

QUALITATIVE ANALYSIS OF THE EXTERNAL DEBTS IN PAKISTAN

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ABSTRACT

This study was conducted to evaluate the objectives of external debts, the trend in external debts, and factors influencing debt in Pakistan. Obviously external debt is risky for economic development in both developed and developing countries but the developing countries are more prone to suffer as compared with developed countries. Developing countries are facing the problems of capital scarcity, low saving, traditional technology, poor education and lack of resources for economic development. The analysis shows that total external debt of Pakistan would touched US\$ 41.2 billion by the end of fiscal year 2008-09, it would also increase to US\$ 43.152 billion in the fiscal year 2009-10, and US\$ 44.904 billion by the end of fiscal year 2010-2011 and further expected to increase to US\$ 46.571 billion by the end of fiscal year 2011-12 because of the growing inflationary spiral in the national as well as international markets. The main sources of loan for Pakistan are bilateral creditors i.e., group of 20 rich countries, multilateral creditors globally known financial institutions, and others are friends, neighboring countries and trade partners etc. This study suggest some essential measure in order to solve the burning debt issues including; simplicity and austerity in all walks of life which needs to be adopted from top level to bottom, and luxurious consumption oriented imports needs to be curtailed and growth of income and investment level to raise per capita income and aggregate supply of goods and services and propensity of saving in the country. Though expenditure on defence is inevitable but it should be appropriated and foreign direct investment inflows should be encouraged.

Keywords: External Debt, Economic Development, Pakistan

INTRODUCTION

A very famous saying of Marcus (106-43 BC) is that "The budget should be balanced. Public debt should be reduced. The arrogance of officialdom should be tempered, and assistance to foreign lands should be curtailed, lest Rome become bankrupt".

Generally that the debt is considered unwanted in most all of the developing countries. Developed countries have the potential to deal with debts, but developing countries mostly face dangling situation. A question arises that how countries tangled in the vicious circle of debt? Simply those having lack of capital, and dependent on traditional technology, conventional education, low saving, poor investment and lack of relevant resources required for economic development. Many such countries add debt whenever they involved in budget deficit. The problem of public debt in Pakistan is very grave and is almost of similar nature. Notwithstanding Pakistan's external debt may increases because of misuse of loans, and many developmental projects remained uncompleted due to political instability and frequent changes in governments policies because each new government plan their new projects and new policies further over burden the economy. Pakistan's population increases very rapidly and therefore demand in-

creases. Pakistan is not self sufficient in food stuffs and even import wheat from abroad. Strong defence is imperative for a country but spending of huge amount on defence increases external debt further. According to Khan (2007), the economic status of Pakistan is very unsafe with unsustainable external debt. Pakistan has been unsuccessful in controlling a balance between expenditure and revenue. This issue is really a matter of concern to the general public of Pakistan and requires some clear elucidation in a simple language understandable to everyone (Hussain 1999-2002). Therefore it is vital to determine the level of debt, its historical consequences, the policy developed to deal with the outcome achieved so far and the proceedings being considered in the future. To mention such policies through which Pakistan's debt services commitments in future can be fulfilled from its own foreign exchange earnings, without accommodating any kind of financial help from the International Monetary Fund and no future rescheduling by the bilateral, multilateral and other creditors. Both external and internal factors sternly affect the debt of a country. An internal factors include resource endowment, economic structure, social and political organizations, domestic policy performance and economic management practices while external factors include terms of trade, external capital flows, natural disasters and man-

made disasters such as civil or inter-country wars (Hussain, 2004). Further A. Khan (1997) has very rightly analyzed that in most of the developing countries, the external debts have very rarely appropriately and productively been utilized. It is obvious that public debts have adverse effects and impedes economic development but on the other hand public debt is an important mean of financing government deficit budget. Efficient utilization of public debt can promote economic growth and facilitate to improve socio-economic welfare of the society. But it has also been observed that public debt works like a double-edged sword. Too much dependence on external debt enlarges macroeconomic risks, obstructs economic growth, and hinders economic development.

