An Open Letter to the IMF

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Introduction

Global debt exceeded $300 trillion in 2021 and is threatening major world economies. Laos, Zambia and Sri Lanka have defaulted on their loans, while Pakistan and many other countries are faced with a grim situation. Covid-19 pandemic, callous third world governments used to affluent lifestyles and lack of rigorous research to determine debt sustainability appear to be contributing factors. The objective of this study is to determine whether Pakistan's debts are sustainable. Following this brief introduction I study the growth of debt in Pakistan during the last 50 years in Section 2. Breakdown of debt is presented in Section 3, while Section 4 studies the all important question of debt sustainability. Section 5 concludes the study.

Growth of Debt

Table 1 shows that the rate of growth of public debt was moderate during 1971-1986. During 1987-2007 the growth started accelerating, with a sharp increase during 2008-2022.

Breakdown of Public Debt

Table 2 shows the breakdown of public debt during 2013 to 2022. Domestic debt increased at the average annual rate of 13.5% during 2013 -2021, while external debt increased at the average annual rate of almost 14% during the same period. During 2018-2021 the average annual rate accelerated to almost 17% for domestic debt and 16.8% for foreign debt. Debt/GDP ratio has remained above 60% throughout the period, except 2018. Although the Fiscal Responsibility Law enjoins upon the government not to exceed 60%.

Debt Servicing

Table 3 shows that a large chunk of our revenues and current expenditures are consumed in servicing both domestic and external debt. Total interest servicing is consuming more than 36% of revenues and almost 29% of current expenditures.

Debt Sustainability

External debt sustainability will be studied through the use of Fiscal Reaction Function (FRF) approach for Pakistan used by Mansoor, Baig and Lal (2020) for the period 1980 to 2019. The authors followed the advice by Bohn (1998), Gali, Perotti, Lane and Richter (2003) and de Mello (2005) to study debt sustainability through the use of FRF approach. This approach implies that external debt is sustainable if an increase in debt to GDP ratio has a positive impact on fiscal deficit and GDP.

The role of macroeconomic policies affect debt sustainability by impacting long-run growth and repayment capacity. The authors state that in the 1990s low Foreign Direct Investment (FDI), sharp decline in Remittances/ GDP and non-response of exports to devaluation reduced repayment capacity resulting in debt trap. During 2013 to 2017 economic growth rate, FDI and remittances increased making debt sustainable. During fiscal Year 2019 due to decline in investment, increase in interest rates and decline in foreign exchange reserves Pakistan was faced with an "unmanageable" debt trap.

The authors have also estimated external debt sustainability potential as the ratio of predicted external debt over actual external debt:

$EDP_{it}=ED_{it}/\Sigma D_{it}$

Where EDP_{it} is the external debt sustainability potential of Pakistan over period (t), while EDP_{it}', is predicted external debt and EDP_{it} is actual external debt.

If the estimated value of the index > 1, it indicates that Pakistan has the potential to raise more debt which is sustainable in the long run. Whereas, EDP _it < 1 indicates that Pakistan has exhausted debt sustainability potential and further debt accumulation may drag Pakistan into a debt crisis. The value of EDP _it= 1 indicates that actual and predicted external debt is equal, implying that current external debt is sustainable in the short run.

Mansoor, Baig and Lal report that primary balance and external debt are negatively related at 10% level of significance, which shows that external debt became unsustainable in Pakistan in 2019 as revealed by the FRF approach, with and without macroeconomic policy interactive term. They report that economic growth and external sector performance play a crucial role in maintaining external sector sustainability, but the impact of external sector is greater than the impact of GDP.

External debt sustainability potential was sustainable for the period 2014 to

2016 as the ED _it ratio > 0. In 2016 the ratio was almost one, reflecting that Pakistan just lost the capacity for further debt accumulation and there is need to explore debt alternatives. Government's recent effort to raise alternative financial resources has caused further distortions, causing cost push inflation, pushing the real sector into recession. The study concludes that Pakistan's external debt has become unsustainable as per the FRF approach, showing that our potential for further debt accumulation has been exhausted.

