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Debt, Spending and Resource Allocation

By Aniqa Arshad

PRIME POLICY PAPERS

Debt, Spending and Resource Allocation

PRIME is an economic policy think tank working for an open, free and prosperous Pakistan by creating and expanding a constituency for protective function of the state and freedom of the market.

This report is a product of the PRIME National Debt Conference held in Islamabad on October 26, 2017. Supported by Friedrich Naumann Foundation for Freedom and National Endowment for Democracy, the objective behind the conference was to initiate an open and informed dialogue on the status of public debt in Pakistan and its consequences for the country's future.

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NOTE

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The conference provided an excellent opportunity for all stakeholders to share their thoughts on the subject. Though public debt is essentially a political economic issue, the dialogue in that conference took place in a non-partisan environment.

It is the government which is ultimately responsible for decisions on debt. However, instead of making the forum as an accountability instrument or a charge sheet against any government, participants presented a cogent analysis, and precise policy recommendations and alternatives.

This report, therefore, serves as a resource paper on the subject of public debt. None of the contents of this report are owned by the author and is reproduced work based on the presentations and the speeches delivered at the conference, this note is to duly acknowledge all the speakers for their content reproduced in this report.

Lastly, while all efforts have been made to acknowledge each speaker for the key policy issues and recommendations presented by them, detailed citations have been intentionally avoided for the purpose of clarity.

Executive Summary[1]

PRIME Institute has organized four annual national debt conferences, once each in 2014, 2015, 2016 and the most recent, 4th National Debt Conference, was organized in October 2017. These conferences have become the only open national platform to discuss the dynamics surrounding public debt and have come up with practical recommendations. The main purpose of the National Debt Conference is to analyze the composition, the usage, sustainability risks, and consequences of public debt for Pakistan's economic freedom. It was attended, like in the past, by Pakistan's leading economists, academia, business leaders, journalists, representatives from the government and parliamentarians. A candid but impartial diagnosis, based on facts is crucial to resolve the challenges around public debt in Pakistan. The 4th National Debt Conference aimed to generate short, medium and long-term policy options that can help Pakistan to steer through the challenges which are imposed by a growing level of debt to a growing economy.

Effective debt management is essential for developing a viable and stable debt portfolio. It mitigates the risks of refinancing, exchange rate fluctuations and debt accumulation that could impede economic growth and stability. Prudent utilization of debt leads to higher economic growth and helps the government to accomplish its social and developmental goals. Unsustainable level of debt coupled with absence of prudent debt management strategy may plague economic growth due to heavy debt servicing requirement resulting in lower development expenditure. Given Pakistan's developing status, the need for effective debt management is of utmost importance as the country requires borrowing to enable its development agenda, accelerate the pace of economic growth without ignoring the intergenerational impact.

The portion of total debt which has a direct charge on government revenues as well as the debt obtained from the IMF is defined as public debt. Pakistan's public debt has two main components, namely domestic debt (which is incurred principally to finance fiscal deficit) and external debt (which is raised primarily to finance development expenditure). Each of these types of debt has its own benefits and drawbacks, with a trade-off between costs of borrowing and exposure to various types of risks that needs to be balanced in order to ensure sufficient and timely access to cost efficient funding.

[1] Rapporteur: Aniqa Arshad, Research Economist at PRIME Institute.

Overview

In 2017, there has been a recent redefinition of the public debt, which has attracted criticism but which has also shown the debt to GDP ratio at a healthy rate of 60.2 percent. The government has made amendments to the definition of Total Public Debt mentioned in Fiscal Responsibility and Debt Limitation Act 2005 through the Finance Bill 2017. The new definition states Total Public Debt as "total debt of the government is public debt less accumulated deposits of the federal and provincial governments with the banking system" where as in the FRDL Act 2005 a definition of debt added in 2016 was originally as "The debt of the government (including the Federal Government and the Provincial Governments) serviced out of the consolidated fund and debts owed to the International Monetary Fund". The effect of the said amendment is that the debt figure now is understated by approximately 2 trillion rupees[2].

However, the more pertinent questions do not pertain to how debt should be defined, but rather what constitutes the debt and how does the government use the borrowed money. Also, a significant question is what level of public debt makes it unsustainable i.e. when the government exhausts its capacity of debt service. And finally, what are the consequences of increasing levels of debt for the country's economic future. In other words, the discussion around public debt should look to analyze the composition, the usage, sustainability risks, and consequences for Pakistan's economic freedom.

In this respect, two camps exist in Pakistan. The government camp, supported by a few economists, claims that there is no need to worry about the public debt as it is directed towards public sector investment. They cite the debt to GDP ratio of 60.2 percent, which in any scenario, is really not a cause of concern. Majority of 'independent economists' dispute all such claims and portray a bleak scenario in the short to medium run while not denying the possible long term positive outcomes of CPEC related investment.

On the other hand, Pakistan's Debt and Liabilities Profile, according to the State Bank of Pakistan, currently stands at PKR 24,001.7 billion, including PSE Domestic Debt, out of which the external debt is equivalent to PKR 8,329.7 billion and domestic debt is PKR 14,849.2 billion and are 75.3 percent of the GDP.

This differential is mainly attributed to an increase in government credit balances with State Bank of Pakistan and commercial banks by the Ministry of Finance. Similarly, the ministry claims an increase in external debt contributed PKR 960.3 billion to public debt. The trend in public debt since FY2000 is depicted in Table 1.

[2] In this report, "rupees" refers to the Pakistani Rupee (PKR).

