Pakistan's economy drifts into the trap of foreign dependence

by Susan Maitra and Ramtanu Maitra

Despite back-handed praise from the World Bank for progress in reducing "macroeconomic imbalances" and restructuring key parts of the economy in 1989 and early 1990, Pakistan's economy is getting more and more hooked on aid and increasing foreign debt.

The World Bank's praise came in the form of a report, "Pakistan—Assessment of Economic Performance in FY89," released in Washington, D.C. on March 15. The "Ides of March" report predicted that after 1992, Pakistan will be able to integrate itself more vigorously into the world economy through trade. And, "with a further deregulated and stronger economy," Pakistan should also be able to attract new and additional sources of financing—in particular, foreign direct investment.

This rosy assessment of Pakistan's economy received a jolt in June when the 1990-91 budget was presented by the then-ruling Pakistan People's Party (PPP) government, amid a tumultuous scene in the National Assembly. The budget document indicated that for the first time in Pakistan's 43 years of nationhood, both debt servicing and defense expenditures will outstrip developmental spending. It also showed that the economy is beset with a serious money crunch, with revenue deficits reaching a gigantic $2.05 billion.

IMF plays hardball

While some oppositionists argued that a good budget can come only from a good government, the fact is that the budget exercise was deeply interfered with by the International Monetary Fund. The three-member IMF team headed by Malcolm Knight that parked itself in Islamabad until May 20, three weeks prior to budget presentation day, made their minds known. Reportedly the team rejected most of the government's proposals for the 1990-91 budget, insisting instead that Pakistan put a tighter leash on budgetary deficits, drastically reduce its allocation for the provinces, and impose additional taxes. Unlike the optimism expressed by its twin, the World Bank, the IMF criticized Pakistan's failure to adhere to the conditionalities contained in its four-year Structural Adjustment Facility (SAF) agreement with the Fund.

The IMF team also told the Pakistan government to eliminate its practice of financing even a part of the budget from resources mobilized through the National Saving Schemes (NSS). The government had been contemplating financing at least 30% of the budget from NSS because of its inability to generate additional revenue without resorting to wider taxation.

The IMF's disagreement with the Pakistan government went beyond suggestions and advice. According to the Karachi daily *The Dawn,* the IMF is withholding the last tranche of about $200 million from the ongoing $800 million SAF program. The IMF claims the budget proposals are completely out of line with the conditionalities of the agreement signed by the previous caretaker government under President Ghulam Ishaq Khan in November 1988.

The same news report indicated that the IMF team under Knight left in disgust after failing to "sell to the government a budget prepared by the Fund," and informed the government on leaving that cancellation of the last tranche of the SAF will drop Pakistan's credit rating from the 18th to 20th position on the list of 32 countries.

Pakistan's major economic indicators

	1987	1988	1989	1990*
Gross Domestic Product (% change)	6.5	7.0	5.6	5.5
Agriculture	3.3	2.7	6.1	5.0
Industry	8.6	8.7	3.9	5.0
Services	5.9	6.8	5.2	5.5
Gross domestic investment (% of GDP)	19.1	18.2	17.5	17.0
Gross national saving (% of GDP)	17.0	13.7	12.6	12.5
Government expenditure (% of GDP)	19.5	20.3	18.3	na
Inflation rate (% change in CPI)	3.6	6.3	10.4	8.5
Merchandise exports (U.S. $ bn)	3.5	4.4	4.6	4.9
Merchandise imports (U.S. $ bn)	5.8	6.9	7.2	7.4
Trade balance (U.S. $ bn)	−2.3	−2.6	−2.6	−2.5
Current account balance (US $ bn)	−0.7	−1.7	−2.0	−1.6
External debt (U.S. $ bn)	16.7	17.0	18.3	19.5
Debt service ratio (%)	26.5	24.7	24.5	25.0

*Projected
Source: Asian Development Bank, *Asian Development Outlook 1990*

Pakistan in throes of wheat production crisis

According to the information coming out of Punjab and Sindh, where Pakistan's main foodgrain crop, wheat, is grown, output for the season might be 20-22% less than the targeted 15 million tons. That would make this season's wheat production less than the 12.6 million tons Pakistan harvested in the drought year of 1987-88.

Once a wheat-surplus nation, Pakistan has failed to attain the production target set a few years ago (see **Table 1**). Over the past two decades, the country's wheat production has gone up by only about 75%, whereas the population has almost doubled. By the end of this century, according to a United Nations projection, another 45 million Pakistanis will be in the market for wheat, bringing the country's population to 156 million.

A wheat shortage scare broke out late last year when the Pakistani media reported that the country's feedstocks could reach a dangerous level by May. In February 1990, the Ministry of Food and Agriculture arranged to import 2.25 million tons of wheat and assured the population that current stocks plus imported wheat would be able to meet the requirements till June, when the new crop would begin to arrive at market. But the shortage of 20-22% now predicted by wheat traders means that by November, Pakistan will be once again in the international market looking to import at least 3.0 million tons of wheat. With growing foreign debt-servicing and an unavoidable trade imbalance, the wheat import bill will further strain Pakistan's foreign exchange reserves.

Pakistan's wheat shortfall for the current year has been attributed to inadequate availability of canal water and to disruption in the supply of all varieties of fertilizers. The government claims that the shortage of fertilizers was caused by delay in clearance from the port; the farmers

TABLE 1
Wheat production always short of target

Year	Production (in million tons)	Target
1984-85	11.6	
1985-86	13.7	
1986-87	13.0	
1987-88	12.6	
1988-89	14.0	
1989-90*	12.0*	15.0

*Estimated

It is not that the Bhutto government openly defied the IMF, but apparently it only capitulated halfway. At issue was the fact that, when the budget was finally released, taxes were only raised by $500 million, not by $1 billion as the IMF demanded. The IMF also objected to the $400 million rise in defense expenditures.

