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Chairman Tierney, Ranking Member Shays, and other members of the subcommittee, I appreciate the opportunity to testify before you today. At the Center for American Progress, my colleague, Caroline Wadhams, and I have organized a working group of distinguished experts on Pakistan and national security policy to examine U.S. policy. We plan to release a report next month with a detailed analysis and recommendations. My testimony is based on the work of this group, as well as my three visits to Pakistan since last December.

The devastating bombing of the Islamabad Marriott this past weekend highlighted the deteriorating security situation in Pakistan—and other members of the panel have stressed in their remarks the complicated security dynamics inside of Pakistan. I will focus my remarks on another component of security often overlooked in Pakistan—economic security. For far too long, U.S. policy has focused almost exclusively on the military and intelligence aspects of our relationship with Pakistan without enough attention on the impact that economic dynamics have on stability in Pakistan.

In the past year, rising food and commodity prices have hit the Pakistani economy hard, leaving many Pakistanis vulnerable as their country attempts to make a crucial transition from military rule to democracy. The newly elected government faces interlinked challenges: tackling emboldened militant groups and terrorist organizations, advancing political reform, and stabilizing the economy. U.S. policymakers cannot afford to ignore any one of these challenges. In particular, the economic troubles that Pakistan faces have potential for further undermining Pakistan's fragile internal stability. If Pakistan's economy experiences further collapse, the government could lose further support of the people.

Economic challenges for ordinary Pakistanis. The basic economic statistics paint a dire picture. Two-thirds of the Pakistani population lives on less than $2 a day, with one-third of the population living below the poverty line. While the Pakistani economy expanded 5.8 percent in the last fiscal year, this rate of economic growth was the slowest since 2003 and is expected to fall to 4.6 percent this year. But the benefits of this economic growth have not reached the vast majority of Pakistanis.

Pakistanis are increasingly having a hard time meeting their basic needs. In a poll of 3,484 Pakistani citizens conducted by the International Republican Institute this past June, 7 in 10 Pakistanis said that their personal economic situation had worsened over the past year. Fully 71 percent said inflation was the most important issue facing Pakistan—followed by unemployment (13 percent), poverty (5 percent), and basic services like electricity and water (4 percent). These basic needs are cited as much more important than law and order (2 percent), suicide bombings (2 percent), and democratic reforms (1 percent) as the most important issue facing Pakistan.[1]

The "silent tsunami" of global food price increases has hit ordinary Pakistanis particularly hard. In a separate poll conducted by Terror Free Tomorrow, 86 percent of Pakistanis reported in May of this year that they had trouble obtaining enough flour each day.[2] That same month, food prices increased 28.5 percent. Pakistanis are finding it increasingly difficult to meet their energy needs. From July 2007 to July 2008, the Pakistani government spent $11.35 billion on foreign oil, a two-thirds increase over the previous year. This year, oil imports may cost up to $14 billion, further exacerbating Pakistan's economic crisis. Overall inflation has skyrocketed, reaching a 30-year high of 24.3 percent in July and hitting 31.55 percent by the first week of September. In addition to the food and fuel price increases, parts of Pakistan have experienced electricity shortages. In my last visit to the country, the capital of Islamabad experienced blackouts due to electricity shortages, and Pakistanis rioted in the city of Multan because of electricity shortages. In June, the port city of Karachi experienced riots due to electricity shortages.

In the Federally Administered Tribal Areas—the heart of the Taliban insurgency and a safe haven for the global Al Qaeda movement—economic conditions are even worse. Per capita income stands at $250, half the overall national income. Almost two-thirds of those living in FATA are below the poverty line. These statistics are indicative of a politically isolated region, left to languish with little to no support from the center.

Pakistan's fiscal and monetary crunch. In large part due to fuel subsidies and other economic obligations, Pakistan's budget deficit of $21 billion is the highest in a decade, and the current account deficit is 8.4 percent of GDP. In all of Asia, Pakistan has the highest interest rates, least valuable currency, and riskiest financial obligations. As a result, Pakistani government debt is considered one of the riskiest in the world. Pakistan's currency, the rupee, has lost 20 percent against the falling dollar and is now near record lows. The Karachi Stock Exchange—Pakistan's oldest and largest stock exchange—has lost 40 percent of its value since April 2008. Just last August, the KSE put a floor on the index to keep shares from falling even further.

Pakistan foreign currency reserves have dropped significantly due to the unstable political and security situation. In less than a year, Pakistan's foreign reserves have dropped from an all-time high of $14 billion last November to just under $6 billion today.

