The Political Economy of Industrial Policy in Pakistan 1947-1971

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The period from 1947 when Pakistan was created to the watershed of 1971 when East Pakistan split off to become Bangladesh is an important one for studying the determinants of industrial performance in the Indian subcontinent. On the one hand, despite substantial differences in the industrial policies of Pakistan and India, their rates of industrial growth were remarkably similar. On the other hand, while Pakistan's authoritarian institutions had many features similar to contemporary East Asian states, in particular South Korea, its long run performance was much poorer than in the East Asian industrializers.

Table 1 Manufacturing Growth Rates in East and South Asia

<table>
<tr><th></th><th colspan="2">East Asia</th><th colspan="4">South Asia</th></tr>
<tr><th></th><th>South Korea</th><th>Taiwan</th><th colspan="3">Pakistan</th><th>India</th></tr>
<tr><th></th><th></th><th></th><th>(West)</th><th></th><th>(East)</th><th></th></tr>
<tr><td>1950-55</td><td>NA</td><td>NA</td><td>NA</td><td>9.1</td><td>NA</td><td rowspan="2">6.1</td></tr>
<tr><td>1955-60</td><td>NA</td><td>NA</td><td>NA</td><td>5.7</td><td>NA</td></tr>
<tr><td>1960-65</td><td>11.8</td><td>12.7</td><td>(11.1)</td><td>10.0</td><td>(5.7)</td><td>6.8</td></tr>
<tr><td>1965-70</td><td>20.0</td><td>19.1</td><td>(7.5)</td><td>6.8</td><td>(6.9)</td><td>4.2</td></tr>
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Sources: Griffin & Khan (1972) Table Intro.3, World Bank (1994b), World Development Report (1992), Taiwan Statistical Yearbook (various years), Chakravarty (1987): Table 5. Figures not available indicated by NA.

Table 1 summarizes the manufacturing performance of several East and South Asian countries. Comparable figures are only available for the sixties. Table 1 suggests that over the long term, Pakistan's performance over this period was very similar to that of India with the exception of a burst of industrial growth in the early sixties under Ayub. In contrast, industrial growth rates in the East Asian countries have been consistently high. In the eighties and nineties industrial growth rates in Pakistan and Bangladesh remained at the long-run South Asian level of between five to ten per cent while the East Asian countries continued to industrialize rapidly.

The high growth rates in manufacturing in Pakistan for 1950-55 are to some extent a statistical artefact as the country started from an exceptionally low industrial base in 1947. Nevertheless, we need to examine how Pakistan managed to kick-start industrialization in this period given its unpropitious initial endowment. More significant is the acceleration in industrial growth rates in the early sixties when it adopted industrial policies that were initially quite similar to (and in fact pre-dated) South Korea. Nevertheless, unlike the East Asian states, Pakistan could only sustain high growth for a very brief period before reverting to the South Asian norm by the late sixties. The failure of Pakistan to sustain East Asian growth rates is therefore interesting in providing insights into the political economy of growth in the South Asian subcontinent. Was its failure due to policy errors or were there other constraints that made rapid industrial growth difficult to sustain?

Section 1 identifies the issues raised. Economists looking at India and Pakistan have usually focussed on policies to account for relatively poor performance. However, most conventional explanations have important shortcomings. In particular, they are difficult to sustain in a comparative context if we look at India, Pakistan and the East Asian countries together. Convincing explanations of relative performance have to identify features which were common to the subcontinental countries but which distinguished them from the East Asian industrializers. We suggest an alternative explanation that looks at the *economic* effects of the growing conflicts within the middle classes over resources allocated by the state. This explanation focuses on a feature which India and Pakistan shared despite important regional variations. This was a shared tradition of political mobilization by emerging “middle” classes. Section 2 looks at the early phase of Pakistan’s industrialization and Section 3 at the industrial policy period of the sixties. The sixties are particularly interesting because by comparing the high growth rates of the early sixties with the decline in performance in the late sixties we are able to test a number of competing hypotheses explaining poor industrial performance in Pakistan.

The importance of the professional members of the middle classes was recognized by Bardhan (1984) who described them as an equal member of the dominant class coalition in India along with capitalists and landlords. In our use of the term “middle class”, we would include not only the professional classes but also the much bigger group of educated and salaried sections of the population. These are groups who have some education, a little capital and who have organizational abilities that distinguish them from the broad masses of the poor. Not all of them are employed. The importance of these non-capitalist intermediate classes in subcontinental politics far outweighs their numbers that in any case would run into many tens of millions.

It was precisely in terms of these inherited traditions of state-society interaction that Pakistan differed significantly from the East Asian countries and in particular South Korea. When Pakistan briefly attempted in the sixties to implement an exclusionary industrial policy, its evolution and results were quite different from that in South Korea. We argue that the social power of excluded groups and their ability to draw on traditions of incorporation and mobilization were important factors explaining why Pakistan performed so differently from South Korea despite the similarities in their policies and institutions. The mechanisms through which the social power of emerging “middle classes” translated into economic consequences are examined. This is also why Pakistan’s industrial performance in the long run is so similar to that of India despite the differences in their institutions and policies in the sixties.

1. The Issues

Pakistan’s early industrial development in the fifties was based on import substituting industrialization under tariff barriers and an overvalued exchange rate. After the first easy phase of import substituting industrialization, industrial strategies evolved into a more coherent industrial policy in the sixties under Ayub’s military regime which took over in 1958. Industrial credit was subsidized and its allocation was controlled by the state through two publicly owned industrial banks. At the same time, enterprises were set up in the public sector and subsequently divested as running ventures to the private sector. Incentives were offered to exporters under an innovative “Bonus Voucher” scheme to promote exports. This period produced some of the highest industrial growth rates ever enjoyed by either Pakistan or post-1971 Bangladesh. Yet, the industrial policy of the sixties collapsed as political opposition to it grew in both East *and* West Pakistan.

The role of political opposition in West Pakistan in sealing the fate of industrial policy is often not recognized. While it is clear that the political crisis in the country led to Bangladesh's war of independence and thereby terminated the industrial policy period, it is often not recognized that political mobilization had begun to affect the *implementation* of the policy as early as the mid-sixties. As a result, industrial policy in Pakistan would have been radically altered even in the absence of the dramatic events that followed. Moreover, even without the growing Bengali nationalism in East Pakistan led by Mujib and the Awami League, Bhutto and his Pakistan People's Party in West Pakistan would probably have brought down Ayub's industrial policy anyway and at about the same time. Indeed, opposition to Ayub *began* in West Pakistan and only subsequently spread to the East.

Ayub's industrial policy was a central target for the emerging middle classes who felt excluded by these policies. From the mid-sixties, their mobilization began to affect the implementation of the policy and began to reduce the rate of growth for reasons that we will carefully examine later. Eventually it led to its abandonment, though the dramatic way in which this actually happened had other determinants. In 1970 East Pakistani politicians won a majority in the first elections to an all-Pakistan parliament held under military rule. The subsequent attempt by Western political leaders (including Bhutto) and the military to prevent them from taking their seats without prior conditions led to the descent into civil war in 1971 which in turn escalated into Bangladesh's war of independence.

Political economists divide into two major groups when it comes to evaluating the experience of industrial policy in Asia in the fifties and sixties. "Statists" argue that industrial policy worked where states were strong, where they could act autonomously of sectional interests and where they had coherent policies and institutions. In contrast liberals argue that state intervention was largely unsuccessful everywhere. The true explanation of the relative success of East Asia was that intervention was relatively limited and where it happened it was "market friendly" serving to develop and promote markets rather than supplement them. Intervention on its own only induced rent-seeking behaviour and allowed efficiency-reducing free-riding by recipients of subsidies whose industries remained less efficient than they would otherwise have been.

An examination of the rise and fall of Pakistan's industrial policy in the context of the political and social changes which were happening in that country is interesting for an evaluation of these two positions. There is now considerable evidence from East Asia in favour of the statist perspective that differentiated incentives *can* help to significantly accelerate the creation of a capitalist sector based on advanced technologies and capable of competition on the world stage. While the proposition is in principle correct, it appears that the implementation of such strategies has been considerably more difficult in the South Asian countries.

