



Pakistan's Balance of Payment Crisis and IMF Loans

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Introduction

International Monetary Fund commonly known as IMF was established in 1944 at Bretton Wood conference in the United States of America. The major aims of this monetary institution were to provide stable framework related to currency exchange rate and reduce frequency of balance of payments deficits by providing member states loan and financial and technical guidance. In broader sense, IMF establishment aimed at ensuring reducing the risk of collapse of world monetary and exchange systems as it happened during 1930 when old exchange system, based on gold standard, collapsed and resulted in economic meltdown that is known as Great Depression of 1930. Furthermore, this monetary institution was created to stabilize and promote free trade or rather free market based on liberal economic principles. Apart from that, the two World wars that happened respectively in 1914-1918, and 1939-1945, had devastated the world economic and render many into severe economic crisis. Thus, IMF intended to help such countries, especially, western European states. Later on IMF widen its purview and helped countries, though not directly affected by wars, facing severe balance of payments crisis (Masters, et al., 2021).

The balance of payments is a comprehensive record of all economic transactions involving products, services, and assets between a country and the rest of the world over a specific period, typically one year. The document is a comprehensive financial statement of the nation, encompassing all monetary inflows and outflows recorded as debits and credits. The balance of payments is utilised to monitor all global financial transactions. The balance of payments includes all transactions carried out by both the private and public sectors, serving to ascertain the inflow and outflow of funds in the country. (Business Standard)

“A balance of payments deficit occurs when a country's imports of goods, capital, and services exceed its exports. The country must acquire funds from foreign nations or financial institutions in order to cover the costs of its imports.”. (BYJU'S)

Pakistan has consistently shown a notable inclination to let balance of payments problems escalate to the point of creating a near-crisis situation every few years. These near crisis situations have often been dealt with by the help of International Monetary Fund. (Hasan, 1961)

Balance of payments problems of Pakistan have been chronic since 1970s. (Sajjad, 2021)

Pakistan from its very inception was not economically strong enough to keep its institutions functioning without any help from outside world. Pakistan joined IMF in 1950. Its government, under the leadership of, then president, General Ayub Khan, first time asked IMF for help; an agreement was signed through which Pakistan would withdraw US \$25,000. But Pakistan did not



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withdraw this money. However, this was the beginning of an endless debt borrowing cycle that would become perpetual problem for economy of Pakistan. Again Ayub's government went twice in IMF programs in 1965 and 1968. Change in political power did not change the practice of borrowing money from IMF. Zulfikar Bhutto's government took loan from IMF thrice in its tenure from 1972 to 1977. General Zia' government went to IMF twice. From 1988 to 1998 Pakistan went to IMF eight times: 5 times under Pakistan People party's governments and 3 times under Nawaz sharif's governments. General Musharraf, from 1999 to 2008, withdrew money from IMF in two attempts during his nine years rule. When Musharraf was replaced by the Pakistan Peoples' Party in 2008, the government of PPP went to IMF and secured the biggest IMF bailout package in our history, amounting to SDR 4.94 billion; in total PPP government borrowed \$ 7.2 billion (Abbasi, 2019).

