EFSAS

EFSAS STUDY PAPER

No. 5 | May 2024

Bailout Politics

Pakistan's Economy and the IMF

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Introduction

Faced with structural weaknesses in the economy, long-term balance of payment issues, and external shocks, the incoming Pakistani government of Prime Minister Shehbaz Sharif has once again turned to support from the International Monetary Fund (IMF). Created in 1944, the IMF is part of the broader Bretton Woods architecture created following the end of the Second World War. As part of its mandate, the IMF seeks to promote global monetary cooperation and stability, provide financial assistance and technical support to member countries facing economic challenges, conduct surveillance and policy analysis to prevent crises and foster sustainable growth, support exchange rate stability and balance of payments adjustment, and assist low-income and developing countries with concessional financing, debt relief, and policy advice (Council on Foreign Relations, 2023). The IMF and Pakistan have a long historical relationship: since Pakistan joined the fund in 1950, the IMF has provided a total of 24 programs to the country (see Figure 1 below) and Pakistan is one of the largest IMF debtors after countries such as Argentina, Egypt, and Ukraine (Go & Irwin-Hunt, 2023). The IMF provides financial packages in a variety of ways. Standby Agreements, for instance, are designed to provide short-to-medium-term financial assistance to countries facing balance of payments problems or economic challenges, whereas Extended Fund Facilities provide medium-term assistance. Both facilities are usually linked with some form of policy conditionality. The Extended Credit Facility, in turn, formulates more specific policy conditions. Lastly, the Structural Adjustment Facility Commitment provides concessional financing with lower interest rates and longer repayment periods compared to other IMF financing mechanisms to be more affordable for low-income countries with limited access to financial markets. The IMF delivers programs in Special Drawing Rights (SDRs), which function as an international reserve asset that is now based on a basket of major international currencies, including the US Dollar (USD), Euro (EUR), Chinese Renminbi (CNY), Japanese Yen (JPY), and British Pound Sterling (GBP). The IMF allocates SDRs to its member countries in proportion to their quotas, which are determined based on each country's relative size in the global economy.

Figure 1: IMF Programs to Pakistan

Form of Funding facility	Year of Facility Finalization	Agreed funding (in million USD)
Standby Arrangement	1958	33.13
Standby Arrangement	1965	49.69
Standby Arrangement	1968	99.38
Standby Arrangement	1972	111.30
Standby Arrangement	1973	99.38
Standby Arrangement	1974	99.38
Standby Arrangement	1977	106
Extended Fund Facility	1980	1,680,13
Extended Fund Facility	1981	1,217,70
Standby Arrangement	1988	257,06
Structural Adjustment Facility Commitment	1988	506,16
Standby Arrangement	1993	116,60
Extended Fund Facility	1994	227,90
Extended Credit Facility	1994	227,90
Standby Arrangement	1995	390,88
Extended Credit Facility	1997	351,13
Extended Fund Facility	1997	149,14
Standby Arrangement	2000	616,14
Extended Credit Facility	2001	1,140,85
Extended Credit Facility	2008	6,540,33
Extended Fund Facility	2013	5,280,84
Extended Fund Facility	2019	1,383,33
Extended Fund Facility	2021	3,643,82
Standby Arrangement	2023	2,981,31

Source: Calculations based on IMF documents

Despite continued assistance from the IMF, the Pakistani economy has failed to take off even as other Asian economies, including in South Asia, have done so. This paper investigates the bailout politics between the IMF and Pakistan since 1947. Pakistan's current economic issues highlight a complex interplay between poor economic management decisions, foreign policy strategies that have undermined growth and domestic stability, and misguided IMF loans that sustained debt dependencies while enforcing severe austerity measures.

The paper is structured as follows. The first section discusses the condition of the Pakistani economy following partition up until 1965, the year of the second war with India. The subsequent section covers the period from 1965 until 1978, including the war in East Pakistan. The third section then covers the years under Zia ul-Haq, who attracted increased investment from the US and the Gulf monarchies but also affected long-term development in various ways. The last sections then examine trends under the first hybrid regime (1988-1999), the Musharraf years (1999-2008), and the second hybrid regime (2008-now).

From Partition to the first bailout

Following the partition of British India in August 1947 into India and Pakistan (comprising East Pakistan, now Bangladesh, and West Pakistan, present-day Pakistan), both countries inherited the underlying structures of the colonial economy. Agriculture was the backbone of the Pakistani economy, employing the majority of the workforce and contributing significantly to the country's gross domestic product (GDP). The agricultural sector primarily focused on the cultivation of crops such as wheat, rice, cotton, sugarcane, and maize. Additionally, livestock farming was an essential component of agricultural activities. Pakistan's industrial base was relatively underdeveloped due to colonial neglect, with industrial output being primarily limited to small-scale manufacturing industries, including textiles, food processing, and handicrafts (Gupta, 2022). The country relied heavily on exports of agricultural commodities such as cotton and jute from East Pakistan for revenue generation and foreign exchange earnings (Gupta, 2022). The lack of infrastructure, technological capabilities, and skilled labour, a result of colonial-era labour market structures, posed significant hurdles to industrial development. Due to Pakistan's previous integration into British India, the newly formed country inherited a complex structure of trade networks and dependencies that was significantly disrupted by partition and the immediate deterioration of the bilateral relationship with India over the contest for Jammu and Kashmir (J&K). As commercial connectivity with India plummeted, Pakistan faced trade imbalances and challenges in establishing new trade routes and partnerships. Partition also led to the division of cross-border infrastructure assets, and Pakistan continued depending on colonial-era infrastructure networks geared toward asserting British control in South Asia. Lastly, partition had led to massive population displacement and a refugee crisis, with millions of people migrating between India and Pakistan. The influx of refugees posed humanitarian challenges and placed additional strains on resources and infrastructure in both countries. The inheritance of parts of the British colonial economy as well as the upheaval generated by partition thus fostered immediate structural-economic challenges.