Despite differences in their institutions and policies, the state in both Pakistan and India tried to accelerate industrialization in the fifties and sixties by centrally allocating resources and creating incentives for the introduction of modern technologies. These policies did two sets of things. On the one hand, they excluded large middle class groups from the immediate benefits of development. On the other, their long-term viability depended on the successful imposition of discipline on the capitalist recipients of state subsidies. These two apparently unrelated features of the development strategy became strongly linked over time. The social and political features of the South Asian countries ruled out any sustained exclusion of the middle classes and the way in which their opposition was accommodated in turn compromised the efficiency of industrial policy.

In India, their exclusion was never as dramatic as in Pakistan but in both countries, there were significant increases in the pressures for incorporation from the mid-sixties onwards. Because of these pressures, a significant proportion of subsidies and licenses had to be allocated in response to political demands rather than on rational economic criteria. This development had far-reaching implications for the effectiveness with which the state could police the allocation of subsidies to capitalists as well. As rational political actors, capitalists in the South Asian countries began to develop their affiliations with powerful political players who would protect their interests. As a result, while the East Asian states were evolving towards a carrot and stick approach to the capitalist sector in the mid-sixties, prodding them to ever greater productivity, the stick was never attempted in the South Asian countries. This is particularly interesting in Pakistan where the state ostensibly had the authoritarian trappings to attempt such disciplining. In India, industrial policy of the Pakistani type was never attempted but even Nehruvian planning with its concessions to many more social demands proved eventually to be too difficult to administer by the late-sixties. By then the ability of the central state apparatus to implement policies had declined dramatically because of the ongoing processes of accommodating regional power brokers in a way remarkably similar to what was happening in Pakistan.

If this explanation captures significant elements of the South Asian state failure story, both the statist and liberal interpretation of the strategies followed by Pakistan and India in the fifties and sixties have to be re-evaluated. The statist position stresses the importance of getting institutions and policies right. However, our explanation suggests that the problem may have been the incompatibility of Pakistan's economic strategy with its underlying society and politics. If Pakistan's industrial policy could not evolve in the South Korean direction this may have had less to do with policy errors of its leaders and more to do with the compromises induced by its social structure. If so, we need to ask whether some other type of policy which was more compatible with its social structure may have been more efficacious for technical progress and accumulation. In other words, if Pakistan's political structure was incompatible with its economic strategy either one or both would have to change. Ayub attempted to change the polity. He introduced a new constitution, which aimed to undercut the urban middle class dominated political parties, and he aimed to make the possibility of repression credible. His successor Yahya Khan was forced into exercising repression on a large scale in an experiment that ultimately failed. The possibility of constructing an alternative economic and institutional strategy, which may have better achieved the objectives of technical progress and growth, were never discussed.

The liberal argument seems to have been vindicated from the mid-seventies onwards as the three large subcontinental countries, India, Pakistan and Bangladesh, have all converged towards liberalization. Moreover, performance has appeared to improve in all of them if only by a little. However, even if liberalization was responsible for this better performance, this does not mean that the mechanisms identified by liberal economics are correct. If poor performance under statist policies was due not to the inherent irrationality of such policies but rather the costs of implementing them in the political context of the Indian subcontinent, liberalization may be producing better results simply be removing some economic activities from the domain of the state. Nevertheless, even liberal policies can only work if the state can efficiently provide a large chunk of public goods such as infrastructure and education. If political contestation over resource use was responsible for the failure of statist policies in the sixties, it may eventually result in no less serious problems for liberal strategies as well. Thus, the debate over why the statism of the fifties and sixties failed in both Pakistan and India may be of great relevance for our understanding of the future prospects of the subcontinental countries.

2. The 1950s: Import-Substitution

The early phase of import substituting industrialization in Pakistan describes the rapid growth of industries in the fifties. The context in which this happened was one of deepening political crisis. The émigré leadership of the Muslim League had its power base in northern and central India and had very weak political roots in the areas that constituted the new country of Pakistan. It was forced in 1947 to forge a viable nation-state out of the two non-contiguous territories that constituted Pakistan. Although the social structure of Pakistan was broadly similar to India's, it faced a number of special problems that created severe tensions between state and society and at the same time forced the state apparatus to play a more centralizing role.

Three factors were particularly important in differentiating Pakistan from India in the immediate aftermath of independence. First, the level of development of industry in the areas that initially comprised Pakistan was exceptionally low. Secondly, the political and bureaucratic leadership felt militarily vulnerable and perceived the need to build up military capability at a much more rapid rate than their counterparts in India. Thirdly, the political and organizational base of the Muslim League, which formed the government, was exceptionally weak. The tensions created by the joint operation of these three factors largely determined the contours of early development strategies in Pakistan. We consider them in turn.

Industrial Underdevelopment. The areas of India out of which Pakistan was formed were overwhelmingly non-industrial. They were composed primarily of the raw material producing agrarian hinterland of India. East Bengal, which became East Pakistan, had previously supplied raw jute to the jute mills located around Calcutta. West Punjab, the most important component of West Pakistan, provided raw cotton to the Bombay cotton textile industry. Some figures will indicate the extent of economic backwardness that the new economy faced. At the time of partition, the two wings of Pakistan constituted 23 per cent of the land mass of India, possessed 18 per cent of its population but inherited less than 10 per cent of its industry (Jalal 1990: 64). It also possessed relatively little in the form of natural resources or known mineral deposits (important deposits of oil and gas were discovered much later). In short, the new state had been carved out of India's agricultural hinterland.

Table 2 Comparative Compositions of National Product: Pakistan and India

	Pakistan (East and West) At 1960 factor cost and expressed as % of GNP			India At 1980 prices and expressed as % of NDP	
	1950	1960	1970	1950	1970
Agriculture	60.0	53.3	44.4	50.1	41.8
Manufacturing	5.9	9.3	12.2	11.4	15.3
(i) Large-Scale	1.4	5.0	9.0		
(ii) Small-Scale	4.4	4.3	3.2		
Others	34.1	37.4	43.4	38.5	42.9

Sources: Amjad (1982): Table 1.2, Indian National Accounts Statistics 1990.

Table 2 shows that in 1950, agriculture accounted for 60% of the GNP of Pakistan while manufacturing accounted for only 5.9% of GNP. Large scale manufacturing accounted for a mere 1.4% of GNP. In comparison, in India in 1950 the share of agriculture in NDP[1] was 50.1% and the share of manufacturing was almost double that of Pakistan at 11.4%. Modern manufacturing in Pakistan was therefore roughly half as developed as in India even after adjusting for the smaller size of its economy. This difference had substantial implications. The low share of manufacturing and particularly of large-scale manufacturing meant there was no indigenous industrial capitalist class that could become a developmental partner of the state. It also meant that the state felt much more vulnerable militarily than its relatively low population alone would suggest.

This explains why compared to India, the state in Pakistan took much more drastic steps to encourage primitive accumulation to *create* an entrepreneurial class. On the one hand it used the state machinery to create enterprises using bureaucrats as entrepreneurs and then sold these off at attractive prices. In addition, the state *induced* the emergence of a new capitalist class by providing exceptional incentives to the private sector. Thus, the state *quite deliberately* created the conditions that pushed a small group of merchants into industry in a short period in the early fifties.

Military Threat Perception. Several authors have identified the perceived military threat in early Pakistan as an important factor determining the actions of state officials and politicians (for instance Jalal 1990). Rightly or wrongly, Pakistan did feel threatened by India's overwhelming military superiority in the context of the bitterness and unresolved territorial disputes following partition. Pakistan inherited 30 per cent of the defence forces of united India, which was more than proportionate to its population (Jalal 1995: 22) but it inherited much less than its share of weaponry and military hardware. Moreover, in conventional warfare, absolute numbers matter and Pakistan's army was hopelessly outnumbered by its larger neighbour. Its military leaders not only felt the need to expand the army but also were also to become a powerful constituency supporting industrialization. They were eventually to take over the running of the country in 1958. However, while the threat perception was important and was no doubt nurtured by the military leadership, other factors were

[1] Net Domestic Product. The sectoral shares in India's Gross National Product (GNP) are not likely to be significantly different.

required to provoke the extreme centralization in economic policy-making that was beginning to emerge.

