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Debate

Pakistan, China and the Structures of Debt Distress: Resisting Bretton Woods

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ABSTRACT

Pakistan has received a total of 23 loan packages from the International Monetary Fund (IMF) between 1958 and 2023, and recurrent indebtedness has hindered structural transformation. Recent crises, such as the COVID-19 pandemic, surging commodity prices, Russia's invasion of Ukraine and diplomatic tensions between the United States and China, have exacerbated Pakistan's indebtedness. This debt has geopolitical importance given the rivalry between the US and China. Multilateral support for restructuring has been complicated by Pakistan's unique alliance with China through the China–Pakistan Economic Corridor, pivotal to the Belt and Road Initiative. This analysis of Pakistan's debt crisis explores this complexity by considering the Pakistani government's attempts to resist the IMF, particularly between 2018 and 2022, when the potential of China as an alternative source of financial support looked increasingly viable. Unlike less critical political analyses on debt, which tend to be preoccupied with endogenous governance failures and fiscal profligacy, this article focuses on the external drivers of debt. In doing so, it highlights the role of a hostile international legal system, standard-setting arrangements, rating agencies and arbitrary charges that impose huge economic burdens and undermine financial stability, as well as the constraints embedded in the global investment and financial architecture that persistently limit Pakistan's policy space.

INTRODUCTION

Pakistan is grappling with an economic crisis that has deep roots in the asymmetrical relations of sovereign debt and the global financial architecture. This crisis has been exacerbated by recent events including the COVID-19 pandemic and the Russia–Ukraine war. In this article, we consider the

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political nature of these asymmetrical relations and their structural causes, given Pakistan's engagements with sources of debt distress — particularly the Bretton Woods institutions, China, and other institutions that constitute an oppressive global financial architecture. As a recipient of 23 loan packages over the past 70 years, Pakistan offers an important case study of a low-middle-income country where external finance — in the form of debt — is embedded in the dominant economic governance and development model.

This article focuses on Pakistan's capacity to overcome the debt trap in which it currently finds itself. According to Pakistan's Ministry of Finance (2022), the country's external debt doubled to US$ 86.6 billion or 37 per cent of GDP between 2015 and 2022 (see Figure 1, below). Economic growth has been erratic: the economy experienced a strong recovery following the pandemic, rebounding from a contraction of 0.94 per cent in 2020 to grow 5.74 per cent and 5.9 per cent in 2021 and 2022 respectively. This trajectory has been accompanied by troublesome imbalances, with external factors such as geopolitics playing a critical role.

To mitigate these imbalances, in 2022 Pakistan became one of the first countries to sign up for the G20's Debt Service Suspension Initiative (DSSI). This initiative allowed for the temporary suspension of payments due to bilateral creditors from May 2020 to December 2021. However, it became evident that this temporary suspension was insufficient, and concerns from creditors about the possibility of a sovereign default became acute (Khaliq, 2020; Reed and Asgari, 2022). The sovereign default by Sri Lanka in April 2022 raised concerns, particularly because Pakistan's economic vulnerability was further heightened by extensive flooding in mid-2022. These floods affected vast areas of the country, leading to the displacement of 8 million people and the destruction of their livelihoods. Pakistan has resisted default so far, but this has largely been through piecemeal contributions — in the form of foreign exchange injections — from some countries. The need for a multilateral solution to debt reform is the subject of a complicated debate because a substantial portion of external debt has been issued by private creditors.

Pakistan's economic precarity is manifested in high inflation and widening inequality. This exacerbates political instability, with party politics undermining effective governance. A coalition government came to power after Imran Khan, leader of the Pakistan Tehreek-e-Insaaf (PTI), was removed through a vote of no confidence in 2022. This turn of events, as discussed in this article, is related to ambitious attempts by the PTI government to adopt an alternative economic approach. Our analysis of Pakistan's current situation of indebtedness draws linkages between historical context and emerging scholarship on global financial and monetary hierarchy. In this context, the global rise of China as a dominant lender and Pakistan's ally through the shared project of the China–Pakistan Economic Corridor

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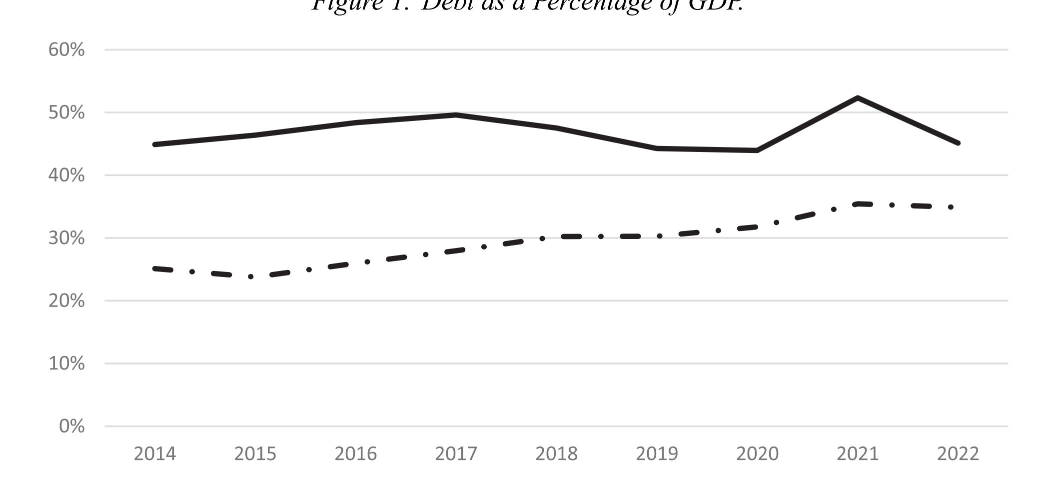
Figure 1. *Debt as a Percentage of GDP*.



Source: authors' compilation based on data from the Ministry of Finance (2022) and the State Bank of Pakistan (www.sbp.org.pk/ecodata/index2.asp, accessed 27 April 2023).

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(CPEC) poses a central question: can lender diversity impact Pakistan's developmental policy space?

Pakistan's geopolitical position and alliance with China set it apart from other debtor nations. Since 2013, China has played a significant role in Pakistan through CPEC, a part of the Belt and Road Initiative (BRI). As interest rates rise globally, Pakistan's debt obligations to US-dominated multilaterals, private creditors and China have become increasingly burdensome. This calls for renewed attention to the complexities of the country's financial and political constraints, which are not captured in the technical discussions about macroeconomic imbalances that the programmes from multilaterals seek to address.

Less critical political analyses on debt tend to focus on endogenous governance failures and a lack of fiscal prudence in debtor countries (Nanda, 2006). This analysis, by contrast, considers the external drivers of debt, highlighting the roles of disadvantageous international legal systems, standard-setting arrangements, rating agencies and arbitrary charges that impose huge financial burdens and undermine financial stability. Developing countries are integrated into the global financial architecture on adverse terms, which inhibit their developmental autonomy. Identifying the reproduction of indebtedness through the concrete ways in which the global financial architecture steers the developmental policy space in the global South allows for a structural analysis of serial debtors.

In this article we show how pressures exerted from institutions such as the International Centre for the Settlement of Investment Dispute (ICSID), the Financial Action Task Force (FATF) and credit rating agencies, as well as skewed penalties, worsen indebtedness. We draw on data and reports from government institutions, the State Bank of Pakistan (SBP) and multilateral institutions to analyse Pakistan's search for alternatives to the Bretton Woods-led financial order from 2018–22. Our contributions cover two evolving and interrelated areas of research using Pakistan as a case study: (1) the viability of China's political and economic support in countering the Bretton Woods institutional order in relation to debt and financial development; and (2) the constraints in the global investment and financial architecture that continue to determine the policy space of developing countries, despite alternative support.

The article provides an overview of Pakistan's relationship with external debt, and reviews perspectives on how external debt can constrain a country's policy space and cause multilateral loan programmes to fail, noting that Chinese debt comes across as an alternative to multilateral debt for Pakistan. The article has an empirical focus and examines how policy constraints between 2018 and 2022 impeded an elected government that was vocally opposed to multilateral debt and was eventually deposed. It expands on the empirical discussion by highlighting that indebtedness is a product not only of need and borrowing, but also of hostile international legal systems, standard-setting arrangements, rating agencies and arbitrary charges.

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The final section concludes by noting that Pakistan's experience with various external and structural constraints exemplifies persistent indebtedness as complex, political and crisis-prone.

