THE PERFORMANCE OF “PAKISTAN FISCAL RESPONSIBILITY AND DEBT LIMITATION” (FRDL) ACT 2005

Imran Naveed Khan

Abstract

Several countries have controlled severe debt problem with the help of formulation of debt management policies and fiscal responsible framework. Total debt has shown rising trend during the last thirty-six years and Pakistan public debt/GDP has been about 91.8% at the start of the 21st century. Pakistan government has also formulated the debt management policy to diminish the debt burden in the economy in the form of FRDL Act 2005. This study analyses the performance of FRDL Act for the period of fiscal year 2003 to fiscal year 2015. Consequently, the PD/GDP ratio fell to 53% in FY07. After that, PD/GDP ratio started to increase and moved around 65% during FY12-FY15, higher than the 60% limit fixed in FRDL Act 2005. As a result, per capita debt burden jumped to Rs. 104530 (US$1027) in FY15 compared to Rs.31308 (US$518) in FY07 and average household family burden rose by more than double during this period. Twin deficits, higher subsidies, double digit inflation, drying up of external program loans, lower revenues, transfer of the 70% federal govt. collection to the provinces under the 7th National Finance Commission (NFC) Award, undeveloped domestic debt market and currency devaluations were the major factors responsible for violation of the FRDL Act 2005.

Keywords: Stabilization, Debt Management, Public Debt, Fiscal Responsibility.

JEL Classification: H390

Introduction

Economic history shows that many countries have faced the debt problems for many years and they controlled the severe debt issues with the help of formulation of proper debt management policies or fiscal responsible frame works. For example, the ratio of public debt to GDP in the US had risen from 32.3% in 1974 to 65.7% in 1993. To tackle the debt problem, the US government had passed the “Omnibus Reconciliation Act” of 1993 (OBRA 2 1993) by raising the revenues and cut appropriations spending over the next five fiscal years (1994-98). Resultantly, public debt/GDP ratio

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2 See OBRA 1993 better known as Deficit Reduction Act of 1993
fell to 54.7% in 2001. New Zealand faced a similar problem of higher debt to GDP ratio in 1980s. In 1985, public debt/GDP (PD/GDP) ratio was at 71.8% compared to 63.1% in 1994. The New Zealand “Fiscal Responsibility Act 1994” designed to improve the fiscal performance and management to bring a long-term concentration to budgeting. Consequently, public debt/GDP ratio fell to 37.6% in 1998.

The historic balance of India resulted in many changes in the Indian economy, comprising the procedure of economic liberalization in India. In 1991, public debt/GDP ratio of India noted at 75.6%, which rose to 84.3 % in 2003. To tackle these changes, Indian government introduced the “Fiscal Responsibility and Budget Management Bill” in 2000 which subsequently changed to the “Fiscal Responsibility and Budget Management” (FRBM) Act 2003.

Like others, Pakistan also faced debt problem for many years and volume of the total debt has shown rising trend during the last thirty-six years. At the start of the 21st century, Pakistan public debt to GDP ratio was about 91.8 %. Pakistan government has made efforts to reduce the debt burden in the economy. Pakistan govt. introduced the “Fiscal Responsibility and Debt Limitation” (FRDL) Act 2005 on 13 June, 2005 for removal of revenue deficit and decline of public debt to a reasonable level by effective “debt management”. As a result, PD/GDP ratio fell to 53.0% in FY07. After that the PD/GDP ratio starting to increase again and moved around 65 % during FY12-FY15, much higher than the limit fixed in FRDL. The objective of this study is to appraise the performance of FRDL ACT for the stipulated time FY03-FY15. The plan of this research is as follows:

Section II analyses the relevant literature and section III delivers a brief discussion on several countries’ debt management policies or fiscal responsible frameworks to handle the debt problems. Section IV discusses the debt structure of Pakistan during the last thirty-six years (FY79-FY15). Section V provides discussion on methodology, data, and sources of different variables used for the debt analysis and FRDL limitations. Section VI describes the performance of FRDL Act 2005 during FY03-FY15. Section VII discusses the conclusion of the study.

