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SOCIAL IMPACT OF GLOBAL RECESSION ON PAKISTAN

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Abstract. This study examines the impact of global recession on the economy of Pakistan. For a fragile economy like Pakistan, coping with even a single economic crisis is difficult, let alone the two, that followed in quick succession — the unprecedented surge in commodity prices and then the global recession. The social impact of these crises on Pakistan can come through: a possible fall in remittances from UAE and the United States, reduced output growth, fiscal tightening, falling exports and a depreciation of the exchange rate. Given the state of economy at the onset of the recession, the Keynesian prescription of strong fiscal stimulus could not be administered for stimulating recovery. Coupled with the adverse changes in the variables referred above, this will serve to increase the poverty head count ratio in the country. If the suspicion of fall in remittances from UAE or US comes true; there is more bad news to be had for the poverty head count ratio.

I. INTRODUCTION

The global financial crisis and the recession that followed were the two worst economic crises that the world had witnessed since the great depression of the 1930s. The direct impact of the global financial crisis on developing countries including Pakistan has been limited due to non-integration of the domestic financial sector with the global financial sector (IMF, March 2009). However, the crisis has set in motion global recession which has not spared the Low Income Countries. The average annual global economic growth is expected to fall to mere 1.0 percent after averaging around 4.0 percent during

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2003-07 (Martin, 2009). How the recession affects an economy depends, among other things, on the state of the economic fundamentals of the country when the recession sets in. Economies with sound macroeconomic indicators will be able to face the recession heads on with the Keynesian prescription-public sector spends more to compensate for the lack of demand in the private sector. The Keynesian recipe, when followed, of course causes macroeconomic indicators, such as fiscal deficit to deteriorate and foreign reserves to fall. Countries with pre-crisis sound fundamentals can afford this kind of luxury. However, countries with poor macroeconomic indicators at the onset of the recession can follow the Keynesian prescription only at the cost triggering a crisis of greater proportion.

The enormous wealth of literature on the impact of global financial crisis and the consequent global recession has identified various channels through which the recession may influence economies. These include remittance and migration, international trade, Foreign Direct Investment (FDI), exchange rate, interest rate and foreign aid. So far no study is available that comprehensively examines the impact of global recession on the economy of Pakistan. The objective of this paper is to fill this gap by analyzing the social impact of the global recession on Pakistan, through the various channels referred above.

The study is organized as follows: Section II reviews the literature on the social impact of recession in different countries. Section III is devoted to the discussion of the state of Pakistan's economy at the onset of recession. Section IV examines the social impact of global recession on Pakistan and section V concludes.

Before we examine the channels through which the global recession influenced Pakistan's economy an examination of the health of the economy at onset of recession is essential to put things in the right perspective. This examination will not only allow us to figure out how the channels worked but will also serve to determine Pakistan's preparedness for coping with the recession, especially the authority's ability to design an appropriate fiscal stimulus package. The response is in particular crucial, since it will ultimately determine the net social impact of the recession on the economy.

II. LITERATURE REVIEW

In this section, we review a few studies to show that a number of countries have faced adverse social consequences in the aftermath of the global recession.

A 90-household panel data collected from nine villages Cambodia in March and May 2009 shows that per capita income as well as per capita consumption declined by around 23 percent and 30 percent respectively and the poverty incidence, based on per capita income of dollar a day, has increased. The global recession has affected the Cambodian economy through the contraction faced by the garments, tourism and construction industry. The greatest impact has been felt by the garment industry where the 18 percent of the total workforce of 352,000 employed by the industry, many of whom were women, has been laid off between September 2008 and May 2009. The sector employs 4 percent of the total workforce and accounted for 38 percent of total employment in manufacturing in 2007. The tourism, in Cambodia, faced contraction, at an average of 3.9 percent, during October 2008 to March 2009. Resultantly, some luxury hotels were closed while others coped with low occupancy rates. Given credit squeeze the Cambodian construction is also likely to feel the brunt as the foreign investors seem inclined to scale down their activity and suspend large projects. The people working in these sectors are vulnerable to poverty and slight decrease in their income is apt to push them into poverty (Tong, 2009).

