Circular Debt in Pakistan's Power Sector

Executive Summary | FY2025–26 policy perspective

DEBT STOCK — JUN 2025

Rs 1.614 tn

Down from Rs 2.393 tn in FY2023–24 — about a one-third reduction.

2025 RESOLUTION

Rs 1.225 tn

Debt workout: Rs 660bn existing loans + Rs 565bn fresh financing.

CORE RISK

Flow persists

Stock clearance is not enough if losses, under-recovery and high fixed costs continue.

POLICY PRIORITY

Stop re-build

DISCO efficiency + recoveries + targeted subsidies + lower generation cost.

- Circular debt is the financial result of structural inefficiencies across the electricity value chain.
- FY2024–25 delivered a major stock reduction, but FY2025–26 remains a test of whether new debt flow can be contained.
- The durable solution is operational reform—not repeated fiscal injections alone.

Primary source: Pakistan Economic Survey 2025–26; Ministry of Finance power-sector releases.

What is Circular Debt?

A chain of unpaid obligations across the power sector

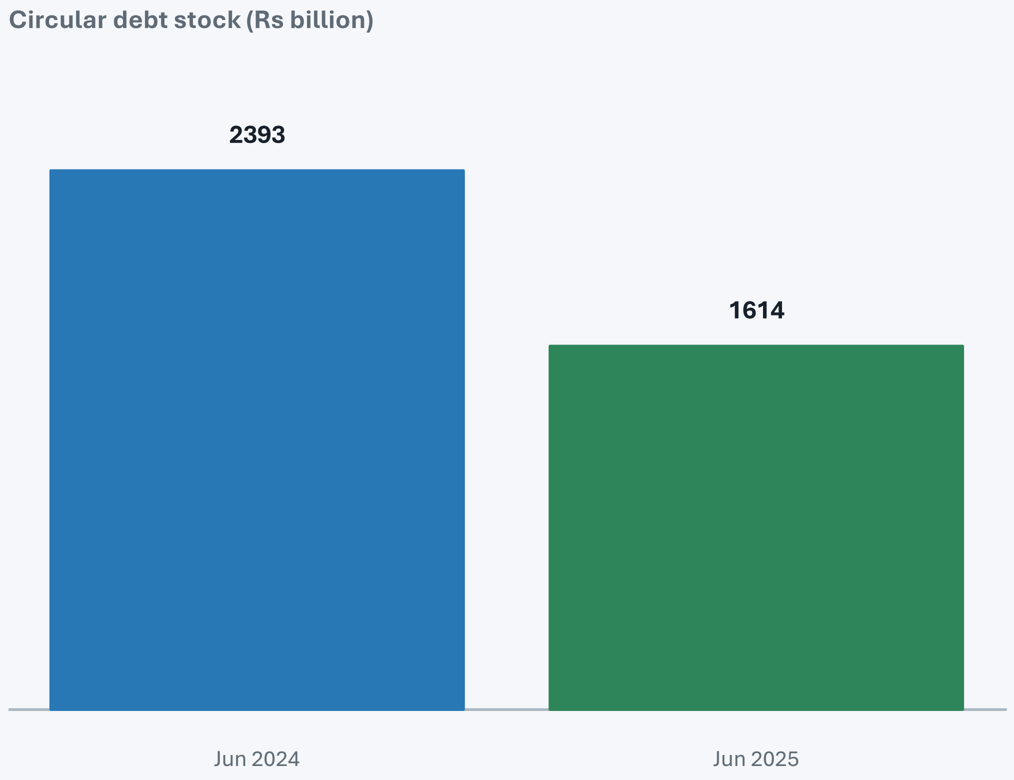
Consumers → **DISCOs** → **CPPA / Buyer** → **Generators** → **Fuel / Banks**

When collections + subsidies + allowed tariffs are insufficient, payment shortfalls move through the chain and accumulate as circular debt.

Conceptual framework based on Pakistan power-sector payment chain.

The Turning Point: FY2024–25

Power-sector circular debt stock fell sharply



REDUCTION

Rs 779 bn

Approximate decline in one year.

DECLINE

~33%

Largest recent step-down in the stock.

- The improvement reflected stock-clearance measures and power-sector reforms.
- The policy question for FY2025–26 is whether this lower base can be sustained without renewed accumulation.

