

**Structural Vulnerabilities and Economic Stability in Pakistan: Explaining IMF and World Bank Reliance (2018–2025)**

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**ABSTRACT**

*Frequent instances of economic instability in Pakistan—marked by rising inflation, a weakening currency, fiscal challenges, and external funding shortages—are often viewed as results of macroeconomic disturbances as well as underlying structural flaws. This paper explains how structural vulnerabilities reduce Pakistan’s resilience and increase reliance on international financial institutions (IFIs), particularly the IMF and the World Bank. Using a conceptual and analytical framework, the study evaluates Pakistan across six variables: (i) GDP and GNP growth behavior and volatility relative to regional peers; (ii) the pattern and quality of economic growth; (iii) inflation (including episodes exceeding 15%) and debt servicing costs and their implications for fiscal health (with emphasis on 2018–2025); (iv) trade and investment dynamics, including export-led sector constraints and import dependence; (v) employment outcomes, including unemployment levels (often estimated around 6–7%), skill mismatch, underemployment, and informality; and (vi) industrial and technological capacity, including limited diversification and low R&D investment (often reported near 0.3% of GDP). By synthesizing the existing literature, this paper contends that the instability in Pakistan arises not only from external shocks but also from ongoing limitations in productivity growth, the ability to mobilize fiscal revenue, competitiveness in exports, labor absorption, and capacity for innovation. Ultimately, it suggests policy approaches designed to lessen reliance on the IMF and World Bank by focusing on structural transformation, building credibility, and enhancing domestic financing capabilities.*

**Keywords:** Pakistan economy, structural vulnerabilities, debt servicing, trade dependence, labor market informality, industrial diversification, IMF programs.

**INTRODUCTION**

The economic viability of a country is directly proportional to its capacity to maintain price stability, external sustainability, and financial stability, along with development objectives. Pakistan has witnessed a number of macroeconomic challenges as well as periods of stability, with challenges such as higher rates of inflation, declining foreign currency reserves, and growing need to address public debt. Factors such as fluctuations in commodity prices and changes in global interest rates have a huge

impact on Pakistan. However, on closer analysis, it has been noted that macroeconomic instability often results in crises due to fundamental structural issues.

One of the notable features of Pakistan's crisis prevention/crisis management strategy has been the reliance on IFIs. Typically, support from the IMF is associated with stabilization financing and associated policy conditionality. This usually involves fiscal adjustment, monetary tightening, and structural reform efforts to restore balance of payments stability. Development financing and associated institutional support are more characteristic of support from the World Bank. Yet again, the repeated experience may be associated with an impression of inadequate domestic policy space. The question that arises here is that why are structural vulnerabilities persisting even after the implementation of IMF/World Bank support?

The objective of this paper is to analyze the basic factors that are responsible for the unstable economy of Pakistan and its reliance on support from the IMF and the World Bank, with a focus on the period from 2018 to 2025, while drawing on a longer period.

### **Aim**

To analyze the core structural factors driving Pakistan's economic instability and strengthening its reliance on IMF and World Bank programs.

### **Objectives**

The paper evaluates Pakistan across the following variables:

- GDP and GNP performance: consequences of historical growth volatility (often in the ~3–5% band at various times) compared to regional peers.
- Economic growth rate: durability, inclusiveness, and productivity orientation of growth.
- Inflation and debt servicing: impact of high inflation, which may include figures above 15%, and debt servicing.
- Trade and investment: performance by sector, composition of trade, and reliance on external markets or resources.
- Employment and Labor Force: unemployment is projected to be about 6-7%, along with a skills gap, underemployment, and informal job situations.
- Industrial and Technological Opportunities: There is limited diversity in our industrial base, and the allocation for research and development typically remains near ~0. 3% of GDP.

### **Research question**

What role do structural vulnerabilities play in Pakistan in interacting with macroeconomic shocks to create instability, hence increasing reliance on IFI financing and conditionality?

## CONCEPTUAL FRAMEWORK AND LITERATURE REVIEW

The theme that cuts across much of the macroeconomic and development literature is that instability results from the interaction of shocks with weak economic fundamentals. Vulnerabilities such as low revenue mobilization, export competitiveness, and productivity problems limit the capacity to withstand shocks without causing destabilizing inflation, exchange rate, and fiscal balance problems. The debt dynamics literature also points to the impact of high inflation rates, currency depreciation, and refinancing risks that may generate debt sustainability problems even when the initial deficits are small, due to the worsening of interest growth differentials (IMF, 2013).

