

The Problem of External Debt Liabilities Management in Pakistan

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Abstract

The deficit financing has been a distinguishing characteristic of developing economies because of resource constraint. Pakistan has, incidentally, been in a whirlpool of foreign debt since its emergence in 1947. It should have resolved its economic problems by now because of long distance it covered during more than sixty three years but unfortunately the situation has been aggravating with each day passed. The last two decades were, in fact, the loans carrying spans which burdened the economy beyond imagination and if the situation not checked it may endanger its sovereignty. This paper will analyze the various aspects of External Debts Liabilities in context of economic growth achieved during the period and Problems faced by Pakistan in liquidating the external debt liabilities which phenomena has been aggravating the situation persistently. To arrive at a conclusion secondary data available on official record of the Govt. of Pakistan will be preferred for analysis. The data can also be obtained from within Pakistan and also from the lending agencies if necessary.

Key words: *Pakistan Economy, Resource Constraints, Deficit financing, External Debt liabilities, problems of liquidation.*

Methodology: *1. Study and analysis of printed material in the form of Annual Reports of State Bank of Pakistan, Economic Survey of Pakistan, Any other information on External Debt of Pakistan.*

Challenges to Pakistan's Economy

At the time of independence Pakistan had to face the challenges of rapid industrial development in the wake of fast growing industrialization world over In the absence of industrial infrastructure and social overhead capital the country had to initiate the industrialization process from zero point.¹

It, therefore, necessitated following a synchronized growth policy for both agriculture and industry so that both industries may flourish simultaneously. Also to exploit the huge natural resources for use as raw material in the manufacturing process the establishment of industrial base needed import of machinery which required huge amount of foreign exchange. Existing resources at the disposal of the government did not suffice to meet the development needs of the state and consequently the govt. had to resort to borrowing both within and from abroad. Pakistan soon after its establishment started development through a planned process and the First Five Year Plan of the Country was put to operation in 1955. This was the era when regular flow of foreign funds was urgently required for smooth and successful implementation of the Plans. The borrowing was, therefore, allowed to accelerate the process of industrialization.

At the beginning rate of flow of foreign loans/grants remain very low as compared to overall investment. However, with the acceleration in the process of economic development the need for import of Machinery, Raw material and consumption goods like petroleum, chemicals, automobiles, and food stuff began creating huge trade deficits problems. The following table No.1. Reveals that the persistent both trade and current account deficit has been one of the major reasons for accumulation of external debt through out the period.

Components of Balance of Payments (As Percent of GDP)

Table .1

(Average for five years period)

Year	Exports	Imports	Trade Deficit	Worker's Remittances #	Current Account Deficit #
1980---85 average	8.96	18.72	9.74	8.30	3.82%
1985---90 Average	11.28	17.10	5.78	5.94	4.00%
1990---95 Average	13.52	17.80	4.26	3.20	4.54%
1995---00 Average	13.22	16.86	3.64	2.02	4.44%
2001---05	12.94	15.74	2.78	3.50	1.86%
2005---10 Average	11.28	21.12	9.86	3.92	5.10%

Source: FBS, SBP & E.A. Wing, Finance Division

During the period from 1980 to 1985 average trade deficit was Us \$ 9.74 billions which declined to Us \$ 5.78 billions for the period from 1985 to 1990 and then gradually fell to an average of Us \$ 2.78 billions during the five years i.e. 2001 to 2005. However, the period from 2005 to 2010 witnessed the highest average trade deficit of Us \$ 9.86 billions. The status of current account also reveals that the economy has been under pressure during the whole period of twenty years from 1980 to 2000. The current deficit was counted as 3.82 of the GDP for the period 1980 to 1985. It rose to 4.54 for the years 1990 to 1995. It was only during the year 2001-02, 2002-03 and 2003-04 that our current account showed a surplus. Resultantly the average deficit during this period fell to 1.86 of the GDP. Like trade deficit the current account deficit during the five year period from 2005 to 2010 reached the highest peak of an average of 5.10% of the GDP. The continuous deficit in both the trade and current accounts pointing to a critical situation where the only resort left is to look for the foreign assistance. This phenomena caused dual gap and necessitated seeking financial assistance from the multilateral lenders including International Monetary Fund

Table No.2, above reveals the amount borrowed and amount incurred on debt servicing during the period from 1951 to March, 2011.

