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THE PROFILE OF DEBT STRUCTURE: MONETARY AND FISCAL POLICIES A Case of Pakistan (1971-2007)

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Abstract. This paper examines a complete profile of public debt structure for the past three decades in the context of the fiscal and external sector imbalances as the key determinants of public debt burden. Despite initiation of several reforms the stock of public debt, its growth and debt servicing remain to be high. Increase in debt is almost equally attributed to domestic and external debt and the structure of debt remain to be the same. Increased reliance on short term domestic debt from the central bank indicates the structure of debt is dominated by short-term debt. The rescheduling and restructuring of debt in the first half of 2000s had brought some relief in the external debt indicators. However, the rising fiscal and external accounts gap, in the second half of 2000s, has adversely affected the debt to GDP ratio and growth in external debt remains high. Obvious implication of growing debt stock is that the debt servicing cost would increase, fiscal adjustment would be difficult and debt sustainability indicators may deteriorate in the future.

I. INTRODUCTION

The economy of Pakistan continues to rely heavily on domestic and external resources to meet its deficits; large resource gap is a mirror image of its economic performance and also reflects the way macro economic accounts were managed overtime. Clearly, government spending on goods and services and repayment of public debt needs to be covered by the sources of funds available to the government, *i.e.* raise funds through taxation, create high-powered money or borrow. This financial constraint implies that

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government has one degree of freedom less than it appears. It cannot fix money growth, borrowing, spending and taxes independent of each other. If money growth, taxes and borrowing are set exogenous then government expenditure cannot be set exogenously. Even if government expenditure is considered as endogenous where government spending is adjusted to make fiscal space for interest payment on debt, high GDP growth may be unsustainable if adjustments are made in the development expenditure, which were most often cut in the past to create fiscal space.

Undoubtedly the economy is principally governed by the interplay of monetary and fiscal policies; and all macroeconomic indicators have remained highly sensitive to these policies pursued in the past. Both these policies are the key determinants of the structure of public debt stock, its growth and debt servicing. One major concern in this regard is that government expenditure and its role extends beyond its resources causing increased fiscal deficit. Whereas, the resources generated through tax and non-tax sources are insufficient to meet the growing expenditure needs.

Public expenditure needs have grown at a faster pace due to inflexibility of major expenditure heads, limited maneuvering space, pressures to over-commit resources and increasing burden of continuous support for inefficient public sector enterprises. The most damaging consequence of unrestrained public expenditure is the emergence of twin deficits problem and eventually increase in domestic and external debt along with increase in interest payment on debt. This tendency led to further deterioration of the fiscal deficit position. The overall debt that started to swell in the 1980s became unsustainable in 1990s; persistent primary deficit was recorded until FY 1995-96 and the same situation has re-emerged since 2005.

Despite the reform process public debt was 54.4 percent of GDP in 1980, increased to 102.85 percent by 2000 and is still as high as 67.7 percent of GDP in 2007. Debt servicing, as a percent of tax revenues was as high as 103 percent in 2000, which increased to 123 percent in 2002 and declined to 60 percent by 2007 has again increased to 64 percent of tax revenue by 2008 whereas the Fiscal Responsibility Limitation Act, 2005 require a revenue surplus by FY 2008.

Similarly, the ratio of the total external debt obligation to foreign exchange earnings rose from 204 percent in 1980 to 334 percent in 2000 and is 145 in 2007.[1] The ratio of debt service payment to foreign exchange

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[1] The sustainable limit is 200 percent as suggested by Debt Reduction and Management Committee (Mach 2001).

earnings has risen sharply, from 16.5 percent in 1980 to 27.3 percent in 2000.[2] In other words, most of the foreign exchange earnings are paid to the foreign creditors leaving little for import of essential goods and services. Moreover, Pakistan‘s stock of external debt as a percentage of GDP and also as percent of export of goods and services is above the average of developing and South Asian countries (World Bank, 2005). The debt servicing indicators are also higher than the average of developing countries as a group (*see* Annexure 2).

Thus, the fundamental question addressed in this paper is whether the magnitude, structure, composition and growth of public debt has changed overtime and to what extent the inter play of fiscal and monetary management in general and the reform policies in particular have impacted the burden of debt stock, its structure, composition, growth and debt servicing.

This paper is organized in the following manner: Section II establishes the linkage between monetary and fiscal management to assess how the fiscal and external sector deficits were financed that eventually contributed to the build up of public debt. Section III reports the complete profile of debt that includes the basic aspects of structure of public debt, its composition, percentage share, growth trends and debt servicing over time (1971-2007). A comparative debt indicator analysis is also undertaken in order to meaningful comparison of pre and post 2000 debt to GDP ratios.[3] Section IV briefly discusses the external debt management and section V gives the conclusions emerging from this study and policy implications. All the estimates mentioned in various sections are based on data set of CD_ROM IFS (2006), Global Development Finance (CD-2007) and various issues of Economic survey of Pakistan, whereas the data set for the last two years was taken from *Economic Survey of Pakistan* and (2006-07) and *Annual Report* of State Bank of Pakistan 2007.

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[2]Following a credible strategy of debt reduction over last few years, Pakistan succeeded in reducing external debt and foreign exchange liabilities by $1.386 billion by June 2002. During year 2002-03, Pakistan succeeded in reducing another $0.945 billion worth of debt and liabilities.

[3]This comparison is warranted because of the fact that the Debt Policy Coordination Office of the Government of Pakistan is now using GDP statistics rebased at FY 2000 prices for calculating debt indicators. In this study the GDP statistics of pre-2000 would be converted at the new base, *i.e.* at FY 2000 prices, and the figures of post 2000 periods would be adjusted at the previous base for making the accurate comparison of debt ratios.

II. AN APPRAISAL OF FISCAL AND MONETARY MANAGEMENT (1971 TO 2007)

While historically, both taxation and budgetary issues were a major concern of public and the politicians, the monetary and debt management policies have been relatively passive instruments until 1990. It was the imperatives of macro economic adjustment and stabilization policies that brought monetary policy and debt management also to the forefront as the key determinants of the future course of economy. The budgetary financing priorities have always impacted the monetary conditions in the economy and impinged upon the effectiveness of monetary policy.

Before the financial sector reforms period (1990s) the National Credit Consultative Council (NCCC) formulated the Annual Credit Plan. Monetary expansion and credit allocation to the various sectors was made with specified set of guidelines and direct controls were the main instruments to regulate the banking and credit system.[4] Treasury Bills were issued on ad hoc basis whenever the government required funds for budgetary purpose and the state owned banks were to buy the bills at fixed rates of return. Besides treasury bills government also used the National Savings Schemes to raise debt by offering high rate of returns.

In the pre reform set up the monetary policy objective of price and financial sector stability was fairly attained and growth took place at a regular sustainable pace. Table 1 report that the average growth rate of GDP was 5 percent in 1970s and rose to 7 percent in 1980s. Although the inflation rate was more than 12 percent on average in the 1970s, mainly due to rapid increase in world oil prices, it was brought down to 7.6 percent in the decade of 1980s along with a slight decline in reserve money growth from 15.8 percent in 1970s to 14.8 percent in 1980s.

During the same period fiscal deficit was as high as 7.6 percent in 1970s and 6.8 percent of GDP in 1980s. Overall fiscal effort was low and major emphasis of taxation policy during this time was on indirect taxes and high tax rates. Taxes were levied on ‘easy to tax’ areas like excise duty at production stage or at the import stage, *i.e.* customs and sales tax etc. The sales tax structure was regressive and the corporate tax rates were extremely

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[4]The side effects of these direct controls of the pre reform set up were that unfortunately a number of distortions were created in the form of lower deposit rates, low savings and inefficient resource allocation. Moreover the specialized finance schemes of central bank including trade finance and credit for capital goods producing industries etc added to the inefficiencies in the financial system (Janjua, 2003).

high and discriminatory. High protective barriers were in place through tariffs, which resulted into anti export bias. Too many exemptions, concessions and low incidence of taxes on consumption reduced the tax base, increased the incidence of tax evasion and avoidance. The taxation system lacked transparency and fairness; it was based on manual operations and caused undue delays and harassment. The revenue targets were routinely missed and tax to GDP ratio remained persistently low and stagnant around 12 to 13 percent of GDP. Thus, the resource gap was either financed by monetizing the deficit or by borrowing from non-bank and the external sources, and fiscal space was created by keeping the share of development expenditure low as a percentage of GDP.

