



CENTRE for AEROSPACE & SECURITY STUDIES

**State Bank Independence
and
Pakistan's Economic Security**

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Research Assistant, Economic Affairs & National Development

Working Paper

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Abstract

In 2022, Pakistan witnessed two simultaneous and substantial developments on the national front, i.e., formal endorsement of the first National Security Policy (NSP) of Pakistan, 2022-2026, and adoption of the State Bank of Pakistan (SBP) Amendment Act, 2021 as law granting statutory independence to the SBP. The NSP categorically emphasises the importance of economic security and places it at the core of the national security vision. Given the critical role of central bank policies on key macro- and socioeconomic variables, it remains pertinent to ascertain what the SBP independence could mean for Pakistan's goal of economic security. In answering this, the paper presents detailed findings on the competing perspectives regarding SBP independence and draws their linkage with the domains of economic security highlighted in the NSP. The findings show that it is irrational and premature to deem any single perspective superior to another. At the same time, the study asserts that the SBP will have a critical role in determining Pakistan's progress in the domain of economic security. Therefore, it puts forward recommendations that can help ensure that the institutional independence granted to the SBP works to supplement Pakistan's efforts towards achieving the goal of economic security rather than acting as an impediment to it.

Keywords: State Bank, NSP, SBP Amendment Act, Economic Security, Central Banks, CBI.

Introduction

In recent decades, many countries have granted varying degrees of independence to their central banks in the design and execution of their policies. In a similar vein, the passage of the State Bank of Pakistan Amendment Act, 2021 granted statutory and institutional independence to the State Bank of Pakistan (SBP) in January 2022. The Act has introduced several key amendments in the previous SBP Act, 1956 in domains including, inter alia, policy objectives, terms of offices, procedure of appointments, or the mechanism for coordination between the government and SBP. In particular, it has modified the mandate of the SBP by placing price stability as the primary objective, followed by financial stability and economic growth. In doing so, the Act seeks to serve six key purposes that include:

- i. clearly outlining the SBP's objectives;
- ii. delineating its functions in accordance with the objectives;
- iii. making available the necessary financial resources to the Bank;
- iv. strengthening its institutional and functional independence;
- v. enhancing transparency in its operations; and
- vi. increasing accountability by expanding reporting requirements and oversight functions.¹

However, some scholars, economists, and policymakers have raised a cascade of apprehensions vis-à-vis the SBP independence. These apprehensions are backed by multiple arguments, ranging from potential intrusion of external entities in the country's economic affairs to the lack of accountability with regards to the Bank's inflation targets and the disconnect created between the monetary and fiscal authorities.

This clearly suggests that the subject of SBP independence remains a matter of debate. Given this, it would be pertinent to ascertain what the SBP independence means for Pakistan's vision of economic security as enshrined in the country's first-ever and recently endorsed National Security Policy (NSP), 2022-2026. Especially so, given that the NSP aims to reinforce Pakistan's human and traditional security by placing the dimension of 'economic security' at the nucleus of the national security

¹ Salman Siddiqui, "SBP Act Changes Won't Cause 'State Within a State'," *Express Tribune*, January 8, 2022, <https://tribune.com.pk/story/2337702/sbp-act-changes-wont-cause-state-within-state>.

vision. In this context, the policy document categorically states that the placement of economic security at the core of national security can best serve the country's vital national security interests.²

The paper, therefore, aims to explore what SBP independence could mean for Pakistan's goal of economic security. In answering this question, the paper will first provide an overview of the concept of Central Bank Independence (CBI) and the SBP Amendment Act, 2021. It will, then, present detailed findings on the competing perspectives regarding SBP independence and draw their linkage with the domains of economic security highlighted in the NSP. This is followed by discussion and policy recommendations.

Concept of Central Bank Independence

Central Bank Independence (CBI) refers to '*the freedom of monetary policymakers from governmental or political influence in the conduct of policy.*'³ This widely cited definition of CBI suggests that the primary aim of central bank autonomy is to prevent political meddling in decisions regarding policy tools that remain under the disposal of central banks. Given this, quite a few countries today have granted independent status to their central banks by bringing amendments in their respective laws on central banking.