The design of External Debt: Literature Review

The international political economy literature on the asymmetrical power relations of sovereign debt theorizes debt as a historical continuum shared by many countries in the global South, intrinsically connected to the contradictions and struggles of neoliberalism (Soederberg, 2013) and empire (Amin, 2011; Sylla, 2023). Debt and the social reproduction of indebtedness are structural features of a global financial architecture, even when national circumstances differ. Pakistan's case is illustrative of the political nature of external lending compounded by structural constraints which continue to contribute towards non-repayment.

The initial context of Bretton Woods lending to Pakistan can be located in Pakistan's geopolitics and the Cold War. US policy in South Asia and the Middle East enabled Pakistan to become a 'frontline state' serving in the regional curtailment of communism from the 1950s to the 1990s (Akhtar, 2010: 105; Khan, 2022). More recently, Pakistan's receipt of grants, concessional loans and military aid was a reward for its active role in countering the Soviet invasion of Afghanistan in 1979 and its alliance with the US in the so-called 'War on Terror' which began in 2001.

While reform targets dictated by the International Monetary Fund (IMF) and the World Bank remained unfulfilled, lending continued. During the period 1988–2000, a total amount of US$ 4.07 billion in IMF loans to Pakistan was agreed, although only US$ 2.10 billion, or 51.5 per cent, was actually disbursed (Anwar, 2006: 159). New World Bank targets were issued notwithstanding the country's poor reform record. Similarly, despite poor economic progress, IMF lending decisions remained firmly embedded in Pakistan's external political alliances. Pakistan's cooperation with the US in the War on Terror was a major driver in restoring IMF funds suspended when Pakistan tested its nuclear weapons. The political importance of Pakistan to the IMF is evidenced by the fact that in 1999 Pakistan was one of the developing countries with the most staff working for the IMF (Barro and Lee, 2002). Evaluating a series of IMF lending policies to different countries since 1980, the IMF's (2002) independent evaluation office report highlighted Pakistan as a classic example of a country to which IMF loans were largely politically motivated.

Political lending despite non-compliance is not unique to Pakistan. Reinsberg et al. (2022) analyse country non-compliance with IMF loans from a structural and comparative perspective (also see Kentikelenis et al., 2016). In their analysis of the history of the IMF as a global lender of last resort, particularly for developing countries, and the organization's evolving

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role as a provider of a global financial safety net (IMF, 2016), the authors interrogate the recurring pattern of interruptions in IMF programmes and the tendency to repeat lending. Their analysis shows a close link between the number of conditions and implementation failure, suggesting that IMF programmes that are over-ambitious tend to be 'unimplementable by design' (Reinsberg et al., 2022: 1036). This analysis is also reflected in the specific literature on IMF policies in Pakistan, which shows that conditionalities attached to recent IMF loans have exacerbated inequality and poverty, and therefore undermined long-term development goals (see Fasihuddin, 2009; Khan, 2002; Naqvi, 2018; Zaidi, 1996). However, many analyses also emphasize Pakistan's recurrent fiscal failures, noting that a very low tax to GDP ratio limits the scope of domestic debt. In these perspectives IMF policies for stabilization are bound to fail because they are not fit for the purpose of expanding fiscal space (Bilquees, 1987; Pasha and Akbar, 1993).

Within a framework of political lending and consequent non-compliance of repayments, there is also the question of the state's inability to pay owing to the hegemony of the dollar. The inability of states to repay sovereign debt in their own currency has been discussed in different iterations as an outcome of 'original sin', which refers to the inability of some countries to borrow externally in their own currencies (Eichengreen and Hausmann, 2010: 13) and linked to the historical and imperial domination of the dollar (Desai, 2013). One particular feature of countries that are subordinated, and hence economically precarious, is that demand for foreign currency often exceeds the supply of foreign currency leading to balance-of-payments crises, currency devaluations and high inflation (Ocampo, 2011). To overcome this form of precarity, countries seek external finance, but then precarity is enhanced when countries require foreign currency for debt servicing.

As Naqvi (2019) notes, the development trajectories of many countries in the global South are undermined by recurrent bouts of sharp exchange rate depreciations and financial instability, driven by conditions in international financial markets. Thus, despite China being the world's largest exporter since 2010 and its foreign direct investment (FDI) to developing economies regularly surpassing the amount directed to developed economies, the distribution of risks and rewards in the global financial system are consistently uneven, to the detriment of developing and emerging economies (Alami et al., 2023). The lack of control over currency limits monetary sovereignty and complicates the regulation of money supply and exchange rates needed to avoid crises of insolvency. Not only does indebtedness limit monetary sovereignty, but loans often come with conditions that further complicate economic management. In this context, scholars have theorized that sovereign debt crises will remain a permanent feature of the global economy as long as the system is structured upon a global hierarchy of currencies (Lima, 2022; see also, for example, Ali, 2023). The future of indebtedness remains especially contingent on monetary subordination for countries like Pakistan, which experienced extreme dollar devaluation in the aftermath of

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recent global crises but which are still required to pay exorbitant fees (or surcharges) on IMF loans (discussed below).

The composition of Pakistan's traditional creditors has also changed. The rise of commercial and private debtors as well as multilateral and bilateral creditors such as the Asian Infrastructure and Investment Bank (AIIB) and China have changed Pakistan's lender profile in the last 10 years. The explicit long-term commitment of China to CPEC — which was formally announced in 2015 — has been viewed by some as a welcome change from the short-term IMF stabilization and adjustment packages that Pakistan has repeatedly received (McCartney, 2021).

China's emergence as a global creditor has coincided with increased private lending, and its role as a prolific lender has also complicated debt restructuring because other bondholders do not want any relief provided to be used to repay China (Wigglesworth and Yu, 2023). News, media outlets and think-tanks regularly publish accounts of Chinese lending through the narrative of China's 'debt trap diplomacy' (for an overview, see Jones and Hameiri, 2020). Vastly contrasting estimations of China's 'hidden debt' have been published and while empirical measures have been keen to calculate the 'grey' areas of debt reporting (Malik et al., 2021), there is limited analysis which contextualizes both the size and impact of Chinese debt *in relation to* other multilateral, bilateral and private donors (for exceptions see Acker et al., 2020; Brautigam, 2022; Brautigam and Huang, 2023). Other analyses show how the very concept of Chinese debt trap diplomacy is fragile (Himmer and Rod, 2023) given that private creditors are the primary driver of rising indebtedness for developing countries (Debt Justice, 2022; Jones and Hameiri, 2020).

In other quarters, Chinese investment is associated with 'patient finance', unlike Western investment in the global South. This distinction stems from several key characteristics, including a greater capacity for risk tolerance, long-term investment horizons and an absence of policy conditionality (Kaplan, 2021). Investors deploying patient capital are better equipped to assume risks and develop a comparative advantage in infrastructure financing compared to the more traditional neoliberal approach of complete capital account liberalization and shorter-term investor interests (Lin and Wang, 2017). Consequently, China's approach involves the expansion of foreign aid and concessional finance institutions and resources. This supports the broader intended outbound investment diversification agenda, but also fosters the gradual internationalization of China's financial sector and its currency, the renminbi (Johnston, 2019).

In the context of Pakistan, the concept of 'patient finance' assumes a distinct role, acting as a means of deterring outright failure. The strategic alignment between sectoral projects, including logistics, infrastructure and energy generation, ensures operational continuity despite constraints, delays and even when productivity outcomes do not reach optimal levels. China's consistent strategy of rolling over its debt to Pakistan and its

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willingness to waive prepayment penalties in case of early repayment exemplify this commitment (*Dawn*, 2023; Shalal, 2022). Notably, this contrasts with IMF surcharges, which we will discuss further in this article.

The prominence of Chinese loan packages is linked to a broader conversation about China's shifting role in the global financial and monetary system. For example, the People's Bank of China has sought to use currency swaps to internationalize the renminbi. With bilateral currency swap arrangements with 32 countries, renminbi trade settlements and payments have increased (Iwata, 2018). China has also used currency swaps to rescue countries facing financial crises. Argentina, for example, used its currency swap line with China in 2014 to address a dollar liquidity shortage, instead of relying on the central bank liquidity swap arrangement with the US Federal Reserve (ibid.). As McDowell (2019) shows, in May 2013 Pakistan availed itself of approximately US$ 600 million from its RMB 10 billion swap line (equivalent to US$ 1.5 billion) with the People's Bank of China. This was a response to a sharp plunge in Pakistan's foreign exchange reserves and mounting pressure on the Pakistani rupee. The SBP thus exchanged renminbi for US dollars to bolster its reserve holdings. This strategic measure steadied Pakistan's reserve cache during a period of economic uncertainty and exemplifies the dual use of swap agreements and the likely use of the Chinese offshore renminbi market (ibid.).[1]

China's growing economic power and its desire to challenge the dominance of the US dollar in global trade is also reflected in the idea of the 'petro yuan', as the currency for trading oil on the global market (Alshareef, 2023). This would be an alternative to the US dollar, which has been the dominant currency for oil trading for decades. By using its own currency for oil trading, China has sought to increase the international use and acceptance of the yuan, as well as reduce its dependence on the US dollar. This initiative began in 2018 with the introduction of yuan-denominated oil futures contracts on the Shanghai International Energy Exchange.

