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PAKISTAN'S ECONOMY - Are Exchange Rates Fudged?

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Introduction

To understand the current political landscape of Pakistan, it is important to understand its political history and dynamics, and anytime political discourse around a governmental agenda takes place, the one institution that cannot be ignored is the Pakistani Armed Forces. The Army in Pakistan holds considerable amounts of influence over the government and its decision-making, which is only present under a civilian government, with three major military coups taking place in 1958, 1971, and 1999¹.

In recent times, political upheaval against the military has been gaining traction, leading to a particularly unstable period for Pakistan. It is important to understand the background behind the events leading to the current crisis.

Background

In recent times, while the history of the factors contributing to Pakistan's crisis goes back decades, the past two years of Pakistani politics have been particularly unstable in the context of the Pakistani economy. Firstly, there was the crisis in Ukraine, which is one of the world's largest agricultural powers. Not only were oil supply chains heavily affected due to the sanctions on Russia, but also the wheat trade between Ukraine and Pakistan was heavily hit, which as of 2020-

¹ Wong, C. (2021, February 25). <https://economictimes.indiatimes.com/news/international/world-news/98-per-cent-of-chinas-development-funding-to-pakistan-is-in-form-of-less-than-generous-loans-report/articleshow/105046911.cms?from=mdr>. Retrieved from scmp.com:

21 was about 2.1 metric tonnes.² The Ukraine crisis was also a large diplomatic challenge for Pakistan to navigate, since, at the time, Pakistan's Prime Minister Imran Khan had been on an official state visit to Russia on February 23rd-24th, which is when the invasion of Ukraine was announced.³

Another important factor was the flood that had took in 2022, killing more than 1700 people and injuring 13000, the damages of which have been estimated to be around \$30 Billion⁴ (Ethirajan, 2023). The flash floods in Pakistan highlighted its lack of infrastructural capability, as well as its susceptibility to the effects of climate change.⁵ It was recorded that 40% of young children were enduring stunted growth as a result of families struggling to navigate a lack of food and healthcare while also coping with rapidly spreading waterborne diseases such as cholera and dengue.⁶

In the midst of these crises, another growing issue was the Pakistani political crisis, which took place after former Prime Minister Imran Khan was ousted from office after a no-confidence motion that proved his party, the Pakistan Tehreek-e-Insaaf (PTI), to not be fit to rule. The ousted Imran Khan was locking horns with the military over public support, alongside a corrupt judiciary that

² Mehmood, R. (2023, May 3). Russia Ukraine Crisis: Implications for Pakistan . Retrieved from pakistantoday.com.pk: <https://www.pakistantoday.com.pk/2023/05/03/russia-ukraine-crisis-implications-for-pakistan/>

³ Humayun, F. (2022, March 3). Why was Pakistan's PM in Russia amid the Ukraine invasion? Retrieved from Aljazeera: <https://www.aljazeera.com/opinions/2022/3/3/why-was-pakistans-pm-in-russia-amid-ukraine-invasion>

⁴ Ethirajan, A. (2023, December 6). Pakistan economy: Price spikes, political woes hit millions. Retrieved from BBC: <https://www.bbc.com/news/world-asia-67494013>

⁵ Red Cross. (2023). A year on from devastating flooding: what is happening in Pakistan? Red Cross Red Crescent.

⁶ Ibid.

had led to Khan's arrest on the May 9, 2023. This led to his supporters rampaging throughout Lahore in protest against the new government led by Shehbaz Sharif, the brother of former Prime Minister Nawaz Sharif, and the following political crisis dividing the country into two political camps.⁷ Imran Khan's ouster from office also had a lot in correlation with the economic crisis Pakistan was going through under his governance, where Pakistan narrowly avoided an economic default on its debt payments by signing debt relief packages from the IMF, the U.S., China, Saudi Arabia, and the United Arab Emirates.⁸

Lastly, the country had started facing a considerable security crisis from an indigenous terrorist organisation called the Tehreek-e-Taliban Pakistan (TTP), which is a splinter group of the Taliban based in Afghanistan. TTP attacks in Pakistan nearly tripled between 2020 and 2023, with the monthly attack average increasing from 14.5 in 2020 to 23.5 in 2021 to 48.7 in 2023.⁹

The Economic Crisis

Pakistan's economic crisis has reached extreme levels of inflation and has put the country in dire need of debt relief. The current caretaker government has announced that it is in talks with China

⁷ Shukla, A. (2023). Pakistan's Multifaceted Political Crisis. Delhi: Insitute for Defence Studies and Analysis.

