Pakistan's Public Debt: The shocks and aftershocks

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Abstract

Public debt is an important means of bridging government financing gaps. Effective and efficient utilization of public debt can increase economic growth. However, excessive reliance on public debt raises macroeconomic problems. A large gap between revenue and expenditure forces a country to obtain debt. Debt thus obtained further deteriorates expenditure side. High level of public debt holds back the government to meet its macroeconomic objectives of economic growth, price stability and a viable balance of payment. The major implications are sluggish economic growth, macroeconomic uncertainty, decreasing development, investment crowding out, inflation, higher unemployment, deteriorating social conditions and rising poverty causing economic destabilization which itself leads to destabilization of the state. Nation of such a country is often involved in corruption, organized riots, violent protests, strikes, man-slaughter, terrorism and other such crimes. In case of Pakistan, the major cause of poor economic performance is extraordinary burden of both domestic and external debt. The current situation is unsustainable and if it is not altered immediately than collapse of Pakistan's economy is for certain. It is therefore essential for the government to plan and place policies and structural reforms to take charge of the havoc being played by unsustainable level of public debt.

Key Words: Public Debt, Economic Growth, Macroeconomic Instability, Pakistan Economy.

JEL Classification: H62, H63, E62.H50, I00

1 Introduction

Public debt is a vital tool employed by the government to bridge government financing gaps. Effective and efficient utilization of public debt can increase economic growth and help a government to achieve its development and social objectives. Financing development related projects can help a country to build its production capacity and facilitate economic growth. In particular, borrowing from external sources enables a country to finance capital formation not only by mobilizing domestic savings but also by tapping into foreign capital surplus. Foreign borrowing can thus lead to more rapid growth. For example, foreign borrowing increased resource availability and contributed to economic growth in South Asian countries. Borrowing allows a country to invest and consume beyond the limit of current production, and can be conducive to economic growth.

However, if the public debt is not efficiently managed than it imposes the biggest curse on the economy. Unfortunately, Pakistan was not as fortunate and efficient in managing and utilizing its debt as compared to other South Asian countries. There is a growing recognition in Pakistan of the macroeconomic consequences of high levels of public debt resulting from the cumulative impact of large and growing budget deficits and the affiliated needs for borrowing. The heavy burden of debt servicing on the budget has frequently been highlighted by government, media and concerned citizens. In recent years, it has emerged as the biggest claimant of public resources, even more than defense expenditure and outlays on development. The resulting resource squeeze has implied a cut back in expenditures on social development, economic infrastructure, subsidies, etc. In fact, there are concerns that the country is effectively caught in a 'debt trap' whereby a high existing level of outstanding debt implies a high level of interest payments which lead to a large budget deficit that has to be financed by correspondingly large borrowings which add to the debt and so on. The result is explosive growth in debt and budget deficits which creates fundamental macro economic imbalances and has a number of unfavorable consequences including the 'crowding out' of the private sector and a decline in private investment through rise in interest rates and/or a rise in the current account deficit in the balance of payments.

Budget deficits can be financed in four ways; (i) borrowing domestically, (ii) borrowing abroad, (iii) running down foreign exchange reserves and (iv) by printing money. Each form of financing is associated with a major macro economic imbalance. Money printing is associated with inflation; foreign reserve use with the onset of an exchange crisis; foreign borrowing with an external debt crisis; and domestic borrowing with higher real interest rates and possibly explosive debt dynamics. In the case of high domestic borrowings also, the budget deficit eventually get monetized. This creates strong inflationary pressures on the economy and the possibility of hyper inflation. Inappropriate public debt management raises macroeconomic risks, impede economic growth, and hinder economic development. For example, high public debt demand can increase the domestic interest rate thereby crowding out private investment. An escalating external public debt stock increases the probability of default, raising the interest risk premium charged by creditors. High interest payments further enlarge a country's public debt obligations, accelerate budget outlays, and squeeze capital investment and social expenditure. In extreme cases, governments can be forced into defaulting on public debt, which tarnishes a country's reputation and makes further borrowing difficult. All of these actions are likely to precipitate capital flight and spark financial crisis.

2 Data

Pakistan's total public debt and domestic and external debt over the last three decades are summarized in Table 1 at Annex A. Table 2 gives the growth of different economic indicators over the last two decades. Table 3 traces the components of public expenditure over the last two decades. Table 4 relates the debt indicator to GDP and revenues. Table 5 gives the trend of external debt in terms of long term and short/medium term debt. Table 6 relates the total debt and debt servicing to export. Table 7 gives the yearly export, import and interest payment since last decade. Table 8 gives external debt sustainability indicators.

Graph 1 at Annex B shows the trend of increasing domestic and external debt over the years. Graph 2 shows total revenue, expenditure, interest payments trend from 1981 to 2008. Graph 3 gives growth rates trend of different economic indicators since 1981. Graph 4 shows interest payment, defense expenditure & development expenditure as % of total expenditure trend from 1981 to 2008. Graph 5 trend of short term and long term external debt from 1991 to 2008. Graph 6 shows total debt servicing, principal payment & interest payment trend from 1991 to 2008. Graph 7 shows trend in external debt sustainability indicators from 1991 to 2008. Graph 8 shows external debt & liabilities to foreign exchange earning from 1991 to 2008.

There are several points that emerge from a systematic examination of the evolution of Pakistan's public debt problem in its historical context. First, the debt problem has been in making for a long time. Second, by all indicators of debt burden, the debt problem has continued to grow notwithstanding fiscal adjustment in the previous few years. Third, the nature of public debt problem has changed significantly over the last decade, the debt is now driven largely by interest rate costs and the debt indicators are worsening because the key growth rates of GDP, revenues and exports have all declined sharply. It is also evident from most indicators that debt burden situation showed some improvement in earlier years of this century but it has again started to worsen with much greater pace. In the light of this data, it can be forecasted that if the current trend gets a firm hold than Pakistan's economic collapse is for certain.

3 Pakistan's Public Debt Burden - Historical Context

The alarm signals about the rising burden of public debt should have gone up a long time ago. During the 11 years of Zia rule, 1977–88, the public debt grew six folds reflecting large and growing fiscal deficits. The debt grew by the average annual rate of 17.7

percent in nominal terms and nearly 10 percent in real terms during this period. The rate of growth of real debt was substantially higher than the growth rate of GDP and exceeded growth of government revenues. The main source of growth in real debt was the large primary deficit. But the cost of borrowing, though low on average, was also increasing steadily during 1977–88 as a large portion of domestic debt was raised through very costly borrowing from non-bank sources (i.e. National Saving Schemes). As Table 4 shows, the ratio of debt to GDP increased from 48.16 percent in 1980-81 to 81 percent in 1988- 89. Interest payments on debt in the budget increased from 12 percent of the revenues to 28 percent over the same period.

The debt problem with which the democratic governments struggled, although unsuccessfully, during the 1990's decade was to a considerable extent inherited from the Zia period. The debt burden has been made much worse, however, by the inability or unwillingness of elected leaders to reduce the fiscal deficit significantly, a slowing economy, and last but not least a marked falling off in growth in real revenues in the 1990s. Pakistan's debt situation reached unsustainable level by 1999 because of persistence of large fiscal and current account deficits during the last two decades. The "twin deficits" resulted in an explosive accumulation of both domestic and external debt. Domestic debt grew at an average annual rate of almost 28 per cent during the first half of the 80's; 22 percent during the second half and 16 percent during the first nine years of the 90's. In other words; Pakistan's total external debt and foreign exchange liabilities which stood at $ 9 billion in 1980-81, reached almost $ 22 billion by the end of the 80's and by 97-98 touched a high figure of $ 42.7 billion. It is not surprising that the debt indicators which relate debt or debt service to revenues have shown much greater deterioration in the 1990s than the indicator relating debt to GDP. While the ratio of public debt to GDP increased further from 82.6 percent in 1989-90 to over 100 percent in 1998-99, the ratio of debt to revenues increased from over 400 percent to 600 percent and the proportion of interest payments to revenues rose to well over 40 percent.