Literature Review

Various studies have estimated the connection between the debt and real GDP. Three views prevail in literature regarding the impact of deficits/debt on economic activity. Sawhney and Di-Pietro (1994) studied the influence of public debt/deficit on the economic performance of cross-sectional data for 50 countries during 1976-83 and showed that capital, labor, human capital, and trade openness contributed significantly while debt and deficits have insignificant impact on economic growth. Smyth and Hsing (1995) examined the presence of an optimal debt to GDP ratio that maximizes “economic growth of USA” for 1960-91. The results show that economic growth and its determinants were co-integrated and have a stable long-run relationship. Optimal debt ratio (is 38.4%) for public debt and 48.9% for total debt in the USA which are much higher than the debt fixed in the Budget
Reconciliation Bill of 1993. Friedman (1992) bids many insightful observations about debt issue and deficits in the Reagan administration (the 1980’s). Declines in expenditure were less than the cuts in tax receipts. Private investment fell because of greater deficits. The “Laffer curve” has positive slop. Therefore, cut in tax rates dropped the total tax revenues, which leads to massive deficits.

Barro (1989) examined the economic effects (particularly on consumption and current account balance) of budget deficits in terms of Ricardian and others standard views, which explained that there is no correlation between budget deficit and real interest rate whereas many economists such as Evans (1988) tested these proposition and found a little/weak relationship between budget deficits and interest rate. Baker (2005) analyzed the second term of President Bush administration in regards to foreign challenges, reasons for historical highest budget deficits, and its impact on the world economy. In this article he also criticized the lack of economic leadership in cutting its budget deficits and examined the impact of serious efforts (if it took place) for reduction in the US fiscal deficit on helpful in stabilizing international capital flows, depreciation of USD, and exports of economic partners.

Koeda (2008) presented a model to describe how debt overhangs generated in LIC and its implication for design and formulation of policies for aid and relief of debt. He found that the analysis of debt-overhang and debt relief policies depend on the primary economic conditions and factor productivity in the recipient country. Siddiqui and Afia (2001) discussed the link between economic growth and debt in South Asian economies and found that debt burden indicators (debt/GDP, debt servicing to export ratio, etc.) highlight the importance of improving macroeconomic management by the efficient use of resources to reduce debt burden. As far as the Pakistan debt burden was concerned, the mismanagement of resources, loss of competitiveness in global market, macro imbalances, and the role of political agents has seriously raised the debt burden.

Ahmad et al. (2000) elaborated the crucial issue of acceleration of economic growth in developing economies and investigated causality between export growth, economic growth, and external debt by using the cointegration test to Asian countries (South Asia and South East Asia region separately) during 1970-97. Reinhart and Rogoff (2010) analyzed the relationship of inflation economic and growth at different debt levels for 44 countries for two centuries. The main results of this study are (a) the relationship between economic growth and government debt is weedy for debt/GDP ratio below 90%, (b) above 90%, median growth rates decline by 1%, and average growth falls much more, (c) threshold level of public debt is similar in emerging and advanced economies, (d) when foreign debt to GDP ratio reaches 60%, annual economic growth decline by 2%, (e) for higher external debt to GDP ratio, growth rate slash by half %, and (f) there was a strong relationship between inflation and debt level in emerging economies, inflation rises sharply as debt increases.

Greeenidge et al. (2012) tackled the issue of threshold effects between economic growth and public debt for 12 Caribbean countries for 1980-2010 and found that a threshold debt/GDP ratio (of 55-56%) prevailed in the countries. In addition, debt dynamics also change before the threshold level.
Lower than 30% debt/GDP ratio related with faster economic growth. After that level effect on economic growth weakens quickly and as debt/GDP reached at 55-56% level, the growth impacts switched from positive to negative.

Review of selected economies3 debt management policies and fiscal responsibility framework

A large number of debt management and fiscal responsibility frameworks were developed all over the world in 1990s, which includes both developed and developing economies to handle the fiscal discipline. These policies dealt with the issue of short term movements of deficits/debt ratios and long-term commitments. The main objective of FRBM act was to institutionalize financial discipline, improve macroeconomic management, and reduce India fiscal deficit. Following were the main fiscal targets/indicators of FRBM act:

- “To eliminate the revenue deficit by March 31, 2009.
- Minimum annual reduction of revenue deficits by 0.5% or more of GDP at the end of each fiscal year, beginning of 2004-05
- The ceiling for fiscal deficit is 3% of GDP by March 31, 2008.
- Minimum annual reduction of fiscal deficits by 0.3% of GDP.
- Total debt to GDP ratio fixed at 9% (a target increased from the original 6% requirement in 2004-05).
- Total debt/GDP ratio reduces by 1% on annual basis.
- Reserve Bank of India purchase of Government bonds – to cease from April 1, 2006”.

Nevertheless, due to 2007 global crises, deadlines or implementation of the targets in the act was postponed and deferred in 2009. In 2011, Indian government reinstated the provisions of the FRBMA. Some of the major findings are presented below.

