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# Effects Of Money Devaluation On Macroeconomic Indicators Of Developing Countries: Evidence From Pakistan.

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## **ABSTRACT**

*Pakistan economy is experiencing a biggest trade deficit of history amounting \$2.683 billion, hyperinflation, highest rate of unemployment, negative growth rate ticking around -0.2% to -0.4% and US dollar hanging around Rs.160.36. Governments within any state or country are entitled to make most important decisions to run the day to day affairs which affects the lives of people. The policy of currency devaluation exchange rate has been adopted by many countries to shift patterns spending to achieve high levels of production of exportable goods. However along with increasing demand of exportable goods money devaluation has the tendencies of improving trade bills, balancing trade deficits as well but with certain implications. What these implications are and how these effect macroeconomic indicators discussed in this paper. Two variables (Money Devaluation independent variable and Macroeconomic indicators dependent variables) are incorporated to study the cause and effect of the two. Different statistical tools like, Reliability statistics, Regression analysis (ANOVA & Model Summary), Coefficients and Correlation analysis have been to statistically prove the validity of survey study and it's generalized acceptability.*

## **1. INTRODUCTION**

Historically Pakistan's economy gone through ups & downs and crises but this time around economy is going through a turmoil. Every step has been taken including money devaluation in Pakistan to improve economic indicators to make economy perform well and achieve a decent growth rate. In this article primary focus is to discuss macroeconomic indicators (inflation, unemployment, exports and imports). Pakistan economy is experiencing a biggest trade deficit of history amounting \$2.683 billion, hyperinflation, highest rate of unemployment, negative growth rate ticking around -0.2% to -0.4% and US dollar hanging around Rs.160.36. Governments within any state or country are entitled to make most important decisions to run the day to day affairs which affects the lives of people. The most important part of these decisions is surrounded around monetary or financial endeavors. Economic growth targets, growth rate, interest rates, inflation rates and monetary policy is all decided by governments under the umbrella of Public Policy in broader interests of general masses. Appreciating or depreciating value of currency/money is also a significant part of financial decision made by governments. In this article we will try to unearth the certain

possible implications or repercussions of depreciation or devaluation of money with regard to Pakistan's economy. Before going into discussion first we will learn what actually devaluation of money or money devaluation is.

*"It is defined as, Money Devaluation is a deliberate attempt towards a downward adjustment of value of a country's money relative to another currency or group of currencies, or currency standard. Currency devaluation powers only can be exercised by currency dispensing of country."*

By Majaski & Sonnenshien

Most of the economies in the world are US dollar backed economies so as Pakistan's economy is. For example if in fiscal year Pakistani Rs. 100 can buy \$. 1 and in next fiscal year \$. 1 can be bought in Rs. 130 that suggests Pakistani Rupee devalued against US Dollar (US \$ is an international standard exchange rate. Hence, lessening the rate of money/currency against the international standard of exchange rate like US Dollar/\$ is devaluation. The policy of currency devaluation exchange rate has been adopted by many countries to shift pattern spending to achieve high levels of production of exportable goods to get most out of GDP and earn more money outside from geographical borders of a state, improve overall economy and specifically factors impacting general masses lives like inflation & unemployment as well as exports & imports to control inflation and create more employment. However along with increasing demand of exportable goods money devaluation has the tendencies of improving trade bills, balancing trade deficits as well but with certain implications. Higher demands of exportable goods more likely can increase production that might cause an increase in employment to meet the task of higher production. Hence, job market can get better prospects and can absorb more skilled and educated labour. But it depends upon state and orientation of economy. What is the state of economy is an important question, whether it is underdeveloped, developing or developed economy to discuss before adopting over-valuating or devaluating exchange rate policy. If state of economy is underdeveloped or developing and it is import oriented than there are Implications and limitations to discuss.

## **2. LITERATURE REVIEW**

Dr. Ahmad (2020) said that there is general perception that money devaluation can bring positive shifts in exports aggregate demand but when underdeveloped or developing country adopts such policy few things must revise and reviewed closely. Most of the industries in underdeveloped or developing economies are rely upon imports of materials, crude oil, technology and machinery. When currency is devalued the prices of imported goods in such economies increases and that also pushes the cost of doing business and at the same time the price of exportable goods or cost of manufacturing exportable goods increases at home. Hence, exporters' loss competitiveness in international market. So, currency devaluation works negatively and proves counterproductive. Another misleading perception is Pakistan imports billions of rupees luxury item. But if we look at the list of imported goods, we will know that it is more necessity, food & industrial items than luxury ones'. Pakistan imports food items amounting US \$5 Billion (edible oil, baby milk, pulses & wheat) while the import of luxury items is US \$ 500 million. Every time rupee devalued triggered economic chaos and crises in Pakistan which not only left daunting marks for several years but made life miserable for general public. The measures or in the name of economic reforms devaluation failed on all fronts nor exports increased neither employment and inflation went sky high. So, it is rightly said there is no justification of actions repeating which are fruitless.