TABLE 1

Overall Macroeconomic Environment

Variables/Years	1970s	1980s	1990s	2000s[5]
Growth Rates				
GDP	5.0	7.1	4.4	5.8
Inflation (GDP Deflator)	12.2	7.6	10.0	6.3
Percent of GDP				
Saving	11.2	14.8	13.8	17.3
Investment	17.1	18.7	18.3	18.6
Budget Deficit	7.6	6.8	7.3	4.6
Current Account Balance	–5.2	–2.8	–4.1	–0.02

Source: Various Issues of *Economic Survey of Pakistan*.

This resource gap is also reflected in the low growth of domestic savings that ranged between 11 percent of GDP to 14.8 percent of GDP. The contribution of public sector savings to domestic savings remained insignificant, private savings as the major component of domestic savings ranged between 10 to 13 percent of GDP and savings of the corporate sector have remained stagnant despite having a major share in financial sector domestic credit allocation. Thus, the growth and economic policies pursued were not accompanied with significant increase in savings rate in particular saving in financial instruments.

[5]Estimates for the decade of 2000s are based on data for the time period 2000-2007 and do not provide a decade wise comparison which may obscure the actual position and trends to some extent.

TABLE 2

Fiscal Indicators: Revenues and Expenditure

Variables/Years	1970s	1980s	1990s	2000s
Percent of GDP				
Tax	11.4	13.2	13.0	12.5
Non-Tax	2.3	3.6	4.2	4.0
Revenues	13.7	16.8	17.2	16.4
Grants	0.6	0.7	0.3	0.9
Total Revenues Grants	14.3	17.6	17.6	17.4
Percent of GDP				
Interest payments	1.7	3.3	6.0	6.6
Defense	6.0	6.3	5.8	3.9
Current Expenditure	13.7	17.8	19.8	17.8
Development Expenditure	3.3	2.9	3.4	3.7
Net Lending to PSEs	4.9	3.7	1.7	0.4
Grand Expenditure	21.9	24.3	24.8	22.0
Percent of GDP				
Primary Deficit	5.9	3.5	1.3	–2.0
Fiscal Deficit	7.6	6.8	7.3	5.0

Source: CD_ROM IFS (2006).

Since 1990s, the financial sector of Pakistan has undergone a major reform process and the pre 1990 set up of monetary policy and monetary management was replaced by a market based system of monetary and credit management although until recently the credit distribution continued to be based on annual credit plan.[6] During this period monetary policy objectives of price stability and sustainable economic growth were largely not met, GDP growth was as low as 4.4 percent, fiscal deficit was 7 .3 percent of GDP, reserve money growth and inflation increased to 10.7 percent and 10

[6]Despite financial reforms general awareness about the existing financial and saving instruments like stocks, mutual funds, modarabas etc is limited to urban areas of big cities, the low and middle income group still rely on informal sources of savings and the equity market still has a narrow base.

percent respectively.[7] The major causative factors of monetary expansion during the period of eighties and nineties originated from net domestic assets caused by government borrowing.

In the post reform period fiscal deficit was the most critical issue to be dealt with, as its impact on the external sector balance of payments deficits and effectiveness of monetary policy remained to be high via the price expectations and the exchange rate channels of transmission mechanism. To tackle macroeconomic and fiscal imbalances the fiscal and monetary policy coordination was strengthened, to adopt revenue rising and expenditure cutting measures so as to control inflationary potential of credit expansion to the government Janjua (2003). The share of direct taxes increased from 18 percent to 34 percent and the share of indirect taxes declined from 82 percent to 66 percent mainly due to decline in share of customs and excise duty whereas the share of sales tax increased. Tax rates were reduced and switched from 'production and investment' to tax on 'consumption and income'.

TABLE 3

Monetary Sector Indicators

Variables/Years	1970s	1980s	1990s	2000s
AS Percent of M2				
Government Borrowing	44.9	44.8	49.7	22.4
Private Sector credit	49.7	55.3	54.6	99.4
Domestic Credit	94.7	100.1	104.3	255.7
M2 as % of GDP	44.4	47.4	46.8	23.7
Reserve Money (Growth %)	15.8	14.8	13.6	14.5

Source: CD_ROM IFS (2006)

Further, the cost of public debt on domestic bank and non-bank sources of financing fiscal deficit was rationalized. Government debt was raised through auction of T-bills and government bonds. Despite these measures the tax to GDP ratio remained stagnant, reduction in expenditures was met with little success and whatever fiscal adjustment was made it was primarily

[7]Other factors that periodically contributed to price increase were supply side bottlenecks, the adjustment of government-administered prices, exchange rate pass through, increased indirect taxes and inflationary expectations.

through cuts in development expenditure. Although the major tax reforms improved the tax structure it did not improve the tax to GDP ratio. Reforms pushed the interest rates upwards with fiscal deficit increasing and the interest expenditure rose to 8.3 percent of GDP in FY 2000 compared to 5.5 percent of GDP in FY 1990. Premature liberalization and improper sequencing of reforms deteriorated the fiscal position through rising interest expense on domestic debt (Cole and Betty, 1999; Yaqub Muhammad, 1998).

The period of 2000s witnessed both contractionary and expansionary phases of the monetary policy. Tight monetary stance in the early period of 2000s was mainly driven by the objective of maintaining the value of Rupee and to remain within the net domestic assets target set under the IMF program for government borrowing from the State Bank. At the same time record high inflow of foreign exchange through remittances led to reserve money growth as high as 14.5 percent. Later easy monetary policy stance led to sharp decline in interest rates and the bench mark T bill rates declined from 12.8 to a record low of 1.6 percent. Government debt held by SBP was retired. As a result the growth rate of GDP remained steady, averaging close to 6 percent. Fiscal deficit declined to an average of 3.5 percent, revenue collection registered positive improvement and tax receipts increased substantially, inflation was 3.5 percent on average and the rising trends in public as well as external debt were arrested as a result of prudent debt management policy. However, this phenomenon of improved macro economic performance could not be maintained for long and the gains achieved in the first half of 2000s were easily eroded. The fact remains that development expenditure to GDP ratio is low, and fiscal deficit after a decline again rose to 7.6 percent of GDP by 2008. The annual monetary targets for growth of money supply were easily missed and despite tight monetary stance reserve money grew as high as 14.5 percent on average in 2000s causing inflation to increase from an average of 3.5 percent during 2000-03 to over 10 percent during 2005-07 and further increased to 20 percent in 2008.

In addition to the fiscal deficit, the external sector accounts remained non impressive through out the past three decades, both the trade and the current account balances always remained in deficit. Consistent trade and current account deficit was mainly due to rising imports, stagnant exports, rising interest payments and varying level of remittances. As shown in Table 4, persistent deficit in the current account has implications for the public debt stock and it's servicing. To finance the external account deficit reliance on external borrowing increased. By 1990s trade was liberalized to a great extent, tariff restrictions and quota restrictions were removed, exchange rate was liberalized and made fully convertible on current account. Despite these measures the trade to GDP ratio remains low, the value of exports grew by 6 percent on average annually and the current account remained persistently negative except for the first half of 2000s.

TABLE 4

External Sector Indicators

Variables/Years	Percent of GDP			
	1970s	1980s	1990s	2000s
Trade Gap	–6.79	–9.47	–4.81	–3.62
Interest payments	1.00	1.63	1.80	1.33
Remittances	3.13	7.40	2.96	3.82
Current Account Balance	–5.19	–2.79	–4.07	–0.02
Foreign Direct Investment	0.05	0.31	0.85	1.36
Portfolio Investment		0.14	0.52	–0.08

Source: CD_ROM IFS (2006) and *Economic Survey of Pakistan*, various issues.