Given these ambitions, what is the extent to which China might seek to replace the IMF? The idea that Chinese lending can be a substitute for IMF loans is not a novel one and this trend is particularly visible in some contexts: Chinese loans have allowed some countries with valuable natural resources or important strategic locations to avoid seeking help from the IMF (Sundquist, 2021). But as the example of Pakistan shows, there are several limitations to the use of Chinese loans as an alternative to the IMF.

1. The onshore mainland China market uses the Chinese yuan, the CNY, but there is also the Chinese offshore (CNH) market which includes traditional yuan centres such as Hong Kong, as well as London, Luxembourg and Singapore. See: www.nasdaq.com/articles/cnh-vs-cny-differences-between-two-yuan-2018-09-12

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Pakistan in debt: background and overview

Pakistan's political and economic instability is shaped by a complex interplay of domestic, global and regional interests (Khan, 2022). Globally, Pakistan's economic path diverged significantly from countries like Israel, South Korea and Taiwan, which also received financial aid and FDI in exchange for political alliance and military cooperation with the US. The economic success of these countries is usually attributed to proficient state-led investment, which generated unprecedented industrial growth, but this was also supported by heavy US-led assistance which enabled the internationalization of their exports as well as financial capital (Broude et al., 2013; Chiang, 2014; Glassman and Choi, 2014). Whereas these states eventually emerged as long-term strategic allies of the US, Pakistan's allegiance was only instrumentalized for specific historical moments and remained limited to short-term and ad hoc financial flows, particularly in the 1980s during the Cold War and early 2000s during the War on Terror; indeed these events played a key role in enhancing the role of Pakistan's military in politics (Ahmed, 2013).

In contrast to Israel, South Korea and Taiwan, Pakistan and other developing countries were left to experiment with a series of Bretton Woods' recommended policies, encompassed in the term Washington Consensus. As Naqvi (2018) notes, in Pakistan's case, since the late 1990s various banking sector reforms have advanced financial liberalization but failed to achieve the simple goal of reducing government deficits and promoting productive sector lending. Since the 1970s each government has drawn on external finances from the IMF and other donors (see Table 1 and Figure 1).

On the governance front, since gaining independence from British rule in 1947, Pakistan's politics has mostly oscillated between two democratic political parties and the military.

Although Pakistan joined the IMF in 1950, lending intensified in the wake of secession by East Pakistan in 1971 and the OPEC oil shock in 1973. In 1972–77, under the government of Zulfikar Ali Bhutto, Pakistan received regular support from the IMF to ease its current account deficit. In 1980 and 1981, as shown in Table 1, Pakistan under General Zia-ul-Haq's military regime signed two major agreements under the IMF Stand-by Arrangement (IMF, 2021).[2] It also received considerable US grant aid and military support to counter the Soviet threat in Afghanistan. Despite this, Pakistan was adversely impacted by the 1980s global debt crisis and by 1999 the country had made at least nine loan agreements with the IMF under different governments. During this period, as Husain (2020) notes, politicians

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2. The Stand-by Arrangement was created in June 1952 to provide financing to countries requiring help with balance of payments problems. This arrangement has often been used by member countries and is the dominant lending instrument of the IMF, especially for emerging market countries.

Table 1. History of IMF Lending Commitments to Pakistan

Government	IMF Facility
1958–71 1958 Military coup d'état 1962–69 Presidential republic 1969–71 Martial law	Stand-by Arrangement 1958, 1965, 1968
1971–77 Democratic government	Stand-by Arrangement 1972, 1973, 1974, 1977
1977–88 Second military era — General Zia-ul-Haq	Stand-by Arrangement 1980, 1981, 1988 Structural Adjustment Facility Commitment 1988
1988–99 Democratic government	Stand-by Arrangement 1993 Extended Fund Facility 1994 Extended Credit Facility 1994 Stand-by Arrangement 1995 Extended Credit Facility 1997 Extended Fund Facility 1977
1999–2007 Third military era — General Pervez Musharraf	Stand-by Arrangement 2000 Extended Credit Facility 2001
2008–19 Democratic government	Stand-by Arrangement 2008 Extended Fund Facility 2013
2020 Democratic government	Extended Fund Facility 2019 Rapid Financing Instrument 2020

Source: authors' compilation based on IMF (2021).

focused on short-term economic benefits by addressing external imbalances through IMF loans and other external financial resources. Policy makers thus avoided fundamental structural reforms that would have been politically costly, opting instead for superficial changes that did not address the underlying issues. A major consequence of this has been Pakistan's failure to address low domestic taxation and widespread tax evasion. The tax to GDP ratio over recent decades has hovered between 9 and 11 per cent (Ministry of Finance, 2021, 2022). This has strained resource distribution, hindering capital formation and reinvestment in basic infrastructure. A lack of investment in sectors such as energy was also followed by structural adjustment conditions necessitating rapid liberalization and privatization. However, this did not solve the problem of energy supply deficits; instead, privatization became a major drain on the economy especially since a substantial portion of electricity is generated by private producers with tariffs linked to the US dollar exchange rate (Naqvi, 2016).

Frequent power outages and expensive electricity have impeded industrialization. The manufacturing sector including textiles, which accounts for over 67 per cent of the country's total export earnings and about 46 per cent of total manufacturing, remains severely hampered by outages (Sattar, 2023). Remittances became central to Pakistan's economy as an alternative to export growth and domestic revenue. These remittances amount to nearly half of the import bill and bridge the deficit in the trade of goods account. However, their consistency is linked to the ebbs and flows of global value

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chains and financial prosperity, which are unreliable as a long-term strategy in the absence of domestic investment. The impetus for much-needed structural reform of Pakistan's economy remained mired in political instability. In 1999, General Pervez Musharraf's military coup set the trajectory of a new role for Pakistan, which was even more oriented to US influence.

As Momani (2004) shows, this period was an intricate interplay of politics, finance and security with a prominent role for Pakistan–IMF relations. The US War on Terror in 2001 provided Pakistan with substantial financial aid, enabling it to sidestep some of the more rigorous economic reforms typically mandated by the IMF in return for external assistance. Pakistan experienced a financial boom as the United States greenlighted inflows based on Pakistan's strategic value (for a critical review, see Hayat, 2020).

In 2008, the newly elected Pakistan People's Party secured the biggest IMF bailout package in the country's history and started working on extensive reforms. This led to a tussle between a strict fiscal and monetary policy with other structural reforms. The War on Terror continued, but US–Pakistan relations had become strained for many reasons, including US drone strikes in Pakistan's tribal areas, the killing of civilians by a US military contractor in Lahore, and disagreements over how to handle militants operating along the Pakistan–Afghanistan border. Additionally, the US was concerned about Pakistan's nuclear weapons programme and its perceived soft stance on extremist groups like the Taliban and Al-Qaeda (Nadim, 2022). Nevertheless, in 2013, the second-highest ever loan was taken out by the newly elected Pakistan Muslim League (N) (PML-N) government of Nawaz Sharif, which also sought to fulfil one of its election promises — to address power shortages by seeking help from China. Chinese Premier Li Keqiang visited Pakistan during that same year and signed several agreements related to energy, infrastructure and economic cooperation (Hussain, 2014). CPEC was thus launched, albeit unofficially (see Figures 2 and 3).

Despite vocal opposition to external debt dependency, particularly from the IMF, the Imran Khan government (elected in 2018) succumbed to deteriorating economic conditions and in 2019 asked the IMF for help (IMF, 2019). Alternative strategies such as diaspora bonds and other stabilization measures had been used as well but with limited results. A bailout package of US$ 1 billion was agreed, but conditionalities included the removal of subsidies on fuel, restoration of taxes, increase in power tariffs, and a balanced budget through cuts in development spending. The IMF was temporarily flexible on policy implementation because of the COVID-19 pandemic, but by 2022 the government had to accept IMF demands, particularly when the war in Ukraine caused oil prices to surge and sparked a currency and cost of living crisis (Jafri, 2022).

