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Strategic Management of Pakistan's Forex Reserves: Boosting Exports & Investment Flows

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POLICY ACTION: WAY FORWARD

A. STRENGTHENING FOREX MANAGEMENT

Pegged Exchange Rate

Adopt a currency peg with scheduled evaluations based on adequacy ratios and the REER index.

Enhance Through NPCs & RDA

- Offer incentives for 3 & 5-year NPCs to attract long-term investment.
- Allow RDA investment in SEZs and agricultural processing to boost productive investment.

Strengthen Formal Channels

- Offer cash incentives or open-market-aligned exchange rates for FOREX deposits and withdrawals.
- Gradually integrate exchange companies into banks to formalize inflows and curb hoarding.

Forex Capital Controls

- Restrict leisure travel during low forex shortages.
- Apply periodic tourism fees, require purpose documentation for non-business travel.
- Lower credit card limit to $15K, or impose a 5-10% fine on excess spending.

Other Measures

- Incentivize dollar deposits with tax exemptions for year-long holdings.
- Promote digital transactions by cutting per-transaction & annual fees for businesses, particularly in the tourism sector.

B. ADVANCING TRADE AND FOREIGN INVESTMENT STRATEGIES

Enhancing Trade & Export Regulations

- Update FBR valuation to curb under-invoicing, avoid ad-hoc import bans.
- Set export-linked import quotas, and amend SBP's export fines policy with sector-specific exceptions.

Strengthening Bank Infrastructure

- Simplify opening conditions for Corporate FCAs
- Encourage the use of multinational banks for enhanced coordination or support local banks in opening international branches to avoid payment delays.

Boosting Trade & Payments Platform

- Promote trade within the Asian region and use of PKR in ACU trade and attract export-driven FDI through sector-specific incentives.
- Ease policy and regulatory barriers to bring global payment platforms like PayPal.

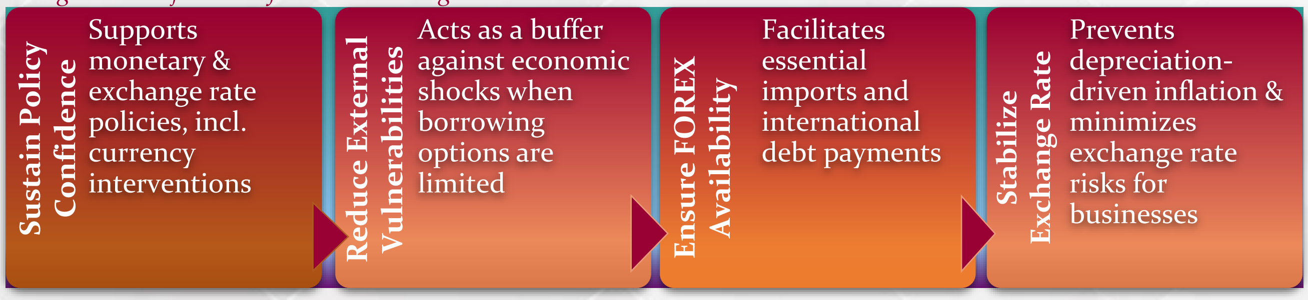
Advancing Skill Development

- Revitalize institutions via public-private partnerships and mandate vocational education alongside secondary schooling.
- Issue internationally recognized certifications for a competitive workforce

1. INTRODUCTION

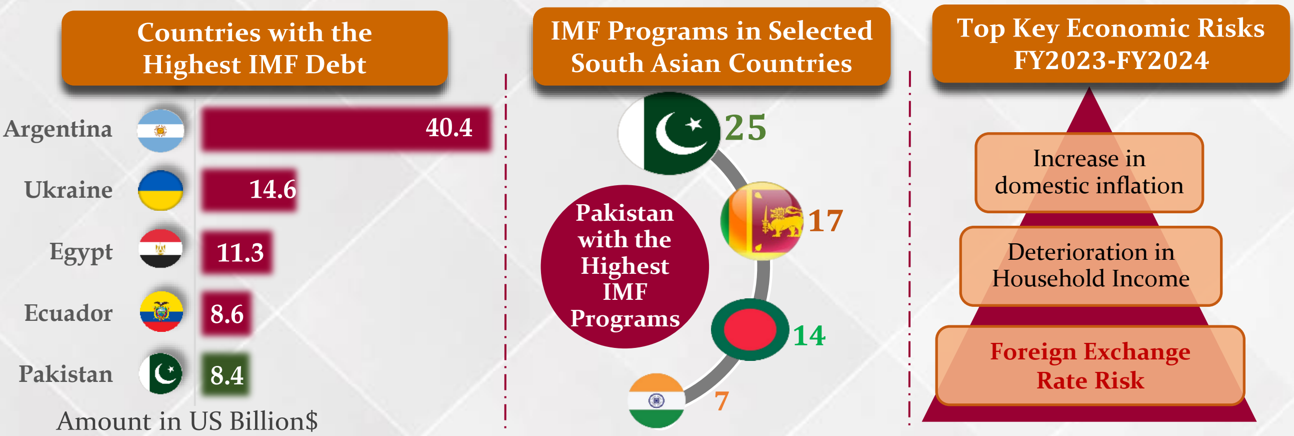
In the dynamic landscape of global finance, foreign exchange reserves represent a cornerstone of economic stability and resilience for countries worldwide. As shown in Figure 1, the primary objectives of forex management are multifarious yet interconnected.

Figure 1: Objectives of FOREX management



A pertinent illustration of these objectives can be seen in the case of Pakistan's economy. Pakistan's ongoing Balance of Payment crisis, driven by a trade deficit, has led to repeated IMF interventions, underscoring the need for strong reserve management (Figure 2).