Facility	Date of Arrangement	Expiration Date 4/	Amount Agreed	Amount Drawn	Amount Outstanding
Extended Fund Facility	Jul 03, 2019	Oct 02, 2022	4,268,000	1,044,000	1,044,000
Extended Fund Facility	Sep 04, 2013	Sep 30, 2016	4,393,000	4,393,000	3,793,000
Standby Arrangement	Nov 24, 2008	Sep 30, 2011	7,235,900	4,936,035	0
Extended Credit Facility	Dec 06, 2001	Dec 05, 2004	1,033,700	861,420	0
Standby Arrangement	Nov 29, 2000	Sep 30, 2001	465,000	465,000	0
Extended Fund Facility	Oct 20, 1997	Oct 19, 2000	454,920	113,740	0
Extended Credit Facility	Oct 20, 1997	Oct 19, 2000	682,380	265,370	0
Standby Arrangement	Dec 13, 1995	Sep 30, 1997	562,590	294,690	0
Extended Credit Facility	Feb 22, 1994	Dec 13, 1995	606,600	172,200	0
Extended Fund Facility	Feb 22, 1994	Dec 04, 1995	379,100	123,200	0
Standby Arrangement	Sep 16, 1993	Feb 22, 1994	265,400	88,000	0
Structural Adjustment Facility Commitment	Dec 28, 1988	Dec 27, 1991	382,410	382,410	0
Standby Arrangement	Dec 28, 1988	Nov 30, 1990	273,150	194,480	0
Extended Fund Facility	Dec 02, 1981	Nov 23, 1983	919,000	730,000	0
Extended Fund Facility	Nov 24, 1980	Dec 01, 1981	1,268,000	349,000	0
Standby Arrangement	Mar 09, 1977	Mar 08, 1978	80,000	80,000	0
Standby Arrangement	Nov 11, 1974	Nov 10, 1975	75,000	75,000	0
Standby Arrangement	Aug 11, 1973	Aug 10, 1974	75,000	75,000	0
Standby Arrangement	May 18, 1972	May 17, 1973	100,000	84,000	0
Standby Arrangement	Oct 17, 1968	Oct 16, 1969	75,000	75,000	0
Standby Arrangement	Mar 16, 1965	Mar 15, 1966	37,500	37,500	0
Standby Arrangement	Dec 08, 1958	Sep 22, 1959	25,000	0	0
Total			23,656,650	14,839,045	4,837,000



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(Abbasi, 2019)

Research Questions:

1. Why could Pakistan not maintain balance of payment?
2. Why does Pakistan have to borrow money from IMF again and again?

Literature review:

The nature and cause of balance of payments crisis show enormous diversity.

However, Pakistan has demonstrated a distinctive tendency to allow balance of payments pressures to into build a near-crisis situation every few years. These near crisis situations have often been dealt with by the help of International Monetary Fund. Generally, such situations Efforts have successfully curtailed the occurrence of full-fledged economic crises, but the consequence of these crisis-prevention measures has been a deceleration in both economic and social progress. Furthermore, immediate measures were implemented to tackle the aforementioned difficulties, but without sufficient structural adjustments. Consequently, the inherent vulnerabilities resurfaced in response to subsequent external shocks or instances of internal economic mismanagement.

In countries like Pakistan which are dependent on the export of a few primary products for which market show a great deal of instability, the wide fluctuations in the prices of such products causes the balance of payment difficulties. In Pakistan the balance of payment crisis arise from the basic disequilibrium in receipts and payments. The absence of basic disequilibrium requires that a country is capable to meet its payment out of receipts from the current transaction and ordinary capital inflow, without being compelled to slow down economic activities or resorting to control the imports to avoid a deficit in its balance of payments.

One of the frequent causes of this balance of payments crisis, especially in developing world, is monetary imbalance often caused by an excessive rate of credit creation. The inflationary pressures - excess of money demanded over the supply of goods and services at given price level- lead to balance of payments problems. Economists who view the balance of payments problems through monetary lenses believe excessive credit expansion as the cause of payments difficulties. For example, if the domestic price level has got out of line with the international price level, then, foreign demand for exports would decline while the demand of imports would be stimulated. (Hasan,1961)

Balance of payments problems of Pakistan have been chronic since 1970s. The imports of fuel - petrol, diesel and gas- has been responsible for the trade imbalance. However, remittances from Middle Eastern countries, where large Pakistani labor force works, have helped Pakistan to keep balance of payment in a cheek.

Whenever economy of Pakistan is about to take off, the rising import hit economy hard and journey of economic progress come to an abrupt end. (Sajjad, 2021)

Growth driven balance of payment crisis:



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Pakistan is a youthful nation with a sizable population that joins the workforce annually. A minimum of 7% of the real GDP growth rate is required to offset this inflow. Although Pakistan experienced periods of economic growth in the 1960s and 1980s that averaged over 7%, it is currently extremely difficult to maintain economic growth at the necessary 7% rate in order to accommodate the country's expanding population. Pakistan's growth rate during the past ten years has averaged 4%. The balance of payments crisis's restriction on GDP growth is the main cause of the economy's poor growth. Scholarly investigations have indicated that Pakistan's economy could only expand by 4%. Past this point, the import bill begins to rise uncontrollably, which puts Pakistan's balance of payments in jeopardy. Pakistan ultimately finds itself at the doorstep of foreign lenders such as the International Monetary Fund (IMF) (Sajjad, 2021).

