8 Domestic and External Debt

8.1 Overview

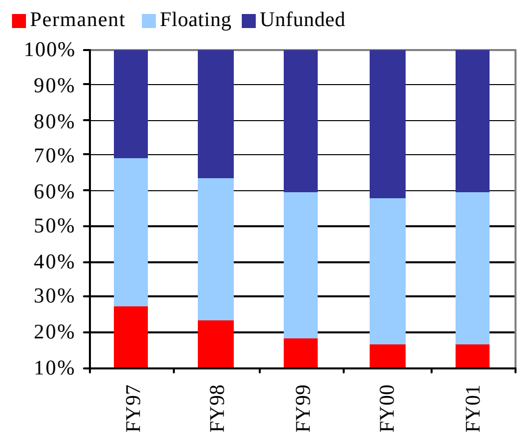
The government's growing indebtedness has become the gravest problem faced by the economy. The stock of total debt has exceeded Pakistan's Gross Domestic Product (at market price); income per capita is lower than per citizen indebtedness.[1] This accumulated public debt is the result of structural weaknesses in the domestic economy and the external account. Excessive government expenditures, stagnant tax revenues, high returns on government securities and inappropriate sequencing of financial reforms, led to a bludgeoning domestic debt profile. On the external front, large current account deficits, stagnant export revenues and declining worker remittances, effectively forced Pakistan into an unsustainable situation. Until mid 1998, about half of the current account deficit was financed using inflows into resident and non-resident foreign currency accounts (FCAs), while the remaining part was covered (more or less) by expensive short-term commercial credit.

In Rupee terms, FY01 saw the highest one-year increase in total debt mainly driven by a large Rupee depreciation during the course of the year. The share of external debt has risen to 55.5 percent (see **Table 8.1**). During the year, net addition to the stock of debt was Rs 587.2 billion, a sharp increase compared to the average Rs 372.2 billion figure realized over the previous two years. At its present level, this constitutes 115.3 percent of the country's GDP relative to 107.3 percent a year earlier. The increase in Pakistan's debt to GDP came exclusively from external debt. More specifically, the valuation impact of multilateral and bilateral debt, resumption of IFIs assistance and the 18.6 percent depreciation, are responsible for this impetus despite concerted GOP efforts to manage the debt burden more effectively.[2] Furthermore, FY01 also witnessed important changes in the profile of Pakistan's external debt and liabilities. These changes are discussed in the following pages.

8.2 Domestic Debt

Domestic debt increased by Rs 148.6 billion over the course of FY01. The composition of this debt reveals two interesting features: (1) the share of unfunded debt is no longer the highest-a positive consequence of interest rate rationalization and other measures taken with respect to the National Saving Schemes (NSS) in the recent past, and (2) the share of permanent debt has stabilized with the introduction of the Pakistan Investment Bond (PIB) in December 2000, and higher inflows in the Prize Bond schemes (see **Figure 8.1**).

Figure 8.1: Composition of Domestic Debt



8.2.1 Permanent Debt

The outstanding volume of permanent debt totaled Rs 281.1 billion at end June 2001, showing an increase of Rs 21.5 billion over last year. The main reason for this increase was the newly launched PIB, which contributed Rs 46.1 billion (see **Table 8.5** in ***Statistical Annexure***). Additionally, FY01 saw an increase of Rs 10.4 billion in the stock of Prize Bonds compared to a decline of Rs 33.0

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[1] Per capita debt surpassed per capita GDP in FY99 and the gap continues to rise. In FY01, per capita debt is Rs 28,784 as compared to per capita GDP of Rs 24,965 only.

[2] Proposals were put forward in the Debt Reduction and Management Committee report issued in August 2001.

million last year. Since the number of prizes drives the demand for Prize Bonds, the reduced demand last year was in response to a fall in the number of prizes; in absence of other high yielding substitutes, demand has revived in FY01.

In terms of Market Loans, SLIC bonds and FIBs, stocks continued to fall in the absence of fresh sales. After the sale of FIBs was stopped in June 1998, and institution investment in NSS was banned in March 2000, the PIB was launched in order to provide institutional investors with an avenue to place their long-term funds. As a result, after its successful launch in December 2000, the share of long-term debt has improved from 51.3 to 56.6 percent in the permanent debt. This is without doubt a healthy sign for the country's domestic debt profile.[3]

Table 8.1: Profile of Domestic and External Debt

billion Rupees

	FY98	FY99	FY00	FY01
Total debt	**2,671.9**	**3,135.4**	**3,416.2**	**4,003.3**
1. Domestic debt	**1,176.2**	**1,375.9**	**1,559.9**	**1,708.5**
	(44.0)	(43.9)	(45.7)	(42.7)
2. External debt [1]	**1,483.1**	**1,695.9**	**1,788.4**	**2,223.8**
	(55.5)	(54.1)	(52.4)	(55.5)
3. Explicit liabilities [2]	**12.6**	**63.6**	**67.8**	**71.0**
	(0.5)	(2.0)	(2.0)	(1.8)
Total debt as % of GDP	99.8	106.7	107.3	115.3
Domestic debt as % of GDP	43.9	46.8	49.0	49.2
External debt as % of GDP [3]	55.4	57.7	56.2	64.0
Explicit liabilities as % of GDP	0.5	2.2	2.1	2.0
Total debt servicing	**278.3**	**343.1**	**353.9**	**325.0**
Total interest payment	191.6	220.1	256.8	237.1
Domestic	160.1	178.9	206.3	178.8
Foreign	28.7	38.0	44.9	50.5
Explicit liabilities	2.8	3.2	5.6	7.8
Repayment of principal [4]	86.7	123.0	97.1	87.9
Ratio of external debt servicing to				
Export earnings	55.4	35.3	36.5	37.4
Foreign exchange earnings	34.9	23.6	23.4	23.3
Ratio of total debt servicing to				
Tax revenue	78.4	87.8	87.2	68.9
Total revenue	64.8	73.2	65.9	57.0
Total expenditure	43.9	53.0	47.6	49.5
Current expenditure	52.5	62.7	55.0	49.3

