

Chapter 2

Debt Management

2.1 Debt Management Strategy

Owing largely to the unprecedented growth in debt during the 1990s, management of public debt became a primary challenge for economic managers of the country. Reducing the debt burden to a manageable level thus became an important objective of the economic revival program. To draw a strategy for debt management, the government had set-up a committee whose report was adopted in 2001. It now forms the basis of our debt strategy and management in Pakistan. Under the strategy, remarkable progress has been made in bringing the debt burden within a sustainable level. The committee suggested the following measures for resolving the debt problem:

1. Seeking rescheduling and debt write off from bilateral donors
2. Borrowing only on concessional terms
3. Fiscal consolidation
4. Prepayment of expensive debt
5. Fiscal responsibility law

2.2 Debt Rescheduling

Re-profiling of Pakistan's external debt by the Paris Club was envisaged in the debt management strategy. The deal negotiated by Pakistan with the Paris Club creditors is among the best for non-HIPC cases. The entire debt stock of about \$12.5 billion has been rescheduled for a period of 38 years and 23 years, for ODA and Non-ODA, with grace periods of 15 years and 5 years, respectively.

From several bilateral creditors commitments were also obtained to either cancel their debts or to swap them for social sector spending for up to \$1.5 billion. The relief implicit in these arrangements is between 30-43% in net present value terms. Pakistan has gained estimated relief of \$ 1.2 to \$ 1.5 billion annually which will accrue in payment of debt servicing on its external debt in the medium term i.e. during the years 2001-2002 to 2004-2005. This would have an additional favorable effect on the Balance of Payments as well as external/financial position of the economy.

Table 2.1: Country Wise Amounts of Rescheduled Debt

Country	Rescheduled	Cancelled/ Written Off	Non- Consolidated Not Covered Under Agreement	Deferred For 5 Years	Total
European Union	3,354.75	66.20		10.44	3,431.39
Switzerland	72.84				72.84
Canada	392.91				392.91

\$ Million

Japan	4,561.12		12.71	3.01	4,576.83
Korea	499.57		311.75		811.31
USA	2,013.37	1,000.00		6.07	3,019.44
Russia	143.25				143.25
Total	10,964.98	1,066.20	324.45	19.51	12,447.98

Out of 18 Paris Club Creditors, bilateral rescheduling agreements with 17 countries namely Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Korea, Netherlands, Norway, Spain, Sweden, Switzerland, USA, and U.K. amounting to US\$ 11.475 billion were finalized and signed during the year 2002-2003.

Rescheduling agreement with the only remaining Paris Club Creditor i.e. Russian Federation amounting to US\$ 143 million is currently being pursued. Efforts are underway to arrange an expert level meeting with Russia during which the dormant forum of inter-governmental commission will be reactivated and a rescheduling agreement will be signed.

In addition to the 17 Paris Club Creditors, rescheduling agreements with non-Paris Club creditors viz. Saudi Fund for Development, Kuwait, Czech Republic and Turkish Exim Bank for US\$ 154 million were also concluded during the year 2002-03. The EAD is vigorously pursuing agreements with remaining non-Paris Club countries i.e. China, UAE and Libya.

2.3 Debt Swap

Rescheduling agreements have a provision for voluntary debt relief on a bilateral basis by means of debt swaps. Some of the countries have acceded to Pakistan's request for providing debt relief against expenditures in education and other social sectors. A Social Sector Development Fund (SSDF) has been created for this purpose which is administered through the Debt Swap Committee. A separate Rupee account has been opened with the State Bank of Pakistan to undertake debt swap transactions in a transparent manner. The following countries have offered debt swap arrangements:-

Table 2.2: Countries offering Debt Swap

Country	Swap Amount	Status
Italy	€ 69.9 million	Both the Governments agreed to swap outstanding debt of \$ 85 million against the already incurred expenditures on Afghan refugees. Pakistan has conveyed statement of expenditure equivalent to debt amount. Government of Italy has indicated to swap €

		4.1 million shortly while remaining amounts would be swapped in installments of € 20 million each during subsequent years.
Germany	€ 50 million	<p>Pakistan and Germany have agreed that Government of Pakistan will allocate in the federal PSDP Rupee equivalent of €12.5 million each for basic education in the provinces of Punjab and NWFP over and above their normal share. The German Government will reduce € 25 million against each allocation of 12.5 million.</p> <p>PC-1 of NWFP has been approved and awaits clearance of the Priorities Committee for allocation in Federal PSDP for FY 2004-05. Government of Punjab has yet to prepare their PC-I.</p>
Canada	C\$ 447 million	Canada has offered debt swap for teachers training. Both the governments have negotiated 'elements of agreement'. CIDA has completed due diligence study. After reaching agreement on modalities an MOU will be signed for implementing the understanding.
Norway	\$ 136,370.9	Norway has expressed its preference for primary education particularly for girls. Norway has agreed to the mechanism of SSDF and indicated to follow the pattern of debt swap arrangements being finalized with Canada.

