Research Report

on

The institutional issues in public debt sustainability in Pakistan

Submitted by

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DECLARATION

I, Qaisrani Muhammad Atif, (Student ID 51219620) hereby present my research report, "What are the institutional issues in public debt sustainability in Pakistan?" and declare that this research report is written on my own after conducting thorough research study.

I, also, confirm that I have not presented this research report in any other degree awarding institution in its current form and this has never been published before. In addition to this, I acknowledge the fact that all the material used from previous research studies and literature presented in this report is recognized and duly referenced.

Qaisrani, Muhammad Atif

5/6/2021

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SUMMARY

This study investigates the institutional issues in public debt sustainability in Pakistan including; coverage of fiscal statistics in Pakistan, explores cyclicality and structural problems in the economy, fiscal transparency and role of single treasury account for effective debt management in Pakistan. It also investigates public debt sustainability in Pakistan using responsiveness of primary surplus/GDP ratio against changes in public debt/GDP ratio between 1976-2020.

The finding of the research shows that the primary balance in relation to public debt in Pakistan between 1976-2020 shows a mix trend, wherein, policy inaction and policy inconsistency are both vibrant. The institutional coverage and accounting framework in Pakistan lacks in recording expenditure arrears and commitment accounting is not adopted in its true sense. The problem of increasing debt in Pakistan is not a cyclical problem but stems from structural problems. Fiscal transparency is increasing yet financial managers circumvent fiscal rules and institutions to keep important debt charges off-balance sheet. Lastly, single treasury account is not followed in its true sense in the country thus asymmetric information is available to the government.

It is advised that government responsiveness of increase in public debt/GDP ratio must be counter-balanced by increase in primary surplus/GDP ratio so as to keep stock of public debt liabilities under control. Government is also advised to fully adopt commitment accounting so as to lay foundation for adoption of accrual basis of accounting to enhance institutional coverage of debt statistics in Pakistan. Lastly, adoption of Treasury Single Account with unified banking system and

fiscal transparency must be ensured for sustainable fiscal and debt management in the country.

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CPEC	China-Pakistan Economic Corridor
DPCO	Debt Policy Coordination Office
EDL	External Debt Liabilities
FDI	Foreign Direct Investment
FRDLA	Fiscal Responsibility and Debt Limitation Act, 2005
GDP	Gross Domestic Product
GFS	Government Finance Statistics
IMF	International Monetary Fund
IFMIS	Integrated Financial Management Information System
IPSAS	International Public Sector Accounting Standards
NSS	National Savings Scheme
NFC	National Finance Commission
PDI	Personal Disposable Income
PPP	Public Private Partnership
SBP	State Bank of Pakistan
SAP	Systems Application and Products in data processing
TSA	Treasury Single Account

Chapter 1. Introduction

1.1. Introduction

Pakistan is a developing country and facing myriad of socio-economic problems on the domestic and international front. The strategic location of the country bordering the war trodden Afghanistan and having troubled relations with India, makes it difficult to maintain a sustained growth trajectory. The economy of Pakistan replicates the common characteristics of developing economies with structural and cyclical factors contributing to overall fiscal deficit. These factors include; twin deficit, low savings rate, less than optimal development of financial sector; low degree of openness, governance issues, security related expenditures with a huge outlay and structural problems. Owing to these reasons, the economy is always under pressure to generate enough resources to meet the expenditures. Resultantly, the government resorts to domestic and international borrowing to bridge the resource expenditure gap or fiscal deficit that translates into public debt.

Since, Pakistan is a developing country with low tax to GDP ratio and low carrying capacity to impose more taxes, the financial managers of the country resorts to internal and external financing which led to huge pileup of debt liabilities over the years. The question, however, remained how much is too much? And whether public debt is sustainable or not? In this regard a debt committee was established in the early 2000s to setup a road map for reduction and management of debt in the long-run. The said efforts lead to the creation of Debt Policy Coordination office (DPCO) and enactment of “Fiscal Responsibility and Debt Limitation Act, 2005”. The committee adopted a fiscal rule which is 60% of debt to GDP ratio limit for the economy although, technical analysis by IMF staff set the prudential limit of 40% for developing countries and 60% of debt to GDP ratio for developed countries and guides that such limits may not be breached in the long-run.

The underlying problem in fiscal management in Pakistan with few inelastic appropriations and expenditures albeit consuming high share has led to substantial increase in debt liabilities of Pakistan in the last decade. The main reasons for this surge in public debt liabilities are institutional issues such as fiscal mismanagement, fiscal federalism, fiscal transparency, coverage of fiscal statistics, accounting framework, lack of single treasury account on one hand and operational factors such as low level of tax revenue and non-tax revenue, high expenditure on debt servicing, high defense related expenditures, huge outlay on pension expenditures, losses from public sector enterprises, power sector losses, phenomenal decrease in FDI, grants, portfolio investment and exports, war on terror, security related expenditures and natural calamities like floods and earthquake during the reference period.

It has been observed that Pakistan has borrowed heavily in the past few years. The composition of public debt shows that most of the debt is raised from domestic sources and between year 2008 to 2019, government has added almost Rs.20,007 billion in domestic debt which is 64% of total public debt liabilities of the government currently standing at Rs. 23,281 (USD 138 bn), while external debt has increased to Rs.13,116 billion (USD 78 bn) that accounts for 36% of the total public debt. If this trend goes unchecked, Pakistan debt profile will likely worsen in the next few years that will have impact on macroeconomic stability due to increase in debt servicing appropriations thereby squeezing constrained resources for socio-economic expenditures

A close look into the components of public debt including domestic and external debt reveals that domestic debt has raised sharply from year 2010-11 onwards till the signing of new Extended fund facility in 2014 and a new agreement in 2018 by the newly elected government. The main reason for this tilt towards domestic borrowing was suspension of stand-by facility by the IMF due to non-compliance of the commitments given by the government of Pakistan to the IMF. This, not only, led to decrease in financing from the IMF but other donors that shy away from providing the necessary financing for carrying out expenditure on physical infrastructure, human development, education and health that ultimately had a negative impact on GDP growth that declined sharply and economy grew between 2.5% to 3% annually between 2008 to 2014. The government was left with no option but to raise immediate financing from high interest bearing short-term domestic sources. This led to sharp increase in domestic debt that was almost 52% of the public debt to 64% in 2020. On the other hand, external debt has also increased from Rs.2852 billion in 2008 to Rs.13,116 billion in 2020 although most of the funding comes from China through China Pakistan Economic Corridor (CPEC) but share of external debt liabilities in the debt portfolio has decreased from almost 59% to 36% in 2020.

The unbridled increase in public debt liabilities causes growth, poverty and employment to bear the brunt of increase due to decrease in investment as investors fear the uncertainty of policies following the rising level of debt and shy away from investment in long-term projects resulting in decrease in employment opportunities and increase in poverty. Similarly, increase in public debt translates into flight of capital as private sector fears the future increase in taxes to service the debt or imminent devaluation.

The ideal response of response of primary surplus to increase in public debt is positive, however, the debt profile becomes susceptible to higher risk and compromises fiscal and debt sustainability if the response is negative or haphazard that shows policy inconsistency or policy inaction by the government. The primary balance in relation to public debt in Pakistan between 1976-2020 shows a mix trend, wherein, policy inaction and policy inconsistency are both vibrant. Moreover, the political regime in place during the reference period also determines fiscal stance of the government since it includes both the rule of democratically elected governments and military dictators. The analyses show that average primary balance between 1976-1990 was -4.2% that suggests that fiscal stance during the reference period was expansionary and increase in public debt was not countered by increasing primary surplus. The period between 1991-2000 shows an average primary balance of 0.6% which shows that despite the increase in public debt, government was able to stay afloat and produced primary surplus during democratically elected government's rule. The period between 2001-2010, the primary balance remained 0.2% on average due to the fact that the country got massive inflows in response to war on terror and becoming ally of the US. This period also witnessed tremendous decrease in public debt liabilities including rescheduling of loans especially the Paris club loans yet the economy was more consumption oriented and investment was largely ignored. It is due to this reason that the era between 2010-2020 witnessed primary balance of -1.9% on average that shows policy inaction or following of expansionary fiscal stance which could be gauged from the fact that economy could grew at 5.3% in 2017-18 and massive development activities were carried on during this period. This period also witnessed shifting of debt liabilities from external to domestic debt liabilities and it was due to this reason that interest expenditures on debt servicing increased many folds which the new government after 2018 started to change with the help of fiscal consolidation. This could unfortunately not be realized in its true sense due to COVID 19 pandemic and bailout package amid low level of business activity.

Since, Primary balance was the main thrust of this research report, it explored many other intriguing issues that require immediate attention of the policy makers in

Pakistan. This inter-alia includes, use of specific accounting framework which is currently modified cash basis of accounting that lacks in capturing accruals in the form of commitments both on the assets and liabilities side of the balance sheet. The report also finds fiscal transparency to be compromised as budget strategy was not shared with the public during the reference period, information on off-balance sheet activities that carry significant hidden risk is not reflected in the financial statements of the country, in-year reports are made but not published with the timeliness of 01 month, the annual budget execution report is not made available with the timeliness of 06 months and hence it loses its essence, pre-budget statement is never made public and annual audit report is published with a timeliness of more than 06 months. It is not only the availability of information is important but availability of information at the right time is more import to make timely decision and fix responsibility.

The reports also highlight the issue of fiscal indiscipline in the economy, wherein, it finds that there is significant difference between estimates and actual execution due to virements, re-appropriations, supplementary budgets and mini budgets to curtail expenditures and enhance revenues. This is one of the biggest threats to the fiscal sustainability in the country as the revenue and expenditure outturns are realized on the negative side with revenues falling short of targets and expenditures more than the forecasted expenditures. This results in incurring fiscal deficit which adds to the stock of debt liabilities and help in making public debt to GDP ratio increase thus making debt dynamics more explosive if efforts for fiscal consolidation are not carried out. This requires both additional revenue mobilization and increasing the tax base and reducing unnecessary expenditures especially those that are non-development expenditures.

The report also finds lack of treasury single account causes the government of Pakistan significant losses as government institutions used to manage accounts in commercial banks and when the central government needed to raise loans it usually floats market securities which are purchased by the institutional investors including banks. The cash balance kept with these banks by those government entities is used to purchase government securities. This lack of symmetric information due to absence of true TSA causes government to borrow from commercial banks the money that actually belonged to the government. This was a serious flaw in the system which is now being tackled with the creation of robust structure of treasury single account accommodating all the government entities.

The report also reflects upon fiscal federalism and sharing of resources between central government and sub-national governments and find the distribution rather skewed in favor of provinces. This causes serious shortfalls for the central government who is responsible for big ticket items including defense, subsidies, military & civil pension, interest expenditures and calamities as and when happens. Resource distribution of 56.5% in favor of provinces is not sustainable and it is due to this reason that provincial governments shy away from revenue mobilization efforts and political onus of increasing the tax base falls on the central government and political governments tries to strike a balance between economic management and political survival. It is due to this reason that fiscal issues are also flagrant in the economy which report finds that Pakistan has significantly low tax to GDP ratio (10.1% in 2019), low savings rate (13.9%) and low investment rate (15.4%) causing sluggish economic growth in the country.

The report also finds the problem of circular debt, albeit, considered an off-balance sheet activity and not reflected in the official public debt liabilities of the general government requires incorporation to have an explicit picture of the public debt liabilities of Pakistan. The variance between public debt liabilities with and without addition of circular debt remained on average 3% of the GDP between 2016-2020. This poses a serious macro-fiscal threat to the economy in the event of default by the oil marketing companies to the foreign exporters.

The report concludes that the pension system in Pakistan is very generous and it is also non-contributory pension system that means the government is responsible for payment by either mobilizing tax and non-tax revenue or by raising debt to defray the liability. This has serious policy implications as pension expenditures have increased many folds and is bound to becoming unsustainable in few years.

The report also finds out that the public debt management in Pakistan is managed by a debt policy coordination office which was established after the enactment of fiscal responsibility and debt limitation act, 2005 amended 2016. The act also provides for fiscal institutions though loosely managed to restrict fiscal deficit and put a cap on public debt to GDP ratio and also requires the central government to make a strategy for reduction in debt. Another important aspect of public debt management is medium-term debt strategy which is made in line with the medium-term budgetary framework. This provides a definite path for fiscal management in the country in a way that medium-term planning is carried out with a focus on annual year and roll-over to next 02 years. The strategies made show policy actions of the government to better fiscal outcomes. The FRDLA act 2005 amended 2016 also requires issuance of annual fiscal policy statement and the debt policy statement that defines broad contours of both the policies. The report also highlights domestic source of funding, external source of funding, portfolio diversification and advocates for mobilization of domestic savings and tap the excess liquidity available with the Islamic financial institutions.

The above findings of the report present policy advice to the government. The most important fact of public debt management is to maintain sustainable level of public debt that includes borrowing strategies for minimization of costs & risks in a way that necessary funding is made available in a timely manner to spur growth in the economy. Government is also required to maintain fiscal discipline and budget must be carved out after a well thought out process. This requires budget planning not at the top level but also at the bottom level including line ministries and attached departments. The budget credibility must be ensured in order to avoid in-year changes that causes poor predictions with frequent changes. The report also presents a view on fiscal transparency in the country and demands frequent flow of information with reduced timeliness as data is calibrated and consolidated with much time delays causing the essence of fiscal reporting to help make decisions and fix responsibility. The annual budget execution report, mid-year reports, audit reports and financial statement must be made public with reduced timeliness. The government of Pakistan should also make efforts to consolidate modified cash basis of accounting as adoption of accrual basis of accounting is a huge task and cannot be carried out in next few years. This will help for better commitment accounting and expenditure arrears and commitments may be rolled over to next year budget with necessary appropriations made in the annual budget so as to reduce estimated and realized budget variations and enhance budget credibility. There is another risk looming and will become more flagrant in years to come associated with off-balance sheet activities that must be catered for and disclosures must be made in the financial statement explicitly showing the contingent liabilities in the country. This includes off-balance sheet activities like PPP mode of financing which is otherwise a good source of funding but finance managers may use this to circumvent the fiscal rules of keeping the public debt to a certain threshold as these contingent liabilities don’t made part of balance sheet and public debt liabilities in the country. This should also include debt liabilities which are established yet not made part of public debt liabilities like circular debt of power sector which is more than PKR 2.4 trillion that make almost 5% of the GDP in 2020 and yet ignored to be made part of public debt liabilities in Pakistan.

The reports also focus on the fact that the government is operating a single treasury account with Non-food account and Food Account. The system lacks in true sense of treasury single account that includes all the public entities linked to single account with a unified banking system so as to have a report on cash balance of the government all the times. The government is working on it, however, there is friction from commercial entities that have huge resource potential but lying outside the single treasury account. Once all the public institutions are linked with TSA, it will become much easier for the government to reduce its cost of borrowing and replenishing the same accounts in timely manner so as not to disrupt function of those entities. The report also advocates that Fiscal federalism and associated National Finance Commission award must be revised and new consensus needs to be developed so as to enhance the share of central government and make provincial governments more responsible for revenue mobilization and sensitive to incurring expenditures. This will help the central government to make appropriations for big ticket items including, defense, pensions, debt servicing and contingencies as and when happens. There is another startling issue that is ballooning for the past few years related to generous pension system which is non-contributory. This means the government either raise tax /non-tax revenue or incur debt to pay for pension expenditures. A necessary creation of contributory pension fund is recommended to the government so as to manage this huge liability. It is advised that actuarial study may be conducted and world bank Pension simulation toolkit may be utilized for this purpose and necessary funding may be obtained through world bank.

1.2. Research Objective

Research objective of this study primarily focuses on assessing whether respective democratic government and military dictators pursued sustainable debt policy or not. In additional to this, this research report will also reflect upon institutional coverage of debt statistics in Pakistan which is a very important aspect of fiscal management and debt statistics. This research will assess the cyclical and structural nature of public debt in Pakistan i.e., the debt trajectory will be gauged using cyclical and structural nature of public debt. This research will also help us to ascertain fiscal transparency in public debt statistics in the country so as to provide a debt statistic by including all the avenues that charge consolidated fund of the country. Another, important thing is the role of single treasury account system which helps in efficient decision making by knowing the actual resource position thus contributing to fiscal management and public debt sustainability through direct channel. Thus, we have the following objectives in relation to Pakistan; 1) to Assess sustainability of public debt in Pakistan; 2) to Find institutional coverage of debt statistics of Pakistan; 3) to know Cyclical and structural nature of growth in public debt; 4) to determine Public Debt statistics transparency; 5) to find the role of single treasury account in debt management.

1.3. Research Question

The research question will primarily focus on the following question;

I. What is the response of primary budget surplus to change in the level of Public Debt is sustainable in Pakistan between 1976-2018?

II. What is the institutional coverage of debt in fiscal statistics of Pakistan?

III. Whether the growth in public debt in Pakistan is due to cyclicality or is it due to structural problems in the economy?

IV. Whether Fiscal statistics are transparent in Pakistan or not?

V. What is the role of single treasury account for effective debt management in the country?

The core focus of research is to assess institutional issues in public debt sustainability in Pakistan. In this context we will also try to find out whether the response of primary surplus/GDP ratio is positive or negative in relation to variations in public debt/GDP ratio in Pakistan between 1976-2020

1.4. Methodology

I plan to conduct this qualitative and quantitative study using secondary as well as primary sources of data which will be collected through research trips and official reports of the ministry of finance, state bank of Pakistan, Pakistan bureau of statistics, Ministry of economic affairs, federal board of revenue. In addition to this; economic indicators, working papers, international reports like fiscal monitor, Public expenditure and financial accountability (PEFA) and guidelines from debt sustainability framework of international monetary fund and world bank will also be used. Lastly, textbooks and academic papers will also be used to help gauge the sustainability of public debt in

Pakistan. In addition to this simulation exercises will also be carried out to evaluate policy consistent and policy change scenario to give policy recommendation at the end of the report.

