INSTITUTE FOR POLICY REFORMS

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REPORT

FOREIGN AID AND ITS PURPOSE: PAKISTAN MUST SLOWDOWN EXTERNAL BORROWING

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Executive Summary

Though GoP has controlled the current account deficit at present, the respite is precarious and likely short lived. To all appearances, the economy would stay in its present state of low growth, low exports, and close to default. What that leads to would depend on policy makers. We could see further devaluation of the rupee or a more restrictive monetary policy and even more increase in administered prices. If all of that happens, the cure may turn out to be worse than the disease. The people of Pakistan are paying a huge cost for years of poor economic management.

The most critical problem faced by the Pakistan economy is repayment and servicing of external debt. Years of ill-advised financial management has brought us to this pass.

- In the last ten years, external debt servicing (principal and interest) has ranged between 1 % of GDP in 2014 to almost 5% of GDP in FY 2020 Figure 1.
- Remitting such large sums of money overseas without drawing any productive benefit from it, is a loss to the economy.
- In FY 20, principal + interest paid to foreign creditors (Rs. 2.3 T) was almost twice the amount spent on all development, federal and provincial, (Rs. 1.2 T). Just interest paid to foreign creditors (Rs 406 B), was 1/3 of total development.
- New external loans, often at high commercial rates, are taken to service past debt, a solution fraught with risks, but one that has become especially acute in recent years Table 2.
- In essence, the economy is in a debt trap, see Table 1 and Figure1.
- In addition, Pakistan remits over 0.5% of GDP in FDI profits annually. While this is a necessary part of FDI, these are not export oriented investments. Remittance of profits adds to forex squeeze.
- Also, in FY 19 and FY 20, outflow of foreign private funds invested in Pakistan government's debt instruments amounted to US $ 1,002 Million and 241 Million, respectively. This debt was incurred at a very high cost of up to 13%.
- Pakistan must end its preference for accessing any available foreign fund regardless of interest cost. Also, the country must take a deep look at its public fiscal management, i.e., how it raises funds (revenue and debt) and what it spends that money on.
- In the last twenty years, Pakistan has paid external creditors more than it has received from them. Yet its external debt has grown by over 200% from $ 37.2 B in FY 01 to $ 112.9 B in FY 20, Table 7. We may have paid back the original loan more than once and still owe it to the creditor.
- Between FY 01 and FY 20, external debt disbursed to Pakistan totalled US $ 112.6. During the same period, it has paid to foreign creditors a sum of US 117.9 B in principal and interest. That is, it has paid back US $ 5.2 B more than it received, a negative resource transfer. Of the $ 117.9 B paid, $ 90.6 B was principal, and 27.2 B was interest. Average annual interest paid was US $ 1.4 B, Table 6.
- This is the result of borrowing to service past debt and the effect of compounding, which makes even concessional credit expensive.
- As a result, most solvency and liquidity indicators have worsened in recent years. Table 9.
- Taking another measure, GoP spends the bulk of government revenue on paying interest on public debt. In the last ten years, it has spent annually an average of 60% of federal net revenue receipts on interest payment (on both domestic and external debt). Any principal paid is extra. In FY 19, interest payment was 103% of net revenue receipts, Figure 1. That is every government expense other than interest payment was met from loans.

- Two approaches define Pakistan's economic policy making: 1. For years, it has tried to deal with macro issues through macro policy. Economic growth, which would yield tax revenues and export earnings has not been a priority, 2. It has not made sufficient effort to control expenditure on subsidies and security, preferring to borrow from both within and outside the country to meet these expenses.
- GoP's logic for incurring foreign debt is that it helps economic development and macro stability. Yet, all evidence is to the contrary. Most macroeconomic or GDP growth indicators have worsened during the last twenty years. Seen over 20 years, our fiscal and current account deficits have stayed high, inflation has resisted a tight monetary policy, and Rupee value has weakened consistently (Figures 2 to 7 and Table 8). Many a times, we have put controls on imports and have repeatedly sought IMF help. Short periods of moderate GDP growth have been followed by more years of economic slowdown. Savings, investment, and exports have taken a huge hit Figures 10 A to D. Resultantly, in a serious setback, our agriculture production has declined, and manufacturing has languished Figure 10 E. Also, Pakistan has fallen in UN HDI ranking to 156 of 189 countries.
- The role of IFIs too has been unhelpful.
  - About 20 years ago, they made a shift to programme lending, which further fueled GoP's spending beyond means. As a result, we find more and more foreign loans go to BoP and budget support. In the decade of 1990s, 7.7% of total foreign loans was for BoP support. In the last two fiscal years that number reached 70%, Tables 2 and 5. An economy cannot grow if such a high portion of foreign debt goes to consumption.
  - IFIs have been unhelpful with their advice too. Firmly in the neo-liberal fold, they advised Pakistan on a role for the private sector in infrastructure development. The chaos it has brought to the power sector is well known. Their other projects too have had low impact. According to World Bank evaluation, the Social Action Programme, the TARP (Tax Administration Reforms Project) and their structural assistance loans have had mixed results. So, has ADB's judicial reform project. Despite their own negative evaluation, IFIs continued to lend. For example, they funded SAP II "when SAP clearly was not working". See pages 17-19.
  - Regardless, Pakistani taxpayers must pay back the loans with interest. The creditors face no consequence for their weak programme design and inability to learn from mistakes. In designing their loans, they have consistently disregarded Pakistan's weak governance and the low capacity of the economy. For example, in promoting costly private power production, they disregarded the consumers inability to pay the high cost of power. Rather than help, such loans have harmed our economy.
- It is time for policy makers to carry out a deep review of fiscal management. They must understand the grave consequences of flawed fiscal management on our businesses and citizens. Policy makers must address the issues of political economy that has spurred spending in unproductive areas. They must develop home grown policies rather than donor driven ones. Also, GoP must have guidelines for use of foreign loans, so that they are used mostly for public projects that boosts private sector productivity and export growth. They must increase domestic savings rate Figure 10 A. Public debt helps when their use yields higher rates of GDP growth than the buildup of liabilities. In our case, the situation is the opposite and by a wide margin.

So, the myth that borrowing creates growth is misplaced. In Pakistan's case, borrowing creates more borrowing with an external account crisis waiting to happen.

Foreign Aid and Its Purpose: Pakistan must slowdown external borrowing

There is wide consensus that loans to developing economies from IFIs and rich countries benefit the recipients. Most discussion in Pakistan on foreign aid reinforces this thinking. It is thus not surprising that even as government claims that external imbalance is Pakistan's leading economic concern, it continues to borrow more. GoP's solution to the problem is one that worsens it.

Perhaps it is this belief in the blessings of foreign loans that leads the Ministry of Economic Affairs' Annual Report to state that GoP acquires foreign aid to meet two main goals "sustainable social and economic growth … to reduce poverty and inequality". The other goal is to reduce fiscal imbalances for macro stability". Quoting the OECD, it says that 'Foreign Economic Assistance (FEA) can be defined as "government aid designed to promote the economic development and welfare of developing countries"[1].'

MoF's Debt Policy Statement states that developing countries "need to borrow in order to facilitate the development process". It recognizes though the need to do so prudently[2]. The ministry's Pakistan Economic Survey of FY 20 laboriously informs that "concessional long-term development loans from bilateral sources and multilateral institutions are particularly attractive because of long repayment periods which are in-line with the long-term economic benefits reaped from the underlying development projects"[3]. Translated, they are saying that 'concessional' credit finance development projects, which yield long-term economic gains.

We will soon test the above assumptions and likely find that what GoP posits as 'concessional' credit often exacts a high cost. Also, such loans do not always serve the goals of development. In fact, they now pose a burden, which constrains the economy's capacity for growth.

Why do we believe in the benefits of foreign loans when all evidence is to the contrary? And if the loans do not foster GDP or export growth, how will they be repaid?

Importantly, GoP's choice of words about the purpose of foreign loans is not well informed. In fact, it is likely misleading. GoP's documents suggest that foreign aid is necessary and inevitable and something that the economy cannot do without if it is to grow. By framing it as inevitable and unavoidable, GoP may unwittingly be shifting the focus from the real issues that encumber our public financial management. They involve questions about where public resources come from and what they are spent on. Understanding these fundamental questions will inform us why government is always short of funds, forcing it to borrow from outside. It is important to know that foreign borrowing is a choice that GoP exercises. There is nothing inevitable or binding about it. It can be avoided.

The reason we are in such a situation is because:

- The loans are not used for the purpose of development. And when they are, their use is inefficient. Thus, use of external loans do not generate the returns needed to repay them.
- And these loans are not cheap, even concessional credit entail high servicing expense, as will be seen below. Continuing to believe in its benefits reinforces the lack of fiscal discipline.