OBJECTIVES OF THE STUDY

The main objective of the study to know about the growing trend of debt in Pakistan, and also to know about sources of loans and the impact of debt on economic development and to sort out those factors, which are influencing debt in Pakistan.

TREND IN EXTERNAL DEBT IN PAKISTAN

Pakistan’s total external debt estimated US\$ 37.461 billion during 2006-07, which was US\$ 35.679 billion in 2005-06, and reached US\$ 39.593 billion during 2007-08. Ministry of finance planned to reduce external debt as per export exports ratio from 175.2 percent in the fiscal 2007-08 to 143.4 percent by the end of fiscal year 2011-12. Both International Monetary Fund and ministry of finance brought down external debt to the exports ratio to 220.5 percent in fiscal year 2003-04 which was 243.9 percent in the fiscal year 2002-03. This ratio further reduced to 191.2 percent, 175.6 percent and 176.7 percent in the fiscal year 2004-05, 2005-06, and in 2006-07 respectively. According to the latest evidences, external debt reached to US\$ 41.2 billion in 2008-09, it would further increase to US\$ 43.152 billion and US\$ 44.904 billion in 2009-10 and in 2010-2011 respectively. It is anticipated that external debt would touch US\$ 46.571 billion in 2011-12. Debt stabilization projection and estimates developed by the said authorities disclosed that without interest payments Pakistan’s baseline external debt should be brought down to US\$ 20.2 billion in 2011-12 from US\$ 24.4 billion in 2007-08. It has noticed that total public debt is planned to reduce to 42.2 percent of the GDP in 2011-12 from 51.3 percent of the GDP in 2007-08. Total government debt was 57.3 percent, 54.6 percent and 51.3 percent of the GDP in

2005-06, 2006-07 and in 2007-08 respectively. New protrusions disclose that total government debt to GDP ratio to be 48.8 percent, 46.2 percent, 44 percent and 42.2 percent of the GDP in 2008-09, 2009-2010, 2010-11 and in 2011-12 respectively. In addition, recently in March 2008 China has granted US\$ 500 million loan to help Pakistan on the issue of balance of payments. The details of the total external liabilities are given in table-I. Moreover, according to the survey of World Fact Book (2008), in total 203 countries of the world, Pakistan rank 52 in external debt and USA and UK are in rank 1 and 2 respectively, which further explore growing trend of external debts of Pakistan.

Obviously debt situation in the decade of 1990s was one of the most horrible in the history of Pakistan. Political instability and foreign sanctions enforced after the nuclear blast in 1998 decline Pakistan’s economic position and was nearly to become defaulter. Total public debt in 1990 was US\$ 19.2 billion and reached to US\$ 33.5 billion in 1999 showing about 75 percent increase in nine years. Total external debt shows consistent increasing trend except in 2000 and in 2001, where total external debt reduced to US\$ 32.196 billion and US\$ 32.144 billion respectively. Foreign exchange liabilities were US\$ 1.3 billion during 1990, regular increase for the three consecutive years reached the debts burden to US\$ 5.015 billion in 2001. In 2002 foreign exchange liabilities trim down to US\$ 3.312 billion, this decreasing trend continued up to 2007 where foreign exchange liabilities reached to US\$ 1.502 billion (see figure 1).

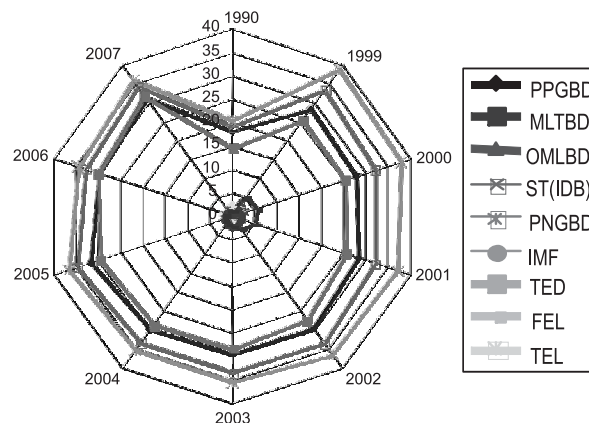


Fig. 1: Over all Debt Position

Source: Based on data taken from Economic Survey of Pakistan (2007-08)

