Pakistani Economy

Pakistan's Eurobond Inflow: A Short-Term Fix or Another Link in the Debt Trap?

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KARACHI: Last week, Pakistan celebrated a milestone. According to the State Bank of Pakistan (SBP), total liquid foreign exchange reserves crossed the USD 21 billion mark, driven primarily by the successful issuance of a USD 750 million Eurobond, marking the country's return to international capital markets after four years. The news was met with relief. The SBP's reserves climbed by USD 730 million to reach USD 15.8 billion, cushioning the blow of a simultaneous USD 3.5 billion debt repayment to the United Arab Emirates. An additional USD 3 billion from Saudi Arabia helped stabilise the picture. But beneath the headline lies a more complex and troubling reality. Is this a genuine return to stability, or is Pakistan merely entering a deeper phase of the "vicious circle of debt" that post-Keynesian economists have long warned about?

The Mechanics of a Eurobond Inflow

First, let us understand what actually happened. A Eurobond is a debt instrument issued in a currency not native to the country where it is sold. For Pakistan:

- Currency: Issued in US dollars, not euros.
- Structure: A 3-year bond, initially set at USD

500 million but upsized to USD 750 million due to strong investor demand (via a "greenshoe option").

When the bond was issued, Pakistan received USD 750 million in cash. That money directly entered the central bank's foreign exchange reserves, creating an immediate, visible improvement. This is the "inflow" that news reports celebrate.

However, a bond is not a gift. It is a contract. At maturity (2029), Pakistan must repay the full face value of USD 750 million plus any agreed interest (coupon). If the bond was issued at a discount (sold below face value), the effective borrowing cost is even higher.

The Hidden Cost: Devaluation as the Bond's Real Price

Here is the critical point that official statements often overlook. The cost of a foreign-currency bond is not merely the interest rate. It is also the exchange rate at the time of repayment.

Consider this simplified example:

- At issuance (2026): Exchange rate = PKR 280 per USD. Liability in local currency = PKR 210 billion.
- At maturity (2029): If the rupee devalues to PKR 350 per USD (a realistic risk given Pakistan's fundamentals), liability in local currency = PKR

262.5 billion.

- Extra cost from devaluation alone: PKR 52.5 billion (25% more).

This additional cost is not a line item in the budget. It does not appear as a coupon payment. But it is a very real price of the bond. Under a fixed exchange rate regime, this cost is predictable but brittle (the peg may break). Under a floating or managed regime, devaluation silently inflates the debt burden.

Thus, devaluation is not separate from the bond's cost; it is the bond's hidden price when repayment comes due under a non-fixed regime.

The Vicious Circle of Debt Instruments

Pakistan's external financing does not come from a single source. It comes from a web of interconnected, often short-term instruments:

- Eurobonds: High-cost, short-maturity (3-7 years), subject to investor sentiment.
- IMF loans: Accompanied by austerity conditions, but necessary to unlock other financing.
- Bilateral loans: From Saudi Arabia, UAE, and China, often short-term deposits that can be withdrawn.
- Commercial bank foreign reserves: Volatile, responsive to import payments and speculation.

Each source feeds the next. Eurobond proceeds are partly used to repay older Eurobonds or IMF instalments. Bilateral deposits cushion one outflow while another matures. The foreign exchange market becomes not a market for trade, but a battlefield for rolling over debt.

This is not stability. This is liquidity management dressed as stability.

The Post-Keynesian Critique: The Trap of Financialisation

Post-Keynesian economists (following Hyman Minsky, Wynne Godley, and others) have long described this exact pattern. They call it the trap of financialisation, and it operates through several structural features:

1. Original Sin

Developing countries like Pakistan cannot borrow internationally in their own currency. They must borrow in dollars, euros, or yen. This forces a currency mismatch: the government earns in rupees (taxes, local revenues) but repays in hard currency. Any devaluation explodes the debt burden.(1)

[1]The concept of "original sin" was coined by Barry Eichengreen and Ricardo Hausmann in 1999, working within mainstream international economics rather than the post-Keynesian tradition. Post-Keynesians engage extensively with the concept but did not originate it. See Eichengreen & Hausmann (1999).

2. Short-Termism

Borrowers (the government) and lenders (bond buyers) both focus on rolling over debt, not on productive investment. The question is never "What will we build?" but "Will the next bond subscription cover the maturity?"

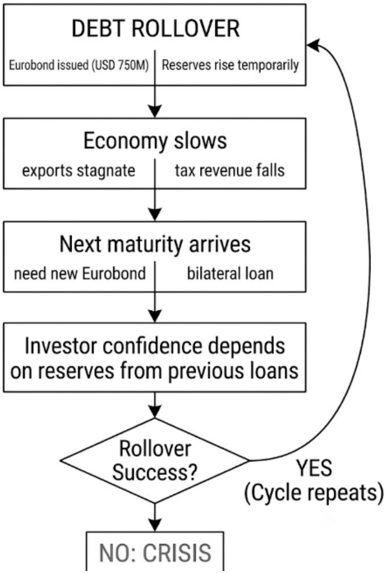
3. The Austerity Spiral

IMF loans come with conditionalities: reduce fiscal deficit, raise interest rates, cut subsidies, devalue currency, and privatise key utility sectors. These measures slow economic growth, which reduces tax revenues and export competitiveness. The result? The country needs additional IMF tranches and Eurobond issuances merely to remain solvent.