These challenges would define Pakistani policy priorities in the post-partition era, ultimately exacerbating structural imbalances in the economy. As it sought to establish administrative and institutional frameworks, address refugee rehabilitation, and build infrastructure, the government embarked on ambitious development plans to foster economic growth and alleviate poverty. However, the underlying weaknesses of the economy meant that the government faced challenges in managing its finances, mobilizing revenue, and addressing external imbalances. The country's import-heavy economy, coupled with low export earnings in often noncompetitive domains, exacerbated its vulnerability to external shocks. Moving into the 1950s, Pakistan thus faced a severe balance of payments crisis characterized by a persistent current account deficit and dwindling foreign exchange reserves. The imbalance between imports and exports, coupled with external debt obligations, led to a situation where the country struggled to meet its international payment obligations. In 1950, Pakistan joined the IMF.

Faced with a significant drop in foreign exchange reserves, the IMF launched its first bailout program in Pakistan in 1958. On the back of balance of payment challenges, Islamabad had begun encountering difficulties in managing its finances effectively, with fiscal deficits being prevalent due to factors such as low tax revenue collection, high government expenditure, and subsidies on essential goods. Pakistan's external debt burden was also escalating as the country relied on external borrowing to finance development projects and meet budgetary requirements, leading to a growing debt burden that strained its fiscal base (Abbasi, 2019). Whilst these issues were not unique to Pakistan, Pakistan's economic capacity to respond to the challenges was limited due to the economy's structural fragility, manifested in its heavy reliance on agriculture, limited industrial diversification, and inadequate infrastructure. Structural weaknesses were further amplified by the lack of effective policy coordination mechanisms as policy formulation and implementation often remained fragmented, leading to inconsistencies and inefficiencies in economic management. The global and regional trade environment also contributed to Pakistan's economic difficulties as fluctuations in commodity prices, adverse weather conditions affecting agricultural output, and geopolitical tensions with India exacerbated the effects of structural weaknesses. The need for the first IMF bailout was thus driven by a combination of internal and external factors, including balance of payments pressures, fiscal imbalances, structural weaknesses, and external shocks. IMF assistance was sought to address immediate financing needs, stabilize the economy, and implement policy reforms aimed at promoting sustainable economic growth and stability. As part of the program, Pakistan received a total of $33.13 million (IMF, 2020). The first IMF program laid the foundation for Pakistan's engagement with international financial institutions and signalled the country's willingness to adopt policy reforms in exchange for external assistance. However, the need for the program also reflected the complex factors shaping Pakistan's economy in the post-partition era, with both underlying weaknesses in the economy and elements of mismanaged governance undermining performance.

1965-1978: The India-Pakistan war & independence of Bangladesh

In 1965, India and Pakistan went to war again in their contest over control over J&K. By August 1965, Indian and Pakistani units had begun repeatedly engaging in cross-border skirmishes. Although the clashes escalated, leading to casualties on both sides, the British Prime Minister Harold Wilson managed to negotiate an initial ceasefire. However, tensions escalated into a full-blown conflict in September, when Pakistani forces crossed the Line of Control (LOC) and launched a large-scale incursion into Indian-administered J&K to foment an insurgency and support Kashmiri separatists. Both sides engaged in intense fighting across multiple fronts, including in J&K, Punjab, and Rajasthan that saw Delhi and Islamabad suffer significant casualties and incur heavy equipment losses. On 22 September, India and Pakistan signed a ceasefire agreement amid significant international pressure from the United States and the United Nations. In January 1966, the two sides signed the Tashkent Agreement, mediated by the Soviet Union, which restored peace and 'normalized' relations between India and Pakistan (Latif & Adil, 2022). Pakistan's increasingly hostile posturing toward India under the military dictatorship of Ayub Khan had led to renewed and intensified border tensions.

The 1965 war had significant economic repercussions for Pakistan, which ultimately led to the country facing financial difficulties and seeking renewed assistance from the IMF. The build-up to the war had resulted in a substantial increase in defence spending as Khan began mobilizing resources to fight India. The cost of financing the war effort, including military operations, procurement of weapons and equipment, and troop deployments, further strained Pakistan's fiscal resources (Chawla, 2001). In March 1965, the IMF thus provided a standby agreement worth $49.69 million to Pakistan (IMF, 2020). The eventual conflict disrupted economic activities in Pakistan, particularly in the affected border regions, by damaging infrastructure, disrupting trade routes, and displacing populations (Sreedhar, 1975). The war thus exacerbated budget imbalances while further undermining Pakistan's already weak economic infrastructure. Investor confidence was undermined, and foreign investment inflows dwindled amid geopolitical tensions and uncertainties surrounding the conflict. The combination of increased defence spending, economic disruptions, and trade challenges contributed to a balance of payments crisis in Pakistan as Pakistan once again began to struggle to finance its import requirements, service external debt obligations, and maintain adequate foreign exchange reserves. Faced with mounting economic challenges and a deteriorating financial situation, Pakistan turned to the IMF, which provided an additional $99.38 million in support (IMF, 2020). Unlike in 1958, a worsening of economic conditions was clearly shaped by Pakistani foreign policy decisions - a trend that would define the following years and decades.