[1] External debt is based on new format so these numbers are different from those numbers reported in previous *Annual Reports*.
[2] Explicit Liabilities include Special US $ Bonds, FEBCs, FCBCs and DBCs; of which Special US $ Bond is a foreign liability, while FEBCs, FCBCs and DBCs are also foreign liabilities payable in Rupees. Outstanding stock is computed on a monthly basis by adding to the previous Rupee stock, so revaluation effect is not included.
[3] External debt to GDP ratio is not comparable to ratio calculated in **Table 8.6** due to a methodological difference. This ratio is calculated by converting the external debt into Pak. Rupee using end-June Exchange rates.
[4] It includes repayment of foreign debt.
Figures in parentheses are shares in total debt or total interest payments.
Sources: i) SBP ii) MoF

[3]Permanent debt includes market loans, SLIC bonds, FIBs, and PIBs etc. Outstanding FIBs are maturing since the suspension of their auctions from June 1998. PIBs were launched in FY01 and are tapping the long-term bond market.

8.2.2 Floating Debt

Floating debt (term debt with maturity of one year and below) is used to meet mismatches between federal government receipts/payments and forms the basis of SBP's monetary policy. The composition, in terms of debt raised from commercial banks or the central bank, is critical for inflationary control, liquidity management and short-term interest rates.

During FY00, uncertain liquidity conditions and the absence of targets on central bank financing allowed the government to borrow more from SBP and used these funds to retire its debt to commercial banks. On the other hand, binding targets were in place this year to contain government borrowing from SBP and the banking system in general. Therefore, borrowing from SBP through the creation of MTBs for replenishment increased by Rs 41.0 billion against an increase of Rs 137.6 billion last year (see **Table 8.5** in ***Statistical Annexure***).

8.2.3 Unfunded Debt

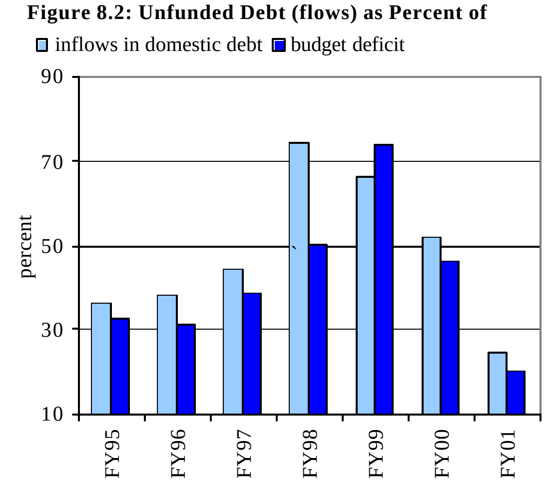
Unfunded debt (largely comprising NSS) recorded an increase of Rs 36.8 billion in FY01. Consequently, the stock of unfunded debt rose to Rs 689.7 billion at end-June 2001, which is 40.4 percent of total domestic debt. Although, the share of unfunded debt has witnessed a consistent increase in the second half of the 1990s, this marginally declined in FY01 (see **Figure 8.1**). The net addition to unfunded debt was much lower than the annual average increase over the last three years (Rs 110.3 billion). This decline was on account of significantly lower receipts from popular NSS instruments, namely defense saving certificates (DSCs), special saving certificates (SSCs) and regular income certificates (RICs); these together account for over 90 percent of Pakistan's unfunded debt. The fall in mobilization from NSS was due to the reduction in profit rates and the ban on institutional investment (more later).

Table 8.2: Major NSS Instruments
billion Rupees

	FY98	FY99	FY00	FY01
DSCs	32.3	38.4	41.2	16.3
SSCs	21.1	30.0	24.3	10.7
RICs	54.4	59.1	26.1	8.4
Total	**107.8**	**127.4**	**91.7**	**35.4**

The compositional breakdown of unfunded debt is shown in **Table 8.5** (***Statistical Annexure)***. As can be seen, the prime contributor is DSC followed by SSCs and RICs, while the share of other instruments is relatively insignificant. DSCs, a long-term bullet bond of ten-year maturity accounts for 38.4 percent of unfunded debt. Following the linking of DSC rates to market based returns posted by the PIBs in early 2001, only Rs 16.3 billion was mobilized by this instrument compared to Rs 41.2 billion in FY00. SSCs and RICs also mobilized lower amounts this year compared to FY00, primarily due to three successive rate cuts that started in May 14, 1999.[4] The total contribution of NSS through these three instruments is shown in **Table 8.2**

Figure 8.2: Unfunded Debt (flows) as Percent of



Unfunded Debt and Deficit Financing

Over the years, inflows in unfunded debt comprised the key source of non-bank borrowing, by the federal government. As depicted in **Figure 8.2**, the use of unfunded debt

[4] The other two cuts took place on January 1, 2000 and July 1, 2000.

to financing the budget deficit ranged from 20.4 percent to 73.8 percent. The rising trend was a result of upward revisions in profit rates with effect from November 11, 1996, whereas short reversal was attributed to three successive cuts in profit rates. More recently, the restriction on institutional investment has added to this decline.

Interest Rate Dynamics

The onset of financial sector reforms in the early 1990s,which aimed at eliminating the segmentation in Pakistan's debt markets, was setback in 1993 and 1996 when returns on NSS instruments were revised upward and kept unchanged till May 14, 1999. The resulting interest rate structure guided the changing composition of domestic debt, as private savings were channelled into attractive NSS instruments. These developments captured the government's attention in 1999, when returns on NSS instruments were reduced, indicating efforts to eliminate anomalies in the interest rate structure following an ADB report on deepening Pakistan's capital markets. The changing interest rate structure in FY00 and FY01 is shown in **Figure 8.3**.

As stated earlier, the government launched a new market based long-term instrument called the Pakistan Investment Bond (PIB) in December 2000. As a part of our understanding with the IFIs, the resulting yield curve was to be used as a benchmark to determine the profit structure on NSS instruments, especially the DSC.[5] **Figure 8.3-c** plots the yield structure of PIBs and DSCs, which almost overlaps except for the first two years.

