FISCAL RISK STATEMENT

FY2024-25

FOREWORD

It is with great satisfaction that I present the Fiscal Risk Statement of the Government of Khyber Pakhtunkhwa. This document marks Khyber Pakhtunkhwa's step forward towards strengthening fiscal discipline through identification and quantification of major fiscal risks to accurately capture the financial standing of the province.

This report provides a comprehensive overview of the key fiscal risks in the context of Khyber Pakhtunkhwa. These include both the exogenous fiscal risks such as those arising from natural disaster and macroeconomic shocks, and endogenous fiscal risks originating from challenges of public debt management, pension liabilities, public private partnership contracts, transfers from federal government, and managing public sector enterprises. I believe that by understanding and managing these risks, the KP government can steer the economy in the right direction.

Additionally, this document allows the policymakers to understand the financial standing of the province at deeper level for better decision making and avoid uncertainties that could strain public resources. This report aims to support more informed, transparent, and forward-looking policies that keep public finances stable and sustainable in the long run.

I want to express my appreciation to the Debt Management Team, especially Mr. Abdul Qayyum Khan (Team Lead, Debt & Risk Management Unit) and Mr. Muhammad Imtiaz (Financial Analyst, Risk Management Unit), as well as Mr. Waqas Paracha and his entire team from the Sub-National Governance (SNG-II) Project, for their hard work in creating the province's first fiscal risk statement.

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Introduction

Fiscal risks refer to uncertainties that may cause actual fiscal outcomes to diverge from planned projections, potentially undermining a government's financial stability and its ability to deliver public services effectively. In the case of Khyber Pakhtunkhwa, these risks can arise from multiple sources, such as macroeconomic volatility, the effects of climate change and natural disasters, unpredictable variations in federal transfers, and the growing burden of provincial debt and associated debt servicing cost.

As part of the medium-term macroeconomic and fiscal planning, the Finance Department is responsible for building a solid institutional framework to handle fiscal risks. This involves setting up systems that help identify, measure, analyze, and manage these risks. By doing this, the Finance Department can better predict and respond to potential threats to the province's financial stability. The framework will provide the tools needed to quantify risks, develop strategies to minimize their impact, and ensure that fiscal management practices are more consistent and sustainable in the long term. This approach will help the government make well-informed decisions, protect public resources, and maintain financial discipline.

The significance of preparing and publishing a Fiscal Risk Statement (FRS) is underscored by both the KP Fiscal Responsibility and Debt Management Act (FRDMA) 2022 and the KP Public Financial Management (PFM) Act 2022. According to Section 7 (1) of the FRDMA Act, GoKP is mandated to approve and present an annual FRS to the Provincial Assembly of KP alongside the annual budget.

The statement of fiscal risks shall include:

(a) Review the actual fiscal outcomes of the last completed financial year with the budget estimates for that year and the projections made in medium term fiscal framework in respect of that year and identify the reasons for deviation.
(b) Identify the major sources of risk that can result in significant deviations between actual and expected fiscal outcomes.
(c) Review the measures already taken by the Government to address the fiscal risks.
(d) Identification of the measures needed to strengthen the management of fiscal risks, and
(e) Contain discussion on fiscal risks posed by explicit as well as implicit contingent liabilities.

In general, the Statement of Fiscal Risks framework captures three primary categories:

1. General economic risks,
2. Specific fiscal risks, and
3. Structural or institutional risks

Fiscal risks, under these three broad pillars, are categorized into six major areas, each presenting distinct challenges and implications for KP's fiscal management and sustainability. These areas are outlined as follows:

1. Risks from Macro-Economic Factors and Federal Transfers
2. Fiscal Sustainability Risks
3. Public Debt Management Risks
4. Climate and Natural Disasters
5. Risks in Public-Private Partnerships Agreements
6. Challenges in Managing Public-Sector Entities (PSEs)

The Statement of Fiscal Risks categorizes potential fiscal vulnerabilities using a fiscal risk matrix, which facilitates the visualization and prioritization of risks based on their probability of occurrence and potential fiscal impact. This analytical tool enables the Government of Khyber Pakhtunkhwa to allocate resources and policy attention more effectively. High-impact risks—such as external debt obligations and rising pension liabilities—are identified for immediate mitigation measures. Medium-level risks, including climate-induced natural disasters, warrant continuous monitoring and contingency planning. Lower-probability risks, such as delays in the implementation of PPP projects, are kept under observation to ensure timely intervention if required. The matrix is informed by budgetary data, historical trends, and internal risk assessments to support evidence-based fiscal planning.

Likelihood of Realization	Low	Medium	High
Probable	Federal tax transfers	PSEs inefficiencies Net hydel profits	External debt liabilities Pension payments
Possible	Macro-economic challenges	Climate-induced disasters PPP projects material price hikes	Public investment management
Remote	PPP project delays		Large climate or natural disaster
	Potential Fiscal Impact		

Figure 1: Risk grading of KP's fiscal risks

1. Risk from Macroeconomic Factors and Federal Transfers

The global economy shows moderate growth recovery prospects, with the IMF projecting global GDP to expand by 3.3% in both 2025 and 2026, an improvement from 3.2% in 2024, yet below the historical average of 3.7% (IMF, January 2025). Advanced economies exhibit mixed growth trajectories, with the US economy anticipated to grow robustly at 2.7% in 2025, driven by supportive financial conditions and strong consumer demand. Conversely, the Eurozone continues to recover slowly, expected to grow at 1.0% in 2025, restrained by persistent geopolitical tensions.

Emerging markets maintain steady growth projections at 4.2% for 2025 and 2026. China's economic growth slightly slows to 4.6% in 2025 from 4.8% in 2024, influenced by a fiscal stimulus package that mitigates the negative impacts of ongoing trade uncertainties and property market challenges (World Bank, January 2025). Global inflation rates are projected to decline to 4.2% in 2025 from the previous year's higher levels, providing relief for import-dependent countries. The following table shows world economic growth.

Table 1: Global GDP Growth

Country/Region	GDP Growth 2024 (%)	GDP Growth 2025 (%)	GDP Growth 2026 (%)
World	3.2	3.3	3.3
USA	2.1	2.7	2.1
Euro Area	0.8	1	1.4
China	4.8	4.6	4.5

Source: IMF, World Economic Outlook, January 2025.

