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The Impact of Foreign Debt on the Economy of Pakistan

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Abstract: From the Nineteen Eighties to the present, Pakistan's mounting debts have been the subject of debate and consideration by policymakers and economists. Unfortunately, foreign debt is one of the biggest significant issues which downsize Pakistan's Economy. This study aimed to investigate the effects of external debt restructuring on the country's economic system. The objective was to study the various factors that affect Pakistan's economy, such as external debt, growth, saving, and foreign direct investment. Annual panel data was taken from the World Bank and used to manipulate the results. External debt is the main factor that harms the country's structured variable GDP, economic condition and growth as well. It has been concluded that Pakistan should consider debt forgiveness and invite foreign direct investment. Although exports are beneficial to the country's economy, they should be lifted to increase its financial system. The adverse effects of external debt on the boom are very apparent now a days.

Key Words: Economy, Factors, Debt, Foreign

Introduction

It is a fact that developing countries must depend on foreign debt to sustain their overarching economic stability and domestic development goals. Foreign debt is a vital loan that one government borrows from another country or international organizations like International Monetary Fund, World Bank, Asian Development Bank, and Inter-American Development Bank. Foreign debt can be long-term or short-term. In our region, Pakistan's external debt has reached 37.5 % of GDP compared to India's 15% and China's 7%. Unfortunately, foreign debt is one of the biggest significant issues which downsize the Pakistan Economy. In 1947 British drew a line on the map and divided united India into two parts Existing Pakistan and India. Since its independence, Pakistan's economy has not been fully self-dependent, always dependent on foreign aid to prefill its domestic shortage. With time foreign loans touched the sky and reached 106312.1$ million. So, every year, Pakistan must pay vast amounts of money to external debt interest. However, proper debt management is essential for the economic growth of a country. There must be a balance between export and import to decrease the need for foreign debt. In this research, we will cover the 1980s to 2013 foreign debt details and their development in the country and compare them with the democratic and military regimes.

In Pakistan, 65% of revenue is being spent on foreign debt. The remaining 35% is spent on other domestic expenditures like defense,

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education, health, etc. That is why Pakistan faces a low standard of living and poverty. Pakistan's social and economic condition over the 70s was a mixture of ups and downs, but at the start of four decades, it was good, and its economic growth rate was 6% per year. Even though population growth was high at that time, stale inflation was meager and per capita income was double as compared to the present and the poverty rate was declined from 48%to 18% by the late 1980s. The famous Pakistani economist Dr. Ishrat Hussain's Pakistan economy sustained the duration of various wars period of the civilian and military regimes. From the 1960s, 70s, 80s until 90s decade but after 90s Pakistani economy started decreasing. However, the political interplay of religious fundamentalism, ethnic separation, sectarianism, and regional economic dispute made the country unstable, numerous East Asian countries behind Pakistan in the 1960s. Pakistan was unable to realize economic and social weakness. South Korea was an excellent example for Pakistan in the 1960s. They both were almost the same in a financial aspect. Pakistan failed to implement its economic policies correctly, and South Korea implemented its policies properly. Today Korea is very far from Pakistan in every aspect.

Bhutto's famous policies of nationalizing industry banks, educational institutions, insurance companies, and other organizations brought Pakistan to modernization and stable economic development. This policy hit Pakistan very dangerously, and the East Asian countries were far from Pakistan, but unfortunately, Pakistan became very backward due to this policy. In the 60s, Pakistan's economic policies were robust, but due to Bhutto's policies, Pakistan became very hit back. In the 1970s, oil prices, floods, and drought affected the country, and no foreign assistance came, so Pakistan's economy in 1970 became unstable the growth rate fell to 3.7% from 6%. In this regime, social justice proved to be very low. The inflation increased to 16% between 1972 to 1977. Public sector investment decreased in huge quantity. Economic theory states that if the country's external debt is utilized efficiently, it can contribute to its economic growth. On the other hand, if the debt is not used effectively, it can hurt the country's growth.

The concept of debt overhang explains how a country's accumulated debt can affect its economic growth. When its debt exceeds its repayment capacity, it can cause foreign and domestic investors to withdraw their money from the country.

