VII. Domestic and External Debt

Total Debt[1]

Fiscal slippages and structural imbalances in the external sector have led to persistent budget and current account deficits. Over the 1980s, with the cold war in full swing, Pakistan had access to abundant foreign aid, which coupled with a large volume of remittances from expatriates, kept the growth of total debt in check. With inappropriate sequencing of financial reforms in the early 1990s, the introduction of foreign currency accounts, the use of short-term (ST) commercial borrowings, and falling concessional lending, Pakistan's total indebtedness not only increased rapidly, but the repayment of both internal and external liabilities created excess pressure on government expenditures and also put the country on a tightrope to meet external payments.

Furthermore, the 1990s also witnessed the maturity structure of Pakistan's debt shifting increasingly towards shorter term (external) and unfunded debt (domestic). At the close of FY00, total debt stood at Rs 3,095.5 billion, indicating a near doubling in five years (see **Table VII.1**). Although net additions to this stock has come down to less than Rs 200 billion in FY00 (from an average increase of nearly Rs 350 billion over the previous four years), at its present level, Pakistan's total debt constitutes 97.5 percent of the country's nominal GDP. Of the two categories of total debt, FY00 saw a very minor increase in external debt, which was primarily on account of Rupee depreciation (the outstanding stock of external debt in Dollar Terms actually fell – see **Table VII.6**[2]), while domestic debt showed an unhealthy increase.

Domestic Debt

With decreased foreign assistance to the country, and high net mobilization of resources

[1] Special US$ Bonds, FEBCs, FCBCs, and DBCs were previously included under the permanent debt head in total domestic debt. This year, these have been re-categorized as external liabilities (Special US$ Bonds) and external liabilities payable in Rupees (FEBCs, FCBCs and DBCs) – see **Table I.4** in Overview Section. Due to these categorization changes the numbers in **Table VII.1**, **Figure VII.7**, **Table VII.4**, and **Table 7.3 and 7.5** in the *Statistical Annexure* are not consistent with previous *Annual Reports*; total debt, domestic debt, total debt servicing, and domestic debt servicing numbers along with the relevant ratios, will fall as US$ Bonds, FEBCs, FCBCs, and DBCs have been excluded.

[2] The external debt reported in this table is consistent with the earlier classification, which included debt due to consortium countries, non-consortium countries, financial institutions, Islamic countries, IMF, IDB (ST), private loans/credits, and commercial loans/credits. Under a revised categorization (**Table I.4** in the Overview), the scope of external debt also includes, Pakistan's Eurobonds, NHA Bonds, Military Debt, and central bank deposits.

Table VII.1: Profile of Domestic and External Debt

(Rs billion)

	FY96	FY97	FY98	FY99	FY00
Total Debt	**1877.3**	**2184.5**	**2516.1**	**2907.1**	**3095.5**
1. Domestic Debt	**901.4**	**1037.2**	**1176.2**	**1375.9**	**1558.8**
	(48.0)	(47.5)	(46.7)	(47.3)	(50.4)
2. External Debt *	**975.9**	**1147.3**	**1339.8**	**1531.2**	**1536.7**
	(52.0)	(52.5)	(53.3)	(52.7)	(49.6)
Total Debt as % of GDP	88.5	90.0	94.0	99.8	97.5
Domestic Debt as % of GDP	42.5	42.7	43.9	47.2	49.1
External Debt as % of GDP	46.0	47.2	50.0	52.6	48.4
Total Debt Servicing	**199.8**	**255.9**	**275.5**	**339.9**	**338.2**
a. Total Interest payment	130.5	158.4	188.8	216.9	240.2
Domestic	104.8	129.9	160.1	178.9	189.6
Foreign**	25.7	28.5	28.7	38.0	50.5
b. Repayment of principal (foreign)**	69.3	97.5	86.7	123.0	98.1
Ratio of External Debt Servicing to:					
Export Earnings	52.3	62.7	55.4	35.3	36.0
Foreign Exchange Earnings***	33.9	39.3	34.9	23.6	23.0
Ratio of Total Debt Servicing to:					
Tax Revenue	65.4	78.8	76.2	87.0	83.3
Total Revenue	54.2	66.6	63.1	72.5	63.0
Total Expenditure	38.6	47.3	46.7	52.5	45.5
Current Expenditure	47.1	56.2	55.5	62.1	52.6

* Based on Table VII.6; **Based on Table VII.10. Sources: i) SBP, ii) MOF

***Foreign exchange earnings include inflows under the trade and service account, along with private transfers. This primarily comprises export receipts, shipment earnings, transportation charges, investment income, home remittances, inflows into resident FCAs, and kerb purchases.

Figures in parentheses are shares in total debt or total interest payments.