Figure 8.3 a: Yield Curves: DSCs vs T.Bills

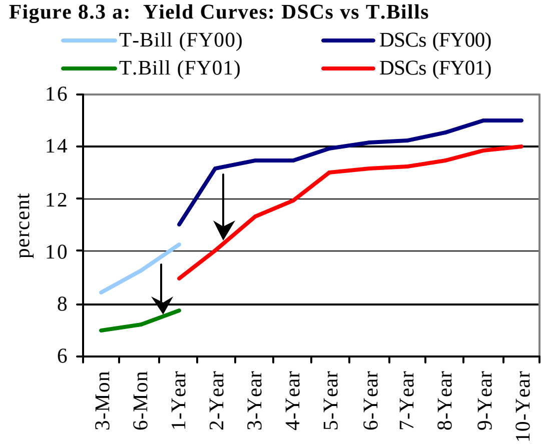


Figure 8.3 b: Yield Curves: SSCs vs T-Bills

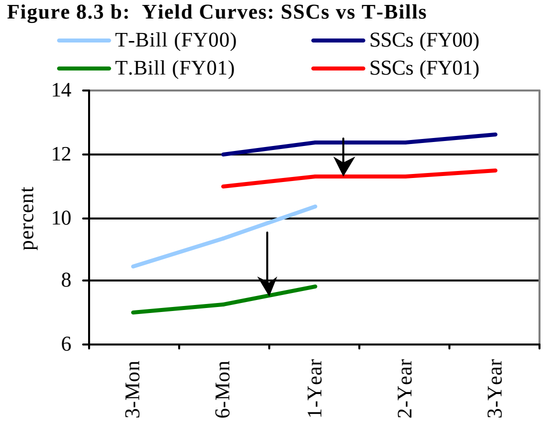
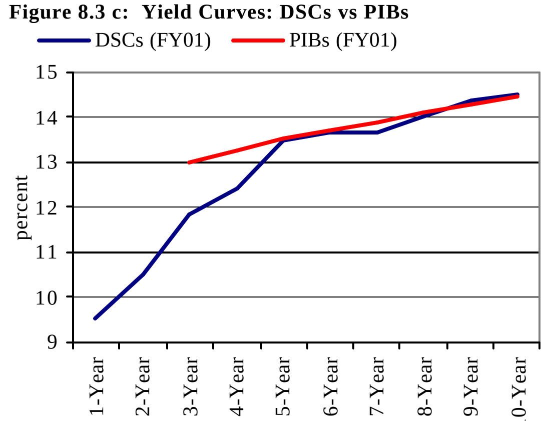


Figure 8.3 c: Yield Curves: DSCs vs PIBs



Interest burden

Attractive returns on NSS instruments coupled with higher yields on T-bills following the first stage of the financial liberalization process, led to a sharp increase in interest payments on domestic debt in the 1990s. However, government efforts to rationalize the interest rate structure in the past two years has resulted in a significant Rs 27.5 billion decline in domestic interest payments (see **Table 8.1**). Nevertheless, the servicing of unfunded debt, which constitutes 47.9 percent of domestic debt

[5] The government linked profit rate on DSCs with PIBs with effect from January 1, 2001.

servicing, creates cash flow problems for the government as the premature encashment facility available on NSS instruments makes it difficult to project outflows.

8.2.4 Ownership Classification of Domestic Debt

The banking system (including SBP) holds about 49 percent of total domestic debt while 51 percent is held by non-banks (general public in the form of NSS, Prize Bonds and long-term government bonds). This ratio has remained fairly stable during the last three years (see **Table 8.3**). In the banking system, SBP is the largest holder of domestic debt (36 percent) while schedule banks own about 13 percent. Debt held by the banking system recorded a single-digit increase in FY01 compared to double-digit last year. Compared to FY00, the growth of domestic debt held by the banking system has declined, largely on account of the stabilization program. Government debt held by non-banks registered an increase of 10.4 percent in FY01 (compared to 13.4 percent in FY00) largely on account of reduced receipts from NSS instruments. Had the PIB not been launched, this decline would have been even greater.

The composition of domestic debt held by banks and non-banks is given in **Table 8.3.** As can be seen, FY01 saw scheduled bank's stock of T-bills increase from Rs 103.8 billion to Rs 123.9 billion, reflecting a sharp compositional change compared to FY00, while borrowing from SBP shows a meager increase during the current year (see **Chapter 5**). The creation of MTBs for replenishment increased by 6.1 percent against a 71.6 rise percent last year.

Table 8.3: Who Owns Domestic Debt?

billion Rupees

	FY99	FY00	FY01	Share FY01
Banking System	**680.9**	**772.0**	**838.8**	**49.1**
1. Scheduled banks	**314.0**	**213.5**	**219.8**	**12.9**
Govt. securities	109.9	109.7	95.9	5.6
Treasury bills	204.2	103.8	123.9	7.3
2. State Bank	**366.8**	**558.5**	**619.0**	**36.2**
Govt. securities	10.5	11.3	8.6	0.5
Treasury bills	266.3	457.1	485.0	28.4
Adhoc treasury bills	90.0	90.1	125.3	7.3
Non bank (general public)	**695.0**	**788.0**	**869.7**	**50.9**
Total	**1375.9**	**1559.9**	**1708.5**	**100.0**

8.2.5 Interest Payments on Domestic Debt

A long awaited reduction in interest rates was realized in FY01, with the result that interest payments witnessed an impressive decline of Rs 19.7 billion compared to FY00. The Rs 27.5 billion fall in domestic interest payments led the way for this easing in debt payments. This decline was largely attributed to lower interest payments on permanent debt, while an additional impetus came from reduced interest expense on floating and unfunded debts.[6] The lower interest payments on permanent debt were the result of reduced returns (prizes) on the National Prize Bonds scheme, and a lower interest payment on SLIC bonds due to continuing maturities.