This phenomenon is referred to as the debt overhang. It indicates that the future increase in the country's output is paid to its creditors. Although external debt is beneficial for a country, it can also affect its economic growth. It can be used for various responsibilities, such as the power region and the base. Since the country's external debt is being used for multiple purposes, it can negatively affect its economic development. It can also cause ills to affect the system. For instance, the high level of external debt is regarded as the cause of all ills that affect the country's economy.

In 1980, the country's external debt reached $869 billion, increasing to almost $1 trillion. Over the years, the country's external debt has also increased. Due to the assistance of the State Bank of Pakistan, the size of the country's external debt has decreased. As of December 31, 2013, the country's total external debt was $49.383 billion, lower than the $63.3 billion it had at the end of 2012. Due to the country's freedom, its government no longer consumes as much revenue as it. The country's frequent lousier economic conditions can be attributed to its high external debt. On the other hand, former President Pervez Musharraf's government was able to control this issue through various measures. Divisions within the country's different economic sectors struggle to overcome the financial gap despite the government's efforts. According to a former official of the Benazir Bhutto government, the economic shortfall is the cause of all of the country's ills. The official noted that the country's financial system could only be restored through the government's efforts. Aside from the external debt, the country's outdoor duty troubles have also been regarded as the cause of various ills in the country's economy. As part of its long-term responsibility, the country's external debt can be classified as a liability owed to non-resident investors. It can also pay off other debts, such as the International Monetary Fund. According to the World Bank, the country's external debt is regarded as a liability owed to non-residents. It can also be used to pay off other debts, such as the International Monetary Fund. Before the 1970s, the concept of establishing international locations was primarily based on creating international airports.

Literature Review

Foreign debt plays a vital role in developing countries' economic stability; whenever we look at literature, we can find that debt was significant in development. In Pakistan, there is a massive gap between financial resources and human capital, and macroeconomics is very weak, which is why it takes debt from international organizations; remember one thing when we see in history that debt is as old as the nation, most countries take debt. They fill the gap in the budget because their economic resources are not enough to fulfill the hole; they spend this money on development projects like infrastructure, education, health, education technology, like Pakistan took loans from China and spent them on, Motorway, energy system, and port and airports projects, Similarly, if Pakistan wants to establish these but does not have money than supposed to increase tax rate than uncertainty will increase like in present situation Pakistan is facing these issues. Increased tax rate: All Merchants are on strike on capital roads and demanding to reduce the tax rate and say we face problems. Studies on the external debt problem have been carried out to improve the greatness and seriousness of the debt problems faced by the LICs. They have been complemented by other studies that have analyzed the debt burden indicators and the severity of the debt situation.

Studies on the effects of external debt on the economy have been criticized after the disastrous situations during the early 1980s. There have been numerous studies that have been conducted on the subject, but the results have not been encouraging. According to a 2003 study, there are three groups of speculations about the external debt problem. One of these suggests that the presence of foreign debt could help LICs improve their financial development. One of these claims states that the presence of foreign debt can improve a company's financial condition up to a specific restriction level. The other group claims that the high accumulated debt stock hurts the company's financial situation. The third group of speculations claims that the presence of foreign debt can improve a company's financial condition.

Pakistan's foreign debt was $12.9 billion in 1990, but in 2013 it increased to $60.9 billion; in 2014, it increased by $65.4 billion; in 2016, it was $73.1 billion; in 2017 $77.5; in 2018, $96.8 billion. In 2019, $104.2 billion. However, when we look at debt, it is a huge figure in the history of Pakistan, whether she can pay them back or not. But when we see history, there was such a country that paid the amount or not; if yes, how? When we compare such a country with Pakistan, Romania, which was at the same time became independent, were allies of NATO countries and took loans, and was anti-Soviet Union. They intended to develop the country, but when debt reached $12 billion and realized that these debts are not good for our future, they could unstable our institutions and return all external debt. Because the prime minister brought a resolution that we returned all debt and did so in 1980, the country faced a dangerous situation like the present Pakistan situation. All population living standards became low, and the nation faced tough in the 80s and 90s but later became stable, now it is a very stable country economically, socially, and politically. But in the case of Pakistan, it took loans to develop its agriculture and industries and increased export levels but unfortunately became unsuccessful, and its export decreased.