1.5. Structure of the paper

The structure of the paper is as follows; Chapter 2 is public debt liabilities in Pakistan; Chapter 3 presents literature review on public debt in Pakistan; Chapter 4 discusses the institutional issues in public debt in Pakistan and trend analysis Chapter 5 Presents Discussion and Analysis of public debt in Pakistan; Chapter 6 presents conclusion and policy Recommendation (introduction, summary of findings, policy recommendations)

Chapter 2. Public Debt Liabilities in Pakistan

2.1. Introduction

Prudent debt management strategy espouses availability of financing for incurring recurring and development expenditures in addition to settling obligation/commitments of the government in medium and long term with least degree of risk and minimum cost. This includes government to reduce its expenditures and run primary surplus which is the difference between government revenue and expenditures excluding the expenditure on debt servicing i.e., interest payments. Intrinsically, this translates into a fiscal stance which adopts for fiscal consolidation albeit it does not support sluggish economic growth. This also demands stable rate of inflation and exchange rate to augment economic growth and adoption of exchange rate which adheres to economic fundamentals of the country.

2.2. Current Debt Stance in Pakistan

Ever since, the new government took over the reins of the government in 2018, it has adopted the policy of fiscal consolidation and has been aggressive in managing the public debt portfolio. Accordingly, most of the domestic debt raised by the government in these two years has come from long-term debt securities. Primarily, funding requirements have been met through funded debt including Pakistan investment bonds with a maturity spanning from 3 years to 20 years. Similarly, long-term unfunded debt was raised through national savings schemes (NSS) which tend to have longer redemption period and imposes penalty on early withdrawal of the principal amount. An important facet of this debt financing is availability of debt at a rate lower than the policy rate of the central bank (State Bank of Pakistan) with long-term maturity shows confidence of the lenders in the macroeconomic policies of the government. Given the stance mentioned above, government resorted to reissuance of fix rate investment bonds with a maturity of 15-year which will help in shifting maturity profile of debt portfolio from short-term to long-term. In addition to this, the government has started tapping Islamic financing due to the fact that excess liquidity was available with the Islamic financial institutions including the banks and takaful (Islamic insurance). In this regard, 5-year Islamic Sukuk has been issued with floating rate. Similarly, government has also retired debt raised from the central bank which is otherwise inflationary in nature and hampers economic growth. Lastly, the debt portfolio has shifted in favor of long-term concessional financing from multi-lateral and bilateral sources instead of Eurobonds and other commercial financing options which are otherwise expensive and causes solvency problem at maturity. This leads to Ponzi game of raising new debt to retire old debt. All the above mentioned measured has led to improving the debt portfolio of the country significantly and immediate threat of default or rundown has been thwarted but this has consequences in the long-term that needs to be addressed through adoption of macroeconomic policies that augment economic growth to generate surpluses in order to retire the long-term debt of the government at maturity.

2.3. Composition of public Debt in Pakistan

Public debt in Pakistan is composed of domestic debt liabilities and external debt liabilities. Domestic debt is raised from the public/private savings within the country and external debt is raised from outside the country. The composition of domestic public debt is discussed below with respect to different dimensions for better understanding;

2.2.1. Domestic Debt Liabilities in Pakistan

Instrument based classification of Domestic debt is composed of long-term permanent debt, short-term floating debt which are otherwise subsumed as funded debt.

This debt is primarily funded debt and it is mainly offered by institutional lenders and makes up to 84.2% of domestic debt portfolio in June, 2020. There is another form of domestic unfunded debt that comprises of national savings schemes (NSS) for tapping resources from general public with excess liquidity to offer to the government against profit/interest. This makes up to 15.8% of total domestic debt liabilities in June, 2020. The domestic debt liabilities raised through different instruments are shown below;

Table 2. 1 Composition of Domestic Debt (Instruments)

		June, 2020
	PKR(Billions)	**USD(Billions)**
I+II Funded Debt	**19,608**	**116**
I Permanent Debt	**14,030**	**83**
Pakistan investment bonds	12,886	77
Prize bonds	734	4
Bai Muajjal/Sukuk Islamic Bonds	399	2
Others	11	-
II Floating Debt	**5,578**	**33**
Treasury Bills	5,578	33
III Unfunded debt	**3,672**	**22**
National Savings Schemes	3,523	21
Others	149	1
I+II+III Total domestic debt	**23,280**	**138**

Source: State Bank of Pakistan/ debt policy coordination office, Ministry of Finance Pakistan

Since, most of the debt is raised from long-term investments and floating debt, it is very important to learn about the creditor profile of the government of Pakistan. This reveals important information on saving patterns in the society and provision of excess liquidity to the government. Lastly, it helps in policy formulation for future public/private savings in the country. The composition of creditors to the government is shown below with respect to institutional lenders including banks, non-bank financial institutions, Development financial institutions and private lenders;

Table 2. 2 Composition of Domestic Debt (Creditors)

		June, 2020
	PKR(Billions)	**% of total**
I Government Securities (Institutional investors/Banks)	**18,863**	**81**
Scheduled bank investment	9,398	40
State Bank of Pakistan investment	7,191	31
Non-Banks Investment	2,274	10
II Non-Bank Debt	**4,418**	**19**
National Savings Schemes (Prize bonds included)	4,257	18
Others (Government Provident fund, PLI)	161	1
I+II Total Domestic Debt	**23,281**	**100**

Source: State Bank of Pakistan/ debt policy coordination office, Ministry of Finance Pakistan

This composition shows that most of the financing is channelized from institutional lenders to the government and its share in domestic debt is as high as 81%, while share of non-bank debt primarily mobilized through general public is 19%.

Another, dimension of categorizing the public domestic debt is to give a look to the maturity profile of the current debt. This helps in gauging the solvency of the borrower. A rule of thumb is to have a portfolio mix with medium to long-term maturity instead of short-term maturity to avoid any imminent threat of rundown on the government. The maturity profile of domestic debt in Pakistan is shown below;

Table 2. 3 Maturity profile of domestic debt in Pakistan

		June, 2020
	PKR(Billions)	**% of total**
I Short-term Debt (Less than 01 year)	**7,182**	**31**
Treasury bills	5,578	24
Long-term debt (retiring in less than 01 year)	1,604	7
II long-term debt (Greater than 01 year)	**16,099**	**69**
I+II Total Domestic Debt	**23,281**	**100**

Source: State Bank of Pakistan/ debt policy coordination office, Ministry of Finance Pakistan

The above composition of public debt with resp etc. to maturity reveals that most of the domestic debt is concentrated in long-term debt, however, caution is to exercise as current debt is financed through increased taxation in the future that may kick in debt overhang effects and investors shy away from long-term investments.

Lastly, type of instrument with respect to fixed or floating rate of interest is very important to gauge refinancing and interest rate risk in the future given the dynamics of the economy and prevailing situation of the money market. The table below shows composition of domestic public debt of Pakistan with floating and fixed rate of interest;

Table 2. 4 Interest rate composition of domestic debt in Pakistan

	June, 2020	
	PKR(Billions)	**% of total**
I Floating rate	**12,379**	**53**
Treasury bills	5,578	24
Floating rate bonds	6,801	29
II Fixed rate	**10,902**	**47**
I+II Total Domestic Debt	**23,281**	**100**

Source: State Bank of Pakistan/ debt policy coordination office, Ministry of Finance Pakistan

The above table reveals that domestic debt portfolio is optimally balanced with 47% share of fixed rate securities and 53% floating rate securities.

2.2.2. External Debt Liabilities in Pakistan

External debt liabilities of a country include portion of public debt which is raised from external sources. This includes debt raised from multilateral financial institutions, bilaterally from donor countries, raised from international financial institutions and commercial banks. External debt helps in borrowing portfolio diversification, built up forex reserves and are generally raised at lower interest rates to augment development activities in the country and lastly provide budgetary support to the government at the time of distress and helps in avoiding crowding out of private investment in the country, thereby, leaving funds available for investors in the domestic market.

The growth trajectory of external debt in Pakistan shows a steady growth up to 2014, however, investment related to China Pakistan Economic Corridor required huge amount of external financing that added significantly to external debt liabilities of the country. The composition of external public debt is composed of central and provincial government debt and debt owed by the government to the IMF. The breakup of external debt having different dimensions is as under;

Table 2. 5 Composition of External Public Debt

	June, 2020		
	PKR (Billion)	**USD (Million)**	**% of total**
External Public debt	**13,117**	**77,988**	**100%**
I Long-term government debt	**11,589**	**68,908**	**88%**
Paris club loans	1,837	10,924	14%
Multilateral	5,196	30,898	40%
Other bilateral	2,258	13,428	17%
Euro/Sukuk bonds	891	5,300	7%
Commercial loans/credits	1,381	8,210	11%
others	26	148	0.2%
II Short-term external public debt	**237**	**1,400**	**2%**
Multilateral	138	814	1%
Local currency securities (T-bills)	99	586	1%
III IMF	**1,291**	**7,680**	**10%**
Central/Federal Government	476	2,833	4%
Central bank	815	4,847	6%

Source: State Bank of Pakistan/ debt policy coordination office, Ministry of Finance Pakistan

The above table shows that most of the loan is concentrated in long-term external debt. The composition is skewed towards long-term debt which contributes 88% of the total debt excluding the IMF which contributes 10% in total external debt liabilities of Pakistan. Furthermore, external debt is primarily financed from Multilateral institutions (51%) and bilateral sources (31%) which are concessionary in nature. IMF contribution in total debt portfolio is 10% and a small portion of loan in relation to total external public debt comes from commercial sources (11%) by tapping international capital market where financing has been mobilized through Euro bonds and sukuk bonds.

Table 2. 6 Source Wise External Debt

	June, 2020	
	$ Million	**% of Total**
I Multilateral	**39,392**	**51%**
World Bank	16,184	21%
Asian Development Bank	12,741	16%
IMF	7,680	10%
Others	2,787	4%
II Bilateral	**24,352**	**31%**
Paris Club	10,924	14%
Non-Paris club	13,428	17%
III Commercial	**14,244**	**18%**
Eurobonds/Pakistan international Sukuk bond	5,300	7%
Loans from foreign commercial banks/others	8,944	11%
I+II+III External Debt Liabilities	**77,988**	**100%**

Source: State Bank of Pakistan/ debt policy coordination office, Ministry of Finance Pakistan

The above table shows that most of the external debt is raised from multilateral and bilateral sources which contributes 51% and 31% respectively, while share of commercial financing is 18%. It is pertinent to mention that external financing raised from multilateral and bilateral sources are concessionary in nature, however, commercial financing is expensive intrinsically both in the domestic market as well as in the international capital market. This, however, is used to have better footprint in international capital market in terms of credit ratings or at the time of distress when financing is not available from Multilateral and bilateral sources.

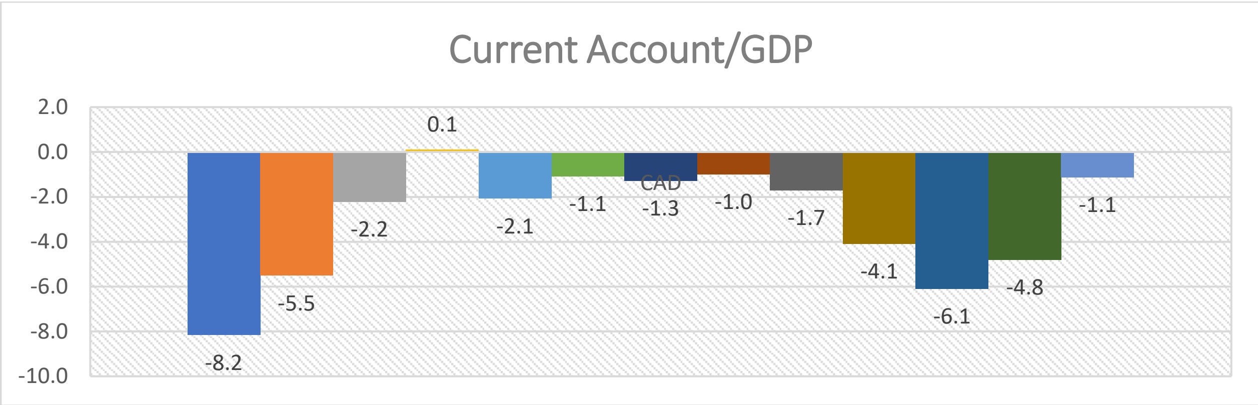
One of the most important reasons of incurring huge amount of external debt liabilities is current account deficit. Current account is composed of sum of balance of trade of goods and services (Exports-Imports), net income from abroad (income transfers between resident) and net current transfers (aids, donations etc.). A positive balance of current account shows that country absorption capacity is less than the production capacity, it eventually lends to other nations. A negative current account or deficit, on the contrary shows deficit which shows that country absorption is more than the production capacity and eventually it borrows from other economies. Unfortunately, this is the case with Pakistan over the years. Country is consuming more than what it produces and hence it is generating current account deficit for number of years together and its menace has yet not been capped. It is due to this reason that the country needs to borrow thus incurring huge amount of external debt liabilities. This is substantiated by data as under,

Table 2. 7 Current Account/GDP

Year	Current Account/GDP
2007	-8.2
2008	-5.5
2009	-2.2
2010	0.1
2011	-2.1
2012	-1.1
2013	-1.3
2014	-1.0
2015	-1.7
2016	-4.1
2017	-6.1
2018	-4.8
2019	-1.1

Source: State Bank of Pakistan

Figure 2. 1 Current Account to GDP Ratio



Source: State Bank of Pakistan

Figure 2. 2 Trend of Current Account to GDP Ratio

Source: State Bank of Pakistan

It is evident from the data above that country has relied on foreign savings and borrowings to bridge resource-expenditure gap and incurred high current account deficit leading to increase in public debt liabilities to increase.

Chapter 3. Literature Review

3.1. Introduction

Numerous studies have been conducted in the past on the topic of debt sustainability. Most of the approaches discussed debt sustainability in terms of growth in debt in relation to increase in interest rate using Grainger causality test and co-integration techniques. Similarly, researches put their focus on debt sustainability in terms of threshold approach. Many researches also did three gap model for assessing debt sustainability. Some of the approaches used in the past have been discussed in this chapter and a brief on public debt in Pakistan and subsequent research is presented

3.2. Public debt and Growth

Public debt shows increasing trend following a financial crisis. Historic evidence suggests that almost all the economies of the world, irrespective of their level of income witnessed increase in public debt and slowdown in economic growth (Reinhart and Rogoff 2010). The uncontrollable pile-up in debt liabilities raises concerns that accumulation of too much debt might result in a problem and there exists a point beyond which positive gains of debt might vanish and it starts charging the economy by way of sluggish economic growth and finally leading to debt sustainability issues given the underlying debt dynamics become explosive.

It is pertinent to mention that debts are directly linked with fiscal deficits in a way that fiscal deficit translates into Public debt. An insight into public debt can never be gained without looking into the drivers of public debt. Focus is brought onto the examination of fiscal operations of the country i.e., the revenues and the expenditures and the resultant differential that leads to fiscal deficit/surplus. The findings will eventually help us to understand the structural and cyclical nature of deficits that lead to pile-up of debt liabilities. The finance managers attribute increase in fiscal deficit to cyclical factors (war on terror, security related expenditures, expenditure on temporarily displaced persons, natural calamities, temporary exogenous shocks) resulting in growth of public debt. This helps in nurturing the narrative that structurally budget is sound and growth in public debt is due to temporary factors and do not pose any serious threat to debt sustainability in the long-run. The structural weaknesses of the budget are explained on the revenue side having low buoyancy of both the tax revenue and the non-tax revenue along with growth in expenditures related to subsidies, wages & pensions and interest expenditures are often overlooked by the finance managers. Therefore, it is important to know all the factors contributing in growth of public debt.

The underlying problem is public debt and economic growth with a view to debt sustainability. The evidence from the research conducted by Reinhart and Rogoff (2010) for 44 developed and developing economies suggests that there exists a certain threshold level above which growth prospects are severely compromised and suggested a 90% Debt to GDP ratio as the tipping point before positive gains turns into negative. The findings of Reinhart and Rogoff (2010) were, however, challenged by Herdon et al. (2013), who argued that threshold effect disappears once we change the weighting scheme and correcting for the coding errors. The debate continued with the publication of another paper by Reinhhart and Rogoff in which they suggested that even correcting for coding and errors and using a different weighting scheme, there exists a threshold effect of debt to GDP ratio beyond which growth prospects are severely compromised.

The same results, albeit with different level of threshold were found by Kumar and Woo (2010), who claims to find nonlinearity in debt to GDP ratio and that high level of debt leads to slowdown in economic growth. Baum et al. (2013), finds 95% debt to GDP ratio beyond which there exists a non-linear relationship between debt and economic growth.

Time period involved in debt and economic growth dynamics is important because of the problem of causality; whether debt leads to slowdown in economic growth or it's the recession that needs to be blamed for accumulation of debt or there could be an identical variable such as war or financial crises that affects growth and debt simultaneously. As time is important, such an impact of missing variables or causality is of concern when dealing with short-term data spanning over a few years, however, Reinhart and Rogoff (2010), used data of 44 developing and developed economies for a prolonged time and suggested that growth is low particularly during the periods of debt overhang.

Since, we recognize that there exists a certain threshold level and that the threshold level is identical for each economy, there must be a plausible reason for such a variation between developed and developing economies. The debt dynamics for developing countries are different from developed economies, because of less-than-optimal level of development in financial markets; difference in degree of openness to the world economies (Frankel and Romer 1999; Levine and Rennet 1992); and different institutions (Acemoglu et al. 2003; Alfaro and Volosovych 2008).