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[1] Ministry of Economic Affairs/EAD, Annual Report on Foreign Economic Assistance (FY 2019–20), Page 1
[2] MoF Debt Policy Statement, January 2021, Page 1
[3] MoF, Pakistan Economic Survey 2019-20, Pages 187-188

This is not to say that foreign loans are all bad. Some economies have used it well to boost growth and exports. Those economies that have benefited make foreign credit one part of their financing plan for a comprehensive growth strategy. Their "public debt did not get out of hand", not least because "the economy grew faster than the stock of public liabilities"[4]. These economies kept an eye on overall fiscal discipline.

Growth depends on investment. To the extent that investment is financed from foreign debt, it must be on a scale that does not create risks for the economy. Also, public investment must be such that "relieves infrastructure bottlenecks"[5]. That is, it should boost private sector productivity and international competitiveness.

Table 1
Pakistan External Debt and Liabilities

Billion USD

	June 2007	June 2013	June 2018	June 2019	June 2020
Public Debt incl PSEs	***38.1***	***52.6***	***78.1***	***88.1***	***92.9***
Public and Guaranteed Debt	**38.1**	**50.2**	**75.4**	**83.9**	**87.9**
• Multilateral and Paris Club	31.4	37.7	39.7	39.0	41.8
• Other bilateral	1.0	2.9	8.7	12.7	13.4
• Bonds, Sukuks, commercial	2.9	1.6	14.1	14.8	13.6
• Short-term debt	0	0	1.6	1.3	1.5
• IMF	1.4	1.4	6.1	5.6	7.7
• Forex Liabilities guaranteed	1.4	2.4	5.1	10.5	9.9
• PSEs	**--**	**2.1**	**2.7**	**3.9**	**4.9**
Banks	**--**	**1.5**	**4.4**	**4.7**	**4.5**
Private debt	**2.0**	**3.1**	**9.2**	**10.5**	**11.1**
Intercompany debt	**--**	**2.8**	**3.6**	**3.3**	**4.4**
Total Ext Debt & Liabilities	**40.1**	**59.8**	**95.2**	**106.3**	**112.9**
Official liquid reserves	13.3	6.0	9.9	7.7	12.5
Ext Debt & Liabilities % of GDP	**28**	**25**	**30**	**37**	**45**[6]
GDP in Billion USD	**144**	**237**	**313**	**279**	**264**

Source: SBP Annual State of the Economy Report for relevant years (private bank borrowing not included, which explains discrepancy in Fys 13, 18,)

[4] World Bank, The Growth Report, Commission on Growth and Development, Page 24, albeit referring to all public debt, not only external
[5] World Bank, The Growth Report, Commission on Growth and Development, Page 54
[6] Source for EDL/GDP is SBP's Annual State of the Economy Report FY 20, Pg 81, Table 5.7

So, foreign credit helps development if its use is subject to the following:

a. There should be guidelines for their use, so that they only serve development purposes.

b. They should be invested to build human capital and soft and hard infrastructure that removes growth bottlenecks and reduces cost of doing business.

c. They should not be used for budget support, except as a short term measure for a specific end.

The essence of sustainable external debt is that it should boost GDP growth. Preferably, that growth should build exports, so that the economy has the capacity to repay the debt. As the economy progresses, reliance on external debt as a financing source must reduce and investment must be financed from own resources.

China is an (aspirational) example. China's outstanding stock of external debt by 2019 was over US$ 2.1 Trillion. But that stock is just 14.4% of GDP (compared to Pakistan's 45.5%) and less than China's annual export of US$ 2.5 Trillion in 2019. Its debt servicing amount of about $ 470 Billion is less than its trade surplus. For many years, China has consistently run a current account surplus[7]. In the 1950s, Japan incurred foreign loans, but kept it to 1% of total investment plans.

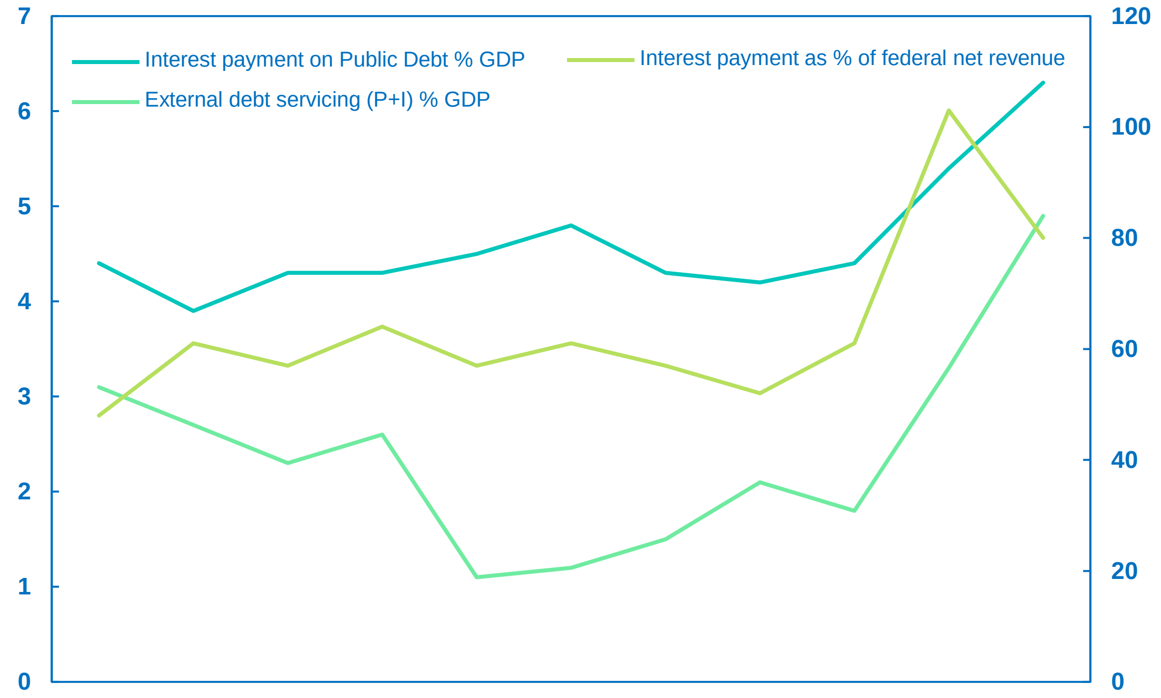
Naturally, this belief that loans are innately good for recipients is also shared by creditors. In fact, they may have first spawned the idea. In its description about what it does, the World Bank claims to have helped fight poverty, supported economic growth and made gains in the quality of peoples' lives in developing countries. Through loans and technical advice, it claims also to have helped over a hundred countries adjust to major changes in the world economy in the areas of food security, climate change and much more[8].

The Asian Development Bank's mission, its website tells us, is a "prosperous, inclusive, resilient, and sustainable Asia and the Pacific". The IMF promotes international financial stability and monetary cooperation as well as trade and sustainable economic growth while reducing poverty. The Encyclopedia Britannica sums up this widely held consensus about the purpose of foreign aid by defining it as "international transfer of capital goods, or services from a country or an international organization for the benefit of the recipient country"[9].

However, much evidence is to the contrary. Behind these simple but overweening declarations, lie many considerations that affect effectiveness of their loans. Their effectiveness depends on recipient country's economic strategy, sector or project selection, project and credit design, and measuring of outcomes. There is many a slip between the laudable goals of lending and their outcomes. The most important single element in loan effectiveness is the role of recipient countries. The rigour of their economic policy, fiscal discipline, and programme and project delivery has a huge bearing on outcomes.

[7] Data for 2019 taken from various sources: World Bank data, CEIC, and China Focus
[8] Word Bank website, worldbank.org, under tabs what we do and who we are
[9] Respective websites of ADB, IMF and the Encyclopedia Britannica

FIGURE 1
High cost of debt servicing 2010-2020



The overall hypothesis of this paper is not that foreign debt is bad. This paper avers that under certain conditions foreign loans yield benefits for the economy. And that when these are breached, as they are in the case of Pakistan, they are the cause of much of the economy's problems. Pakistan has not used the massive amounts of credit available to it to good purpose. Thus, it is challenged in its ability to repay the loans.

To get the most out of it, foreign credit must feed capital accumulation and structural transformation. These are the two key determinants for economic transformation that boost GDP and export growth, resulting in an escalating cycle of value addition. Loans help economies that have a strong domestic policy framework for growth. They can leverage the credit to build firm level productivity and overall production capacity of the economy.

This paper will now:

1. Review the rationale put forth by the Pakistan government for incurring high levels of debt and whether the results match GoP's claims.
2. It then examines data that lie behind GoP's oft repeated truisms about the need and value of foreign aid.
3. It will analyze the real cause of high indebtedness and how substantively aid can bring value.

