Chapter 9

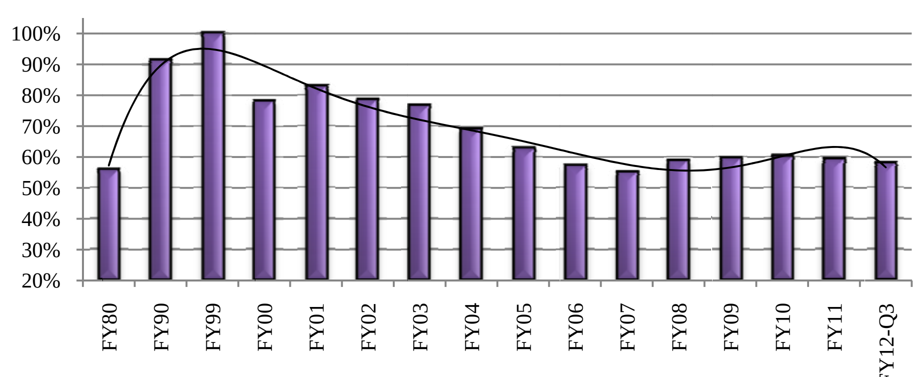
Public Debt

9.1 Introduction

Developing countries hinge in a delicate balance; they need to borrow in order to facilitate their development process - on the other hand the borrowing should be allocated efficiently in view of their repayment ability. Debt may well act as a catalyst in the course of growth of an economy, but only if it is undertaken to facilitate a very well thought out road map devised with due diligence. Such measures can also lead to strengthening a country's capacity of repayment. Unsustainable levels of debt can plague economic growth by lowering the actual developmental expenditure due to heavy debt servicing requirement. This intricate scenario calls for a comprehensive, dynamic and rule based policy which ensures the right choices among several options, addresses financial constraints and ensures intergenerational welfare impact.

Pakistan's debt dynamics have undergone substantial changes since fiscal year 2007. A myriad of domestic issues and the international recession and credit crises have impacted the country's debt position. Higher interest payments, large subsidies specially food and energy, growing security spending needs, narrow tax base and rising international commodity prices have resulted in large twin account (i.e. fiscal and current account) deficits. The financing of the fiscal deficit is a growing challenge in the wake of the shrinking net foreign assets of the banking system in Pakistan owing to the current account deficit; the resultant liquidity crunch is exerting pressure on domestic interest rates. Lower FDI and other non-debt creating flows due to energy shortages and security concerns have contributed towards negative balance of payment and drawdown on official foreign currency reserves of the country. Total Liquid Foreign Exchange Reserves were $16.49 billion by end-April 2012, compared to $18.24 billion as of end June 2011.

Fig-9.1: Public Debt (as percent of GDP)



9.2 Public Debt

Total public debt is a measure of government indebtedness. It includes all government and government guaranteed obligations denominated in rupee as well as foreign currency. It is an important means of bridging government financing gaps. However, excessive reliance on public debt and inappropriate public debt management raise macroeconomic risks, impede economic growth, and hinder economic development. Domestic and external debt should be treated separately. Domestic debt is a charge on the budget and must be serviced through government revenues and/or additional borrowings whereas external debt (both public and private) in addition to government revenues is also a charge on the balance of payment and must be serviced from foreign exchange earnings, reserve drawdown, and additional borrowings.

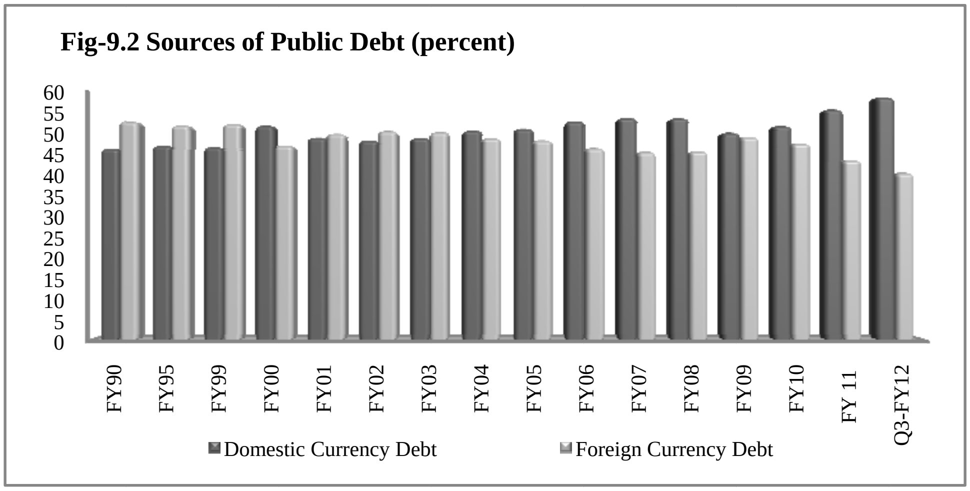
As at end of March 2012, public debt stood at Rs. 12,024 billion registering an increase of Rs. 1,315 billion or 12.3 percent as compared to fiscal year 2011. The increased amount includes Rs. 391 billion consolidated by the government into public debt against outstanding previous years subsidies related to the food and energy sectors. Public debt as a percent of GDP stood at 58.2 percent by end-March 2012 compared to 55.5 percent of GDP during the same period last year.