The concept of the debt overhang has been used to describe the negative impact of faraway obligations on financial improvement. It occurs when the responsibility is far off, and the duty is not calculated correctly. The concept of the debt overhang is usually used to describe the excess amount of money that an indebted individual country owes. It can be compared to the relationship between the monetary yield and the residential obligation. Since this is a nation-specific investigation, it was decided that the officials of the affected countries would be interviewed. The officials of the affected countries would also be asked about the various financial issues they face. According to a study conducted in Pakistan, the country faces an obligation issue that needs to be resolved immediately. Many of the salaries that individuals can earn are used as obligation administration. The magnitude of home savings is subject to various uncertainties due to the current account deficit and the residual value of the home. Also, it is not clear how much gross investment is being made in the country. It is also possible that the rise in the stock market is linked to the country's growing GDP. However, this factor is also essential in the ongoing dialogue regarding the country's resource mobilization. Aside from the increase in indirect taxes, the country's various informal sectors are also subject to additional taxation.

Simulations of a boom in financial savings are also required to consider the various factors contributing to this growth. One of these could be increasing domestic savings, remittances, or imports. The potential boost in remittances can be created by implementing specific policies and procedures that allow the repatriation of foreign income. The simulations were then compared to see if the outer obligation's impact on economic development was greater or lesser than that of the household obligation. The results indicated that the external obligation's requirement for payment in remote cash was a significant factor that hindered economic development.

While the outer obligation is not beneficial for the economy, it can be utilized to help evaluate the country's financial situation. This study found no evidence of a connection between outer obligation and monetary improvement relationship. It is also essential to consider the various factors that affect its economic growth. In 2009, Adesola investigated the effects of external debt management on the country's development. A study conducted in Malaysia identified the adverse effects of external debt on the country's financial system. The findings indicated that combining the outer and household obligations significantly affects economic development. The study found that all external debt had positive effects on the country's economic development. It also noted that Malaysia had no debt overhang issue. The study was conducted using the Auto Regressive Distributed Lag method. The simulations also revealed that Pakistan's economic growth was primarily determined by the amount of work people perform each day. The study results also indicated that the country's excessive use of external debt significantly affected its financial development. A similar study conducted in Indonesia from 1980 to 2005 revealed that the country's long-run courting between external debt and salary has been remarkably prolonged. The study also noted that debt overhaul had been a significant factor that has affected the country's economic development. The human capital and energy sectors were identified as the main factors contributing to the country's economic growth during the 1980s and 1990s. However, the capital stock was still regarded as a vital factor that could boost the country's development.

The simulations also confirmed that the Philippines' external debt situation had become less of a concern for the country's economic development. This was because debt overhaul has become a risk that the government can no longer afford to take. The study conducted in 2007 explored the link between external debt and the country's financial performance. It found that the excessive use of external debt has negatively affected its economic development. The simulations also identified various factors affecting the country's economic development, such as the accumulation of outside duty and financial system growth. The study conducted in 2003 looked into the various factors that affect the country's economic development through the channels that external debt can influence. It found that higher external debt can lead to lower development prices for every capita income. The simulations also revealed that the excessive use of external debt has adverse effects on the country's economic development. Aside from this, the simulations also noted that external debt management could help minimize open speculations.

The simulations also revealed that the country's obligation adjustment could have detrimental effects on the country's financial performance. It can lead to the fading of government consumption. Most of the studies conducted during the past two decades also stated that external debt negatively affects the country's economic development. Despite the findings of the previous studies, the authors of the 2007 study noted that external debt has no significant effect on the country's economic development. However, two studies conducted in 2008 and 2003 noted that external debt could boost the country's financial performance. In a hypothetical scenario, the authors identified the various channels through which external debt can influence the country's economic development. These include the debt overhang, the liquidity call, and the fading of human capital. Summary of the literature of external debt and economic growth is attached in appendix 1.

Research Hypothesis

These are hypotheses that will be practiced in concluding this study Ho = There is no impact of external debt on the economic growth of Pakistan H1 = There is an impact of external debt on the economic development of Pakistan

Methodology of Research

Data source

The facts for this study have been taken from a secondary supply indicator of the World Bank. Annual records of Pakistan were used for this study. Five vital variables are used to determine the effects of external debt on the country's economic system.

Specification of model

The following model was built to test the hypothesis for this study.