An economy adrift

But if the government of Prime Minister Benazir Bhutto sought to retain some authority in economic matters, it is not necessarily cause for economic optimism. The budget as such reflects an economy that is dangerously adrift, and getting increasingly stuck in financing non-developmental activities. Fully 80% of revenue expenditure is accounted for between debt servicing and defense, while maintenance of law and order ate up another 10%.

According to official sources cited by *The Dawn* on July 8, Pakistan's foreign debt servicing has shot up to 25.7% of its export receipts, 15.7% of its total foreign exchange earnings, and 3% of Gross National Product. Pakistan now carries a total foreign debt burden of about $19 billion; another $9.3 billion remains locked in the aid pipeline because the government is unable to raise matching funds in Pakistani rupees. Long-term debt outstanding is nerly 40% of GNP. In addition, Islamabad is under pressure from the IMF to further liberalize imports. Already, 90 more consumer items have been put on the "free" list.

According to the budget proposals, total debt expenditure for the year will be $4.0 billion—an increase of $2.5 billion since 1985-86. Along with that, defense expenditures will rise to $3.1 billion—up from $1.17 billion in 1983-84. By contrast, the Annual Development Plan shows a steady decline over the years. In 1979-80 it accounted for about 40% of the budget outlay, but now it has come down to about 25%. Out of this—which amounts to about $3.1 billion—more than two-thirds will come from external funds, largely foreign loans carrying substantial interest rates.

Such overdependence on external funds has already taken a toll on Pakistan's ability to make independent decisions. With more loans taken at commercial rates of interest, debt-servicing requirements are rising at a faster rate than disbursement of loans. While short-term borrowing accounted for only 2.3% of total external debt in 1978, it is over 15% today.

Analysts underline that it is getting to the point where foreign exchange receipts (export earnings plus remittances by Pakistani nationals living abroad) will not cover the import bill. Then, foreign debt-servicing, which last year stood at blame both the public and private sectors, in collaboration with the multinationals, for creating an artificial shortage that hiked black market fertilizer prices sharply. A bag of urea, for example, was selling at $8.

The wheat shortfall confirms fears expressed by many agriculturists over the years. According to them, the much-vaunted proclamation by the government that Pakistan has achieved self-sufficiency in wheat production, is a hollow one. With only a few exceptions, Pakistan has depended on imports from abroad every year. In each of the years 1985-86 and 1988-89, about 1.6 million tons of wheat (excluding the quantities required for the Afghan refugees) were imported. During 1987-88, importation was nominal; but in 1989-90, the government has imported 2.25 million tons.

According to calculations made by the Agricultural Prices Commission, wheat production grew at an average compound rate of 2.64% annually from 1978-79 to 1988-89, whereas during the same period population grew at a rate of 3.0%.

Besides the obvious shortfall in production, Pakistan has to come to grips with its problem of low productivity. In Pakistan, where wheat is grown in about 10 million hectares of land, more than 75% of sown land is under canal command area, and is classified as "good" or "very good" for agricultural work. Since water availability in the coming years could only be marginally better, at best, the authorities will have to tackle the low productivity. Although greater fertilizer use may alleviate the situation temporarily, low wheat productivity is not due to inadequate inputs alone.

On the contrary, behind the growing crisis are other factors which, according to experts, the government keeps sweeping under the rug. Many of the big landlords, who hold Pakistan's fragile political system at bay, are not active agriculturalists. Many are "absentee landlords" who plough their farmland profits into real estate and other industries which give them a faster and greater return.

One of the reasons wheat production is considered "less profitable," is because the wheat price has been kept very low—even significantly lower than that in neighboring India—in order to allow the vast majority of poor to buy wheat, their chief source of calories. Any significant rise in wheat prices may entice the big landlords to produce more, but it may also have a harmful effect on the poor. Under the circumstances, should Pakistan fail to raise its wheat productivity substantially, through more and better management of inputs and comprehensive pricing policy which does not hurt the poor but, at the same time, provides the required initiative to the producers, in coming years it is doomed to become a perennial wheat-importing nation.


World Bank

Harvesting wheat by hand in Pakistan. The country's shortfall for the current year has been attributed to disruption in availability of water and fertilizers.

$1.27 billion, will simply not be possible without a further reduction in development programs. Added to this conundrum, is the continuing weakness of Pakistan's export sector.

Pakistan's exports consist primarily of rice, cotton, leather and related primary products, and as such is relatively inflexible. Exports cannot be increased simply by increasing demand. At the same time, the frail manufacturing sector is highly dependent on development of physical and social infrastructure, besides import of machinery and intermediate products. Cannibalization of the economy has deeply affected infrastructure development and the ability to spend on social services. In spite of the sorry state of literacy (only 26% of all adults) and public health, the budget allocation to these sectors remains minuscule.

Further, the government's earlier optimism on foreign investment and the involvement of the private sector in large infrastructure projects has not yet materialized. While foreign investors have shown some interest, real investment is simply not coming in. A Japanese consortium's recent decision to withdraw from a $1.0 billion 1200 megawatt power plant project at Hub has come as a particularly painful blow, and has dampened earlier enthusiasm expressed by the government that the answer to power shortages is private sector participation.