Institutional and policy-credibility perspectives further argue that when policymakers face weak constraints and inconsistent policy signals, expectations become unstable, strengthening inflation persistence and destabilizing capital flows (Blanchard, Dell' Ariccia, & Mauro, 2010). In such settings, IFI programs can become a mechanism for restoring credibility and financing gaps—yet structural weaknesses may cause repeated cycles.

### **Growth, Volatility, and Macro-Fiscal Feedback**

Growth volatility which refers to the instability, unpredictability, or rapid fluctuations in an economy's rate of growth, usually measured by the standard deviation of GDP growth, can undermine fiscal stability by reducing tax revenues and increasing contingent spending. In addition, when growth is concentrated in low-productivity sectors or constrained by energy supply, investment quality declines and long-run productive capacity stagnates (World Bank, 2022). The literature on fiscal policy emphasizes that in developing economies, fiscal slippages often interact with exchange-rate and inflation dynamics through financing methods (IMF, 2020).

### **Inflation, Fiscal Health, and Debt Servicing**

Fiscal health is the ability of a government to meet its financial obligations and pay for services, now and in the future. It indicates long-term sustainability by analyzing revenue, expenditure, debt levels, and flexibility to manage economic shocks. A healthy entity can balance its budget and maintain infrastructure. Inflation is also closely associated with fiscal capacity (government's potential ability to generate revenue (through taxes or other sources) to finance public goods and services without jeopardizing economic stability). Domestic debt is closely associated with higher inflation because of its impact via monetization pressures, increased risk premia, and expectations (Blanchard et al., 2010). High inflation also reduces the value of revenues raised with administrative lag and raises uncertainty, which can undermine investment (IMF, 2020). High inflation and depreciation can accelerate debt service due to nominal debt accumulation, which can create a vicious cycle (IMF, 2013).

### **External Sector Stress, Trade Structure, and Conditional Stabilization**

The balance-of-payments constraint is another phenomenon that frequently appears in Pakistan's macroeconomic instability. According to the literature, the effects of export concentration, import dependence, and low levels of foreign direct investment, which are likely to result in balance of payments difficulties, are addressed. In such situations, programs from the IMF often aim at reducing demand, aligning exchange rates, and implementing policies that enhance external competitiveness

(IMF, 2020). A significant perspective has arisen, suggesting that macroeconomic approaches aimed at managing instability might not be enough on their own. The need to implement guidelines that will not only boost productivity but will also enhance export growth cannot be overstated. Despite their capability to provide temporary solutions to stabilize any financial situation, financial organizations often ignore the underlying issues that are creating the instability (World Bank, 2022).

### **Labor Market Outcomes and Inclusiveness**

The degree of inclusion within the labor market is essential to determine if economic growth will have any welfare benefits on a national scale. When unemployment is moderate but informality and underemployment are high, it is possible to experience “weak job-rich growth.” This is because informality can undermine fiscal resilience and shocks, while skill mismatch can undermine the capacity for sectors to grow in labor-demanding activities (ILO, 2018; World Bank, 2019).

### **Industrial Capacity, Technology, and Innovation Constraints**

The relationship between system innovation and improvement in the industry is based on the improvement in productivity and competitiveness in exports. Research in the field of innovation economics has shown that low investment in research and development, as well as poor relationships between businesses and universities, result in the slow diffusion of technology (World Bank, 2022). Where diversification is low in a country, stagnant productivity and lack of improvement in exports pose a risk to the balance; therefore, there is a high probability of requiring external funding.

### **Historical Context (with focus on 2018–2025)**

#### **GDP and GNP: Growth Volatility and Development Constraints**

Pakistan’s growth has been influenced by business cycles in global conditions and policy disturbances in the country. While the growth rates may vary in a ‘moderate’ range, the importance lies in the fact that volatility affects investment, accumulation of human capital, and predictability in revenue (IMF, 2020). The past has shown that Pakistan’s growth has often been interrupted by macroeconomic imbalances and financing constraints, which means that growth is not necessarily supported by investment in productivity-enhancing ways.

In comparison to more industrially diversified economies, the economic growth in Pakistan has failed to show corresponding productivity gains. Wherever the GNP is affected by net factor income (profits, interest, and remittances), the role of external debts and patterns of external earnings may also come into play. Under such conditions, external borrowing and IFI intervention become more likely because the economy cannot finance structural investment internally (IMF, 2013; IMF, 2020).

Implication for stability: growth volatility weakens fiscal buffers and reduces the ability to finance external obligations, increasing the need for balance-of-payments support.

