Economic Disruption caused by COVID19 in Pakistan is exacerbating an already existing crisis. Pakistan's debt-ridden economy does not have the capacity to absorb the massive shocks caused by the pandemic. The government which was cutting into its expenditure on health and other social service sectors will have to reverse the trend in the light of the pandemic. A drastic decline in exports and remittances is likely to have an impact resulting in an increase in the deficits. The government debt is thus likely to surge in the present circumstances.

Pakistan's economy is already under the burden of a mountain of debt. Even before the pandemic, the central government's debt surged by over five percent in the first eight months of FY20, and by nearly 21 percent year-on-year in February 2020. The debt to GDP ratio is 85% and is likely to increase to 90% with negative GDP growth and a higher budget deficit as compared to the previous year(8.9 per cent). According to 2019-20 Economic Survey of Pakistan, Pakistan's total public debt increased by 7.6% in this fiscal year. Total public debt recorded at the end of March 2020 was 35, 207 billion (USD 21.03 billion) Pakistani Rupees. Astonishingly, 47% of what the government generates is going to pay of debt while the ratio should be less than 30% to allocate more resources to social service sectors.

Image source: Getty

While the debt has been rising for years, tall claims have often been made by big leaders former Prime Minister Nawaz Sharif made a promise during his election campaign that on assuming power he will get rid of 'cancer of debts' and will break the 'begging bowl'. Current PM Imran Khan once said that he would prefer suicide rather than going to the IMF. To his embarrassment, under his government Pakistan reached out to the IMF for the 23rd time in its existence, seeking a $6 billion bailout in May 2019. This came in response to a sharp depreciation in the Pakistani rupee and high fiscal deficit that resulted in higher inflation, the cost of which is bore by the poor and common man. IMF pointed out some structural weaknesses of the economy in its report and came to the conclusion that an urgent policy action was required, otherwise economic and financial stability of the economy could be at risk.

Dissecting the causes

Pakistan has a whopping external debt of $111 billion. It owes $11.3 billion to The Paris Club, $27 billion to multilateral donors, $5.765 billion to International Monetary Fund, and $12 billion to international bonds such as Eurobond, and Sukuk. However, it's indebtedness to China forms the major chunk of its external debt. This has come about largely as a result of the China-Pakistan Economic Corridor (CPEC). The project resulted in massive inflow of external loans which led to a surge in external debt by 46% to $76.3 billion by 2018. This project has since its inception added to the problems of an already messed up Pakistani economy. When the project began initially in 2014, it was valued at $46 billion. By 2019, this increased to a whopping $62 billion in a very short span of time.

Image source: Dawn

The project involves the state-owned enterprises of both the sides, adding to Pakistan's corruption. This results in pushing the cost of the project higher day by day. An enquiry commission was set up to investigate the Independent Power Projects in Pakistan. The report found that a "$1.7 billion power transmission line project of the China-Pakistan Economic Corridor (CPEC) was 234% more expensive than a similar project in India with better technology". The project as of now is far from over and the cost is only rising. Pakistan will have to reschedule its debt several times before it brings it to a finish. The country is thus moving towards a debt trap and in a position similar to Sri Lanka. What unfolded in Hambantota port was swapping of "debt with equity", resulting in handover of CPEC to China.

Pakistan’s regime has only shunned off these apprehensions by commentators as a means of spoiling relationship between the two countries. This points towards a larger problem in the political establishment of Pakistan. Pakistan is grappled with a dysfunctional political system which runs on rent-seeking and patronage and is devoid of any transparency. The country has several structural weaknesses that are largely unaddressed. The weak tax administration is one of them. Only one per cent of the Pakistanis pay their taxes. The country has one of the lowest tax-to-GDP ratios in the world. The elites look for opportunities to evade taxes and often also control power. The cost of government inaction is thus levied on poor who pay in various indirect ways.

The public sector of Pakistan is rampant with corruption and is rent-seeking to a major extent. The public sector enterprises added continuously to the debt profile of the country. The period of 2013 to 2018 saw an increase in the domestic debt of these enterprises by 242% reaching Rs1,068 billion. While public sector undertakings eat out of the common man’s pocket and there are no source of revenue generation, the government keeps on increasing its non-developmental expenditure. While the pandemic is day by day taking an upwards turn in Pakistan, the government has allocated $7.85bn for defence and merely $151m for health in the budget for the financial year 2020-2021. This does not still include the true budget which is hidden to avoid harsh questions by the IMF and is expected to be around $11 billion for military expenditure. The government pays $2 billion in military pension every year but is not allowed to question what the military does with its $20 billion privately owned business empire. While the chances of war between India and Pakistan are bleak, and India is grappled with problems with China on the other side of the border, the funds could have been used to handle the ongoing crisis than going to the elite non-transparent military of Islamabad. It seems that the government is more interested in pleasing the military than its people which is what the Pakistani regimes have got wrong for decades now.

Conclusion

It is time for the government to muster courage and prioritise the collective interests of its citizen over the privileged few in these challenging times. Any attempt to reform would result in a stringent opposition from those who are benefitted by this dysfunctional political system of Pakistan. The government needs to take on these moneyed elites who turn the markets in their favour by using unfair practices and tax evasion. Pakistan seems to be grappled in a vicious cycle that forces it to borrow in order to accommodate the interest of the army and the powerful economic elite. There needs to be a halt on the ever-increasing military budget and a just tax needs to be implemented.

If Pakistan wants to get out of its debt trap, it has to prioritise providing an investment-friendly environment. The country needs to bring changes to its custom laws and regulations. An impetus has to be provided to the domestic investment by implementing a more flexible tax policy that encourages Small and Medium-Sized Enterprises (SMEs). The country must invest in infrastructure and ICT adoption in order to provide a favourable business environment. Exports too need to be diversified. Any investment in Research and Development (R&D) ecosystem can hence provide encouragement to innovation and enhancement of labour productivity.

Islamabad must take this opportunity provided by the pandemic to address its structural and diplomatic failures. Failing to do so may further deteriorate the economy and a further increase in inflation and unemployment provides a ground to social unrest. The dysfunctional political system must be given due attention to counter any challenges to destabilise the government which might roll back even little degree of democratic progress that has been made by Pakistan. It is high time for Pakistan to take a mirror view of reality and make attempts to create a truly stable and sustainable economy.

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