Besides the war with India, the independence of Bangladesh marked another severe shock to the Pakistani economy. East Pakistan had been systematically marginalized by elites in West Pakistan in terms of the delivery of public services and investments (Akmam, 2002). This policy agenda was driven by a perception of Bengalis as racially inferior, impure, effeminate, and frequently more akin to the Hindu population of West Bengal in India (Guruswamy, 2016). Bengali nationalists thus began demanding greater autonomy for the Eastern wing, leading to a rapid deterioration in political relations between East and West Pakistan. In the ensuing war of 1971, in which Bengali nationalists were supported by India, Pakistan ultimately suffered a humiliating defeat that saw Bangladesh gain independence in December 1971. Bangladesh's secession resulted in the loss of valuable economic assets for Pakistan as East Pakistan had been a major contributor to Pakistan's economy, accounting for a significant share of agricultural production, industrial output, and foreign exchange earnings. The loss of this economic base had profound implications for Pakistan's economic structure and development trajectory. Trade routes, transportation networks, and economic linkages between East and West Pakistan were severed, leading to trade disruptions and logistical challenges for Pakistan's economy. The loss of access to East Pakistani markets and resources further exacerbated Pakistan's economic difficulties. The economic costs of the 1971 war, including military expenditures, reconstruction efforts, and humanitarian assistance, also imposed a heavy burden on Pakistan's finances. The diversion of resources towards military expenditures and conflict-related expenses strained Pakistan's fiscal position and hindered economic development initiatives. As in 1965, poor strategic decisions and a tendency to resort to violent conflict resolution mechanisms came to undermine Pakistan's long-term growth trajectory. Pakistan's dependence on IMF financing support sharply intensified as a result of the war. Under the civilian government of Zulfikar Ali Bhutto, Pakistan entered four standby agreements with the IMF between 1972 and 1978 worth a total of $417 million (IMF, 2020). Bhutto also renationalized significant parts of the industrial sector (Khan & Kim, 1999). As its economic and industrial base deteriorated as a result of foreign policy mishaps, the broader growth trajectory of Pakistan began to decline as well.

1978-1988: Zia ul-Haq and financing diversification

The rise of General Muhammad Zia-ul-Haq, who came to power following a military coup in July 1977, had a profound impact on Pakistan's economy. Zia's regime implemented a series of economic policies and reforms that aimed to address the country's economic challenges and promote a specific vision of Islamization and conservative governance. One of the key aspects of the new military regime was the promotion of Islamization policies, which sought to Islamise various aspects of society, including the economy, by introducing Islamic banking and financial systems, emphasizing interest-free banking (Riba-free), and implementing Sharia-compliant economic practices (Nagaoke, 2012). At the same time, Zia initiated policies to privatize State-owned enterprises and deregulate parts of the economy following Bhutto's nationalization effort to reduce the government's role in the economy, promote private sector growth, and improve efficiency and competitiveness (Khan & Kim, 1999). After Pakistan became a key supporter of the Afghan Mujahideen following the Soviet invasion of Afghanistan in 1979, Zia also significantly increased military spending, which had further implications for government finances and reduced investment in other sectors of the economy (Chawla, 2001). In line with the Islamization of Pakistan's domestic and foreign policy, the regime thus oversaw the alteration of domestic economic structures.

Connected to the war in Afghanistan, one key change that occurred under Zia was the increased influx of aid and investment from the United States. The Soviet invasion of Afghanistan entrenched Pakistan's role as a key US ally in Central and South Asia, meaning that enhanced aid and investment were seen as essential components of strengthening the strategic partnership between the two countries and supporting Pakistan's role in the war in Afghanistan (Ali, 2009). Military cooperation between the United States and Pakistan thus deepened under Zia as Pakistan served as a conduit for US military assistance to Mujahideen fighters. The United States also provided military aid, equipment, and training to bolster Pakistan's military capabilities, which were instrumental in supporting the Afghan resistance against Soviet forces (Ali, 2009). However, Washington's collusion with the military establishment in Pakistan also strengthened the establishment's increasingly consolidated domestic role. In addition to military aid, the United States provided economic assistance and investment to Pakistan to support its economic development and promote pro-Western economic policies aligned with US interests. The influence of neoliberal US thinking on economic policy thus likely shaped

Zia's attempt to deregulate the economy and allow for increased foreign direct investment. Changing geostrategic environments thus also had key ramifications for the structure of the domestic economy.

The second major economic change under Zia was the growing exposure to and dependence on financial flows from the Gulf States. The Gulf States, particularly Saudi Arabia and the United Arab Emirates (UAE), provided enhanced aid and investment to Zia's regime in Pakistan for several strategic reasons. Broadly underpinning this rapprochement was the convergence of geopolitical objectives: Zia's promotion of Islamization policies resonated with the Gulf States, which valued Pakistan's commitment to Islamist principles and converged in its opposition to communism (Weinbaum & Khurram, 2014). Following the Iranian revolution of 1979, Zia also firmly positioned Pakistan in the Sunni camp led by Saudi Arabia, including by ramping up repression against Shia communities in Pakistan (International Crisis Group, 2022). Pakistan also provided military training and support to the Gulf States, including through the stationing of up to 20,000 troops in Saudi Arabia (Jaffrelot, 2017). Furthermore, Pakistan's geographical proximity to the Gulf and its growing energy needs made it a primary export destination for energy deliveries. Reflecting its broader reorientation in foreign policy toward the US and its allies in the Middle East, the military establishment thus began closely cooperating with the conservative Gulf monarchies.

This alignment had long-term effects for the domestic economy by raising the overall public debt levels. While the aid and investment from the Gulf States provided short-term economic benefits, it also created a degree of dependency and indebtedness. Pakistan's reliance on external assistance, including loans and grants from the Gulf States, increased its vulnerability to external economic shocks and geopolitical pressures. This also extended to funding from the United States, which contributed to Pakistan's debt burden and long-term economic vulnerabilities. Furthermore, deregulation measures frequently contributed not to enhanced competitiveness between firms but to the capture of entire industries by individual family conglomerates, such as the Sharifs (Sattar & Gupta, 2022). As such, the alignment with the Gulf States and the US drove up debt while allowing for increased economic concentration and industrial consolidation.