Stagnant exports:

Stagnant exports are major a problem in this regard. Exports of Pakistan have remained concentrated in commodities like rice and basic textile like grey fabric. Despite being pioneers in textile, Pakistan could not graduate to high value-added exports. (Sajjad, 2021)

Only a small portion of total exports consists of more advanced export products that have a higher amount of domestic value added. The primary export category of Pakistan is textiles, which constituted 58% of its total exports in 2017. Pakistan's export industry experienced a decline in competitiveness between 2012 and 2017 due to an overvalued currency rate. Moreover, exporters faced significant expenses due to elevated energy prices and inadequate energy provisions (Rosbach, *et al* 2019).

Exports have remained stagnant over time at around \$20-25 billion. (Sajjad, 2021)

However, the majority of prosperous emerging countries pursued a strategy that focused on increasing both the amount and quality of their exports. Countries such as China, Korea, Thailand, Vietnam, and Malaysia initially had economies that relied on basic commodities or low-value manufacturing. However, these countries have since significantly increased the quantity, variety, and complexity of their exports. Nevertheless, Pakistan's exports have consistently constituted a relatively smaller proportion of its GDP since gaining independence in 1947.

In recent years, a combination of concerns such as security issues, energy deficits, inadequate infrastructure, and declining commodity prices have significantly reduced exports to less than 10% of the Gross Domestic Product (GDP). Pakistan ranks 147th in the World Bank's Doing Business report, which evaluates nations based on their business environment. This report indicates that business environment in Pakistan is less-than favorable. (Ahmed, 2018)

Pakistan's export sector has exhibited a prolonged period of feeble performance. Export growth has remained static since 2010, while the average trade deficit has been increasing. Pakistan's exports are experiencing a decline in market share due to an increasing proportion of unsophisticated export goods. Pakistan was placed 74th out of 89 countries in the economic complexity ranking, according to the Massachusetts Institute of Technology (MIT) Observatory of Economic Complexity (Rosbach, *et al* 2019).



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Protected environment for domestic market also cause contributes to low level of exports. This has rendered import substitution a lucrative and less hazardous enterprise. Additionally, the top corporations in Pakistan primarily engage in either domestic market manufacturing or the services sector. Consequently, the exports of Pakistan have not been able to rise thus far as a result of these factors. (Ahmed, 2018) In addition, typical industrial companies engage in real estate and construct shopping malls because constructing a manufacturing facility is considerably more challenging than investing money in the property market. Deindustrialization has become a significant obstacle to the expansion of exports. (Jahangir, 2019).

Exports of goods in 2017

Country or Group	USD billion	% of GDP
Pakistan	23.1	7.62
Turkey	166.1	19.56
Malaysia	188.0	59.76
Thailand	235.1	51.63
India	304.1	11.65
Bangladesh	35.30	13.51
Middle-Income Countries Average	76.65	24.47

Rather than devising a comprehensive export strategy, in recent years Pakistan has relied on large and growing volume of remittances and on official and private financing to cover its import bill. However, such inflow of money is volatile to internal as well as external shocks. (Ahmed, 2018)

Inelastic imports of Pakistan:

Annually Pakistan imports crude oil of around \$10-12 billion and edible oil of around \$3-4 billion. (Sajjad, 2021)

Recently, however, the State Bank of Pakistan has pointed out that the import of petroleum products have doubled to \$18.9 billion in 2022 from \$9.7 billion in fiscal year 2021. (Riazuddin, 2022)

Furthermore, the increasing penetration of imported goods into daily lives' of people has put strain on the balance of payments. Similarly, the conditions of trade have been unfavourable for Pakistan over the years. The terms of trade index has decreased from over 80 in 2004 to 58 in 2021. In essence, the average prices of Pakistan's exports have decreased in comparison to the



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prices of imported commodities. This has worsened the balance of payment crisis in the country (Sajjad, 2019).

