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Foreign Debt Dynamics and Economic Growth: Evidence from Pakistan

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ABSTRACT

Background: Foreign debt plays an important role in the economic development of a country like Pakistan.

Objectives: The paper has explored the relationship between exports, public debts, external debts, and the economic growth of Pakistan.

Methods: This study has adopted a time series methodology for the data analysis. Data range from 1985 to 2017. Thirty-two observations were used for each variable. The required data for the time series vectors have been collected from official websites of State Bank of Pakistan (SBP), International Monetary Fund (IMF), and World Bank Indicators (WBI). Augmented Dicky Fuller (ADF) test for stationarity of the data and co-integration model has been used for the relationship among the variables.

Results: The findings of the ADF test argued that the series has unit root at a level while they are having stationary nature at first difference. The finding of the co-integration model shows that exports, public debts, and external debts are having a long-run relationship with GDP/economic growth.

Conclusion: The study recommends that the policymakers should try to stabilize the current so that they might get the source for the price stability. The government should support the local producers so that they can compete in the market and provide low prices products to the consumers.

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1. INTRODUCTION

The obligations of creating nations have been expanding because of globalization and having trouble with their economies (Muhammad et al., 2020b). There will be various components that power the framework to take cash from different nations or establishments: long-haul factors and momentary explanation are the elements of commitments gathering. Studies contended that the previous exhibition of financial development can be considered as the huge variables for the growth. This implies that, the monetary development is the main consideration for having higher or expanding requirements of any nation (Bakar & Hassan, 2008).

Most of the 'solutions' identified for Pakistan's economy are quite reasonable and almost quite drained. Further, few would demand the need for better government, more and better schools, justice and so on (Zaidi, 2000). Parvez Hasan's complete evaluation of Bhutto is extremely critical: "Bhutto's policy initiatives and style of government have had very negative and long-term consequences for the Pakistan economy

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and have seriously delayed progress towards self-sustained and balanced economic growth in the country. Bhutto's economic policies not only stopped the growth of the modern industrial sector but also reinforced the anti-export bias of the industrial strategy", and "much more than their adverse short-term impact, Bhutto's economic policies must be questioned for their negative effects on long-term growth and institutional development" (p 229). However, as mentioned below, Parvez Hasan is not sparing of his criticism of other leaders either (Zaidi, 2000).

Despite "remarkable" economic performance, the economy under Zia, "concealed a developing of the long-term structural problems". However, "none of the difficult policy issues which had emerged during the 1960s and the 1970s were resolutely endeavored under Zia and were further left to fester under the surface. At the same time, serious shortages of physical infrastructure, especially power, roads, and water supply emerged which not only affected the quality of life but also the quality of growth as well" (Zaidi, 2000).

Since independence, Pakistan has been threatened by highly expanding outer and household obligations while attempting to take care of their monetary issue alongside the expanding deficiency in the segments. The significant disadvantage in this term is the absence of outside records as well as noteworthy and economical examples of open accounts. Because of this factor, the consequence goes to the higher acquiring and taking of advances lead to having higher open compulsions and expanded commitment overhauling trouble on the economy. In the financial arrangement of Pakistan, the expanded obligations and higher responsibility adjusting rose in the 80s which proceeded in the same manner in 90s and in the second half of 2000. On the off chance that we take a gander at these variables regarding the level of GDP, open responsibility on Pakistan was 54.4 percent in the 80s which expanded just about 100% in 2000 (Warde, 2000). These variables lead to the higher obligation overhauling risk on Pakistan consistently which upset the monetary and financial arrangements of Pakistan. In case that we take a gander at the obligation adjusting, it was 41.4 percent of Pakistan's income which was being spent on the requirement overhauling and afterward, it reached to 74 percent in 2000.

In the era of 2000, the policymakers have made some debt reduction strategies where they tried to pursue some temporary relief for successful debt rescheduling, but the strategy was not much effective and only 10 percent of the debts and liabilities have been increased in 2007 (Hassan & Khan, 2007). This condition led to the increase in the short-term foreign debt as well as increase in floating interest rate. The dynamics in the public debt in the economy argued that the variation in the ratio of debt to GDP can be due to the interest rate relative, primary imbalance, changes in the exchange rate and also the imbalance in the rupee value (Butt & Hassan, 2008). The higher imbalances were not only to slow down the mobilization of revenue but also increasing government expenditure. Furthermore, the payment for imports also led to slow economic growth which ultimately increased burden on the local markets.