Table 2: Global Economic Overview

Indicator	2024 Estimate	2025 Forecast	Source
Global GDP Growth	**3.2%**	**3.3%**	**IMF**
Global Inflation	**5.8%**	**4.4%**	**IMF**
Developing Asia Growth	**5.0%**	**4.9%**	**ADB**
World Bank Global Growth	**2.6%**	**2.7%**	**World Bank**

However, Potential escalation of trade conflicts, especially among major global economies, poses risks to global supply chains, threatening to dampen overall economic growth. Additionally, shifts and uncertainties in fiscal and monetary policies, notably from key economies like the U.S. and China, could introduce volatility into financial markets, adversely affecting global economic stability. High debt burdens in many countries, particularly in the developing world, further compound these challenges by risking fiscal sustainability and economic resilience. Lastly, climate change presents a critical threat, with an increasing frequency of climate-related disasters likely to negatively impact agricultural productivity and infrastructure, particularly in vulnerable regions, potentially exacerbating global economic vulnerabilities.

Following a challenging period, Pakistan's economic growth is forecasted to gradually improve from 2024 to 2026. For 2024, the economy is projected to grow at a modest rate of 2.5%, reflecting ongoing stabilization measures and gradual economic recovery. Moving into 2025, growth is anticipated to experience a slight increase to 2.6%, contingent primarily upon sustained implementation of economic reforms and continued external financial support as indicated by the

IMF. By 2026, economic growth is expected to accelerate notably to around 3.6%, supported by improved macroeconomic fundamentals and increased investments.

Inflation remains a major concern for Pakistan's economic outlook. After reaching a substantial peak of 23.4% in 2024, inflation rates are expected to decline markedly to 5.1% in 2025, signaling effective monetary and fiscal policies. However, inflation is forecasted to rise slightly again in 2026, reaching 7.7%, reflecting ongoing volatility in global commodity prices and domestic economic adjustments. The State Bank of Pakistan (SBP) has currently maintained the benchmark interest rate at 12%, with any future changes being closely tied to the evolving inflation trends and external economic conditions.

The external sector shows a mixed yet improving picture. Pakistan's current account deficit, as a percentage of GDP, is expected to narrow from -0.5% in 2024 to an improved -0.1% in 2025. A slight widening is anticipated again in 2026, settling at -0.4%, driven by increasing imports linked to economic recovery. Meanwhile, foreign exchange reserves have shown improvement, standing at $10.5 billion, with strategic targets set to reach $14 billion.

Fiscal and structural reforms remain central to Pakistan's economic stabilization strategy. Pakistan is currently benefiting from a $7 billion IMF Extended Fund Facility, which emphasizes fiscal consolidation, reforms in the energy sector, and improvements in tax policies to ensure long-term economic stability and sustainability. Additionally, the World Bank has committed to a substantial $20 billion, 10-year funding plan focused on important sectors such as renewable energy, education, and social infrastructure. This important financial support underscores international confidence and commitment towards Pakistan's structural reform agenda.

Despite these positive indicators, certain risks persist. Geopolitical tensions, especially with neighboring countries, present potential disruptions in trade and investment flows, posing threats to economic stability and growth. Additionally, although inflation rates are projected to decline, potential supply shocks or any missteps in policy implementation could reverse these gains, adding volatility to the economic environment. Furthermore, delays or slow progress in executing necessary structural reforms could pose major risks, potentially hindering economic growth prospects and fiscal sustainability in the medium term. Following table shows Key economic outlook of Pakistan.

Table 3: Pakistan Economic Outlook

Pakistan Economic Outlook (2024–2026)				
Key Economic Indicators				
Indicator	2024 Actual	2025 Actual	2026 Forecast	Source
Real GDP Growth	2.50%	2.60%	3.60%	IMF
Inflation Rate (CPI)	23.40%	5.10%	7.70%	IMF
Unemployment Rate	8.30%	8.00%	7.50%	IMF
Current Account Balance (% of GDP)	-0.50%	-0.10%	-0.40%	IMF
Policy Interest Rate	12.00%	11%	TBD	SBP
Foreign Reserves (USD)	$10.5B	$14B	TBD	Reuters

1.1. Revenue Profile

The fiscal risk statement 2024-25 outlines the KP's revenue profile in three primary categories including general revenue receipts, capital receipts, and development receipts. The table XX shows the estimated vs actual revenue comparison in the last four years.

The revenue data for fiscal year 2024-25 is analyzed based on actual collection of 10 months and forecast figure of 2 months on a pro-rata basis. Analyzing the data showed that from FY 2021-22 – FY 2024-25, there has been discrepancies between budgeted and actual revenues under certain major heads, pointing towards the weakness in the actual forecasting of revenues. These include transfers under net hydel profits under which the government is unable to realize 70% of the target amount. Other heads under which there is huge mismatch between the budgeted versus actual are general capital receipts and development receipts.

Table 4: Variance in revenue profile of Khyber Pakhtunkhwa (in PKR million)

	FY 2021-22			FY 2022-23			FY 2023-24			FY 2024-25		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual *	Variance
General Revenue Receipts	709.0	673.6	-5%	817.5	770.4	-6%	1156.9	943.5	-18%	1305.536	1198.98	-8.16%
Total Federal Transfers	634.0	611.5	-4%	732.5	703.6	-4%	1071.9	867.3	-19%	1212.036	1105.48	-8.79%
Federal Transfers – Tax Assignment	475.6	498.6	5%	570.9	586.4	3%	764.6	721.6	-6%	902.508	904.90	0.27%
Federal Transfers – 1% War on Terror	57.2	59.9	5%	68.6	70.5	3%	91.9	86.7	-6%	108.443	108.73	0.26%
Federal Transfers – Net Hydel Profit	74.7	21.0	-72%	62.0	4.9	-92%	85.1	8.5	-90%	111.303	32.40	-70.89%
Federal Transfers – Straight Transfers	26.5	32.0	21%	31.0	41.8	35%	38.7	50.4	30%	42.955	58.17	35.42%
Windfall Levy	0.0	0.0	-	0.0	0.0	-	91.7	0.0	-100%	46.82	1.28	-97.27%
Provincial Own Receipts	75.0	62.2	-17%	85.0	66.8	-21%	85.0	76.2	-10%	93.50	93.5	0%
Provincial Tax Collection	43.2	41.8	-3%	52.7	41.7	-21%	56.5	53.6	-5%	63.188	63.19	0%
Provincial Non-Tax Collection	31.8	20.3	-36%	32.3	25.1	-23%	28.5	22.6	-21%	30.312	30.31	0%
General Capital Receipts	112.7	174.5	55%	204.6	246.1	20%	0.3	0.2	-40%	31.550	4.31	-86%
Development Receipts	296.7	179.3	-40%	310.1	168.3	-46%	299.6	184.9	-38%	289.29	127.5	-55.93%
Total Receipts	1118.3	1027.5	-8%	1332.1	1184.8	-11%	1456.7	1128.6	-23%	1626.37	1330.79	-18%

Actual FY 2024-25 – 10 months actual + 2 months projected

2. Fiscal Sustainability Risks

2.1. Unfunded Pension Liability

Pension obligations have become a major fiscal challenge across the globe. In Pakistan, the situation is particularly critical, as the pension system is entirely unfunded. Many public sector institutions across the country are struggling, with some even unable to pay commutation due to severe financial constraints.