Table-9.1 Public Debt

	1990	1995	2000	2005	2008	2009	2010	2011	2012*
	(In billion Rs.)								
Domestic Currency Debt	374	790	1,576	2,178	3,275	3,859	4,654	6,015	7,206
Foreign Currency Debt	428	873	1,442	1,913	2,780	3,736	4,284	4,694	4,818
Total Public Debt	801	1,662	3,018	4,091	6,055	7,595	8,938	10,709	12,024
	(In percent of GDP)								
Rupee Debt	42.8	42.3	41.2	33.5	32.0	30.3	31.4	33.4	34.9
Foreign Currency Debt	48.9	46.8	37.7	29.4	27.1	29.4	28.9	26.0	23.3
Total Public Debt	91.7	89.1	78.9	62.9	59.1	59.7	60.4	59.4	58.2
	(In percent of Revenue)								
Rupee Debt	235	245	308	242	218	208	224	266	251
Foreign Currency Debt	269	270	281	213	185	202	206	208	168
Total Public Debt	505	515	589	455	404	410	430	474	419
	(In percent of Total Debt)								
Rupee Debt	46.6	47.5	52.2	53.2	54.1	50.8	52.1	56.2	59.9
Foreign Currency Debt	53.4	52.5	47.8	46.8	45.9	49.2	47.9	43.8	40.1
Memo:									
Foreign Currency Debt ($ Billion)	19.5	28.1	27.5	32.1	40.7	45.9	50.1	54.6	53.1
Exchange Rate (Rs./U.S.$, E.O.P)	21.9	31.1	52.5	59.7	68.3	81.4	85.5	86.0	90.7
GDP (in Rs. Billion)	874	1,866	3,826	6,500	10,243	12,724	14,804	18,033	20,654
Total Revenue (in Rs. Billion)	159	323	513	900	1,499	1,851	2,078	2,261	2,871

Source: State Bank of Pakistan, Budget Wing, Economic Adviser's Wing & Debt Policy Coordination Office
* End-March

Historically, public debt stock accounted for almost the same burden from domestic and external sources. However, government has increasingly focused on the domestic part over the last few years owing to non-availability of sufficient external financing i.e. domestic borrowings inched up in share from 46.6 percent in fiscal year 1990 to 59.9 percent at end March, 2012.



The public debt may be understated without reporting contingent liabilities. Contingent liabilities are not added to the overall debt of the country. However, contingent liabilities are possible obligations that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the government. In the case of Pakistan, these include, for instance, explicit and implicit guarantees issued to Public Sector Enterprises (PSEs) and unfunded losses of state owned entities. The Government of Pakistan issued new guarantees aggregating Rs. 146.6 billion or 0.71 percent of GDP. Total outstanding stock of government guarantees as of March 2012 stood at Rs. 487 billion.

Table-9.2 Guarantees Outstanding as of March 31, 2012 **(Rs. Billion)**

Outstanding Guarantees extended to PSEs	487
-Domestic Currency	256
-Foreign Currency	231
Memo:	
Foreign Currency (US$ Million)	2,544

Source: Debt Policy Coordination Office

9.2.1 Dynamics of Public Debt Burden

Borrowing domestically or externally is a normal, indeed, necessary part of economic activity. The economic rationale for debt creation is that borrowers can earn a higher economic return than the cost of invested funds and that these economic returns can then be translated into financial returns. Debt problems for governments arise if debt-servicing capacity does not keep pace with growth of debt. This may also be expressed as debt exceeding sustainable levels.

The level of debt depends on the debt servicing capacity of the economy i.e. export earnings and revenue generation. The debt burden can be expressed in terms of the stock ratio i.e. debt to GDP, external debt to GDP or flow ratios i.e. debt to revenue, external debt to foreign exchange earnings. It is common practice to measure the public debt burden as a percentage of GDP; however, it makes more sense to measure debt burden in terms of flow ratios because earning potential reflects more accurately on repayment capacity as GDP changes do not fully translate into revenues, particularly in case of Pakistan where the taxation systems are inelastic and the taxation machinery is weak.

Table-9.3 Dynamics of Public Debt Burden

	2007	2008	2009	2010	2011	2012*
Public Debt to GDP	60.1	59.1	59.7	60.4	59.4	58.2
Real Growth of Public Debt	2.3	8.3	5.2	4.3	1.1	2.4
Real Growth of Revenues	11.9	-0.6	2.9	0.3	-8.4	1.5**
Real Growth of Public Debt Burden	-9.7	8.9	2.3	4.0	9.5	0.9
Real Growth of GDP	6.8	3.7	1.7	3.8	2.4	3.7

Source: Budget Wing, SBP and Debt Policy Coordination Office
*End March, 2012
**Growth as compared to same period in 2011

If the primary balance (fiscal deficit before interest payments) is zero and the real growth in revenue is higher than the real growth in debt, the debt burden will ease. Pakistan saw a primary surplus in fiscal year 2004, however, since then it is running a primary deficit. In fiscal year 2009 the government was able to bring the deficit down to 0.1 percent of GDP from 2.5 percent in fiscal year 2008 as a result of fiscal consolidation and rationalization of expenditure. However since fiscal year 2010, owing to increased security expenditure, sustained food and energy subsidies and the great floods of 2010, the fiscal adjustment path was altered and the primary deficit reached 2.5 percent of GDP at the end of June 2011.