In addition to that, the increase in overall imports was mostly driven by energy imports. Pakistan's energy supplies are inadequate and its energy mix heavily depends on imported furnace oil and natural gas. Furthermore, Pakistan failed to manufacture essential machinery required for industry and infrastructural growth, thereby perpetuating its dependence on imports. In addition, previous investments failed to enhance the country's productive capacities, preventing it from substituting imports and shifting its specialisation towards more advanced items. The source cited is Rosbach et al. (2019).

Analysts assert that the root causes of the persistent balance of payment crisis in Pakistan are not solely of an economic origin. This perpetual cycle of balance of payment crises can also be attributed to political decision making. Concentrating resources in a small number of individuals leads to increased imports and, thus, a higher trade imbalance. Conversely, distributing income more equally encourages greater demand for domestic products and creates a more favourable atmosphere for mass production. However, the unequal distribution of resources results in a limited ability to produce goods, which in turn hinders the ability to grow exports. This leads to a significant increase in the trade imbalance.

Another political aspect that has contributed to the situation is the deliberate maintenance of an overvalued currency rate. This policy, unlike those adopted by many Chinese and East Asian economies, has resulted in a boost in imports and a disadvantage for exports. The inflated exchange rate frequently serves as a representation of what is commonly referred to as national pride and a measure to assess economic achievement. Therefore, the foreign trade strategy of Pakistan is guided by political expediency rather than economic fact. Furthermore, the presence of crony capitalism in Pakistan has exerted significant pressure on the country's balance of payment. The sugar mafia in Pakistan serves as a prime illustration of this phenomenon. (Jahangir, 2019)

The Pakistani government establishes an annual support price for sugar. The ostensible objective is to promote food security by providing a minimum price guarantee to farmers, but in reality, the support price system mostly benefits individuals who control vast amounts of land. This policy leads to an excess production of sugar, to the detriment of other commodities, such as cotton. The domestic price of sugar significantly exceeds its worldwide price, necessitating government subsidies for exported sugar, so straining the national exchequer. Zaidi (2021) Additional aspects in political economy encompass a militarily dominant force, influential business firms, and a government that wields significant authority in allocating resources and privileges, as well as granting tax exemptions to specific individuals and organisations. In addition, the economic institutions lack autonomy, which means that they are unable to prevent violations of norms and regulations that are in place to maintain control over the budget. This includes violations of Pakistan's Fiscal Responsibility and Debt Limitation Act, as well as disregard for regulations governing energy tariffs, resulting in significant unpaid debts to



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electricity companies that the government ultimately has to cover. In addition to these domestic concerns, Pakistan has leveraged its strategic location to secure substantial financial aid from the United States, China, and countries in the Persian Gulf. Policymakers' excessive dependence on aid has skewed their motivations away from implementing sustainable policies, as they anticipate being rescued by the international community during times of economic hardship. But now as the geopolitical position has been changing and Pakistan also is aligning more closely with China, so its prospects of receiving economic help from countries wary of China has also been diminishing. (Mazarei, 2019)

Pakistan's Reliance on IMF Loan Packages

Pakistan became a member of International Monetary Fund in 1950, however joined the IMF program for a bailout package in 1958 under the Ayub government. This practice of borrowing money continued under successive governments. In 1990s when democratic governments were in charge the pace of borrowing money intensified. In 1999 India, neighbor of Pakistan, said goodbye to IMF but Pakistan kept borrowing money from IMF. Pakistan has approached IMF for 22 times. (Vankwani, 2022). In seven decades Pakistan has been in IMF program for 22 times. Despite the being in IMF programs Pakistan has yet to achieve long lasting solution. All governments in Pakistan have not been ready to take any tough decision. They have always been eager for easy solutions. (The News, 2021)

The total amount of foreign currency loans exceeds \$90.5 billion as of December 31, 2021. To fully understand Pakistan's debt situation, it is crucial to consider its domestic debt. As of December 2021, the domestic debt had surpassed Rs26.7 trillion (about \$151.5 billion based on the closing rate of December 31, 2021). This has led to a total debt over \$242 billion, which accounts for around 77 percent of the country's GDP. The circular debt, which stood at Rs161bn in 2008, has increased to exceed Rs2.46tr by March 2022. Allana, 2022

Ishrat Hussain, a former Governor of the State Bank of Pakistan, identified six frequent reasons that prompt nations to seek help from the International Monetary Fund (IMF).

