PAKISTAN DEBT CRISIS

China and Belt and Road Are the Solution, Not the Cause!

by Hussein Askary

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May 28—A new wave of the thoroughly debunked fake narrative of "China debt-trap" is trying to make a fresh return in Western media, taking advantage of the current global economic and financial crisis that is hitting many nations. Pakistan is admittedly facing a debt crisis. However, this is not unique to Pakistan today. Sri Lanka, Turkey and many countries in Asia and Africa are reeling under multi-faceted debt burdens, in addition to fuel and food crises.

Most of those nations have also been hit severely by the economic and financial consequences of the COVID-19 pandemic. The media narrative takes the global financial and economic crisis and its causes out of the story about a country, and then attributes the problem to the intimate cooperation between that country and China to jointly build the Belt and Road.

The most acute aspect of this global crisis is the major rise in global energy prices starting already in 2021, but augmented by the crisis in Ukraine. With supplies threatened, and sanctions imposed on the largest exporter of natural gas, Russia, prices have hit the roof. The rise in fuel prices created shock waves across every aspect of the global economy, especially consumer goods. Added to this, the crisis in Ukraine created a supply crisis in global wheat markets as Ukraine, Belarus, and Russia are major producers, and also threatened the production of food elsewhere since Russia is the world leader in production of fertilizers. Countries that do not have domestic oil and gas resources nor fertilizer production are hit the worst. This applies to the EU and other industrial nations, not only poor countries. But the U.S., the EU and Japan can resort to money printing without suffering a global blowback. Developing countries can be severely punished if they do so, and their currencies collapse under the pressure of hyperinflation.

As we show here, Pakistan's debt crisis has absolutely nothing to do with Pakistan's cooperation with China to build the China-Pakistan Economic Corridor (CPEC). On the contrary, the CPEC is one of the main *solutions* to this problem.

Facts: The Composition and Source of Debt

Two essential facts are ignored when the media in the West (and also in India) deal with the external debt of Pakistan: the composition of the debt, and the causes of the debt. We will discuss these two here. A third factor, which we will not discuss here, is that Pakistan has been a victim of America's and NATO's decades-long wars in Afghanistan, first in support of the Mujahideen against the Soviet Union in the 1980s, and later fighting the same Mujahideen (now morphed into terrorists) since 9/11 in 2001. These wars caused devastating economic loss, besides an incredible loss of human life.

Contrary to the narrative, through the CPEC, China has played a positive role in Pakistan's fight to remedy decades of economic stagnation. One of the most important aspects of this cooperation is resolving the country's infrastructure bottleneck, with power generation and distribution as key to its economic salvation. It is very important to remember that CPEC power projects in Pakistan are Chinese investments, not loan-financed contracts. They are build-own-operate-transfer (BOOT) projects. The Chinese investments are recouped through sales of electricity to the Pakistani market over a specific period.

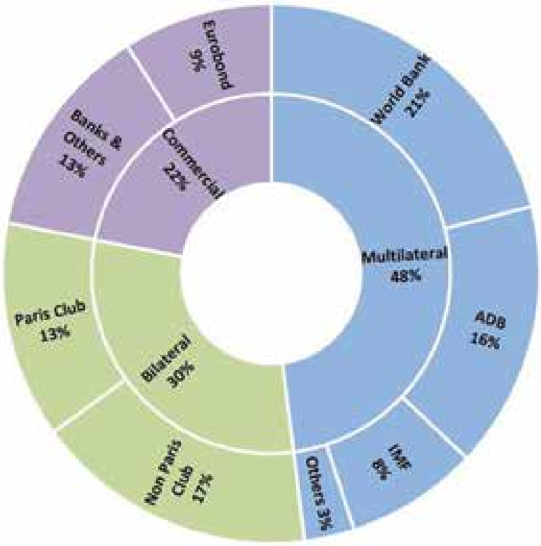
Composition of Pakistan's external debt. China's share of Pakistan's external debt, compared to that of Western and other Asian nations and institutions, is relatively small, reaching no more than 10% of the total.