Beyond economic considerations, the influx of especially Gulf money also directly contributed to the growing radicalization of Pakistani society. Gulf States, especially Saudi Arabia, adhered to Wahhabi Islam, a conservative and puritanical interpretation of Sunni Islam. They actively promoted this ideology in Pakistan through financial support to religious institutions, mosques, Madrassas (religious seminaries), and missionary activities (Afzal, 2019). This funding facilitated the spread of Wahhabi teachings, which often clashed with the traditional Sufi-influenced practices prevalent in Pakistan. Gulf funding therefore played a significant role in the proliferation of Madrassas across Pakistan. While some Madrassas focused on providing education, others became breeding grounds for radicalization, promoting extremist ideologies and recruiting fighters for militant groups (Craig, 2015). Crucially, much of the fighting force of the Afghan Taliban was later raised from refugee communities that had fled Afghanistan and had been educated in partially Saudi-funded Madrassas in Pakistan (Maizland, 2023). Pakistan's alignment with the Saudis and its support for Saudi funding thus had indirect long-term ramifications for the wider region by raising a new generation of often traumatized and radicalized young men who would later become part of various militant organizations in Afghanistan and Pakistan. Gulf funding also supported militant groups in Pakistan, particularly those involved in the Afghan Jihad against the Soviet Union. While the objective was to bolster resistance against the Soviet occupation of Afghanistan, some of these groups later turned their focus towards domestic extremism and violence or inspired later iterations of radicalized outfits. More broadly, the influx of Gulf funding influenced the religious discourse in Pakistan, shifting it towards a more conservative and sectarian narrative as Wahhabi interpretations gained prominence, leading to the imposition of stricter dress codes, gender segregation, and restrictions on personal freedoms. More broadly, the increased influence of radical teachings led to increased intolerance towards religious minorities and dissenting voices within Islam and contributed to the marginalization of moderate voices and the polarization of Pakistani society along religious and sectarian lines.

While having long-term effects on the Pakistani economy and domestic societal structures, increased funding from the US and the Gulf monarchies also did not reduce Pakistan's dependence on IMF programs. As noted, Pakistan's external debt burden increased significantly during Zia's rule, primarily due to large-scale borrowing to finance military expenditures, development projects, and budgetary deficits, which strained the country's balance of payments and undermined the State's ability to service debt obligations. Exacerbated by factors such as declining export earnings, rising import bills (particularly for oil), and external debt servicing obligations, Pakistan experienced recurrent balance of payments crises during the 1980s that put pressure on Pakistan's foreign exchange reserves and necessitated external financial assistance to stabilize the economy. Furthermore, macroeconomic instability manifested in high inflation, volatile exchange rates, and fluctuating economic growth. These imbalances undermined investor confidence, contributed to capital flight, and hindered sustainable economic development. Under Zia, Pakistan thus underwent two IMF programs worth a total of almost $3 billion (IMF, 2020). Shortly after Zia's death in a plane crash in August 1988, Pakistan entered another two programs amounting to more than $763 million (IMF, 2020). The existence of and need for those programs exemplified that the foreign policy reorientation advanced by Zia and the military establishment exacerbated rather than alleviated debt dependencies.

1988-1999: Hybrid regime economics

The death of Zia marked the return to a civilian government that worked in close cooperation with the military establishment, translating into the rise of a hybrid regime. Zia was succeeded as President by Ghulam Ishaq Khan, then Chairman of the Senate. In November 1988, the transitional administration held general elections that saw the victory of the Pakistan People's Party (PPP) led by Benazir Bhutto, the daughter of Zulfikar Bhutto. In 1990, Benazir Bhutto was replaced by a conservative coalition government led by Nawaz Sharif after Bhutto had been sacked by President Khan due to corruption allegations in 1990, paving the way for new general elections (Reuters, 2007). The Pakistani Inter-Services Intelligence (ISI), Pakistan's primary military establishment institution and the country's premier intelligence agency, supported the Sharif-led alliance as a counterweight to the left-leaning PPP (Yasmeen, 1994). The 1988 and 1990 elections thus reinforced a growing coalition between the military establishment, most notably the ISI, and conservative Islamists (Hughes & Shaffer, 2021). Once in power, the Sharif government promoted the deregulation of the economy by encouraging liberalization, privatization, and seeking to attract greater foreign capital inflows (Bhowmik, 1995, p. 932). Over time, Sharif's relationship with the military establishment fractured, ultimately leading to the return of Benazir Bhutto as Prime Minister in 1993. When Bhutto sought to assert power, however, the military establishment again replaced her with Sharif in 1997. Despite the return to ostensibly civilian rule, the military thus continued playing the dominant role in Pakistan's political system.

As in the 1980s, underlying economic issues meant that Pakistan kept on returning to IMF support programs to keep its economy afloat. As discussed, Pakistan experienced economic instability characterized by high inflation, fiscal deficits, balance of payments crises, and external debt accumulation despite periods of economic growth during Zia's rule. The heavy reliance on external borrowing to finance military expenditures, development projects, and budgetary deficits led to unsustainable debt levels and fiscal imbalances. Between 1993 and 1997, Pakistan thus resorted to support from the IMF on six occasions, receiving a total of $2.95 billion in funding - a much higher amount than ever before (IMF, 2020). The IMF programs aimed to restore macroeconomic stability by addressing inflationary pressures, stabilizing exchange rates, and reducing fiscal deficits. Additionally, the programs aimed to improve Pakistan's external balance by reducing the current account deficit and building foreign exchange reserves by promoting export growth, curbing import demand, and addressing external debt sustainability concerns. To enable a structural reform of the Pakistani economy, reforms aimed to enhance economic efficiency, promote private sector development, and improve the business environment. Key areas of focus included trade liberalization, privatization, deregulation, tax reforms, and public sector restructuring. The increased rather than reduced dependence on IMF support embodied the economic quagmire previous administrations under military control had created.