3.3. Public Debt in Pakistan

Pakistan is a developing country and facing myriad of socio-economic problems on the domestic and international front. The strategic location of the country bordering the war trodden Afghanistan and having troubled relations with India, makes it difficult to maintain a sustained growth trajectory. The economy of Pakistan replicates the common characteristics of developing economies with structural and cyclical factors contributing to overall fiscal deficit. The factors include; twin deficit, low savings rate, less than optimal development of financial sector; low degree of openness, governance issues and structural problems. Owing to these reasons, the economy is always under pressure to generate enough resources to meet the expenditures.

Since, Pakistan is a developing country with low tax to GDP ratio and low carrying capacity to impose more taxes, the financial managers of the country resorts to internal and external financing which lead to huge pileup of debt liabilities over the years. The question, however, remained how much is too much? And whether public debt is sustainable or not? In this regard a debt committee was established in the early 2000s to setup a road map for reduction and management of debt in the long-run. The said efforts lead to the creation of Debt Policy Coordination office (DPCO) and enactment of Fiscal Responsibility and Debt Limitation Act, 2005. The committee adopted a Fiscal rule which is 60% of debt to GDP ratio limit for the economy although, technical analysis by IMF staff set the prudential limit of 40% for developing countries and 60% of debt to GDP ratio for developed countries and guides that such limits may not be breached in the long-run.

A number of studies conducted in this regard suggests that internal and external debt liabilities impact GDP growth rate and a time comes when growth in public debt surpasses the growth in GDP. In this situation, the debt dynamics become difficult to manage and transmits signals of underlying problem to the creditors/donors of unsustainable debt in the future. Empirical results of a time series study conducted by Arshad et all (2014), using extended Solow growth model and Johnston co-integration technique for model testing and also taking into account the relationship between public debt and GDP growth rate using Granger causality test found out that external debt affects growth positively while internal debt has negative implications for GDP growth. The finding of study conducted by Naeem (2011), confirms the problem of debt overhang in the presence of high level of public external debt that hampers economic growth. Ayyoub et al. (2014) conducted a study to find relationship between debt and GDP growth, manufacturing sector and unemployment using OLS technique on secondary data from 1990 to 2010. The study found a negative relationship between domestic debt and growth; however, the study found a statistically significant positive relationship between GDP growth and external debt.

Fosu (1996), suggests that countries confronting high levels of debt suffers 1% of GDP annually but did not come up with a specific threshold level of debt to GDP ratio beyond which 1% of GDP loss kicks in. The public debt situation of Pakistan is not very encouraging and the problem seems to be worsening. The country had a debt to GDP ratio of 54.4% in 1980 which soared as high as 103% in year 2000. Moreover, 43% of total revenues were consumed for debt servicing which later increased to 63% in 2000. Such a high level of debt was a concern for the financial managers and international monetary institution and owing to this reason, efforts for curtailing and managing public debt started which resulted in the formation of Debt reduction Strategy Papers, Debt Policy coordination office in the ministry of finance and enactment of FRDLA, 2005.

Pakistan Public debt has increased substantially in the last decade. The main contributors to this surge in public debt are fiscal mismanagement on one hand and phenomenal decrease in FDI, grants, portfolio investment and exports on the other hand. The reasons for increase in debt stems from both cyclical factors such as war on terror, security related expenditures, problems of Temporarily displaced persons, floods and structural problems including low tax revenue, power sectors losses and losses from public sector enterprises.

It has been observed that Pakistan has borrowed heavily in the past few years. The composition of public debt shows that most of the debt is raised from domestic sources between year 2008 to 2017, government has added almost Rs.11,473 billion in domestic debt while external debt has increased from Rs.3272 billion in rupee term. If this trend goes unchecked, Pakistan debt profile will likely worsen in the next few years that will have impact on macroeconomic stability.

A close look into the components of public debt including domestic and external debt reveals that domestic debt has raised sharply from year 2010-11 onwards till the signing of new Extended fund facility in 2014.The main reason for this tilt towards domestic borrowing was suspension of stand-by facility by the IMF due to non-compliance of the commitments given by the government of Pakistan to the IMF. This, not only, led to decrease in financing from the IMF but other donors that shy away from providing the necessary financing for carrying out expenditure on physical infrastructure, human development, education and health that ultimately had a negative impact on GDP growth that decline sharply and economy grew between 2.5% to 3% annually between 2008 to 2014. The government was left with no option but to raise immediate financing from high interest bearing short-term domestic sources. This led to sharp increase in domestic debt that was almost 52% of the public debt to almost 70% in 2017. On the other hand, external debt has also increased from Rs.2852 billion in 2008 to Rs.6124 billion in 2017 but its share in the debt portfolio has decreased from almost 59% to 29% in 2017.

Growth, poverty and employment bear the brunt of increase in debt due to decrease in investment as investors fear the uncertainty of policies following the rising level of debt and shy away from investment in long-term projects resulting in decrease in employment opportunities and increase in poverty. Similarly, increase in public debt will translate into flight of capital as private sector fears the future increase in taxes to service the debt or imminent devaluation.

Empirical evidence on the topic of debt sustainability conducted by Khurram and Attiya (2012) using debt dynamics framework suggests that public debt and external debt of Pakistan is sustainable in few years but unsustainable in many. Bilquees (2003), research on the topic following three Gap model suggests persistent deficits over the extended time period and domestic borrowing at high interest rates without domestic resource mobilization and controlling of expenditures results in absorption of all available domestic and external resources. Research conducted on the topic by Tahir et al (2009) by using data from 1970-2005 finds twin deficit, higher level of interest payments and exchange rate fluctuations as the core variables that lead to increase in debt burden and worsening of debt ratios. Mahmood et al (2009) research on debt sustainability using data from 1970-2000 and employing threshold debt indicators approach and debt sustainability conditions finds that both the public debt and external debt is not sustainable in Pakistan. The focus of our study is to evaluate whether the current public debt of Pakistan is sustainable or not. This research will help us to explore public debt sustainability in terms of primary surplus/debt ratio and public debt/GDP ratio. This research presents a new dimension of public debt sustainability analysis in Pakistan as previously this approach has not been used. Moreover, this research will also introduce few intriguing issues that are directly related to Public debt sustainability in a country but have largely been ignored at policy level and remained eclipsed from other dimensions of public debt sustainability in Pakistan. These issues include; use of specific accounting framework, fiscal transparency, role of single treasury account & effective cash management, generous pension system, power sector circular debt, institutional coverage of fiscal statistics and cyclical/structural issues in public debt sustainability in Pakistan. In addition to this, persistent problems including low Tax/GDP ratio, low savings rate and other fiscal issues have been addressed. This research report also presents readers with strengths in managing public debt in Pakistan that inter-alia includes; Fiscal responsibility and debt limitation act, medium-term debt strategy, medium-term budgetary framework, debt policy coordination office and fiscal institutions thereof. It also presents with grey areas in maintaining public debt sustainability in Pakistan including; fiscal indiscipline, fiscal risk and contingent liabilities, budget credibility issues, policy inconsistency and associated political risk, lack of commitment accounting, expenditure arrears, poor payroll control, fiscal federalism and National Finance Commission. It also presents readers with tapping in opportunities including; domestic sources of funding, external debt liabilities, portfolio diversification, and use of Islamic financial instruments to control the menace of public debt in Pakistan.

Chapter 4. Institutional Issues in Public Debt Management in Pakistan

4.1. Introduction

This chapter gives insight on institutional coverage of fiscal statistics in Pakistan with a view to budgetary central government and budgetary general government as well as the use of specific accounting framework for recording and reporting fiscal statistics, fiscal transparency, effective cash management & treasury single account, Fiscal issues(Low Tax/GDP ratio, Low savings rate and generous pension system), Power sector losses, Public sector enterprises accumulated losses, Current Account deficit and fiscal federalism in Pakistan.

4.2. Institutional Coverage/Accounting Frame in Pakistan

The emergence of different measures of deficit depends on recognition of assets and liabilities and the use of specific type of accounting framework that generates an identical level of debt for the said framework. The two most important recognized methods of recording of assets and liabilities are; Cash Accounting and Accrual Accounting. The former is more prone to window dressing by way of not recording for deferred payments & commitments, cheap to construct and simple to explain while latter is less prone to window dressing by accounting for deferred payments, data accumulated is most relevant for analysis and presents complete and true picture of financial and economic position of the government, however, it is not very easy to construct and requires both financing and capacity building before fully adopting the standard.

The government of Pakistan uses International Public Sector Accounting Standards (IPSAS) and use modified cash basis of accounting for recording revenue and expenditure transactions and generating reports. This is done through SAP-based system known as Integrated Financial Management Information System (IFMIS). All revenues are collected through a well-defined system in the National bank of Pakistan, or agent banks and reported to treasuries for onward transmission to State bank of Pakistan. Similarly, all expenditures are recorded following a pre-audit system followed in all the accounting offices and real time budget execution reports are generated using SAP based IFMIS.

The accrual basis of accounting captures transactions when accrued and not when actual cash is paid or received. The synthesis of cash and accrual basis accounting is known as modified cash basis of accounting. This system of accounting records long-term transactions on accrual basis and short-term transaction on cash basis. As mentioned above, the government of Pakistan is using modified cash basis of accounting but commitments are not recorded and arrears are not budgeted. This system is only good for cash forecasting but lacks in presenting a holistic picture to make appropriations in the annual budget thus act as a poor DSS (Decision Support System) The next step is to adopt modified cash basis completely before moving towards a more complex accrual basis of accounting that requires time and effort before fully rolling out the new system.

4.3. Fiscal Transparency

Debt sustainability framework also includes coverage of fiscal statistics and fiscal transparency that gained prominence after the Asian financial crises. The decade preceding financial crises of 2008 witnessed greater demand for transparency followed by rapid slowdown despite many initiatives such as; Open Budget partnership, Revenue watch, Transparency International and indexes like doing of Business, corruption index and governance index. Fiscal transparency denotes openness toward the public at large about government functions, its structure, fiscal policy intention, economic & fiscal projections and accounts of the public sector. The concept stresses upon reliable, timely, comprehensive, plausible and internationally comparable information on activities of the government sector. Its ultimate purpose is to make sure availability of true information to assess financial position of the government and accurate costs and benefits of government activities that have socio-economic implications. Empirical evidence suggests that countries which are more transparent have better fiscal outcomes, but causality remains a problem. Is it the fiscal transparency of the country that leads to better outcomes or better outcomes lead to transparency or there is some other factor that affects the both? Research on transparency suggests that transparency led to lower debt, controlling for other influences (Alt and Lessen 2006), transparency improves credit ratings, directly and indirectly (Arbatli and Escolano 2012). On the other hand, models can be developed that actually show harmful impact of transparency (Justin Fox 2006).

Fiscal transparency is given importance with respect to debt sustainability and empirical research on the topic of fiscal transparency has been conducted for so many years with results favoring and negating the idea of transparency. The whole idea revolves around the possibility of deriving better fiscal outcome with at least the most plausible information available. Transparency is imperative because it helps the finance managers to evaluate their true financial position before embarking on another avenue that may lead to economic disaster. Fiscal transparency is also a prerequisite for accountability of those at the helm of affairs which requires well defined objectives and responsibility. Secondly, it is a prerequisite for participation of the cabinet, the executive, legislature and the civil society. Information like unreported deficits, arrears, contingent liabilities, risks emanating from State owned Enterprises (SOEs) and Public Private Partnerships (PPP) and other such information which is not disclosed may lead to underreporting of the public debt, is required to be evaluated for better fiscal outcomes and understanding of the level of actual debt owed by the government. An important reference is made to circular debt liabilities which will be discussed at length later on shows a significant difference of 5% of total debt liabilities combined with circular debt liabilities alone in 2020 as against total debt to GDP ratio. This raises an alarm that these hidden liabilities which are not accounted for in debt liabilities have significant impact on public debt profile of the country. Similarly, sovereign guarantees that make up to 20% of the GDP every year needs to be accounted for and be made part of debt liabilities. This makes a case strong enough for other hidden liabilities to be made explicit and considered while making debt framework of the country.

The government of Pakistan enacted a law called 'Right of access to information act 2017", yet information on many aspects related to Public Finance Management is missing. This includes inter-alia information on budget strategy that contains fiscal plans of the government which is not made available to the public, information on off-balance sheet activities are not reflected in the financial statements of the country, in year reports are prepared but not published with the timeliness of 01 month, the annual budget execution report containing information on general government activities is not made available with the timeliness of 06 month, pre-budget statement is never made public and annual audit report is published with a timeliness of more than 06 month, the yearly performance report following output based budget is now being public after enaction of Public Finance management act, 2018. All these aspects are very important because not only availability of information is important but availability of information at the right time is of paramount importance to make timely decisions that may affect fiscal sustainability in the future. Issues like circular debt, contingent liabilities and using narrow definition of public debt to avoid ballooning of public debt to GDP ratio by moving liabilities off-balance sheet is not a good practice. The government fiscal statistics on public debt must reflect on all the avenues of implicit and explicit charges that may affect consolidated fund of the government. However, caution must be exercised while disseminating information and not too much of information be made available that it might lead to decisions by the stakeholders in a negative way.

4.4. Treasury Single Account & Effective Cash Management

The cash resources of the government are effectively controlled and managed through a sound system of government banking arrangements. According to IMF, the government banking arrangements are critical to ensure that; i) all revenues including the tax revenue & non-tax revenue, loans raised, and repayment of loans to the government and expenditures defrayed/ payments are made correctly in an effective and efficient time manner; and ii) optimally managed cash resource to reduce borrowing cost. All this can be done with an efficient system of banking arrangement, wherein, all the information related to cash resources of the government is consolidated and true cash position is made available to the financial managers in the ministry of Finance to make informed decision.

Fragmentation in the banking arrangement of the government causes effectiveness of cash management function as this does not ensure aggregate control of the government on resources. The poor fragmented banking operation led to development of a system which contains all the information on government resources backed by a strong accounting system and is known as Treasury Single Account. This consolidation of information leads to avoidance of raising debt and incurring interest cost when complete information is available on deficit government unit requiring financing and surplus government unit having idle cash available in its account. Similarly, aggregation helps in cash management, debt management and conduct of monetary policy in the country. It is imperative to mention that TSA system should adopt the following principles for effective cash management in the country;

I. A unified banking system that ensures fungibility of cash resources in the central government as well as sub-national government
II. Treasury oversight on all the government agencies/units banking arrangements
III. A comprehensive TSA that includes budgetary units as well as extra budgetary units

Although design of TSA varies among countries depending on the degree of development in the banking system and inter-bank clearance system availability, however, the best sought out practice is to create TSA in the central bank encompassing all the revenues, expenditures, loans, budgetary units/extra budgetary units together with the backing of defined accounting system that accounts for all the transactions of government entities. The other TSA that may be applied allows for decentralized system of accounting and transaction processing but all linked to TSA having an effective oversight mechanism.

The government of Pakistan moved towards TSA few years back, however, the system was not comprehensive and it did not contain information on all the entities of the government having accounts in commercial banks which are not reported in the fiscal statistics of the country. According to one estimate, government entities were operating 450,000 commercial bank accounts with a cash balance of PKR 2.3 trillion that would make 7.2% of GDP in 2017. This practice led to several problems including over estimation of expenditures and underreporting of revenues thus inflating fiscal deficit and causing finance managers to overestimate borrowing needs as entities would move balances to their commercial bank accounts which were not linked to TSA. The government, however, took serious notice of this malpractice and ordered complete closure of commercial bank account and one time swapping the balances to the TSA in central bank of the country by enactment a PFM law in 2019. This will help in effective cash management and allows for decreased interest expenditures by raising from the domestic market for short-term expenditure needs.

4.5. Fiscal Federalism

Fiscal federalism is an important aspect of public debt sustainability in the country. It is a process that delineates taxation authority, expenditure responsibility and regulatory powers of the central government and sub-national governments. These authorities and responsibilities for different tiers of the government are provided in the constitution, however, it is to be noted that an identical fiscal policy emerges, combining the budget strategies of all the tiers of the government once the arrangement is executed.

The building blocks of Fiscal Federalism includes, inter-alia, autonomy which refers to the ability of the government to raise revenues, incur expenditures, borrow resources and make budgetary frameworks. The second element relates to responsibility which constraints decisions of the government so that breaches may be addressed. The third element highlights the importance of co-determination of fiscal policies and the limit up to which central government can affect fiscal policies of the sub-national governments. Fourth element of fiscal frameworks is budgetary framework that limit fiscal discretion of the governments through rules. Lastly, stability that determines modification in constitutional rules and fiscal institutions related to fiscal policy such as limit to fiscal deficit and incurring debt.

Fiscal Federalism in Pakistan is divided between central government and provincial governments and this system of division of powers has evolved over the years ultimately culminating into much skewed powers to the provincial government through modification of the constitution by finally enacting 18th constitutional amendment of the constitution of 1973. This also led to deliberation and agreeing on new National Finance Commission for vertical distribution of resources between central government and the provincial governments as well as horizontal distribution of resources among provinces based on certain criteria. NFC award essentially entails decentralization of financial powers which is supported by preference-matching principle that espouses close relationship between the local population and representatives in an arrangements where public goods for the local are provided through budgetary allocation thus increasing allocative efficiency. The other argument in favor of decentralization focusses on accountability of the representatives getting most of the resources Shah (2006). Lastly, it helps in power reduction which is one of the biggest problems in developing countries Mustafa (2007).

NFC award is constitutional binding on the government to setup a new award after every 05 years which is defined in Article 160 of the constitution of Pakistan 1973 for distribution of resources between central government and the provincial governments. Pakistan has so far 7 awards since its creation. A cursory look on all the awards reveals that the proponents of these awards argued on decentralization and resource sharing formula, wherein, provinces demanded more share in the vertical distribution between central government and provinces and provinces also demanded changing criteria for horizontal distribution of resources as population was the sole criteria for determining the share of resources. However, strenuous efforts lead to constitution of 7th NFC award in 2009-10 that lead to increase resource for provinces and adoption of not only population but also inverse population density, revenue generation and poverty/backwardness as the criteria for distribution of resources. Similarly, concurrent list was abolished that defined functions that were performed both by the central and provincial governments and all the function with resources were transferred to provincial governments. In nutshell, central government sacrificed 10% of its share, while 56% of the resources were transferred to provinces in the first year, and 57.5 from next year onwards. General sales tax on services was also transferred to provinces and collection charges were reduced from 5% to 1% by the central government. The arrangement resulted in 40,000 employees in the surplus pool and asked for 05 ministries to be devolved to provinces.

