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PAKISTAN

POLICY BRIEF

Pakistan's Debt Crisis

Understanding the Challenges, Consequences, and Pathways to Reform

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About Accountability Lab Pakistan

Accountability Lab (AL) is an Islamabad-based think tank registered in Pakistan under the Societies Act 1860 as a non-profit organization and certified by the Pakistan Center for Philanthropy (PCP). Accountability Lab works to make governance work for people by supporting active citizens, responsible leaders, and accountable institutions. We are reimagining how to build accountability to support a world where resources are used wisely, decisions benefit everyone fairly, and people lead secure lives.

Executive Summary

This policy brief underscores the urgent need for a holistic and inclusive approach to address Pakistan's escalating debt crisis. With a national debt burden reaching Rs. 67,525 billion by 2024 amounting to 74.3% of GDP, the country faces a formidable economic challenge that jeopardizes fiscal stability, development priorities, and social equity. Mounting interest payments, inefficient debt utilization, and heavy reliance on domestic and external borrowing highlight the structural vulnerabilities in Pakistan's public finance architecture. These challenges demand strategic reforms that ensure fiscal responsibility, enhance revenue generation, and direct resources towards productive and inclusive development.

Recognizing the diverse socioeconomic impacts of debt mismanagement, especially on vulnerable populations, the brief advocates for debt strategies that protect social safety nets, improve investment in human development, and prevent diversion of funds from essential sectors like health, education, and climate resilience. An alarming 94.2% of Pakistan's net revenue is allocated to debt servicing, leaving marginal fiscal space for welfare and development; a trend that threatens intergenerational equity and long-term sustainability.

Initial recommendations emphasize the need for transparent debt management frameworks, better risk assessment mechanisms, and restructured SOEs to eliminate fiscal leakages. Targeted reforms in tax policy and improved oversight of debt-related expenditures are crucial for restoring macroeconomic balance. Subsequently, the brief recommends adopting international best practices such as Brazil's fiscal responsibility law, India's FRBM Act, and Vietnam's concessional borrowing model, to inform Pakistan's path to fiscal discipline, debt sustainability, and growth-oriented investment.

This brief calls for a transformative shift towards a debt policy that not only stabilizes the economy but also advances inclusive development and human capital investment. Through global cooperation, institutional reforms, and responsible leadership, Pakistan can break free from the debt spiral and chart a resilient, transparent, and equitable economic future.

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A Simple Look at Pakistan's Debt

Imagine Pakistan as a household. Like any household, Pakistan sometimes needs to borrow money to cover expenses. These expenses can be big things like building roads and hospitals, or smaller things like dealing with unexpected problems like floods or a sudden drop in exports.

Pakistan's debts were initially controllable. It mostly borrowed from international organisations like the World Bank and friendly nations like the US and China. These loans aided in the construction of the nation's power plants, roadways, and dams.

Pakistan's needs increased along with its population size. The nation's finances were strained by natural calamities like floods and man-made calamities like wars. This frequently necessitated further borrowing, as did economic downturns. Lately, these loans have not been spent to add productive capacity to the economy. Instead, Pakistan has now been borrowing to meet its debt servicing needs.

In recent decades, Pakistan’s debt levels have risen exponentially, generally caused by the nation’s economic slowdowns and external impacts such as COVID-19. Due to expensive, partially-completed development projects, such as the China-Pakistan Economic Corridor, along with the slowed economy, Pakistan is stuck in debt servicing challenges. As the government’s revenue decreases, it becomes further challenging to repay its debts.

Where Does the Debt Come From?

- International Organisations: To promote economic stability and progress, organisations such as the World Bank and the International Monetary Fund (IMF) offer loans. Nevertheless, these loans frequently have requirements.
- Bilateral lenders: Pakistan borrows from other countries, like China, the United States, and Saudi Arabia. These loans often come with specific conditions or agreements.
- Private Lenders: Sometimes, Pakistan borrows from banks and investors.

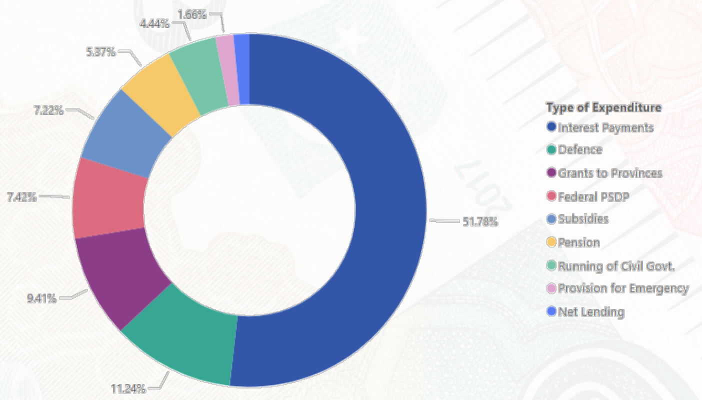
Paying Back the Debt:

Just like a household, Pakistan needs to pay back its loans. This is called "debt servicing." It involves:

- Repaying the Principal: This is the original amount borrowed.
- Paying Interest: This is like a rent on the borrowed money.