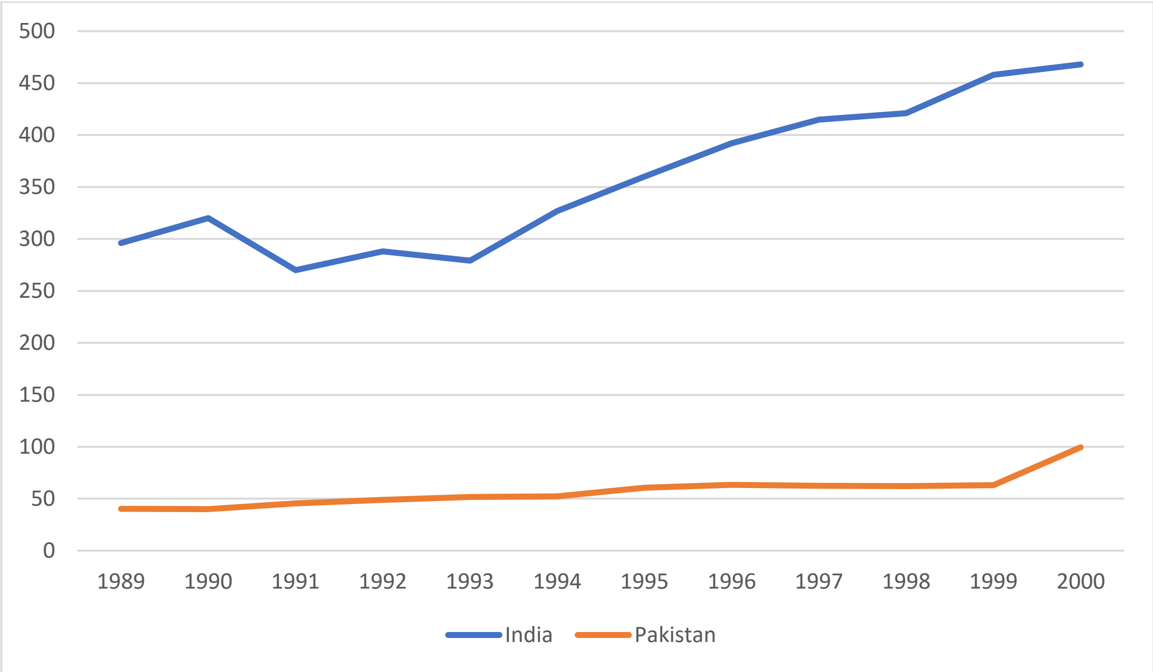
While IMF programs aimed to address economic imbalances and promote long-term sustainability, the implementation of austerity measures and structural reforms often had adverse effects on ordinary Pakistanis. IMF programs typically require governments to implement austerity measures to reduce budget deficits and stabilize the economy. These measures often involve cuts in public spending, including social welfare programs, education, healthcare, and subsidies (Ray, 2021). As a result, civilians, particularly the poor and vulnerable, frequently face reduced access to essential services and support systems (Human Rights Watch, 2023). Measures aimed at reducing inflation and fiscal deficits can also lead to price increases for essential goods and services that disproportionately affect low-income households, exacerbating poverty and economic hardship. IMF-promoted deregulation and labour market reforms lead to job losses, wage cuts, and precarious employment conditions. As fiscal consolidation and expenditure rationalization is emphasized, this contributed to reductions in social assistance, welfare benefits, and unemployment insurance that left vulnerable populations without adequate support, increasing the risk of poverty, inequality, and social exclusion. Lastly, austerity measures surrounding health and education undermined access to quality healthcare and education, particularly for marginalized communities while enhancing the demand for private institutions, including poorly regulated Madrassas. In Pakistan and elsewhere, the effects of IMF programs thus disproportionately disadvantage already marginalized populations while further weakening long-term State capacity.

Pakistan's economic development was also once again affected by foreign policy decisions such as the 1998 nuclear tests. In May 1998, India conducted a series of nuclear explosions now commonly known as the Pokhran-II tests. The successful execution of these tests made India a de facto nuclear power that operated in overt violation of the Non-Proliferation Treaty, which Pakistan had also not signed. Less than two weeks later, Pakistan conducted its own series of nuclear tests (Rizvi, 2001). The testing of the nuclear arsenal replaced Pakistan's previous strategy of nuclear ambiguity with one that was aimed at maintaining a "credible minimum deterrent" vis-à-vis India (The Nuclear Threat Initiative, 2019). The India-Pakistan conflict now had obtained a nuclear dimension. In response to the Indian and Pakistani nuclear explosions, the US momentarily cut off aid to Islamabad and New Delhi in accordance with the Glenn Amendment, which the US Congress had passed in 1994 as part of the Arms Export Control Act. Under the Glenn Amendment, any US government was prohibited from delivering any economic and military assistance to any non-nuclear-weapon State that carries out a nuclear explosion (Wagner, 2001). The sanctions imposed on India and Pakistan included the suspension of economic and military assistance, restrictions on high-technology trade, and the withdrawal of loans from international financial institutions such as the IMF. Once again, tensions with India came to weaken the national economy.

The economy took a further hit during the 1999 Kargil War with India. In early May 1999, Pakistani troops entered the Kargil district on the Indian-administered side of J&K. The conflict ended in late July with the complete withdrawal of Pakistani regular and irregular forces from Indian-administered territory, restoring the territorial status quo ante bellum and inflicting a humiliating defeat on Pakistan. The war with India had immediate implications for Islamabad's relations with the US. Despite its long-standing strategic partnership with Pakistan, the US supported India's rather than Pakistan's diplomatic position as Washington called on Pakistan to immediately withdraw its troops from the Indian side of the LOC and work towards a peaceful resolution of the conflict. Pressure on the Sharif government also ramped up as Washington had not been informed about the Pakistani plans to attack in advance (Riedel, 2019). The war thus further isolated Pakistan from the United States.

Continued bailout politics and various foreign policy challenges ultimately meant that Pakistan missed a crucial window of opportunity for becoming more closely integrated into global supply and value chains following the end of the Cold War. As Figure 2 indicates, the 1990s were a period in which the Indian economy begun to take off while the Pakistani economy largely stagnated.