Table 1: Year Wise Public Debt Position

Year	Public Debt	Domestic Debt	External Debt
FY00	3,172	1,645	1,527
FY01	3,684	1,799	1,885
FY02	3,636	1,775	1,862
FY03	3,694	1,895	1,800
FY04	3,866	2,028	1,839
FY05	4,211	2,178	2,034
FY06	4,359	2,322	2,038
FY07	4,802	2,601	2,201
FY08	6,126	3,275	2,852
FY09	7,731	3,860	3,871
FY10	9,006	4,654	4,352
FY11	10,767	6,017	4,750
FY12	12,695	7,638	5,057
FY13	14,318	9,522	4,797
FY14	15,991	10,920	5,071
FY15	17,381	12,199	5,182
FY16	19,678	13,627	6,051
FY17 (Mar)	20,873	14,748	6,124

Source: Pakistan Economic Survey 2016-17, Ministry of Finance (2016), [Available Online]: http://www.finance.gov.pk/survey/chapters_17/09-Public_Debt.pdf

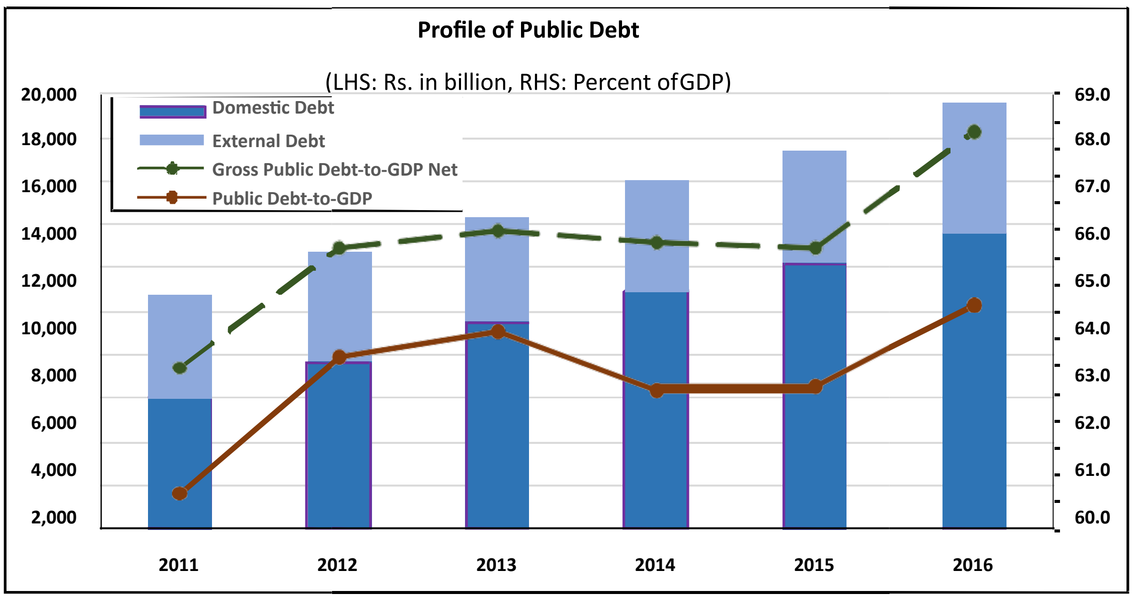
As compared to Fiscal Year 15-16, debt by the end of FY16-17 was 11 percent higher. The domestic debt witnessed a net increase of PKR 1.534 trillion by the end of July 2017 and short-term loans made-up half of this figure.

In last seventeen years, since 2000, the public debt has grown 6.04 times, whereas the domestic debt has increased 8.15 times and the external debt has increased by 3.78 times. In the same time period, the economy grew by 3.84 times. It seems that Pakistan have failed to utilize our borrowings to spur economic development effectively.

Prior to 2017 the debt burden that this government inherited in 2013 was reduced – Dr. Waqar Masood

It is a common practice to measure the public debt burden as a percentage of GDP. Another approach is to scale public debt levels against actual government revenues as this ratio measures debt repayment capacity of the country. At the end of March 2016, public debt to GDP ratio stood at 64.8 percent which includes an adverse effect of around 2.3 percent of GDP on account of increase in credit balances of government with SBP, commercial banks and revaluation loss on account of cross currency movements.

Figure 1: Profile of Public Debt

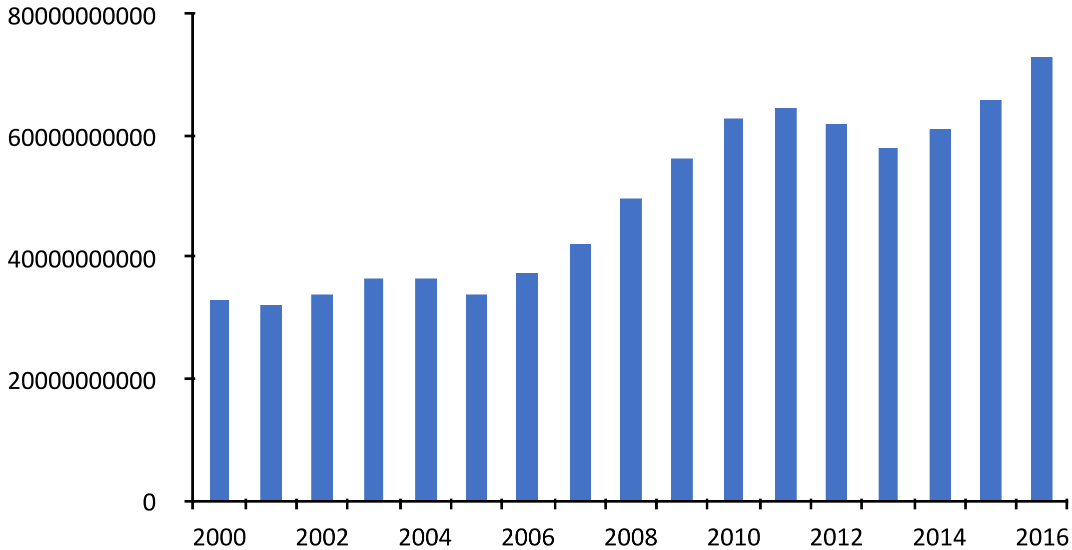


Source: Pakistan Economic Survey 2016-17, Ministry of Finance (2016)

