Historical Perspective of External Debt in Pakistan: Identifying Key Determinants / Strategies

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ARTICLE DETAILS

ABSTRACT

The non-developmental use of external debt creates macroeconomic instability which results in massive unemployment, poverty, inflation, and political instability in any country. The present study is focused on historical perspective of external debt in Pakistan. This study found that the leadership of Pakistan has heavily borrowed external debt without considering its sustainability and repayment capacity. On the basis of the systematic literature review of past studies, the key policy variables are highlighted to reduce the burden of external debt. The study indicated that external debt burden of Pakistan can be managed by lowering the consumption oriented imports, focusing targeted inflation, exchange rate and by promoting sustainable inclusive economic growth. The policy mix based on efficient management of macro-economic indicators are helpful in addressing external debt in Pakistan.

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1. Introduction

In 21st century, developing countries face two major interconnected problems i.e., heavy external debt and poverty. In economic growth perspective, both of these factors have significant implications. The general theoretical models failed to explain the possible transmission mechanisms between incidences of poverty with high external debts (Ashraf et al. 2020). External debt is the key source to finance the budget deficit and balance of payment deficit in the developing countries. It has been playing both a positive and negative role in the process of economic development, particularly
in developing countries. It is very helpful for a country, when a country utilizes it on investment-oriented projects, like on power, infrastructure, and agriculture sectors. It affects harmfully when it is used for unproductive activities, which does not give any output and ultimately increases poverty.

The present study explored the historical perspective of external debt in Pakistan. Pakistan is considered as big consumer of international lending institutions. It has implemented various stabilization and Structural Adjustment Programs (SAP) of the IMF and the World Bank since 1987 but only a few have been fully implemented. Malik and Siddiqui (2002) pointed out that Pakistan faced a higher debt ratio as compared to South Asian and many other developing countries. While Anwar and Chaudhary (2002) indicated that Pakistan has huge potentials to repay its debt. For the repayments of external debt, the government has to increase taxes. Usually, the government of Pakistan imposes taxes on less elastic goods to enhance tax collection. It reduces the real income of the poor as well as the public expenditures especially the development and social sector expenditures. Due to these reasons, in Pakistan large population is sleeve behind the availability of basic needs. People are not self-sufficient in nutrition, education, and health facilities and their productivity is declining sharply.

Pakistan borrowed loans from three ways. Firstly, the central borrowing (Government contracted loans), second is the guaranteed loans (loans contracted by the regional and provincial government autonomous bodies and corporations; financial institutions, credit agencies, industrial concerns, etc., in the private sector guaranteed by the government) and the third is Private Non-Guaranteed (external obligation of a private debtor). There are two types of loans i.e., project loans and non-project loans. Project loan is used to finance the cost of technical equipment, machinery, and services. While non-project loans are used to finance the import of raw materials and necessary consumer goods.

On the basis of the above discussion, following three objectives of the present research study are considered:
1. To highlight the historical perspective of external debt in Pakistan.
2. To conduct desk / literature review of developing countries to identify key strategies / determinants of external debt.
3. To suggest policy options on the basis of literature / desk review to address external debt of Pakistan.

The methodology of the paper is discussed in second section. In third section of this study, the historical perspective of external debt is presented and key strategies/determinants of external debt in developing countries are discussed in fourth section of this research study. The conclusions and recommendations are portrayed in last section of the study.

2. Methodology of the Study
The descriptive research methodology is used in this study which includes the review of different documents and systematic literature review to envisage the key determinants / strategies for addressing external debt burden in Pakistan. In this study, the historical perspective of external debt is highlighted by reviewing different documents. Then a systematic literature / desk review of relevant studies are conducted to identify the key strategies of managing external debt burden especially in developing countries. On the basis of this desk review, specific key determinants /
strategies are highlighted with perspective of Pakistan to manage external debt burden.

3. Historical Perspective of External Debt

At the time of independence, Pakistan was a poor and undeveloped country. At that time, the main problem was provision of basic shelter and basic necessities of life. Today, Pakistan is not the most indebted country in the world, but its high debt to GDP ratio indicates poor economic management of the country. Sensible utilization of debt helps to higher economic growth and assists the government to achieve its social and economic goals. An unattainable level of debt may slow down the economic growth and social sector growth. Appropriate debt administration is necessary for the reasonable development of a country. There should be a balance in the external debt for the limited requirements for the shortfall in the monetary and fiscal deficit (Akram, 2011).