Figure 2: Total GDP (in billion USD) of India and Pakistan (1989-2000)



Source: World Bank data

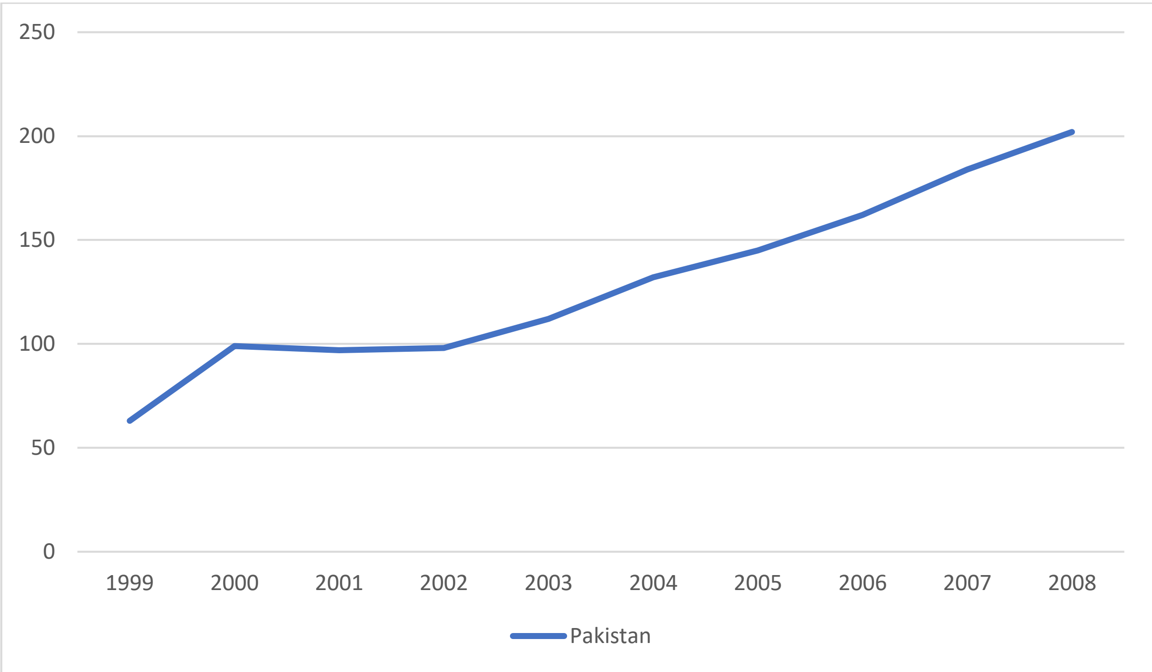
Despite the transition from military rule under Zia toward a more hybrid regime that included a stronger civilian government, the economy continued to struggle. Indeed, Pakistan ended up becoming more, not less, dependent on support from the IMF. This reflected long-standing payment issues that had been driven up further by Zia's growing dependence on American and Gulf State funding. However, the politics of debt persisted under the hybrid regime as the underlying power arrangement within Pakistani elite politics was not modified. As the military establishment continued focusing on its rivalry with India rather than economic recovery and development, the State's fiscal situation continued deteriorating while the lives of Pakistani citizens grew materially worse.

1999-2008: The Musharraf years

Following the defeat in the Kargil War, the relationship between the military establishment and the civilian government of Nawaz Sharif began to rapidly deteriorate, culminating in General Pervez Musharraf staging a coup d'etat in 1999 and re-establishing direct military rule. Sharif squarely blamed the loss on Musharraf who, as Chief of Army Staff, had been responsible for devising the overall war strategy and, according to Sharif, had made the decision to ultimately go to war. Sharif then sought to dismiss Musharraf and prevent him from re-entering Pakistan during a trip Musharraf made to Sri Lanka in October 1999. In response, Musharraf-administered military forces took control over public infrastructure and detained Sharif. On the 14th of October 1999, Musharraf declared martial law, suspended the Pakistani Constitution, and dissolved the National Assembly alongside four province-level assemblies. Pakistan therefore returned to direct military rule.

The Musharraf administration presided over a rapid economic growth period. Musharraf's government implemented economic reforms aimed at stabilizing the economy and promoting growth via fiscal consolidation, monetary policy tightening, exchange rate adjustments, and the privatization of State-owned enterprises (Bashir, 2022). The fiscal deficit was reduced, and foreign exchange reserves increased, contributing to improved macroeconomic stability and investor confidence. This was reflected in the growing influx of foreign direct investment, which remained relatively modest compared to other emerging markets but generally increased during Musharraf's rule (Khizar, 2023). Enhanced FDI thus allowed for industrial expansion in sectors such as manufacturing, services, telecommunications, and construction. These positive elements of economic performance were reflected in GDP growth rates (see Figure 3 below).

Figure 3: Total GDP (in billion USD) of Pakistan under Musharraf (1999-2008)



Source: World Bank data

As was the case under Zia, one key factor driving strong macroeconomic performance was Afghanistan-related military aid and economic assistance from the United States that accelerated following the American invasion of Afghanistan in 2001. After the 9/11 attacks, Musharraf faced growing international pressure to clamp down on Jihadist networks in Pakistan, which were closely linked to the Afghan Taliban and Al-Qaeda (Yamin, 2015). Although Musharraf's opposition towards extremist groups was highly inconsistent (as his government only targeted groups that were deemed anti-Pakistan, with significant leeway given to groups that the State could employ as strategic assets in Afghanistan and India), his regime thus emerged as a key partner for the US' anti-Taliban missions in Afghanistan (Tellis, 2007, p. 4). A case in point were the intensification of counterterrorism operations in North and South Waziristan in the Federally Administered Tribal Areas (FATA) and the granting of significant "staging and overflight support" for American air force and drone operators, including through the lease of an airfield in Balochistan to the CIA (Haqqani, 2016, p. 336). As it expanded operations in Afghanistan, the United States significantly increased economic assistance to Pakistan via military aid, development assistance, and economic support aimed at bolstering Pakistan's capacity to fight terrorist groups and support American military operations in Afghanistan (Fort, 2007). Washington also supported efforts to provide economic relief and assistance to Pakistan through debt relief initiatives, bilateral aid programs, and multilateral assistance efforts that aimed to address Pakistan's balance of payments challenges and promote sustainable economic development (Momani, 2004). In the context of the Global War on Terror, American economic support was frequently conditioned on Pakistani support for American counterterrorism operations in Afghanistan and the Pashtun heartlands in the Hindu Kush. Like Zia, Musharraf and the Pakistani economy therefore benefited from the short-term influx of foreign capital linked to the United States' strategic objectives in Afghanistan. However, this also rendered macroeconomic performance dependent on the presence and extent of US financial assistance.