The immediate consequence of the military imperative was to starve other sectors of funds. The demands on the budget to maintain an army that could begin to match India as well as protect the potentially vulnerable North-West placed intolerable strains on other sectors. India, it is worth recalling, was four times as populous as Pakistan and more industrially developed. The military imperative resulted in starving spending on social sectors. Jalal points out that in 1950-1 the central government of Pakistan could sanction a paltry Rs. 10m for provincial development programmes that included health and education. In contrast, India at that time was spending Rs 250 to 300 million in provincial development programmes. Allowing for the factor of 5 by which India's population exceeded Pakistan's, its per capita spending on provincial development was 6 times larger compared to Pakistan (Jalal 1995: 22). This in turn meant that Pakistan's development could not be broadly based and the available resources were inevitably concentrated in a few hands where it was much more conspicuous. This was ultimately going to accelerate the mobilization of excluded “intermediate classes” in Pakistan much before the demands of similar classes gathered strength in India at a later stage.

The Weak Political Roots of the Muslim League Leadership. The most important factor distinguishing Pakistan from India was the weak social base of the political elites who took over after independence. While the Congress Party in India had developed a nation-wide representative structure over a long period, the Muslim League in Pakistan lacked a similar political and organizational base in the areas that came to constitute Pakistan. Thus while the Congress Party could serve in the early years as an institutional mechanism for accommodating competing factions and interest groups, the Muslim League in Pakistan could not perform the same function.

This difference is important. The Muslim League’s social and organizational strength was concentrated in the Muslim-minority provinces of middle India, such as the United Provinces and the Bombay Presidency from whence Jinnah himself came. The Muslim elites in these provinces feared they would be permanently swamped in a future Hindu-dominated India and their fears provided a powerful motivation for a separate Muslim organization to demand constitutional guarantees for the Muslim minority. In contrast, the most important Muslim majority areas of India were Punjab and Bengal but in both these provinces, the Muslim elite were doing quite well in provincial politics. Although some of them belonged to the Muslim League, many others belonged to other parties. Most of them were not at all interested in the concept of a separate Pakistan at least until the early to mid-forties.

In Bengal, an upcoming Muslim rich peasant class known as the *jotedar* class were challenging the economically dominant and more established Hindu landlord class of *zamindars*. As elsewhere, Bengal's emerging Muslim "middle classes" demanded access to government jobs and places in educational establishments. Partition was not on the agenda for the bulk of the Muslim *jotedars* simply because it did not suit their economic aspirations. They had more to gain from exercising their majority position in a united Bengal. In the Punjab, the class distinction between Muslims, Hindus and Sikhs was not so clear cut but even here, the majority Muslims were less advanced in economic and social positions compared to the other communities. But as in Bengal, the Punjabi Muslim political elite were generally not separatists and did not believe they had much to gain from a partition of their province.

If the Muslim-majority provinces were *not* separatist, the interesting question is whether Jinnah and the other leaders from the Muslim-minority provinces *were*. It is hard to see what these leaders had to gain from partition since even if they were to migrate; the millions of Muslims in the minority provinces who were their constituency were unlikely to do so. In fact, while this group frequently made separatist noises, they were equally frequently engaged in making deals with Congress that promised constitutional protection for minorities. The most coherent interpretation of Jinnah's strategy was that he was attempting to obtain constitutional protection for the Muslims in the Muslim-minority provinces in exchange for appearing to deliver the Muslim-majority provinces of Bengal and Punjab to the Indian union (Jalal 1985).

That this was really the Muslim League's goal is supported by a number of key actions such as the Lucknow Pact with Congress in 1916 and most spectacularly Jinnah's acceptance of the Cabinet Mission Plan of 1946 which would have allowed India to stay together as a federal country if substantial powers were transferred to the provinces. Jinnah not only accepted the Cabinet Mission Plan, he is on record for having torn up the plan for an independent Pakistan literally months before the country was actually born. Nehru and eventually the Congress rejected the Cabinet Mission Plan no doubt thinking that the price of partition was worth paying to avoid a weak centre, which would have resulted from the Cabinet Mission's model of federalism. Nehru's ambition was to modernize India under a strong centralized state. The Congress leadership may also have calculated that Jinnah's demand for Pakistan was a bluff and the time had come to call it or even that if Pakistan was created it would soon collapse and return to the Indian union as an unviable economy (Alavi 1983: 46-7). In the end, what transpired proved to be an extremely costly denouement for both sides.

In Pakistan, the result was a rapid descent towards authoritarianism. The Muslim League leadership had to abandon its constituency in North India and run territories in which it had no political roots. They soon discovered that the regional leaders of Pakistan had different priorities. Whether they were originally landlords or rich peasants, in the days of united India they were primarily involved in redistributive politics using their ability to organize their constituencies to compete for resources with the economically more advanced Hindus. Their redistributive demands suddenly made far less sense when the old Hindu elites disappeared and resources had to be allocated to create a new industrial base. The Muslim League leadership thus discovered that to preserve the hastily constructed union and their own survival they increasingly had to rely on the bureaucracy. Alavi (1983: 78-9) is therefore probably too harsh in attributing the turn towards bureaucratization in early Pakistan largely to the poor quality of the political leadership. Yet, the use of bureaucratic methods certainly further weakened the political leadership and strengthened the bureaucracy and the military.

Thus, ironically, the imperative of industrialization and the need to over-ride the regional demands of emerging classes converted the Muslim League from a party of federalism into a party of strong centralism. There are obvious parallels between the Muslim League's responses to regional politicians in the new Pakistan and Nehru's rejection of the Muslim League's earlier federalist demands. In fact, the Muslim League faced a worse predicament than Nehru. Unlike Nehru who had a constituency which supported planning, the Muslim League had no such constituency in Pakistan. As we have seen, Pakistan was largely a rural hinterland whose politicians were primarily regional power brokers.

Already in 1954, the lower-middle classes in East Pakistan who dominated the polity (the *jotedars* in the countryside and the urban petty bourgeoisie) revolted against the Muslim League and elected a United Front government. The East Pakistani political elite had simply discovered that the Muslim League was not receptive to its demands for more autonomy for (and hence local access to state power in) East Pakistan (Sayeed, K. 1960 and 1967). The central bureaucracy however quickly suppressed political assertion by the class that had won East Bengal for Pakistan. The East Pakistan legislative assembly was dismissed and Governor's Rule imposed. These political experiences provided the backdrop to the development of the capitalist class in the fifties through the policies of import substituting industrialization.

Creating Capitalists through Import Substitution. It was in this context that the Muslim League government in the fifties began to look around for a strategy to create a new industrial base. The key plank of the early strategy was to push the tiny merchant capitalist class many of whom had emigrated from India to become a new class of industrialists. The Muslim League leadership had personal contacts with some of these émigré traders dating back to pre-partition days. These traders in India in alliance with the Muslim League had established 'Nation Building Companies' like the Mohammadi Steamship Company and Habib Bank Limited, and they provided obvious candidates when individuals or companies had to be offered industrial projects (Rashid & Gardezi 1983: 1-8). However, Rashid and Gardezi describe this phase of Pakistan's economic policy as a period of mercantilism where trading interests were given priority. This interpretation is not consistent with the quite explicit objective of the state to create a new *industrial* capitalist class. It is more accurate to describe policy in this phase as attempting to create at least a few industrial capitalists out of the merchant capitalists who were around in early Pakistan. Industrialization was induced by rapidly increasing the profitability of investing in industry, by providing subsidized funds for investment, and by sharing some of the risks of setting up new and untried ventures. These goals were achieved through a number of measures.

First, Pakistan decided not to devalue the Pakistan Rupee in line with the Indian Rupee when sterling devalued against the dollar in 1949. This effectively overvalued the Pakistan Rupee against both the Indian Rupee and the pound to which the latter was linked and made it more expensive for India to import raw materials such as cotton and jute fibres from Pakistan. At the same time, it made imports of machines into Pakistan cheaper, particularly from the sterling area. This provided a strong incentive for Pakistani traders to enter industry and to step into the shoes of Calcutta and Bombay industrialists. The refusal to devalue was thus an expression of economic nationalism. It broke the trade links that the Pakistani regions had with India as an agricultural hinterland and provided an important spur for import substituting industrialization. As we shall see later, the overvaluation effectively transferred resources from agricultural exporters primarily in East Pakistan to industrial machinery importers based mostly in the West.