4.6. Fiscal Issues in Pakistan

The economy of Pakistan had myriad of fiscal issues including low tax to GDP ratio, low savings rate, generous pension system and huge defense spending. All these issues combined put economy financial position under distress causing expenditure to grow beyond revenues resulting in incurring fiscal deficit that ultimately translates into external and internal debt. A brief description of each of the problems is discussed below;

4.7. Low Tax to GDP Ratio

The economy of Pakistan is suffering from low tax to GDP ratio over the years with marginal changes in revenue growth. It has one of the lowest Tax to GDP ratio in the region and is characterized by narrow tax base and most of the taxes are indirect taxes that contribute up to 62.2% of the tax resources and direct taxes comprising only 27.8% in FY2019-20. Similarly, the problem of tax evasion is pervasive in the economy and it is estimated that black economy is 5 to 6 times the GDP of the country although there are conflicting figures regarding the size of black economy. In addition to this, massive tax exemptions have been provided by the government resulting in colossal tax expenditure which is revenue foregone. Lastly, the problem of tax administration and necessary reforms is lingering over the years and no real effort has been made in this regard. All these factors combined together has a reinforcing effect on low growth of tax revenue that can be substantiated from more recent data given below;

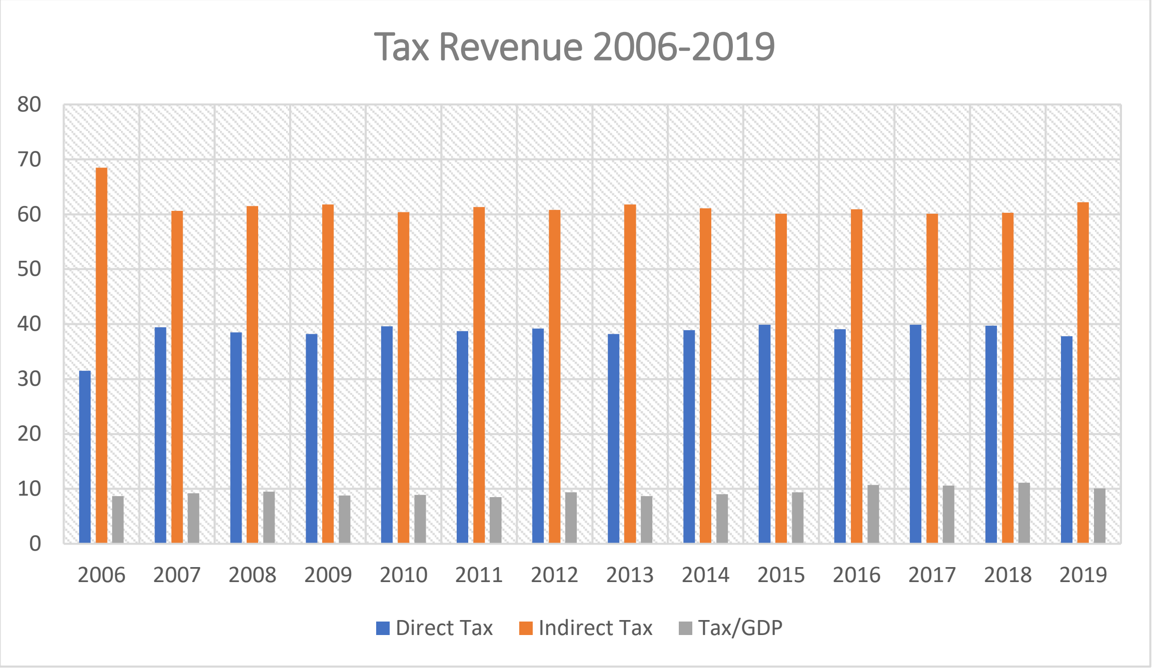
Table 4. 1 Tax Revenue and Tax to GDP Ratio

Year	Direct Tax	Indirect Tax	Tax/GDP
2006	31.5	68.5	8.7
2007	39.4	60.6	9.2
2008	38.5	61.5	9.5
2009	38.2	61.8	8.8
2010	39.6	60.4	8.9
2011	38.7	61.3	8.5
2012	39.2	60.8	9.4
2013	38.2	61.8	8.7
2014	38.9	61.1	9
2015	39.9	60.1	9.4
2016	39.1	60.9	10.7
2017	39.9	60.1	10.6
2018	39.7	60.3	11.1
2019	37.8	62.2	10.1

Source: Economic Survey of Pakistan, Federal Board of Revenue & (NSDP) Pakistan Bureau of Statistics

A visual representation of Tax structure in Pakistan is given below with direct taxes, indirect taxes and tax to GDP ratio between FY 2006-2019;

Figure 4. 1 **Tax Revenue Break-up**



Source: Economic Survey of Pakistan

It can be seen from the graph above that most of the taxes are concentrated in indirect taxes and the composition has not changed very much over the last one and a half decade.

The stagnant growth trend of tax to GDP ratio is show in graph below which shows that tax to GDP ratio has not changed much for more than one and a half decade which substantiates the claim that there have not been much reforms in taxation structure and tax administration in Pakistan.

Figure 4. 2 Growth in Tax Revenue as a % of GDP

Source: Economic Survey of Pakistan

4.8. Low Savings Rate

It is an interesting fact that high growth periods in the economy of Pakistan coincide with high level of foreign savings inflow in the form of foreign debt, grants and foreign remittances. The growth in GDP seems to dry away as soon as the inflows stops. This helps to infer an important characteristic of the economy which suggests low savings rate in the economy to augment GDP growth. A more recent time series data for the last 15 years is given in table below;

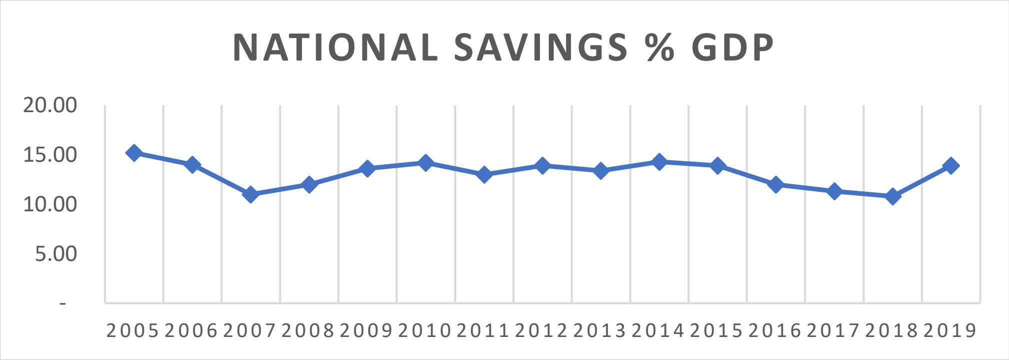
Table 4. 2 National Savings 2005-2019

Year	National Savings % GDP
2005	15.2
2006	14
2007	11
2008	12
2009	13.6
2010	14.2
2011	13
2012	13.9
2013	13.4
2014	14.3
2015	13.9
2016	12
2017	11.3
2018	10.8
2019	13.9

Source: Economic Survey of Pakistan

The trend analysis below shows that national savings on average remained dismally low and could not help investments to grow using domestic creditors. This made a case strong for foreign savings inflow and increase in public debt.

Figure 4. 3 ***National Savings as a % of GDP***



Source: Economic Survey of Pakistan

4.9. Generous Pension System in Pakistan

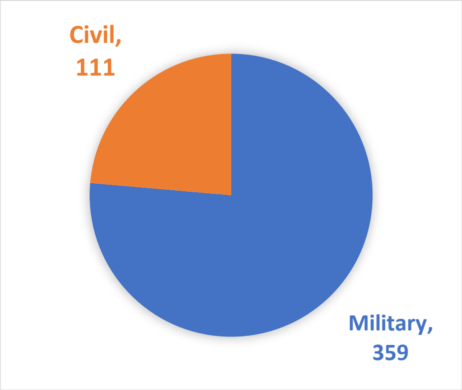
Pakistan has a very generous pension system, wherein, an employee qualifies for pension after serving 25 years in government service or till he retires at the age of superannuation which happens to be 60 years for civil servants and around 48 years for military personnel. This is just the beginning of the story. The pension liability of the central government alone in 2020 stands at PKR 470 billion up from PKR 421 billion in 2019 which shows an annual increase of 11.63%. The break-up of pension liability between civil government and military stands is as under;

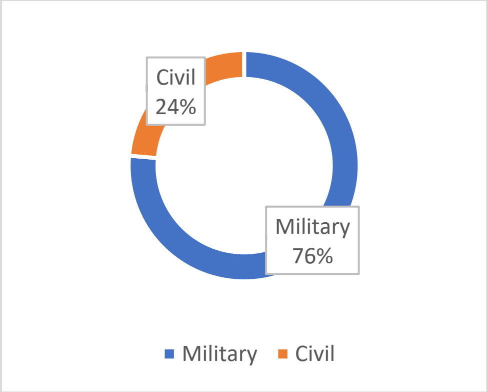
Table 4. 3 Pension Liability of central government 2020

	Amount (In Billion)	**% Share**
Military	359	76%
Civil	111	24%
Total	**470**	**100%**

Source: Budget in Brief, Ministry of Finance, Islamabad

Figure 4. 4 Civil & Military Pension Break-up 2020





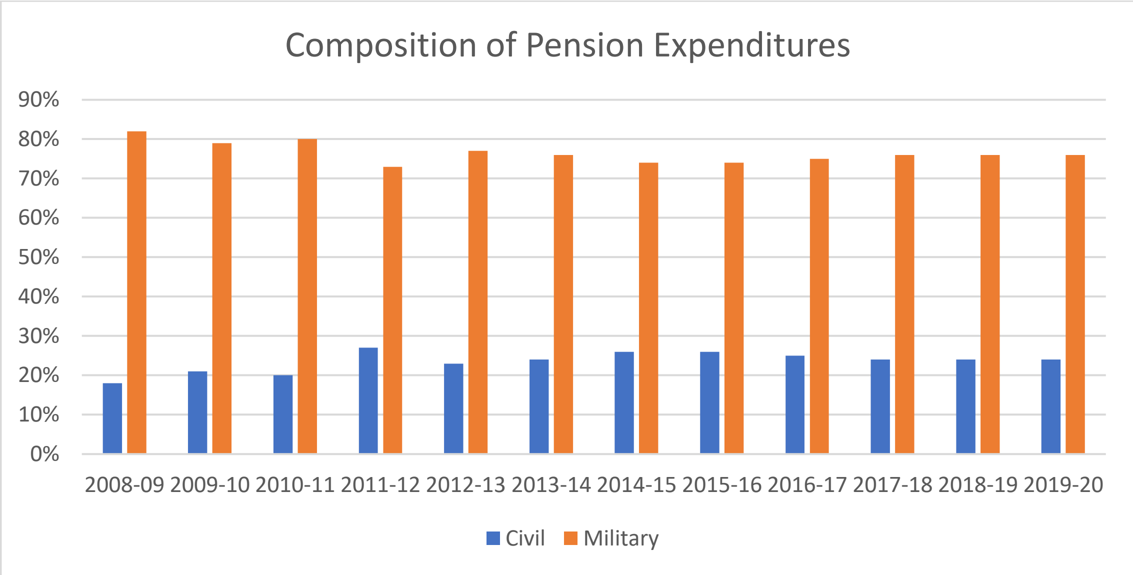
This break-up shows that pension liability is much skewed towards military. Similarly, year wise comparison of pension expenditure for the central government is shown as under;

Table 4. 4 Pension expenditure (2009-2020)

						PKR (In Billion)
Year	**Civil**	**% share**	**Military**	**% share**	**Grand Total**	**Annua Growth**
2008-09	13	18%	59	82%	71	-
2009-10	17	21%	65	79%	82	15%
2010-11	23	20%	89	80%	112	36%
2011-12	39	27%	106	73%	145	30%
2012-13	39	23%	134	77%	173	19%
2013-14	46	24%	143	76%	189	10%
2014-15	53	26%	153	74%	207	9%
2015-16	66	26%	185	74%	251	21%
2016-17	75	25%	229	75%	304	21%
2017-18	83	24%	259	76%	342	13%
2018-19	96	24%	296	76%	392	15%
2019-20	109	24%	338	76%	447	14%

Source: Appropriation Accounts, Controller general of accounts

Figure 4. 5 Composition of Pension Expenditure Civil & Military 2009-2020



Source: Appropriation Accounts, Controller general of accounts

The table above shows that most of the expenditure is related to Military personnel with a share of almost 76% while civil pensions contribute only 24% to the total pension bill. The data also exhibits another important information on annual growth in pension liabilities. The average annual growth in pension liabilities between 2009 and 2020 is 18%, while most of the increase is attributed to year 2011, 2012, 2016 and 2017. This is the time when ad-hoc relief allowances were merged into basic salaries resulting in increase in qualified pay for pension causing an increase in expenditures. Another important fact can be extracted from the table above related to military personnel causing huge drain on fiscal space through early age of retirement which happens at 48 years, a term 12 years shorter than their counterpart civilians. This results in huge pension liability and commutation payments that are made early.

Figure 4. 6 Annual Growth in Pension 2009-2020

The generous pension system can be gauged from the fact that a pension can run for 100 years in Pakistan. A pension either retired after qualifying service of 25 years of 60 years is eligible for pension till his death which is converted upon his death and paid to the widow of a male pensioner. Once the mother dies, pension is given to a son who is unmarried and below the age of 24 and stops afterwards, however, if the son dies, pension is given to her widow or if there is unmarried daughter, pension is given to her and if her husband dies and she becomes a widow, she is qualified to take the pension and this defines the end of generous pension system.

A close look at the pension system in Pakistan reveals that it is a non-contributory system of pension, wherein, employee and employer do not contribute into a pool of resources or pension fund to invest or to at least defray the expenditure using the same. It is the sole responsibility of the government to pay pension using its own fiscal space which is made up of tax revenues and non-tax revenues and supplemented through borrowings.

Given the huge problem of pension liabilities, it is need of the hour to come up with a plan to contain this head of expenditure as it is becoming a huge drain on government resources. Actuarial study needs to be done and appropriate changes must be made to come up with a solution for this looming crisis in the future. IMF and World bank is also stressing upon the government to look into this issue as uncontrolled growth in pension expenditure will have significant impact on overall public debt liabilities of the country.

4.10. Power Sector Circular Debt

Circular debt is relatively a new term coined in Pakistan which shows a cascade of non-payment by different players in the power sector of the economy. The problem gets its start from many sources with non-payment by end users being the prime reason, transmission & distribution losses, difference between the production cost and tariff rationalization. As this happens, the distribution companies cannot make payment to production companies resulting them not to be able to make payment to the oil marketing companies and hence, this shifting responsibility of debt get its name 'the circular debt'.

The problem is a great threat to macroeconomic stability of the country with accumulated circular debt expected to grow up to PKR 2.6 trillion by the end of FY 2021 as indicated by the M/o energy in its latest report to the National assembly of Pakistan. Historically, the problem of power outages started in the 90's due to excess demand, low level of supply and ageing infrastructure. This also had a profound impact on the growth of manufacturing and services sector which could not grow at potential growth rate and suffered heavy losses due to closure of businesses.

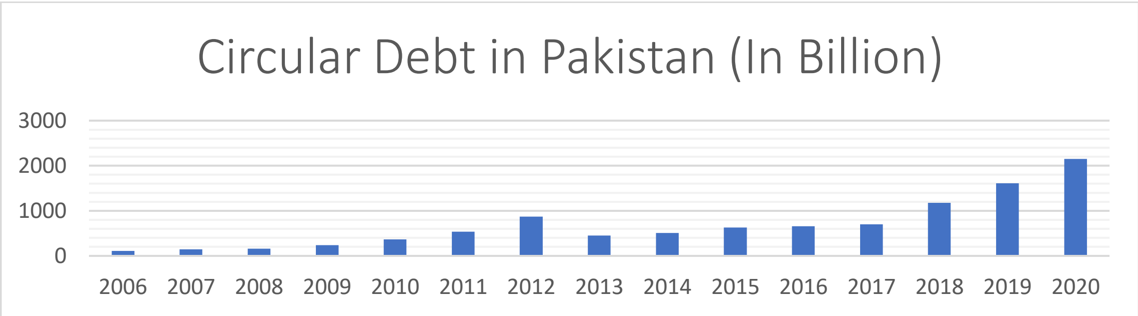
The problem of circular debt, albeit, considered an off-balance sheet activity and not reflected in the official public debt liabilities of the general government requires incorporation to have an explicit picture of the public debt liabilities of Pakistan. This poses a serious macro-fiscal threat to the economy in the event of default by the oil marketing companies to the foreign exporters. A historical time series data on circular debt is shown below to gauge the enormity of the problem;

Table 4. 5 Circular Debt of Pakistan

Year	PKR (In Billion)
2006	111
2007	145
2008	161
2009	235
2010	365
2011	537
2012	872
2013	450
2014	510
2015	630
2016	660
2017	700
2018	1180
2019	1612
2020	2150

Source: Ministry of Energy, Power Division

Figure 4. 7 Power Sector Circular Debt (2006-2020)



Source: Ministry of Energy, Power Division.