According to the World Bank, External Debt in Pakistan increased to 82,981 million dollars[3] in the second quarter of 2017 from USD 75,747 million in the first quarter of 2017. External Debt in Pakistan averaged USD 49,260 million from 2002 until 2017, reaching an all-time high in 2017.

[3] Refers to the US dollar (USD).

Figure 2 - External Debt Stocks, Total (DOD, Current US$)



Source: World Bank Data, [Available Online]: *https://data.worldbank.org*

Dr. Waqar Masood in his address said that in 2008, Pakistan faced the international oil price and commodity price shocks and consequently the government was pushed to an IMF program. The economy stabilized over time but soon ran into the same cycle in 2013. It seems that a storm is gathering and this may be the fate once again in 2018: as this is the last year of the government and it is a political challenge because it is not the same government anymore which it was at the start of its tenure, in terms of its capacity to learn. This is a cycle, in which Pakistan seems to be constantly trapped in. However, it's not a flat cycle, if you map each circle there is still a growing trend. Pakistan's economy initially was hardly around USD 120 billion in 2001, now it is approximately a USD 300 billion economy and it bounces back very quickly. Dr. Waqar further added that there was a need for leadership such that it would make consistency the hallmark of its policies and give the country a direction which would enable it to not fear the constant repetition of this vicious cycle.

The problem of the ever-increasing debt has been a topic of debate at many forums. The Senate Standing Committee on Finance expressed concern over growing external and domestic debts saying that in May 2017, debt stood at USD 58 billion for foreign loans, whereas the domestic debt was PKR 12,956 billion (USD 123.46 billion[4]) with an increase of PKR 1.18 trillion over the previous fiscal year 2015-16. Finance Ministry officials said the external debt in 2015-16 was USD 57 billion and there has been an increase of USD 3.8 billion in 2016-17 (up to May).

[4] Conversion based on average selling rate of dollar for May 2017, based on data from State Bank of Pakistan. [online]: http://www.sbp.org.pk/ecodata/Rates/WAR/history/2017/FY2016-2017.xlsx

Historical Analysis of Public Debt[5]

There is a contentious debate about the sustainability of external debt in Pakistan. In his keynote address Dr. Ishrat Husain, former Governor State Bank of Pakistan, said a lot of criticism is based on the misunderstanding of the debt itself. Following passages highlight the main arguments, as well as data, presented by Dr. Ishrat Husain in his speech.

Trends in Public Debt

The debt situation has become rather controversial in Pakistan. It was therefore essential to analyze it from a different perspective and take into account the changes that occurred over the years. This section presents a historical perspective of the last seventeen years of Pakistan's Public Debt profile. Even though Pakistan's debt profile dates back to almost sixty years, but the more interesting period began when Pakistan's debt to GDP ratio actually reached almost hundred percent of the GDP in FY2000. Thereafter the government managed to bring it down to almost fifty percent of the GDP. But once again, in FY2017, it has gone back up to seventy-nine percent of GDP.

National debt raised its ugly head once again in 2017 – Dr. Ishrat Husain

Definitions and Concepts of Public Debt

Most of the time confusions arise from the basic concepts and definitions being used in the Public Debt Profile. To clarify, this section first elaborates upon the basic concepts and definitions. The whole picture presented while addressing public debt is that of total debt and liabilities. Total debt and liabilities consists of two components, namely the public and private debt. When the government quotes numbers it mostly always talks about the public debt. It does not take into consideration the private debt. While State Bank of Pakistan, in its report, uses the total debt and liabilities figure. Total debt and liabilities consists of both domestic and external debt. Domestic debt is mainly public, but external debt is further divided into two components, public and private external debt: these; together present a holistic picture of our debt burden.

[5] This chapter is mostly based on the presentations given by Dr. Ishrat Husain.

Table 2: Trends in Public Debt

Trends in Public Debt (PKR billion)									
FY 2000-2017	2000		2008		2013		2017		percent of Total
	Rs. Billion	percent of total	Rs. Billion	percent of total	Rs. Billion	percent of total	Rs. Billion	percent of total	
Total Public Debt	3189		6476		14291		21407		100
External	1610	50.5	3064	47.3	4,769	33.4	6,552	30.6	30.6
Domestic	1579	49.5	3412	52.7	9,522	66.6	14,855	69.4	69.4
As Percentage of GDP									
	2000	**2008**	**2013**	**2017**					
Total Public Debt	84.1	59.0	64.0	67.2					
External	42.5	27.1	21.4	20.6					
Domestic	41.6	31.9	42.5	46.6					
Annual Rates of Growth									
	2012-2016	**2016-2017**							
Total Public Debt	12.4percent	8.8percent							

Pakistan's total debt and liabilities consist of public debt and private debt. Total stock of outstanding debt and liabilities on June 30, 2017 stood at seventy-nine percent of GDP. Of this, Gross Public Debt accounted for eighty-five percent of the total outstanding or 67.2 percent of GDP. The remaining fifteen percent is the private debt mostly to borrowers outside the country, for which the government has no fiscal obligation, but the SBP has to provide foreign exchange to service this debt. Within the gross public debt, the government's share was predominant – almost ninety-two percent while the balance was owed by the public enterprises but guaranteed by the government. Borrowing from IMF is also included in gross public debt, although it is a liability of the State Bank of Pakistan.