To better understand the gravity of the issue, let us focus on the case of Khyber Pakhtunkhwa (KP):

- As of June 2020, an actuarial valuation projected KP's accrued pension liability at Rs. 3 trillion.
- At that time, the province had 564,000 active employees and 170,000 pensioners.
- As of today, active employees have increased to over 600,000, and the number of pensioners has risen to 228,000, showing that the current accrued liability may now exceed Rs. 3.5 trillion.

2.2. Rising Annual Pension Burden

- The pension expenditure for the current financial year is Rs. 160 billion.
- This is expected to rise to Rs. 193 billion in the upcoming fiscal year—posing a significant and unsustainable burden on the provincial budget.

2.3. Mitigation Strategy

Transition to a Funded Pension Regime

KP is the first province in Pakistan to transition from an unfunded to a funded pension system, introducing a Defined Contribution (DC) scheme exclusively for new entrants into government service.

- Since its launch, 59,433 employees have been enrolled in the DC scheme.
- In the current financial year, the government has contributed Rs. 1.5 billion as the employer's share for these employees.
- Next year the same employer share will be Rs. 2.4 billion
- During the transition period (until 2045), the government must finance both the old Defined Benefit (DB) scheme and the new Define Contribution Pension scheme (DC), effectively bearing a dual pension burden.

Long-Term Relief

Despite the short- to medium-term strain, the dual pension system is a necessary step toward sustainability. By 2045, the DB scheme is expected to be phased out, and the DC scheme will fully take over, thereby containing long-term pension liabilities and easing the burden on the provincial exchequer.

Parametric Pension Reforms

In view of the looming pension crisis, the government is actively considering parametric pension reforms. These reforms aim to adjust key features of the existing Defined Benefit (DB) scheme—such as retirement age, commutation formula, and pension indexation—with the objective of reducing fiscal pressure and potentially shortening the transition period to a fully funded Defined Contribution (DC) system well before 2045.

3. Public Debt Management Risks

As of June 2025, Khyber Pakhtunkhwa's (KP) loan liability stood at PKR. 723,139 million, reflecting an increase of 6.4% increase compared to the total loan liability of PKR. 679,547 million recorded in FY 2023-24. The percentage increase in the total liabilities has reduced in comparison to those recorded in 2023-24 and 2022-23.

During the Financial Year 2024-25, the province's outstanding debt portfolio increased by 6.41%, primarily influenced by two key factors:

1. The increase in net receipts (disbursements less principal repayments) was PKR 56,658 million which is an increase of 8.34**%** from the previous year**.**
2. Decrease in foreign currency exchange rates from 285 to 280 which had a weighted average impact of -1.75% (PKR -13,066 million)

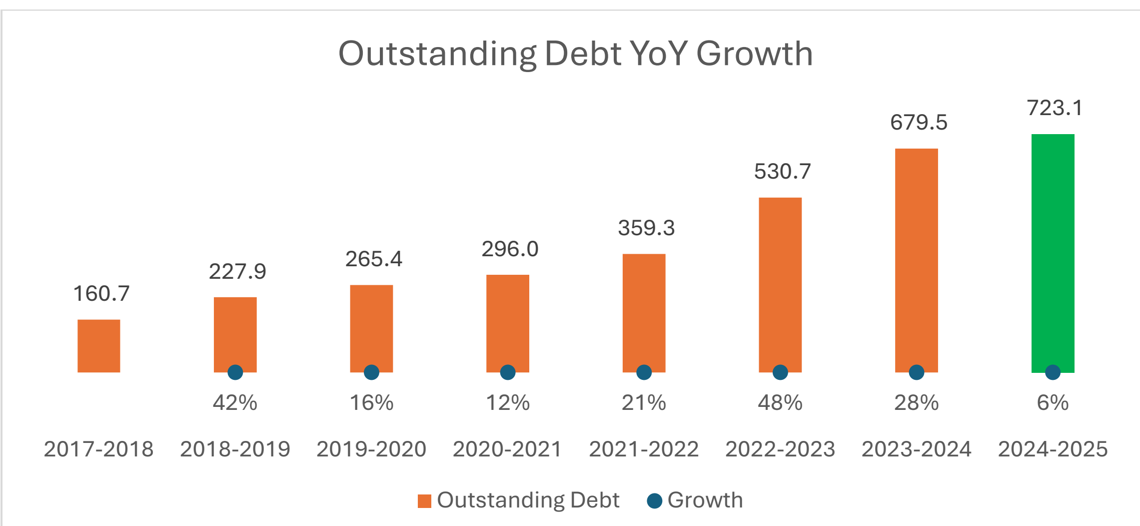

Figure 2: Khyber Pakhtunkhwa's Debt Stock (In million)