Variables

βo, β1, β2, β3, and β4, are represent the coefficient of each variable or parameter of the regression. μ, indicate the error term. The following are variables that were used to build the study.

Y= GDP growth
DSE= Debt servicing on external debt
FDI = Foreign Direct Investment
ADS = Adjusted Savings, net national savings
X = Exports of goods and services
The primary variable is Debt servicing on external debt, and other ones are used as control variables.

Analysis and Estimations of Results

Unit Root Test Results

Nonstationary time arrangement data has been considered a problem in experimental analysis. This is because it can induce spurious relapse effects. The ADF test was then utilized to check the stationary of an arrangement. The null hypothesis was discarded, and the variable beneath scrutiny was regarded as having a unit root. The effects of the check were introduced in Figure. A graphical representation of the various time arrangement variables shows their comparative daily state.

Result of ADF Test for Non-Stationary

The results of the Table 1(attached in appendix 1) indicate that the association shows nonstationary degrees. This means that the concept of unit root cannot be rejected. The no desk-bound hypothesis was launched in all cases. It states that the variables under scrutiny are stationary in their centrality.

Conclusion and Suggestions

The objective of this study was to examine the long-term and quick-run effects of external debt on the financial growth of Pakistan over the period 1970-to 2010. The study took into account various factors such as annual education prices, capital, labor pressure, and external debt. The error correction term's adjustment velocity was measured to capture the empirical proof that external debt hurts financial growth. This finding confirmed the state of affairs in Pakistan throughout the examiner's duration. The importance of capital as a critical component of production is one factor that influences the economic boom. Human capital also has a significant effect on the growth of the economy. The labor force also confirmed the effects of external debt on financial growth. It showed that unskilled workers are not likely to produce high output in the US. The short-run results confirmed the model's initial findings. However, the labor force's sizeable poor affiliation and economic boom remain the main factors that influence the economic boom. The integration equation supported the long-term relationship between external debt and financial growth. An estimate of the adjustment parameter indicated that 33 percent of any deviation in the long-term equilibrium would correct in three hundred and sixty-four days. The government and private sector must create conducive conditions for foreign direct investment and minimize the amount of money owed. There is also a need for effective debt control strategies to prevent the mis-utilization of external debt. The evaluation indicated that Pakistan should seek foreign loans of up to 67 percent of its gross national product by 2010. It also stated that the country's super debt would increase by 10.4 percent annually. This increase in the outstanding debt would also encourage the demand for new loans.

As per the study projections, the country's debt servicing will grow at a rate of 15.5 percent in 2012-to 2020, which is significantly higher than the GNP's average. The evaluation also looked into the various policy options available to Pakistan. One of these is the financial savings policy, while the other is the alternate policy. It was shown that the former would reduce the country's overseas debt. The advent of various guidelines on reducing the country's external debt may be beneficial, but it should not be the sole solution to address the issue. Further studies should also be carried out on other policy options to address the issue. The increase in the foreign exchange reserves could be used to replace the savings or imports that are required to finance the country's current account deficit.