Sadly, the persistent increase in external debt is the key issue to the downfall of Pakistan's economy. Unfortunately, Pakistan is considered as fourth largest debt recipient economy in this region. Its external debt has reached about 45 % of the GNP as compared to India 21 %, Nepal is about 23 % and Bangladesh is 19%. It is a common observation that usually Pakistan borrowed debt for pleasure and pride and primarily to repay the debt obligations.

![External debt stocks (% of GNI)](image)

**Figure 1: External debt stocks (% of GNP) in South Asian Countries**

Most of the researchers have examined that the need for external debt had been started after the independence (Ali & Mustafa, 2012). Pakistan first time received 121 million dollars in 1951-55. In the next five years, it became triple, when Pakistan played a vital role in the Cold war. By the end of 1969, the external debt reached about 2.7 billion dollars including Bangladesh (Iqbal & Iqbal, 1972). Figure 2 shows the total external debts stocks from 1970 to 2020.
In figure 2, it is marked that from 1970-77, slowdown in the growth of domestic product was one of the key factors causing a large deficit in balance of payment which required a large amount of external debt. In 1973 there was a massive increase in the oil prices which caused high inflation, unemployment, and recession in the domestic economy (Smith, 1996). These factors forced the non-oil exporting countries to borrow external loans or reduce their reserves. At that time Pakistan was also facing these problems like the other non-oil exporting countries face. To overcome this problem of external payments, Pakistan borrowed a huge amount of external debt from foreign lending institutions. At that time, the volume of international debt and debt servicing liabilities increased rapidly (Qadri & Khan, 2017).

In December 1971, Pakistan’s external debt reached $3.62 billion. At that time East Pakistan tragically separated from Pakistan. After the separation of East Pakistan, external debt increased subsequently $6.78 billion in 1977(Mahmood et al. 2009). While in this era, dollar rate was an average of 5 Pakistani rupees. From 1978 to 1981, Pakistan devaluated its currency. At that time, Pakistan received hard loans and short-term loans to support the Balance of Payments (BOP). At the end of 1980, total external debt stock reached $8.52 billion while dollar price doubled the Pakistani rupees and reached to10 Pak rupees.

In the era of 1981-90, the external debt doubled from 1981 and reached $16.64 billion. Over 1980, in cold war era, Pakistan had accessed a lot of foreign aid which coupled with a large volume of remittances from the expatriate. At that time, Pakistan became the tenth-largest recipient country of the IMF and World Bank. It was the time when IMF initiated the Structural Adjustment Program (SAP). The General Zia-ul-Haq for first time received loans under the SAP in 1982 to establish the military regulation. After receiving the first installment of the loans from the SAP, the economic managers of Zia-ul-Haq decided not to proceed with the rest (Naeem & Sherbaz, 2016).

However, in the 1990s situation was reversed. In this era, Pakistan spent more or less 80 percent of the foreign assistance on non-development expenditures and defense. All of this foreign assistance and loans were at a very high-interest rate. In 1990-92 debt situation was at horrible stage
in the history of Pakistan. The crunch of the SAP by the General Zia regime came back in the era of Benazir Bhutto and Nawaz Sharif regimes. In this era of civil government, the external debt of the economy doubled than Zia's period which reached $16.64 billion in 1990-91. In this era, most of the external debt was taken from the SAP of IMF (Zaidi, 2006).

When Nawaz replaced the first government of Pakistan People Party (PPP) of Benazir Bhutto, launched the first significant package of the SAP to maintain the economy. Prime Minister Nawaz Sharif lifted the control on the foreign exchange. The first batch of the assets of the state privatized, many businesses and industries also privatized and expenditure of the public on social programs was reduced. After observing the extraordinary performance of the Pakistani Government, IMF and World Bank released another installment of $400 million in SAP loans over 3 years in Nawaz Sharif’s first Government (Fatima, 1997).

In the era of 1993-1997, Moen Qureshi the representative of the World Bank became the advisor to the Prime Minister. The advisor of the prime minister implemented another round of the SAP, including 10% of the devaluation of currency, increased the prices of electricity and petroleum goods which increased the prices of flour, cooking oil, and reduction in tariffs. After Moen Qureshi Government, Benazir Bhutto’s government came back. Another round of the IMF and World Bank of SAP agreed and grant these institutions loans of $1.5 billion. To fulfill the condition of these loans by the SAP, the privatization of the government institution took place in Pakistan. The new regressive sale tax was imposed on 268 commodities. The import duties were reduced and another 7% devaluation of the rupees took place. From 1990 to 2000 all the foreign loans were spent on debt servicing. In 1993, total external debt reached $21.48 billion and within the next 5 years, this external debt reached $30.42 billion (Bilquees, 2003).