Figure 2: Pakistan's Forex Challenges, IMF Dependence, and Economic Risks

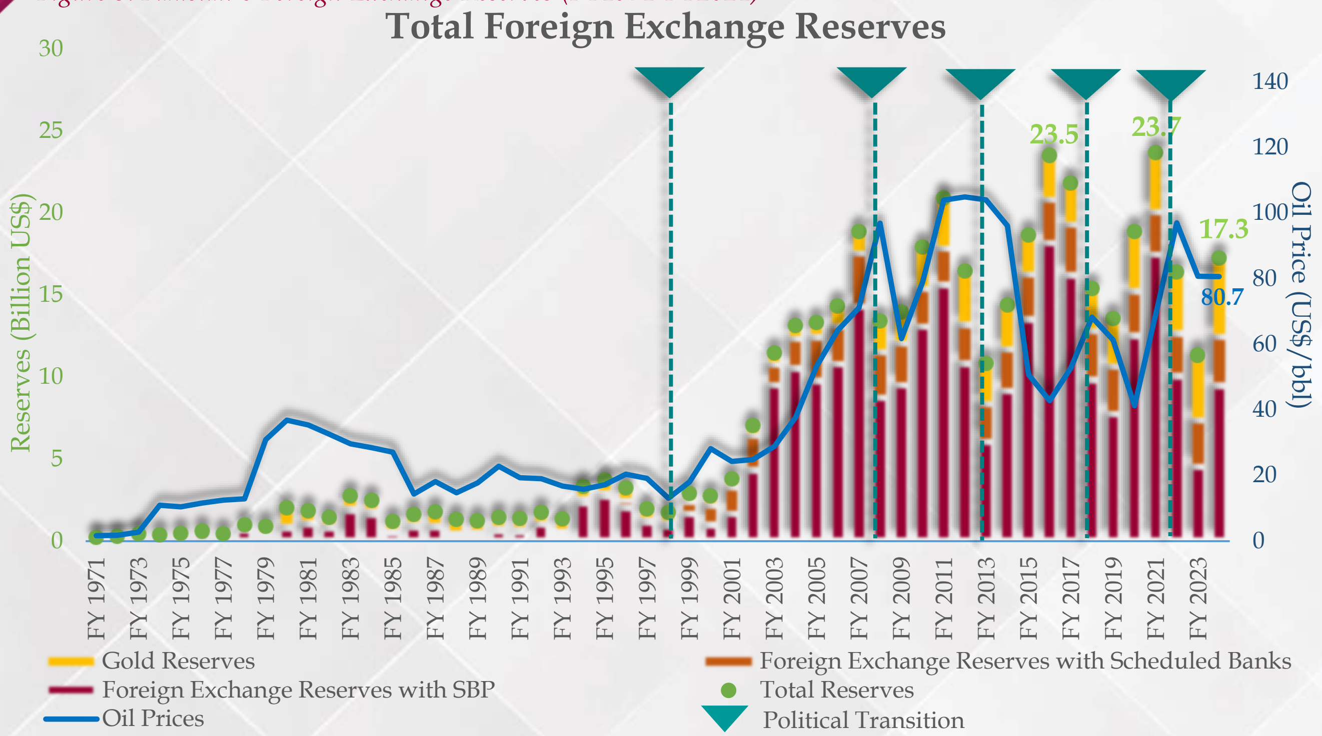


Source: International Monetary Fund (IMF) and SBP's Systematic Risk Survey
Note: IMF Loan Values are updated as of January 2025

2. FOREX RESERVES AND EXTERNAL SECTOR

Pakistan's foreign exchange reserves have seen significant fluctuations over the years, reflecting the country's economic shifts and external factors. The reserves steadily grew over time from $0.2 billion in 1960 to a peak of $23.5 billion in 2016 before declining to $11.3 billion in 2023, a level insufficient for three weeks of imports. In response, the government implemented measures, such as banning imports of over 500 items, restricting letters of credit (LCs), and introducing cash margin requirements. These steps helped curb import growth and conserve crucial foreign exchange reserves. By FY2024, Pakistan's liquid net forex reserves had rebounded to $17.3 billion, with the State Bank of Pakistan's (SBP) holdings rising to $9.5 billion.

Figure 3: Pakistan's Foreign Exchange Reserves (FY1971-FY2024)



Source: State Bank of Pakistan (SBP)

Box 1: Key factors playing role in Pakistan's forex reserves

Oil Shocks:
Oil price shocks (such as in 2008, 2012-13, 2022) strain Pakistan's forex reserves, as petroleum imports account for 30% of the import bill and 55-65% of the export earnings.

Political Cycles:
Political transitions weaken reserves by eroding investor confidence, triggering capital flight, and reducing foreign inflows due to policy uncertainty.