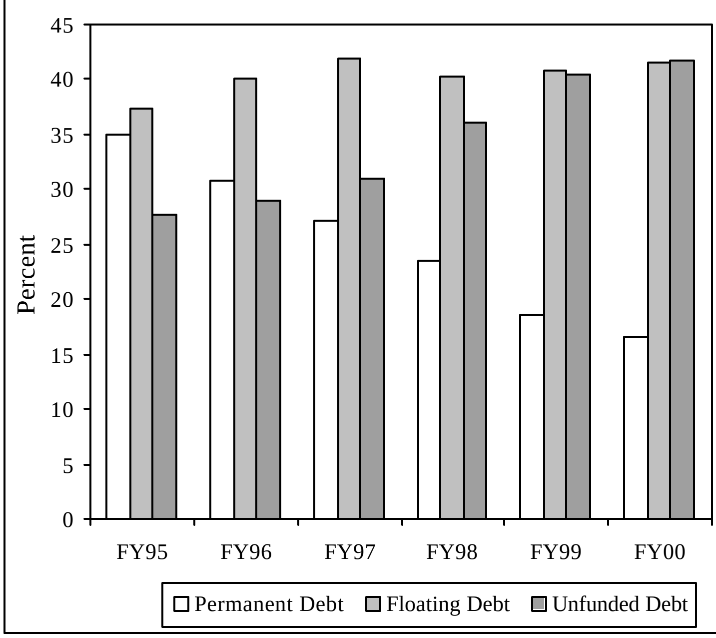
through National Savings Schemes (NSS), the share of domestic debt in overall debt has been gradually rising (from 48.0 percent in FY96, the share of domestic debt has increased to 50.4 percent in FY00). Before getting into an analysis of domestic debt, the following points need to be highlighted:

- Domestic debt is divided into three categories: permanent debt, floating debt, and unfunded debt.

- Permanent debt represents government borrowing using instruments of greater than one-year maturity. Floating debt is short-term borrowing (up to one year) primarily at market rates. Unfunded debt refers to mobilization from NSS instruments that are encashable on demand.

- As shown in **Figure VII.1**, the share of permanent debt has fallen consistently, with a corresponding shift towards unfunded debt. Market priced floating debt has not shown any perceptible trend since FY95, but still continues to hold a dominant position in Pakistan's domestic debt. This changing profile is hardly a welcome development, which explains the priority given to debt management by this government.

Figure VII.1: Composition of Total Domestic Debt



In terms of the broad categories of domestic debt, **Table 7.5** (*Statistical Annexure*) presents the stocks since FY97.

***Permanent Debt*[3]**

- Market loans: To meet financing requirements, the government used to invite applications for subscriptions by indicating the amount of credit required, and the cost they would be willing to pay. As the federal government has stopped this practice since FY92, and provincial governments since FY98, with on-going maturities and no new additions, the outstanding balance has come down.

- SLIC bonds: In the early 1980s, the government borrowed from State Life Insurance Corporation (SLIC) using special 15-year bullet bonds.[4] The first and second payments were made in FY96 and FY97, but payment pressures forced the government to issue new five-year bonds to cover these payments since the last three fiscal years. This explains the marginal increase in the outstanding stock since FY98.

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[3] See Footnote 1.

[4] Bullet bond: All interest and principal repayments are made at maturity.

- FIBs: Since no new sale of FIBs has taken place since June 1998, the outstanding stock has fallen.
- Prize Bonds: The outstanding stock of Prize Bonds fell by Rs 32 million during FY00, which is in sharp contrast to an average increase of nearly Rs 10 billion over the last three years. This is primarily attributable to the discontinuation of the old Prize Bond scheme that carried an effective average return of 12 percent, while the new scheme pays an average return of 6 percent; these are expected returns, which account for the number of prizes, the amounts, and the number of eligible bonds that can win.

Floating Debt (Market Treasury Bills)

- Indicating the compositional change in government borrowing from the banking system, the stock of MTBs held by scheduled banks fell to Rs 90.0 billion in FY00, from Rs 141.8 billion in FY99; while SBP's holding of MTBs increased by Rs 137.6 billion to Rs 467.3 billion at the end of FY00 (see **Table 7.5** *in Statistical Annexure*). This compositional shift is discussed in more detail in Chapter V.
- Adhoc treasury bills are only issued under special circumstances. Although no interest is charged, these usually carry a service charge of 0.5 percent per annum. The Rs 28.5 billion increase in adhoc treasury bills in FY99 was on account of SBP's anticipated exchange loss following the unification of the exchange rate in May 1999.