1. **Let's take GoP's rationale for foreign borrowing Vs what this paper finds.**

    a. **GoP position 1:** Foreign credit promotes economic development and welfare and leads to sustainable social and economic growth

        ➢ Pakistan's case shows no relationship between foreign credit and growth. Repeated research have shown low impact and foreign debt filling import-gap for consumption[10]. Despite high levels of foreign borrowing, Pakistan's GDP growth rates have been consistently moderate to low and uneven, see Figures 2 and 3. Figure 2 shows a weak inverse correlation of -0.36 between debt levels and growth. This holds true even with time lag. Figure 3 shows negative correlation between debt servicing and growth of -0.18.

FIGURE 2

Higher debt does not give high growth

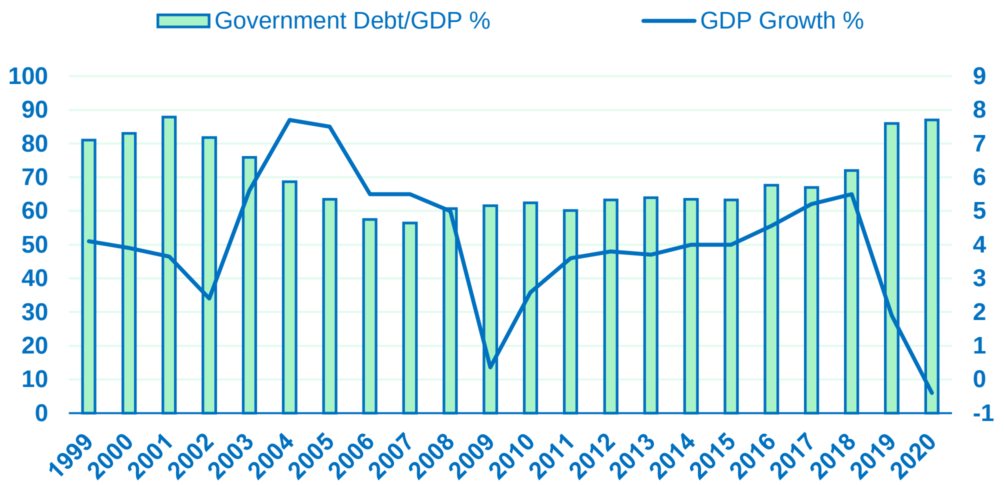


FIGURE 3

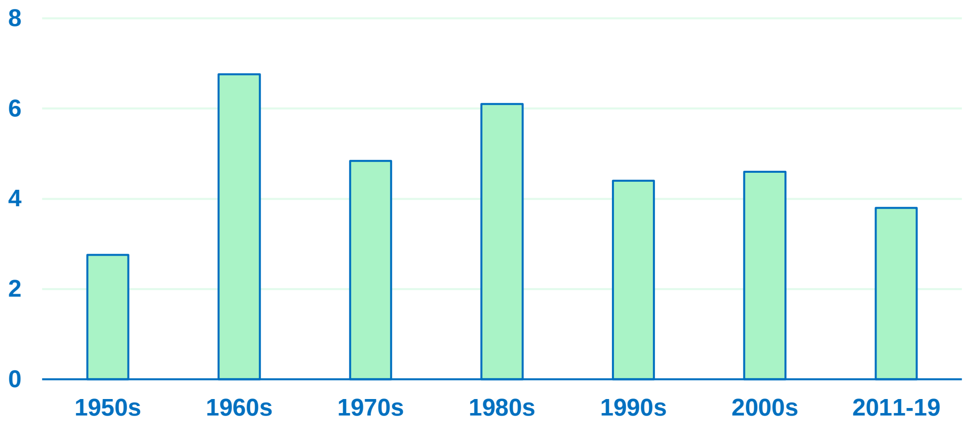
Higher debt does not give high growth

What's more, as debt servicing preempted ever more resources, the economy's growth potential declined. Pakistan received high amounts of grant aid and loans in the first decade of the 2000s, yet average growth was below the 1980s, a period also of substantial aid.

[10] Including, "The Impact of Foreign Aid on Pakistan's Economy", Abdul Ghafoor Awan, Muhammad Moeen-ud-Din, Science International 2015, which says "Foreign aid has negative affect on the economic growth of Pakistan and there is no improvement in GDP". Impact of Foreign Aid on Economic Development in Pakistan [1960-2002], Mohey-ud-din, Ghulam, Munich Personal Repec Arvhive

FIGURE 4

Growth Potential: Average annual growth by decades



Regarding, GoP's claim that foreign debt promotes the social sector. Pakistan's social indicators have remained weak. Our rank in the UN HDI index has consistently fallen. It presently stands at 154 of 189 countries[11]. Pakistan's index score has increased marginally. However, it is too small to make an overall difference. Indicators of health, education, and those pertaining to standard of living are low. For example, skilled labour as percent of total workforce is a mere 27.8%. Percent of population vulnerable to multidimensional poverty and in severe poverty total 34%[12].

b. GoP position 2: Foreign aid reduces fiscal imbalances for macro stability:

- Pakistan's economic leadership has repeatedly cited external imbalance as the major constraint to economic growth. Frequent current account crises have meant that Pakistan is in its 22nd IMF programme. Clearly, the high level of aid flows from IMF and other concessional creditors have not stabilized Pakistan's external account. See Figures 5 and 6 for fiscal and current account imbalance.
- Pakistan has repeatedly devalued its currency in large sudden shifts, in addition consistent gradual decline. This indicates that the crisis was deep and serious. The constant decline in value means that exports cannot compete. Borrowing further to solve the crises has only perpetuated it. Figure 7.
- It has often taken steps to limit imports because of Forex squeeze, raising the cost of doing business for our firms.

Foreign loans have not fixed external imbalances.

Nor have they helped with other macro indicators. Below we look at four main components of macro stability: budget deficit, current account deficit, shifts in exchange rates, and inflation:

- **Budget deficit:** In the last 20 years, there has not been a single year of a surplus or balanced budget. Nineteen of those twenty fiscal years also had a revenue deficit[13]. This means that government revenue was not enough to

[11] UNDP HDI Index 2020

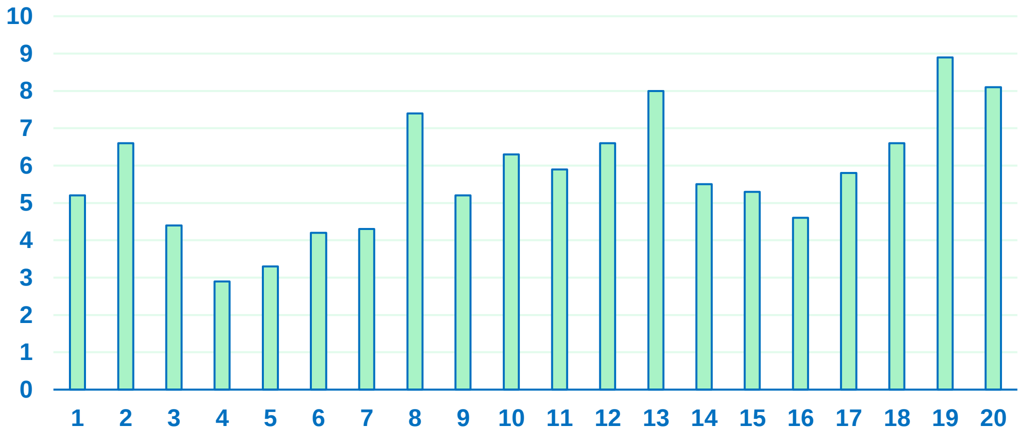
[12] UNDP HDI Index 2020, Pages 391 and 365, respectively

[13] Current expenditure exceeding total consolidated revenues

meet even its basic functions[14]. A revenue deficit suggests government dissaving and use of resources that other sectors of the economy could have used better. In FY 19, GoP's revenue deficit reached a peak of 5.7% of GDP, or Rs. 2.2 Trillion. In FY 20, revenue deficit was 5.4% of GDP, also Rs 2.2 Trillion. Much of the revenue deficit is caused by high debt servicing. Mark-up paid on domestic and external debt in FY 20 was 6.3% of GDP, 80% of net and 45% of gross federal revenue receipts, and 43% of current expenditure. This has put pressure on development spending. Just once in the last 10 years, PSDP/GDP was above 2%. This is not enough for even moderate economic growth. Clearly, debt servicing's huge claim on government budget has not helped macro stability or growth.