Conclusion

Every government that comes to power in Pakistan goes to the IMF for budgetary support without studying the sustainability of debts. This is because they want to continue with their princely life styles at the expense of the poor in Pakistan. While the people of Pakistan can barely afford to eat one square meal a day, they maintain filthy life styles of those who govern them. Those in the corridors of power couldn't care less whether debts are sustainable or not. Unsustainability of debt means that the country will not be able to service these debts in future. Pakistan's selfish and corrupt ruling clique doesn't seem to care about sustainability of debt, but it is puzzling that the IMF which is answerable to rich western countries, with a large number of economists on its payroll are unaware about the sustainability of debts. It is the responsibility of the International Financial Institutions to carry out rigorous studies to determine debt sustainability of debtor countries. Pakistan has already fulfilled very harsh conditionalities for the $6 billion agreement it signed with the IMF. Any attempt by the Government of Pakistan to expand the existing agreement with the IMF or sign a new agreement will push Pakistan towards default. If the Government of Pakistan couldn't care less, will the IMF show the same callousness towards rich countries' monies they have been entrusted with?

	2013	2018	2019	2020	2021	2022	AGR 2018-2021	AGR 2013-2021
Domestic Debt	9,520	16,416	20,732	23,283	26,265	28,076	16.96%	13.53%
External Debt	4,771	8,537	11,976	13,116	13,601	16,290	16.79%	13.99%
Total Public Debt	14,292	24,953	32,708	36,399	39,866	44,366	16.90%	13.68%
Total Debt of the Government1	13,457	23,024	29,521	33,235	35,669	39,882	15.71%	12.96%
Total Debt of the Government (% to GDP)	60.1	58.7	67.4	69.9	63.9			

The trend in total public debt since 1971 is presented in Box-1.

Box-1: Trend in Total Public Debt (end-June position)

(Rs in billion)

Year	Domestic Debt	External Debt	Public Debt	Year	Domestic Debt	External Debt	Public Debt	Year	Domestic Debt	External Debt	Public Debt
1971	14	16	30	1989	333	300	634	2007	2,601	2,201	4,802
1972	17	38	55	1990	381	330	711	2008	3,274	2,853	6,127
1973	20	40	60	1991	448	377	825	2009	3,860	3,871	7,731
1974	19	44	62	1992	532	437	969	2010	4,653	4,357	9,010
1975	23	48	70	1993	617	519	1,135	2011	6,014	4,756	10,771
1976	28	57	85	1994	716	624	1,340	2012	7,638	5,059	12,697
1977	34	63	97	1995	809	688	1,497	2013	9,520	4,771	14,292
1978	41	71	112	1996	920	784	1,704	2014	10,907	5,085	15,991
1979	52	77	130	1997	1,056	939	1,995	2015	12,193	5,188	17,380
1980	60	86	146	1998	1,199	1,193	2,392	2016	13,626	6,051	19,677
1981	58	87	145	1999	1,389	1,557	2,946	2017	14,849	6,559	21,409
1982	81	107	189	2000	1,645	1,527	3,172	2018	16,416	8,537	24,953
1983	104	123	227	2001	1,799	1,885	3,684	2019	20,732	11,976	32,708
1984	125	132	257	2002	1,775	1,862	3,636	2020	23,283	13,116	36,399
1985	153	156	309	2003	1,895	1,800	3,694	2021	26,265	13,601	39,866
1986	203	187	390	2004	2,028	1,839	3,866	2022 (end March)	28,076	16,290	44,366
1987	248	209	458	2005	2,178	2,034	4,211				
1988	290	233	523	2006	2,322	2,038	4,359				

Source: State Bank of Pakistan, Debt Policy Coordination Office

Fig 9.1: Trend in Domestic and External Debt (end-Jun position) (Rs in billion)

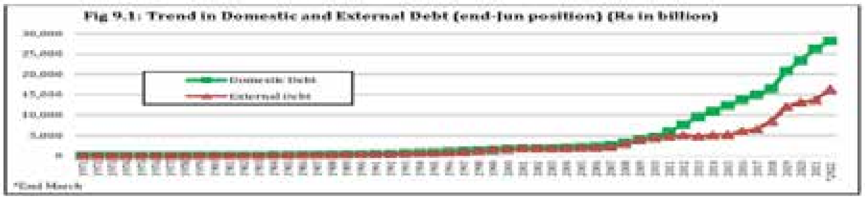

Table 9.4: Public Debt Servicing FY2021-22 (Rs billion)

	Budgeted (2021-22)	Actual (Jul-Mar 2021-22)	Percent of Revenue	Percent of Current Expenditure
Servicing of External Debt	303	221	3.8	3.0
Servicing of Domestic Debt	2,757	1,897	32.3	25.7
Total Interest Servicing	**3,060**	**2,118**	**36.1**	**28.7**

Source: Budget Wing and Debt Policy Coordination Office Staff Calculations, Ministry of Finance

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