Pakistan's economic policymakers have used different packages of IMF and different debt reforms in 1990s i.e., deregulation, liberalization, and privatization which, however, proved to be insignificant in managing a current account and fiscal balances (Williamson, 1990). The reforms have always been designed and implemented for controlling the increasing cost of debts. Moreover, the increasing debts always bring the shift of increasing public debts as well as higher interest for the domestic borrowings (Broner et al., 2014). In addition, the studies argued that the changes in the exchange rate not only affect the debt reforms but also decrease the value of local currency which ultimately leads to the higher cost of borrowing for the country (Gruber & Kamin, 2007). The reforms designed by the policymakers were not appropriate to get a higher level of exports, instead, this led to getting higher imports and lesser exports which significantly contributed to the higher imbalances in the current account. As a result, the debt burden and higher public debts lead to unstable economic growth (Coccia, 2017).

Distinctive nations have planned an appealing approach to get higher unacquainted capital yet they incline toward it by advancement and development of different methods. These sources can be much critical for expanding the interests in the nation and further can be noteworthy for monetary development too (Afzal et al., 2021). The higher unacquainted capital can be critical for expanding the financial development, however, its part in the monetary development can be of various perspectives in past. As Pakistan is confronting higher obligations and expanding each year, it is the greatest harm for the monetary development of the country (Nemana & Nadiri, 2011). Further, Pakistan is getting expanded obligations and higher responsibility overhauling. Moreover, outside duties of Pakistan are having expanding pattern constantly and in the 1990s it was $20.66 Billion and afterward in a similar time it came to $33.90 Billion. Despite that, in 2000, because of obligation rescheduling, it was discovered $32.78 Billion (Dixit, 2003). Again in 2003, it reached to $35.74 Billion and further discovered $54.60 Billion in 2010. In 2016, the outside obligations came to $65.4 Billion which reached to $73.1 Billion in 2017 (Adams, 2013). Therefore, understanding of relationship between economic growth and public debt is an important issue to be addressed in the context of Pakistan. Not only the understanding of issue but also the recommendations of best possible strategies for macro policy making is quite essential in the context of current fragile economic condition of Pakistan.

The study has findings from 1980 to 2013 having the board information and gathered from the wellsprings of World Bank Indicators (WBI). The results have been analyzed by utilizing the Relapse Model (Ngerema, 2019). The results suggest that the outside obligation is having primary yet a negative impact on the GDP. This has contended that Pakistan must follow the diminishing of obligations and attempt to draw in FDI and expanding interests in the market (Callinicos, 2010). The results further included that Adjusting sparing (ADS) is having a positive and critical relationship with monetary development (GDP) and contended sparing propensity for the helpless nation can lead them to reliable financial development and budgetary solidness (Kanbur et al., 1999). Results show that the fares are the main consideration that can be useful for the nation to get higher income and soundness of the neighborhood market. The factor of fare can play a significant role in achievement of noteworthy and positive monetary development.

The findings by Coccia (2017) contended that there is a constructive upshot of open obligations on the financial obligation discoveries. In case, they have been sorted out productively, it may be noteworthy for the monetary development and can expand the limit of reimbursing both the inside and outside obligations. The negative impacts of the obligations can be partitioned into "Swarming impacts" and "Obligation Overhang". This examination has analyzed the effect of outside obligations financial development of Pakistan from 1972 to 2009. The investigation has utilized the Autoregressive Regressive Distributed Lag (ARDL) strategy for the assessment of the model and information analysis. Coccia (2017) argues that the consequences contended that outer obligations of Pakistan are having a negative relationship with the financial development/GDP and this affirms the "responsibility overhang impacts". Yet, it has discovered negative and inconsequential impacts of requirement overhauling on per capita GDP this doesn't defend the crowded impact and the theories have not been upheld (Hassan, 2021). The discoveries further included that household duties are having a negative relationship with per capita GDP and speculation.