Pakistan's Expenditure Allocation

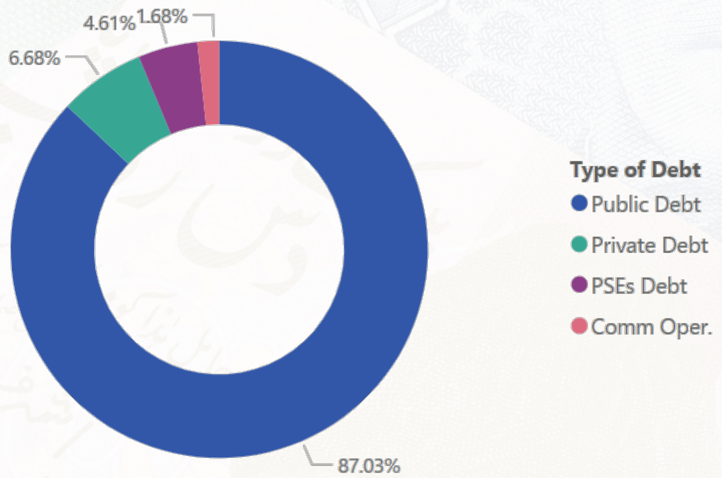
The Type of Expenditure



Source: Budget in Brief 2024-25

This chart reveals a concerning picture of Pakistan's expenditure allocation. If the country's total expenditure were Rs. 100, a staggering Rs. 51.78 would be spent on interest payments alone, highlighting the burden of debt servicing on the national budget. This leaves a significantly smaller portion for essential sectors like defence (Rs. 11.12), grants to provinces (Rs. 9.41), and federal Public Sector Development Programs (Rs. 7.47). Subsidies consume another Rs. 7.22, while pension and running the civil government account for Rs. 5.37 and Rs. 4.44, respectively. A mere Rs. 3.37 is allocated for emergency provisions, and only Rs. 1.66 is dedicated to net lending.

Composition of Debt by Type of Debt



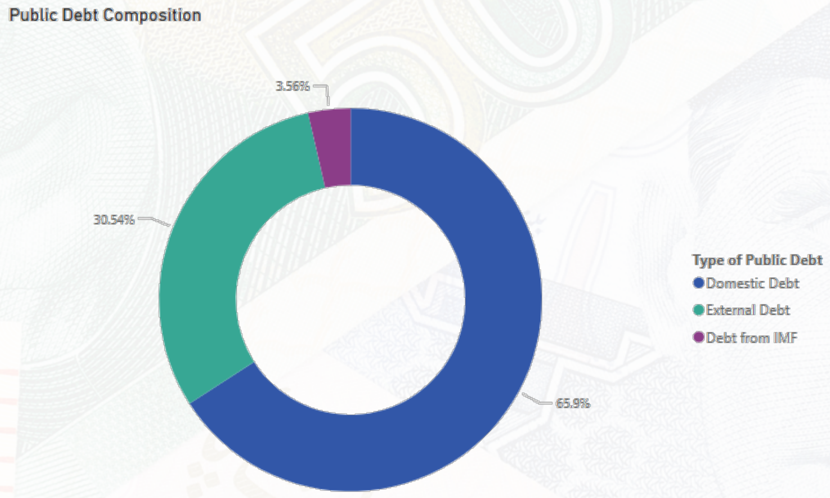
Source: State Bank of Pakistan – Pakistan's Debt and Liabilities

Comprehensive Analysis of Debt Accumulation:

This chart illustrates the breakdown of Pakistan's total debt by its different types. The most significant portion of the debt is attributed to **Public Debt**, constituting a substantial 87.03% of the total. This is followed by **Private Debt** at 6.68%, **Public Sector Enterprises (PSEs) Debt** at 4.61%, and **Commercial Operations (Comm Oper)** at 1.68%.

Definitions of Debt Types:

- **Public Debt:** The debt incurred by the government.
- **Private Debt:** This encompasses debt contracted by private entities within the country, like businesses or individuals.
- **PSEs Debt:** the debt of Public Sector Enterprises (PSEs), which are state-owned companies or corporations.
- **Comm Oper. Debt:** The debt related to commercial operations or activities within the country.



Source: State Bank of Pakistan – Pakistan's Debt and Liabilities

The chart demonstrates that Public Debt is the dominant component of Pakistan's overall debt burden, further divided into three segments.

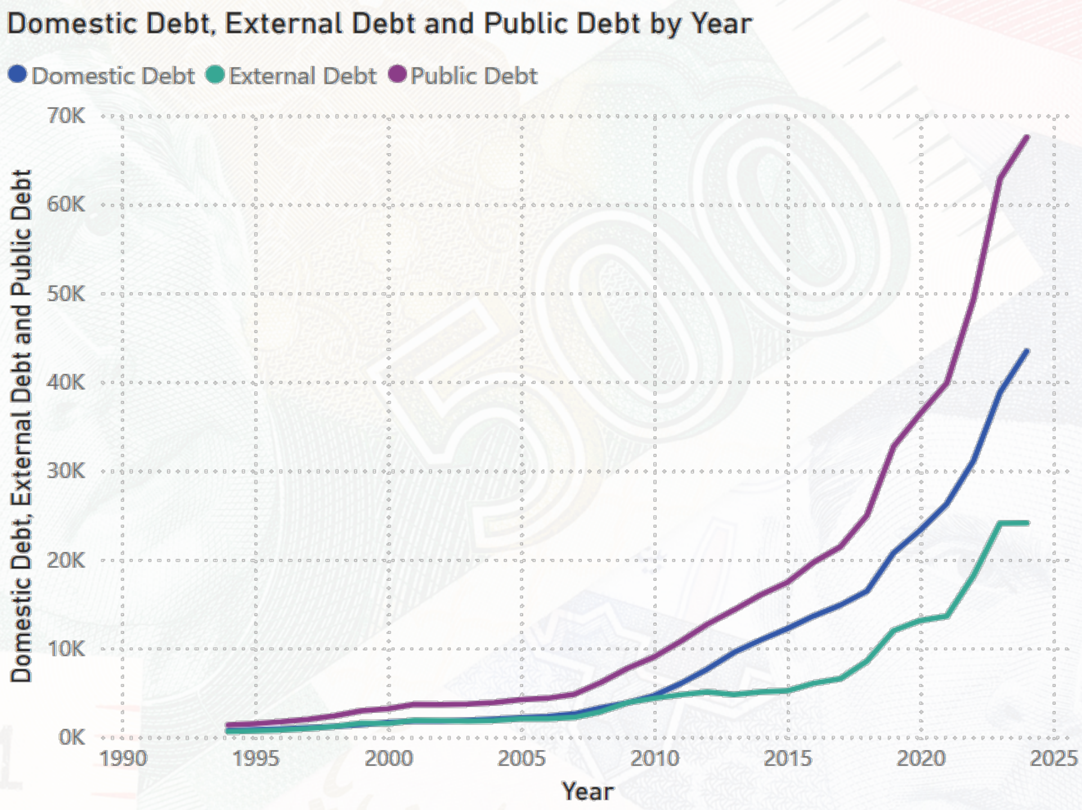
1. Debt from IMF: As per the state bank of Pakistan, about 3.56% of the total public debt is owed to the IMF.