Table 8.4: Interest Payments on Domestic Debt

billion Rupees

	FY99	FY00	FY01[R]
Total interest payments	**178.9** (15.2)	**206.3** (15.0)	**178.8** (11.5)
Permanent debt	38.0 (13.7)	54.8 (21.3)	38.9 (15.0)
Floating debt	63.4 (13.4)	58.3 (10.4)	54.3 (8.4)
Unfunded debt[1]	77.5 (18.2)	93.2 (16.7)	85.7 (13.1)

[R] Revised

Note: Figures in parentheses are effective interest rates, which are the ratio of interest payments to outstanding level of debt in the previous year.

[1] Interest payments on unfunded debt also include interest paid on other obligations, and interest paid by provincial governments.

[6] Interest payment on permanent debt excludes interest paid on FEBC, FCBC, Special US$ Bonds and US$ Bearer Certificates, since these securities have been reclassified and treated as external liabilities and external liabilities payable in Rupees. However, to remain consistent with previous annual reports, except Annual Report 1999-2000, a third category is added to total interest payments in **Table 8.1**.

Looking at **Table 8.4**, average interest rate on each category of domestic debt has witnessed a significant decline in FY01 over last year. This indicates that government borrowing from the banking system is the cheapest, while permanent debt is the most expensive, closely followed by unfunded debt. Declining average interest rates also explain lower interest payments on domestic debt in FY01. More specifically, interest payments on floating debt registered a decline Rs 4.0 billion in FY01 compared to the year before. This decline was largely driven by lower T-bill rates in FY00 and net retirement to the banking sector in FY01. Interest on unfunded debt, also witnessed a marginal decline as NSS instruments started loosing their attractiveness. As mentioned before, this was driven by successive rate cuts on NSS instruments, the ban on institutional investment, and the introduction of a penalty on early encashment of RICs.

8.3 External Debt

Over the last decade, unsustainable commercial borrowing imposed a heavy burden on external payments. Pakistan's external debt/liabilities have risen from just over US$ 22.0 billion in the late 1980s to over US$ 38.0 billion at the end of the 1990s. More damaging is the shift towards short-term commercial loans, which had not only increased the volume of indebtedness per se, but also put tremendous pressure on yearly debt payments. However, the freeze on FCAs, low disbursements from IFIs and smaller inflows of commercial credit, have slowed the growth in the last few years.

Provisional estimates for FY01 show that the total stock of external debt and liabilities has remained almost unchanged compared to FY00 (revised estimates - see **Table 8.5** and **Chart 8.1**). The main difference from last year estimates presented in the *Annual Report*, is an increase in stock due to revaluation of US$ 1.5 billion (see **section 8.3.1**).

To see how changes in external debt and liabilities have impacted Pakistan's debt indicators (see **Table 8.6**), these ratios should be viewed in light of the following points:

?? The worsening external debt/liabilities to GDP ratios, are the result of the 18.6 percent depreciation of the Rupee/Dollar parity over the course of FY01. As a result, GDP in US$ terms, actually fell in FY01.

?? The improvement (stability) in the external debt to export earnings and foreign exchange earnings ratios, is on the back of higher export receipts in FY01.

?? The external debt/liability to foreign exchange reserves, uses the net SBP reserve position; it does not include balances held with commercial banks. This is why FY01 does not depict much improvement even though total reserves exceeded the US$ 3.0 billion level.

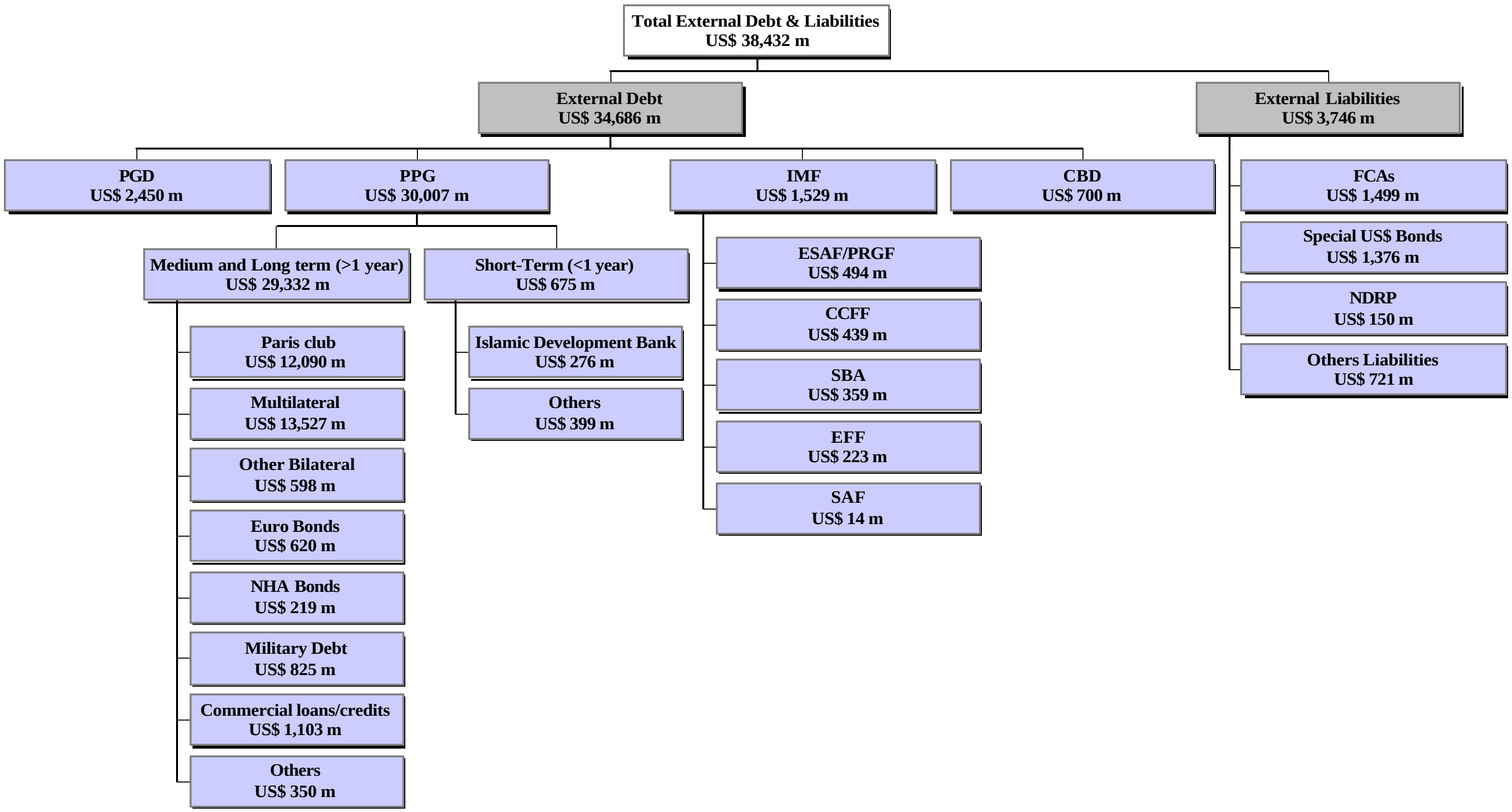
8.3.1 Public and Publicly Guaranteed Debt

