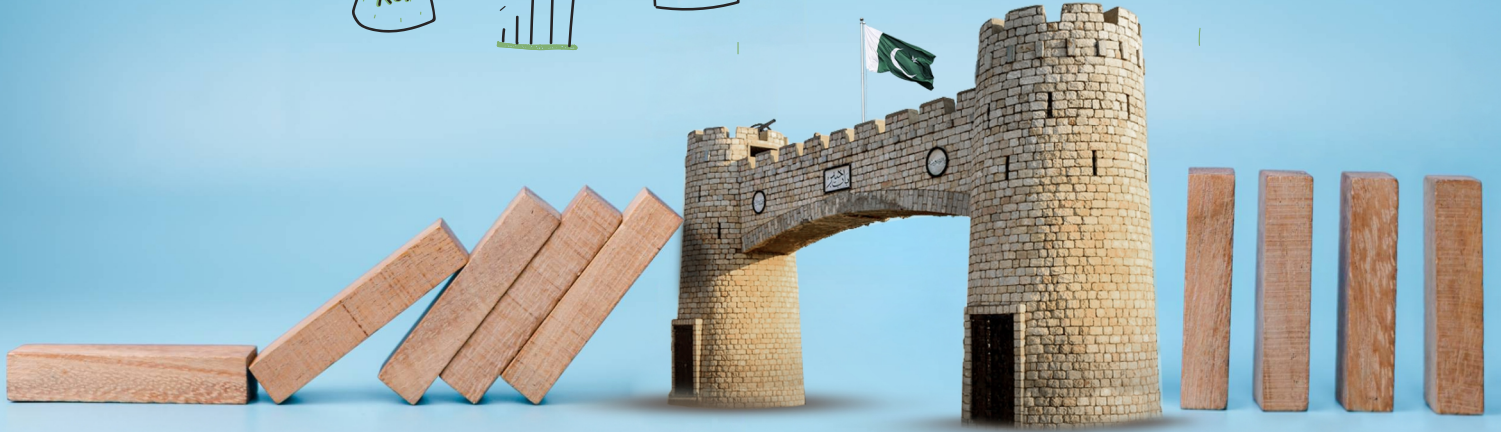




FINANCE
DEPARTMENT
GOVERNMENT OF
KHYBER PAKHTUNKHWA

فنانس
ڈیپارٹمنٹ
حکومت خیبرپختونخوا

FISCAL RISK STATEMENT FY 2025-26



FOREWORD

I am pleased to present the Fiscal Risk Statement of the Government of Khyber Pakhtunkhwa. This document reflects the Government's continued commitment to strengthening fiscal discipline, enhancing transparency, and promoting prudent financial management.

Risks have been categorized into Inherent risks arise from the Province's fiscal structure and long-term obligations, including public debt, pension liabilities, and commitments under Public-Private Partnership (PPP) arrangements.

Systemic risks, external factors beyond the direct control of the Government, such as macroeconomic fluctuations, changes in federal transfers, and natural disasters that may adversely affect public finances.

Operational risks relate to challenges in the management and performance of public sector entities, governance processes, and the implementation of fiscal policies and programs. It is expected that this Fiscal Risk Statement will contribute to more evidence-based policymaking and help maintain the stability and sustainability of public finances.

The Governance, Finance & Compliance (GFC) Portal, launched in March 2025, is operational for enhancing transparency and centralized oversight of all 185 Public Sector Entities. By standardizing reporting requirements and providing real-time access to critical institutional data, the portal will enable policymakers, oversight bodies, and the Finance Department to effectively monitor organizational performance, identify emerging risks, track compliance with corporate governance frameworks and government policies, and take timely corrective actions.

The efforts of Mr. Abdul Qayyum Khan, (Chief Team Lead); Mr. Arsalan Ahmed, (Team Lead, Corporate Governance Unit), Mr. Basharat Ullah, (Cash Management Analyst, Cashflow Management Unit), Mr. Ishrat Alam, (Senior Financial Analyst, Debt Management Unit) and Mr. Haris Kundi (Analyst, Internal Support Unit) for valuable contributions to the development of Fiscal Risk Statement is appreciated.

Muzzammil Aslam
Advisor to Chief Minister for Finance

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INTRODUCTION

Government frequently encounter situations where actual fiscal outcomes differ from those anticipated during the budgeting and planning process. Deviations driven by forces both within and beyond a government's control are termed as fiscal risks. The sources of such risk are particularly diverse. They range from shifts in global and national macroeconomic conditions, to the ever-present threat of climate-induced disasters, to volatility in the province's share of federal revenues and to the compounding effects of a growing public debt portfolio and associated debt servicing obligations.

Recognising and proactively managing these risks is not merely a matter of fiscal prudence but a legal obligation too. The KP Fiscal Responsibility and Debt Management Act (FRDMA) 2022 and the KP Public Financial Management (PFM) Act 2022 together mandate the Finance Department to maintain a robust institutional framework for the identification, measurement, and mitigation of fiscal risks. Section 7(1) of the FRDMA Act specifically requires the Government of Khyber Pakhtunkhwa to prepare and present an annual Fiscal Risk Statement (FRS) to the Provincial Assembly, alongside the annual budget. This document fulfils that statutory requirement for FY2026-27.

