

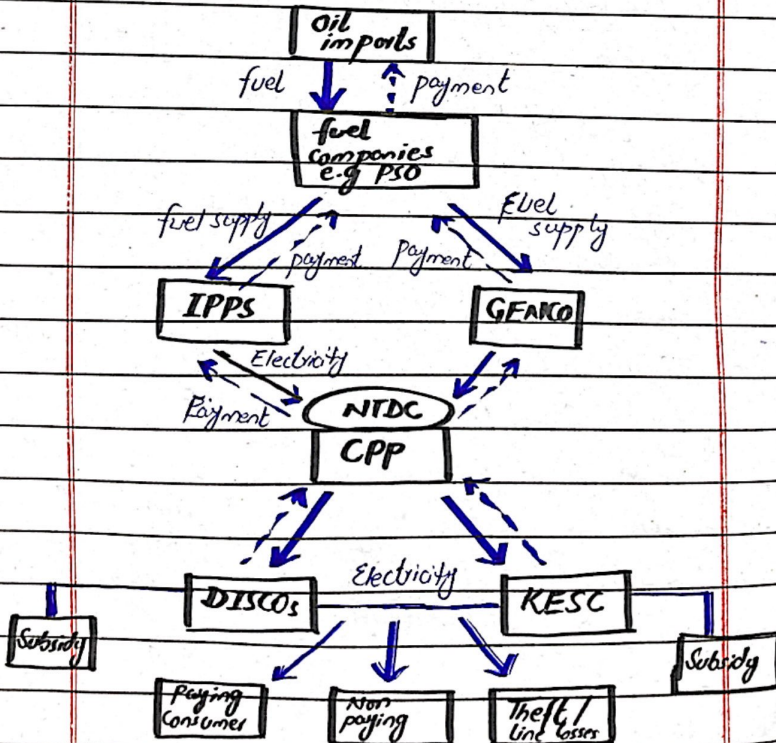
With mounting Circular debt of Pakistan, highlight causes of this burgeoning debt crisis and delineate a way out?

1/ Introduction

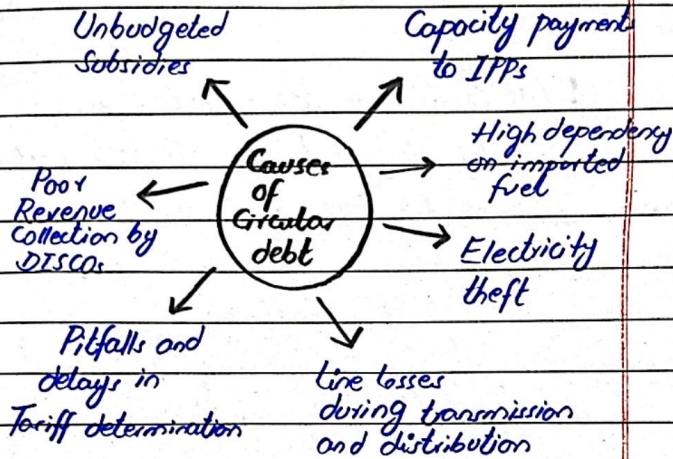
The circular debt crisis in Pakistan has become economic bottleneck, primarily rooted in systemic issues within energy sector. This debt refers to ongoing cycle of unpaid bills in energy sector, where distribution companies fail to receive payments, creating a debt loop. The major reasons include energy theft, subsidized tariffs, transmission and distribution losses, capacity payment to IPPs, and high dependency on fuel imports. It can be mitigated by reducing line losses, shift on renewables, renegotiation of IPP contracts and improvement of DISCOs.

1/ Circular debt-a vicious cycle

Circular debt is a recurring financial shortfall in energy sector, where distribution companies fail to recover full cost of energy. This results in unpaid dues to power producers, who, in turn, fail to pay to fuel supplier creating a vicious cycle.



3/ Causes of Circular Debt



(A) Flawed contracts with IPPs (Take or Pay Model)

In 1994 power policy combined with successive power policies, Pakistan is obliged to make capacity payments, regardless of actual consumption.

The tragedy with Pakistan is that demand is less and surplus is power generation. According to **Economic Survey 2024**, Pakistan's installed capacity is **42131 MW**, but demand

in June 2024 was 26000 MW

FY23-24

1.9 trillion PKR accumulated
on Pakistan in Capacity Payment.

(B) Energy theft adding
to debt

A high percentage of energy is lost
in theft. The cost cannot be covered
by companies and debt increases

Electricity theft amounts to
Rs 600 billion a year

(Awais Iqbal)

- Federal Energy
Minister

(C) High Transmission
and Distribution losses
causing debt sprawl

Transmission and distribution losses
in Pakistan are above global average.
Due to outdated infrastructure and

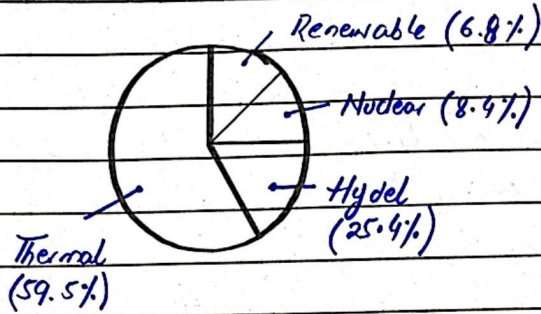
limited technological adoption, the gap between power produced and power billed widens, further adding to circular debt.

In 2022-23, Distribution Companies lost over 19.17 bn units - or 16.4 pc of units purchased from GENCOs due to T&D losses and theft

(NEPRA)

(D) High dependency on imported fuel

A large portion of Pakistan's energy mix is dependent on oil and gas exposing country to volatile global energy prices. When prices rise, Pakistan's cost of generation increases and with low tariff recovery, debt accumulates.