The immediate beneficiaries were the small class of merchant capitalists, many of them Gujarati Muslim emigres who had settled in the growing port city of Karachi. These emigre merchants had recently acquired substantial wealth through their trading activities. The Korean War boom had left large surpluses with these traders that were potentially available for investment in industry. The change in relative prices brought about by the currency overvaluation now created powerful incentives for using this cash to import machinery and to set up import substituting industries. However, an overvalued exchange rate makes all imports cheap and all exports expensive. Without further intervention, it would have led very soon to a foreign exchange crisis with demand for foreign exchange outrunning supply. To counter this, and in common with import substituting strategies in other countries, further interventions such as tariffs, import licensing and credit allocation were introduced to prevent a balance of payments crisis.

A differentiated tariff regime was set up which made some imports more expensive than others. Differentiated tariffs allow the government to raise the import price of goods that can be produced at home. This discourages domestic consumers from importing these goods and at the same time encourages them to buy the domestic products whose higher prices or lower quality may have prevented them from competing with foreign products in the early stages of industrialization. In theory, as long as these tariffs can be credibly lowered over time, domestic infant industries are given an incentive to set up and mature. From the mid to late fifties, the average rate of tariffs in Pakistan was 65 per cent for consumer goods, 40 per cent for intermediate goods and 39 per cent for capital goods (Lewis 1969: 74). Thus, the tariff structure aimed to promote industrialization in the consumer goods sectors in the first instance.

A third component of import substituting industrialization strategies is usually some form of import rationing or licensing. Tariffs can limit the demand for imported consumer goods but excess demand is likely to persist for capital goods. After all, the point of the overvalued exchange rate is to keep the price of imported machinery low for investors. Thus, excess demand for foreign exchange from investors wanting to import machinery is likely to persist. As a result, access to foreign exchange for importing machinery often has to be rationed directly. The import licensing system played a key role here as a mechanism for rationing scarce foreign exchange across the different industrialists who wanted to import capital goods.

The bureaucratic mechanisms for implementing a licensing regime already existed. Pakistan, like India, inherited a licensing system from British India, which had practised import licensing during the war. Importers required a license for all key imports. The supply of licenses was in theory centrally controlled so that in principle, the state could control who imported and how much they imported. Over the fifties import rationing in Pakistan was extended to cover all important imports of machinery and raw materials as well as of consumer goods. Although the East Asian states did not use the formal mechanism of licensing, the difference was more apparent than real. The work of Amsden (1989), Wade (1990) and others suggests that at an equivalent stage of industrialization both South Korea and Taiwan used extensive state intervention to ration scarce foreign exchange across sectors and often across firms.

A fourth component of import substituting industrialization is often the centralized allocation of credit through publicly owned financial institutions. When the state has credit to disburse, its ability to disburse it to particular sectors or companies can determine the structure of the industrial sector and the sequence of industries set up. These are critical components of an industrial policy as the later South Korean experience was to show. However, in the early phase of import substituting industrialization in Pakistan the state did not have the resources to directly allocate credit. It did set up two industrial banks, the Pakistan Industrial Credit and Investment Corporation (PICIC) and the Pakistan Industrial Finance Corporation later called Industrial Development Bank of Pakistan (IDBP), which were to assume much greater importance in later years (Alavi 1983: 46-50, Amjad 1983: 235-50). These institutions are often referred to in the literature as “development finance institutions” (or DFIs).

Table 3 Foreign Inflows as Percentage of Provincial GDP

	1950-55	1955-60	1960	1965	1970
West Pakistan	5.6	6.5	5.4	8.9	3.1
East Pakistan	-1.7	-0.7	0.3	4.6	3.2

Note: Foreign inflows for each province include inflows from the other province. The outflows from East Pakistan in the fifties were going entirely to West Pakistan.
Source: Haq (1966) Table 16, Amjad (1982) Table 1.3.

One reason why the state’s allocation of credit through the DFIs or otherwise was relatively unimportant in the fifties was that the state had relatively little to distribute. Its powers to raise domestic resources through taxation were (and remain) underdeveloped. Foreign capital inflows in the form of aid and soft credit were also relatively scarce in the fifties. This is shown in Table 3. In the early fifties there *were* significant inflows into West Pakistan but a large part of these were transfers from East Pakistan as foreign exchange earned by the agricultural exports of the East were invested in the West. The transfer reduced somewhat over the fifties and terminated by 1960. East Pakistan continued to get less than its share of foreign inflows until the late sixties. This transfer was to prove to be a powerful symbol which excluded elites in the East were eventually to use to mobilize East Pakistani opposition to Pakistan's industrial policy. Unfortunately, Bangladesh achieved its independence just as political pressure was shifting the balance of investment in its favour and as a result, it lost any chance of recovering the investment it had made in the joint industrialization of Pakistan in the decades before that.

What is important is that true foreign inflows (netting out transfers between the provinces) were relatively small in the fifties and did not become substantial until the mid-sixties. Since an important part of aid and soft loans were allocated domestically by the DFIs, it was only in the early to mid-sixties that the state was able to play a more important role in directly allocating investible resources through the two industrial banks. The early import substituting industrialization in the fifties thus relied on other sources of funds for investment. Much of this came from the retained profits of the merchant capitalists, which in turn was based on squeezing consumers and the agricultural sector (Papanek 1967: 184-225). The squeeze on the agricultural sector was particularly important and is partly reflected in the transfer of resources from East to West Pakistan. Import substituting industrialization generally squeezes agriculture. If the exchange rate in overvalued, agricultural producers have to be willing to accept lower rupee prices for their crops. Their sacrifice is converted into lower prices for importers of machinery, thereby transferring resources from agriculture to industry.

The transfer from agriculture through this mechanism was particularly severe between 1949 and 1955. In 1955, the rupee was devalued by 30 per cent but even after that, the rupee remained substantially overvalued. On top of the exchange rate squeeze, the Pakistan government imposed additional export taxes on raw cotton and jute, the two major cash crops. Through these two mechanisms, agriculture provided the bulk of the surplus for industrialization in the early phase of Pakistan's industrialization. This no doubt contributed to the growing alienation between the political representatives of rural vote banks and the state bureaucracy, which was at that time primarily interested in strengthening the industrial base of the country.

The final policy plank of the early industrialization was an institutional innovation of the Pakistani state, which allowed it to absorb some of the risks facing emerging capitalists. The state in Pakistan recognised at a very early stage that entrepreneurial risk-aversion was a major constraint to capitalist industrialization in Pakistan. However, instead of developing a large public sector as in India, the Pakistani policy-makers came up with an innovative solution where the public sector assumed the risk of setting up new enterprises but the enterprises developed were sold off at attractive prices to private sector individuals as soon as they were up and running. This allowed the same group of public sector entrepreneurs to turn over many more enterprises than if they had to run them permanently. This solution followed from the poor entrepreneurial response received by the government a month after independence when an industries conference was convened and various forms of assistance was offered to businesspersons. Partly because of this disappointment, in 1952 the Pakistan Industrial Development Corporation (PIDC) was set up, with the objective of setting up and divesting to private owners new industrial units. The PIDC would become a key player in later years (Papanek 1967).

The high industrial growth rates achieved through the fifties (see Table 1) reflect the efficacy of these early policies. The very high growth rates of the early fifties are statistically exaggerated because of the almost non-existent industry in 1947 in the areas that constituted Pakistan (Lewis 1970: 15-16). Nevertheless, growth was high even after allowing for this and reflected the success of these policies in maintaining profitability in the emerging industrial sector at very high levels. Papanek (1967: 39) reports that profit rates were as high as 50-100 per cent in industry in the early fifties, declining to 20-50 per cent by the late fifties. These incentives had the desired effect and merchants fell over each other to invest in industry (Papanek 1967, Lewis 1969, 1970, Lewis & Soligo 1965 and Amjad 1982). There was a rapid growth particularly in consumer good industries such as oil processing, rice milling and food manufacturing which were generally not capital-intensive and which mostly involved low risks. On the other hand, there was also some development of more capital-intensive intermediate industries such as textiles through the fifties.