After the publication of SBP's *Annual Report* last year, the Economic Affairs Division (EAD) carried out a revaluation of Pakistan's debt to Paris Club members, other bilateral, and multilateral agencies (IFIs) and requested all creditors to provide debt stocks outstanding in their currencies. In order to explain why such a large difference arose, one must look into how debt stock numbers are calculated. For public and publicly guaranteed debt, the stock for a particular year is estimated as shown in **Chart**

Chart 8.2: Methodology–stock calculations

Multilateral Creditors	Bilateral Creditors (Paris & non-Paris Club)
Opening Stock	**Opening Stock**
Add: Disbursements during the reporting period	Add: Disbursements during the reporting period
	Add: Rescheduled interest
Less: Principal repayments during the reporting period	Less: Principal Repayments during the reporting period (Include non-rescheduled principal repayments)
Closing Stock	**Closing Stock**

Chart 8.1: Pakistan's External Debt and Liabilities



Abbreviations: PGD: Private non-guaranteed debt; PPG: Public & publicly guaranteed debt; CBD: Central bank deposits; CCFF: Compensatory contingent finance facility; ESAF: Enhanced structural adjustment facility; PRGF: Poverty reduction & growth facility; SAF: Structural adjustment facility; SBA: Standby arrangement; EFF: Extended finance facility; NDRP: National debt retirement program.

8.2 It should be noted that such loans are denominated in several different currencies. These amounts are aggregated and converted to US Dollars to report the outstanding stock at a particular point in time. The problem with EAD's debt numbers can be traced to the fact that multilateral disbursements and repayments were being valued at current exchange rates, but previous debt stocks had not been revalued accordingly. Hence, past discrepancies in cross rates were being compounded. Consequently, with creditors providing their numbers, an upward revision was required in the multilateral debt stock for FY00. The net valuation impact amounted to US$ 101 million in FY01, with a downward adjustment in the case of Paris Club creditors, and an upward revision in multilateral and other bilateral debt stocks.

Table 8.5: Pakistan's External Debt and Liabilities

million US$

	FY98	FY99	FY00 AR	FY00 R	FY01 P
1. Public and publicly guaranteed debt	**27,088**	**26,904**	**27,654**	**29,189**	**30,007**
A. Medium and long term (> 1 year)	26,536	26,486	27,093	28,628	29,332
Paris club	10,264	11,873	12,428	12,428	12,090
Multilateral	12,186	10,599	10,767	12,292	13,527
Other bilateral	592	629	639	639	598
Eurobonds	628	608	610	620	620
Foreign currency bonds (NHA)	285	263	241	241	219
Military debt	1,006	1,004	958	958	825
Commercial loans/credits	1,225	1,160	1,100	1,100	1,103
Others	350	350	350	350	350
B. Short-Term (=1 year)	552	418	561	561	675
IDB	173	152	130	130	276
Others	379	266	431	431	399
2. Private non-guaranteed Debts (M&LT: >1 yr)	**3,127**	**3,435**	**2,842**	**2,842**	**2,450**
3. Central bank deposits	**450**	**700**	**700**	**700**	**700**
4. IMF	**1,415**	**1,825**	**1,550**	**1,550**	**1,529**
Total external debt (1 thru 4)	**32,080**	**32,864**	**32,746**	**34,281**	**34,686**
5. Foreign exchange liabilities	**1,760**	**3,736**	**3,942**	**3,942**	**3,746**
Foreign currency accounts	1,507	1,719	1,733	1,733	1,499
FCAs prior to freeze			**Frozen**		
FE-45	1,507	1,380	1,072	1,072	774
FE-25 accounts [1]	0	67	361	361	399
FE-13/For FY01: FE-25 CRR w/SBP	0	67	361	361	399
FE-31 deposits (incremental)	0	272	300	300	326
Special US Dollar bonds	0	1,164	1,297	1,297	1,376
National debt retirement program	0	196	156	156	150
Others liabilities	253	657	756	756	721
FEBCs					
FCBCs			**Frozen**		
DBCs					
Total external liabilities (1 to 5)	**33,840**	**36,600**	**36,688**	**38,223**	**38,432**
External liabilities payable in Rupees	**8,500**	**3,391**	**1,720**	**1,720**	**1,243**
Frozen FCAs	8,172	3,196	1,572	1,572	1,153
FEBC	193	129	109	109	65
FCBC	131	63	36	36	22
DBC	4	3	3	3	3
[1] FE-25 accounts (outside SBP)	0	550	616	616	1,144

AR *Annual report*; R revised; P provisional.