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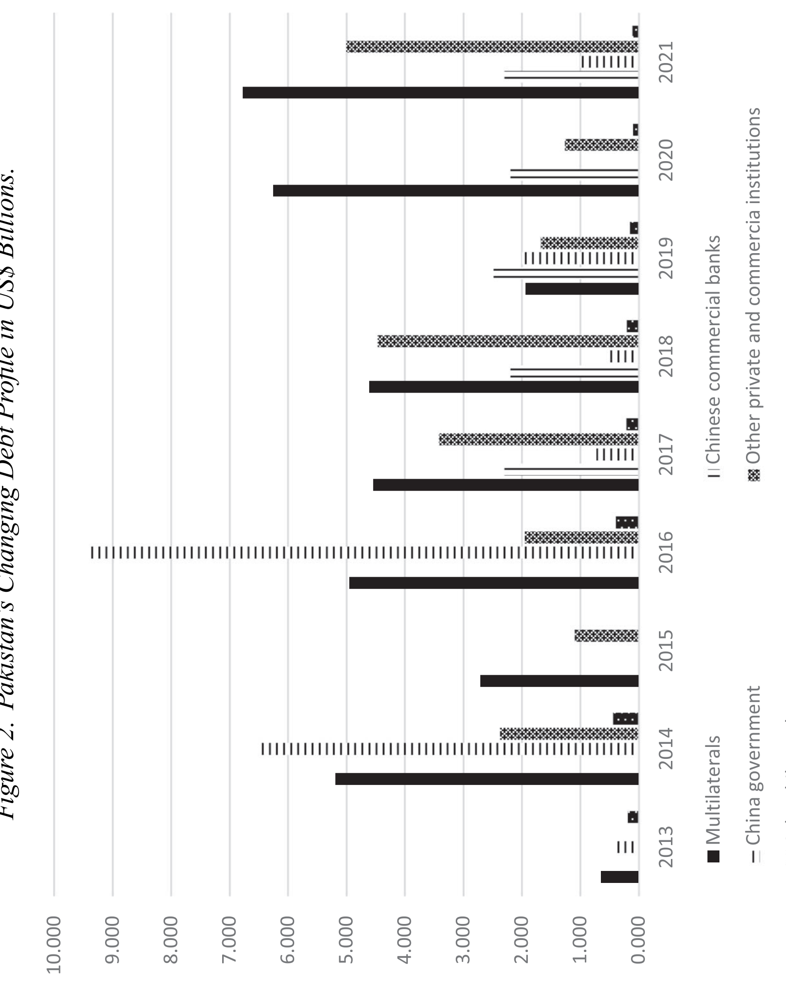
Figure 2. Pakistan's Changing Debt Profile in US$ Billions.



Source: Ministry of Finance (2022).

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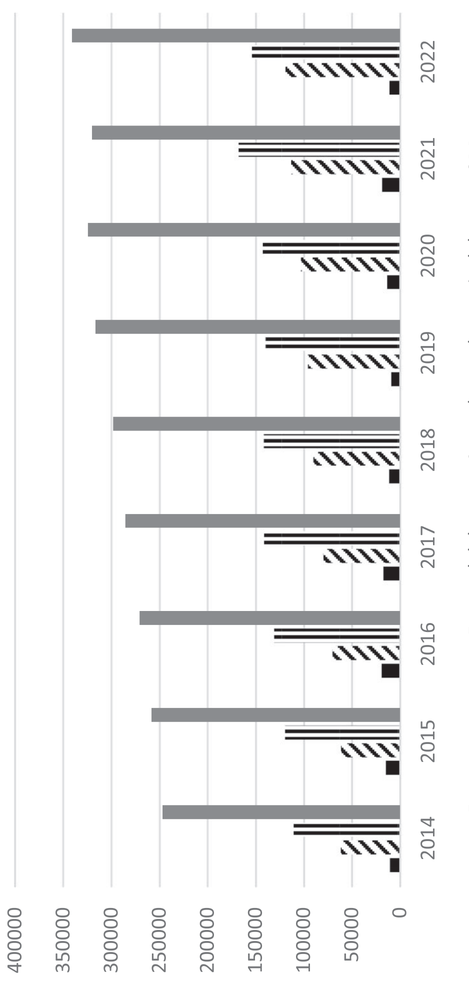
Figure 3. *Pakistan's Debt Overview 2014–22 in US$ Millions.*



Source: authors' compilation based on data from the Ministry of Finance (2022) and World Bank (https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?locations%20ph=null&locations=PK accessed 27 April 2023).

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China, Pakistan and Debt

The official launch of the CPEC in 2015, a key part of China's BRI, was a critical moment for Pakistan. This initiative confirmed China's long-term commitment to an integrative project of socio-economic transformation in Pakistan. An integral aspect of China's own external policy, it presented Pakistan with an unprecedented economic investment opportunity; initially announced with a total investment amount of US$ 46 billion in 2015, the value of the CPEC package has since increased to US$ 62 billion (Ali, 2022). As a whole, CPEC is a series of infrastructural and energy projects (see Table 2) to transform the Pakistani economy and enhance integration with China and the BRI countries (Ali, 2022) This necessitates the creation of special economic zones and industrial hubs, potential for renminbi offshoring, settlement in domestic currencies (for example, the Pakistani rupee) and investments in social infrastructure such as health and vocational and skill development projects (CPEC Secretariat, 2017).

These projects have also been accompanied by an expansion of China's financial footprint in Pakistan. In 2016, Chinese exchanges acquired a 40 per cent stake in the Pakistan Stock Exchange (PSX), ostensibly to align domestic capital markets with other BRI countries and expand investment opportunities (*Dawn*, 2016). Pakistani banks have also developed strong commercial relations with the Industrial and Commercial Bank of China and the China Development Bank (Ali, 2022).

A comprehensive analysis focusing on the impact of CPEC is beyond the scope and aim of this article, but the progress of the initiative can be summarized on three levels. First, the implementation of projects has been mixed. Seven years after initiation, many CPEC projects have been successfully completed and are currently in operation. However, there has been significant contestation over investment resources under CPEC. This includes the struggle between the federal government and provinces as well as inter-party struggles to gain voter support in provinces that benefit the most from CPEC projects (Boni and Adeney, 2020). This issue was particularly visible in large CPEC projects, which were assigned to the most economically marginalized provinces and areas but failed to materialize (ibid.).

Second, CPEC has become part of Pakistan's divisive politics on multiple levels. The impact of CPEC projects has also led to unrest in the form of civilian protests; many citizens have not only been displaced because of such projects but have yet to see a change in their socio-economic conditions. Progressive leftist parties in Pakistan are also divided in supporting or opposing Chinese investments in the country (Tariq, 2020). The Balochistan province, particularly its strategic Gwadar Port, has also emerged as a site of separatist militancy, specifically targeting CPEC infrastructure and Chinese nationals (Garlick, 2021). Concerns over a lack of transparency in government bidding processes to favour Chinese companies and a bias in hiring

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Table 2. Long-term Plan for China–Pakistan Economic Corridor 2017–30

Nature of Project Cooperation under CPEC	Terms
Typology of CPEC projects	— CPEC commercial projects, operated in a market-oriented way — quasi-commercial major infrastructure projects — non-commercial projects which involve multiple participants and implemented through fair competition.
Financial cooperation	— two countries should promote monetary cooperation between the central banks — implement existing bilateral currency swap arrangements — research to expand the amount of currency swap and enrich the use scope of bilateral currency swap — assign the foreign currency to domestic banks through credit-based bids to support financing for projects along the CPEC — promote the settlement in domestic currencies (renminbi and rupees) to reduce the demand for third-party currency — encourage clearing and settlement of the financial institutions from both sides through Cross-border Inter-bank Payment System (CIPS)
Cooperation between financial institutions	— China supports Pakistan to cooperate with the Asian Infrastructure Investment Bank (AIIB) — promote the mutual opening of their financial sectors and the establishment of financial institutions in each other's countries — encourage financial institutions of the two countries to support financing, including loans from international consortium of banks, for the projects along the CPEC — establish and improve a cross-border credit system, and promote financial services such as export credit, project financing, syndicated loan, trade finance, investment bank, cross-border renminbi business, financial market, assets management, e-bank, and financial lease; support the project financing by RMB loans and establish the evaluation model of power bill in renminbi.
Financial cooperation between Free Trade Zones (FTZs).	— Pakistan shall promote the construction of Gwadar Port Free Zone by drawing on the experience of China (Shanghai) Pilot Free Trade Zone and other Pilot Free Trade Zones in China and explore renminbi offshore — both countries shall strengthen financial cooperation between their Free Trade Zones and explore the formation of a renminbi backflow mechanism
Other innovative investment and financing methods	— effective ways shall be explored for Pakistan's federal and provincial governments, enterprises and financial institutions to conduct renminbi financing in mainland China, Hong Kong and other offshore renminbi centres — Chinese and Pakistani market players are supported and encouraged to finance projects along the CPEC in the international market and in Pakistan
Loans from international financial institutions	both countries welcome the World Bank, the Asian Development Bank (ADB), the Asia Infrastructure Investment Bank (AIIB), and other international financial institutions to provide long-term concessional loans to support investment and financing for the projects along the CPEC

Source: CPEC Secretariat (2017)

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Chinese workers instead of Pakistani workers have also been raised (Zaidi, 2019).