A similar pattern was witnessed in terms of real growth of revenues; from a high of 11.9 percent in fiscal year 2007 it declined to -8.4 percent in fiscal year 2011. On the other hand a gradual decline in real growth of debt has been witnessed since fiscal year 2008. However, the real growth of debt has been greater than the real growth of revenues; and, this complemented by the primary deficit resulted in increase of the debt burden. The public debt stood at 4.7 times government revenues at the end of fiscal year 2011. Ideally the debt to revenue ratio should be 3.5 or lower.

9.2.2 Servicing of Public Debt

Increases in the outstanding stock of total public debt have implications for the economy in the shape of a greater amount of resource allocation towards debt servicing in the future. In order to meet debt servicing obligations, an extra burden is placed on limited government resources and might have costs in the shape of foregone public investment or expenditure in other sectors of the economy.

Table-9.4 Public Debt Servicing

	2010-2011				2011-2012			
	Budgeted	Actual	Percent of Govt. Revenue	Percent of Current Expenditure	Budgeted	Actual*	Percent of Govt. Revenue	Percent of Current Expenditure
	(In billion Rs.)		%	%	(In billion Rs.)		%	%
Servicing of External Debt	76.8	68.4	3.0	2.4	76.3	45.9	2.6	2.1
Repayment of External Loans	174.4	154.2	6.8	5.3	243.2	94.5	5.4	4.4
Servicing of Domestic Debt	621.8	629.7	27.9	21.7	714.7	578.6	33.3	26.9
Servicing of Public Debt	872.9	852.2	37.7	29.4	1,034.2	719.0	41.3	33.4

Source: Debt Policy Coordination Office
* July-March, 2012

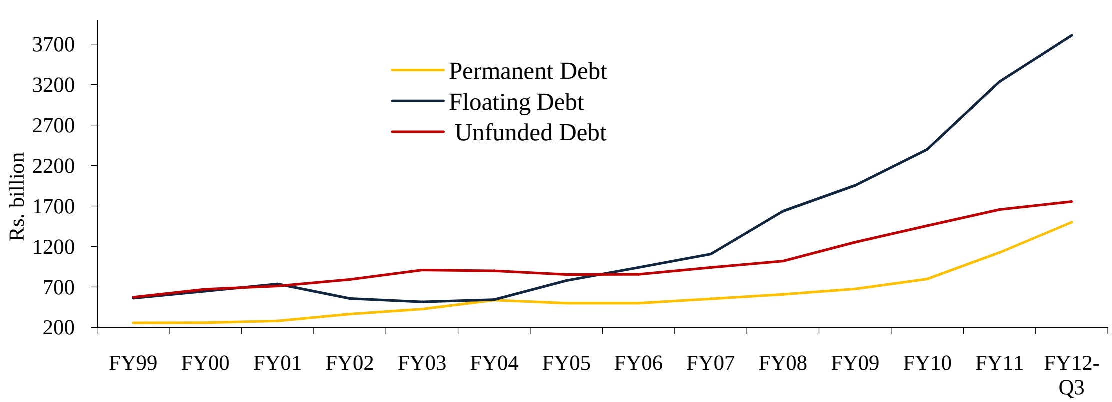
During the year 2010-11, servicing of public debt amounted to Rs. 852.2 billion as opposed to a budgeted amount of Rs. 872.9 billion (Table 9.4). The saving of Rs. 20.7 billion has mostly been due to stable dollar rupee parity; which reduced the amount used for interest and principal repayments of foreign loans in Rupee terms. Repayment of foreign loans stood at Rs. 154.2 billion as opposed to a target of Rs. 174.4 billion, while interest payments on foreign loans, which were budgeted at Rs. 76.8 billion, reached Rs 68.4 billion by end-June 2011. An amount of Rs. 629.7 billion was spent on account of servicing of domestic debt against the budgeted estimate of Rs. 621.8 billion. The increase in domestic debt servicing is partly the result of a tight monetary stance taken in order to arrest the monetary overhang caused by previous policies. As at the end of March 2012, servicing of the public debt stood at Rs. 719 billion against the budget amount of Rs. 1,034.2 billion.

9.3 Domestic Debt

Pakistan's domestic debt comprises permanent debt (medium and long-term), floating debt (short-term) and unfunded debt (made up of the various instruments available under the National Savings Scheme) having shares of 21.6 percent, 54.5 percent and 23.9 percent respectively in total domestic debt. Banks' preference of risk-free sovereign credit in view of mushrooming non-performing loans augured well for the government securities market and overwhelming participation was witnessed in the auctions of T-Bills, PIBs and Government Ijara Sukuk.