Table 4. 6 Power sector Circular debt & Total public debt

(Rs. In Billion)

Year	Public Debt	Circular debt	Public debt +Circular Debt	GDP	Public Debt Ratio	Public Debt+ Circular Debt to GDP	Variance
2006	4359	111	4470	8,216	53%	54%	1%
2007	4802	145	4947	9,240	52%	54%	2%
2008	6127	161	6288	10,638	58%	59%	2%
2009	7731	235	7966	13,200	59%	60%	2%
2010	9010	365	9375	14,867	61%	63%	2%
2011	10771	537	11308	18,276	59%	62%	3%
2012	12697	872	13569	20,047	63%	68%	4%
2013	14292	450	14742	22,379	64%	66%	2%
2014	15991	510	16501	25,068	64%	66%	2%
2015	17380	630	18010	27,384	63%	66%	2%
2016	19677	660	20337	29,598	66%	69%	2%
2017	21409	700	22109	31,862	67%	69%	2%
2018	24953	1180	26133	34,396	73%	76%	3%
2019	32708	1612	34320	38,559	85%	89%	4%
2020	36397	2150	38547	41,727	87%	92%	5%

Source: Ministry of Finance, State Bank of Pakistan, Ministry of Energy

The variance of ratio of total debt liabilities with circular debt liability added and total debt liabilities as a percentage of GDP shows a significant difference of 5% in year 2020. As the problem of circular debt was not flagrant prior to 2000 and started popping-up lately and not being capped by the government through reforms, it poses a grave threat to the economy as it is already contributing 5% of intrinsic risk which is not reported anywhere and makes a case strong for reporting of off-balance sheet activities.

4.11. Growth Trend in Public Debt Liabilities in Pakistan

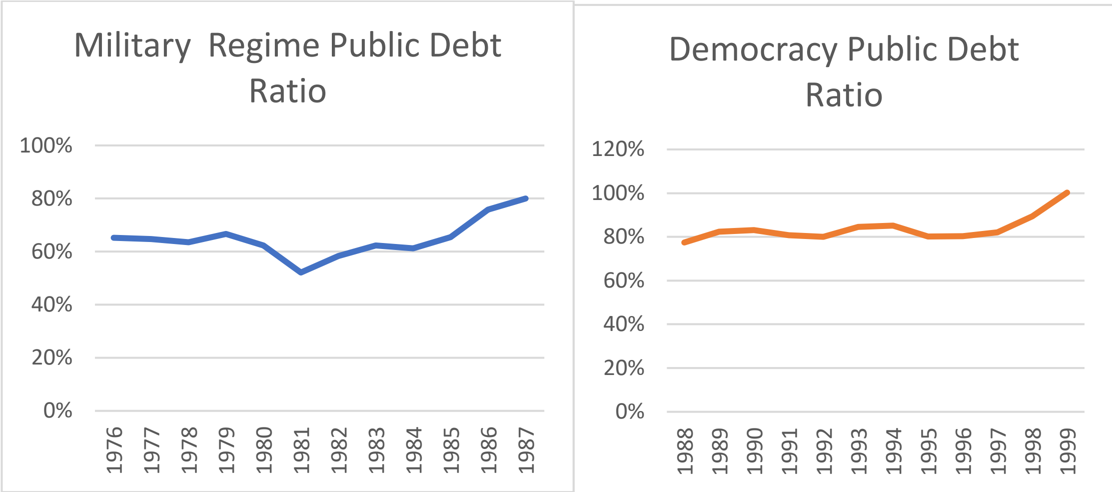
A cursory look on the debt growth trajectory of Pakistan reveals that both cyclicality and structural issues in the economy. The cyclicality is however, dependents on external factors that confirms reliance on external resources. These up and down turns are, however, political in nature and is dependent on whether democratically elected government is running the government or military dictators. In the given data set between 1976 to 2019, the country is ruled over for over 17 years by the military dictators, wherein, General Zia-ul-Haqq ruled between 1976-1977 and General Musharraf hold the reins between 1999-2007. It is during these periods that the major political developments were taking place. The first one was the Afghan invasion by the former Soviet Union which is one of the neighboring countries of Pakistan and the second was again in Afghanistan following the 9/11 attacks and subsequent invasion of Afghanistan by the Americans. In both these events, Pakistan supported Americans by virtue of its strategic location and ally to the US since signing SEATO (1954) and leaving the same in 1972 after separation of east Pakistan now called Bangladesh. IN response to this, the country was provided with financial and military aid which resulted in decrease in defense expenditures on one side and helped in containing the public debt on the other side. This is evident from the data between these two periods. The average public debt during the rule of military dictators was as low as 61% while the democratically elected government has a highest average debt of around 84% of the GDP. This clearly shows that military dictators could garner more financial support during the time of need by the Americans and when the purpose was achieved, aid was stopped and even sanctions were imposed on the democratically elected governments by the US. This can also be substantiated with the fact that Pressler amendment was made and sanctions were imposed on Pakistan in 1995 and 1999. It is due to this reason that public debt liabilities increased in Pakistan and shows a cyclical trend which is political in nature between democratically elected government with high level of debt and military dictators with low level of public debt.

Table 4. 7 Military Rule Vs Democracy Public Debt Ratio

Year	TDL/GDP	Ruler
1976	65%	Military
1977	65%	Military
1978	64%	Military
1979	67%	Military
1980	62%	Military
1981	52%	Military
1982	58%	Military
1983	62%	Military
1984	61%	Military
1985	65%	Military
1986	76%	Military
1987	80%	Military
1988	77%	Democracy
1989	82%	Democracy
1990	83%	Democracy
1991	81%	Democracy
1992	80%	Democracy
1993	85%	Democracy
1994	85%	Democracy
1995	80%	Democracy
1996	80%	Democracy
1997	82%	Democracy
1998	89%	Democracy
1999	100%	Democracy
2000	83%	Military
2001	88%	Military
2002	82%	Military
2003	76%	Military
2004	69%	Military
2005	65%	Military
2006	53%	Military
2007	52%	Military
2008	58%	Democracy
2009	59%	Democracy
2010	61%	Democracy
2011	59%	Democracy
2012	63%	Democracy
2013	64%	Democracy
2014	64%	Democracy
2015	63%	Democracy
2016	66%	Democracy
2017	67%	Democracy
2018	73%	Democracy
2019	85%	Democracy
2020	87%	Democracy

Source: Ministry of Finance, State bank of Pakistan

Figure 4. 8 **Military Vs Democratic Government Public Debt Ratio**



Source: Ministry of Finance, State bank of Pakistan

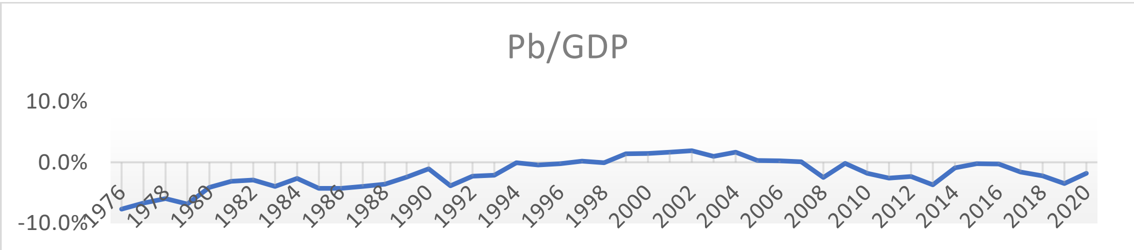
The above description and historical reference substantiated by data shows the cyclical nature of public debt, however, the structural issues of public debt cannot be ignored as there are many intriguing issues that causes public debt liabilities to increase in Pakistan. This, inter-alia, includes; Fiscal indiscipline, low tax to GDP ratio, low savings rate, narrow tax base, tax exemptions and evasions, slow reforms in tax administration, generous pension system, huge defense spending, untargeted subsidies, power sector losses, loss making public sector entities, lack of fiscal transparency, low level of exports and reliance on imported goods, All these factors combined together causes huge revenue-expenditure gap causing fiscal deficit to increase, thereby, translating into ballooning of Public Debt liabilities.

4.12. Primary Balance Ratio Trend (1976-2020)

The ideal response of primary balance to growth in public debt liabilities is counter-cyclical which means any increase in public debt in a given year must be countered by increase in primary balance so as to off-set the impact. However, the debt dynamics of a country become susceptible if primary surplus in the subsequent year is not increasing but decreasing and if this trend persists the public debt of the country becomes unsustainable in the long-run. The underlying dynamics in this scenario suggests that the response of the government towards sustainable debt path is not positive and no counter measures have been taken in the subsequent years to reduce expenditures other than interest expenditures. This persistent execution of budget towards debt accumulation helps us to know policy inaction of the government as well as behavior of the government towards ineffective and expansionary of fiscal policy which otherwise was required to adopt fiscal consolidation initially and then following a sustainable debt policy stance. This requires decrease in current expenditures without compromising on the development/capital expenditures which help economy to grow.

The economy of Pakistan is suffering from fiscal deficit over the years and this had led to accumulation of public debt liabilities that have reached up to 84% in FY 2019-20. The following graph table below presents time series data on primary budget balance between 1976 to 2020.

Figure 4. 9 ***Primary balance as % of GDP***



Source: Ministry of Finance

Table 4. 8 Primary Balance to GDP

		(Rs. In Billion)
Year	**Primary Balance**	**Pb/GDP**
1976	-10.025	-7.7%
1977	-10.056	-6.7%
1978	-10.537	-6.0%
1979	-13.339	-6.8%
1980	-9.593	-4.1%
1981	-8.709	-3.1%
1982	-9.513	-2.9%
1983	-14.515	-4.0%
1984	-11.019	-2.6%
1985	-20.248	-4.3%
1986	-21.91	-4.3%
1987	-22.755	-4.0%
1988	-24.325	-3.6%
1989	-18.747	-2.4%
1990	-9.347	-1.1%
1991	-39.145	-3.8%
1992	-27.57	-2.3%
1993	-28.72	-2.1%
1994	-1.279	-0.1%
1995	-8.106	-0.4%
1996	-5.31	-0.3%
1997	4.566	0.2%
1998	-2.204	-0.1%
1999	40.923	1.4%
2000	55.947	1.5%
2001	69.552	1.7%
2002	84.842	1.9%
2003	47.21	1.0%
2004	92.387	1.6%
2005	17.785	0.3%
2006	21.028	0.3%
2007	9.415	0.1%
2008	-267.595	-2.5%
2009	-24.148	-0.2%
2010	-267.791	-1.8%
2011	-477.805	-2.6%
2012	-467.785	-2.3%
2013	-828.066	-3.7%
2014	-226.843	-0.9%
2015	-64.677	-0.2%
2016	-85.9	-0.3%
2017	-515.4	-1.6%
2018	-760.5	-2.2%
2019	-1353.8	-3.5%
2020	-756.5	-1.8%

Source: Ministry of Finance, Budget Wing

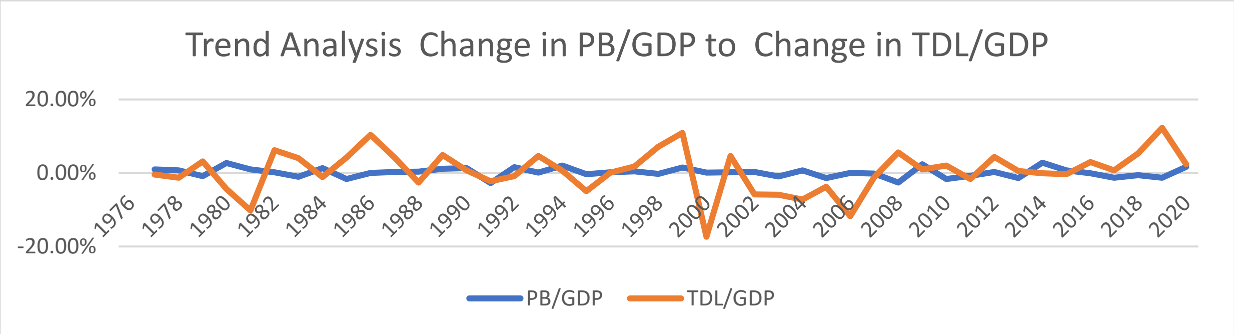
Table 4. 9 Primary Balance & Public Debt to GDP

Year	Pb/GDP	TDL/GDP
1976	-7.7%	65%
1977	-6.7%	65%
1978	-6.0%	64%
1979	-6.8%	67%
1980	-4.1%	62%
1981	-3.1%	52%
1982	-2.9%	58%
1983	-4.0%	62%
1984	-2.6%	61%
1985	-4.3%	65%
1986	-4.3%	76%
1987	-4.0%	80%
1988	-3.6%	77%
1989	-2.4%	82%
1990	-1.1%	83%
1991	-3.8%	81%
1992	-2.3%	80%
1993	-2.1%	85%
1994	-0.1%	85%
1995	-0.4%	80%
1996	-0.3%	80%
1997	0.2%	82%
1998	-0.1%	89%
1999	1.4%	100%
2000	1.5%	83%
2001	1.7%	88%
2002	1.9%	82%
2003	1.0%	76%
2004	1.6%	69%
2005	0.3%	65%
2006	0.3%	53%
2007	0.1%	52%
2008	-2.5%	58%
2009	-0.2%	59%
2010	-1.8%	61%
2011	-2.6%	59%
2012	-2.3%	63%
2013	-3.7%	64%
2014	-0.9%	64%
2015	-0.2%	63%
2016	-0.3%	66%
2017	-1.6%	67%
2018	-2.2%	73%
2019	-3.5%	85%
2020	-1.8%	87%

Source: Ministry of Finance, Budget Wing

The above table shows that average primary balance between 1976-1990 was -4.2% which otherwise suggests that government during the same period were not pursuing fiscal policy to increase primary surplus in response to increase in public debt or vice versa. The time period between 1991-2000 reports -0.6% primary balance on average. The response of the government r was not countering the increase in public debt by increasing the primary surplus but towards the end of the period the policy action was such that the primary budget balance becomes positive in response to increase in public debt. The reason for soaring debt during this era was economic sanctions on the government for becoming a nuclear state by detonating atomic bombs in a controlled environment in 1998 in response to India nuclear blast and Kargil war. However, this increase was rightly controlled by the government through increase in primary balance and decrease in expenditures other than interest expenditures. The third period starts from 2001 to 2010. During this period primary balance was 0.2% on average. This comes for a reason of 9/11 and becoming an ally to the US which provided financial assistance to the country as well as helped to reschedule earlier loans and interest payment especially the pending external loans from the Paris club. As revenues increased, the government could afford expenditures in a better way. Similarly, this era shows that public debt with respect to GDP decreased from 88% in 2001 to 61% in 2010. However, the period between 2011-2020 shows that average primary balance was -1.9%. This is departure from the earlier positive gains between 2001-2010. This is due to the reason that US was trying to end the war on terror in Afghanistan and this economic aid flowing decreased. Similarly, the government pursued expansionary fiscal policy, thereby, increasing current expenditures which led to increase in primary budget deficit. This era also witnessed 02 election in year 2014 and 2018. The government between 2014 to 2018 pursued fiscal policy which was expansionary in nature, however, it primarily focused on development activities which helped the economy to grow up to 5.3% but the downside was increase in public debt both domestic as well as external, however, the increase in domestic debt was much more than the increase in external debt. This era also shows the impact of debt rescheduling done in early 2000s which were scheduled to be paid from 2017 onwards. As these come along, the interest payments started increasing and more of the resources are being directed towards debt servicing, a little is left for other expenditures thus causing the financial managers to borrow more leading to increase in debt liabilities which are now reported at 84% of the GDP in FY 2020. Now, we turn our focus towards changes in primary balance and public debt both being relative to GDP in the graph and table below;

Figure 4. 10 ***Trend Analysis Change in Primary Balance and Total Debt Liabilities as % of GDP***



Source: Ministry of Finance, Budget Wing

The graph and table above reveal the changes in primary balance and public debt liabilities between 1976-2020 which is characterized by haphazard movements in both the indicators. This depicts that there was no counter policy and behavioral measures taken by the government in response to increase or decrease in public debt liabilities and primary balance. Both the series show inconsistency in terms of changes. In few years, increase in public debt liabilities led to decrease in primary budget balance while in few years it shows increase in primary budget balance. Similarly, decrease in public debt liabilities is followed by increase in primary balance in the subsequent years. A good policy response is counter-cyclical and the one which keeps economy in equilibrium, however, we see no direct response by the government between 1976-2020. This is related to more arbitrary execution of fiscal policy without taking into consideration the debt dynamics of the country. However, creation of debt policy coordination office and subsequent adoption of Medium-term debt strategy consistent with medium-term budgetary framework and medium-term expenditure framework may help the country to execute more sustainable and fiscal policy with growth orientation by adopting cost effective and long-term securities with low exposure to risk for financing needs.