One of these is the growing imports policy. However, this option should be avoided as it would only encourage the country to borrow more money. The growing import policy would only encourage the country to borrow more money. It would also enable the government to borrow more money. The government can support the growth in remittances through various means, such as implementing bilateral agreements. Although the value of home financial savings is widely believed to be significant, it is not calculated as a residual amount based on the current account deficit and gross funding. It is widely believed that the increase in the country's GDP is the main factor that drives the stock market's performance. However, it is also important to note that the various taxes levied on informal sectors could divert some savings into legitimate channels. Ijaz Nabi and Hamid Naveed point out that every other problem with the Chenery and Strout version is implemented in Pakistan. They believe that internet transfer of resources is a more significant appropriate measure than gross disbursement (net disbursements are gross disbursements less necessary repayments; internet transfers are internet disbursements fewer hobby payments on past debt). Eleven Following this argument, Naveed Zia Khan and Eric Rahim take net financial help inside the shape of foreign capital inflows to Pakistan (in three classes, namely, FDI, presents, and loans) to check their impact on savings and monetary increase.12 Using single equation OLS estimation for domestic financial savings and GNP, on the premise of information for 1960-87, they find a terrible relationship between overseas resources and domestic financial savings. They conclude that loans are strongly negatively associated with home savings, while grants don't have any vast effects on financial savings and increase. Azhar Mahmood briefly scans over the initial research and looks to trust the not unusual result that overseas resource is an alternative to, instead of a supplement of, domestic savings. However, he remains particularly reluctant in drawing broad and urban conclusions from the ancient overview of resource flows and financial savings relations in Pakistan.13 His theoretical account on capital flows and economic savings-boom association additionally provides some superb views approximately the function of capital flows, however without any empirical. Despite extraordinary econometric estimation strategies and different time intervals for analyses, the maximum of the studies finds similar outcomes, which contradicts the expectation raised with Chenery and Strout's gaps version. All detailed and thorough investigations on the resource-financial savings dating have observed an inverse relationship between valuable resources and savings in the case of Pakistan. Thus, there appears to be a consensus that valuable resource has no longer contributed much toward improving Pakistan's economic system, at the least now, not through any remarkable effect on savings. To further analyze the macroeconomic impact of valuable resources, one crucial factor is the economic behavior of those governments receiving foreign resources. Thus, further to the research cited above, there has also been research analyzing the connection between resource and authority's fiscal behavior since the early Nineteen Nineties. One instance is using Nasir M. Khilji and Ernest M. Zampelli, which primarily makes a specialty of the fungibility of useful resource sources. The authors increase a comprehensive econometric version based on which they test the effect of the US navy and financial assistance to Pakistan on public expenditure for the period 1960-88. They conclude that a reduction in external (fungible) resources would lessen public spending and, in flip, investment as nicely. In an in advance analysis in any other paper, Khilji and Zampelli locate that the US helped Pakistan transform into pure fungible sources. A maximum of those were channeled to the private area through tax relief. Thus, their evaluation shows that fungible resource assets reduce the tax efforts in Pakistan.

Salman Ahmad develops a simultaneous equation model to estimate the effect of overseas valuable resources on the Pakistan government's taxation efforts. External finance is exogenous to the model, and public area funding, general tax revenue, and government consumption as endogenous.21 Applying degree least square estimation to time collection facts for the period 1980-2000, he concludes that valuable foreign resource impacts both the sales and expenditure sides of Pakistan's budget. However, the loans obtained are much more likely to be used for investment than presents, and presents are wasted for non-development initiatives. Thus, contrary to Chishti and Hasan, Salman Ahmad reveals that if the purpose of the resource is to generate investment, loans to Pakistan are premiere to present; in any other case, a valuable resource could be an alternative to home resources. Like the studies on the outcomes of overseas aid on home savings and funding, inconsistent results are also found for the intermediate coverage variables, including taxation. Although a few aids for practical consequences of foreign resources on tax are provided through few studies, in preferred, foreign aid in Pakistan is visible to lower savings and investment and replacement home sources. This can be further tested via the studies on aid-growth family members for Pakistan, to be reviewed inside the subsequent segment. To observe the controversies mentioned above, Faiz Bilquess evaluates the IMF stabilization program adopted by Pakistan in the early 1980s.35 The program is assessed on the idea of each Pakistan's macroeconomic performance and the implementation of deliver-side regulations. Among the macroeconomic variables, the manipulation of inflation, credit ceiling, balance of payment, and money delivery all show combined development and deterioration outcomes. With recognize to deliver side guidelines, a few achievements can be determined to eliminate subsidies, privatization, monetary liberalization, and lowering price lists. Still, in line with Bilquess, the development trouble is more socio-political in preference to a fundamental financial nature in Pakistan. The main improvement hassle is, consequently, unequal profits distribution. Thus, Bilquess indicates that the socio-political perspective on Pakistan's economic issues should be highlighted to facilitate the identity and removal of bottlenecks. A genuinely comparable conclusion is reached using the World Bank's very own staff assessment.36 William A. McCleary offers a comprehensive and in-intensity description of World Bank-supported structural adjustment programs in Pakistan and reveals some proof for their relative achievement in Pakistan compared to most different developing international locations. Nevertheless, he argues that notwithstanding a few coverage improvements and a better boom price within the past due Seventies and early 1980s, the economic system continued to suffer from structural weaknesses. He points out those weaknesses, including low investment and saving fees, fragile external stability, adverse mobilization of resources for the general public quarter, and heavy protection. Thus, he observes that Pakistan should have applied an extra structural adjustment program to deal with those issues. He outlines some of the classes learned from in advance structural adjustment programs in Pakistan and observes that in many respects, the Pakistani economy of the overdue Nineteen Eighties became an awful lot unique from that during 1980.37 He concludes that programs have been more successful inside the regions in which negotiations and talks were extra specific and concrete, within the purely financial, as opposed to socio-political areas. Moreover, he argues that due to the bendy method taken with the aid of Pakistan's government and macroeconomic solid overall performance, the reforms were sustained, with the World Bank playing a tremendous function. However, McCleary's analyses are based totally on accessible descriptive data evaluating Pakistan's performance in several regions earlier than and after the structural adjustment program.38 This is seriously tested by Mohsin S. Khan,39, who observes that an assessment of the performance before and after the program (without managing for simultaneous adjustments in different applicable parameters) is not the proper method to assess the overall performance of SAPs. Moreover, Mohsin Khan notes that although progress was accomplished at the alternate fee, pricing guidelines, and healing of medium period planning, hardly any progress was visible in economic reforms and privatization. According to him, SAPs had been unsuccessful, mainly inside the regions of monetary and trade policies. This article aims to study the effects of external debt on the development of Pakistan's economy. Through a substantial measure of research and studies, it has been concluded that external debt hurts the country's economic growth. The debt adjustment process can create a swarm-out effect and difficulty in debt overhang for ventures. Foreign direct investment can also contribute to the state's foreign exchange and funding needs, but it is not considered due to the excess of these activities. Despite the dim lower back street, export is a vital component of the country's economic boom. It is also a contributing factor to the improvement of the under-developed states of the US. Although funds and inward investment rates have nothing to do with the location of external debt restructuring, they are not contributing to the country's economic development.