The wages in the Indonesian economy had been on the rise since 2001 due to strict enforcement of labour regulation especially the minimum wage regulation. Coupled with this the appreciation of the Indonesian Ruppiah has also contributed to the rise in wages. As wages are sticky downwards, the cost of Indonesian exports has not declined significantly in the face reduced international demand. High wages and lower global demand has caused the manufactured exports to decline during the first quarter of 2009. This is likely to add to the unemployment. It is expected that majority of the 2 million joining the labour force each year are likely to remain unemployed (Papanek and Basri, 2009).

For Papua New Guinea the global recession has been a mixed blessing. The majority of the rural population, in New Guinea, produces for its own consumption plus some crops for cash income. The decline in commodity prices is bound to affect the rural income and hence the condition of the rural population. The devaluation first raised income levels of the rural communities across all regions however later on the imported inflation tamed positive income effect. However the income effect varied across regions, with palm oil cocoa regions experiencing a positive impact while coffee region registered a negative impact due to fall in international prices (Mellor, 2009).

A study by Turk and Mason conducted in 2009 has examined the impact of global recession on 5 East Asian countries. The authors reveal that falling remittances and labour market shocks induced by low national as well international demand have been the two primary channels of influence for at least 4 out of the 5 countries examined. These include Thailand, Vietnam, Cambodia and Lao Peoples Democratic Republic. For Magnolia the chief channel of influence has been the decline in international commodity prices causing the income levels to dip.

III. THE STATE OF ECONOMY: AT THE ONSET OF RECESSION

The global recession, as we know, was preceded by a steep surge in commodity prices the world over. Pakistan being a large importer of fuel oil and other commodities, such as vegetable oil and at times wheat as well, ended up importing inflation. Commodity prices especially those of fuel oil went through the roof in 2007, however the year being an election year in Pakistan, the then government, in accord with political cycle theory, chose not to pass on the oil price hike to consumers. Electricity, in Pakistan is primarily distributed by a public sector entity, Water and Power Development Authority (WAPDA), while the price is determined by the government. A substantial part of the electricity consumed is generated using furnace oil. With the increase in oil prices the cost of production of electricity had also increased but the government again refrained from passing on the increase to the consumers. The decision not to pass on the increase in cost of fuel and electricity to the ultimate consumers obviously worsened the fiscal deficit.

The impetus to demand from the high fiscal deficit and surge in international commodity prices had caused the external current account which was already in deficit, to further deteriorate. The impact of the sharp increase in external current deficit was accentuated further by the decline in capital account surplus. Pakistan’s current account deficit had stood large even before the financial crisis unfolded, but a host of factors had allowed the country to finance the deficit through inflows on the capital account. International as well domestic environment was congenial to capital inflows and the current account deficit was comfortably financed from grants and foreign aid on soft terms from bilateral and multilateral institutions, sovereign debt issues in international financial markets and proceeds from privatization of profitable public sector enterprises. However, as the financial crisis led to a liquidity crunch, it became difficult to float debt issues in the international financial markets at affordable terms and find buyers for planned privatization deals. Aid flows also slowed down for a while for geo-strategic reasons. These factors had an adverse impact on the external account. Moreover, with the increase in international commodity prices, the trade deficit also deteriorated sharply. The state of balance of payments suggested that the exchange rate, if left completely to market forces, would depreciate. However the intervention of the monetary authority in the foreign exchange market averted a significant fall in the value of domestic currency. The intervention mechanism primarily used, which had been in vogue since November 2004, was to provide foreign currency to the oil companies for the import of oil. Therefore as the oil prices increased, the intervention increased as well. A sharp depreciation of the domestic currency was avoided in Fiscal Year[1] (FY hereafter) 2006-07, but at the cost of depletion of foreign reserves to dangerously low levels.

We now turn to Pakistan's key macroeconomic indicators immediately before and after the rise in international commodity prices, *i.e.* FY 2006-07 and FY 2007-08 and then after going through recession for a year (FY 2008-09).