Prior to the reform period exchange rate was based on managed float system and the level of variation in exchange rate was low. However, in the post reform period exchange rate variation increased sharply indicating volatility in the exchange rate. Rupee remained under pressure and to manage the pressure of foreign exchange reserves capital controls were initiated. A two-tier exchange rate system was introduced which was unified later in 2000. In 2003, SBP managed to purchase record level of foreign exchange in the inter bank market and accumulated huge foreign reserves that stabilized the rupee value for a few years Janjua (2003). Current account improved due to rise in workers remittances, fall in interest payments as a result of prepayment of expensive debt, restructuring of expensive loans with cheap loans, inflow of funds for logistic support and high growth in export earnings.

However, during the second half of 2000s improvement in current account was reversed and the current account deficit for the FY 2007-08 alone has been as high as 9 percent of GDP and continues to rise, leading to a record trade deficit that now is almost the same as country’s official foreign exchange reserves. Moreover the services account that had also begun to rise sharply due to rapidly rising remittances amounting to $ 18.5 billion during the last five years has also started slowing down. The greater access to the markets of USA and EU countries that helped in achieving significant upsurge in Exports has also slowed down. As a result rupee has come under severe pressure, it depreciated by almost twenty percent and the foreign exchange reserves dwindled from almost US $ 14 billion to US $ 6 billion during 2007-2008.

To sum up the evaluation of macro economic policies reveal that, except for the decade of 1990s, despite high growth rate of GDP domestic savings were insufficient to meet the fiscal and external sector gaps. The resource gap was financed throughout from domestic sources and external finances. Thus an obvious result of these fiscal and monetary policy preferences and low domestic savings was an ever-rising inflation, accumulation of public debt and debt servicing as percentage of GDP.

III. PUBLIC DEBT

The appraisal of fiscal and monetary policies suggests that the issue of high stock of public debt and its servicing is obviously the outcome of these policies. Since the overall structure and composition of public debt has a central place in the analysis of debt management and it is important to examine and assess the extent to which the fiscal and monetary policies and the reform process has impacted the various aspects of public debt overtime.

STRUCTURE OF PUBLIC DEBT

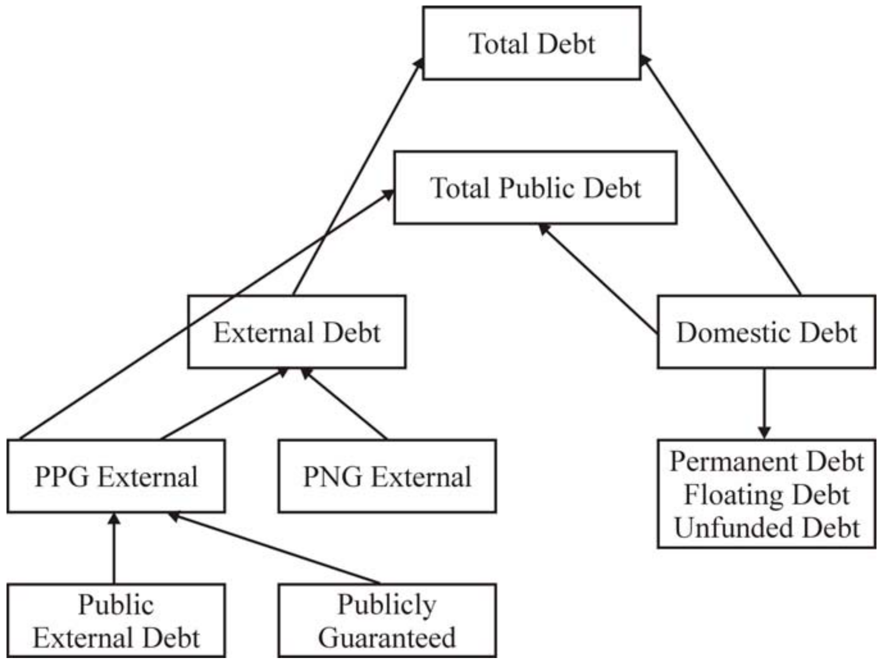
A chart (Figure 1) gives a bird's eye view of the structure of debt that includes the two main classifications of debt, *i.e.* Domestic debt and External debt, whereas public debt includes domestic debt as well as public portion of external debt. Distinction between domestic debt and external debt is essential as both may have different implications for the macroeconomic environment of a country and debt repayment. Domestic debt is serviced in rupees from government revenues and is an important part of current expenditure that has implications for fiscal space, growth and development expenditure. Whereas the external debt stock (including public external and private external debt) is to be paid in US dollars and depreciation of Rupee adversely impacts the external debt and balance of payments position Hasan (2000). Main components of public debt on which our analysis is based are:

Public Debt

Measured as the cumulative government borrowing to finance the resource gap and budget deficits. Its two major components include (*i*) domestic debt (bank and non-bank) and (*ii*) external debt (excluding non-guaranteed debt by government).

FIGURE 1

Structure of Debt



Where PPG is Public and publicly guaranteed debt, and
PNG is Private non-guaranteed debt.

(*a*) **Domestic Debt:** It is measured as the debt issued to the government by banks, non-bank financial institutions and the general public. It also includes borrowings of the state enterprises and private non-guaranteed domestic borrowing.

(*b*) **External Debt:** It is measured as public and publicly guaranteed debt and private non-guaranteed debt borrowed from bilateral and multilateral sources internationally.

Since the overall fiscal gap, as percent of GDP has remained high throughout the four decades under review, Table 5 broadly summarize the percentage share of two main sources of financing the resource gap, *i.e.* the domestic sources (including bank and the non-bank) and the external sources. Domestic finance remained the dominant source of financing the fiscal deficit and relative to bank borrowing government relied more on non-bank borrowing to finance its fiscal deficit. With the exception of the decade of 2000s, the combined share of external borrowing and domestic bank borrowing, in deficit financing has remained high. However, their total share declined from 59 percent in 1990s to 38.5 percent in 2000s and the remaining 61.5 percent of deficit financing was done through non inflationary non bank borrowing which suggests that overtime the domestic debt obligations and fiscal deficit were largely impacted by the fiscal and monetary policy financing priorities of that time. Failure to mobilize resources and manage expenditures impacted the debt management efforts and the overall debt stock remained high.

TABLE 5

Fiscal Indicators: Gaps and Financings

Variables/Years	1970s	1980s	1990s	2000s
Percent of GDP				
Primary Balance (surplus)	5.9	3.5	1.3	–2.0
Overall Deficit	7.6	6.8	7.3	5.0
Percent of Overall Deficit				
External Financing	50.9	22.6	30.7	26.5
Domestic Financing	49.1	77.4	69.3	73.5
Bank borrowing	21.2	27.8	28.5	12.0
Non-Bank borrowing	28.0	49.6	40.8	61.5

Source: CD_ROM IFS (2006).

PUBLIC DEBT TREND – REBASING OF GDP

Before examining the trend in the structure of public debt in detail, it is worthwhile to take note of the fact that published data pre and post 2000 period is based on different base years. For making any meaningful comparison it is worthwhile to adjust the data at the prevailing and previous base year, it is interesting to report that the findings of the debt management office in fact under report the public debt to GDP ratio when data Post FY 2000 is adjusted at prevailing and previous base year.

Table 6 reports that in Rupee terms Public debt increased from Rs.127 billions in 1980 to Rs. 674 billions in 1990 and to Rs. 3266 billions in 2000, which lately peaked at Rs. 4935 billions by June 2007. The public debt situation of Pakistan in actual fact started worsening in the decade of 1990s and was the worst in the early years of 2000s and it is reported to be as high as 102.8 percent of GDP which declined sharply[8] to 56.7 percent of GDP by

[8]The Debt Policy of Pakistan (2005-06) and State Bank Annual Report (2008).