However, central banks worldwide differ significantly with regards to the forms of independence that they enjoy, namely goal independence, operational/functional independence, and institutional independence (Table 1). Goal independence entails the ability of the bank to define its policy goals and decide on the instruments to pursue them. On the other hand, operational/functional independence indicates the central bank's freedom to select the means and tools necessary to attain the goals that governments have stipulated. Finally, institutional independence refers to the maximum extent of separation between the central banks and the domain of politics, either through the formal enshrinement of the bank's independence into law or through a significant degree of informal dissociation between politics and the central bank.⁴

² National Security Division, "National Security Policy of Pakistan 2022-2026," Government of Pakistan, <https://onsa.gov.pk/wp-content/uploads/2022/01/NSP.pdf>.

³ Carl E. Walsh, "Central Bank Independence," in *Monetary Economics. The New Palgrave Economics Collection*, ed. S.N. Durlauf and L.E. Blume (London: Palgrave Macmillan, 2010), 21.

⁴ Usman W. Chohan, "Central Banks as Public Managers," in *Reimagining Public Managers Delivering Public Value*, ed. Usman W. Chohan (New York: Routledge, 2021), 93.

Table 1: Forms of Central Bank's Independence

Forms	Explanation
Goal Independence	The central bank defines its own policy goals and decides on the instruments to pursue them.
Operational/Functional Independence	The central bank has the independence to select the means and tools necessary to attain the goals that governments have stipulated.
Institutional Independence	The central bank is independent to the maximum extent due to the formal enshrinement of its independence into law, protecting it from all forms of political pressures.

Source: Usman W. Chohan, "Central Banks as Public Managers," in *Reimagining Public Managers Delivering Public Value*, ed. Usman W. Chohan (New York: Routledge, 2021), 93.

To precisely measure CBI, Cukierman, Webb, and Neyapti's index based on four legal characteristics is widely employed (Box 1).⁵ According to this index, a central bank is more independent if the bank's board appoints the chief executive who has a longer-term in office and is not subject to dismissal, and if the bank has the authority to make independent policy decisions.⁶ Moreover, independence is also greater if the central bank's charter stipulates price stability as the overriding objective, and the bank is limited in terms of being able to direct credit to the government.⁷

Box 1: Characteristics of High Central Bank Independence

- i. The Chief Executive, appointed by the central bank board, has a long office term, and is not subject to dismissal.
- ii. The central bank makes most of its decisions independently from the governmental interference.
- iii. The charter of the bank mentions price stability as the primary goal of the bank.
- iv. The bank is limited in terms of being able to direct credit to the government.

Source: Carl E. Walsh, "Central Bank Independence," in *Monetary Economics*. The New Palgrave Economics Collection, ed. S.N. Durlauf and L.E. Blume (London: Palgrave Macmillan, 2010).

Central Bank Independence in Pakistan: State Bank of Pakistan Amendment Act, 2021

In Pakistan, the State Bank of Pakistan Act, 1956 first defined the role of the SBP, with inflation and growth being its dual objectives.⁸ Nevertheless, the Act of 1956

⁵ Walsh, "Central Bank Independence", 22.

⁶ Ibid., 358-359.

⁷ Ibid., 358-359.

⁸ Zafar Hayat, "Pakistan's Monetary Policy: Some Fundamental Issues," *Pakistan Institute of Development Economics* 56, no. 1 (2017): 31-58, <https://www.jstor.org/stable/44986515>.

underwent several amendments, including in 1994, 1997, 2012, and 2015,⁹ which extended the operations and control of the SBP (Table 2):

Table 2: Major Changes introduced in the SBP Act before 2021

Year of Amendment	Major Changes Introduced
1994	<ul style="list-style-type: none"> • SBP was given exclusive authority over the conduct of monetary policy keeping in view the government's national policy objectives.
1997	<ul style="list-style-type: none"> • SBP was allowed to assume the responsibility to monitor and formulate credit policy. • SBP was given the responsibility to determine the extent of the government's borrowing from commercial banks keeping in view liquidity expansion and credit requirements of the private sector.
2012	<ul style="list-style-type: none"> • Government was required to ensure zero net flow of borrowings from SBP by the end of each quarter. • Government was required to take necessary steps to retire the existing stock of SBP borrowings over the course of the next seven years.
2015	<ul style="list-style-type: none"> • An independent monetary policy committee was formed and orientated with the responsibility to: <ul style="list-style-type: none"> -formulate and support monetary policy, -make decisions pertinent to key interest rates, intermediate monetary objectives, and supply of reserves, and -propose regulations for the implementation of its decisions.

