Pakistan is not out of the woods

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Almost a year ago in August 2008, Pakistan was at the brink of default. Its foreign exchange reserves were hitting the bottom rock of $4 billion, depleting rapidly in the range of $250 to $330 million weekly, which were hardly sufficient to fulfill requirements of one month of imports.

Pakistan's sovereign debt and liabilities were the riskiest, which had crossed the $45 billion mark. Pak rupee had depreciated to 23 per cent. The gap between balance of trade was widening to the alarming extent. Poor law and order situation was scaring away the investors. Financial analysts were predicting Pakistan teetering on the edge of solvency, terming the situation as a natural consequence of Pakistan's support to US-led war on terrorism.

It was a tough time for a new PPP government. With begging bowl, Pakistan was imploring before Saudi Arabia and China to escape the impending default, but it could get nothing substantial. Finding no other option the desperate Pakistan decided to knock the IMF door. Despite strong opposition from many in Pakistan, the government finally entered into $7.6 billion Stand By Arrangement (SBA) loan with the Fund in November 08.

A recent report by *The Economist* (April 23rd 2009) "Full Fear and Credit: Pakistan's Political instability brings macroeconomic calm" claims that Pakistan has unique exemption from ill effects of the global contraction and under IMF program it has only to do one thing; to narrow its fiscal deficit to $ 7 billion, 4.3 % of GDP. The report gives impression that thanks to IMF leniency, Pakistan is getting economic stability. This is otherwise untrue. As a long list of conditionalities is there to follow.

For example the Stand By Arrangement (SBA) also calls for eliminating fuel and electricity subsidies, doing away with exemptions on income and agriculture taxes, continuing privatization process and cutting social sector spending. The only thing IMF did not emphasize to cut was the military budget. Besides privatization of industrial units Pakistan under IMF pinch is also offering one million acres of farmland for sale to countries seeking to secure their food supplies.

Under IMF pressure the government has not only withdrew fuel subsidies, but also increased electricity rates causing widespread protests.

The government was also forced to remove about 125 projects from the Public Sector Development Program (PSDP). Another 432 projects are facing implementation delays because the government is trying to reduce spending and bring down budget deficit to 4.2 per cent of the Gross Domestic Product as promised with IMF. Funding for the higher education sector has also been cut by 73 per cent. This cut in the PSDP is by now estimated at Rs.100 billion. Some unconfirmed reports suggest that Pakistan may seek another $4.5 billion from the IMF. So far it is also not clear how much money would be made available and on what terms and for what specific purpose.

In persuasion of to IMF conditionalities, Pakistan's Federal Board of Revenue has resorted to a tyrannical structure of taxation. It is pertinent to mention that the tax system of Pakistan, was progressive till 1990, but converted into a regressive regime in 1991 with the introduction of massive indirect taxes. As a result, during these 19 years (1991-2009), the tax burden on the poorest households increased by 17.4 percent, while it declined by 15.9 percent for the richest households.

The IMF is now bent upon destroying the agriculture sector of Pakistan, through the imposition of new taxes, despite the fact that this sector already pays a number of taxes. Though IMF facility has brought temporary macro-economic stability, but without a production-led economic growth, economic fundamentals will remain weak.

About 700,000 jobs have been lost because of closure of more than 300 textile units over the past two years as a result of energy crisis. Till 2007 the sector was contributing 60 per cent of the country's exports and employing 38 per cent of the workforce. It had an 8.5 per cent share in the Gross Domestic Product. (Daily The News 26 April 09).

In view of country's never-ending economic woes and more importantly the roaring threat of Taliban's possible access to nuclear assets of Pakistan, the Friends of Pakistan-Group of 31 countries and international agencies gathered in Tokyo on 17 April 09 to pledge $5.28 billion for uplift of social sector in Pakistan. US and Japan would give $1 billion each over a period of two years. Saudis will offer $700 million. European Union's $640 million will come in four years.

Though the break-up of the entire $5.2 billion is not yet available, Iran, UAE and Turkey have pledged $330 million, $300 million and $100 million respectively. The EU's amount includes $150 million pledged by Germany. While these funds would shore up the weakening rupee and replenish foreign exchange reserves, but there is normally much gap between pledges and disbursements of promised assistance.

Parallel to the Friends of Pakistan pledges, the US administration and lawmakers are also considering a proposal to give a one-time assistance of $5 billion to help stabilize the Pakistani economy (*Daily Dawn* 12 March 09). Senator John Kerry, who cosponsored the aid package, proposed an immediate injection of about $5 billion into the Pakistani economy to prevent an imminent meltdown. He warned that "the Pakistan government has between 6-12 months to put in place and implement security and economic policies or face the very real prospect of considerable domestic and political turbulence".