In accordance with the Act, the Fiscal Risk Statement addresses the following:

- a) Review the actual fiscal outcomes of last completed financial year with the budget estimates of that year and the projections made in medium term fiscal framework in respect of that year and identify the reasons of 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 Government to address the fiscal risks.
- d) Identify 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.

The analytical framework organises fiscal risks into three categories: general economic risks, specific fiscal risks, and structural or institutional risks. Within these three pillars, this document examines the following risk areas that are particularly relevant to Khyber Pakhtunkhwa:

- 1) Risks arising from macroeconomic conditions
- 2) Federal transfer risks
- 3) Fiscal sustainability risks, principally driven by pension obligations
- 4) Public debt management risks
- 5) Climate change and natural disaster risks
- 6) Fiscal risks associated with Public-Private Partnership agreements
- 7) Governance and financial management challenges in Public Sector Entities (PSEs)

1. ECONOMIC REVIEW AND OUTLOOK

According to the IMF World Economic Outlook (April 2026), global GDP growth is expected to slow to **3.1% in 2026** and **3.2% in 2027**, down from **3.4% in 2025**. The main reason for this slowdown is the conflict in the Middle East, which has raised energy prices and disrupted supply chains.

Among major economies, the United States is projected to grow at **2.3% in 2026**, while the Euro Area is expected to grow at a slower **1.1% in 2026** due to ongoing regional instability. Emerging markets remain relatively resilient, with growth projected at **4.9% in 2026**. China is expected to grow at **4.4% in 2026**, supported by government stimulus measures.

Global inflation is projected at **4.4% in 2026**. This figure could rise further if geopolitical tensions escalate and push commodity prices higher. The table below presents detailed GDP growth projections by country and region.

Table 1: Global GDP Growth

| Country/Region | GDP Growth 2025 (%) | GDP Growth 2026 (%) | GDP Growth 2027 (%) |
|---------------------|---------------------|---------------------|---------------------|
| World | 3.4 | 3.1 | 3.2 |
| USA | 2.1 | 2.3 | 2.1 |
| Euro Area | 1.4 | 1.1 | 1.2 |
| China | 5.0 | 4.4 | 4.0 |
| Emerging Market | 4.4 | 3.9 | 4.2 |
| Pakistan (PBS data) | 3.2 | 3.7 | 4.0 |

Source: IMF, World Economic Outlook, April 2026.

Trade tensions between major economies continue to threaten supply chains and global risks remain elevated. The Middle East conflict that erupted in February 2026 has pushed oil prices higher, adding pressure to Pakistan's import bill and inflation. High debt levels in developing countries, including Pakistan, add further strain on fiscal stability.

Pakistan's economy is gradually recovering. GDP growth reached 3.2% in FY2024-25 and is expected to hold at 3.7% in both FY2025-26 and targeted at 4.0% for FY2026-27 (PBS data). Inflation, which had peaked at 23.4% in FY2023-24, fell sharply to 4.6% in FY2024-25. However, it has since risen again to 11.7% in May 2026 and is projected at 8.4% in FY2026-27, driven by higher energy prices and spillovers from the Middle East conflict. To control inflation, the State Bank of Pakistan raised its benchmark interest rate from 10.5% to 11.5% in April 2026.

The external position of Pakistan has seen mixed results, in FY2024-25, the current account recorded a small surplus of 0.5% of GDP but is expected to reverse, with a deficit of 0.4% of GDP in FY2025-26, widening further to 0.9% of GDP in FY2026-27 as imports rise with economic recovery and energy costs increase. However, foreign exchange reserves reached \$17.1bn on May 22, 2026 (SBP).

Continued conflict in the Middle East could keep oil prices high, worsen inflation, and strain Pakistan's balance of payments. This would directly affect KP through reduced federal transfers and tighter space for development spending. The table below presents Pakistan's key economic indicators.

Table 2: Pakistan's Economic Outlook

Pakistan Economic Outlook (2025–2027) – Key Economic Indicators

| Indicator | 2025 Actual | 2026 Projected | 2027 Forecast | Source |
|-------------------------|-------------|----------------|---------------|--------------|
| Real GDP Growth | 3.2% | 3.7% | 4.0% | PBS data |
| Inflation Rate (CPI) | 4.6% | 6.7% (May) | 8.4% | PBS data/IMF |
| Unemployment Rate | 7.1% | 6.9% | 6.5% | IMF |
| Current Account (% GDP) | 0.5% | -0.4% | -0.9% | IMF |
| Policy Interest Rate | 11.0% | 11.5% | - | SBP |
| Foreign Reserves (USD) | \$14.5 B | \$17.1 B | - | SBP |

1.1. Macroeconomic Risks In FY2025-26

Based on the April 2026 Monetary Policy Statement of the State Bank of Pakistan and broader review of the economy, following are the most important fiscal and external risks in the backdrop of middle east conflict:

1.1.1. Fiscal Sector - Negative Implications

The ongoing Middle East conflict has made fiscal management more challenging. The pass-through of higher international oil prices to domestic consumers necessitated support for vulnerable groups through targeted subsidies. To achieve the targeted full-year primary surplus, a larger cut in expenditures may be required. In this regard, the MPC emphasized the need for sustained fiscal reforms, including broadening the tax base and curtailing SOE losses, to strengthen fiscal sustainability and resilience.