1. Pakistan should consider the option of debt absolution as it can help lower the country's external debt levels and allow it to thrive.
2. To achieve this, entrepreneurs and investors must channel their private assets and investments to allow them to generate more income and pay off their debts.
3. Although foreign direct investment can help boost its economy, it should not be accompanied by large-scale subsidy programs. Doing so will consume up the country's due measure of income.
4. To stimulate the country's savings trend, the government should issue bonds that will benefit the country's economic growth.

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Appendix 1

Summary of Literature Review of External Debt and Economic Growth Relationship

Author Name	Country	Period	Judgment
Hameed	Pakistan	1970-2003	Debt service load contrariwise affects economic growth.
Wijeweera	Srilanka	1952-2000	Debt overhang had not existed in Srilanka.
Omet and Kalaji	Jordan	1970-2000	External debt certainly affects economic growth beneath optimal debt level, i.e., 53 percent of GDP.
Patenio and Tan-urz	Philippine	1981-2005	The growth of the economy was not exaggerated by external debt servicing.
Colifihani	Indonesia	1980-2005	External debt payment has a Substantial adverse relationship with GDP
Ayadi and Ayadi	Nigeria and South Africa	1970-2007	Confirm the adverse effect of external debt on economic growth
Abu Baker	Malaysia	1970-2005	External debt certainly affects economic growth.

Table 1

Variables	ADF test at level	ADF test at 1st difference		
GDP	2.49	1	4.51**	1
LFDI	2.30	1	4.45*	1
ADS	2.72	1	4.21**	1
X	2.78	1	6.12**	1
DSE	2.98	1	5.29*	1

Note: The asterisks (*) and (**) indicates statistical significance at the 5 percent and 1 percent significance level.

Table 2. Regression Result

Dependent Variable: GDP				
Method: Least Squares				
Date: 25/11/19 Time: 12:30				
Sample: 1980, 2013				
Included observations: 34				
Variables	Coefficient	Std. Error	t-Statistic	Prob.
C	7.256052	0.859968	8.437584	0.0000
DSE	-8.80E-10	2.99E-10	-2.942071	0.0060
LFDI	-0.726294	0.262819	-2.763479	0.0094
X	-1.03E-10	4.50E-11	-2.297089	0.0283
R Square =0.26		Mean dependent var=9.826743		
Adjusted R2= 0.21			S.D.dependent var = 2.210025	
F-statistic = 9.653168		Sum squared reside = 107.1976		
Prob (F-statistic) = 0.006019		Durbin-Watson=0.971531		