

*The Pakistan Development Review*  
35 : 4 Part I (Winter 1996) pp. 343—382

*The Iqbal Memorial Lecture*

## **Pakistan's Development and Asian Experience**

GUSTAV F. PAPANEK

*To summarise* the conclusions of this paper:

1. Pakistan not only has to deal with a cash flow problem, it also has to make the difficult structural adjustment of living within its means, after nearly 50 years of failing to do so.
2. Despite large resource inflows and periods of good economic management Pakistan's per capita growth has been less than half of that in rapidly growing Asian economies. The country has therefore failed to reduce poverty as much as it could have.
3. This performance was the result of inadequate export growth, savings and attractiveness to foreign private investment. Two periods of good economic management show the impressive potential of the economy.
4. The heart of an appropriate economic strategy is to make non-traditional exports more profitable.
5. It is appropriate to emphasise the need for further decontrol and greater reliance on the market. But government has an important role in providing infant industry incentives for exports and compensating for externalities.
6. To maintain political support for reforms government must allocate fairly the pain and gains, and reduce corruption.

### **A. SHORT-TERM CRISIS AND SERIOUS NEW STRUCTURAL PROBLEM**

It is by now widely accepted that Pakistan faces an immediate crisis in finding the foreign exchange to meet its debt and other obligations. But there is less recognition that there is also a long-term structural imbalance that requires a structural solution.

Gustav F. Papanek, formerly Professor of Economics, Boston University, is President, Boston Institute for Developing Economies, Ltd., Lexington, Mass., U.S.A.

### **1. The Short-term Foreign Exchange Crisis**

The short-term crisis is well recognised and being dealt with. Moreover any comments can quickly be outdated by events. A few remarks will therefore suffice. Since macroeconomic imbalances are related, one can look at the situation from different perspectives. The Balance of Payments is perhaps the easiest to understand. The State Bank (1996) estimates the current account deficit for this year at about 6.6 percent, while a later World Bank estimate is for the even more daunting 7.2 percent (1997). This deficit has 2 major elements:

- a deficit on trade and services account, that is imports of goods and services greater than exports;
- the need to pay interest on the debt which the Pakistan government (and private entities) have incurred.

Somehow this deficit has to be covered, because the cost of defaulting on debt is too great. Foreign official transfers are likely to cover only 1 percent on a net basis, leaving 5.6–6.0 percent to be met from remittances and from other items in the capital account.

But the capital account adds to the problem. The Pakistan government has commercial debts which are falling due this year and need to be paid. Moreover, past current account deficits have been partly financed for some years by volatile inflows of:

- Portfolio investment.
- Foreign currency Deposits from residents and non-residents.
- Short-term foreign borrowing from the capital market through a variety of devices, and by drawing down foreign exchange reserves. The reserves are now too low. They need to be high under current circumstances because substantial sums can quite readily flow out again.

A largely convertible currency and a capital account that is quite open greatly increases both the likelihood and the cost of macroeconomic instability and changing expectations. When large sums of money can and do slosh in and out of a country a country needs far larger foreign exchange reserves and is highly vulnerable to changes in perceptions and expectations. When expectations turn sour, exchange reserves of a billion dollars can quite quickly be wiped out, as short-term debt is not rolled over, dollar deposits are withdrawn, remittances decline and net inflows of portfolio investment change from positive to negative. Yet Pakistan's foreign exchange reserves have generally been less than one billion dollars recently (about \$ 1 billion March 1997).

Pakistan's reserves have been particularly vulnerable recently. It is not well-covered in the international press. But three stories were widely covered and affected international investors and lenders:

- Ethnic strife and crime in Karachi earlier and political instability in 1996.
- Pakistan's listing as the second most corrupt country in the world, the most corrupt in Asia. It is ironic that some Asian competitors escaped notice because they were not among the top five in corruption and many newspapers listed only the top five. The difference between the second and sixth most corrupt is not very meaningful, since these evaluations are highly subjective. But it became meaningful to bankers and investors if only the top five were mentioned in the media.
- The business press covered the downgrading of Pakistan's debt by one ranking service.

These three reports increased the volatility of Pakistan's foreign exchange flows and the need to maintain large reserves to meet debt servicing needs, the trade and services deficit and any short-term outflows of funds.

It is always possible to deal with the short-term problem of increasing both the reserves and the confidence of depositors and investors by cutting back sharply on imports and government investment and raising interest rates. Indonesia when faced with a similar problem took steps which resulted in short term interest rates of 100 percent. That brought an immediate repatriation of funds, cut imports as stocks and working capital became very costly, and encouraged an inflow of funds. The short-term costs of such measures are substantial since they are likely to result in a shrinking of the economy and a sharp drop in investment.

The alternative is to increase short-term borrowing from other countries, the IMF and foreign banks to provide reserves sufficient to reassure lenders, investors and those who deposit foreign exchange in the banking system. This strategy as well has substantial short-term costs. Foreign banks are unlikely to lend without the assurance provided by an IMF agreement and even so will now demand higher interest costs than a year or two ago. The IMF will insist on a stabilisation programme, that will also curtail demand/income and raise prices. The immediate contractionary costs of stabilisation may be less, but only at the cost of aggravating long term problems. The short-term debt would increase and with it the debt servicing costs.

## **2. Confusing the Effects of Stabilisation and Those of Reforms**

Both approaches then tend to be contractionary, sharply but temporarily reducing the rate of growth. Indeed they usually lead to a decline in per capita

income. Both also tend to include a reduction in the government deficit, partly by a decline in some subsidies, and a devaluation. The poor are hurt by the slow-down in the economy and accelerating inflation [Papanek (1996) and below]. Prices rise more rapidly because of the withdrawal of some subsidies and the standard devaluation.

In Pakistan as elsewhere a reform programme is often launched at the same time as the stabilisation effort. Reforms are seen as painful, and are therefore accepted as politically possible only when the government has its back against the wall, precisely the time when stabilisation is also needed. The decline in the consumption of the poor, greater than that of most other groups, is then blamed on the reform by those opposed to the reforms, although it is really caused by the stabilisation effort.

In fact, sensible reforms which accelerate growth benefit the poor. It is stabilisation, usually made necessary by profligate governments which should, but rarely is, blamed. (For a more detailed discussion of this point and evidence supporting it see Papanek 1996.)

*In Short*, whatever government is in power in 1997, it will not be able to avoid imposing a stabilisation programme. If it is a traditional stabilisation effort then it will cause shrinkage of the economy and pain for the majority of the population and especially for the poor (but see below). The pain should not be blamed on the reforms that should take place at the same time but on the excessive spending of previous governments.

### **3. Living Beyond Its Means Since Independence**

Pakistan's problem, however, is not just a short term liquidity crisis. Rather it is also structural. Pakistan has been living beyond its means since Independence, except for some very brief periods. That is, it has consumed (and invested) more than it has produced, it has imported more than it has exported. The Balance on Current Account, a good measure, has shown an inflow of foreign resources of 6 percent of GDP or higher most years since the 1960s (see Table 6 (b)).

First the gap between consumption/production and imports/exports was met by Sterling balances. Then came a brief period when Pakistan was able to live within its means because of the Korean war boom in the prices of goods it exported. This was followed by a period of great austerity. Then foreign aid met the gap, later supplemented by remittances. Finally Pakistan was able to borrow at negative real rates of interest, which means loans were a minimal burden.

