Pakistan facing bankruptcy as world financial crisis deepens

By Vilani Peiris
Global Research, October 20, 2008
WSWS.org 20 October 2008

Region: Asia
Theme: Global Economy

Wracked by political instability and hard hit by the global economic crisis, Pakistan is teetering on the brink of default. The country's foreign reserves have dwindled to around $4.5 billion, equivalent to about six weeks of imports, foreign investors have fled the country in droves and the rupee has fallen sharply. The international credit rating agency, Standard & Poor's, has downgraded Pakistan to a position superior only to the Seychelles, which has already defaulted.

The government is desperately seeking an infusion of up to $10 billion to shore up the country's finances. It had been hoping for assistance from longtime ally China, but President Asif Ali Zardari returned from Beijing last Friday without any commitment of cash. Another traditional ally, Saudi Arabia, has refused to provide financial concessions on oil exports to Pakistan.

As a final option, Pakistan may be forced to apply to the IMF for assistance. Such a step would certainly come with unpalatable strings attached that would hit the poor and provoke further unrest. Shaukat Tarin, financial adviser to the prime minister, told Bloomberg.com that he would write to the IMF in three to four weeks if Pakistan is unable to obtain funds from other agencies and allies.

Tarin said that Pakistan had already presented its economic stabilisation plan to the IMF which included an end to price subsidies, tighter monetary policy and plans to slash the budget deficit. Such austerity measures will lead to further prices rises and cutbacks to the country's limited social spending. A Pakistani delegation is due to meet IMF officials in Dubai today and tomorrow.

The impact of any financial implosion would certainly compound the country's political crisis which is already being intensified by US demands for the Pakistani army to step up its war on Islamist militias along the border with Afghanistan. Its support for the bogus "war on terror" has been transformed into an argument for financial aid. As a Pakistani official explained to the New York Times: "A selling point to us even has been, if the economy really collapses this is going to mean civil strife and strikes, and put the war on terror in jeopardy."

A top secret National Intelligence Estimate (NIE) drafted by US intelligence agencies and leaked to the media last week, summed up the situation in Pakistan as "no money, no energy, no government". According to McClatchy newspapers, the NIE warned that the government was facing an accelerating economic crisis that includes food and energy shortages, escalating fuel costs, a sinking currency and a massive flight of foreign capital accelerated by an escalating insurgency.

Just two years ago, economic commentators were describing Pakistan as a success story under former military strongman President Pervez Musharraf and speculated that it would be the "next Asian Tiger". But the situation dramatically changed after Musharraf was compelled to call elections. His party suffered a humiliating defeat in February and he was finally forced to step down as president in August. The ruling coalition led by President Zardari's Pakistan People's Party (PPP) is already confronting mass resentment over the continuing war in the border areas and a worsening social turmoil.

The political crisis has contributed to a huge exodus of foreign capital and exacerbated the country's economic problems. As much as $1.2 billion a month was fleeing Pakistan in the northern summer. The rupee has slumped by more than 30 percent against the US dollar since the beginning of the year and share prices have crashed by 40 percent since their all-time high in April.

The country's plight was graphically symbolised by scenes outside the Karachi stock exchange last Monday. With trading at an all-time low, police surrounded the building to keep angry investors at bay. Chairman of the Small Investors Association, Kayusar Qaimkhani, told the media: "There are no longer small investors left in the stock market, they have all been destroyed." On July 16, angry investors chanted anti-government slogans and stoned the stock exchange.

The stock market is virtually dysfunctional. When the index fell another 286 points or 3 percent on August 27, the exchange authorities imposed a floor of 9,144 to prevent it plunging further. Since then trading has declined to record lows with a flight from shares that are regarded as overpriced. The floor is due to be removed on October 27, with analysts predicting sharp falls as foreign investors dump an estimated 20 percent of their equities. Foreign investment in equities has already dropped from $4.8 billion to $2 billion since the beginning of the year.

The Daily Times warned on October 14: "The recent decline in the Pakistan stock market suggests that the bubble has burst and experts fear that this is likely to spread to the real estate market, which like the stock market is 'irrationally overpriced'."

Global crisis

Market analyst Muhammad Suhail told the Los Angeles Times last week: "The global crisis has really added fuel to the fire. There was a time window earlier this year to address all this, and we missed it." The drying up of credit internationally has hit Pakistan hard with the banking system suffering a severe liquidity problem this month. Overnight call rates rose to high levels ranging from 32 to 40 percent, despite the injection of 54 billion rupees into the financial system by the central bank.

A Newsweek article entitled "Can Pakistan Stay Afloat" on October 10 described the chaotic situation inside Pakistan. "This time it wasn't the terrorist scare making Pakistanis nervous. Depositors thronged banks over the past few days to retrieve cash and valuables. Rumours that the government was on the verge of seizing bank lockers and foreign-currency accounts to rescue its deteriorating financial position had been popping up on cell phones." The panic was temporarily laid to rest by the appointment of Shaukat Tarin, a former banker, as the new financial adviser.

Describing the mounting public hostility, Newsweek explained: "[T]he Zardari-led coalition government, already besieged by political rivals and insurgent groups, has had to take unpopular measures to prop up the economy. It has raised taxes, upsetting the business community. It has trimmed government spending, prompting bureaucrats to grumble. It has increased tariffs on power, angering consumers and businesses already fed up with outages. And it has phased out subsidies on imported fuel, leading to price increases for everything from bus rides to cooking oil and prompting small, periodic protests."

Pakistan is heavily indebted with foreign debts standing at $44.5 billion. The Pakistani Dawn reported this month that the country's domestic and foreign borrowing rose by 100 percent in the past three months, reaching $2.21 billion—compared to $1 billion for the same period last year. Loan repayments are contributing to the government's large budget deficit.

Economic growth is slowing sharply. The IMF's World Economic Outlook report released last week predicted that Pakistan's GDP would decline to 3.5 percent for the next fiscal year beginning in July 2009—down from 5.8 percent for 2007-2008 and an estimated 5.4 percent for 2008-2009. "The main concern is a build up of stress in the global financial system and a sharper than anticipated global slowdown," the report stated.

Ordinary working people are already being affected by inflation that is running at nearly 25 percent on average. The inflation figure measured by the sensitive price index (SPI) reached 30 percent in the week ending October 9. Sharp increases have been reported for essential items such as flour, sugar and transport. Worst hit are the poor. According to the SPI figures, inflation was 33 percent for household groups with incomes less than 3,000 rupees.

The government estimates that about 25 percent of the population of 169 million is living below the poverty line of $1 a day, but other sources put the figure far higher. An Oxfam report released this month estimated that "the number of poor in the country has risen from 60 to 77 million because of food inflation". It found that the poorest 20 percent spent 50 to 58 percent of their income just to buy cereals.

The government has announced a cosmetic welfare program, known as the Benazir Income Support Program, to attempt to quell popular anger, but has already slashed the allocation from 50 to 34 billion rupees even before the scheme has started. Its main efforts have been directed towards securing financial aid, propping up the banking system and wooing foreign investors with bigger tax holidays at the expense of working people. Even if Pakistan avoids default, the country confronts a rapidly deepening economic and political crisis.