Third, in the absence of empirical analysis, the overall impact of CPEC is often presented as one of two very different, polarized perspectives: Chinese investment as new colonialism, or CPEC as a progressive 'game changer' for Pakistan. However, both versions are limited by a methodological nationalist approach to CPEC as they overlook the globalized nature of the Pakistani state. For example, despite an intergovernmental partnership, CPEC encourages other foreign investment in Pakistan, although contestation and complementarity in FDI is complicated by the Pakistani and Chinese military's shared security interests. Similarly, extractive narratives, including that on CPEC as a source of Pakistan's debt, fail to contextualize the origins and current drivers of Pakistani debt (Sohail, 2022). Finally, as one part of the greater BRI, CPEC is not a static initiative but is instead contingent on China's domestic accumulation and external expansion strategies. A comprehensive analysis of CPEC's developmental impact in Pakistan therefore requires attention to domestic and external drivers of Pakistan's developmental policy space as well as regional transformations in the greater BRI and China's global role.

In the aftermath of CPEC's official launch, Chinese investment was not accompanied by any visible external alliances. Politically, the PML-N government under which CPEC was launched took a cautious approach to managing relationships with the US, vis-à-vis China. In contrast, the PTI in opposition came across as receptive to Chinese assistance but was derisive about IMF loans and the proverbial 'begging bowl' (*Dawn*, 2019). The US's cynicism regarding CPEC is typically framed as concern about an unsustainable debt burden (Markey, 2020). This perspective is echoed by the IMF, which has often sought to discourage Chinese lending in Pakistan, and other BRI countries (Gerstel, 2018). In 2018 then US Secretary of State, Mike Pompeo, explicitly warned that IMF funding, if potentially approved, for the newly elected PTI government should not be used to service Chinese debt (*Reuters*, 2018). Chinese and Pakistani officials reacted strongly to rebut claims from Pompeo and other US officials that China had put Pakistan into debt traps. The Chinese Ambassador to Pakistan, Yao Jing, accused US Deputy Assistant Secretary Wells of spreading inaccurate information and propaganda, stating that, unlike the US-backed IMF, China would not force Pakistan to repay credit on timelines that harm Pakistan's interests (Markey, 2020). Similarly, Geng Shuang, the Deputy Director of the Foreign Ministry Information Department and Foreign Ministry Spokesperson, rejected US accusations and claimed that half of Pakistan's outstanding debts come from multilateral financial institutions and that more than 80 per cent of CPEC projects are funded by direct investment or grants from China (ibid.).

The Pakistan–China alliance is more than a collaboration on CPEC. It is a geopolitical nexus of regional alliances and security. Through CPEC,

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Pakistan has sought to strengthen its economic development whilst also enhancing trade ties with both Iran and Saudi Arabia, and to further the neutralization of India (Garlick, 2021). Whilst there is some consensus on a regional balance of power, as evident in China's recent mediating role between Iran and Saudi Arabia, Pakistan's ability to instrumentalize CPEC to the ends of enhancing its developmental policy space has been limited.

A Losing Battle: Pakistan Tehreek-e-Insaaf and the IMF 2018–22

The 2018 general election was a momentous event for Pakistan because it led to the formation of a coalition government led by the party, Pakistan Tehreek-e-Insaaf. This was the first new civilian party to be elected to power since independence. Although the victory of PTI came about because of the promise of a new trajectory, it was not a complete break from the past, where the military, civilian elites, private sector interests and international influences held power. Nevertheless, the PTI government's electoral success reflected the desire of ordinary citizens for economic transformation. As a first task, the government sought to address issues of debt distress to ensure the continuation of investment. Pakistan's current account deficit at the time was US$ 18 billion (see Figure 4).

The PTI government, under Prime Minister Imran Khan, also sought to uphold its election promises of countering dependency on the IMF by diversifying Pakistan's donor base. It managed to gather US$ 15.8 billion from different countries, including China, Qatar, Saudi Arabia and the United Arab Emirates. Additionally, the extension of a bilateral currency swap arrangement with China helped strengthen trade and financial cooperation. However, all of this was not enough to overcome the issues of a weak fiscal position and dwindling foreign exchange reserves due to the sharp devaluation of the Pakistani rupee (PKR). In May 2019, the government resumed negotiations with the IMF, and in 2021, the IMF completed the sixth review under the Extended Fund Facility (EFF) for Pakistan, allowing Pakistan to draw the equivalent of SDR 750 million[3] or about US$ 1 billion (IMF, 2022a; Khaliq, 2020).

When the COVID-19 pandemic sparked an emergency, the government availed temporary suspension and rescheduling of external debt through the DSSI. This was established in May 2020 by the G20 initiative to allow the poorest countries in the world to temporarily suspend debt payments to official bilateral creditors such as the IMF and the World Bank and other multilateral development banks (World Bank, 2021). The suspension period

3. The currency value of the SDR, or Special Drawing Right, is an international reserve asset. It is determined by summing the values in US dollars of a basket of major currencies (Chinese renminbi, the euro, Japanese yen, pound sterling and the US dollar) and is based on market exchange rates.

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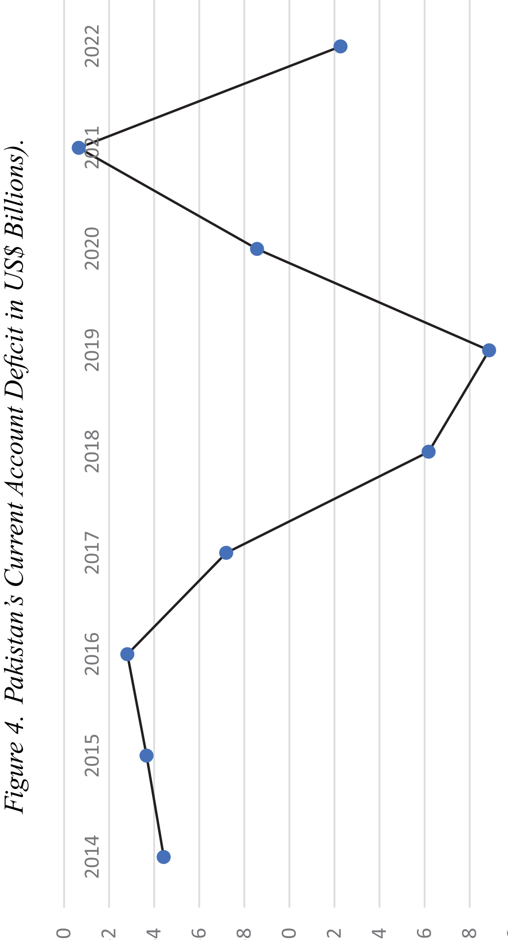
Figure 4. Pakistan's Current Account Deficit in US$ Billions).



Source: authors' compilation based on economic data from the State Bank of Pakistan (www.sbp.org.pk/ecodata/index2.asp, accessed 27 April 2023).

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began on 1 May 2020 and was initially set to end on 31 December 2020, but this was later extended through the end of 2021. The initiative aimed to free up resources for the poorest countries to use to fight the pandemic and support their economies.

Although the combined impact of new loans, suspension and rescheduling provided some breathing space, the temporality of the suspension, coupled with a chaotic regime change and instability in Afghanistan, left Pakistan facing financial insecurity (Khaliq, 2020). In August 2021, the US withdrew from Afghanistan and the Taliban took over. The ensuing instability and power imbalance was acutely to the detriment of Pakistan, China and the neighbouring Central Asian states.

Two out of the six corridors being developed under the BRI are near Afghanistan (China–Central Asia–West Asia Corridor and CPEC). China's engagement in Afghanistan — based on concerns about spilling of religious extremism and loss of control in Xinjiang, natural resources in Afghanistan and a greater geopolitical and competitive interest to deter US and Indian influence in Afghanistan — became open to uncertainty (Ali, 2022). Pakistan's own historical engagement with Afghanistan, including the disputed border of the Durand Line as well as active and passive intervention in Afghanistan, led to an increase in security concerns in Pakistan, as it faced a surge in terrorism and instability in its western border regions. This, in turn, led to a decline in foreign investment and a flight of capital from the country.