Source: State Bank of Pakistan

As far as a comparison with revised FY00 numbers is concerned, **Table 8.7** is illustrative. As can be seen, gross disbursements amounted to almost US$ 1.5 billion. These inflows are detailed in the following points:

?? Compared to FY00, Paris Club disbursements fell by US$ 361 million.[7] This was largely on account of the absence of inflows under the Commodity Credit Corporation (a US wheat import facility), and the Australian Wheat Board (AWB). With a bumper crop at home, there was no need to import this commodity.[8]

?? With the resumption of IFI assistance following Pakistan's successful negotiations for the SBA, the following inflows have been realized:

?? US$ 203.0 million from the Asian Development Bank (ADB) under the Energy Sector Restructuring Program (ESRP). Signed on December 12, 2000, the ESRP aims to improve pricing and cost-recovery in the energy sector. More specifically, this seeks to improve operational efficiencies, enhance competition, financially restructure the public utilities and strengthen market regulation.

?? Another US$ 50.0 million from ADB for the newly launched micro-credit Khushali Bank.

?? US$ 30.0 million under ADB's SME Trade Enhancement Facility. Approved in December 2000, the facility provides exporters with foreign currency financing for their import requirements

?? US$ 50.0 million under the Trade Export Promotion and Industry Program Loan of the ADB. Approved on March 31, 1999, the facility aims to support the private sector exports by focusing on trade liberalization, financing, facilitation for trade and export, and the privatization of manufacturing units.

?? US$ 344.0 million from the World Bank (specifically IDA). This loan matures in 35 years, has a 10-year grace period and aims to support structural reforms in Pakistan. It focuses on governance, economic growth and the delivery of social services.

Table 8.6: Selected External Debt/Liabilities Indicators [1]

	Total debt (TD) to				Total liabilities (TL) to			
	GDP	EE	FEE	RES/TD	GDP	EE	FEE	RES/TL
FY95	48.1	378.4	237.3	9.3	60.9	478.5	300.0	7.4
FY96	48.2	366.3	237.4	6.8	62.9	478.2	309.9	5.2
FY97	50.3	387.3	242.6	3.9	68.0	523.3	327.7	2.9
FY98	51.7	380.4	240.0	2.9	54.6	401.2	253.2	2.7
FY99	56.1	436.6	292.3	5.3	62.5	486.2	325.5	4.7
FY00	55.8	418.6	268.1	3.9	62.2	467.7	299.0	3.5
FY01	58.4	388.6	242.1	6.0	64.7	430.6	268.2	5.4

[1] Provisional numbers

Note: FEE is the sum of earnings from goods, services, and income (credit entry from Item A: BOP -IMF/92) and private transfer (credit entry from Item B.7:BOP-IMF/92).

Abbreviations

TD: Total Debt; TL: Total Liabilities; RES: Foreign Exch. Reserves

EE: Export Earnings; FEE: Foreign Exchange Earnings

Table 8.7: Sources of Growth in Public/Publicly Guaranteed Debt

millions US$

	Paris club	Multilateral	Other bilateral	Total
FY99 opening stocks	**11,873**	**10,599**	**629**	**23,101**
+ Disbursements	566	733	4	1,303
+ Interest rescheduled	297	0	26	323
- Repayments	307	565	21	893
FY00^{AR} ending stocks	**12,428**	**10,767**	**639**	**23,834**
+ Valuation adjustment	0	1,525	0	1,525
FY00^{R} ending stocks	**12,428**	**12,292**	**639**	**25,359**
FY00 opening stocks	**12,428**	**12,292**	**639**	**25,359**
+ Disbursements	205	1,240	19	1,463
+ Interest rescheduled	253	0	13	266
+ Valuation adjustment	(580)	578	104	101
- Repayments	216	582	176	974
FY01 ending stocks	**12,090**	**13,527**	**598**	**26,215**

^{AR} Annual Report; ^{R} Revised

In terms of explaining the remaining categories of external debt, the following points are instructive:

[7] This does not include the amounts rescheduled.

[8] The Commodity Credit Corporation (CCC) loan is for the financing of wheat imports from the US. It is extended against a promissory note, and guarantees a portion of the payments from importers (in Pakistan) to exporters (in the US).

?? Commercial Loans and Credits depict a net increase of US$ 3.0 million in FY01. More specifically, inflows from Shamil Bank (in June 2001) amounted to US$ 200 million, while US$ 193 million oil import financing from NBP and Citibank was also realized. These inflows were offset by hard currency payments on account of PTMA (US$ 297 million), and normal repayments of commercial loans and credit maturing during FY01 (US$ 146 million).

?? Medium & Long-term (others): The US$ 350 million stock represents amounts placed by the Bank of China. The deposits, first realized in FY97, had an original maturity of two years with full repayment at maturity, but have been rolled over indefinitely. This deposit is made up of two separate placements. The first, worth US$ 200 million is priced at 8.87 percent payable half-yearly, while the second, worth US$ 150 million, carries an interest rate of 8.32 percent also payable half-yearly.

?? IDB: US$ 147 million for import of oil and fertilizer.

?? ST Others: The Bank of China placed another US$ 150 million deposit in FY98; with an original maturity of one-year, the placement is priced at 8.08 percent.

?? Central Bank Deposits: This category is made up of three placements; two from the United Arab Emirates (UAE) and one from Kuwait. The UAE deposits were originally placed in FY97 and FY98, to be repaid in full at the original date of maturity, but have been rolled-over indefinitely. Interest payments are to be made on a quarterly basis. The deposit from Kuwait Monetary Authority had also been originally placed for two year in August 1998 but has been rolled-over for two year.

?? Private loans and credits have seen fresh inflows in fertilizer, power and the cement sector. These loans were contracted in FY97, prior to Pakistan's nuclear tests.

8.4 External Liabilities

FE-25 accounts

On March 31, 2001 (through BSD Circular 18), the option of placing FE-25 deposits with SBP was withdrawn. Commercial banks and NBFIs are now allowed to invest these deposits either in Pakistan or abroad. Although these financial institutions are to maintain 25 percent as cash and statutory reserve requirements, they are free to remunerate deposits in line with international interest rates. However, mobilizing institutions have been advised to ensure that these deposits are not invested in junk bonds or other high-risk instruments.

Following this decision, with the on-going maturity of these placements with SBP, this liability has been removed from Pakistan's external liabilities. However, since these deposits do represent a foreign exchange liability for mobilizing banks, they are being shown as a memorandum item in the lead table (see **Table 8.5**).