FIGURE 5

Fiscal Deficit % GDP 2001-2020

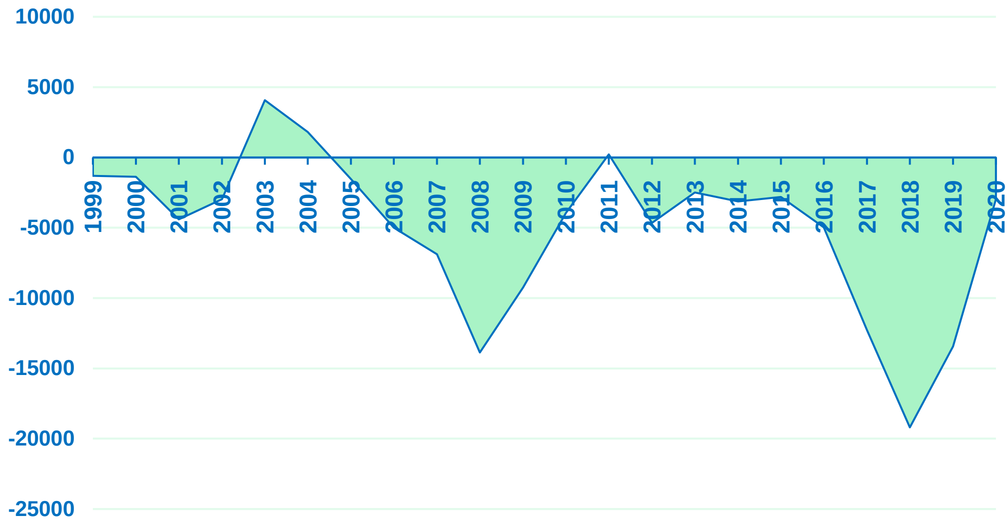


- **Current Account Deficit:** With a chronic deficit in trade in goods and services and large debt servicing needs, it is hard to see that Pakistan will have a balanced current account for a sustained period in the foreseeable future. In the last 25 years, Pakistan has had three years of current account surplus, two of those during the post 9/11 aid flows. So, it is no surprise that Pakistan has had financial crises at regular intervals. Each time this happened, Pakistan re-entered an IMF programme. Understandably, IMF's recipe has been major devaluation of the Rupee and tight monetary policy. This resulted in periods of low GDP growth with the economy losing momentum. That Pakistan has done so 22 times in forty years, confirms that what we are doing hasn't worked. There are two reasons that our solution has not worked. First, that most times we have abandoned the IMF programme midway, unable to follow through on the needed fiscal discipline. Second, because macro problems cannot be solved by macro policies alone. The economy needs growth to generate the revenue and export dollars to solve the problem of fiscal and current account deficits. IMF programmes have the opposite effect. Despite many IMF programmes and incurring high debt continuously, macro instability including external imbalances has eluded us.

[14] Current account data sourced from SBP balance of payment statistics and budget and revenue deficit data from MoF's fiscal operations data.

FIGURE 6

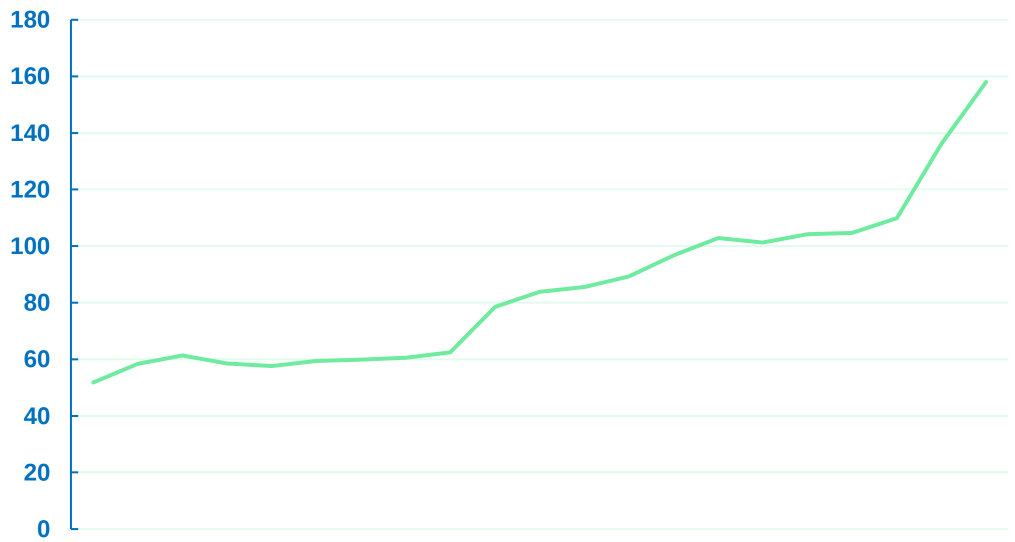
Current Account Deficit in Million US$



- **Exchange rate**: Despite a policy of managed float during which the Rupee gradually loses value, Pakistan has faced regular financial crises. These necessitated a further major adjustment in Rupee value and high interest rates, causing severe jolts to the economy. Our firms have to readjust to the twin shocks of high prices from loss in exchange value and high interest rates. Consumption in the economy falls, and industry suffers because of high in input cost. Because overall competitiveness of the economy is weak, exports do not rise at the same rate as fall in Rupee value. These sudden jolts occurred in 1998, 2007, and in 2018, Figure 7[15]. They happened because of lack of fiscal discipline and adjustments and because we did not pursue growth. Usually, they have occurred also during periods of political uncertainty.

FIGURE 7

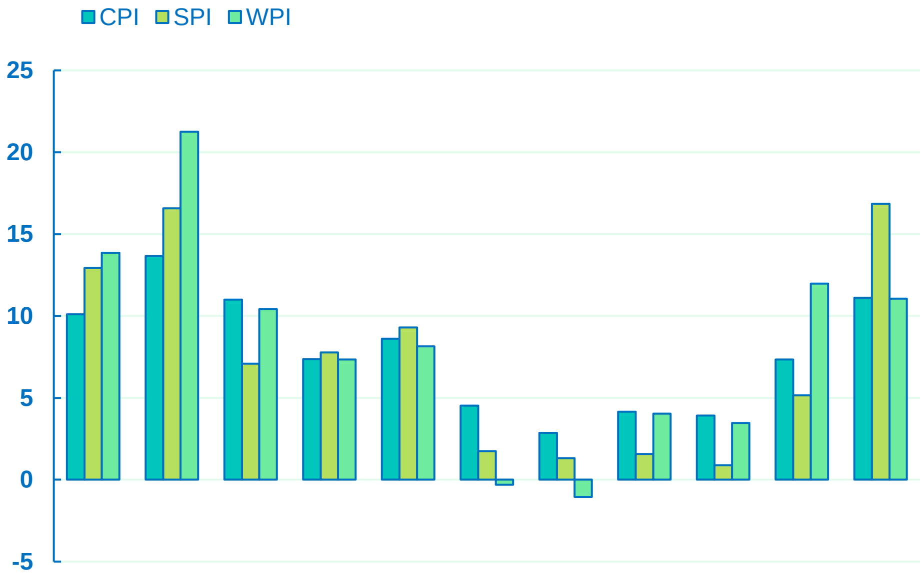
Falling Rupee Value
PKR-US$ Rate 1995-2020



[15] SBP statistics for external sector

➢ **Inflation**: Data for the last ten years shows that in four out of ten years, CPI was more than 10%. In three years, all three price indicators (CPI,SPI,WPI) were in double digits. Primarily, high price increase is because of fall in the value of the rupee and shifts in world energy price. The fall in global energy prices slowed down inflation in Pakistan from 2013. More recent inflation is because of increase in administered costs, distribution flaws and falling production[16].

FIGURE 8
Prices
CPI, SPI, WPI 2010-2020



c. **GoP position 3:** Foreign aid in large part is concessional and by investing in public development projects it brings long term economic benefits for the economy and creates the ability to repay them:

➢ Terms of bilateral and multilateral loans are indeed soft. They have low interest rate and long tenure periods. Yet, the combined effect of using loans to service past credit and the effects of compounding have increased the stock of debt. It has also caused transfer of resources to creditors in rich countries through payment of large sums as interest to 'concessional' sources. During the last five years, interest payment to four 'concessional' sources total US $ 4.5 Billion. The four sources are multilateral (mostly WB and ADB, interest paid in five years is $ 1.8 B), Paris Club (a group of 22 rich countries, $ 1 Billion), other bilateral (mostly China, $ 1.2 Billion), and IMF ($ 568 Million). Interest amount of US $ 4.5 B paid to these four sources during the last five fiscal years average 34% of total debt servicing paid to them. See Table 4 below.

[16] Pakistan Bureau of Statistics, Price statistics

There is no evidence to suggest that foreign credit serves the laudable goals often cited by GoP. They are growth and development and macro stability, or that it is concessional.

Much of what we borrow is not used to build projects. They meet Balance of Payments needs and budget shortfall. Simply put, foreign loans merely encourage our tendency to live beyond our means.

