

# The Effect of External Debt in the Economic Growth of Pakistan

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## ABSTRACT

In this study we examine the effect of external debt with the economic growth of Pakistan. External debt is a debt which is held by the creditors of foreign countries in the world. Time series data is collected from the World Bank site for the last thirty years ranges from 1986-2015. Statistics analysis and ordinary least square regression is performed through a descriptive statistical table. To check the relationship between economic growth and external debt OLS model is used. GDP is our dependent variable. Gross domestic saving, gross capital formation and external Debt stock is our independent variable. The results show that the huge amount of number of GDP of country is backed by external debt.

**Keywords:** External Debt, Economic Growth, Pakistan, OLS model

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## INTRODUCTION

External debt is known as foreign debt. External debt is a kind of debt which is held by the creditors of foreign countries of the world. These are the debts that including the interest, this is the interest must usually be paid in the currency in which the loan was made. Pakistan usually takes loan in the form of dollars from IMF and USA and from the other countries. Pakistan has to pay that loan in the form of dollars. Pakistan current external debt is \$56 billion. In 2012 the external debt of Pakistan was almost \$54 billion. The IMF is one of the few international agencies which are actively involved in the work of measuring and monitoring the external debt of the countries. The external debt of Pakistan increases at a rate of 7.6 percent annually. Almost every country in the world borrows the money from the other countries despite of this the country is rich or not. Because the world economies are inter related with each other. Sometimes it is much easier for a country to take an external debt from the other countries rather than take the loan domestically from the central bank of that country. Pakistan ranks at number 59th in the list of external debts by a country. In this article we will able to find the role of external debt in the economy of Pakistan. Pakistan also ranked as the most developing countries in the world and Pakistan is one of the countries in the world that is facing serious external debt problems. Pakistan

is taken loan from IMF and other banks for various reasons. Such as developing projects in country, buying of different types of equipment from other countries, meeting the long term and as well as short term liabilities. These are the reasons for which the external debt of Pakistan is increasing day by day. Role of external debt in any country has no consensus. There are different articles that are published to define the role of external debt in the economy of country. Different researchers gain different types of data. Some researchers said that there is a positive relation of external debt towards the development of a country. Some researchers said that the external debt providing the foreign capital for industrial development of the country.

## PROBLEM STATEMENT

External debt of Pakistan:

The external debt of Pakistan is \$52.43 billion. Pakistan is in the 59th number in the list of external debts by a country. Pakistan external debt is increasing day by day. Every Pakistani having a liability of about 66,000 pkr. The external debt of Pakistan increases at a rate of 7.6 percent annually. Pakistan has recently taken a loan from IMF which definitely increases the debt of the country.

External debts of other countries:

USA is a country having more external debt than other countries. USA is currently having an external debt of US\$15680 Billion. Ranks first in the list made by the World Bank. UK is having a debt of US\$6977 Billion. Which is came after USA in the World Bank list. India is currently having an external debt of US\$412.2 Billion and ranks 28<sup>th</sup> in the list.

How Pakistan can reduce its foreign debt:

There are many ways in which Pakistan can reduce its foreign debt. The first and better way is that Pakistan has to reduce its imports and balance of payments and should establish the resources to promote the exports. Pakistan can reduce its debts by paying the debt.

## OBJECTIVES

The objective of this research is to find out the positive and negative effect of external debt towards the economy of Pakistan, to find whether external debt increases capital inflow of the country or not and to find out the reasons why external debt is taken.

## LITERATURE REVIEW

There are a large number of studies which have been conducted by the different economists and the researchers having a goal to check that either the external debt effect the growth of the country or not. The economists and researchers apply different techniques and methods to find the relationship. They have find mixed relationship and conclude different results, the studies of the researchers shows that external debt affect the growth of the country significantly while on the other hand some researchers are failed to draw the same result. Researchers used different type of variables to conclude the effect of external debt to the growth of the country. Some of the conclusions made by the researchers are given below:

Arshad, Aslam, Fatima and Muzaffar (2015) has conducted a research to investigate whether the foreign debt lead the economic growth of the country in the longer run or not.