According to data provided by the State Bank of Pakistan (SBP) and the Ministry of Finance and Revenue reviewed by the BRIX (see **Figure 1**),

FIGURE 1

Composition of Pakistan External Public Debt

End of June 2021



		Jun-2019		Jun-2020		Jun-2021	
		PKR billion	$ million	PKR billion	$ million	PKR billion	$ million
I+II	External Public Debt	11,976	73,449	13,116	77,994	13,594	86,415
I	Govt External Debt (a+b)	11,055	67,800	11,825	70,314	12,432	79,031
	a- Long term (>1 year)	10,849	66,536	11,565	68,773	12,297	78,173
	- Paris Club	1,832	11,235	1,837	10,924	1,687	10,726
	- Multilateral	4,531	27,788	5,196	30,898	5,323	33,836
	- Other Bilateral	2,074	12,717	2,258	13,428	2,332	14,821
	- Euro/Sukuk Bonds	1,027	6,300	891	5,300	1,227	7,800
	- Commercial Loans	1,381	8,470	1,357	8,068	1,525	9,696
	- Others	4	26	26	155	204	1,294
	b- Short term (<1 year)	206	1,264	259	1,542	135	858
	- Multilateral	127	778	137	814	80	506
	- Local Currency Securities (T-bills)	0	0	99	586	55	352
	- Commercial Loans	79	486	24	141	-	-
II	Debt from the IMF	921	5,648	1,291	7,680	1,162	7,384
	- Federal Government	-	-	476	2,833	541	3,437
	- Central Bank	921	5,648	815	4,847	621	3,947

Source: Ministry of Economic Affairs, State Bank of Pakistan & Debt Policy Coordination Office, Ministry of Finance

Pakistan's creditors are mostly Western-controlled financial institutions such as the World bank (21%); International Monetary Fund (8%); Asian Development Bank[1] (16%); the Paris Club (13%); and international commercial banks and bond markets (22%). China's share is included in the 17% from non-Paris club states, dominated by the Gulf states, and also in the category of commercial loans.

Therefore, Pakistan's fiscal policies have been dominated by *conditionalities* imposed by these international institutions to a large extent for many years, but emphatically since 2016, when Pakistan's economy witnessed a severe downturn. Bailout negotiations were characterized by demands to impose austerity and reduce government investments in infrastructure and public services. These typical demands are terribly counterproductive in developing countries and lead to lowering the productivity and competitiveness of the domestic economy.

Pakistan's total external debt (public and private) in December 2021 was $130 billion, and debt service for 2021 was $10.9 billion. This compares to $116.5 billion in 2020, and $93 billion with debt service of $6 billion in 2019.

Some relief was offered from international sources when in 2021 Pakistan became eligible for the Debt Service Suspension Initiative (DSSI) in the aftermath of the COVID-19 pandemic. The DSSI is a World Bank-administered G20 initiative.

Domestic debt is larger and has risen in a similar manner in the same period. Its level in local currency, rupees, was equivalent to $127 billion in 2019; reached $138.5 in 2020; and finally in 2021 rose to $167 billion. So the rise since 2019 can be said to be somewhat dramatic.

Causes of the debt crisis. One of the main causes of Pakistan's resorting to borrowing externally is financing its current account deficit (CAD), where its imports have outpaced its exports for many years. A look at what commodities are the largest items of Pakistan's bill of imports reveals why the CAD has been increasing dramatically. In 2020 they were: refined petroleum ($3.87 billion); petroleum gas ($2.24 billion); palm oil ($2.15 billion); crude petroleum ($1.92 billion), and raw cotton ($1.68 billion). The fact that petroleum products dominate the imports bill indicates that the price rises of these items since early 2021, but most dramatically since the start of the Ukraine crisis in February 2022, will make this deficit even deeper and force Pakistan to borrow even more hard currency to pay for its energy bill.

1. Despite what the name suggests, the Asian Development Bank's major donors include, besides Japan and the USA, also Australia, Canada, France, Germany, Britain and a few Asian countries such as China, India, and Indonesia. Its policies are similar to those of the World Bank and IMF.

Solving the Electric Power Problem

It is important to note that Pakistan still relies for power generation on expensive imported oil and gas; of its total installed generation capacity of 40,000 megawatts, 15% is fueled by oil, 12% by natural gas, and 25% by liquified natural gas. Other power sources are hydroelectric (26%), coal (9%), nuclear (8%) and solar and wind (5%). This problem will be gradually resolved when more power from CPEC hydropower, coal and nuclear plants, and renewables come online in the next 3-5 years. This will tackle the major problem of trade deficit caused by expensive imports of oil and gas. Thus, the external debt problem will be reduced.

At the same time, Pakistan's export items, mostly textiles, don't increase as dramatically in price, although they achieved important growth in the past three years.

The trade deficit increased by 83% from 2020 to 2021, reaching US$32 billion. It reached an all-time monthly high in January 2022, hitting $2.6 billion. This record has been broken each month, and will very likely break the $40 billion annual level by the end of this year.

This is the main cause of alarm in the country, which will have to resort to the IMF, international markets at higher interest rates, and to friendly countries for bailout. This will add more to the pile of external debt.