Instability in Pakistan was further exacerbated by US sanctions on the Taliban government, including the seizure of US$ 9.5 billion in assets from Afghanistan's central bank, the Da Afghanistan Bank.[4] This action by the US restricted the country's access to the international banking system and blocked Afghanistan's ability to pay for imports, including food, fuel and medicines; the resulting demand for US dollars caused a surge in cross-border smuggling of cash dollars. The Exchange Companies Association of Pakistan estimate this to be as much as US$ 70 million on a monthly basis (Shahid, 2023), contributing to a shortage of US dollars and the depletion of Forex reserves in Pakistan.

This situation was exacerbated by the PTI government's awkward position amidst geopolitical rivalry between Russia and the US. Imran Khan's visit to Moscow and subsequent meeting with the Russian President Vladimir Putin coincided with Russia's invasion of Ukraine on 24 February 2022. Khan insisted that he was unaware of the invasion before the meeting was arranged, but he did not condemn the invasion and cited the need for trade, specifically the import of Russian wheat and natural gas, as a reason to

4. This US policy exemplifies the weaponization of the dollar which has been economically crippling for other developing countries as well, particularly Cuba and Iran. Mona Ali's arguments for 'deweaponizing the dollar' conceptualize this very clearly (Ali, 2023).

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maintain cordial relations with Russia (Sky News, 2023). Pakistan was not the only country that came across as soft on Russia, but the meeting with Putin contributed to the domestic unrest which culminated in the dissolution of Parliament followed by the expulsion of Imran Khan.[5] In the run up to this event, the Ministry of Foreign Affairs of the Russian Federation condemned the role of the United States as 'shameless US interference in the internal affairs of an independent state' (*Dawn*, 2022). The impact of Russia's invasion of Ukraine, which included inflationary pressures particularly from rapid increases in energy and food prices, and a sharp (24 per cent) appreciation of the US dollar between May 2021 and October 2022, caused a severe cost-of-living crisis in many countries. UNCTAD (2022) reports that between 2020 and 2022, Pakistan's wheat import bill rose by 132 per cent primarily due to a combination of currency devaluation (as shown in Figure 5), accelerating consumer price inflation (see Figure 6) and higher commodity prices due to the war in Ukraine.

In 2022, a few months after the creation of a new coalition government led by Shahbaz Sharif (of the Pakistan Democratic Movement), heavy monsoon rains in Pakistan caused severe floods and massive damage to core infrastructure, including roads, bridges and buildings. In July and August of that year, 200,000 people were displaced from their homes and over 400 lives were lost (ReliefWeb, 2023). Government funds were diverted to provide relief and aid to those affected, including food supplies, shelter and medical assistance (ibid.).

The flooding had a significant impact on the country's agricultural sector, causing crop damage and livestock losses. According to estimates by the National Disaster Management Authority, around 1.7 million acres of crops were destroyed, with losses estimated at PKR 200 billion or approximately US$ 1.2 billion (IOM Pakistan, 2022). Under immense financial strain, the government had to bear substantial costs for relief and rehabilitation (Jan, 2022). Negotiations with the IMF became more urgent and resulted in a US$ 1.17 billion funding package in 2022 under the EFF (IMF, 2022a). This was originally part of a government bailout loan from 2019, but the final payments had been held up after the previous PTI administration had resisted IMF demands to slash fuel subsidies.

Under the new arrangement, the IMF and Pakistan agreed on several conditionalities including fiscal consolidation measures based on privatization, deregulation projects, further cuts in subsidies and social sector spending as well as tax reforms (IMF, 2022b). The resumption of this newest IMF loan programme requires high levels of debt servicing at the expense of social investment, particularly cuts in the public

5. In subsequent months these foreign policy tensions would become the subject of the scandal often referred to as the 'cipher controversy' (Grim and Hussain, 2023a, 2023b).

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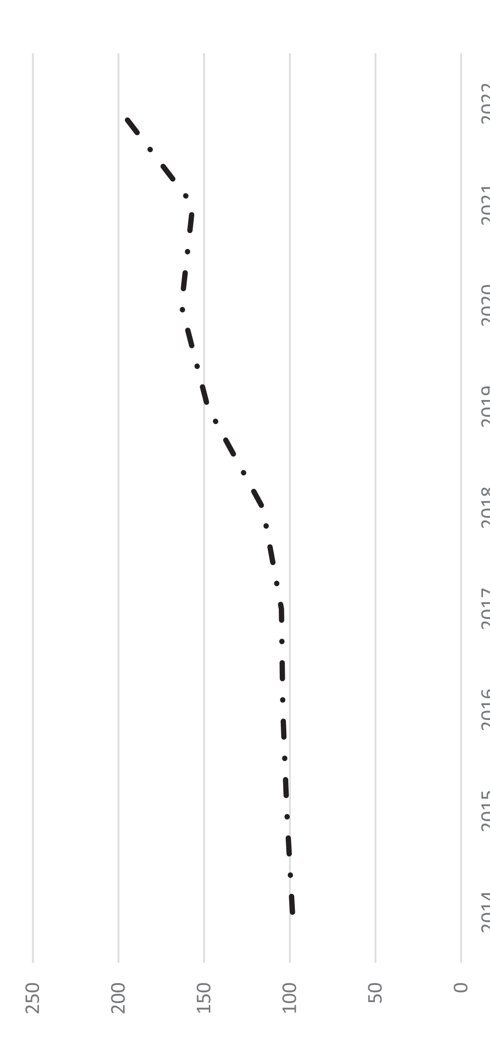
Figure 5. Pakistan Rupee Depreciation Relative to the US Dollar.



Source: authors' compilation based on XE.com data (www.xe.com/currencyconverter/convert/?Amount=1&From=USD&To=PKR, accessed 27 April 2023).

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Figure 6. Consumer Price Inflation.

Source: authors' compilation based on World Bank data (https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?locations%20ph=null&locations=PK, accessed 27 April 2023).

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provision of health and education. To qualify for a revival of the programme, the government issued a mini-budget or the Supplementary Finance Bill 2021 (Federal Board of Revenue, 2021) which intensified inflationary pressure through a withdrawal of sales tax exemptions across all sectors, the implementation of new tariffs and a higher tax collection goal. Once this had received parliamentary approval in January 2022, the IMF commenced with the sixth review of the programme, the announcement of which in early February 2022 allowed Pakistan to tap international markets.[6]

Infrastructural Straitjackets and Pakistan's Debt

Pakistan's recurring debt problem is complex, multifaceted and reproduced by the country's position in the global hierarchies of financial power. Geopolitics motivates US-led international institutions to create an infrastructural straitjacket — under the guise of rules and regulations — and directly constrain Pakistan's ability to service its debt. Such institutions are, for example: (1) the International Centre for Settlement of Investment Disputes under the World Bank, which is designed to support transnational corporations over poor countries; (2) the Financial Action Task Force, which operates through the mechanisms of soft law to obscure its political nature as a tool of US foreign policy; (3) credit rating agencies including Fitch and Moody's, which suppressed Pakistan's demand for climate reparations; and (4) the IMF, which imposed surcharges and new conditionalities which penalize indebted countries for requiring additional debt.

ICSID and the Reko Diq Affair

The role of the World Bank's ICSID in the Reko Diq controversy demonstrates the asymmetrical relations between poor countries and those that govern the international financial architecture. The Reko Diq mining project is centred on a large copper-gold porphyry deposit in Chagai, Balochistan province in Pakistan. The project commenced in the early 1990s and was based on a joint venture agreement between the Balochistan Development Authority and US-based BHP Minerals Incorporated. After a series of mergers and acquisitions over several years, BHP became the

6. There have been many developments since this date, but they are beyond the scope of this article. It is worth mentioning, however, that unfortunately for Pakistan, due to domestic political instability combined with volatility in global financial markets over 2022 and 2023, external and fiscal deficits became troublesome, again requiring new budgetary measures. It was not until July 2023 that the IMF approved an immediate disbursement of US$ 1.2 billion (see IMF, 2023).

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Australian incorporated Tethyan Copper Company (TCC), a joint venture between Antofagasta plc, a Chilean company incorporated in the United Kingdom, and the Canadian company, Barrick Gold Corporation.

In 2011, the Balochistan government decided not to renew TCC's mining lease, citing irregularities and legal flaws in the lease agreement. TCC successfully challenged the government's decision in international arbitration, arguing that the decision violated Pakistan's obligations under a Pakistan–Australia Bilateral Investment Treaty (BIT) (Darr, 2019). In 2019, ICSID ordered Pakistan to pay US$ 6 billion in compensation to TCC, an amount roughly equivalent to the IMF bailout loan Pakistan had been granted in that same year (ibid.). This amount was based on a discounted cash flow valuation methodology which Pakistan disagreed with, proposing instead that the valuation be based on a fair market value based on past transactions, adjusted by several factors occurring between those transactions and the valuation date. These factors included changes in world metals markets and country risk, as well as any subsequent efficient, proven investments that might have been considered by a hypothetical buyer of the asset on the valuation date.