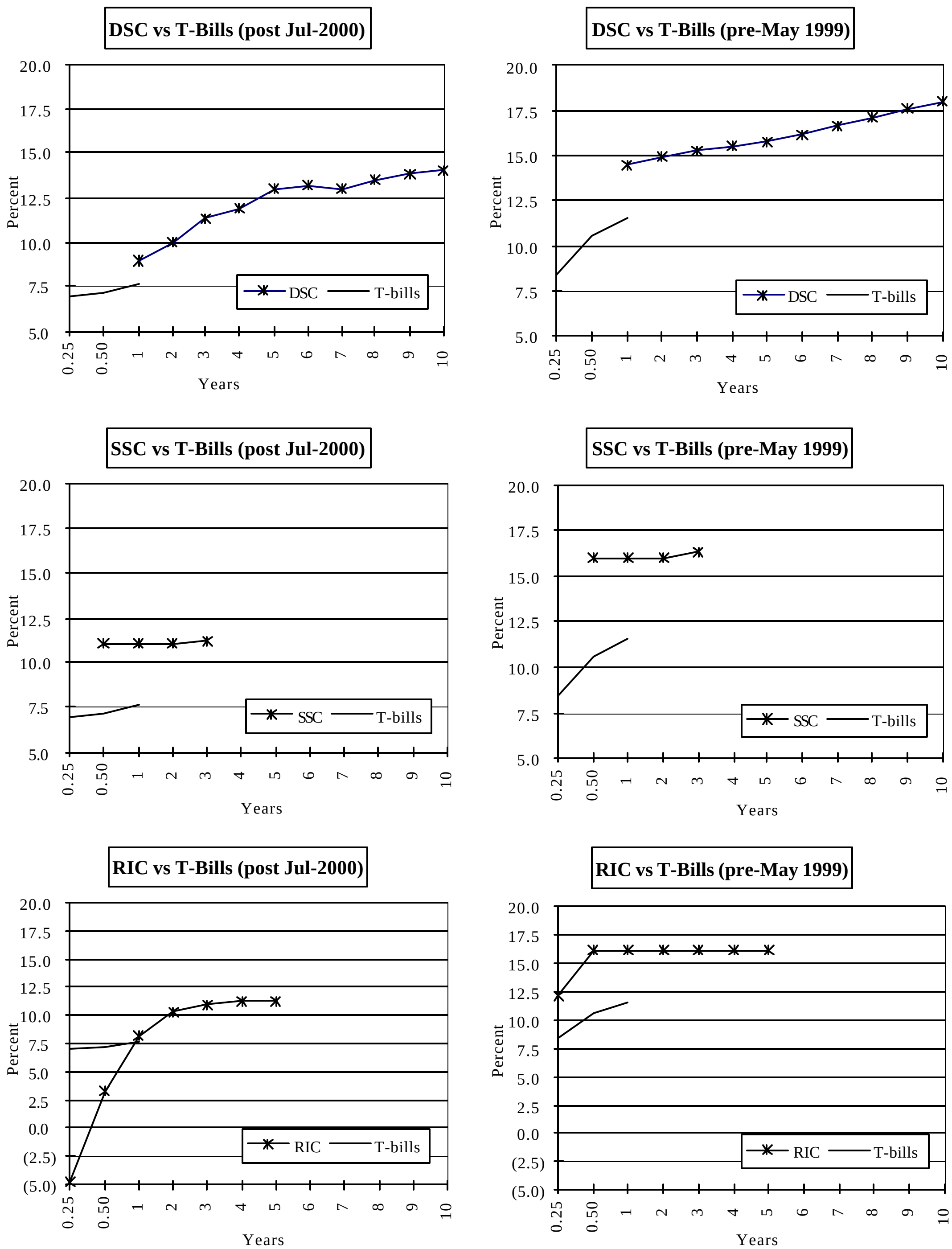
Unfunded debt (National Saving Schemes)

As seen in **Table 7.5** (*Statistical Annexure*) and **Figure VII.1**, despite the overall increase in Pakistan's domestic debt, the share of the unfunded component increased consistently over the last five fiscal years. Comprising 27.7 percent of total domestic debt in FY95, this has increased to 41.8 percent in FY00, indicating a near tripling in Rupee terms in six years. Given the attractive returns on NSS instruments coupled with the government's inability to control the actual amount of such borrowing (as these instruments are available on tap to the general public), unfunded debt has become the single largest category in Pakistan's domestic debt. The three consecutive rate cuts since May 1999, were much-needed steps towards more effective management of Pakistan's domestic debt. During FY99, GOP retired Rs 84.1 billion to the scheduled banks, while T-bill rates fell from 15.6 percent to 10.6 percent during the course of the year. However, during this period, the government continued borrowing in net terms through NSS instruments (Rs 130.6 billion[5]) at rates above 14.0.

Of the three most popular instruments offered by the Central Directorate of National Savings (CDNS), the most popular is the Defense Savings Certificate (DSC). A bullet-bond of 10-year maturity, the outstanding stock of debt on account of this instrument alone is Rs 247.8 billion as of end-FY00. This is followed by Rs 202.3 billion from Special Saving Certificates (SSC) and Accounts, and Rs 170.1 billion from Regular Income Certificates (RIC). The total

[5] Excluding prize bonds; total of net mobilization from all accounts and certificates.

Figure VII.2: Yield Curves of Interest Rates on NSS Instruments and T-Bills



mobilization from just these three instruments is 39.7 percent[6] of domestic debt outstanding.

Taking note of the high inflows into NSS because of the sharp increase in real returns, the government reduced rates in May 1999, and also imposed penalties on early encashment on RIC. It also banned institutional investment in all NSS instruments from April 2000.[7] The new yields, before and after these cuts are shown in **Figure VII.2**. The impact of these changes on net mobilization is shown in **Table VII.2** and **Figure VII.3.**

As a result of the rate cuts, net mobilization by the three largest instruments (DSC, SSC and RIC) fell from Rs 123.4 billion in FY99 to Rs 84.8 billion in FY00. Following penalties on early encashment of RIC on 14th May 1999, and the lower returns, net mobilization by this instrument has been the worst hit. As can be seen from **Table VII.2**, net inflows fell sharply in June 1999, and have not been able to show stable inflows during FY00.[9] This is also clear from the fact that net additions to stock were Rs 25.9 billion in FY00 compared with Rs 59.1 billion in FY99. With the rate cuts, investment in SSC has been impacted more than DSC.