Despite strong growth rates, Pakistan's dependence on IMF bailouts continued to further accelerate under Musharraf. The IMF provided almost $2 billion in financial support to the Musharraf government in two separate programs in 2000 and 2001 respectively (IMF, 2020), with the larger assistance package being passed in December 2001 - just as the United States ramped up operations in Afghanistan and sought to incentivize Pakistani support for its presence in the country. While Musharraf could thus leverage Pakistan's strategic significance for Washington's counterterrorism operations in negotiations with the IMF and thus indirectly with the United States, the growing financial volume of IMF bailouts also reflected the continued fragility of the Pakistani economy.

While overseeing a period of strong economic performance, Musharraf's dualistic approach toward Islamic extremism also contributed to the development of long-term conditions that have undermined the growth prospects of Pakistan's economy. As noted, Musharraf selectively supported American counterterrorism operations while bolstering Islamist outfits that could be used as assets in Afghanistan and India. Musharraf's publicly largely supportive position for the US and his crackdown on anti-Pakistani Islamists nevertheless alienated large elements of Pakistan's Islamist scene (Hoodbhoy, 2017). In July 2007, the Pakistani Army besieged the Red Mosque in Islamabad, in which Islamist teachers and students had barricaded themselves while advocating for the nation-wide implementation of Sharia law (Sayed & Hamming, 2021). When the Army stormed the mosque, it killed up to 40 Islamists (Gall & Masood, 2007). The siege on the Red Mosque marked a major inflection point for large parts of Pakistan's Islamist scene, already disillusioned by the State's support for the US. In the months following the siege, Pashtun Jihadi leaders gathered in the FATA and held a Shura (Pashto for council) that culminated in the founding of the Tehrik-i-Taliban Pakistan (TTP). The TTP then launched an anti-State terror campaign and has been significantly strengthened following the Taliban's victory in Afghanistan in 2021, which has allowed the TTP to launch a growing number of cross-border attacks into Pakistan (Afzal, 2022). The growing presence and capacity of extremist groups in Pakistan undermines the security of assets and investments, thus restricting international investments. As such, Musharraf’s approach toward managing Islamist groups has had detrimental effects for the long-term sustainability of the Pakistani economy.

2008-now: Return to hybrid rule and fiscal deterioration

Pakistan returned to civilian rule in 2008 following the ousting of Musharraf, with subsequent civilian administrations continuing to rely on support from the IMF while partially pursuing closer economic relations with China. The new civilian government of Asif Ali Zardari oversaw the implementation of a new IMF bailout worth more than $6.5 billion - the largest single bailout in Pakistani history up until that point. The new civilian government also had to grapple with volatile coalition dynamics, a worsening security situation, and a broader economic downturn amid the Global Financial Crisis. When Nawaz Sharif returned as Prime Minister following the 2013 general elections, Sharif negotiated a renewed IMF bailout worth an additional $5.28 billion (IMF, 2020). To spur on investment, Sharif also began promoting Chinese investments in Pakistan under China’s Belt-and-Road Initiative (BRI). In 2015, Chinese and Pakistani representatives formally launched the China-Pakistan Economic Corridor (CPEC), which connects the port of Gwadar in Balochistan with the Chinese city of Kashgar in Xinjiang. Pakistani policymakers hope that CPEC can bolster Pakistan’s integration into global trade networks, provide external infrastructure investment, and address Pakistan’s chronic electricity shortages (Amir, 2016). CPEC consists of several mining projects, the construction of power plants, the upgrading and construction of new transport infrastructure throughout Pakistan, the establishment of special economic zones (SEZs), and the broader investment in regional connectivity (Khan & Anwar, 2016). Worth up to $62 billion, CPEC was hailed by the Sharif government as a ‘game changer’ for the Pakistani economy and signalled both China’s emergence as a leading international lender as well as Pakistan’s increasingly close economic relationship with Beijing.