2. External Debt: External debts are comprised of public debt obligations that foreign governments, international financial institutions, and foreign commercial lenders hold. External Public debt accounts for 30.54% of all public debt.

3. Domestic Debt: The domestic debt segment shows all the public debt that is owed to the Pakistani financial institutions, banks, and individuals. Public debt components show domestic debt dominates with 65.9% while external debt stands at 30.54% of the total debt.

The graph below illustrates a rising trend in public debt of Pakistan, with both domestic and external parts contributing to this increase. The rapid growth of Domestic Debt is a notable feature.

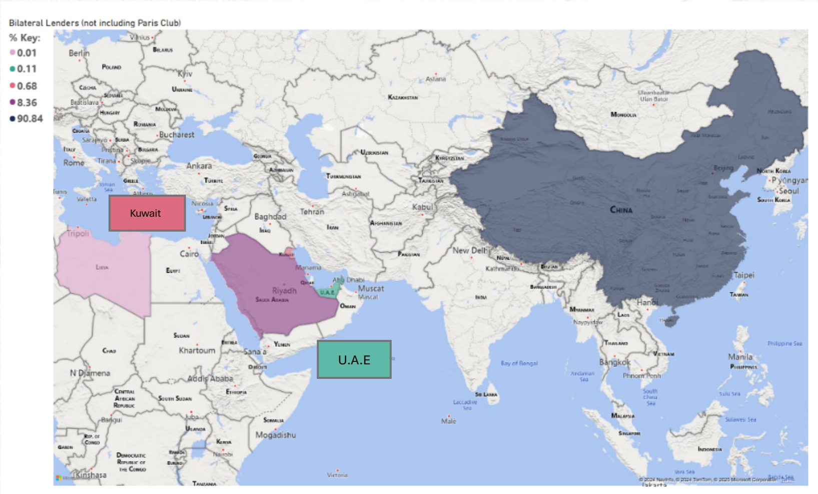
Source: Economic Survey of Pakistan – Chapter: Public Debt



Key Creditors

Bilateral lenders

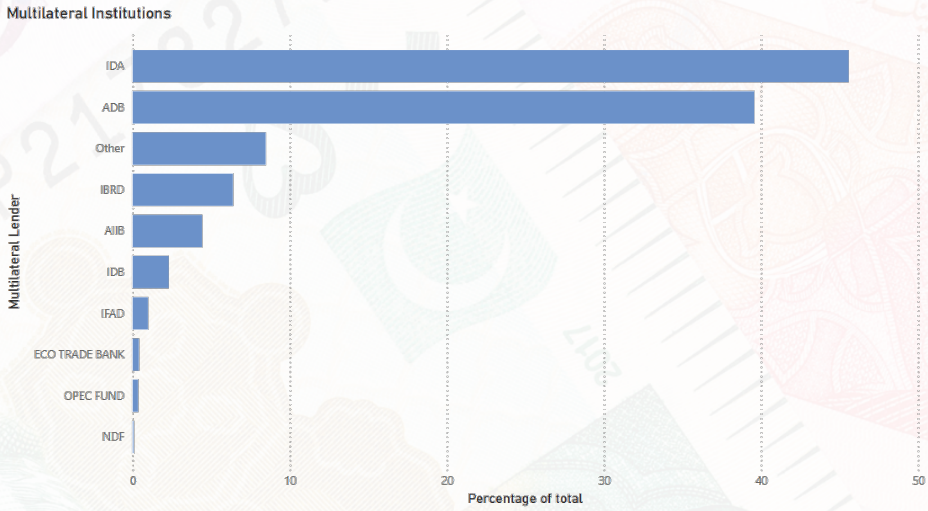
The map visually represents the distribution of Pakistan's bilateral lenders, excluding the Paris Club. It emphasizes China's significant role as a creditor to Pakistan, a contribution exceeding 90.84%, overshadowing other bilateral lenders. This map further shows a reliance on lending from the Middle East, particularly Saudi Arabia and the UAE.



Source: Economic Survey of Pakistan – Chapter: Public Debt

Multilateral institutions

1. **Dominance of IDA and ADB:** The International Development Association (IDA) and the Asian Development Bank (ADB) are the two largest contributors, with IDA holding the highest share. It should be noted that the International Bank of Reconstruction and Development (IBRD) and IDA, together, form the World Bank.
2. **Other Institutions:** A category labelled "Other" represents a significant portion of the funding, indicating contributions from multiple smaller institutions.
3. **Smaller Contributions:** Different international institutions, such as the International Bank for Reconstruction and Development (IBRD), along with the Asian Infrastructure Investment Bank (AIIB) and the Islamic Development Bank (IDB), and others, contribute notable amounts.
4. **Minimal Contributions:** The Eco Trade Bank, OPEC Fund, and Nordic Development Fund (NDF) have smaller contributions to Pakistan's funding.