4. The Minsky Moment

Hyman Minsky, a post-Keynesian economist, argued that financial stability is inherently destabilising: prolonged calm encourages ever-riskier borrowing, moving from "hedge" (able to repay principal and interest) to "speculative" (able to pay interest but must roll over principal) to "Ponzi" (cannot even cover interest, needing new debt to pay old interest). The Minsky Moment is the sudden collapse when lenders stop rolling over loans, forcing distressed sales and crisis. For Pakistan, each new Eurobond or IMF tranche that merely rolls over maturing debt without building genuine export earnings moves the country closer to that moment where no buyer appears for the next bond, reserves evaporate, and default becomes unavoidable.

A Visual Representation of the Cycle: The Debt Trap



This is the debt trap as described by Michael Rowbotham in his 2000 book Goodbye America!: Globalisation, Debt and the Dollar Empire(2). According to him, the post-WWII financial system, shaped by creditor nations, forced poorer countries to borrow in foreign currencies, setting the stage for perpetual, unrepayable debts. For Rowbotham, Third

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[2]Rowbotham develops this argument specifically in Goodbye America! (2000); his earlier book, The Grip of Death (1998), addresses fractional-reserve banking and domestic debt-based money creation rather than Third World sovereign debt.

World debt (including Pakistan's Eurobond) is a moral fiction: "immoral, invalid, and inherently unrepayable."

What Would a Genuine Stability Policy Look Like?

The current approach is crisis management, not stability. A genuine post-Keynesian-inspired stability policy for Pakistan would require the following.

Solutions for Pakistan to Avoid the Debt Trap

The previous analysis of Pakistan's Eurobond inflow, IMF conditionalities, and post-Keynesian critique leads to one inescapable conclusion: the current path of rolling over foreign-currency debt is unsustainable. What follows is a set of coherent policy solutions to break the vicious circle.

1. Shift Exports from Dollar Dependence to Currency Swap Networks

Pakistan's exports fell to $25.21 billion in the first ten months of FY26 (10MFY26), a decline of over 6% from the previous year. One major reason is the reliance on dollar-denominated trade, which exposes exporters to rupee devaluation, dollar shortages, and volatile global financing costs. The solution is to aggressively expand non-dollar export markets using bilateral currency swaps.

How to implement:

- Activate existing swap agreements with China

(RMB), Russia, Iran, and Turkey. Ensure that commercial banks offer exporters letter of credit (LC) facilities directly in RMB, rouble, or lira, bypassing the dollar entirely.

- Negotiate new swaps with ASEAN nations (Indonesia, Malaysia) and Central Asian republics (Uzbekistan, Kazakhstan), where Pakistan already has diplomatic ties but low trade volume.
- Set a national target: increase the share of non-dollar exports from current limited levels to 30% of total exports within three years. This would insulate roughly $12 billion of export earnings (calculated against Pakistan's combined goods-and-services exports of roughly $40 billion) from dollar devaluation and reserve volatility.

Expected outcome: Exporters face lower currency risk, transaction costs decrease, and Pakistan can continue trading even when dollar reserves are under pressure. This directly counters the debt trap by earning foreign currency without creating new dollar liabilities.

2. Import Substitution Policy: Replace Imports with Domestic Production, Reject IMF Liberalisation

Imports rose to $57.19 billion, up 7% year-on-year, while exports fell. This is the opposite of what a stable economy requires. The IMF's insistence on removing non-tariff barriers and liberalising imports will only worsen the trade deficit. Pakistan must instead pursue a strategic import-substitution policy.

Priority sectors for localisation:

- Electronics: Implement a phased five-year plan to end imports of electric and electrical appliances. Allocate low-cost financing (via the State Bank's refinance schemes) to companies that commit to local component manufacturing.
- Power equipment: The domestic market is $5.3 billion annually, with 90% met by imports. Enforce local procurement quotas (30-35% within three years) for transmission and distribution equipment. Adjust tariffs to protect nascent local manufacturers.
- Ceramics: Pakistan has reduced import dependency in this sector from 74% to 4%. Replicate that model by offering the same combination of FDI incentives and local-content requirements to other industries.
- Steel and auto components: The "Sea to Steel Corridor" could cut steel imports by 20% ($13 billion over a decade). Mandate localisation for auto assemblers (as India has done) and provide tax credits for domestic reprocessing of scrap steel.

Policy mechanism:

- Do not comply with IMF Article VIII obligations that require removal of import restrictions when the balance of payments is in crisis. Pakistan has legal grounds under the same IMF articles to maintain temporary import controls.
- Impose a surcharge on luxury and non-essential imports (e.g., completely built-up (CBU) cars, high-end electronics, branded cosmetics) to reduce dollar outflows without hurting industrial inputs.
- Redirect financing: the SBP should instruct commercial banks to prioritise lending to the above import-substitution sectors, with interest-rate subsidies drawn from savings on reduced import bills.