#### **Economic Growth Rate: Sustainability and Excellence**

At its essence, development is crucial; growth that solely depends on temporary boosts in investments, rising consumption, or inconsistent fiscal and monetary strategies is prone to collapse when financial

resources are limited. Research on stabilizing the economy suggests that reliable policies are essential for maintaining investment and reducing risk premiums (Blanchard et al. , 2010). In the case of Pakistan, periods of instability have often been accompanied by rising inflationary expectations, exchange rate adjustments, and/or fiscal tightening that may squeeze public investment and slow employment creation.

Moreover, when growth does not expand into more valuable tradable goods, it limits the increase in earnings from exports. This emphasizes the repeated “stop-go” cycle, in which periods of consistent advancement are followed by new challenges stemming from unresolved core issues (World Bank, 2022). Implication for stability: If the economy does not focus on improving productivity and boosting exports, it will keep encountering restrictions on creating steady foreign currency.

### **Inflation above 15% and Debt Servicing: Fiscal Health under Stress**

Elevated inflation levels arise from and additionally lead to structural disparities. When inflation surpasses 15%, it leads to a decline in purchasing ability, increased uncertainty, and less access to financial means. Inflation can also affect the fiscal balances due to the delay in revenues and increase in interest expenses. In Pakistan’s case, debt servicing is a major fiscal challenge in many periods due to interest expenses crowding out resources for development and social spending (IMF, 2013). The debt sustainability literature recognizes that debt vulnerabilities can escalate quickly in an environment with high inflation and exchange rate depreciation driving up domestic currency values of foreign exchange debt while nominal interest rates are high (IMF, 2013). Once debt servicing becomes a dominant fiscal issue, governments can cut back investment, which in turn can slow productivity growth further.

**Emphasis on 2018-2025:** Pakistan’s period includes several episodes with high inflation and large changes in exchange rates and nominal interest rates. These conditions have often limited flexibility in budgets and increased the possibility of seeking IMF assistance to stabilize economic factors and provide funds (IMF, 2020).

**Effects on Stability:** High inflation and debt repayment limit policy options, which in turn limits stabilization efforts and requires foreign financial assistance.

### **Trade and Investment: Export Dependency and External Financing Gaps**

The external vulnerability of Pakistan is also related to trade structure. In a situation where exports are growing at a slower rate than imports due to low diversification, low competitiveness, and limitations in tradable sectors, external balances are likely to be under pressure. This will impact the reserves as well as the exchange rate. (IMF, 2020)

The export-driven growth theory, just like literature on development, highlights the fact that the advancement of value chains is supported by the maintenance of macroeconomic stability, investments in enhancing productivity, and the effectiveness of industrial strategies. In reports issued by the World Bank on issues of development, there are often references to issues like high logistics costs, unreliable infrastructure, and issues of accessing finance, etc. (World Bank, 2022) In situations where there is a high reliance on exports and a pressing need to import raw materials, changes in global demand and prices can have a big impact on the balance of payments.

Implication for stability: In relation to the issue of macroeconomic stability, the balance of payments position of Pakistan puts it in a position where it has to rely on foreign finance, which is often backed by financial institutions in a crisis.

### **Employment and Labor Force: Unemployment, Underemployment, and Informality**

The issue of employment is a stability issue because it relates to household welfare, social cohesion, and political economy. In cases where unemployment is not a major concern in an economy, Pakistan's challenges in its labor market involve issues with underemployment and informality. Informal employment in Pakistan not only contributes to low levels of tax compliance but also limits productivity growth because firms tend to stay small and informal (ILO, 2018; World Bank, 2019).

The issue of skill mismatch limits labor absorption in growing sectors. Where growth does not support the needs of the labor market, particularly among youths, welfare-related issues undermine stability to sustain reforms, causing instability (World Bank, 2019).

**Implication for stability:** low job creation and informality make it harder to sustain stabilization with a focus on reforms.

### **Industrial and Technological Capacity: Diversification Limits and Low R&D**

It has been observed that there is a link between the growth of productivity and improvements in exports with technological abilities. When R&D investment is low (commonly cited as ~0.3% of GDP), firms are not able to take up new processes or products. This affects competitiveness as well as upgrading to higher value-added activities (World Bank, 2022).

The limited diversification makes Pakistan's growth vulnerable to sector-specific shocks as well as fluctuations in the global cycle. In such situations, stabilization policies may be effective in re-establishing macroeconomic stability, but without addressing industrial capabilities, underlying external balances are not addressed.

**Impact on stability:** a lack of innovation and poor diversification maintain gaps in productivity and limit exports, increasing dependence on the IMF.

