How Bad is a Bad Loan?

By Zubair Faisal Abbasi [i]

After looking at the debt liabilities of different countries, specially the ones which grew faster than others, many analysts argue that it is not the debt per se which matters. No doubt there is a school of thought which argues for a 'sustainable debt' as well. However, there is a synthesis that what matters most is the judicious use of resources and effectiveness of economic policy which allocates resources in different sections of the economy to generate streams of economic growth. The argument is that if economy is growing and new sources of economic growth are being successfully experimented with, then an apparently large debt is manageable. If growth is not picking up momentum then the size of debt and the ability to pay back matters most. In the case of Pakistan, it appears that since the rate of growth has come down (around 3 percent) after FY07 and the debt situation has worsened from 55 percent of GDP to 62 percent of GDP, there are some areas in which the country needs to be vigilant.

For example, the issue of debt servicing (retiring the debt) requires attention because the money routed for debt servicing is five times higher than the federal development budget. Another worrisome factor is that the country has received around half of the committed US$ 1.4 billion from the Coalition Support Fund (CSF) while the expenditure on security has actually increased many folds during the last three years -- taking Pakistan in a very difficult financial situation. This needs to be addressed on a priority. There has been a reported increase in debt-servicing by 43 percent during the last five years which is around US$ 3.112 billion while the total external debt has reached US$ 55 billion in June 2010. By September 2010, the total debt and liabilities were reported to stand at 73.3 percent of the GDP. A worrisome situation is that around 65 percent of the budget goes to debt retirement, defence related expenditures (total external debt is also contributed by defence related debt), and current expenditure of the government. At the same time, some analysts argue that around 60 percent of Pakistan's economy is out of the tax net which makes our debt burdens more burdensome.

It has been argued that the government is pursuing the policy of taking more loans to retire the old ones. Where this state -- the state meaning the people and the government -- is failing? In fact, it is not being able to restructure the system of public finance and mobilize resource from domestic economic activity. Some analysts have claimed that the government has violated almost all of the provisions of 'Fiscal Responsibility and Debt Limitation Act'. It is important to mention here that a certain section of economic policy experts have contradictory opinion on such Acts which have been enacted at the behest of International Financial Institutions (IFIs). They argue that such efforts for the so-called 'stabilisation' have resulted in erosion of financial capacity of the state to fuel the engine of economic growth through public investments in creation of new markets, human development expenditures, initiation of new production lines, and investments in research and development capacity. In this line of argument, they conclude that public sector investment which thus 'crowds in' the private investment has been reduced in a number of countries. Pakistan also needs to undertake a serious analysis of such impacts of the Act.

On another account, the prescription of IMF to impose RGST and bring agriculture and services sector under tax net is not bad in itself but it is tricky to collect taxes and ask businessmen to contribute when economy is not showing signs of growth. However, a counter argument is that Pakistan's economy has average natural rate of economic growth which is

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around 2-3 percent per annum and, currently, the economy is running along that curve. Therefore, the new taxes are needed to stabilise the economy in the first phase and generate growth momentum later. At the same time, if the US$11.3 billion debt trap has to be escaped then Pakistan needs to seriously pursue a growth strategy which is rooted more in empirical evidences of successful growth strategies across the world and its own circumstances than being carved out of the text books of neo-liberal Chicago economics. However, in the short run, the country needs to balance its books so that not only the next US$ 1.7 billion tranche is released but also the stalled assistance from World Bank, Asian Development Bank and Islamic Development Bank, which is close to US$ 500 million, also joins the financial stream of Pakistan.

While the rate of growth is faltering, the issue of debt burden and needed economic growth is becoming complex, especially when slogan of 'austerity' allows governments to cut development budget without removing fat on wasteful expenditures. What is a 'waste' is a tricky question as well. For example, the Planning Commission has removed scholarships for Pakistani students who wanted to go abroad with a promise to come back and serve Pakistan. Such expenditures were thought to be a fat and removed. While providing a new vision for growth strategy based on innovation and research and development as argued by famous economist Paul Romer, the economic policy prescription on scholarships seems to be a significant contradiction which is a hallmark of the State of Pakistan in a number of ways.

Economic managers of Pakistan should know where the fat actually lies, where the social efficiency lies, and where the real waste and leakages have to be plugged so that they can manage debt while keeping Pakistan growing at a respectable rate.

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