TABLE 1

Key Macroeconomic Indicators (Percentage)

	2006-07	2007-08	2008-09
Inflation (average)	7.8	12.0	20.8
GDP Growth	6.8	4.1	2.0
Large Scale Manufacturing	8.6	4.8	–8.2
Tax Revenue*	10.2	10.6	9.2
Fiscal Deficit*	4.3	7.6	5.2
External Account Deficit*	5.1	8.5	5.3

*As percent of GDP

Source: *Pakistan Economic Survey* 2008-09.

It is clear from Table 1 that Pakistan's macroeconomic indicators had worsened even before the onset of global recession. While on one hand inflation and fiscal deficit had increased during 2007-08, on the other hand GDP growth had declined. Growth in large scale manufacturing; that had declined significantly in FY 2007-08, became negative in FY 2008-09. The

[1]Fiscal Year in Pakistan commences on July 01.

country was faced with a severe energy shortfall and factories had to cope with frequent power shut-downs, which restrained the production units from operating at the optimal production capacity level. However, the energy shortfall is also, at least, partially due to an increase in the price of crude oil. As the cost of producing thermal energy increased, WAPDA, in its poor financial position, failed to procure all the electricity that private sector power projects could produce.

The account of the economy given above serves to show that at the onset of recession, economic fundamentals of the country were poor ─ fiscal deficit as well as inflation was high and GDP growth rate as well as foreign exchange reserves were low and on the decline. Given this scenario, the country was in no position to offer the fiscal stimulus package ─ the typical Keynesian recipe adopted by developed countries to cope with recession. Rather, to stay afloat the country had to seek funds from the IMF. The Fund's 'conditionality' demanded that the country go into a fiscal tightening mode whereas coping with the recession called for a fiscal expansion. Thus, the country simply did not have the instruments at hand with which to protect the public from the adverse economic and social consequences of the global recession. This scenario makes it easier to understand the economic and social impact of global recession.

IV. GLOBAL RECESSION AND SOCIAL IMPACT: CHANNELS OF INFLUENCE

With the scenario painted above in mind, one can now consider the impact of the global recession on Pakistan's economy; focusing on in this section we examine the impact of global recession upon economy with specific focus upon social outcomes, changes in migration patterns and remittance levels, public spending, export performance, balance of payments and exchange rate and the impact of these on national poverty levels.

MIGRATION AND REMITTANCES

Remittances from overseas workers constitute one channel that has been the most discussed in the context of impact of the global recession on developing countries. It is widely feared that the lay-offs in labour importing countries will affect migrant workers as well, with the host countries being naturally more concerned about their own citizens, the migrant workers are likely to be among the first ones to be laid off. The lay-offs would not only cause remittance levels to decline, but may well induce the return of the migrant worker to his home country, thereby increasing home country unemployment. The decrease in remittances would adversely influence aggregate consumption and investment in the labour exporting countries. Moreover remittances are an important source of foreign exchange for the labour exporting country and any decline in the amount of remittances would cause an adverse impact on foreign exchange reserves and hence the value of the country's currency vis-à-vis other countries. This in turn has the potential to affect number of other macroeconomic variables such as inflation, fiscal deficit and even output. Given the wide ranging consequences of the fall in remittances, the trend of remittances is being closely monitored in the remittances exporting countries.

Data from most countries that are host to remittances[2] suggest that despite the almost daily reports of shut downs and lay offs since October 2007, the effect on migrant workers is still not clear because so far significant drop in remittances from the overseas workers has not been observed. There are at least four possible reasons why remittance levels have not declined so far. The first line of reasoning is in accord with the notion of life cycle hypothesis put forward by Modigliani way back in 1950s (Modglianni, 1954). Under the life cycle hypothesis economic agents tend to smoothen their consumption pattern over their lifetime and therefore when the agents earn unusually high income they save a part of that income and when their income is not enough to meet certain minimum level of expenditures, they consume out of their savings to maintain a certain stable consumption pattern. Thus one reason for the continuing trend in remittances could be that the workers are remitting money out of their savings, to allow their dependents to maintain a stable consumption pattern while weathering out the storm.