Source: Economic Survey of Pakistan – Chapter: Public Debt

Overall, the chart highlights the significant role played by the IDA and ADB in providing funding to Pakistan, while also indicating the presence of a diverse range of multilateral institutions contributing to the country's development.

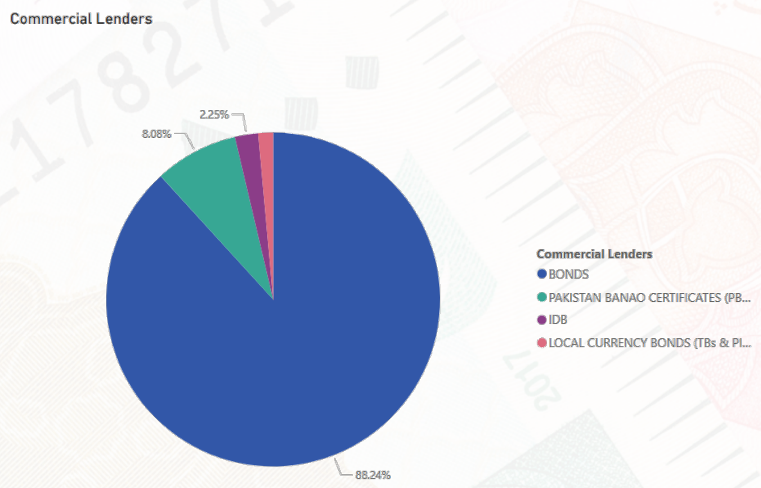
It is pertinent to mention that the State Bank of Pakistan does not categorize IMF under Multilateral Institutions, therefore it is mentioned in the composition of Public Debt above and not in this section.

Commercial lenders

The chart shows the composition of debt from Commercial Lenders, highlighting the different sources of borrowing.

- **Bonds:** This is the largest component, accounting for a substantial 88.24% of the total debt from Commercial Lenders.
- **Pakistan Banao Certificates (PBCs), Naya Pakistan Certificates (NPCs):** This category represents 8.08% of the debt.
- **IDB (Short-term credit):** This category accounts for 2.25% of the debt.
- **Local Currency Bonds (TBS & PIBs):** This category represents 1.43% of the debt.

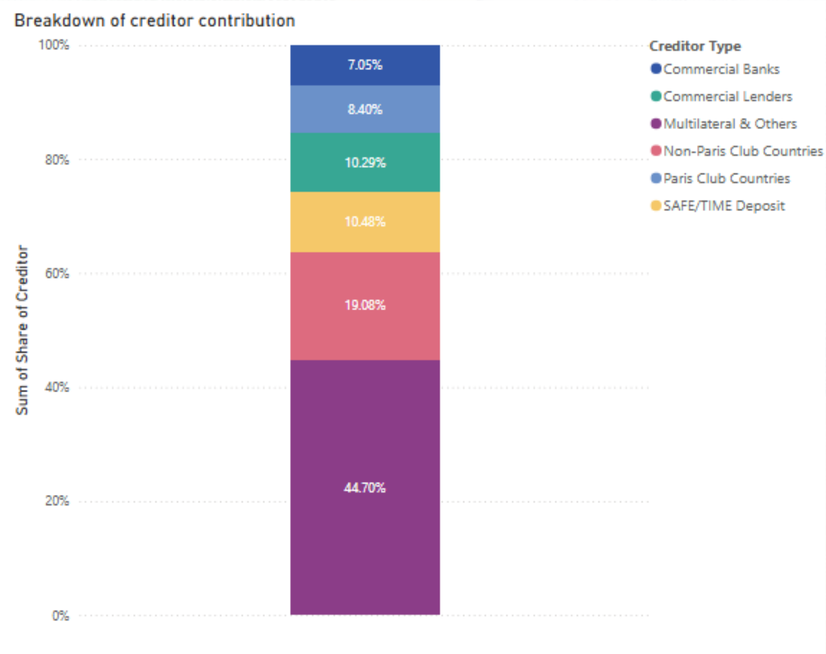
The chart emphasizes the dominance of Bonds as the primary source of debt from Commercial Lenders, comprising much of their borrowing.



Source: Economic Survey of Pakistan – Chapter: Public Debt

The breakdown of creditor contributions to Pakistan's debt is displayed in the stacked chart. With 44.70% of the overall debt, the Multilateral Institutions are the biggest contributors. Non-Paris Club nations make up 19.08% of the total, with Paris Club nations, Commercial Lenders, SAFE/TIME Deposits, and Commercial Banks contributing smaller proportions.

The total public debt has risen to Rs 67,525 billion by 2024.