The import coverage ratio of the reserves is in a very precarious situation – Dr. Ishrat Husain

The total debt and liabilities figure is made up of borrowings in rupees – from SBP, banks, National Savings schemes, prize bonds, Sukuk etc. and borrowings in foreign currency – from multilateral institutions such as the World Bank, Asian Development Bank, Islamic Development Bank, bilateral countries or international financial markets in the form of

Eurobonds or Sukuk. The Rupee denominated borrowing is termed as Domestic Debt, while the foreign currency denominated borrowing is called External Debt.

Dr. Ishrat Husain during his presentation said, "It is not advisable to examine the debt burden in terms of absolute amounts or per capita terms. The correct way to assess is to use various indicators that relate total Public Debt stock to nominal income, exports, revenues, total foreign exchange earnings, foreign exchange reserves, and total revenues."

A more important and relevant way is to look at the total debt servicing capacity, especially that of External Debt. As this has to be paid in foreign exchange, the capacity is much dependent on current and future earnings of foreign exchange and the level of reserves. This requires careful examination of the tenor (medium or long term, short term), element of concessionality, interest rate, and grace period of each loan contracted.

Risks of Debt

The risks of Domestic Debt are quite different from those of External Debt. Dr. Ishrat further pointed out that "Lumping Domestic and External Debt together was analytically incorrect." While both create debt servicing liability for the budgetary purposes, and therefore affect the fiscal balances, the risk profiles of the two are quite different. He stated "Domestic Debt has to be paid in rupees which can be printed or the Central Bank can acquire those obligations on its balance sheet by creating reserve money. It involves creating possible inflationary pressures but there is no risk of default which is a real threat in case of foreign currency denominated debt." Countries which have suffered debt crisis have faced solvency and liquidity risks in servicing their foreign currency loans.

Risks arising in case of Domestic Debt are rollover risk, interest rate risk, and crowding out of private sector credit only. Which is why, the remaining discussion largely focuses on the External debt and liabilities, and its servicing.

Domestic debt poses no real risk as there is no risk of default – Dr. Ishrat Husain

Table 3: Evolution of Pakistan's Debt Servicing Profile

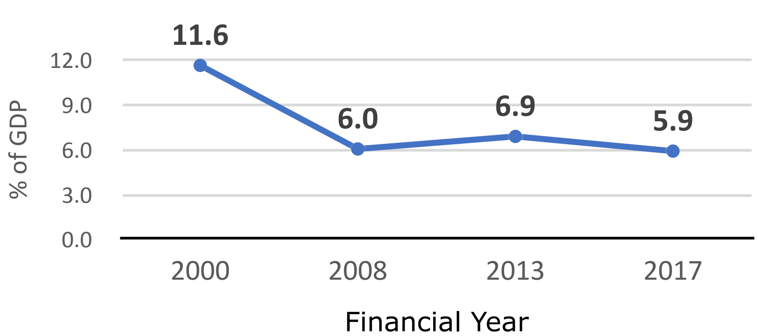
Evolution of Pakistan's Debt Servicing Profile (PKR billion)								
FY 2000-2017	FY00		FY08		FY13		FY17	
	Amount	**percent of GDP**	**Amount**	**percent of GDP**	**Amount**	**percent of GDP**	**Amount**	**percent of GDP**
Total Debt and Liabilities	3,337	106.0	6,691	62.9	16,338	73.0	25,064	78.7
Public Debt	3,189	101.3	6,476	60.9	14,291	63.8	21,409	67.2
Domestic	1,579	50.2	3,412	32.1	9,520	42.5	14,849	46.6
External	1,610	51.2	3,064	28.8	4,771	21.3	6,560	20.6
Private Debt	148	4.7	215	2.0	2,047	9.1	3,653	11.5
GDP (PKR Billion)	3,147		10,638		22,386		31,862	

Source: Dr. Ishrat's presentation at 4th National Debt Conference

Trends in External Debt

External Debt situation was out of control in 2000 when the debt servicing payments due were as high as 290 percent of the official liquid reserves available. Between 2000 and 2008 the debt reprofiling by Paris Club, accumulation of official reserves led to an easing of the burden and by 2008 debt servicing payments amounted to only twenty-five percent of reserves. There was a further pressure in 2013 but it took a turn for better in the next four years, raising its ugly head once again in 2017. The rapid depletion of reserves in recent months has created serious concern, as import growth is quite accelerated and the current account deficit is widening. Total debt servicing obligations have, however, remained at the same level as in 2008 i.e. around six percent of GDP and have in fact declined by one percentage point from 2013.

