

Events Influencing the External Debts of Pakistan

Nawaz Ahmad
Visiting Professor, Iqra University, Karachi

Abstract

This study was conducted to evaluate the trend in external debts, and events influencing the increase or decrease in external debts of 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 problem of public debt in Pakistan is very grave and is almost of similar nature. Although Pakistan's external debt has increased 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 increases. Pakistan is not self-sufficient in food stuffs and even imports wheat from abroad. Strong defense is imperative for a country but spending of huge amount on defense increases external debt further. The economic status of Pakistan is very unsafe with unsustainable external debt. Pakistan has been unsuccessful in controlling a balance between expenditure and revenue. High and rising external debt burden constitutes a serious constraint for development; a major barrier to macroeconomic stability and hence, to growth and poverty reduction; a discouragement to foreign investment because it creates a high risk environment and exchange rate depreciation; and a discouragement for government to carry out structural reforms in the various sectors of the economy.

Keywords: External Debt, Event study, Regimes, Pakistan

1. Introduction

1.1 Overview

External debt plays both a positive and negative role in shaping economic growth, particularly of the developing countries. External debt is helpful when the government utilizes it for investment-oriented projects such as power, infrastructure and the agricultural sector. On the other hand, it would affect negatively when it is used for private and public consumption purposes, which do not bring any return. Additionally, a low level of external debt impacts economic growth positively, but this relationship becomes negative at a higher level.

The burden of unsustainable external debt severely compromises the economic prosperity and progress of any developing country. If foreign debt cannot be serviced through a country's foreign exchange reserves, then the country either defaults or borrows to repay the debt at heavy terms. On the other hand, if debt liabilities are postponed through fresh borrowings or rescheduling, then the costs include a severe compromise on a country's economic and thereby political sovereignty.

Over the 1980s, with the cold war in full swing, Pakistan had access to abundant foreign aid, which coupled with a large volume of remittances from expatriates, kept the growth of total debt in check. Obviously, debt situation in the decade of 1990s was one of the most horrible in the history of Pakistan. This was accompanied by consistent budget and balance of payments deficits, which in turn narrowed the range of fiscal options available to economic managers. Since a large portion of government revenues was used to service debts, little room was left to undertake development activities in the public sector, with the result that public expenditure on education, health, and social welfare declined even in absolute terms. Poverty and the unequal distribution of income, which were almost forgotten, returned to occupy central stage in economic analyses.

Political instability and foreign sanctions enforced after the nuclear blast in 1998 decline Pakistan's economic position and was nearly to become defaulter.

Pakistan's external debt is seen to be the cause of all problems badly affecting the economy. External debt increased from \$19.200 billion in 1990 to \$33.60 billion in 1999 and further to \$37.362 billion by 2007. Moreover, in most of the fiscal years since independence, the government's revenue has less than its expenditure, which in turn would cause fiscal deficit which could be bridged through borrowing from both internal and external (debt). However, the situation becomes worse when the country is unable to repay its debt servicing.

If a debt crisis of the same magnitude as that of the 1990s should reoccur, the burden of its economic and social costs on citizens would be more severe this time. The already existing circular debt in the energy sector, which has choked economic activity flows, would add fuel to the fire. Additional complications would arise, especially for the poor and middle-income classes, due to deteriorating public infrastructure and high food prices. The balance of payments account, which appears in relatively good shape due to an unprecedented increase in foreign remittances, would be likely to deteriorate because of the expected increase in future debt-servicing costs.

It appears as though, after a decade of calm, Pakistan is again on the brink of debt crises both on the

foreign and domestic fronts. While the quantitative burden of external debt, as measured by the debt-to-GDP ratio has registered a significant increase from 58.57 percent in 2006/07 to 65.19 percent in 2010, the country's repayment capacity in terms of foreign exchange earnings and capital inflows does not present an alarming picture. Foreign aid has become a burden, rather than a blessing. Pakistan is the most heavily debt country in the world with \$60 billion external debts.

1.2 Problem Statement

The main objective of the study is to gather events influencing the increase or decrease in external debts of Pakistan.

1.3 Outline of the Study

The most important purpose of this study was to gather events influencing the increase or decrease in external debts of Pakistan and to do trend analysis of external debt.

1.4 Definitions

External debts: External debt (or foreign debt) is that part of the total debt in a country that is owed to creditors outside the country. The debtors can be the government, corporations or private households. The debt includes money owed to private commercial banks, other governments, or international financial institutions such as the International Monetary Fund (IMF) and World Bank.

