CAPITAL ACCOUNT LIBERALISATION AND DEVELOPMENT IN PAKISTAN

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Abstract

This paper explores Pakistan's experience of capital account liberalisation and its effects on the economic performance of the country. Pakistan initiated the process as early as in the mid-1980s, however major policy changes were introduced towards the end of 1990s in response to IMF's conditions. Today most capital controls on inflow transactions have been relaxed and the country's capital account is essentially fully liberalised in that context, however the outflows by residents are not allowed to flow as freely. By using a multivariate VAR model on quarterly data from 1990-2017, the paper concludes no significant impact of opening of the capital account of Pakistan. A review of policies and trend of capital flows suggests that it is largely because a substantial portion of foreign inflows to Pakistan comprise of external debt (i.e., short-term commercial bank credit and official loans) rather than long term stable direct investment. Moreover, these funds have been used by the government to stabilise liquidity in the foreign exchange market instead of being directing towards productive investment. Fluctuation in economic performance of the country, large current account deficit, overvaluation of the exchange rate and political instability have in turn triggered capital outflows. In addition, insufficient design and implementation of complementary policies pertaining to reforms in domestic financial sector and fiscal discipline have limited any potential positive impact that opening up of capital account could have had on the economy.