As indicated by the investigation of Tchereni et al. (2013) who studied the effect of outer commitments on the monetary development from 1970 to 2010, contended negative connection between them. The discoveries of the investigation concocted the consequence that there is a negative and unimportant connection between unfamiliar obligations and monetary development for Malawi from 1975 to 2003 (Chambers, 2012). The discoveries of the investigation depended on time arrangement examination. The examination contended that the nation should support the nearby makers so they can oppose different contenders and can have their influence in the monetary exercises and subsequently they won't depend on the acquiring and will attempt their own to extend their economy.

Including more, the findings of Iyoha (1996) which was based on external obligations and monetary development in African nations, found that there is a negative connection between monetary development and outside obligations and backing swarming out the impact. The findings of Mahmood Ali Shah et al. (2014) likewise affirm similar discoveries for the Pakistani market from 1972 to 2010 and 1972 to 2009 individually. It has been affirming that the higher open obligations will rebelliously prompt poor monetary and social conditions (Belshaw et al., 2001). Further, Shabbir (2021) analyzed the connection between the financial development among the creating nations taken from 1976 to 2003. The current work has been inspected by taking board information relapse. The aftereffects of the investigation contended that the commitment adjusting is having a negative relationship with the monetary the nation. This implies in this condition, the market will have fewer assets for the financial specialists to put more in the market which can influence the monetary development, this affirms the swarming out impact (Muhammad & Ximei, 2020).

2. METHODS

2.1 Study design

The study has used a time series study design, in which the foreign debt and economic growth in Pakistan are regressed. The times series analysis deals with the data points collected at consistent intervals or periods over a period of time. Time series data is used for trend analysis.

2.2 Setting

In this research, we have taken Pakistan as a case study. Due to consistent economic policies, Pakistan experienced a respectable growth rate from 1970 to 1988 (Al-Fazari, 2006). After 1988, again there was a declining trend in GDP growth rate, which was due to political instability, inconsistent economic policies of governments and the preference of personal political interests over national interest. After 2000, there was an increasing trend in GDP growth rate (Malik et al., 2010). Since independence, Pakistan is facing serious problems in balance of payments deficit. To finance this balance of payments deficit, the country adopted to rely on external debt (McEachern, 2016). World Bank classified Pakistan as severely indebted country of South Asia in 2001. External debt compromises about 50% of the total GDP of Pakistan. Pakistan had to reschedule its external debt two times between 1998 and 2001, because the country was unable to serve its external debt. The country has experienced a fluctuated economic growth in this time. In growing economies, the major share is usually forwarded by the public debt structure and this also disturbs the economic growth (Atique & Malik, 2012). The country's higher dependence on the external debts cannot be rationalized and the higher level of domestic borrowing sometimes lead to the financial instability and also having significant effects on the private sector (McEachern, 2016). Therefore, this study has explored the relationship among external debt, public debt, exports and economic growth.

2.3 Variables

The study has used export, external debt, Gross Domestic product (GDP), and public debt. The GDP is taken as the dependent variable, while the rest are independent variables.

2.4 Data sources and management

The study has been based on time series data for the impact of external debts on Pakistan's economic growth. The study has used some other factors i.e., public debts and exports that have also a time series nature. The study has used data collection sources such as the official website of International Monetary Fund (IMF), State Bank of Pakistan (SBP) and World Development Indicators (WDI) (World Bank, 2014). The time panel for the existing work has been taken from 1985 to 2017.

2.5 Statistical methods

The acquired expanded model has been embraced by Usman (2017) and Zaidi (2000) who have led to check the effect of open obligations, fares and outer obligations on the GDP/financial development of Pakistan.

Significantly, the time arrangement pointers remembered for the investigation ought to be the ideal opportunity for the univariate by embracing the unit pull test for each arrangement before moving to the last condition. As per the idea of unit root, when the arrangement is having a unit root then the markers can be considered as non-fixed. Notwithstanding, the assessment depends on the assessment who are non-fixed may sometimes 1080measurements without having any financial hugeness (Newbold & Granger, 1974). It is the standard method of checking the unit root and assessing the fixed and non-fixed.

