Pakistan: A Snapshot View

Events since Pakistan's nuclear tests early this summer have put severe pressure on an already fragile situation. The government of Pakistan is negotiating a program with the International Monetary Fund to deal with their short-term financial problems and their longer-term development challenges. Implementing it will pose a challenge for the country's political and governmental institutions. In addition, the government needs to deal with a worsening relationship with India, strains in its ties with the United States, and an uncertain situation in Afghanistan.

The Economy: Cash Crunch and Structural Problems. Pakistan owes $5.5 billion in loan repayments this financial year. With only $540 million in foreign exchange reserves, covering just over two weeks of imports, the country may face an impending default crisis unless IMF funding is resumed. Much of the expected new multilateral assistance to the country was suspended following its nuclear tests.

Sanctions have exacerbated the country's fragile financing situation, but its present economic predicament is the result of fiscal mismanagement over the last decade. Pakistan's most pressing immediate problem is its high budget deficit (6 percent of GDP in 1996-1997) and the high level of debt incurred to finance it. Contributing to the deficit are the imperative of high defense spending (6.1 percent of GNP in 1995), low taxation revenues and loss-making public-sector enterprises. The deficit in turn has spawned higher interest rates (up to 12 percent), inflation (10-11 percent), and lagging investment. The external debt was $30.2 billion in 1997. Total debt service expenditure accounted for 5.1 percent of GNP in 1996, and was second only to defense expenditure.

Sustained growth has been hard to achieve in this climate of macroeconomic uncertainty. Over 1996-1997 economic growth (3.1 percent) barely kept pace with population growth (3 percent). Agriculture, the predominant sector in the economy (25 percent of GDP), grew at only 0.7 percent in 1997. Growth in the manufacturing sector also lagged (1.8 percent). Years of heavy taxation and high tariffs have stunted manufacturing growth. Crop failures over the last three years have reduced exports of the country's main exportable commodity, cotton. The current account reached a record deficit of $4.2 billion in 1996. Investment has also suffered because of the high interest rates required for debt financing, low domestic savings rate (13-14 percent of GDP in 1996), and limited foreign investment (less than $1 billion in 1996-1997).

The public sector is in perhaps the most distressed condition. Tax revenue was only 15.3 percent of GNP in 1996. The agricultural sector is virtually untaxed, largely because of the vehement opposition of landowners, upon whom both major political parties depend for support. State sector banks are burdened with non-performing loans, to the tune of 140 billion Pakistan Rupees (approx. $3.4 billion). Many of these bad loans arise from politically motivated lending. Most public-sector enterprises are loss-making. Privatization has begun to move forward, notably in power, telecommunications, and banking, but has been plagued by accusations of cronism and controversy over power purchasing contracts.

In the longer term, Pakistan urgently needs to undertake structural reforms, including restructuring of public-sector enterprises and changes in center-province fiscal relations. Also vital to the country's future is increased investment in human capital. Pakistan's literacy rate (36 percent), is one of the region's lowest, and its population growth rate one of the highest. Despite an average growth rate of 5-6 percent a year since 1947, poverty remains widespread (34 percent of the population lives in absolute poverty), partly because of a highly unequal income distribution. Addressing these issues will require public-sector resources which the present budget picture puts out of reach.

Political System under Strain. Pakistan's federal system unites four provinces which differ in language, economics, and ethnic composition. The country has been ruled by military governments for about half its 50 years of independence. Since the death of President Zia-ul-Haq in 1988, the country has maintained elected governments, alternating between the Pakistan People's Party, under Benazir Bhutto, and the Pakistan Muslim League, led by Nawaz Sharif. Both parties are dominated by their leaders. Each has been removed from office by extra-constitutional means amid charges of corruption.
and misgovernance, Ms. Bhutto twice and Nawaz Sharif once. Relations between the two, and between their parties, are passionately hostile.

The present government, under Prime Minister Nawaz Sharif, was elected with an overwhelming majority in February 1997. After a promising beginning, the prime minister became embroiled in a serious dispute with the president and the Supreme Court. Sharif ultimately prevailed, with the quiet support of the military. The president resigned, and the Parliament amended the Constitution to revoke the president's authority to remove the prime minister from office. Nawaz Sharif emerged from the crisis with a power base unprecedented in recent years. He subsequently enhanced his power by replacing the army's chief of staff, General Karamat, with one of his own men. Mr Sharif is presently trying to push the Islamic Law Bill (whereby Islamic law would become the supreme law in the country) through the Senate; the bill has already been approved by the lower house. Critics of Mr. Sharif argue the bill is a ploy to further suspend democratic processes and to concentrate power in his own hands.

Looking Ahead: Key Issues for the Sharif Government. Nawaz Sharif's decision to test a nuclear device was widely regarded as the only feasible response to the security challenge posed by India's test. It has accentuated several pressing problems his government now needs to deal with:

- Relations with India have worsened. With both countries' nuclear capabilities now overt, they urgently need to reduce the risks posed by their military confrontation in Kashmir. Pakistan has sought international help in solving the Kashmir dispute before tackling other aspects of the India relationship. India opposes any third-party role in its dealings with Pakistan, and prefers to tackle the easier problems in the relationship first. A meeting between the two prime ministers in July did not resolve the impasse; they will have another opportunity in September, on the margins of the Non-Aligned meeting.

- Pakistan's nuclear test complicated its political relationships with its Western friends. Intense discussions are under way with the United States in an effort to put the relationship back on track, and ideally provide a basis for ending economic sanctions. The key issues here have to do with Pakistan's participation in the international nonproliferation regime; Pakistan would like to engage the U.S. in solving the Kashmir problem.

- In neighboring Afghanistan, the government has close ties with the Taliban group, which is gaining ascendancy, and no doubt hopes that these friendly relations will carry over to the governmental level once the Taliban's control is consolidated. The stormy history of Pak-Afghan relations suggests that this may be hard to achieve.

UPDATE:

The IMF and the Government of Pakistan agreed upon a $5.5 billion package on November 25, conditional upon final approval from the IMF Board of Directors next month. IMF conditionalities pertain to banking sector and tax administration reform, as well as to improvements in governance. The loan was badly needed and will help the country avert default on its short-term external debt obligations.