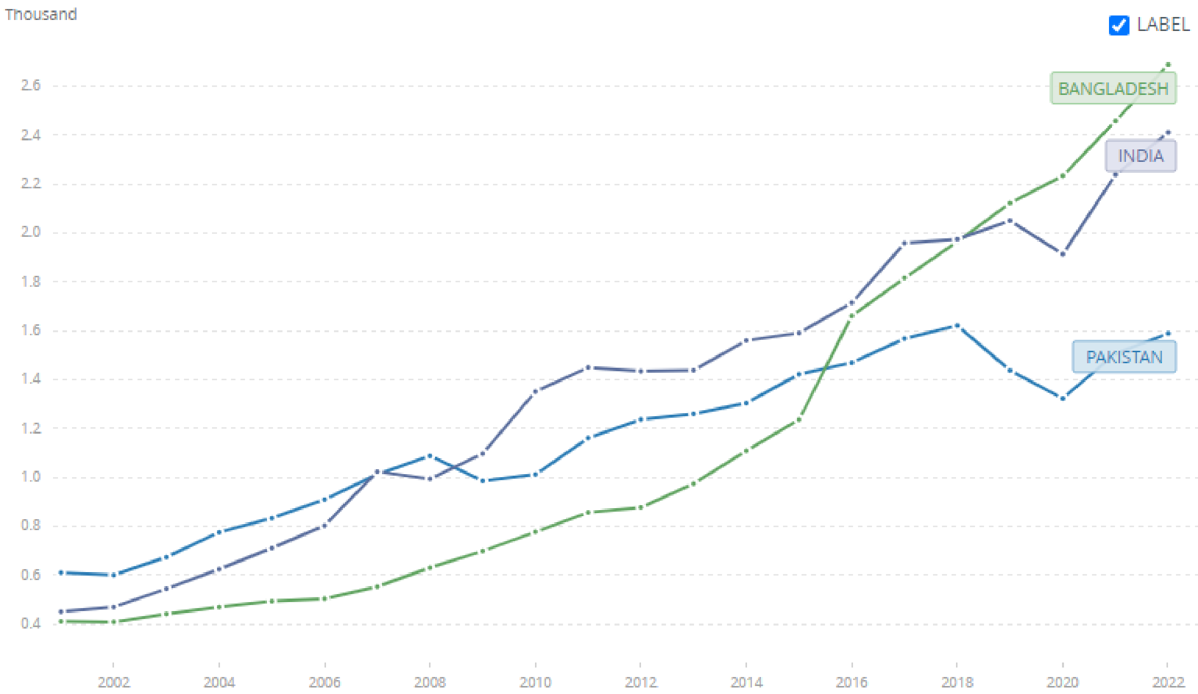
The growing relationship with China was intensified by Sharif’s successor Imran Khan, under whom Pakistan became increasingly dependent on Chinese financing. Khan, who was elected in 2018, negotiated a 2019 bailout package worth $1.38 billion from the IMF (IMF, 2020). However, IMF austerity-focused loan conditionalities frequently clashed with Khan’s populist policies, such as sustained subsidies for basic goods, and led to parts of the program not being paid out to the Khan government (Deutsche Welle, 2022). Under Khan, China rapidly emerged as Pakistan’s largest public creditor: by 2013, only 9.3% of Pakistan's total public debt of $44.35 billion was owed to China (Younus, 2021). By 2021, this debt had grown to $90.12 billion, 27.4% of which was owed to China (Younus, 2021). Much of this debt has been accumulated as a result of Chinese investments under CPEC. Chinese investments have thus further burdened Pakistan’s fiscal structure.

Since then, the COVID-19 pandemic and the catastrophic floods of 2021 have further complicated matters for the embattled economy. The pandemic hit Pakistan hard and in August 2021, the IMF provided $2.75 billion in COVID-related financial assistance (Reuters, 2021).

The fund provided another $1.1 billion in funding in response to the floods, although this sum was part of the 2019 bailout package that had been withheld as Khan did not deliver on loan conditionalities (Deutsche Welle, 2022). To access IMF funding, the Shehbaz Sharif government implemented highly unpopular austerity measures, including the slashing of fuel subsidies. On top of external shocks, IMF conditionalities thus exacerbated the suffering of the civilian population. Yet, Pakistan remains dependent on IMF funding, and the present government stated in March 2024 that a renewed IMF bailout is *"inevitable"* (Shahzad, 2024). While avoiding sovereign default, Pakistan's economy has slumped along without any real sign of improvement and no real prospects for progress.

Faced with these various issues and the complications associated with bailout politics, the Pakistani economy has ultimately failed to develop apace with comparable regional economies such as that of India and Bangladesh. Although GDP per capita has increased slightly in Pakistan since the period of relative growth under Musharraf, both India and Bangladesh have registered significantly stronger macroeconomic performances in the 21st century (see Figure 4 below).

Figure 4: GDP per capita (in thousand USD) in Bangladesh, India and Pakistan (2001-2022)



Source: World Bank (2024)

At the end of the day, Pakistanis had a comparable starting position relative to India and Bangladesh at the turn of the millennia. Faced with continued economic mismanagement, austerity measures, and external crises, however, everyday Pakistanis are now significantly less materially prosperous and less secure than their counterparts in India and Bangladesh. The IMF has decisively contributed to this misery through its 'pretend-and-extend' bailout politics: while IMF loans help to prevent sovereign default, Pakistan is simply incapable of repaying the loans provided by the IMF and lacks the underlying economic capacity to significantly alter its economic structures in a way that would allow for improved long-term prospects. IMF loans have thus played a key role in keeping the economy afloat without enabling it to develop an improved long-term vision for Pakistani citizens. At the same time, Pakistani elites have shaped this situation through decades-long mismanagement, the sustenance of elite-focused economic structures that advantage them but fail ordinary people, and the pursuit of a foreign policy that has isolated Pakistan internationally while keeping its population in precarious and insecure conditions. The ultimate victim, as so often, is the Pakistani civilian population.

Conclusion

The IMF has played a key role in developments pertaining to the Pakistani economy since Pakistan joined the fund in 1950. Over time, Pakistan has become increasingly dependent on funding via the IMF as Pakistani policymakers have proven unable to stabilize historical balance of payments issues. Although IMF loans have had some short-term stabilizing effects, conditionality-linked austerity measures also reduce the capacity of the Pakistani economy to develop a healthy and long-term growth trajectory. As is the case elsewhere, the IMF must thus be viewed as part of the problem rather than part of the solution as its neoliberal policy prescriptions have directly contributed to the underlying structural weaknesses shaping contemporary Pakistani political economy.

At the same time, the fragility of the Pakistani economy is also the direct and logical outcome of decades of mismanagement and policy decisions that repeatedly deprioritize economic development and an improvement in living standards. The geopolitical rivalry with India has dominated elite-level Pakistani decision-making processes since independence, leading to various wars and a broader policy approach that advances the interests of some institutional actors, most notably the military, while restricting policymakers' capacity to meaningfully improve regional relations and domestic livelihoods. In the same vein, Pakistan's long-term support for regional Jihadist outfits does not just affect Pakistani security today, most notably in the context of the TTP, but ultimately isolates Pakistan in the world and dissociates it from the integration of globally supply and value chains.

As noted, the people suffering most from this are ordinary Pakistanis that are left behind in a system that has at no point prioritized their needs and demands for a better and safer life. Ever since independence, Pakistan has remained a country for the elites and their increasingly delusional visions of a Pakistan that can compete with its hated rival, India.

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