-GDP Projections, we use the following State Bank categories:

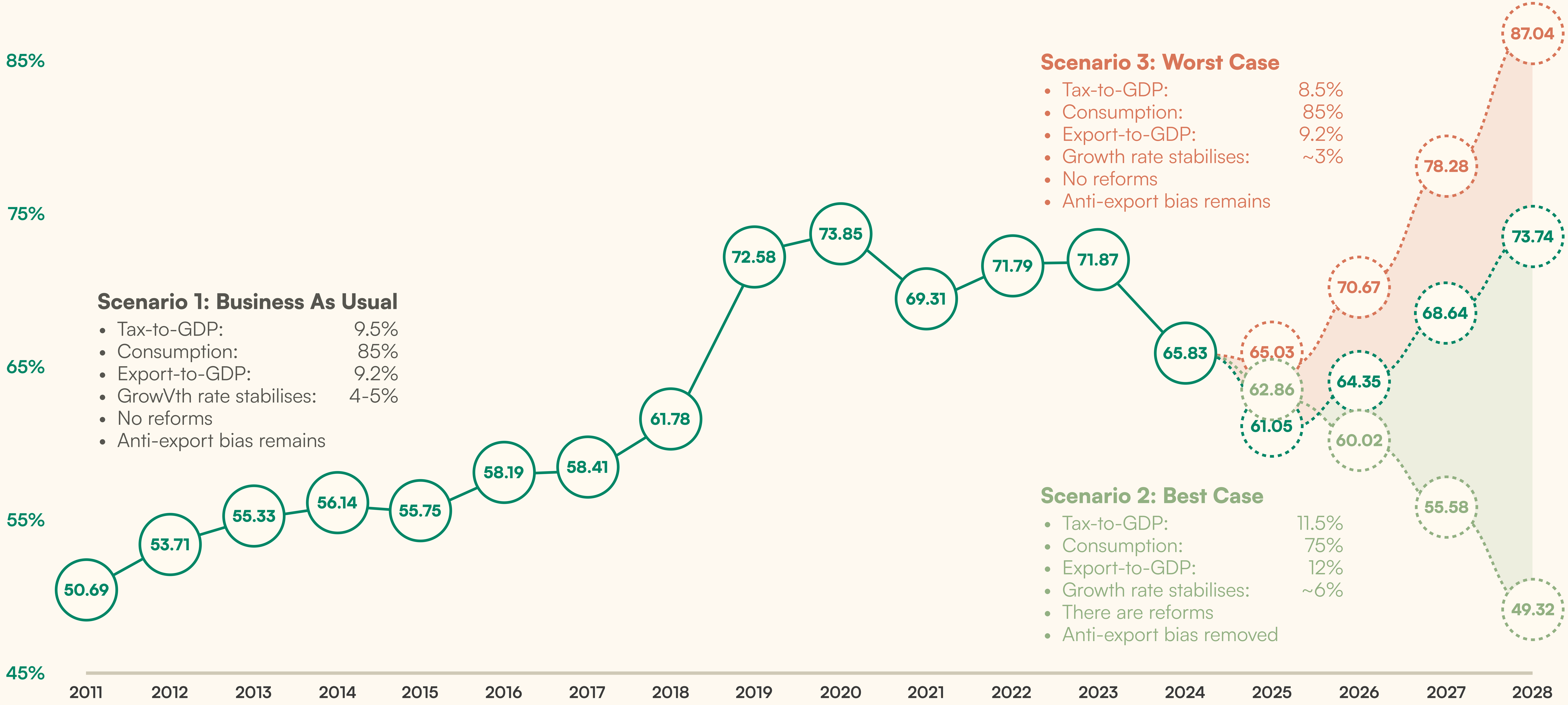
No.	Category	PKR trillion	USD billion
I.	Government Domestic Debt	38.8	135.5
II.	Government External Debt	22.03	76.9
III.	Debt from IMF	2.04	7.1
IV.	External Liabilities	3.10	10.8
V.	Private Sector External Debt	5.22	18.2
VI.	PSEs' External Debt	2.15	7.5
VII.	PSEs' Domestic Debt	1.69	5.9
VIII.	Commodity Operations	1.49	5.2
IX.	Intercompany External Debt	1.14	4.0
	Total	**60.83**	**212.4**

TABADLAB

Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

Projections: Public Debt-to-GDP Ratio

Government Domestic and External Debt (line items I and II in SBP Debt & Liabilities Summary)



Source: State Bank of Pakistan, Pakistan Debt & Liabilities Summary, via https://www.sbp.org.pk/ecodata/Summary-Arch.xls.

What does this mean?

Unsustainable Debt

The quantum of debt Pakistan requires is growing faster than the net output of the economy (GDP). This means that the economy's ability to grow or increase output is constrained. This is unsustainable. It demands transformational change.

Transformational Change

Unless there are sweeping reforms and dramatic changes to the status quo, Pakistan will continue to sink deeper, headed towards an inevitable default, which would be the start of the spiral.

Climate Swaps as a Solution?

Climate needs inevitably exacerbate Pakistan’s debt profile unless climate swaps are leveraged to mitigate both problems.