In 1998, Prime Minister, Mian Muhammad Nawaz Sharif ordered to conduct 1st nuclear test in response to Indian nuclear test. The nuclear test of Nawaz Sharif met great hostility and anger of the United States after President Clinton placed an economic ban on Pakistan. From 1998 to 2002, no new loan was given whereas only continued projects received loans. Incidentally, the number of foreign loans stayed low during this period (Shah, 2002). In 1999 the total external debt was $30.43 billion and it declined in 2000 and reached about $29.82 billion. In 2001 the debt further decreased gradually by $28.69 billion.

In 2002-07, In the Musharraf regime 9/11 happened and the United States of America once again shook hands with Pakistan Government. In 2003, Musharraf borrowed a huge amount of over $15 billion (Uppal, 2017). Once again in the era of 2003-04, the external debt reached $33.15 billion. On October 8, 2005, the earthquake was the most devastating natural disaster in Pakistan's history. The government of Japan gave emergency grant assistance to Pakistan along with yen loan assistance. With other assistance the Japan’s assistance related to earthquakes amounts to just about more than US $200 million. On October 8, 2005, the World Bank and other aid packages having total $850 million aid package announced for the relief of earthquake. In 2006, the International Foundation for Electoral System (IFES) implemented a $9 million contract through USAID to install the computerized electoral system for Pakistan. The external debt had reached up to $43.82 billion in 2008 from $30.43 billion in 1999.

In 2007-09, the foreign debt liabilities increased in rupee value by more than Rs.705 billion in less than six months 2008-09, simply due to Rs. 15 per dollar decline in currency value. The overall
external debt of Pakistan had been raised almost $5.41 billion to $43.81 billion since 2008 (Economic survey, 2010). In 2010-11, the flood occurred in Pakistan; the Federal Flood commission received 87.8 billion rupees ($900 million). Federal Flood commission record showed that a lot of projects started and were completed but subsequent reports indicated that little progress was done due to ineffective administration and corruption (Epstein & Kronstadt, 2011). In 1970 to 2012, External debt increased 2354% in terms of percentage. While in monetary terms $2.7 billion to $66.23 billion. Between 1999 and 2012, Pakistan's foreign external debt increased 120%, from $30.2 billion to $66.2 billion. These external debts increased $55.9 billion by the end of 2010, and $59.5 billion by March 2011.

During the regime of the Pakistan People Party government 2008-2012, the Government received a big amount of debt of Rs. 8136 billion from the external and internal sources to finance the budget deficit. It should be noted that during the PPP government between March 2008 and March 2012, the country's public debt increased by 6,924 billion rupees, in which the worst data reached 11,726 billion rupees reached. In the era of the first sixty years of the constitution, the economy's general debt was only Rs.4802 billion. Since the US dollar and rupees parity had fallen from 51.77 rupees in the financial year 1999-2000, it is more than Rs 100 in the fiscal year of 2008-12.

As a result of the general election 2013, the PMLN government came into power. In the first year of the PMLN government, the total external debt slightly declined from $63.06 billion to $60.06 billion in 2013 (Economic survey, 2014). During 2013-2017, Pakistan's total debt stock grew an average of 34% from $60.05 billion to $91.67 billion (World Bank). In the entire history of Pakistan, this debt ratio was considered the highest. It faced also alike issues as the PPP government faced power shortage, the balance of payment deficit, higher oil prices above $100 per barrel till 2015. After 2015 dramatically international oil prices declined below $50 per barrel. It proved to be a good sign of the Pakistan government to establish the economy. This PMLN government got another good opportunity of international low-interest rates for borrowing. This was a good opportunity for the PMLN government to formulate policies that focus to decline external debts. But this government failed to deal with the debt crisis.

In the era of 2009-2015, the Pakistani democratic government received $ 27.483 billion of foreign loan, but $ 22.111 billion was paid as loan service, while $16.436 billion as a principal return and 5.675 Billions of dollars included as a refund (Debt policy statement 2008-09). During the regime of PPP and PMLN, the domestic debt stocks also increased very rapidly as labeled in figure 3.
In the 2018 general election, Pakistan Tehreek-e-insaf (PTI) came into power. The former government left dangerous issues for the new government. The major issue faced PTI of huge current account deficit. It is quite difficult to finance this deficit with internal resources. So, within the first 10th month PTI government moved to the IMF doorstep (Amjad et al. 2021). In 2018, the total debt stock increased and reached $99.23 billion. Figure 4 shows the current account deficit during 2018-2022.