All these inflows were largely "unrequited". That is, Pakistan did not have to pay for them. World Bank loans, for instance, had to be repaid. But with only a 1 percent charge, a 10 year grace period and 25 years to repay, their real cost to the economy were small. Inflation meant that their servicing cost was a fraction of their value.

#### 4. The Need for Structural Reform—Facing a Changed World

Pakistan now faces a different situation and will have to adjust by carrying out fundamental structural reforms in addition to a stabilisation programme to meet a liquidity crisis.

##### (a) *The End of Large Unrequited Transfers*

Pakistan's ability to finance its gap at low cost came to an end some years ago. Net foreign aid is now small (1 percent of GDP) and has higher cost. Remittances have declined. The resource gap has increasingly been financed by short-term commercial borrowing; by Foreign Currency Deposits (FCD) by both residents and non-residents; and by some Foreign Private Investment (FPI), both portfolio and direct. All these sources of funds are not unrequited. Depositors, lenders and investors expect a return and as the perceived risk has increased they expect an increasingly higher return [see Ahmed (1994)]. Moreover most of these funds are highly volatile. With the exception of FPI they can move out of the country rather quickly.

Pakistan can continue to run a large deficit only if it can attract PFI which is used to finance investments that will generate sufficient income to pay both the interest and profit which foreigners expect and to repay the principal when demanded.

##### (b) *Accumulating Larger Reserves*

Over and above that Pakistan will have to produce and export enough to accumulate much larger foreign exchange reserves. The greater the reserves, the less vulnerable the country to a sudden loss of confidence and the quick loss of foreign exchange. Inevitably there will be periods when confidence is dented by a bad harvest, a decline in world prices for the goods Pakistan exports or a rise in those it imports. The larger the reserves at that time, the less the cost to the economy in terms of very high interest rates or short-term stabilisation measures.

##### (c) *The Need for Higher Growth*

A 6 percent rate of economic growth has been considered quite satisfactory in the past and 7 percent was considered by some as excessively optimistic. But these are modest numbers if Pakistan is to simultaneously:

- meet the rising expectations of middle and upper income groups who have done well for years, as the result of borrowed money;
- reduce poverty as rapidly as all parties have promised;
- reduce the large debt burden which is hanging over Pakistan and which will result in periodic crisis if it is not reduced;—achieve this reduction in debt

without harsh stabilisation measures that cut consumption and fall most heavily on the poor.

**(d) A More Competitive Environment**

When Pakistan expanded its non-traditional exports in the 1960s it was doing so in a world where competition from other low-wage countries was limited. South Korea started on its reforms later than Pakistan. China, India, Indonesia and Thailand were not serious competitors. Indeed even at the end of the 1960s only Korea among the larger countries was producing more manufactured exports than Pakistan (if population is taken into account; see Table 8). Pakistan was a leader in rapidly increasing manufactured exports.

Now Pakistan is a laggard. In 1970 its manufactured exports were more than 10 times those of Indonesia. In 1980 they were still triple those of the larger country, and more than 5 times on a per capita basis. Indonesia brought in a reform package in 1986 and eight years later its manufactured exports were more than 3 times those of Pakistan.

Now Pakistan must compete with China, India, Indonesia, Vietnam and Bangladesh, among other countries for a large, but still limited, pool of private investment funds and for markets. All these countries are reforming, all are becoming more competitive, and Pakistan's labour costs are higher than in some of them. If Pakistan is to compete effectively it must move faster and smarter, it must again become a leader, rather than being a laggard.

*In short*, Pakistan must deal with both a short term balance of payments crisis and a fundamental structural adjustment. For the first time in its history it needs to fully earn its way, balancing consumption with production and imports with exports and financing any gap which remains largely with foreign private investment that it must attract. And it must do so in a world in which there are many competitors for investment funds and markets that are also reforming their economies.

**B. HOW WELL HAS PAKISTAN DONE?**

To put into perspective the task of dealing with the structural problem now faced by Pakistan one needs to examine the issue of how well the economy is performing. This question can only be answered in comparative terms. Compared to the country's past performance and the handicaps under which the economy operates it is doing well. But compared to other economies in Asia and its own potential it is doing quite poorly. And the costs of lackluster performance are great. There are many more poor people in Pakistan and they are more miserably poor than they need and would be if the economy's performance were better.

## 1. Criteria of Success

What is the criterion of success? There has been a gradual shift over the decades from almost exclusive preoccupation with growth to primary emphasis on poverty reduction. In the process there has been considerable debate on whether these are conflicting or consistent goals.

By now the evidence is overwhelming that these are quite consistent goals in poorer countries. Poor countries are labour abundant and low wage economies. In these countries the most effective way for raising the income of the poor is to increase the demand for unskilled labour and, to a lesser extent, to reduce the supply of labour to the commercial or competitive sector. This was a major theme of two previous lectures or papers under PIDE auspices, so it is not worthwhile to address it in any detail [Papanek (1986, 1991)].

These and other papers have shown that rapid growth, as long as it is not distorted to make it unduly capital intensive, benefits the poor more than other groups. To put it into simplified quantitative terms: a correlation analysis for 6 countries over 30 years comparing periods of rapid and slow growth shows that for every 1 percent increase in the rate of per capita growth real wages of unskilled labour increase by about 1.5 percent [Papanek (1989)]. When income distribution and poverty data are available they show the same relationship. The same paper also discusses why data for changes in the real wages of unskilled labour are a good proxy for changes in the income of the poor.

The most recent work along these lines has been done for India, where poverty data are available for long periods and many individual years, and wage data for agricultural labour are quite reliable. As shown in Table 1, in the three periods when per capita GNP growth averaged over 3 percent per year, real wages increased at the very high average annual rate of nearly 9 percent. By contrast in the three periods when per capita GNP stagnated the real wages of agricultural workers declined on average by 4.5 percent a year. In short, real agricultural wages increased by over 13 percent a year more rapidly in a growing than in a stagnant economy in India.

Table 1

*Growth Rates and Changes in Real Wages in India, 1950s to 1990s*  
(Annual Percentage Rate over Various Time Periods)

Per Capita GNP Growth		Average Change in Real Wages of Agricultural Labour
Range	Average	
3.2% or more	3.7%	8.8%
1.5 and 1.9%	1.6%	0.7%
-1.1 to 1.3%	0.4	-4.5%

Source: Reported in Papanek (1996) and calculated from Acharya and Papanek (1995).

The data on the proportion of persons below the poverty line are consistent with these findings. From 1980-81 to 1986-87 there was relatively rapid growth. During a roughly corresponding period (1977-78 to 1986-87) both rural and urban poverty declined by about 17 percent. Growth and poverty reduction were not conflicting objectives; consistently they went together.

It is therefore quite reasonable, as a first approximation to Pakistan's performance in poverty alleviation, to analyse the country's performance in terms of the old criterion of the rate of growth. This is fortunate since there are reasonably good data on the rate of growth, but only sporadic data on changes in the number of poor people. Of course, to the extent that data are available, it is highly desirable to also analyse directly the effect of growth on poverty.

## **2. Pakistan's Growth Performance in a Historical and Comparative Perspective**

Over the 47 years from Independence through 1994-95 Pakistan has grown on average at 5 percent per year. But that growth has been quite variable, reaching nearly 7 percent in the 1960s after 3.5 percent in the 1950s (see Table 2). In the 1990s growth has been at historical averages of 5 percent (for GDP at Factor Costs, but only 4.4 percent for GNP at Market prices for 1990-91 through 1995-96 [World Bank (1997)]).