2. A deeper look at the data in support of GoP's claims about the need and value of foreign credit:

Table 2 below looks at the last five years as a microcosm of what is going on. They also reflect the most recent trends in our economic management. In the last five completed fiscal years since FY 16, Pakistan has borrowed USD 52.4 Billion from foreign sources in government and guaranteed loans. Over 68% of this amount was for balance of payment needs (i.e., for consumption), and 31% for projects. Loans of an additional US $ 7.8 B was private non-guaranteed. Later Tables would include them too, as those liabilities too are liquidated from the same Forex kitty.

Table 2
Allocation of government and guaranteed disbursed loans

Million USD

	Project Aid	BoP Support	Total	% BoP
FY 16	2,411	5,137	7,548	68
FY 17	3,609	7,073	10,682	66
FY 18	3,826	7,661	11,487	67
FY 19	3,501	7,318	10.819	68
FY 20	3,164	8,736	11,900	73
	16,511	35,925	52,436	68.5

Against this inflow of $ 52.4 B of public and guaranteed debt, our outflow was $ 42.9 B or 82%, Table 4. So, the net transfer of resources to Pakistan was $ 9.5 B or 18% of what we borrowed. Of the $ 42.9 B, an amount of $ 9.7 B was paid as interest, 23% of total debt servicing. Interest paid to foreign creditors is a net transfer of resources from our foreign exchange scarce economy.

Just the interest paid on debt in five years is one a half times more than the credit being given to us under IMF Enhanced Fund Facility signed in 2019. To be noted that these are cash flow numbers.

Table 3 Total Disbursed and Serviced Debt FY 16-20					
	Debt Disbursed	Principal	Interest	Total	Net Transfer
Public and guaranteed	52,436	33,290	9,704	42,994	9,442
Private non-guaranteed	7,835	2,364	1,768	4,132	3,703
Total	60,271	35,654	11,472	47,126	13,145

During the five years, an additional amount of US $ 7.5 B was received as private non-guaranteed loan, Table 3. Against this amount, repayment and interest paid was S 4.1 B, with $ 1.8 B in interest. Including private debt, net inflow in five years was US $ 13.1 B of, or 22% of total amount of $ 60.27 B disbursed. Against net transfer of $ 13.1 B, Pakistan's outstanding stock of external debt and liabilities increased by US $ 38.9 B during this period. There has to be a fundamental flaw in management of public finance when in 5 years, the stock of debt grew 3 times more than the net transfer.

Need to end commercial borrowing from the market:

Of the 47.1 B in debt servicing, $ 13.4 B was paid for Eurobonds and commercial banks, including $ 3.1 B interest. Commercial borrowing at market rates is a recent phenomenon of the last 15 years or so. The stated purpose of doing so is to diversify sources of debt and to build forex reserves[17]. It also supposedly tests the economy's credit worthiness. This kind of thoughtless fiscal management defies logic.

First, borrowing is not inevitable. It is a choice. Further, borrowing at commercial rates of up to 8%, raises average cost of capital while reducing average tenure. Growth of foreign exchange reserves by incurring such high cost of capital defeats the purpose for which it is borrowed. It adds to the debt burden, and its servicing does not build reserves, but depletes it. This in turn reduces our credit worthiness. A similar logic applies to private portfolio flows, whose volatility GoP must understand is destabilizing for the economy. When it comes as debt, it is at very high cost. Policy makers that take such capricious decisions face no consequences.

[17] Op Cit 1

Table 4 was referred to already in the foregoing Section 1 C. Suffice it to say here that because of the effect of compounding and borrowing to service old debts, in actual fact concessional credit carry high effective rates. In the last 5 years, interest paid to multilateral lenders was 21% of total debt servicing. Multilateral debt (WB and ADB mostly) is the cheapest source of debt. Interest paid to IMF was 43% of total, to Paris Club 41%, and to ‘other bilateral’ lenders 32% of total. Average interest paid to the 4 concessional sources was 34%. Why commercial credit entails less cost of 31% is because of their short tenure.

Table 4
Loans principal and interest serviced FY 16-20

Million USD

	Multilateral		Paris Club		Other Bilat		IMF		Total Four Concessional		Eurobond & Commercial		Total All Long-term		Short-term	Total Prin + Int
	Prin	Int	Prin	Int	prin	Int	Prin	Int	Prin	Int	Prin	Int	Prin	Int	Prin	
FY 16	1,221	239	220	244	220	136	53	51	1,714	670	725	387	2,751	1,256	896	5,318
FY 17	1,255	295	412	242	788	200	0	86	2,455	641	1,239	432	4,022	1,459	2,083	8,147
FY 18	1,317	357	611	240	182	203	86	128	2,195	928	489	614	3,003	1,926	1,852	7,495
FY 19	1,375	440	641	231	329	310	375	143	2,720	1,124	3,097	915	6,044	2,492	2,111	11,589
FY 20	1,455	477	376	120	1,455	364	744	160	4,030	1,121	4,879	846	8,809	2,571	1,719	14578
Total	6,623	1,808	2,260	1,077	2,974	1,213	1,258	568	13114	4484	10,429	3,194	24,629	9,704	8661	42,994
Int % total		21%		41%		32%		43%		34%		31%		39%		

Until now, this paper looked at 5 year data to understand recent economic policy. It finds GoP's liberal use of foreign debt to meet budget and BoP needs. Doing so, the economy did not create the assets that would boost GDP growth and enhance the capacity to repay. Our recent approach to policy making is one that is destined to bring about economic crises.

We now look at longer term data. Above, this paper expounds the belief that foreign debt is sustainable only when it is used on projects that boost GDP growth, especially export growth. They become a burden when used for BoP support. That is, when they are used for consumption and not investment. Their allocation to BoP or budget support shows the proportion that goes to consumption. Table 5 below breaks down allocation for the last 30 years. From early 2000s, IFIs offered easily disbursed programme loans, and GoP availed them liberally. Loans for BoP support hiked sharply from 7.7% in the 1990s decade to over 51% in 2000s. In the last two years, loans for BoP have reached an unsustainable 70.5% of total. One good development is that cheaper new loans have liquidated commercial finance. But that does not account for all of the borrowing.

Table 5
Foreign Loans for BoP Support

Million USD

	PPP + PML FY 89-99	Musharraf + PML Q FY 00- 08	PPP FY 09-13	PML N FY 14-18	PTI FY 19-20
Total Foreign Loans	27,271	19,587	15,558	42,355	22,719
Projects	21,005	7014	6789	14812	6665
BoP	2,102	10123	5429	27200	16017
% BoP	7.7	51.6	35	64	70.5

This paper now analyzes the buildup of debt in the Pakistan economy as well as its cost. Table 6 looks at a 20 year period, breaking it into 5 year intervals to reflect the approach followed by policy makers at different times. It finds that even as GoP considered the external account a major concern for the economy, it continued to borrow in higher amounts. Average annual borrowing in the four periods in Table 4, rose from US $ 2 B/year during FY 01 to 05 to a massive US $ 12.2 B/year during FY 16-17. In the intervening two periods, the economy incurred debt at the rate of US $ 4 B/per year. Per year borrowing grew by 3 times in 20 years. Thus, solvency indicators have worsened. As Table 1 shows, Pakistan's total external debt and liabilities grew from 23% of GDP in 2013, to 30% of GDP in 2018, to the present 45.5% of GDP. See also Table 9. Interest paid has grown sharply too. In the first three periods, we paid about $ 1 Billion/year as interest. In the last five years, this amount has more than doubled to $ 2.3 B/year. External debt has gradually moved from relative sustainability towards the present unsustainable level.

Table 6 Receipt of Loans and their debt servicing 2001-2020 Million USD							
	Loans Disbursed	Repayment			Net Transfer	Stock of debt	Amount + % in 5 years
		Principal	Interest	Total			
FY 16-20	60,270	35,655	11,472 24%	47,127	13,143 22%	112,858	47,755 73%
FY 11-15	22,580	22279	5108 19%	27,387	-4,807	65,103	9,477 17%
FY 06-10	19,597	13,928	5,413 28%	19,341	256 1.3%	55,626	19,792 55%
FY 01-05	10,196	18,790	5220 22%	24,010	-13,814	35,834	-1,365 -3.7%
Total	112.644	90,652	27,213 23%	117,865	-5,221	37,199 June 01	

Source: SBP Respective Annual State of the Economy Report

Table 6A Total Disbursed and Serviced Debt FY 01-20					
	Debt disbursed	Repayment			Net Transfer
		Principal	Interest	Total	
Public and guaranteed	98,791	81,916	23,805	105,721	-6,930
Private non-guaranteed	13,853	8,736	3,408 28%	12,144	1,709
Total	112,644	90,652	27,213	117,865	-5,221

In the last 20 years, Pakistan received loans amounting to US $ 112.6 Billion from all sources, including non-guaranteed private debt of US $ 13.8 B. During this period, we paid back US $ 117.9 Billion, a negative net transfer of US $ 5.2 Billion. Government and guaranteed debt disbursed was $ 98.8 Billion.