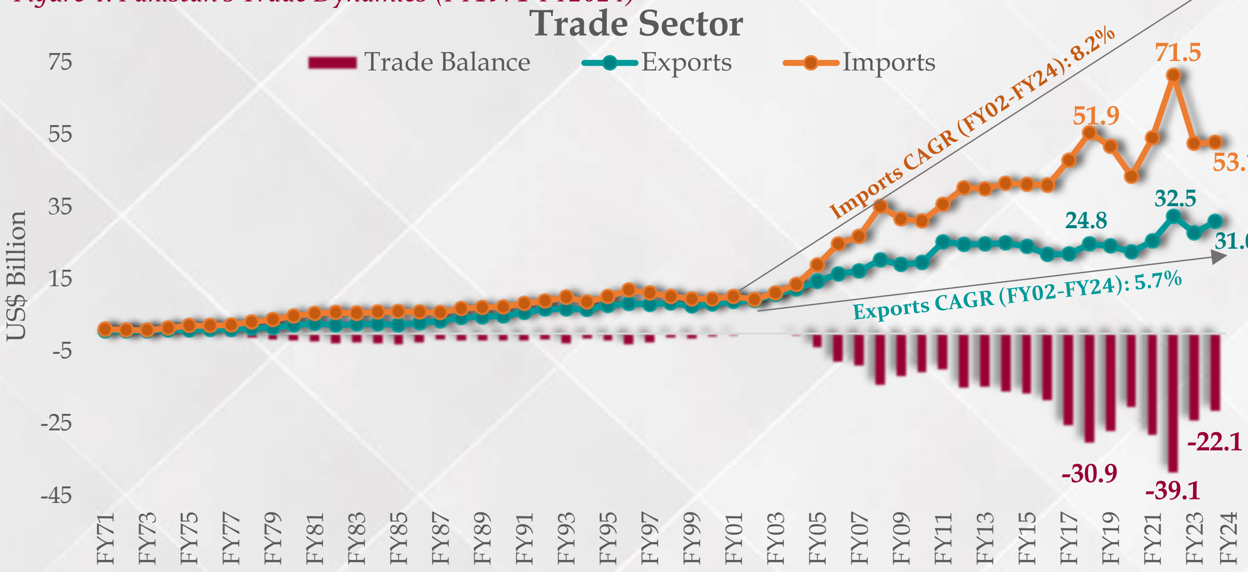
These dwindling reserves have imparted considerable stress on exchange rate stability, inflation trends, and the broader economic landscape. Beyond exchange rate movements, key factors influencing reserves must be examined to thoroughly understand the fluctuations (Flow Chart 1). The inflow of foreign exchange in Pakistan is mainly through export proceeds, foreign direct investment (FDI), and remittances (Bashir et al., 2014).

Flow Chart 1: Understanding FOREX Reserves Flow in Pakistan

2.1. TRADE SECTOR

Pakistan's trade dynamics have experienced significant shifts over the years, with a growing disparity between exports and imports. Various factors, including the limited diversification of exports and an increasing reliance on imports, have fueled this growing imbalance. Since trade liberalization, exports grew at a compound annual rate of 5.7% from FY 2004 to FY 2024, reaching $31.0 billion, but they remain stagnant with a narrow base. In contrast, imports expanded at 8.2% CAGR, reaching $53.1 billion in FY 2024, outpacing exports. The controlled trade deficit in FY2022-FY2024 resulted from government-imposed import restrictions amid exchange rate volatility and a near-default crisis, which led to a $17 billion drop in imports.

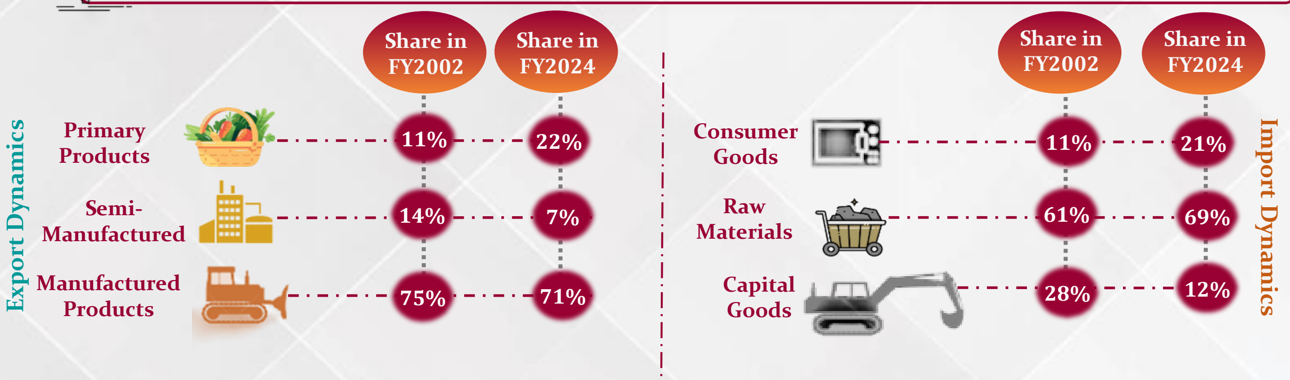
Figure 4: Pakistan's Trade Dynamics (FY1971-FY2024)



Source: State Bank of Pakistan (SBP)

Over the past two decades, Pakistan's export composition has shifted more towards primary products, while the share of semi-manufactured and manufactured goods has declined. Simultaneously, imports reflect a growing preference for consumption over investment, with an increased share of consumer goods and raw materials alongside a decline in capital goods posing challenges for industrial growth, and long-term development (See Box 2).

Box 2: Shifts in Pakistan's Export and Import Composition (FY2002-FY2024)