2.4 Debt Cancellation

Pakistan has also been successful in obtaining debt cancellation from the United States and the United Kingdom. In 2002 USA cancelled \$ 1 billion of debt outstanding against Pakistan. On 17 July, 2004 USA cancelled another \$ 496 million outstanding debt. The United Kingdom has also cancelled 20 million pounds of Common Wealth Development Corporation (CDC) loans against Pakistan. Denmark also waived off their entire outstanding debt of US\$ 18.4 million while Netherlands has given remission in debt service payments falling due during October 2001 to December 2002 equivalent to US\$ 14.3 million.

2.5 Prepayment of Expensive Debt

Pakistan's economy has considerably improved during the last four years providing favorable monetary conditions, increased flow of remittances and reversal in flight of capital. Pakistan has large current account surplus and a favorable debt trajectory. Our foreign currency reserves are \$ 12 billion and the public debt burden has come down from 108% of GDP in FY 2000-01 to 85% during FY 2003-04. Pakistan has therefore started prepaying expensive debt. In January 2004 Pakistan prepaid \$ 1 billion expensive debt owed to the Asian Development Bank. This loan carried high

interest rates ranging from 8% to 11%. GOP intends to prepay some other expensive loans of ADB and IBRD in the near future.

The domestic debt, which stood at 50.5% of GDP in 2001, has also come down to 41.3% of GDP in 2003-04. The overall debt servicing, which claimed more than 50% of our revenues in 2000-01, has been brought down to only 27% of revenues in 2003-04. Debt sustainability is thus evident from the fact that our external debt and liabilities as percentage of our foreign exchange reserves, which were as high as nearly 2000% have been brought down to mere 282%.

Table 2.3: Interest Payments on External Debt

Year	Interest Payment
1998-99	1491
1999-2000	1715
2000-01	1661
2001-02	1579
2002-03	1273

\$ Millions

2.6 Debt Reduction

Over the last two years, Pakistan has reduced the size of most expensive foreign liabilities by nearly \$5 billion from \$38 billion at the end of FY00 to \$33.5 billion at the end of June 2004. This represents a reduction of nearly 13% in foreign liabilities.

Table 2.4: Pakistan's External Debt Profile as on 30-06-2004

A: Multilateral Creditors	16,111.44
ADB	5,553.72
IBRD	2,525.56
IDA	6,019.57
IMF	1,762.00
Others	250.59
B: Bilateral Creditors	14,196.66
Paris Club	13,503.73
Non-Paris Club	692.93
C: Others	1,874.40
I. Public & Publicly Guaranteed Debt (A+B+C)	32,182.50
II. Private Sector Debt	1,282.00
Total External Debt (I+II)	33,464.50

2.7 Debt Rescheduling offered by Pakistan

Pakistan extended loans and credits to various friendly countries during 1980s and 1990s. Most of the beneficiary countries are not in a position to repay the debt. Therefore only US\$ 33.9 million have been recovered out of the total due amount of US\$ 128 million. In view of the difficult financial condition of the borrowers Pakistan has started rescheduling on a case to case basis. During financial year 2003-04 Pakistan agreed to the rescheduling requests of Tajikistan and Kyrgyz Republic. Rescheduling agreements with these countries were signed on 17 September 2003 and 31 January 2004 respectively.

2.8 Recovery of onlent loans

Economic Affairs Division also recovers the loans extended to various agencies. recently some institutions had started defaulting on amounts due on them. However EAD launched a vigorous campaign during the period under report to recover all defaulted amounts.

During FY 2002-03 Rs. 17.58 billion were recovered from various provincial governments, local bodies, financial and non financial institutions against the budgeted amount of Rs. 42.37 billion. Recoverable amount of Rs. 16.8 billion from WAPDA was converted into GOP's equity. Recovery is, however, less than budgeted on account of default in payment by BEL, IDBP, CDA, NHA and NLC.

During FY 2003-04 Rs. 63.31 billion were recovered from various provincial governments, local bodies, financial and non financial institutions against the budgeted amount of Rs. 39.142 billion. Main reasons for this higher level of recovery are prepayment by SSGPL, SNGPL, NTC and CAA, 100% recoveries from KPT, PAEC, UBL, MEC, HBL, NBP, ABL, NFC and also the recovery of total defaulted amount of Balochistan Wheels Ltd. through encashment of bank guarantees issued by the National Bank of Pakistan.