Prospects for Debt Relief

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Debt Servicing Cost Unsustainable

- Nothing wrong with borrowing-creates opportunities for a more productive economy. Concern is funding of wasteful expenditures & low priority, poorly designed projects.
- $ 66.5 bln (more than 50% of total) added in the 1990s and between 2008 to 2018
- Servicing of the external and domestic debts looks increasingly unsustainable.
  Gross Public Debt is 667% of Revenues , Av. 214% for more than 20 comparators.
- External debt is 232% of Exports, Av. 64% of more than 20 Comparators
- External Servicing of Public Debt, SOEs, Private- &20.8 bln (58.6% of Exports of Goods & Services) of which Govt plus govt guaranteed debt $18.7 bln
- Prospects for recovery depend on progress of restoration of debts to manageable levels.
- What possible options available to renegotiate contracts-debt relief/restructuring of this debt, with issues like foreign currency Swap arrangements, deposits with SBP, bonds with a large number of holders covered by New York Laws-Commercial lenders charging high interest rates to cover risks but still demand country pay up in full
- Thus, debt restructuring is complex-no short-cut solutions. While 30 low-income countries
  are facing debt servicing issues, so far only 4-5 have sought restructuring, with negotiations lasting more than a year.

Level of Debt (Sept 2023)

Debt Category	Rs. in billion (Sept 2023)	% of GDP (June2023)
Total Plus Liabilities	77,937	90
Gross Public (govt plus IMF)	74,868	74
Govt Domestic	39,852	46
External (govt portion 22,594, IMF 2,258, non-govt 7,480)	33,472	44
Breakdown of External	**US$ bln**	
Total plus Liabilities	128.1	42
Public External Plus SOEs	106.2	37

Who are Our Creditors

- 48% of debt owed to multilaterals (IMF, World Bank, ADB)-excl. publicly guaranteed debt. Most at highly concessional rates, making them preferred creditors- lending cannot be rescheduled under present scheme of things. In recent years 60% of aid/borrowing has been budgetary support.
- Share of bilaterlas incl China-31% (excl deposits with SBP and Swaps of SBP-approx. US$8 bln)- of which debt of Paris Club members (China & Gulf countries not members) was rescheduled in 2001/02 -repayable in second half of twenty thirties (2030s). Remaining debts are Private (20%).
- 22% of Maturity<1 year, 32% between 2-5 years & 22%>10 yrs
- Terms and conditions of Chinese lending not fully transparent. So far, Chinese rolling over repayments when they become due (around US$ 8 bn), but reluctant to accept losses on their lending portfolio. Another complication is how to categorize a Chinese lending institution- bilateral or commercial.
- According to AidData China's funding to Pakistan until 2021 was US$70.3 billion (only 2% was in form of grants)-19.6% off GDP. The average interest rate on the loans was 3.72% with an average maturity period of just under 10 years (with a grace period of roughly 3.74 years).
- Share of energy related loans was 40% and general budget support 30% (referred to as Rescue Lending). Since 2017 Rescue lending has been the largest proportion of its financing, covered by a set of loan repayment safeguards-of which details are not available.

The Global Initiative for Debt Relief

- Following the ravages of COVID and the stresses faced by low income countries on account of war in Ukraine and the global environment of high interest rates there is growing recognition among multilateral institutions and several bilaterals that some countries (including Pakistan) are under debt distress and need debt relief-including possibly a reduction in the face value of debt.
- The G20 Common Framework for Debt Treatment is such an initiative for heavily indebted countries. It has brought together the multilaterals, bilaterals (including China) and private lenders-participation of all lenders to address creditor disagreements to provide timely and meaningful resolution-admittedly easier said than done.
- To date only Chad has got relief under this initiative. Negotiations on-going with Zambia & Ghana. Sri Lanka was upper-middle income country and got re-categorized as lower-middle income- did’nt qualify under this framework. Pakistan lower middle-income-could get the same treatment.
- Other countries also under debt stress are seemingly reluctant to suspend debt servicing payments, fearing the pain and downgrading of credit rating leading to loss of access to capital markets.
- Some proposals argue that success of initiative requires all creditors to share debt relief burden on equitable basis under the framework of a debt sustainability analysis by the IMF (i.e. country would have to be in a Fund Program)
- Need for a set of fair rules that, for comparability, factor in the cost of lending of each participant/category of creditor. For instance, in the case of Sri Lanka the understanding is transparency and parity in debt restructuring treatment of major creditors, consistent with IMF’s debt sustainability analysis.

Our Similarities with Sri Lanka

- It had a higher per capita income than S. Korea in 1960.
- Generous tax exemptions & expenditures running wild (esp subsidies). Primary surplus in only 3 years since 1951. Result-unsustainable fiscal deficits (12.2% of GDP)-financed by foreign & domestic borrowings. So, huge public debt (128% of GDP)- interest payments 72% of revenues.
- External debt ($44.5 Bn.) 64% of GDP and Domestic 50%
- Efforts to address macroeconomic imbalances under 16 IMF programs not sustained (9 not completed)
- Central bank supported fiscal indiscipline (in our case through injections of Rs.12.8 trln-12% of GDP)
- Support to inward looking import substitution and very low levels of investment (7% of GDP)
- Overvalued exchange rate. Remittances flowing through informal networks (dual markets). Anti-export bias with domestically protected businesses resisting timely adjustments in exchange rate
- Long-term exemptions of income tax and import duties hardly succeeded in attracting FDI inflows
- External Reserves built essentially through borrowings
- Frequent policy reversals combined with ad hoc state interventions.