1.1.2. Federal Transfer Risks Due To Slow Growth In FBR Taxes

With initial budget projection of FBR taxes over Rs14 trillion, reduced to Rs 13 trillion, FBR tax collection fell well below its target during FY2025-26. Consequently, the Province's share in divisible pool transfers declines proportionately, reducing the fiscal space available to meet development and recurrent expenditure needs. Nevertheless, projected FBR tax revenues for FY2025–26 are expected to reach approximately 10 percent above the FY2024–25 collection level of Rs. 11.744 trillion. This anticipated growth is expected to provide some fiscal cushion for growing financing essential public expenditures.

Further, the ambitious revenue targets assigned to the FBR in the Federal annual budget necessitate corresponding fiscal planning by the Province. However, shortfall in the achievement of these targets during the fiscal year pose a significant fiscal risk, as it leads to lower-than-expected federal transfers and adversely affecting the Province's budgetary position and expenditure commitments.

During previous four years, growth rates were 26%, 30%, 17% and 30%. With GDP growth projected at 4% and tax base not expanding; federal tax collections may not show double-digit growth in coming years.

1.1.3. Surge In Inflation

Inflation has moved into double digit with May 2026 CPI at 11.7% and 10.9% in April 2026, as government has increased domestic fuel prices by high margin. Higher inflation will pose serious risk to fiscal position, amid increase in debt servicing cost. SBP has initiated tightening in April by increasing the policy rate by 100bps to 11.5%. The MPC noted that this outlook is subject to multiple risks, particularly the duration and intensity of the ongoing conflict, extent of pass-through of changes in global energy prices to domestic economy, and potential fiscal slippages.

1.1.4. GDP Growth Moderating

GDP growth momentum has slowed down since March amid middle east conflict and surge in global fuel prices. Real GDP growth for FY2025-26 is projected to trend lower than expected, reflecting moderation in agricultural output, primarily on account of below-target wheat production, along with subdued industrial and services sector activity in the last quarter of the year. The moderation in economic activity is likely to continue in FY2026-27, though the outlook is subject to multiple risks, including the duration and intensity of the ongoing conflict. Overall, government is targeting 4% GDP growth in FY2026-27, up from 3.7% growth estimated for FY2025-26. Slow GDP growth will have the usual negative macro implications in the form of lower tax collections, lower development spending and lower job creation.

1.1.5. Possible Decline In Remittances From Middle East

KP has relatively higher share of workers remittances from the middle east countries. Amidst the ongoing conflict in the region, the gulf countries such as UAE, Qatar, Kuwait, Saudi Arabia are facing slowdown in economic activity which could pose serious threat to remittances as workers may lose their jobs, see decline in wages or return back to their home countries. Given the high dependency of province population on remittances, this could pose serious fiscal challenge for the KP government resulting in higher public sector expenditure.

1.2. Revenue Profile

This Fiscal Risk Statement reviews KP's revenue under three broad categories

- a) General revenue receipts
- b) Capital receipts, and
- c) Development receipts

For FY2025-26, the figures are based on ten months of actual collections, with the remaining two months estimated on a pro-rata basis.

The data reveals a consistent pattern over the four-year period actual revenues have repeatedly fallen short of budget targets in several key areas. The most significant shortfall is under Net Hydel Profit transfers, where actual receipts have consistently been far below what was budgeted. Similar gaps are observed in General Capital Receipts and Development Receipts, where actual collections have also underperformed against budget estimates year after year.

2. FEDERAL TRANSFER RISKS

The fiscal review of Khyber Pakhtunkhwa (FY2022-23 to FY2025-26) highlights a persistent and structural gap between budgeted and actual revenues/receipts. Major deviations have been witnessed in hydel profits (net and arrears) estimates, merged districts grants, and foreign loans (FPA) projections.