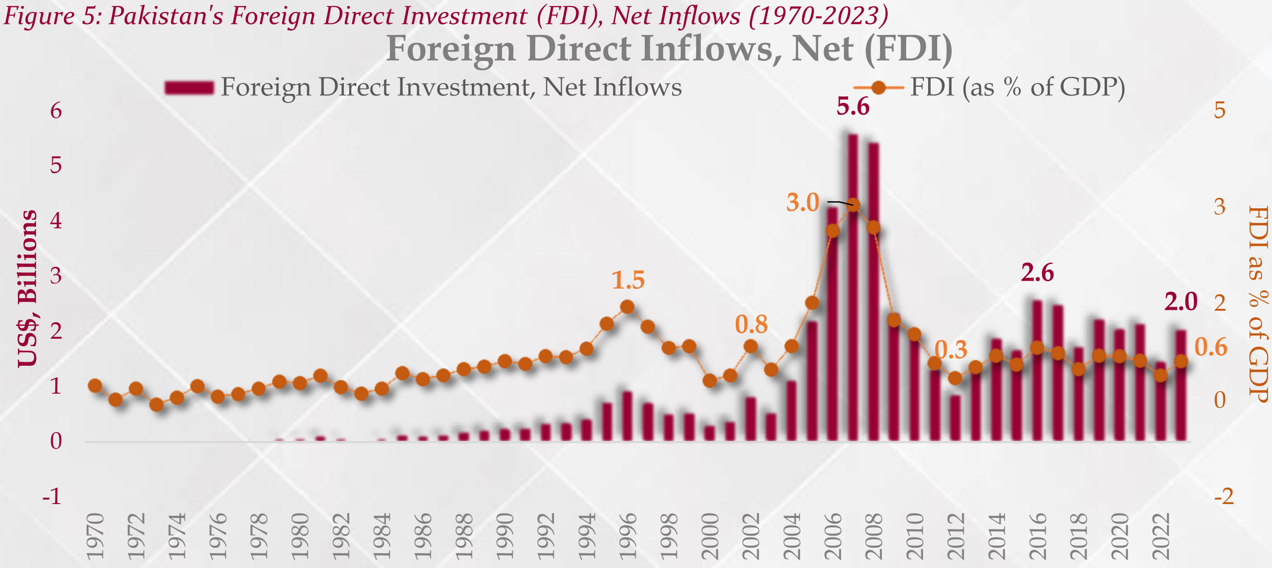


Source: Pakistan Economic Survey (2023-24)

2.2. FOREIGN DIRECT INVESTMENT

FDI plays a vital role in economic development by providing capital, technology, and expertise. In Pakistan, the FDI has remained volatile, peaking at $5.59 billion in 2007 before dropping to $1.82 billion in 2023. Surges in 1990-1996 were driven by forex liberalization (allowing up to 100%), withdrawal of restrictions on profit repatriation, and currency holdings), while the mid-2000s boom stemmed from privatization and sectoral expansion. However, political instability and security concerns have led to a sharp decline since then.

Figure 5: Pakistan's Foreign Direct Investment (FDI), Net Inflows (1970-2023)



Source: World Bank (WB)

Pakistan's average FDI-to-GDP ratio stands at 0.66%, lagging behind regional peers. Notably, peak FDI inflows in Pakistan were concentrated in consumption-driven sectors like energy, and finance, unlike Vietnam, where FDI has been export-driven and focused on manufacturing (See Box 3).

Box 3: FDI Patterns in Pakistan vs Regional Peers

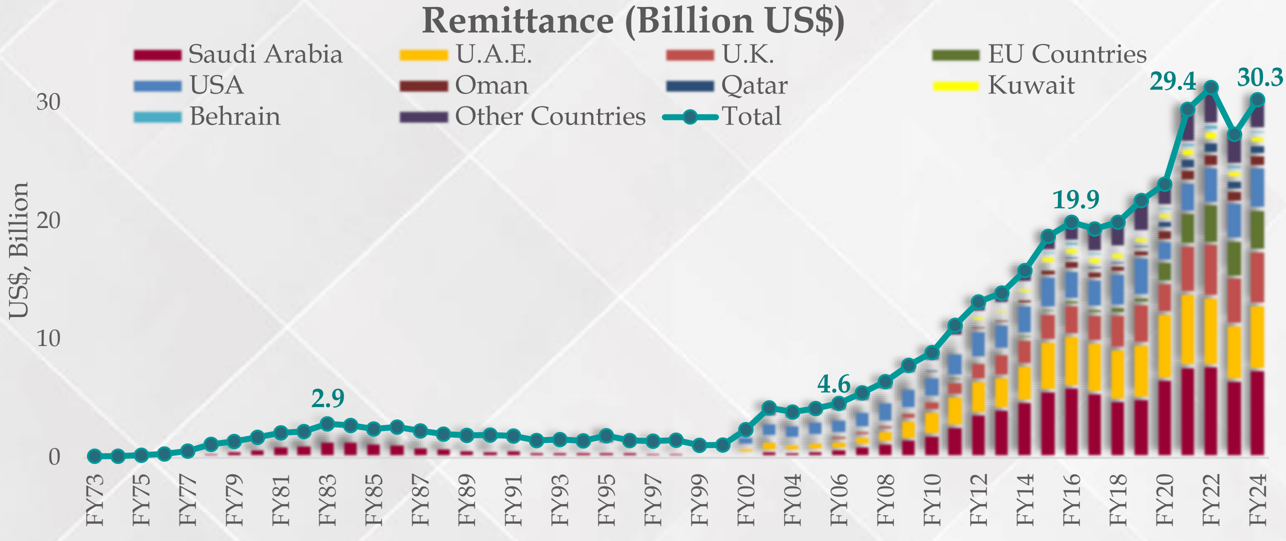
Source: World Bank (WB) and State Bank of Pakistan (SBP)

2.3. REMITTANCES

Workers' remittances have played a critical role in bolstering Pakistan's foreign exchange reserves. From FY 1976 to FY 2006, annual remittance inflows remained below $5.0 billion. However, during the FY 2007 to FY 2024 period, remittances grew significantly—from $5.5 billion to $30.3 billion—reflecting the increasing reliance on overseas Pakistani workers. The majority of these inflows originate from Saudi Arabia (30.94%), the UAE (15.54%), the United States (13.11%), and the United Kingdom (11.82%).

Despite this growth, remittances continue to face challenges due to informal transfer channels such as Hawala and Hundi. These are largely driven by disparities between official and parallel market exchange rates, with the gap reaching Rs. 23 in 2023. The figure below illustrates the evolving trends in remittance volumes and their key source countries.