In Table 7 below, this paper makes plain some key points:

- That despite large sums paid back, stock of debt has risen greatly, even as net transfer to Pakistan is a small proportion of total disbursed amount.
- That whether concessional or other creditors, share of interest in total servicing is high. It ranges from 20% for multilateral creditors to 51% for Paris Club lenders.
- Where debt buildup and interest paid are concerned, concessional debt is a euphemism. There is not much difference in cost to GoP. Concessional debt merely adds to the myth of the usefulness of foreign debt.

The high level of debt have resulted in huge sums paid as interest to IFIs and bilateral lenders. This is flow of scarce resources from Pakistan to creditors in rich countries. In the last five years, Pakistan has paid annually US $ 2.3 Billion as interest, Table 7. In the last 20 years, we have paid US $ 1.4 Billion annually. In all, we paid US $ 27.2 B as interest since 2001. Of this, US $ 12.9 Billion have been paid to 'concessional creditors', IFIs and bilateral. Add US $ 1.6 Billion paid to IMF in 20 years and we paid US $ 725 Million per year to 'concessional' lenders. Meanwhile, our foreign indebtedness has grown to US $ 113 Billion, Table 7.

Table 7
Disbursement and Servicing of Concessional Credit FY 01-20
Million USD

	Disbursed FY 01-20	Principal	Interest	Total	Net Transfer	Debt Stock +/- %
Multilateral	36,946	23,313	5,694 20%	29,007	7,939	31,712 +18,402
Paris Club	2,871	5,297	5,475 51%	10,770	-7,951	10,924 -921
Other Bilateral	17,360	3,530	1,818 34%	5,348	12,012	13,428 +12,977
Total Above 3	57,177	32,140	12,987 29%	45,127	12,000	55,250 +30,458
Grand Total	112,644	90,652	27,213 23%	117,865	-5,221	112,858 +75,699

Source: SBP data

3. **Analyze the real cause of high indebtedness and how substantively aid can bring value**

   Why is this so?

   - The problem lies in the way we have used external debt. Notwithstanding our affirmations, a major part of foreign aid is used for BoP and budget support. It was not always so. The problem has worsened incrementally. In the last ten years, loans for BoP was 61% of total foreign loans and in the last 20 years, 59%. Use of foreign loans to pay back past debt, became a norm. During 1989 to 1999, just 7.7% of borrowing was for BoP support. During nine years of the Musharraf government, foreign loans for BoP support jumped abruptly to 52% of the total. This is when IFIs began 'programme loans' such as DPL and PRSC i.e., Development Policy Loan and the Poverty Reduction Support Credit. These were quick disbursing loans not linked to any project. Despite their high sounding goals, they had few measurable outcomes. Conditions for release of funds were lax. It was for the lenders and receiving governments to exercise restraint in their use. Apparently, GoP has not done so. This happened despite very large sums of money received by Pakistan post 9/11. We received aid in the shape of grants, Coalition Support Fund, KSA's deferred payment for oil imports, and re-scheduling of Paris Club loans. Despite the world's largesse, we added few projects to leverage future growth. Since 2006, when energy prices suddenly hiked, they were used to fund oil import. During the PML N years 2014-18, much of the borrowing was used to build Forex reserves and to keep the Rupee value high, a policy that defies logic.

So, the myth that borrowing creates growth is misplaced. In Pakistan's case, borrowing creates more borrowing with an external account crisis waiting to happen.

The buildup of public debt with no recognized impact on growth, social indicators, or macro stability is a powerful reminder of our flawed public finance management. It is also a commentary on how 'aid' is programmed by lenders. Research based on data from 96 countries shows the following[18]:

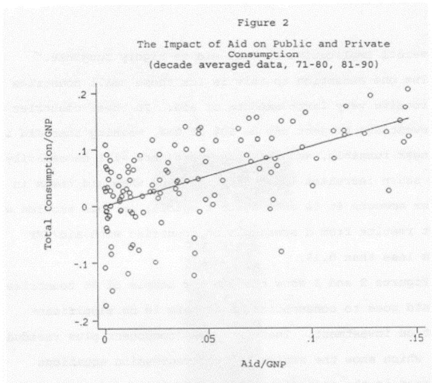
- Foreign credit fuels consumption with "no significant impact on investment'. The absence of any effect on growth should be no surprise Figure 9 A to E.
- The same research also shows that among recipients, there is no improvement in social sector indicators such as infant mortality, life expectancy and primary schooling.
- In fact, the pressure of debt servicing and repayment result in economic crises. (Figure 9 A to E shows these effects as regression of the 96 samples)

Yet, these economies have to service and repay these loans whose burden falls on taxpayers, consumers and investors. Both lenders and recipient governments must do a better job of assessing loan effectiveness and repayment capacity.

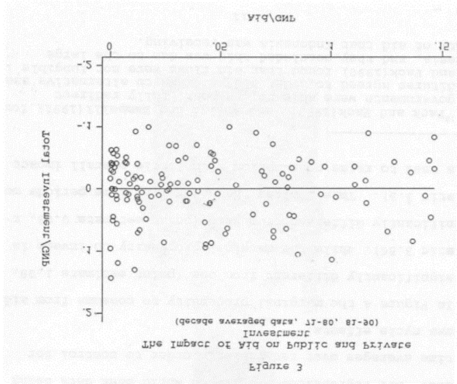
[18] Boone, Peter and Faguet, Jean-Paul (1998) Multilateral aid, politics and poverty: past failures and future challenges, . In: Grant, Richard and Nijman, Jan, (eds.) The global crisis in foreign aid. Space, place and society series . Syracuse University Press, Syracuse, USA, pp. 11-28. Analysis from various pages, Figures in 9 A to E appear after Page 9.

FIGURE 9A to E

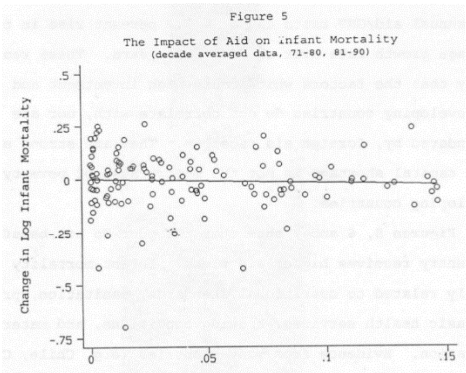
Regression of data from 96 countries



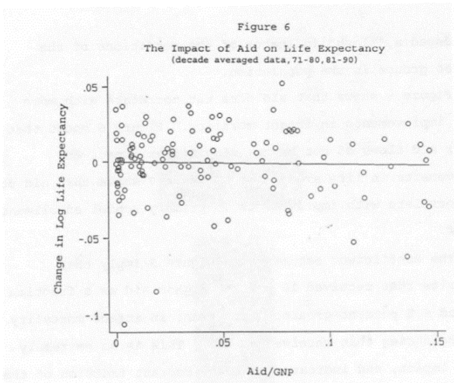
Consumption



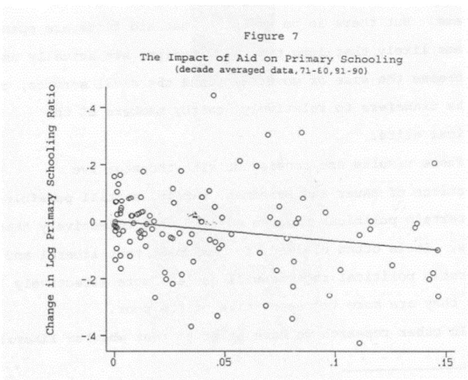
Investment



Infant mortality



Life expectancy



Primary schooling

Responsibility of the recipient state in agreeing to incur debt for BoP or budget support is greater. GoP must take decisions in the interest of the people of Pakistan and the economy. They must direct these loans to well considered projects that fit in to a strategy for growth and to build private sector productivity. When loans are used for consumption, GoP is exercising a political choice. Clearly, this is not prudent fiscal management. Yet even the lender must reduce their exposure to such economies.

In the case of Pakistan, there is injudicious behaviour both by borrower and lender.