Source: Muhammad Farooq Arby, "State Bank of Pakistan: Evolution, Functions, and Organization," (paper, Munich Personal RePEc Archive, Munich, 2004), https://mpra.ub.uni-muenchen.de/13614/1/MPRA_paper_13614.pdf; SBP Amendment Act, 2012; State Bank of Pakistan, "The Role of Monetary Policy in Pakistan's Economic Stability and Growth," <https://www.sbp.org.pk/70/sup-12.asp>.

However, the SBP Amendment Act, 2021 reflects the most significant revision, granting statutory and institutional independence to the SBP. The following major revisions have been introduced (Box 2):

⁹ Finance Division, "Brief on State Bank Amendment Act 2021," Government of Pakistan, 2021, https://www.finance.gov.pk/SBP_Amendment_Act_2021.pdf.

Box 2: Major Revisions in SBP Act (2021)

- i. The SBP will serve the primary objective of price stability, followed by financial stability and economic growth as the secondary and tertiary objectives.
- ii. The Bank will no longer direct credit to a government-owned entity as opposed to the previous arrangement of limited borrowing (i.e., zero net quarterly borrowings).
- iii. The Monetary and Fiscal Policies Coordination Board (MFPCB) will cease to exist and be replaced by a 'close liaison' arrangement between the monetary and fiscal authorities.
- iv. The Bank will discontinue its quasi-fiscal operations but continue to provide refinancing facilities.
- v. The members of the Board of Directors, the monetary policy committee, any other Board committee, and the SBP employees will be immune from the proceedings of FIA, NAB, and the like institutions without the prior consent of the SBP's Board of Directors.
- vi. The term of the Governor, SBP, will be increased from 3 to 5 years.

Source: Finance Division "Salient Proposed Changes in the State Bank of Pakistan Act, 1956," Government of Pakistan, http://www.finance.gov.pk/SBP_Amendment_Act_2021.pdf.

State Bank Independence and Pakistan's Economic Security

The subsequent section discusses competing perspectives on the likely impact of SBP independence and draws their linkage with the goals of economic security, including reducing the external imbalance, and horizontal and vertical inequalities. Moreover, it also draws their linkage with the domains that can directly impact the above-mentioned dimensions including fiscal management; growth and development; and trade, investment, and connectivity, as highlighted in the NSP.

External Imbalance

The NSP emphasises the need for redressing Pakistan's current account deficit. The policy document states that this goal would be attained through export-oriented Foreign Direct Investment (FDI), export growth, and increased remittance inflows.¹⁰ Going by the optimistic line of reasoning on the SBP Amendment, an autonomous State Bank may have merits for redressing the country's current account deficit through export growth. Advocates of the SBP Amendment point to the fact that an

¹⁰ National Security Division, "National Security Policy of Pakistan 2022-2026."

autonomous central bank will benefit the economy's long-term needs, given that it will be insulated from governmental interference.¹¹

Evidence suggests that an overvalued rupee is the treasury's preferred policy due to economic and political reasons,¹² which increases the cost of production and erodes export competitiveness.¹³ It is also well-established that fiscal authorities in the past have attempted to manipulate exchange rates by exerting pressure over the SBP,¹⁴ thus, affecting the latter's performance. For example, during 2015-17, SBP's lack of empowerment to independently pursue its objectives inhibited its ability to adjust the surging external account deficit.¹⁵ Thus, an autonomous State Bank in the new scheme of things may prevent political meddling in determining policies on the exchange rate, avoid an over appreciation of the rupee, and raise the country's exports while lowering imports.

On the contrary, critical perspectives also indicate that the Amendment may have potentially negative consequences for the country's exports and external imbalance. With the SBP Amendment, price stability has become the overriding objective of the Bank. It is contended that the resultant seizure of the Bank's development role can risk the country's exports as the exporters remain dependent on the Export Refinance Facility (ERF) of the SBP.¹⁶ Moreover, concerns exist that the Amendment puts the SBP in a subordinate position vis-à-vis the International Monetary Fund (IMF) and the United States (US) government. The State Bank could, therefore, take decisions that can undermine the China-Pakistan Economic Corridor (CPEC), reduce South-South

¹¹ Pakistan Institute of Development Economics, *The Autonomy of State Bank: A Fresh Look at Central Bank Independence*, report (Islamabad: PIDE, 2021), <https://www.pide.org.pk/pdf/brief/The-Autonomy-of-State-Bank-Webinar-Brief-29.pdf>.

¹² Sajid Amin Javed, "First Response to the SBP Amendment Act 2021," (paper, Sustainable Development Policy Institute, Islamabad, 2021), https://think-asia.org/bitstream/handle/11540/13579/First-response-to-the-SBP-Amendment-Act-2021-First-Response_SA_Final.pdf?sequence=1.