2.5.1 Unit Root

The research study has utilized Augmented Dicky Fuller (ADF) test for the assessment of fixed and non-fixed of the arrangement taken in the investigation. The ADF (Eq. 1) test has included various detail for example at levels, taking pattern, block, and both; the second level is the first distinction and having a similar determination for this level moreover. The invalid speculations for the ADF test are the arrangement is having a unit root or they are non-fixed or the markers are having no unit root or they are fixed.

$$\Delta Y_t = \mu + \gamma Y_{t-1} + \sum_{j=1}^{p} \alpha_j \Delta Y_{t-j} + \beta t + \omega_t \quad \text{(Eq. 1)}$$

Where YT is relevant to time series, t is time trend and εt is the white noise error term.

The important section of the ADF test is having the recommended lag length; the low number of lag lengths sometimes leads to the rejection of the null hypotheses means it will affect the size of the test. A higher number of lags in the test means a low level of power of the test which also has negative effects on the test (Cengiz & Holmer, 2021).

2.5.2 Co-integration

The important concept is the estimation of the relationship between the time series which can be attained by using the co-integration model. The concept has been taken from the Schwarz criterion (SC) and HQ information criterion (HQ) for the selection of appropriate lag length. The idea for the co-integration model is to check whether these time series are co-integrated or not.

3. RESULTS

3.1 Descriptive Statistics

Export is measured as the percentage of GDP; the average is about 22.7% of the GDP. Public debts are more as a percentage of GDP (mean=68.2%). GDP is measured as purchasing power parity; its mean value is 657.1. GDP calculated at the PPP is a good indicator of economic growth (The Economic Times, 2010), the external debts are 50.08 as a percentage of GDP in Pakistan.

Table 1. Descriptive Statistics of the study variables

Variable	Unit	Max	Min	Mean	SD
Exports	% of GDP	27.35	13.7	22.72	5.33834
Public debts	PPP	73.4	52.3	68.2	8.74413
GDP	% of GDP	1156	456.3	657.16	240.707
External debt	% of GDP	66.04	43.44	50.08	11.8685

3.2 Result of Unit Root Test

The time arrangement examination once in a while find complex for the observational investigation. Utilizing some quantitative strategies on the non-fixed arrangement for example relapse and so on are discovered negligible. Accordingly, it is significant that the suggested model ought to be utilized for the information examination for the time arrangement markers. The investigation has received an ADF test (Table 2) to check the fixed or non-fixed nature of the arrangement or as such to check the unit root in the current arrangement.

Table 2. Unit Root Test Results

	ADF at Level		ADF at 1st Difference	
	Calculated	Lags	Calculated	Lags
Exports	-2.209	1	-4.460**	1
External Debts	-2.009	1	-5.399**	1
GDP	-2.002	1	-4.457**	1
Public Debts	-2.078	1	-5.634**	1

Note. The asterisks (*) indicates the statistical significance at a 5 percent level of significance.

The table shows the discoveries of the ADF test which has been utilized to check the fixed or non-fixed nature of the arrangement. The table has results uphold in the non-fixed conduct at levels so at this stage the invalid speculations can't be dismissed. In any case, the outcomes change for the situation for the first distinction there is no help of unit root at this stage. The finish of the table is that the arrangements are in a cycle of fixed from the outset distinction (Figure 1).