2007. However, this improvement is the outcome of statistical bias engineered through rebasing the data for GDP at price level of FY 2000 and is therefore questionable. After adjusting the data at the previous base it is found that in FY 2000 the debt to GDP ratio was 102.8 at the previous base and it actually declined to 67.7 percent of GDP in 2007 instead of the reported 56.7 percent of GDP measured at the new base of FY 2000.

TABLE 6
Composition of Public Debt in Pakistan

Years	1980	1990	2000	2001	2002	2003	2004	2005	2006	2007
Billions Rupee										
Domestic Debt	57	377	1579	1731	1718	1854	1979	2129	2322	2597
External Debt	71	298	1687	1769	1822	1916	2000	1963	2147	2338
Public Debt	128	675	3266	3500	3540	3770	3979	4092	4469	4935
Public Debt As % of										
Gross Domestic Product (Previous base)	54.4	79.0	102.8	102.3	97.6	93.8	85.9	74.6	70.3	67.7
Gross Domestic Product (2000 base)	45.6	66.1	86.1	85.6	81.7	78.6	71.9	62.5	58.8	56.7
Shares of Public Debt										
Domestic Debt	44.5	55.9	48.3	49.5	48.5	49.2	49.7	52.0	52.0	52.6
External Debt	55.5	44.1	51.7	50.5	51.5	50.8	50.3	48.0	48.0	47.4

Source: Data for the last two years from *Economic Survey of Pakistan* (2006-07). CD_ROM IFS (2006).

Data regarding the percentage share of domestic and external debt in public debt shows that overtime the structure of public debt has witnessed modest change. Although the share of domestic debt has increased from 44.5 percent in 1980 to 52.6 percent in 2007, the importance of share of external debt in public debt remains high despite the fact that it fluctuated from 55.5 percent to 47.4 percent during the same period. Table 6 shows the total public external debt increased rapidly overtime, it was Rs. 71 billions in 1980s and increased to Rs.298 billions in 1990, it rose to Rs.2000 billions by June 2004 and further increased to Rs 2338 billion by 2007. In this way the share of external debt in public debt was as high as 55.5 percent of public debt in 1980s. However in the later half of 1980s external debt declined mainly due to tougher conditionality of the donors, *i.e.* IMF, IBRD etc., and the share of external debt reduced to the level of 44.1 percent of the public debt in 1990 and again increased to almost 50 percent in the decade of 2000s with slight variations annually.

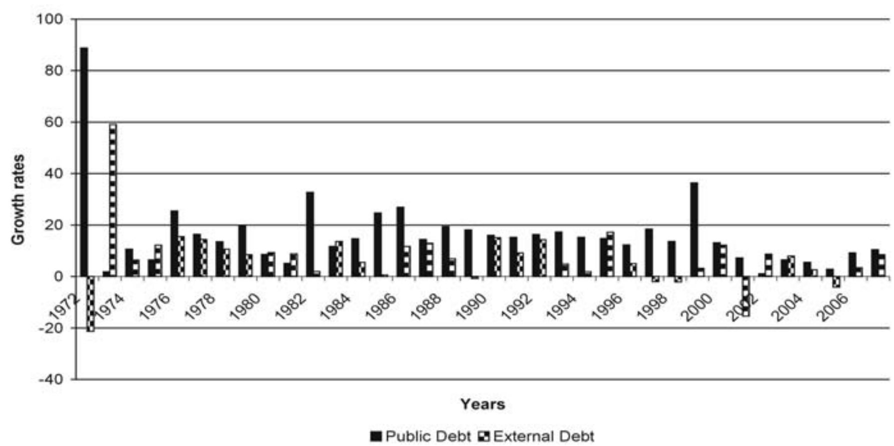
TABLE 7
Annual compound Growth Rates

Years	1970s	1980s	1990s	2000s
Domestic Debt payable in Rupee	18.1	21.2	15.6	8.2
External Debt payable in Rupee	26.9	14.4	20.1	5.8
Total Public Debt	21.9	17.6	17.6	7.0

Source: *Global Development Finance* (CD-2007).

Similarly, with the exception of a few years growth in public debt has not only remained positive through out but has been quite high. The persistent and large fiscal deficit led to growth in public debt by an average rate of 21.9 percent in 1970s and remained 17.6 percent per annum in the decade of 1980s and 1990s (*see* Table 7/Annexure 1). Growth in public debt in the decade of 2000s has fluctuated significantly and after a consistent decline since 2001 growth in public debt has once again increased and was almost 10% in 2007.[9] It is worthwhile to note that although growth rate of public external debt was lowered in the decade of 1980s to 14.4 percent, it however increased in the subsequent decade of 1990s and was also higher than the growth rate of public domestic debt which grew at 15.6 percent on average compared to 21.2 percent in1980s (*see* Table 7).

FIGURE 2
Graph of Public and External Debt Growth Rates



[9]The debt stock increased by 27 percent during 2007-08 and the growth of domestic and external debt was as high as 26 percent and 29 percent respectively. By the end of 2008 debt stock was Rs. 6302 billion.

COMPONENTS OF DOMESTIC DEBT

The three components of domestic debt comprising of permanent debt (medium and long term), floating debt (short terms) and unfunded debt (non-bank borrowing) are given in Table: 8. It is shown that the shares of floating and unfunded debt have been high relative to permanent debt.

TABLE 8

Structure of Domestic Debt

Years	1972	1980	1990	2000	2001	2002	2003	2004	2005	2006	2007
	Billion Rupees										
Permanents	9	15	95	260	281	368	428	537	526	500	553
Floating	5	35	145	647	738	558	516	543	778	940	1108
Unfunded	3	11	138	672	712	792	909	896	854	857	937
Total Debt	17	61	378	1579	1731	1718	1854	1975	2158	2297	2598
	Growth Rates										
Permanents	3.6	11.2	23.5	1.0	8.3	30.9	16.3	25.4	–2.0	–5.0	10.6
Floating	73.6	12.6	7.2	15.3	14.0	–24.4	–7.4	5.2	43.3	20.8	17.8
Unfunded	16.5	14.3	15.1	17.0	6.0	11.2	14.8	–1.5	-4.6	0.3	9.3
Total Debt	20.1	12.5	13.8	13.4	9.6	–0.8	7.9	6.6	9.3	6.4	13.1
	Shares of Total Debt										
Permanents	54.4	24.3	25.1	16.4	16.2	21.4	23.1	27.2	24.4	21.8	21.3
Floating	29.7	57.1	38.3	41.0	42.6	32.5	27.9	27.5	36.1	40.9	42.7
Unfunded	15.9	18.6	36.6	42.5	41.1	46.1	49.1	45.3	39.6	37.3	36.1
Total Debt	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: *Pakistan Economic Survey* (Various issues).

The share of permanent debt, which is mostly raised by issuing long-term government bonds of different tenors, *i.e.* 3, 10, 20 and 30 years (Pakistan Investment Bonds PIBs) and prize bonds, has remained the lowest in domestic debt. In fact except for slight variations its share has remained almost the same in the past three decades, *i.e.* 1980 to 2000s. It increased marginally from 24.3% in 1980 to 25.1% in 1990, during the second half of 1990s its share decreased significantly to 16.4% and after an increase of 24.4% in 2005 it declined further to 21.3 percent in 2007. This reflects modest development of capital market for long-term government securities and heavy reliance on short-term money market borrowings.

The share of short-term floating debt, secured mostly through the sale of market treasury bills, declined significantly from 57 percent in 1980 to 38.3 percent in 1990, which again rose to 42.6 percent in 2001. After declining to 27.5 percent in 2004 it re emerged as a dominant component of total domestic debt and its share was the highest as 42.7 percent in 2007. These fluctuations in the share of floating debt are a reflection of variations in market interest rates as a result of financial sector reforms that led to market based auction of treasury bills and increased cost of borrowing of this component of domestic debt. Recent increase in the share of floating debt in total domestic debt also reflects increased reliance of government on monetizing its debt, which has serious implications for inflation and erosion of growth.