However, this success should not be overstated. Table 2 shows that even in 1960, the share of large scale manufacturing industry had only increased to five per cent of GNP while agriculture still accounted for 53.3 per cent (Ahmad & Amjad 1984: 4). Moreover, by the late fifties, easy import substituting possibilities had been exhausted and the industrial growth rate began to decline sharply (see Table 1). The industrial sector needed a more targeted policy regime to sustain further growth, to increase investments in better and more sophisticated technologies and to persuade the early industrialists to upgrade their technologies and improve productivity. The problem was not that the economy necessarily needed to move into more capital intensive industries or into the production of capital goods. It was rather that further industrialization involved greater risks and required more targeted allocations of capital for longer periods as new expertise had to be acquired and new markets captured. This held true not only for capital goods industries but also for more sophisticated consumer goods industries. And yet, at the very moment when simple consumer goods had been mastered and the industrial sector was ready to move into more risky investments, the country faced a growing political crisis.

Economic historians who have examined the political impasse before the military coup of October 1958 have often tended to impose inappropriate categories on the conflict. For instance, Amjad (1983: 206-10) explains the crisis in terms of a conflict between the West Pakistani 'feudal oligarchy' who dominated the Constituent Assembly and the bureaucracy imported from British India who he claims were the agents of the bourgeoisie. The large West Pakistani landlords were undoubtedly over-represented in the Constituent Assembly, just as the *jotedar* dominated the East Pakistan Legislative Assembly. But like the *jotedar* voice in the East, the 'landed interests' of the West were not primarily interested in rural issues let alone feudalism. The conflict between the 'feudal oligarchy' of West Pakistan and the primarily *jotedar* representatives from East Pakistan was about the weight of representation of each wing in the central legislature. This was a critically important issue because it would determine the political power of these aspiring regional "middle class" groups demanding access to the surplus allocated by the state. Whatever their agrarian origins, neither of these groups of politicians showed any legislative interest in the fate of agriculture. Thus, the claim that there was a growing conflict between “feudal” political representatives and emerging capitalists represented by the bureaucracy is not entirely accurate.

Alavi (1983) rightly criticizes the description of the West Pakistani political representatives as feudal. However, he explains the shift to authoritarianism in 1958 in terms of the 'structural imperative of peripheral capitalism’. But while Alavi is right in pointing out that emerging capitalism in developing countries is different from the capitalism that developed in the early developers, Alavi does not have an analytical model telling us what the structural imperatives of ‘peripheral capitalism’ really are apart from the fact that they eventually lead to the military-bureaucratic takeover. A similar imperative towards military takeover does not seem to have operated in India. It would be more accurate to say that the opportunities created for a military takeover in Pakistan compared to India were due to a combination of a much more serious distributive crisis created by competing demands from non-capitalist classes at a much earlier stage of development and a weaker political organization for institutionally organizing accommodation. Add to this the perception amongst key military and bureaucratic leaders that industrialization was essential for the country’s political survival and we have the ingredients for a sufficient explanation of the shift towards authoritarianism. An ambitious general could seize power and could rely on the tacit support of nationalist bureaucrats and politicians.

Thus by the late fifties two parallel processes were working to bring to a close the first stage of import substituting industrialization. On the one hand, there were economic factors such as the exhaustion of easy substitution possibilities and the need to progress into more risky ventures that needed new economic policies and appropriate state institutions. Secondly, at the very moment that industrialization was moving into a more difficult phase, political challenges from indigenous intermediate classes who had been effectively excluded from these processes were also coming to a head. Governor’s rule in various parts of the country was not leading to political quiescence but its reverse. Yet, political stability was a precondition for working out any institutional solutions to the pressing economic problems.

The military-bureaucratic leaders responsible for the October 1958 coup were very clear in their own minds about the importance of political peace and the need to suppress the demands of the political classes if industrial accumulation was to continue. Behind the coup were several powerful bureaucrats, men like Ghulam Mohammad, Chaudhri Mohammed Ali and Iskandar Mirza, in whose perception, the state faced a stark choice. If it conceded to the demands of the political representatives, they feared the politicians would be unable to resolve their distributive conflicts and the bulk of the country's investible resources would be absorbed by these political coalitions at the cost of industrialization. On the other hand, they clearly understood that political suppression carried grave risks of its own. In October 1958, they chose to go down the second route encouraging and supporting General Ayub Khan's bid for power.

3. The 1960s: Military Takeover and Industrial Policy

While the October coup was in the first place a response to a political crisis, the temporary cessation of distributive conflicts that followed allowed new responses to the economic problems facing the country. It is instructive to compare the evolution of industrial policy in Pakistan with the parallel processes unfolding in South Korea where a similar coup took place in 1961. In both countries, economic experiments after the coup led to a similar evolution towards industrial policy. However, the South Korean coup consolidated the state in a society where intermediate classes were weak to start with. As a result, the institutions of the state could continue to coordinate industrial policy allocations over a sustained period of almost three decades (Amsden 1989: 147, Kim & Ma 1997).

In Pakistan, the early experience of the benefits of state coordination under the military regime led to a very similar set of policies and institutions for state-led industrialization. The Ayub regime, like Park Chung Hee's in South Korea, was committed to the development of capitalism. Neither leader saw any contradiction in using the state in detailed interventions to achieve this goal. Thus we would argue that Gardezi & Rashid's (1983: 4-11) description of the sixties as a period of 'laissez faire' does not square with the evidence.

The real contrast between Pakistan and South Korea is in the way in which politics and policy evolved in the two countries. The intermediate classes who had been temporarily bypassed by the 1958 coup in Pakistan did not remain quiescent for long. The 1962 constitution legitimized for a time the subordination of the powerful middle class and emerging middle class factions. Their voices were temporarily overwhelmed by the voices of those lower down the social structure through the electoral rules of Ayub's Basic Democracy experiment. This allowed for a time the allocation of huge resources to a very small group of industrialists. This in turn allowed very rapid accumulation and industrial growth. It was this rapid accumulation rather than the effects of a limited liberalization of the licensing system that drove the impressive industrial boom of the early sixties. However, by the mid-sixties the intermediate classes had to be accommodated once again with important consequences for the implementation and sustainability of industrial policy.

Liberalization. The liberalization and decontrol that happened in the early sixties was not insignificant. The items imported on license declined from 90.3% of total imports in 1960/61 to 39.5% by 1964/65 (Amjad 1982: 39). It became easier for businesspersons to import raw materials and capacity utilization increased. The overvalued exchange rate had become a problem because there was a growing manufacturing sector whose exports were being hampered by the overvaluation. Instead of devaluing, Ayub's regime devised the ingenious solution of multiple exchange rates by giving exporters of manufactured goods an "export bonus" in the form of a bonus voucher that was effectively an additional claim on foreign exchange. These measures induced an investment boom in the early sixties and exports of manufactured products such as jute textiles rapidly increased.

The Role of Accumulation. The driving force behind the acceleration of industrial growth in the early sixties was simply rapid investment, which in turn was made possible by the centralized allocation of investible resources to selected industrial investors. In the space of a couple of years, the regime developed, through a process of trial and error, the incentives and credit allocations which economists describe as industrial policy. The distinctive feature of industrial policy is that specific sectors or even business houses are targeted for support to accelerate the process of industrialization and technology acquisition.

Industrial policy therefore requires either a degree of social consensus that these policies are in the common interest or it requires a state that is able to override the resistance of those who oppose its allocations. The industrial policies that emerged in both Pakistan and South Korea were initially based on social exclusion rather than consensus. The militaristic forms of the governments that emerged in these countries in the early sixties played a critical role in allowing the two states to do this.

An indirect measure of the success with which industrial policy in Pakistan directed resources to the new (and tiny) class of big capitalists is provided by the huge concentration of wealth which soon emerged in the industrial sector. This evidence is usually presented as an indication of the failure of industrial policy. In fact since this is exactly what the regime was *intending* to achieve, the figures for concentration give us an indication of the success of the policy in directing resources to the small class of capitalists. Of course, resources could have been targeted to a broader group of capitalists and indeed the Second Plan and Third Plans, which covered the sixties, paid lip service to the objectives of maintaining regional and inter-sectoral balances. Nevertheless, in the absence of any attempt to find and cultivate a broader capitalist class, the growing concentration reflects the rapid investment going on in industry.