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3 These economies were randomly selected and lot of material is available in literature regarding the performance of debt management in these economies.
4 See FRBMA 2003
policies or fiscal responsible frameworks. For example, the ratio of public debt to GDP in the US had risen by more than double during this period. Twin deficits, higher subsidies, double digit inflation, (US$1027) in FY15 compared to Rs.31308 (US$518) in FY07 and average household family burden the 60 % limit fixed in FRDL Act 2005. As a result, per capita debt burden jumped to Rs. 104530 period of fiscal year 2003 to fiscal year 2015. Consequently, the PD/GDP ratio fell to 53% in FY07. Several countries have controlled severe debt problem with the help of formulation of debt manage-

Introduction

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Figure 1: India Revenue Deficit

The performance of Indian government regarding revenue target (both in percent of GDP and growth) is presented in Figure-1. Similar trend was also seen in the performance of gross fiscal deficits during 2004-05 to 2011-12 (Figure 2).

Figure 2: India Gross Fiscal Deficit

The OBRA-93\(^5\) was passed by congress and signed by President Bill Clinton. The main points of OBRA-93 were as following:

\(^5\) It also known as the “Deficit Reduction Act” or “Revenue Reconciliation Act “of 1993.
Table-1 demonstrates the major categories of deficits reduction over the time period of 1994 to 1998. The reduction in deficits was a combination of increase in revenues as well as decline in the expenditure. As results of efforts made in OBRA-93, the US public debt to GDP ratio declined from 65.4% in 1993 to 60.8% in 1999 and further fell to 53% as GDP in next two years (see Figure 3).

**Table 1:**
*Selected Major Categories of Deficits Reduction (billion US$)*

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<td>Revenues</td>
<td>29</td>
<td>44</td>
<td>48</td>
<td>61</td>
<td>59</td>
<td>241</td>
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<td>Mandatory Cuts</td>
<td>11</td>
<td>12</td>
<td>21</td>
<td>25</td>
<td>30</td>
<td>99</td>
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<td>Discretionary Cuts</td>
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<td>15</td>
<td>17</td>
<td>25</td>
<td>36</td>
<td>102</td>
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<tr>
<td>Interest Savings</td>
<td>1</td>
<td>4</td>
<td>9</td>
<td>16</td>
<td>24</td>
<td>54</td>
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<tr>
<td><strong>Total</strong></td>
<td>50</td>
<td>75</td>
<td>95</td>
<td>127</td>
<td>149</td>
<td>496</td>
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*Figure 3: Public Debt to GDP Ratio in USA*

New Zealand economy also faced severe debt problems in early 1990s. Government expenditure increased to about 40% of GDP in early 90s against 30% of GDP in 70s. This rise in expenditure was shared by rising benefit expenditure and higher debt servicing. Public debt/GDP augmented from 40.6% in 1974 to 76.1% (a peak level) in 1987. To improve the fiscal or debt management, New Zealand government introduced the “Fiscal Responsibility Act” (FRA6) in 1994 to identifying principles of fiscal responsible management and firming reporting requirements. Following were the five principles for effective fiscal management policy as discussed in FRA-1994:

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6 Improve fiscal policy, code identification for responsible fiscal management and firming reporting requirements were the main goals of FRA.
1. Reducing total Crown debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of total Crown debt in the future by ensuring that until such levels have been achieved, the total operating expenses of the Crown in each financial year are less than its total operating revenues in the same financial year.
2. Once prudent levels of total Crown debt have been achieved, maintaining these levels by ensuring that, on average, over a reasonable period of time, the total operating expenses of the Crown do not exceed its total operating revenues.
3. Achieving and maintaining levels of Crown net worth that provides a buffer against factors that may impact adversely on the Crown’s net worth in the future.
4. Managing Prudently the fiscal risks facing the Crown.
5. Pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

It is important to note that departure from the principles is possible. However, in that case the law requires such departures to be short lived and that the Finance Minister describes the situation which resulted in the depart. During the first half of 1990s, New Zealand fiscal position improved mainly on the basis of reduction in expenditure while the revenue as percent of GDP remained broadly stable. The fall in spending partly reflects fiscal surpluses, lower finance costs, and sales of asset to reduce the overall debt. In addition, decline in expenses through the 1990s also moderately reveals the economic upswing and the allied reduction in unemployment benefit costs. The fiscal discipline in the core public sector and rise in the age of entitlement for New Zealand Superannuation (NZS) also backed the decline in expenses-to-GDP. Changes in the debt/GDP ratio (both public debt and net debt) improved significantly after the implementation of the FRA-1993 (see Figure 4).