The composition of major components shaping the domestic debt portfolio has undergone a transformation from a high dominance of unfunded debt to an increasing dependence on floating component of the domestic debt. The unfunded category comprising about 44.6 percent of the aggregate domestic debt stock in fiscal year 2002 has declined to 23.9 percent by end March, 2012. Contrary to this, the share of floating debt to total domestic debt has reached 54.5 percent by end-March 2012 as compared with 31.4 percent in fiscal year 2002 indicating an over reliance on shorter duration instruments i.e. 54.5 percent of the total domestic debt has the duration of 0.31 years at end March 2012 which is fairly low owing to market appetite for shorter duration reflecting inflationary expectations and higher interest rates in the second half of the fiscal year 2012. Undue reliance on short-term sources of financing raises the rollover or refinancing risk for the government. Failure to issue new debt in order to mature a large amount of outstanding short term debt may trigger a liquidity or debt rollover crisis. The increase in frequency of such operations (due to their short term nature) coupled with any adverse rise in interest rates may leave the government vulnerable to the high cost of debt. The trends in domestic debt are discussed in the following graph:

Fig-9.3 Trends in Permanent, Floating & Unfunded Debt



9.3.1 Outstanding Domestic Debt

The total domestic debt was positioned at Rs. 7,206.9 billion at end-March 2012, representing an increase of Rs. 1,190.5 billion in the first nine months of the current fiscal year. This increase stems from net issuance of market debt namely Treasury bills (Rs. 576.4 billion) and PIBs (Rs. 307.5 billion). In relation to GDP the domestic debt stood at 34.9 percent which is higher than end-June 2011 level at 33.4 percent. The domestic debt grew by 19.8 percent in first nine months of current fiscal year. The focus on deficit financing through internal sources owing to lower external receipts has been the major cause.

Table-9.5 Trends in Domestic Debt

	2002	2003	2004	2005	2008	2009	2010	2011	2012*
	(In billions Rs.)								
Permanent Debt	424.8	468.8	570.0	526.2	616.8	685.9	797.7	1125.3	1554.6
Floating Debt	557.8	516.3	542.9	778.2	1637.4	1903.5	2398.7	3235.4	3926.9
Unfunded Debt	792.1	909.5	899.2	873.2	1020.4	1269.2	1457.5	1655.8	1725.4
Total	**1774.7**	**1894.5**	**2012.2**	**2177.6**	**3274.5**	**3858.7**	**4653.9**	**6016.4**	**7206.9**
	(In percent of GDP)								
Permanent Debt	9.7	9.7	10.1	8.1	6.0	5.4	5.4	6.2	7.5
Floating Debt	12.7	10.7	9.6	12.0	16.0	15.0	16.2	17.9	19.0
Unfunded Debt	18.0	18.9	15.9	13.4	10.0	10.0	9.8	9.2	8.4
Total	**40.3**	**39.3**	**35.7**	**33.5**	**32.0**	**30.3**	**31.4**	**33.4**	**34.9**
	(In percent of Total Debt)								
Permanent Debt	23.9	24.7	28.3	24.2	18.8	17.8	17.1	18.7	21.6
Floating Debt	31.4	27.3	27.0	35.7	50.0	49.3	51.5	53.8	54.5
Unfunded Debt	44.6	48.0	44.7	40.1	31.2	32.9	31.3	27.5	23.9
Memo:									
GDP (in billion of Rs.)	**4402**	**4823**	**5641**	**6500**	**10243**	**12724**	**14804**	**18033**	**20654**

Source: Budget Wing, Ministry of Finance
* End-March

The following section highlights the developments in the various components of domestic debt during first nine months of the outgoing fiscal year.

I. Permanent Debt

Permanent Debt mainly consists of medium to long term instruments including Pakistan Investment Bonds (PIBs), Government Ijara Sukuk bond, Prize Bond etc. PIBs are non-callable instruments, with semi-annual coupon payment. PIBs are issued in tenors of 3, 5, 7, 10, 15, 20 and 30 -years maturity. The 3, 5 and 10 years tenor are most liquid while longer maturities are thinly traded. Government Ijarah Sukuks are medium term Shariah compliant bonds currently issued in 3 years tenor. The purpose of issuance was to raise money from Islamic banking which has grown substantially in Pakistan in recent years.

The total share of permanent debt in the government’s domestic debt stood at Rs. 1,554.6 billion as at end-March 2012 compared to Rs. 1,125.3 billion in 2011 registering an increase of Rs. 429.3 billion. The share of permanent debt in total domestic debt inched up from 18.7 percent in 2011 to 21.6 percent at end March 2012. Sizeable receipts from Government Ijara Sukuk bond and Pakistan Investment Bonds contributed to this expansion. Government mopped up net of retirement Rs. 80.5 billion through successful auctions of Ijara Sukuk bond and Rs. 307.5 billion through Pakistan Investment Bonds during July-March, 2012.

II. Floating Debt

Floating debt consists of short term domestic borrowing instruments such as Treasury Bills and State Bank borrowing through the purchase of Market Related Treasury Bills (MRTBs). Treasury Bills are zero coupon or discounted instruments issued in tenors of 3 months (introduced in 1997), 6 months (introduced in 1990) and 12 months (introduced in 1997). The share of 3 months, 6 months and 12 months maturity in total T-Bills portfolio is 9 percent, 20 percent and 71 percent respectively as at end-Mar 2012. In order to raise short term liquidity, the government borrows from the domestic banks through auction in the form of Treasury Bills. The auction of Treasury bills is arranged by the State Bank of Pakistan (SBP) twice a month. Treasury Bills having maturity of 6 months are also created by SBP on average rate of interest of previous auction on need basis.

Floating Debt share in overall public debt and domestic debt stood at 32.7 percent and 54.5 percent respectively as at end-March 2012. During July-March, 2012, the floating debt grew by Rs. 691.5 billion or 21.4 percent. Around 58 percent of the total increase in government domestic debt stock was contributed by floating debt instruments during July-March, 2012.