Figure 3: Total Debt Servicing as Percent of GDP



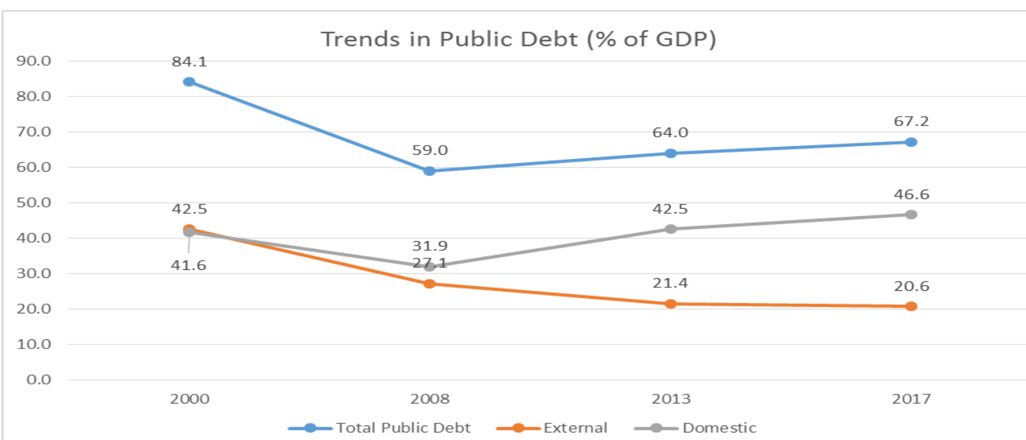
Source: Dr. Ishrat's presentation at 4th National Debt Conference

Public External Debt is lower in 2017 i.e. 20.6 percent of GDP while it was 27.1 percent in 2008 and 21.4 percent in 2013. About 93 percent of the public external debt falls under the category of Medium and Long term while seven percent under the short term. Therefore, the risk appetite for further short term borrowing to tide over payment difficulties cannot be ruled out as the short term public external debt to SBP reserves ratio is 5.5. Concessional loans still form more than half of the outstanding stock and commercial loans account for only 1.6 percent of the total.

By international standards Pakistan is not exposed to unusual external debt - Dr. Waqar Masood

Total stock of Total Debt and Liabilities on June 30, 2017 stood at 79 percent of GDP which is 16 percentage points higher than 2008 and six percentage points than 2013. Domestic Debt now accounts for 70 percent of Total Debt and Liabilities up from 52 percent in 2008 while external debt is down to about 30 percent of the Total Debt and Liabilities. The share of Gross Public Debt was 67.2 percent of GDP which did not rise at the same speed as the Total Debt and Liabilities (6.8 percentage points higher than 2008 and 3.4 percentage points higher than 2013).

Figure 4: Trends in Public Debt (percent of GDP)



Source: Dr. Ishrat's presentation at 4th National Debt Conference

The real culprit was the private sector debt which rose from two percent of GDP in 2008 to 11.5 percent in 2017. It is pertinent to point out that for private debt the government has no fiscal obligation but the SBP has to provide foreign exchange to service this debt. Borrowing from the IMF is also included in gross public debt, although it is a liability of the SBP and has no fiscal consequences.

A major setback has been caused by stagnation in foreign exchange earnings due to a 4 billion dollar drop in export receipts since 2013. This has raised the EDL to FEE ratio from 121 to 162 in 2017. This would give me sleepless nights if I were at the SBP – Dr. Ishrat Husain

There has been some growth in exports in last few months but the pace is unspectacular to make a dent. The other element which is picking up is Foreign Direct Investment but that also would not be able to lower this ratio significantly.

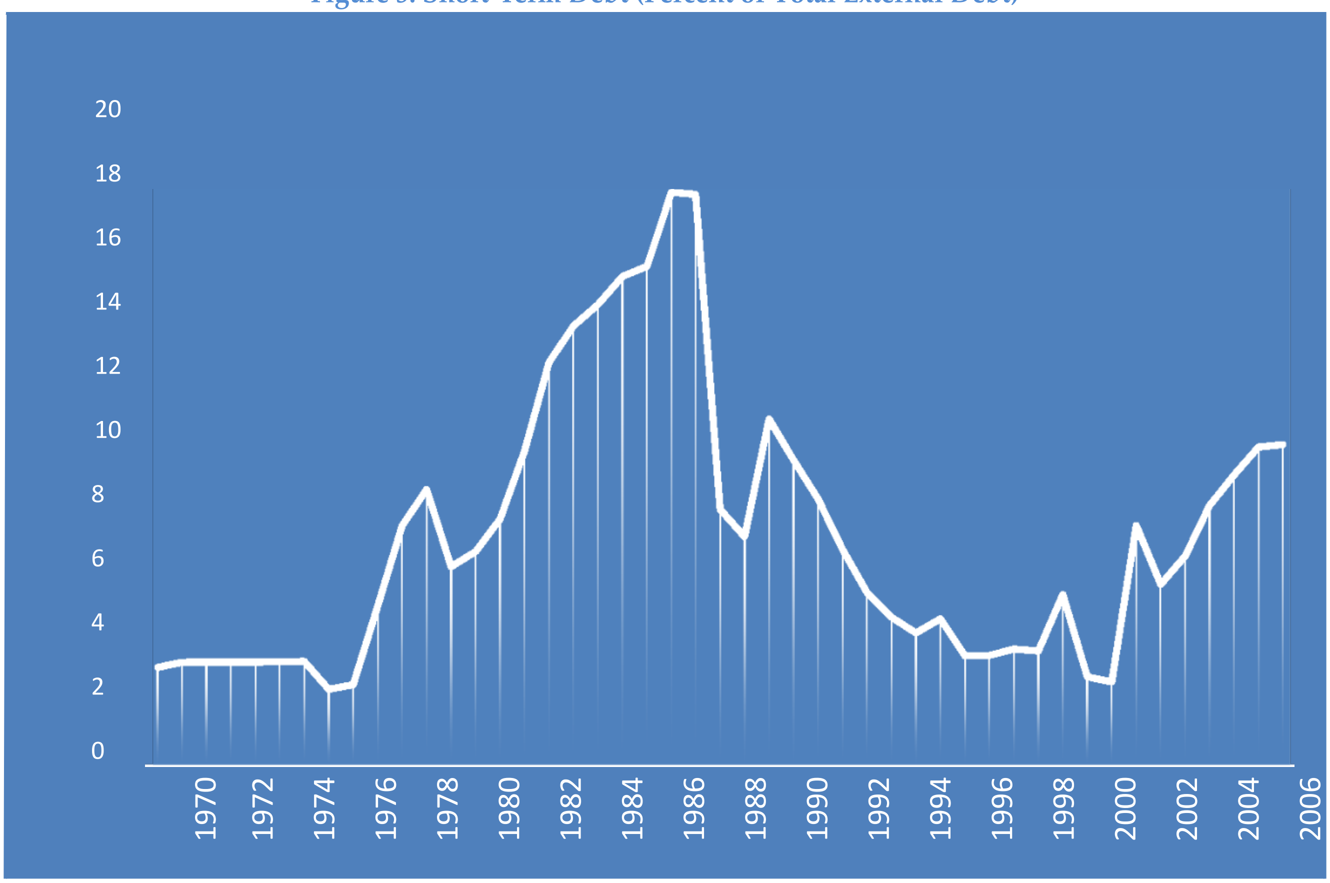
On the fiscal side, almost 24 percent of government revenues were pre-empted by payments of interest and foreign loan repayments. The average interest rate is down to 6.3 percent with domestic debt being relatively expensive at 8.2 percent. Dr. Ishrat Husain added that "We (Pakistan) have a pipeline of projects where disbursement has not taken place for the reasons of inefficiency by the agencies responsible, which is creating a serious problem. Can this be solved in the next eight months, I'm not quite sure." Dr. Ishrat concluded his presentation stating that there was need for a proactive management of the external account because the foreign exchange earnings ratio is quite troublesome.