Figure 6: Pakistan's Personal Remittances, Received (FY 1973-FY 2024)



Source: State Bank of Pakistan (SBP)

Pakistan recorded one of the highest Compound Annual Growth Rates (CAGR) of 6.1% for remittances during 2013-2023. However, despite 8.9 million overseas workers, remittances per expatriate lagged behind Mexico, the Philippines, and India as shown in Table 1.

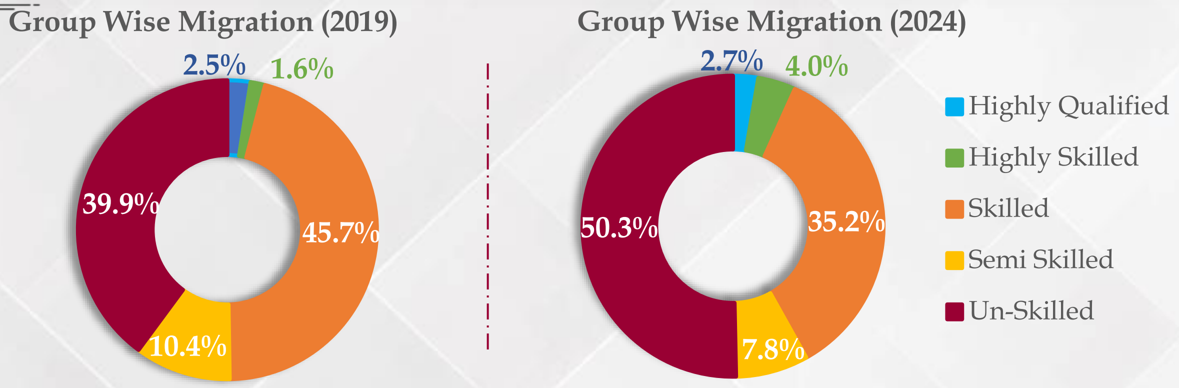
Table 1: Personal Remittances, Received - Selected Competitor Countries (2013-2023)

Countries	Remittance (US$ Million)		Remittance CAGR (%)	Remittance per Capita 2023 (US$ Million)	Remittance Per Expatriate (US$ Million)
	2013	2023	2013-2023		
Philippines	26,716.8	39,096.9	3.9	340.3	16,779.8
Thailand	6,584.9	9,692.0	3.9	136.5	9,703.0
Mexico	23,976.1	66,237.8	10.7	510.5	5,914.2
China	17,790.1	29,110.3	5.0	20.6	4,626.2
India	69,970.4	119,526.1	5.5	83.1	3,906.3
Bangladesh	13,867.0	22,168.0	4.8	129.3	2,948.7
Pakistan	**14,629.0**	**26,558.0**	**6.1**	**107.3**	**2,529.3**
Indonesia	7,614.4	14,466.8	6.6	51.4	1,808.4
Sri Lanka	6,422.2	6,022.6	-0.6	273.3	1,800.0

Source: World Bank (WB)

Migration from Pakistan has increased in recent years, warranting a closer look at labor outflows. In 2024, just 7.8% of migrants were highly skilled, 39.2% were skilled or semi-skilled, and 50.3% were unskilled. The share of unskilled workers has risen since 2019 and is likely underreported (see Box 4).This trend reflects a disconnect between industry demands and the training offered by Pakistan's Technical and Vocational Education and Training (TVET) system. Only 6% of the labor force is enrolled in TVET programs, and just 2.5% receives on-the-job training. These gaps highlight the urgent need for skill development to boost workforce competitiveness.

Box 4: Out-Migration Trend in Pakistan

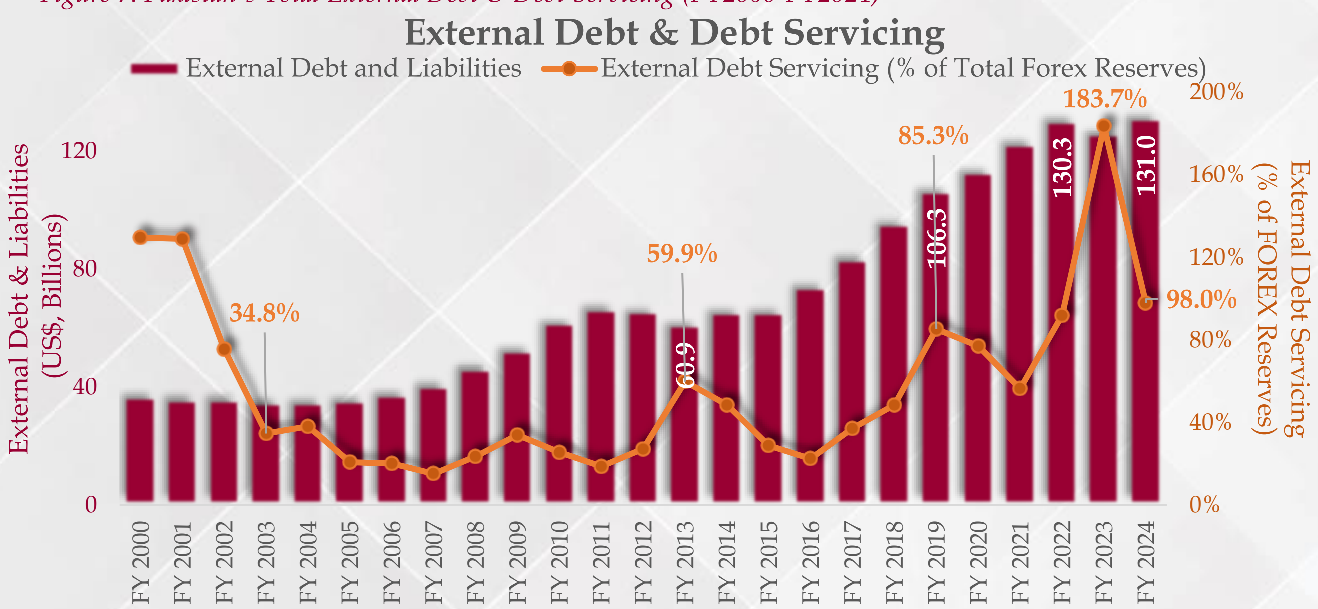


Source: Bureau of Emigration & Overseas Employment (BE&OE)