Events: Anything that takes place or happens, something important; happening; incident.

2 Literature Review

Since external debt contains different elements, some definitional classifications are in order. External debt consists of both long-term and short/medium term debt. Long-term debt is generally taken from the World Bank in the form of project aid and from the aid to Pakistan Development Forum. Its maturity period ranges from five to 30 years and is on concessional interest rates. Some loans of the IMF are also of a long-term nature for balance of payments stabilization purposes. Medium-term debt is of course for a shorter period, ranging from one to five years, and the interest charged is variable. Short-term debt is borrowed from commercial sources and in most cases has to be repaid in one year. The minimum interest charged is the prevailing market interest rate (Ali, 2000). Prior to early 1970s, the external debt of developing countries was primarily small and official phenomenon, the majority of creditors being foreign governments and international financial institutions offer loan for development project (Todaro, 1988).

In most of the developing countries, the external debts have hardly ever correctly and productively been utilized. It is clear that external debts have adverse effects and slow down economic development but on the other hand, external debt is an important mean of financing government insufficiency of budget. Efficient utilization of external debt can promote economic growth and facilitate to improve socio-economic welfare of the society (A. Khan, 1997)

External debt is really a matter of concern to the public of Pakistan and requires some clear clarification in a simple language understandable to everyone (Hussain 1999-2002).

Some of the terrible consequences of a debt overhang are: limited availability of foreign financing in future, additional tax burden on economy to pay the debt, and greater uncertainty in the economy. These factors discourage investment and hence compress economic growth of the country (Monteil, 2003).

Fiscal deficit and external debt can be considered as cause and effect for each other. Higher deficits create higher loan requirements, which further enhance debt burden of a country (Ishfaq & Chaudhry, 1999)

The implications of trade liberalization on Pakistan's foreign debt burden from 1972 to 2007 by employing recent econometric developments. The trade liberalization is a causal factor of growth of external debt in Pakistan (Zafar, 2008)

Growth in external debt with respect to exchange rate changes, primary budget deficits, and interest rate are responsible for debt accumulation in Pakistan (Bilquees, 2003)

Foreign aid is a major factor responsible for growth of external debt because aid is substituted for domestic savings in Pakistan (Mohey-ud-din, 2005)

The increasing burden of foreign debt is mainly due to current account deficits and patterns of financing in Pakistan (Hasan, 1999)

The economic status of Pakistan is very unsafe with unsustainable external debt. Pakistan has been unsuccessful in controlling a balance between expenditure and revenue (Khan, 2007)

The history of crisis modeling in composition, classification and changing terms of International macroeconomics reveals that each external debt is making it difficult for Pakistani towards succeeding sign of crises representing possibilities for crisis, government to keep the domestic debt within sustainable limits. Economies facing debt crisis have to face many troubles due to it. The investment and growth are depressed in cause of debt accumulation. Due to high debt, an economy by increasing its debts increases the chances to go

defaulter. The rich international creditors such as the World Bank, the IMF and the Paris Club have been adding value to the economic development of Pakistan. Relationship showed that debt service affects Gross Domestic Product depressingly, whereas capital and labor foreign assistance from these institutions as they are not affect it optimistically (Atique & Malik, 2012).

The burden of unsustainable external debt severely compromises the economic prosperity and progress of any developing country. If foreign debt cannot be serviced through a country's foreign exchange reserves, then the country either defaults or borrows to repay the debt at onerous terms. The former severely jeopardizes growth prospects through a collapse in investment. On the other hand, if debt liabilities are postponed through fresh borrowings or rescheduling, then the costs include a severe compromise on a country's economic and thereby political sovereignty. Although, Pakistan is no longer on the verge of an external debt crisis, a number of issues still need to be addressed. Sustainable debt servicing requires high and sustainable growth in GDP and foreign exchange earnings. The country is yet to achieve these goals (Sayeed & Rashid, 2003).

Ahmad (2013) compared growth of external debts between military and democratic regimes of Pakistan over 41 years between 1972 to 2012 which resulted that democratic regimes contribute more to it.

3 Research Methods

3.1 Method of Data Collection

This research was based on secondary data, which was collected from various website. The variable external debts were taken. The data was collected from the year 1970 till 2010.

3.2 Sample size

The sample size of the observations is 40 (yearly).

3.3 Research Model

Descriptive and exploratory models.