Much of the proceeds accrued through Market Treasury Bills (MTBs) as Rs. 576.4 billion was added to the stock of June 30, 2011. On the other hand, government borrowed Rs. 167.3 billion by issuing Market Related Treasury Bills (MRTBs) to SBP.

III. Unfunded Debt

Unfunded Debt made up of the various instruments available under the National Savings Scheme (NSS). A number of different schemes are offered under NSS in the investment horizon of 3 years to 10 years. The total share of unfunded debt in the government's domestic debt stood at Rs. 1,725.4 billion or 23.9 percent on end-March 2012. The stock of unfunded debt increased by Rs. 69.6 billion or 4.2 percent compared with fiscal year 2011. Net receipts in Regular Income Scheme were up by 17.2 percent in July-March, 2012, as the stock increased from Rs. 182.6 billion in June, 2011 to Rs. 214 billion at end-March 2011. Special NSS Schemes including Bahbood Savings Certificates and Pensioner's Benefits Accounts registered a combined nominal increase of Rs. 49.3 billion compared to Rs. 59 billion during July-March 2011. Rates of return on NSS instruments were revised downward in October 2011 and January 2012 in response to the decrease in the benchmark discount rate.

9.3.2 Duration of Domestic Debt

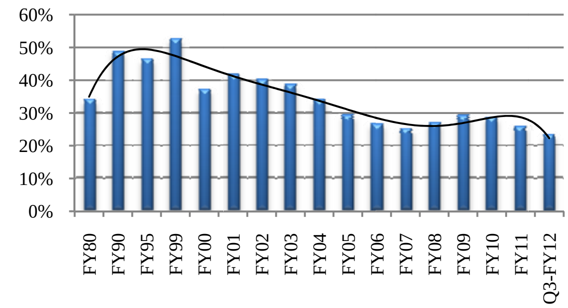
As at end March 2012, duration of domestic debt stood at 2 years excluding SBP Market Related Treasury Bills (MRTBs). Duration including MRTBs stood at 1.61 years. This estimate of duration may be a little inconsistent owing to the non-availability of actual maturity profile of NSS and manual operations of Central Directorate of National Savings (CDNS). A behavioral analysis was undertaken to estimate the maturity of NSS instruments. Generally, across the globe, governments desire to incur the lowest annual debt servicing cost while ignoring portfolio risks. It is important for the government to take necessary measures to lengthen the maturity profile of domestic debt. Though this may result in additional debt servicing cost in the short term, it would certainly help in reducing the associated liquidity and refinancing risks in the domestic debt portfolio.

9.4 External Debt and Liabilities

Pakistan's external debt and liabilities (EDL) include all foreign currency debt contracted by the public and private sector, as well as foreign exchange liabilities of the State Bank. EDL has been dominated by Public and Publically Guaranteed Debt having share of 76 percent owing to current account deficit which is financed through loans from multilateral and bilateral donors. Debt obligations of the private sector are fairly limited and have been a minor proportion of EDL (6 percent). Borrowing from IMF contributed 13 percent in EDL Stock which was intended for Balance of Payment (BoP) support and is reflected in foreign currency reserves of the country. The explicit concessional terms of loans (low cost and long tenors) contracted with international financial institutions or donor countries have concealed the inherent capital loss associated with foreign currency debt to some extent. However, the analysis of currency movement of last 20 years reveals that cost of foreign currency borrowing adjusted for exchange rates movement has been 1.5 percent lower than the average domestic interest rates.

Pakistan External Debt and Liabilities (EDL) stock was recorded at $60.3 billion as of March 2012. During July-March 2012, $179 million was added to the EDL stock. As a percentage of GDP in dollar terms, the EDL was down by 200 basis points in July-March, 2012 compared to fiscal year 2011 and approximated to 26.5 percent. Since fiscal year 2010, EDL has increased in absolute terms, but decreased in relation to GDP However, focusing on the absolute increase in the outstanding stock of EDL can be misleading for two main reasons. Firstly, the outstanding stock of debt must be analyzed in relation to the size of the economy and its repayment capacity (in terms of GDP and other macroeconomic indicators). Secondly, the absolute change in EDL neglects classification between an actual increase in stock and increases caused by fluctuations in international exchange rates.

Fig-9.4 External Public Debt (as percent of GDP)



The composition and structure of Pakistan External Debt as on March 31, 2012 is depicted through following graphs:

Fig-9.5: Structure of EDL - End March, 2012

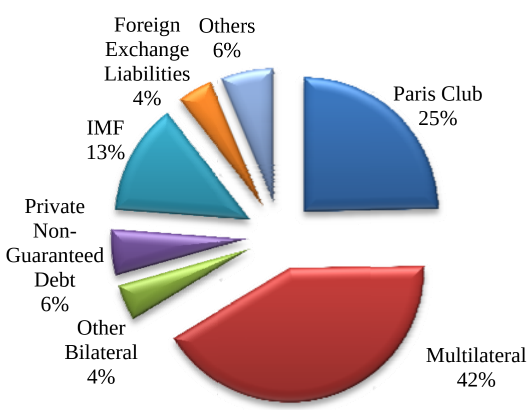
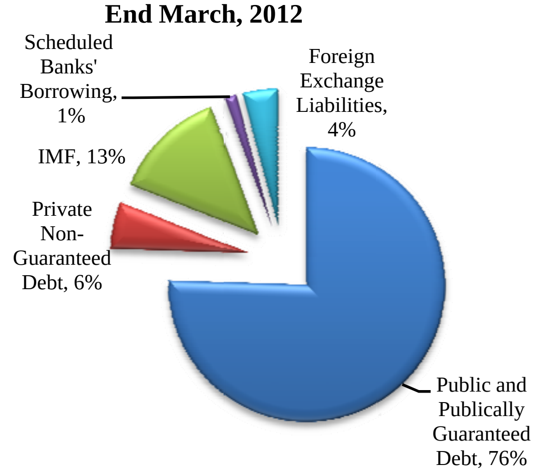


Fig-9.6 : Components of EDL - End March, 2012



The following section highlights the developments in the various components of EDL during the first nine months of the outgoing fiscal year.

I. Public and Publicly Guaranteed Debt (PPG)

At the end-March 2012, Public and publicly guaranteed debt accounted for the largest share of 76 percent in EDL. Public and publicly guaranteed debt is dominated by the loans from bilateral and multilateral donors. Multilateral debt, which is the largest component of Pakistan's EDL witnessed a decrease of $730 million during the period under review. The project-based nature of loans contracted under this category hinges on Pakistan's ability to instill project efficiency. Debt from bilateral sources includes loan contracted with Paris Club countries and other countries outside the Paris Club. It is second largest component of Pakistan's EDL. It witnessed an increase of $137 million during the period under review.

II. IMF Debt

At the end-March 2012, debt owed to IMF aggregated up to $8.1 billion. Payment amounting to $793 million has been made in the 3rd and 4th quarter of fiscal year 2012.

III. Private Non-Guaranteed Debt

The share of private non-guaranteed debt in total EDL stood at 6 percent at end-March 2012. The stock of private non-guaranteed debt decreased by $147 million; from $3.48 billion in June 2011 to $3.34 billion by end-March 2012.

Table-9.6: Pakistan External Debt and Liabilities

	2004	2005	2006	2007	2008	2009	2010	2011	2012-Q3
1. Public and Publically Guaranteed debt	29.9	31.1	32.9	35.3	40.6	42.6	43.1	46.7	46.4
A. Medium and long term(>1 year)	29.9	30.8	32.7	35.3	39.5	41.1	42.3	46.1	45.8
B. Short Term (<1 year)	0.0	0.3	0.2	0.0	1.1	1.5	0.8	0.6	0.6
2. Private Non-guaranteed Debt (>1 yr)	1.7	1.3	1.6	2.3	2.9	3.3	3.4	3.5	3.3
3. IMF	1.8	1.6	1.5	1.4	1.3	5.1	8.1	8.9	8.1
Total External Debt (1 through 3)	**33.4**	**34.0**	**36.0**	**39.0**	**44.9**	**51.1**	**54.6**	**59.1**	**57.8**
4. Foreign Exchange Liabilities	2.0	1.8	1.6	1.5	1.3	1.3	1.3	1.0	2.5
Total External Debt & Liabilities (1 to 4)	**35.3**	**35.8**	**37.6**	**40.5**	**46.2**	**52.3**	**55.9**	**60.1**	**60.3**
(of which) Public Debt	31.3	32.1	33.9	36.5	40.9	46.3	49.5	54.6	53.1
	(In percent of GDP)								
Total External Debt (1 through 3)	**34.1**	**31.1**	**28.2**	**27.3**	**27.4**	**31.5**	**30.9**	**28.1**	**25.4**
1. Public and Publically Guaranteed debt	30.6	28.4	25.8	24.7	24.8	26.3	24.5	22.1	20.1
A. Medium and long term(>1 year)	30.5	28.1	25.7	24.7	24.1	25.4	24.0	21.8	19.8
B. Short Term (<1 year)	0.0	0.2	0.1	0.0	0.7	0.9	0.4	0.3	0.2
2. Private Non-guaranteed Debt (>1 yr)	0.02	0.01	0.01	0.02	0.02	0.02	0.02	0.02	0.01
3. IMF	1.8	1.5	1.2	1.0	0.8	3.2	4.6	4.2	3.5
4. Foreign Exchange Liabilities	2.0	1.6	1.2	1.0	0.8	0.8	0.6	0.5	1.1
Total External Debt & Liabilities (1 to 4)	**36.1**	**32.7**	**29.5**	**28.3**	**28.2**	**32.3**	**31.5**	**28.5**	**26.5**
	Memo:								
GDP (in billion of Rs.)	5641	6500	7623	8673	10243	12724	14804	18033	20,654
Exchange Rate (Rs./U.S. dollar, Period Avg.)	57.6	59.4	59.9	60.6	62.5	78.5	83.8	85.6	90.8
Exchange Rate (Rs./US$, EOP)	57.9	59.7	60.2	60.6	68.3	81.4	85.5	86.0	90.7
GDP (in billions of U.S. dollars)	98.0	109.5	127.4	143.0	163.8	162.1	176.5	210.8	227.8

Source: State Bank of Pakistan, EAD and Debt Policy Coordination Office

9.4.1 Composition of Foreign Economic Assistance

The total amount of foreign economic assistance received in the first nine months of 2011-12 stood at $1,660 million. The composition of this assistance is as follows:

I. Commitments

The commitments of foreign economic assistance were $4,580 million during 2010-11, while during July-March 2012, total commitments amounted to $1,967 million. About 76 percent of total commitments during July-March 2012 were in the shape of project aid while the remaining comprised non-project aid. Out of total non-project aid, share of BOP/budgetary support was 78 percent.