Source: Economic Survey
of Pak 2023-24

(E) Poor Revenue collection by DISCOs mounting circular debt

Low recovery of bills add to
debt accumulation

The DISCOs charged 81.5 bn
through detection bills during
FY 2023-24 with recovery
of Rs 1.172 billion, with
recovery percentage of 73.9%
(NEPRA)

(F) Pitfalls and delays in tariff determination

The rates notified by government for end consumers are often lower than tariffs recommended by NEPRA due to political reasons. This creates disparity between electric costs and revenues. The notification process is frequently delayed by an average **9-12 months**. This delay adds to payment arrears.

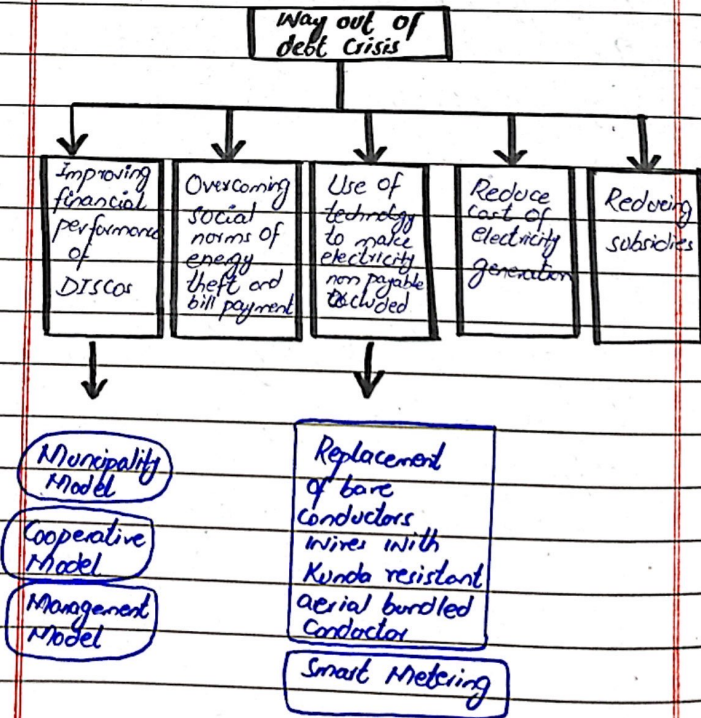
(G) Unbudgeted Subsidies

Government provides tariff subsidies to DISCOs for distributing electricity to end consumers at government notified power tariffs. But most often government cannot fully fund these subsidies to DISCOs. These unfunded subsidies have contributed to increase in circular debt.

Power Subsidies have surged from Rs 236 bn in 2020 to Rs 1190 bn in 2024, bringing circular debt in power sector to Rs 2-3 billion in 2024

(World Bank)

4/ Navigating Circular debt Crisis



(A) Improving financial performance of DISCOs

Following governance and managerial models can be undertaken for DISCOs financial turnaround, suggested by **IPRI**.

(i) Municipality Model

Decentralizing DISCOs through a municipality based model would enhance bill recovery and reduce political interference by placing responsibility on local authorities backed by law enforcement.

(ii) Cooperative Model

The cooperative method empowers rural communities to manage power distribution by taking ownership of bill collection and payments. This approach is successful in China and US.

(iii) Management Model

The management model proposes creating boards of 20-25 experts for each DISCO, reducing government control and enhancing decision making.

(B) Overcoming social norms of electricity theft / non payment of bills

(i) Shifting public perception on electricity from entitlement towards a private good

Eliminating electricity subsidies through tariff reforms and replacing them with direct cash transfers to poorest consumers can ensure equitable access and prevent exploitation by wealthier users.

(ii) Incentive Scheme

Introducing performance incentives for bill collectors where higher collection leads to bonuses can enhance collection.

(C) Use of technology to make non payers excluded

(i) Replacement of bare conductors wires with Kunda resistant aerial bundled conductors

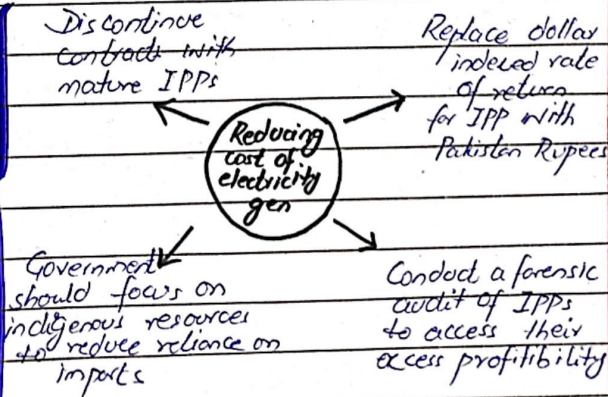
Installing Kunda resistant ABC cables can reduce electricity theft as demonstrated by KElectric's success in high theft areas.

(iii) Smart Metering

Implementing smart metering across DISCOs can enhance bill recovery by allowing officials to remotely disconnect non payers, and offering inbuilt prepaid billing options for consumers.

(iv) Reducing cost of electricity generation

Reforms suggested by IPRI in curbing growth of Greater debt in Power sector



(E) Reducing Subsidies

Government should terminate subsidies on electricity and provide direct cash.

5/ Conclusion

Circular debt is a major challenge.

Circular debt is caused by energy theft, line losses, capacity payment to IPPs, high dependence on imported oil and low collection of bills by DISCOs. It can be addressed by improving financial performance of DISCOs, use of technology to make electricity excludable for non payers, reducing theft of energy and cost of generation.