The external debt and foreign exchange liabilities grew at an average rate of 2.0 per cent per annum in the first half of the 80's, 17.7 per cent in the second half; and 6.5 percent during the nine years of the 90's.Such a sharp build up in both domestic and external debt have had serious implications for the country's budgetary as well as balance of payments situation. In 80-81,debt servicing as percentage of total revenue was 11.6 percent, reached 38 per cent by the end of the 80's and was further up to 64 per cent by 98-99. Similarly, over the years, Pakistan's external debt servicing liability continued to rise as high as $ 6 to 7 billion by 98-99.

Pakistan entered the 21 Century with serious financial problems. Public debt exceeded 90% of its GDP, over 600% of its annual revenues, and debt servicing accounted for over half of current revenues. In 2001, Pakistan was the only country in South Asia to be classified as a severely indebted country by the World Bank. Due to the inability to service external debt, there were several consecutive rounds of debt rescheduling by Paris Club members and one from the quasi-London Club between 1998 and 2001. Pakistan had to seek exceptional financing arrangements from the International Monetary Fund in January 1999, after facing a severe balance of payments' crisis. This outcome was the result of persistent and rising fiscal deficits, stagnant export receipts, declining worker remittances, and large current account deficits.

Pakistan economy experienced some improvements during the earlier years of this century. Growth some what accelerated, and most macroeconomic indicators improved. Public debt indicators also showed significant improvement. Modest growth in public debt, coupled with the growth in nominal GDP, led to a significant fall in public debt to GDP ratio, from 81.4% in 2001/02 to 56.1% in FY 2006. Over the same period, domestic public debt to GDP ratio fell from 40.4% to 29.9%, while the external public debt to GDP ratio fell from 41.0% to 26.2%. The improvement in the public debt to GDP ratio in FY06 was due to the fact that both domestic and external debt grew slower than GDP. The growth in domestic debt has been faster than that of external debt. It rose by about 5.9% while external public debt grew by about 5.0% relative to the previous year. Total public debt stock stood at around Rs 4363 billion, about 5.5%, higher than the previous year, of which domestic public debt consists of about Rs 2041 billion. As a result of a stronger rise in domestic debt, the share of external public debt in total public debt decreased from 50.4% in FY2002/03 to 46.7% in 2005/06.

But this trend didn't last long. Pakistan again started facing huge fiscal and current account deficit in last few years. More damage has however, been done to public debt in the current fiscal year due to a further widening of the fiscal and current account deficits, increased borrowing from domestic and external sources to finance the deficits, and a sharper alteration of the exchange rate. Both domestic and external debt has faced sharp increase in the current fiscal year. Domestic debt has increased to Rs 3 trillion, while external debt has increased to Rs 3.4 trillion. Public debt as a percentage of GDP, which stood at 55.2 percent in June 2007 has increased to 61 percent in current fiscal year – an increase of almost 6 percentage points of GDP in one year. Public debt as percentage of revenue stood at 370 percent by March 2008 has increase to 441 percent in current fiscal year – an increase of 71 percentage points of revenue. Fiscal year 2007-08 has also witnessed violation of various elements of the Fiscal Responsibility and Debt Limitation Act 2005. Under the act, the revenue deficit (*total revenue minus current expenditure*) was to become zero by end-June 2008. As a consequence of large fiscal slippages, the revenue deficit has increased to be Rs. 287 billion or 2.7 percent of GDP- a violation of the Act. Similarly, the Act also requires that public debt as percentage of GDP must decline by 2.5 percentage points each year. Instead of declining, public debt has increased over the last year- once again a clear violation of the Act. The key to the success of reducing public debt burden includes: a reduction in fiscal and current account deficits and stability in the exchange rate. A declining public debt would release government resources for public sector investment, would enable private sector to borrow more (crowding-in) for investment, and thus promote growth.

4 Macroeconomic Implications of Public Debt

Public debt raised through different sources has different macroeconomic implications. Borrowing directly from central banks is equivalent to printing money. It increases the reserve money which in turn translates into monetary expansion. This approach is thus highly inflationary and is generally discouraged. Borrowing from domestic commercial banks is less inflationary, although it may crowd out private investment. Government borrowing from the non-banking sector 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 exert an upward pressure on interest rates from the demand side. Borrowing from non-banking sector is also comparatively expensive increasing the debt servicing burden of the economy. On the external side, excessive reliance on foreign borrowing exposes a country to numerous risks. Excessive foreign borrowing and its improper use generate severe debt service obligations and can constrain economic policies and growth.

In order to evaluate the implications of public debt on economy I have presented the effects of public debt on economy systematically.

4.1 Public Debt and Development

When a nation spends more than half of total revenue to finance one budgetary item, leaving aside only half of revenue to be spent on defense, civil administration, development projects, education, health, etc, what would be the state of country's education, health, physical infrastructure and defense? Country's physical and social infrastructure and irrigation system were bound to deteriorate. How can the government continue to provide raise in government servants' salaries, which are undoubtedly highly underpaid? This resulted in deterioration in governance.

The same is the case with Pakistan. In 1990s, more than half of the total revenues were consumed for debt servicing alone which forced the government to cut Public Sector Development Program (PSDP). The country's infrastructure, both physical and human, started deteriorating because allocation to these sectors were started declining as percentage of GDP. Since the private sector and the public sector investments are harmonizing in nature, the decline in public sector investment also resulted in decline in private sector investment. Therefore, total investment which used to be 19 to 20 per cent of GDP in early 90's continued to decelerate and reached 15-16 percent level by the end of the 90s'.

The onslaught of rising interest payments continued to crowd out not only development spending but defense spending as well. It is beyond doubt that Pakistan's fiscal crises in the 80's and the 90's were interest payment driven. As depicted in table 3, Interest payments, which used to be Rs 6 billion in 80-81 as compared with 15 billion on defense spending and 26 billion of development spending out performed both by a wide margin. By 93-94 interest payment and defense budget came at par at Rs 91 billion but interest payment surpassed development spending at Rs 71 billion and then there was no looking back thereafter. Interest payments continued to soar and by end of the 90s these were as high as Rs 262 billion against Rs 151 billion for defense and Rs 90 billion for development. As shown in table 4, Interest payment as % of revenue was at 51% while development expenditure as % of revenue was at 19% in 1999 Apart from slight improvement in the initial years of 21^{st} century, the complexion of the expenditure has again deteriorated. The priorities in our federal budgets have been upside down. One would assume that in an impoverished and developing country like ours, developmental expenditure would receive the highest priority and, in case of shortage of resources, would be the last item to be reduced. In our federal budgets, the reverse has been true. In 2007-08, because of the budgetary crunch, there was an acute need to reduce the overall expenditure. This was done mainly by reducing the development expenditure from the estimated provision of Rs 520 billion to actual expenditure of Rs 490 billion. The current expenditure, on the other hand, increased from the estimate of Rs 1056 billion to Rs 1400 billion. In the current year, interest payment stands at Rs. 600 billion, development expenditure at Rs 493 billion and defense expenditure at Rs. 275 billion. In terms of % of total revenue, interest payment stands at 41%, development expenditure at 33.4% and defense expenditure at 18%. Pakistan is facing all sorts of problem in every sector as there has nothing being done to improve the infrastructure of our country. Currently the most severe problems are the energy crisis and the water shortage. Among the two problems especially the energy crisis should have been addressed long time ago. But limited resources to deploy for development have held back government to start reasonable major development projects in the country.

4.2 Debt Accumulating More Debt

What happens when a government borrows to meet the revenue - expenditure gap? Naturally the debt will accumulate. The stock of public debt (debt payable in rupees and foreign debt in rupee terms) stood at Rs 155 billion by end of the 1970's and by end of the 80's another Rs 646 billion was added which caused public debt to rise at Rs 801 billion. But by end of the 90's, another Rs 2430 billion was added to the public debt, which stood at Rs 3231 billion. The absolute number of public debt is not much of interest. What is more damaging is the burden of the public debt, which means as percentage of GDP or total revenue. At the end of 70's, the public debt was 56 per cent of GDP or 317 per cent of total revenue. It rose to 92 per cent of GDP or 505 per cent of the revenue by the end of the 80's.It was over 100 per cent of GDP and 630 per cent of the revenues by the end of the 90's.