The unfunded debt comprising of National Savings Schemes, was equally preferred as it is a non-inflationary source of domestic finance. Attractive returns on the National Savings Schemes with the added advantage of tax exemption helped in mobilizing domestic savings. Heavy institutional investment in these saving schemes also brought a sharp rise in the unfunded debt and it was at par with floating debt. Thus the share of unfunded debt in total domestic debt has persistently increased from 18.6 percent in 1980 to 36.6% in 1990 and 49.1 percent in 2000.

However, the with drawl of tax exemptions, ban on institutional investment and the rationalization of interest rate in various instruments of the National Saving Schemes in 2000 and subsequent periods resulted in sharp decline in growth rate and share of unfunded debt in domestic debt. Although the share of unfunded debt recorded a modest decline in the second half of 2000s, its share remained almost one third, *i.e.* 36.1 percent of domestic debt in 2007.

From the above information it can be suggested that the structure of domestic debt has not changed significantly over the years, floating and unfunded debt remain to be the two major sources of domestic debt. This reflects the limited options of savings instruments available to the public at large.[10]

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[10]More recently the unfunded debt has recorded high growth between 2005 and 2007 from –4.6 to 9.3 respectively. This impressive performance of unfunded debt has been mainly due to revision of rate of returns, removal of institutional ban on investment in saving schemes, government's preference for non bank medium to long term borrowing and the introduction of pensioner's and senior citizen's pensioner schemes offering higher returns.

So far as the growth rate of the three components of domestic debt is concerned, it has varied significantly overtime, which is a reflection of the changing preference for different sources of debt and the prevailing market conditions of that time. However, the overall growth of domestic debt mostly remained high except for a momentary decline in the growth of domestic debt in 2002, which again recorded a rapid increase in the subsequent years.

TABLE 9

Domestic Debt and Impact of Reforms on Debt Management (Rs. Billion)

	Pre Reform Period		Beginning	Post Reform Period	
	1980	1985	1990	1995	2000
Domestic Debt	Rs. 61	Rs. 153.0	Rs. 377	Rs. 807.6	Rs. 1579
As percent of GDP					
Domestic Debt	25.5	32.4	44.5	42.9	51.6
Permanent debt	5.6	7.8	11.5	15.4	10.2
Floating debt	15.0	15.5	16.9	15.6	20.4
Unfunded debt	4.9	9.1	16.1	11.9	21.0
As % of Total Revenue					
Domestic Debt	155.2	197.6	240.1	254.0	305.8
Permanent debt	34.4	47.6	62.1	91.3	60.5
Floating debt	91.1	94.4	91.3	92.5	120.6
Unfunded debt	29.7	55.6	86.7	70.2	124.7

Source: *Pakistan Economic Survey* (Various issues).

Similarly, Table 9 gives a comparison of the various financial sector reform measures on domestic debt and its management. It is observed that in the post reform period the domestic debt situation instead of improving actually deteriorated. The debt burden in terms of GDP was 44.5 percent in 1990, which rose to 51.6 percent in 2000. The situation is even worse in terms of revenue, which increased from 240.1 percent of revenue in 1990 to 305.8 percent in 2000.

STRUCTURES AND COMPOSITION OF EXTERNAL DEBT

Prior to 1970s, the external debt was relatively small and primarily an official phenomenon comprising of loans obtained mostly on concessional terms. However, since the early 1980s, short-term expensive commercial loans also began to play an increasing role for balance of payments support.

Later in 2000s Pakistan also resorted to borrowing in the international capital market by floating bonds at floating rates, which has led to increase in its external debt and debt-servicing burden.

Table 10 shows the composition of external debt, the four components include public and publicly guaranteed debt, private non guaranteed debt, short term commercial debt and IMF loans. The volume of total external debt of Pakistan remains to be very high despite the fact that the total external debt to GDP ratio and foreign exchange earnings ratio has declined.

TABLE 10
Composition of External Debt (million $)

Years	1980	1990	2000	2001	2002	2003	2004	2005	2006	2007
Long Term	8213	15562	31832	27017	29143	31565	32712	31580	33995	37267
Public and Publicly Guaranteed	8196	15425	29288	24863	27106	29752	31135	30085	32410	35265
Private Non-Guaranteed	17	137.2	2545	2154	2037	1813	1578	1495	1585	2002
Use of IMF	624	878	1708	1550	1906	2072	1991	1677	1491	1407
Short Term	589	2963	1766	1311	1416	1396	1245	1233	169	25
Total Debt	9425	19403	35306	29878	32465	35033	35948	34491	35655	38699
External Debt as % of										
Gross Domestic Product	39.8	48.7	57.5	51.1	54.9	51.0	44.7	37.3	33.5	32.2
Export of Goods and Services	329	306	369	292	287	258	231	199	175	183
Foreign exchange earning*	204	234	334	264	237	197	185	160	143	145

Source: *Global Development Finance* (CD-2007).
*Foreign exchange earning is equal to export of goods and services including workers remittances.

Table 10 shows that the total outstanding stock of external debt was as low as $ 9.43 billions in 1980 which doubled to $ 19.40 billions in 1990; it amounted to $ 35.3 billions in 2000, it further increased to $ 38.7 billions in 2007.[11] Although external debt as percentage of GDP has declined modestly between 1980 to 2007 from 39.8 percent to 32 percent respectively, it has declined substantially as a percent of export of goods and services and foreign exchange earnings.

[11]The total external debt increased to $ 46 billion by end of June 2008.

TABLE 11

External Debt Profile

Years	1970s	1980s	1990s	2000s
	Share in total Debt			
Long term	90.9	81.6	84.2	91.8
Public and Publicly Guaranteed	90.6	81.3	79.6	86.3
Private Non-Guaranteed	0.3	0.3	4.6	5.5
Use of IMF	6.0	8.7	4.7	5.0
Short Term	3.1	9.7	11.1	3.2
	Growth rate			
Long term	12.2	6.0	7.6	4.0
Public and Publicly Guaranteed	12.2	6.0	6.8	4.4
Private Non-Guaranteed	19.0	23.4	40.4	-0.8
Use of IMF	41.9	4.0	8.1	0.3
Short Term	17.2	24.7	0.5	-26.1

Source: *Global Development Finance* (CD-2007).

Table 11 reports the structure of external debt as dominated by long-term debt with slight variations overtime. The average share of long-term debt was almost 90.9 percent during 1970s, declined to 81.6 percent in 1980s and increased from 84.2 percent to 91.8 percent of the total by the end of 1990s and 2000s respectively. The share of pubic and publicly guaranteed external debt (PPG) in long term debt relative to private non guaranteed debt remained dominant throughout and was on average as high as 90.6 percent of the total debt in 1970s, after a slight decline in the decades of 1980s and1990s it was as high as 86.3 percent in the decade of 2000s. Although, the growth rate of public and publicly guaranteed debt has been declining while the dominance of public external debt remains unchanged over the past three decades. The private non-guaranteed external debt was increasing in 1990s as compared to its share in the earlier decades, but it had always been below 10 percent of the total external debt. The private sector share in external debt was 0.3 percent in 1980s, 4.6 percent in 1990s, and 5.5 percent in 2000s. Although, the share of short-term debt remained high at 11.1 percent particularly during 1990s (*see* Table 11), its growth has declined significantly since the decade of 1990s and was negative in 2000s.

TABLE 12

Public and Publicly Guaranteed Debt

Years	1970s	1980s	1990s	2000s
	Share in PPG			
Official Creditor	93.8	92.6	94.0	94.7
Multilateral	17.4	25.4	48.1	51.5
Bilateral	76.3	67.2	46.0	43.2
Private Creditor	6.2	7.4	6.0	5.3
	Growths Rates			
Official Creditor				
Multilateral	11.3	13.8	10.7	5.1
Bilateral	13.5	3.1	3.1	3.5
Private Creditor	2.9	7.9	13.4	10.6

Source: *Global Development Finance* (CD-2007).