¹³ Sajid Amin Javed, Wajid Ali and Vaqar Ahmed, "Exchange Rate and External Competitiveness: A Case of Pakistan," (paper, Sustainable Development Policy Institute, Islamabad, 2016), <https://think-asia.org/bitstream/handle/11540/9288/ExchangeRateandExternalCompetitiveness.pdf>.

¹⁴ Ramsha Noshab, "Should the State Bank be Autonomous," *GEO News*, January 5, 2022, <https://www.geo.tv/latest/391696-should-the-state-bank-be-autonomous>.

¹⁵ Nadir Cheema, "State Bank Independence," *Dawn*, April 26, 2021, <https://www.dawn.com/news/1620435/state-bank-independence>.

¹⁶ Mohammad Ishaq Dar, "State Sovereignty vs State Bank Autonomy," *News International*, November 15, 2021, <https://www.thenews.com.pk/print/908879-state-sovereignty-versus-state-bank-autonomy>.

trade and prospects for regional connectivity,¹⁷ which can adversely influence exports. This has already been demonstrated by Governor SBP’s decision to exclude export earnings accruing through land routes from aggregate export earnings.¹⁸ Table 3 provides a summary of this discussion:

Table 3: SBP Amendment and External Imbalance: Competing Views

Optimistic Views	An autonomous State Bank can help raise the country’s exports and lower imports by preventing political interference and, thus, over-appreciation of the rupee, which erodes export competitiveness.
Pessimistic Views	The Amendment puts the SBP in a subordinate position vis-à-vis the IMF and the US, which can lead it to make decisions that can undermine CPEC and reduce South-South trade.
	The seizure of the SBP’s development role can risk exports as exporters remain dependent on the Export Refinance Facility (ERF) of the SBP.

Source: Author’s compilation.

Inequalities

The NSP states that it is essential to remove the gap between the rich and poor and remove interregional disparities.¹⁹ Apprehension, however, exists that the SBP Amendment may have consequences for inequality, poverty, and social outcomes. This is backed by the latest evidence suggesting that autonomous central banks encourage the deregulation of markets, which increases the value of assets possessed by the wealthy and constrain fiscal policy, which can affect a government’s redistribution policies.²⁰ Moreover, during the initial phases of independence, central banks generally pursue a tighter monetary policy, which leads to a surge in unemployment. To counteract this, governments weaken labour market regulations, which eventually exerts negative pressure on the earnings of the poor.²¹

It has been argued that the inability of the Government of Pakistan (GoP) to engage in net borrowing from the SBP in the new scheme of things may compress the former’s

¹⁷ Centre for Aerospace & Security Studies (CASS), *Central Bank Independence: Reformation or Deformation*, report (Islamabad: CASS, 2022), <https://casstt.com/central-bank-independence-reformation-or-deformation-2/>.

¹⁸ Ibid., 14.

¹⁹ National Security Division, “National Security Policy of Pakistan 2022-2026.”

²⁰ Michael Aklin, Andreas Kern and Mario Negre, “Does Central Bank Independence Increase Inequality?” (paper, The World Bank, Washington, D.C., 2021), quoted in Sajid Amin Javed, “Monetary Policy for All: Understanding the Social Footprint of Monetary Policy in Pakistan,” (paper, Friedrich-Ebert-Stiftung, Islamabad, 2021), <https://library.fes.de/pdf-files/bueros/pakistan/18610.pdf>.

²¹ Ibid.

fiscal space and lead to spending cuts,²² which can inevitably hurt the poor and reduce development expenditures. This also coincides with the concern that the government's recourse to commercial banks and the resultant rise in debt may put the country's development-related expenditures on the backburner since debt servicing will be accorded priority.²³ Hence, within a pessimistic perspective, SBP independence may inhibit efforts to mitigate inequalities.

However, according to the alternative view, government borrowing from commercial banks is inflationary in nature and synonymous with printing money, which causes an increase in prices.²⁴ Moreover, advocates of CBI reference empirical findings that show a negative relationship between CBI and inflation in the aftermath of the oil price shocks in the 1980s.²⁵ Inflation, per se, is equivalent to an indirect tax and has the greatest effect on the poor.²⁶ These viewpoints are, thus, suggestive that eliminating the government's right to borrow from the SBP in the legal framework can generate poverty and inequality reducing effects. Table 4 provides a summary of this discussion.