Table VII.2: Net Mobilization by NSS[8]

(Rs million)

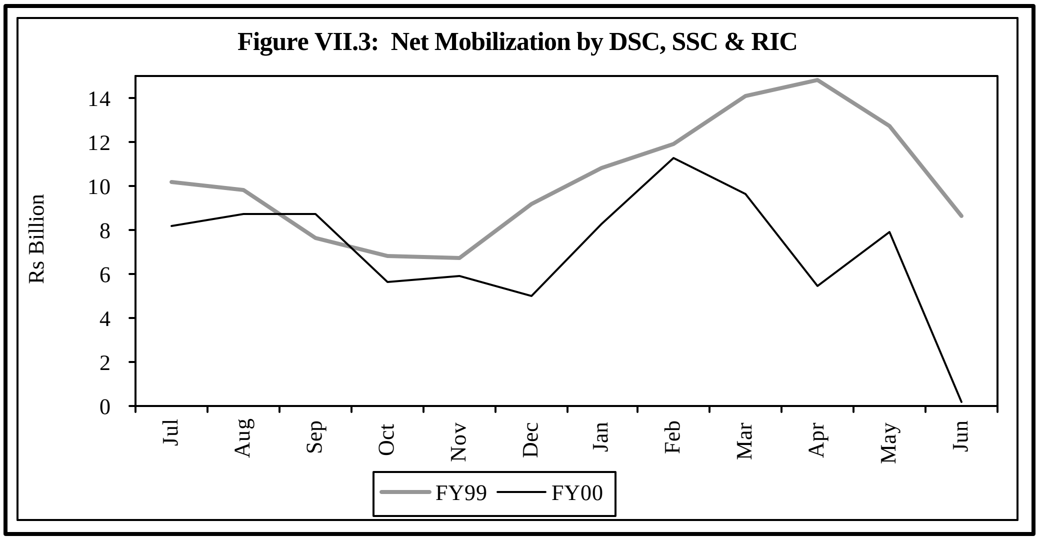
Months	FY99				FY00			
	DSC	RIC	SSC (R)	Total	DSC	RIC	SSC (R)	Total
July	3,398	4,713	2,073	10,184	4,826	85	3,307	8,218
August	2,967	4,765	2,084	9,816	2,710	2,296	3,681	8,687
September	2,594	3,699	1,318	7,611	3,376	3,387	1,988	8,751
October	2,247	3,752	841	6,840	2,565	2,149	893	5,607
November	2,150	3,523	1,083	6,756	2,862	3,317	(273)	5,906
December	2,320	5,396	1,461	9,177	1,448	3,329	213	4,990
January	3,776	5,588	1,497	10,861	4,105	2,436	1,753	8,294
February	2,666	7,103	2,119	11,888	4,888	3,939	2,407	11,234
March	2,252	9,563	2,245	14,060	3,936	3,375	2,285	9,596
April	6,615	5,419	2,803	14,837	2,233	1,416	1,770	5,419
May	3,691	4,551	4,445	12,687	5,087	1,235	1,581	7,903
June	4,662	1,027	2,988	8,677	1,368	(1,081)	(129)	158
Annual	**39,338**	**59,099**	**24,957**	**123,394**	**39,404**	**25,883**	**19,476**	**84,763**

[6] The SSC stock used in the calculation includes Special Saving Accounts, along with bearer and registered certificates.

[7] Anecdotal evidence suggests that institutional investment is about one-third of the outstanding stock of DSC, since this is the least transaction intensive.

[8] The numbers in this table do not match with the flow that can be calculated from **Table 7.5** in the *Statistical Annexure*, because **Table VII.2** is based on monthly numbers, while **Table 7.5** is based on yearly numbers. Reconciliation is underway at CDNS.

[9] It is important to realize that RIC was spearheading net mobilization by CDNS since FY97



Bank Borrowing

Domestic debt is also categorized between debt held by banks and non-banks (see **Table VII.3**). As discussed in Chapter V, the absence of targets to contain central bank financing in FY00 resulted in a compositional change in government borrowing, from commercial banks to SBP. Scheduled bank holdings of treasury bills fell from Rs 204.2 billion in FY99 to Rs 103.8 billion in FY00, while borrowing from SBP increased from Rs 366.8 billion to Rs 558.5 billion in the same year.

Table VII.3: Debt Held by Banks And Non Banks

(Rs billion)

	30-Jun-99	30-Jun-00
A. Banking System	**680.9**	**772.0**
1. Scheduled Banks	**314.0**	**213.5**
a) Government securities	109.9	109.7
b) Market Treasury Bills	204.2	103.8
2. State Bank	**366.8**	**558.5**
a) Government securities	10.5	11.3
b) Market Treasury Bills	266.3	457.1
c) Adhoc Treasury Bills	90.0	90.1
B. Non Bank System	**695.0**	**786.8**
Total (A+B)	**1,375.9**	**1,558.8**

Debt Servicing[10]

The increasing level of debt stock has led to a sharp increase in debt servicing over the period FY96 to FY99. However, with the NSS rate cut, and the stagnating stock of external debt, the rate of growth in debt servicing has come down in FY00. The impact of this is clearly shown by the fall in the share of interest on domestic debt to total interest payments, from a peak of 84.8 percent in FY98 to 78.9 percent in FY00. At its present level, interest payments

[10] See Footnote 1.

on domestic debt account for 46.7 percent of tax revenues, and 25.5 percent of total expenditures (see **Table VII.4**).