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[1] International Republican Institute, "IRI Index: Pakistan Public Opinion Survey," poll conducted with 3,484 Pakistani adults June 1-15, 2008, results available at: http://www.iri.org/mena/pakistan/pdfs/2008%20July%2017%20Survey%20of%20Pakistan%20Public%20Opinion,%20June%201-15,%202008.pdf

[2] Terror Free Tomorrow, "Results of a New Nationwide Public Opinion Survey of Pakistan," poll conducted with 1,306 Pakistani adults May 25 – June 1, 2008. Results available at http://www.newamerica.net/files/TFTPakistanPowerPointv3.pdf

This sum will only cover two months worth of imports. Foreign investment, which had been increasing since 2001, became stagnant last year.

While Pakistan will likely receive some support from the World Bank, the Asian Development Bank, the Islamic Development Bank, and countries like Saudi Arabia, its financial requirement of $8 billion to $10 billion will probably not be met through international support. The Pakistani government reportedly expects to obtain commitments of between $3 billion and $5 billion from a "Friends of Pakistan" forum to coincide with the UN General Assembly this week.

In the past week, the Pakistani Finance Ministry has unveiled a four-point plan to attempt to stabilize the economy, including four key steps: 1) eliminating subsidies on fuel and power; 2) holding the budget deficit at 4.7 percent by increasing revenue through taxes and cutting development expenditures; 3) increasing saving through National Saving Schemes, Pakistan Investment Bonds, and other measures; and 4) the privatization of oil, gas, and power sectors.

While the Pakistani government rejected International Monetary Fund assistance in crafting these reforms, they broadly align with standard IMF recommendations for structural economic reform. As such, these reforms emphasize curbing inflation and reducing budget deficits over investing in the Pakistani people and helping them meet their basic needs. The government plans to reduce fuel subsidies before the end of this year, and it also plans to eliminate electricity subsidies. Pakistan will need external assistance as it moves through this economic transition at a time of great internal instability and continued threats from extremist groups. It is therefore imperative for the security interests of the United States to get the Pakistani economy moving again.

What should the United States do? First, the United States needs to work with other countries to assist the Pakistani government in implementing a reform agenda that guards against any potential increased internal insecurity resulting from economic troubles. The United States should support Pakistan's efforts to organize international assistance through the "Friends of Pakistan" group convened at the UN General Assembly this week. Other global and regional powers such as China and Saudi Arabia play a vital role in shaping Pakistan's economy, and a more organized international effort to help Pakistan address its economic difficulties is necessary.

Second, the United States should redirect its economic assistance to support those Pakistanis most affected by increasing food and commodity prices. Additional food aid and energy assistance should be provided from the United States to poor Pakistanis to help them weather the storm while the Pakistani government attempts to rein in inflation and deficits. In addition, USAID should support basic infrastructure and agricultural development programs to help lay the foundation for better economic prospects in the future. In particular, the United States must also provide more development assistance to FATA coupled with better oversight. Without economic and political integration into the rest of Pakistan, it is unlikely that the national security threat from FATA will diminish any time soon.

Finally, as the United States works to provide Pakistan with much-needed economic support, it should more closely monitor the Pakistani military's extensive involvement in Pakistan's economy, which has contributed to problems of corruption and lack of transparency. Sooner or later Pakistan will have to reckon with the deep military penetration of its economic structure.

All of this means that the U.S. policy approach toward Pakistan is in need of a major overhaul—a more expansive approach that looks at all components of U.S. power – military, political, and economic. Earlier this summer, Senators Biden and Lugar took a step in the right direction in introducing legislation that seeks to change the nature of the U.S.-Pakistani relationship. Among other provisions, the legislation would authorize $7.5 billion over the next five fiscal years in non-military aid to Pakistan. An emphasis on so-called "soft power" measures will be vital in the years to come in Pakistan—and we cannot afford to focus solely on military solutions to the challenges of stabilizing Pakistan.

One final closing note—in order to adopt a new policy towards Pakistan that advances our country's interests, we're going to require substantial reform of our national security agencies here at home. Defense Secretary Robert Gates has stressed this point in a series of speeches that have not received the attention they deserve. Secretary Gates has argued that while military force will continue to play a role in the central fight against terrorist networks and other extremists, "we cannot kill or capture our way to victory." Instead, he says we must expand our diplomatic and development capabilities. In a speech last November, Gates argued, "One of the most important lessons of the wars in Iraq and Afghanistan is that military success is not sufficient to win: economic development, institution-building and the rule of law, promoting internal reconciliation, good governance, providing basic services to the people, training and equipping indigenous military and police forces, strategic communications, and more—these, along with security, are essential ingredients for long-term success."

In the months and years ahead, Pakistan will be a major test case for whether the United States will reform its overall approach to national security. In the struggle to help Pakistan achieve greater internal stability, the United States will need to have a comprehensive strategy—one that puts more attention on eliminating terrorist safe havens and advancing political reform, but also keeps a focus on helping Pakistan address its economic troubles.