Table 4: SBP Amendment and Inequalities: Competing Views

Optimistic Views	Government borrowing from central banks leads to increase in inflation. Thus, the inability of the government to borrow from SBP following the Amendment can help reduce inflation, which has the greatest effect on the poor.
	Empirical findings suggest that CBI has a negative relationship with inflation.
Pessimistic Views	An autonomous central bank can increase the value of assets possessed by the wealthy and adversely affect the government's redistribution policies by encouraging deregulation of markets.
	In the initial phases of CBI, central banks pursue a tighter monetary policy, which can lead to a surge in unemployment.
	The inability of the government to borrow from the SBP and the resultant recourse to commercial banks, which charge higher interest rates, can compress the government's fiscal space and lead to spending cuts.

Source: Author's compilation.

²² Usman W. Chohan, "Their Map, Our Territory," *Nation*, March 8, 2022, <https://nation.com.pk/2022/03/08/their-map-our-territory/>.

²³ Shahida Wizarat, "Making the SBP Autonomous or the Governor SBP All Powerful," *Consul*, March 2022, sec. O., 29.

²⁴ Finance Division, "Response to Common Misperceptions about State Bank of Pakistan Amendment Act, 2021," Government of Pakistan, https://www.finance.gov.pk/SBP_Brief_2021.pdf.

²⁵ Ishrat Hussain, "Central Bank Independence," [Online], <https://ishrathusain.iba.edu.pk/dawn-articles/CENTRALBANKINDEPENDENCE.pdf>.

²⁶ Finance Division, "Response to Common Misperceptions about State Bank of Pakistan Amendment Act, 2021."

Fiscal Management

The NSP states that continued fiscal deficits have surged public debt, and efforts are now being directed towards bringing debt to sustainable levels and increasing the state's ability to create higher revenue through a responsive, transparent, and progressive tax regime.²⁷ In this respect, optimistic reasoning would suggest that the SBP Amendment augurs well for the country's fiscal sustainability and revenue generation. It is evidenced that recourse to borrowing from the central bank in the past has delayed fiscal reforms,²⁸ and resulted in a lack of fiscal discipline, low revenue generation, and need for frequent IMF assistance.²⁹ With the SBP Amendment, the State Bank will no longer be able to guarantee any obligation of or direct credit to a public or government-owned entity (Article 9C), thus encouraging the government to increase domestic resource mobilisation by raising the tax-to-GDP ratios.³⁰

However, critics argue otherwise. The critical view contends that Article 9C will have detrimental consequences for fiscal management, as the current and successive governments will be unable to fix shortfalls in the fiscal budget through funds from the SBP.³¹ Moreover, the government's inability to engage in net borrowing from the SBP may increase domestic debt as it will have to resort to commercial banks, which generally charge higher interest rates.³² A higher indebtedness will exert further negative pressure on the fiscal space. Table 5 provides a summary of this discussion:

²⁷ National Security Division, "National Security Policy of Pakistan 2022-2026."

²⁸ Nadir Cheema, "State Bank Independence," *Dawn*, April 26, 2021, <https://www.dawn.com/news/1620435/state-bank-independence>.

²⁹ Erum Zaidi, "SBP Steps Up to Clear Misperceptions about Proposed Act," *News International*, January 9, 2022, <https://www.thenews.com.pk/print/923660-sbp-steps-up-to-clear-misperceptions-about-proposed-act>.

³⁰ Centre for Aerospace & Security Studies, *Central Bank Independence: Reformation or Deformation*.

³¹ Abid Mustafa, "National Security Policy: Where is Economic Security?" *Express Tribune*, January 31, 2022, <https://tribune.com.pk/article/97535/the-national-security-policy-where-is-the-economic-security>.

³² Zubair Khan, "Does SBP need Further Independence," *Express Tribune*, January 8, 2022, <https://tribune.com.pk/story/2337618/does-sbp-need-further-independence>.

Table 5: SBP Amendment and Fiscal Management: Competing Views

Optimistic Views	The government's inability to engage in net borrowing from SBP will encourage fiscal reforms and domestic resource mobilisation by raising the tax-to-GDP ratios.
Pessimistic Views	The government's inability to borrow from SBP will constrain its ability to fix shortfalls in the fiscal budget.
	The government's recourse to commercial banks for borrowing will increase the country's debt levels as commercial banks tend to charge higher interest rates.

Source: Author's compilation.