![Figure 4: New Zealand Public Debt to GDP Ratio](image)

Similarly, UK government has set out numerous fiscal policy principles in 1997. The Golden Rule was introduced by Mr. Gordon Brown in 1997 and approved in December 1998. These rule states that over the economic crises, the Government will borrow only for capital formulation (to
benefit for the future generations) and not for funding of current outlay. The framework of the “golden rule” is to maintain a stable allocation of resources in the business cycle. Stability is defined in terms of the following ratios:

2. The ratio of public current expenditure to national income.
3. The ratio of public sector income to national income”

The UK witnessed 10% deficits/GDP (with one of the highest deficits in the G20). UK ran surpluses in just three years (1999-2001). From around 2002 a stubborn gap opened between expenditure and revenue which the Treasury did little to close. This gap expended further in 2008 on the back of arrival of the financial crisis led to much lower tax revenue while spending continued to grow. The deficit in the public finances was due to higher spending than tax. During the period of 1997 to 2008, tax revenues to GDP ratio almost remained unchanged, around 37 percent of GDP. Figure 5 presented the trend of UK public debt as share of GDP with rising trend since 2002. The above analysis also shows that UK government has unable to control the expenditure as well as debt burden in the economy.

![Figure 5: UK Public Debt to GDP Ratio](image)

Howard Coalition Government had introduced the “Charter of Budget Honesty Act” (CBHA) in 1998\(^7\) in Australia to prevent an echo of the fiscal misrepresentation during the 1996 election campaign. This act provides a structure for fiscal policy and to improve fiscal policy outcomes, which is based on principles of comprehensive fiscal management. The Charter provides for the publication of regular updates of the state of the nation’s finances as a complement to the annual budget.

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\(^7\) The aim of CBHA is to improve fiscal policy framework or fiscal strategy, which is based on rigorous fiscal management and performance of fiscal policy.
Several countries have controlled severe debt problems with the help of formulation of debt management policies and fiscal responsibility frameworks. Pakistan government has made efforts to reduce the debt burden. On June 13, 2005 Government of Pakistan issued the "Fiscal Responsibility and Debt Limitation" (FRDL) Act 2005 with the objective to bring fiscal discipline in the economy. Pakistan govt. introduced the "Fiscal Responsibility and Budget Management" (FRBM) Act 2003.

Australia’s economic performance remained exceptional with a continuous economic growth over 20 years. Around 3.5 percent annual (average) real growth rate was recorded in the last decade, while nominal (average) growth rate was about 7.25 percent (see Figure 6). Australia’s outstanding economic performance is attributed to trade liberalization, abolishing foreign exchange controls, structural reforms, floating the Australian dollar, interest rate controls, independent Reserve Bank of Australia, inflation targeting, tax reform aimed widening the tax base, extensive privatization of government business enterprises, prolonged boom in commodity demand by China, India, and other developing countries and higher commodity prices.

Similarly, Australia’s budget remained in budget surplus witnessed in Australian economy in last sixteen years except for 2001/02 with a modest deficit of 0.01%. Figure 7 shows the performance of Australia’s BB/GDP for the same period. The government used the budget surpluses, particularly...
proceeds of the sale of assets\(^8\) to pay down debt. Resultantly, PD/GDP fell to 9.5 in 2005/06 (Figure 8).

\[\textbf{Figure 8: Australia Public Debt to GDP Ratio (percent)}\]

**Pakistan Debt Structure**

The Pakistan economy continuously depends on internal as well as external resources for fiscal deficits financing.

\[\textbf{Figure 9: Fiscal Balances (in percent)}\]

Figure-9 presented the eye views performance of Pakistan fiscal deficits in terms of growth rate and as percent of GDP for FY79-FY15 period. The highest fiscal deficit to GDP ratio was recorded at 8.2 in FY13 against the lowest ratio of 2.3 in FY04. The movement of fiscal deficits was the true picture of the variation of the trade balances and current account balances. Consistent trade and current account deficits were because of upward trend of imports, stagnant and non-diversify exports, rising debt services, and varying remittances (see Figure-10).