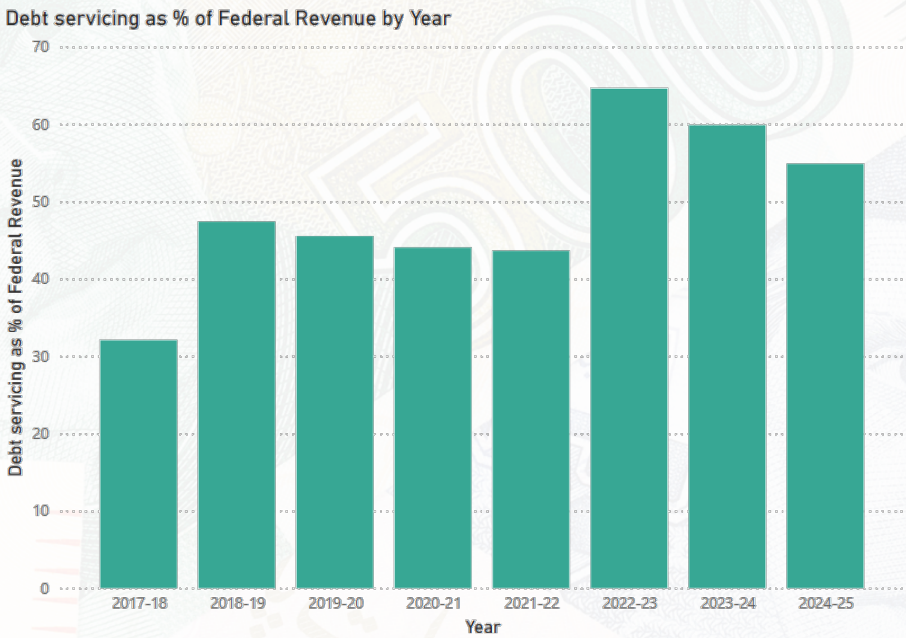


Source: Economic Survey of Pakistan – Chapter: Public Debt

Assessment of Interest Rates and Repayment Schedules

Notable patterns in interest rates and repayment plans are revealed by analysing International Debt Statistics from 2013 to 2023. Interest rates varied, reaching a high of 4.4% in 2018, reflecting lending practices and the state of the world economy. As average loan maturities decreased from 21.1 years in 2013 to 11.3 years in 2018 before levelling off around 14–16 years, repayment plans were more stringent. Additionally, grace periods decreased from 6.0 years in 2014 to 3.6 years in 2023, suggesting a move away from more lenient borrowing conditions. The chart displays the proportion of federal revenue allocated towards debt servicing (interest payments) in Pakistan over the years 2017-18 to 2024-25.

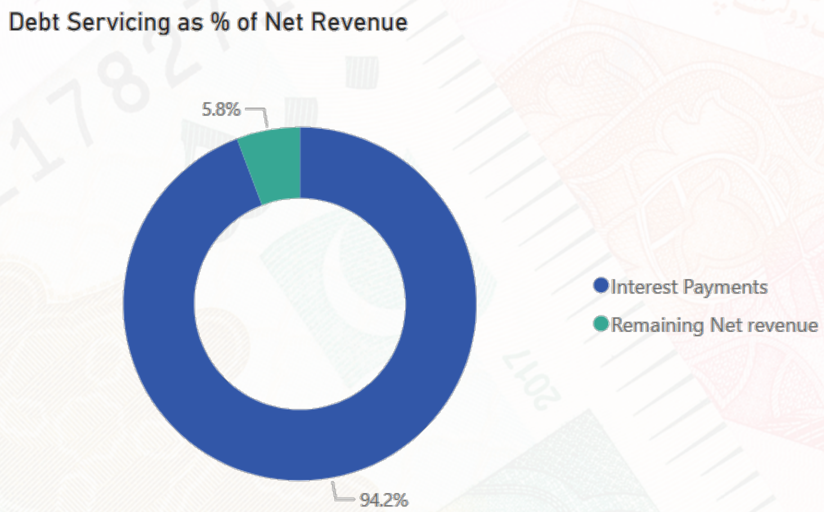
The federal revenue dedicated to debt servicing has steadily increased, with a significant spike in 2022-23. This trend persists in subsequent years, indicating a sustained burden on the federal budget.



Source: Economic Survey of Pakistan – Chapter: Fiscal Development

The pie chart illustrates the proportion of net revenue allocated to debt servicing. Net revenue refers to the **total revenue of the country minus the total expenses.**

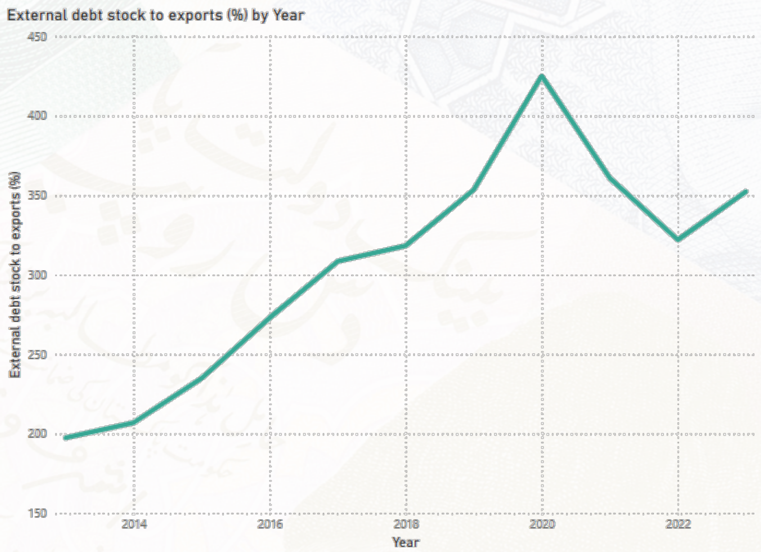
- **A large portion (94.2%)** of the net revenue is used for debt servicing.
- **Only 5.8%** of the net revenue is left for other expenses.