Naz (2019) stated that money devaluation brought only liabilities and abrupt increase in external debt in Pakistan. According to author .75 to 1% devaluation potentially can increase Rs.110 to Rs.125 Billion in national debt. Pakistan's food consumption is highly reliant on imports. Crude oil, edible oil, pulses, wheat and sugar are imported and currency devaluation making them more expensive. Currency Devaluation also discourage investments as well specially in industry because most of the capital goods and machinery is imported from other countries and it increases the cost of doing business in Pakistan. Since 2017 exchange rate of US dollar went high to 35% in Pakistan. At one hand inflation is deteriorating buying power and low investment in industrial growth is increasing unemployment. While our exports are also not making ground breaking inroads and not contributing much in foreign exchange reserves. Therefore, State Bank, financial monetary & regulatory authorities along with government must take certain steps to revisit and review the currency devaluation policy to prevent economy from further destabilization and ultimately bankruptcy of economy.

Tejvan Pettinger (2019) said that a reduction in the value of a money means devaluation. Major effects of devaluation are; exports might become inexpensive for foreign customers and imports more expensive. For short period of time money devaluation can improve macroeconomic indicators like increase in aggregate demand, higher growth rate and increased demand for exports.

Mohammed, Agboola & Oladipupo (2015) said that during last century many developed, developing and under developed economies experienced worst currency crises which anticipated them to take economic reforms to improve economic indicators including currency devaluation. These reforms of currency devaluation taken very seriously by economists and financial experts and new era of currency devaluation merits and demerits started. Some argue it is a good measure increase exports, GDP and employment while other counter argued that it will bring heaps of inflationary trends. Though in short run aggregate demand may increase but in long run mere devaluation will not be advantageous. Therefore financial experts believe that economic reforms or currency revaluation (over-valuation or devaluation) policies should be taken after proper analysis of international market and tendencies of shifts in international must be vigilantly studied before going for any decision. Financial sector must be seriously regulated and internal consumption of goods manufactured within state boundaries be promoted to strengthen economy. If these points not considered seriously and focus remain on currency devaluation than there is possibility foreign debt may reach to irreparable situation and country may declared bankrupt.

Shah, Kazi, Khaskheley, Shaikh & Shaoiab (2015) said that Pakistan's industry is highly dependent on raw materials and capital goods imported from abroad used for industrial consumption. Pakistan is a developing economy and it has prospects for industrial development as well but it requires imports of crude oil, machinery and industrial goods to fulfill the requirements of expanding industry. Imports need cash inflows but due to constraints or limited foreign exchange reserves it not easy to make two ends meet. Overall financial situation is less attract for foreign investment as well. Government's internal borrowing has already created a chaotic situation due high inflationary trends. Import & export gap is ever widening and economic growth rate is going down with each passing day. In this situation devaluating money can be proven fatal for any economy. Over reliance on imports always increases inflation (cost push inflation) and for some time aggregate demand for exports may rise and that could raise inflation rates (demand pull inflation). Short term cash inflows can improve economic landscape of a country but it is always damaging in long run. If we look closely at consequences of money devaluation it proved to be toxic for exports and cost Pakistan's economy on both ends as exporter as well as importer. Money Devaluation never let us to grow as sovereign economy, never ending inflationary trends,

imbalance BoP (Balance of Payment) and larger import bills always made governments to take poisonous pills central bank borrowings and look towards IMF and World Bank. That made the circumstances to never come out vicious economic conditions.

Malik (2014) said that more often than not when there is a deficiency in demand and supply of currency like US dollar the exchange rate increases and value of currency goes down. For instance, if the Pakistani Rupee depreciates as comparative to the US dollar, the price of dollar against Pakistani currency rises and it lead to devaluation. In 1995-96 1 US dollar costs Pakistani Rs.34, while in 2013 1 US dollar reached Rs.108. That causes Pakistan external debt from Rs.1035 Billion to Rs.6499 Billion but if Pakistan's rupee remained unwavering the debt would have been around Rs.2069 Billion. The devaluation policy since 2000's daunted Pakistani economy badly. Currency devaluation in Pakistan caused hyperinflation, worsened unemployment and imports became costliest. At one end demand pull inflation and one other cost push inflation made business startups near about impossible and running businesses lost competitiveness internally and internationally. In Pakistan currency devaluation proved counterproductive and contractionary.