Table 3: Variance in Revenue Profile of Khyber Pakhtunkhwa (in PKR million)

| Revenue Head | FY2022 -23 | | | FY2023 -24 | | | FY2024 -25 | | | FY2025 -26 | | |
|--|------------|---------|----------|------------|---------|----------|------------|---------|----------|------------|-------------|----------|
| | Budget | Actual | Variance | Budget | Actual | Variance | Budget | Actual | Variance | Budget | Projected * | Variance |
| General Revenue Receipts | 817.5 | 768.2 | -6.0% | 1,157.0 | 943.4 | -18.5% | 1,305.5 | 1,232.3 | -5.6% | 1,635.9 | 1,338.9 | -18.2% |
| Total Federal Transfers | 732.5 | 703.6 | -3.9% | 1,072.0 | 867.2 | -19.1% | 1,212.0 | 1,138.4 | -6.1% | 1,506.9 | 1,218.4 | -19.1% |
| Federal Transfers Tax Assignment | 570.9 | 586.4 | 2.7% | 764.6 | 721.6 | -5.6% | 902.5 | 934.6 | 3.6% | 1,147.8 | 1,017.9 | -11.3% |
| Fed. Transfers 1% War on Terror | 68.6 | 70.5 | 2.8% | 91.9 | 86.7 | -5.7% | 108.4 | 112.3 | 3.6% | 137.9 | 122.3 | -11.3% |
| Fed. Transfers Net Hydel Profit | 62.0 | 4.9 | -92.1% | 85.1 | 8.5 | -90.0% | 111.3 | 33.0 | -70.4% | 106.0 | 32.4 | -69.4% |
| Fed. Transfers Straight Transfers | 31.0 | 41.8 | 34.8% | 38.7 | 50.4 | 30.2% | 43.0 | 56.0 | 30.3% | 57.1 | 45.7 | -20.0% |
| Windfall Levy | - | - | - | 91.7 | - | -100.0% | 46.8 | 2.5 | -94.6% | 58.2 | - | -100.0% |
| Provincial Own Receipts | 85.0 | 64.6 | -24.0% | 85.0 | 76.2 | -10.4% | 93.5 | 93.9 | 0.5% | 129.0 | 120.6 | -6.5% |
| Provincial Tax Collection | 52.7 | 41.4 | -21.5% | 56.5 | 53.6 | -5.1% | 63.2 | 65.2 | 3.2% | 83.5 | 81.1 | -2.9% |
| Provincial Non-Tax Collection | 32.3 | 23.2 | -28.0% | 28.5 | 22.6 | -20.7% | 30.3 | 28.7 | -5.2% | 45.5 | 39.5 | -13.2% |
| General Capital Receipts | 204.6 | 273.6 | 33.7% | 0.3 | 0.2 | -33.3% | 31.6 | 4.3 | -86.4% | 10.3 | 0.2 | -97.9% |
| NMAs - Non-dev Grant, Current grant, 3% share and TDPs | 158.5 | 60.0 | -62.1% | 116.9 | 66.0 | -43.5% | 183.9 | 66.0 | -64.1% | 202.7 | 88.0 | -56.6% |
| Development Receipts | 151.6 | 73.4 | -51.6% | 182.7 | 118.9 | -34.9% | 233.0 | 180.3 | -22.6% | 270.1 | 98.9 | -63.4% |
| TOTAL RECEIPTS | 1,332.2 | 1,175.2 | -11.8% | 1,456.9 | 1,128.5 | -22.5% | 1,754.0 | 1,483.0 | -15.5% | 2,119.0 | 1,526.1 | -28.0% |

* FY2025-26 – 10 months actual + 2 months projected

2.1. NHP Arears

The existing NHP arrangement places the Province at a serious structural disadvantage. The tariff rate applied to KP's hydel contribution remains significantly below the electricity tariffs currently charged to consumers across the country. This arrangement will continue to impose a material and recurring fiscal cost on the Province. Net hydel profit share paid to KP is Rs 27bn in first 10 months of FY2025-26 and Rs 33bn in FY2024-25 while NHP arears still stands over Rs 100bn.

2.2. Shortfall in Grants for Merged Districts

A major structural challenge facing provincial finances is the absence of a dedicated allocation for the merged tribal districts (presently covered under NMA grants from GoP), which were integrated into Khyber Pakhtunkhwa but have not yet been accorded their due share in the federal divisible pool. This omission has imposed sustained fiscal pressure on the province, as it continues to finance the extension of policing, judicial, education, health, and administrative systems in these areas. The current NFC framework does not fully internalize the costs associated with merged districts integration, security responsibilities, and heightened climate risks. Over the past three NFC cycles, these factors have remained inadequately reflected in the distribution formula, placing Khyber Pakhtunkhwa at a persistent fiscal disadvantage

Receipts in the form of grants projected for merged districts from GoP have fallen by big margin against the budget amount of Rs 203 bn, with province getting only Rs 73 bn of the total budget amount in 10-months.

2.3. Status Quo on NFC

The Government of Khyber Pakhtunkhwa maintains that the existing National Finance Commission (NFC) arrangements do not adequately reflect the province's fiscal realities and structural cost disabilities. The province continues to bear national responsibilities that extend beyond its fiscal capacity, particularly in the areas of security, post-merger integration of the tribal districts, and climate vulnerability. In this context, a revised NFC Award is essential to reflect fiscal equity, national cohesion, and macroeconomic stability.