\(^8\) Including “privatization of government business enterprises” such as transaction of sale of Qantas Airways in 1995-96, sale of airports, auction of the first tranche of Commonwealth Bank in 1991, the sale of the first tranche (starting in 1997/98) and final tranche of “Telstra” (telecommunications company) in 2006, and concluding the sale of Sydney Airport in 2002.
Smyth and Hsing (1995) examined the presence of an optimal debt to GDP ratio that maximizes economic growth contributed significantly while debt and deficits have insignificant impact on economic growth. Data for 50 countries during 1976-83 and showed that capital, labor, human capital, and trade openness contributed significantly. The OBRA-93 was passed by congress and signed by President Bill Clinton. The main provisions of the act were to reduce the overall debt. In addition, decline in expenses through the 1990s also moderately reveals the role of political agents has seriously raised the debt burden.

A large number of debt management and fiscal responsibility frameworks were developed all over the developed world. The responsibility of the government to increase the overall revenue to reduce the overall debt. In next year, PD/GDP further fell by 2.1 percent to 56.4 percent; just missed the limit of FRDL Act 2005 for the fifth consecutive years. The current account deficits, fiscal deficits, higher subsidies, consumption, and investment were identified as important factors for the deterioration in the financial position. The government has breached the FRDL Act 2005 Developments during FY03-FY15. The current account deficits, fiscal deficits, higher subsidies, consumption, and investment were identified as important factors for the deterioration in the financial position.

Similarly, UK government has set out numerous fiscal policy principles in 1997. The Golden Rule was introduced, according to which the government has to meet the consolidated budget deficit as a percentage of GDP in the medium term. The government committed to meeting the deficit target, and the government has to meet the deficit target in the medium term. The government has to meet the deficit target in the medium term. The government has to meet the deficit target in the medium term. The government has to meet the deficit target in the medium term. The government has to meet the deficit target in the medium term.

The OBRA-93 was passed by congress and signed by President Bill Clinton. The main provisions of the act were to reduce the overall debt. In addition, decline in expenses through the 1990s also moderately reveals the role of political agents has seriously raised the debt burden.

Nevertheless, due to 2007 global crises, deadlines or implementation of the targets in the act was not achieved. The ceiling for fiscal deficit is 3% of GDP by March 31, 2008. The responsibility of the government to increase the overall revenue to reduce the overall debt. In next year, PD/GDP further fell by 2.1 percent to 56.4 percent; just missed the limit of FRDL Act 2005 for the fifth consecutive years. The current account deficits, fiscal deficits, higher subsidies, consumption, and investment were identified as important factors for the deterioration in the financial position.

A huge jump was observed in Pakistan total debt during the last nine years (FY07-FY15). Total debt reached to Rs. 19.85 trillion in FY15 compared to Rs. 5.05 trillion in FY07, showing a growth of 293.3 percent in the same period. The debt burden per capita amounted to Rs. 104530 in FY15 as against Rs. 31308 in FY07-per capita burden rose by more than double during this period (see Figure-11). For an average household family (having 6.35 member per household in FY14), the debt burden surges to Rs. 663764 in FY14 compared with Rs. 267313 for average household family (with 6.58 members per household in FY07) in FY08.
Figure-12 describes structure of Pakistan debt that includes domestic debt and external debt for the reviewed period. The domestic debt is denominated in local currency (Pak Rupee) and serviced as part of the government current expenditure, which has implication for fiscal gap, growth, and development expenditure. In contrast external debt service is to be paid in foreign currency (mostly in US$) and variation in domestic currency and major currencies against US dollar has a strong impact on external debt stock and balance of payment. There are two components of change in EDL (1) change in the debt stock due to addition or repayment of debt, and (2) change in debt stock on the back of conversion of debt denominated in various currencies to Base Currency (BC), which owing to appreciation/depreciation of BC vis-a-vis other currencies. This variation is, generally known as gain/loss (translational change). The development (appreciation/depreciation) in US$ with respect to major currencies has noteworthy impact on Pakistan’s external debt.

During the first four years of 21st century (FY01-04), Pakistan’s total external debt stretched to US$35 billion with a translation loss of US$4.8 following the appreciation of Pakistani rupee beside the dollar during this period, and dollar weakened against major international currencies. In the next three years, external debt, included liabilities, increased by US$ 5.1 billion to US$ 40.3 billion at the end of FY07. In this period Pakistan has earned “translational gain” of about US$ 10 billion on appreciation of US dollar against major currencies, mostly against Japanese yen. During the last six fiscal years (FY08-FY15) the highest translational loss of US$ 3349 million was recorded in FY11 (Figure-13), which was about 70 percent of the total increase of external debt of US$ 4799 million and remaining addition was the new external debt. The depreciation of dollar against 3 currencies (euro, yen, and SDR) was the main contributors, having more than 94 percent share, in total translational loss in FY11. Pakistan’s total EDL fell by US$ 262 million during the year and reached to US$ 65.1 billion by June 30, 2015. Despite substantial amount of credit payment by IFIs and mobilization of US$ 1000.0 million through Sukuk in 2014-15, the stock of EDL declined on account of bulky US$ 4.2 billion revaluation gains, which were realized due to appreciation of American dollar in terms of other
main currencies (euro, Yen, and SDR).