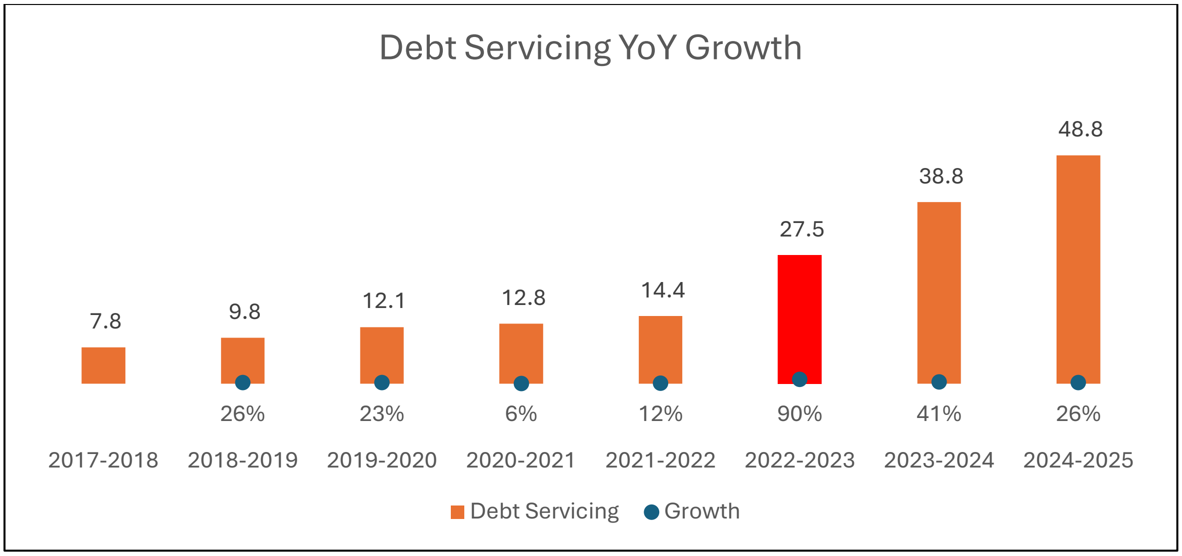

Figure 3: Khyber Pakhtunkhwa's Debt Servicing (In million)

Under the KP FRDMA, the Government of KP is mandated to formulate and approve a Medium-Term Debt Management Strategy (MTDS) that aligns with the overarching medium-term fiscal framework. This strategy, which spans a minimum of three years, is an essential instrument for fiscal and debt management, ensuring that the province's borrowing and debt servicing activities are sustainable. The MTDS, updated annually, is presented alongside the annual budget to the Provincial Assembly for transparency and legislative oversight. The medium-term debt management strategy addresses several aspects and outlines the following debt limitations as stipulated by the FRDMA:

- **Debt Servicing Limit:** Debt servicing costs in a financial year should not exceed 10 percent of the KP's average revenue,
- **Public Debt and Guarantees Limit:** The combined stock of total public debt and guarantees must not exceed 150 percent of the province's average revenue, preventing excessive borrowing that could jeopardize fiscal stability.