NFC is the single largest component of revenue for all the four provinces. KP's share in this divisible pool is 14.62% and 1% share as war on terror. While a separate grant is allocated to Khyber Pakhtunkhwa for the Merged Districts, the quantum of grant falls significantly short of what the Merged Districts would have been entitled to receive under the constitutional formula. Based on the NFC methodology, the Merged Districts' share is estimated at approximately 2.5% of the divisible pool, equivalent to around Rs. 320 bn on the basis of FY2025-26 FBR revenues.

2.4. Fiscal Outlook Under a Status Quo NFC Scenario

If the new NFC Award retains the existing horizontal distribution formula and vertical share, Khyber Pakhtunkhwa is likely to face continued structural fiscal stress over the medium term.

On the revenue side, growth in federal transfers would remain tied primarily to federal tax performance, without adjustment for provincial cost disabilities. In real terms, per capita transfers are likely to decline due to population growth, inflation, and rising service delivery obligations, resulting in a widening gap between resource inflows and expenditure requirements.

On the expenditures side, fiscal pressures are projected to continue to intensify due to largely inelastic commitments, including salaries and pensions, merged districts integration costs, climate adaptation and disaster response spending, and law and order responsibilities that are unique in scale to the province. The limited discretionary space within the budget constrains the province's ability to offset these pressures through expenditure rationalization alone.

Under this scenario, the province will face serious challenges in maintaining fiscal surpluses, while development spending would face increasing compression. The province may be compelled to reduce the size of the Annual Development Program (ADP), delay project completion, increase reliance on borrowing, or accumulate payment arrears. Such outcomes would crowd out development expenditures and weaken growth and service delivery.

3. FISCAL SUSTAINABILITY RISKS

The fiscal review of Khyber Pakhtunkhwa (FY2022-23 to FY2025-26) highlights a persistent and structural gap between budgeted and actual revenues/receipts. Major deviations have been witnessed in hydel profits (net and arrears) estimates, merged districts grants, and foreign loans (FPA) projections.

3.1. Unfunded Pension Liability

KP faces a particularly difficult situation because unfunded pension system. As a result, many public sector organisations are struggling to meet their pension obligations, and some cannot even pay lump-sum commutation amounts to retiring employees.

The scale of the problem in KP is significant and growing:

- In June 2020, an independent actuarial study estimated KP's total pension liability at Rs. 3 trillion. At that time, the province had 564,000 active government employees and 170,000 pensioners.
- By FY2025-26, the number of active employees had declined to 555,664 and while number of pensioners numbers had increased to around 230,000.
- KP's accrued pension liability stood at Rs. 3 trillion as of June 2020 (actuarial valuation, 2022). Applying the actuarially projected liability growth rate of 10-12% per annum, the liability is estimated to be approaching Rs. 4.5 trillion by FY2025-26.

The government owes an enormous and growing amount in future pension payments, with no dedicated fund to cover it. Every year, more employees retire and join the pensioner roll. This is one of the most pressing long-term fiscal risks Province is facing.

3.2. Rising Annual Pension Burden

KP faces a particularly difficult situation because unfunded pension system. As a result, many public sector organisations are struggling to meet their pension obligations, and some cannot even pay lump-sum commutation amounts to retiring employees.

The scale of the problem in KP is significant and growing:

- The pension expenditure for FY2025-26 is Rs. 190 bn, compared to Rs. 160 bn in FY2024-25.
- This is projected to rise to Rs. 208 bn in FY2026-27 posing a significant and unsustainable burden on the provincial budget.

3.3. Mitigation Strategy

The growing pension liability poses a significant long-term fiscal risk for the Province. To address this, the Government has initiated two structural reforms. With effect from June 2022, all newly recruited Civil Servants/Government Employees are enrolled under the Contributory Provident (CP) Fund Scheme, replacing the Defined Benefit (DB) arrangement, with employee and employer, contributions fixed at 10% and 12% of basic pay, respectively. This reform halts further accumulation of unfunded liability for new entrants and is expected to reduce the long-term pension burden.

In parallel, dedicated budgetary allocations are being made to the Pension Fund, invested through selected Asset Management Companies (AMCs) to generate regular returns and to fund the outstanding liability. These measures mark a transition from a fully unfunded to a funded, contributory pension framework, which is expected to progressively ease the pension liability on the Province over the medium to long term.

4. PUBLIC DEBT MANAGEMENT RISKS

As of December 2025, Khyber Pakhtunkhwa's outstanding foreign loan liability stood at PKR 809,742 mn, compared to PKR 776,321 mn at the close of FY2024-25 (June 2025), representing an increase of 4.30% during the first six months of FY2025-26. The increase is primarily attributable to net loan disbursements under ongoing externally financed development projects.

The province's external debt portfolio remains exposed to depreciation of Pakistan Rupees. Any significant depreciation of the Pakistani Rupee against major lending currencies, could increase the local currency value of outstanding liabilities and future debt servicing costs. Ongoing geopolitical tensions in the Middle East, coupled with broader global economic uncertainties, may contribute to volatility in international financial markets and influence the trajectory of global interest rates.