Growth and Development

According to the NSP, development, and growth are the hallmarks of a secure nation. It further asserts that consistently high growth is the need of time given a large number of annual entrants to the workforce today.³³ Therefore, the policy document calls for raising the savings rate and enhancing productivity in the agriculture, industrial, and services sectors.³⁴ The optimistic views on the SBP Amendment would suggest that the autonomy of the State Bank augurs well for the country's long-term growth and development as envisioned in the NSP.

First, government borrowing from the SBP inhibits savings by depressing interest rates. This lowers investment by virtue of the lower amounts of loanable funds in the financial system.³⁵ Elimination of the government's right to directly borrow from the SBP can, therefore, increase the savings rate and promote investment.

Second, prior to the SBP Amendment, clarity on the SBP's exact role relating to inflation, and economic growth, among other things, did not exist.³⁶ With the SBP Amendment, price stability has become the Bank's overriding objective, followed by financial stability and economic growth as the secondary and tertiary objectives. The clear specification of the Bank's goals would allow the SBP to prioritise its policy decisions, which is conducive for sustainable economic growth.³⁷ This also coincides

³³ National Security Division, "National Security Policy of Pakistan 2022-2026."

³⁴ Ibid.

³⁵ Riaz Riazuddin, "Perils of Direct SBP Credit," *Dawn*, February 22, 2022, <https://www.dawn.com/news/1676406>.

³⁶ Abdul Jalil, "Autonomy of the SBP," *News International*, March 25, 2021, <https://www.thenews.com.pk/print/809347-autonomy-for-the-sbp>.

³⁷ Shahzad Paracha, "Cabinet Approves Revised SBP Amendment Bill," *Profit*, December 29, 2021, <https://profit.pakistantoday.com.pk/2021/12/29/cabinet-approves-revised-sbp-amendment-bill/>.

with the evidence cited in favour of the SBP Amendment that price stability contributes to economic growth.³⁸

Third, prohibition on government borrowing from the SBP may incentivise it to focus on its revenue targets, thus stimulating the growth process.³⁹

However, the optimistic assertions remain increasingly challenged. First, critical arguments point out that the SBP Amendment will divert the Bank's focus towards solely stabilising prices at the expense of fostering growth and development,⁴⁰ as the latter has been relegated to the tertiary level. Second, as discussed earlier, development-related expenditures may suffer.⁴¹ Third, government borrowing from commercial banks will provide the latter with a prized client, which can potentially disincentivise them from lending to the industries and reduce the country's prospects for growth.⁴² Fourth, the disconnect created between fiscal and monetary authorities may also hinder growth, especially so, given that the economic community today has been emphasising the importance of integrating fiscal and monetary policies for durable economic growth.⁴³ This disconnect may cause the SBP to lay down a monetary policy having contradictory objectives to the country's growth needs,⁴⁴ and potentially even lead the SBP to work against the government's development agenda.⁴⁵ The latter assertion is backed by the Japanese example where the introduction of IMF-styled liberal ideology created space for the Central Bank of Japan to work against the Ministry of Finance and dismantle the national development model.⁴⁶ Fifth, the Amendment also absolves the Bank of its quasi-fiscal functions which are important to assist the key economic sectors,⁴⁷ thus having a negative impact on the latter. Lastly, the SBP has been pursuing an erroneous strategy to control cost-pull inflation by increasing the lending rate which intensifies the cost of

³⁸ Javed, "First Response to the SBP Amendment Act 2021."

³⁹ Pakistan Institute of Development Economics, *The Autonomy of State Bank: A Fresh Look at Central Bank Independence*.

⁴⁰ Mohiuddin Azam, "The State and the State Bank Autonomy," *Dawn*, January 10, 2022, <https://www.dawn.com/news/1668655>.

⁴¹ Wizarat, "Making the SBP Autonomous or the Governor SBP All Powerful," 29.

⁴² Mustafa, "National Security Policy: Where is the Economic Security?"

⁴³ Mirwaise Khan, "SBP Amendment Bill 2021: More Power and Zero Accountability," *Paradigm Shift*, April 21, 2021, <https://www.paradigmshift.com.pk/sbp-amendment-bill-2021/>.

⁴⁴ Institute of Policy Studies, "SBP Amendment Bill," May 18, 2021, <https://www.ips.org.pk/sbp-amendment-bill-2021/>.

⁴⁵ Usman W. Chohan, "The Vanguard of Geo-economics," *Centre for Aerospace & Security Studies*, January 18, 2022, <https://casstt.com/post/the-vanguard-of-geo-economics/559>.