- 1) To acquire financial resources to address the balance of payments issue;
- 2) To ensure access to money from additional international financial organisations such as the World Bank and bilateral donors;
- 3) To obtain endorsement for pursuing commercial and export credit facilities.
- 4) To attribute the responsibility for the politically unfavourable decision to external forces and coercion;
- 5) Effort by reformist economic administrators to limit and impede the implementation of populist measures by political leaders;
- 6) To eliminate the provision of debt relief and rescheduling.

In 1999, Ishrat Hussain analysed the Political Economy of reforms and highlighted that the primary objective of these programmes was not to achieve long-term change of the economic structure, but rather to focus on short-term goals. Primarily to mitigate foreign exchange shortages and augment foreign exchange reserves. Adjustment is commonly regarded as a temporary measure to create a delay rather than a chance to commence essential policy and institutional changes. The interest groups who were expected to be disadvantaged by the reforms



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held significant political and economic influence over the decision-making process. Consequently, they implemented superficial alterations just to secure funding from the IMF and other international sources, with the intention of continuing their regular operations. Significant structural adjustments that have substantial political consequences were mostly evaded. The total amount of foreign currency loans exceeds \$90.5 billion as of December 31, 2021. In order to fully understand Pakistan's debt situation, it is crucial to consider its domestic debt. As of December 2021, the domestic debt had surpassed Rs26.7 trillion (equivalent to around \$151.5 billion based on the closing rate of December 31, 2021). This has led to a total debt over \$242 billion, which accounts for around 77 percent of the country's GDP. The circular debt, which stood at Rs161bn in 2008, has increased to exceed Rs2.46tr by March 2022. Allana, 2022

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Moreover, the economic growth formula of Pakistan is flawed. Pakistan borrows foreign currency-denominated loans for building some large-scale infrastructure and subsequently get growth spurt in the process. As soon as this growth spurt fades, the country has to repeat the same cycle again to borrow money to keep growth spurt going on. Thus Pakistan ends up accumulating more debt and creating a balance of payment crisis. When the challenge becomes more severe Pakistan has to approach IMF to secure loan from it. (Wani, 2018)

In addition to the flawed economic growth formula, the more severe problem that so far has compelled Pakistan since its inception to knock on the door IMF is its balance of payment deficit. Country has to rely on external debt, mainly from International Monetary Fund and



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World Bank, to finance the deficit in balance of payment. Due to reliance on external debt to finance its deficits World Bank had classified Pakistan as severely indebted country in South Asia in 2001. (Rais *et al*, 2012)



Source: Ministry of Finance 1947-2018| Graph constructed by authors

(Finnigan, 2019)

Annually, developing nations such as Pakistan necessitate financial assistance from diverse external sources to close the deficit in their external financing. A substantial portion of the external financing requirements of Pakistan are derived from the economy's recurring current account deficits. An additional significant element of external financing requirements consists of external loans that require servicing or rollover. (Allana, 2022)

Apart from bridging the current account deficit, Pakistan has to borrow money to bridge the yawning gap in fiscal budget. The Ministry of Finance disclosed in its yearly consolidated federal and provincial budgetary operations report that the budget deficit for fiscal year 2017-18 expanded to Rs2.26 trillion, or 6.6% of gross domestic product (GDP). Pakistan secured a surplus of Rs1.5 trillion in domestic loans and Rs785 billion in foreign loans during the previous fiscal year in an effort to close the yawning gap. (Rana, 2018)

Pakistan is obligated to make substantial annual debt service payments. Pakistan is anticipated to pay \$23 billion in debt servicing during fiscal year 2022-23, the majority of which will be devoted to the repayment of commercial loans, which currently comprise the majority of the outstanding total debt obligations. By 2026-27, the nation will be required to repay \$49.23 billion over the subsequent five years, from 2022-23.



