



# Can the Economic Crisis Offer an Opportunity for Reform in Pakistan?



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Compelled to deal with multiple crises at the same time, Pakistan is indeed going through one of the most challenging times. Pakistan's economic, political, and security challenges invariably share a linkage, and one intensifies the other. Pakistan's inability and unwillingness to address the structural deficiencies of the economy have repeatedly led to an economic crisis. Pakistan's external debt and liabilities stand at around US \$130 billion, accounting for approximately 95 per cent of its GDP. The nation has been in an intensifying debt spiral on account of financial mismanagement, structural economic flaws, and, more importantly, the national priorities it defined for itself and the strategic choices it opted to fulfil those national priorities. Over the decades, the state evolved into a security state that prioritises military modernisation at the expense of economic development and the welfare of its people. There are a number of factors responsible for Pakistan's economic crisis, including the military's dominance and high stakes in the economy, its obsession with neutralising India's military capability, maintaining its narrative on Kashmir, excessive reliance on China, constant diversion of national resources towards non-development expenditure, and continued fiscal mismanagement.

With all the existing problems, the reality is also that Pakistan has a large military well equipped with modern weaponry, which it received from the West and continues to import from its all-weather ally China. Pakistan also has a rapidly growing nuclear arsenal with reportedly 165 warheads and is immensely proud of achieving 'full spectrum deterrence.' Pakistan's focus on weapon modernisation has projected distinct trends in the last two decades. On the conventional front, the focus has been on the build-up of the air force and the maritime strike capabilities of the

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navy. On the nuclear front, it has focused on expanding the arsenal and diversifying the delivery systems. Weapon modernisation has remained unaffected by Pakistan's economic crisis.

The nuclear weapons for Pakistan aim to prevent war and deny India space for a conventional war. It has conducted a proxy war through terrorism in India (in Kashmir and other parts) for more than three decades under the nuclear overhang. Pakistan's geographical location facilitated strategic dividends for the state from major powers, including the United States and China. The nuclear weapons that it developed during the 1980s while fighting the Russians as a front-line state of the US and the terrorism infrastructure it has nurtured for decades to 'bleed India' and 'seek strategic depth' in neighbouring Afghanistan have made Pakistan a state that is arguably 'too dangerous to fail.'

Pakistan's geopolitical location, its ability to assert itself militarily in the region, and its nuclear arsenal made it a critical strategic player for the major powers seeking regional dominance. Pakistan's debt burdens were repeatedly eased in the past by its friends and allies, who perceived the stability of Pakistan in their larger strategic interests. This rather unconditional flow of external assistance never allowed a change in Islamabad's thinking, national priorities, or for that matter, its strategic choices.

However, the current phase of the economic crisis projects different posturing and also donor fatigue from Pakistan's traditional donors and friends. The much-needed commitments and actual actions relieving Pakistan's economic burdens have not been easy and unconditional (in this phase). Pakistan has been keen on the US \$1.1 billion tranche of the International Monetary Fund (IMF) loan. However, the international lender has remained firm and has been cautiously asserting the conditions and scrutinising Pakistan's adherence to the preconditions of the loan. The IMF wants Pakistan to enhance its revenue base, increase taxes, reduce subsidies, allow the needy to have access to the subsidies, and have a market-determined exchange rate. The IMF conditions also include cutting defence expenditure by 15 percent and abandoning the long-range nuclear missile programme. The financial body has been concerned that the IMF loan should not be used to repay Chinese loans by Pakistan. Hence, the IMF has insisted on Pakistan receiving assurances from Pakistan-friendly countries that they would bridge the gap in external finances.<sup>1</sup> Although Pakistan has been trying hard to get the IMF loan, the fact is that the IMF tranche of US \$1.1 billion is not enough to save Pakistan from default. Still, it is certainly likely to give it a breather and potentially

open other channels of economic assistance, like the World Bank and the Asian Development Bank. The IMF loan also signifies support from the West for Pakistan.