The second reason could be that that the laid off workers are returning with their hard earned savings. Such one-off remittances have compensated for the decline in periodic earnings that were being remitted earlier, if this argument holds the field than the one-off increase in remittances could be the precursor to a decline in future. A third view is that given the high inflation that preceded the recession, the impact of which is yet to dissipate fully, workers were remitting greater amount to their kith and kin back home to make ends meet for them. A fourth possibility put forth by Abella and Ducanes (2009) is that migrant workers are either in occupations that have been rejected by domestic workers or are in occupations that continue to be in strong demand despite the economic downturn. We examine next, which one of the possibilities referred to above is relevant in the context of Pakistan.

[2]For example, *see* Ruhunage (2009) and Skider (2009).

During FY 2009, Pakistan received remittances from overseas Pakistanis to the tune of US $ 7.8 billion. United States, Saudi Arabia, UAE and United Kingdom are the four major remitter countries to Pakistan. It is clear from Table 2 that not only, the remittances from Pakistan's overseas workers have not registered a decline so far, against fears to the contrary, but have rather maintained a healthy growth trend. This trend is contrary to expectation and warrants further investigation.

TABLE 2

Remittances from Pakistan's Workers Overseas

Countries	Share in FY 2009 (%)	US $ (billion)		Growth over previous FY 2009 (%)
		FY 2008	FY 2009	
United States	22.2	1,762	1,736	–1.5
UAE	21.6	1,090	1,689	54.8
Saudi Arabia	20.0	1,251	1,560	24.6
United Kingdom	7.8	458	606	31.9
Others GCC Countries	15.4	983	1,203	22.3
Others	13.0	905	1,017	12.4
Total	100.0	6,449	7,811	21.1

Source: State Bank of Pakistan (various reports).

Roughly 70 percent of Pakistan's remittances come from four countries, namely, United States, UAE, Saudi Arabia and United Kingdom (Table 2). It is clear that except for a marginal decline in remittances from the United States, the inflows from other countries have not been affected so far; rather some have exhibited an increase in 2009 as compared to previous years. For example, in 2009, remittances from UAE showed a growth of 54 percent as against a growth of 26 percent in 2008. The main driver of this growth was a staggering 124 percent increase in remittances from Abu Dhabi. These unusual growth rates of remittances come at a time when these were in fact expected to decline; giving credence to the hypothesis that workers from these countries are returning and they are bringing back their hard earned savings in bulk. If this is indeed the case, the unusual increase would be a one-off phenomenon and remittances would decline in future due to the return of the migrant workers. However, given the non-availability of data on returning migrants, we are not able to test the hypothesis beyond this point. The unusual increase in remittances also lends some credence to the view that overseas workers are sending more money home to allow their dependents to make ends meet in the face of rather high inflation. Yet another reason for the no decline being observable in remittances could be that these may respond with a lag to decline in income as the worker for sometime can draw upon his savings. This line of reasoning is in accord with the life-cycle hypothesis put forth by Modigliani. The point made by Abella and Ducanes (2009) that migrant workers are either in occupations that have been rejected by domestic workers or are in occupations that continue to have strong demand in spite of economic downturn, cannot be ignored altogether. This could be especially true in case of migrants to developed countries such as United States and United Kingdom. Thus it is a combination of the reasons discussed above, rather than just one reason that has so far prevented the decline in remittances.

Given the trend of remittances to Pakistan so far, it is not difficult to conclude that so far, the global recession has not had any significant adverse economic and social impact on Pakistan, but as far as the future impact is concerned, one should remain skeptical for the moment.

Future Trend of Remittances

What about the flow of remittances in the future? Will Pakistan be able to sustain the growth trend in remittances or at least manage to avoid a decline? To answer this question let us have a look at the growth projections for our major remitter countries. The growth projections for all four major countries for the next two years are rather dismal (Table 3).