The Pakistani economist Mahbub-ul-Haq, who used the phrase functional inequality to describe the social utility of an initial period of inequality, provided the justification. In an argument that would have appeared attractive to a later generation of production-oriented Marxists like Bill Warren, Haq argued that capitalist growth required the re-investment of profits and large profits implied an initial period of inequality. Redistribution and welfare could be (indeed had to be) postponed until a later date. This identified Haq with the trickle down school although his work was extremely sophisticated for his time. It is important to note that Haq’s argument was to defend *some* initial income inequality not to defend a huge concentration of industrial assets in a few hands. In other words, Haq saw no necessity for large scale production or of economies of scale that would have justified in addition a concentration of asset ownership.

By the late sixties, the same Haq was so appalled by the extent of *asset* concentration in Pakistan that he coined another phrase that was to have wide-ranging repercussions in Pakistani politics. Using Planning Commission data, (which has still not been made public) he described the beneficiaries of industrial policy resource allocation as the *22 Families* who in 1968 apparently controlled 66% of Pakistan's industrial wealth. A more careful study by Amjad later suggested that the top 18 groups controlled 35% of industrial assets while the top 44 controlled around 50% (Amjad 1982: 47). This asset concentration was due to a combination of two things. First, Pakistan was adopting industries that typically benefited from large scale production because of economies of scale. These were industries like cotton and jute textiles, cement, chemical industries, and so on. The type of technologies Pakistan was adopting is indicated by the studies of capital-labour ratios done in the sixties. A.R. Khan (1970) found that the capital-labour ratios in most manufacturing sectors in 1962 were higher in Pakistan than in Japan! A similar study by Rizwanul Islam (1976) for 1969 reached the same conclusion. Thus, the small scale sector was virtually absent in the new technologies that were being adopted through the allocation of credit and licenses through industrial policy.

But a second factor behind these concentration figures was the allocation of the bulk of state controlled loans to a small number of families. This may have been justified if managerial skills were in very short supply and if the particular families were able to meet this shortage because of their longer entrepreneurial experience. It is very likely that the actual concentration of lending to these families was more than could be justified by their greater entrepreneurial skills though this would be difficult to empirically test.

Whatever the reasons, between 1958 and the breakdown of industrial policy in 1970, the larger of the two industrial banks (the Pakistan Industrial Credit and Investment Corporation) lent 45% of its loans to 13 monopoly houses. The smaller industrial bank (the Industrial Development Bank of Pakistan that concentrated on smaller loans) lent 32% of its loans to 30 monopoly houses (Amjad 1982: Table 2.6). While these state owned industrial banks only allocated about a fifth of industrial investment funds over this period, the private banks did not contribute to a widening industrial ownership structure either. In fact, of the 17 privately owned banks, seven were directly under the control of the very same large business houses.

Concentration versus the Absence of Conditionalities for Subsidies. The important question is whether industrial concentration contributed to the economic slowdown of the late sixties. This is an important question since a number of subsequent Pakistani economists including Amjad (1982) identify the industrial concentration as a major contributor to the subsequent slowdown. An alternative explanation is that the slowdown happened because subsidies were effectively being given to the capitalist sector without any conditions. The simple concentration argument draws on textbook neoclassical models where concentration and market power can result in inefficient pricing policies by monopolistic firms. As an explanation for declining growth, this argument does not stand up if there are significant economies of scale in these industries.

However, it could be argued that monopoly power can also reduce the incentives for technical progress and quality improvement which competition induces. This is where the conditionalities imposed by the state on subsidy recipients become important. There is no necessary connection between domestic concentration and competition because large firms can be induced to vigorously compete by exposing them to international competition. Moreover, competition can also be promoted by encouraging vigorous competition in the domestic market. Comparing Pakistan with India and South Korea shows the importance of this point.

Both India and South Korea had concentration ratios that were very high, comparable to those in Pakistan although strictly comparable figures are hard to come by. In India, the Dutt Committee reported in 1969 that in terms of licenses awarded, the top 73 industrial houses accounted for 56% of the total proposed private corporate sector investment in machinery and 60% of its investment in capital goods (which includes buildings etc) (Datt and Sundharam 1991: 142). These figures are based on licenses and not actual ownership and only cover the private corporate sector so they are not comparable to the Pakistani data. But they do show a substantial *intended* industrial concentration by the Indian planners quite similar to that observed in Pakistan.

On the other hand, it is difficult to sustain the argument that concentration always induces inefficiency when we look at South Korea. Asset figures for industrial concentration are not available for South Korea but according to Amsden the *sales* of the top 10 *chaebol* (family owned holding companies) in 1974 accounted for 15.1 % of GNP. This figure grew to 67.4% of GNP by 1984 (Amsden 1989: 116). Given South Korea's rapid industrial growth over the seventies, these figures show that an astounding growth in concentration nevertheless did not constrain growth. Clearly, concentration by itself does not necessarily result in poor performance. Indeed, the South Korean case shows that industrial enterprises in sectors that benefit from economies of scale clearly benefit from concentration.

In South Korea, concentration did not result in inefficiency because it did not prevent the intense competition of the *chaebol* with international competitors. The state was able to induce this competition by making export growth a condition of subsidies. It was able to do this by demonstrating that it was able to withdraw subsidies from *chaebol* if it wished, for failure to export or for any other reason. Clearly, the *power* of the state to make this type of threat credible was the distinguishing feature of the South Korean state and its industrial policy (Khan 1989, 1996a). In contrast, the inability of both the Pakistan and Indian states to give conditional subsidies resulted in poor performance accompanying the growth in industrial concentration.

Sectorally Targeted Investments. When a state can impose conditions on the recipients of subsidies, one of these conditions can be that the resources are invested in particular sectors or in particular technologies. The ability of the South Korean state to discipline its *chaebol* is closely related to a second distinguishing feature of its industrial policy. Over the sixties its industrial policy evolved by becoming more targeted. The state increasingly used its power to allocate resources to allocate them to high technology sectors. Sectoral policy reached its peak under their Heavy and Chemical Industry Promotion Plan that was formally adopted in 1973. The state became involved in detailed imperative planning where particular sectors were prioritized. Following the work of Alice Amsden and others, this period has come to characterize the high point of South Korean industrial policy interventionism. Despite the eventual problems which South Korea's industrial and financial sectors were to face in the nineties, there is no doubt that state-led industrial policy was a key factor behind its success in organizing rapid industrial accumulation and growth in the sixties, seventies and into the eighties.

There is no evidence that the Pakistan state ever acquired a similar degree of control over sectoral allocation. It published investment schedules, which publicized desired investments in different sectors, but there were no sanctions for excessive investment in some sectors and under-investment in others. It should be said that the South Korean regime did not invent all these features overnight or at the very outset. It groped towards a system that paid large dividends over a period of almost three decades. The real question is why the evolution of the Pakistani system took it in such a different direction. Why did the leaders of the state not understand that by monitoring what they were allocating they could generate much larger dividends for the country, for the capitalists and even for themselves in the form of bribes or kickbacks from rapidly growing profits?

Changes in the Political Context. It would be wrong to attribute the evolution of Pakistan's industrial policy to policy failures at the leadership level alone. We also have to look for constraints that may have prevented the leadership from moving in the direction of the South Korean model. In fact, by the mid-sixties, serious cracks were appearing in the very foundations of Pakistan's industrial policy regime. The state's ability to even sustain the allocation of credit and foreign exchange to the old groups was rapidly declining and there was no question of a sustained deepening of the industrial policy regime by enforcing the allocation of conditional credit to identified high technology sectors. It is at this point that we begin to see the steep decline in industrial growth rates in Pakistan in the late sixties (Table 1 above).

From the mid sixties onwards, the Ayub regime faced a growing and increasingly powerful resistance from excluded social groups demanding accommodation and inclusion. Political mobilization against Ayub began to be organized in West Pakistan from around 1967 by Bhutto under the banner of Islamic Socialism. Bhutto's newly articulated ideology was used to challenge the concentrated allocations of resources which industrial policy had entailed. The battle was joined shortly afterwards by Mujib-ur-Rahman in East Pakistan under the banner of Bengali nationalism. He too challenged the concentration of industrial resources in the hands of the emerging capitalists who happened to be almost entirely non-Bengali. These changes in the political environment were extremely important in determining the efficiency of interventions and allocations at the micro level which industrial policy required.