Compared to the other large countries in South Asia Pakistan's growth has been remarkably high. Over 40-plus years for which good data exist, India has averaged 3.7 percent and Bangladesh 3.3 percent. Pakistan's performance is especially noteworthy in comparison with India, which had a far better endowment of trained and experienced business and industrial managers, technicians and skilled labour, and higher literacy rates. India's endowment of natural resources was also far superior, except for agricultural land. Nevertheless, Pakistan has grown more rapidly, except for the 1950s (Table 2).

Pakistan's performance is less impressive when it is analysed in per capita terms and is quite poor when compared with the successful East and Southeast Asian (ESEA) economies. The latter have grown at an average of around 8 percent since 1965. With a population growth rate of only 1.5 percent since 1980 their per capita incomes have grown at over 6 percent. Their per capita growth has accelerated over time as population growth has fallen and in the 1990s has reached the remarkable rate of over 7 percent on average. Contrast that with Pakistan's per capita growth of about 2.5 percent over the same 30 years period and only 2 percent in the 1990s. Clearly a 3 percent population growth rate, double that of the East and Southeast Asian (ESEA) economies, was a major factor in Pakistan's slower per capita growth.

The implications of slower growth are clear: At the current rate it takes Pakistan over 30 years to double its income per person while the fast-growers do it in



Table 2

## Income Growth in South Asia: A Comparison

	1950-1994		1950s		1960s		1965-80		1980-90		1990-94	
	GDP	Per Cap	GDP	GAP	GDP	Per Cap	GDP	Per Cap	GDP	Per Cap	GDP	Per Cap
Pakistan	5.1	2.1	3.5	6.9	5.2	2.1	6.3	3.2	5.1			
India	3.7	1.6	3.8	3.8	3.6	1.3	5.3	3.2	3.8			
Bangladesh	3.3	0.9	1.7	4.7	1.7	-0.9	4.3	2.0	4.2			
Average	4.0	1.5	3.0	5.1	3.5	0.7	5.3	2.8	4.2			
Indonesia	5.4	3.3	2.7	1.9	7.0	4.6	5.5	3.7	7.6			
Thailand	7.8	5.3	5.7	8.2	7.3	4.4	7.6	5.8	8.2			
China	7.2	5.1	4.5	5.1	6.8	4.6	9.5	8.1	12.9			
S. Korea	7.6	5.6	5.1	8.6	9.9	7.9	9.7	8.6	6.6			
Average	7.0	4.8	4.5	5.95	7.75	5.4	8.0	6.6	8.8			

10 years. The rapidly growing Asian economies have increased per capita income about 6-fold in a period when Pakistan only doubled it.

### 3. Pakistan's Poverty Alleviation Performance

Because of the correlation between a higher rate of growth and a more rapid reduction in poverty, Pakistan's performance in poverty alleviation was good but not as good as in the more rapidly growing countries. Moreover, it varied with the rate of growth and was therefore better in some periods than in others.

The most striking statistic is that between 1963-64 and 1990-91 the (real) income of the poorest 20 percent of the population increased roughly 2.5 times, after adjusting for inflation (Table 3). Most of the gain occurred during the two periods of rapid growth in the 1960s and the late 1980s. During the 12 years of rapid growth, per capita GDP increased about 70 percent but the income of the poor more than doubled (nearly 125 percent; see Table 4). Clearly growth benefited the poor more than the average person in Pakistan as well as elsewhere in the world.

The data on the percentage of those under the poverty line is more ambiguous. One major problem is that the percent of poor has been calculated only for selected years and that no consistent time series exists even for those years. For the 1960s, where data exist for several years, analysts summarised in Table 3 do not always agree on conclusions. For other years there are fewer observations and firm conclusions would be hazardous. What one can say is that it is likely that the proportion of the poor declined both in the 1960s and the late 1980s and they may have increased in the early 70s.

The wages of unskilled agricultural and construction labour usually provide a very good index of what has been happening to the absolute income of the poor. But data in this respect are poor in Pakistan compared to most countries. The World Bank (1995) concludes that the data show an increase of about 2 percent a year between the mid-70s and early 1990s for the Punjab. This is consistent with the increase in the income of the poorest 20 percent cited above. As in the case of the other data, a big increase in real wages (27 percent) came in the period of more rapid growth of 1978-79 to 1986-87 and a smaller increase (15 percent) during the slower growth of 1986-87 to 1991-92. Real wages stagnated thereafter. The same series for construction workers (this time an average for major cities) shows a 40 percent increase in the rapid growth 1960s, followed by stagnation in the slow growth early 1970s, followed by a 65 percent increase in the middle and late 1970s and stagnation to 1981-82 when that series ends [Papanek (1989)].

In terms of time periods the wage data for Pakistan are therefore not inconsistent with those derived from the much broader Household Income and Expenditure Surveys. Statistical analysis of 6 countries, including Pakistan, shows

Table 3  
Poverty and Income Distribution in Pakistan

Years	1 Gini	2 Share of Poorest 20%	3 Income of Poorest 20% (Rs in 80-81 Prices)	4 Per Capita GDP	5 % in Poverty		Both
					Rural	Urban	
63-4	.39	6.4	645	2,016	37(57)+	40(50)+	45*
66-7	.36	7.6	860	2,262			
68-9	.34	8.2	942	2,298			
69-70	.34	8.0	1052	2,629	44(36)+	34(30)+	36*
70-1	.33	8.4	1087	2,587			
71-2	.35	7.9	1010	2,558	(42)+	(42)+	43*
1979	.37	7.4	1134	3,066	29	24	
84-5	.37	7.3	1378	3,776	24(49)	19(30)	(46)
85-6	.36	7.6	1469	3,865			
86-7	.35	7.9	1560	3,990			
87-8	.35	8.0	1668	4,171	(40)	(31)	(37)
90-1	.41	7.3	1604	4,394	(37)	(28)	(34)

Notes and Sources: The indicators of poverty and income distribution in Table 3 are flawed measures. The Household Income and Expenditure Surveys from which the data are drawn have been criticised. Inflation adjustments are also subject to dispute. Trends also depend on how the poverty line is defined. Only major changes therefore should be taken seriously. Specifically:

1 & 2. Official statistics from the Federal Bureau of Statistics, but early surveys regarded as more flawed. See Noman.

3. Calculated from columns 2 and 4.

4. Two different series have been spliced together, which can introduce unknown error. The old series is at 1959-60 prices (from Government of Pakistan 1993) covers 59-60 to 87-88. A new series, uses a different methodology, is at 1980-81 prices (from World Bank 1995) and covers 1972-73 through 1994-95. The old series was used only for years before 1972-73. The two series were spliced together using an average multiplier for the oldest overlapping years in the new +series.

1979 is the average of 1978-79 and 1979-80.

5. Uses 4 different series, which are not comparable. They differ in definitions of poverty line, in deflator used and in adjustments made. Only data drawn from the same series can be compared. The series are: no modifier is from Malik (1988).

\* Naseem (1977).

(+) Afauddin (1975).

( ) World Bank (1995).

The first three are from Noman (1994) and the last from the World Bank document itself. 1979 is for 1978-79.

that real wages are negatively affected by the rate of inflation and positively by growth in output (*Ibid*). These conclusions seem to hold for Pakistan as well.