Table -2

(Amount in Millions Dollars)

Year	Loans/Grants Disbursement			Debt Servicing		
	Loans	Grants	Total	Principal Paid Back	Interest Paid	Total
I. Pre – Plan 1951 – 55					1.0	1.0
Sub-total (I)				--	1.0	1.0
II 1st 5year plan 1955-1956	192	650	842	17.0	15.0	32.0
III. 2nd – Plan 1960 –1965	1232	1162	2394	146.0	73.0	219.0
IV. 3rd – Plan 1965 – 70						
Sub-total (IV)	2324	719	3043	353.0	259.0	612.0
V. Non – Plan 1970 – 78	5083	634	5717	1022.0	941.0	1963.0
Sub-total (V)						
VI. 5th – Plan 1978 – 83	4418	1375	5793	1621.0	1635.0	3256.0
Sub-total (VI)						
VII. 6th – Plan 1983 – 88	5158	2025	7183	2983.0	2379.0	5362.0
Sub-total (VII)						
VIII. 7th – Plan 1988 –93	9540	2541	12081	4128.0	3125.0	7253.0
Sub-total (VIII)						
IX. 8th – Plan 1993 – 98	11522	1226	12748	6861.0	4105.0	10966.0
Sub-total (IX)						
X. Non – Plan 1998 –2005	12596	3142	15738	9515.0	5579.0	15094.0
Sub-total (X)						
Total	52065	13474	65539	26646	18112	44758

Table. 2b

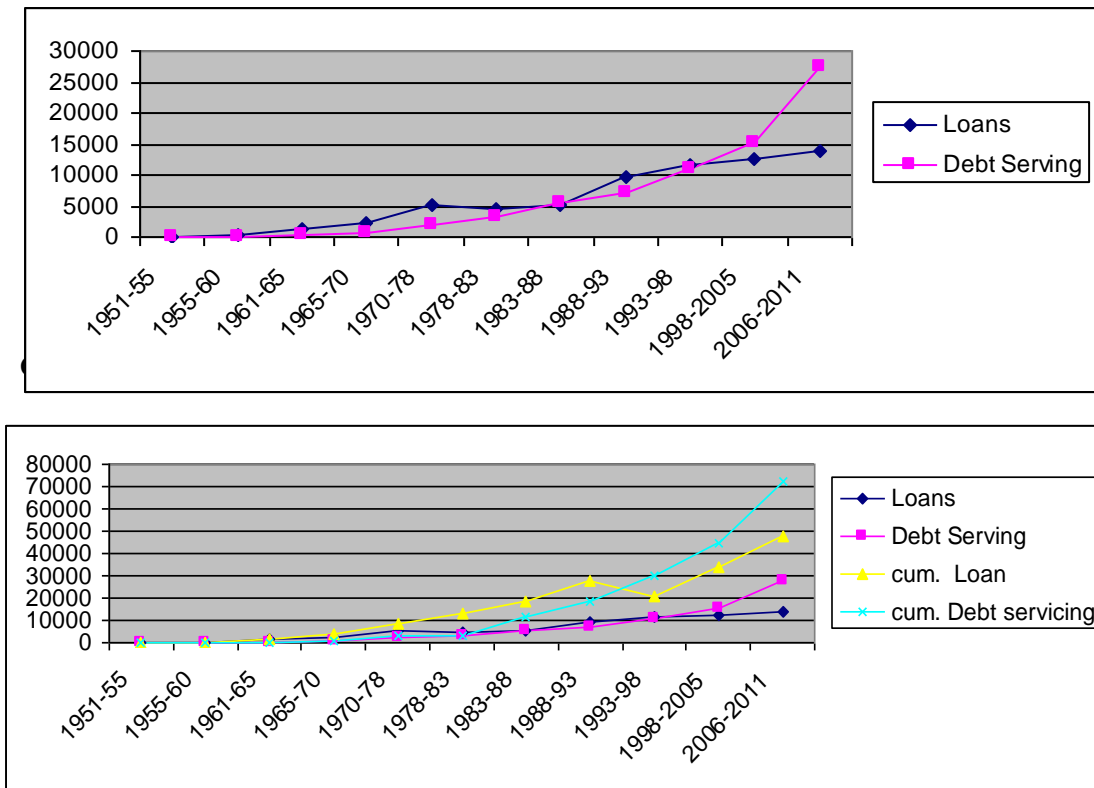
Year	Loans	Relief	Total	Principal	Interest	Total
2006	2068	-	2068	2171	944	3115 *
2007	2884	0397	3281	1785	1091	2876
2008	2210	0869	3079	1935	1248	3183
2009	3640	0366	4.006	3588	1159	4747
July,2009- March,2010*	1691	0139	1830	4632	1009	5641
July,2010- March,2011*	1409	-----	1409	6200	1600	7800
SubTotal	13902	1771	15673	20311	7051	27362
Grand Total	65967	15245	79803	44786	25163	72120