- Even in lending for projects to Pakistan, there were severe flaws in the design of credit. They resulted in weak project outcomes. Though program/project design are government owned, it is well known that lenders bring 'quality' expertise and have more say in their design. During project implementation, lenders closely monitor progress. Disbursements are contingent on progress. Their own evaluations show weak to moderate impact. Despite this disbursements continued. The loans are a burden on Pakistani tax-payers and service users. They must be repaid with interest. The lenders that have a major say in project design take no responsibility.
- Examples of weak economic impact are available in World Bank's "Independent Evaluation Report on its Pakistan programme for the 10 year period 1994-2003". The World Bank is a major source of credit for Pakistan. At the time of evaluation, it had a share of 28% in outstanding external debt. In June 2020, it is still the biggest at 21.7% of total. WB also has high level of technical and analytical sophistication. But this is what its own independent evaluation has to say:
    - The report recounts the four major themes of WB lending during the period 1994-2003: i. macro stability, ii poverty reduction and social sector uplift, iii sustainable growth, and iv governance. It says that "outcomes of Bank assistance were unsatisfactory in poverty reduction and social sector development, governance, agriculture and natural resource management, fixed infrastructure, and revenue mobilization and expenditure management. Therefore, overall outcomes of the Bank's assistance program are rated moderately unsatisfactory"[19]. Going into each programme and project, the report finds serious flaws in programme design and outcome measures. During this period, the World Bank's IDA and IBRD disbursements totaled US $ 3.7 Billion. Pakistan still must pay for these loans that had weak impact on economic growth or citizen welfare. In fact, their addition to the debt burden most likely had the opposite effect of what was intended.

  The evaluations' comments on individual programme or project:

  Private power: As part of the Bank's strategy to include private sector in infrastructure development, Pakistan was the pioneer of the Bank's energy policy. It soon had to "face the consequences of adopting an untested set of reforms"[20]. Before long "a number of problems emerged in implementation". The report says that the issues that had encumbered Pakistan's power sector such as line losses, recovery, and tariff rates were well known to the Bank. The Bank failed "to design projects that reflect the political economy and governance climate". The Bank's project design did not encourage

[19] World Bank, Independent Evaluation Report on its Pakistan programme for the 10 year period 1994-2003, 2006, quote taken from Page XV, discussion from many pages of document
[20] Ibid Page 24

competitive pricing. It could have designed the programme for 'lower cost more optimal set of generation investment". Also, "Bank management failed to recognize the considerable risks associated with the IPP program in Pakistan, particularly the excessive fiscal and external account risks placed on the country as a result of the government guarantees to the private power producers"[21]. The Pakistan firm and consumer has since paid a high cost of power with no improvement in supply quality. Resultantly, Pakistan firms further lost competitiveness.

Overall, "The Bank failed to develop realistic strategies in key areas such as poverty, rural development, power, and governance. Although the Bank knew that commitment, sustainability, and institutional capacity were limited and that vested interests often overruled good policy, project design failed to take those factors into account. The Bank also failed to stick to its own plans". The Bank also "was slow to acknowledge mistakes (following up with SAP II when SAP clearly was not working) and slow to address repeated problems"[22].

Similarly, TARP or Tax Administration Reforms Project of US $ 195 M and ADB's reform of the judiciary have had modest success. The structural assistance loans by the World Bank have been for macro stability. In Figures 5 to 8, this paper shows charts for macro stability.

Below, with additional evidence, Table 8 further confirms that macro stability continues to elude us. Despite several IMF programmes and supplemental structural adjustment loans by WB and ADB, macro indicators are as fragile as they were in the 1990s. Fiscal and current account deficits are high, while exports have crumpled. During FY 94 and 04, the WB alone disbursed US $ 1,890 solely for this purpose. There is hardly any change in indicators between FY 94 and 04. The marginal improvement in current account balance and Forex reserves is because of massive post 9/11 grants. Soon as grant aid petered out, these indicators weakened again. One major improvement that came from country efforts was in export to GDP ratio.

The evaluation report of WB's project, "The Fiscally Sustainable and Inclusive Growth, Development Policy Credit" rated it as moderately successful with substantial to high risk to development outcomes[23]. In 2015, under this project, Pakistan received US $ 900 Million[24]. Again, despite the weak impact, Pakistan taxpayer will repay these disbursements with interest.

[21] Ibid Page 25
[22] Ibid Page 38
[23] WB Independent Evaluation Group Report PAKISTAN First and Second Programmatic Fiscally Sustainable and Inclusive Growth Development Policy Credit, June 2020, Page 19
[24]Ibid, Page 2

Table 8
Selected Macroeconomic Indicators
(% of GDP, except where noted)

	FY 94	FY '00	FY 04	FY 20
Total revenue and grants	17.2	16.6	18.3	15.0
Tax revenue	13.3	12.8	13.5	11.3
Non-tax revenue	4.0	3.7	4.0	3.4
Grants	-	0.1	0.7	-
Expenditures	23.5	22.9	21.6	23.1
Budget balance	-6.3	-6.3	-3.3	-7.6
Budget balance (excluding grants)	--	--	-4.0	-
Exports	12.7	13.3	15.7	8.5
Imports	16.6	15.6	16.6	16.0
Current account	-3.8	-3.4	2.1	-1.1
Total public debt	93.2	91.6	84.1	84.7
o/w external public debt	49.3	45.7	39.4	45
Total reserves mos. of imports	2.7	0.9	6.0	3.4
Inflation CPI, annual %	10.0	4.1	4.1	10.7
REER as of 30 June	97.6	85.2	76.1	93.0

Source: For FYs 94 to 04 World Bank Pakistan: An Evaluation of the World Bank's Assistance. For FY 20, SBP State of the Economy Report

Clearly, as a believer in the neo-liberal mantra of private sector infrastructure with policy reforms, the Bank continued to lend with little regard for their evaluation. GoP ever in need of foreign exchange, kept borrowing. The effect of such borrowing is for all to see. The loans lacked effectiveness. Our economic and development indicators showed no improvement. Yet the burden on the economy and transfer of scarce resources continued to impoverish the country.

Solvency and liquidity indicators

Table 9
Indicators of External Debt Sustainability

%	FY 15	FY 18	FY 20
Solvency indicators			
Total external debt and liabilities/GDP	24.2	33.4	45.5
Public external debt/GDP	21.2	22.3	31.2
Total reserves/total external debt & liabilities	31.2	17.2	16.7
SBP reserves/total external debt & liabilities	14	10.3	11.1
External debt servicing/FX earnings	10.4	13.6	26.8
External debt servicing/export earnings	19.4	24.4	52.1
Liquidity indicators			
Short-term public external debt/PEDL	2.8	2.1	1.8
Short-term external public debt/total reserves	7.3	9.9	8.2
Short-term public external debt/SBP reserves	9.3	16.6	12.3

Source: SBP Annual State of the Economy Report FY 20 and MoF Pakistan Economic Survey FY 19-20. In both cases chapters on Public Debt

- **Debt burden indicators**

In 20 years from FY 01 to FY 20, Pakistan received US $ 112,644 Million. This amount includes US $ 13,854 Million in private non-guaranteed loans. During this period, the country paid back US $ 90,652 Million as principal and US $ 27,213 Million in interest for a total debt servicing of US $ 117, 865 Million. Of this amount, US $ 17,419 was private debt servicing. The net transfer of resources including private non-guaranteed loans was US $ - 5,221 Million from Pakistan to the creditors. Having serviced US $ 5.2 B more than what the country received, our stock of debt has grown from US $ 37.2 Billion in FY 01 to US $ 112.9 Billion in FY 20, by over 200%. No comprehensive strategy Consumption trend Doc 1 Funds are available their use is found

FIGURE 10 A to E

FIGURE 10 A

Falling Savings and Investment as % of GDP					
	2003-04	2007-08	2012-13	2017-18	2018-19
Investment	16.4	19.2	14.96	16.7	15.4
Savings	17.7	11.0	13.9	10.4	10.7
Domestic	15.7	9.1	8.7	5.1	4.2