As a result of the growing political contestation which emerged from the mid-sixties onwards, allocations under the plans were increasingly made not to the capitalists who had the greatest chance of success but to capitalists who had the most significant political connections in the sense that their political patrons needed to be accommodated for the sake of political stability. Industrial policy increasingly became part of the process of political containment rather than of economic planning. Because of this, even the existing capitalist sector was soon affected. The possibility of monitoring and imposing discipline on the established capitalists steeply declined. This is because as rational political actors, even potentially efficient capitalists had strong incentives to cultivate political patrons after which they were effectively protected from any questioning about the use they made of the subsidized resources allocated to them.

As provincial and regional political fragmentation grew over the sixties, it became increasingly easy for individual capitalists to find and cultivate competing factions of politicians each of whom would protect “their” capitalists, no doubt in exchange for “campaign finances”. Thus, productivity could not be forced up even in the industries already set up by threatening to withdraw subsidies. Threats of subsidy withdrawal are not likely to be either credible or feasible when they and other centrally allocated rights are allocated according to political criteria (see Khan 1996a, 1996b, 1997, 1998a for an analysis of these and related issues and for comparative evidence).

Changing Political Constraints versus Cutbacks in Aid-Financed Investments. The changing political context had immediate implications for the state’s ability even to continue allocating resources in the old way to the big capitalists. This is important to establish since the slowdown of industrial growth has also been attributed to a decline in investments in the late sixties due to a cutback in aid. Thus, Amjad (1982) argues that industrialization slowed down because of a decline in aid and soft credit inflows into Pakistan that in turn led to a decline in industrial investments.

It is undoubtedly true that Pakistan suffered from a cutback in aid in the mid-sixties. In fact following the 1965 war with India both Pakistan and India suffered cutbacks in aid. In Pakistan, this affected the flow of resources through the industrial banks or DFIs that had a knock-on effect on industrial investment. We see some evidence in support of this thesis when we look at the figures for industrial investment in West Pakistan. In West Pakistan industrial investment peaked in 1965 and then suffered an approximately 25% drop in the late sixties in real terms. However, a more complex story emerges when we include East Pakistan in the picture. The total industrial investment for Pakistan does not suffer an equivalent drop according to Amjad's own figures shown in Table 4. What seems to be happening in the late sixties in terms of these figures is extremely interesting and is surprisingly not commented on in the economic literature of either Pakistan or contemporary Bangladesh.

Table 4. Industrial Investment in East and West Pakistan 1961-70

(Million Rupees in Constant 1960 Prices)

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
W Pak	852.94	846.15	757.05	1062.50	1221.43	1087.96	987.16	1013.79	916.87	1061.36
%Public Sector	5.1	3.9	15.6	3.2	9.8	10.8	10.9	11.6	8.3	3.2
E Pak	205.99	459.42	332.21	382.30	450.21	390.00	477.02	799.81	796.84	700.88
%Public Sector	21.7	13.8	29.8	24.3	24.3	25.0	24.8	53.0	50.7	45.7
All Pak	1058.9	1305.6	1089.3	1444.8	1671.6	1478.0	1464.2	1813.6	1713.7	1762.2

Source: Amjad (1982) Table A.9

From around 1967, which is the year when provincial conflicts suddenly escalate, the central government started to shift a significant proportion of industrial investments to East Pakistan in response to the growing political pressure from the East. History was to show that it was too little and too late. What is interesting is that the re-allocation had begun as early as 1967 and on a significant scale.

If the aid-based explanation of the industrial slowdown were correct, we would expect to see a *general* drop in industrial investment in the late sixties. Instead, total investment does not fall and indeed reaches a peak in 1968. What we do see is a significant regional re-allocation of the total investment. Can this be related to the industrial slowdown? A change in investment allocation across regions does not in itself explain why there should have been a drop in performance. A possible explanation is suggested by the figures for the public sector. Two decades of neglect had meant that East Pakistan did not have many entrepreneurs yet political pressure from the East was powerful enough to result in a rapid relocation of new investments. Since Bengali entrepreneurs were not forthcoming the share of the public sector shot up in East Pakistan. Not only was there a bigger pot of investment going to East Pakistan (for the first time approaching parity with West Pakistan which was still slightly smaller in terms of population), but also around half of these investments were in the public sector. By and large these public sector investments were usually capital-intensive. Such investments have long gestation periods and the bunching of new start-ups in the late sixties could be one reason why industrial output declined despite overall investment being maintained.

Despite the importance of the public sector, which indicates the weakness of the Bengali bourgeoisie, a new Bengali bourgeoisie was rapidly being created. By 1971, one study found sixteen major Bengali business houses, each with assets of more than Rs. 25 million, and with combined assets of nearly Rs. 700 million (S. Baranov, cited in Sobhan 1980: 15). The bulk of the nascent industrial bourgeoisie was, however, small to medium entrepreneurs. Excluding the large jute and textile industries, state financial institutions had, by 1971 given over 3000 loans to Bengalis, mostly below Rs. 400,000 each, helping to set up around 1300 units (Sobhan & Ahmad 1980: 64-5).

Inevitably, some of the new Bengali entrepreneurs were political entrepreneurs or entrepreneurs with strong political linkages. After all, the sudden shift in investment philosophy had been clearly driven by politics and not by a reassessment of economic strategy. In an extremely perceptive description, Hamza Alavi calls the emerging class of new men in East Pakistan in the late sixties the "*contactors*" as distinct from the ubiquitous class of small entrepreneurs who are known in the subcontinent as contractors who mainly engage in small scale construction projects (Alavi 1973: 169-70). Unlike the contractors, the *contactors* were entrepreneurs whose source of power was their "contact" with someone in politics. The *contactors* represented in a pure form the use of political power to accumulate economic resources. The resources going to this class in the late sixties were probably almost entirely a waste. A few did eventually accumulate enough and were to become the big capitalists of independent Bangladesh. But in most cases, the diversion of investible resources to this emerging class of political entrepreneurs must be part of the explanation for the slowdown in overall industrial growth in the late sixties.

Conditionalities Revisited: The Role of Politics. The picture of increasing political contestation can help to explain a more important feature of Pakistan's industrial policy. We have already seen that the imposition of conditionalities for subsidy recipients was never attempted in Pakistan or indeed anywhere in the Indian subcontinent. Yet, in principle a state that is trying to maximize economic growth (or even its own wealth in the form of bribes) should by a process of trial and error discover that growth is enhanced by allocating resources in particular ways and with particular conditions. The political context suggests an obvious reason why this kind of thinking did not emerge in leading planning circles. If the exercise of political power can lead to the reallocation of vast sums of investment as we have seen in the case of the unfolding East-West conflict in Pakistan, it can also prevent the imposition of discipline on individual capitalists. We now examine how capitalists as rational economic and political players took full advantage of the political situation to protect their private interests.

Stanley Kochanek (1983) examines the persistent and growing politicization of capitalists in Pakistan by looking at the internal politics of the Pakistan Chambers of Commerce in the fifties, sixties and beyond. From the very beginning of the Ayub regime, the potential of political opposition was a consistent worry for the leadership. Ayub responded to this using both the carrot of buying off those who would promise to be quiescent as well as the stick of repression. The latter, however, was soon recognized as implausible given the disposition of forces between a relatively weak state apparatus and a potentially well organized middle class that could easily mobilize broader social protest. Thus, even after the 1958 coup, the practice of distributing licenses (to import or invest) to political entrepreneurs to "buy them off" continued. These entrepreneurs were mostly Pathans and Punjabis in West Pakistan, suggesting that the tradition of *contactors* was neither new nor East Pakistani, although there was clearly a major new irruption of *contactors* in East Pakistan in the late sixties. The early West Pakistani *contactors* would sell on their licenses to businesses, thereby capitalizing their organizational power (Kochanek 1983: 264, Feldman 1972: 204).