TABLE 3

Growth Rate of Real GDP (Percentage)

Countries	Actual		Projected	
Year	2007	2008	2009	2010
Saudi Arabia	3.5	4.6	–0.9	2.9
United Arab Emirates	6.3	7.4	–0.6	1.9
United States	2.0	1.1	–2.8	0.0
United Kingdom	3.0	0.7	–4.1	0.4

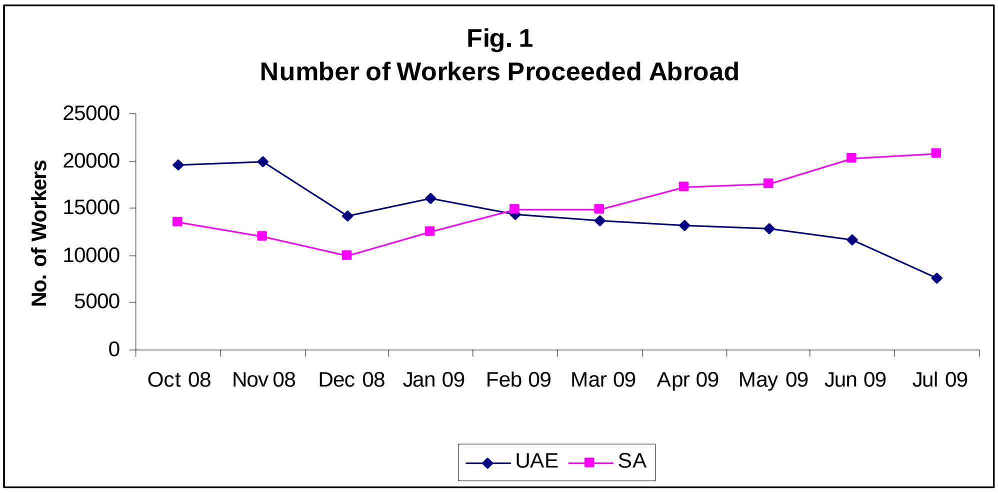
Source: "World Economic Outlook: Crisis and Recovery"

How can one expect that no worker from Pakistan will be laid off when firms by the dozens are shutting down daily, with daily lay offs of employees being in hundreds if not in thousands. The gloomy growth prospects of our major remitter countries restrain us from rejoicing over the healthy growth of remittance in FY 2009. To gauge accurately whether or not remittances would decline in times to come, what is required is to conduct a household survey to inquire whether workers have returned and if yes what amount they were remitting periodically.

A rough prediction about the growth trend of remittances in future can be made by examining the outflow of labour since the onset of recession. If the outflow has decreased in recent months this would imply that remittances may decline in future. Fortunately we have data of labour migration, through the formal channels, for at least two of the four major remitter countries to Pakistan. The two remitter countries, namely Saudi Arabia and UAE, both contributed 22 percent each to the total remittances to Pakistan in FY 2008-09.

FIGURE 1

Number of Workers Proceeded Abroad



Source: Ministry of Labour and Manpower (2009), Government of Pakistan.

Figure 1 shows that labour flows to UAE have unambiguously declined sharply (October 2008: 19,592 workers, July 2009: 7,354 workers) in the 10 month period covering October 2008- July 2009 while the labour flows to Saudi Arabia have increased for the same time period. The decrease in labour flows to UAE is understandably due to recession but the increase in flows to

Saudi Arabia is surprising. One reason perhaps could be the decision of the Saudi authorities to undertake mega infrastructure projects including the development of five new urban centers (Abella and Ducanes, 2009). Given the trend of labour flows to the two countries there exists a strong possibility of decline in remittances from UAE. It is noteworthy here that UAE's share in total remittances of $ 7.8 billion for FY 2008-09 was as high as 22 percent. Thus the unusual increase in remittances from the UAE during FY 2008-09 may herald the upcoming decline. The decline may however be offset at the aggregate level by the increase in remittances from Saudi Arabia.