4 Findings & Events

4.1 Findings

years	debt in billions \$	Prime Ministers of Pakistan	Era	Dollar Rates End of the Year
1970	0.0140	Nurul Amin	7 October 1958 – 7 December 1971	4.7697
1971	3.79			
1972	4.05			11.0078
1973	4.52	Zulfikar Ali Bhutto	20 December 1971 – 14 August 1973	
1974	5.05			9.9078
1975	5.68			
1976	6.71			
1977	7.46	Muhammad Khan Junejo	5 July 1977 – 24 March 1985	
1978	8.21			
1979	8.79			
1980	9.79			
1981	10.44			
1982	11.53			
1983	11.85			
1984	12.09			15.3678
1985	13.34	Benazir Bhutto	24 March 1985 – 2 December 1988	
1986	14.85			15.9878
1987	16.69			
1988	16.96			18.6967
1989	18.27			
1990	20.59	Nawaz Sharif	11/6/1990 to 18 April 1993	21.9548
1991	23.29			
1992	24.85			25.7643
1993	24.46	Benazir Bhutto	10/19/1993 to 5 November 1996	
1994	27.32			30.8770
1995	30.17			
1996	29.77			40.2203
1997	30.01	Nawaz Sharif	2/17/1997 to 12 October 1999	
1998	32.21			46.1150
1999	34.07			
2000	32.95			57.9863
2001	31.91			
2002	33.80	Zafarullah Khan Jamali	11/1/2002 to 26 June 2004	58.3724
2003	36.44			
2004	36.33	Shaukat Aziz	8/20/2004 to 16 November 2007	59.4485
2005	33.99			
2006	37.15			60.8855
2007	41.98			
2008	49.51	Yousaf Raza Gillani	3/25/2008 to 19 June 2012	78.9692
2009	56.33			
2010	58.49			85.6601
2011	60.18			

In 1960, Dollar was 4.76 Pakistani rupees. 1980, dollars 9.97 Pakistani rupees 1985, dollars was 16.28 Pakistani rupees, 1990, dollars was 21.41 Pakistani rupees, 1995, dollar was 30.62 Pakistani rupees and Inflation

2000,dollars was 51.64 Pakistani rupees,2005,dollars was 60.40 Pakistani rupees,2009,dollars was 76.5 Rupees and in 2011,dollars rate was 85.66 rupees

4.2 Events

4.2.1 "1971-1973"

The devaluation of Pakistan rupee was occurred in May 1971 and diversion of exports from former East Pakistan to foreign markets that helped achieve a surplus in 1972-73. Thus, the gap between exports earnings and import expenditures was to meet through external borrowing.

In the first seven years of the 1970s, marked slowdown in growth of domestic product was one of the factors causing large balance of payments deficits necessitating an increase in foreign loans.

4.2.2 "1973-1977"

In 1973, there was increase in oil prices, inflation and recession in the developed market economies. The combination of these factors led to a general decline in the external payments position of the non-oil exporting developing countries and forced many of them to borrow heavily or reduce their reserves. Pakistan also suffered from these international events of outstanding nature, which imposed severe damages on its balance-of-payments position, disadvantaged its development efforts and led to a noticeable increase in the volume of international indebtedness as well as its debt servicing liabilities.

4.2.3 "1978-81"

From 1978-81 again the devaluation of the Rupee was occurred and Pakistan received hard loans and short-term loans for balance of payments support and the country's total external debt reached to 16885 million dollars by the end of 1980s.

4.2.4 "1981-1990"

The external debt approximately doubled over from 1981 to 1990 and reached to \$ 20.66 billion. Over the 1980s, with the cold war in full swing, Pakistan had access to abundant foreign aid, which coupled with a large volume of remittances from expatriates, kept the growth of total debt in check. Pakistan had become the 10th largest recipient of the World Bank/IMF loans. The first of the loans under the Structural Adjustment Programme (SAP) was approved in 1982 when General Zia had established his military rule. But after receiving the first tranche of the SAP loan the General's economic managers decided not to proceed with the rest. Somewhere in the 1980's and the 1990's the situation had reversed. Approximately 80 per cent of the foreign aid package for Pakistan was being spent on defense and other non-development expenditures, almost all of the foreign resources for the country were in the form of loans, credits and direct investments at quite harsh conditions and heavy interest rates.

4.2.5 "1990-1992"

Obviously, debt situation in the decade of 1990s was one of the most horrible in the history of Pakistan. The crunch of SAP loans came after Zia's downfall in 1990s and during the alternating civilian governments of Benazir Bhutto and Nawaz Sharif. The outgoing Zia regime had almost doubled the country's foreign debt liabilities, which stood at \$15.5 billion in the year 1990-91, creating greater dependency on SAP loans. When Sharif replaced Benazir's first short-lived government, he launched the first substantial package of structural adjustments to the economy in earnest. Controls on foreign exchange were lifted, first batch of state assets were privatized, business and industry was deregulated, and public expenditures on social programs were curtailed. Pleased with this performance, the World Bank/IMF released an average of \$400 million in SAP loans over the 3 years of Sharif's first government.