The main point, though, is that rapid growth (especially if accompanied by low inflation) is good for the poor. The reasons are obvious from Table 4. During the periods of rapid growth, income distribution improved. With both rapid growth in average income and improving income distribution, the income of the poor naturally rose quite rapidly. The facts in Pakistan simply do not bear out the argument that rapid growth benefits primarily the rich, that there is a trade off between growth and income distribution.

Table 4  
*Poverty and Income Distribution during Periods of Rapid and Slow Growth*  
(All in % Change)

	Per Capita GDP	Income of Poorest 20% in Constant Prices	Share of Poorest 20% in Total Income	Gini
<b>Slow Growth</b>				
69-70—79	16.6	7.8	-7.5	+8.8
86-87—90-91	10.1	2.7	-7.6	+17.1
<b>Rapid Growth</b>				
63-64 — 69-70	30.4	63.1	+ 67	-12.8
79 — 86-87	30.1	37.6	+ 6.8	- 5.4

Source: Calculated from Table 3.

Note: An increase in the Gini coefficient indicates greater inequality.

#### 4. Poverty Alleviation in a Cross-country Perspective

The World Bank concludes that Pakistan's record in poverty alleviation was better than that of most countries, but lagged that of the rapidly growing countries of East Asia and Southeast Asia (ESEA). Its 1990 report showed that Indonesia and Malaysia reduced poverty substantially more rapidly than Pakistan, Thailand performed about equally well, while India and Sri Lanka did substantially less well.

But it is well known that when it comes to other indicators of the welfare of the poor, Pakistan lags most of the other countries of South Asia as well. Tables 5 and 6 give some of the data. But it is not useful to dwell on this at length because little new can be said; the dismal story is too well known.

Table 5

*Welfare Indicators for the Poor*

	Life	Adult	Infant Mortality	
	Expectancy	Illiteracy	per 1,000	
	at Birth	(%)	Live Births	
	1994	1995	1980	1994
Pakistan	60	62	124	92
India	62	48	116	70
Sri Lanka	72	10	34	16
Bangladesh	57	62	132	81
Indonesia	63	16	90	53
Thailand	69	6	49	36
Philippines	65	5	52	40
Malaysia	71	17	30	12
China	69	19	42	30
S. Korea	71	0	32	12

Source: World Bank (1996).

*In Short,*

- (i) Pakistan's rate of economic growth was the highest in South Asia over 40-odd years;
- (ii) but because of its high population growth its per capita growth was superior only to a smaller degree;
- (iii) also Pakistan's per capita growth was less than half that of countries in East and Southeast Asia;
- (iv) more important, its growth was highly variable. When more appropriate policies were in effect, Pakistan's growth in the 1960s *exceeded* the average for the countries of East and Southeast Asia, showing the potential of the economy;
- (v) most important, the periods of more rapid growth were also the periods of the most rapid increase in the income of the poor and reduction in the number of poor.

**C. WHAT INFLUENCES PAKISTAN'S ECONOMIC PERFORMANCE**

The crucial question therefore is how to increase the rate of growth and, above all, the rate of increase in the income of the poor? Historical data provide the most useful clues in answering that question. By analysing different time periods in Pakistan and the differences between Pakistan and other countries one can approach that question most effectively.

Table 6(a)

*Factors in Income Growth: Comparing South and East/Southeast Asia*

	Population				Inflation Rate				
	(Annual % Growth)				(Annual % Change)				
	65-80	80-90	65-80	80-90	84-94				
Pakistan	3.1%	3.1%	10.3%	6.7%	8.8%				
India	2.3%	2.1%	7.5%	7.9%	9.7%				
Bangladesh	2.6%	2.3%	15.9%	9.6%	6.6%				
Average	2.7%	2.5%	11.2%	8.0%	8.4%				
Indonesia	2.4%	1.8%	35.5%	8.4%	8.9%				
Thailand	2.9%	1.8%	6.2%	3.4%	5.0%				
China	2.2%	1.4%	-0.3%	5.8%	8.4%				
S. Korea	2.0%	1.1%	18.4%	5.1%	6.8%				
Average	2.4%	1.5%	14.9%	5.7%	7.2%				

  

	Investment				Savings				
	(as % of GDP)				(as % of GDP)				
	65	75	90	94	51-60	65	75	90	94
Pakistan	21%	16%	19%	20%	9%*	13%	5%	12%	17%
India	17%	21%	23%	23%	11%	15%	21%	20%	21%
Bangladesh	11%	6%	12%	14%	9%*	8%	1%	2%	8%
Average	16%	14%	18%	18%	10%	12%	9%	11%	15%
Indonesia	8%	24%	36%	29%	7%	8%	26%	37%	30%
Thailand	20%	27%	37%	40%	12%	19%	22%	34%	35%
China	24%	30%	39%	42%	n/a	25%	31%	43%	44%
S. Korea	15%	27%	37%	38%	5%	8%	19%	37%	39%
Average	17%	27%	37%	30%	8%	15%	25%	38%	37%

\*No separate data exist for Pakistan and Bangladesh for this period. The savings rate for the then Pakistan was used for both countries.

Table 6(b)

	Resource Inflows (as % of GDP)			Incremental Capital- Output Ratio (ICOR)	
	1965	1990	1994	1970s	1990s
Pakistan	8%	7%	5%	+3.6	2.8
India	2%	3%	2%	5.3	4.2
Bangladesh	4%	10%	6%	5.0	2.1
Average	5%	7%	4%	4.6	3.0
Indonesia	0%	-1%	-1%	2.3	5.5
Thailand	1%	3%	5%	3.2	4.2
China	-1%	-4%	-2%	4.0	3.6
S. Korea	7%	1%	-1%	2.1	3.3
Average	0%	-1%	1%	2.9	4.15

Note: +Figure in parenthesis is for 1995-96. From World Bank (1997).

#### Education -- as % of Relevant Age Cohort

	Primary					Secondary		
	50	65	89	93		50	65	89
				Fem.	Male			
Pakistan	16%*	40%	38%	49	80	15%*	12%	20%
India	21%	74%	98%	91	113	14%	27%	43%
Bangladesh	16%*	49%	70%	105	128	15%*	13%	17%
Average	19%	54%	69%	82	107	15%	17%	27%
Indonesia	29%	72%	118%	112	116	3%	12%	47%
Thailand	52%	78%	86%	97	98	7%	14%	28%
China	21%	89%	135%	116	120	3%	24%	86%
S. Korea	53%	101%	108%	102	100	20%	35%	86%
Average	39%	85%	112%	107	109	8%	21%	51%

Sources: Table 2 all from World Bank, mostly 1991, 1992, and 1996. 1951-60 savings data from World Bank 1971.

Notes: Population and inflation are annual compounded rates of growth. Investment, savings, and resource inflows are as percent of GDP. ICOR is the rate of investment divided by the rate of growth. For investment: average for 1965 and 1975 for 1970s, average for 1975 and 1990 for 1990s.

\* No separate data exist for Pakistan and Bangladesh for this period. The savings rate for the then Pakistan was used for both countries.

### **1. Savings and Investment**

The ESEA countries have a rate of investment nearly double that of Pakistan's since the 1970s (Indonesia in 1994 was only 50 percent higher; Table 6). If investment were used as efficiently in both areas, that would result in a rate of GDP growth double in ESEA what it was in Pakistan for much of the period. Since their average growth rate was less than twice Pakistan's, the rate of investment actually overexplains all the difference in growth and a simple minded analyst need look no further.

