Pakistan Economic Crisis [UPSC Notes]

Pakistan, India's neighbour, has been in a tight spot over its economy for some time now. Amidst very high inflation and extremely low forex reserves, the country has been denied further funds from the International Monetary Fund (IMF). This is an important development in international affairs and is hence a relevant topic for the IAS exam. In this article, you can read all the latest about the economic crisis in Pakistan.

A delegation from the IMF arrived in Pakistan to attempt last-ditch negotiations to restart crucial financial aid that has been frozen for months. As Pakistan fights a worsening economic crisis, the country's prime minister claimed that the government would have to accept "beyond imagination" IMF bailout requirements. For fear of reaction before the upcoming elections in October 2023, the Pakistani administration has refused to implement the tax increases and subsidy reductions that the IMF has required.

Economic Crisis in Pakistan Explained

The Pakistani economy is in dire straits as explained below.

- **High Inflation:** Pakistan experienced a high inflation in 2022 of about 24.5%. The percentage was about 29% higher in rural Pakistan.
- **High Indebtedness:** Pakistan has long struggled with a number of issues; its current condition is not new. Due to this, Pakistan is heavily indebted to friendly countries and the International Monetary Fund (IMF).
- **Weak External Position**: Pakistan was finally taken off the Financial Action Task Force (FATF) grey list in 2022, after being on it for many years. This had an impact on Pakistan's standing globally and led to the imposition of several economic sanctions.
- **Food Crisis:** The cost of perishable foods has increased by over 56%. In Pakistan, the cost of wheat flour has been steadily rising to uncomfortable proportions.
- **Rising Terrorism:** In an effort to split Pakistan into two countries, Tehreek-e-Taliban Pakistan (TTP) has increased its terrorist activities there since 2022.

Crisis in Pakistan Causes

Some of the major reasons for the current situation in Pakistan are:

- **2022 floods:** The floods in Pakistan in 2022 cost the nation an unprecedented $3 billion in damages, destroyed essential infrastructure, uprooted 8 million people, and reduced domestic output.

- **Economic policies that are inconsistent and procyclical**: Many of Pakistan's growth-enhancing initiatives came at the expense of growing vulnerabilities and enduring structural and institutional shortcomings.
- **Local problems:** According to analysts, Pakistan's distribution challenges are more of a concern than its insufficient supply levels, which have led to shortages and price increases.

IMF Bailout Package for Pakistan

- The phrase "bailout" refers to providing financial assistance to a business or a nation that may soon face bankruptcy.
    - A nation is in serious economic trouble when it approaches the IMF for a loan.
    - To pay for imports and loan repayments in particular, it lacks sufficient foreign currency (or "dollars").
    - Basically, the nation is unable to pay its debts abroad. It hence requires a bailout.
- The help provided by the IMF will be 'cash' in the sense that it is not required to be used for a specific purpose. It can utilize this money to pay its bills.
    - But the IMF will set some restrictions. Spending less, both at home and abroad, is a fundamental requirement.
- In November 2022, IMF had refused to release a pending payment of $1.18 billion due to the Pakistan government’s reluctance to meet certain demands including assurances from the country on:
    - Increasing energy rates
    - Imposing more taxes
    - Artificial control over the exchange rate

About Extended Fund Facility (EFF):

- It was created to help nations dealing with severe payment imbalances brought on by structural barriers, poor growth, and an inherent weak balance-of-payments position.
- It offers support for comprehensive initiatives that include the regulations required to permanently address structural inequalities.
- It serves to assist national economic plans aimed at achieving macroeconomic stability and sustainability in line with robust and long-lasting poverty reduction and growth.
- The Extended Credit Facility (ECF) might also act as a catalyst for new international aid.
- **Eligibility:**
    - It is accessible to all member nations that meet the requirements of the Poverty Reduction and Growth Trust (PRGT) and have a persistent Balance of Payments (BOP) issue.
- **Continuity and frequent use:**
    - Assistance under an Extended Credit Facility (ECF) agreement is given for an initial period of three to five years, with a five-year overall maximum.

- Additional ECF arrangements may be approved after the expiration, cancellation, or termination of an ECF arrangement.

- **Focused conditionality:**
    - Under the ECF, member nations consent to put in place a series of measures that will advance them toward a long-term, stable, and sustainable macroeconomic position.
    - The letter of intent from the nation outlines these pledges in detail, along with any additional terms.