Public Debt Sustainability and Management[6]

One of the key concerns regarding external debt in Pakistan is that it is on the rise again. Dr. Vaqar Ahmed, Deputy Executive Director at Sustainable Development Policy Institute, in his address, discussed the debt strategy and debt regulation policy for Pakistan. The following passages highlight the main arguments, as well as data, presented by Dr. Vaqar Ahmed in his speech.

It took the treasury a lot of effort to bring down the short-term debt (percentage of total external debt) in the past decade, so it is now a key concern that the trend is on the rise again. In monetary terms that is approximately a total external debt of PKR 8,329.7 billion at the end of fiscal year 2017. A SBP report indicates this specific amount is approximately USD 9 billion more than that of the last fiscal year.

Figure 5: Short-Term Debt (Percent of Total External Debt)



Source: Economic Survey of Pakistan, Various Issues; State Bank of Pakistan

[6]This chapter is mostly based on the presentation given by Dr. Vaqar Ahmed, Deputy Executive Director, SDPI.

The evidence from economic literature on Pakistan explains that the single most important determinant of debt burden in Pakistan remained the ever out-of-control fiscal deficit i.e. the difference between government's revenues and expenditures. Pakistan's total debt and liabilities now stand at 79 percent of the national income. Almost 60 percent of this is domestic debt while almost 35 percent represents external debt and liabilities of the government, private sector and public-sector enterprises. Servicing of this debt i.e. making the payments on the principal and interest of outstanding loans uses up almost 36 percent of the entire revenue collected by the government. In monetary terms Pakistan's total external debt and liabilities had reached USD 83 billion at the end of the previous fiscal year, representing an annual increase of USD 9 billion. The annual report by the State Bank of Pakistan highlights that 88 percent of the above-mentioned increase was in the last quarter of fiscal year 2017 mainly due to the economy's urgent debt procurement from China, mostly in form of loans, and from commercial banks.

During the fiscal year 2017 most of the external borrowing was procured at floating interest rates. Intuitively any rise in the proportion of floating debt implies greater vulnerability - Dr. Vaqar Ahmed

It may also be noted that during the fiscal year 2017 most of the external borrowing was procured at floating interest rates. Intuitively any rise in the proportion of floating debt implies greater vulnerability with respect to movements in global interest rates. With foreign exchange reserves not growing at a rate envisaged in the macroeconomic framework developed by the Ministry of Finance in fiscal year 2015, another concern therefore is the short-term nature of current debt. A significant portion of these loans will mature within a period of three years from now and with non-debt external inflows not increasing this could bring further bad news for the deteriorating balance of payments.

Recent data reveals that all solvency indicators of external debt sustainability have worsened during fiscal year 2017. This among other reasons is attributed to an increase in borrowing from external sources, falling foreign exchange reserves, and an increase in debt servicing.

Is the Debt Strategy Delivering?

Pakistan's debt management strategy is prepared by the Ministry of Finance. The main objectives of this strategy include "covering the government's financing needs and payment obligations, while minimizing medium and long-term costs; minimizing the risks of the government public debt portfolio; and facilitating the development of domestic debt market".

Contrary to the objectives of debt management strategy, the debt market still has a very low participation of new players – Dr. Vaqar Ahmad

Against these objectives let us now turn to the outcomes from the recent economic performance. The country's inability to manage the growing fiscal deficit is resulting in fast growing share of short term debt which now stands at 31 percent of total public debt. Lenders are not much interested to lock themselves in to longer term offerings primarily due to unattractive interest rates, expected inflation, rising current account deficit, and uncertainty facing the future of economic policy in an election year. While the federal government likes to separately exhibit the debt of public sector enterprises, however this is indeed backed by a government guarantee which on several occasions results in loss to the exchequer.