While other factors are addressed below, it is necessary first to explain why investment is low. Savings to finance investment have always been low in Pakistan, not only compared to the ESEA countries but also to India. Private saving has been hampered during many periods by political risk and uncertainty and by the foreign exchange constraint. Public savings have always been low or negative, in part because of high defense expenditures. Recently increasing debt servicing and subsidy costs have added to the public deficit.

Pakistan has failed to attract substantial foreign private investment to help make up for low domestic savings, even in the 1990s. At \$ 13 per capita of net private capital flows in 1994, it receives only one third of China's, South Korea's and Indonesia's \$ 39-40 (Table 7). Thailand (\$ 72) and Malaysia (\$ 333) receive per capita private inflows 5-26 times larger than Pakistan's. For many years, however, Pakistan has done well in terms of foreign aid. In the 1960s and 70s it was around 7 percent. By 1980 it was down to 5 percent, but still a multiple of India's and Indonesia's 1.3 percent. By 1994 it no longer made a major contribution to investment, having fallen to about 1 percent of GDP on a net basis (however gross inflows were still considerable by the standards of large countries not among the poorest).

### **2. Macroeconomic Stability—The Rate of Inflation**

There is concern now because inflation has been in double digits since 1993-94. Moreover it has been accelerating. But over its history, Pakistan has been no more inflation prone than the ESEA countries (Table 6). This has been true even in the decade since 1984 when Pakistan's inflation rate was quite comparable to those of the ESEA countries.

More important, during their period of most rapid growth (1965-80) both South Korea and Indonesia had rates of inflation that substantially exceeded those of Pakistan even for the most recent period of rapid inflation. There is evidence that hyper-inflation, accelerating inflation or sharp fluctuations in the rate of price increase create uncertainties and risk which have negative effects on some forms of savings and longer-term investment, especially if output prices are sticky. They can



Table 7

*Foreign Private Investment: A Comparative Analysis*

	1	2	3	4		5	
	Population (Million)	Net Priv. Cap. Flows (\$ Bil)	Priv. Cap. Flows per Capita	For. Dir. Inv. (\$ Bil)	per Capita	Other Foreign Private Flows (\$ Bil)	per Capita
Pakistan	126	1.7	13	0.4(1.1)	4(9)	1.3(.2)	10(1.3)
India	914	5.5	6	2.0	2	1.5	2
Bangladesh	118	0.05	0.4				
Thailand	58	4.1	71	2.3	40	5.9	102
Malaysia	20	6.7	333	5.8	305	6.3	332
Indonesia	190	7.4	40	4.5	24	6.9	37
S. Korea	45	8.1	181				
China	1191	46.6	39	38.0	32	6.7	6

- Notes:* 1. 1994 population data from World Bank (1996).  
2. From World Bank (1996).  
3. Column 2 divided by column 1.  
4. Foreign Direct Investment compiled by Jon O'Rourke, USAID/India from World Bank "World Debt Tables, 1995" for countries other than Pakistan. From State Bank "Annual Report." \$0.4 billion for 1994-95 is probably more directly comparable with other countries; \$1.1 billion in parentheses is for 1995-96.  
5. Foreign Indirect Investment which includes net changes in debt and in equity portfolio investment also from O'Rourke, except for Pakistan. For Pakistan, only portfolio investment is shown. It is therefore not strictly comparable.

also introduce inefficiencies. But there is no very persuasive evidence in the history of ESEA, or that of South Asian countries for that matter, that the rates of inflation which Pakistan has had historically have a negative effect on growth.

There is excellent evidence, however, that high and accelerating rates of inflation harm the poor by reducing the real wages of unskilled workers [Papanek (1989)]. It is therefore highly likely that the double digit inflation for most of the last 6.5 years has hurt the poor.

A more fundamental issue is the question of what has caused the acceleration of inflation and whether it represents a short-term or a structural problem. This is addressed below.

### 3. The Foreign Exchange Constraint

Until quite recently it has been painfully evident that Pakistan faced a serious foreign exchange constraint. Output from existing investment in industry, and less obviously in other sectors, was well below capacity because of a lack of imported inputs. Some investment was periodically constrained by inadequate imports of machinery.

Growth shot up when the constraint was relaxed because exports and remittances boomed, and/or foreign aid, foreign borrowing or foreign private investment increased. The 1960s were one such period when exports and foreign aid both increased. In the late 80s and early 90s growth was also high partly because of increased exports. For a while growth can also be high if Pakistan increases foreign borrowing. But that process can not continue for long. With the decline in worldwide aid flows, aid is no longer a major factor in relaxing the foreign exchange constraint. Growth has become increasingly dependent on increasing exports or on attracting foreign private investment.

Over the longer term a crucial factor in the growth of exports is the incentive to export. The most important incentive is the Real Effective Exchange Rate (REER). In the 1960s the REER was substantially devalued/improved for non-traditional exports by the use of a dual exchange rate, the Export Bonus Voucher Scheme. As a result Pakistan became a significant exporter of manufactures. The REER again declined from 1985 to 1990 (by 40 percent—all IMF estimates). Manufactured and miscellaneous exports more than doubled in 5 years, a growth rate of nearly 15 percent a year. Between June 1990 and October 1993 the Pakistan government did a good job of slowly devaluing the REER despite substantial inflation. It declined by nearly 10 percent. Manufactured exports increased by more than 50 percent in 3 years. Subsequently the REER appreciated 3–5 percent. It thus provided no further impetus to export growth, which slowed after 1993.

An important disincentive to non-traditional exports is the continued strong import substitution bias in Pakistan. Although quantitative restrictions on imports have been largely eliminated, tariffs continue to be high, despite substantial reductions over the last decade. They have recently averaged around 40 percent on consumer goods and 35 percent on all imports, giving producers for the domestic market an average 35 percent subsidy compared to exporters. Since this incidence was calculated by comparing the value of imports with actual duty collections it takes account of exemptions. However, it does not take account of smuggling which greatly reduces the real subsidy on some, especially consumer, goods.

Exporters are further handicapped because their costs are increased for imported inputs and capital goods by tariffs that have recently averaged around 35 percent for the former and 45 percent for the latter. The drawback system has not to functioned well. Needed bribes reduce its benefits by about 20 percent, according to one estimate, and so do delays in receiving the drawback. Therefore these tariffs impose real costs on exporters, particularly in commodities where duties are high and effective (e.g. steel).

Moreover there are substantial differences in tariff rates. The highest rates have now been brought down to 65 percent while the lowest are zero, in some cases because of exemptions. The result is naturally to provide highly differential

incentives in terms of Effective Rates of Protection (ERP). The most recent available study of ERPs is for 1990-91 [Kemal, Mahmood and Ahmed (1994)]. It is likely to still be reasonably valid since nominal protection that year was 39 percent on average compared to 34 percent in 1994-95. That study showed an implicit effective protection rate of 77 percent for manufacturing, which means nearly half (43 percent) of the value added was due to protection or implicit subsidy. There was great variation in the rate of protection, with some industries taxed and some so heavily subsidised that they are actually resulting in a loss of foreign exchange for the country.