![Figure 13: Valuation Impact-Gain/Loss (Million US$)](image)

**The Methodology and Data Sources**

To see the performance of FRDL Act 2005 during the study period, we have used the limitations settled for public debt/GDP ratio on 60% on June 30, 2013, reduction in debt/GDP ratio by 2.5% every fiscal year, poverty alleviation and social related spending are not reduced below 4.5 percent of estimated GDP for any given fiscal year, budgetary allocation to health and education, will be doubled from current level percent of GDP during the next 10 years, reduce “revenue deficit” to nil not later than June 30, 2008, and then maintaining a revenue surplus, and not issue “new guarantee”, containing of rupee lending, rates of return, output purchase agreements, bonds, and all other claims & commitments that may be recommended from time to time, for any amount more than 2.0% of the projected GDP during any fiscal year.

The information about GDP, public debt, revenue balances, current expenditure, total revenues, social and welfare expenditures, budgetary allocation of health and education, and issuance of new guarantee were collected from Economic Surveys, State Bank of Pakistan Annual Reports, Handbook of Statistics of Pakistan Economy (SBP Publication), Pakistan fiscal operation ministry of Finance website, and various debt policy statements. The data on the above mentioned variables has been used for FY79-FY15, whereas for FRDL Act 2005 analysis, we have used FY03 to FY13 time period and in the next two years.

**FRDL Act 2005 Developments during FY03-FY15**

Pakistan government promulgated the FRDL Act 2005 on June 13, 2005 for abolition of revenue deficit and reduction of public debt by effective debt management. A performance report of
FRDL act is presented below:

1. “Ensure that within a period of ten financial years, beginning from July 1, 2003 and ending on June 30, 2013, the total public debt at the end of 10th financial year does not exceed 60 percent of the estimated GDP for that year and thereafter maintaining the total public debt below 60 percent of GDP for any given year.”

Government of Pakistan had accomplished the limit of PD/GDP as 60% within 3 years instead of 10 years (time decided in FRDL Act). TD/GDP ratio continuously dropped from 78.1% in FY03 to 56.4% as on June 30, 2007 (see Figure-14) due to incredible higher “economic growth” and somewhat stable exchange rate during the same period. In 2007-08, debt/GDP ratio start rising once again and reached 60.7% surpassing the 60% ratio set for end June 2013 and further moving upward to 64.5 in FY12 and moved around 65 percent in the next three years (FY13-FY15). Upward trend in debt/GDP ratio since FY08 was because of big current account deficit, higher trade deficit, around 263% growth in fiscal deficit, double-digit inflation (from FY08-FY12 with highest inflation of 17 percent and lowest inflation of 10.1 percent), 67.3 percent significant depreciation of PKR against US$ (during FY07-FY15) as economic growth stayed slow.

2. “Ensure that in every financial year, beginning from July 1, 2003 and ending on June 30, 2013 the total public debt is reduced by no less than 2.5 percent of the estimated GDP for any given year; provided that the social and poverty alleviation related expenditures are not reduced below 4.5 percent of estimated GDP for any given year and budgetary allocation to education and health will be doubled from existing level in terms of percentage of GDP during the next ten years.”

Government of Pakistan has effectively fullfill this requirement during FY03-FY06. At the beginning of FY03, the PD/GDP ratio stood at 78.1% while at the end of FY06 this ratio fell to 58.6 percent. In next year, PD/GDP further fell by 2.1 percent to 56.4 percent; just missed the limit of
reduction in PD/GDP ratio by 0.4 percentage points. After that year, government has never met the above said requirement of FRDL Act 2005 (see Figure-15). In FY12, PD/GDP ratio stood at 64.5 percent representing a surge of 4.3% against 1.9% fall in PD/GDP ratio in FY11. This raise was shared by addition of domestic and external debt on account of highest twin deficits in these years.

