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Why breaching debt limit has no consequence

Pakistan's public debt at Rs27.8 trillion and counting violates the legally permissible debt limit and threatens the economic future of the country and its people.

According to data released by the State Bank of Pakistan (SBP), the public debt of Pakistan amounted Rs27.8tr on May 4. Some newspaper reports put the figure at Rs33tr, probably referring to the total debt in April, without quoting the source.

Last month, the International Monetary Fund (IMF) projected the fiscal deficit at 7.9pc of GDP for 2018-19 and 8.7pc for 2019-20. Its fiscal monitor put Pakistan's net debt-to-GDP ratio at 72.2pc for the current fiscal year and 75.3pc for 2019-20.

The Fiscal Responsibility and Debt Limitation Act 2005 binds the government to reduce the total public debt and maintain it within prudent limits. It requires that the fiscal deficit be limited to 4pc of GDP in the three years beginning from 2017-18 and a maximum of 3.5pc thereafter.

The said law also dictates that the total public debt should be reduced to 60pc of GDP within two fiscal years beginning from 2016-17.

The Fiscal Responsibility and Debt Limitation Act 2005 is weak because it recommends no penalty for the government's violation of the debt ceiling

The debt law was persistently violated by the last PML-N government. Its Rs2.2tr fiscal deficit was equivalent to 6.5pc of GDP in 2017-18 against the 4pc legally permissible limit. The total public debt as a percentage of GDP stood at 72.5pc against the 60pc threshold. Unfortunately, the debt profile of the country has worsened over the past nine months under Prime Minister Imran Khan.

Abdul Rehman Warraich, who recently became director general of Debt Policy Coordination at the Ministry of Finance, was candid while discussing with Dawn the rising level of debt and its possible impact on key economic indicators and drivers. He considered the relevant law weak because it is quiet about consequences in the case of a violation.

"It is more of a document that expresses the policy intent on the public debt and sets some thresholds in this regard," he said while referring to the Fiscal Responsibility and Debt Limitation Act 2005.

"To achieve compliance, there is a need to reassess and review the law to address the above-mentioned shortcomings," he said.

He believes that adhering to prudent fiscal management is the starting point for bringing the public debt down to a sustainable level.

"You can't deal with the issue of debt management in isolation. All efforts to contain and control the pace of piling debt may go in vain if the government fails to enforce fiscal discipline, exhaust the potential for resource mobilisation and keep spending in check. The upcoming IMF programme is also important as it will help in the course correction," he said.

Warraich was in favour of a stable policy and exchange rate. Both the exchange rate hike and the devaluation of the rupee have consequence for the domestic and external debt. The recent spike in the public debt is partially attributed to the policy rate hike (for domestic debt) and the weakening of the rupee (for external liabilities).

"I do not support further monitory tightening. It would suffocate the economy and hurt both investment and consumption to a point of suppressing the economic activity when it is already sagging," he said.

"Instead of focusing on monthly inflation data, the policymakers need to see the price hike in the year-long spectrum. Yes, the interest rate needs to be higher than the average current fiscal year's inflation rate that comes to around 7.5pc. In our case, a policy rate that is 2pc higher than average inflation is fine. Currently, the interest rate of 10.75pc is already over 3pc higher than the average inflation rate. So yes, it now needs to be stable," commented a young economist working for a brokerage house.

Deliberating on the evolving public debt strategy, the director general of debt dropped some hints. "We are considering entering the global debt market with a systematic programme of borrowing like the one we have in the domestic market where treasury bills and Pakistan Investment Bonds are floated at regular intervals. It will ensure our presence in the global bond market and increase our familiarity with available options. It will also increase our access and introduce new tools and opportunities. It will require some procedural work that we are looking at," he said.

"We are also considering switching to floating rate bonds from fixed rate bonds to mitigate the risk of piling debt at a higher rate of return. Yes, there is a need to study the public debt profile closely to evaluate the policy of renegotiating and rescheduling of debt where possible. We can bargain cautiously by offering a higher rate for extending the period of maturity to manage the liabilities," he said.

The hierarchy in the Ministry of Finance was too occupied last week with the IMF team, Financial Action Task Force deliberations and standing committees of the National Assembly and the Senate to respond to queries.

Outgoing SBP Governor Tariq Bajwa mentioned Section 9C of the SBP Act 1956 that obligates the finance minister to report and give an explanation for the violation of the debt limit to parliament. The text of the Act is available online for those who are interested. Central bankers have told Dawn privately that the government has been warned time and again but it was not inclined to pay heed.

"The fact that the current and previous governments violated the law wilfully erodes their credibility as much as that of the legal framework. It also compromises the moral high ground of the government to demand that people should abide by the law and raises questions about the fairness of the system that seeks to punish the violators of fiscal laws," commented an analyst.

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