In regard to this a time series data from 1970-2014 are taken and ordinary least square method is used in this regard. Lee and Ng (2015) checked whether the variables such as external debt and budget expenditure having an impact on economic development. A data from 1971-2003 is taken and the results shows that there is a negative of public debt on GDP. Zafar, Sabri, Ilyas and Kousar (2015) investigated whether the external debt is having a positive impact on economic growth or not. Unit root test has been applied and the results show that there is negative impact of external debt in economic development of a country. Emori (2015) examined the impact of the external debt on the economic growth of Nigeria. The co integration method is used and the results show that impact of external debt having a positive impact on economic growth of Nigeria. The study findings of Alin and Bedir (2015) showed that there is negative impact of external debt in the economic growth of a country. Hussain, Haque and Igwike (2015) has conducted a research to find that is debt is a burden for economic growth and the data from 1995-2012 has been taken and garner causality test is applied and the results shows that there negative correlation between the GDP and debt. Mencinger, Aristovnik and Verbic (2015) found the role of external debt in growing economies and a data from 1980-2010 is taken and the results shows that there is a positive negative correlation between debts to GDP ratio. Lahiani and d'Orléans (2015) showed that the external debt effected the economic growth of South Africa. The results from 1980-2014 has been taken and the results show that there is a positive relation of external debt in the economic growth of South Africa. Cuestas and Regis (2015) stated a study to check the level of sustainability of external debt. The results from 1984-2013 has been taken and the results has shown that there is a positive relation of external debt in economic growth.

## RESEARCH METHODOLOGY

Analysis of the units:

We want to study the economy of Pakistan; in this case we select different units large portion of Pakistan economy is financed by the external institutions.

Data analysis and collection of data:

From the site of World Bank we collected secondary data. Time series data is collected from the World Bank site for the last thirty years ranges from 1986-2015.

Econometrics techniques:

Statistics analysis and ordinary least square regression is performed through a descriptive statistical table.

Specification of the model:

To check the relationship between economic growth and external debt OLS model is used. GDP is our dependent variable. Gross domestic saving, gross capital formation and external Debt stock is our independent variable. So the equation become

$$\text{GDP: } \beta_0 + \beta_1 \text{EDS} + \beta_2 \text{GCF} + \beta_3 \text{GDS} + \mu$$

## DATA ANALYSIS AND REPORT WRITING

Descriptive statistics:

Descriptive results which are obtained by the descriptive statistics are given in the table below. The table shows that there are 30 observations which have been chosen as a

sample. There are different statistical facts which are shown in the table such as median, mean, standard deviation, minimum, maximum etc. Pakistan average GDP from the year 1985-2015 is 98540 million US\$. The average of external debt stock is 34164 million US\$. The results show that the huge amount of number of GDP of country is backed by external debt.

#### Statistics

		GDP	GCF	EDS	GDS
N	Valid	30	30	29	30
	Missing	0	0	1	0
Mean		98540.3667	16690.9333	34164.3793	11318.4667
Std. Error of Mean		12314.20894	1830.12573	2704.22584	997.19130
Median		67813.5000	12009.5000	32214.0000	10948.0000
Std. Deviation		67447.70014	10024.01146	14562.70181	5461.84169
Minimum		31145.00	5706.00	13344.00	1847.00
Maximum		246876.00	34537.00	63989.00	19483.00

#### Ordinary least square result of GDP:

The results show that the model R square is 98 which is very high. This means that 98 is the change in the dependent variable. The Durban Watson is an analysis that shows the auto correlation. The Durban Watson is .678 which is likely to be a positive serial correlation. This tells us that positive error of an observation increase the chance of positive error of other observation. The table tells us that there is 98% variability in GDP.

#### Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-23489.335	5399.708		-4.350	.000
	EDS	1.605	.370	.374	4.340	.000
	GCF	4.776	.529	.735	9.035	.000
	GDS	-1.327	.798	-.114	-1.662	.109

a. Dependent Variable: GDP

#### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.988 <sup>a</sup>	.977	.974	10025.54947	.678

a. Predictors: (Constant), GDS, GCF, EDS

b. Dependent Variable: GDP

## CONCLUSION AND RECOMMENDATIONS

In this research we conclude that there is a negative impact of external debt and positive impact of domestic debt on the economic growth. We conclude that external debt is having a negative impact on the economic growth and the external debt is considering a burden on nation and economy. Some researchers studies shows that external debt is having positive impact on the economic growth of a country and some researcher studies shows that external debt is having negative impact on the economic growth of a country. Huge amount of number of GDP of country is backed by external debt.

In the light of my research, following are my recommendation that can lead to improvement in our GDP. Government has to make a focus on the efforts to manage the

external debt of the country by using them in the productive activities which results to increase the level of output in the country. Government should emphasize on encouraging capital formation as it will lead to improve Gross Domestic Production of the country. There should be effective Government policies that provoke capital formation on the large scale. Furthermore, there should be proper planning for the efficient use of external debt stock as it will make a positive impact on Gross Domestic production as well.

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