Table 4: KP Outstanding Debt Movement Summary (PKR million)

| Description | June 2024 | June 2025 | Dec 2025 | June 2026 Projected |
|------------------------------|-----------|-----------|----------|---------------------|
| KP Outstanding Debt (PKR mn) | 679,547 | 776,321 | 809,742 | 855,771 |
| Debt Servicing (PKR mn) | 38,733 | 49,350 | 25,565* | 61,813 |

* Debt servicing for six months

4.1. Risk Mitigation Strategies

4.1.1. Debt Limitation

The Government of Khyber Pakhtunkhwa has undertaken two major policy initiatives, including the introduction of statutory debt ceilings through proposed amendments to the Fiscal Responsibility and Debt Management Act, 2022, and the establishment of a dedicated reserve fund for public debt management.

Under the proposed amendments (Bill 2026) to the Fiscal Responsibility and Debt Management Act, 2022, the following key provisions have been introduced:

1. Financing of fiscal deficits will be permitted only under special circumstances.
2. The limit for net investment in non-financial assets has been increased from 10% to 20% of the province's average revenue.
3. Annual debt servicing has been capped at 5% of the province's average revenue.
4. The ceiling on total public debt stock at any point in time has been reduced from 150% to 75% of provincial revenue.

4.1.2. Debt Management Fund

The Government of Khyber Pakhtunkhwa has established a Debt Management Fund to mitigate the fiscal impact of borrowing and strengthen the Province's debt management framework. The Fund constitutes a strategic financial asset that is invested to generate a sustainable revenue stream for the Province. As of the current fiscal year, the Fund has accumulated resources amounting to PKR 158 bn and has earned a profit of 8.9 bn (4.3 bn FY2024-25 and 4.6 bn FY2025-26).

5. CLIMATE AND NATURAL DISASTERS

Khyber Pakhtunkhwa, home to over 40.85 mn people (2023 census), faces an exceptionally wide spectrum of natural hazards from heat waves, forest fires, and droughts to monsoon flooding, landslides, earthquakes, avalanches, and glacial lake outburst floods.

The 2025 monsoon season inflicted unprecedented devastation on Khyber Pakhtunkhwa. Intense cloudbursts and torrential rainfall in mid-August triggered widespread flash floods and landslides across the province. KP bore the heaviest human cost nationwide, with 504 lives lost and approximately 1.57 mn people affected across 10 districts. Buner emerged as the worst-affected district, where 237 people perished. Bajaur, Shangla, and Swat suffered comparable devastation, collectively accounting for thousands of displaced families, 4,668 damaged or destroyed homes, and 60 health facilities rendered non-functional. The infrastructural toll was equally severe: 45 bridges were washed away, roughly 200 km of road networks disrupted, and over 45,000 residents displaced.

5.1. Mitigating Measures to Reduce the Impact of Disaster

The Government of Khyber Pakhtunkhwa has established a Debt Management Fund to mitigate the fiscal impact of borrowings and strengthen the Province's debt management framework. The Fund constitutes a strategic financial asset that is invested to generate a sustainable revenue stream for the Province. As of the current fiscal year, the Fund has accumulated resources amounting to PKR 158 bn and has earned a profit of 8.9 bn (4.3 bn FY2024-25 and 4.6 bn FY2025-26).

5.1.1. Disaster Risk Reduction (DRR) Policy

The Provincial Disaster Management Authority (PDMA) has formulated the Disaster Risk Reduction (DRR) Policy for Khyber Pakhtunkhwa. This marks a fundamental shift in KP's approach to disaster management from a reactive, relief-centric model to a proactive, risk-informed framework. The Policy is aligned with the Sendai Framework for Disaster Risk Reduction, the Sustainable Development Goals (SDGs), and Pakistan's National Disaster Management Act (2010).

5.1.2. Disaster Risk Management Fund

The provincial Government has allocated 12 bn fund as disaster risk management fund. Meanwhile, a ten-year Disaster Risk Financing Strategy (DRFS) is under preparation, aimed at establishing a comprehensive and sustainable framework to mitigate the fiscal impact of disasters and strengthen the Province's financial resilience against climate-related and natural hazard risks.

6. PUBLIC PRIVATE PARTNERSHIP

The Government of Khyber Pakhtunkhwa has increasingly expanded the use of Public-Private Partnerships (PPPs) across infrastructure, health, and education sectors to mobilize private investment and improve service delivery.

In the infrastructure sector, major PPP transport projects such as Swat Motorway Phase II and the proposed Peshawar–Dera Ismail Khan Motorway under a BOT model involve large-scale financing creating potential contingent liabilities linked to guarantees and contractual commitments. In the health sector, the outsourcing of 72 hospitals along with diagnostic services (MRI/CT scans) across multiple facilities under the Khyber Pakhtunkhwa Health Foundation entails substantial recurring government payment obligations and performance-based commitments. In the education sector, around 1,500 underperforming schools are being outsourced under a two-year PPP framework, with quarterly payments to private operators that introduce medium-term recurrent fiscal pressures.