In terms of creditors, public and publicly guaranteed debt includes debt from official creditors both multi lateral and bilateral and also debt from private creditors. The share of official creditors in public and publicly guaranteed external debt was 93.8 percent in 1970s and 92.6 percent on average during 1980s; it however increased from 94 percent in 1990s, to 94.7 percent in 2000s on average. The bulk of increase over the period 1980-2005 has been recorded under multilateral debt. The average share of multilateral debt in official creditors has increased from 25.4 percent in 1980s to 48.1 percent in 1990s and further increased to around 51.5 percent in 2000s whereas the share of bilateral creditors decreased from 76.3 percent in 1970s to 67.2 percent in 1980s to 43.2 percent in 2000s. On the other hand, the public and publicly guaranteed external debt owed to private creditors declined to 5.3 percent in 2000s from 7.4 percent in 1980s in general. The average share of private creditors constituted 6.2 percent of the public and publicly guaranteed external debt in 1970s but it declined to 5.3 percent during 2000s (Table 12).

Table 13 indicates that over the years, share of concessional debt in the long-term external debt was as high as 78.4 percent in 1970s and 81.1 percent in 1980s. It was however touched a minimum of 64.4 percent in

1990s and has improved to 70.9 percent in 2000s. Similarly during the same period the share of multilateral concessional debt has persistently increased from a low level of 12.8 percent to 46.6 percent between 1970s and 2000s, while the share of bilateral concessional debt declined steadily from its highest ever level of 87.2 percent in 1970s to 53.4 percent in the decade of 2000s.[12]

TABLE 13

Share in Concessional Loan

Years	1970s	1980s	1990s	2000s
	Share in Long term Debt			
Concessional	78.4	81.1	64.4	70.9
Non-Concessional	21.3	18.5	30.2	20.5
	Share in Concessional			
Multilateral	12.8	20.7	40.4	46.6
Bilateral	87.2	79.3	59.6	53.4

Source: *Global Development Finance* (CD-2007):

PUBLIC DEBT SERVICING

As shown above the stock of public debt has been persistently rising leading to ever rising debt servicing obligations. In absolute terms the interest payment on both domestic and external debt has always been high and so has the total debt servicing.

Even, in terms of percentages of a few selected indicators debt servicing still remains to be high. For example, in 1980, 24.5 percent of total revenues were used for debt servicing which reached to 43.24 percent in 1990 and in 2005, 54.51 percent of total revenues were being consumed for debt servicing and the scope of development expenditure was very limited. Similarly as a percentage of GDP, debt servicing amounted to as high as two thirds of the current expenditure in 2001 which means it was three to four times higher than the development expenditure in the first half of the decade of 2000s.

[12]The total capital inflows in the form of aids and concessional loans from Pakistan Aid Consortium and OPEC countries were about $ 23 billions from 1973-1990.

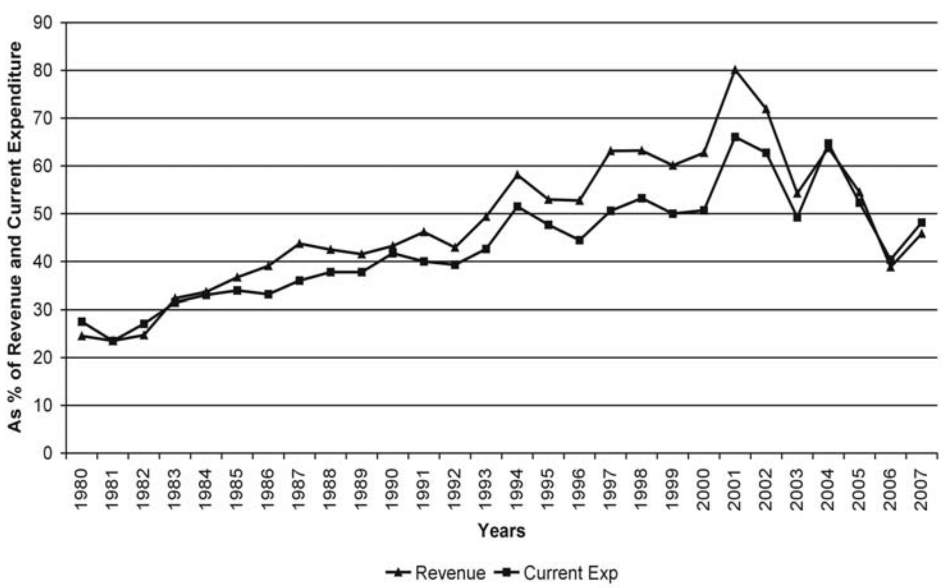
TABLE 14

Composition of Public Debt Servicing

Years	1980	1990	2000	2001	2002	2003	2004	2005	2006	2007
Interest Payments	Billion Rupees									
Domestic	1.8	31.2	184.2	259.5	267.3	208.3	271.0	299.3	234.5	310.4
External	3.1	16.9	52.3	53.2	51.4	49.2	46.7	48.9	42.1	48.4
Total	4.9	48.1	236.6	312.7	318.7	257.4	317.7	348.2	276.6	358.8
Amortization	4.5	22.7	96.8	116.2	126.4	123.2	167.6	112.4	85.4	67.3
Debt Servicing	9.3	70.8	333.4	428.9	445.1	380.7	485.3	460.6	362.0	426.1
	As percentage of									
Tax Revenue	29.9	62.1	86.4	101.4	96.9	72.4	83.7	70.0	52.0	58.1
Total Revenue	24.5	43.2	62.8	80.2	71.9	54.3	63.8	54.5	38.8	45.8
Current Expenditure	27.5	41.7	50.7	66.1	62.7	49.2	64.7	52.3	40.4	48.1
Grand Expenditure	17.5	32.6	45.0	57.7	50.2	42.3	51.1	41.4	29.8	34.7
GDP	4.0	8.3	10.5	12.5	12.3	9.5	10.5	8.4	6.6	7.3

Source: *Global Development Finance* (CD-2007).

FIGURE 3
Trends in Debt Servicing from 1980 to 2005



Domestic debt servicing of various components of domestic debt reported in Table 14 shows that the debt servicing burden deteriorated in general and more importantly the impact of reforms worsened in terms of percent of GDP, revenue and debt levels. For example, debt servicing in terms of GDP for permanent debt rose from 1.3 percent in 1990 to 1.9 percent in 2000 due to introduction of Federal Investment Bonds at high coupon rates, which increased interest from 11.5 percent in 1990 to 18.6 percent in 2000. Similarly debt servicing burden of floating debt in terms of GDP increased from 0.7 percent in 1990 to 1.5 percent in 2000 due to a shift from tap T bill system with 6 percent yield to auction based T bills with yields from 8 to 17 percent and also a shift from ad hoc T bills yielding 0.5 percent to auction based yields. Further interest rates on floating debt also increased from 3.9 percent in 1990 to 7.6 percent in 2000.

TABLE 15
Domestic Debt Servicing

	Pre Reform Period		Beginning	Post Reform Period	
	1980	1985	1990	1995	2000
As percent of GDP					
Domestic Debt	1.1	2.3	4.3	4.8	7.0
Permanent Debt	0.4	0.7	1.3	1.8	1.9
Floating Debt	0.3	0.4	0.7	0.8	1.5
Unfunded Debt	0.3	1.0	2.0	1.3	2.8
As percent of Total Revenue					
Domestic Debt	7.0	13.8	23.2	28.6	41.3
Permanent Debt	2.4	4.2	7.1	10.6	11.2
Floating Debt	2.1	2.5	3.5	5.0	9.2
Unfunded Debt	1.6	6.0	10.7	7.9	16.8
As Percent of Debt level					
Domestic Debt	4.5	7.1	9.6	11.3	13.5
Permanent Debt	7.0	9.0	11.5	11.6	18.6
Floating Debt	2.3	2.9	3.9	5.5	7.6
Unfunded Debt	5.4	11.6	12.3	11.3	13.5

Source: Financial Sector Assessment SBP (2003).