2.4. EXTERNAL DEBT

Pakistan's external debt has been a major factor in the depletion of foreign exchange reserves, rising from $32.2 billion in FY2000 to $114.1 billion by FY2024—with $59.4 billion added over the past decade (FY2013–FY2024). Foreign commercial banks and multilateral lenders remain primary sources of this debt. The mounting pressure on reserves is evident, as debt servicing rose from 34.8% of reserves in FY2003 to 59.9% in FY2013, and nearly tripled to 98.0% by FY2024, underscoring the increasing strain on Pakistan's financial stability..

Figure 7: Pakistan's Total External Debt & Debt Servicing (FY2000-FY2024)

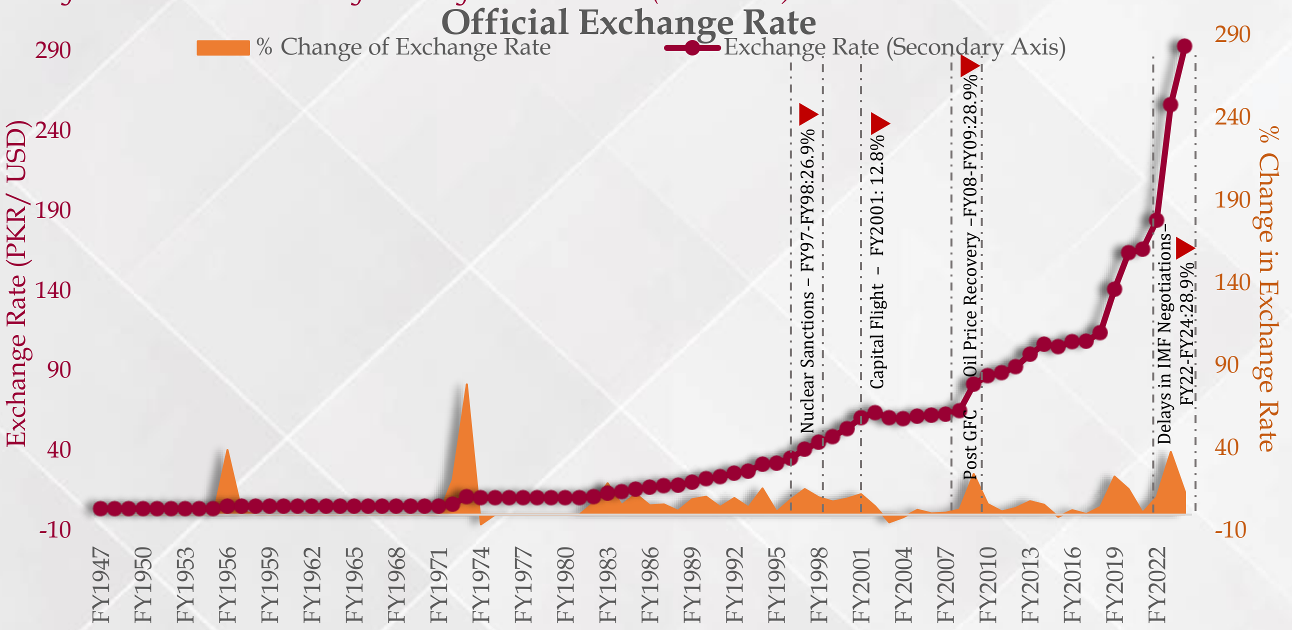


Source: State Bank of Pakistan (SBP)

3. EXCHANGE RATE REGIMES IN PAKISTAN

Pakistan's currency has shifted through various exchange rate regimes: pegged from 1947-1981, managed floating from 1982-1999, and flexible since 1999 as per SBP's claims. However, according to the IMF, the Pakistani government has periodically intervened to stabilize the rate. There are five notable periods when the Pakistani Rupee (PKR) witnessed massive depreciation indicated in the graph below.

