Pakistan: Who needs a crisis?*

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With Imran Khan's Pakistan Tehreek-e-Insaaf (PTI) or "Movement for Justice" winning 116 of the 272 seats filled through election in Pakistan's National Assembly, the former cricketer is set to be installed as his country's next Prime Minister. So attention has now shifted to how he would address the 'crisis' the country faces. That crisis is not a crisis of growth. Pakistan has registered year-on-year growth rates exceeding 5.4 per cent in the three consecutive years ending financial year 2017-18, a record matched this century only in the globally-synchronised, high growth years 2003-2007. Nor could it be identified as a crisis of extreme inequality or deep poverty, since that is a problem that afflicted Pakistan ever since its creation and characterises most less-developed countries, including neighbouring India.

The problem lies in Pakistan's balance of payments or external account. Exports have been sluggish for reasons external and domestic, whereas imports have risen, partly because of a rising oil import bill, and partly because growth rode on a wave of import-intensive spending under the previous regime. The three dominant categories of imports were Machinery, Petroleum and Other chemicals, with Petroleum accounting for much of the increase between year ending June 2016 and year ending June 2018. As a consequence the trade deficits widened, and with remittances stagnant for a few years now, so did the current account deficit or the excess of foreign exchange spending relative to current receipts of foreign exchange. It also did not help that with a rise in external debt financed spending, interest payments on foreign borrowing were also in the rise. The trade deficit which stood at $3.9 billion in the first quarter of 2015, rose to $8.8 billion in the first quarter of 2017 and $10.5 billion in the second quarter of 2018. Simultaneously, the current account deficit rose from $2.8 billion in 2015, to $7.1 billion in 2016 and $15.8 billion in 2017. Relative to GDP the current account deficit rose from 1.0 per cent in 2015 to 5.2 per cent in 2017.

As is inevitable, this was possible only because of capital inflows which were substantially in the form of borrowing. Outstanding external debt rose from $62.7 billion at the end of March 2015, to $70.4 billion at the end of March 2016, $77.9 billion at the end of March 2017 and $91.8 billion at the end of March 2018. But that alone was inadequate to finance the rising deficit, and official liquid reserves had to be run down from $18.4 billion at the end of 2016 to $11.8 billion at the end of March 2018. This has triggered a sharp depreciation of the Pakistani rupee from 105.5 to the dollar in November 2017 to 119.4 to the dollar in June 2018 or by 13 per cent in 7 months. Those are the symptoms of the current crisis in Pakistan.

In response to this crisis the narrative that has gained popularity is that Pakistan has been pushed into these circumstances because it is enmeshed in the grand power designs of a rising and belligerent China. The principal instrument for Chinese expansion both economically and strategically is identified as the Belt and Road Initiative (BRI), that would encourage infrastructural investments in a large number of countries aimed at providing China access to and control over multiple East-West trade routes. This was expected to benefit the countries involved because of the stimulus to growth that the large infrastructural investments would provide. However, the catch, it is now being argued, is that under this 21st-century, Chinese version of the Marshall Plan, the capital to finance the infrastructural investments are not in the form of grants or even concessional credit, but of loans on commercial terms. The resulting debt build up is making it difficult for countries to service these loans, and they are vulnerable to debt and currency crises.

China on the other hand gains through the interest earned on its capital, exports of capital equipment from its factories at home and access to trade infrastructure. Even if the borrower defaults on debt, China would gain through the transfer of control of infrastructural facilities that could not have been created without the involvement of the local government in the country concerned. An example repeatedly quoted as an instance of the last of these possibilities is the Hambantota port in Sri Lanka, financed with and $8 billion loan at 6 per cent interest from China to the Sri Lankan government. Unable to generate the foreign exchange revenues, the Sri Lankan government decided to hand over the port to China on a 99-year lease for the latter to recoup the amortisation and interest equivalent on its loan. So the Belt and Road Initiative is presented as a grand and conspiratorial plan for hegemony in multiple regions across the globe.

Pakistan did see in the BRI a possibility of turning around its economy with support from China for a string of projects that are part of the China-Pakistan Economic Corridor (CPEC). With reason. Under the CPEC, the Gawadar Port was seen as a “game changer”, and projects like the Karot power station, the Orange Line Train in Lahore, the Karachi Circular Railway and the Karakoram Highway were expected to stimulate growth and boost Pakistan’s exports, which in turn would provide it the wherewithal to service the debt used to finance them. Given its role in designing the whole of the Belt and Road Initiative, China was willing to provide that debt, and Pakistan’s borrowing from China did rise in the years after 2013 when work on the CPEC began. It is estimated that all of the projects initiated would require investment to the tune of $60 billion or more. As of the end of June 2018, Pakistan’s exposure to Chinese debt is placed at only $19 billion, not all of which is due to projects that are part of the BRI. Yet, already, those unhappy with China’s influence are declaring with glee that the project is unravelling.