⁴⁶ Ibid.

⁴⁷ Ibid.

production, and reduces output and investment, among other things.⁴⁸ Taken together, these multiple caveats suggest that the SBP Amendment may have growth- and development-inhibiting effects. Table 6 provides a summary of this discussion.

Table 6: SBP Amendment and Growth and Development: Competing Views

Optimistic Views	The government's borrowing from SBP inhibits savings by increasing interest rates. Thus, the elimination of the government's right to directly borrow from the SBP can increase the national savings rate and promote investment.
	Clear specification of the Bank's goals following the Amendment would allow it to prioritise its policy decisions, which is conducive to sustainable economic growth.
	Prohibition on government borrowing from SBP may incentivise it to focus on its revenue targets.
Pessimistic Views	The SBP Amendment will divert the Bank's focus toward stabilising prices at the expense of fostering growth and development.
	Government borrowing from commercial banks will provide the latter with a prized client, which can potentially disincentivise them from lending to the industries.
	The disconnect created between fiscal and monetary authorities may cause the SBP to lay down a monetary policy having contradictory objectives to the country's growth needs.
	The Amendment absolves the Bank of its quasi-fiscal functions which are important to assist key economic sectors.
	The SBP has been pursuing an erroneous strategy to control cost-pull inflation by increasing the lending rate which intensifies the cost of production and reduces output and investment.

Source: Author's compilation.

Trade, Investment and Connectivity

The NSP seeks to capitalise on Pakistan's geoeconomic location by enhancing connectivity with the Middle East, Africa, and Central and South Asia, build a win-win relationship in investment and trade and improve economic outreach aimed at increasing exports.⁴⁹ Within this context, it also observes that the China-Pakistan Economic Corridor (CPEC) offers Pakistan an opportunity to expand its industrial base and exports.⁵⁰ The critical viewpoint, however, highlights that SBP independence may not bode well for CPEC, prospects of regional connectivity and South-South trade.

⁴⁸ Wizarat, "Making the SBP Autonomous or the Governor SBP All Powerful," 30.

⁴⁹ National Security Division, "National Security Policy of Pakistan 2022-2026."

⁵⁰ Ibid.

First, it suggests that prohibition on the provision of guarantees for short-term relief by the government to the commercial banks in the SBP Act may create conditions for the collapse of the country's financial sector, thus impeding Pakistan's ability to meet expenditures related to CPEC.⁵¹ Second, as pointed out in an earlier section, the Amendment puts the SBP in a subordinate position vis-à-vis the IMF and the US government. The latter already antagonistic to CPEC in particular.⁵²

Conclusion and Recommendations

The preceding findings have shown that the present debate surrounding the SBP Amendment Act, 2021 remains highly divided. The optimistic reasoning suggests that the timing of the Amendment has coincided well with the launch of the NSP, which not only introduced the notion of 'economic security' but also placed it at the focal point. The pessimistic reasoning, however, suggests otherwise. Under these circumstances and given that no objective criterion can help determine the superiority of any single perspective with the multiple variables in question, it would be irrational and premature to show a bias towards a single perspective.

Although most of the evidence from around the globe testifies to the importance of CBI, it cannot serve as a reasonably strong basis given the differences in local contexts which affect the outcomes. For instance, evidence suggests that political economy constraints interact with the implementation of CBI reforms and affect the outcomes,⁵³ while the level of autonomy also influences the impact of CBI on inflation and macroeconomic variables.⁵⁴ In fact, it has been shown that the negative association between inflation and CBI ceases to exist once different dynamics are introduced into the model and the model is controlled for the effects of institutional and macroeconomic variables.⁵⁵

⁵¹ Wizarat, "Making the SBP Autonomous or the Governor SBP All Powerful," 30.

⁵² Centre for Aerospace & Security Studies, *Central Bank Independence: Reformation or Deformation*.

⁵³ Daron Acemoglu, Simon Johnson, Pablo Querubin and James A. Robinson, "When Do Policy Reforms Work: The Case of Central Bank Independence," (paper, National Bureau of Economic Research, Massachusetts, 2008), https://www.nber.org/system/files/working_papers/w14033/w14033.pdf.

⁵⁴ Ranajoy Ray Chaudhri, *Central Bank Independence, Regulations, and Monetary Policy* (New York, NY: Palgrave Macmillan, 2018), 351.