Table VII.4: Domestic Debt Servicing (Interest Payments)

Years	Interest Payments (Rs billion)	Ratio of Interest Payments on Domestic Debt to:				
		Total Revenue	Total Expenditure	Current Expenditure	Tax Revenue	GDP (mp)
FY96	104.8	28.5	20.2	24.7	34.3	4.9
FY97	129.9	33.8	24.0	28.5	40.0	5.4
FY98	160.1	36.7	27.1	32.3	44.3	6.0
FY99	178.9	38.2	27.6	32.7	45.8	6.1
FY00	189.6	35.3	25.5	29.5	46.7	6.0

Source: Ministry of Finance

External Debt

This section is different from previous *Annual Reports* in that debt categories are *explicitly* defined and more comprehensive picture of Pakistan's external liabilities is presented. At the onset it would be useful to differentiate between external debt and liabilities. External debt is the sum of: (1) public and publicly guaranteed debt, (2) private non-guaranteed credits, (3) central bank deposits, and (4) loans due to the IMF. It has the following *broad* characteristics: it is actively solicited, has a well-defined repayment structure, and is held by non-residents. Liabilities, on the other hand, have the following characteristics: (1) repayments are not structured by any set schedule, (2) the government does not receive the Rupee counterpart funds in *all* cases, (3) it is not generally solicited, and (4) is primarily held by residents. While the revised format is given in **Table I.4**, a reconciliation table is given below that shows the difference between the previous and revised formats (**Table VII.5**).

Long-Term Debt

While the revised categorization of external debt/liabilities is discussed in greater detail later, in order to maintain consistency in the formats that have been used in earlier *Annual Reports*, the tables shown in this Chapter are comparable with previous Annual Reports. Looking at Pakistan's external debt situation at the end of FY00 (**Table VII.6**). There has been no significant change in the outstanding volume of LT debt. This clearly shows that Pakistan's LT debt is not the problem, but the repayments on ST debt, and more importantly, Pakistan's external liabilities that have forced a rescheduling.

Furthermore, **Table VII.7** shows the profile of Pakistan's creditors under public and publicly guaranteed debt. As can be seen, the largest share in LT debt stock is due to consortium creditors, which shows the dominant role of G-7 countries. These loans are made by a host of development agencies, but end-use tends to be strictly specified by the donors. The

Table VII.5: Reconciliation Table - External debt: previous & revised format

(US$ millions)

Previous format		
Long Term Public & publicly guaranteed debt		23,834
Consortium	11,115	
Non-consortium	1,788	
Financial Institutions	10,529	
Islamic Countries	404	
Short & Medium Term Debt		5,622
Commercial Loans/credits	1,100	
IDB	130	
IMF	1,550	
Private Loans/Credits	2,842	
External Debt (Table VII.6)		**29,456**
New categories (not included in previous format)		
Eurobonds (added under PPG - M&LT)	610	
NHA Bonds (added under PPG - M&LT)	241	
Military Debt (added under PPG - M&LT)	958	
M&LT (Others)	350	
ST (Others)	431	
Central Bank Deposits	700	
Total		**3,290**
External Debt-revised format (Table I.4)		**32,746**

PPG: Public and Publicly Guaranteed Debt.

increase of US$ 503 million is driven by lending from Japan. This reaffirms the supportive role of Japan vis-à-vis other G-7 countries. The outstanding level of debt to Islamic countries has fallen, which suggests that LT funding was not made available during this trying period. However, in kind assistance, specifically the Saudi Oil facility and central bank deposits from certain Gulf countries, did make a significant difference in Pakistan's balance of payments.

Short & Medium Term Debt

Table VII.8 shows short and medium term debt as a sum of private loans/credits, commercial loans/credits, IMF financing, and funding from IDB.[11] The stock of S&MT debt decreased by 14.5 percent over FY99, on account of falls in all four sub-categories mentioned above.

[11] A reclassification has been done according to **Table I.4** in the Overview.

Table VII.6: Outstanding External Debt to Official Creditors

(US$ million)

Years	LT[a]	ST/MT	Total	Growth Rates		
				LT	ST/MT	Total
FY95	22,117	4,409	26,526	8.8	6.5	8.4
	(83.4)	*(16.6)*				
FY96	22,275	5,460	27,735	0.7	23.8	4.6
	(80.3)	*(19.7)*				
FY97	23,145	5,140	28,285	3.9	-5.9	2.0
	(81.8)	*(18.2)*				
FY98	23,042	5,940	28,982	-0.5	15.6	2.5
	(79.5)	*(20.5)*				
FY99	23,101	6,572	29,673	0.3	10.6	2.4
	(77.9)	*(22.2)*				
FY00	23,834	5,622	29,456	3.2	-14.5	-0.7
	(80.9)	*(19.1)*				

LT= Long-term, ST= Short-term, MT= Medium-term; a: breakdown in Table VII.7.

Note: Figures in parentheses represent percentage share in total.