The proposed $5 billion, however, will not go directly into the government of Pakistan funds. The money will be spent on projects supervised by the US Agency for International Development. The supervision, it is claimed, will reduce the chances of corruption and misappropriation. But this will also increase the overhead expenses to 25 to 30 per cent, running into hundreds of millions on one hand and also ensure return of the major amount to US, through its expensive consultancy services. The USAID is required to hire US contractors who then can hire Pakistani sub-contractors to work on the proposed projects. The entire aid package, which may go up to $15 billion if extended for 10 years, will focus on the economy and social sectors.

Meanwhile United States is also working on a common economic package for Pakistan and Afghanistan, besides involving the two countries in formulating a new security strategy for the region. The additional aid –will be attached to a package proposing an annual assistance of $1.5 billion over the next five years. The package can be extended for five more years with congressional approval. Another US bill to set up reconstruction opportunity zones (ROZs) along the Pak-Afghan border is also under consideration. But US administration has warned that the pledge of $7.5 billion in civilian aid over five years will only be forthcoming if Pakistan demonstrates its commitment to uprooting Al Qaeda and other violent extremists.

Meanwhile The Asian Development Bank reportedly will also provide $4.4 billion under its Country Partnership Strategy (CPS) for energy, infrastructure, urban services and institutional reforms projects. (*Daily Dawn* 11 March). While the inflow of these funds will help expand the public sector development spending, the question is would government of Pakistan be able to come out of the IMF program as quickly as possible and achieve the growth targets? Will it be able to come out of the debt trap? These questions are hard to answer.

The prevailing financial scenario is apparently quite rosy for Pakistan but prevailing political economic situation is not encouraging. Though both mainstream political parties are inching closer to each other, but a plethora of constitutional issue has dangerous potential to create another divide among PPP and PML-N, as far as political instability is concerned.

After a lot of political upheaval during the last couple of years, things are going to be mended and the two major political parties are once again heading towards some rapprochement. In a sense political stability is limping towards normalcy and both the Pakistan Peoples Party and Muslim League-Nawaz are now in no mood to destabilize each other. Notwithstanding the temporary macroeconomic calm political economy is still weak to buck up the investment climate.

Foe example recent new wave of nationalist insurgency in Balochistan, a bordering province with Iran and roaring Taliban movement in Sawat, Waziristan, Boneer and other bordering areas with Afghanistan are the potential headaches for the government. There is a difference of opinion among Army and political leadership on specific issue of strategy to deal Talbanization and war on terrorism. This chasm between the Military and political leadership also contribute to political instability.

Nevertheless, as result of IMF package, the foreign exchange reserves have soared to over $ 8 billion, the economic activity is still crawling. Major bottlenecks including, poor law and situation, government's poor political will, severe power shortage and its impact on industrial sector, IMF conditionalities and rising debt are playing havoc with economic situation.

The ever increasing debt burden and the cost of servicing this debt is still the most important economic issue in the country. During the last seven months the $ 5 billion has been added up to external debt, increasing the amount to 51 billion in May 09 from $ 46 billion in September 2008.

Though Pakistan's is taking time to correct the negative image, reinforced by the recent terrorist attacks on Sri Lankan cricketers and Police academy in Lahore, but investment climate is limping towards normalcy. The fears on the part of US and international community, regarding weakening of the state of Pakistan in the face of impending talbanization cannot be ruled out.

There is real threat, do doubt, to the nuclear assets of Pakistan, which scares the rest of the world. So dealing with the prevailing situation we cannot ignore the contributors of this serious situation and US is one of the major actor, which has put Pakistan and rest of the world in a potential danger, through its faulty policies of war on terrorism.

The roaring talbanization is rapidly marginalizing the peaceful and democratic forces in Pakistan. Therefore, to combat globalised fear of talbanization international community should help grow strong democratic and political culture in Pakistan. Instead of supporting Military dictators US must back democratic forces to fight Taliban ideology. Pakistan does not need injections of temporary macroeconomic calm, but durable support for production-led growth. And that is possible only by focusing the much-ignored social sector.

A stable democratic and economically sound Pakistan is in the interest of the world today. Therefore, IMF, WB, Asian Development Bank or donor agencies instead of extending new loans to Pakistan, should think about canceling the by-lateral and multilateral external debts of Pakistan, enabling it economically powerful enough to eliminate religious fundamentalism and fanaticism.

P.S.

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