⁵⁵ Goran Petrevski, Jane Bogoev and Bruno S. Sergi, "The Link Between Central Bank Independence and Inflation in Central and Eastern Europe," *Journal of Post Keynesian Economics* 34, no. 4 (2012): 611-652, <https://doi.org/10.2753/PKE0160-3477340403>.

However, the findings of the research have exemplified beyond doubt that the economic security goals should not be seen in isolation from the critical role of central banks. The decisions that central banks make will have important implications for key economic variables, including but not limited to savings and investment rate, unemployment rate, inflation rate, or the debt/GDP ratio - all of which will directly affect the country's ability to achieve economic security and realise the national security vision envisioned in the NSP. Therefore, it is prudent to determine how the SBP can function as an efficient vehicle in attaining the economic security goals, ensure that the critical perspective does not triumph over the optimistic perspective, and the potential benefits of CBI are capitalised on. The paper argues that both of the competing perspectives may have an application, determined in part by how the SBP operates and whether the provisions of the new amended Act are regularly reviewed based on empirical research. From this point of view, the paper puts forward the following recommendations:

Box 3: Recommendations

- i. The SBP needs to increase the scope of in-house research to determine the impact of the Bank's policies on a range of variables such as saving or investment rate, GDP, poverty and equality, or productivity and output in the agricultural or services sectors, and rectify the policy measures accordingly.
- ii. Academia and think tanks should be provided with grants to conduct research (by employing before-and-after study designs) in order to understand the implications of SBP autonomy on the key macro- and socioeconomic variables and economic sectors.
- iii. The SBP should employ multiple channels such as regular interviews and press conferences, or monthly bulletins, to meet the responsibility of transparency in its policy decisions and increase its credibility.
- iv. It is important that the SBP officials are held legally liable to ensure that their actions are not at variance with the state's national objectives and interests.
- v. The SBP should regularly engage in consultations and meetings with government officials to ensure that the policies and actions of one body do not interfere with achieving the objectives of the other and that their actions are coordinated and aligned.

Source: Based on author's analysis.

First, the SBP should increase the scope of in-house research to determine how the Bank's policies affect a range of variables such as saving or investment rate, GDP, poverty and equality, or productivity and output in the agricultural or services sectors. This would require employing a wide range of quantitative, qualitative, and mixed-method methodologies, and studying the direct as well as the indirect associations.

The research output will allow the Bank to determine the unexpected implications of its policies and rectify the policy measures accordingly. However, it is essential that the in-house research produced by the SBP does not remain concealed; rather, the SBP must disclose the findings and the methodologies employed to the government agencies.

Second, a related policy recommendation is that before-and-after study designs should be used to understand the implications of SBP autonomy on the key macro- and socioeconomic variables and economic sectors. Similarly, the implications of the discontinuation of certain functions of the SBP should be empirically studied. Think tanks and academia have a much wider role in this regard and need to be provided with research grants. The provisions of the SBP Amendment Act can be reconsidered if required in light of the research output. For instance, the discontinuation of the Bank's quasi-fiscal functions can be re-examined if the research findings suggest that it is impinging indirectly on the key economic sectors. Similarly, the relegation of the Bank's role in economic growth to the tertiary level might require reconsideration if the research suggests that the costs outweigh the benefits.

Third, the SBP should employ multiple channels such as regular interviews and press conferences, or monthly bulletins, to meet the responsibility of transparency in its policy decisions. This will help improve its credibility and may also bring other benefits. For instance, it has been evidenced that SBP's communication with the public shapes inflation expectations and brings efficiency in the conduct of monetary policy.

However, responsibility does not only rest on the SBP, it is also essential that the content and reports being produced by the Bank are thoroughly scanned and scrutinised by government bodies and think tanks as well.

Fourth, the grant of immunity to the officials of the SBP from the proceedings of the Federal Investigation Agency (FIA), National Accountability Bureau (NAB), and the like institutions should be reconsidered. It is important that the SBP officials are held legally liable to ensure that their actions are not at variance with the state's national objectives and interests, and they are cognizant of the risk involved in disregarding those objectives.

Fifth, the SBP should regularly engage in consultations and meetings with government officials to ensure that the policies and actions of one body do not interfere with achieving the objectives of the other, and their actions are coordinated and aligned. In this respect, the proposed 'informal liaison' between the government and

the SBP that the Act envisages cannot be a perfect substitute for the institutionalised arrangement, i.e., the MFPCB. Hence, the changed mechanism for coordination between government and SBP needs to be reassessed on a priority basis.

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