Table-I: External Liabilities of Pakistan (US\$ Billion)

Debt/Years	1990	1999	2000	2001	2002	2003	2004	2005	2006	2007
Total External Liabilities	20.9	38.9	37.86	37.16	36.53	35.47	35.26	35.834	37.241	38.86

Source: Economic Survey of Pakistan (2007-08)

Public and privately granted debt is the main component of the total external debt. This component shows increasing trend since 1990 except in 2000, where it has slightly reduced. In 1990 Public and privately granted debt was US\$18.2 billion and reached to US\$ 28.3 billion in 1999, showing 55percent increase in period of nine years. Such as, during 2000, public and privately granted debt reduced to US\$ 27.80 billion, showing 1.77percent reduction from previous level. After that, public and publicly granted debt continuously increased up to 2007. In 2007 the public and privately granted debt reached to US\$ 31.084 billion (see figure 1).

In 2000 a committee called Debt Reduction and Management Committee (DRMC) was established by the Government of Pakistan, soon after Mr. Pervaiz Musharraf took over powers as a chief executive, to manage the problems of external and domestic debt. After 1999 total public debt shows continuous decreasing trend except in 2001 and 2004 where it reflects light increasing trend. Though total external debt decreased from 51.7 percent of GDP in 1999 to 27.1 percent of GDP in 2007, showing total decrease of approximately 47.58percent in seven years (Economic Survey of Pakistan (2007-08).

The data analysis shows that, external debt and liabilities were 51.7 percent as a percentage of GDP in 1999-00. It increased in 2000-01 and reached to 52.1 percent, after that continuously decreasing. It decreased to 51 percent, 43.1 percent, 36.7 percent, 32.7 percent, 29.4 percent, and 27.1 percent in 2001-02, 2002-03, 2003-04, 2004-05, 2005-06 and 2006-07 respectively as depicted in figure-2.



Fig. 2: External Debt & Liabilities as % GDP

Source: Based on data taken from Economic Survey of Pakistan (2007-08)

It further shows that external debts and liabilities were 297.3 percent as a percentage of foreign exchange earning in 1999-00. This ratio gradually decreased in a

Fig. 3: External Debt & Liabilities as % FEE
Source: Economic Survey of Pakistan (2007-08)

stretch for seven years. It decreased to 259.5 percent, 236.8 percent, 181.2 percent, 164.6 percent, 134.3 percent, 120.1 percent and 119.7 percent in 2000-01, 2001-02, 2002-03, 2003-04, 2004-05, 2005-06 and 2006-07 respectively as depicted in figure-3.

EXTERNAL DEBT AND DEVELOPING COUNTRIES

Applying the analysis most of the developing countries entrapped in vicious circle of external debts. Not only developing countries but also developed countries like America total federal debt were recorded as US\$ 9.5 trillion in April 2008. Debt problem has moved to go ahead because external debt is reaching the dangerous level in Asian, African and Latin American countries as explored by Dornbusch and Draghi, (1992). Some of these countries have debt to GDP ratio hundred percent or more. During the last decades, developing countries of the world have accumulated great amounts of external debt often at low interest rates. It was expected that these external debts would help in increasing the momentum of development because of high investment and rapid growth. In 1980s, debt burden reached to very high level and it become impossible for heavily indebted developing countries to pay back all their debts. Thus, in 1980s, several middle-income countries specifically Latin American faced severe debt crises, and in mid 1990s, the IMF and the World Bank started the Heavily Indebted Poor Countries (HIPC) plan to bring down the level of debt of low-income countries to an affordable level (Pattillo et. al., 2002)