While these arrangements have supported development outcomes, they also generate significant contingent fiscal risks through government guarantees (including Standby Letters of Credit), Viability Gap Funding, and potential obligations arising from force majeure events, demand shortfalls, or underperformance.

Table 5: List of major PPP projects

| Sector | No. of Projects | Key Projects |
|---------------------------------------|-----------------|---|
| Road Infrastructure | 4 | Swat Motorway Phase -II; Peshawar -D.I. Khan Motorway; Hakla -D.I. Khan Link Road; Dir Motorway |
| Tourism | 3 | Thandiani Tourism Project; Ganool ITZ; Buyun Ski Resort Kalam |
| Industrial Development | 1 | Economic Zone in Daraban |
| Transport / Logistics | 2 | Trucking Terminals; EV Buses |
| Forest / Climate / Wildlife | 3 | Safari Park; Carbon Removal through Reforestation; related forestry/climate initiatives |
| Livestock | 1 | Harichand Dairy Farm Modernization |
| Urban Development / Commercial Assets | 3 | New Peshawar Valley; PDA Projects; Nishtarabad Heights |
| Municipal Services / Waste Management | 1 | CCCL MSW/RDF Project |

6.1. Risk Mitigation in PPP's

The Government of Khyber Pakhtunkhwa has established a comprehensive institutional and legal framework to manage fiscal risks arising from Public-Private Partnerships (PPPs). This framework is anchored in the Khyber Pakhtunkhwa PPP Act 2020, which strengthened the earlier 2017 legislation to create a more enabling and structured environment for PPPs. A dedicated PPP Unit within the Planning and Development Department, along with PPP Nodes in line departments acting as contracting authorities, provides project-level oversight, ensuring systematic appraisal, approval, and monitoring of PPP transactions and associated fiscal exposures.

To further mitigate fiscal risks, the government has introduced targeted financial and risk management instruments. Viability Gap Funding (VGF) is used to enhance the commercial viability of priority infrastructure projects by bridging financing gaps, as demonstrated in the Swat Motorway Phase II through its SPV-based financial closure. In addition, Standby Letters of Credit (SBLCs) and KIBOR-linked protections are applied to manage cost overruns and interest rate risks, thereby improving project bankability. These measures are reinforced by PPP Risk Management Guidelines, which establish standardized principles for risk allocation, disclosure, and monitoring of contingent liabilities to ensure fiscal sustainability.

7. CHALLENGES IN MANAGING PUBLIC SECTOR ENTITIES (PSEs)

In Khyber Pakhtunkhwa, a total of 185 Public Sector Entities (PSEs) and Autonomous Bodies (ABs) operate under various provincial government departments. These entities have been established to enhance public service delivery through efficient, effective, and cost-conscious management of resources. While some entities undertake commercial and revenue-generating activities, others perform regulatory, developmental, social, or administrative functions with varying degrees of operational autonomy. Collectively, they play a vital role in implementing government policies, delivering essential public services, and ensuring the prudent management and utilization of public assets and resources across the province.

7.1. Public Sector Entities in Khyber Pakhtunkhwa

There are 13 Public Sector Companies (PSCs), while the remaining are Autonomous Bodies (ABs), including Medical Teaching Institutions (MTIs), schools, universities, and other statutory organizations. Although the PSCs were established to undertake commercial and revenue-generating activities, many do not operate on a full cost-recovery basis and continue to rely on government support. Among 13 PSCs, there are 7 Water and Sanitation Services Companies (WSSCs), which provide municipal water supply, sanitation, and waste management services across various districts of the province.

PSCs and Autonomous Bodies receive budgetary allocations from the provincial government to finance operational expenditures and address revenue shortfalls where necessary. Funding requests are initially reviewed and endorsed by the respective line departments before being submitted to the Finance Department for consideration and release of funds. Expenditure approvals and oversight responsibilities rest with the administrative department concerned, under the authority of the respective Secretary of the line department, in accordance with applicable financial and administrative regulations.

7.2. Key Fiscal Risks Associated with Public Sector Entities

A key factor contributing to the financial shortfalls of Public Sector Companies (PSCs) and Autonomous Bodies (ABs) is the provision of essential public services at government-mandated tariffs and user charges that are often set below the actual cost of service delivery. This is particularly evident in almost all services provided by the Government, sectors such as municipal services, water and sanitation, healthcare, transport and education, where affordability considerations frequently take precedence over cost recovery. As a result, many entities are unable to generate sufficient revenues to fully cover their operational and maintenance expenditures, creating a recurring dependence on government budgetary support.

In addition to financial sustainability challenges, several Autonomous Bodies face governance and oversight weaknesses that may give rise to fiscal risks. These challenges include limited transparency in financial and operational reporting, inadequate monitoring and performance evaluation mechanisms, weak governance structures, and inconsistent public disclosure practices. The relatively autonomous nature of these entities can, in some cases, reduce the effectiveness of government oversight and accountability arrangements, increasing the risk of operational inefficiencies, financial mismanagement, and unforeseen liabilities for the provincial government.