Source. Economic Affairs Division /Ministry of Finance, Govt. of Pakistan

*Source State Bank of Pakistan Annual Report 2006-7

*July-March 2009-10

*July-March2010-11



Graph. B.

The above graph gives a very interesting picture wherein the loans borrowed are shown in **Black Curve** while the amount spent on debt servicing has been shown in **Red Curve**. Surprisingly the **Red Curve** after 1993-1998 is fast moving upward above the **Black Curve** which depicts a very critical situation for an economy which is already caught up in the vicious circle of poverty. This phenomenon is putting the economy at the mercy of lending agencies. It is evident that total payment of interest as well as that of principal amounts to Us \$ 44.758 billions till 2005-2006 which has been putting pressure on the over all financial strength of the economy because major portion of loans received each time was incurred on debt servicing and at times the loans were taken merely because the economy could not generate the resources to repay the agreed amount during the period. Interestingly out of this, payment of US \$18.112 billions was made by way of interest and principal was redeemed only to the tune of \$ 26.646 billions. Surprisingly during the 5th plan period a sum of Us \$ 3.256 billions has been incurred as debt servicing against a loan amount of US\$ 4.418.00 billions which is 73.69 of the original loan.

The 6th plan period ate up the entire amount of loan disbursed to Pakistan because the debt servicing of US \$ 5.362 billions was more than the loan amount of Us \$ 5.158. Also agonizing are the figures of disbursement of loan i.e. US\$ 11.522 billions and repayment of principal plus interest comes to US \$ 10.966 billions during the 8th plan period where debt servicing is 95 % of the loan amount disbursed during the period from 1993-1994 to 1997-1998. The non plan period from 1998 to 2005 was again more crucial from the debt servicing point of view. Incidentally during this period Pakistan paid a sum of US \$15.094 billion of which US \$ 9.515 for partial liquation of loan liabilities and US \$ 5.579 billions as interest against a disbursement of US \$ 12.596 billions. Here debt servicing is 119.83% of the loan disbursement.

However, from 2006 to March ,2011 the repayment of principal has increased at much fast rate and during this period the debt servicing cost US \$ 27.362 billions against total disbursement of US \$13.902 billions. The interest amount of Us \$ 7.051 billions counts 50.7 of the total disbursement for the corresponding period. Looking at the table it appears that during the period from 1951 to March, 2011 there was disbursement of loan to the tune of US \$ 65.967 billions whereas govt. of Pakistan has since paid a sum of Us \$ 72.120 billions which is more than the actual amount paid to Pakistan by way of Loans. As such due to heavy interest payments a nominal amount of principal is redeemed. Resultantly the outstanding amount of foreign debt and liabilities rose from US \$38 billion in 2001 to more than US \$ 59.5 billion till March, 2011. This phenomenon has been aggravating the repayment situation which, if not checked and corrected, will ultimately affect the national integrity. On account of repayment difficulties rescheduling and restructuring became necessary to maintain the integrity in the International Community. The first rescheduling necessitated in 1972 due to debacle of East Pakistan which involved an amount of US\$ 234 million. An other amount of US \$260 millions was rescheduled in 1981(i.e.) Paris Club allowed a cash flow relief of US \$3.3 billions ‘for the loans which were falling due during the period from January, 1999 and December 2000, under Houston Terms’. The Club also approved restructuring of US \$1.8 billions which were due for payment within the period from December 2000 to September, 2001.

