

## **Fiscal Situation in Pakistan and its consequences for Economic Growth and Poverty**

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### **Abstract**

A sound fiscal position is an essential pre-requisite for achieving macroeconomic stability and is a critical ingredient of sustainable economic growth and poverty reduction. Better fiscal management helps mobilize domestic savings, increase efficiency of resource allocation and achieve other worthwhile development goals. On the other hand, lax fiscal policy limits options open to the government for economic recovery, sustainable growth and poverty alleviation. The present study evaluates the fiscal situation in Pakistan and sheds light on its implications for Economic Growth and poverty reduction. Study finds that Pakistan economy have shown great resilience over the years against disastrous events. However, situation of poverty reduction is not satisfactory; Pakistan's health and education indicators depict a dismal picture when compared with the countries with same level of development. As revenue generation efforts was only partially successful and Pakistan was unable to generate adequate revenues to meet expenditure. Consequently, successive governments have tried to reduce the deficit by reducing the development expenditure which hampered the growth process and resulted in a decline in human development indicators and increased the incidence of poverty.

**Key words:** Fiscal Policy, Poverty, Economic growth.

**JEL Classification:** H63, I32, O43

### **1. Introduction**

Pakistan having per capita income of U.S. \$ 1,085 per annum and a population of 160.9 million is the 6<sup>th</sup> most populous country on the planet.<sup>2</sup> 23.9% of the population is living below the poverty line. On the human poverty index Pakistan is ranked 77 among 108 countries and 136<sup>th</sup> among 177 countries on the human development index.<sup>3</sup> In order to improve the living standards of the population it is mandatory that the Macroeconomic Policies are made in such a way that result in boosting the economic growth and reducing the poverty along with income inequality. A sound fiscal position is an essential pre-requisite for achieving macroeconomic stability and is a critical ingredient for promoting sustainable economic growth and poverty reduction. Better fiscal management helps in mobilizing domestic savings, increasing the efficiency of resource allocation and achieving the development goals. On other hand a lax fiscal policy limits the options open to the government for economic recovery, sustainable growth, and poverty alleviation.

It may lead to higher inflation along with higher interest rates and crowding out of private investment, all of which would hamper growth and poverty reduction. The importance of a prudent fiscal policy, therefore, cannot be over emphasized.

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<sup>1</sup> **Authors Note:** The viewpoints presented in the paper are author's personal and do not reflect the view points of their affiliated institutions.

<sup>2</sup> Economic Survey 2007-08

<sup>3</sup> Human development report 2007-08

In the paper, role of fiscal policy in general and public debt in particular for Economic growth and poverty reduction would be highlighted. It is worth mentioning that Public debt and other components of fiscal policy are interrelated, it is very much important that while analyzing the consequences of public debt the situation of overall fiscal situation would be discussed. The purpose of this chapter is to highlight the major issues regarding the Public Debt and Fiscal scenario in Pakistan.

The paper is divided into Seven different sections: After introduction Section I provides a brief introduction of fiscal Policy and its objectives, Section II deals with the issue of Public expenditure and its composition, Section III Concerns with the available resources to meet the expenditure and evaluate the structure of tax collection, in Section IV the deficit problem is highlighted and its nature and structure was discussed, Section V relates to the situation of public debt in Pakistan, in this section problem of debt, its structure and implication for overall economic performance would be highlighted. Section VI Discusses the Pakistan's economic growth performance over the years and in Section VII situation of poverty reduction was discussed in brief. At the end major conclusions emerged from the paper were highlighted.

## **2. Importance of Fiscal Policy**

In a developing country government has to play crucial role for promoting economic growth and breaking the vicious cycle of poverty, the fiscal policy is a major instrument for attaining this purpose.<sup>4</sup> In the economic survey of Pakistan (2005-06) it is stated that the Government's fiscal policy has both microeconomic and macroeconomic objectives.

“Microeconomic objectives includes, improved distribution of income and wealth, equitable access to social services, meeting the basic needs of the poor, promoting investment in public goods, and enhancing the efficiency with which the public and private sectors produce goods and services and their responsiveness to the needs of consumers. Macroeconomic objectives relate to evolution of the economy as a whole – national income and output, jobs, inflation and the balance of payments. Fiscal policy must also ensure that the level and structure of taxes promote equity and redistribution, and do not interfere unduly in people's investment and consumption decisions.”

Fiscal policy is recognized as a powerful instrument to enhance capital formation, economic growth, per capita income and level of employment. Fiscal policies have a significant impact on economic growth and distributing its benefits to all segments of the society. Primarily, Fiscal policy deals with the level and composition of government expenditure, revenue, deficits and Public debt.

## **3. Public Expenditure**

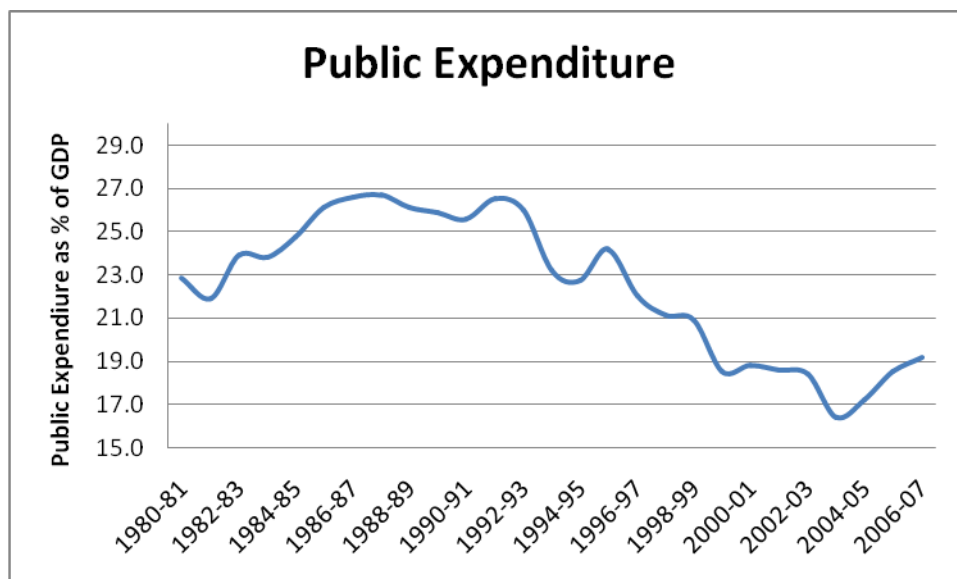
There are certain sectors of economy where due to one or other reason private sector is reluctant to invest or was banned by the government; in these sectors government utilizes public spending to fill out this gap. Public expenditure reveals the preferences of the government for public goods and creates effective demand in the market. The impact of public expenditure on economic growth is an unsettled issue theoretically as well as empirically. However, theoretically a conventional wisdom is that large size of government expenditure is a source of economic instability or stagnation. But this conventional wisdom was not supported by the empirical studies.<sup>5</sup>

Public expenditure as percentage of GDP has grown consistently in Pakistan since 1960s. During 1960's public expenditure was on average 11.6 % of GDP, during 1970s it was accelerated and reached at 21.5% of GDP. During 1970s nationalization is the major reason for increase in public expenditure. However, due to nationalization of assets owned by the private sector, government lost its control over fiscal expenditures. And expenditures on inefficient public sector became a permanent drain on the national exchequer. Public expenditures continue to grow and in 1980s it becomes 24.9 % of GDP. On the other hand the revenues remain stagnant and the budget deficit widened, in order to fill the deficit there is no other option available for government except to rely on external debt.

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<sup>4</sup> Musgrave (1989)

<sup>5</sup> Empirical studies have yielded conflicting results: Devarajan (1996), Ghura (1995) supports the hypothesis that a rise in the share of public spending is associated with a decline in economic growth, while Knoop (1999) and Aschauer (1990) has found that public spending has a positive relationship with economic growth, similarly according to Nelson and Singh (1994) and Lindauer and Velenchik (1992) there exist no significant relationship between Public expenditure and economic growth.

**Figure 1 : Trends in Total Public Expenditure in Pakistan**

Source: Economic Survey of Pakistan

During the 1990s debt problem become severe and it forced Pakistan to adopt structural adjustment program. Due to commitment made with the International Financial Institutions (IFI's) and financial crunch faced by Pakistan; Public expenditure were curtailed and they were on average 23.1% of GDP during 1990s. This reduction in public expenditure has slow down the economic growth in 1990s. However, total expenditure of the government has remained more or less stable in a narrow band of 17 to 19 percent of GDP during 1999-2007. The trends in Public expenditure in last two decades are summarized in Figure 1. It can be seen that public expenditure as percentage of GDP was continuously rising in 1980s but at the start of 1990s it started declining.

The composition of expenditure is also very important, because different components of expenditure show the preferences of government regarding growth and development.