As far as the remittances from the two countries in the Middle East are concerned the impact may not be felt at the aggregate level, however the families dependent on remittances from UAE are likely to face difficult times ahead. The data available with Pakistan's Ministry of Labour and Manpower, suggests that out of the total migrant labour force from Pakistan to all countries put together, around half of migrant workforce is unskilled. These unskilled workers are likely to belong to the poorest rung of the society. With such large proportion of workers belonging to the poorest segment of the society, therefore any lay offs and the consequent decrease in remittances is expected to increase the poverty headcount in the country. We do not have enough data to predict the trend of remittances from United States and United Kingdom, however the marginal decrease in remittances from United States in FY 2008-09 provides a cause of concern.

IMPACT ON PUBLIC SPENDING AND ITS SOCIAL CONSEQUENCES

When the incumbent regime came to power in February 2008, the government finances were in poor shape and by the end of fiscal year in June 2008 the fiscal deficit was projected to be in the range of 9.0 percent of GDP — almost five percentage points higher than the previous year's figure. To restore fiscal discipline the government had to cut down expenditure on various development projects. Similarly for FY 2008-09, a public sector development plan (PSDP) of Rs. 330 billion was budgeted, but the plan had to be revised downward by a staggering 41 percent to Rs. 192 billion due the shortfall in expected government revenues and projected capital flows. The shortfall in revenues and capital flows in turn is mainly due to the global recession. With the cut in PSDP a number of development projects planned to be undertaken had to be suspended (*see* Table 4 for a list of the sectors that received major cuts in their original allocation under PSDP for FY 2008-09).

TABLE 4

Revision of PSDP Due to Financing Shortfall

	Budgeted Allocation (Billion Rupees)		Decrease over Original Allocation (%)
	Original	Revised	
Education	24	17	29
Health and Nutrition	20	15	25
Special Programs	58	24	58
Water	73	38	48
Power	46	7	85
Others	109	91	17
Total PSDP	330	192	41

Source: Planning and Development Division (2009), Government of Pakistan.

Power, Water, Education and Health sector projects received major cuts in their PSDP allocation for FY 2008-09, which had a ripple effect on the economy. In the first place such cuts would adversely influence immediate earnings of those who would have been involved in the projects planned, as employees, contractors or suppliers. Thus, efforts to reduce poverty have received a dent to the extent that low paid jobs, that were to be created by implementation of these projects, were not created. Moreover such cuts would have other far reaching consequences. Resolution of a power crisis that has already taken a heavy toll on the domestic economy would be delayed to the extent that these projects were expected to contribute to meeting the electric power shortage in the country. The same holds true for water projects affected by the cut in PDSP. The cut of 29 percent for education sector has affected the Higher Education Commission (HEC) the most. Hundreds of scholars who were awarded scholarships by the HEC for higher studies abroad were restrained from actually undertaking their study programs due to lack of funds. This will undoubtedly without doubt have some impact upon the state of human capital in Pakistan in the near future. Thus, the cut in PSDP, which was primarily forced upon due to the global recession, will have adverse social consequences for Pakistan.

IMPACT UPON EXPORTS AND ITS SOCIAL CONSEQUENCES

The global recession which has decreased demand for goods and services world-wide has had a particularly severe impact on the demand levels in the developed countries. Majority of Pakistan's exports are destined for developed countries and have accordingly been affected. The net decrease in exports for FY 2008-09 relative to the previous year has been 6 percent (US $ 1.2 billion). Regardless of the net impact upon the economy, a number of industries have suffered adversely, which has had undesirable social consequences. The textile industry that typically contributes over 50 percent of export earnings, has lost over 5 percent of its earnings (US $ 578 million) in FY 2008-09, with readymade garments being the hardest hit (18 percent, US $ 221 million) (*see* Table 5 for details of industries that have reported significant decline in export earnings).

TABLE 5

Pakistan's Export Performance – FY 2008-09

	Share in Total Exports (%)	Decrease over previous year	
		Amount (US $ Billion)	Decrease (%)
Textile	50	578	5.6
Readymade Garments	6	221	18.3
Cotton Yarn	6	179	15.3
Other Textile Products	3	111	18.8
Knitwear	10	80	3.7
Cotton Carded	1	75	35.6
Cotton Cloth	10	66	12.9
Manufactures (excl. Textiles)	23	236	5.0
Petroleum Products	4	95	13.2
Solid Fuel	3	252	41.5
Leather Tanned	3	80	15.4
Carpets and Rugs	1	70	29.3
Footballs	1	55	25.3
Molasses	0.3	49	93.6
Total Exports	–	20.4	5.9

Source: State Bank of Pakistan (2009).