### **Why IMF and World Bank Dependence Persists**

Drawing from the literature reviewed, Pakistan's reliance can be explained as a repeated interaction among:

1. Macroeconomic shocks (external interest rates, commodity prices, exchange-rate pressures)
2. Weak fiscal buffers (revenue capacity constraints; high interest costs; debt dynamics)
3. External gaps (export constraints; import dependence; limited reserve resilience)
4. Limited structural transformation (industrial upgrading delays; technology gaps)

5. Labor market vulnerabilities (informality, mismatch, low job-rich growth)

The IMF programs are usually geared to resolving some of these issues under (2) and (3) on a short-term basis. The World Bank programs are geared to resolving some of these issues on a longer-term basis. However, if some of these issues under industrial policies, innovation capabilities, and revenue generation are still difficult to resolve, then there is a risk that the economy could fall into instability once again, thereby creating a cycle of reliance on these institutions once more (IMF, 2020; World Bank, 2022).

The IFI programs may be able to alleviate some of the symptoms, but some of the underlying causes are still there.

### **Strategies to Reduce Dependency on IMF and World Bank Programs**

The paper's policy discussion is organized as "prevention," "credibility," and "capacity-building."

#### **Improve domestic fiscal capacity and debt management**

- Strengthen tax administration and reduce narrow exemptions that weaken the base (World Bank, 2022).
- Building frameworks for spending over the medium term, safeguarding key investment in development while keeping public debt at sustainable levels (IMF, 2013).
- Improving debt management, which will help reduce refinancing risks as well as better align domestic and international borrowing.

#### **Build credible inflation and exchange-rate frameworks**

- To reduce the persistence of inflation influenced by expectations, enhance the credibility of policies by ensuring coordination between monetary and fiscal measures (Blanchard et al. , 2010; IMF, 2020).
- Tackle supply chain issues and improve energy pricing efficiency to diminish the factors causing structural inflation (IMF, 2020).

#### **Transition from stabilization-only to reforms focused on growth and productivity**

- While stabilization offers respite, actual growth necessitates upgrades in productivity:
- Safeguard and prioritize public investments that yield high growth multipliers (logistics, human resources, infrastructure) (World Bank, 2022); modify business environment barriers to foster investment in tradable goods.

#### **Strengthen export competitiveness and diversify trade/investment opportunities**

- Implement measures that simplify trade, hence reducing the cost and time of export and import.
- Assisting value chain development in areas with export opportunities, with a focus on productivity support rather than protection.
- Improving access to finance for small to medium-sized enterprises as well as exporters to build upon these advances and achieve quality standards (World Bank, 2022).

#### **Confront informal employment and workforce issues**

- To address the issue of improving job matching as well as labor market prospects, it is important to enhance training and apprenticeship programs that match the needs of industries (World Bank, 2019).
- The development of formal jobs is to be encouraged through the simplification of policies as well as incentives.

#### **Build Innovation Systems and Increase R&D Effectiveness**

- Increase R&D and innovation spending while improving governance of R&D programs to ensure measurable outputs (World Bank, 2022).
- strengthen university–industry linkages and technology transfer mechanisms to accelerate diffusion.

#### **Develop External Resilience and Reduce Stop–Go Financing Risk**

- Encourage longer-term financing, reserve buffers, and risk management for external shocks (IMF, 2020).
- Improve current account sustainability by aligning import demand with productivity-building investment.

### **DISCUSSION**

The main contribution that this paper makes is to link weaknesses to ongoing instability and dependency on international financial institutions. As programs from international financial institutions like the IMF and World Bank help stabilize various macroeconomic balances, the fact that this situation persists means that reforms need to address basic issues that have to do with fiscal strength, competitiveness in exports, development in industry, and the ability to innovate. Moreover, the weakness of the labor market has implications for inclusiveness as well as the political environment, which has implications for reliability as well.

Hence, breaking free from dependency is not only about meeting program objectives but rather developing capabilities to support stability through productivity as well as fiscal/external resilience.

## CONCLUSION

The economic instability of Pakistan can be best understood as an outcome of structural factors that have an impact on the economy. Factors like high rates of inflation, which have touched as high as 15% or even more at times, have a negative impact on the economy. Also, the fact that Pakistan's economy is struggling to pay off its debt adds to the instability. Another factor that adds to the instability of the economy of Pakistan is that of employment, as the unemployment rates are at an average of mid-single digits. The fact that there is limited diversification of industry adds to the instability of the economy of Pakistan.

Hence, it can be concluded that if the government of Pakistan wants to reduce its reliance on the support of the IMF and the World Bank, it will have to shift from crisis management to crisis prevention.

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