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Different reactions, same crisis

The economies of both Pakistan and India stand to suffer greatly from the crisis in the Persian Gulf.

The very different responses of India and Pakistan to the Gulf crisis were predictable. Pakistan jumped onto the Bush bandwagon, sensing the chance to regain "front-line" status it had lost when the superpowers shut down the Afghan war; the Pakistanis even arrogated to themselves a vanguard role brokering a new Saudi-Iran-U.S.-Pakistan axis in the Gulf. India, meanwhile, has sought levers to defuse the crisis and a U.N. forum for its resolution. But the two feuding neighbors have one thing in common: For both, the Gulf crisis is delivering a severe economic blow.

From the outset, New Delhi has been acutely attuned to the economic implications of the crisis. Iraq and Kuwait supply fully 40% of India's oil and petroleum product imports. More than the disruption of supply, the rise in oil prices threatens to destroy India's precarious balance of payments position. Each dollar increase in the price of crude, costs the country $240 million. As of Aug. 15, India's import bill had already ballooned by some $1.2 billion.

An Aug. 9 report in one of the major business dailies here, that India has entered into an "arrangement" with the International Monetary Fund (IMF), whereby $600 million will be made available for balance of payments support, points to the seriousness of the situation. Though officials here refuse to confirm or deny the report, the truth will come out next month when Finance Minister Madhu Dandavate meets with IMF officials in Washington.

Next month too, a review team from Moody's, the American credit-rating agency, will visit India to find out first-hand whether the country's debt-servicing capacity has been eroded, and whether government measures are sufficient to restore the trade balance. On Aug. 1, Moody's announced it was placing the ratings for two Indian government organizations—the State Bank of India and the Industrial Credit and Investment Corporation of India—under "watch."

The two had previously been given high ratings by both Moody's and Standard and Poors. Other Indian organizations have so far faced no difficulty raising funds from the international capital markets, though spreads on Indian loans in the Eurobond market and on Indian paper in the secondary market have gone up.

But as of early August, India's foreign exchange reserves were down to a mere 42 days' import cover—less than the previous low of 1980, when India took a $5 billion loan from the IMF—and alarm bells went off. The country's import bill can only rise, and export performance for the first quarter of 1990-91 has fallen short of target.

The potential for a payments crunch has been apparent for some time. In July, the World Bank reported that India's external debt, exclusive of obligations to the IMF, was projected to be $70 billion for 1990, and $77 billion for 1991. This is "peanuts" considering that India is a nation of 800 million people, but what makes it troublesome is the fact that from 1985 to 1990 India's debt service ratio has jumped from 21.9 to 29.2.

A classic debt-trap dynamic is at work. With debt rising faster than total inflow of funds, net financial transfers to India, which were $1 billion in 1985, became negative in 1986, marginally positive in 1987, and negative again in 1988. Most of India's debt is long-term. But recently, a rapid build-up of short-term borrowing has occurred, both commercially and in the form of non-resident Indian deposits, which jumped from nothing in 1985 to some $10 billion today. This has eased the liquidity position, but at the cost of mounting interest charges, and thus increased dependence on short-term funds.

Pakistan, which has been paying out some $1.5 billion annually for oil imports, all from the Gulf, stands to have its import bill doubled if the price reaches $30 per barrel or more. This will certainly derail the IMF adjustment program, imposed under a four-year agreement made in 1988.

On Aug. 20 the first of six IMF teams arrived to begin their review of Pakistan's compliance. Under the agreement, development investment has been slashed and taxes doubled, but the IMF targets have not been met. One report from Pakistan speculates, however, that the Bush administration may order the IMF to go easy, given Pakistan's cooperation in the Perisan Gulf.

But such a reprieve will not raise the foreign exchange needed to cover the oil bill. Pakistan's trade regime is rigid, with imports high and exports limited to raw agricultural commodities and textiles whose demand is relatively fixed. Moreover, the nearly $2 billion in foreign exchange earnings Pakistan enjoys in the form of remittances from Pakistani laborers employed in the Middle East may be choked off under conditions of war in the region.

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