Table 4. 10 Analysis of Change in Primary balance & Public debt to GDP

Year	PB/GDP	TDL/GDP
1977	0.97%	-0.43%
1978	0.74%	-1.26%
1979	-0.87%	3.18%
1980	2.75%	-4.35%
1981	0.97%	-10.22%
1982	0.20%	6.18%
1983	-1.05%	3.99%
1984	1.36%	-1.08%
1985	-1.66%	4.22%
1986	0.03%	10.35%
1987	0.28%	4.21%
1988	0.37%	-2.57%
1989	1.17%	4.93%
1990	1.34%	0.70%
1991	-2.74%	-2.23%
1992	1.56%	-0.84%
1993	0.14%	4.61%
1994	2.06%	0.58%
1995	-0.35%	-4.95%
1996	0.18%	0.14%
1997	0.44%	1.79%
1998	-0.27%	7.18%
1999	1.48%	10.93%
2000	0.07%	-17.36%
2001	0.19%	4.60%
2002	0.25%	-5.85%
2003	-0.94%	-5.89%
2004	0.67%	-7.23%
2005	-1.36%	-3.75%
2006	-0.02%	-11.73%
2007	-0.15%	-1.08%
2008	-2.62%	5.63%
2009	2.33%	0.97%
2010	-1.62%	2.03%
2011	-0.81%	-1.67%
2012	0.28%	4.40%
2013	-1.37%	0.53%
2014	2.80%	-0.07%
2015	0.67%	-0.32%
2016	-0.05%	3.01%
2017	-1.33%	0.71%
2018	-0.59%	5.35%
2019	-1.30%	12.28%
2020	1.70%	2.40%

Chapter 5. Discussion and Analysis

5.1. Introduction

This section presents important underlying findings that reflect upon public debt sustainability in Pakistan. These findings help us to know the strengths and weaknesses of public debt management in Pakistan and presents us with opportunities to successfully manage the soaring public debt in the country. This includes; Enactment of fiscal responsibility and debt limitation act 2005 amended in 2016, effective management of debt through Debt policy coordination office, Medium-term Debt Strategy, issuance of fiscal policy statement, Debt policy statement, Fiscal institutions in place Fiscal indiscipline, Fiscal Risk and contingent liabilities, budget credibility, political risk and policy inconsistency, Treasury Single Account, Expenditure arrears, poor payroll controls, fiscal federalism & national finance commission, Domestic Sources of Funding, external debt liabilities, portfolio diversification, mobilizing domestic savings, Islamic finance instruments for tapping excess liquidity in Islamic money market.

5.2. Positive Aspects of Public Debt Management in Pakistan

This section presents with the positive aspects of public debt management in Pakistan. The below mentioned findings help to consolidate the fiscal and debt stance in the country and helps in maintaining the solvency;

5.2.1. Fiscal Responsibility and Debt Limitation Act, 2005

The debt committee establish in year 2000 led to enactment of fiscal responsibility and debt limitation act, 2005 amended in 2016. The act states that, *"An Act to provide for reduction of Federal fiscal deficit and ratio of public debt to gross domestic product to a prudent level by effective public debt management"*. The FRDLA, 2005 amended in 2016 provides principles of sound economic management that warrants pursuance of policy objectives to reduce fiscal deficit and reduction of public debt to GDP ratio within the prudent limits. More specifically, it demands reduction of fiscal deficit to 4% of the GDP in next 03 years starting from 2017-18 and maintaining the same at 3.5% afterwards. It also provides for reduction of debt to 60% within a period of 02 fiscal years starting from 2016-17. Similarly, it envisages debt reduction of 0.5% each year from 2018-19 to 2023 and 0.75% from 2023 until the debt reaches 50% of GDP. However, the government may department from the principles given the unforeseen circumstances, war, issue of national security and natural calamities etc.

The FRDLA was an important legislation that not only provides for principles of sound economic management but also provides for transparency and accountability by laying the policies before the parliament. In this regard, medium-term budgetary statement, the fiscal policy statement, the debt policy statement is required to be presented by the ministry of Finance to the parliament each year. In addition to this, the FRDLA also demanded creation of debt policy coordination office for the purpose of better coordination between different institutions producing and management domestic and external debt liabilities and mainlining meta data and actual data on debt liabilities. The more detailed explanation of this important institution is as under;

5.2.2. Debt Policy Coordination Office

Given the high debt growth in Pakistan in 1990’s and hike in public debt liabilities up to 100% of the of the GDP led government and international financial institutions towards establishment of debt policy committee to come up with a roadmap for management and reduction of public debt liabilities in Pakistan in the long-run. This led to creation of Debt policy coordination office with front, back and middle office. The office so established was to work in coordination with ministry of Finance where the DPCO office was established to collaborate with Ministry of Economic affairs for external debt liabilities, The state Bank of Pakistan for external debt liabilities, Central directorate of national savings for domestic debt liabilities and State bank of Pakistan for consolidation of data and securities which are floated through banking sector especially the Treasury bills and market related treasury bills. The step is a welcome gesture and its creation led towards reduction in debt over the next few years. The office acts as secretariat for Fiscal responsibility and Debt limitation act, 2005 and works as per guidelines of the FRDLA,2005 and its mandate is to present fiscal policy and debt policy statement to the parliament in January each year thus delineating the measures taken for sustainable growth in public debt liabilities in the country. The main functions of the office include; preparation of debt reduction trajectory to achieve sustainable fiscal and debt management, evaluation and monitoring of borrowing strategies for domestic and external debt, to present objectives analysis of exposure external debt liabilities with respect to foreign exchange risk, maintenance of central database for effective data management related to overall public debt liabilities in the country. This office also prepares Medium-term debt strategy consistent with medium-term budgetary frame and medium-term fiscal framework. The office also presents Debt management risk report, annual debt review and public debt bulletin each year.

5.2.3. Medium Term Debt Strategy

The medium-term debt strategy is a 03 year rolling targets-based strategy for creation of robust debt portfolio by capitalizing different sources of borrowing keeping in view the trade-off between cost and risk. The MTDS is made and updated in-line with the medium-term fiscal framework and medium-term budgetary framework. Similarly, the implementation status of the strategy is published annual as greater part of transparency and accountability. The main objectives of MTDS include; cost minimization of the debt, availability of financing as and when required for financing needs and debt servicing and creation of domestic debt capital market for primary issuance of debt securities.

5.2.4. Fiscal Policy statement

An important aspect of public debt management is Fiscal policy statement which is prepared and presented in the parliament as a requirement prescribed in Fiscal responsibility and debt limitation act 2005 which, inter-alia, presents analyses of the following macroeconomic indicators;

- Total consolidated revenues of the federation
- Total consolidated expenditures of the federation
- Fiscal deficit of the federation
- Fiscal deficit of the federation excluding foreign grants
- Total stock of public debt
- Per capita debt owed

The fiscal policy statement presents views of the government on these fiscal indicators and explanation of how these indicators according to the principles of sound economic management. It also presents any deviation from in fiscal indicators related to revenues, expenditures, subsidies and borrowing by the government.

5.2.5. Debt Policy statement

The government of Pakistan prepares and present a debt policy statement to the parliament in June every year that inter-alia contains assessment of the federal government debt policy in meeting the set targets of public debt against annual GDP growth rate in line with the debt reduction path. It also evaluates external and internal debt borrowing strategies and provides policy advice, takes into account foreign currency exposure in relation to external debt, explicit information on disbursements and repayments vis-à-vis external and internal loans for the whole year is presented and trend analysis of public debt and actions by the government to align its debt policy implementation with the agreed debt reduction path is presented to the parliament.

5.2.6. Fiscal Institutions

The FRDLA 2005, presents with upper limits for both the fiscal deficit and public debt to GDP ratio. These institutions are very important for containing the negative outcomes resulting in increasing the public debt. In this regard, the FRDLA 2005 amended 2017 demands reduction of fiscal deficit to 4% of the GDP in next 03 years starting from 2017-18 and maintaining the same at 3.5% afterwards. It also provides for reduction of debt to 60% within a period of 02 fiscal years starting from 2016-17. Similarly, it envisages debt reduction of 0.5% each year from 2018-19 to 2023 and 0.75% from 2023 until the debt reaches 50% of GDP. However, the government may department from the principles given the unforeseen circumstances, war, issue of national security and natural calamities etc.

5.2.7. Medium-term budgetary framework & Performance Monitoring

The annual incremental budget was replaced by Medium-Term budgetary framework. The annual budgeting system in Pakistan lacked ion fiscal discipline, poor strategic allocation of resources and operational efficiency. However, introduction of MTBF along with Medium Term Expenditure Framework and Medium-Term Fiscal Framework (MTFF) led to development of annual and medium budget based on strategy enumerating fiscal priorities of the government. It also replaced bottom-up budgeting with top-bottom budgeting, ensured budget ceilings to the line ministries and inculcated fiscal discipline for better fiscal management in the federation. This also led to development of output-based budgeting system with defined key performance indicators of the all the line ministries/PAO. The reform also advocated for issuance of performance monitoring report that finally got approval in 2019 by enactment of public finance act 2019 to give authority and fix responsibility for outputs in the context of output-based budgeting. All these changes help in better fiscal outcomes and containment of fiscal deficit for sustainable growth in public debt liabilities in the country and this reform has gained larger acceptance in most of the countries in the world albeit with different degree of implementation and integration with the existing system.

5.3. Grey areas of Public Debt Management in Pakistan

This section explores the grey areas in public debt management in Pakistan. These issues affect public debt management significantly and are required to be controlled in order to ensure long-term sustainability of fiscal and debt management in Pakistan;

5.3.1. Fiscal Indiscipline

The public finance management in Pakistan is replete with inadequacies which is reflected through fiscal indiscipline which is highlighted in the form of expenditure and revenues outturns. The country lacked in budget law that could help cure the menace of poor management in expenditures and revenues resulting in huge fiscal deficits that ultimately translates into public debt. The downside of this lack of organic law resulted in number of in-year adjustments without any limit defined in the law, however, legally provided for. Similarly, the absence of budget law resulted in issuance of instructions by the ministry of finance and planning which were largely ignored by the line ministries causing both revenue shortfall and huge expenditure outturn causing fiscal indiscipline. The PFM system in Pakistan is governed by various regulation including General financial rules (GFR), treasury rules, fundamental rules & supplementary rules, new accounting model, PPRA, accounting code, auditing code.

Apparently, all these rules and instructions are contradictory to each other and come cause of fiscal indiscipline. Similarly, treasury single account was missing for number of years and there was no requirement of keeping funds in accounting which were linked to treasury single account. There is also no system to record commitments despite employing commitment-based accounting on one side and no internal audit system on the other side. All these factors have contributed negatively in maintaining fiscal discipline in the country, however, the recent changes in the PFM systems has resulted in enactment of new PFM LAW in 2019, subsequent issuance of Cash management and Treasury single account rules 2020, legislation for performance based budgeting and performance monitoring, adoption of new strategy to apply check on payroll to contain expenditures within allocated budget and adoption of regulations for financial management and powers of principal accounting officers regulations. It is expected that these laws and regulations will result in better fiscal outcome, however, it will take time to fully rollout these changes thereby causing greater fiscal discipline in the country.

5.3.2. Fiscal Risk & Contingent liabilities

Fiscal risk emanates from deviation of fiscal outcomes from fiscal forecast. Macroeconomic shocks and realization of contingent liabilities that are otherwise triggered by unknow circumstances significantly contribute to the fiscal risk. Fiscal risk also emanates from the financial position of sub-national governments and performance of state-owned entities and operation of extra budgetary units. The liabilities are categorized as explicit liabilities like government guarantees and explicit liabilities in the form of charges on government revenues from transactions like default by special purpose vehicle (SPV) in PPP mode both of which are categorized as extra-budgetary operations and off-balance sheet activities in cash and modified cash basis of accounting. The information on explicit guarantees issued by the federal government is made available quarterly and the only document that provides analysis on contingent liabilities is debt policy statement by debt policy coordination office (DPCO) but the analysis is only confined to financing instruments used in PPP mode of financing. Similarly, potential threats emanating from commitments are not recognized as commitments are not recorded. In addition to this assets and liabilities registers are not maintained. The budget wing documents do not record potential claims through legal proceeding in the court of law that may significantly affect federal consolidated fund in case a claim against government is awarded by the court. Likewise monitoring of public corporations is not very good and financial reports are furnished to the government within 09-month time period. Similarly, financial statement of the provincials/sub-national governments are made available with the timeliness of 09 months. Fiscal risks other than the above mentioned are recorded after enactment of public finance act 2019, however, there is no appropriation made in the budget to offset adverse shocks in the future by creating contingent fund.

5.3.3. Budget Credibility

The budget execution in Pakistan manifests frequent in-year changes that require ex-post approval by the parliament. These variations in budgeted vs actual expenditures poses serious threat to fiscal position of the federation, thereby, undermining credibility of the budget. There is also no set time period when these changes in the budget are entertained. The request for changes in the budget comes from principal accounting officers (PAO) of the ministries reflecting changing policy priorities of the political government in place or significant lack of adherence to the defined process of preparation of annual and medium0term budget. Although, General Financial Rules (GFR) defines rules and regulations for changes in budget yet it is observed that the M/o

Finance lacks the ability to challenge the requests from PAOs and PAOs themselves lack in the ability to prepare correct budget estimates. This causes expenditure outturns more than the budgeted amount and revenues shortfalls causing fiscal deficit to increase thereby translating into public debt in the ensuing year.

5.3.4. Political Risk and policy inconsistency

Political risk is another factor that contributes to negative to the macroeconomic conditions of the country and public debt profile. The reference period between 1976-2020 shows frequent changes in political governments. There were two military dictators who served the country for more than 16 years while democratic governments kept on changing after every two to three years during 1990s. This helped fueled fiscal indiscipline and skewed priorities by the rules as well as policy inconsistency as the new government would wipe out previous government policies and come up with new. This caused significant problems in macro-fiscal management of the country. The departure of budget forecast and budget actuals in relation to both revenues and expenditures caused fiscal deficit to increase causing public debt to increase. Most of the times these changing governments forecast regarding revenues including tax and non-tax revenues falls short of target and expenditures forecasts are less than the actual appropriations, therefore, both are considered ambitious.

5.3.5. Treasury Single Account

The government of Pakistan before 2020 was operating a partial Treasury Single Account (TSA) since most the revenues make part of consolidated fund, however, there are many entities that were legally allowed to operate outside the TSA and maintain their bank accounts in other commercial banks which are not linked to TSA. An estimated 2.2 trillion was parked outside treasury single account in 2018-19 as per State

Bank of Pakistan estimates. This causes net public debt to increase by the same amount as it should ideally be subtracted from gross public debt to come up with net public debt. This weak treasury single account is also reinforced by absence of robust cash forecasting system. This serious deficiency in the system causes variance in revenues and expenditures thus denting the credibility of the budget and helps in increasing fiscal deficit in the country thereby increasing public debt liabilities. The TSA requires creation of unified banking account system for all the government entities in order to facilitate ministry of finance track movement of public funds and manage cash resources so as to estimate borrowing requirement, secondly no government entity should have been allowed to operate outside treasury single account and lastly, consolidation across all government entities must be ensured where the entities are provided through budgetary process or outside of annual budget.

5.3.6. Expenditure Arrears

Commitment accounting demands recording of in-year expenditure commitments and maintenance of year end stock of arrears, however, there is no mechanism in the public finance management system (PFM) in Pakistan to this effect. Although, handbook of accounting warrants recording of commitments yet there is no legal binding in the law or by the ministry of Finance to make it incumbent on the line ministries to record and maintain liabilities and commitment registers. It is due to this reason that the next year budget does not reflect appropriation for these expenditure arrears and the PAO concerned has to make a request for supplementary grant to make up for the payment causing variance in budget execution. It is pertinent to mention that there is no centralized entity to record payment arrears and it is, therefore, not possible to ascertain the total stock of payment arrears or its percentage in relation to total expenditure.

5.3.7. Poor Payroll controls

The government uses SAP R/3 system for disbursement of salaries to the employees. It is an automated system wherein data of all the employees are maintained and paid through payroll execution every month. Any change in salaries is made part of the system which is automatically executed. However, there is a problem with this system in a way that expenditure ceilings are distributed amongst line ministries in the form of single-line budget which is distributed by them as per their priorities. Any expenditure over and above the allocated budget in expenditure heads other than salaries are rejected at the time of execution in the SAP system, however, salaries are never stopped even though budget allocation is less than the expenditure. This causes expenditure to be more than the budget and cause significant variance in the total expenditure thus contributing in overall fiscal deficit and stock of public debt.

5.3.8. Fiscal Federalism & National Finance Commission

Fiscal federalism deals with division of responsibilities paid trough finances segregated amongst central government, provincial government and local government in order to achieve allocative efficiency in order to achieve public policy objectives. The field necessarily study financial relationship between different level of government including revenues assignment and nature of service to be provided. Fiscal federalism in Pakistan is governed by National Finance Commission award which is constituted after lapse of 05-year time period. The latest award in Pakistan was constituted in 2010-11. Prior to this award provinces were assigned 32 percent of the revenues from federal divisible pool which is made up of tax revenue and other duties except levy taxes which are not shared and used exclusively by the central government. The 7th award constituted thereafter shifted balance of revenue share in favor of provinces up to 46.5 percent in the first year of this award. This had serious consequences on the financial position of the central government as the revenues prior to the award were enough to defray expenditures on debt servicing, defense and sufficient balance was available for other functions of the central government, however, the 7th NFC award caused significant shortfall for the central government and it could not even meet defense and debt expenditures and government had to borrow for current and development expenditures through borrowing till date that happens to be the primary reason for increasing fiscal deficit consequently leading to an increase in public debt in the country. The commission falsely assumed that central share in expenditures will decrease from 72 percent to 55 percent and revenues would increase from 13.5 to 16.5 of the GDP, however, the actual outcome was only 13.4 percent revenue as a percentage of GDP. This shows that central government loose significant share of resources and due to inelastic expenditures and revenues, the revenue expenditure gap increased and thus lead to increasing fiscal deficit and public debt liabilities in the country. Another shocking projection made at the time of award was reduction of fiscal deficit of the country to 2.5 percent at the end of award, however, this did not happen and fiscal deficit could only be reduced to 4.1 percent of the GDP showing a significant difference between projection and actual outcome. Combined all together, fiscal federalism and NFC award caused central government to lose significantly and it is due to this reason that public debt liabilities increased at this time period which is evident from trend analysis of public debt which increased from 59% in 2009 to 64% in 2014 and reach up to 87 percent of the GDP in 2020. This precarious situation needs adoption of immediate correction mechanism. Article 160 of the constitution provides sufficient flexibility to review the award for a viable solution to restore fiscal balance.