Table VII.7: LT Public & Publicly Guaranteed Debt Outstanding

(US$ million)

	1-Jul-99	30-Jun-00
Consortium	**10,612**	**11,115**
1 Japan	4,425	4,827
2 USA	2,705	2,702
3 Germany	1,255	1,280
4 France	1,231	1,276
Non-Consortium	**1,719**	**1,788**
1 China	397	409
2 Austria	381	382
3 Australia	493	486
Financial Institutions	**10,352**	**10,529**
1 ADB	4,957	5,107
2 IBRD	2,542	2,417
3 IDA	2,703	2,855
Islamic Countries	**417**	**404**
1 IDB	134	118
2 Kuwait	78	80
3 Turkey	48	58
Total	**23,101**	**23,834**

Source: Economic Affairs Division

As shown in **Table VII.8**, there is no real change in the outstanding debt to IMF/IDB since the mid-1990s, while private loans rose sharply in FY94 with funding for IPPs playing an important role. The increase in the stock of commercial loans in the mid-1990s coincides with the increasing use of trade finance by foreign banks operating in Pakistan. The volatility shown is a reflection of the ST nature of the borrowing, the demand for import finance and, the uncertainty whether new loans would be forthcoming.

Although **Table VII.9** shows the obvious impact of the nuclear tests on Pakistan's sovereign ratings, what is interesting to note is that despite regular use of ST financing to meet external payments from the mid-1990s to May 1998, the country's sovereign ratings did not worsen. This allowed Pakistan to continue using ST commercial credit.

Table VII.8: Details of Short/Medium Term Loans

(US$ million)

	Commercial Loans/Credits	IDB	IMF	Private Loans/ Credits	Total
FY91	659	142	716	339	1,856
FY92	360	144	1,005	548	2,057
FY93	530	245	1,065	960	2,800
FY94	906	216	1,406	1,611	4,139
FY95	1,232	129	1,630	1,418	4,409
FY96	1,328	192	1,535	2,405	5,460
FY97	828	291	1,316	2,705	5,140
FY98	1,225	173	1,415	3,127	5,940
FY99	1,160	152	1,825	3,435	6,572
FY00	1,100	130	1,550	2,842	5,622

External Debt Servicing

Table VII.10 shows Pakistan's debt servicing over the last 6 fiscal years. The following points highlight the main findings:

- The decrease in debt servicing over the last two years is on account of the rescheduling of Pakistan's external debt. Most of this leeway comes from postponing principal payments.
- The nature of S&MT debt implies that principal payments dominate interest payments.
- Despite the slowdown in the growth of external debt, Rupee payments have increased sharply between FY96 to FY99 (see **Table VII.1**). This is due to two factors: (1) the debt rescheduling does not impact the budgetary allowance for debt servicing, as the Rupee counterpart for rescheduled payments continues to be credited in a special account with SBP, and (2) the depreciation of the Rupee has a direct pass through impact on this Rupee allocation.

Table VII.9: Standard & Poor's Sovereign Rating History of Pakistan

	Local Currency Rating			Foreign Currency Rating		
	Short-Term	Long-Term	Outlook	Short-Term	Long-Term	Outlook
29-Sep-00	B	B+	Stable	B	B-	Stable
21-Dec-99	B	B+	Stable	B	B-	Stable
09-Jul-99	B	B	Stable	SD	SD*	Not Meaningful
29-Jan-99	-	-	-	SD	SD	Not Meaningful
03-Dec-98	-	-	-	C	CC	Negative
12-Oct-98	-	-	-	C	CC	Negative
14-Jul-98	-	-	-	C	CCC	CW**-Neg.
01-Jun-98	-	-	-	C	B-	CW-Neg.
22-May-98	-	-	-	B	B+	CW-Neg.
14-Jan-98	-	-	-	B	B+	Negative
03-Aug-95	-	-	-	B	B+	Stable
21-Nov-94	-	-	-	—	B+	Positive

*SD = Selected Default; **CW: Credit Watch

It is important to repeat the point that the rescheduling of external debts has not had any impact on Pakistan's Rupee debt servicing. All rescheduled repayments still require the borrower (the government or PSCEs) to make Rupee payments to SBP according to the original schedule of repayments. This has been done to insulate the impact of the external constraint (which required the rescheduling) from the performance of Pakistan's fiscal system. Since payments on external debt are a significant part of total debt servicing, it was important to make sure that the leeway provided in terms of hard currency payments was not being reflected in lower debt servicing. In effect, the government and PSCEs that have had their debts rescheduled are still required to pay the Rupee equivalent to SBP. A similar procedure has also been adopted for the country's balance of payments where the accrual method of accounting has been used (see **Chapter VIII**).

Table VII.10: External Debt Servicing to Official Creditors

(US$ million)

Years	Long-Term			Short/ Medium-Term			Total Debt Servicing		
	Principal	Interest	Total	Principal	Interest	Total	Principal	Interest	Total
FY95	1,334	760	2,094	1,970	260	2,230	3,304	1,020	4,324
FY96	1,371	799	2,170	1,891	286	2,177	3,262	1,085	4,347
FY97	1,532	754	2,286	2,506	288	2,794	4,038	1,042	5,080
FY98	1,711	763	2,474	1,864	332	2,196	3,575	1,095	4,670
FY99	987	444	1,431	918	308	1,226	1,905	752	2,657
FY00	893	509	1,402	1,069	465	1,534	1,962	974	2,936

Conclusion

Continuous imbalances in the external sector have resulted in heavy reliance on external borrowings. However, the stagnant external debt stock belies the acute financing problem that Pakistan faced in the latter half of the 1990s. Although inflows of LT and S&MT debt are important components of financing the country's external deficit, there was an increasing reliance on external liabilities. Nevertheless, the shorter repayment schedule on S&MT debt did add to Pakistan's repayment pressure.