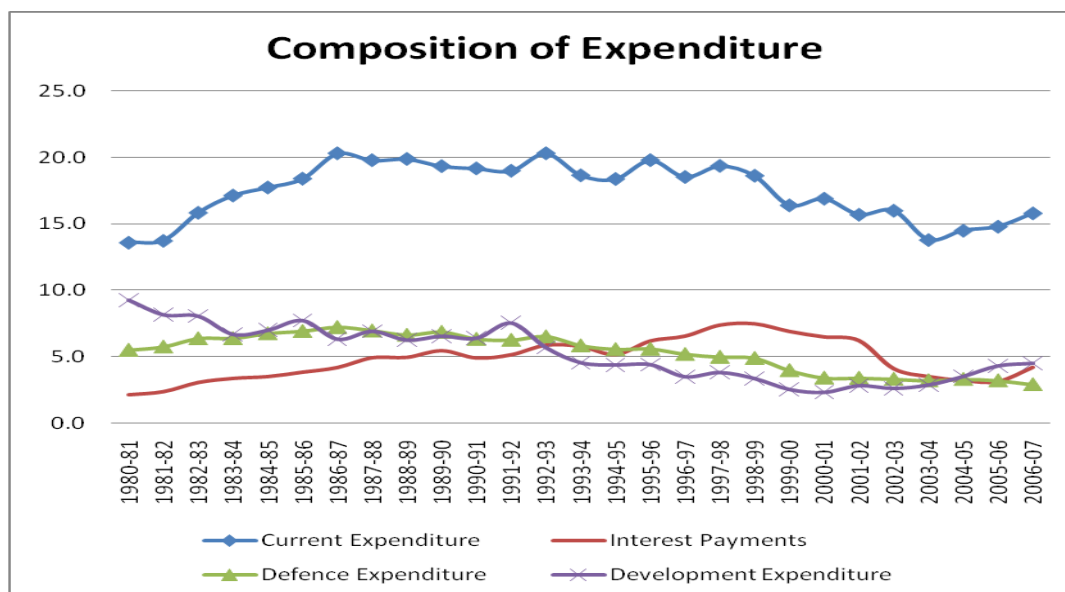
### 3.1 Current Expenditure

Current expenditure incurred in order to finance the goods and services such as salaries, rent, maintenance and interest payments, which are used up within a short period of time usually in a fiscal year. As it can be seen in Figure 2, current expenditure in Pakistan grew at a steady rate since 1980's. Current expenditure was on average 17.6% of GDP during the 1980s and it become 19.1% of GDP during the 1990-98. During that period the total expenditure was reduced but on the expense of development expenditure and current expenditure were on the rise. It can be concluded that when successive regimes have faced the fiscal pressures they have chosen to cut down the development expenditure rather than expenditure on government itself.<sup>6</sup> The current expenditure augmented so rapidly during 1980-99 that despite of huge reductions in development expenditure, fiscal deficits did not decline significantly. However the rising trends in current expenditure was controlled during the 1999-2006 and it was on average 15.5 % of GDP during that period.

### 3.2 Defence Expenditure and Interest Payment

Interest payments and defence expenditures are the major part of the current expenditures. They have collectively made almost two-third of the current expenditures. During the 1970s defence expenditure grew significantly, as higher defence expenditures were part of Bhutto's policy of refurbishing the defence establishment in a hope of winning it over. Similarly due to wars with India and Kashmir dispute Pakistan was compelled to increase its defence expenditure. Defence expenditure as a percentage of GDP increased from 2.7% in 1965 to 6.7% in 1974-75. During the 1980s as a result of Afghan war Pakistan has increased the defence expenditure and during that time period these were on average 6.5% of GDP.

<sup>6</sup> Hussain (2003)

**Figure 2: Composition of Public Expenditure in Pakistan**

Source: Economic Survey of Pakistan

However defence expenditure was gradually reduced in 1990s and it was on average 5.5% of GDP, this reduction continues and it was reduced to 2.9% of GDP in FY 2006-07. If regional tensions subside and the Kashmir dispute would be resolved, then it could provide fiscal cushion in the form “peace dividend”, and Pakistan may reduce the defence expenditure.

Pakistan has been facing financial crisis since its creation, in order to get out of this financial constraint, Pakistan has relied on borrowing. Consequently, Pakistan has to spend considerable portion of its GDP on the interest payments of the loans. During the 1980s Pakistan has spent on average 3.8% of its GDP on interest payments. However, during 1980s the Afghan war was going on and as the interests of developed countries are there so Pakistan was provided aid accompanied with concessions on debt servicing. But after the Afghan war the problem become severe and in 1997-98, expenditure on debt servicing reaches 7.5 % of GDP. Once again after the event of 9/11, Pakistan got considerable relief on debt obligation, and expenditure on interest payment started reducing and in FY 2006-07 it shrunk to 4.2 % of GDP.

### 3.3 Development Expenditure

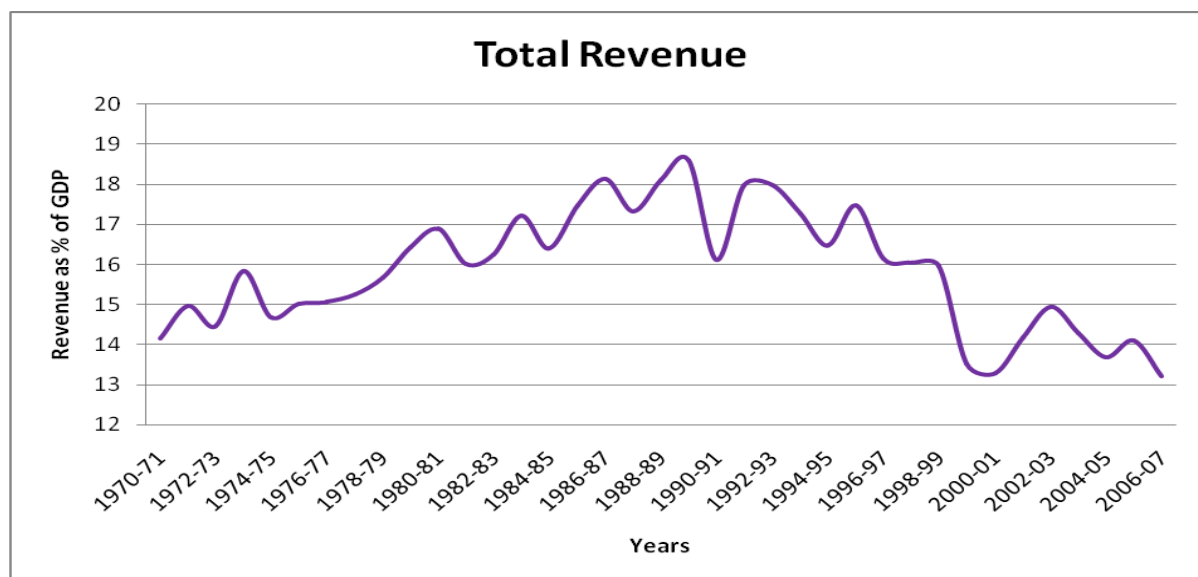
Development expenditure plays an extremely crucial role in economic growth, poverty reduction and overall development of the country. Development expenditure normally incurred on the incremental addition to existing capital stock e.g. expenditure on infrastructure, health, education etc. As mentioned earlier successive governments being unable to reduce their unproductive expenditures, so they reduced the development expenditure to make the total expenditure on a sustainable level and meet the commitments with IFI's. As a result development expenditure squeezed from an average of 7.4% of GDP during 1973-77 to mere 2.3 % of GDP in the FY 2000-01. In 1980s development expenditure was on average 7.3 % of GDP, due to fiscal problem Pakistan faced in 1990s these were shrunk to only 4.6 % of GDP during 1990s. Development expenditure continued to decline and during 2000-03 they were on average only 2.6 % of GDP, but thereafter situation starts improving and in FY 2006-07 it was 4.5 % of GDP. The diminution in development expenditure has adversely affected the economic growth in Pakistan via three channels. Firstly, reductions in social spending on health & education have stunt the development of human capital which is a prerequisite for sustainable economic growth. Secondly, cuts in public investment, especially in infrastructure such as roads, power, water supply and irrigation have created bottlenecks in the economy and raised the cost of doing business in Pakistan. Thirdly, these cuts in development expenditure were also resulted in discouraging the private investment, which is complementary to public investment in infrastructure.

### 4. Public Revenue

In order to finance the expenditure, the government collects resources from various sources in such a way that it is equitable, improves social welfare and does not create distortions in the economy. In Pakistan total revenue collection during 1960's was on average 13.1% of GDP, this ratio rises to 16.8% of GDP during 1970s, in 1980s public revenues as percentage of GDP has further increased to 17.3 %.