External debt servicing figures reported in Table 15 also shows that it increased from $ 763 millions in 1980 to $ 1850 millions in 1990 and reached to $ 2883 millions in year 2000; registering an average increase of 9.5 percent and 7.3 percent per annum respectively during the decades of 1980s and 1990s. On average $1.8 billions were paid annually in debt servicing during 1990s.[13] The terms of the loans negotiated during this period were extremely unfavorable, *i.e.* high interest rates, short maturity period and declining percentage of grant element.[14] The increased reliance on short-term commercial borrowing contributed towards buildup of debt servicing payments. Although the interest payment on external debt continues to be rising in the decade of 2000s the debt-servicing burden, which was highest in 2004 amounting to US $ 3710 million, has declined significantly in the second half of the 2000s.

TABLE 16

External Debt Servicing (millions $)

Years	1970	1980	1990	2000	2001	2002	2003	2004	2005	2006	2007
Interest Payments	106	312	790	1012	908	837	841	810	752	754	863
Long Term	94	231	480	901	792	736	762	752	691	724	829
IMF	12	29	53	46	50	46	33	23	17	16	24
Short Term	0	52	257	64	66	55	45	34	44	14	10
Principal Repayment	139	452	1060	1872	1984	2058	2108	2900	1894	1382	1165
Long Term	125	330	872	1613	1763	1840	1677	2309	1494	1239	1045
IMF Repurchases	14	122	188	259	221	218	431	592	400	143	120
Total Debt Servicing	244	763	1850	2883	2892	2895	2948	3710	2646	2136	2028

Source: *Global Development Finance* (CD-2007).

Overall, during the last couple of years the debt servicing liabilities have declined sharply from 62.8 percent of total revenues and 50.7 percent of the current expenditure in 2000 to 54.5 percent of revenue and 52.3 percent of current expenditure in year 2005. Debt servicing as a percentage of GDP has also declined significantly in the decade of 2000s, this reduction was caused

[13]Total debt repayment during 1991-1999 were about $32 billions (Pakistan economy during 1990s by ABN AMRO Bank).

[14]On average Grant elements were 86% of Total ODA in 1952-53, 66% in 1954-55, 23% during 1978-88 and 12% during in 1989-2000 (*Economic Survey of Pakistan*).

by high GDP growth. The reduction in interest payment burden is also the outcome of declining interest rates domestically, debt management strategy and the premature payment of expensive debt amounting to US $ 1.17 billion to ADB. However, these favorable trends seem to have reversed lately in 2007 due to a rise in interest rates and maturity of government bonds issued domestically and externally.[15]

DEBT MANAGEMENT AND EXTERNAL DEBT

The rising debt burden and debt servicing made it essential to adopt a debt management strategy that aims at reducing debt burden sharply by 2010. A debt reduction strategy was set in FY 2001-02 to work towards debt rescheduling and debt restructuring from bilateral sources besides other measures to reduce the cost of debt.[16]

Historically Pakistan has been availing debt relief under various packages, *i.e.* the consortium interim relief, the stand by arrangement of IMF and rescheduling of debt during 1972-1982. Besides that debt relief programs were also signed with IMF during 1988-1999. Debt relief was again secured in 1999 and January 2001. The last rescheduling agreement, was negotiated with the Paris Club in December 2001 wherein the rescheduling, of entire outstanding stock was availed.

Debt rescheduling only provide a temporary relief and it implies that all flows of debt servicing including arrears accumulated are postponed and are to be paid after a grace period. Unlike the past, relief was obtained in both debt stock as well as debt flow, *i.e.* on the entire stock of public and publicly guaranteed bilateral debt of $ 12.5 billions. It contains the Official Development Assistance (ODA) debt of $ 8.73 billion and Non-Official Development Assistance debt of $ 4.1 billion. The ODA rescheduled debt is repayable over a period of 38 years including 15 years of grace period with same interest rate as provided in the original contracts. The Non-ODA rescheduled debt is to be repaid over a period of 23 years including 5 years of grace period at an appropriate market rate. In this way the total

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[15]In case of external debt the debt servicing burden is likely to increase further as payments for rescheduled multilateral debt stock will resume in FY 2008, the Euro bonds and Sukuk issued will be due in FY 2009 and onwards, thus the trend in the indicators of debt servicing may deteriorate.

[16]In the form of increased access to European markets, the rescheduling of debt by Paris Club and higher remittances from expatriate Pakistani’s largely helped in stabilizing the external sector. It also focused on improving debt carrying capacity, reducing future borrowing, and continuation of the privatization process.

cancellation of debt comes to $ 1.062 billions. Thus total amount of $ 11.80 billions rescheduled; includes the debts from non-Paris Club creditors. It is estimated that debt rescheduling resulted in an estimated relief of $ 1.2 billion to $ 1.5 billion annually in payments of debt servicing from 2001-02 to 2004-05 (Hussain, 2005).

The second aspect of debt management strategy was that while multi-lateral debt cannot be rescheduled or reprofiled Pakistan substituted hard term loans by soft term loans to reduce the overall burden of debt servicing. The non-concessional loans obtained in the past from the World Bank, Asian Development Bank and IMF are repaid and replaced with new loans on concessional terms. For instance, IDA and PRGF were obtained on concessional terms compared to the stand-by arrangements negotiated in 2000. The Asian Development Bank was also to increase its assistance, however, more recently there is a shift from concessional Asian Development Fund (ADF) to non-concessional ADF terms (Hussain, 2005).

TABLE 17

Debt Restructuring

	1974	1999	2000	2001	2002
Total Amount		3399	919	12852	145
Debt Stock Rescheduled		615	29	11398	
Principal Rescheduled		2158	653	1325	0
Official		1453	575	1187	
Private		705	78	138	
Interest Rescheduled		626	237	129	145
Official		508	200	109	145
Private		118	37	20	

Source: *Global Development Finance* (CD-2007).

The third part of debt management strategy was that in contrast to the past trend of building reserves through commercial short term borrowing which added to the stock of debt and the debt servicing obligations, reserves were built mostly by mopping up excess supply of foreign currencies available in the open market and in the inter bank market. Although Pakistan successfully built up its reserves amounting to approximately US $ 13 billion, simultaneously it led to rapid increase in the net foreign component of reserve money that eventually led to high inflation (Hussain, 2005).

It was supposed that this relief along with fresh disbursements from multilateral and bilateral creditors' would have favorable effect on the balance of payments position, foreign exchange reserve position and credit rating of the country. However, the recent increasing current and fiscal sector imbalances, rising debt stock and non concessional borrowing at floating rates, forthcoming maturity of Euro Bonds in the coming few years, depreciation of rupee etc are a source of concern and if the resource gap continues to widen it may aggravate the already rising debt situation mentioned above.

TABLE 18

Average Terms of New Commitments

Years	1975	1980	1985	1990	1995	2000	2003	2005
All Creditors								
Interest rate (%)	4	4	6	5	5	6	2	2
Maturity Years	34	30	27	23	17	13	20	24
Grace Period	8	7	6	6	5	3	5	8
Grant Elements (%)	54	48	34	35	31	20	53	58
Official								
Interest rate (%)	3	3	5	5	5	6	2	2
Maturity Years	35	35	28	23	19	13	20	27
Grace Period	9	8	7	6	5	3	5	8
Grant Elements (%)	56	62	36	35	33	21	52	64
Private Creditors								
Interest rate (%)	7.0	11.0	9.0	9.0	7.0	8.0	2.0	5
Maturity Years	9.0	11.0	11.0	11.0	4.0	5.0	30.0	5
Grace Period	1.0	1.0	2.0	5.0	1.0	1.0	9.0	5
Grant Elements (%)	10.0	-4.0	5.0	5.0	8.0	4.0	67.0	18

Source: *Global Development Finance* (CD-2007).