With the freeze of FCAs, these problems were brought to the forefront. The foreign exchange crisis that followed, led to the suspension of certain debt repayments, which provided the basis for the rescheduling agreements concluded in January and December 1999 under the Paris and quasi-London Clubs, respectively. With the consolidation period set to end in December 2000, and in the absence of a fundamental change in the external sector, an extension will be sought to rehabilitate Pakistan's repayment capacity.[12] With an improvement in international prices, this leeway should be used to make the difficult structural adjustments in Pakistan's external sector. The required changes include: (1) increasing worker's remittances from the Gulf region, (2) export diversification to ensure that revenues are not vulnerable to international prices, and (3) containing domestic consumption of imported oil.

If these changes can be made, it will credibly reduce Pakistan's external deficit. This, in turn, should create the capacity to repay past loans (especially ST commercial credits) without having to borrow more. Privatization proceeds will help, but this requires prior actions to improve foreign investor confidence.

Reclassification of external debt and liabilities[13]

The following pages highlight the new classification of external debt and liabilities. See **Table I.4** in the Overview for the revised format. The definitions, and stocks, under each sub-head are presented below.

Public & publicly guaranteed debt

The sphere of public and publicly guaranteed debt is such that it includes all loans, credits, market debt, etc. that is either borrowed directly or guaranteed by the federal government. More specifically, public debt primarily represents project loans contracted by the government for social and economic development.

Publicly guaranteed debt refers to loans contracted by non-government entities (e.g. public utilities and other PSCEs) on the basis of federal government guarantees. While these do not represent a direct liability of the federal government, in case of cash flow difficulties, the

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[12] The inability to develop their capacity in the past two years is not so much a reflection of Pakistan's ability to implement changes in the domestic economy, but adverse international prices.
[13] See Footnote 1.

federal government must make the hard currency payments. Additionally, the earlier breakdown of public and publicly guaranteed debt was in terms of consortium, non-consortium, Islamic countries and financial institutions. After the country's rescheduling agreements, this breakdown can be revised to a more 'universal' categorization in term of: Paris Club, multilateral, and other bilaterals (See **Table VII.11)**.

Table VII.11: Pakistan's creditors

(US$ million)

	1-Jul-99	30-Jun-00
Paris club	**11,873**	**12,428**
1 Japan	4,425	4,827
2 USA	2,705	2,702
3 Germany	1,255	1,280
4 France	1,231	1,276
Multilateral	**10,599**	**10,767**
1 ADB	4,957	5,107
2 IBRD	2,542	2,417
3 IDA	2,703	2,855
Other Bilateral	**629**	**639**
1 China	397	409
2 Kuwait	78	80
3 UAE	56	58
4 Saudi Arabia	39	40
Total	**23,101**	**23,834**

Source: Economic Affairs Division

Medium & LT debt (> 1 year)

Eurobonds

Following an agreement with the quasi-London Club creditors, Pakistan launched a voluntary exchange offer on 15th November 1999, to convert the three existing issues of market debt for one bond with a realized value of US$ 610 million. The terms of the restructured bond are: 10 percent rate of interest payable semi-annually, and a final maturity of 6 years, where the first three years entail no principal payments (grace period); the first principal repayment is due on 13th December 2002. The successful exchange offer was based on a number of factors: (1) a credible possibility of default by Pakistan if these bonds were not restructured, (2) the terms of the exchange offer were better than the bonds being replaced, (3) the better rating by Standard & Poor's on the new bond (from D on the existing instruments to B- on the new bond), and (4) there were a limited number of bond holders, which made negotiations easier. Outstanding stock as of end FY00: US$ 610 million.

NHA Bonds

In July 1990, the GOP issued foreign currency bonds on account of a failed National Highway Authority contract in the Gulf, which carried a GOP guarantee. The guaranteeing banks paid off the amount, and GOP (in exchange) issued 20 foreign currency bonds (of 20-year maturity) to these banks. The last principal repayment of these bonds will take place on 1st July 2010. End-FY00 stock: US$ 241 million.

Commercial Loans/Credits

These are federal government guaranteed loans, usually of less than 3-year maturity. Except for oil import facilities, these are mostly cash disbursing loans for BOP support, and come in one or multiple tranches. Reflecting the increased hesitancy of commercial creditors to lend to Pakistan, the stock of these loans decreased from US$ 1.2 billion in FY99 to US$ 1.1

billion in FY00. As fresh disbursements fell, principal repayments continued on non-rescheduled debt thereby decreasing the overall stock.

Short term (1 year)

IDB

The Islamic Development Bank (IDB) does not provide any cash disbursing loans. IDB credits are usually for the import for crude oil and fertilizer, whereby the supplier is paid off directly by IDB. End FY00 stock: US$ 130 million.