Later on in 1990s public revenue as percentage of GDP starts declining and it was on average 17.1%, this trend persisted in the first seven years of 21<sup>st</sup> century, in FY 2006-07 the total revenues were only 13.2 % of GDP.

**Figure 3: Total Revenue in Pakistan**



Source: Economic Survey of Pakistan

Trends in the collection of total revenue during 1970-2007 are summarized in the Figure 3. It can be concluded that the revenue collection is not satisfactory in Pakistan and is a major reason of deficit problem. US Aid in its report describes this situation by saying that the ratio of government revenue to GDP was 14.3 percent in 2003-04, which was far below of the low-income Asia average of 17.7 percent.

Public revenue can be classified into two categories; tax revenue and non tax revenue.

#### 4.1 Tax Revenue

If the government wants to increase its development expenditures in order to provide basic services to the people and finance necessary current expenditures without increasing indebtedness, then increase in the Tax-GDP ratio and elasticity of tax revenue is essential.

Pakistan is recognized as a country of having narrow tax base, grossly inadequate tax to GDP ratio and low elasticity of tax revenue with respect to GDP growth rate. The tax revenue was on average 13.7 % of GDP during the 1980s this ratio was reduced to 13.1 % in the 1990's, this declining trend persisted and in FY 2006-07 tax revenues were only 10.6% of GDP. Consequently, even with good growth performance, the low tax collection has forced the governments to rely on loans for financing the deficit. In order to increase the tax revenue in 2001 tax reforms were introduced, and numerous steps were taken by the Central Board of Revenue. The introduction of large Tax-Payer Units (LTU), Medium Tax-Payer Units (MTU), Universal Self Assessment Scheme (USAS) and enlargement of the tax base, were resulted in increased tax revenues. This increase is excellent in absolute terms but as a percentage of GDP these tax reforms are a failure.<sup>7</sup>

Tax revenue is further classified into two sub categories; direct taxes and indirect taxes. Both are different in nature, method of collection and have different implications for the economy.

##### 4.1.1 Direct taxes

Direct taxes are normally taxed on income/wealth and levied in the form of income tax, wealth tax, capital value tax, corporate tax and worker's welfare fund etc. In FY 1990-91 direct taxes were only 18% of total tax collections, this ratio has been increased to 32 % in FY 2000-01 and become 39.6% in FY 2006-07. The direct taxes have increased thirteen fold from Rs 20 billion in 1990-91 to Rs 264.7 in 2006-07, and emerged as the leading contributor in federal tax collection, a much desired transition on equity and efficiency grounds. But still direct taxes in Pakistan comprise only 4% of GDP whereas in other competing developing countries this ratio is as high as 7% of GDP.

<sup>7</sup> Siddiqui (2006)

#### 4.1.2 Indirect Taxes

Indirect tax consists of outlays and levies like custom duties, excise duties, sales tax etc. Indirect taxes harm the lower income groups more severely as compared with higher income groups. Despite the rapid growth in direct taxes, indirect taxes are still largest contributor in the tax collection. As the governments are mostly under severe pressure by powerful groups, to generate more revenues from indirect taxes rather than taxing the elite class directly, the collection of revenue in developing countries are mainly from indirect taxes.

In the FY 2007-08 indirect taxes were 62% of the total revenue, over the time the share of indirect taxes is decreased considerably as in FY 1990-91 the share of indirect taxes was 82% of total revenue. It can be concluded that although a considerable shift from indirect taxes to direct taxes have taken place but still Pakistanis are heavily burdened by the indirect taxes and the share of direct taxes in overall taxes is far better in many middle income countries, at the same level of development.

#### 4.2 Non-tax revenue

The revenue collected through public undertakings such as user fee, dividends of public sector enterprises and by issuing the short-term and long-term bonds is categorized as non-tax revenue. The non-tax revenue was on average 3.5% of GDP in 1980, slightly increased to 3.7% in 1990s and become 3.9% of GDP during FY 2006-07. The above discussion reveals that in order to curtail the poverty and stimulate the economic growth and development, Pakistan requires to increase public expenditure especially development expenditure, but the country has been facing the constraint of the low revenue collection. This gap between revenue and expenditure is resulting in a persistent deficit problem.

### 5. Public Deficit

If liabilities exceed assets, expenditures exceed income, imports exceed exports, or losses exceed profits then government faces the situation of deficit. Fiscal Deficit and Current Account Deficit are two well known categories of deficit.

#### 5.1 Fiscal Deficit

When government's total expenditures exceeds the total revenue that it generates then situation of fiscal deficit emerges. Fiscal deficit has got greater attention after Brettonwoods, during the last two decades most of the developing countries including Pakistan have faced Fiscal deficits and is considered as one of the major source of macro-economic imbalances.<sup>8</sup> However it is extremely difficult to conclude that a reduction in fiscal deficit always yields positive outcome. If reduced deficit is achieved by reduced expenditure especially by reducing the development expenditure, rather than expansion in the revenue collection, then long-run impact of this reduction in deficit would be negative for economic growth.

Fiscal deficit has been a regular aspect of Pakistan's economy, during 1960's fiscal deficit was only 2.1 % of GDP, during the 1972-80 fiscal deficit was on average 8.0% of its GNP, during that time period due to 1971 war, East Pakistan was separated and there is crunch in revenue and expenditure were on rise. Later on during the 1980s Fiscal deficit was reduced and during that time period it was on average 7.1 % of GDP. During 1990s government has tried its level best to bring the fiscal deficit to 4% of GDP as agreed with IMF in Structural Adjustment Program, but it was able to reduce the fiscal deficit to only 6.9% of GDP. However, Fiscal deficit continued to decrease, in FY 2003-04 it was only 2.3% of GDP. But thereafter it once again starts increasing and in FY 2006-07 it become 4% of GDP and it was estimated that fiscal deficit would be 6.5% of GDP for FY 2007-08.

Siddiqui (2006) has pointed out that since 1980s, both the ratios of revenue-GDP and the expenditure-GDP has a declining trend in Pakistan, and decline in expenditure-GDP ratio was faster than the decline in revenue-GDP ratio. Moreover development expenditure was reduced more than other components of the expenditure and the situation has affected economic growth adversely. It is most appropriate that reduction in fiscal deficit would be achieved by revenue mobilization, reduction in the debt burden, and privatization efforts and not by curtailing the development expenditure.

#### 5.2 Current Account Deficit

Current account deficit crop up when the country's total imports of goods, services and transfers exceed the exports of goods, services and receipts. Over the 60 years of Pakistan history most of the times, there exists current account deficit, current account was in surplus for only six years.<sup>9</sup>

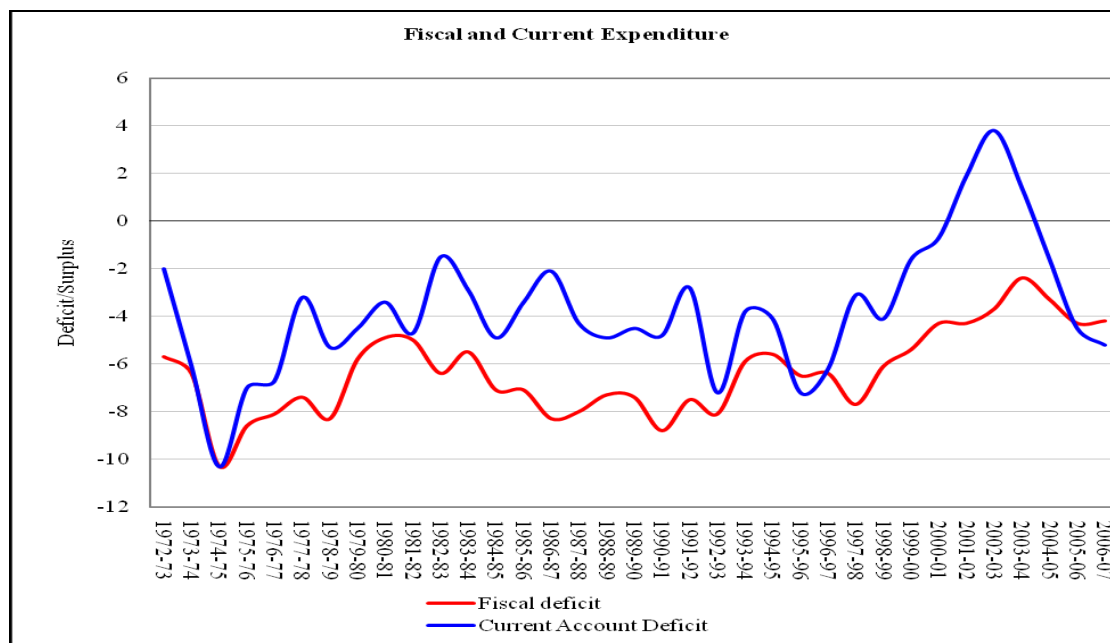
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<sup>8</sup> Uzair(2004)

<sup>9</sup> Pakistan Development Policy Review (2002)

This structural feature of the economy is a result of the fact that Pakistan is one of those developing countries which neither export oil nor any other mineral. Moreover, Current Account Balance becomes very critical for those developing countries that are facing the fiscal deficit. If there is surplus in the current account then the deficit in the fiscal account can be financed by this surplus, and the country need not to obtain loans for financing of deficit.