The situation was some how improved during the period of 2001 to 2004. In this period the accumulation of debt was not as rapid as the previous period. But this trend didn’t last long. From 2005 the public debt again started accumulating with more pace than the previous period. In the last four years there has been an increase of Rs. 2600 billion in public debt. This reflects a 69% increase in the debt stock in last four years. By any standard, this is a horrifying number for any country.

4.3 Debt Overhang

The term “debt overhang” indicates a situation in which a debt is so large that any earnings generated by new investment projects are entirely appropriated by existing debt holders, and hence even projects with a positive net present value cannot reduce the debt or result in the slowing of economic growth. As sovereign governments service their debt by taxing firms and households, high levels of debt imply an increase in the economic sector's expected future tax burden. Debt overhang characterizes a situation in which this future debt burden is perceived to be so high that it acts as a disincentive to current investment. Investors think that the proceeds of any new project will be taxed away to service the pre-existing debt. A weaker version requires only uncertainty on the part of lenders to investors who may not be sure whether their claims will take precedence over or be superseded by the government's taxing power. Lower levels of current investment, in turn, lead to lower growth and, for a given tax rate, lower government revenues, lower ability to pay, and lower expected value of the debt. Therefore, countries that suffer from debt overhang will have no net resource flows.

4.4 Public Debt and Private Investment Crowding Out

In economics, crowding out theoretically occurs when the government expands its borrowing to finance increased expenditure or tax reduction, crowding out private sector investment by way of higher interest rates. If increased borrowing leads to higher interest rates by creating a greater demand for funds and hence a higher "price", the private sector, which is sensitive to interest rates will likely reduce investment due to a lower rate of return. This is the investment that is crowded out. The weakening of fixed investment and other interest-sensitive expenditure counteracts to varying extents the expansionary effect of government deficits. More importantly, a fall in fixed investment by business can hurt long-term economic growth of the supply side, i.e., the growth of potential output.

The same thing happened with Pakistan. Pakistan has been facing fiscal deficit for which the government had to borrow heavily from the banking system to finance its fiscal deficit, pushing interest rates upward. On the other hand, the government continued to offer very high interest rates on various instruments of National Savings Scheme(NSS) to attract resources in this scheme as it was the major source of government borrowing from the non-bank sources. That's why during the 80's and 90's the rates of return on various NSS instruments were exceptionally high.

Consequently the overall interest rates were not conducive for investors within the country. Because of the crowding out on the one hand and decline in public sector investment on the other, the total investment continued to decline in the 1990s resulting in slowing down of economic activity in the country. The same has been depicted in table 2, where it is evident that investment growth rate was very low on the average during the 1990s

In addition to that, adverse law and order situation in most part of the 90's, as well as inconsistencies in policies, frequent adjustments in exchange rate, senseless taxation and freezing of foreign currency accounts badly damaged investors' confidence.

Things started to improve in the start of this century. With economic growth Pakistan was able to sustain the debt or decrease its debt growth rate. But later on things again started deteriorating. Growth again slowed down. Due to huge twin deficit government borrowing has reached unsustainable level. To make the situation worse, law and order situation in Pakistan is not conducive for investors. The political instability in the country is also driving the investors out of our country which will cause the growth to further halt.

4.5 Public Debt Leading to Poverty

The poor is badly affected by the increased macroeconomic uncertainty and volatility due to high indebtedness. Slower growth in the economy reduces the employment generation capacity of the economy Increased precautionary savings caused by higher uncertainty about future income may increase poverty due to reduced growth. In addition, credit market effects, i.e. higher incidence of credit rationing or increased risk premium and borrowing rates for private firms may affect negatively the poor via fallen labor demand. Higher levels of debt may also increase the propensity of debt crisis. Debt crisis affect the income of the poor in the longer-run via asymmetric effects, i.e. poverty is less reduced in subsequent expansions than increased during contractions. Firstly expectations may be more pessimistic during phases of crisis than optimistic in booming times. Secondly, credits may be rationed to firms due to a higher perceived risk of default in recessions. This effect may not completely offset during expansions. Thirdly, inadequate insurance for poorer households may prevent the ability to smooth consumption with possible negative effects. Finally, unskilled workers may lose their jobs first in recessions if firms “hoard” their skilled labor force due to higher turnover costs. In addition to that during expansions companies may increase fixed investment if complementarily between skilled labor and physical capital is high, leading to persistent unskilled unemployment.

Unfortunately, the poverty situation in Pakistan has become from bad to worst. The most important problem faced by the people of Pakistan is theirs absolute poverty. Low per capita income has also put the country among the poorest of the low-income nations in the world. According to the World Bank Reports, Pakistan is among the High Indebted Countries & Low Income Nations of the World. A bigger part of poverty in the country is due to low investments in the socio-economic uplift of the people at all levels. Due to the adverse effects of public debt on economy, the income generating capacity of a large number of the population has gone drastically down. The effects on the people have been devastating due to poverty. Education levels have gone down and illiteracy is rampant. School going children are out of school and working on road side workshops or restaurants. Health sector is in tatters. Children are dying of curable diseases. Economic opportunities in the country are disappearing fast because of lack of substantial economic growth in the country. Environment is degrading fast and affecting the lives and sustainability of both the people as well as the fragile ecology. The result is diminishing natural resources for future sustainability. As an example of Pakistan’s low investment in human development, the South Asian Institute’s Report clearly states, "While South Asia is the most illiterate region in the world, Pakistan is among the most illiterate countries within South Asia".

4.6 Public Debt and Social Development

Public debt also causes increase in the interest expense which translates into reduction of the availability of funds for social development. The same is evident from Table 3 which shows that due to debt accumulation interest payments are consistently increasing at the expense of decreasing development expenditure. It is difficult to visualize a self-sustained process of economic growth without human resource development, particularly without high levels of investment in education and health. This is the fate that people of Pakistan are facing right from the beginning. The situation was worse during the 1990s period which resulted in low social development leading to low quality of life. While even in the period of high growth no solid development has been made to increase the quality of life of people of Pakistan.

Many of the significant indicators of social and living standards in Pakistan have reportedly gone from bad to worst in the last five years. According to the Pakistan Social and Living Standards Measurement (PSLM) survey 2005-06, the total enrolment in Government schools has been on a steady decline since 2001-02 when it stood at 74 per cent. The PSLM survey 2004-05 reported "decrease in the share of primary enrolment that is in Government schools. The overall share has declined from 72 per cent in 2004-05 to 65 per cent in 2005-06." Full immunization of children has declined from 77 per cent in 2004-05 to 71 per cent in 2005-06. The survey reveals that more than 30 per cent population did not have toilet facility while more than 41 per cent people did not have any sanitation system. In Pakistan, World Bank estimates indicate that only 57 per cent of girls and women can read and write and in rural areas only 22 per cent of girls have completed primary level schooling, as compared to 47 per cent of boys. Around 89 of Pakistan's 112 Districts are facing problems of food insecurity, including malnutrition, under-nutrition, hunger, diseases and poverty, according to a World Food Program study. The study, the first of its kind in Pakistan, was done to identify food insecure segments in urban areas of Pakistan. The study declares 39 Districts extremely vulnerable, 31 very vulnerable and 19 vulnerable to food insecurity. Among the Districts with food security it places 15 districts under the category of normal and eight under the sufficient category.

Pakistan is a nation that is spending only 1.8 percent of its budget on Education, 0.5 per cent on its health. And where 80 per cent of its villages are without clean drinking water, sewerage, hygiene facilities, and 60 per cent are without electricity. Where one child under the age of 5 dies every 40 seconds and one child is born every 10 seconds. Where one mother dies in child birth every 90 seconds because of lack of health facilities. This situation no doubt raises concern of the world for deteriorating social condition notwithstanding the aid and fund being deployed by different world organizations in Pakistan.

