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Sovereign debt

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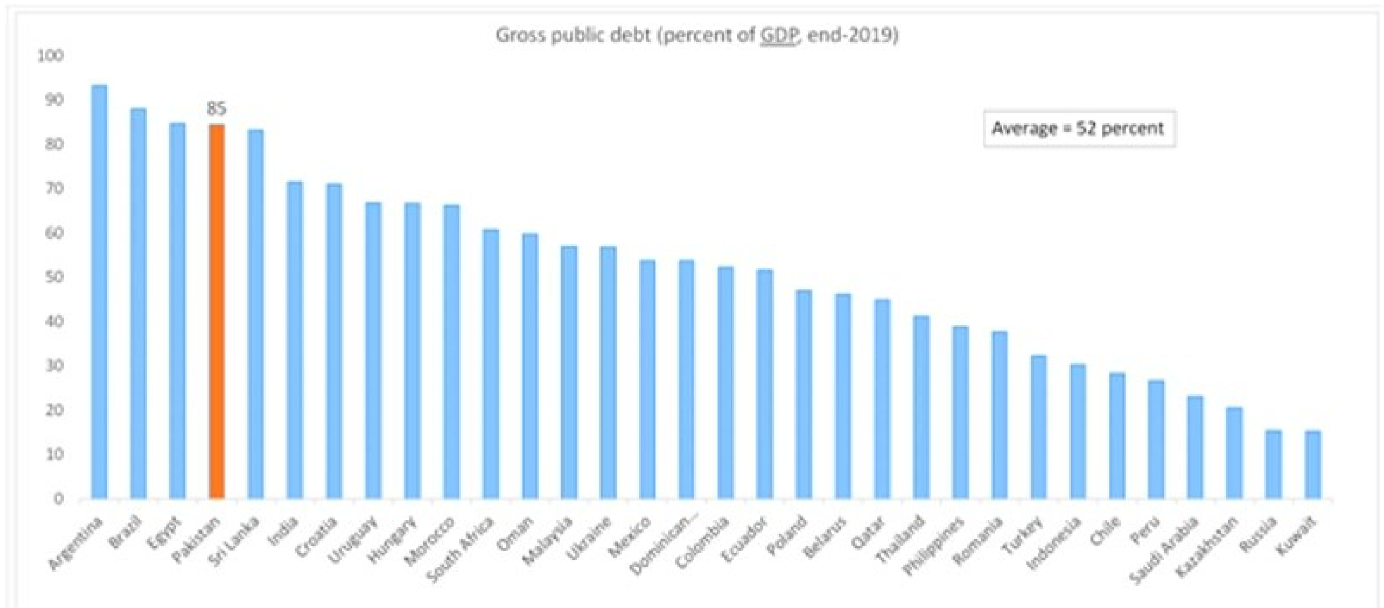
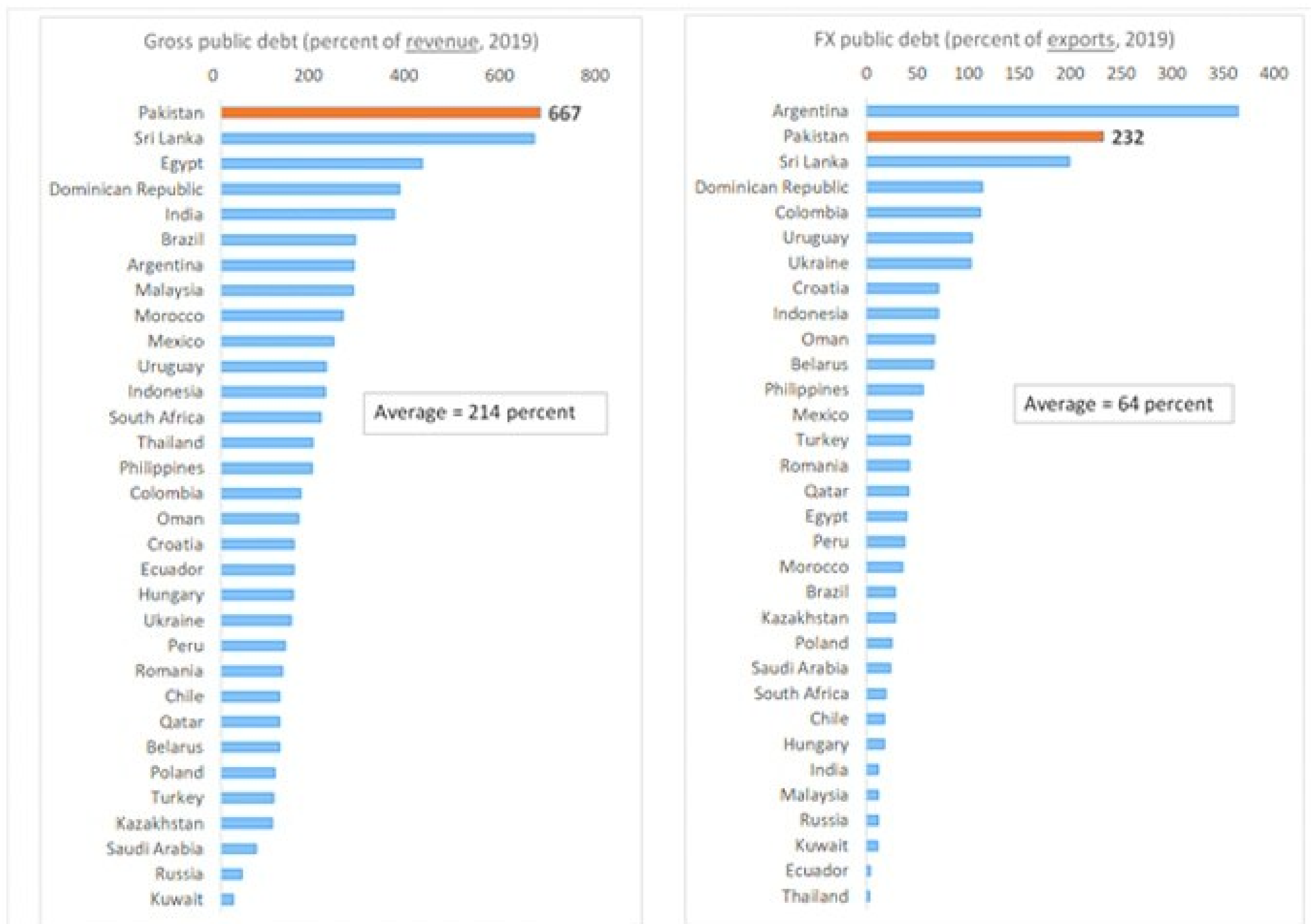
THE recently released Debt Policy Statement for 2019-20 is a sobering reminder of Pakistan's massive public debt vulnerabilities. The report places Pakistan's public debt to GDP ratio at 85 percent at end-2019. This is indeed high relative to the 60 per cent benchmark set in the country's Fiscal Responsibility and Debt Limitation Act, 2005. It is even higher compared with the 52pc average for other emerging