Since the outstanding amount of foreign debts and liabilities continued increasing at much fast rate, the Govt. of Pakistan had to seek assistance in rescheduling/restructuring and now the last resort of roll over. Borrowing for a developing economy is, no doubt, a common characteristic but it must eventually result in minimizing the need for borrowing and the economy must steadily move towards the self sustaining stage. In case of Pakistan, the economy was a role model for the developing nations during the 60’s decade but due to political instability and also loss of public confidence the subsequent years could not witness the remarkable reduction in the quantum of foreign loans.

Table No.5.

(Amount in million \$)

Year	Gross Disbursements	Debt Servicing	Net Transfers (N.T)	NT as % of Gross Disbursements
1990-91	2045	1316	729	36
1991-92	2366	1513	853	36
1992-93	2436	1648	788	32
1993-94	2530	1746	784	31
1994-95	2571	2042	529	21
1995-96	2555	2136	419	16
1996-97	2231	2265	-34	-2
1997-98	2800	2353	447	16
1998-99	2440	1638	802	33
1999-00	1426	1778	-352	-25
2000-01	1599	1546	53	3
2001-02	2316	1190	1126	49
2002-03	1553	1327	226	15
2003-04	1270	2978	-1708	-134
2004-05	2275	1461	814	36
2005-06	2863	1572	1291	45
2006-07	3232	1748	1484	46
2007-08	2503	1413	1090	44

@ July-March

Source: Economic Affairs Division

There was one of the solid reasons that heavy interest rate added to the difficulties in repaying the loans. No. of lenders increased due to increased demand for further loans which has naturally been putting further strain on the growing economy. In-ability to increase export to the level of bringing equilibrium in the export and import or at least bringing down the import to the minimum causing severe trade as well as balance of payment problems and consequently placed the economy at the mercy of the lending agencies and donors. The second major reason is the minimum ratio of net transfer to Pakistan. Besides, tied loans constraints, very nominal amount used to be left for utilizing in the process of economic development.

The figures in the above table No.5 reveal the miserable position of the State on account of loan amount which is taken back by the lending agencies. The volume of loans left at the disposal of the Govt. of Pakistan is no more than salt in bread. Looking at the above table it is evident that during the period from 1990 to 1994 the residual amount or for that matter the NET TRANSFERS was/were gradually declining from 36% to 21%. In 1995-1996 it fell to 16 whereas in the year 1996-1997 the amount of loan disbursed to Pakistan was not only taken back by way of debt servicing but 2 of the existing resources had to be used for fulfilling the commitment. During the year 1999-2000 State had to pay 25% more than the amount disbursed and much excruciatingly was the year 2003-2004 when Pakistan reimbursed 134% more than it had received by way of loan from the foreign countries.

It is a considered opinion that projects have a longer gestation period. It takes years to come into operation and generate revenue. Under such circumstances repayments disturb the project implementation and completion. Again the non Project Aid is normally consumed and the instant repayment creates financial crisis in the developing countries. This has always put severe strain on financial health of the economy of Pakistan. Pakistan has been suffering from this malady for which reasons she had to seek rescheduling and restructuring of loans fallen due for repayment. One of the reasons was larger amount lent as non project aid.

Table No.6.below tells the quantum of aid which has been advanced for non project purposes.