⁸ "Pakistan's Debt Rose to Rs 149 Trillion during Imran Khan-Led Govt." The Economic Times. Accessed March 2024. <https://economictimes.indiatimes.com/news/international/world-news/pakistans-debt-rose-to-rs-149-trillion-during-imran-khan-led-govt/articleshow/85887922.cms?from=mdr>

⁹ Sayed, A. (2023). The Tehrik-i-Taliban Pakistan After the Taliban's Afghanistan Takeover. CTC Sentinel

and Saudi Arabia to secure \$11 billion and is also attempting to accept IMF conditions to unlock another \$700 million to help with debt financing.¹⁰

The pharmaceutical industry is facing shortages, banks are hesitant to open letters of credit due to a lack of US dollars, and treatments for diseases such as cancer, diabetes, and epilepsy have severe shortages. The health card scheme, which was a policy under Prime Minister Imran Khan towards universal health coverage, had been blocked in Pakistan's largest province, Punjab.¹¹

The issue with this approach to debt financing is that the sheer amount of debt Pakistan has causes the state to gather new debt to pay off older debt. This means that most of Pakistan's future debt relief might be taken to pay off older debt, placing Pakistan in a continuous cycle of debt financing.

The source of the debt relief is also important. While organisations such as the IMF are entirely based on helping developing countries tackle debt financing, other countries are not. This means that organisations such as the IMF will offer interest rates that are low or even interest-free bailouts to countries, which ensures that most of the debt relief is not directed towards debt financing itself and that the country can carry out reform and help itself out of an economic crisis.

¹⁰ LiveMint. (2023, September 29). Economic crisis: Pakistan in talks with China, Saudi Arabia to secure \$11 billion. Retrieved from livemint.com: <https://www.livemint.com/news/world/economic-crisis-pakistan-in-talks-with-china-saudi-arabia-to-secure-11-billion-11695970946538.html>

¹¹ Khabir, Y. (2023, September 9). Pakistan's economic and health crisis: calls for urgent action. Retrieved from The Lancet: [https://www.thelancet.com/journals/lancet/article/PIIS0140-6736\(23\)00566-4/fulltext](https://www.thelancet.com/journals/lancet/article/PIIS0140-6736(23)00566-4/fulltext)

Specific governments providing debt relief, however, provide loans based on an incentive, which is a financial opportunity for the provider. In this case, the government that is providing the finance would offer extremely high interest rates and often cause the country getting the relief to direct a lot of their debt relief towards debt payments themselves. Pakistan stands to be the perfect example of this, given China's high interest rates and low maturity periods.¹² This also means that countries such as China can add specific clauses to these debt relief agreements that are strategically beneficial to them, such as the port in Sri Lanka that was given to China on a 99-year lease ownership.¹³

An incentive to take debt relief from other countries, such as Saudi Arabia, instead of organisations such as the IMF would be the unwillingness of the government to carry out reform, which is often a prerequisite required to be fulfilled to get relief from the IMF.

Are Exchange Rates Fudged?

The value of the Pakistani rupee has plummeted in the past 17 months, with its value now being 3.2 Pakistani rupees to the Indian rupee and 279 Pakistani rupees to the dollar. While a weaker currency does make imports far more expensive to afford, in a proper free market system, it is

¹² The Economic Times. (2023, November 07). 98 per cent of China's development funding to Pakistan is in form of less-than-generous loans: Report. Retrieved from [economictimes: https://economictimes.indiatimes.com/news/international/world-news/98-per-cent-of-chinas-development-funding-to-pakistan-is-in-form-of-less-than-generous-loans-report/articleshow/105046911.cms?from=mdr](https://economictimes.indiatimes.com/news/international/world-news/98-per-cent-of-chinas-development-funding-to-pakistan-is-in-form-of-less-than-generous-loans-report/articleshow/105046911.cms?from=mdr)

