SECURING PAKISTAN'S ECONOMY IN THE FACE OF GULF ENERGY DISRUPTIONS

PRIME ECONOMIC THINK TANK

Prime Brief

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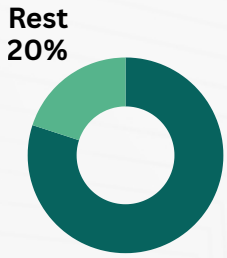
Overview

Pakistan faces significant economic risks from the ongoing Gulf energy disruptions, exposed due to the structural vulnerabilities, particularly its dependence on imported energy and Gulf-linked remittances. To lessen the external vulnerability, short-term crisis management should be complemented with medium-to long-term structural change. The crisis transmits to Pakistan mainly through imported fuel prices, freight and insurance costs, pressure on the current account, inflation spillovers, and fiscal strain if the state tries to suppress pass-through.

Recommendations

- Adjust prices from once a week to twice a week.
- Plan household sector energy needs around solar
- Fasten pace of CTBCM adoption and expand to cover 50% of industrial energy consumption by 6-12 months
- Position Pakistan as a preferred flag carrier, and adjust rules accordingly
- Reignite Iran oil imports and consider revival of Iran-Pak Gas Pipeline
- Open up private credit to enable technology transition at the household consumer level.

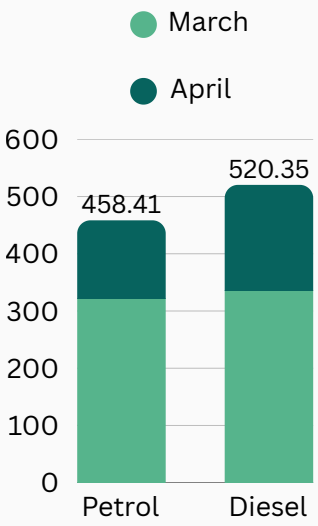


Pakistan imports nearly 80% of its energy from the Gulf

Strait of Hormuz

Introduction

Pakistan faces significant economic risks from the ongoing Gulf energy disruptions, manifested in rising oil prices, external account pressures, inflation, and fiscal strain. Despite relative macroeconomic stability, Pakistan remains exposed due to the structural vulnerabilities, particularly its dependence on imported energy and Gulf-linked remittances. In this context, recent directions by Prime Minister Shehbaz Sharif to formulate a comprehensive strategy to mitigate the economic impact of the evolving regional situation underscore the urgency of a coordinated policy response. The ongoing regional war necessitates a carefully developed policy response that maintains macroeconomic stability, avoids distortionary subsidies, and accelerates energy sector reforms. The government's recent decision to raise petrol prices to Rs 458.4 per litre and high-speed diesel to Rs 520.35 per litre reflects a commitment to cost-reflective, market-based pricing, aligning with the recommendations from institutions, including Prime Institute, that fuel prices should be cost-reflective and market-based. This policy brief is a direct response to that call, outlining a set of targeted measures to manage immediate risk while complementing short-term crisis management with long-term structural reforms aimed at reducing external vulnerability.



Fuel Price Increase in Pakistan

Economic Exposure & Risk Channels

The crisis transmits to Pakistan mainly through imported fuel prices, freight and insurance costs, pressure on the current account, inflation spillovers, and fiscal strain if the state tries to suppress pass-through.

1. **External Sector Pressures**
    - Rising global oil prices directly inflate the import bill, with crude exceeding $110/barrel at peak levels.
    - Pakistan imports nearly 80% of its energy from the Gulf, creating it structurally exposed to any Gulf supply disruption.
    - Pakistan faces significant monthly economic exposure from the ongoing Gulf energy disruptions, with potential impacts on exports, remittances, oil import costs, and shipping and aviation sectors.
2. **Remittances and Labour Market Risks**

Over 54% of Pakistan's $38.3 billion remittances originate from GCC economies.

    - A slowdown in Gulf construction and transportation sectors could significantly weaken inflows, with no protection from maritime arrangements.

3. **Inflationary Pressures**
    - Diesel prices increase freight and agricultural costs.
    - Spillovers into food inflation are likely, particularly during the wheat harvest cycle.
    - Non-price costs (logistics, delays, insurance) further amplify inflation.
4. **Fiscal and Debt Vulnerabilities**
    - Petroleum-related levies remain a key revenue source.
    - Any attempt to suppress price pass-through through subsidies would increase fiscal deficits and undermine IMF programme commitments.
    - External debt servicing and reserve constraints heighten sensitivity to oil shocks.
5. **Energy Security Constraints**

Pakistan maintains only ~20 days of strategic fuel reserves, limiting its ability to absorb supply disruptions.

    - A temporary diplomatic arrangement allowing Pakistani vessels through the Strait of Hormuz reduces immediate risk but remains fragile and reversible.

Policy Response Options

The following policy measures outline how Pakistan can manage immediate energy shocks while strengthening resilience in the medium and long term.