4.7 Public Debt and Inflation

As we know that public debt consists of domestic and external debt Government has different sources to obtain domestic debt i.e. Central bank, commercial banks and non banking financial resources. If the borrowing is done through central bank, than it results in the increase of money supply. This further results in excessive increase in demand which translates into inflation. This in the end makes the poor worst off who was already having difficulty in making the ends meet. The same thing has happened in Pakistan in the current period. In the last 4 years, government has obtained excessive debt from the State Bank. The absolute increase in domestic debt is more than Rs. 1 trillion which depicts an increase of 55% from 2004 to 2008. This increase has resulted in highest ever inflation rate for Pakistan. Pakistan's overall annual inflation rate peaked at an all-time height of more than 24.3 per cent in July 2008 from about 21.5 per cent in June. Prices of non-perishable food items rose about 35.4 per cent year on year in July 2008 while those of perishable food items rose about 22.8 per cent. This has happened due to excessive borrowing from State bank to some extent along with cost push inflation all over the world.

4.8 External Front

On the external front, when a nation is spending $ 2 to 3 billion on debt servicing out of total foreign exchange earnings of $ 7 to 8 billion how can it finance imports worth $ 9 to 10 billion? Naturally, it had to go to with a begging bowl to borrow $ 3 to 4 billion every year. How can it maintain its financial sovereignty with a begging bowl in its hand? This is what has happened in the era of 1990s.

Pakistan sustained a current account deficit of 4 percent of GDP in the 80s, 4.5 per cent in the first half of the 90s and 5.2 per cent during 95-96 and 98-99. This is a huge number for a poor country like Pakistan. Naturally when a country sustains such a large gap in external accounts, it has to borrow to fill this gap. Pakistan's external debt and foreign exchange liability continued to rise reaching as high as $ 38 billion by 98-99. Pakistan's export remained stagnant around $ 8 billion for 6 years in a row. In the mean time inflow of workers remittances also continue to decline from $ 1.9 billion to less than one billion dollars. On the other hand, Pakistan's external debt and foreign exchange liability continued to raise, therefore, the country's debt carrying capacity started eroding. In 1980- 81, external debt liability as percentage of foreign exchange earnings was 147 per cent, by the end of the 80s it stood at 257 per cent. As we entered into the 90s, the debt burden deteriorated and by 98-99 it stood at 335 per cent. In other words, Pakistan's external debt burden was even worse than many countries. This suggests that Pakistan was in league with countries like Liberia, Congo, Malawi, Rwanda etc. This was the state of affairs on external front. Pakistan almost lost its financial sovereignty. Credit rating in international capital market was at its lowest. No country or institution was ready to lend to Pakistan because of its fragile balance of payment position. No nation can survive as a sovereign state in such circumstances.

The day of 9/11 appeared to be a turning point for Pakistan's economy. By allying with USA and Europe in the so called war against terrorism, Pakistan was able to enjoy certain privileges which enabled it to ease off the extensive pressure on the economy U.S assistance has played a key role in moving Pakistan's economy from the brink of collapse to setting record high levels of foreign reserves and exports, dramatically lowering levels of solid debt. During this period External debt & liability decreased by $2.5 billion in 7 years. External debt & liability as % of GDP which was 64% in 1999 decreased to 28.3% in 2006. And External debt & liability to foreign exchange earnings ratio which was 335% in 1999 decreased to 128% in 2006.

However, this improving trend didn't last long External debt and liability situation has started further deteriorating. As can be seen in table 8, most of the debt sustainability indicators have shown adverse trends. External debt & liability as a percentage of GDP has become 33.5%. It has shown a 20% increase in just one year. External debt & liability as percentage of foreign exchange has increased to 155%, showing an increase of 25%. External debt & liability to foreign exchange reserve ratio has become 4.7, showing an increase of 57%. Interest payment as a percentage of foreign exchange earning has become 4.1%, depicting an increase of 28% since 2007. The most contributing factor in the sharp increase in these indicators is large depreciation in the rupee. From the present figures it can be calculated that with every one rupee depreciation in our currency against US dollar, Pakistan's external debt increases by Rs 47 billion. It is interesting to note that during fiscal year 2007-08, the greenback appreciated against the rupee by more than fifteen rupees. This means that if no additional external debt was obtained in current fiscal year than just because of the depreciating Rupee, Pakistan's external debt has increased by Rs. 600 billions since December 2007. This reflects a 24% increase in the external debt in terms of Rupees. Other significant factors of deteriorating external debt indicators are sharp increase in imports, sluggish growth of export and declining foreign direct investment and portfolio flows negatively affecting Pakistan's external liquidity position, given its large current account deficit of about 6.8 per cent of gross domestic product. Due to situation developing in the external sector, our country encounters increasing difficulty in refinancing its external debt as lenders' risk aversion toward Pakistan has increased. According to Moody's credit rating, many of the credit stresses, which led to downgrading of Pakistan's sovereign credit ratings to B2 from SI in May 2008, are still present. Foreign exchange reserves of the country are depleting fast and stood at only $9.13 billion on 30th August 2008 compared to a record high of $16.5 billion in October last year. Of these reserves, only $5.76 billion are held by the State Bank and are freely usable. In short Pakistan is currently facing unsustainable level of external debt and liabilities. With the present trend continuing in future, it looks like we are sleep walking towards a default and an eventual economic collapse.

5 Concluding Remarks

From the discussion presented above, it is evident that public debt has played havoc with the economy of our country. Deterioration in most of the economic indicators and some of the social indicators are end results of the unsustainable level of public debt. The major factors contributing towards accumulation of debt are twin deficit that our country faces. Government need to finance its deficit which itself is a burden on the economy as the expenditure side further inclines due to rising interest expense. Our governments have not properly managed and planed to cut down its deficits due to which the gap between revenue and expenditure has increased, forcing the country to obtain more debt in each fiscal year. High level of public debt has held back the government to meet its macroeconomic objectives of economic growth, price stability and viable external balance of payment. Without achieving the macroeconomic objectives, government cannot achieve its social objectives as well. The major implications of public debt are sluggish economic growth, macroeconomic uncertainty, decreasing development, investment crowding out, inflation, higher unemployment, deteriorating social conditions and rising poverty. These factors have also contributed to destabilize the macroeconomic condition in case of Pakistan. The current situation that we face is due to inefficiency of the past governments; however, the situation has become worst in last few years. Pakistan's current leadership is under immense pressure in order to suppress the current weakening economic condition. If some thing hasn't done immediately than economic collapse of our country is for certain. It is therefore essential for the government to properly manage and lower public debt level in order to take charge of the havoc being played with the economy by unsustainable level of public debt. In order to so, government must take immediate step to lower its twin deficit. Government must come up with policies and structural reforms to increase the revenue and lower its current expenditure. In addition to that, it must proficiently plan the retirement of the existing debt along with managing the debt servicing. Finally it will require competence and expertise to ensure affective implementation of the plan. It is time to join heads and hands to stabilize the macroeconomic conditions of our country in order to prove the world that Pakistan is not a failed state.