The abolition of the export duty on cotton removed a major distortion. The subsidy to yarn (and cloth) had led to the tripling of cotton yarn exports and of all cotton-based manufactures in dollar terms from 1986-87 to 1994-95 (volumes doubled for yarn and cloth). The effective subsidy (ERP) is greatest for industries where cotton constituted the highest proportion of total costs. It therefore favoured industries which tended to be low value added and which generated fewer jobs than might have been the case without such subsidies. Nevertheless a substantial subsidy to cotton manufactures could be justified in the 1950s and early 60s on infant industry grounds. But for low count yarn and coarse cloth, subsidies had lost their rationale a long time ago, since they were infant industries in the mid-1950s. Even for garments any rationale for subsidy applied at best to medium and higher fashion garments where Pakistan was a newcomer in the international market. But the subsidies were, as is so often the case, perverse in benefiting disproportionately those who produced well established exports.

The abolition of the implicit subsidy inherent in the export duty on cotton and in control of exports was therefore desirable. But it was bound to have negative effects in the short run. When an industry has been subsidised for long then it needs time to adjust to the end of subsidies. Some machinery was old, it had too much debt at too high a cost, some plants were overstaffed, it had not adapted to changes in the market and, above all, it had not been under pressure to be efficient. It required the pressure of reduced subsidies to force correction. But until the adjustment was made, output inevitably dropped with the end of the subsidy provided by cheap cotton.

Exporters were also handicapped in competing by wages that were high relative to some competitors. The wages of unskilled construction workers in Lahore in 1992-1994 were nearly US\$ 3 a day. For casual agricultural labour in the Punjab they were nearly \$ 2. Agricultural labour in Indonesia (island of Java) and Bangladesh at the same time received wages closer to \$ 1 a day and unskilled industrial or construction labour closer to \$ 1.5. Wages for unskilled labour in Pakistan seem to have been about double those in some competing countries.

Wage rates matter a great deal in industries where unskilled labour is a high proportion of total cost. The garment industry, especially sewing, are one such

industry. Construction is another, of importance since its costs affect the cost of investment throughout the economy. The problem of high wages is compounded in Pakistan by constraints on the employment of women. Women's wages are significantly lower than men's in all competing Asian countries. The effective wage in some industries is the wage paid to women (garments, electronics, toys, textiles, pharmaceuticals). If women are excluded from some occupations in Pakistan then higher men's wages have to be paid. Labour costs then are a handicap for Pakistan's exporters in some industries.

Exporters do benefit from some subsidies. The most important in the past was the export duty on cotton. The export duty on yarn also helped exporters of cloth. Both have now been eliminated. Some subsidy is provided by lower interest rates on export finance. If the gap between the market and export rate is about 10 percent and loans run for 5 months then this is a subsidy of 4 percent of export value. This is modest compared to the Export Bonus Voucher Scheme which provided subsidies of 20–30 percent or to the average tariff of 34 percent, a subsidy for those producing for the domestic market.

For these and other reasons Pakistan's exports have grown much more slowly than in the rapidly growing economies of ESEA (Table 8), where it was exporters

Table 8  
*Manufactured and Total Exports: A Comparative Analysis*

	1		2		3		4		5
	Manufactured Exports to OECD-\$ Bill		Total Exports \$ Billion		Manufactured Total \$ Billion		Exports per Capita US \$		Population Million
	1970	1993	1980	1994	1980	1994	1980	1994	1994
Pakistan	0.21	3.6	2.6	7.4	1.3	6.3	16	50	126
India	0.53	12.2	8.6	25.0	5.1	18.8	7	21	914
Bangladesh	n.a	2.0	0.8	2.7	0.5	2.2	6	19	118
Thailand	0.03	16.9	6.5	45.3	1.8	33.0	39	570	58
Malaysia	0.04	20.6	13.0	58.8	2.5	41.1	176	2056	20
Indonesia	0.02	12.1	21.9	40.0	0.4	21.2	3	112	190
S. Korea	0.52	39.5	17.5	96.0	15.8	89.3	415	1984	45
China	0.24	72.1	18.1	121.0	8.7	98.0	9	82	1191

*Sources and Notes:* 1. From World Bank (1995).  
 2. From World Bank (1996).  
 3. Column 2 divided by percent of exports that are manufactures, also from World Bank (1996).  
 4. Column 3 divided by respective populations, *Ibid.*  
 5. 1994 populations from *Ibid.*

who received the greatest subsidies. Manufactured exports are the largest category of non-traditional exports in all of the countries analysed and provide the best index of the effect of policies (such traditional exports as oil, raw cotton, jute and rice are more affected by fluctuations in international prices). Pakistan's manufactured exports (to OECD countries) increased 17-fold in 23 years, while Indonesia's increased more than 600-fold and China's 300 fold. That implies a growth rate of less than 15 percent a year for Pakistan and more than double that for Indonesia. To put it another way, in 1970 Pakistan was just behind Korea in per capita exports of manufactures. It led all the countries of Southeast Asia and was far ahead of its neighbours. Indeed Pakistan exported as much as China, although it is obviously a much smaller country. By 1994 the country was far behind all of ESEA in both total and per capita exports. Even India and Bangladesh were catching up. The relatively slow growth of exports, due to a lower rate of increase in non-traditional exports, was a principal obstacle to more rapid poverty reduction in Pakistan in the medium term.

#### **4. Human Capital Endowment**

There has already been some discussion of the negative effect on growth and equity of Pakistan's poor performance with respect to public health and education, and especially the education of women. Table 6(b) provides a stark picture of the distance which Pakistan lags behind other countries. All other countries in South Asia as well as ESEA had achieved virtually universal primary education by the 1990s. But Pakistan had only half of its girls in school. The effects of Pakistan's neglect of human capital can be summarised:

- (a) They contributed to the high rate of population growth which slowed per capita growth. Slow growth in turn reduced savings and investment. High population growth also meant a high cost of achieving better standards of education and health.
- (b) They raised the cost of labour and especially of educated labour and therefore reduced Pakistan's competitiveness in higher value-added exports.
- (c) Pakistan therefore is less attractive for foreign investors.
- (d) Illiterate or poorly educated people find it more difficult to adapt to new technology and to a factory environment.
- (e) Greater illness causes losses in both production and the cost of treating people.

Over the longer term the poor educational and health standards are a crucial obstacle to poverty reduction.

### **5. Policy—The Efficiency of Resource Use**

A crucial factor in the rate of growth and poverty alleviation is the effectiveness of government policy. It greatly affects the efficiency with which resources are used. Pakistan had a high rate of growth compared to other countries in South Asia and was ahead even of ESEA in the 1960s because it followed effective policies during this period.

The efficiency of an economy is notoriously hard to measure. One very crude index is the ICOR, the Incremental Capital-Output Ratio, which indicates how many Rs or \$ or percent of GDP are required to increase output by one Rs or \$ or percent of GDP. For long periods of time (the 1960s, part of the 1980s and the 90s) Pakistan's ICOR was 3 or less, indicating that it took investment of 3 percent of GDP to increase output or growth by 1 percent of GDP. For long periods of time the other countries in South Asia and ESEA had ICORs closer to 4 or even higher. That is, some of their advantage in higher rates of investment were neutralised by Pakistan's more efficient use of investment.

There were several reasons for a lower ICOR in Pakistan:

- (a) Agriculture tends to have a low ICOR, its growth can be increased at little cost in terms of investment if growth is due to greater use of improved seeds, application of more fertiliser and of more inexpensive water, produced by simple wells rather than large multi-purpose irrigation projects. Agriculture in turn was a more important sector in Pakistan than in most of the other countries.
- (b) Much of industrial development in Pakistan was labour intensive, while in countries like India (and Indonesia in the 1990s) it was much more capital intensive, requiring more investment to produce the same increase in output.
- (c) The inefficient and capital intensive public sector enterprises were a smaller proportion on domestic product in Pakistan than in India, China and, recently, Indonesia.
- (d) During long periods of time Pakistan relied more heavily on market incentives than some other countries. Market incentives in labour abundant countries result in growth in labour intensive industries and in methods of production. They also foster investment in competitive industries. The result is greater efficiency than in countries with a heavy reliance on non-market incentives through government ownership and control.