Expected outcome: Within three years, import substitution could reduce the annual import bill by $8-10 billion, directly improving the current account without requiring new foreign loans.

3. Keep the Current Account Deficit Below 2% of GDP; Finance Only with Long-Term, Non-Debt Flows

Approved financing instruments:

- Long-term FDI (minimum five-year lock-in): target strategic sectors such as minerals processing (Pakistan's government estimates untapped reserves at $6 trillion, though independent geological assessments put recoverable value considerably lower), renewable energy, and IT infrastructure. Use government-to-government (G2G) channels rather than relying on portfolio flows.

- Local currency swaps: when essential imports (e.g., oil from Russia, machinery from China) must be financed, structure the payment as a currency swap, not a dollar loan. The central bank agrees to exchange rupees for yuan or roubles at a fixed rate, with no net dollar outflow.
- Build-Operate-Transfer (BOT) models: for major infrastructure (ports, highways, power plants), invite foreign firms to build and operate for 15-20 years, then transfer ownership to Pakistan. This attracts private capital without any immediate current-account hit. Payment can be in local currency or through toll-revenue sharing, not dollars.

Prohibited instruments:

- No new Eurobonds with maturity under seven years. The three-year bond just issued is exactly the kind of short-term, dollar-denominated liability that creates the Minsky risk.
- No acceptance of bilateral deposits from Saudi

Arabia, UAE, or China that are callable (withdrawable on short notice). Any bilateral support must be in the form of project-linked long-term loans with at least ten-year maturities and grace periods.

- No hot-money portfolio investment in the stock exchange or T-bills. Institute a Tobin tax (0.5% on inflows and outflows of less than one year) to discourage short-term speculation.

Expected outcome: The CAD is financed by patient, productive capital that does not create a refinancing cliff. Pakistan's external vulnerability drops dramatically because no single maturity date poses a rollover risk.

4. Cancel or Restructure Morally Invalid Debt (Rowbotham's Prescription)

Following Michael Rowbotham's argument in Goodbye America!: Globalisation, Debt and the Dollar Empire (and, earlier, The Grip of Death), much of Pakistan's external debt, particularly Eurobonds issued at high yields, short maturities, and in foreign currency, is morally invalid. It was incurred not for productive investment but to service previous debt, rolled over at predatory rates, and imposed through coercive IMF conditionalities.(3)

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[3]This is a version of the "odious debt" argument. Odious debt is a well-established doctrine in international law and economics, with precedent

Practical steps:

- Commission a sovereign debt audit to identify which external liabilities meet the criteria of "odious" or "morally invalid" debt, defined as debt that was not used for the benefit of the Pakistani people, was contracted without proper parliamentary oversight, or was imposed under duress.
- Unilaterally suspend payments on the most egregious Eurobonds (e.g., the 2026 issuance, with its three-year maturity and hidden devaluation cost) while entering good-faith negotiations for restructuring.
- Organise a coalition of Global South nations (Sri Lanka, Ghana, Zambia, Egypt) to collectively demand a new sovereign debt resolution mechanism under the UN, bypassing the Paris Club and IMF-dominated processes.

Expected outcome: Even if outright cancellation is politically difficult, a successful restructuring that extends maturities to 20 years and swaps dollar-denominated bonds for local-currency instruments (with GDP-linked coupons) would transform the debt from a trap into a manageable burden.

in the US repudiation of Cuba's Spanish colonial debt in 1898, and has since been invoked by Ecuador, Iraq, and others in modern debt restructuring. See Jayachandran & Kremer (2006).

5. Monetary Reform: Separate Money Creation from Banking (Rowbotham's Long-Term Solution)

Ultimately, the debt trap exists because Pakistan cannot borrow in its own currency and because most money is created as interest-bearing debt by commercial banks. The post-Keynesian and Rowbotham solution is sovereign money creation.

Implementation:

- The SBP would become the sole creator of the rupee, spending new money into existence for public infrastructure, education, health, and direct job creation, all without borrowing.
- Commercial banks would become true intermediaries, lending only the deposits they hold, rather than creating new money through fractional-reserve lending.

Expected outcome: With the ability to create debt-free money for productive investment, Pakistan would no longer need to borrow dollars for domestic spending. The external account would be reserved only for financing genuine trade deficits, not for rolling over past debt.

Conclusion: From Debt Trap to Economic Growth Path

The solutions above are not theoretical; each has been implemented successfully in other countries (e.g., China's currency swaps for trade, Malaysia's capital controls in 1998, India's import substitution in electronics). For Pakistan, avoiding the debt trap requires abandoning the IMF-led model of dollar-dependent, short-term borrowing and replacing it with:

1. Non-dollar exports via swaps.

2. Import substitution via domestic production financing.

3. CAD financing only through long-term FDI, BOT, and local currency swaps.

4. Debt cancellation or restructuring of morally invalid obligations.

5. Monetary reform to break the debt-based money-creation system.

The current Eurobond inflow is not a solution; it is a symptom of the trap. The path to genuine stability lies in the above policies, implemented decisively and collectively.

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