**Figure 4: Deficit over the years**



Source: Author's Calculations

But if fiscal deficit is accompanied by the current account deficit then situation becomes extremely adverse and it is declared as "Twin Deficit Problem". A prolonged period of "twin" fiscal and current account deficits is usually unsustainable, as real interest rates rises and investment gets crowded out. As the country's overall financing constraint becomes binding. Fiscal deficits fed into current account deficits and the external debt problem became part of the public debt problem.

During the 1972-80 current account deficit was on average 5.4 % of GNP. In that period due to separation of East Pakistan exports have reduced, moreover in order to rebuild the country after the war Pakistan requires equipment and machinery so imports were rising. This increasing imports and soaring exports widened the current account deficit. In 1970s immigration to Middle East countries has considerably increased. Consequently worker's remittances have increased during 1980s and it helps in reducing the current account deficit to 3.9% of GDP. However in 1990s the current account deficit again raised to 4.5% of GDP. After that situation starts improving and in FY 2001-02 we have a surplus of 1.9% of GDP or 1.3 billion US \$, In 2004-05 after three years of surplus Pakistan once again caught by deficit of 1.6% of GDP. Rising price of crude oil, commodities, increase in the prices of exports due to higher domestic inflation and electricity crisis etc. are the major reason for the sharp increase in the current account deficit in recent years.

As figure 4 shows that during 1972-2007 except for three years the twin deficit exist, due to this unsustainable deficit Pakistan went deeper into the quagmire of debt.

## 6. Public Debt

Public debt refers to the borrowing by a government from inside or outside the geographical boundaries of the country over a period covering its entire history. There is a small distinction between public debt and deficit of a country debt is referred as a stock variable while deficit as a flow variable. Accumulation of deficit over the years becomes the debt of the country it can be further described by the following equations.<sup>10</sup> If  $G_t$  is government expenditure and  $T_t$  is tax revenue, then

$$\text{Primary deficit} = G_t - T_t$$

If  $D_{t-1}$  is last year's debt, and  $r$  is the interest rate, then

<sup>10</sup> Wikipedia (an online encyclopedia)

$$\text{Total deficit} = G_t + rD_{t-1} - T_t$$

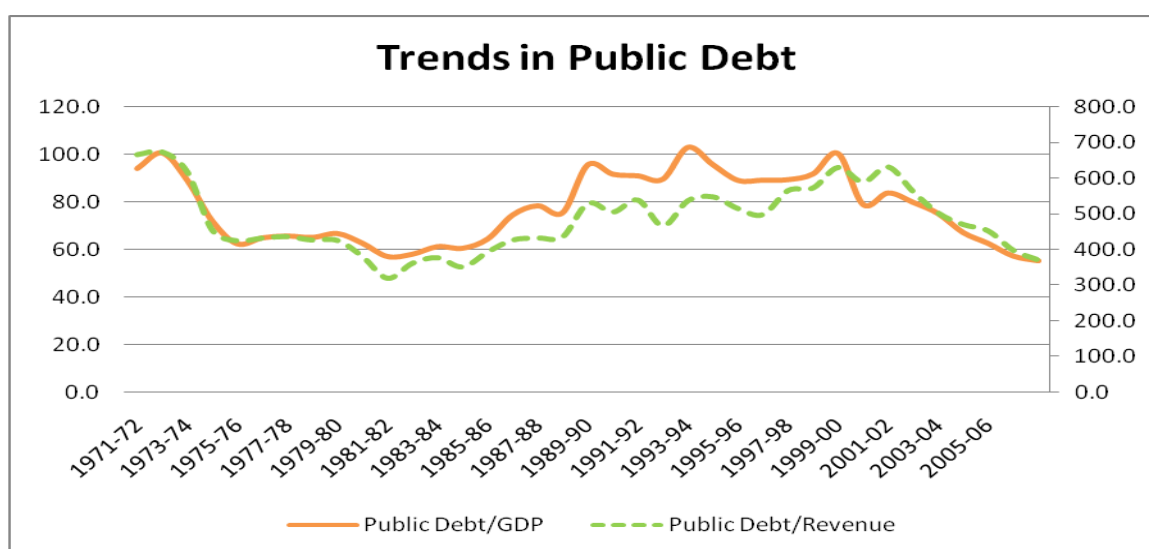
Finally, this year's debt can be calculated from last year's debt and this year's total deficit:

$$D_t = (1 + r)D_{t-1} + G_t - T_t$$

Public debt is an important resource of bridging government financing gaps. Effective and efficient utilization of public debt can increase economic growth and helps the government to achieve its development and social objectives. However, public debt is also a doubled-edged sword. Excessive reliance on public debt and inappropriate public debt management raise macroeconomic risks, impede economic growth, and hinder economic development.

Large fiscal and current account deficits coupled with the savings ratio below the investment ratio, resulted in accumulation of domestic and external debt in Pakistan. Pakistan entered the 21 Century with serious financial problems.<sup>11</sup> Public debt exceeded 90% of its GDP, over 600% of its annual revenues and debt servicing accounted for over half of the revenues. This situation was a result of slow economic growth, and heavily reliance on external resources over the years.

**Figure 5: Dynamics of Public debt in Pakistan**



Source: Economic Survey of Pakistan and SBP annual Reports

During the 1970's Public Debt was on average 74.3% of GDP and 493.4 % of revenues, in FY 1971-72 the public debt was 100% of GDP thereafter situation starts improving, and in 1979-80 it was reduced to only 62.6% of GDP. The debt problem with which the democratic governments struggled, although unsuccessfully, during the last decade was to a considerable extent inherited from the Zia period. During the Zia regime, 1977-88 public debt grew six folds and in nominal terms public debt grew at an average rate of 17.7% per annum and nearly 10 % per annum in real terms.<sup>12</sup> It reflects that growth rate of real debt was much higher than the growth rate of GDP and revenues. Rising primary deficit was a major reason of debt accumulation. It is worth mentioning that during 1980s as long as Afghan war was in full swing Pakistan debt was in sustainable levels, in FY1984-85 it was only 64.4 % of GDP, thereafter it start increasing and in 1989-90 it become 91.7% of GDP.

Inability of democratic governments to reduce the fiscal deficit significantly accompanied by recession and declining real revenues in the 1990s made the situation of debt burden even severe. During 1990s public debt as percentage GDP increased further and it become over 100 percent in 1998-99, the ratio of debt to revenues also increased from over 400% to 600 % moreover the ratio of interest payments to revenues also rose to well over 40 percent. 1990s would be remembered as a lost decade for the economy of Pakistan. During 1990s economic growth slows down and the entire macroeconomic variables shows a deterioration, the public debt was one of major factor for all that because during 1990s public debt was on average 91.8% of GDP and 545.6% of revenues. At that point of time, after the debt servicing Pakistan have very little resources available for social sector or development purposes.

<sup>11</sup> Fan (2007)

<sup>12</sup> Hassan (1999)

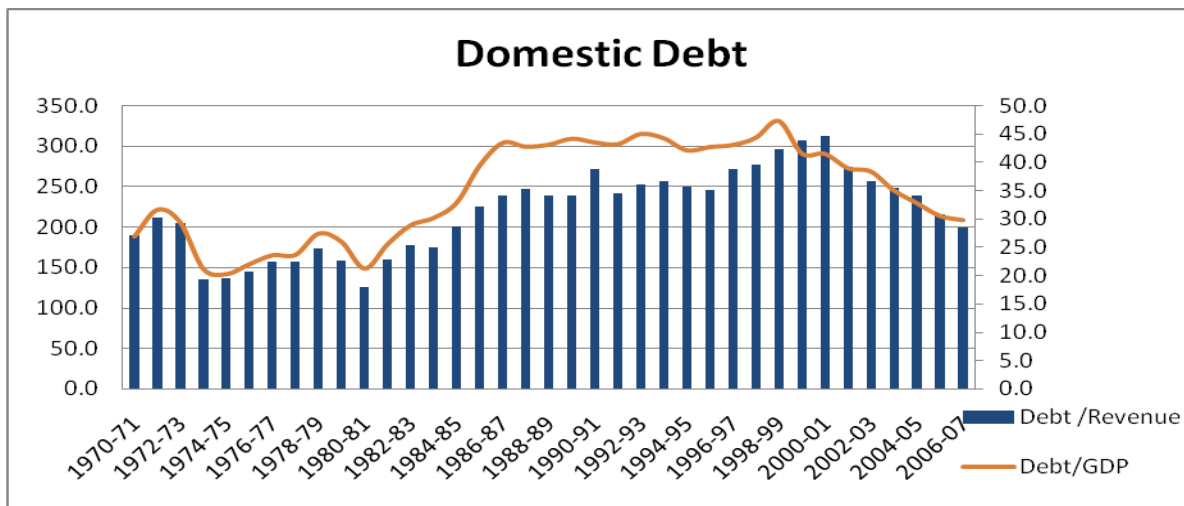


As far as Public debt is concerned 9/11 proved to be a blessing for Pakistan, it enable the country to reschedule its external debt and the Public debt to GDP ratio decreased in 2006-07 it become 55.2 % of GDP and 371% of revenues. Government can borrow from numerous sources, including central bank, domestic commercial banks, domestic non-bank sectors, and external sources. Government utilizes different options at the same time. Public debt has two major types; Domestic Debt and External Debt, debt accumulation by these sources has different macroeconomic implications.