Furthermore the terms and conditions of new commitments from official creditors are becoming harder as is reflected in Table 18. The interest rate has increased to 6 percent in 2000, from a level of 3 percent in 1980, which remained stable at level of 5 percent from 1985 up to 1995. The average maturity of new lending dropped from over 35 years in 1980 to 13 years in 2000 and increased to 20 years in 2003, the average grace period declined from over 8 years to 5 years in the same period and again increased to 8 years in 2007. Moreover, the grant element in new lending decreased from 62 percent in 1980 to less than 21 percent by 2000 and then increased again up to 64 percent in 2005.

IV. CONCLUSION AND POLICY IMPLICATIONS

The analysis presented above indicates that although a modest improvement in the public debt situation has been attained yet the structure of debt remains unchanged, the stock of debt has increased; growth of public debt has remained positive throughout and is quite high presently. It is also found that the share of domestic debt is high relative to the external debt and the combined share of floating and unfunded debt in domestic debt remains very high. Although debt servicing of domestic debt as percentage of total revenue has declined significantly, as percentage of GDP and current expenditure it is still high. Similarly, the volume of external debt of Pakistan remains to be high despite the fact that the total external debt to GDP ratio and foreign exchange ratio has declined. The long-term external debt dominates the debt stock and the share of short-term debt has declined significantly, however, the terms and conditions for new debt commitments remained unfavorable throughout. The share of multilateral debt has increased against the bilateral debt and the share of concessional and non-concessional debt remains more or less unchanged. The recent rescheduling and restructuring of debt provided some relief in terms of debt servicing and repayment which seem to have been eroded by the recent drawing down of foreign exchange reserves and depreciation of rupee. Thus the growing debt burden indicates fiscal and financial reforms have at best kept the debt structure, and its composition the same, growth rate of debt remain high , the saving investment gap persist and Pakistan continues to borrow more to meet its fiscal and external sector deficits.

Whether any significant improvement in the debt situation is expected in the near future will depend on the degrees of freedom available. The scope of reducing current as well as development expenditure remains limited. Reduction in fiscal deficit would therefore depend largely on government’s ability to mobilize revenue and its efficient utilization. Similarly correction of external sector imbalances is conditional upon the extent to which exports can increase as the scope of reduction in imports remain limited and any attempt to enhance growth by increase in imports will only be consistent if exports also increase. Thus the scope of reducing fiscal and external accounts resource gap is limited to the extent to which revenue and exports can be increased and the ease with which imports can be substituted, the direction of movement in oil prices, sustained increase in remittances and pressure on exchange rate. The fiscal and external imbalances have been building up over the past many years and the increasing debt burden is a mirror image of the many weakness in the real, fiscal, financial and external sectors of the economy. These weaknesses will continue to impact the future prospects of self-reliance adversely. Fiscal space may shrink in the future and the economic managers may remain preoccupied with managing interest rate, inflation and exchange rate pressure. Thus both the domestic and external debt position is likely to deteriorate in the future and the debt sustainability indicators may be affected adversely.

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Annexure 1

Structure of Public Debt

Year	Public Debt (Rs. mls)		Total External		As Percent of GDP		Growth Rate	
	Domes-tic	External	Total	Debt (mls $)	Public Debt	External Debt	Public Debt	External Debt
1971	12873	13223	26096	3635	51.7	34.4		
1972	16667	32604	49271	2860	91.1	30.8	88.8	–21.3
1973	17818	32329	50147	4552	75.0	71.9	1.8	59.1
1974	17426	38049	55475	4845	63.9	55.2	10.6	6.4
1975	21245	37857	59102	5438	53.2	48.4	6.5	12.2
1976	27420	46728	74148	6278	56.9	47.7	25.5	15.5
1977	32700	53579	86279	7184	57.6	47.5	16.4	14.4
1978	38530	59435	97965	7947	55.6	44.6	13.5	10.6
1979	49371	67983	117354	8625	60.2	43.8	19.8	8.5
1980	56754	70738	127492	9425	54.4	39.8	8.6	9.3
1981	60088	73924	134012	10256	48.2	36.5	5.1	8.8
1982	76656	101172	177828	10452	54.9	34.3	32.7	1.9
1983	87856	110726	198582	11869	54.5	41.5	11.7	13.6
1984	106554	121240	227794	12524	54.3	40.3	14.7	5.5
1985	143930	140155	284085	12594	60.2	40.7	24.7	0.6
1986	193385	167003	360388	14064	70.0	44.1	26.9	11.7
1987	225246	187030	412276	15881	72.0	47.7	14.4	12.9
1988	284492	207744	492236	16983	72.9	44.2	19.4	6.9
1989	327534	253658	581192	16855	75.6	42.2	18.1	-0.8
1990	376596	297652	674248	19402	79.0	48.7	16.0	15.1
1991	441580	335003	776583	21195	76.4	46.8	15.2	9.2
1992	527595	375233	902828	24233	74.9	49.9	16.3	14.3
1993	612642	446040	1058682	25400	79.4	49.5	17.3	4.8
1994	695972	523891	1219863	25853	78.1	50.1	15.2	1.8
1995	800464	600083	1400547	30292	75.1	50.0	14.8	17.2
1996	915180	658158	1573338	31796	74.2	50.6	12.3	5.0
1997	1050221	813108	1863329	31160	76.7	50.2	18.4	–2.0
1998	1183230	934390	2117620	30492	79.1	49.3	13.6	–2.1
1999	1392463	1494966	2887429	31479	98.3	50.2	36.4	3.2
2000	1578809	1687434	3266243	35306	102.8	57.5	13.1	12.2
2001	1730991	1769233	3500224	29878	102.3	51.1	7.2	–15.4
2002	1717934	1822163	3540097	32465	97.6	54.9	1.1	8.7
2003	1853675	1916478	3770153	35033	93.8	51.0	6.5	7.9
2004	1978969	1999757	3978726	35948	85.9	44.7	5.5	2.6
2005	2129100	1962797	4091897	34491	74.6	37.3	2.8	–4.1
2006	2321700	2146900	4468600	35655	70.3	33.5	9.2	3.4
2007	2597000	2337700	4934700	38699	67.7	32.2	10.4	8.5

Source: *Global Development Finance* (CD-2007).

Various issues of *Annual Reports* of State Bank of Pakistan.

Annexure 2

A Cross-Country Comparison of External Debt Indicators

Debt Ratios/Years	1990	2000	2004
Total External Debt (% of Gross National Income)			
Pakistan	49.5	45.9	45.5
All Developing Countries	36.1	40.2	35.2
Low-Income Developing Countries	56.8	45.7	40.1
Middle-Income Developing Countries	32.1	39.3	38.3
South Asia	31.3	26.8	22.5
External Interest payments (% of Gross National Income)			
Pakistan	2	1.4	1.1
All Developing Countries	1.7	2.1	1.7
Low-Income Developing Countries	1.9	1.1	0.9
Middle-Income Developing Countries	1.7	2.3	1.6
South Asia	1.7	0.9	1.6
Total External Debt (% of Exports of Goods and Services)			
Pakistan	231.2	289.8	191.5
All Developing Countries	178.3	121.4	87
Low-Income Developing Countries	350.1	186.2	147.9
Middle-Income Developing Countries	152.9	113.3	98.6
South Asia	303	155.3	112.7
Total External Debt Service (% of Exports of Goods and Services)			
Pakistan	21.3	25.2	16
All Developing Countries	19.7	20	12.5
Low-Income Developing Countries	22.9	13.1	17.3
Middle-Income Developing Countries	19.3	20.8	18.9
South Asia	27.5	15	18.8
External Interest Payments (% of Exports of Goods and Services)			
Pakistan	9.3	8.7	4.5
All Developing Countries	8.5	6.4	3.5
Low-Income Developing Countries	11.6	4.6	3.4
Middle-Income Developing Countries	8.1	6.6	4.2
South Asia	14.7	5.5	3.5

Sources: *Global Development Finance* (CD-2007).

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