Contrary to the objectives of debt management strategy, the debt market still has a very low participation of new players. For example, 90 percent of the T-bills – debt instrument issued by the government through the State Bank of Pakistan via auction – are held by the commercial banks. The non-bank institutions still remain reluctant to trade in long-term debt instruments on a large scale. More recently a declining interest was seen in the case of corporate investments and mutual funds to participate in long-term debt instruments, in fact last year both were net retirees. While the insurance sector did see a promising growth during fiscal year 2017, however its investment in long term debt instruments has not increased.

Policies still remain critical to the stabilization process – Dr. Waqar Masood

The debt management system in place at the Ministry of Finance also needed to be strengthened. Pakistan now understands that the inability to appropriately forecast deficit financing needs resulted in the federal government borrowing more than its requirement during fiscal year 2016. This borrowed sum was then kept in various banks at the prevalent interest rate which was lower than the cost of borrowing. So, who exactly is responsible for incurring this loss?

Dr. Vaqar said, "As policy researchers we are not trained to blame entities or individuals. Therefore, we shall try finding the answer to this question in the law that regulates debt management and the underlying Rules of Business of the Government of Pakistan which support implementation of this law." Pakistan's debt management strategy should follow the General Finance Rules of the Government of Pakistan, which allow the principal accounting officer the powers to manage the borrowed sum. This can prove to be extremely important, in terms of the large sum of debt now being carried by our public-sector enterprises.

How is Debt Regulated in Pakistan?

The primary purpose of the laws under the Fiscal Responsibility and Debt Limitation (FRDL) Act of 2005 is to regulate debt in Pakistan. Unfortunately, this law was not able to deliver due to the weak demand and supply side accountability measures, which should be part of this law. On the supply side the parliament could only weakly challenge the amendments twice brought on the floor for amending this act through use of another act i.e. Finance Act 2017. The latter was helpful for the government as the upper house of the parliament lacks the powers to vote on Finance Bill.

The role of parliamentary oversight is extremely important here however during the whole of last year, there was only one full dedicated day which the Senate Standing Committee on Finance devoted to discussing Pakistan's debt. Due to the weak accountability governing FRDL Act, any government now has the ability to change the definitions of basic debt accounting concepts including the overall definition of public debt. In short, this act is a loose piece of legislation due to the ease with which it can be manipulated.

The FRDL act is a loose piece of legislation due to the ease with which it can be manipulated – Dr. Vaqar Ahmed

Most political administrations, in Pakistan, once in power, really appreciate the allowance which fungibility of debt provides them with. At times even, the external debt and liabilities are also regarded as fungible, i.e. the ability to use debt for purposes other than what it is actually meant for. This is an important issue, as Pakistan are now being blamed by the United States and other countries, saying that the assistance to Pakistan, whether military or non-military including debt was transformed into fungible assets with very little impact on public welfare spending. The poor allocation of previously procured debt has also weakened the confidence of other potential lenders. The low non-China commitments in our short-term portfolio in fact endorse this.

Such practices, coupled with uncertain political environment, weaken Pakistan's position in the international debt markets. Resultantly Pakistan ended up with poorly negotiated debt arrangements which bite harder under a weak balance of payments position in turn also affecting future credit worthiness of the economy.

A key reason for fungibility was also the ambition to pursue politically motivated public consumption programs. A question arises at this point: why is there no legal or regulatory mechanism to stop the government from not pursuing public programs which do not deliver and in the end, expand the fiscal deficit? Currently according to the Public Accounts Committee there are over 1000 projects in the public investment portfolio which are running a cost and time overrun, and this certainly increases the fiscal deficit.

The above-mentioned situation analysis is not specific to the current government. Most administrations in the past have shown weak resolve to streamlining debt management in Pakistan. One could look at the economic chapters of manifestos of any mainstream political party. It just seems that the subject was too technical for the economic thinkers within these political parties due to which in the overall envisioned macroeconomic management, a scarce space was given to the remedial measures for debt dilemma.

Recommendations

The following recommendations were presented by Dr. Vaqar Ahmed during his speech at the National Debt Conference.

First, Pakistan needs to strengthen the political discourse on debt. Most governments in the past have shown weak resolve to streamline debt in Pakistan.

Second, the way forward may be found in a very comprehensive report which was prepared by the Debt Reduction and Management Committee in 2001. The report called for going back to the basics and the overarching message was not to make debt a pillar of public finance needs rather "reduce the rate of future borrowing by reducing the fiscal and current account deficits, and reducing the large losses of state owned enterprises that augment the budget deficit". The committee had also provided specific suggestions on "improving the effectiveness of government expenditures especially the use of borrowed resources". Also, the committee had called for "monitoring systems to effectively review and monitor progress on debt including on contingency management in the context of a rolling medium-term macroeconomic framework".

- Bringing down the real cost of government
- Accelerating the process of privatization and
- Improving the effectiveness of government
- Adopting a medium and long-term debt strategy with clearly

Source: *Debt Committee Report 2001, Ministry of Finance http://www.finance.gov.pk/publications/debt%20committee%20report%20march%202001.pdf*

Unfortunately, today there are three different macroeconomic frameworks in Pakistan leading to a lack of shared vision within the economic management institutions. Ministry of Finance, Planning Commission and SBP have different visions for the economic performance. The recommendations also suggested that optimal debt stock should be in line with economic growth requirements. Such optimization analysis is not being done on a regular basis by any of the three institutions (Ministry of Finance; Ministry of Planning, Development and Reforms; and State Bank of Pakistan) that prepare these macroeconomic frameworks.