**6.1 Domestic Debt**

Government borrowing from internal sources is referred as domestic debt. Government can kindle internal sources by different ways and all these have different insinuation. Borrowing directly from central bank is identical to printing money; it is highly inflationary in nature and normally discouraged. On the other hand borrowing from domestic commercial banks is less inflationary; however it has ‘crowding out effect’ for the private investment. Government can borrow from the non-bank private sector, it has no effect on the money supply and hence no implications for rise in interest rates and inflation, but the debt held by general public would exert upward pressure on interest rates from the demand side. The justification behind the creation of domestic debt in poor countries is that it could stimulate the development of deep and liquid internal financial markets and protect them from adverse external shocks and alleviate foreign exchange risk.

**Figure 6: Situation of domestic debt**



Source: SBP Annual Reports, Economic Survey of Pakistan

The ratio of domestic debt/GDP and domestic debt/ Revenue represents a country’s debt carrying capacity, empirically for domestic debt ‘threshold level’ has not been estimated yet. In Pakistan during the 1960s domestic debt was on average 25.5% of GDP, in the 1970s there is a slight change in this ratio and it was reduced to 25.2% of GDP and the domestic debt as percentage of revenue was on average 167.1 %, however in 1980s domestic debt increased and it become 35.2% of GDP and 203.1% of revenues. The 1990s was a period of debt crisis in Pakistan and during that period all the debt indicators become volatile, domestic debt become 43.8% of GDP with a maximum of 47.4 % of GDP in 1998-99. Similarly domestic debt as percentage of revenue also went up to 267.5%. After the 2001-02 the situation of debt starts improving and domestic debt which was once 47.4 % of GDP is reduced to mere 29.8 % of GDP in 2006-07. Similarly debt as percentage of revenue also improved and in FY1999-00 it was 308% of revenue, this declining trend persisted in next few years and in 2006-07 domestic debt was only 200.1 % of revenue. As Figure 6 shows that debt to GDP ratio and Debt to Revenue ratio grows almost at same rate until 1998-99, in 2000-01 debt to GDP ratio starts declining, but due to low revenue collection domestic debt as percentage of revenue continued to increase, and as the revenue was increased much slower than GDP, debt to revenue ratio also reduced slower than debt/GDP ratio. The domestic debt grew on average almost 28% per annum during 1980-85, 22% per annum during 1986-90 and 16% per annum during the 1990s. In spite of the high growth in government’s domestic borrowings during last two decades, growth in domestic debt started dipping at the beginning of 21<sup>st</sup> century.<sup>13</sup> The growth rate fell to 6.6% during 2003-04. Improvement in fiscal discipline, privatization of public sector enterprises coupled with rescheduling of external liabilities helps to reduce the growth in domestic debt.

<sup>13</sup> Economic Survey 2005-06

However, during FY 2006-07 growth rate in domestic debt was 11.9% per annum, this is a sharp increase compared to average growth rate of 7.7% per annum in last four years. The present scenario shows that the downward trend persisted from the beginning of this decade have started diminishing and demands strict policies regarding public borrowing.

### 6.1.1 External Debt

If domestic savings are not sufficient to meet the requirements of investment then the country has to rely on foreign savings and borrowing from external sources. External debt can be in the form of unilateral borrowing, multilateral borrowing, borrowing from consortium and donor agencies etc. Foreign borrowing allows a country to invest and consume beyond the limit of current domestic production and can be conducive for economic growth. However, excessive dependence on foreign borrowing exposes a country to several risks. Financing development related projects can help a country to build its production capacity and smooth the progress of economic growth. Particularly, borrowing from external sources enables a country to finance capital formation not only by mobilizing domestic savings but also by tapping into foreign capital surplus. However, excessive foreign borrowing and its improper use generates severe debt service obligations and hampers the economic growth.

Since 1947 Pakistan is facing resource constraint, as Pakistani society is consumption oriented so savings are much lower than the requirements of investment, and governments have been compelled to rely on foreign savings and external debt. 1960s is remembered as the decade of development but this growth was attained by applying the trickledown theory, in that period failure of the economic elite to save their increased income resulted in dire need for foreign aid. Resultantly, gross foreign aid inflows increased from US\$373 million in 1950-55 to US\$ 2,701 million in 1965-70. External debt and liabilities were only US \$ 3.4 billion in 1970-71 and it augmented to US \$ 6.3 billion in 1976-77. External debt during the Zia regime grew at faster pace, the external debt and liabilities which were US \$ 6.3 billion at the start of Zia regime went up to US \$ 21.8 billion in 1988-89. However due to Afghan war Pakistan has attained numerous concessions regarding debt servicing, and flow of foreign capital was also in rise. This situation enables Pakistan to evade the negative effects of external debt. But at the end of Afghan war, debt relief was withdrawn; the underlying problems began to become visible. Consequently, debt servicing combined with low savings rates, high borrowings and current account deficits (due to low export growth and poor infrastructure) resulted in prolonged economic recession in 1990s.

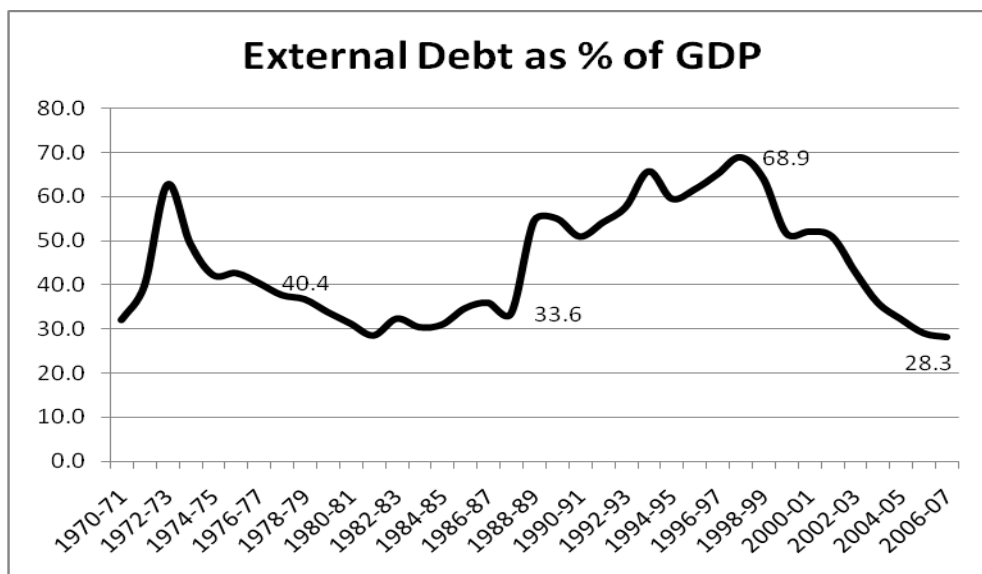
In 1990s external debt continued to grow and in 1997-98 it reached to US \$ 42.7 billion, After the Nuclear tests in 1998, different sanctions were imposed and the borrowing from external sources become limited, so external debt was slightly reduced to US \$ 37.6 billion. The event of 9/11 proved beneficial for Pakistan regarding external debt obligations, and external debt reduced to US \$ 35.3 billion in 2004-05. But thereafter external debt starts once again rising and reached US \$ 40.5 billion in 2006-07 and become US \$ 46.0 billion in 2007-08. The mounting current account deficit and currency depreciation are the key reasons at the back of the rise in external debt in recent years. In order to analyze the debt carrying capacity different indicators were used; the stock measurements of the external debt burdens are generally expressed in terms of ratios to GDP, ratio to foreign exchange earnings and ratio to exports of goods and services.<sup>14</sup> Similarly in the perspective of short-term debt or other short-term obligations, the level of foreign exchange reserves is an important indicator of the ability to withstand unexpected foreign exchange pressures. But stock measures must be supplemented by the appropriate flow measures. In the case of external debt, the most frequently used measure is the total annual debt service as a percentage of exports of goods and services.