II. Disbursements

During July-March 2010-11, disbursements of $1,660 million were for different purposes like Project Aid ($1,113 million), Programme-loans/Budgetary Support ($99 million) and relief ($448 million). Project aid accounted for 67 percent of the total disbursements.

9.4.2 External Debt Servicing

During fiscal year 2011, external debt servicing summed to US$ 4,799 million that is 14.3 percent lower than the previous year. A segregation of this aggregate number shows a payment of US$ 2,348 million in respect of maturing EDL stock where interest payments were US$ 963 million. US$ 1,488 million was rolled-over.

Table-9.7 Pakistan's Public External Debt Servicing

Years	Actual Amount Paid	Amount Rolled Over	Total
	(in million of US$)		
2006-07	2,326	1,300	3,626
2007-08	2,558	1,200	3,758
2008-09	3,986	1,600	5,586
2009-10	3,880	1,723	5,603
2010-11	3,311	1,488	4,799
2011-12*	2,325	1,243	3,567

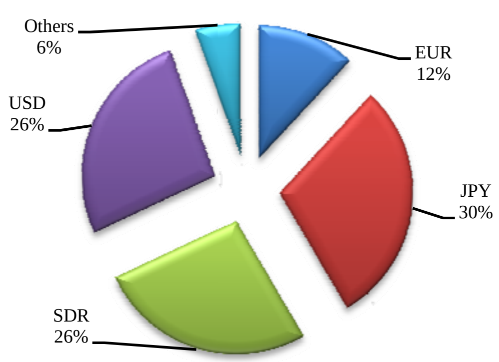
Source: State Bank of Pakistan
*July-March 2012

Servicing of external debt and liabilities during the first nine months of fiscal year 2012 amounted to $3,567million. Out of the total, $1,692 million was paid against principal while interest payments were $633 million. US$ 1,243 million was rolled-over. When compared to a stock of approximately US$ 60.1 billion at the end of fiscal year 2011, the relatively smaller amount of interest payments made during the first three quarters of fiscal year 2012 signal towards the concessional nature of most of the foreign loans contracted by Pakistan. Notwithstanding, with the IMF-SBA repayments over next two years, the servicing will increase.

9.4.3 Impact of Exchange Rate Fluctuations

Pakistan External Debt is contracted in multiple currencies, however, outstanding balance of these loans is converted into US$ for reporting purposes. As at end March 2012, 94 percent of total External Debt is contracted in 4 major currencies as depicted in the following graph:

Fig-9.7 Currency Wise External Debt Composition (as on March 2012)



Apart from net fresh disbursements, exchange rate fluctuations in US$ against these currencies can also result in change in External Debt Stock i.e. appreciation of US$ against other currencies will result in decrease in External Debt Stock or vice versa. The total translational gain on account of cross-currency movement against US$ amounted to $1,129 million which can be attributed to appreciation of US $ against hard currencies like Euro, Japanese yen (JPY), SDR by 7.9 percent, 2.0 percent and 3.2 percent respectively.

9.4.4 External Debt Sustainability

Analysis of the current account deficit provides important clues as to the future direction of the external debt path. Higher current account in the absence of offsetting increases to current transfers and non-debt creating capital flows can add to the stock of external debt. Similarly, any increase in interest rates and exchange rate depreciation will increase the debt servicing cost of the country and will affect the sovereign debt portfolio. External Debt and Liabilities expressed as a percentage of GDP might be a common means of measuring the indebtedness of an economy, but repayment capacity is more accurately captured through expressing the levels of debt as a percentage of the economy's foreign exchange earnings and reserves. In order to ensure sustainability, government can assign threshold levels to the debt stock as a ratio of economic indicators and comparison with international thresholds provides insight into a country's debt position.

During 2010-11, the non interest current account showed a surplus of 0.8 percent of nominal GDP on account of improved trade balance (higher cotton prices) and swelling inflows in remittances. This indicator showed a downward trend in fiscal year 2012 by recording a deficit of 1.2 percent of nominal GDP compared to a surplus of 0.66 percent of nominal GDP during the same period last year owing to high value of oil imports.

EDL as a percentage of Foreign Exchange Earnings (FEE) gives a measure of a country's debt repayment capacity by comparing levels of external debt to the sum of exports, services receipts, and private unrequited transfers. A generally acceptable threshold requires a country's

EDL to remain below 2 times of FEE. Improvement was observed in the EDL-to-FEE ratio, which was 1.3 in fiscal year 2011 compared to 1.5 in fiscal year 2010 at the back of strong workers' remittances and a positive turn-around in export earnings. The improvement of this ratio suggests that Pakistan's stock of external debt and liabilities is growing at a slower rate than its foreign exchange earnings. During July-March 2012, the ratio stood at 1.7against 1.3 during the same period last year.