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Annex A - Tables

Table 1: Pakistan's Public Debt

Rupees in Billion (Stated Otherwise)

Year	Domestic Debt	External Debt	Total Debt	Domestic Debt	External Debt	Total Debt
	Rupees in Billion			As % of GDP		
1972-73	17.8	32.3	50.1	26.6	48.3	74.9
1976-77	32.7	53.6	86.3	21.8	35.8	57.6
1979-80	56.8	70.7	137.5	24.3	30.2	54.5
1980–81	60.1	73.9	134	21.6	26.7	48.3
1984-85	143.9	140.2	284.1	30.5	29.7	60.2
1985-86	200.1	186.8	387.6	39.0	36.3	75.3
1986-87	247.3	208.6	455.9	43.2	36.4	79.6
1987-88	288.6	232.4	521	42.7	34.4	77.1
1988-89	331.1	299.4	630.5	43.0	38.9	81.9
1989-90	378.3	328.9	707.2	44.4	38.4	82.6
1990-91	445.1	436.3	821.1	43.6	38.4	80.5
1991-92	521.8	436.3	958.1	43.1	36.0	79.1
1992-93	602.4	517.2	1119.6	44.9	38.6	83.4
1993-94	702	749.4	1451.4	44.6	47.6	92.2
1994-95	798.6	785.1	1731.7	42.4	41.7	84.1
1995-96	908.9	951	1859.9	42.4	44.4	86.8
1996-97	1041.9	1127.3	2169.2	43.3	46.9	90.2
1997-98	1151.4	1366.9	2518.3	41.7	49.5	91.2
1998-99	1389.3	1581.9	2971.2	47.7	54.3	102.0
1999-2000	1576	1442	3018	41.2	38.0	78.9
2000-01	1728	1761	3489	41.5	42.3	83.8
2001-02	1715	1795	3510	39.0	40.8	79.8
2002-03	1852	1766	3618	38.4	36.6	75.3
2003-04	1979	1810	3789	35.1	32.1	67.8
2004-05	2152	1913	4064	33.1	29.4	62.5
2005-06	2322	2041	4363	30.5	26.8	57.2
2006-07	2601	2213	4814	29.8	25.4	55.2
2007-08	3016	3384	6400	28.7	32.2	64.3

Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Table 2: Growth Rates of Different Economic Indicators

(Growth Rates in Percentage)

Year	Real GDP Growth	Debt Growth	Inflation	Real Revenue Growth	Real Investment Growth
1981	6.2	5.0	11.9	9	6.2
1982	6.5	30.8	5.9	36.9	13.68
1983	6.8	19.8	6.4	7.7	3.33
1984	5.1	13.2	6.1	15.7	5.91
1985	7.6	21.6	5.6	1.4	7.21
1986	5.5	24.6	3.5	12.5	8.09
1987	6.5	18.7	4.7	9.2	8.78
1988	7.6	12.9	8.8	7.4	2.31
1989	5.0	19.5	7.9	9.6	11.76
1990	4.5	14.5	9.1	5.7	2.28
1991	5.5	20.7	12.6	-8.9	6.68
1992	7.8	13.8	4.9	29.9	21.36
1993	1.9	16.0	9.8	-5.7	3.94
1994	3.9	15.3	11.3	1.8	-1.26
1995	5.1	10.2	13.0	5.4	0.40
1996	4.7	7.4	10.8	7.0	5.63
1997	-0.4	16.6	11.8	-9.7	-8.04
1998	5.3	16.1	7.8	11.0	6.00
1999	3.5	18.0	5.7	8.2	-9.80
2000	3.9	1.6	3.6	5.77	5.37
2001	1.8	15.6	4.4	3.5	27.95
2002	3.1	0.6	2.5	10.36	9.53
2003	4.7	3.1	3.1	12.38	7.54
2004	7.5	4.7	4.6	5.58	9.84
2005	9	7.3	9.3	4.06	23.34
2006	5.8	7.4	7.9	11.7	25.38
2007	6.8	10.3	7.8	12.76	13.08
2008	5.8	33.0	21.0	7.6	1.56

Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Table 3: Trends in Components of Expenditure

Rupees in Billion (Stated Otherwise)

Year	Total Expenditure	Current Expenditure	Interest Payments	Defense Expenditure	Development Expenditure	Interest Expenditure	Defense Expenditure	Development Expenditure
	Rupees in Billion					As % of Total Expenditure		
1980-81	63.6	37.8	5.9	15.3	25.8	9.3	40.5	68.3
1984-85	116.8	83.7	16.5	31.8	33.1	14.1	38.0	39.5
1988-89	201.2	153.1	38.1	51.1	48.1	18.9	33.4	31.4
1989-90	221.6	165.6	46.7	58.7	56.1	21.1	35.4	33.9
1990-91	260.9	195.7	50	64.6	65.3	19.2	33.0	33.4
1991-92	321.5	230.1	62.4	75.7	91.3	19.4	32.9	39.7
1998-99	615	547.3	220.1	143.5	98.3	35.8	26.2	18.0
1999-2000	709.1	626.4	262.2	150.4	95.6	37.0	24.0	15.3
2000-01	717.9	645.7	249.3	131.2	89.8	34.7	20.3	13.9
2001-02	826.3	700.2	273.9	149.3	126.2	33.1	21.3	18.0
2002-03	898.1	781.9	199.8	159.7	129.2	22.2	20.4	16.5
2003-04	923.6	778.4	196.3	180.4	160.9	21.3	23.2	20.7
2004-05	1117	943.1	210.2	211.7	228	18.8	22.4	24.2
2005-06	1401.8	1121	237.1	242	326.7	16.9	21.6	29.1
2006-07	1663	1296	368.8	249.9	411	22.2	19.3	31.7
2007-08	1874.7	1378.2	602	275	493	32.0	20.0	35.8

Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Table 4: Debt Indicators in relation to GDP and Revenue

(In Percentage)

Year	Public Debt	Interest Expense	Public Debt	Interest Expense	Interest Expense	Interest Expense
	As % of GDP		As % of Revenue		As % of tax revenue	As % of non-tax revenue
1980-81	48.16	2.12	285.11	12.55	-	-
1984-85	60.22	3.50	367.53	21.35	-	-
1988-89	81.88	4.95	453.27	27.39	-	-
1989-90	83.00	5.48	445.34	29.41	-	-
1990-91	80.43	4.90	500.98	30.51	38.57	116.61
1991-92	79.14	5.15	442.54	28.82	37.62	93.71
1998-99	102.01	7.56	634.06	46.97	56.82	279.88
1999-2000	78.90	6.85	588.88	51.16	64.06	244.80
2000-01	83.79	5.99	630.92	45.08	56.48	221.75
2001-02	79.82	6.23	562.41	43.89	57.14	188.75
2002-03	75.02	4.14	502.01	27.72	36.02	121.84
2003-04	67.20	3.48	477.14	24.72	31.65	105.50
2004-05	62.51	3.23	451.46	23.35	32.01	87.38
2005-06	57.31	3.11	405.26	22.02	29.95	81.96
2006-07	55.15	4.19	370.88	28.19	38.41	108.34
2007-08	61.80	5.71	440.60	40.70	54.70	157.90

Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Table 5: Outstanding External Debt and its Growth

US $ in Million (Stated Otherwise)

Year	Long term	Short/ medium term	Total	Long term	Short/ medium term	Total
	US $ in million			Growth rates (%)		
1991	15,471	1,856	17,327			
1992	17,361	2,057	19,418	12.2	10.8	12.1
1993	19,044	2,800	21,844	9.7	36.1	12.5
1994	20,322	4,139	24,461	6.7	47.8	12
1995	22,117	4,409	26,526	8.8	6.5	8.4
1996	22,275	5,460	27,735	0.7	23.8	4.6
1997	23,145	5,140	28,285	3.91	-5.9	1.98
1998	23,042	5,940	28,982	-0.45	15.6	2.46
1999	33600	6,572	38900	45.82	10.6	34.22
2000	29820	5,622	35890	-11.25	-14.5	-7.74
2001	32100	5000	37100	7.65	-11.06	3.37
2002	31600	3132	34732	-1.56	-37.36	-6.38
2003	33300	2100	35400	5.38	-32.95	1.92
2004	35280	2000	37280	5.95	-4.76	5.31
2005	35530	1800	37330	0.71	-10.00	0.13
2006	37430	1600	39030	5.35	-11.11	4.55
2007	40470	1500	41970	8.12	-6.25	7.53
2008	46390	1300	47690	14.63	-13.33	13.63

Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Table 6: Total External Debt and Debt Servicing Indicators

US $ in Million (Stated Otherwise)