5

DE-RISKING THE ENVIRONMENT

EXPAND TAX NET

FIX THE TWIN DEFICIT PROBLEM

LOOK OUTWARDS

INCREASE DOLLAR INFLOWS

CLIMATE FINANCING

INTERNAL RECALIBRATIONS

Key terms & concepts

DEBT-FOR-NATURE SWAPS

Exchanging a portion of a country's debt for commitments to environmental conservation projects

CLIMATE FINANCING

Financial support provided to projects aimed at addressing climate change

DOMESTIC DEBT SERVICING

Repayment of borrowed money (interest and principal) to domestic creditors

CLIMATE ADAPTATION

Adjustments to cope with the impact of climate change (e.g. capacity-building)

CARBON CREDITS

Tradable permit allowing holder to emit a certain amount of greenhouse gasses to promote emission reduction

NFC

National Finance Commission

1. De-Risk the Business Environment

Before expecting investments in the country or export growth, it is critical to **de-risk** the environment.

How: Local and foreign investors require a stable legal framework and consistent sovereign commitments to consider long-term and high-risk investments. Honouring commitments, timely resolution of legal disputes, and swift bankruptcy proceedings are essential to reducing risk.

Reforms: The sovereign's risk is linked to its inability to control spending and boost revenues, leading to heavy reliance on debt, thus increasing overall risk. Showing the capability to implement fiscal reforms is crucial for reducing risk.

Policy continuity: Investment tends to favour higher return environments adjusted for risk. Volatility in policy decisions due to changes in the political environment increases risk.

2. Fix the Twin Deficit Problem

The twin deficits, unless managed, will continue to demand borrowing, which will increase servicing, continuing the endless downward spiral.

Fiscal Discipline and Expenditure Management: Implementing fiscal discipline and effective expenditure management can help in reducing the fiscal deficit. This involves controlling government spending, prioritising public investments, and ensuring efficient use of resources.

Export Promotion and Diversification: By promoting exports and diversifying the export base, Pakistan can work towards improving its current account balance. This can be achieved by identifying new export markets, supporting export-oriented industries, and enhancing trade competitiveness (see Idea 6).

3. Increase Foreign Currency Inflows for Capital Development

How: Create special funds and partnerships to bring in capital for important projects. These projects must prioritise export-oriented agricultural and industrial development.

Encourage Global Investments: Make it easier for global pension funds and government funds to invest directly into these projects instead of buying government bonds.

Tax Benefits: Offer investors tax benefits in key sectors that need growth. This solution is only viable if there is policy continuity and regulatory stability (see Idea 1).

4. Make Internal Recalibrations

For Pakistan's economy to grow, critical internal recalibrations need to be made in how we handle state owned enterprises (SOEs), and public-private partnerships (PPPs).

Managing SOEs: Privatise, sell, or at least break SOEs into smaller, competitive entities, capping subsidies and cross-subsidies.

Prioritise PPPs: Prioritise and expand a public-private partnership ecosystem, with stringent governance to mitigate inevitable elite rent-seeking. Public Sector Development Programme projects can be structured as PPPs, crowding-in local capital and foreign investors, establishing that they will become rarer.

Capital Reallocation: Encourage this by implementing policy changes, such as amendments to tax and commercial codes, improved compliance, and the reduction of subsidies, to redirect investment and capital allocation away from non-productive and non-export-oriented industries.

5. Expand Direct Tax Net

Political Will: No solution for improving the tax net is viable without political will and elite drawdown from rent-seeking.

Expand Tax Net: Include retail and wholesale trade in the tax net; incentivise provinces to increase property taxes. Digitise the economy and increase banked population to increase the tax net.

Redirecting Marginal Investor: Expanding the tax net means bringing more people and sectors into the tax system to increase government revenue, but also to redirect marginal investors to more productive sectors.

Redesign NFC: The NFC award must be redesigned to have provinces be responsible for expenditures, particularly for devolved subjects.

6. Look Outwards

Pakistan needs to improve its fiscal regime to open space for private credit, particularly for local firms and industries. All of this needs to be viewed through an export-focused lens.

How: Establish an export-oriented industrial policy and reduce trade barriers, incentivising redirection of credit and capital towards local firms, allowing them to be more productive, therefore allowing greater exports and increased FDI.

Export-Orientation:

- First, it needs to come through a consistent dollar devaluation policy (or at least an end to attempts to shore it up).
- Second, it needs a drawdown of incentives for local investments, to give the marginal investor reason to go towards exports.
- Third, it needs to draw down industry-specific subsidies that have resulted in elite capture, even among exporters.

7. Rethink Climate Financing

Pakistan can use the debt it already owes towards fighting climate change, in addition to forging a strong internal carbon credit regime.

How: Leverage debt-for-nature swaps to meet Pakistan's extensive climate change needs in adaptation, resilience, and green transition.

Climate-Linked Debt: Identify Pakistan's climate needs, negotiate with creditors, devise climate performance metrics, link repayments to identified metrics, ensure third-party oversight, and extensive monitoring, evaluation, and learning.

Carbon Credits: Create a robust carbon trading ecosystem to both make it costly for companies to pollute, and fund projects that accelerate climate transition.

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Errata: *Previous version contained errors on slide 17 mislabeling France and Germany, and an error on slide 36 on the number of IMF programmes Pakistan has availed. This version reflects corrections.*

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