In 2021, Pakistan terminated 23 bilateral investment treaties with different countries to avoid risking Investor-state Dispute Settlement (ISDS) cases with firms on commercial contracts (IISD, 2021). As Kahale (2015) observes, many investment disputes are based on BITs which were signed in the past without negotiation and often because visiting foreign dignitaries 'couldn't think of any other document to sign' and because 'a BIT provides a good photo opportunity' (ibid.). These agreements cannot be dismantled or rebuilt without resorting to a complex and expensive process of investor-state arbitration, such as through ICSID (see ICSID, 2023).

The processes and rules that shape ICSID rulings tend to disadvantage poor countries because they are based on the principles of investment law, designed to protect the interests of transnational corporations. The ISDS mechanism allows foreign investors to resolve disputes with host governments (UNCTAD, 2021). The largest single category of disputes — approximately 46 per cent in 2022 — pertain to energy and extractive industries; another 11 per cent of cases pertain to construction (ICSID, 2022). Appointments to ICSID tribunals, commissions and ad hoc committees are dominated by nationals of Western Europe and North America, with 62 per cent of appointments representing these regions in 2022; during the same period France, the UK and the USA were most overrepresented in appointments (ibid.).

The design of ISDS and the role of ICSID have been heavily criticized by developing countries because they are instruments that privilege developed countries' interests (see Kahale, 2015). As Broad (2015) notes, these concerns pre-date the creation of ICSID; at the 1964 Tokyo World Bank and IMF annual meeting, 21 developing country governments voted 'no' to the convention to set up this new part of the World Bank Group

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in which transnational corporations could sue governments and bypass domestic courts, thus dramatically eroding local democratic control over important political and economic decisions. ICSID has been criticized for various reasons, but particularly for a lack of transparency and disproportionately large amounts in claims and awards (see Broad, 2015; Kahale, 2015). Ecuador and Venezuela are no longer part of ICSID, Brazil has never been a member, and other emerging economies, including India, Indonesia and South Africa are actively revisiting their investment laws and treaties to limit the influence of ISDS on their economies (Broad, 2015).

FATF and the Grey-listing of Pakistan

Pakistan's economic policy is also subject to the normative soft law of the FATF. The FATF was launched as a G7 initiative in 1989 and has evolved over three decades to become an international organization (Nance, 2018). FATF sets standards to promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. It is not treaty bound and its recommendations are not binding; however, FATF became an influential policy-making body after the 2001 global War on Terror began. In its contemporary state, FATF is a global regulatory organization, which operates as a transnational network and shapes policy on both finance and security. As Nance (2018) notes, because of FATF, the fight against illicit money has bled into nearly every corner of government activity.

Governments seek to comply with FATF recommendations to avoid being blacklisted. The blacklist includes those jurisdictions or countries seen to have 'weak measures' to counter money laundering, terrorist financing, and financing of proliferation (FATF, 2023: 1), that is, those states which have not complied with FATF recommendations. So, while the recommendations are in themselves non-binding, their reverberations are substantial as financial intermediaries including accountancy, insurance, banking and legal firms withdraw resources from states that come across as non-compliant. Non-compliance thus carries economic costs and has led to a substantial increase in the number of countries with laws criminalizing terrorist financing (Morse, 2019). As such, FATF recommendations serve as a tool of global governance by threatening and imposing high reputational and financial costs on a state. This is consistent with the increasing use of blacklisting as a policy instrument which weakens economies by limiting new investment, precipitating capital flight and causing losses in government revenue (Eggenberger, 2018; Sharman, 2009). There is a growing scholarship that problematizes blacklisting as being part of an authoritarian and hierarchical US-driven security and finance agenda, exerted through the overreach of a network of international organizations; this includes research

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on Pakistan as an ally in the War on Terror (Amoore and de Goede, 2011) and broader insights on the weaponization of financial power (McDowell, 2023).[7]

Pakistan has had a complicated relationship with FATF because of grey-listing. The state has avoided the blacklist but has entered and exited from the grey list three times: 2008–09, 2012–15 and 2018–22. The most recent period is the most contentious because Pakistan's grey-listing in 2018 was through an atypical process, given FATF norms. Usually, grey list inclusion is based on a country's mutual evaluation report (MER). The MER process is conducted by regional organizations, established under FATF for this purpose,[8] which assess the implementation of FATF recommendations and provide detailed commentary and recommendations. In the case of Pakistan, FATF did not wait for the MER analysis. Pakistani officials were critical of this procedure, calling it 'unprecedented and in clear violation of the established rules and practices of FATF', and believed that it was 'politically motivated', mainly due to pressure from the United States (*Express Tribune*, 2018; see also Sardar, 2021).

Grey-listing is often the outcome of politically driven and contested processes. Pakistan's time on the grey list has been lengthened by its unfriendly relationship with neighbouring India. India has persistently sought Pakistan's inclusion on the blacklist, particularly since 2019, when a suicide bomber in Pulwama, Kashmir, killed 46 Indian security personnel (Shah, 2021). India has received US support in pushing for Pakistan to remain grey-listed and has lobbied other countries for this objective. While Pakistan had some initial success in countering these efforts with the support of friendly countries such as China, Saudi Arabia and Turkey, US pressure prevailed and Pakistan was grey-listed in 2018 for the third time (ibid.).

This series of events demonstrates a common criticism of FATF. The reputation of this watchdog agency as an organization working towards a non-partisan agenda of countering illegal financial flows is undermined by its misuse as a platform to express the rival geopolitical concerns of different actors. Under regular circumstances, FATF decisions are based on a single discussion at a plenary session about each country under review. In 2018, however, the US pushed for a second debate on Pakistan after an initial call to grey-list Pakistan was aborted. Pakistan was then classified as a jurisdiction under increased monitoring (Shah, 2021). This was an unusual outcome

7. As of June 2023, three countries — Iran, Myanmar and North Korea — are on the FATF blacklist. But there is also a much-dreaded FATF grey list for countries classified as jurisdictions under increased monitoring for being imperfectly aligned with FATF's guidance on money laundering and terrorist financing. The grey list currently includes 21 countries. Grey list classification is less punitive than the blacklist but is nevertheless harmful to economic activity.
8. The organization responsible for Pakistan's mutual evaluation is the Asia Pacific Group. For commentary on the nature and implications of this arrangement, see Hameiri and Jones (2015).

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as it meant that the country would be not given the opportunity, typical in FATF proceedings, to be under observation for at least 12 months before it could be grey-listed. This was a surprising turn of events, given that Pakistan had already taken steps to overcome AML/CFT[9] deficiencies through multiple legislative, regulatory and practical steps.

The approach of the US changed over recent years, particularly as a result of Pakistan's diplomatic role in facilitating the US–Taliban deal of 2020, and the subsequent withdrawal of US troops from Afghanistan in 2021 (see Zhang, 2022). Pakistan was removed from the grey list in 2022, but the economic results of grey-listing have lasting effects. As Sardar (2021) shows, this includes economic losses of US$ 38 billion. This decline in GDP may be partially attributed to reduced household and government consumption expenditures of approximately US$ 22 billion. The higher transaction costs that come with grey-listing also lead to lower levels of both exports and inward FDI. As Kida and Paetzold (2021) note, these flows weaken because foreign investors are unsure about how domestic firms will cope and how other investors will respond in the new environment, and also because payments tend to move from formal to informal channels.

The removal of Pakistan from the FATF grey list in 2022 was a success for the country's policy makers but in the same year — in the months preceding the FATF announcement — the economy was ravaged by floods. Aside from massive losses in human life and agricultural produce, and damage to core infrastructure, sovereign rating downgrades by the major credit rating agencies substantially weakened the country's economic position.

Credit Ratings and Loss and Damage Funding

Credit ratings are a prerequisite for access to global capital markets as they allow public and private borrowers to attract foreign investments, primarily by selling fixed-income instruments. This practice reflects the prevalence of the originate-to-distribute (OTD) model of finance.[10] Under this arrangement, a better credit rating translates into more cost-efficient funding (Kiff et al., 2010). The role of credit rating agencies (CRAs) in shaping global financial flows came under intense scrutiny immediately after the global financial crisis in 2007–09 (see, for example, Sinclair, 2013). For countries like Pakistan, and others seeking investments and development funding from abroad, credit rating agencies became important because of a growing emphasis on private finance as a complement, if not a substitute, for official development assistance.

9. AML/CFT stands for anti-money laundering and countering the financing of terrorism.
10. This model of finance is an alternative to the traditional approach in which banks originate loans and keep them on their balance sheets until maturity. In the OTD model, banks distribute the loans they originate. For commentary on this shift, see Jafri (2019).