5.4. Prospects of Effective Debt Management in Pakistan

All the cash starved government looks for opportunities to raise funding from domestic and international market with minimum cost and low exposure to risk. the domestic sources of funding are readily available albeit with higher cost and low risk exposure, however, external funding is much cheaper if money is borrowed from international financial institutions and costlier if it were raised from international capital markets. This analysis evaluates domestic and international funding opportunities for effective debt management and creating a robust debt portfolio with reduced cost and minimum exposure to risk;

5.4.1. Domestic Sources of Funding

Marketable government securities are used as domestic source of funding in Pakistan. This includes short-term instruments in Market related treasury bills, Treasury bills and medium to long-term Pakistan investment bonds with a maturity profile of 3,5,7,10 and 20 years for fixed rate PIBs and 10-year floating rate PIBs with a semi-annual coupon on all the PIBs issued by SBP. A small percentage of debt is also raised using Islamic mode of financing, however, its share in total debt portfolio is minimal. The Instrument based classification of Domestic debt is composed of long-term permanent debt, short-term floating debt which are otherwise subsumed as funded debt. This debt is primarily funded debt and it is mainly offered by institutional lenders and makes up to 84.2% of domestic debt portfolio in June, 2020. There is another form of domestic unfunded debt that comprises of national savings schemes for tapping resources from general public with excess liquidity to offer to the government against profit/interest. This makes up to 15.8% of total domestic debt liabilities in June, 2020.

5.4.2. External Debt Liabilities in Pakistan

External debt liabilities of a country include portion of public debt which is raised from external sources. This includes debt raised from multilateral financial institutions, bilaterally from donor countries, raised from international financial institutions and commercial banks. External debt helps in borrowing portfolio diversification, built up forex reserves and are generally raised at lower interest rates to augment development activities in the country and lastly provide budgetary support to the government at the time of distress and helps in avoiding crowding out of private investment in the country, thereby, leaving funds available for investors in the domestic market.

The growth trajectory of external debt in Pakistan shows a steady growth up to 2014, however, investment related to China Pakistan Economic Corridor. The composition of external public debt is composed of central and provincial government debt and debt owed by the

government to the IMF. The breakup of external debt having different dimensions is as under;

Table 5. 1 Composition of External Debt **June, 2020**

	PKR (Billion)	USD (Million)	% of total
External Public debt	**13,117**	**77,988**	**100%**
I Long-term government debt	**11,589**	**68,908**	**88%**
Paris club loans	1,837	10,924	14%
Multilateral	5,196	30,898	40%
Other bilateral	2,258	13,428	17%
Euro/Sukuk bonds	891	5,300	7%
Commercial loans/credits	1,381	8,210	11%
others	26	148	0.2%
II Short-term external public debt	**237**	**1,400**	**2%**
Multilateral	138	814	1%
Local currency securities (T-bills)	99	586	1%
III IMF	**1,291**	**7,680**	**10%**
Central/Federal Government	476	2,833	4%
Central bank	815	4,847	6%

Source: State Bank of Pakistan/ debt policy coordination office, Ministry of Finance Pakistan

The above table shows that most of the loan is concentrated in long-term external debt. The composition is skewed towards long-term debt which contributes 88% of the total debt excluding the IMF which contributes 10% in total external debt liabilities of Pakistan. Furthermore, external debt is primarily financed from Multilateral institutions (51%) and bilateral sources (31%) which are concessionary in nature. IMF contribution in total debt portfolio is 10% and a small portion of loan in relation to total external public debt comes from commercial sources (11%) by tapping international capital market where financing has been mobilized through Euro bonds and sukuk bonds.

Table 5. 2 Source Wise External Debt

	June, 2020	
	$ Million	**% of Total**
I Multilateral	**39,392**	**51%**
World Bank	16,184	21%
Asian Development Bank	12,741	16%
IMF	7,680	10%
Others	2,787	4%
II Bilateral	**24,352**	**31%**
Paris Club	10,924	14%
Non-Paris club	13,428	17%
III Commercial	**14,244**	**18%**
Eurobonds/Pakistan international Sukuk bond	5,300	7%
Loans from foreign commercial banks/others	8,944	11%
I+II+III External Debt Liabilities	**77,988**	**100%**

Source: State Bank of Pakistan/ debt policy coordination office, Ministry of Finance Pakistan

The above table shows that most of the external debt is raised from multilateral and bilateral sources which contributes 51% and 31% respectively, while share of commercial financing is 18%. It is pertinent to mention that external financing raised from multilateral and bilateral sources are concessionary in nature, however, commercial financing is expensive intrinsically both in the domestic market as well as in the international capital market. This, however, is used to have better footprint in international capital market in terms of credit ratings or at the time of distress when financing is not available from Multilateral and bilateral sources.

5.4.3. Portfolio Diversification

The government needs to diversify its portfolio in order to meet financing requirements as and when required at minimum cost with lowest exposure to refinancing risk, interest rate risk and foreign currency risk. As most of the financing requirements of the government are met through domestic market, it is required to create offer a range of securities suitable to individual and institutional investors. In this regard, the government has started issuing floating rate securities like 10-year PIBs and is working on issuing floating rate PIBS with 3- and 5-year maturity profile and offering quarterly coupon payments This will help the government to tap resources as investors tend to invest in short-term Treasury bills with 3-month maturity that poses a serious problem of rolling over and liquidity risk to the government. It is also expected that more investors will try to invest in three variable rate PIBs as it will reduce the interest rate risk which is more profound in case of T-Bills.

5.4.4. National Savings Scheme

The NSS makes part of non-banking financial institutions will a large customer base offering significant number of resources to the government and makes part of un-funded debt of the government. The NSS provides opportunities to mobilize resources from retail investors in the domestic primary and secondary markets. In order to augment this objective, the government has enacted a new legislation related to Islamic savings account in 2019 namely SARWA Islamic savings account act, 2019. This will enhance the product base of the government NSS/CDNS and attract investors with excess liquidity but no avenue to park in Islamic savings account.

5.4.5. Islamic Sukuk Bonds

It is estimated that ample liquidity is available with the Islamic banking industry in Pakistan. The ministry of finance in its drive to diversify portfolio and increasing the investor base is also working on issuance of Islamic financing instruments to tap the Individual and institutional investors like shariah based Islamic banking sector as well as takaful funds of Islamic insurance institutions. This will help generate financing from the domestic market easily on need basis as a and when required and it will be an opportunity to investors to invest in government asset backed securities multiple time in a calendar year on the same footings as conventional bonds are offered in multiple auctions. The tenor will also be in line with the government medium-term securities of up to 5 year based on Sukuk and it is also intended to introduce non-competitive bidding to meet the demand of financial sectors other than the banking sector. In addition to Sukuk, the government also has the opportunity to issue securities based on Musharakah, Murabaha, Ijarah and other Islamic financing instruments. In this regard Islamic Banking wing has recently been established in the ministry of Finance to guide and engineer these kinds of products in collaboration of State Bank of Pakistan (SBP) that acts as a regulator to Islamic Banking industry in Pakistan.

5.5. Simulation Exercises

Now, a few simulation exercises will be carried out to evaluate different scenarios having policy implication. The few are given below;

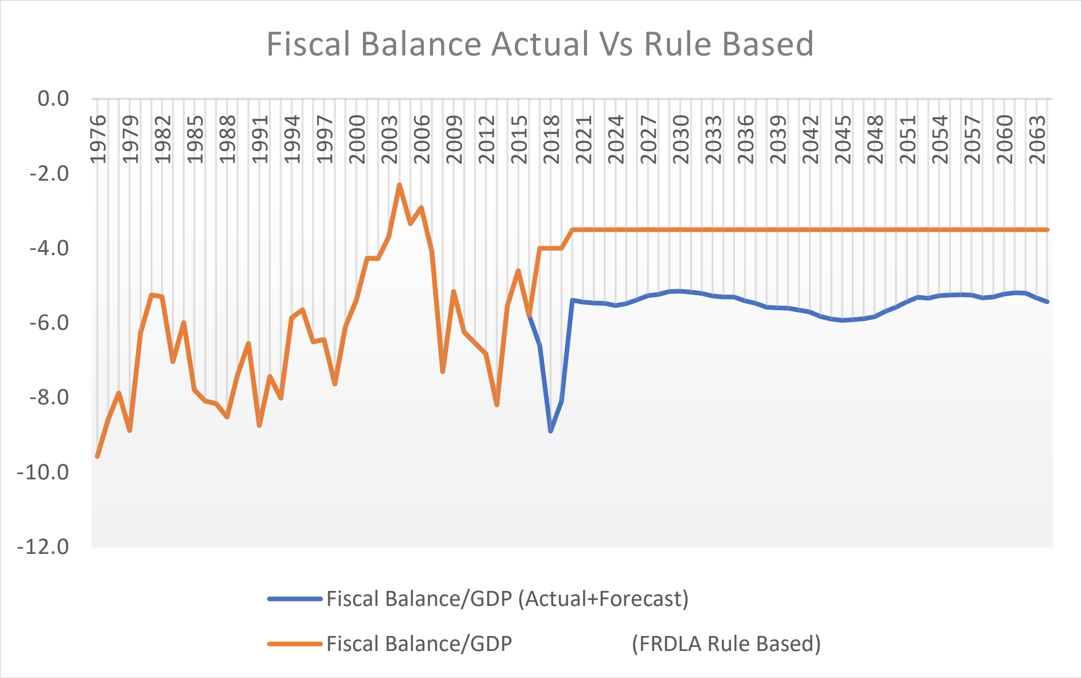
Table 5. 3 Fiscal Balance Actual Vs FRDLA stance

Year	Fiscal Balance/GDP (Actual + Forecast)	Type	Fiscal Balance/GDP (Rule Based)	Type
1976	-9.6	Actual	-9.6	Actual
1977	-8.6	Actual	-8.6	Actual
1978	-7.9	Actual	-7.9	Actual
1979	-8.9	Actual	-8.9	Actual
1980	-6.3	Actual	-6.3	Actual
1981	-5.3	Actual	-5.3	Actual
1982	-5.3	Actual	-5.3	Actual
1983	-7.0	Actual	-7.0	Actual
1984	-6.0	Actual	-6.0	Actual
1985	-7.8	Actual	-7.8	Actual
1986	-8.1	Actual	-8.1	Actual
1987	-8.2	Actual	-8.2	Actual
1988	-8.5	Actual	-8.5	Actual
1989	-7.4	Actual	-7.4	Actual
1990	-6.5	Actual	-6.5	Actual
1991	-8.7	Actual	-8.7	Actual
1992	-7.4	Actual	-7.4	Actual
1993	-8.0	Actual	-8.0	Actual
1994	-5.9	Actual	-5.9	Actual
1995	-5.6	Actual	-5.6	Actual
1996	-6.5	Actual	-6.5	Actual
1997	-6.4	Actual	-6.4	Actual
1998	-7.6	Actual	-7.6	Actual
1999	-6.1	Actual	-6.1	Actual
2000	-5.4	Actual	-5.4	Actual
2001	-4.3	Actual	-4.3	Actual
2002	-4.3	Actual	-4.3	Actual
2003	-3.7	Actual	-3.7	Actual
2004	-2.3	Actual	-2.3	Actual
2005	-3.3	Actual	-3.3	Actual
2006	-2.9	Actual	-2.9	Actual
2007	-4.1	Actual	-4.1	Actual
2008	-7.3	Actual	-7.3	Actual
2009	-5.2	Actual	-5.2	Actual
2010	-6.2	Actual	-6.2	Actual
2011	-6.5	Actual	-6.5	Actual
2012	-6.8	Actual	-6.8	Actual
2013	-8.2	Actual	-8.2	Actual
2014	-5.5	Actual	-5.5	Actual

2015	-4.6	Actual	-4.6	Actual
2016	-5.8	Actual	-5.8	Actual
2017	-6.6	Actual	-4.0	Rule Based
2018	-8.9	Actual	-4.0	Rule Based
2019	-8.1	Actual	-4.0	Rule Based
2020	-5.4	Forecast	-3.5	Rule Based
2021	-5.4	Forecast	-3.5	Rule Based
2022	-5.5	Forecast	-3.5	Rule Based
2023	-5.5	Forecast	-3.5	Rule Based
2024	-5.5	Forecast	-3.5	Rule Based
2025	-5.5	Forecast	-3.5	Rule Based
2026	-5.4	Forecast	-3.5	Rule Based
2027	-5.3	Forecast	-3.5	Rule Based
2028	-5.2	Forecast	-3.5	Rule Based
2029	-5.2	Forecast	-3.5	Rule Based
2030	-5.2	Forecast	-3.5	Rule Based
2031	-5.2	Forecast	-3.5	Rule Based
2032	-5.2	Forecast	-3.5	Rule Based
2033	-5.3	Forecast	-3.5	Rule Based
2034	-5.3	Forecast	-3.5	Rule Based
2035	-5.3	Forecast	-3.5	Rule Based
2036	-5.4	Forecast	-3.5	Rule Based
2037	-5.5	Forecast	-3.5	Rule Based
2038	-5.6	Forecast	-3.5	Rule Based
2039	-5.6	Forecast	-3.5	Rule Based
2040	-5.6	Forecast	-3.5	Rule Based
2041	-5.7	Forecast	-3.5	Rule Based
2042	-5.7	Forecast	-3.5	Rule Based
2043	-5.8	Forecast	-3.5	Rule Based
2044	-5.9	Forecast	-3.5	Rule Based
2045	-5.9	Forecast	-3.5	Rule Based
2046	-5.9	Forecast	-3.5	Rule Based
2047	-5.9	Forecast	-3.5	Rule Based
2048	-5.8	Forecast	-3.5	Rule Based
2049	-5.7	Forecast	-3.5	Rule Based
2050	-5.6	Forecast	-3.5	Rule Based
2051	-5.4	Forecast	-3.5	Rule Based
2052	-5.3	Forecast	-3.5	Rule Based
2053	-5.3	Forecast	-3.5	Rule Based
2054	-5.3	Forecast	-3.5	Rule Based
2055	-5.2	Forecast	-3.5	Rule Based
2056	-5.2	Forecast	-3.5	Rule Based
2057	-5.3	Forecast	-3.5	Rule Based
2058	-5.3	Forecast	-3.5	Rule Based
2059	-5.3	Forecast	-3.5	Rule Based
2060	-5.2	Forecast	-3.5	Rule Based
2061	-5.2	Forecast	-3.5	Rule Based
2062	-5.2	Forecast	-3.5	Rule Based
2063	-5.3	Forecast	-3.5	Rule Based
2064	-5.4	Forecast	-3.5	Rule Based

Source: State Bank of Pakistan/Ministry of Finance

Figure 5. 1 Fiscal Balance Historic trend, forecasting & Rule based reduction



Source: State Bank of Pakistan/Ministry of Finance

The fiscal responsibility and debt limitation act 2005 amended 2016, prescribed a deficit rule of 4% for first three years starting from 2017 to 2019 and 3.5% onwards until debt is reduced to 50% of the GDP and maintenance of the same thereafter. However, the actual data shown above shows that this has never been realized and fiscal deficit during the first 03-year time period was -6.6, -8.9 and -8.1 which was way above the threshold of fiscal deficit of 4% as stipulated in FRDLA. This on the other hand means that realization of reduced fiscal deficit is not an easy task and requires strenuous efforts by the government in the form of fiscal consolidation, increase in tax revenues, decrease in expenditures by adopting austerity measures etc. The non-realization of target also suggest that fiscal rules as stipulated in FRDLA are indicative and not binding. This also shows that the responsibility law application is not stringent and there is flexibility available in the system as this can only be discussed in the parliament, however, no punitive action can be taken against the government of the minister for Finance. There is another important fact that can be deduced in favor of minister for

Finance which is a fact that the sources of debt and its emergence is not solely dependent on the current government but the past governments as well as debt is both a stock and a flow variable. The current regime in place at time it is only responsible for generating debt in time T+1, however, it has to perform the function of debt servicing for time T-1 and if the stock of public debt is high in time T-1 then the government at time T has to appropriate huge number of resources towards debt servicing through application of its revenues or by borrowing more money to retire previous debt, thus making it a *non-Ponzi* game. This is the case that is happening with Pakistan and evident from the fact that almost interest cost of the previous debt was 39% of the total expenditures for the central government in 2019-20. This fact raises serious alarm bells for the policy makers as more of the resources are being appropriated for debt servicing thus reducing the much-needed fiscal space to augment growth in the economy keeping in view the fact that the economy is running a primary budget deficit and not been able to defray its expenditures excluding the interest cost of the previous debt. The fact is evident from the simulation exercise that reinforces the argument that the government needs to bring about massive structural changes and bring about reforms to have a policy stance that supports the country responsibility law of reducing fiscal deficit to 3.5% and mainlining a public debt. /GDP ratio of 50% in the future. This can easily be seen from the simulation exercise that shows forecast from 2020-2064 in the table above that the policy consistent scenario or the current government stance will not help the government to reduce fiscal deficit to 3.5% even up to 2064. In other words, this requires other changes as mentioned above that need to be done in order to reduce debt burden on the economy.