The effort now is to use Pakistan’s balance of payments difficulties to stall or even abort the activities planned under the BRI. The West would like that, and so would the IMF that had represented western interests in Pakistan for much of that country’s history. This has set off an argument that Pakistan cannot afford the luxury of the projects planned under the CPEC. So the process of resolving the current balance of payments difficulties should include a decision to retreat from projects linked to those initiatives. Reportedly, the IMF would like to help with balance of payments financing to the tune of $10-12 billion, but as US Secretary of State Mike Pompeo declared in a recent visit to Pakistan, IMF dollars should not be used to service Chinese debt. In his words: “Make no mistake: we will be watching what the IMF does. There's no rationale for IMF tax dollars — and associated with that, American dollars that are part of the IMF funding — for those to go to bail out Chinese bondholders or China itself.”

Besides the fact that it is not Pompeo’s brief to speak for a multilateral institution like the IMF, the argument itself is absurd. This is like Russia saying that it will not allow Greece, if it is given an IMF standby loan to deal with an external payments problem, to use any of those dollars to repay debt owed to any European country Russia does not get along with and which had over lent to Greek borrowers to promote its own interests. If it did and the IMF had to listen to one of its top 10 member states, the Greek crisis could not have been addressed (even if not resolved) the way it was.

But coming from a senior official of the Trump administration Pompeo's words reek as much of desperation as they do of arrogance. The Trump administration has already dumped a long-term ally in the region, on the grounds that it was soft on terrorism and even abetting it. President Trump has attacked Pakistan for giving the US just "lies and deceit" in return for $33 billion of aid over 15 years and for providing "safe haven" to terrorists. His administration also suspended $255 million in military aid to Pakistan on those grounds. For that administration to displace the Chinese as Pakistan's friend would be difficult.

The new Pakistani government too will prefer not to turn to the IMF, though there is considerable pressure on it to do so. The reasons are simple. Besides not wanting to give up on the opportunities implicit in the CPEC, which is what resulted in the good growth record under the previous government, accepting an IMF loan would require accepting conditionalities that spell austerity and therefore an inability to implement any of the campaign promises made by Imran Khan. The question is, whom can he turn to? The obvious answer is China, for which Pakistan is both economically and strategically important. It is to be expected that China would respond positively for help, but would set its own conditions, as would any lender. In fact there is evidence that it has already provided some emergency help. Pakistan chose to take the options on offer as part of CPEC, and it would have to negotiate terms needed to restructure loans it had taken on for the purpose. Given China's own interests they are unlikely to be more onerous than the costs associated with aligning with the US in the past.

However, faced with this possibility horror stories of the consequences of turning to China are being constructed. In particular, the case is that going with China would result in Pakistan becoming a near-colonial dependency of the former, with control of assets moving from nationals and the Pakistani state to Chinese interests. That can be avoided by turning to the IMF, it is argued. There is some duplicity here, inasmuch as it portrays the IMF as an 'independent', purely technocratic agency, and China as a political power with hegemonic intent. Pompeo's statement made clear that this is not the way the US administration perceives the IMF. And experience too suggests otherwise.

Historically, the IMF, known for the harsh conditionalities associated with its lending, has been different in its attitude towards and "lenient" with the government of Pakistan. This is clearly because, Pakistan is a country that the IMF wants as borrower to influence its strategic and economic behaviour. Pakistan received its first Extended Financing Facility loan from the IMF in 1988. Since then Pakistan has been rewarded with exceptional financing under 12 IMF programmes, as compared with one for India, three for Bangladesh and two for Sri Lanka. Pakistan remained a favoured borrower even though during almost all those IMF programmes policymakers failed to deliver on targets set by the Fund, especially with respect to reducing the fiscal deficit. As a result, 11 out of these 12 programmes were stalled midway. Yet each time, after a short gap, when Pakistan needed more funding to stave off balance of payments difficulties, the IMF returned to negotiate a new facility.

Analysts have for long seen a US hand behind this unusual behaviour. A December 2012 working paper from the Asia Research Centre of the London School of Economics authored by two erstwhile IMF hands from Pakistan (Ehtisham Ahmad and Azizali Mohammed, “Pakistan, the United States and the IMF: Great game or a curious case of Dutch Disease without the oil?”) argues that: “A history of Pakistan’s relations with the IMF (and the Bretton Woods Institutions in general) cannot be told without reference to the complex and changing role played by the United States, especially since the mid-1980s when the Reagan administration stepped up responses to the Soviet Union in Afghanistan.” Whenever expenditures on strategic grounds were needed they flowed in the form of bilateral commitments by the US government. But when political considerations led to the cessation of bilateral assistance, the IMF stepped in, even if temporarily.

This political (mis)use of a multilateral institution meant that Pakistan benefited from “exceptionally favourable conditionality and flexibility in giving waivers, on not meeting even soft conditionality standards.” The hypocrisy involved in presenting the IMF as a technocratic alternative to a hegemonic China is more than obvious.

It is to be seen how this proxy stand-off between a retreating power treating shabbily its former ally whose policies it has shaped and a rising power, willing to put its money where its mouth is, would play out. China is bound to offer Pakistan it support but is unlikely not to extract some concessions that strengthen its position. Historically, no nation has used its resources to finance the power play of a competing power.

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