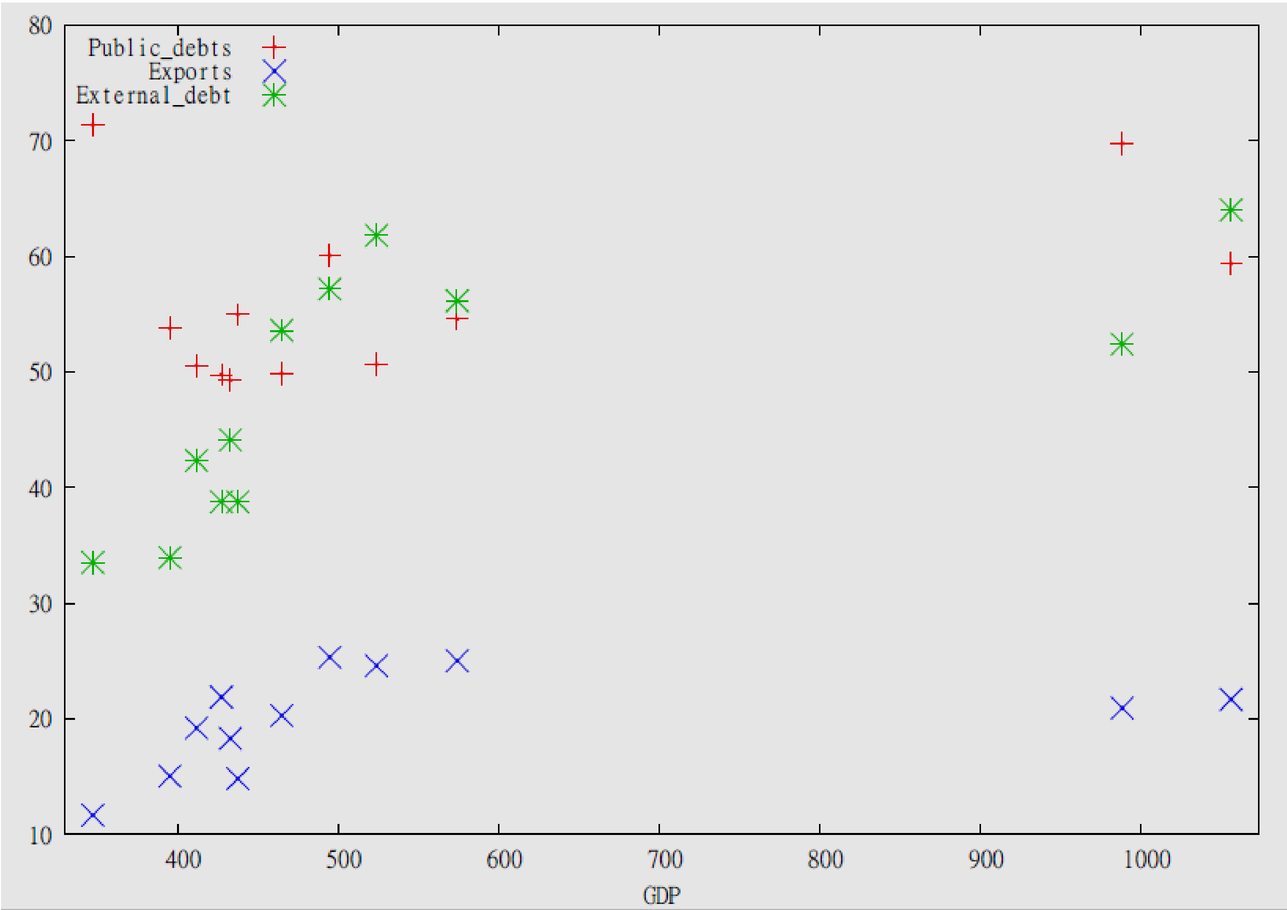

Figure 1. Scatter plot of the variables

Optimal Lag Selection

For the time series analysis, findings must be estimated based on proper lag length. The existing test has been used for the recommended lag length. The test has been estimated on the basis for SC and HQ test and the conclusion of the test is that the single lag length has been recommended for analysis (Table 3).

Table 3. Results of Optimal Lag Selection

Lag	SC	HQ
0	-5.296	-5.103
1	-4.203*	-6.247*
2	-10.340	-12.70
3	-9.501	-11.701

* Indicates lag order selected by the criterion; SC: Schwarz criterion; HQ: Hannan-Quinn information criterion

3.3 Results from the Cointegration Analysis

The discoveries taken from the table contended that all the elements were found non-fixed at a level while they go to fix from the outset distinction. While the slack length determination shows that the single slack will be proper for the assessment of results.

3.3.1 Unrestricted Cointegration Rank Test

Table 4. Results of Co-Integration Test (Trace Statistics)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.920128	54.95958	48.85723	0.0120
At most 1	0.825728	27.17430	30.79807	0.1346
At most 2	0.392402	7.038732	16.50471	0.5857
At most 3	0.156487	1.743447	3.842566	0.1978

3.3.2 Unrestricted Cointegration Rank Test

Table 5. Results of Co-integration test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.920118	27.79518	27.59534	0.0582
At most 1	0.835718	19.15977	21.14272	0.0937
At most 2	0.392502	5.294395	15.37560	0.7168
At most 3	0.157587	1.753437	3.852566	0.1868