![Total domestic debt stock of Pakistan during 2008-2018](image)

**Figure 3:** Total domestic debt stock of Pakistan during 2008-2018

In 2018 the higher current account deficit was financed by the IMF 13th loan program. It is noted in figure 4 that this deficit declined in the coming years due to a decline in oil prices (Zaidi, 2021). PTI government faced catastrophic and dangerous effects of the Covid-19 pandemic. This pandemic paralyzed the world economy. In 2020 the volume of external debt stock reached $116.52 billion. One good sign is to check the size of total debt to the economy is the debt to GNP ratio. The calculation of the debt to GNP ratio is the ratio of total debt and GNP of an economy. Suppose nation A has total debt is $2.5 million and GNP is $2 million. If it is calculated the debt to GNP ratio is $2.5/$2×100=125 percent. This shows that economy A has a debt GNP ratio is 125 percent; it means that debt is 25 percent is greater than GNP.

![Pakistan current account deficit](image)

**Figure 4:** Pakistan current account deficit  
(Source: ADB September 2021)
Figure 5: External debt as % of GNP

Source: WDI Pakistan database 2022

Figure 5 shows the debt to GNP ratio of Pakistan from 1971 to 2020. It can be observed that after 1970 the debt services ratio gradually declined till 1985. After 1985 the debt to GNP ratio increased till 1999, after 1999 the debt to GNP ratio showed downward trends. The era of 2006 shows a low debt to GNP ratio era. After this external debt to GNP consistently increased.

4. Key Determinants / Strategies of Managing External Debt

In this section key determinants / strategies to manage the external debt are discussed. Awan et al., (2015) conducted research for Pakistan and identified that fiscal deficit, nominal exchange rate and terms of trade are the main reasons of trade deficit in Pakistan. Chiminya and Nicolaïdou (2015) explored that economic factors and political institutions have their impact on external debt for Sub Sahara African countries. The research further explores that economic growth has the impact in reducing the burden of external debt across these countries. Murwirapachena and Kapingura (2015) identified that slow economic growth and higher expenditures on infrastructure are the core reasons for increasing external debt in South African countries. Bittencourt (2015) identified that economic growth, inflation and income inequality are the main factors impacting external debt. Al-Fawwaz (2016) envisaged for the case of Jordan that the economic growth has the tendency to lower the external debt, while, the expansion of trade increases the burden of external debt. Lau and Lee (2016) identified for the case of Thailand that the inflation rate and real exchange rate increases the burden of external debt.

Waheed et al. (2017) conducted research to ascertain the key determinants of external debt for the case of Oil exporting countries and found that different macroeconomic indicators are impacting external debt of sample countries. Gokmenoglu and Rafik (2018) conducted research to ascertain the key factors impacting external debt for the case of Malaysia. The study findings suggest that economic growth and capital expenditure increases external debt. Dunne et al., (2019) identified that military expenditures and war conflicts are the key determinants of external debt for most of the Sub Saharan African countries. Ibhaqhui (2018) identified that trade openness increases external debt by creating imbalance of current account for the case of Sub Saharan African countries. It is further highlighted that in developing countries, the trade openness promotes consumption oriented imports which creates trade deficit and external debt from international institutions is used to bridge
the trade deficit. Zaghdoudi (2018) conducted research for large sample of developing countries and identified the non-linear relationship between external debt and human resource development. The study results indicated that investment on human resource development promotes economic activity which is very helpful in reducing reliance on external debt.

Abbas and Wizarat (2018) conducted research for South Asian countries to determine the major causes of external debt. The results of study revealed that military expenditures are directly increasing the external debt, while the local investment promotes economic growth and reduces external debt in south Asian countries. Agyapong and Bedjabeng (2019) conducted research for African economies and identified that foreign direct investment is highly important for economic growth which implicitly reduces the burden of external debt. It was further highlighted that the external debt for development expenditures have more positive impact in promoting economic growth. Kharusi and Ada (2018) conducted research for Jordan and found that the rising external debt is reducing economic growth and only the productive use of external debt can improve the investment status in the country which directly accelerates the process of economic growth. Diana et al. (2019) ascertained that productive use of external debt promoted investment in Ghana, which was very helpful in increasing economic growth. Gövdeli (2019) analysed the data of economic growth and external debt of Turkey and found that the developmental use of external debt is very helpful in increasing the economic growth. Furthermore, the inflation and exchange rate must be kept in targeted limits by the central bank to reap the fruitful benefits of external debt for promotion of investment.