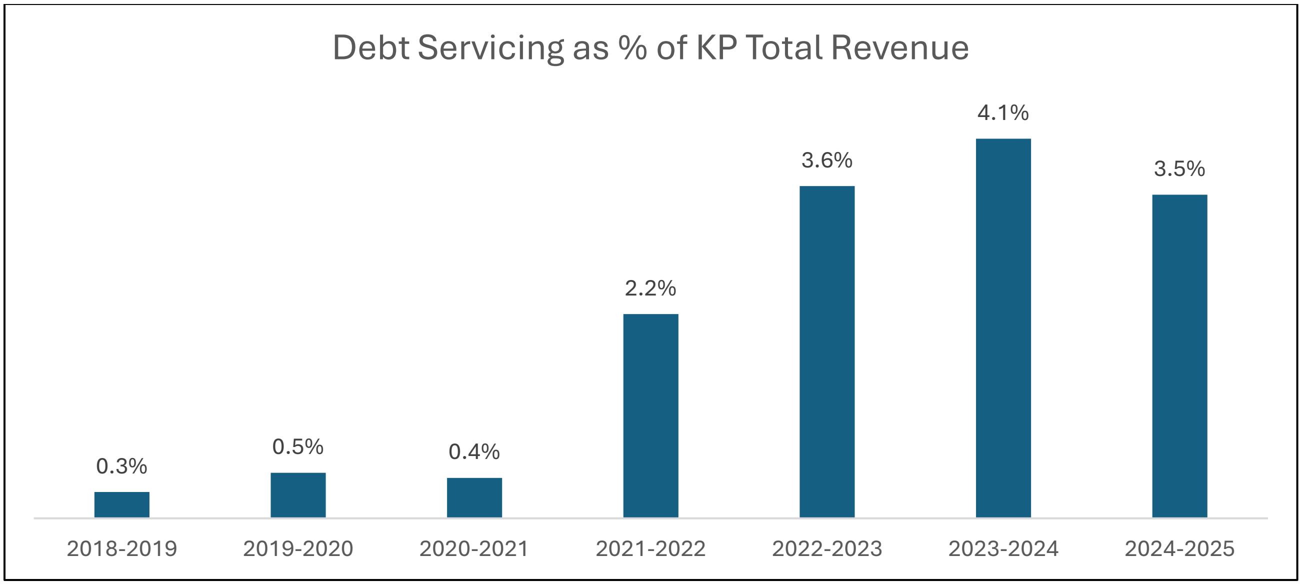

Figure 4: Khyber Pakhtunkhwa's Debt Servicing as percentage of revenue

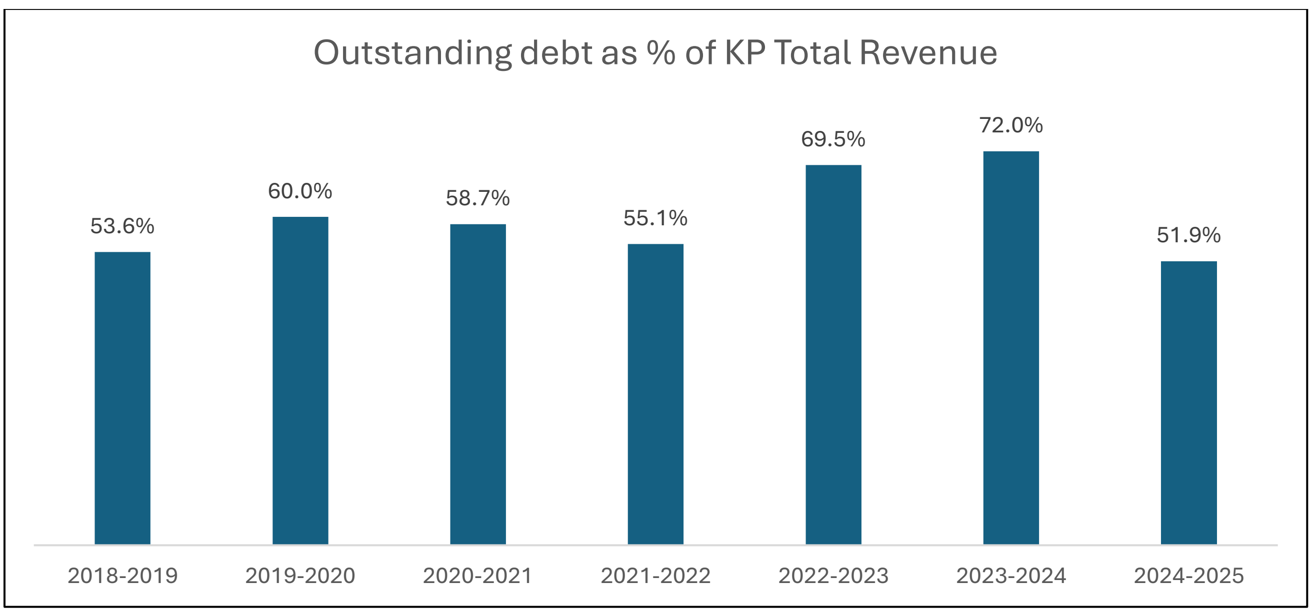

Figure 5: Khyber Pakhtunkhwa's Outstanding Debt as percentage of revenue

Currency conversion risk remains a key fiscal concern for the Government of Khyber Pakhtunkhwa, given its exposure to foreign-denominated loans, the majority of which—approximately 77%—are denominated in US dollars. While the Pakistani Rupee (PKR) has exhibited relative stability over the past year, any depreciation against the US dollar can significantly increase debt servicing costs and raise the fiscal burden on externally funded loan projects. Although recent exchange rate trends have provided some relief, the province remains vulnerable to global economic volatility, monetary policy changes in the US, and geopolitical developments that could adversely affect the PKR-USD exchange rate.

Interest rate risk has moderated somewhat over the past year due to easing global inflation and a more stable interest rate environment. However, a portion of the province's foreign debt portfolio remains linked to variable international benchmarks such as the Secured Overnight Financing Rate (SOFR), Japanese Yen Tokyo Overnight Average Rate (TONA), and the Euro Interbank Offered Rate (EURIBOR). While recent trends indicate a slowdown or pause in global rate hikes, any future tightening by major central banks could increase the cost of debt servicing. This leaves the provincial fiscal position exposed to external monetary policy shifts. Active monitoring of international rate movements or fixed rate borrowing options, where feasible, remain critical for managing this risk effectively.

3.1. Risk Mitigation Strategies

3.1.1. Debt Limitation and Debt Target Measures

To manage risks, the Government of KP has started focusing on two main policy approaches: first, clearly setting debt limits and sticking to those, and second, making sure development spending is more efficient.

As part of the Fiscal Responsibility and Debt Management Act (FRDMA), the Government of KP is committed to keeping debt levels under control. The key strategies include:

- Debt Limits: The Government of KP has set specific debt limits under the FRDMA to ensure it doesn't face situations where access to market financing could be cut off.
- Debt Thresholds: These are set levels where debt starts to hurt the economy, making it harder for GoKP to manage economic stability and threatening long-term debt sustainability.
- Debt Targets: GoKP has set cautious debt targets to make sure debt stays within safe limits, even during times of economic challenges.

3.1.2. GoKP Debt Management Fund

The GoKP as per the mandate of the KP Public Financial Management Act 2022, established the debt management fund which is critical for long-term economic stability. The Fund invests unutilized balance from the government treasury into low-risk instruments. The Fund not only creates a revenue source that offsets growing debt obligations, but also results in optimal cash management, ensuring the province can better manage its financial obligations and ensure that substantial fiscal space is available to prioritize expenditure on delivery service. An initial allocation of PKR. 30 billion was made, and with the passage of time through further injections of funds, this has grown to PKR 150 billion by June 2025. Furthermore, GoKP also developed debt management fund rules, 2024 for governing the control, management, utilization and oversight of the Debt Management Fund.

3.1.3. Review of Foreign Project Loans

The loans borrowed by GoKP are in a range of currencies including Euro, US dollar and Japanese Yen (JPY). However, the US dollar dominates the portfolio, with over 80% of the loans dominated in USD. The mix of fixed and variable interest rates, combined with multi-currency borrowing requires careful debt management to ensure long-term sustainability of the loan portfolio, while minimizing the risk associated with fluctuations in interest rates and foreign exchange rates. To mitigate the impact of fluctuations, the finance department instructed all the line departments that no loans should be borrowed, nor negotiated, without the prior approval of the Finance Department.