Source: Budget in Brief 2024-25

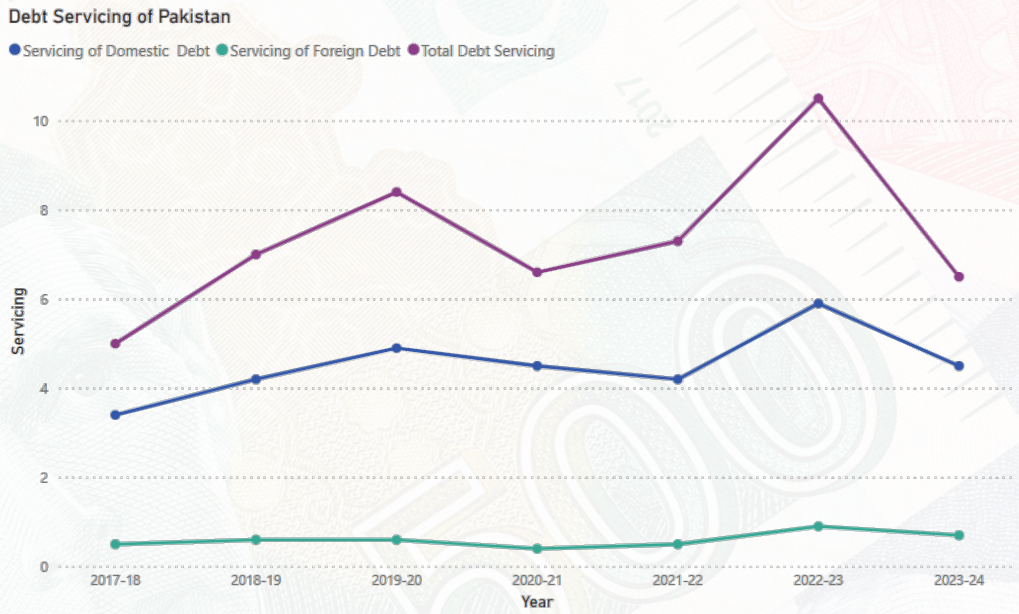
The graph depicts the ratio of External Debt Stock to Exports as a percentage from 2013 to 2023.

- The ratio exhibits a generally increasing trend throughout the observed period, indicating a growing burden of external debt on the country's export earnings.
- The ratio appears to have risen steadily from 2013, reaching a peak in 2020. This suggests that more export revenue is now required to service external debt obligations. However, it is alarming to note that exports have not been growing significantly in Pakistan. So, Pakistan has to rely on other sources of foreign exchange, including remittances and more debt.



Source: World Bank - IDS 2024

This trend highlights a potential concern for the country's economic health. As a higher portion of forex inflow is directed toward debt servicing, it could limit the available resources for domestic investment, economic growth, and development. The rising trend suggests a growing burden of debt servicing on the country's ability to earn foreign exchange. A high debt service burden can negatively impact the competitiveness of exports, hindering economic growth.



Source: Economic Survey of Pakistan – Chapter: Public Debt

The graph indicates that Pakistan's overall debt servicing increased significantly between 2017–18 and 2023–24, peaking in 2022–23. With a minor decline in recent years, domestic debt servicing has stayed stable. The service of foreign debt has significantly increased in 2022–2023. This demonstrates the mounting strain that debt servicing is placing on the Pakistani economy and raises the possibility that more government funds are being used for debt repayment, which might reduce spending on vital sectors like healthcare and education.

At 74.3% of its GDP (Taseer Hadi & Co., 2024)., Pakistan's state debt has increased dramatically. Heavy reliance on domestic debt, rising government spending, and circular debt in the energy sector are factors behind this expansion. External shocks, currency depreciation, and a lack of structural reforms have made the debt issue worse (Khan, 2024). Reliance on government creditors, the maturity and composition of external debt, and a lack of investment in areas that spur growth have all contributed to the rise in debt. Reliance on official creditors for foreign debt restricts debt management options and jeopardizes sustainability for the Pakistani government. Growth opportunities and revenue generation to pay off the debt have been constrained by a lack of investment in climate resilience and infrastructure projects (Husain, A. M., 2024).

Debt Management Gaps

Numerous studies point to significant shortcomings in Pakistan's debt management. Investor trust has been damaged and efficient fiscal management has been impeded by inconsistent fiscal policies, which are marked by frequent changes and a lack of long-term planning (Khan, 2024; KPMG Taseer Hadi & Co., 2024). The negative effects of policy uncertainty and the lack of a unified national fiscal framework are further highlighted by the World Bank (2024).

Additionally, excessive dependence on external funding, especially from official creditors, has made people more susceptible to outside shocks (Husain, 2024; World Bank, 2024). This reliance exposes the economy to possible delays in payments and restricts flexibility in managing repayment schedules. The crowding-out effect of government borrowing on private-sector finance is another cautionary tale from the World Bank (2024). The failure to expand the tax base remains the main hurdle that stands in the way. Government debt payments remain challenging because the existing tax-to-GDP ratio remains low even after-tax collection efforts (World Bank, 2024). Inefficiency in tax collection worsens because the government has a restricted tax base and limited systemwide measures to enroll non-compliant taxpayers (International Monetary Fund, 2023; Khan, 2024).

The findings demonstrate that Pakistan must undertake substantial changes to its debt management structure to achieve sustainable economic development. The necessary reforms require establishing both a wider tax foundation and multiple funding streams along with improved fiscal control measures.

Inefficiencies

Several studies indicate that inefficiencies are putting pressure on Pakistan's debt management. The prevalence of unsustainable borrowing for low-return companies is one notable inefficiency. The government is saddled with debt that does not generate the economic advantages required to pay it back because of this misallocation of resources (Khan, 2024; World Bank, 2024). The finest illustration of this inefficiency is found in prior investments in State-Owned Enterprises (SOEs) that have underperformed (Khan, 2024).

Underperforming SOEs are another major inefficiency (Husain, 2024; Khan, 2024; World Bank, 2024). These enterprises often suffer from mismanagement, leading to financial losses that necessitate government bailouts and guarantees (Khan, 2024; KPMG Taseer Hadi & Co., 2024). The World Bank (2024) particularly highlights the energy sector as a place where fiscal resources are severely strained by inefficiencies and circular debt.