Sri Lankan Default and Lessons

- Defaulted in May 2022. Owed $7 bn for the year- reserves were $1.7 bn
- After default economy contracted by 7.8% in 2022 and 3.8% in 2023. There were shortages of fuel, gas, medicines and many essential items and inflation was 67.4%
- 28% owed to multilaterals, 31% to bilaterals & 41% commercial bonds & loans @ interest rate of 7.5%. China share of debt 20%. Negotiations began Sept 2022.
- All lenders (incl. multilaterals, domestic and private) asked to take 30% haircut, to attain debt sustainability at 95% of GDP.
- Progress on debt restructuring v. slow. Still no assurances of debt restructuring from bond holders (000s of them), Japan and India. But even after this restructuring interest costs look unsustainable ($4-5 bln per year-5% of GDP). Recently China Export-Import Bank reached a deal on China related debt-but no details available.
- After Fund program some progress on reforms. Inflation has come down sharply (single digit). Availability of essentials has improved but unaffordable for a very large segment of population. Many middle income families have slipped below poverty line
- Youth and skilled personnel desperate to leave country-311k left in 2022
- **Lessons-a)** all creditors will have to take a haircut;

-**b)** country seeking debt relief will have to present a broader domestic reform plan, showing how and where the debt restructuring fits into the proposed reform strategy. This would be a pre-condition for lenders to consider such a request- a demonstrable commitment to prevent the return of the conditions requiring debt relief. So pain will have to be administered and test of leadership is how equitably it can be distribute between different economic classes based on their capability to bear the burden of required adjustment

Possible Package of Reforms

- Rationalization of Govt Expenditures, starting with the shrinking of over-staffed Fed Govt to reflect transfer of functions post 18th Amendment (still 43 Divisions + 400 attached Depts with 650k employees) & right sizing & skilling of provincial govts (Punjab had 22 Depts in 2000 now 48 with an army of peons, drivers, chowkidras, clerks).
- Finalize list of several agencies & autonomous orgs. to be wound up (520 k employees)- (duplication of functions, redundancy of purposes or uses for which established). Only a handful would be candidates for privatization
- And then for the **two proposals** above:
  - Retire who have completed 30 yrs of service (protecting pension entitlements attained to date). If politically difficult put them in “surplus pool”-save on rent, utilities, cars, etc.
  - Surrender all vacant posts and all such positions (banning new recruitments
  - Similar exercise to be conducted at provincial level
- Move to contributory pension systems for new entrants to Civil Service (current liability Rs.25 trl). For existing employees adopt it, protect pension entitlements to date. Redesign compensation structure, monetized perks.
- Revisit defence strategy and frameworks-shed non-core and commercial activities
- Prune size of conventional forces (3/4ths of pension allocations on them) & other non-combat expenditure (e.g. upgrading of posts to accommodate growing numbers of officer cadre, time & expenditure on protocols on routine visits of seniors)

Possible Package of Reforms (contd.)

- No additional projects in PSDP. Also, no intra-provincial projects & parliamentarians dev. schemes. Only donor assisted & on-going trunk infrastructure projects or nearing completion. Treat as sunk investment (and w/off) those on which less than 25% expnd-incurred (most of it on salaries, vehicles and utilities)

- Reduce footprint of State in economy-distorting markets & raising cost of doing business by excessive regulation-lack of clarity why activity needs regulation

- Address trust deficit owing to unpredictability of govt policies& actions sentiment

- Phase out heavy protection to industries (motor vehicles, cement, sugar, polyester, etc.) -even FDI inward looking. Rationalize import tariff structure to make economy more competitive and enabling participation in global value-added/supply chains

Possible Package of Reforms (contd.)

- Revamp tax structure. Tax income not transactions. Simplify-fewer number of taxes and rates-lowering the effective rates. Similar treatment for same income levels irrespective of source -e.g retail and wholesale, transport services, light taxation of capital gains in real estate (made haven for black money) and trade in equities & tax concessions to agriculture sector (subsidies on fertilizer, irrigation water & electricity for tubewells, support prices-wheat & sugarcane >global prices)

- Structural reforms in the Energy Sector, including renegotiations with IPPs (starting with Public Sector IPPs)-admittedly easier said than done.

- Reduction in external debt may need to be complemented by capital controls & import restrictions.

Possible Adjustments in Domestic Debt Obligations

- As brought out in the Sri Lankan case, to seek a write down of the external debt or its /reprofiling will, for external lenders to accommodate the request, also require similar adjustments in domestic debt.
- Interest on domestic debt consumes 90% of the annual allocation for interest payments (2023/24- 120% of Fed Govt Net Revenues). It has grown more sharply than other public expenditure, requiring mobilization of a primary surplus of more than 5% of GDP!
- Banks being the largest lenders to a bankrupt borrower will have to bear the burden of some pain. Debt reduction will bring down the cost of debt servicing creating a large fiscal space and help stimulate growth.
- The reduction (or liquidation) of this debt will require a gradual approach, involving a combination of significantly negative real interest rates, a moratorium/suspension of interest payments for some years, longer maturities and some write-down of its face value.
- A substantial reduction in face value will hit the capital base of banks (who are also likely to be under stress of non-performing loans). The restoration will require loans to them at concessional rates and a short-term relaxation of the SBP's prudential regulations on capital adequacy.
- And to check a run on the banks a hefty withholding tax may be required to prevent large cash withdrawals. This may have to be supplemented by govt guaranteeing all deposits for a 2-3 year period.
- The fourth/fifth option, although not the preferred solution, could be a higher tax rate on bank incomes.