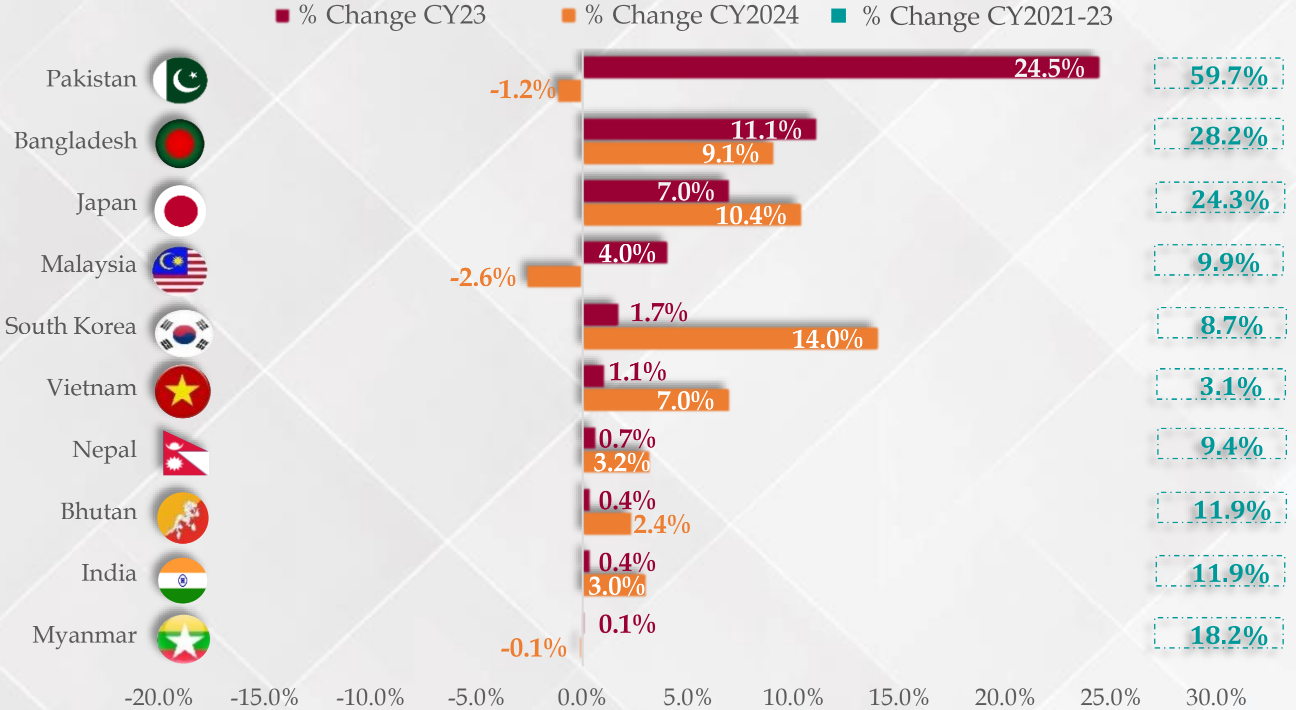
Figure 8: Pakistan's Exchange Rate against US Dollar (1947-2024)



Source: State Bank of Pakistan (SBP)

Box 5: Asia's Worst Performing Currency 2023 – PAK Rupee (PKR)

Pakistan faced the steepest depreciation in 2022 and 2023, totaling 59.7%. The rupee depreciated by 28.3% in 2022 and 24.5% in 2023, positioning it as the second-worst (after Sri Lanka) and worst-performing currency in Asia, respectively, during these periods.



Source: International Monetary Fund (IMF)

Note: The top 10 Asian countries have been taken with the most significant currency fluctuations during 2024.

4. PAKISTAN'S FOREIGN EXCHANGE FRAMEWORK

4.1. FOREIGN EXCHANGE REGULATIONS

- **Foreign Currency Accounts Restrictions (FCAs):**
  - FCAs allow individuals to receive remittances, and foreign currency payments from government securities, and issue travelers' cheques. Corporations can open FCAs to receive foreign loans or equity for investments in securities or real estate.
  - Corporate FCAs require extensive documentation, NTN numbers, and biometric verification, causing delays in opening accounts.
  - Since 2018, only active tax filers (individuals not corporates) can hold locally purchased dollars in FCAs to reduce malpractices.
  - Limited coordination between local and intermediary banks results in delays in international remittances and payments.

- **Remittance Restrictions on Exchange Companies:** Since 2022, SBP introduced several restrictions on authorized dealers, including requirements for remittance inflows to pass through Pakistani banks. Buying, selling, and inward/outward remittances now require specific documentation. Additionally, the minimum capital requirement for dealers has been increased.

- **Realization of Export Proceeds & LC Closures:** Along with restricted LC openings, SBP introduced fines for delayed export payments beyond 180 days, with penalties ranging from 3% to 9% in 2023. These fines aim to prevent forex shortages and stabilize the rupee, but exporters argue that delays are often due to banking procedures rather than deliberate withholding. While the LC restriction offered short-term relief, the measure disrupted exports by limiting access to imported inputs, slowing industrial activity.

- **Restrictions on Foreign Currency Outflows:**
  - **Spending Limits:** While FCAs have minimal restrictions, individual credit card spending is capped at $30,000 annually, making a total of $63.4 billion on 2.1 million cards currently in use[1]. In addition, no restrictions on frequent foreign trips for tourism have also been putting downward pressure on reserves.
  - **Travel Limits:** Annual limits are $30,000 for adults and $15,000 for minors, while per-visit limits have been reduced to $5,000 for adults and $2,500 for minors.

- **Lack of International Money Transfer Agencies:** Pakistan lacks services like PayPal and Stripe due to regulatory hurdles (minimum capital requirement, three-stage license approval)[2], fraud risks, and weak security laws. Freelancers rely on costly alternatives or foreign IDs to keep their forex earnings abroad. Despite exiting the FATF grey list, economic instability and policy uncertainty continue to block these services, leading to nearly $1 billion in undocumented IT service exports.

[1] SBP's Payment Systems Quarterly Review (Q12024-25). Available at: https://www.sbp.org.pk/psd/pdf/PS-Review-Q4FY25.pdf

[2] https://www.sbp.org.pk/ps/EMI.htm#:~:text=Under%20the%20Regulations%2C%20Prospective%20EMI,the%20Final%20Approval%20i.e.%20License.

4.2. COMPARATIVE ANALYSIS WITH OTHER COUNTRIES

a. **Diaspora Bonds:** Diaspora bonds have become a crucial tool for governments to tap into overseas communities' financial resources during crises, with revenues supporting relief and infrastructure projects. Key highlights from the comparison of overseas bonds are as follows:

- Pakistan's NPCs and the Philippines' RTBs are open to both resident and non-resident investors, unlike India's NRI Bonds and Bangladesh's WEDB.
- Bangladesh's WEDB limits returns to local currency (BDT), while Pakistan offers foreign currency options.
- Despite consecutive policy rate cuts, Pakistan's returns remain competitive.
- India's NRI Bonds attract more overseas investors due to stronger local institutional frameworks.