Mujahid & Zeb (2014) said that money devaluation adopted to shift expenditure patterns from imported goods consumption to local made goods and also increase the quantity of exportable goods. It is always intended to achieve shifts in paradigms and patterns of consumption with slighter money devaluation but high rate of devaluation can be counterproductive or even become fatal for developing economy. So, costs and benefits must be analyzed critically to create a balance in adopting a viable exchange rate policy. Devaluation currency policy viewed as trade mark policy to reduce balance of payment problems, expand exports and outputs, reduce unemployment and improve trade balance. First time in history Pakistani rupee deliberately devalued during Gen. Ayub Khan's regime in 1959. It was proved very productive because vast amount of foreign exchange yielded. Z.A Bhutto government also devalued Pakistan money to settle trade balance and it proved only last time beneficiary. During Ayub Regime and Z.A Bhutto governments the policy of exchange rate bestowed Pakistan's economy because during both governments there was industrial boom in Pakistan. Exports were far higher than today and only industrial goods and machinery was imported hence it earned surplus. Forthcoming governments implemented these policies of devaluation dynamically different to prior policies with no effect at all or negative impacts on the economy like inflation, unemployment and expanding gap in imports and exports. When payments for imports exceed receipts of revenues from exports governments tend to implement policy of devaluation. Ideally money devaluation expands overall economy by encouraging local consumption for industrial inputs but usually it not produced any results rather increases inflation.

Asif & Rashid (2011) stated that currency devaluation policy is not exclusive measure to improve trade deficits, lower imports and increase exports. This policy needs serious restructuring and reconsideration for international business. Since partition in 1947 till 2020 economists and financial experts adopted the policy currency re-valuation and always ended up on devaluation of money to improve trade deficits, balance of payments, create a balance in imports and exports, control inflation and control unemployment. But occasionally this policy succeeded. According to author mere shifts here and there in currency re-valuation is not the solution of problems in Pakistan's economy rather it requires a scientific approach. That is to implement devaluation to encourage exports to improve trade balance to for short term but for long term this policy is not advisable in case of developing or vulnerable economies like Pakistan. In short run after improving trade deficits, increasing exports and improving import bills a mature and conventional economic policy is viable. Better alternative of imported products must be produced and quality control measures must be

implemented to avoid export shocks to sustain what is achieved by devaluation policy. Money Devaluation must never be taken as long term part of economic policy because it has greater implications in long run. It potentially cause brain drain, give rise to cost push & demand pull inflation and ultimately hamper industrial development.

#### *Research Justification or Background of Survey*

The scholar is inclined to study matter in discussion due to continuous failure of economists and financial scientist in understanding the money devaluation dynamics and it's impacts and ultimate outcomes on Macro-Economic Indicators (inflation, unemployment, exports & imports) of Pakistan economy.

Question to be addressed in this study.

#### *Research Questions*

1. How devaluation of money affected Pakistan's Economy?
2. How inflation, employment, exports and imports of Pakistan halted by money devaluation?

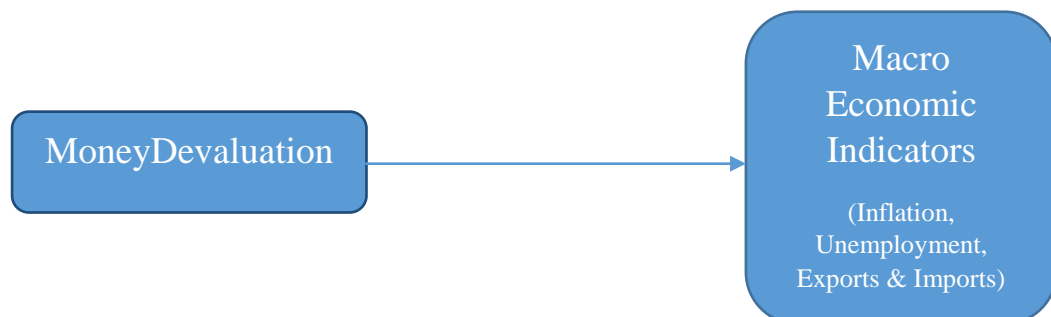
#### *Objectives*

This Study will be conducted to predict impacts and find out relationship of money devaluation on macro-economic indicators of Pakistan. Major focus will be on shifts in inflation, unemployment, exports and imports.

#### *Proposed Research Model*

There are two variables; Money Devaluation is Independent Variable and Macro-Economic Indicators (inflation, unemployment, exports and imports) is Dependent Variable.

#### *Model*



#### *Hypotheses*

H1: There is positive and significant impact of Money Devaluation on Macro-Economic Indicators of Pakistan.

H2: There is negative and insignificant impact of Money Devaluation on Macro-Economic Indicators of Pakistan.