The model is first checked for the autocorrelation and heteroskedasticity. No autocorrelation is found as the value of the Durbin Watson is 1.9, near to 2, that show no auto correlation (Table 6). The square of residual is egressed and tested for ANOVA is procedure for the Brush Pegan test or checking of heteroscedastic. The p-value is >0.05, which show that there is no heteroscedastic

The subsequent stage is the nearness that runs relationship among the time arrangement taken in the chosen model. The examination led by Katircioglu (2009) utilize a co-joining approach for the assessment of a single or more integration relationship. The Johansen cointegration test has been utilized in the investigation to gauge the cointegrating conduct of the arrangement in the condition. At the point when the cointegration vector ($0 \leq r \leq n$) is zero then it will be in favor of having no long-run relationship between the time series vectors. In contrast when there are cointegrating vectors then it will be considered as the relationship among the time series. The findings in the table have been estimated based on two tests i.e., Trace Test and Max Eigenvalue test respectively (Table 4-5). The discoveries of these tests show the presence of since quite a while ago run relationship among the fares, open obligations, outer obligations, and GDP growth in Pakistan (Table 6). The discoveries depended on the premise for fixed time arrangement and discovered noteworthy since quite a while ago run relationship among the arrangement. In such a manner, the invalid speculations have been dismissed of no since quite a while ago run relationship among the cointegrating vectors. On the opposite side, the single cointegrating vector has been acknowledged on the standard critical level. So the discoveries contended on the premise for a cointegrating model that there is a since quite a while ago run connection between the fares, open duties, outer obligations, and monetary development. Iyoha (1996) has been directed on outside requirements and financial development in African nations. The examination found that there is a negative connection between monetary development and outside obligations and backing swarming out the impact (Agyapong & Bedjabeng, 2019). It has been affirming that higher open obligations will resistant lead to poor monetary and social conditions.

3.4 Long-Run Equilibrium Equation

Table 6. Results of long-run equilibrium

Independent Variables	Coefficient	t statistics
External Debt	-0.67912*	-2.162031
Exports	0.51419*	3.528262
Public Debts	-0.61310*	-3.313032
Constant	-0.39951	-1.346054
Durbin Watson	1.97	
Square Residual ANOVA p-vaue	0.159	

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

4. DISCUSSION

Looking at the developing country's perspective, the economic theory argues that exports can be found as the most significant factor of economic growth. Some of the economic theories consider import, export, and debts as important elements of economic growth. Different developing countries have used to design an effective policy to get higher foreign capital but they prefer it by loans and other means. Therefore, these sources can be significant not only for increasing the investments in the country but also for economic growth as well. Furthermore, higher foreign capital can be significant for increasing the economic growth but its role in economic growth has different views in previous studies (Alvarado et al., 2017). The study of Mosely (1980) which was conducted on the association between the economic growth and aid for the UK found a positive relationship. This study, on the other hand, has found a negative relationship for the Scandinavian and French.

5. CONCLUSION

The research study was directed in the monetary arrangement of Pakistan to survey the since quite a while ago run relationship among sends out, open duties, external obligations, and financial development. The examination has used time arrangements for information investigation. In case of Pakistan, the debt (both foreign and public) is increasing with every passing year. The findings taken from the models used in the analysis argued that there is a negative relationship among the public debt, external debt and economic growth such as GDP of Pakistan. The findings show that the poor fiscal policies and inappropriate monetary management by the government lead to the higher inflation, increasing interest rate, budget deficits, current account deficits, decreasing export and increasing imports are the major setbacks for the economic growth of Pakistan. Just like the other developing countries, there is a negative relationship between the debts and economic growth. The discoveries of the examination contended that the nations continually attempting to get reserves both from inner and external sources to fund their drawn-out ventures. The producing nations like Pakistan continually searching for getting cash for running their high-marking projects (Muhammad et al., 2020a). But the case is diverse for the progressive nations. The products expose that the outside obligations and monetary development are having a positive relationship for the progressive nations while they are having a negative relationship on account of developing nations. As export is considered as the significant factor of monetary development for the creating nations, therefore, they should diminish their hole of current record which can be achieved with the assistance of higher fares. The nations consistently attempt to diminish their obligation overhauling cost to control the dependability of ash which can be useful in offering back to the nearby producers. It has been suggested that the arrangement creators should expand trades by offering benefits so they may go for higher imports which, however, depends on the nearby market which can be useful in settling the costs.

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