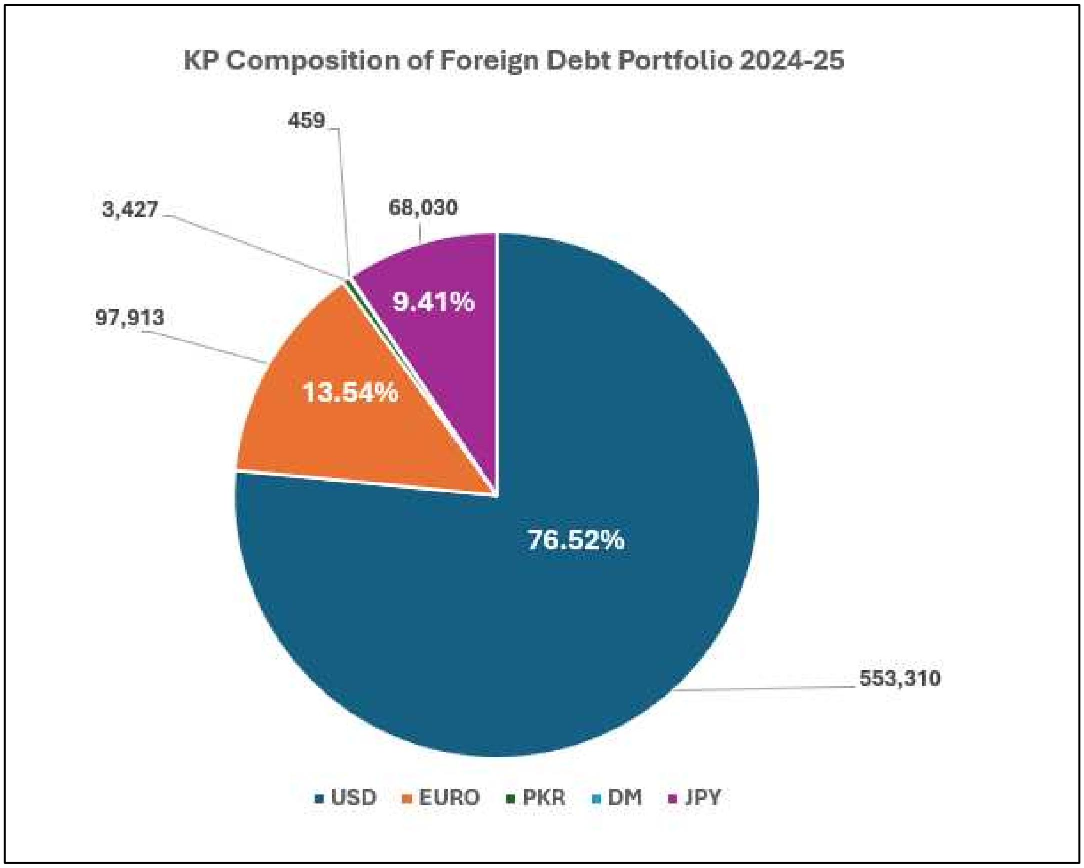

Figure 6: KP Foreign Debt Stock Composition

4. Climate and Natural Disasters

Khyber Pakhtunkhwa, a province with over 40.85 million people (2023 census), is exposed to a multitude of natural disasters including heat waves and forest fires to torrential monsoon flooding, landslides, earthquakes, snow avalanches, glacial lake outburst floods, growing desertification and droughts. Moreover, the province is affected by an increasing frequency and magnitude of these disasters. Riverine and flash floods are a recurrent phenomenon in the province and monsoons are getting worse over time. Over the last thirty years, the province has seen a rise in its mean temperature from 0.3 to 1.2 degrees centigrade and its average rainfall from 11mm to 15mm[1]. KP has experienced 222 earthquakes over the last 100 years. Of the total, 201 were of moderate intensity, whereas 21 were of severe intensity with a magnitude of over 6.0

[1] https://asc-centralasia.edu.pk/old_site/Issue_73/06_samreen.html

on the Richter scale. The 2005 earthquake, with a magnitude of 7.6 Richter scale, was the worst in the history of Pakistan; 29,342 people died and another 37,190 were injured in KP alone.

4.1. Quantifying the Impact of Climate and Natural Disasters for Relief and Rehabilitation Efforts

The Provincial Disaster Management Authority (PDMA) of the Government of KP has implemented measures for preparedness and mitigation during monsoon seasons. To calculate immediate fiscal costs, PDMA has classified historical monsoon flood patterns into three broad classifications:

1. Category A (frequent flooding). The rivers are Kabul, Khiali, Panjkora, Kunhar etc.
2. Category B (Less frequently flooding): Which receive less frequent floods
3. Category C (Occasional flood): Occasional floods because of heavy concentrated rainfall in their catchment areas

Based on the intensity and frequency of past disasters, a methodology has been formulated to estimate future relief and rehabilitation costs to Government of KP. This has been based taking into consideration the timeline of past events summarized in Figure 7 below.

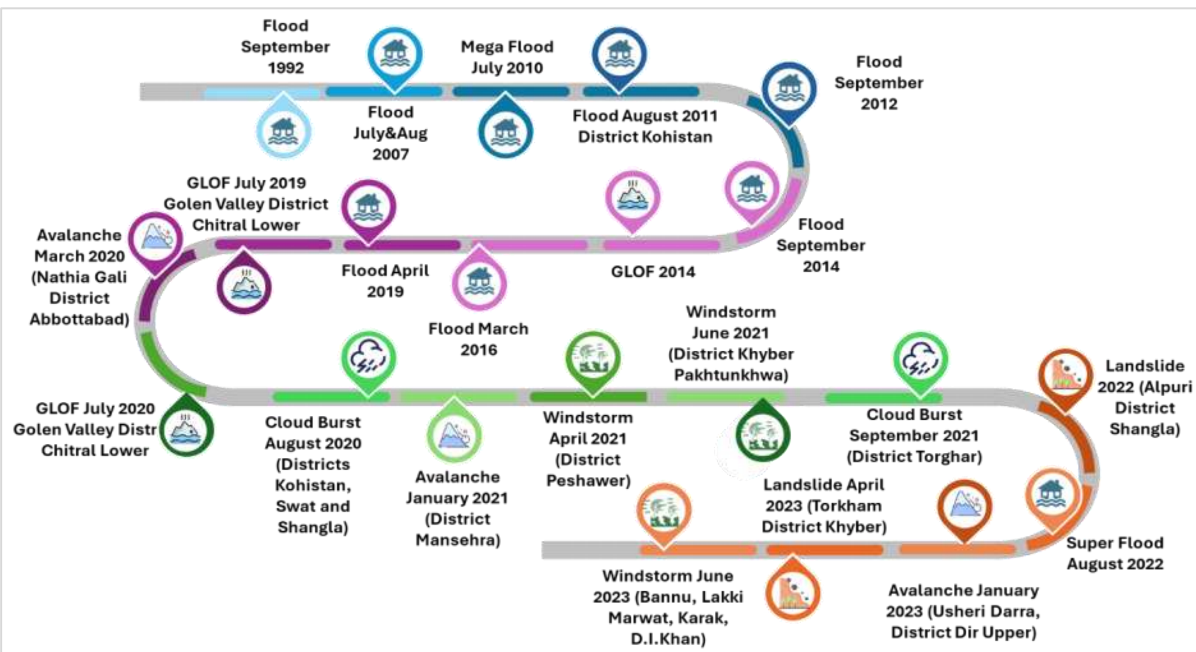

Figure 7: Historical Timeline of Climate and Disaster Events in Pakistan

4.2. Mitigating Measures to Reduce the Impact of Disaster

To reduce the impact of climate and natural disasters, the government has taken several proactive steps, including the development of Provincial Emergency Operations Centre (PEOC), Flood Telemetry. GoKP has also established Humanitarian Response Facility which is a centralized facility in collaboration with UNDP and the World Food Program to store emergency supplies like tents, blankets, and hygiene kits, improving the province's ability to respond quickly to disasters.

4.2.1. Future Interventions to reduce the fiscal impact of Natural Disaster

Provincial Disaster Risk Reduction Policy: The Provincial Disaster Management Authority (PDMA) been finalized the Disaster Risk Reduction (DRR) and is scheduled for launch in FY 2025–26. The policy will serve as a comprehensive framework for managing disaster risks and reducing their impact across the province.