Other industries affected include tanned leather, carpet and rugs, and football manufacture. Workers have suffered and employer earnings have dwindled in the industries that have lost export earnings. The decrease in earnings of the workers would, without doubt, serve to increase poverty level in the country.

A decline in export earnings for certain industries implies factories being shut-down and employees being laid off, with the daily wage worker being the first one to feel the brunt. Thus, the adverse impact of reduced export earnings on poverty on account of the global recession is not hard to imagine.

IMPACT ON BALANCE OF PAYMENTS, EXCHANGE RATE AND SOCIAL CONSEQUENCES

Depreciation of the exchange rate can result in an increase in cost of inputs and consumables for countries that import industrial inputs and different consumer goods. The countries dependent on oil imports for energy needs could be especially hard hit if demand for the product is less elastic. During a period of three years; *i.e.* from October 2004 to October 2007, the Pakistani rupee had maintained remarkable stability against US dollar, with depreciation of the currency being a mere one percent over a period of three years. However, since the global financial crisis came to fore, the domestic currency has depreciated by a whooping 36 percent in a period of less than two years (October 2007-August 2009). During the period of stable exchange rate, the current account balance has almost always remained negative (Table 6).

TABLE 6

External Current Account Balance

2004-05	2005-06	2006-07	2007-08	2008-09
–1.6	–4.4	–5.1	–8.5	–5.3*

Note: *due to IMF package

Source: *Pakistan Economic Survey* 2007-08.

The receipts on the capital account were not only used to finance the deficit on the current account but also contributed to incremental increases in foreign reserves as well. These included inflows on account of Foreign Direct Investment as well as portfolio investment, proceeds from privatization of public sector entities, sovereign debt issues in international financial markets and multilateral as well as bilateral aid. On top of all this, the country’s central bank (State Bank of Pakistan) had been providing the bulk of foreign exchange required for the purchase of oil since November 2004. This was an implicit intervention in foreign exchange market that has now been phased out as a condition of financing arrangement executed with the IMF in December 2008. The extent of implicit intervention and its impact upon the exchange rate can be gauged from examining the share of petroleum products in total imports of the Pakistan (*see* Table 7).

TABLE 7

Share of Import of Petroleum Products in Total Imports (%)

FY	2004-05	2005-06	2006-07	2007-08	2008-09
Import of Petroleum Products	19	24	27	30	32

Source: State Bank of Pakistan, (various reports), Economic Data.

The implicit intervention in the foreign exchange market and a host of other congenial factors that had allowed the surplus on capital account to finance the deficit on the current account were not effective during much of FY 2008-09. With the onset of recession, the capital flows have dwindled – FDI has declined significantly while portfolio investment for the first time in many years has seen net outflows. Due to the liquidity crunch, the country has neither been able to issue sovereign debt in the international market nor has it been able to secure receipts from sale of its public sector entities. All these factors combined have contributed to the deterioration of balance of payments, drawdown of foreign reserves and steep depreciation in the value of domestic currency vis-à-vis its foreign counterparts. One may take the view that phasing out of the intervention in foreign exchange market, forced upon by IMF, is responsible for the depreciation of the currency's value. While this may be partially true, one needs to keep in mind the fact, that for intervention in the foreign exchange market to avert deprecation of the exchange rate, the country requires foreign reserves in sufficient quantity. The foreign reserves of Pakistan have been depleting since mid 2007 at a fast pace due to reduction in capital flows, which is in turn is owed to recession. As such, given the level of foreign reserves, even without the IMF restraint, the country would not have been able to engage in interventions in the foreign exchange market in 2009. Lastly, the country in the first place, had to go to the IMF due to financial crunch caused by the financial crisis/global recession. Thus, in essence it is the recession that has contributed to the depreciation of the Pakistani Rupee's parity vis-à-vis the US Dollar.