Figure 10 B

Pakistan's falling investment/GDP 1992-2020

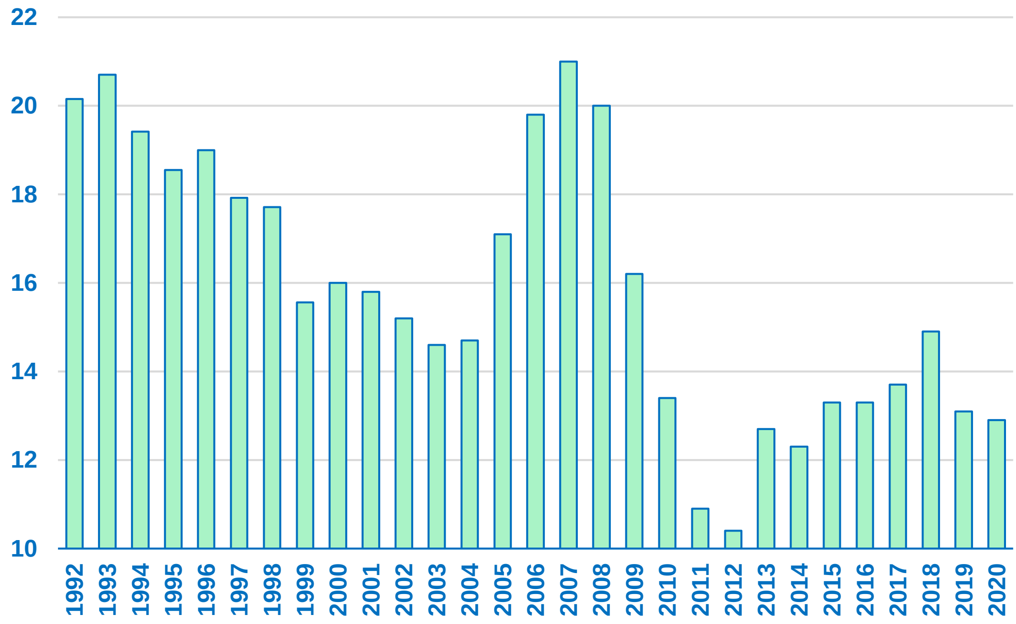
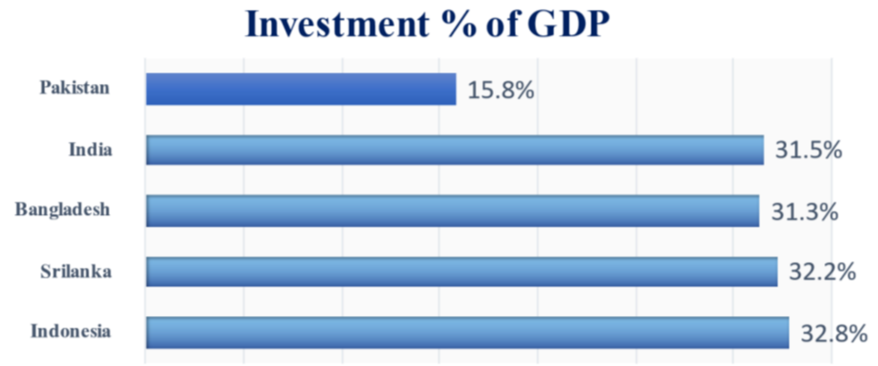


Figure 10 C



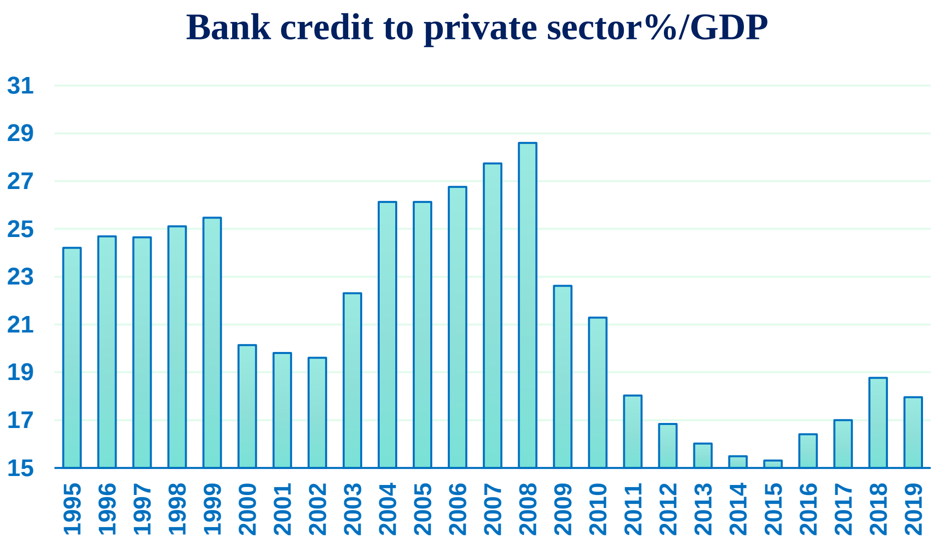


Figure 10 D

Loss in competitiveness: Pakistan's declining export to GDP 1992-2020

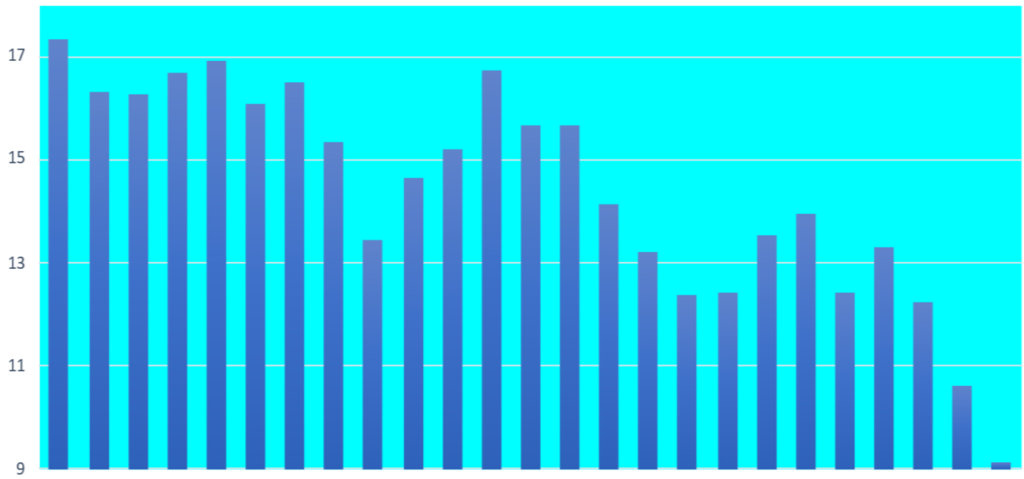
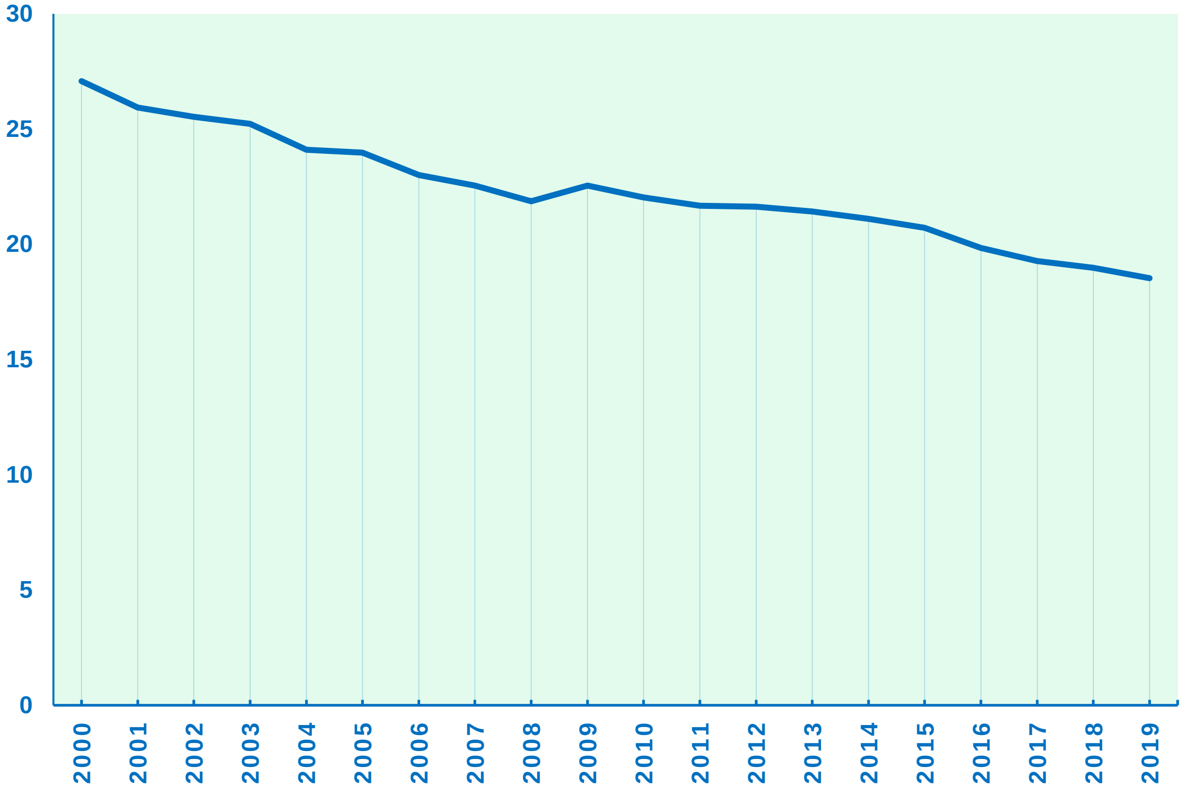


Figure 10 E

Percent Share of Agriculture in GDP
2000-2019



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