Third, demand-side accountability is also important for future regulation of debt in Pakistan. The Open Government Partnership which is a multilateral initiative to promote transparency brings governments and citizens together. Pakistan has twice missed the deadline to submit its commitments under OGP. The current government can demonstrate a bold stance by committing to form a Steering Committee having participation of government and independent experts to oversee Pakistan's debt management.

Finally, in 2016 using the Computable General Equilibrium Model, Sustainable Development Policy Institute showed that the impact of financing infrastructure in Pakistan through foreign debt versus local taxes. In the long run both may have the same macroeconomic impact however in the shorter term, financing from international borrowing had a *Dutch disease effect* as economists call it which led to the decline in long term exports and will also call for continuous improvement in own revenue generation capacity.

Question and Answers

The individual speaker sessions were followed by a question answer session where the audience directed questions regarding the prevailing debt situation. This section contains a thematic summary of the questions posed and their relevant answers.

Certain topics gather momentum in such a manner that they become highly politicized; following which the facts are often muddled with sensational content rather than facts. Something similar seems to have happened in the situation pertaining to Pakistan's debt. Vague figures are often directed at the general public which remain incomprehensible to them. Consequently, making it hard for the general public to evaluate the situation neutrally: the government tries to portray a picture of healthy economy but the opposition quotes an ever-increasing figure of debt. Amongst the audience there were similar queries regarding the accumulating debt figure in relation to the positive image of the overall economy. An individual from the audience showed concern regarding the current quoted figure of External Debt and Liabilities to Foreign Exchange Earnings Ratio (162%) and asked whether there was a sustainable level for this ratio.

In response to these questions the panelists explained that debt should not be considered in terms of absolute figures or per capita. Pakistan's population is currently around 200 million, the economy used to be approximately USD 100 per capita, now it amounts to around USD 1600 per capita so absolute figures hold no authority. The general public needs to understand that debt is not a dirty word; quoting China's example Mr. Ishrat Husain quoted "China's debt is 266% of their GDP yet it has the highest imports and will soon be crossing the American economy to become number one. Also 700 million Chinese who were below the poverty line, today lie in the middle -income group. So instead of questioning the amount being borrowed, there is a need to ask where the debt is being invested." The panelists further clarified that the debt situation has become highly politicized, which is why there is a need to know the facts and talk realistically rather emotionally. Hence the per capita debt figure needs to be compared to the per capita income, instead of comparing the absolute figures, the relevant trends need to be compared. In case of the current quoted figure of External Debt and Liabilities to Foreign Exchange Earnings Ratio the panelists emphasized that it would be worrisome if the External Debt and Liabilities to Foreign Exchange Earnings Ratio was not declining. Emphasizing that there was a need to observe trends and not absolute figures. And according to the trend EDL to FEE ratio has gone up from 121% to 162%, if the state bank or ministry of finance can demonstrate a strategy to bring this figure down, that should be satisfactory. There is no parameter in order to determine the appropriate ratio, but the greater a country's FEEs are, the greater is its ability to service its debt and cover the imports. However recently, the figures of debt have become worrisome for Pakistan, but the situation has not gone haywire and can be corrected with apt policy measures.

Addressing the doubts regarding unreliable data provided by the government, Dr. Waqar Masood cleared out the existing misconception. Facts are oftentimes established through data, and if the data becomes questionable especially data at the level of national accounts, it becomes a little hard to establish facts. Government figures are often said to be over or understated to distort the true scenario. However, this is not the case. Official national accounts data is collected through an elaborate process: data is first collected through hundreds of data reporting channels and then combined which is then verified by several international bodies. Furthermore, the methodologies followed are those predefined by the United Nations National Accounts System; additionally, the local data collectors or statisticians interact with international statistical data experts from organizations such as the World Bank and the International Monetary Fund. Over the collection period, if an error is made it has already been corrected before the data is released. Reverification of data, the system which is developed over decades and the fact that one person alone is not responsible for data collection makes it almost impossible to manipulate the national accounts. So, if analysts begin to doubt the national accounts data, they will be left with absolutely no data make comparisons with.

The attendees were curious regarding what would happen if Pakistan were to default on its debt and what possible measures could be taken to prevent such a thing from happening. The panelists unanimously agreed that as responsible member of the international community Pakistan has obligations and despite changing governments, it needs to fulfil those obligations. Pakistan should really not consider this as an option because countries such as Argentina, which did default on their payments, faced drastic circumstances including human resource drain along with very high levels of dissatisfaction. Countries which default on their debt are clearly abusing their ability to borrow. The panelists suggested that currently there was a need to reduce the budget deficit and cut it back to approximately four percent, which will lead to an end of the instability primarily caused by over-spending of the government. Pakistan's primary problem is that of self-discipline and resource allocation rather than that of borrowing.

Annexure

Agenda

First Session: ***Public Debt***		
09:30	Welcome Note	Dr. Almut Besold, Country Director, FNF Pakistan
09:40	Key Note Address	Dr. Ishrat Husain, Professor Emeritus, IBA and ex- Governor, State Bank of Pakistan
10:10	Panel Discussion on Public Debt	Dr. Vaqar Ahmed, Deputy Executive Director, SDPI Mr. Ali Salman, Founder PRIME Dr. Waqar Masood, Former Secretary Finance, Ministry of Finance
11.00	Discussion	All Participants