Risk Assessments: The government plans to conduct multi-hazard vulnerability risk assessments (MHVRA) to identify and address areas most at risk from disasters, ensuring better resource allocation and preparedness. As a pilot initiative, the Provincial Disaster Management Authority (PDMA) plans to carry out MHVRA in two districts—Nowshera and Charsadda—to quantify the financial and fiscal impacts of floods, droughts, and heatwaves on crops, households, and infrastructure. Based on the findings from this pilot, PDMA aims to develop a Provincial Disaster Risk Information System (PDRIS), which will serve as a centralized platform to support the phased rollout of MHVRA across all districts in Khyber Pakhtunkhwa.

Disaster Risk Financing Strategy: GoKP plans to launch the 10-year disaster risk financing (DRF) strategy (2025-2035) to strengthen the ability and capacity of the Government to access sufficient funding for, and to respond in a timely manner to disasters. The DRFS focuses on reducing the impact of natural hazards, with a particular emphasis on annually recurring monsoon floods, which are heavily impacting the agriculture sector and the population, thereby creating severe fiscal and socio-economic challenges. The DRF strategy has been formulated to meet the strategic priorities of the GoKP and has been aligned with the five-year Disaster Risk Reduction (DRR) policy and Disaster Risk Management (DRM) plan, currently under formulation. It is also aligned with the government's commitment to achieve the Sustainable

Development Goals (SDGs), with huge strides already accomplished by GoKP for compliance with SDGs 3 and 7.

5. Public Private Partnership

Khyber Pakhtunkhwa has continued to make progress in leveraging Public-Private Partnerships (PPPs) to attract private investment in infrastructure and economic development. Notable operational projects include Swat Motorway Phase I and the Rashakai Special Economic Zone, both of which demonstrate the province's ability to implement complex PPP transactions and create long-term economic value.

The Swat Motorway Phase 2 is currently in the pipeline, with several having reached a commercial close but still awaiting financial close. To support investor confidence and enhance bankability, the Government of KP has structured these projects with key risk mitigation instruments, including Standby Letters of Credit (SBLCs) covering cost overruns, KIBOR-based interest rate overruns, and operational viability gap funding (VGF). These mechanisms are designed to protect private partners from key financial risks and ensure the commercial sustainability of projects. Continued institutional strengthening and effective risk-sharing frameworks remain essential for the long-term success of the province's PPP program.

Public-Private Partnership (PPP) projects in Khyber Pakhtunkhwa, while instrumental in advancing infrastructure and economic development, expose the provincial government to a range of fiscal risks. These include contingent liabilities from guarantees such as Standby Letter of Credits (SBLCs) for cost and KIBOR overruns, as well as commitments to operational viability gap funding (VGF). A key example is the Swat Motorway Phase I PPP project, where the Government of KP had to bear unanticipated costs due to force majeure event, highlighting the operational risks inherent in such projects.

5.1. Risk Mitigation in PPP's

To mitigate this risk, the government has developed and adopted PPP Risk Management Guidelines that clearly define the principles and rules of risk allocation between public and private parties. These guidelines are critical to ensuring a transparent, consistent, and fiscally responsible approach to managing current and future PPP commitments.

The Viability Gap Fund (VGF) Rules, 2022, formulated by the Government of Khyber Pakhtunkhwa, provide a structured framework for offering financial support to PPP projects that are economically and socially desirable but not financially viable on a standalone basis. These rules outline the eligibility criteria, approval process, and disbursement mechanisms for capital and operational VGF. The objective is to attract private investment in critical infrastructure by bridging the revenue shortfall and ensuring long-term commercial sustainability. The VGF Rules also emphasize transparency, competitive bidding, and performance-based disbursements to safeguard public resources and enhance accountability. The VGF has become a vital policy tool for enabling inclusive development while managing fiscal risks associated with PPPs.

6. Challenges in Managing Public Sector Entities (PSEs)

In Khyber Pakhtunkhwa, there are in total 186 public sector entities (PSEs) and Autonomous Bodies (ABs), working under different provincial departments. The purpose of these autonomous bodies is to provide service delivery to the public in an efficient and cost-effective manner. Some of these companies focus on commercial activities, while others work independently, all contributing to managing public resources effectively.

6.1. Public Sector Entities in Khyber Pakhtunkhwa

The Khyber Pakhtunkhwa, there are 13 public sector entities, and the rest are autonomous bodies which include MTIs, schools, universities, etc. While the commercially oriented PSCs have been created for profit but usually, they do not operate on a cost recovery basis. These PSCs also contain 7 WSSCS (Water & Sanitation Services Companies) that function across the province.

The PSCs and Autonomous Bodies have funds allocated to them through the budget for running expenditure and meeting any revenue shortfalls. The requisitions for funds are first consulted with the line departments for approval before forwarding requests to the Finance Department (FD). Expenditures are approved by the respective Secretary of PSC's Line Department.