¹³ Wong, C. (2021, February 25). <https://economictimes.indiatimes.com/news/international/world-news/98-per-cent-of-chinas-development-funding-to-pakistan-is-in-form-of-less-than-generous-loans-report/articleshow/105046911.cms?from=mdr>. Retrieved from [scmp.com](https://www.scmp.com):

supposed to be helpful to an economy struggling with debt. This is because, with imports becoming more expensive, it is common for the population of a country to buy less from abroad and explore the local economy instead. At the same time, it promotes the local economy not only to a domestic market but also to the global market since products from the home country become cheaper for populations abroad. This makes the exports from the home country far more competitive and helps it compete with other countries over exports.

The question of whether or not the exchange rates are fudged is a particularly challenging one, though. To keep imports cheaper comes at a cost of competitiveness for local exports, but it is also an electorally important asset for any ruling party that can convince the public that its policies are keeping prices lower than the other. While it has a short-term effect, it greatly hurts the economy in the long term. In a free-market system where the value of the currency is entirely based on market values, the currency should theoretically come to its actual value over time, but governments usually retain some to total control over their currencies for monetary policy making and sovereignty over their country's participation in the global markets. An example of this would be Pakistan's protectionist policies towards its automobile market regarding vehicles from Japan.¹⁴

Necessary Policy Changes

To exit this economic crisis, Pakistan needs to carry out reforms throughout the economy and polity of the country.

Firstly, it is important that the government in control is a democratically elected civilian government that has complete autonomy over its decisions, being elected and gaining legitimacy

¹⁴ Legamart Editorial . (2020, April 1). Import Tariff Protectionism: Still Ideal for Pakistan? Retrieved from Legamart.com: <https://legamart.com/articles/import-tariff-protectionism/>

through the public directly. This means that the military should eventually stop intervening in the affairs of the government and should focus completely on security. The military itself gains legitimacy by convincing the populace that it is the only competent organisation in the country and that it needs the amount of power and influence it has. Secondly, it gains legitimacy from majoritarian politics that often uses a religious angle to gain the support of the people, which is also a practice that needs to be stopped.¹⁵

Next, Pakistan urgently needs to stop sabotaging long-term interests for short-term gain. This includes the discussed electoral interests of different parties that might convince the public that the said party has legitimate control over the economy but, in the long run, hurts the economy instead for electoral purposes. An example of this would be constantly giving out oil and fuel subsidies to the population to gain electoral power, which has a very poorly planned economic model behind it.¹⁶

Pakistan also needs to fulfil the conditions of the IMF in a manner where it can carry out systematic reform, pay back its loans, and provide direct relief and aid towards development and ease of inflation for the people. This would include a more free market and the previously mentioned reforms as well as a reduction in the amount of influence countries such as China and Saudi Arabia hold over Pakistani internal affairs.

¹⁵ Farooq, U. (2022, June 13). Here's How And Why The Pakistan Military Draws Political Legitimacy . Retrieved from thefridaytimes.com: <https://thefridaytimes.com/13-Jun-2022/here-s-how-and-why-the-pakistan-military-draws-political-legitimacy>

¹⁶ Shahzad, A. (2022, March 2). Pakistan confident of defending \$1.5 billion fuel subsidy at IMF review. Retrieved from reuters.com: <https://www.reuters.com/markets/rates-bonds/pakistan-confident-defending-15-billion-fuel-subsidy-imf-review-2022-03-04/>

Conclusion

All in all, Pakistan is in a great economic and political crisis. It is unclear if the issues will end anytime soon, but it is evident that to help the country get out of this accrued debt, it needs sudden policy reform all throughout the country.

Whether or not the reform takes place is a difficult answer to predict given that it is possible to carry out this reform, but it is also improbable given the constant power struggle that Pakistan is in. Not only would economic reform be improbable thanks to its diplomatic relations with countries such as China, but its internal strife between the civilian population and the military will be a massive deterrent to reform as well.

Whatever the future of Pakistan is, it is very important not only to its people but also to Pakistan's neighbours and countries integrated into the international political economy that a nuclear power such as Pakistan sustains in its deep debt trap and peacefully resolves its issues. Whether that would happen is, however, very unclear.