<u>Special US Dollar Bonds</u>

After the freeze of FCAs, the Government of Pakistan launched the US Dollar Bond scheme in July 1998. This scheme offered Dollar denominated instruments in three tenures of 3, 5 and 7 years, with interest payable half yearly at LIBOR + 1, 1.5 and 2 percent, respectively. These Bonds could be purchased against frozen FCAs, FCBC, DBCs, or by surrendering hard currency. As of end-June 2001 (see **Table 8.5)**, the outstanding stock amounted to US$ 1,376 million, of which 71.0 percent is in three-year, 12.9 percent in five-year, and 16.1 percent in seven-year instruments. As shown in **Table 8.8**, the bulk of US Dollar Bonds have been purchased from frozen FCAs.

Given the maturity profile of the Special US Dollar Bond, the bulk of maturities have started in August 2001, and will continue till the end of the current calendar year. In order to ease pressures on reserves and the interbank market, other than encashment in hard currency, the Government of Pakistan has offered the following incentives:

Table 8.8: Outstanding Balances of Special US$ Bonds (Cumulative)

million US$

	Gross sales			Encashment	Total
	Conversion from FCAs	Fresh	Total		
FY99	1,403	19	**1,422**	258	**1,164**
FY00	1,870	35	**1,904**	608	**1,297**
FY01	1,960	70	**2,030**	654	**1,376**

?? If the Bonds are redeemed in Rupees, the holder will be paid a Rupee redemption bonus of 5 percent of the face value of the bond. And,

?? The face value of the bond can be re-invested for a further 3-years (from the date of redemption) at LIBOR + 2 percent.

The National Debt Retirement Program [9]

The National Debt Retirement Program (NDRP) was launched on February 27, 1997 to solicit funds from non-resident Pakistanis (NRPs) towards retiring the country's external debt. Resident Pakistanis were also allowed to participate in the scheme using their foreign currency accounts, FEBCs, FCBCs, traveler cheques, remittance from abroad or by surrendering hard currency.[10] Deposits in three currencies (US Dollar, Pound Sterling, and the German Deutsche Mark) could be placed in the following:

?? An outright donation with no payback (referred to as NDRP I).

?? *Qarz-e-Hasna* deposits for a minimum period of two years; no interest payments but principal repayments could be taken in Rupees or hard currency (NDRP II).

?? A profit bearing deposit for a minimum period of two years (NDRP III).[11] The interest payable is indicated in **Table 8.9**.

To ensure the scheme's success, the following incentives were provided to mobilizing institutions: (1) Full *zakat* and tax exemption, (2) the Authorized Dealers (ADs) were instructed to handle all incoming remittances free of charge, and (3) ADs were allowed to purchase forward cover against these deposits at the then existing rate (5.5 percent for US Dollars), which would be applicable for the entire length of the deposit. Although FCAs were frozen in May 1998, SBP through two

Table 8.9: Deposits under NDRP - FY01

in million

	Currency-wise collection			**Total**	**LCY**
	US$	**£**	**DM**	**US$**	**collection**
Donations	27.9	0.1	0.0	28.0	824.0
Qarz-e-Hasna	1.5	0.0	0.0	1.6	96.4
PBD	134.4	8.9	4.2	148.8	305.8
2-Year	2.0	0.2	0.2	2.3	-
3-Year	2.4	0.2	0.6	3.0	-
4-Year	0.7	0.1	-	0.9	-
5-Year	129.3	8.4	3.4	142.6	304.8
Total	**163.8**	**9.0**	**4.2**	**178.3**	**1,226.2**

PBD: Profit bearing deposits; LCY: Local currency (Rs)

[9] Given the emphasis on transparency, this special subsection covers the details available on the NDRP and the utilization of the funds generated.
[10] For details, please see FE Circular 2 of February 24, 1997.
[11] For NDRP III, premature encashment is not allowed in hard currency, but can be withdrawn before maturity in Rupees.

separate circulars clarified that the restrictions on hard currency withdrawals did not apply to NDRP and that they would, and are still being, serviced in hard currency.[12]

Table 8.9 shows the total stock from NDRP I, II, & III as of end-June 2001. The majority of these donations, Qarz-e-Hasna, and profit bearing deposits were made in the first year of the scheme. Subsequent years have seen minor inflows. As can be seen from the table, the largest inflows have been in the profit bearing deposits.

As far as the usage of NDRP funds is concerned, the equivalent Rupees generated under NDRP I & II are credited to the government account with SBP. The foreign exchange component, against which these Rupees are generated, form part of the central bank's foreign exchange reserves. The federal government has used these Rupees to retire domestic debt of about Rs 1.7 billion, which carried a 17.3 percent rate of interest per annum. Inflows from NDRP III form part of SBP's foreign reserves, while the generated Rupees are credited to the mobilizing institution. For collections in Rupees, the amount collected by commercial banks is surrendered to the relevant SBP local office, which credits the government account on receipt.

Other liabilities

These comprise foreign currency swaps conducted with moneychangers and commercial banks, which witnessed a net contraction of US$ 35 million in FY01. This was done to meet the NFA target of end-June under the SBA. With an overall limit imposed on the stock figure of such swaps, transactions amounting to US$ 158 million with commercial banks were closed out, while new swaps of US$ 126 million were carried out during June 2001.

External liabilities payable in Rupees

After the freeze of FCAs, the bulk of these frozen accounts (along with FCBCs, FEBCs and DBCs) were converted into Rupees during FY99 and FY00 (see **Table 8.5**). As expected, the momentum of Rupee conversions has slowed down this year.