Private non-guaranteed debt

Medium and long term (> 1 year)

Private Loans/Credits

Also known as private non-guaranteed credits, most of these loans are of greater than 5 years maturity. The federal government does not directly guarantee these loans, but they usually carry guarantees by SBP (foreign exchange convertibility guarantee), multilaterals, NCBs, and Export Credit Agencies belonging to OECD countries. Most of these loans and credits are L/C based comprising: (1) Supplier credit, (2) Buyer's credit (when the credit-providing agency buys the goods and sends them to Pakistan), and (3) Commercial credit (cash loans kept abroad that are used to finance imports). After the systemic problems following the nuclear tests, fresh inflows of private loans have fallen dramatically. This is reflected in the stock decreases in FY00. Stock as of end-FY00: US$ 2,842 million.

Central Bank Deposits

Used for BOP support, these LT deposits placed with SBP from Gulf countries. End-FY00 stock: US$ 700 million.

IMF

This represents financial assistance from the IMF for various BOP support facilities. As no new flows were forthcoming from this institution in FY00, the debt stock fell to US$ 1,550 million from US$ 1,825 million in FY99.

Summing these components, Pakistan's total external debt is US$ 32,746 million.

Foreign exchange liabilities

Special US$ Bonds

These were launched in July 1998 to facilitate conversions from frozen FCAs. Initially, banks were given the option of retaining the Rupee counterpart from the Dollar Bonds as a special government deposit for one year if they had liquidity problems. This option was revoked on 13th November 1999 with the Rupee counterpart of subsequent conversions to be surrendered immediately to the government. Given this restriction, all Rupee counterpart funds (against Dollar Bonds) will be surrendered to GOP by mid-November 2000. Premature encashments of these bonds are in Rupees, while interest payments and principal repayment (at maturity) is in US Dollars. End-FY00 stock: US$ 1,297 million.

Foreign Currency Accounts

FE 45: These are foreign currency deposits solicited by commercial banks and NBFIs operating in Pakistan from their overseas network, or syndicated from other financial institutions abroad. Foreign banks had a large role in raising these deposits. GOP actively solicited these deposits in the mid-1990s, primarily for BOP support at above international interest rates.[14] Rupee liquidity and forward cover is still provided to mobilizing banks against these deposits (see Chapter V). No new inflows have taken place since the freeze in 1998. End-FY00 stock: US$ 1,072 million.

FE 25: Initially, commercial banks were free to place these FCAs locally or abroad; but lacking demand for hard currency loans in Pakistan, mobilizing banks placed these funds abroad. However, in June 1999, restrictions were imposed on the placement of additional deposits abroad, as there was a real concern about the risk profile of the assets in which banks were placing these funds.[15] Although these restrictions forced banks to use the funds locally, lacking alternatives, all incremental deposits were placed with SBP. Stock as of end-FY00: US$ 616 million (outside SBP).

FE 13: Commercial banks place these FCAs raised through FE 25 since June 1999, with the State Bank at a rate less than LIBOR (this is revised at the beginning of every month). Currently, the rate is set between 4.0 to 4.5 percent per annum depending on maturity. No Rupee liquidity is provided against these deposits. Although these deposits are included in Pakistan's foreign exchange reserves, they are reported separately. Stock as of end-FY00: US$ 361 million.

FE 31 (incremental): These represent the incremental deposits in the old frozen FCA scheme. As was the case with the frozen FCAs, commercial banks are provided Rupee liquidity against these deposits at the prevailing interbank rate exchange rate, and mobilizing banks are permitted to purchase forward cover at a rate of 8 percent per annum. End-FY00 stock: US$ 300 million.

National Debt Retirement Program (NDRP)

In February 1997, the then Prime Minister launched the NDRP, appealing to non-resident Pakistanis to help repay external debt. The salient features of this scheme are as under:

- Donation can be made in three currencies, US Dollars, Pound Sterling, and Deutsche Marks, in deposits of two to five year maturity.
- The donations can be in three forms:
    - *Outright donation*, meaning no liability or servicing on the amount deposited.

[14] This currently stand at LIBOR + 0.75 percent.
[15] Banks were not required to bring back deposits that had been placed abroad prior to the restrictions, a cap was placed on the additional deposits mobilized.

- *Qarz-e-Hasna*, which carries no servicing liability, but principal repayment at maturity is payable in hard currency or Rupees; a minimum period of 2 years for the deposit was allowed.
- *Profit bearing deposits*, carrying varying interest rates (in a range of 5.10 to 9.75 percent) payable quarterly, depending on maturity and currency.

The amount outstanding as of end-FY00 is US$ 156.1 million (under the last two forms of deposits).

External liabilities payable in Rupees

Frozen FCAs

End-FY00 stock: US$ 1,572 million. As hard currency withdrawals are not permitted from these accounts, they are not part of foreign exchange liabilities, but represent external liabilities payable in Rupees. Returns were brought down following the freeze and the increase in forward cover charge.

FEBC, FCBC & DBC

In the circular that froze hard currency withdrawals from FCAs, Dollar repayments on account of FEBCs, FCBCs or DBCs were also suspended. Therefore, they do not represent a foreign exchange liability in the true sense, but Rupee payments are linked to the exchange rate at the time of repayment. End-FY00 stocks are given below:

- Foreign Exchange Bearer Certificates: US$ 108.6 million.
- Foreign Currency Bearer Certificates: US$ 35.7 million.
- Dollar Bearer Certificates: US$ 3.1 million.