Sources: Pakistan Economic Survey 2025–26 context; Ministry of Finance / Power Division official figures.

Why Circular Debt Builds Up

Four recurring structural drivers

T&D losses

Technical losses, theft and weak networks reduce billable energy.

Under-recovery

Billed electricity is not fully collected; cash gaps propagate.

Cost / tariff mismatch

Delayed adjustments or unfunded subsidies create financing gaps.

Fixed & capacity costs

High contracted/fixed costs become heavier when grid demand is weak.

Pakistan Economic Survey 2025–26 and official power-sector reform narrative.

DISCO Performance is the Front Line

Collections and losses determine whether debt re-accumulates

FY2024 RECOVERY GAP

Rs 315 bn

Historical under-recovery burden.

FY2025 RECOVERY GAP

Rs 132 bn

A reduction of about Rs 183bn.

RECOVERY RATE

96.6%

Reported FY2025 DISCO recovery, up from 92.4%.

- Better collection directly reduces the financing gap.
- High-loss feeders, theft, weak governance and delayed public-sector payments remain key operational risks.
- Smart metering and management accountability should be concentrated first in high-loss areas.

Official Power Division figures reported in 2025–26 reform updates.

Demand is Changing the Economics of the Grid

Solarization and weak grid sales increase pressure on fixed-cost recovery

GRID SALES — 2023

113 bn units

Reference level before further solar migration.

EXPECTED — 2026

~101 bn units

Lower grid sales spread fixed costs over fewer units.

SYSTEM EFFECT

Cost shift

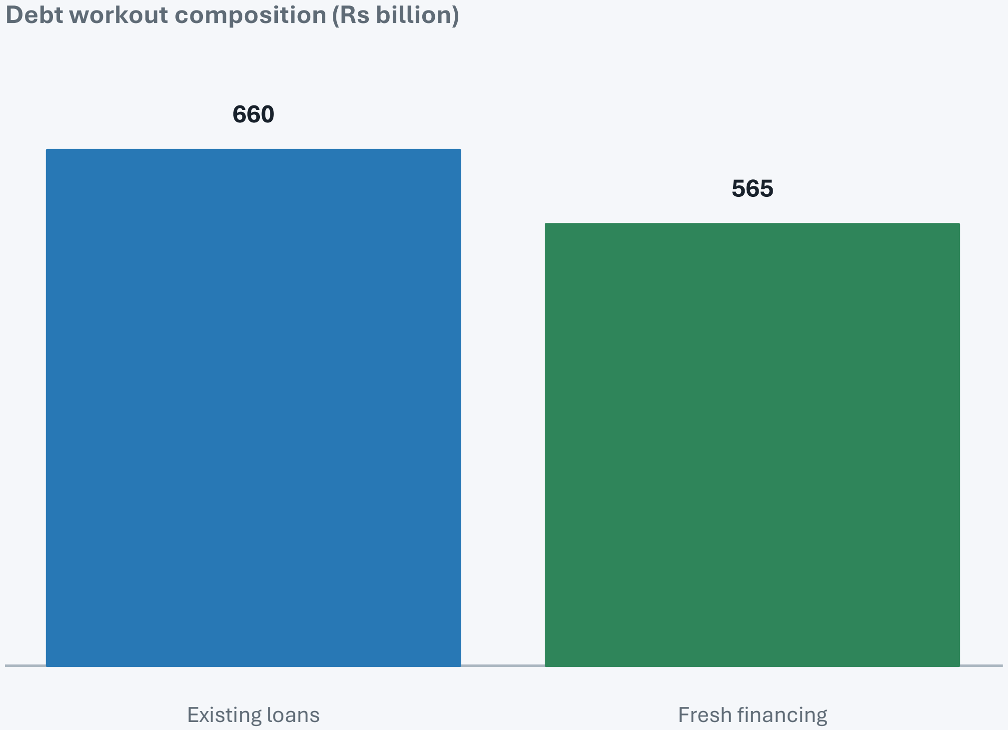
Remaining grid consumers can bear a larger share of fixed network/capacity costs.

Demand transition → fewer billed grid units → higher average fixed cost per unit → tariff pressure → further grid exit risk

Power Division FY2026 planning figures; PES 2025–26 energy-sector context.