Didia and Ayokunle (2020) conducted research for Nigeria and identified that domestic debt is relatively more appropriate approach to reduce debt burden of external loans. Navarro-Ortiz and Sapena (2020) conducted research to assess the sustainability of external debt for developing countries. The study results suggested that deviations from targeted growth rates and projected interest rates creates sustainability issues of external debt. Turan and Yanikkaya (2021) explored that high level of external debt reduces economic growth by impacting the channels of investment. The study highlighted that the rising burden of external debt reduces economic growth for inefficient governments. Furthermore, rising external debt and high volume of interest payments reduces the opportunities of investment within the country, which ultimately lowers economic growth.

The literature indicates that external debt has remained as significant problem for developing countries (Ibhagui, 2018; Navarro-Ortiz & Sapena, 2020). The researchers have engaged different variables to explain the variations in external debt of different countries (Chiminya & Nicolaidou, 2015; Waheed et al., 2017; Didia & Ayokunle, 2020). The most of the analysis indicate that productive use of external debt increases economic growth which is very helpful in sustainability of external debt (Waheed et al., 2017; Agyapong & Bedjabeng, 2019; Navarro-Ortiz & Sapena, 2020). It was also observed that efficient political governments having good governance practices for implementation of monetary policies are very helpful to manage external debt (Kharusi & Ada, 2018; Gövdeli, 2019; Turan & Yanikkaya, 2021). The management of inflation, interest rate and exchange rate is highly important in curtailing the external debt burden (Murwirapachen & Kapingura, 2015; Lau & Lee, 2016; Zaghdoudi, 2018). The external debt is highly vulnerable to trade openness of developing countries (Kharusi & Ada, 2018; Abbas & Wizarat, 2018; Turan & Yanikkaya, 2021). The rising import bill having non capital goods increases the burden of external debt to unsustainable levels (Chiminya & Nicolaidou, 2015; Zaghdoudi, 2018).
The desk review for strategies of managing external debt for different countries indicates some policy options for Pakistan. The management of external debt of Pakistan is a dynamic phenomenon and is interlinked with number of variables / indicators. The imports in Pakistan must be preferred for capital goods rather consumption oriented goods. The sustainable targets of economic growth be settled and aligned with expected inflation, real interest rate and effective exchange rate. The improved governance for implementation of fiscal and monetary policy are very helpful in reducing burden of external debt. The government of Pakistan should prefer to spend the foreign debt on developmental infrastructure and productive resources. There should be fair monitoring of foreign investment. Before taking the additional loan, the government should consider the ability to repay capacity. The government of Pakistan should negotiate with the international financial institutions that it should change policy from hard term loans to soft term loans. Repayment of debts should be done from other resources, not to impose a tax on necessities of life.

5. Conclusion

This study explored the historical perspective of external debt in Pakistan. Furthermore, the literature / desk review is conducted for international practices regarding the management of external debt in developing countries. On the basis of this desk review, the policy options / strategies for managing the external debt of Pakistan is advocated. The present study found that Pakistan's external debt is growing rapidly. The political / military leadership has continuously borrowed the external debts without considering repayment plans / capacity. It is alarming situation that Pakistan's total external debts crossed $116.51 billion. There is evidence that a persistent increase in external debts increases the poverty rate in Pakistan (Sheikh & Alam, 2013; Naeem & Sherbaz, 2016; Ashraf et al. 2020). The researchers have verified that when the borrowing money was not spent on the productive projects then the burden of taxes increases with every passing day which adversely affect the process of economic development.

The desk review for strategies of managing external debt for different countries indicates some policy options for Pakistan. The imports in Pakistan must be preferred for capital goods rather consumption oriented goods. The sustainable targets of economic growth be settled and aligned with expected inflation, interest rate and exchange rate. The improved governance for implementation of fiscal and monetary policy are very helpful in reducing burden of external debt. The government of Pakistan should prefer to spend the foreign debt on developmental infrastructure and productive resources. The better negotiations of Pakistan should negotiate with international financial institutions can ensure the provision of loans on soft terms and conditions. Repayment of debts should be scheduled on sustainability principle rather by imposing indirect taxes on basic necessities or taking new loans for payment of interest.

References