8.5 Debt Servicing

After the international sanctions imposed in mid-1998, Pakistan's inability to service external debt has led to two consecutive reschedulings by Paris Club members and one from the *quasi* London Club. After the end of first consolidation period in December 2000, it was clear that Pakistan was unable to build its repayment capacity. Consequently, another round of rescheduling was sought from sovereign and commercial creditors. Following the finalization of the SBA in November 2000, in January 2001, the Paris Club, other bilateral and commercial creditors agreed to restructure debts worth about US$ 1.8 billion.[13]

Despite this rescheduling, Pakistan has made debt payments from its own resources amounting to US$ 3.2 billion and US$ 3.7 billion in FY00 and FY01, respectively (see **Table 8.10**).[14] If servicing of external liabilities is included, the total payments made out of its own resources were US$ 3.8 billion in FY00 and US$ 5.1 billion in FY01. It may be seen that the relief from debt rescheduling and rollover was only US$ 2.8 billion in FY01, compared to US$ 4.0 billion in FY00. Such large payments and accumulation of net reserves to the level of US$ 1.7 billion by end-June 2001, should dispel the popular view that Pakistan has to rely mainly on rescheduling from sovereign and

[12] FE Circular 17 of June 6, 1998 and FE Circular 24 of June 17, 1998.

[13] The debts rescheduled included arrears as on November 30, 2000, and servicing falling due between December 1, 2000, and September 30, 2001 (the consolidation period).

[14] It should be noted that this table is not comparable to **Table 8.11,** which was published in the previous *Annual Report* (see **Table VII.10**). For reconciliation, see **Table 8.12**.

Table 8.10: Pakistan's External Debt and Liabilities Servicing (New Format)
million US$

	FY00		FY01 [1]	
	Actual paid	Rescheduled/ Rollover	Actual paid	Rescheduled/ Rollover
1. Public and Publicly Guaranteed Debt	**1,974**	**2,709**	**2,649**	**1,619**
A. Medium and long term (> 1 year)	1,790	2,559	2,279	1,469
Paris club	423	1,149	432	934
Principal	308	851	221	681
Interest	115	298	211	253
Multilateral	938	0	916	0
Principal	556	0	572	0
Interest	382	0	344	0
Other bilateral	40	132	221	68
Principal	29	104	180	55
Interest	11	28	41	13
Eurobonds	62	610	62	0
Principal	0	610	0	0
Interest	62	0	62	0
Foreign currency loan bonds (NHA)	39	0	39	0
Principal	22	0	22	0
Interest	17	0	17	0
Military debt	49	166	56	117
Principal	49	130	56	92
Interest	0	36	0	25
Commercial loans/credits[2]	211	152	522	0
Principal	59	152	445	0
Interest	152	0	77	0
Others	28	350	31	350
Principal	0	350	0	350
Interest	28	0	31	0
B. Short-term (= 1 year)	184	150	370	150
IDB	148	0	192	0
Principal	141	0	184	0
Interest	7	0	8	0
Others	36	150	178	150
Principal	10	150	147	150
Interest	26	0	31	0
2. Private non-guaranteed Debts	**838**	**0**	**696**	**0**
A. Medium and long term (> 1 year)	838	0	696	0
Private loans/credits	838	0	696	0
Principal	590	0	500	0
Interest	248	0	196	0
B. Short-term (= 1 year)	0	0	0	0
3. Central bank deposits	**43**	**300**	**46**	**400**
Principal	0	300	0	400
Interest	43	0	46	0
4. IMF	**340**	**0**	**299**	**0**
Repurchases / principal	280	0	239	0
Charges / interest	60	0	60	0
Total debt servicing (1 thru 4)	**3,195**	**3,009**	**3,690**	**2,019**
5. Special US$ bonds	**86**	**0**	**104**	**0**
Principal	0	0	0	0
Interest	86	0	104	0
6. Swaps	**0**	**0**	**866**	**0**
7. FCAs	**392**	**1,072**	**365**	**776**
FE-45 (Institutional)	383	1,072	347	776
Principal	308	1,072	295	776
Interest	75	0	52	0
FE-13 (interest)	9	0	18	0
8. FEBC/FCBC/DBC	**83**	**0**	**76**	**0**
Principal	48	0	39	0
Interest	35	0	37	0
Total	**3,756**	**4,081**	**5,101**	**2,795**

[1] Provisional; [2] Including PTMA payments of principal (US$ 193.3 million) & interest (US$ 46.9 million) during FY01.

commercial creditors to manage debt servicing. As a matter of fact, rescheduling only accounted for 35 percent of total debt service obligations.

Table 8.11: External Debt Servici ng (Actual Paid)
million US$

	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 [R]	942	508	1,450	1,070	467	1,537	2,012	975	2,987
FY01[P]	1,029	596	1,625	1,368	341	1,709	2,397	937	3,334

[R] Revised; [P] Provisional.

Table 8.12: Reconciliation with Previous Debt Servicing Numbers and Revised Format
Million US$

Previous format	FY00			FY01		
	Principal	Interest	Total	Principal	Interest	Total
Long-Term (Public and Publicly Guaranteed)	**942**	**508**	**1,450**	**1,029**	**596**	**1,625**
-Paris club	308	115	423	221	211	432
-Multilateral	556	382	938	572	344	916
-Other Bilateral	29	11	40	180	41	221
-Military Debt[1]	49	0	49	56	0	56
Short/Medium-Term	**1,070**	**467**	**1,537**	**1,368**	**341**	**1,709**
Commercial Loans/Credits	59	152	211	445	77	522
Private Loans/Credits	590	248	838	500	196	696
IMF	280	60	340	239	60	299
IDB	141	7	148	184	8	192
External debt servicing (previous Annual Reports)	**2,012**	**975**	**2,987**	**2,397**	**937**	**3,334**
New categories (not included earlier)	**32**	**176**	**208**	**169**	**187**	**356**
Eurobonds (added under PPG-M&LT)	0	62	62	0	62	62
NHA Bonds (added under PPG-M&LT)	22	17	39	22	17	39
M&LT (Others)	0	28	28	0	31	31
ST (Others)	10	26	36	147	31	178
Central Banks Deposits	0	43	43	0	46	46
External debt-servicing revised format (Table 8.10)	**2,044**	**1,151**	**3,195**	**2,566**	**1,124**	**3,690**

PPG: Public and Publicly Guaranteed Debt, M&LT: Medium and Long-term Debt.
[1] Tentative