5.5.1. Public Debt to GDP Ratio 1976-2020 Simulation

Public debt/GDP ratio is an important indicator of debt solvency and carrying capacity of the country to impose more taxes on the future generations to support the current expenditures. Although, there is no specific threshold for any country yet researches believe that identical economies suffer hampered economic growth beyond a certain threshold which is identical to all the economies yet the debt sustainability analysis of the IMF considers 60% debt/GDP ratio for developed countries and 40% debt/GDP ratio for the developing economies. These are generic and not country specific thresholds yet maintenance of debt/GDP will help countries to avoid future risks causing the sluggish economic growth of the economy. The table below shows actual and simulated results of public debt/GDP for the economy of Pakistan from 1976-2020 and 2021-2065 respectively;

Table 5. 4 Public Debt to GDP Ratio Simulation

Actual		Simulation	
Year	**TDL/GDP**	**Year**	**TDL/GDP**
1976	65%	2021	72%
1977	65%	2022	72%
1978	64%	2023	71%
1979	67%	2024	71%
1980	62%	2025	70%
1981	52%	2026	70%
1982	58%	2027	69%
1983	62%	2028	68%
1984	61%	2029	67%
1985	65%	2030	65%
1986	76%	2031	64%
1987	80%	2032	64%
1988	77%	2033	63%
1989	82%	2034	63%
1990	83%	2035	62%
1991	81%	2036	62%
1992	80%	2037	62%
1993	85%	2038	61%
1994	85%	2039	61%

1995	80%	2040	61%
1996	80%	2041	61%
1997	82%	2042	61%
1998	89%	2043	61%
1999	100%	2044	61%
2000	83%	2045	62%
2001	88%	2046	62%
2002	82%	2047	63%
2003	76%	2048	64%
2004	69%	2049	64%
2005	65%	2050	64%
2006	53%	2051	64%
2007	52%	2052	63%
2008	58%	2053	63%
2009	59%	2054	62%
2010	61%	2055	61%
2011	59%	2056	61%
2012	63%	2057	60%
2013	64%	2058	59%
2014	64%	2059	59%
2015	63%	2060	58%
2016	66%	2061	58%
2017	67%	2062	57%
2018	73%	2063	56%
2019	85%	2064	56%
2020	87%	2065	56%

Source: Ministry of Finance/Author's own calculations

The table above shows actual debt path from 1976 to 2020 and simulation until year 2065. The results show that the FRDLA amended in 2016 stipulating to reduce debt to 50% of the GDO in 15-year debt reduction strategy has not produced results and debt has increased to 87% of the GDP in 2020. This also shows that the government by passed the rule of containing fiscal deficit to 4% in the first three years of amending the FRDLA, maintaining a stable fiscal deficit of 3.5% afterwards and lowering the Debt/GDP to 50% initially and maintaining the same in the future. On the contrary, this also shows that the government did not adopt policy interventions to cause revenues to increase or expenditures to decrease so as to cause the gap between the two to shrink thus sliding it more in the favor of increased revenue and decreased expenditures either augmented by fiscal and monetary policy stance at the public level and by increasing productive capacity through capital formation via the channel of savings-investment. Having gone through above state of affairs, the simulation results show that the effort for reduction of debt/GDP up to 50% with current set of policies cannot be achieved in the next 45 years. This means government should come up with policy interventions to contain fiscal deficit by developing a robust debt reduction strategy, adoption of austerity measures, increase in tax and non-tax revenue, liquidation of assets & loss making entities, bring about pension reforms, curtail expenditures on debt servicing and defense, un-targeted subsidies should be done away and targeted subsidies must be introduced, domestic resource mobilization efforts must be increased and on the external front current account deficit may be bridged by avoiding unnecessary imports and increasing exports so as to generate positive net balance and reduction of external debt.

5.5.2. Power Sector Losses and total Debt Liabilities Simulation

The potential risk fraught in off-balance sheet activities must be disclosed through enhanced coverage of government operations and fostering fiscal transparency to hedge the economy against potential risks emanating from these underlying operations. Since, we have data available on power sector circular debt which is not made part of financial statements of the government, it is necessary to do simulation exercise to know the gravity of the problem. The table below shows actual and simulations for the said data set for next 10 years;

Table 5. 5 Consolidated Public Debt & Circular Debt Simulation

Actual		Simulation	
Year	**Public Debt + Circular Debt to GDP**	**Year**	**Public Debt +Circular Debt to GDP**
2006	54%	**2021**	85%
2007	54%	**2022**	88%
2008	59%	**2023**	90%
2009	60%	**2024**	93%
2010	63%	**2025**	96%
2011	62%	**2026**	99%
2012	68%	**2027**	102%
2013	66%	**2028**	105%
2014	66%	**2029**	109%
2015	66%	**2030**	111%
2016	69%		
2017	69%		
2018	76%		
2019	89%		
2020	92%		

Source: Ministry of Finance/Author's own calculations

The above simulation results show that consolidated public debt including circular debt is increasing with the policy consistent scenario for the next 10 years. Similarly, the simulation exercise of public debt excluding circular debt liabilities is decreasing between 2021-2030. This shows that most of the consolidated debt is generated through circular debt liabilities and the growth rate of circular debt is much higher than the debt reduction rate of the overall public debt.

5.5.3. Pension Expenditure Growth Simulation

Annual pension growth simulation is carried out below so as to evaluate the severity of the problem and make policy recommendation;

Table 5. 6 Annual Pension Growth rate 2009-2020 Simulation

Actual		Simulation	
Year	**Annual growth**	**Year**	**Annual growth**
2010	15%	**2021**	12%
2011	36%	**2022**	8%
2012	30%	**2023**	9%
2013	19%	**2024**	10%
2014	10%	**2025**	10%
2015	9%	**2026**	8%
2016	21%	**2027**	5%
2017	21%	**2028**	5%
2018	13%	**2029**	4%
2019	15%		
2020	14%		

Source: Ministry of Finance/Author’s own calculations

Pension expenditures had a huge bulge in year 2011 and 2012 after merger of all ah-hoc relief allowances and 50% increase in basic salaries. The increase in pension comes from 2 sources including; i) Annual increase in budget ii) New expenditure through addition of newly retired persons. The table above shows actual pension growth between FY 2010-2020 and simulations between 2021 to 2029. Based on the actuals, the policy consistent scenario shows that growth in pension expenditures is likely to decrease and by year 2029, the growth rate drops to 4%. However, it is pertinent to mention that inflation during the reference period will play an important role in determination of expenditure growth. The reference period will also witness holding of 2 general elections that may result in change of current government and new political considerations will have significant impact on pension expenditure growth.

5.5.4. Tax Revenue Growth Simulation

Tax revenue growth simulation below helps us to know whether current efforts are helping to increase tax revenue or policy change scenario is required;

Table 5. 7 Tax Revenue Growth Simulation

Actual				Simulation			
Year	**Direct Tax**	**Indirect Tax**	**Tax/GDP**	**Year**	**Direct Tax**	**Indirect Tax**	**Tax/GDP**
2006	31.5	68.5	8.7	**2020**	40.2	59.8	10.6
2007	39.4	60.6	9.2	**2021**	39.5	60.5	10.7
2008	38.5	61.5	9.5	**2022**	39.6	60.4	11.0
2009	38.2	61.8	8.8	**2023**	39.7	60.3	11.3
2010	39.6	60.4	8.9	**2024**	39.7	60.3	11.5
2011	38.7	61.3	8.5	**2025**	39.8	60.2	11.8
2012	39.2	60.8	9.4	**2026**	39.9	60.1	12.0
2013	38.2	61.8	8.7	**2027**	40.0	60.0	12.2
2014	38.9	61.1	9	**2028**	39.9	60.1	12.3
2015	39.9	60.1	9.4	**2029**	39.9	60.1	12.4
2016	39.1	60.9	10.7	**2030**	40.1	59.9	12.5
2017	39.9	60.1	10.6				
2018	39.7	60.3	11.1				
2019	37.8	62.2	10.1				

Source: Ministry of Finance/Author’s own calculations

The table above shows break-up of actual tax revenue between 2006-2019 and simulation results between 2020-2030. The government of Pakistan is running one of the lowest tax/GDP ratios in world and among regional countries particularly in South Asia. This demands serious policy making on the operational side and administration side to bring upon reform to affect actual growth. Given the policy consistent scenario, it can easily be seen from the simulation exercise that the tax to GDP ratio is only increasing to 12.52% in 2030 from 10.1% in 2019. Alternatively, this means that the current efforts are not paying off and if the increase in tax revenue is not consistent with the growing needs of the economy, financing needs to be done through borrowing that will result in increase in public debt liabilities or strict austerity measures will have to be adopted in the future thus compromising growth prospects of the economy.

5.5.5. National Savings/GDP ratio Simulation

This simulation shows savings encouragement in the country and efforts induced by the government;

Table 5. 8 National Savings/GDP Simulation

Actual		Simulation	
Year	**Saving/GDP**	**Year**	**Saving/GDP**
2005	15.2	**2020**	12.4
2006	14.0	**2021**	12.5
2007	11.0	**2022**	12.6
2008	12.0	**2023**	12.2
2009	13.6	**2024**	11.9
2010	14.2	**2025**	11.8
2011	13.0	**2026**	11.7
2012	13.9	**2027**	11.5
2013	13.4	**2028**	11.4
2014	14.3	**2029**	11.3
2015	13.9	**2030**	11.4
2016	12.0		
2017	11.3		
2018	10.8		
2019	13.9		

Source: Ministry of Finance/Author's own calculations

The table above shows national savings in terms of GDP which is dismally very low. The table above shows a policy consistent scenario, wherein, savings/GDP ratio is decreasing that shows poor performance of the economy in terms of growth which is very low for the past three years and grew negatively last year. The personal disposable income is also reducing and it is natural for the household sector to allocate more of the resources towards consumption which is also supported by the fact that inflation is also on the rise in the country thus leaving little resources for savings. Similarly, the insufficient revenues also lead government to save less and expand more thus causing reduction in public savings. Another explanation for decrease in national savings could be the unattractive policy rates of the National Savings which is unable to increase number of people subscribing to its securities and instruments. All these factors are needed to be controlled and policy interventions must be made by the economic managers of the country to foster economic growth leading to increase in per capita income and PDI thus allocating less resources towards consumption and more towards savings to enhance the current low level of savings rate in the country that will eventually help in fostering investment activities in the country to augment capital formation and enhanced production capacity of the economy.

5.5.6. Primary Balance/GDP ratio Simulation

Table 5. 9 Primary Balance/GDP Simulation

Actual		Simulation	
Year	**Pb/GDP**	**Year**	**Pb/GDP**
1976	-7.7%	**2021**	0.4%
1977	-6.7%	**2022**	0.3%
1978	-6.0%	**2023**	0.2%
1979	-6.8%	**2024**	0.2%
1980	-4.1%	**2025**	0.1%
1981	-3.1%	**2026**	0.1%
1982	-2.9%	**2027**	0.1%
1983	-4.0%	**2028**	0.1%
1984	-2.6%	**2029**	0.1%
1985	-4.3%	**2030**	0.1%
1986	-4.3%	**2031**	0.0%
1987	-4.0%	**2032**	-0.1%
1988	-3.6%	**2033**	-0.2%
1989	-2.4%	**2034**	-0.3%
1990	-1.1%	**2035**	-0.3%
1991	-3.8%	**2036**	-0.3%
1992	-2.3%	**2037**	-0.5%
1993	-2.1%	**2038**	-0.6%

1994	-0.1%	**2039**	-0.7%
1995	-0.4%	**2040**	-0.7%
1996	-0.3%		
1997	0.2%		
1998	-0.1%		
1999	1.4%		
2000	1.5%		
2001	1.7%		
2002	1.9%		
2003	1.0%		
2004	1.6%		
2005	0.3%		
2006	0.3%		
2007	0.1%		
2008	-2.5%		
2009	-0.2%		
2010	-1.8%		
2011	-2.6%		
2012	-2.3%		
2013	-3.7%		
2014	-0.9%		
2015	-0.2%		
2016	-0.3%		
2017	-1.6%		
2018	-2.2%		
2019	-3.5%		
2020	-1.8%		

Source: Ministry of Finance/Author's own calculations

The actual primary balance figure in table above shows a mix trend with policy inaction or non-targeting of the primary balance surplus by the government in year T following a fiscal deficit in period T-1. The current government stance is to cut unnecessary expenditures by adopting austerity measures, dissolution on non-functional departments, mergers and liquidation of assets and loss-making public-sector enterprises. Following the current macro-fiscal stance of the government, this simulation exercise shows that primary surplus will remain positive in the next decade provided that the economy is sheltered from other exogenous shocks. This otherwise means that government will be able to incur expenditures in a controlled manner so that it needs to borrow only for the purpose of debt servicing and not to make other recurring and development expenditures.

Chapter 6. Conclusion and Policy Recommendations

Since, public debt sustainability is an important facet of public finance management (PFM), this chapter presents conclusion of the research and provides policy recommendations for public debt sustainability in Pakistan. It presents findings of the research in terms of maintaining primary surplus in time T against incurring fiscal deficit in time T-1 that eventually translates into public debt liabilities being a flow variable and increase in stock of public debt which is a stock variable.

The counter response of primary surplus to increase in public debt is positive, however, the debt profile becomes susceptible to higher risk and compromises fiscal and debt sustainability if the response is negative or haphazard that shows policy inconsistency or policy inaction by the government. The primary balance in relation to public debt in Pakistan between 1976-2020 shows a mix trend, wherein, policy inaction and policy inconsistency are both vibrant. Moreover, the political regime in place during the reference period also determines fiscal stance of the government since it includes both the rule of democratically elected governments and military dictators. The table below tabulates average primary balance between 1976-2020.

Table 6. 1 Average Primary Balance As a % of GDP

Year	Average Primary Surplus % of GDP
1976-1990	-4.20%
1991-2000	0.60%
2001-2010	0.20%
2010-2020	-1.90%

Source: calculated from Primary surplus data in chapter 4 of this research

The above table shows that the average primary balance between 1976-1990 was -4.2% that suggests that fiscal stance during the reference period was expansionary and increase in public debt was not countered by increasing primary surplus. The period between 1991-2000 shows an average primary balance of 0.6% which shows that despite the increase in public debt, government was able to stay afloat and produced primary surplus during democratically elected government’s rule. The period between 2001-2010, the primary balance remained 0.2% on average due to the fact that the country got massive inflows in response to war on terror and becoming ally of the US. This period also witnessed tremendous decrease in public debt liabilities including rescheduling of loans especially the Paris club loans yet the economy was more consumption oriented and investment was largely ignored. It is due to this reason that the era between 2010-2020 witnessed primary balance of -1.9% on average that shows policy inaction or following of expansionary fiscal stance which could be gauged from the fact that economy could grew at 5.3% in 2017-18 and massive development activities were carried on during this period through China Pakistan Economic Corridor (CPEC). This period also witnessed shifting of debt liabilities from external to domestic debt liabilities and it was due to this reason that interest expenditures on debt servicing increased many folds which the new government after 2018 started to change with the help of fiscal consolidation. This could unfortunately not be realized in its true sense due to COVID 19 pandemic and bailout package amid low level of business activity.

The main thrust of analysis presented above shows that policy inconsistency and inaction was the reason behind accumulation of debt liabilities. Although, the government was cognizant of the fact that debt liabilities were increasing yet continued to incur fiscal deficit that caused sluggish economic growth as more of the resources were appropriated for debt servicing (41.28% of total budget in 2020) and no action was taken to increase the revenues or decrease in expenditures to contain the fiscal deficit year after year thus resulting in ballooning of stock of public debt in the country. In response to above findings, it is advised that the government responsiveness of increase in public debt/GDP ratio must be counter-balanced by increase in primary surplus/GDP ratio so as to keep public debt liabilities under control.

The currently used modified cash basis of accounting in its compromised form underreports revenues, expenditures and liabilities. The best result it produces is in terms of cash reporting, however, it is also compromised in the absence of treasury single account with unified banking arrangements. It is a recognized fact that coverage of fiscal statistics, comprehensiveness, reliability, periodicity and timeliness is of paramount importance to come up with informed decision making ,therefore, the government is advised to fully adopt commitment accounting so as to lay foundation for adoption of accrual basis of accounting to enhance institutional coverage of debt statistics in Pakistan before moving towards accrual basis of accounting which is more difficult to make and requires adoption of updated government finance statistics manual GFSM, the latest being 2014 and the country is still using GFS 1986 which is quite old and lacks in reporting according to Macroeconomic statistics of IMF different statistics manual like system of national accounts 2008 (SNA) , Government Finance Statistics 2014 (GFS) and Balance of payment and investment position manual 2009 (BPM6) which are consistent with each other in terms of definition and concepts albeit with few dissimilarities.

The vertical resource distribution between the central government and provincial governments is largely skewed in favor of provinces. Moreover, the constitutional provision warrants to devise National Finance Commission award (NFC) after every 05-years but do not provide any information on the basis of resource distribution which is mutually agreed by the central government and the provincial governments. The more important point is that the previous awards announced so far make the basis as budget estimates for the previous year while devising the award and not the actual realized value of the resources thus inflating the figures. The government is, therefore, advised to revise resource distribution formula between central government and the provincial governments as set by National Finance commission and also the working basis of calculating the resource distribution formulae. Thus, the central government must be provided higher share in divisible pool through vertical distribution of resources to defray expenditures so as to contain fiscal deficit and incurring more debt.

The FRDLA and fiscal institutions must be adhered to and no government should be allowed to breach the limits prescribed therein. The implicit and explicit avenues of charge on federal consolidated fund must be reported in the balance sheet and off-balance sheet activities like circular debt, risks emanating from contingent liabilities must be made part of public debt analysis to have a holistic picture of the state of economy and for greater fiscal transparency in the country.

Pension expenditure has increased significantly in the revenue expenditure matrix of the country and is bound to become unsustainable in few years that can be gauged from the fact that there is very less difference between pension expenditures and running of the whole civil government in terms of budgetary central government. The government is, therefore, advised to create pension fund by gradually moving away from non-contributory pension system to contributory pension system. The current system of pension and huge outlay if kept unabated will have serious fiscal implications on the public finance management in the country and system will soon become unsustainable.

The findings of the report show that the government of Pakistan losses significantly in terms of expenditures on debt servicing due to asymmetric information available to treasury managers in the country. This is evident from the fact that the public sector resident institutions keep their accounts in commercial banks which do not make part of the treasury single account. This results in underreporting of the available cash with the government and upon need the government offers securities in the debt market to raise loan. The same money that belonged to the government and kept with the commercial banks is used by the commercial banks to lend money to the government through purchase of government securities. If the same information is available to the government through treasury single account (TSA), it could finance its operations using its own resources and avoid interest expenditures. Therefore, it is advised to adopt Treasury Single Account with unified banking system and effective use of financial management information system (FMIS) for fiscal reporting leading to enhanced level of fiscal transparency must be ensured for sustainable fiscal and debt management in the country.

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