The power sector in Pakistan has been the main source of economic trouble for many years. Lack of electricity means load-shedding for hours every day. No industry can survive such circumstances. The main industries of the country—cotton textiles, agriculture, automotive, cement, steel, tobacco, chemicals, machinery and food processing—have suffered reduced productivity and loss of revenues for years.

However, with the increased generating capacity, including from CPEC projects being gradually completed, the problem is no longer the capacity, but delivery, and financing delivery efficiently. The issue here is a phenomenon called "circular debt." Delays have accumulated in payments of government subsidies to power distributors, mainly government enterprises. When these enterprises do not receive the subsidies, they fail, first, to maintain and develop the transmission lines and systems; and second, to pay the power generating companies. The latter need to be paid to buy fuel and develop the electricity production capacity. When the system fails to deliver power regularly to customers, the customers do not pay bills. This leads to further financial shortages for the enterprises distributing the power, and this in turn affects the power-producing utilities. This cascading spiral of "circular debt," is estimated to have reached the equivalent of $14 billion this year.

The government is caught in a trap, because if it lifts the subsidies it is offering to consumers since 1960, it runs the risk of social and political unrest due to rising electricity prices determined by the "market." Not only the poor sectors of society, but even great numbers of small businesses with low revenues will not manage the rising power prices. Therefore, the government is choosing a middle path by slightly raising the electricity tariff rather than lifting the subsidies, according to Nadeem Babar, Chairman of the Prime Minister's Task Force on Energy Reforms. This process will gradually

CC/VileGecko

Projects to resolve Pakistan's infrastructure bottleneck are an important aspect of Pakistan's cooperation with China. Power generation and distribution are a key component. Shown: the 1,320 MW dual unit Port Qasim Coal Power Plant, one of 14 energy projects that are part of the China-Pakistan Economic Corridor of the Belt and Road Initiative.

reduce losses and ease the constraints on the transmission and distribution systems.

But others, backed by the World Bank, recommend a total lifting of subsidies while providing financial support to the neediest citizens and enterprises. Such a sudden move, however, might create a shock with major social and political repercussions, in a politically very fragile nation after the ouster of Prime Minister Imran Khan in early April.

Role of China and the CPEC

The increase in the productivity of the Pakistani economy is the most important solution to the crisis, but it is not a quick fix. While financial experts and international institutions focus on "reforms," some of which are necessary, Pakistan must race to complete Phase I of the CPEC (infrastructure building) and launch Phase II (industrial parks and agriculture sector development). These two phases will reduce the trade deficit and diversify the sources of income of the nation and achieve greater growth.

Newly built industrial parks and special economic zones (SEZ) are attracting both Chinese and international investors. These SEZs are located on or near transport and power transmission arteries of the CPEC. However, the pace of investments in these parks is still slow.

To solve some of the urgent debt issues, Pakistan is approaching China for debt relief or bailout through injections of foreign reserves into the Pakistani Central Bank to stabilize the balance of foreign currency reserves. Pakistani Finance Minister Miftar Ismail announced on June 2 that China had done so, with a $2.3 billion refinancing of Pakistan's reserves by Chinese banks. This came after Ismail's May 31 statement that Pakistan might have to accept an IMF program of more than $30 billion with austerity conditionalities. China had already accepted a Pakistani request to roll over a major $4.2 billion repayment on March 29, providing a major relief. This was announced after the meeting of Foreign Minister Wang Yi with his Pakistani Counterpart Shah Mahmoud Qureshi in Anhui Province, China.

This tranche of debt repayment is not related to CPEC projects, but rather investments by the Chinese State Administration of Foreign Exchange (SAFE). Pakistan is likewise resorting to wealthy Gulf states for similar financial support.

The Fake Narrative of 'Chinese Debt-Trap Diplomacy'

Proving the fallacy of the China "debt-trap diplomacy" narrative is relatively easy. A simple check of the facts from official sources suffices to show why it is a fake story. The debt-trap narrative, especially in the case of Sri Lanka, has been thoroughly debunked by Dr. Deborah Brautigam and associates at the School of Advanced International Studies (SAIS) of Johns Hopkins University, after studying thousands of pages of official documents. This author's own work has also explored this matter by checking facts from the official sources. Yes, it takes some time-consuming homework, but the revelations are rewarding.

The challenge is not in sorting facts from fiction but encountering the massive propaganda machine of the mainstream media in the West, which spews out wave after wave of such stories. Repeating these fake stories does not make them into truths, but the psychological impact and the doubt they plant in the minds of the victims of this exposure are difficult to counter with no equal mass media exposure to the truth.