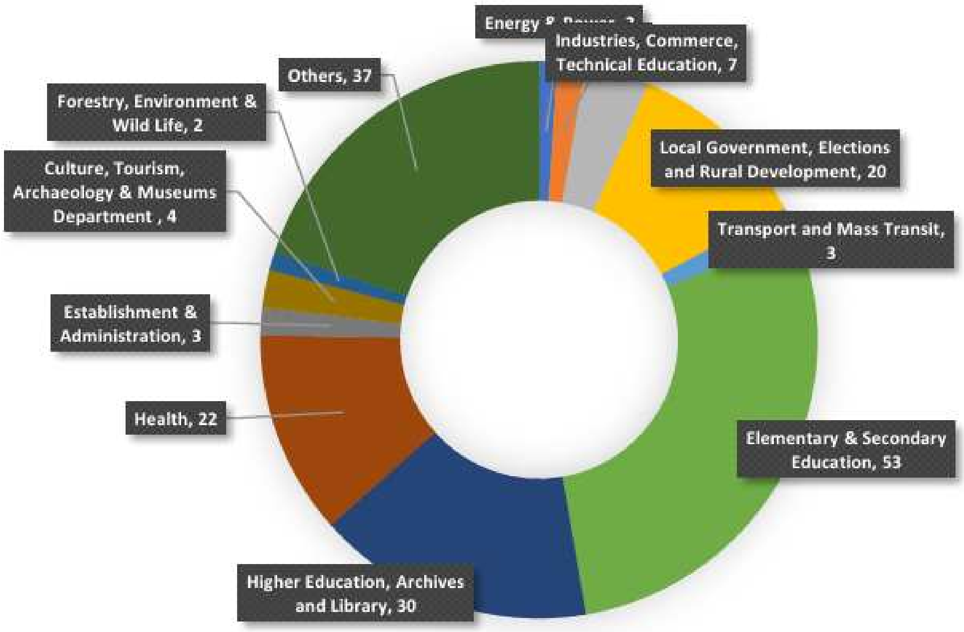

Figure 8: Number of PSEs – Categorization by Department

6.2. Key Fiscal Risks Associated with Public Sector Entities

The primary reason that PSCs and ABs fall short on meeting their expenditure is because government fixes prices of various services (such as lower rates are charged for municipal services, access to healthcare facilities etc.) that are not sufficient to meet its costs. Other challenges associated with autonomous bodies stem from the lack of transparency, weak governance and monitoring structure, and lack of public disclosure due to their autonomous nature.

6.2.1. Lack of transparency in the provision of grant in aid to PSEs

A total number of 128 entities have no Drawing and Disbursement Officer (DDO) code, and this also includes the major entities. Having no DDO code means that the funds disbursed don't have any clear tracking mechanism, making it difficult for the departments to track the exact flow of funds.

As per the existing practice, budgetary release to the entities with out DDO codes are group under a single account named "Grant in Aid" and disbursed through the relevant line department. The lump-sum approach means the Finance Department can only verify the amounts by directly confirming with the entities, making the process less transparent and harder to manage.

This becomes a major source of fiscal leakage primarily because the quantum of outflows to these entities is not readily available without extensive exercise in tracking fund flows and secondly this allows for release of funds to PSCs/ABs that may not have budgeted amounts, bypassing the budgetary process.

Table 5: Entities with and without DDO codes

Department Name	Total Entities	DDO Code Not Available	Entities with DDO Code
Agriculture	1	1	0
Energy & Power	3	3	0
Finance	3	1	2
Industries, Commerce, Technical Education	9	7	2
Local Government, Elections and Rural Development	20	12	8
Transport and Mass Transit	3	2	1
Elementary & Secondary Education	52	46	6
Higher Education, Archives and Library	36	36	0
Health	38	4	34
Labour	4	4	0
Culture, Tourism, Archaeology & Museums Department	4	4	0
Forestry, Environment & Wildlife	2	1	1
Communication & Works	1	0	1
Science & Technology and Information Technology	1	0	1
Law, Parliamentary Affairs & Human Affairs	1	1	0
Housing	2	2	0
Establishment & Administration	3	2	1
Relief & Rehabilitation Department	2	1	1
Livestock, Fisheries and cooperative department	1	1	0
Total	**186**	**128**	**58**

6.2.2. Governance Issues and Weak Monitoring

The Corporate Governance Unit (CGU) was established in 2019 under the Finance Department to reform Public Sector Companies (PSCs) and Autonomous Bodies (ABs). Its mandate includes improving board governance, developing policy frameworks, ensuring compliance, identifying cost-saving or revenue-generating opportunities, and monitoring performance. However, CGU facing major challenges, is understaffed and lacking in enforcement authority, thus leading to poor adherence to its policy frameworks. One major issue is that the policy framework is not being implemented in board appointments.

6.3. Risk Mitigation Strategy for PSEs

6.3.1. Integrated Portal for the Management of PSEs

In a significant move to strengthen the public financial management of all the public sector companies and autonomous bodies, the Finance Department designed an Integrated Information Portal titled "Governance, Finance & Compliance." The portal was officially launched by Chief Minister of Khyber Pakhtunkhwa on 15th March 2025. This portal has been designed exclusively for all Public Sector Entities (PSEs) of the province, with the core objective of enhancing transparency, accountability, and centralized oversight of financial and governance-related data.

To mitigate the risks associated with lumpsum approach of budgetary releases to these entities and governance related matters, the portal is structured around two primary tools:

1. Financial Tool: The portal tool is designed to capture and consolidate financial data from Public Sector Entities (PSEs). It allows entities to input their financial records, enabling centralized access for Administrative Departments, the Finance Department, and other higher authorities. The system automatically generates key reports—Income Statement, Balance Sheet, Cash Flow, and Budget Utilization—at both the entity and departmental levels, as well as consolidated provincial reports. These reports support data-driven budgeting, planning, and highest levels.

2. Governance Tool: This tool documents the governance frameworks of PSEs, capturing details such as organizational structure, board composition, regulatory compliance, internal controls, and policy adherence. It acts as a centralized repository for governance documents and activities, fostering transparency and accountability across entities.

6.3.2. Review of Dormant and Non-active Account of Public Sector Entities

A significant number of Public Sector Entities (PSEs) maintain non-active or dormant bank accounts, many of which contain unutilized balances or show no recent transactional activity. The finance department in collaboration with all the line departments is conducting a review of all those accounts held by public sector entities. The purpose of these reviews is to identify and repatriate idle funds to the provincial consolidated fund, so that it can be reinvested to strengthen the fiscal position of those entities.

7. Contingent Liabilities

Government of Khyber Pakhtunkhwa's (GoKP) exposure to contingent liabilities within its Public-Private Partnership (PPP) portfolio is the Swat Motorway Phase 2 project, implemented under a Build-Operate-Transfer (BOT) / Design-Build-Finance-Operate-Maintain (DBFOM) model by the Pakhtunkhwa Highways Authority (PKHA) in collaboration with private sector partner Zahir Khan & Brothers (ZKB).

The PPP project is structured with a 25-year concession period, and the financial risk-sharing mechanisms embedded in the agreement give rise to potential contingent liabilities including:

(i) Standby Letter of Credit (SBLC) – Operational Viability Gap Funding (VGF): The Government has committed to provide PKR 7.04 billion as operational support through SBLC.

(ii) SBLC – Cost Overruns Support due to Major Materials Price Hike: A commitment of PKR 2.3 billion to cover cost escalations in the prices of key construction materials.

(iii) SBLC – Cost Overruns Support due to KIBOR Hike:
A further PKR 3.0 billion has been earmarked under the SBLC to mitigate financial distress in case of significant increases in the Karachi Interbank Offered Rate (KIBOR).

These three SBLC-backed commitments represent a substantial fiscal exposure of PKR 12.34 billion.