Lastly, most relevant studies highlight the critical inadequacy of debt oversight measures. Effective debt management is hampered by insufficient risk assessment frameworks, disjointed management structures, and opaque debt reporting (World Bank, 2024; KPMG Taseer Hadi & Co., 2024). All these inefficiencies add up to Pakistan's unmanageable debt trajectory.

Long-term fiscal stability and economic growth depend on addressing them through better project evaluation, SOE reforms, and a more centralised and transparent debt management framework (International Monetary Fund, 2024; World Bank, 2024).

Analysis of Loan Refraction Practices

Loan diversion occurs when development loans are diverted to address budgetary shortages, affecting long-term economic progress and reducing the intended benefits. Additionally, current expenditures are financed by external financing, such as foreign institutions, limiting sustainable growth and reducing capital investments.

Impact on Debt Utilization Efficiency

- **Reduced Economic Returns:** Loan misallocation for budgetary deficits reduces expected economic returns on investments (International Monetary Fund, 2024; World Bank, 2024; KPMG Taseer Hadi & Co., 2024). This diminishes the benefits for both the government and lenders (World Bank, 2024).

- **Increased Fiscal Pressure:** When governments fund current expenses through debt, their long-term budget constraints rise (International Monetary Fund, 2024; World Bank, 2024). Government reliance on new loans to fund operational activities creates an unending cycle where borrowing exceeds economic growth. (International Monetary Fund, 2024; World Bank, 2024).

- **Erosion of Credibility and Trust:** Loan diversion erodes trust among domestic and international stakeholders (World Bank, 2024). Lenders may perceive the government as a higher risk, leading to higher borrowing costs or reduced access to future financing (World Bank, 2024).

- **Institutional Framework inadequacies:** According to the World Bank (2024), misallocation is a sign of institutional framework inadequacies that control public financial management. It is easier to redirect funds when there is insufficient control and accountability.

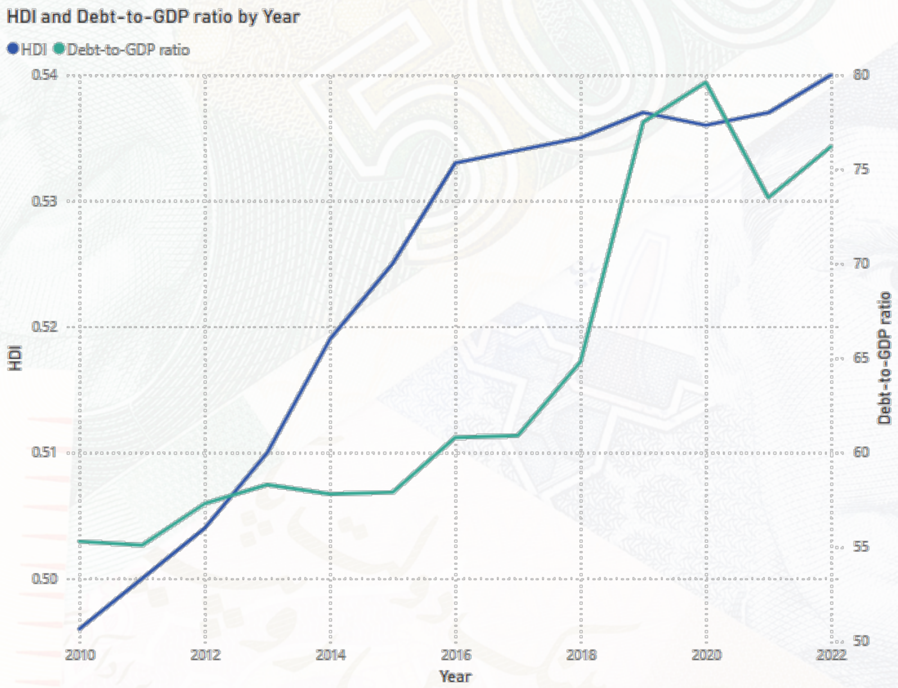
- **Undermining Long-Term Development Goals:** Development projects face long-term growth constraints due to funding misallocation that interferes with achieving sustainable development (International Monetary Fund, 2024; World Bank, 2024). The government's failure to allocate funding to essential fields such as education and infrastructure blocks the path toward future development.

Data on Misdirected Funds

While the studies lack precise quantification of misdirected loans, they highlight the qualitative impact on fiscal sustainability (International Monetary Fund, 2024; World Bank, 2024; Husain, 2024).

- **High-Interest Payments:** A significant portion of government revenue is consumed by interest payments on public debt (Husain, 2024), indicating a substantial amount of borrowed funds is not used effectively (Husain, 2024).
- **Large Fiscal Deficits:** The need to borrow to cover deficits created by fund diversion is a major concern (World Bank, 2024).
- **Subsidy Allocations:** Ineffective targeting of subsidies, particularly in the energy sector, diverts funds from productive investments (KPMG Taseer Hadi & Co., 2024).
- **SOE Support:** The government's financial support to loss-making SOEs reflects funds not directed towards productive investments (World Bank, 2024).

Diverting loans from specific purposes to budgetary deficits significantly undermines debt utilization efficiency in Pakistan. This practice compromises loan objectives, exacerbates fiscal challenges, and contributes to a growing debt burden. Addressing these issues requires a commitment to improved fiscal discipline, ensuring borrowed funds are used effectively for their intended purposes.



Source: UNDP – Human Development Report, IMF

Here we can use Pakistan's Human Development Index (HDI) and Debt-to-GDP ratio over the years to visualise whether loans intended for human development are invested accordingly.