Pakistan owes a significant share of its foreign debt (approximately 30 per cent) to China (including state-owned commercial banks). There have been off-and-on reports regarding commitments of a rollover coming from China, but nothing concrete was confirmed which could change the debt dynamics of Pakistan (till mid-March). However, recent media reports suggest Pakistan received a rollover of US \$2 billion in deposits from China, which would help in easing Pakistan's problems.<sup>2</sup>

Saudi Arabia reportedly committed a financial package of US\$ 4.2 billion in November last year.<sup>3</sup> In January 2023, it was reported that the Saudi Fund for Development would conduct a study on enhancing deposits in Pakistan's central bank and also evaluate the plan to increase investments (US \$10 billion) in Pakistan.<sup>4</sup> In January this year, the UAE agreed to roll over the existing loan of US \$2 billion and grant an additional loan of US \$1 billion.<sup>5</sup> However, there have been limited confirmations on Pakistan receiving the actual assistance so far. Fulfilling the IMF requirements has been a prerequisite for Islamabad to secure loans or assistance from its friends. There seems to be a consensus among Pakistan's donors that Islamabad needs to carry out fiscal reforms. Over the years, Pakistan's allies and friends have witnessed the nation's inability to overcome financial distress even with constant external assistance. Pakistan got into a cycle of living on debt, and the donors failed to see any serious efforts from the country to rectify the structural issues leading to a perpetual fiscal deficit.

Pakistan's relevance at the global level also seems to have declined. Washington's interest in managing Pakistan has been limited after its exit from Afghanistan in August 2020. Also, more importantly, the US has been focused more on the Indo-Pacific strategy aimed at countering China. The fallout of the Russia-Ukraine war has engaged the attention of the Muslim world. India's economic growth and expanding diplomatic profile have attracted suitable attention and curiosity at the global level. Pakistan's decades-old narrative that it cannot be allowed to fail does not seem to be fetching dividends anymore.

Pakistan has never experienced multiple crises of this nature in the last few decades. The economic crisis is coupled with an alarming political uncertainty where Imran Khan has managed to present himself as an extremely popular leader deviating from the traditional dynasty politics in Pakistan. The continuing political unrest raises serious questions about the government's efficacy

in managing the economic situation anytime soon. The image of an all-powerful military, which has been seen as Pakistan's saviour, has been tarnished, and its credibility has been openly challenged by Khan's followers. Now it remains to be seen what options Pakistan will exercise internally to stabilise itself and externally to regain its relevance. Will the crisis compel Pakistan to rethink its strategies and make structural changes, or will it continue to be an ailing state reluctant to compromise its strategic calculus?

*(Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of the Centre for Air Power Studies [CAPS])*

## Notes:

<sup>1</sup> Kamran Yousuf, "Islamabad gets 'positive signals' for help from Riyadh, Beijing", *The Express Tribune*, February 20, 2023, <https://tribune.com.pk/story/2402210/islamabad-gets-positive-signals-for-help-from-riyadh-beijing>. Accessed on February 23, 2023

<sup>2</sup> "Pakistan receives USD 2 billion rollover deposits from China to get IMF bailout: Report", *The Indian Express*, March 24, 2023, <https://indianexpress.com/article/pakistan/pakistan-usd-2-billion-rollover-deposits-china-imf-bailout-report-8516989/>. Accessed on March 25, 2023.

<sup>3</sup> Shahbaz Rana, "Pakistan seeks emergency \$3 b Saudi cash injection", *The Express Tribune*, December 08, 2022, at <https://tribune.com.pk/story/2390048/pakistan-seeks-emergency-3b-saudi-cash-injection>. Accessed on March 27, 2023.

<sup>4</sup> Bloomberg, "Saudi Arabia eyes boosting investments in Pakistan to over \$10 billion", *ALARABIYA News*, January 10, 2023, <https://english.alarabiya.net/News/saudi-arabia/2023/01/10/Saudi-Arabia-eyes-boosting-investment-in-Pakistan-to-over-10-billion>. Accessed on February 23, 2023.

<sup>5</sup> Sanaulah Khan, "UAE agrees to rollover \$2bn loan, give additional \$1bn", *DAWN*, January 12, 2023, <https://www.dawn.com/news/1731269>. Accessed on February 20, 2023.