7.2.1. Governance Issues and limited Monitoring

The Corporate Governance Unit (CGU) was established within the Finance Department in 2019 to strengthen the governance, oversight, and performance of Public Sector Companies (PSCs) and Autonomous Bodies (ABs) in Khyber Pakhtunkhwa. The Unit's mandate encompasses the development of corporate governance and ownership policy frameworks, enhancement of board effectiveness, monitoring of compliance with governance standards, identification of efficiency gains and revenue-enhancement opportunities, and oversight of the financial and operational performance of provincial entities.

Despite its strategic role, the CGU faces significant institutional constraints that limit its effectiveness. The Unit remains understaffed and lacks adequate enforcement powers to ensure compliance with established governance frameworks and directives. Consequently, adherence to prescribed policies and reporting requirements remains inconsistent across entities. A notable governance challenge is the limited implementation of the approved board appointment framework, resulting in appointments that do not always fully align with principles of merit, transparency, competency-based selection, and independence. These weaknesses undermine board effectiveness and reduce the overall accountability and performance of public sector entities.

7.3. Risk Mitigation Strategy for PSEs

7.3.1. Integrated Portal for the Management of PSEs

The Finance Department designed an Integrated Information Portal titled "Governance, Finance & Compliance." The portal was 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.

However, with very limited participation from the PSCs and Autonomous Bodies on the Information Portal, the database still remains small and timely availability of data remains challenging. However, efforts are underway to ensure compliance across all PSEs.

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

During FY2025-26, KP Finance Department established Cash Flow Management Unit (CFMU) with major task for the implementation of Treasury Single Account (TSA) framework in KP. Under this framework, government cash balances maintained across multiple bank accounts by departments, autonomous bodies, projects, and Drawing & Disbursing Officers (DDOs) are being consolidated under a centralized treasury structure. During the year, bank account data of provincial departments/authorities was collected, compiled, mapped in terms of departments, authorities, DDOs, banks. All provincial departments/authorities were given direction/instructions on daily sweeping, closure of dormant accounts and cash management plans. Trainings of DDOs of pilot departments were started and policy documents related to designated bank accounts, rationalization of bank accounts, daily sweeping mechanism, closure of dormant/inactive accounts were prepared. Meetings were also held with commercial banks on TSA implementation and they were made aware of their role in the process.

CONCLUSION

The fiscal outlook for FY2025-26 remains broadly stable; however, significant risks persist from dependence on federal transfers, rising pension obligations, climate-related shocks, and potential liabilities from public sector entities and infrastructure projects. The Government of Khyber Pakhtunkhwa is committed to proactively identifying, monitoring, and mitigating these risks through strengthened fiscal governance, enhanced transparency, and institutional reforms. The publication of this Fiscal Risk Statement represents an important step toward improving fiscal sustainability and supporting sound public financial management in the Province.

ANNEXURE

IMPACT ON BUDGET EXECUTION IN KHYBER PAKHTUNKHWA

| Risk Factor | Key Indicator(s) | Fiscal Impact on KP |
|-------------------------------------|--|---|
| Federal Transfer Risk | FBR tax collection, NFC releases, Federal fiscal deficit | Reduction or delay in federal transfers may create cash shortages, constrain budget execution, delayed salaries and pension payments, and reduce development spending. |
| Inflation Risk | CPI Inflation, Core Inflation, Construction Cost Index | Increases salary, pension, procurement, utility, and project costs, leading to expenditure overruns and supplementary budget requirements. |
| Interest Rate Risk | SBP Policy Rate, Treasury Bill Yields | Higher rates lead to jump in debt servicing costs thus putting pressure on NFC distribution (high fiscal deficit). However, it leads to improve returns on provincial deposits and investments. |
| Exchange Rate Risk | PKR/USD Exchange Rate, Foreign Exchange Reserves | Depreciation of Rupee has seriously negative impact on fiscal side (more rupee needed to repay old Dollar loans). Depreciation increases costs of planned/approved infrastructure projects leading to delays in implementation. |
| Economic Growth Risk | GDP Growth, Industrial Production, Investment Trends | Lower economic activity reduces federal tax revenues and NFC transfers while increasing pressure on social spending. |
| Energy Sector Risk | Electricity Tariffs, Fuel Prices, Circular Debt | Increases operating costs of government departments, hospitals, schools, transport fleets, and public sector entities. |
| Pension Liability Risk | Pension Expenditure Growth, Pension -to- Revenue Ratio | Rise in pension obligations crowds out development expenditure and reduces fiscal flexibility. |
| Climate & Disaster Risk | Flood Events, Disaster Damage Assessments | Requires emergency spending, rehabilitation costs, and reallocation of development funds. |
| Security Risk | Security Incidents, Law & Order Expenditure | Increases policing and security expenditures while discouraging investment and economic activity. |
| Banking & Liquidity Risk | Idle Cash Balances, TSA Coverage Ratio | Fragmented government cash holdings reduce liquidity efficiency, increase borrowing needs, and weaken fiscal control. |

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