economies reported in the latest IMF *Fiscal Monitor*, establishing the need for sustained fiscal consolidation.



The report also has some revealing statistics on the real Achilles heels of Pakistan's public finances: a public debt-to-government revenue ratio of 667pc, three times as high as the average for emerging markets, and largely reflecting Pakistan's very narrow tax base; and a foreign currency public debt-to-exports ratio of 232pc, 3.6 times the average for emerging markets. A third vulnerability – large annual public gross financing needs (projected at 46pc of GDP for 2020 – explained in my last article), appears to have been partly mitigated by a non-trivial extension of the maturity of domestic public debt, from 1.6 years at end-FY2018 to 4.2 years at end-FY2019.



Against the backdrop of these daunting public finance challenges it is useful to reference a new foundational text on sovereign debt that has just been published by Oxford University Press: *Sovereign Debt: A Guide for Economists and Practitioners*. The book is edited by S. Ali Abbas and Alex Pienkowski (two staff members of the IMF) and Professor Kenneth Rogoff of Harvard University.

The text is a comprehensive guide, compiling contributions from the world's leading sovereign debt experts, including, notably, Dr Reza Baqir, the Governor of the State Bank of Pakistan. It covers a wide range of issues, from debt management to debt sustainability, debt reduction policies to sovereign debt restructuring, connecting history to the present, and illuminating actual country examples to help translate theory into practice.

> *The report has some revealing statistics on Pakistan's public finances.*

A number of chapters in the book seem pertinent for Pakistan.

Chapter 2 on **debt concepts and definitions** shows how experts measure and slice public debt. The chapter also highlights the pitfalls of non-transparent public finance reporting, and how it can lead countries into crises later on. In this context, Pakistan would be well advised to

abandon its past practices of hiding deficits and debts, and to also allay concerns about transparency of CPEC-related debts.

Chapter 3 lists the good and bad **motives for government borrowing**. The good ones include tax smoothing/countercyclical demand stimulus, financing productive investments in human and physical capital; and providing a safe financial asset around which financial markets can develop. The bad ones include: electoral/political cycles; pet projects spending (without appropriate regard to hurdle rates), strategic debt accumulation to limit successor government's ability to spend, and transferring resources from future generations to the present. It also notes that fiscal rules (like the FRL benchmark of 60pc debt/GDP) may not work in isolation; an independent fiscal council (currently missing in Pakistan) can serve as an important disciplining device.

Chapter 5 on **debt management** sets out the benefits of developing long-term local currency debt markets, as a substitute for foreign currency borrowing in which the sovereign bears the risk of currency depreciation. The chapter also highlights the need for a sound institutional setup for debt and cash management, and lays out some models which could be considered in the context of a restructuring of the finance ministry.

Chapter 6 on **reducing debt** offers the sobering advice that large fiscal consolidations should not be pursued when the economy is fragile. While Pakistan's ongoing consolidation may have been unavoidable due to the country's tight financing constraints, the government should seize the first opportunity (such as, in the context of the ongoing oil price decline) to give some respite to the economy. In such contexts, the chapter argues, a steady dose of moderate inflation and some financial repression can also help liquidate the burden of local currency public debt.

A guide written for an international audience cannot contain a precise recipe for Pakistan's debt problems. Indeed, the book emphasises that there is no 'one-size-fits-all' approach, and country-specific factors like debt structure, cyclical position, institutional quality, and openness of the economy, matter critically for designing the debt reduction strategy. But the wealth of information in this text renders it a must-read for Pakistan's fiscal policymakers.

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