Table 2: Comparison of Non-Resident/ Overseas Bonds

Country / Features	Pakistan	India	Bangladesh	Philippines
Program Title	**Naya Pakistan Certificate (NPC)**	**Non-Resident Indian (NRI) Bond**	**Wage Earners Development Bond**	**Retail Treasury Bond (RTB)**
Requirement	Roshan Digital Account (RDA)	NRO / NRE Account	Overseas Account	Savings Account
Currency	PKR, USD, GBP, Euro	Any FC or INR	BDT	Any FC or Peso
Minimum/ Maximum Investment	Min.: 5K for PKR, GBP & Euro, 10K for USD, Max.: None	Min.: Varies across types of bonds (INR 1,000) Max.: None	Min.: BDT 25,000	Min.: PHP 5,000
Tenure	3, 6, 9 Months, 1, 3, 5 yr	1 to 40 yrs	6 months - 5 yrs	5 year
Profit Rates	5.25% - 13.50%	5-10%	6.53%-12%	Fixed Rate: 6.25%
Profit Payment Frequency	For 3,6,9 Months: Paid on Maturity, For 3-5 yr: Semi-Annually	Semi-Annually/ Annually	Semi-Annually (Payment in BDT only)	Quarterly
Pre-Mature Encashment	Fully/ Partially at a lower return linked to the nearest maturity	Allowed	Allowed at lower returns in BDT; Principal can be repatriated in FC on maturity	-
Tax Treatment	10% WHT on Profits No Return Filing	Mostly Tax-Exempt	Tax Exempt on Funds & Profits	20% Final WHT with some exemption
Additional Benefits	Pledgeable in certain cases	Offers Investment in State/ Municipal Development Loans, Corporate Bonds, Green Bonds	- Pledgeable - Reinvestment is available up to 15 years	-Convertible -Reinvestment Options -Duty-free Import of Households -Access to FOREX at favorable Rates

Sources: SBP, ICICI Bank, Vance.Tech, Policy Bazar, Bangladesh Bank, Philippines Bureau of the Treasury
Note: NRO = Non-Resident Ordinary, NRE = Non-Resident External, FC = Foreign Currency, WHT = Withholding Tax

b. Skill Development Programs: Skill development is key to workforce competitiveness and remittance growth, especially in migrant-heavy economies like Pakistan, India, and Bangladesh. Pakistan lags, with only 6% TVET participation and 2.5% on-the-job training.[3] The table below highlights these key differences. Key highlights from the comparison of skill development programs are as follows:

- Pakistan faces a TVET-industry mismatch due to minimal private sector involvement, unlike India and Bangladesh with massive industry engagement.
- Government incentives in India and Bangladesh drive higher TVET success, while Pakistan's limited support hinders private-sector engagement.
- Despite HEC's collaboration with Microsoft and Coursera, access to globally recognized certifications in Pakistan remains limited, reducing workers' global employability.
- Pakistan's TVET programs majorly focus on IT, while India diversifies into multiple sectors and Bangladesh tailors training to GCC market needs.

Table 3: Comparison of Skill Development Programs

Characteristics	Pakistan	India	Bangladesh
Government Based Popular TVET Program	Youth Skill Development Program (PMYSDP)	Skill India Skill India Mission	SEIP Skills for Employment Investment Program (SEIP)
Internationally Recognized Certification	Provincial certifications lack federal recognition, Limited international exposure	National & Internationally recognized Certificates	International certification for the SEIP trainees for certain occupations
Focus Sectors	National/Public Institutions: IT & Computer Services	IT & Agriculture, Drone, tech-based farming, Auto Mechanics	Sector-specific, aligned with GCC markets (Pharma, IT, Agro-food Processing)
RPL Programs	Still in development, with mechanisms and criteria for assessment, equivalencies, being established	Strong: 47% of certified earn higher, 63% workplace recognition	Focused on migrant workers (post-COVID)
Industry Engagement	Low Participation Outdated Curriculum The gap between supply and industry needs Few players like Engro & Lucky Cement	Strong engagement in all sectors via Industrial Training Institutes (ITIs) in Curriculum Development	Engagement of Textile, Garment, and Leather Associations for workforce development
Incentives for Industry	Limited government incentives	The government bears 25-50% of the training costs	SEIP covers almost 90% of the training expenses
Marginalized Group	Dedicated Female Institutions, Lack of Awareness & Limited Reach, especially in rural areas	More females are certified in RPL than men	Coverage of Marginalized groups (women, Indigenous communities, & persons with disabilities)

Sources: UNDP (2017), UNESCO (2023), SEIP (2022)[4]

[3] https://www.uil.unesco.org/en/articles/recognition-validation-and-accreditation-pakistan
[4] https://seip-fd.gov.bd/wp-content/uploads/2022/07/Skills-for-Employment-Investment-Program-SEIP.pdf

5. CONCLUSION

Pakistan's foreign exchange position remains under pressure due to both external factors—such as volatile oil prices—and internal challenges, including trade imbalances, rising external debt, political instability, and currency depreciation. The consumption-oriented nature of FDI has limited its contribution to industrial and export growth. Although short-term measures like restrictions on letters of credit have helped stabilize reserves, they have also dampened industrial activity, affecting forex inflows. While remittances continue to rise, their full potential is constrained by informal transfer channels and a predominantly unskilled labor force. To ensure sustainable forex stability and long-term economic resilience, it is crucial to establish predictability in policy. This includes a comprehensive strategy centered on institutional strengthening, more effective FDI utilization, enhanced export competitiveness, and targeted investment in productive sectors.