In conclusion, as far as the external account is concerned, the adverse social impact is being channeled through the exchange rate. With depreciation of the exchange rate, either the prices of some commodities have increased or have not declined to the extent that they would have declined in a recession, had there been no depreciation of exchange rate. This inflation in turn has contributed to an increase in the poverty head count.

IMPACT ON POVERTY

Accurate estimates of the changes in poverty head count ratio are not readily available; however preliminary estimates, by different agencies, point towards a significant increase in poverty levels (around 6 percentage point in FY 2008-09) during the last two years.[3] Four channels (discussed in the forgoing section) have contributed to the increase in poverty. First, trickle-down effect is from the reduction in GDP growth. Growth of large scale manufacturing was negative in FY 2008-09, implying that numerous firms had shut-down and workers had been laid off. Typically the first ones to be laid off are daily wage earners, who are amongst the poorest segments of the society. Thus the increase in poverty is understandable. Second, the expected reduction in remittances from UAE will also contribute to further rise in poverty levels since almost 50 percent of the registered overseas workers are unskilled. These unskilled workers are likely to be from the poorest rung of the society. The return of a part of this workforce will contribute to an increment in poverty head count. Third, the cut in public sector spending means fewer jobs for the poor, poorer health facilities and lesser opportunities of free education for the poor. Fourth, depreciation of the exchange rate, induced by global recession, has contributed to inflation which has robbed the poor of their purchasing power, thereby contributing to a rise in the poverty head count.

Coping with Poverty

Despite the fiscal constraints, Government of Pakistan has introduced a new social safety net, the Benazir Income Support Programme (BISP), to augment the income of the poorest of the poor, who have been severely hit by the global recession. The budgeted allocation (in FY 2008-09) for the BISP was Rs. 70 billion (US $ 875 million). This is the third largest allocation in the total budget and is over 0.3 percent of the GDP for FY 2008-09. The BISP has been initiated to partially offset the impact of inflation on the purchasing power of the poorer sections of the society. Under the BISP the poor, who fulfill a certain criteria, will be given monthly cash support of Rs. 1,000 (approximately US $ 12/month).[4] This monthly grant will increase the income of a family earning Rs. 5,000/month (around US $

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[3]*Pakistan Economic Survey* 2007-08.

[4]At an exchange parity of Rs. 82: US $ 1 prevailing on September 12, 2009.

60/month) by 20 percent. The BISP aims to cover around 15 percent of the entire population, which constitutes 40 percent of the population below the poverty line.

V. CONCLUSION

Theory, empirical evidence and the current response of the developed countries to the global recession, all advocate a strong fiscal stimulus to cope with the recession. However, the surge in commodity prices that preceded the recession had taken its toll on Pakistan and precluded the use of a comparable stimulus package. The then regime in Pakistan had chosen not to pass the full impact of the rise in commodity prices in 2007 to the consumers. This among other policies had contributed to a sudden increase in the fiscal deficit for FY 2007-08. When the recession set in the fiscal deficit was already high and the external account was in poor shape. Pakistan requested IMF financing to stay afloat and in turn agreed to implement fiscal tightening. Thus, the standard Keynesian recipe of fiscal stimulus was not available to stage recovery, which given the high fiscal deficit, could not in any case have been pursued with strong vigour. Given this fiscal constraint, planned public spending in 2008-09 was curtailed for education, health, water, power and a number of other sectors and projects with far reaching social consequences. Given the slack demand and international liquidity crunch, capital flows have shrunk and therefore the exchange rate has depreciated. This depreciation in turn has contributed to inflation. Export performance of a number of industries, especially textiles, has been affected causing shut downs and lay offs. Fiscal tightening, exchange rate depreciation and poor export performance have contributed to the increase in poverty head count. Despite the maintenance of a healthy growth trend of remittances so far, it is too early to celebrate for a number of reasons. Remittances from the United States have registered a marginal decline while the outflow of workers to UAE has reduced significantly. This causes one to suspect that remittances from these two countries, especially from UAE, may decline in future. If this suspicion is true, there is more bad news to be had for the poverty head count.

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