The Rs 1.225 Trillion Debt Resolution

A major financing intervention — but primarily a stock solution



- Rs 660bn: restructuring of existing loans.
- Rs 565bn: fresh financing to clear overdue payments to power producers.
- Repayment designed around the existing Rs 3.23/kWh surcharge.
- The package improves liquidity and unlocks sovereign guarantees—but does not by itself eliminate operational causes.

Ministry of Finance, 25 Sep 2025: Rs 1,225bn Power Sector Circular Debt Resolution.

Macroeconomic Impact

Circular debt is not only an energy-sector accounting issue

Fiscal pressure

Subsidies, guarantees and debt servicing consume fiscal space.

Industrial competitiveness

High electricity costs weaken margins, exports and investment.

Inflation & households

Tariff increases feed cost of living and production costs.

Financial-sector exposure

Power-sector receivables and guarantees create balance-sheet risks.

Investment confidence

Persistent arrears raise perceived policy and payment risk.

Development trade-off

Resources used for sector bailouts cannot fund other priorities.

Policy synthesis from Pakistan Economic Survey 2025–26 and Ministry of Finance reform material.

FY2025–26 Reform Direction

The policy mix is shifting from bailout toward structural correction

- Circular Debt Management Plan: settle legacy obligations while containing new flow.
- DISCO governance: private-sector expertise, restructuring and privatization pathways.
- Tariff rationalization: improve cost recovery while reducing distortions and protecting vulnerable users.
- Generation-cost reduction: renegotiate/optimize contractual and fuel costs where feasible.
- Anti-theft and recovery measures: strengthen enforcement and collection discipline.
- Targeted subsidies: replace broad fiscal leakage with focused social protection.

Pakistan Economic Survey 2025–26; ECC and Ministry of Finance power-sector reform updates.

Stock vs Flow: The Critical Distinction

A lower debt stock is sustainable only if annual additions are controlled

STOCK

Accumulated unpaid obligations

Tools: restructuring, settlements, financing, arrears clearance

FLOW

New debt generated each year

Tools: recoveries, loss reduction, cost reform, timely tariffs & subsidies

Sustainable success = reduce STOCK + stop FLOW

Analytical distinction used in circular-debt management.

Policy Recommendations

Five actions with the highest structural payoff

1. **Make DISCO performance measurable** — Monthly loss, recovery and cash-gap targets; management accountability.
2. **Target high-loss feeders** — Smart meters, feeder analytics, theft enforcement and network upgrades.
3. **Lower underlying power cost** — Optimize generation mix, contracts, dispatch and imported-fuel exposure.
4. **Protect consumers intelligently** — Target subsidies to vulnerable households rather than broad tariff suppression.
5. **Publish a debt-flow dashboard** — Track stock, monthly flow, recoveries, losses, subsidies and arrears transparently.

Recommendations synthesized from PES 2025–26 reform priorities and power-sector diagnostics.

What Should Be Monitored in FY2026–27?

A practical scorecard for policymakers

Indicator	Target
Circular debt stock	↓
Monthly debt flow	≤ 0
DISCO recovery rate	↑
T&D losses	↓
Grid electricity sales	Stabilize
Average generation cost	↓
Subsidy payment delays	↓
Industrial tariff competitiveness	↑

The test is not whether debt can be refinanced — it is whether the sector can operate without creating new arrears.

Suggested monitoring framework based on FY2025–26 policy priorities.

Crux: Circular Debt is a Governance + Cost Problem

Final takeaways

1. PROGRESS

2.393 → 1.614 tn

Pakistan achieved a major reduction in the power-sector debt stock.

2. WARNING

Stock ≠ solution

Debt can return if new flow is not structurally stopped.

3. PRIORITY

Fix DISCOs

Losses, theft, collections and governance are central.

4. END STATE

Affordable + viable

Lower cost, targeted support and financial discipline must coexist.

Bottom line

Pakistan has created fiscal breathing space. The next phase must convert that temporary relief into a self-sustaining power market.

Circular debt will be solved permanently only when the system stops producing it.

Source base: Pakistan Economic Survey 2025–26, Ministry of Finance; official circular-debt resolution and reform updates.