4.2.6 "1993-1997"

In 1993 Moen Qureshi was brought in from the World Bank to serve as interim Prime Minister he implemented another round of structural adjustments, including 10 percent devaluation of currency, increase in prices of petroleum and electricity, dismantling of price controls on flour and cooking oil, and further reduction in Tariffs. After Qureshi's departure and return of Benazir to the Prime Minister's office a new World Bank/IMF Extended Structural Adjustment Facility (ESAF) loan of \$1.5 billion was signed up to be disbursed in installments. To meet the conditions of this loan privatization was stepped up, a new regressive General Sales Tax was imposed on 268 items, import duties were further reduced and later in October, 1995, the rupee as devalued by another 7 percent. In the 1990's and the year 2000 all of the foreign assistance has been spent on debt servicing.

4.2.7 "1998-2002"

In 1998, Prime Minister Nawaz Sharif ordered to conduct first nuclear tests after Benazir Bhutto called for the tests, in response to Indian nuclear tests. Nawaz Sharif's ordering the nuclear tests was met with great hostility and anger in the United States after President Clinton placing the economic embargo on Pakistan. No new loan was given from 1998 to 2002 due to the economic sanctions against the conduction of nuclear tests and political instability. Thus the only continued projects received the loan. Incidentally the amount of loan stayed low during the period.

4.2.8 "2003-2007"

Musharraf regime had borrowed a staggering amount of over \$ 15 billion since 2003. During 2003-04, the total

external debt was \$ 33.352 billion. The 8 October 2005 earthquake was the most debilitating natural disaster in Pakistan's history. The Government of Japan provided emergency grant assistance to Pakistan along with a yen – loan assistance. Together with other assistances, the Japanese assistance related to the earthquake amounts to approximately more than US \$ 200 million. A total of \$850 million aid package announced on October 8 2005 earthquakes by the World Bank.

In 2006, The International Foundation for Electoral Systems (IFES) implemented a 9 million dollar contract through USAID to install a computerized electoral rolls system for the Pakistani government. The external debt has gone up to \$ 45 billion in June 2008 from \$ 33 billion in 1999.

4.2.9 “2007-2009”

The foreign debt and liabilities have increased in rupee value by more than Rs705 billion in less than six months 2008-2009, simply due to the Rs15 per dollar decline in currency value. The country's overall external debt has increased by almost \$7 billion to \$47 billion since June 2007.

4.2.10 “2010-2011”

Flood occurred in Pakistan, the FFC (Federal Flood Commission) has received Rs 87.8 billion (about 900 million USD). FFC documents show that numerous projects were initiated, funded and completed, but reports indicate that little work has actually been done due to ineffective leadership and corruption.

5 Conclusion

By this research, we came to know that the external debts of Pakistan were increasing up until now. In 1970, oil prices increase & the devaluation of rupee led down Pakistan economy. Pakistan were taking debt but not paying on time. Due to the late payment of debts, Pakistan come up to approximately \$ 60 billion debt and more over there is a major reason of increase in debt is increase in dollar rates. The more dollar rate increases on daily basis the more external debts are increasing to repay the debts to IMF and World Bank because Pakistan has to pay them in dollars. Interest rate is also a major reason of increasing in external debt of Pakistan. Pakistan is a favorite debtor country of the World Bank. Between 1950 and 1999, the international donor community contributed nearly \$58 billion to Pakistan. Pakistan's external debt has increase because of misuse of loans, many developmental projects remained uncompleted, and due to political instability and frequent changes in government policies because each new government planed their new projects and new policies further over burden the economy. The economic status of Pakistan is very unsafe with unsustainable external debt. Pakistan has been unsuccessful in controlling a balance between expenditure and revenue. High and rising external debt burden constitutes serious constraints for development, a major barrier to macroeconomics stability and hence, to growth and poverty reduction because it creates a high risk involvement and exchange rate depreciation.

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6.1 Web Links

<http://data.worldbank.org/indicator/DT.DOD.DECT.CDSSS>

http://www.europesworld.org/NewEnglish/Home_old/PartnerPosts/tabid/671/PostID/1287/language/en-US/Default.aspx