Trends in the situation of external debt in Pakistan are highlighted in the Figure 7 along with table 1. During 1970s external debt was on average 43.2 % of GDP, external debt as percentage of GDP has declined in first half of 1980s, and increased in the later half however on average during the 1980s external debt was on average 36.8 % of GDP, the rising trend which started in 1988 persisted in 1990s and during that period external debt obligation increased much more than GDP. In first half of 1990s it was on average 57.6 % of GDP and in the latter half it become 62.3% of GDP and in FY 1997-98 it even went up to 68.9% of GDP. At the beginning of year 2000, economy of Pakistan has experienced a turnaround, GDP growth accelerated and most of the macroeconomic indicators improved significantly

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<sup>14</sup> Hassan (1999)

Figure 7: External Debt in Pakistan



Source: SBP Annual Reports and Economic Survey of Pakistan

Good growth performance accompanied with debt relief after participating in war on terrorism. Pakistan was able to made external debt sustainable and it become 52.1 % of GDP in 2000-01 and further reduced to 28.3% of GDP in 2006-07. It indicates that external debt grew much slower than GDP growth rate.<sup>15</sup>

External debt was 378 % of Foreign Exchange earnings in 1972-73. Pakistan was able to increase foreign exchange earnings by stimulating worker's remittances and exports and curtailing imports in 1980s. Resultantly, in 1980s External debt was on average only 178.1 % of Foreign exchange earnings. However along with other debt indicators this ratio worsened in 1990s and it rose to 292.4% on average with a maximum of 335.4% during 1998-99 (Confidence of investors shattered by freezing foreign currency accounts), reflecting that external debt grew more than our foreign exchange earnings, making the debt servicing capacity very limited. However, after 9/11 capital flows to Pakistan have increased and External debt as a percentage of Foreign exchange earnings was reduced to 124.7% in FY2006-07.

Table 1. External Debt &amp; Liabilities

Year	As Percentage of Foreign exchange earnings	As a ratio of Foreign exchange Reserves	As Percentage of GDP	As Percentage of Exports
1970,s	285.1 (1972-80)	-	43.2	477.2
1980,s	178.1	20.3	36.8	361.9
1990,s	292.4	30.4	59.9	449.2
1990,s-I	270.7	33.0	57.6	427.5
1990,s-II	314.1	27.8	62.3	470.8
2000-01	259.5	11.5	52.1	403.2
2001-02	237.0	5.8	51.0	399.9
2002-03	181.2	3.3	43.1	318.1
2003-04	164.6	3.0	36.0	286.3
2004-05	134.3	2.8	32.3	249.0
2005-06	121.1	2.9	29.1	228.3
2006-07	124.7	3.2	28.3	238.5

Source: Economic Surveys of Pakistan, SBP Annual Reports and Author's own calculations

<sup>15</sup> Hussain(2004)

The situation was alike for external debt as a percentage of Exports, taking 1970s as a starting point external debt was on average 477% of Exports. The situation improved in 1980s and again worsened in 1990s and touches the 500% in FY1993-94. The situation was improved after FY 2000-01, however, External debt as a percentage of exports has improved slower than external debt as percentage of FEE, reflecting that our export performance is not satisfactory. In 2006-07 external debt was 238.5 % of exports.

Another very important indicator is external debt as ratio to Foreign Exchange reserves. External Debt was on average 20 times of Foreign exchange reserves during 1980s. Due to Current account deficit Pakistan was unable to increase its foreign exchange reserves. During 1990s external debt become on average 30 times of Foreign Exchange reserves with a maximum of 46 times in a 1997-98. Thereafter situation starts improving and external debt was 12 times of reserves in 2000-01. As mentioned earlier after 9/11 capital inflows increased so in the next year ratio reduced to half, in 2001-02 external debt was 6 times of Reserves. It continued to decrease and in FY 2004-05 external debt was only 2.8 time of foreign reserves. However due to sluggish growth in exports , rising prices of imports, and rising Current account deficit the situation once again starts worsening and in FY 2006-07 external debt was 3.2 times of Foreign exchange reserves.

The issue of debt servicing is also very much critical and requires a proper analysis.

## 6.2 Public Debt Servicing

According to the report of debt management committee, Pakistan has been facing serious debt servicing problem regarding external debt as well as overall public debt, and the debt servicing is eating up the budget for a long time.

Public debt payments consist of two parts; debt service payments to foreigners for the external debt owed by the government and interest and principal repayments to residents for the domestic debt held by the public sector. There are some merits in considering only interest payments as domestic debt service burden, because monetary authorities of the country have control over their own currency, the rolling over of domestic debt can be taken as an option in the case of default. While on the other hand governments have very little control on the repayments of external debt. So payment of principle amount and interest payment for external debt both will be considered for analyzing the debt servicing of external debt. However in order to gauge the burden of public debt, measurement of annual revenues pre-empted by debt service whether domestic or foreign is very crucial. Detailed situation regarding debt servicing indicators is presented in Table 2.

During 1972-73 the expenditure on debt servicing was only 3.3 % of GDP and 22.4 % of revenues were spent on debt servicing. During 1970s situation of debt servicing remains bit satisfactory and stable, in 1970s total debt servicing was on average 3.3 % of GDP and 22% of revenues. Due to Afghan war Pakistan has received considerable loans in 1980s, as a result debt burden as well as debt servicing increased considerably. In 1980-81 expenditure on debt servicing was 3.3 % of GDP and 19.5% of Revenues; these ratios become double in 1989-90 reaching 7.3 and 39.2 percent respectively. During 1990s debt servicing was on average 8.0 % of GDP and 49.0% of revenues. FY 1997-98 was the worst year when debt servicing become 10% of GDP and the country was consuming 62.4 % of revenues on meeting debt obligations. This situation caused serious consequences for the economic growth in general and the poverty reduction and development in particular. As more than 50% of revenues were used to meet debt servicing obligations, government had very limited choices regarding expenditure.

The governments are not willing to reduce current expenditures which results in slashing development expenditures especially expenditure on health and education were curtailed. But these cutbacks have serious adverse effects on pro-poor economic growth. However due to debt relief attained after 9/11, the situation of debt servicing starts improving. In FY 2005-06 debt servicing was 3.9 % of GDP and 27.3% of revenues. As a result of reductions in debt servicing obligations, Pakistan was able to increase its development expenditure. Although these figures of debt servicing are a devastating, yet they understate the government liabilities. Contingent liabilities which might arise in the foreseeable future were excluded from official public debt figures. Contingent liabilities consist of guarantees to IPPs and public and private enterprises e.g. WAPDA, KESC and Pakistan Steel Mills, and the losses of public sector banks for bad loans.<sup>16</sup>

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<sup>16</sup> Pasha(1996)

Table 2. Debt Servicing

Year	Total Debt Servicing As Percentage of		Domestic Debt Servicing As Percentage of		External Debt Servicing As Percentage of		
	GDP	Revenue	GDP	Revenue	Export Receipts	Foreign Exchange Earnings	GDP
1960,s	-	-	-	-	28.63	-	1.10
1970,s	3.31	21.97	0.84	6.33	25.59	14.40	2.04
1980,s	5.12	29.41	2.55	14.60	25.59	12.33	2.50
1990,s	8.03	48.99	4.94	30.32	24.12	15.60	3.27
2000-01	6.70	50.42	4.53	34.09	21.30	13.70	2.80
2001-02	5.97	42.08	4.30	30.36	13.13	7.78	1.60
2002-03	5.07	33.92	3.46	23.15	12.10	6.50	1.60
2003-04	5.90	41.32	2.86	20.04	23.90	13.50	3.00
2004-05	4.00	29.22	2.68	19.59	10.10	5.40	1.30
2005-06	3.85	27.29	2.63	18.63	9.50	4.90	1.20
2006-07	4.37	33.12	3.26	24.72	9.30	4.90	1.10

Source: Economic Survey of Pakistan, SBP Annual Reports and Author's Own Calculations

Although the overall public debt servicing is a severe problem for long run perspective, external debt undoubtedly is the more pressing problem. Debt servicing burden rose dramatically during the 1960-75. Debt servicing as a percentage of foreign exchange earnings was 4.2 % in FY 1960-61 and it crippled to 18.1 % in FY 1972-73. Similarly external debt servicing as percentage of GDP was only 0.4 % in 1960-61 it rose up to 3.0 % in 1972-73. As far as external debt as a percentage of exports is concerned this ratio was 14.9% in FY 1960-61 and rises to 52.1% in FY 1969-70. All these indicators of external debt servicing illustrates that during the 1960-72 the expenditure on debt servicing rose much more than foreign exchange earnings and GDP, resultantly during that period debt carrying capacity was deteriorated. During 1970s debt servicing as a percentage of exports, foreign exchange earnings and GDP was on average 25.6%, 14.4% and 2.04% respectively. If we distribute the decade of 1980s into two halves: from 1980 to 1985 (when Afghan War is in its full swing) and 1985 onward (when USSR was defeated). During the first half of 1980s, Western countries has granted loans on concessional basis and provided relief on debt servicing, resultantly debt servicing was on average 2.05% of GDP, 22.53% of exports and 9.98 % of foreign exchange earnings. In the latter half the debt servicing as a percentage of GDP, exports and Foreign exchange earnings raised up to 3.0%, 27.2%, and 14.6% respectively. During 1990s debt servicing was on average 15.7% of foreign exchange earnings with maximum of 18% in 1997-98. Similarly external debt servicing on average become 3.3 % of GDP, with a maximum of 3.8 % of GDP in 1997-98. However, after the debt relief granted at the eve of participating in the war against terrorism all the indicators of external debt servicing starts improving and in FY 2006-07 debt servicing was 9.3 % of exports, 4.9% of foreign exchange earnings and 1.1 % of GDP showing a considerable improvement.