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Additionally, the official data indicates that the projected debt servicing for foreign loans was as follows: \$9.984 billion in 2023–24, \$7.336 billion in 2024–25, \$7.694 billion in 2025–25, and \$5.506 billion in 2026–27. During the subsequent five years, the aggregate outstanding foreign debt obligation would amount to \$49.235 billion; however, this figure does not account for private sector foreign debt. (The News, twenty-two)

Results of the Study

Pakistan has been grappling with a balance of payments crisis ever since its establishment. Pakistan has resolved this crisis with the assistance of the International Monetary Fund more often than not. In general, such circumstances have been managed by impeding economic and social progress. Pakistan which relies on the export of few primary products and fluctuation in the prices of such items causes balance of payments difficulties. This balance of payments crisis has become chronic since 1970. Mainly the import of petroleum products has been the driving force in balance of payments crisis.

Economic growth in Pakistan can lead to balance of payments crisis. High growth rate means country has to import more to meet the demands of industries and consumers. High growth rate means more imports therefore this increase in imports cause balance of payments crisis. Along with growth, the stagnant exports growth further compounds the balance of payment crisis. The exports of Pakistan have remained concentrated in commodities like rice and textile etc. The more sophisticated export products with higher domestic value represents a small fraction of total export. The overvalued exchange rate as well as increase in energy prices has affected the competitiveness of export industries of Pakistan. Moreover, the energy shortages, poor infrastructure, security problems have brought exports down to well below of 10% of GDP. The process of deindustrialization since business invest in real estate and building shopping malls not in building industries has role in stagnant exports.

Although the exports of Pakistan has remained stagnant over the years yet its imports bill has been increasing disproportionately. The inelastic imports of Pakistan especially the imports of petroleum products have put severe strain on balance of payments of Pakistan. The penetration of imported goods in lives of people has added more pressure on balance of payments.

Apart from economic problems, political issues can also be said to have been responsible for balance of payments crisis in Pakistan. The political decision making and the concentration of resources in few hands can be blamed for endless cycle of balance of payments crisis in Pakistan. The maintaining of overvalued exchange rate which is presented as symbol of economic performance has encouraged imports and discouraged exports. Thus political expediency not the economic realities drives the foreign trade policy of Pakistan. Other political factors include political powerful military, influential business groups and a government that exert considerable control over the distribution of resources and exempt specific individual from taxation. Along with these internal political issues, Pakistan has used its geopolitical position to receive large amount of money from the United States of America, China and the Persian Gulf countries. This overreliance on aid has distorted policymakers' incentives away from sustainable policies in the



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hope that they will be bail out in time of economic difficulties. But now this geopolitical situation has changed.

Pakistan became member of International Monetary Fund in 1950, however joined the first IMF bailout program in 1958. The practice of borrowing money continued under successive governments. In 1990 when civilian governments were in power the practice of borrowing money intensified. In seven decades, Pakistan has approached IMF for 22 under different structural programs. Pakistan has approached IMF due to several reasons: to avoid foreign exchange shortages and increase foreign exchange reserves.

Moreover the flawed growth formula of Pakistan, which is to borrow foreign currency-denominated loans for constructing large scale infrastructure projects and to spur in growth for short term, leads to accumulation of debt. Thus Pakistan ends up accumulating more debt and creating balance of payments crisis. Therefore it has to approach to IMF to secure loan to prevent severe economic shocks.

Further, Pakistan has to borrow money from IMF and other international financial institution to bridge the deficit in balance of payment. A substantial proportion of external financing requirements stem from the economy's recurring current account deficits.

Apart from bridging the yawning gap in its current account, Pakistan has to borrow money to fill the gap in its fiscal budget. Along with that, Pakistan has to pay in billions of dollars annually in debt servicing each year. And Pakistan does so by borrowing more money to pay its outstanding debts.



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By our correspondent (2021, December 11) Why does Pakistan go to IMF off and on? The News international

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