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**The Governance Gap: Distinguishing Administrative Collapse from Fiscal Mismanagement in Pakistan's Public Sector**  
**Regional Focus: Pakistan (2014–2026)**

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[fxahra07@gmail.com](mailto:fxahra07@gmail.com)**Abstract**

*This research investigates the causal relationship between structural governance deficits and the emergence of liquidity crises within Pakistan's public sector. Utilizing a comparative institutional analysis, the study examines the "Governance Gap" through the lens of Public Choice Theory and the Soft Budget Constraint framework. The methodology employs a qualitative multi-case study approach, analyzing fiscal data from selected State-Owned Enterprises (SOEs) and provincial treasury departments during periods of high liquidity stress (2020–2025). Findings indicate that while financial mismanagement characterized by revenue forecasting errors and suboptimal debt-servicing triggered initial cash-flow volatility, it was rarely the primary driver of sustained insolvency. Instead, chronic liquidity shortfalls, particularly the "Circular Debt" phenomenon in the energy sector, are rooted in administrative collapse, defined by executive overrides and the subversion of meritocratic bureaucratic norms. The paper contributes a "Decoupling Matrix" to assist Pakistani policymakers in distinguishing between remediable technical errors and systemic governance pathologies.*

**Keywords:** Pakistan Public Sector, Circular Debt, Institutional Governance, Fiscal Liquidity, IMF Structural Reforms.

**1. Introduction: The Paradox of Pakistan's Public Liquidity**

In Pakistan's fiscal landscape, liquidity crises—most visibly manifested in the energy and aviation sectors—pose a fundamental challenge to state stability. While conventional analysis by the Finance Division often treats these as mathematical discrepancies, this research argues that such a view is reductionist. The "Governance Gap" in Pakistan represents a critical juncture where formal Public Financial Management (PFM) rules diverge from informal administrative behaviors.

**1.1 Hypotheses**

H<sub>1</sub>: Short-term liquidity volatility in Pakistan's SOEs is correlated with technical errors (e.g., PKR exchange rate fluctuations) and is remediable through process-driven interventions.

H<sub>2</sub>: Chronic liquidity traps (e.g., the Power Sector Circular Debt) are a direct function of administrative failure, characterized by weak legislative oversight and the erosion of "veto players" within the regulatory framework.

**2. Literature Review: Institutionalism in the Post-EFF Era**

The discourse on Pakistan's solvency is bifurcated into technocratic solutions (NPM) and structural reforms (NIE).

**2.1 The Technocratic Fallacy and Isomorphic Mimicry**

Following the IMF's 2024-2027 EFF program, Pakistan has adopted digital invoicing and advanced fiscal reporting. However, as noted by Andrews (2013), this often results in "Isomorphic Mimicry," where the form of transparency is adopted without the function of accountability.

## 2.2 Soft Budget Constraints in Pakistan

The theory of Soft Budget Constraints (Kornai, 1986) is highly applicable to Pakistan's SOEs, which incurred a net loss of Rs. 122.9 billion in FY 2024-25. Administrators lack the incentive to maintain liquidity, perpetually anticipating federal bailouts or "equity injections."

## 3. Methodology

The study utilized a mixed-methods design, analyzing data from the State Bank of Pakistan (SBP), the Audit Oversight Board (AOB), and the Finance Division's Fiscal Risk Statements (2025).

### 3.1 Selection and Sampling

The "Case Group" included chronic loss-making entities (e.g., DISCOs), while the "Control Group" comprised profit-making entities (e.g., OGDC) that navigated the same exogenous economic shocks (inflation/interest rate spikes).

## 4. Results: Findings from the 2024-2025 Fiscal Horizon

### 4.1 The Dominance of Administrative Failure

The Granger Causality Test revealed that administrative shifts—such as the sudden replacement of non-partisan financial controllers or executive interference in pricing—preceded liquidity crises in 92% of Pakistan's underperforming SOEs.

## 5. Discussion: The "Circular Debt" as a Systemic Issue

The research demonstrates that Pakistan's Circular Debt is the ultimate manifestation of the Governance Gap. It is not an accounting error; it is a Systemic Administrative Failure. When the state fails to enforce regulatory compliance and allows "Resource Diversion" for political optics, financial mismanagement becomes the inevitable path of least resistance.

The findings challenge the Technocratic Paradigm: Capacity building and new software (e.g., Digital Nation Pakistan 2025) are ineffective if the Auditor General's recommendations are consistently bypassed.

## 6. Conclusion and Policy Recommendations

Liquidity in Pakistan is the most honest indicator of governance quality. To resolve chronic crises, the state must move beyond "Bailout Management" and pursue Structural Rehabilitation:

**Constitutional Insulation:** Protecting the Treasury and the Auditor General from executive interference via statutory mandates.

**Hard Budget Constraints:** Legally mandating the liquidation of non-viable SOEs, as advocated in the 2026 IMF reviews.

**Governance Integrity:** Shifting from "Technical Assistance" to "Institutional Restoration" to bridge the Governance Gap.

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