Year	External Debt	Debt Servicing	Interest Payment	External Debt	Debt Servicing	Interest Payments
	US $ in Million			As % of export		
1991	17327	1316	380	293.58	22.30	6.44
1992	19418	1513	580	287.16	22.38	8.58
1993	21844	1648	670	321.95	24.29	9.87
1994	24461	1746	840	365.91	26.12	12.57
1995	26526	2042	870	341.87	26.32	11.21
1996	27735	2136	890	333.71	25.70	10.71
1997	28285	2265	870	349.37	27.98	10.75
1998	28982	2353	1000	343.63	27.90	11.86
1999	38900	1638	1200	513.87	21.64	15.85
2000	35890	1778	1190	422.83	20.95	14.02
2001	37100	1546	1230	415.64	17.32	13.78
2002	34732	1190	1015	380.00	13.02	11.11
2003	35400	1327	925	327.78	12.29	8.56
2004	37280	2978	842	302.84	24.19	6.84
2005	37330	1461	910.8	259.42	10.15	6.33
2006	39030	1572	944.1	237.26	9.56	5.74
2007	41970	1748	1,108.30	240.24	10.01	6.34
2008	47690	1801	1134.7	266.87	10.08	6.35

Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Table 7: Trends in Export, Import and Interest Payment

US $ in Million (Stated Otherwise)

Year	Export	Import	Interest Payment	Exports	Imports	Interest Payment
	US $ in Million			Growth rates (%)		
1991	5902	8385	380	19.8	13.1	22.6
1992	6762	8998	580	14.6	7.3	52.6
1993	6785	10049	670	0.3	11.7	15.5
1994	6685	8685	840	-1.5	-13.6	25.4
1995	7759	10296	870	16.1	18.5	3.6
1996	8311	12015	890	7.1	16.7	2.3
1997	8096	11241	870	-2.6	-6.4	-2.2
1998	8434	10301	1000	4.2	-8.4	14.9
1999	7570	9344	1200	-10.2	-9.3	20.0
2000	8488	10033	1190	12.1	7.4	-0.8
2001	8926	10195	1230	5.16	1.61	3.4
2002	9140	9434	1015	2.4	-7.46	-17.5
2003	10800	11300	925	18.16	19.78	-8.9
2004	12310	13600	842	13.98	20.35	-9.0
2005	14390	18990	910	16.9	39.63	8.2
2006	16450	24900	944	14.32	31.12	3.7
2007	17470	26980	1108	6.2	8.35	17.4
2008	17870	37000	1257	2.29	37.14	13.4

Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Table 8: Trends in External Debt Sustainability Indicators

Percent/Ratio

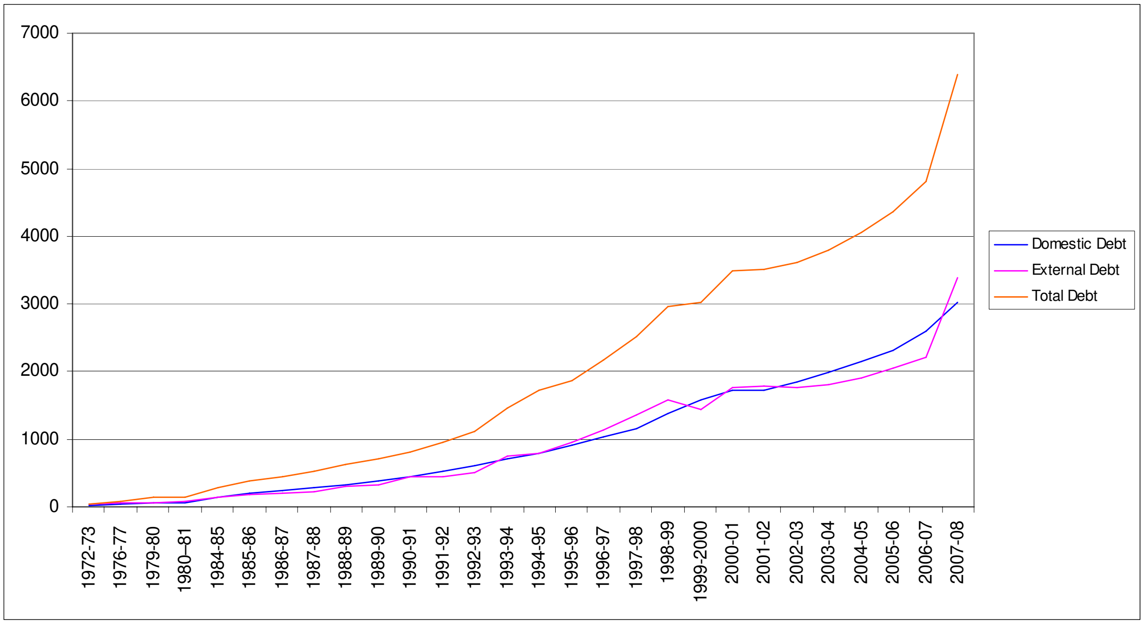
Year	EDL / GDP	EDL / FEE	STD & MTD / EDL	INT / FEE	EDL / FER
	Percent				Ratio
1991	53.2	223.3	12.0	4.9	33.4
1992	51.8	238.1	11.8	7.1	22.8
1993	53.3	271.3	14.7	8.3	18.3
1994	56.4	309.8	20.4	10.6	8.4
1995	50.6	280.5	19.9	9.2	15.4
1996	51.3	279.2	24.5	9.0	51.8
1997	53.7	301.0	22.2	9.3	23.9
1998	57.6	249.1	25.8	10.1	28.2
1999	54.9	346.2	19.6	13.9	25.7
2000	51.7	297.2	18.9	12.5	23.9
2001	52.1	259.5	15.6	12.0	11.5
2002	50.9	236.8	9.9	8.8	5.8
2003	43.1	181.2	6.3	4.7	3.3
2004	36.7	165.0	5.7	3.7	3.0
2005	32.7	134.3	5.1	3.3	2.7
2006	29.4	121.6	4.3	2.9	2.9
2007	28.1	124.1	3.7	3.3	3.0
2008	33.5	155.0	2.8	4.1	4.7

Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys
EDL: External Debt & Liabilities, FEE: Foreign Exchange Earnings, FER: Foreign Exchange Reserves
STD: Short Term Debt, MTD: Medium Term Debt, INT: Interest Payment.

Annex B - Graphs

Graph 1: Public Debt Trend from 1971 to 2008

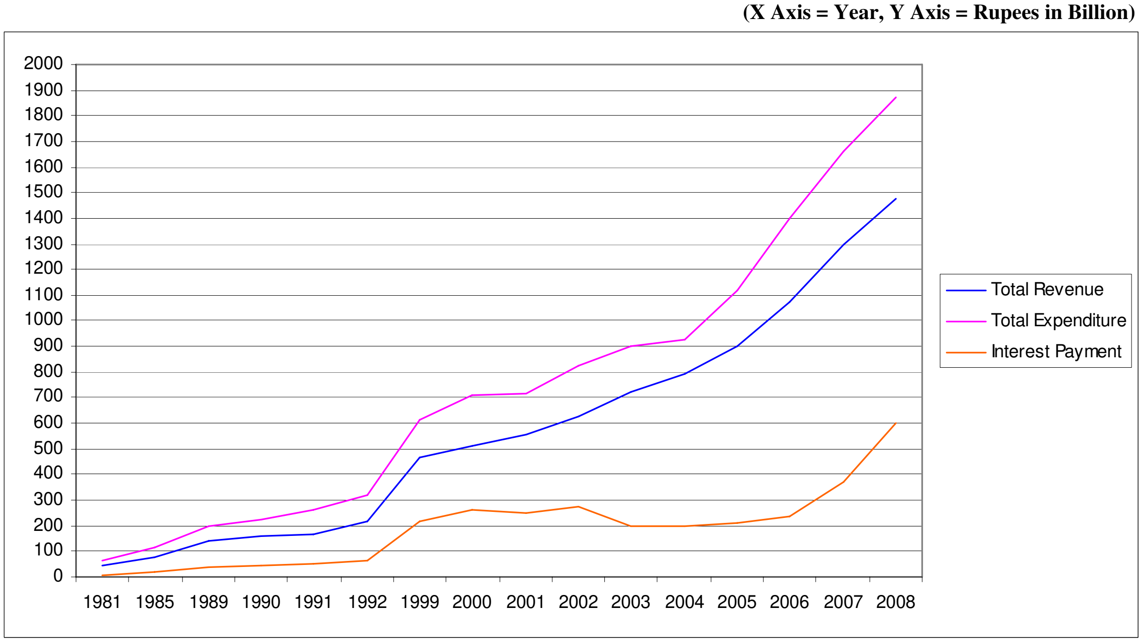
(X Axis = Year, Y Axis = Rupees in Billion)



Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Graph 2: Total Revenue, Expenditure, Interest Payments Trend from 1981 to 2008

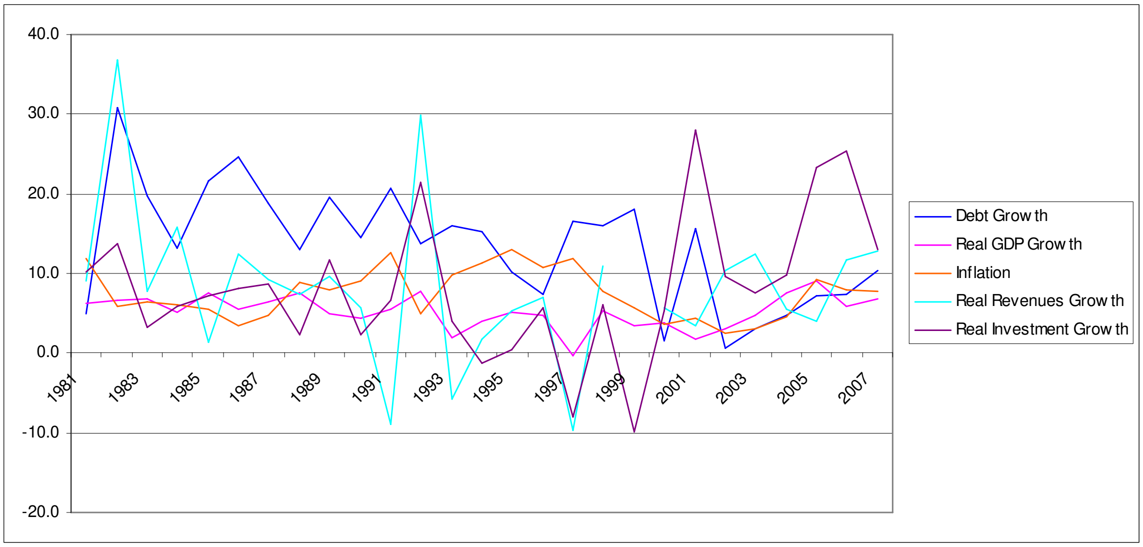
(X Axis = Year, Y Axis = Rupees in Billion)



Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Graph 3: Growth Rate Trends of Economic Indicators from 1981 to 2008

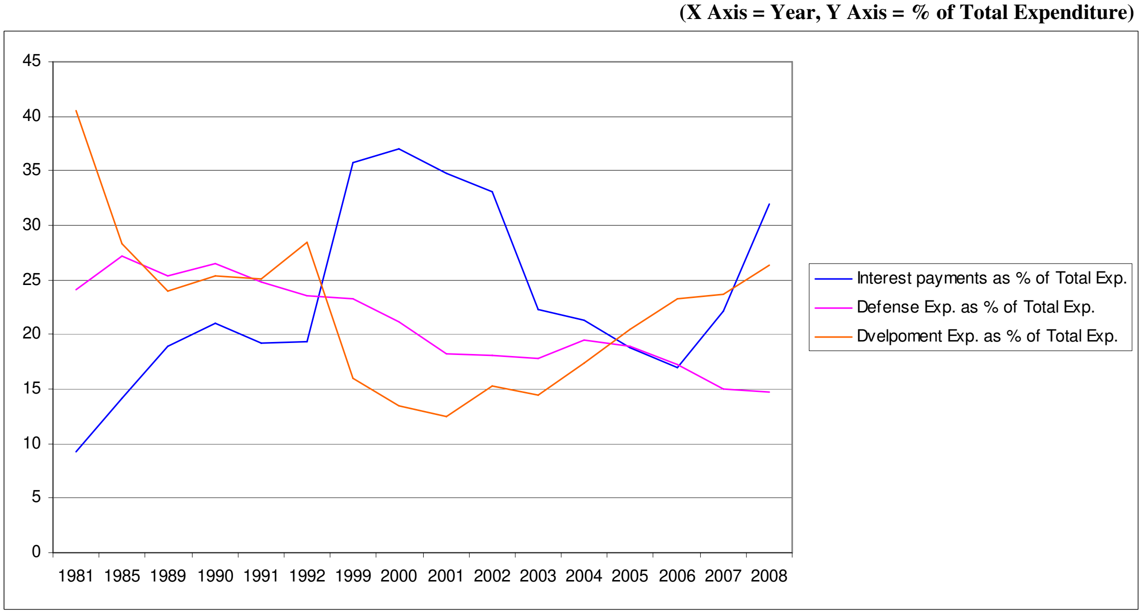
(X Axis = Year, Y Axis = % Growth)



Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Graph 4: Interest Payment, Defense Expenditure & Development Expenditure as % of Total Expenditure Trend from 1981 to 2008

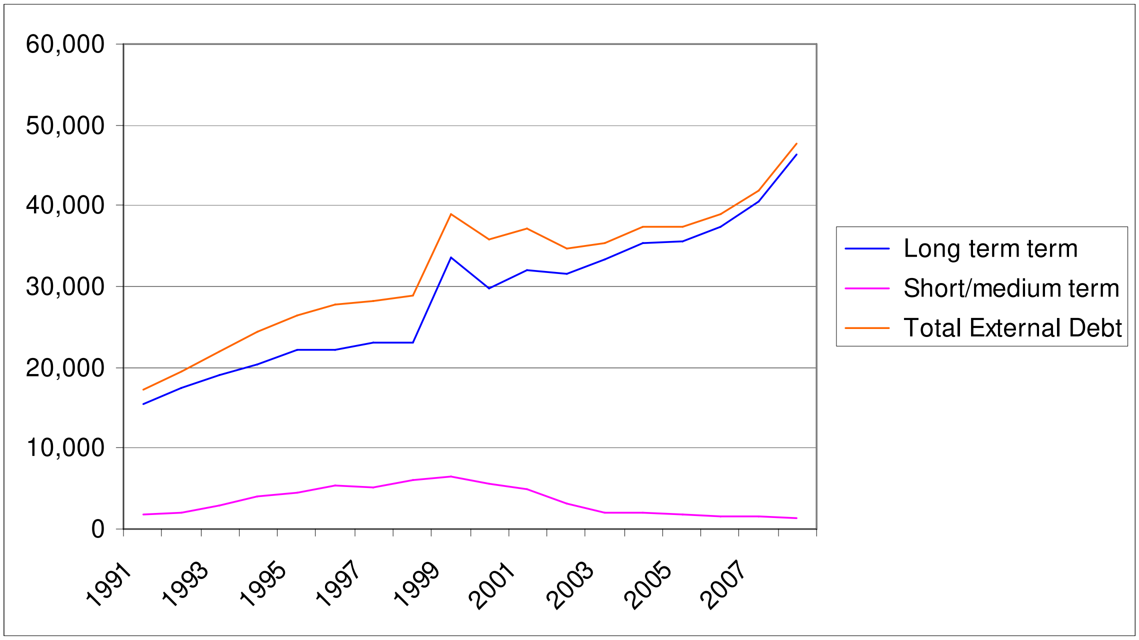
(X Axis = Year, Y Axis = % of Total Expenditure)



Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Graph 5: Long term & Short Term External Debt Trend from 1991 to 2008

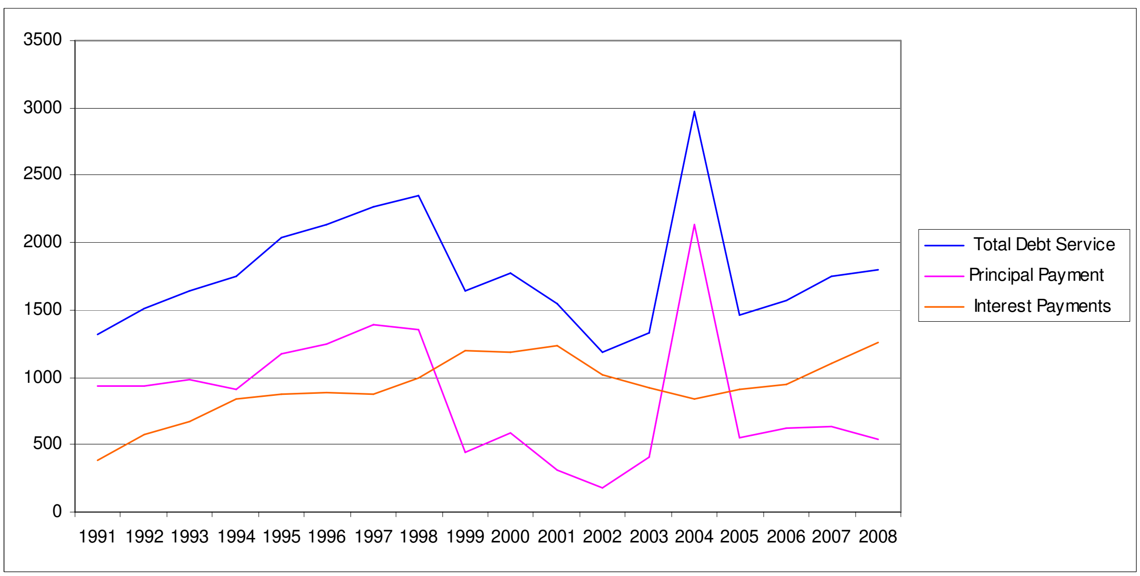
(X Axis = Year, Y Axis = US $ in Million)



Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Graph 6: External Debt Servicing, Principal Payment & Interest Payment Trend from 1991 to 2008

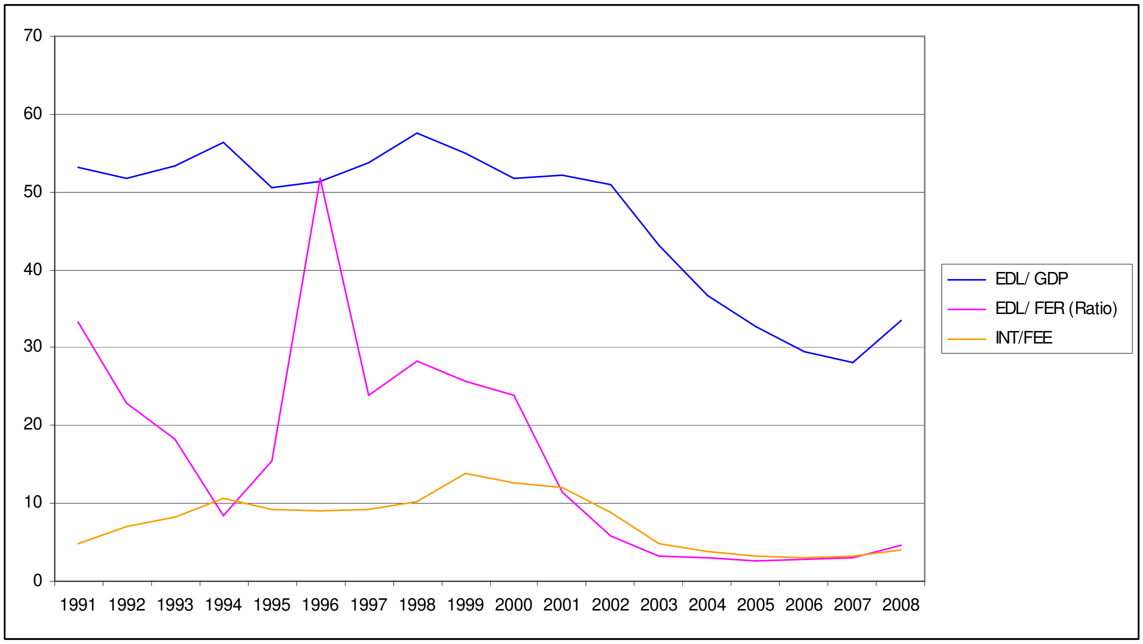
(X Axis = Year, Y Axis = US $ in Million)



Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys

Graph 7: Trend in External Debt Sustainability Indicators from 1991 to 2008

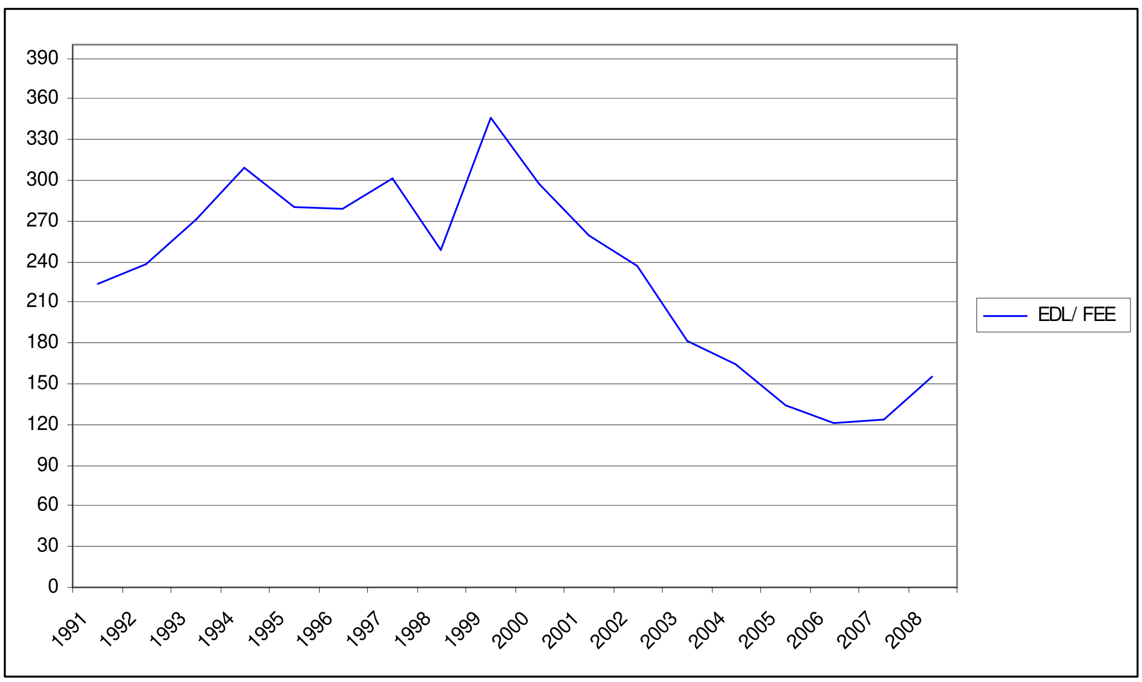
(X Axis = Year, Y Axis = Percent/Ratio)



Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys
EDL: External Debt & Liabilities, Foreign Exchange Earnings, FER: Foreign Exchange Reserves, INT: Interest Payment.

Graph 8: External Debt & liabilities to Foreign Exchange Earning Trend from 1991 to 2008

(X Axis = Year, Y Axis = Percent)



Source: State Bank of Pakistan Annual Reports and Pakistan Economic Surveys
EDL: External Debt & Liabilities, FEE: Foreign Exchange Earnings.