![Figure 15: Pakistan Public Debt (in percent)](image)

In FY06-FY08, social and poverty connected expenses remained (5.5% of GDP) much higher than 4.5% target of 4.5%. A rising trend was observed on account of the expenditure on same account in next four years (FY09-FY12). The same expenditure to GDP increased from 6% in FY09 to 8.2% in FY12. Health and education are the two core elements in nation development. The government of Pakistan had realized the importance of this issue and setting the expenditure (as percent of GDP) target of health & education to double in the next ten years. In actual, health & education expenditure practically remained constant with less than 1% on education and around 2% on health during FY03-FY13 (see Figure 16).

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9 Social and poverty related expenses such as highways, law & order, social security, water supply, road & bridges, education, irrigation, natural calamities, sanitation rural development, land reclamation, food subsidies, village electrification, population planning, and food support programs.
After that, PD/GDP ratio started to increase and moved around 65% during FY12-FY15, higher than the limit fixed in FRDL. The objective of this study is to appraise the performance of FDRL ACT for the stipulated time FY03-FY15. The plan of this research is as follows:

1. Literature Review
2. Literature Summary
3. Literature Evaluation
4. Data Collection
5. Deficits Analysis
6. Conclusion
7. Data Analysis

The Pakistan Development Reforms Act, 2005, (PDR Act) is for the efficient use of resources to reduce debt burden. As far as the Pakistan debt burden was concerned, a huge jump was observed in Pakistan total debt during the last nine years (FY07-FY15). The government has also formulated the debt management policy to diminish the debt burden in view of the efficient use of resources. Several countries have controlled severe debt problem with the help of formulation of debt management and fiscal responsibility frameworks.

The PD/GDP ratio is a key indicator of the fiscal health of a country. The PD/GDP ratio in Pakistan has shown a downward trend since FY03, from 80.9% to 58.6% by the end of FY06, as a result of the implementation of the PDR Act. However, this ratio started to increase again due to several factors such as increased spending, lower revenues, and the movement of the major currencies against the US dollar. A large number of debt management and fiscal responsibility frameworks were developed all over the world.

The definition of debt level is the total amount of debt held by the government at any given time. It is an important indicator of the financial health of a country and is used to measure the government’s ability to meet its financial obligations. The debt-to-GDP ratio in Pakistan has shown a steady increase from 40.6% in 1974 to 76.1% in 1987, which is a peak level. To improve the fiscal or debt management, New Public Management (NPM) was introduced in Pakistan in 1990.

In 2004-05, the PD/GDP ratio stood at 78.1% while at the end of FY06 this ratio fell to 58.6% as a result of the implementation of the PDR Act. The PD/GDP ratio started to increase again during FY07-FY15, rising from 58.6% to 65% by the end of FY15. The main factors contributing to this increase are higher subsidies, twin deficits, and higher inflation. This indicates that the PD/GDP ratio is an important indicator of the fiscal health of a country and should be monitored closely.

Therefore, cut in tax rates dropped the total tax revenues, which leads to massive deficits. As a result, the Pakistan government has formulated the debt management policy to reduce the debt burden. The debt management policy is an important tool for managing the government’s debt and ensuring its financial stability. It includes strategies and plans for managing and reducing the government’s debt.

The FDRL Act 2005 is very important for the efficient use of resources to reduce the debt burden. The PD/GDP ratio in Pakistan has shown a downward trend since FY03, from 80.9% to 58.6% by the end of FY06, as a result of the implementation of the PDR Act. However, this ratio started to increase again due to several factors such as increased spending, lower revenues, and the movement of the major currencies against the US dollar. A large number of debt management and fiscal responsibility frameworks were developed all over the world.

3. “Reduce revenue deficit to nil not later than the 30 June, 2008, and thereafter maintaining a revenue surplus. Revenue deficit means the difference between total current expenditure and total revenue of the government which indicates increase in liabilities of government without corresponding increase in assets of government.”

Total revenue balances mounted at Rs.-70.9 billion in FY03 (the first year of FRDL) with 1.5% as GDP ratio. In FY04, revenue balances took a U-turn and changed into surplus of Rs. 19.0 billion and continued the uprising trend upto FY06 as surplus of Rs.41.9 billion (see Figure-17). Revenue balances took another turn and changed into deficits with the amount of Rs.77.4 billion in FY07. Revenue deficit reached to Rs.353.8 billion in FY08, considerably 357.1 percent more than the revenue deficit of FY07. This is another condition of FRDL Act 2005 which was not met within specified time period (June 30, 2008). Revenue balances remained in deficits during FY07-FY12 and reached Rs.556.0 billion mainly due to significant growth of current expenditure on account of notable rise in debt servicing payments-domestic and external (interest payment), surge in defence expenditure, consecutively increase in government employees' salaries and increase in pension bill over the last few years,

