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The root cause of Pakistan’s crisis: Macroeconomics or geopolitics?

While the mainstream framing of Pakistan’s crisis is a lack of fiscal prudence, what the country really suffers from is a resource curse, not in energy or minerals, but from its position in geopolitics.

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Pakistan’s geopolitical resource curse when combined with chronic misgovernance has also caused stagnation of economic complexity. (File image)

Highlights

- *Pakistan’s economic problems are blamed on fiscal irresponsibility*
- *An alternative view is to identify Pakistan’s problem to be the ‘resource curse’, the resource here being its position in geopolitics*
- *Geopolitics has led to billions of dollars flowing to the country by its geopolitical allies*
- *This bonanza has been misused by its politicians and the army*
- *The resulting misgovernance is responsible for economic stagnation*
- *As a result, the loyalty of the masses has been bought by sops and subsidies, resulting in the fiscal imbalances*
- *The brunt of the IMF restructuring programme will fall on the poorest*
- *The result is a vicious circle of poverty, conflict and economic ruin*

Pakistan is in the throes of a severe macroeconomic crisis. Its GDP has not returned to pre-pandemic levels, growth rates are falling, inflation is raging, interest rates soaring, and foreign currency reserves plummeting. It is once again forced to stand helpless with its arms stretched out to the IMF for a fistful of dollars, pleading to unlock stalled funds from a 2019 bailout package of $7 billion.

On the face of it, this may seem like a business-as-usual economic crisis essentially caused by fiscal profligacy of the Pakistan government reflected by large fiscal deficits since 2010 as well as, to an extent, supply-side shocks of the pandemic and the 2022 floods that wrecked several provinces of the country. Excessive government spending has led to a widening in its current account deficit, which must be funded by foreign currency borrowings – particularly by way of increased sovereign external debt – given Pakistan's poor inflows from leveraging by domestic industry abroad and portfolio investment. The current account deficit trend has, however, been turning chronic since 2018 except for the sharp anomalous contraction in 2020 on account of the pandemic that makes it possible to point fingers at the fiscal deficit rather than supply-side shocks.

The IMF is once again considering bailing out Pakistan with its not unusual set of harsh conditions including letting the Pakistan rupee depreciate and at the same time, privatisation of loss-making public sector units and most importantly, immediate and unsympathetic fiscal consolidation through increasing taxes on and cutting subsidies to all sections of the population. With few remaining options, the **Pakistan government may agree to the IMF terms** and conditions for fiscal reform.

The Pakistan crisis clearly identifies the core of its problem to be the lack of fiscal prudence, resulting in the widening fiscal deficit and consequently, current account deficit too, making Pakistan more reliant on foreign currency loans from China, Saudi Arabia, UAE, the US and the IMF. The solution to the problem is, in a nutshell, fiscal prudence.

The framing in the flow of causation underlying Pakistan's recurring crisis in this way may, however, be flawed.

An alternative viewpoint is to identify Pakistan's problem to be the 'resource curse', the resource here not the usual abundance of mineral or non-renewable natural resources but rather, geopolitics. Its 'allies' have been investing in and loaning tens of billions of dollars to Pakistan. These are not simply economic transactions but deeply rooted in geopolitics.

China sees Pakistan as an important partner to counterbalance the rising military power of India, as a strategic trade and energy corridor that would connect Shanghai to the Arabian Sea, and to sever ties between Chinese Uighur separatists and their Pakistani supporters. For Saudi Arabia, Pakistan is a crucial ally stemming from their Islamic identities, Pakistan's nuclear capability and ensuring that there is no incentive for Pakistan to reassert ties with Iran. Pakistan and UAE have also shared close ties since 1971 with UAE making major investments, providing assistance in health, education and water to Pakistan as well as strong military cooperation including their respective air forces. However, there were tensions in 2015 with UAE over the war in Yemen but this only highlighted the strategic room available to Pakistan to manoeuvre and bargain with its allies. US-Pakistan ties have historically been a function of geopolitics and global security. In spite of Pakistan's closer relations with China and USA's **favouring India as its strategic partner**, the US still cannot afford to see Pakistan slip out of its radar of influence.

Flush with inflows of foreign investments and loans, former Prime Minister Imran Khan **accused** the so-called 'three rats' of Pakistan, namely, its military, government and opposition of having 'jointly sucked the blood of the country … accumulating millions of dollars' worth of property outside the country.' At the same time, political interventions by the army, decline in democratic institutions and weak and corrupt political administration has kept large masses of Pakistan's widely heterogeneous population in poverty amidst widening inequalities in wealth and income.

Misgovernance by the state has also manifested itself in the decline of manufacturing in Pakistan, its share being just 11.5% of GDP in 2020. Gross fixed capital formation by the private sector has also witnessed a secular decline from around 20% of GDP in 1965 to an abysmal 11.5% of GDP in 2020. This has resulted in a stagnation in value added per worker in industry while that of India has almost doubled and China increased five-fold over the last 25 years. It is important to reiterate that these trends are in spite of the massive foreign investments that Pakistan has been receiving from overseas.

Pakistan's geopolitical resource curse when combined with chronic misgovernance has also caused stagnation of economic complexity. In 2020, it ranked 93 out of 127 countries while Vietnam stood at 61 and India at 40. Almost 70% of Pakistan's exports come from the clothing industry. The pandemic and global slowdown impacted this sector adversely, which has made Pakistan easily vulnerable to a balance of payments crisis.

Stagnation in economic development has over decades found an escape in ethnic mobilisations and violence that had then to be suppressed through sops in the form of economic subsidies on energy and food. This is sometimes incorrectly articulated as a model of the welfare state instead of being seen as a consequence of the state's misgovernance and corruption.

The IMF's characterisation of Pakistan's macroeconomic crisis is therefore not only naïve but also dangerous: it argues and pushes for fiscal austerity not just in Pakistan but in every country facing a crisis. As long as Pakistan's resource curse over its advantageous geopolitical levers continue, its allies cannot afford to witness its economic and political collapse. Bailouts will happen but to demonstrate recognition of the possibility of moral hazard, the costs of these bailouts will fall on the poorest and most vulnerable sections of the population through a contraction of GDP, unemployment and lower standards of living or the infamous IMF-induced 'internal devaluations.' This will inevitably draw Pakistan into a vicious spiral of poverty, conflict and economic ruin while the dollars end up in the fists of a few.

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