### **6. The Virtuous Cycles of Growth and Poverty Reduction**

One factor that is often overlooked in the continued rapid growth of ESEA is the self-perpetuating nature of the process. Once a country has started to grow rapidly it is often easier to continue to grow at a high rate. Rapid growth:

- (i) tends to increase the rate of savings and investment;
- (ii) provides incentives to foreign and domestic investment because a rapidly growing market is attractive;
- (iii) augments the resources available for government investment in infrastructure and education by generating more tax revenues; and
- (iv) reduces poverty and increases the resources available to pacify important political groups and can thus contribute to stability, which further enhances the environment for investors; all of which contribute further to growth.

True enough some aspects of rapid growth tend to create problems. The gap among regions may grow and so may perceived inequalities as some families become obviously wealthy. But deliberate government policy can greatly mitigate these problems and rapidly growing economies have the wherewithal to follow such policies. Malaysia is an example. The government used the resources generated by rapid growth to mitigate the most serious social and political problem, that of ethnic tensions.

Conversely a slowly growing economy finds it difficult to radically accelerate growth. Pakistan is unusual in that it had periods of rapid growth which did not lead to further growth. They seem to have been terminated in most cases by political problems, sometimes exacerbated by economic mismanagement and resulting in periods of slow growth.

One reason for virtuous or vicious cycles of growth is that imbalances and problems are interrelated. For instance inadequate savings in Pakistan is in substantial part due to political uncertainty and low or negative government savings. Low savings contributes to low investment and low growth, which in turn discourages foreign private investment. Slow growth makes it difficult to finance the needed human capital investment and social sector operating costs. Slow growth also means that the economy has a great deal of old and outdated machinery which makes it more difficult to export and to compete on the world market. Moreover slow growth makes the economy unattractive and contributes to both capital flight and brain drain.

*To Sum Up:* Pakistan has had an unusually low rate of savings. Unable to attract much foreign private investment, it also had a low rate of investment compared to ESEA once foreign aid declined. It has substantially neglected investment in human capital. The most serious obstacle to ESEA rates of growth in the medium term has been a foreign exchange constraint resulting from a slow growth in exports. There have been periods when Pakistan benefited from a virtuous cycle of high growth, leading to higher investment, which have shown the potential of the economy. During these periods economic management has been better than elsewhere in Asia. With further improvements in economic management Pakistan has

the potential to grow at “Chinese rates” of 10 percent a year or better. But it has never realised that potential.

#### **D. ELEMENTS OF AN ECONOMIC STRATEGY**

##### **1. Contractionary Stabilisation or Expansionary Stabilisation?**

The structural adjustment to declining inflows of foreign resources can come either on the demand or on the supply side or on both. To reduce demand and imports is technically easy and can quickly be done, but it imposes hardship and is politically costly. It also weakens the base for future growth. Most IMF stabilisation programmes are contractionary, in part because the effects are more immediate and more readily monitored.

The more the adjustment is achieved by increasing supply the better for society and economy. An expansionary adjustment can quickly be effective if substantial waste can be eliminated and idle capacity can be put to work. There is quite a lot of both in Pakistan. In the industrial sector a rough estimate is that about one third of total capacity is completely idle much, but by no means all, in the textile sector. Some of these units can never be put to use, because the machinery is gone or because the whole enterprise is bogus. Other firms will take long time to put back into operation. But a lot of idle capacity would come back into operation if it were profitable. If only one third were to be put back to work in the first year that would increase industrial output by 10 percent.

An equally rough estimate is that units which are now operating could increase output also by a third, by working more shifts, more days, adding labour or making more of an effort. If only half of this idle capacity could be used then it would add another 10 percent to output. So a conservative estimate is that industrial output could be increased by over 20 percent in one year if industry is made more profitable.

There is also potential for quickly increasing the value of agricultural output by shifting resources to high value products such as cut flowers and fresh fruit for export. Over the longer term much more can also be done to export dried and canned fruits (and vegetables).

##### **2. Making Non-traditional Exports More Profitable**

The rapid growth in ESEA was all export-led. There are good and well known reasons for this. The world market is huge, especially for a small exporter like Pakistan. Even in commodities where there are quota restrictions rapid growth is quite possible—Bangladesh and Indonesia have both gone from zero exports of garments to over \$ 1 billion in 10 years or less. Indonesia’s shoe exports are also over one billion dollars a year, all added in the last decade (Pakistan is at \$ 50



million, one-twentieth). In addition competing in the world market forces exporters to be efficient. Unless they receive excessive subsidies they do not waste national resources.

All the ESEA countries provided some form of "subsidy" to non-traditional exports. So did Pakistan in the 1960s through the export bonus voucher scheme. The country achieved its highest rate of export growth ever during this period. The response to the scheme was very rapid and dramatic and there is no reason to think it would not be equally rapid in the 1990s if powerful incentives to export were again provided.

**(a) Export Subsidies for the 1990s—A Compensated Devaluation**

However an outright export subsidy, like the Export Bonus Voucher Scheme, is not possible in the 1990s. The WTO and all the developed countries would quickly take measures to make it ineffective, by countervailing duties and other measures. Even in the 1960s and 70s the East Asian countries provided most of the export subsidy by undervaluing their currency. By a "Compensated Devaluation" Pakistan can achieve exactly the same result at exactly the same cost as by a direct government subsidy to non-traditional exports.

In a fully Compensated Devaluation the only prices that change are the Rupee prices of non-traditional exports. All other prices remain the same. This is achieved by lowering tariffs on all imports by the amount required to keep the prices of imports from changing. Traditional exports are subject to an export tax which also keeps their domestic prices unchanged.

For example, if the Rupee is devalued from Rs 40/US\$ 1 to Rs 50/\$ 1, then a 40 percent tariff would be reduced to 12 percent. Before the devaluation the good costs Rs 56 for every \$ of import cost (Rs 40 to buy the dollar and Rs 16 to pay the 40 percent tariff). After the Compensated Devaluation the price would still be Rs 56 per \$ (now Rs 50 to buy the dollar and Rs 6 to pay the 12 percent tariff). Goods with a 25 percent tariff would come in duty free and would cost Rs 50 per dollar before and after the devaluation. Imports with tariffs of less than 25 percent would either have to be subsidised, which might be necessary for such goods as wheat, or would need to have other taxes reduced (e.g. petroleum products) or would rise in price.

A 20 percent export duty on traditional exports would keep their prices also unchanged (Rs 50 per \$ exported, minus 20 percent = Rs 40). Quite simple principles could be established to distinguish traditional and non-traditional exports. For instance any commodity exported in substantial quantity for 10 years or more could be considered traditional, including low count yarn, coarse cloth and simple T-shirts. Any good not exported before or exported for less than 2 years could be considered

non-traditional. Goods in between could be decided on the basis of complexity and other factors.