#### *Research Scheme*

Bothe primary and secondary data collection methods are applied in this article to acquire in-depth knowledge of matter in discussion. Scholarly work of previous authors provide us good insights while first hand or primary data is better way to authenticate & co-relate those works. Quantitative research technique is used, tool or instrument for primary data collection adopted is questionnaire with 5 rating likert scale, target population from first information sought is literate business class of Khairpur and economic, commerce, business and public administration teachers & scholars. For sample size of target population random sampling technique has been used.

*Descriptive Analysis*

## Reliability Statistics

<b>Reliability Statistics</b>	
Cronbach's Alpha	N of Items
.857	15

The Cronbach's Alpha value is .857 of 15 items of questionnaire or simply to say of 15 questions in reliability statistics table. That shows the impact of independent variable Money Devaluation on independent variable is acceptable. In reliability statistics table Cronbach's Alpha measures that how closely questions are related and how much internal consistency these items (questions) show.

## Demographic Table

Question	Option	Percentage	Total
Age	Below 30 years	34.70%	100%
	Above 30 years	65.30%	
Income /month	Less than 100000	23.40%	100%
	More than 100000	76.60%	

Respondents of survey study age group is categorized in to two categories; one is below 30 years and other is above 30 years of age. 34.70% respondents are below 30 years, whereas 65.30% respondents are above 30 years age. Secondly the income wise respondents categorized again into two groups. One group income level is below Rs.100000 and other group income level is more than Rs.100000 per month. 23.40% respondents are those whose income level per month is below Rs.100000 while 76.60% respondents are with income level is more than Rs.100000.

## Regression Analysis

<b>Model Summary</b>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.353 <sup>a</sup>	.125	.123	.93657809
a. Predictors: (Constant), Money Devaluation				

The contribution of independent variable on dependent variable is demonstrated through model summary regression technique. Therefore, we can say that adjusted R square reveals fitness of model in model summary table. Adjusted R square value is .123. Therefore, constants forecast contribution is 12.30% on dependent variable and that indicates model is moderately accurate.

ANOVA<sup>a</sup>

ANOVA <sup>a</sup>						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	52.462	1	52.462	59.808	.000 <sup>b</sup>
	Residual	367.538	419	.877		
	Total	420.000	420			
a. Dependent Variable: Macro Economic Indicators						
b. Predictors: (Constant), Money devaluation						

To figure out whether there is a significant relationship between independent variable and dependent variable is or not ANOVA technique is used. ANOVA Regression technique table is showing that the result is less than .05 and it indicates the relationship between independent and dependent variable is significant.

Coefficients<sup>a</sup>

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.693E-17	.046		.000	1.000
	Money devaluation	.353	.046	.353	7.734	.000
a. Dependent Variable: Macro Economic Indicators						

In this table beta column shows the contribution of independent variables separately (if dependent variables are more than one). While acceptance or rejection of hypotheses thoroughly depends on the result of significance column. Table shows standardized coefficient beta or simply beta result is .353 (35.30%) and significant column result is .000, hence significant. Therefore, contribution of money devaluation on macro-economic indicators is 35.30% and H1 is accepted while H2 is rejected.

## Correlations Analysis

Correlations			
		Money devaluation	Marco-Economic Indicators
Money devaluation	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	421	
Macro-Economic Indicators	Pearson Correlation	.353 <sup>**</sup>	1
	Sig. (2-tailed)	.000	
	N	421	421
**. Correlation is significant at the 0.01 level (2-tailed).			

Correlation analysis statistically indicates whether there is significant relationship between two quantifiable variables. Table shows value is .000 and that is indicating there is

relationship between two variables and Pearson correlation results is .353\*\* which indicates there is a relationship but it is weak relationship.

### 3. CONCLUSION

Money devaluation found shrinking in the case of Pakistan's underdeveloped economy. Exports, imports, FDI (foreign direct investment) indirectly effected by money devaluation. Other macro-economic indicators like inflation (cost push due to expensive import of raw materials and demand pull due to abrupt increase in aggregate demand), buying power decreased, unemployment increased and economic growth declined even reached to negative trends due to this malicious economic reform policy. When money is devalued the supply of money increased with increase in production also increases inflation and unemployment. Pakistan's 85% imports are consist food items like; wheat, pulses, edible oil, baby & dry milk, vegetables and necessity & capital goods like; crude oil, industrial consumption goods, agricultural and industrial machinery.

Therefore, money devaluation effects GDP negatively and economic indicators also present gloomy state. Expensive capital goods and crude oil restricts exporters compatibility and exports lost international competitiveness gravely. Surveys and studies confirms that Pakistan consumes 84% domestic production and any devaluation money potentially can endanger Pakistan's economic sovereignty for international borrowings. Therefore, government and SBP (State Bank of Pakistan) must put forth their efforts to stabilize exchange rates and reconsider the unending policy of Money Devaluation to save people of Pakistan from finance miseries.

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