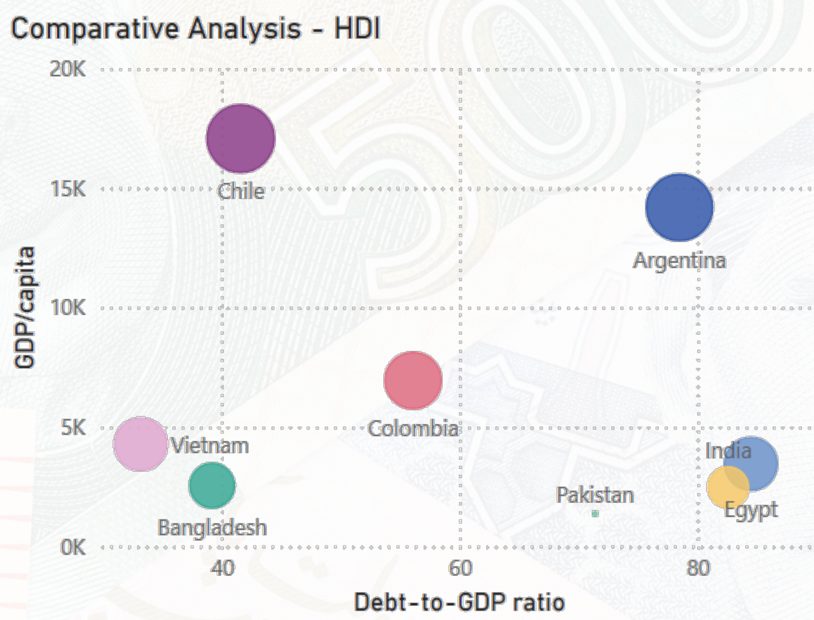
- **Growing Debt:** Throughout the examined time, Pakistan's debt-to-GDP ratio grew exponentially, as the graph exhibits.
- **Stagnant HDI:** The Human Development Index (HDI) exhibits a near horizontal trend from 2016 onwards, with only a minor upward trend, despite a considerable increase in debt.

The effectiveness of loans for development projects is called into question by this discrepancy between growing debt and stagnating HDI. From 2010 to 2022, as the debt-to-GDP ration grows by a staggering 37.7%, HDI only grows by 8.8%. It implies:

- **Misallocation of Funds:** A sizable amount of borrowed money might not go towards social safety nets, healthcare, education, or other areas of human growth.
- **Inefficient Utilisation:** Even when funding is given to these areas, it's possible that it won't be used properly or efficiently to produce the intended development results.
- **Corruption and Leakage**: The system's corruption and leaks may be taking money away from the intended purposes.

Global Comparators

In this study, three indicators are considered for Pakistan's global comparison. With those indicators being:



Source: UNDP, World Bank, IMF

- **Debt-to-GDP Ratio:** represented on x-axis, indicates the level of a country's debt relative to its economic output.
- **GDP per Capita:** represented on the y-axis, an indicator of a country's economic output per person.
- **Bubble Size:** The size of each bubble is relative to the country's Human Development Index (HDI), a composite measure of a country's development level in terms of health, education, and living standards. It is pertinent to mention that HDI here is normalized, where the HDI values were scaled to a range between 0 and 1, to draw a better visual comparison.

- **Pakistan** is positioned towards the lower-left corner of the plot. It has a relatively high debt-to-GDP ratio and a lower GDP per capita. The bubble size for Pakistan is the smallest, indicating low levels of HDI. Whereas India which has a higher debt-to-GDP ratio but also a much larger HDI indicates its significant investment on human capital.

Overall:

- Countries with higher GDP per capita tend to have higher HDIs.
- A high debt-to-GDP ratio doesn't necessarily translate into a low HDI. For example, Argentina has a high Debt-to-GDP ratio but a high HDI, which indicates lesser loan refraction practices.
- There is variation in HDI among countries with similar GDP per capita and Debt-to-GDP ratios, suggesting that other factors besides these two, influence human development.

Recommendations for Pakistan:

- **Fiscal Discipline:** The Fiscal Responsibility Law of Brazil shows Pakistan a model for budgetary responsibility through transparent financial management and expenditure control. A similar mechanism should be developed to improve budgetary discipline while controlling excessive borrowing. Pakistan has failed to implement its own FRDL Act.
- **Diversification of Funding:** India derived considerable knowledge from its accomplishment in expanding its financing base through Foreign Direct Investment and domestic investment. Following its example, Pakistan should examine equivalent strategies to decrease its foreign debt dependence.
- **Social Safety Nets:** Bangladesh's successful social safety nets provide an example that targeted investments also play a vital role in assisting disadvantaged communities within the country, and has a bigger impact on the country's HDI.
- **Debt Restructuring:** Argentina's debt restructuring model teaches Pakistan the essential elements of how proactive creditor negotiations enable transparency and joint participation.
- **Comprehensive Debt Management:** The debt management system in Brazil offers Pakistan important lessons because their single office enhances debt management coordination and control functions while centralizing related operations.
- **Structural Balance Rule:** Chile's sovereign wealth fund and structural balance rule also provide a valuable lesson, which aims to keep a balanced budget throughout the economic cycle. These measures will help Pakistan stabilise its fiscal situation and save for future requirements.
- **Fiscal Reforms and Diversification:** Colombia's fiscal policies, emphasis on tax collection, and economic diversification, demonstrate how countries can get out of the debt cycle.

- **Vietnam's Public Debt Management Strategy:** provides a guide to Pakistan, that debt sustainability can be built through concessional borrowing alongside strict limits and investments in infrastructure and human capital.
- **India's Fiscal Responsibility and Budget Management (FRBM) Act**: The Government of Pakistan should adopt India's FRBM Act as a benchmark for establishing financial discipline while strengthening their public finance administration. The public policy focuses on reducing fiscal deficit while enhancing transparency.

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