![Figure 16: Expenditure on Health and Education (as percent of GDP)](image-url)
risen from 32.3% in 1974 to 65.7% in 1993. To tackle the debt problem, the US government had
and they controlled the severe debt issues with the help of formulation of proper debt management
(US$1027) in FY15 compared to Rs.31308 (US$518) in FY07 and average household family burden
the 60 % limit fixed in FRDL Act 2005. As a result, per capita debt burden jumped to Rs. 104530
Several countries have controlled severe debt problem with the help of formulation of debt manage-

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debt and 48.9% for total debt in the USA which are much higher than the debt fixed in the Budget
Smyth and Hsing (1995) examined the presence of an optimal debt to GDP ratio that maximizes
FY03-FY15. Section VII discusses the conclusion of the study.
level by effective "debt management". As a result, PD/GDP ratio fell to 53.0% in FY07. After that the
Act 2005 on 13 June, 2005 for removal of revenue deficit and decline of public debt to a reasonable
in the economy. Pakistan govt. introduced the "Fiscal Responsibility and Debt Limitation" (FRDL)
debt to GDP ratio was about 91.8 %. Pakistan government has made efforts to reduce the debt burden
acceleration of economic growth in devel-
Ahmad et al. (2000) elaborated the crucial issue of acceleration of economic growth in devel-
and interest rate. Baker (2005) analyzed the second term of President Bush administration in regards

Figure 17: Pakistan Revenue Balances

4. “Not issue new guarantee, including those for output purchase agreements, bonds, rupee lending,
rates of return, and all other claims and commitments that may be prescribed from time to time, for
any amount exceeding 2.0 percent of the estimated GDP in any financial year: provided that the
renewal of existing guarantees shall be considered as issuing a new guarantee.”

Figure 18: Pakistan New Guarantees Issued

Government of Pakistan remained within the required limit of issued new guarantees of 2% of
GDP in almost all fiscal years (FY06-FY15) except for FY09 (see Figure-18). In FY06, Rs.14.0
billion new guarantees (0.2% of GDP) were issued for K-Electric, WAPDA, and PIA. Government
has issued new guarantees (comprise of explicit/implicit guarantees issued to public sector enterprises
and “state owned entities” unfunded losses) amounted Rs. 274.3 billion (2.2% of GDP), which was
higher than the FRDL Act limit (2%). In FY15, Pakistan has issued new guarantees of Rs.156 billion
or 0.6% of GDP. The major portion of these guarantees was issued to Power Holding private Limited
(PHPL) and PIA having 99.3 percent share in total guarantees in FY15.
Summary and Conclusions

Rising trend was observed in the volume of the Pakistan total debt and liabilities during the last three and half decades. In recent years, Pakistan debt has increased to extraordinary levels of Rs 19.75 trillion at the end of FY15 compared with Rs. 5.05 trillion during FY07. Pakistan's debt rose by 293.3% during FY07-FY15. Pakistan total debt and liabilities to GDP ratio enhanced to 72.6% of GDP in FY15 against 54.6% in FY07. As a result, per capita debt burden jumped to Rs. 104530 in FY15 as against Rs.31308 in FY07 and average household family burden rose by more than double during this period.

Pakistan total debt comprising domestic debt and external debt have different implications on macroeconomic situation of Pakistan through current expenditure, development expenditure, fiscal gap, exchange rate movements as translational loss/gain, and balance of payments. Pakistan external debt augmented by US$ 24.8 billion during FY07 to FY15 time period, of which around 25 percent rise was due to the movement of the major currencies against US dollar (base currency).

Pakistan government has made efforts to reduce the debt burden. On June 13, 2005 Government of Pakistan promulgated the FRDL to reduce the government debt to a prudent level and elimination of revenue deficit with effective debt management. The government has breached the FRDL Act 2005 for the fifth consecutive years. The current account deficits, fiscal deficits, higher subsidies, lower revenues, double digit inflation, drying up of external program loans, transfer of the 70% federal government collection to the provinces under the 7th National Finance Commission (NFC) Award, undeveloped domestic debt market and currency devaluations were the major factors for the violation of the FRDL Act 2005. As far as to double the budgetary allocation to education and health in the next ten years is concerned, it’s almost remained constant with less than one percent on education and around two percent on health during FY03-FY15.
References