Table-9.8 External Debt Sustainability (in percent)

External Debt Indicators	**2007**	**2008**	**2009**	**2010**	**2011**	**2012***
Non Interest Current Account/GDP	-3.8	-7.1	-4.5	-1.4	0.8	-1.2
EDL/FEE (times)	1.2	1.2	1.5	1.5	1.3	1.7
EDL/FER	2.5	4.0	4.2	3.3	3.3	3.6
EDL/GDP	28.3	28.2	32.3	31.5	28.5	26.5
EDL Servicing/FEE	12.6	11.7	18.0	16.5	11.4	10.0
STD/EDL	0.1	2.4	2.8	1.4	1.0	0.9

Source: EAD, SBP & Debt Policy Coordination Office
* July - March 2012
FEE: Foreign Exchange Earnings; STD: Short-term Debt; EDL: External Debt and Liabilities; FER: Foreign Exchange Reserves

A decrease in EDL in relations to Foreign Exchange Reserves reflects the consolidation of foreign exchange reserves and a general improvement of the country's repayment capacity or vice versa. On the onset of SBA in 2008, the ratio declined to 3.3 in 2009-10 as EDL growth slowed and foreign exchange reserves shored up. The ratio did not improve in fiscal year 2011 mainly because of stagnation in reserves and lower growth in EDL stock. By end-March 2012, the ratio deteriorated slightly to 3.6 compared to 3.3 by end June 2012 mainly because of drawdown on reserves owing to lower Foreign Direct Investments and other non-debt creating flows.

A major improvement has been witnessed in EDL-to-GDP ratio as it improves from 31.5 percent in fiscal year 2010 to 28.5 percent in fiscal year 2011. By end-March 2012, EDL as a percent of GDP stood at 26.5 percent, thereby showing a decrease of 2.0 percentage points in first nine month of current fiscal year. This improvement is mainly due to faster growth in nominal GDP in relation to slower growth in external debt owing to lower financing from external sources.

External Debt Servicing as a percentage of Foreign Exchange Earnings has been declining since fiscal year 2010 and stood at 11.4 percent during fiscal year 2011 owing to strong workers' remittances and a positive turn-around in export earnings. A generally acceptable threshold requires a country's EDL servicing to remain below 20 percent of FEE. The current levels of servicing are bound to increase as IMF-SBA repayments initiate in fiscal year 2012, that require serious efforts to enhance the export earnings.

Pakistan's level of Short Term Debt (STD) as a percentage of EDL has historically been lower than most other developing countries. It was just 0.1 percent in 2006-07. Fiscal year 2009-10 has seen an improvement in STD as a percentage of EDL to 1.4 percent which decreased to 1 percent in fiscal year 2010-11. During July-March 2012, the ratio stood at 0.9 percent.

9.5 Pakistan's Link with International Capital Market

The first ten months of the current financial year witnessed a period of substantial volatility in the global markets, largely as a consequence of fears relating to the Eurozone's peripheral economies. The Emerging Market Bond Index ("EMBI"), a benchmark index for measuring the total return performance of international government bonds issued by emerging market countries, has depicted an increase over June 2011 levels, implying an increase in costs for tapping international debt capital markets. However, since January 2012 the EMBI has shown a slight decrease indicating that the debt capital markets might be improving, however, uncertainty with respect to the Euro area remains and continues to affect the credit risk appetite of global investors. In the backdrop of prevailing uncertainty in the global markets, the situation for Pakistan is further affected by concerns over higher commodity prices, consequent energy shortages, flood etc. Given the general risk awareness and volatility prevailing in the international markets, Pakistan has not issued any new debt instrument since 2008. The government plans to tap the global markets once the conditions become more favourable.

9.6 Recent Performance of 2017 And 2036 Eurobonds

Pakistan has witnessed an increase in spreads on its 2016, 2017 and 2036 Eurobonds in the first ten months of 2010-11. External factors mainly contributed to the spread performance of Pakistan's bonds over the past year, with an overall tightening witnessed since the beginning of 2012. However, levels remain high when compared to levels seen at the beginning of 2010.

The Eurobond maturing in 2016 is currently (as of May 9th, 2012) trading at a spread of UST+1098 basis points. The 2017 maturity bond, that had an issue spread of UST+200 basis points, is trading currently at a spread of UST+1157 basis points. The 2036 bond, compared to the issue spread of UST+302 basis points and a spread of 681 basis points last year, is trading currently at a spread of UST+1002 basis points. The following table contains the latest position of bond issued by Pakistan along with their current yields.

Table-9.9 Selected Secondary Market Benchmarks

Issuer	Ratings (Moody's/S&P)	Coupon (%)	Maturity	Spread over UST (bps)	Yield (%)
Pakistan	B3/B-	7.125	Mar 2016	1098	11.714
Pakistan	B3/B-	6.875	Jun 2017	1157	12.312
Pakistan	B3/B-	7.875	Mar 2036	1002	13.024

Source: Bloomberg, as at May 9th, 2012

9.7 Conclusion

Pakistan's public debt position declined slightly in the current fiscal year. A host of internal and external factors contributed to the decline. Higher interest payments, large subsidies specially food and energy, growing security spending needs, narrow tax base and rising international commodity prices have resulted in large twin account (i.e. fiscal and current account) deficits. Prudent government policy will be necessary to address the issue of public debt.