Table No.6 (amount in millions \$)

Year	Project Aid		Non-Project Aid		Total
	Amount	Share	Amount	Share	
1990's	1,589	71.7	626	28.3	2,215
2000-01	247	28.1	633	71.9	880
2001-02	1,113	32.5	2,311	67.5	3,424
2002-03	860	42.0	1,188	58.0	2,048
2003-04	1,233	56.2	960	43.8	2,193
2004-05	1,965	63.8	1,117	36.2	3,084
2005-06	1,021	23.8	3,261	76.2	4,282
2006-07	808	28.9	1,985	71.1	2,793
2007-08	471	18.8	2,032	81.2	2,503
2008-09	1,272	27.1	3,415	72.8	4,688
2009-10	840	39.3	1,295	60.7	2,135

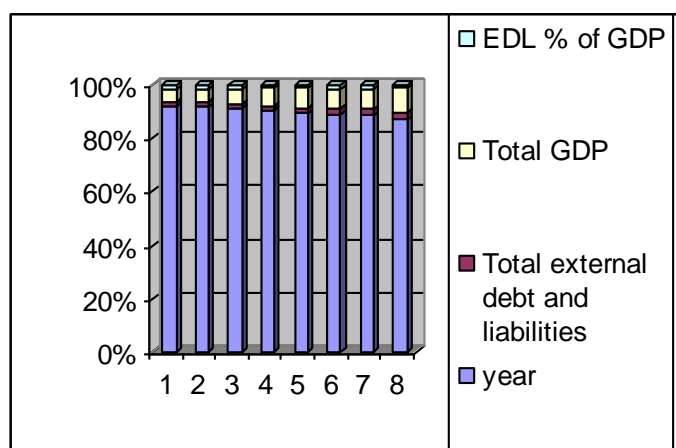
Source. Economic Affairs Division

The above statistics shows a picture of the Aid which is highly unevenly distributed between the Project and Non project portfolios. It is evident that from 2000 onward no project has either been initiated or completed. For the development of economy the Infrastructure is a pre-requisite but in the long run country must be on sound footings to minimize the import bill and raise the level of export to a level so as to continuously increase export and thereby improve upon the quality of finished products. For many reasons the Pakistan's export folio could not be improved as a result of which the major part of foreign Aid had to be used for redressing the Balance of payment problems.

During the year 2000-2001 a total of US \$ 880.0 millions were advanced of which US \$ 633.0 million was non project aid. This was 71.9 of the total aid. Incidentally the amount under non project increased to 76.2 for the year 2005-06 and reached to highest peak of 81.2 during the year 2007-08 when out of the total aid of US \$ 2503.00 the non project aid amounted to US \$2032.00. This is the crux of the problem. Eating up borrowed funds without productive capacity building is putting continuous stress on the economy. Since the borrowed funds were mostly used in the debt servicing, therefore, the burden on economy continued increasing without substantially adding to the real growth of the economy. Resultantly in spite of payment of interest to the tune of 19.868 millions the government was still indebted to the extent of US \$ 46.2 at the end of 2008.

The problem does not end here rather it became more grievous on account of regular flow of foreign loans and the outstanding debt and liabilities amounted to US \$ 55.675(B) at the end of 2009. The following table reveals that during a span of nine months i.e. July, .2010 to March.2011 the amount of loans and liabilities rose from US \$ 55.9 Billions to US \$ 59.5 (B)

Table No 7. below apparently seems a pleasing because External debt liabilities as % of the GDP has fallen from. 36.1 % in the year 2004 to 28.2 % in the year 2011. But factual situation is otherwise as the percentage fall is due to an increase in the quantum of GDP from US \$ 98.0 billions in the year 2004 to US \$ 210.8 billions in the year 2011. In fact there is hardly 21.8 8% fall in the external debt and liabilities where as GDP growth during the corresponding period is 115.10 %.