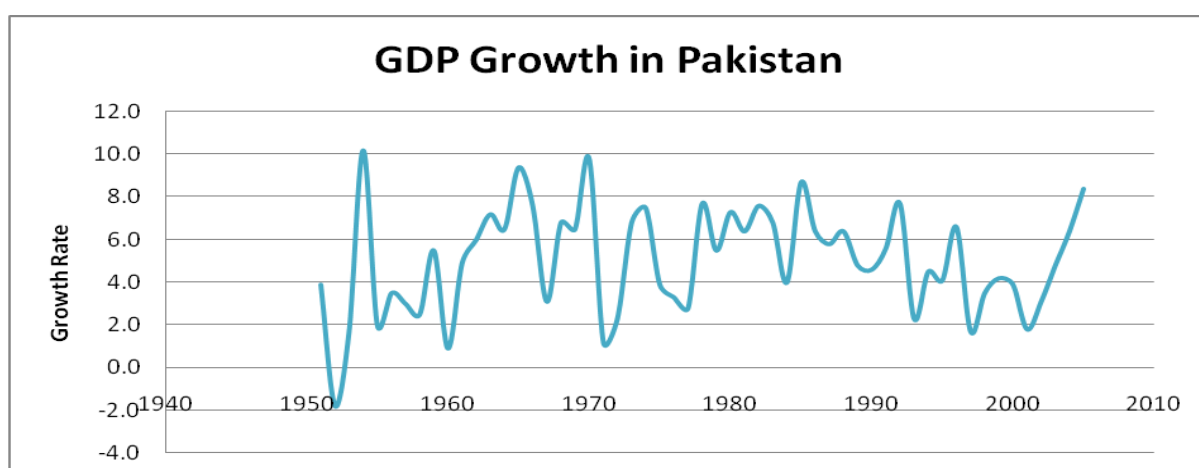
Domestic debt servicing as percentage of GDP and revenue remains stable in the decade of 1970s. Domestic debt servicing was on average 0.84% of GDP and 6.3 % of revenues. In 1970s different enterprises were nationalized. The nationalization policy had serious implications regarding domestic debt because most of these enterprises faced severe losses and in order to tackle these problems government had to take loans from domestic sources. Due to these consequences domestic debt servicing become severe in 1980s it become on average 2.6 % of GDP and 14.6 % of revenues. In 1990s debt servicing emerges as major problem of Pakistan economy. In the decade domestic debt servicing rose dramatically and domestic debt servicing become on average 30.3% of revenues with a maximum of 41.0 % in FY1999-00 and 4.9% of GDP with a maximum of 6.3% in FY1997-98. During first seven years of 21<sup>st</sup> century situation of domestic debt servicing starts improving and in FY 2005-06 domestic debt servicing was 2.63% of GDP and 18.63% of revenues.

## 7. Economic Growth in Pakistan

At the time of independence Pakistan was a very poor and underdeveloped country. Soon after its independence economy went into recession due to communal upsets, lack of infrastructure, weak or virtually absent industrial base.<sup>17</sup> During 1950s Economic growth remains rather sluggish and GDP growth was only 3.1% per annum. In 1960s economy started recovering, in the first half of 1960s due to better economic planning and its effective implementation (successful completion of 2nd five year plan) coupled with green revolution, development of financial institutions and industrial base helped the economy to recover quickly. The latter half of 1960s is attributed by the political unrest and negative impacts of the 1965 war; GDP growth slows down. The overall GDP growth during 1960s was 6.8% per annum. Slow GDP growth in the latter half of the 1960 persisted in the 1970s and 1971 war has made the situation even worst.

Consequently, economy went into recession at the same pace in 1970s as it had recovered during 1960s. Separation of East Pakistan, nationalization of industrial, financial and other institutions accompanied with worldwide recession caused by oil crisis resulted in the recession in Pakistan. During 1970s average GDP growth was only 4.8 % per annum. 1980 is a decade of revival of economic growth; GDP grew at an average rate of 6.5% per annum. This growth rate was achieved by promoting the private sector, denationalization and deregulation of industrial sector combined with stimulating the workers remittance flow and increased capital flows due to participating in Afghan war. During the last decade of twentieth century Pakistan faced severe fiscal imbalances--- Public debt grew rapidly during the 1990s and it become more than 100% of the GDP. Because of Nuclear Test in 1998 different sanctions were imposed on Pakistan. Moreover during the entire decade there was political uncertainty in the country. For these reasons average annual growth fell to 4.6% in the Nineties, with significantly lower growth in the second half of the decade. In the first half of 1990s growth averaged 4.9% and further decelerated to 4.0% per annum in the second half.

**Figure 8: GDP Growths in Pakistan**



Source: SBP Annual Reports

The growth rate touched its lowest of 2.0% in FY 2000-01. During that time more than half of the government's revenue was spent on debt servicing of public debt. After the event of 9/11, economic sanctions imposed following the Pakistan's 1998 nuclear tests, were lifted and debt was rescheduled. Resultantly near stagnant economy suddenly started showing miraculous growth. GDP grew at an average rate of 7.0% per annum during 2003-07. At present due to electricity crisis, rising prices of oil, commodities, increasing current account deficit and bad law in order situation, Pakistan economy is threatened to lose its momentum.

The GDP growth in Pakistan has fluctuated significantly over the years. If in one decade country was categorized as fastest growing in the region, then in other decade it lost those gains. The coefficient of variation of growth rate of GDP was 1.08, 0.28, 0.49, 0.20, 0.42 and 0.45 in 1950's, 1960,s, 1970,s, 1980,s, 1990, and first five years of current decade respectively.<sup>18</sup>It can be summarized that economic mismanagement in general and fiscally imprudent economic policies in particular, caused a large increase in the country's public debt which resulted in reducing the economic growth in 1990s. Pakistan's economic outlook has brightened in recent years in conjunction with rapid economic growth and a dramatic improvement in foreign exchange reserves position.

<sup>17</sup> Khan (2006)

<sup>18</sup> Siddequi (2006)

## **8. Poverty in Pakistan**

Poverty alleviation is a principal objective of the developing countries. In Pakistan, the economic debate on poverty did not receive serious consideration until much later, although Pakistan Peoples Party's slogan of "Roti, Kapra and Makan" brought poverty to the forefront of the political manifesto in early 1970s. The issue entered in academic and research mainstream much later.

Reliability and availability of data is a major constraint for research on the issue of poverty. In Pakistan, household surveys are not conducted on regular intervals. From a poverty assessment prospective, there are merits and demerits of conducting surveys on consistent basis.<sup>19</sup> Consecutive surveys and estimates do not reveal much information about poverty headcount estimates because data shows only minor variations. However they are helpful for monitoring and assessing the sensitivity or robustness of estimates to changing economic conditions. A long time series helps in defining a 'structural' relationship between poverty and other economic indicators. Poverty has numerous dimensions and indicators e.g. income poverty, child mortality, illiteracy, inaccessible markets and vulnerability to economic shocks etc. Health and education are two important dimensions of the incidence of poverty.<sup>20</sup>

Illness resulted in the lost of wages and cause high spending for healthcare and it thrust poverty on the people. The healthcare facilities in Pakistan present a very disappointing scenario. It is the outcome of extremely low expenditure on health over the last 60 years. Health expenditure in Pakistan remains at low band of 0.5-0.8 % of GNP during 1970-2007. In FY 2006-07 health expenditure was only 0.6% of GNP, which was very low compared with other developing countries. Not only the health expenditures are low but delivery of available healthcare facilities is also inefficient. Moreover, primary healthcare and rural health services were ignored and the priority was given to hospitals, medical colleges and curative services in the urban areas. It resulted in high rural-urban disparity in health care facilities and increases the poverty level in rural areas. In Pakistan infant mortality rate was high at 70 per thousand live births; life expectancy was low at 64 years in 2005. Comparing the indicators in 2003, 82 per thousand live births and life expectancy of 63 years, there is improvement in health indicators but pace is rather slow.