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However, this marketized approach to financial assistance, in which CRAs are responsible for telling investors, portfolio managers, financial institutions and regulators what is creditworthy and what is not, can be particularly detrimental for countries afflicted by climate-related emergencies. This is exemplified by the devastating floods over the summer months of 2022 in Pakistan. As is typical, officials sought foreign assistance to avert emergencies around health, food security and internal displacement. Floods have wreaked havoc in the past as well, but the most recent occurrence is unique in that the Prime Minister, Climate Minister, Foreign Minister, as well as various media outlets, all adopted the terminology of climate justice as they called for external support.

In part, this discourse can be attributed to the notion of loss and damage which gained traction during the COP26 (Conference of the Parties) event in Glasgow in 2021. Recent research from the Stockholm Environmental Institute (SEI, 2020) in partnership with Oxfam has reiterated the need for climate justice as the richest 10 per cent of the global population is responsible for 46 per cent of the emissions growth between 1990 and 2015. Loss and damage were a central topic of discussion at the COP26 gathering, pushed especially by participating nations from the global South which had been harmed not only by the effects of climate change on the natural environment, such as rises in sea levels, but also the human impacts, such as migration caused by damage to livelihoods and living standards. The actions of the Santiago Network on Loss and Damage, formed in 2019, represented a triumph of climate activism at COP26, as the network seeks to coordinate technical assistance to developing countries, including accessing finance to help prepare for extreme weather events. At COP27, held in Egypt in 2022, a proposed loss and damage fund became a central — and unresolved — issue after being included on the agenda for the first time after almost two decades of demands from poorer countries. Such a fund would be a finance facility for poor countries impacted by the climate crisis.

Yet financial market mechanisms and initiatives for climate justice in Pakistan have had contradictory effects; as the scale of flood-related damage became increasingly publicized and attracted humanitarian aid, Pakistan's economic fragility attracted attention too. This was reflected in the decisions of two credit rating agencies, Fitch and Moody's, in October 2022, to downgrade Pakistan. The respective drivers of these adjustments included 'large funding needs', linked to flood-related damage, liquidity and external credit weaknesses, and increases in social spending needs, while government revenue is severely hit (Fitch Ratings, 2022; Moody's, 2022). Both credit rating agencies rely on government reports regarding the extent of damage, estimating as falling between US$ 10 billion and US$ 30 billion (ibid.); this reflects substantial economic damage and while the alarming nature of these estimates might drive external assistance, it can also deter capital inflows.

These are emerging concerns and are reflected in the climate economics literature to some extent, noting that some countries are more prone to

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rating downgrades because they are more reliant on climate-dependent industries such as agriculture, and have less climate-resilient infrastructure (for example, poor road quality or flood defences). In addition, more vulnerable countries are also likely to have lower-quality governance and institutions associated with the resource curse (Klusak et al., 2023).

IMF Surcharges: Misguided Borrowing Disincentives

As shown above, lending agreements with the IMF severely limit Pakistan's domestic policy space, and repayments are a crushing burden on the macroeconomy. But an additional financial drain comes from the heavy surcharges as well as other conditionalities affixed to further loans. IMF surcharges are additional charges imposed on those member countries that borrow regularly from the IMF. These were introduced in the 1980s to discourage excessive borrowing, but they have been extensively criticized for their regressive impact on developing countries which are likely to have either large IMF loans or multiple loans. Surcharges are paid in addition to interest payments and principal amortizations, thus adding to the country's debt burden (Eurodad, 2018). Pakistan paid an estimated US$ 65 million in surcharges between 2018 and 2020 and is projected to pay a further US$ 392 million between 2021 and 2030 (see Figure 7). This is despite Pakistan's government having met almost all the other harsh conditions imposed by the IMF, which have caused historic price hikes and deepened poverty. Argentina, Pakistan and other countries have been pushing the IMF to drop — or at least temporarily waive — the surcharges, which the IMF estimates will cost affected borrowers US$ 4 billion, on top of interest payments and fees, from the start of the COVID-19 pandemic through the end of 2022. But Germany, Switzerland and the United States as well as other advanced economies oppose the change, arguing that 'the IMF should not change its financing model at a time when the global economy is facing significant headwinds' (Shalal, 2022).

DISCUSSION AND CONCLUSION

Pakistan's enduring reliance on the IMF is a conundrum because of the economic tensions and social repercussions caused by the demands of 23 IMF lending programmes. In this contribution, we consider how the hold of the IMF might be weakened given the potential role of China as alternative creditor. We show that because of the dominance of the United States in the political economy of sovereign debt, Chinese assistance is not sufficient for resisting the debt trap that Pakistan is currently in. Our analysis uncovers limitations that implicate the politics of the broader global financial landscape, a perspective which is often overlooked in

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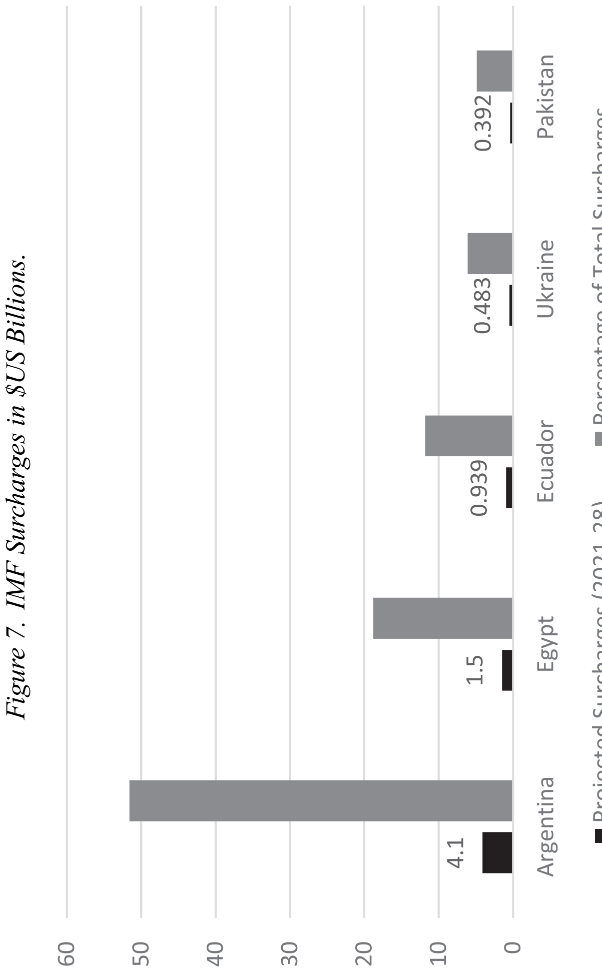
Figure 7. IMF Surcharges in $US Billions.



Source: authors' compilation based on Eurodad (2018).

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conventional debt analyses. Conventional portrayals of creditor–debtor relationships oversimplify the dynamics of indebtedness, equating a weak ability to repay with failure and incompetence on the part of the debtor. We argue that such a perspective overlooks the underlying power imbalances between the global South and the global North. Through an in-depth analysis of external structural constraints faced by Pakistan, we show that persistent indebtedness is complex, political and crisis prone.

Among these constraints, Pakistan's lack of bargaining power in an ICSID case, the influence of FATF's regulatory power curbing Pakistan's economic sovereignty, credit rating agencies stifling prospective climate reparations, and IMF surcharges depleting its foreign currency reserves stand out. These factors demonstrate the complex interplay of power dynamics shaping the debt landscape.

From our findings, three key insights emerge. First, the cycle of underdevelopment and persistent indebtedness must be addressed as a manifestation of asymmetrical power relations between the global South and the global North. Domestic reforms are of course necessary, but they are not sufficient. A comprehensive overhaul of the global financial architecture is essential to tackle the issue of debt faced by many countries in the global South. Second, it is crucial to recognize that not all creditors are alike. The mainstream narrative often differentiates debtors while overlooking the diversity among creditors, such as China, as well as the differences between multilateral, bilateral and private creditors. A nuanced understanding of the varied creditor landscape can inform more targeted and effective policy approaches for developing nations. Third, conventional neoliberal strategies, centred on restructuring and delaying debt repayments, as seen during the COVID-19 pandemic, have proven inadequate. The prevailing debt emergency transcends Pakistan and extends to much of the global South. Taking a historical perspective, and one that includes reparations, alternative debt solutions such as debt cancellation should be earnestly considered.

In conclusion, a comprehensive reassessment of Pakistan's IMF reliance and the potential of Chinese lending as an alternative must acknowledge the broader global power dynamics at play. By addressing these structural constraints and embracing more inclusive and equitable solutions, the global community can move closer to resolving the persistent issue of indebtedness faced by developing nations.

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