Graph.C

Table No. 7 (Amount outstanding in US \$)

GDP(in billion US\$	98.0	109.5	127.4	143.0	163.8	162.1	177.0	210.8
Total external debt. As percent of GDP	34.1	31.1	28.2	27.3	27.4	31.5	30.8	27.7
IMF As percent of GDP	1.8	1.5	1.2	1.0	.8	3.2	4.6	4.2
Total External debt. As percent of GDP	34.1	31.1	28.2	27.3	27.4	31.5	30.8	27.7

End- June(in billion US dollars)	2004	2005	2006	2007	2008	2009	2010	2011
Public & publically guaranteed debt.	29.9	31.1	32.9	35.5	40.6	42.6	43.1	45.6
Private non-guaranteed debt.	1.7	1.3	1.6	2.3	2.9	3.3	3.4	3.8
IMF	1.8	1.6	1.5	1.4	1.3	5.1	8.1	8.9
Total external debt.	33.4	34.0	36.0	39.0	44.9	51.1	54.6	58.3
Foreign exchange Liabilities.	2.0	1.8	1.6	1.5	1.3	1.3	1.3	1.2
Total external debt & liabilities.	35.3	35.8	37.6	40.5	46.2	52.3	55.9	59.5
Total external debt & Liabilities. As percent of GDP	36.1	32.7	29.5	28.3	28.2	32.3	31.6	28.2

Source: State Bank of Pakistan /Economic Survey of Pakistan 2010-2011

The crux of the problem

Pakistan's economy is still constantly depressed with ever increasing burden of foreign loans. The amount of loans, inspite of debt servicing, is rapidly increasing instead of reducing, which phenomena is aggravating the situation with each day passed. In other words the country is caught up in whirlpool of indebtedness.

The difficulties encountered by the Pakistan's govt. are, in fact, due the terms of the loans.

1. Most of the loans are sanctioned under "Tied Loans" schemes whereby major portion of the loan amount is taken back as cost of machinery and technical assistance. Interest is payable on the entire amount. What ever is left is again paid back in debt servicing.

2. All payments abroad are settled in terms of foreign currency. The inflationary spiral is persistently adding to the difficulties because the rising cost of export commodities reduces the profit margin and thus export could not be increased. An other reason of low export is the low productivity due to non existence of peace in the region. Since the inception of Pakistan we have been confronting very hostile neighbors on our both western and eastern borders. To overcome the difficulties in the balance of payment the Govt. has to seek assistance from International Monetary Funds. The Conditionalities of the Funds with regard to tariff rates and other taxes/levies are most of the time resisted by the public which is already facing price hike and paucity of exigencies of life. This creates unrest, mistrust and adversely affects the will to pay. This is one of the reasons that public has been protesting against external borrowing.
3. High interest rate multiplying the financial hardships because inability in timely repayment of foreign debt putting the integrity of the state at stake. Non availability of soft loans has created implications which caused the economy lagging behind. With all such difficulties Pakistan's Economy could hardly execute and complete the Seven mega projects involving foreign exchange components i.e. Warsak Dam (1955-60), Guddu Barrage (1957-62), Mangla Dam hydel power project (1961-67), Tarbela Dam (1968-76), Chashma Power Plant (1970-93), Pakistan steel mills (1973-85), Motorway (1992-97), which have added to the development capacity of the country yet it has not only to liquidate the existing liabilities but also initiate new projects for emancipating the neglected layers of the society from the clutches of poverty.

Remedies

We have abundant natural resources which can be exploited for the betterment of the country provided substantial financial arrangements are ensured.

In order to minimize the disguised unemployment, industrialization is the only Option. Emphasis should be on the development of export oriented and import substitute industries so that our balance of trade difficulties can be minimized. To promote the process of industrialization the availability of input and energy is pre requisite. Also development of agriculture is the need of the day because of its being the major source of input of agro based industries.

It is therefore suggested that.

- a). The existing lenders, in view of the ever increasing quantum of foreign debt due to application of interest, may waive off the entire amount of interest so far applied.
- b). The principal amount may be rescheduled payable in installment over a period of ten to twenty years.
- c). The Regional Co-operation for Development be revived /rejuvenated, its scope be expanded and the oil rich Muslim States may be prevailed upon to join this organization to pool funds, plan development activities and execute such plans from the R.C.D forum as joint ventures.
- d). Direct Foreign Investment, instead of lending, be encouraged from the friendly countries both as joint venture as well as on the basis of "Build Operate and Transfer" However, political infringement must be guarded against.

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