SOURCES OF EXTERNAL DEBT FOR PAKISTAN

Poor countries are borrowing from a number of sources, including internal sources like the Central Bank, Domestic Commercial Banks, Domestic Non-Banking

Sectors, and external sources like Paris Club Countries, Non Paris Club Countries and multilateral like ADB, IBRD. Borrowing from different sources has different insinuation. Borrowing directly from central banks means printing money, which results in monetary expansion. This practice is thus highly inflationary and generally discouraged. Borrowing from domestic commercial banks is less inflationary, but it may crowd out private investment. Government borrowing from the non-banking sectors has no effect on the money supply and hence no implications for interest rates and inflation from the supply side. However, the debt held by people can exercise an upward pressure on interest rates from the demand side. Siddiqui and Malik (2002) found that foreign borrowing increased resource availability and contributed to economic growth in South Asia. However, unnecessary foreign borrowing and its improper utilization generate stern debt service obligations and can hold back economic development and growth.

- **Bilateral Creditors**

It is a group of a few rich countries ranging from 15 to 20 of the world including Australia, Austria, Belgium, Canada, Finland, Denmark, France, Japan, Korea, Netherlands, Norway, Russia, Spain, Sweden, Switzerland, UK & USA which provide loan to needy countries. These rich countries provided almost US\$ 14 billion until 2005 to Pakistan.

- **Multilateral Creditors**

These are world wide known Financial Institutions such as Asian Development Bank (ADB), International Monetary Fund (IMF), World Bank and its branches including International Bank for Re-construction & Development (IBRD), International Development Association (IDB), International Fund for Agriculture Development (IFAD), European Investment Bank (EIB), Commonwealth Development Corporation (CDC) etc.

- **Others**

Apart from these main sources of loan, needy and developing countries of the world also contact to neighboring countries, friends and other countries having close trade relations with in the region to get loans. Pakistan has taken loans from Bahrain, China, Czechoslovakia, Kuwait, Libya, Oman, Qatar, Romania, Saudi Arabia, Turkey and UAE respectively.

CONCLUSION AND RECOMMENDATIONS

This study has been conducted with broad objectives to study the external debt burden of Pakistan. In fact, inappropriate utilization of external debt is believed to have negative impacts on the economic development of a country. According to the careful observations hold in this study, the total external debt of Pakistan would reach US\$ 41.2 billion in 2008-09, and it would further increase to US\$ 43.152 billion in 2009-10, and similarly it would increase to US\$ 44.904 billion in 2010-2011. It

is anticipated that gradually the debt would touch US\$ 46.571 billion in 2011-12. In addition, due rise in oil prices and dollar value, it looks that the external debts will increase more sharply. The main sources of loan for Pakistan are bilateral creditors i.e., group of 20 rich countries, multilateral creditors globally known financial institutions, and others like friends, neighboring countries and trade partners etc have made excess to such debts quite relaxed for most of the developing countries.

However, it is needed to curtail our luxurious and unproductive spending of the external loans. Further A. Khan (1997) has rightly pointed out that it seems essential to control inflation and unemployment to raise domestic saving ratio for the generation of capital formation to reduce the burden of foreign loans and to increase internal investment in different sectors of the economy.

In this study it has further been observed that poor countries go for the external debts due to lack of capital, old-fashioned technology, low education, meager saving, low income and investment level. For the downfall of debt, the authorities should adopt the following measures;

- i. Proper and productive utilization of loan should be made.
- ii. Simplicity and soberness should be adopted from top to bottom level.
- iii. Luxurious consumption oriented imports should be curtailed.
- iv. Expenditure on defence needs to be appropriate.
- v. Agriculture sector be facilitated more, in order to promote export.
- vi. Foreign direct investment inflows should be encouraged.
- vii. Political stability and consistency in economic policies be maintained

At last but not least sensible debt management is vital component of macroeconomic stability and economic growth for developing countries. Developing countries have not only to borrow to finance their developmental expenditures but also have to make sure that the borrowed funds are used for productive purposes. For this purpose a vigorous fiscal policy is essential for precluding macroeconomic imbalances

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