Likewise, low literacy rate is one of the most important determinants of poverty and unequal access to educational opportunity is strongly correlated with income inequality. Public expenditure on education was on average 0.8% of GNP in 1980s, 2.3 % of GNP in 1990's, lowest in FY 2004-05 of only 1% of GNP and 2.4 % in FY 2006-07, that is much lower than other low income countries of the region. Moreover as in the case of health expenditure, most of spending on education goes largely to the recurring expenditure. Similarly, allocation within the sector is also directed to those areas that do not benefit the poor. Historically, priority was given to the higher education, whereas primary education was ignored. As a result, literacy rate was just 55 percent and gross primary enrolment rate was 87 percent in 2006. Pakistan's health and education indicators represent a depressing picture when it is compared with the countries with same level of development such as India, Bangladesh, China and Sri Lanka. There is a dire need to increase the expenditure on health and education.

In contrast to the human development dimensions of poverty, absolute poverty describes poverty in terms of the provision of minimum physical needs, enabling them to engage in economic activity. The most commonly used standard for the measurement of income or consumption related poverty is calculating poverty line (based on some minimum acceptable level of consumption) and estimating the proportion of population below that line. In Pakistan, there has never been a uniform methodology for estimating poverty and that has been the cause of considerable uncertainty regarding the incidence of poverty in the country.

Federal Bureau of Statistics is providing data on poverty since 1964, quality of data is reasonably good. A trend in the situation of the poverty can be seen from Figure 9. Poverty has declined in the urban areas until 1970, but increased in the rural areas leading to an increase in overall poverty in the country. Subsequently, during 1970-88 poverty declined in both rural and urban areas. Numerous factors including; green revolution, boom in the housing and construction sectors, as well as rapid expansion of the public sector, and inflow of workers' remittances from the Middle East has contributed in curtailing the poverty. During 1990s Pakistan faced a sluggish economic growth, macroeconomic instability and debt crisis. Consequently, incidence of poverty also increased from 22 - 26 % in 1991 to 32 - 35 % in 1999.

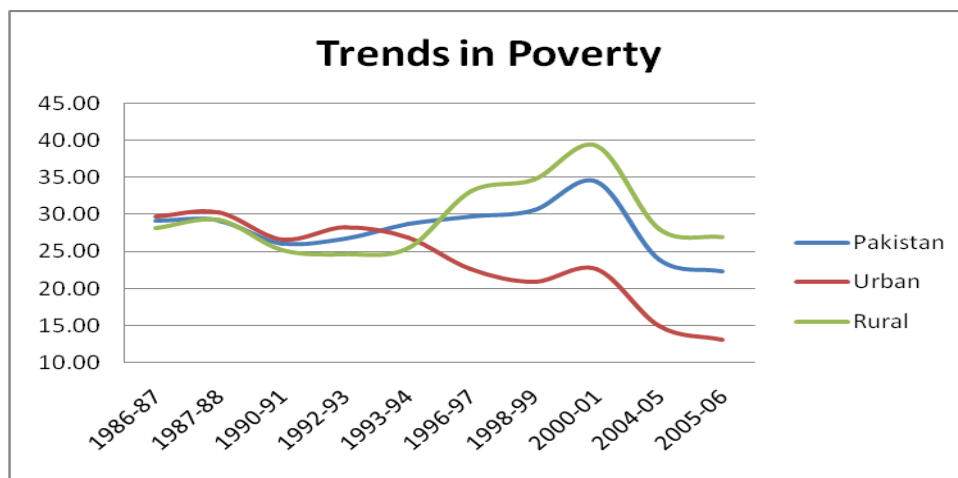
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<sup>19</sup> Economic Survey of Pakistan (2007-08)

<sup>20</sup> Anwar (2004), for a comprehensive discussion see World bank Report No. 24296-PAK, titled Pakistan poverty assessment

Incidence of poverty was 34.5% in 2001, thereafter incidence of poverty starts declining and in 2005 it has reduced to 23.9 % and in the next years it has further reduced to 22.3 %. However reduction in poverty in that period is rather controversial, lot of questions has been raised on the authenticity of the data of PSLM survey of 2004-05.

**Figure 9: Poverty Head count ratios in Pakistan**



Source: Economic Survey of Pakistan

Information on income distribution is considered as an indicator of relative deprivation. In 1987, the income share of the bottom 20 percent of households was 7.9 % and has reduced to 6.9% in 1997. During the period income share of the bottom 40 percent of households declined from 20 percent to 18 percent. Similarly, ratio of the share of the top quintile to the bottom quintile also increased to 6.5 from 5.2 for all areas. However, at the start of 21st century the share of bottom 20 percent has increased, in 2001 it was 10.1 % but according to PSLM 2005-06 this share has reduced to 9.6 %. Similarly, in 2001 ratio of highest to lowest was 3.76 % this ratio has increased to 4.2 % in 2005.

## 9. Conclusion

At the time of independence Pakistan was a poor and underdeveloped country. In order to stimulate economic growth, adequate revenues are a prerequisite but since 1947 Pakistan is facing financial crunch. Confined revenues and savings coupled with rising expenditures have caused the situation of persistent fiscal deficit over the years. Similarly situation of balance of payment is also not satisfactory and Pakistan is facing the current account deficit. Although these deficit were filled by public debt, but Pakistan has to spend considerable portion of its GDP on the interest payments of the loans. The need to service debt obligation is undermining the economic performance and resulting the collapse of development planning. As debt obligations and expenditure on debt servicing become a resource drain for already limited revenues and is halting the economic growth and poverty reduction efforts. Decade of 1990s is a typical example of this situation, during 1990s Pakistan was facing severe fiscal deficit, elevated public debt and near to the ground economic growth and rising incidence of poverty. Developing countries with higher incidence of the public debt have to cope with same situation.

Several points can be concluded after examining the Public debt scenario in Pakistan. Firstly, the debt problem has been in making for a long time. Inability of successive governments to reduce the fiscal deficit significantly, unproductive use of debt and stagnant growth in real revenues has fuelled the debt problem. Secondly, rising public debt in Pakistan is largely contributed by factors like stagnant government revenues and high real cost of borrowing. As a result of the sharp fluctuation in the real cost of borrowing, the dynamics of the growth in public debt also changed over time. Thirdly, debt problem can't be detached from broader issues of economic strategy and management especially policies regarding savings, exports, and revenue, expenditure etc. Lastly, due to rising expenditure on debt servicing governments have always reduced the development expenditure instead of reducing the current expenditure. However, improved situation of Debt obligations aftermath of 9/11, Pakistan got considerable fiscal space to increase expenditure on development projects especially in social sector and infrastructure development, extremely vital for pro poor and sustainable economic growth. Pakistan got much needed fiscal space but it is debatable whether Pakistan has developed a sound fiscal policy to get long term benefits from it or not. Debt explosion coupled with higher fiscal and current account deficit resurfaced in 2008 and is a major threatening syndrome for economic management, it depicts that Pakistan has wasted the opportunity for sustainable growth.



As far as the situation of economic growth and poverty is concerned, Pakistan economy have shown great resilience over the years against disastrous events e.g. Wars with India, Separation of east Pakistan, Afghan War and event of 9/11 etc. Pakistan faced some troubling eras like decade of 1950,s, 1970,s and 1990,s and also economy went from some good times also, e.g. 1960-65, 2001-07 in these time Pakistan was considered as a role model for economic development. The Situation of Poverty reduction is not satisfactory; Pakistan's health and education indicators depict a dismal picture when compared with the countries with same level of development. Incidence of Poverty also increased from 22 - 26 % in 1991 to 32 – 35 % in 2001, but thereafter it has reduced to 22.3 % in 2005-06.

It can be concluded that Pakistan's increasing debt servicing requirements in the 1990s exerted significant strain on fiscal management. In order to meet the commitments under IMF's structural adjustment program, Pakistan had to reduce the size of the budget deficit to less than 5 % of GDP during 1990s. As revenue generation efforts was only partially successful and Pakistan was unable to generate adequate revenues to meet expenditure. Consequently, successive governments have tried to reduce the deficit by reducing the development expenditure which hampered the growth process and resulted in a decline in human development indicators and increased the incidence of poverty. Moreover, public debt servicing placed serious constraints for the priorities of the government's budgetary allocations, leaving very limited resources available for development expenditure. But aftermath of 9/11, Pakistan got debt relief and debt was rescheduled; it provided considerable fiscal space to increase the development expenditure, during that period GDP growth was accelerated, incidence of poverty reduced, social indicators improved although rather slowly.

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