In this context, business developed a very specific pattern of organization both in terms of relationships with each other and with the state. The big capitalists preferred initially to develop personalized contacts with patrons in the state bureaucracy and the highest political leadership consisting of Ayub and his close associates. Later on, these capitalists would become the sole political base for Ayub's rule, financing his party and providing resources for his politics. Such a close nexus between top business and political leaders is also apparent in the South Korea of the time with a similar sharing of rents between the two groups. In Pakistan, however, from the beginning there is another category of medium sized entrepreneurs who are more active in the business and trade associations and who are adept at using their close ties and affinities with local political movements, parties and organizations to press their demands. This group numerically dominates the trade associations, which the Ayub regime tried to set up in the early sixties. Although economically weak, they are not politically weak, and the big groups cannot dominate them in the trade associations.

The political power of the medium and small enterprises is shown by the strategies they followed to further their interests. The politics of their associations was extremely fractious. Economically weaker groups of entrepreneurs strongly resisted the Ayub regime's attempts to create unified national business associations where their power was more likely to be proportional to their economic strength. The weaker groups always resisted this because they felt that with separate representation they would be able to make demands in proportion to the *political* power of the groups they had allied with, even if their economic power was currently small. This was as true of smaller business groups in West Pakistan as it was of the East Pakistani bloc. However, the importance of the East-West divide dominated all other conflicts between business groups because of its potentially explosive implications for the country. Subsequently, the history of both Pakistan and Bangladesh shows the continuing politicization and fractiousness of business in these countries. To push their particular cases, competing business groups in both countries continue to ally themselves with whatever competing regional or (in the case of Bangladesh) ideological identities are current (Kochanek 1983: 122-171).

The East Pakistan case shows that these strategies were rational for the sectional interests who follow them. East Pakistani *contactors* got huge windfalls as a result of their association with the growing regional movement in East Pakistan. The scale of the resource shift to East Pakistan shown in Table 4 captures the significance of this type of politics. We argue that this political context is important to understand the total absence of conditionalities for subsidized loan recipients amongst the big capitalists. As the sixties progressed, the Ayub regime became increasingly politically dependant on the support and acquiescence of the big business interests it had helped to create. Their finances were essential for the regime and it could not afford to lose the last remaining bastion of support. If the regime antagonized any particular big business group too much it would clearly threaten to ally itself with one or other of the many regional and ideological movements which had begun to oppose the regime.

In this context, it is hardly surprising that the Ayubite industrial policy did not progress in the South Korean fashion to become stricter in its conditionality let alone to become more ambitious in directing resources to particular sectors. The big business allies of the regime had to be kept happy and this meant that the stick could not be used. At the same time the carrots available for them were shrinking because emerging middle classes had to be accommodated on a massive scale by the late sixties (the East Pakistani *contactors* being only one example). Despite such accommodation, the country was inexorably descending towards political disaster and the entire Ayubite policy structure collapsed with the descent into civil war and the independence of Bangladesh in 1971.

In providing this explanation, we have not addressed the features of Indian history that explain the relative power of its "middle classes", nor can a satisfactory discussion be attempted here. Several distinctive features of Indian society can however be noted in passing. On the one hand, the relative political weakness of capitalists and workers in the Indian subcontinent at the end of the colonial period reflected the industrial under-development of India to a much greater extent than was the case in the East Asian states. On the other hand, elites whose power was based on positions they occupied within the formal and informal colonial administrative structure were relatively much more powerful. The competing claims of these elites during the colonial period and the manner in which they were accommodated established a tradition of political activity that has lasted well into the post-colonial period.

Competing groups from within the emerging middle classes in the Indian subcontinent continue to organize on the basis of a wide variety of emotive symbols including language, caste and religion to demand preferential subsidies, access to jobs and so on. Politics based on these symbols has not enriched the vast majority of the populations of these countries but *has* enabled successive layers of emerging middle class groups to get access to public resources on the basis of their ability to organize much more numerous groups below them. At the same time, those who happened to be in power have always found it necessary to organize transfers to the most vociferous of the excluded groups in ongoing processes of accommodation and incorporation (Khan 1989).

In stark contrast to the Indian subcontinent, the colonial impact of the Japanese in North East Asia left a society with relatively weak intermediate classes and no tradition of political accommodation in response to pressure. Japanese colonialism destroyed the potential of a new middle class emerging from the countryside by destroying the rentier landlord class. It also ran its colonies with far fewer concessions to the political demands of local power blocs (Kohli 1994). Unlike the British, the Japanese were able to do this because of their numerical dominance over their much smaller colonies as well as their geographical proximity. An unintended and certainly unforeseen consequence of this strategy was that competing factions within indigenous middle classes remained relatively weak in these countries. Later on in the post-colonial period, this allowed their states to remain isolated for a lot longer from the need to accommodate organizationally powerful groups from within the middle and lower middle classes (Khan 1989).

Thus it was the nature of the links between politics and economics that made Pakistan significantly different from South Korea. In the East Asian countries, the centrifugal growth of competing opposition groups did not emerge till the end of the seventies and even then it did so in a much more muted form. By then the foundations for a viable capitalist economy had been established in the East Asian countries and a mature capitalist class had emerged who no longer required differentiated assistance and support to the same degree as before. Most importantly, by the eighties the successful East Asian industrializers had graduated to the ranks of the advanced industrial countries, even if like the advanced industrial countries they are subject to occasional structural crises and bouts of recession.

Conclusion

An examination of the Pakistan industrial policy experiment of the sixties leads us to ask if the strategy failed because of policy errors or because of some deeper incompatibility of the policy with the underlying social structure of the country. We have argued that simple policy error explanations either of the liberal (too-much-intervention) or of the statist (too-little-monitoring) types are not convincing. Explanations which stress structural features such as industrial concentration or contingent shocks like the decline of aid are also not convincing on their own. But does the social structure of the subcontinental countries doom them to low growth and bouts of political upheaval?

Such a conclusion may be too pessimistic. But our analysis certainly does suggest that simple answers are unlikely to be found in either renewed attempts to create a new political consensus or in liberalization. The Ayub regime tried to change its political constraints to make politics more compatible with its economic strategy. Ayub's attempt to over-ride political constraints clearly failed and the country eventually descended into civil war. The political basis of this failure and the ability of emerging middle class groups to consolidate around ever newer symbols is an experience that needs to be carefully studied. It has potentially important lessons for the emerging consensus within sections of the Indian elite that a unified national identity based perhaps on "Hinduism" may enable the Indian state to overcome a parallel structural sclerosis. The Pakistan experience shows that ideology, constitutional change and substantial amounts of force are not sufficient to change patterns of upward mobility in the Indian subcontinent.

In contrast, the current phase of liberalization in the Indian subcontinent may be described as one of changing the economic strategy to make it more compatible with political constraints. It is possible to interpret liberalization as a strategy of state withdrawal given the political failure to implement intervention efficiently. While this makes some sense, there is also a sense in which liberalization is self-defeating. Political stability ultimately depends on growth and the satisfaction of demands and aspirations. Stability will not be achieved for long if these economies do not grow rapidly. While liberalization has improved the prospects of growth in the short-run by removing the worst irrationalities of centralized attempts at resource allocation, it has also harmed long-run prospects by encouraging these countries to move into small-scale, low value-added sectors. Through the eighties, Pakistan has moved into lower quality cotton textiles and garments, diamond polishing has emerged as one of India's major export "industries" and the garment industry has established itself as the miracle industry of Bangladesh.

If our analysis of the political constraints on subcontinental states is roughly correct, it suggests that these states are not going to be too good at monitoring and disciplining large-scale industries if the rest of society is going to concentrate on contesting the associated allocations of resources all the time. This does not mean that these states can do nothing to ensure that high technology industries are adopted. There are plenty of industries such as electronics, which are relatively small-scale, and yet are high technology and high value-adding industries. Such industries are likely to be politically more viable in the Indian subcontinent as they entail the creation of a widely dispersed but high value-adding capitalist class. But these industries are unlikely to spontaneously appear without the coordination of investment plans, technology acquisition licensing and credible assurances being given to foreign investors. States can play a big part in all this as they have done in Taiwan or Malaysia. The challenge is to identify strategies that can promote long-run growth and for which the political support of a large enough group of the population can be found to counter the perennial political pressures constraining the ability of the state to organize development.

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