Immediate Measures to be taken

1. **Cost-reflective energy pricing:** Domestic Fuel prices should be reflective of international price changes, and price changes should be made even fast, from weekly to twice a week as delayed pass-through puts fiscal stress on the government and distorts consumption in the economy. While the IMF program also encourages cost-reflective energy pricing and views broad-based, untargeted subsidies as fiscally inefficient.
2. **Accelerate the managed integration of existing distributed solar into household consumption:** Pakistan should move from treating rooftop and distributed solar as a stand-alone phenomenon toward a planned integration model consisting of technologies such as smart metering, feeder-level balancing, and pilot microgrids for residential clusters and commercial areas. Consumer and indistrual level battery infrastructure, especially Lithium Iron Phosphate LiFePO4 must be made available and any disincentives inhibiting adoption must be identified and removed. This would reduce reliance on imported fuels, improve resilience during external energy shocks, and make better use of capacity that already exists rather than forcing more expensive central generation.
3. **Temporarily reduce or remove duties and taxes on energy-efficient electric alternatives to gas appliances:** In a global fuel shock, Pakistan should lower the cost of switching away from direct gas use by easing import and sales taxes on efficient alternatives such as electric geysers, induction stoves, heat-pump or efficient electric water-heating systems, and space-heating substitutes where feasible.

4. **Remove any restrictions on the scale of CTBCM and aggressively expand ambit beyond the current 800 MW auction quantum:** NEPRA's 2026 wheeling auction guidelines currently limits the aggregate wheeling quantum to 800MW. The government must immediately remove this limit and allow the expansion of CTBCM to cover at least 50% of total industrial consumption within the next 12 months.
5. **Energy pricing & consumer protection:** Avoid blanket fuel subsidies — deploy targeted cash transfers via BISP to protect the bottom two income quintiles while passing through international prices to industrial and commercial consumers to preserve fiscal space and IMF compatibility.
6. **Exchange rate & monetary policy** cannot solve a supply shock, but they must stop it from becoming a credibility crisis. That means allowing measured adjustment, avoiding panic distortions in the FX market, preserving reserves, and preventing a temporary energy shock from feeding into generalized inflation expectations.

every $5/Barrel rise in oil prices costs Pakistan $800M Annually in import costs, so the rate path must be explicitly conditioned on the oil price trajectory.

7. **Establish a market-based financing framework for transitioning to electric vehicles, consumer appliances and batteries:** While existing subsidised credit schemes provide some relief, there is a need for a comprehensive banking loan facility that allows households and businesses to transition to electric vehicles , battery and storage technologies, without relying solely on government subsidies. Such a framework would expand access, improve affordability, and accelerate adoption, supporting both energy security and emissions reduction goals. Loans could be structured with competitive interest rates, longer tenors, and flexible repayment options to cover a broader population and encourage large-scale uptake.
8. **Pakistan as a Preferred Flag Carrier:** Pakistan should re-examine its shipping and flagging regulations to explore opportunities to extend services to third-party vessels, ensuring its framework is competitive and at par with other major registries such as Panama and Liberia. This would allow the country to capitalise on increased demand for secure transit through the Strait of Hormuz and potentially generate additional economic and strategic gains.

Long-Term Reforms

1. **Reduce dependence on imported fuels:** Immediate reexamination of E&P framework, and strengthen to improve upstream investment ecosystem in indigenous fossil fuels, especially petroleum. Pakistan should prioritise a gradual but sustained reduction in its reliance on imported energy by also accelerating renewable energy deployment and promoting electrification where it is economically efficient. The power sector already uses coal and nuclear energy, with around 69.7% of coal consumption serving power generation and over 35,000 MW of nuclear capacity providing stable electricity. However, a significant portion of coal is being imported, underscoring the need to expand the indigenous energy production, diversify the energy mix, and strengthen renewables. At the same time, targeted electrification, particularly in transport, heating, and industrial processes where feasible, can shift demand away from imported fuels. These measures, while gradual in impact, are critical for reducing

structural vulnerabilities in the external account.

2. **Advance politically difficult power sector reforms:** The current crisis provides a window to fast-track long-pending structural reforms in the power sector. This includes reducing system losses across distribution companies, expediting settlement, cancellation, or renegotiating of legacy power purchase contracts, and strengthening governance and regulatory oversight. A clear, time-bound reform roadmap can help anchor expectations and build policy credibility.
3. **Reduce public expenditure and reform state-owned enterprises (SOEs):** Pakistan should significantly reduce fiscal pressures by accelerating reforms in state-owned enterprises, particularly through a credible and transparent privatisation programme. Loss-making SOEs continue to impose a substantial burden on public finances, crowding out productive expenditure. Streamlining public spending, improving SOE governance, and divesting from commercially viable entities can create fiscal space, enhance efficiency, and support macroeconomic stability over the long term.
4. **Develop a mechanism to expand trade with Iran,** especially with a view to purchasing fossil fuels from Iran, and consider restarting the Iran–Pakistan gas pipeline: Pakistan should evaluate the potential for importing energy resources from Iran as part of a broader strategy to diversify supply sources.

Conclusion

Pakistan's exposure to a Gulf energy shock is both immediate and structural. While short-term diplomatic and logistical measures can mitigate disruption, the underlying vulnerabilities of energy dependence, fiscal sensitivity, and external sector fragility require sustained reform. The current crisis should be treated not only as a risk, but as a policy window to accelerate long-overdue energy and macroeconomic reforms.

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