Under such a fully Compensated Devaluation government would receive less revenue from import duty than at present but more from export duty. The initial cost to government would be the same as the cost of a subsidy to non-traditional exports. But calculations in a number of countries, including Bangladesh, have shown that the increased income in the economy as a result of putting idle capacity to work to produce exports will generate more revenue than the cost of the subsidy. There will be more income taxes from the income generated not only in the exporting industries, but also from the firms and workers selling to those industries. With more exports there will be more imports and therefore more import taxes. Higher incomes also means more sales and excise taxes and so on.

Note that a compensated devaluation does not reduce the protection available to firms producing for the domestic market. A higher exchange rate makes up for the lower tariffs.

Another advantage of the compensated devaluation is that it sharply curtails smuggling. It therefore increases government revenues and actually would provide more effective protection to domestic industry than the present high tariffs for goods that are heavily smuggled. In the previous example a smuggler at present buys the good at Rs 40 per dollar abroad and saves Rs 16 in tariffs and some Rs 11 more in sales tax. He would therefore have up to Rs 27 per dollar of imports available to pay bribes, the extra transport costs of smuggling and to keep as profit. After the compensated devaluation he would pay Rs 50 to buy the good and would save only Rs 6 in tariffs and at most Rs 11 in sales tax or Rs 17 to cover costs and provide incentives. That is much less attractive and there will therefore be less smuggling. For goods that bear no tariff after the compensated devaluation smuggling would obviously no longer pay.

The experience of Indonesia is most useful, since that country's economy has many similarities to Pakistan. In the mid-1980s it carried out a 60 percent devaluation that was only partly compensated. Some tariffs were brought down, some export prices were kept stable. But by stabilising the price of rice Indonesia kept wages of unskilled workers from rising. The real income of workers did not fall by much since their principal item of consumption did not rise in price and other goods consumed by them rose by less than the devaluation. But wages and other local inputs became much cheaper in dollar or yen terms after the devaluation. This provided a major impetus to rapid growth of manufactured exports.

A compensated devaluation is much more powerful in stimulating exports than a traditional, uncompensated one. In the compensated devaluation the Rupee value of exports rises sharply but the Rupee cost of labour and imported inputs rises little. Exports therefore become much more profitable.

**(b) Other Subsidies/Incentives to Exports**

The effectiveness of the incentive provided by the partly compensated devaluation was increased by further steps in Indonesia:

- (i) A generalised tariff and tax drawback scheme was introduced under which exporters were compensated for the tariffs and taxes they paid on inputs. The rate at which the drawback was to be paid was set for each export commodity. The drawback was paid as soon as it was proved that the export of the commodity had taken place. It was not necessary to prove that imports had actually been used in the production process or that tariffs and taxes had been paid on the imports. Exporters who used domestically produced inputs therefore received a hidden subsidy which provided an impetus to buying inputs locally and to export the output.
- (ii) Drawbacks were automatic, they required no bribes and were paid with little delay.
- (iii) Export finance was available at a substantial subsidy compared to other loans and received priority from the banks, including a special Export-Import bank.

**(c) Freeing Imported Inputs into Exports**

Exporters could import without restriction any input they needed for the production of exports. The inputs were available at no (or lower) duty. A factory was considered as being an exporter if 65 percent or more of its production was exported. It could therefore get its inputs more cheaply in some cases than factories producing for the domestic market. This provided another hidden subsidy if the plant could use some of the imported inputs to produce the 35 percent of goods it was allowed to sell in the domestic market.

**(d) No Restrictions on Foreign Investors Producing for Export**

In some lines foreign investment was important in gaining access to foreign markets and technology. For goods where quality and brand names were important, foreign participation and often foreign quality control, were necessary to break into the foreign market in the first place. Any foreign investor planning to produce for export faced virtually no restrictions. In part as a result of this opening to foreign direct investment Indonesia attracted 10 times as much foreign direct investment as Pakistan and became seen as a base from which foreign firms served the world market.

*(e) The Effects of Export Incentives*

The increase in Indonesian exports has already been noted. After the reforms Indonesian manufactured exports grew at about 25 percent a year for most of a decade. This doubling of manufactured exports every 3 years would also stimulate domestic production to supply exporting industries and the expanded income of their employees. This clearly would make a great difference to the growth of jobs and income in Pakistan.

**3. Other Measures to Improve the Functioning of the Economy**

A comprehensive reform programme would include many other elements, but just 2 important ones will be mentioned here.

*(a) Reduce the Government Deficit*

A major reason for Pakistan's low savings rate is the large government deficit. Strong efforts have been made to increase government revenues, not with much success, but little has been done on the expenditure side. Moreover some government salaries should be raised to curb corruption, increase tax collection and improve the effectiveness of government (see below). To finance these increased expenditures while at the same time reducing the deficit other government expenditures will have to be substantially reduced.

A *voluntary early retirement* programme can substantially reduce the government payroll, especially if there are alternative jobs in the private sector. If exports are booming then a good "golden handshake" can induce a number of people to leave the government. If government reorganisation is largely financed by concessional loans such a programme can pay for itself in 2-3 years. Even if the funds necessary to finance the programme have to be borrowed on commercial terms the programme can have a high return if it is well designed.

Of course every reduction in expenditure does double duty. First it saves the expenditure itself, then it saves the interest on the borrowing that would otherwise have been necessary to finance it. By the magic of compound interest any savings become large over time.

*Privatisation of Public Enterprises* can do triple duty. First, if the proceeds are used to pay off debt then interest costs are saved in perpetuity. Since about 1/3 of the budget now covers debt service that saving can be substantial. Second, if the enterprise is loss making then eliminating these losses also reduces the deficit. Lastly if the enterprise starts paying taxes the deficit is reduced further.

*Reducing corruption* can reduce many government expenses. This is addressed further below.

*Tax reforms* are needed not only to raise revenue but to reduce distortions in the economy. A shift from relatively high import duties with many exemptions to low tariffs plus taxes on traditional exports will have several advantages:

- Traditional exports tend to be bulky commodities which it is more costly to smuggle, so this will reduce smuggling.
- As already mentioned lower tariff rates will also reduce smuggling and other forms of evasion.
- This implies a general principle which may have wider application: in many cases lower rates with fewer exceptions and a wider tax base is both more efficient and more equitable.
- But the most important step in tax reform is to improve administration. This is addressed below.

**(b) Banking Reform**

The need for banking reform is widely recognised. Since the ending of import licensing the banks have become in Pakistan, as elsewhere, the principal channel for corruption and distortions in the economy. It is important that scarce savings be well allocated and not wasted on borrowers who contribute little or nothing to production and who spend the money on consumption.

Privatisation is probably a necessary, but not sufficient, condition for reform. Privatisation can help assure that:

- competition reduces the administrative margin in banking; and
- that banks make loans that will be used well, as competition drives out improvident banks.

But it will work only if there is effective regulation which assures that bankers do not lend to themselves, their families or to other improvident friends. This is yet another area where good governance is important.

## **E. THE ROLE OF GOVERNMENT**

There is now a general consensus that government is less effective than private enterprise at managing competitive enterprises. But this is true primarily because it has proved easier to expose private firms to the pressure of competition and to let them fail. In general it is more difficult to expose public firms to competition and failure. Some have taken this argument a step further and have contended that the best government is the least government. In Pakistan, as elsewhere, governments still have an important role to play even in a market dominated economy.

### **1. The Importance of Government Regulation and Operation**

Governments need to regulate monopolies or operate them, because a non-competitive private firm is generally no better and can be worse than a private one. However, in an economy open to international competition, which Pakistan increasingly is, such monopolies are not very widespread. As has been shown elsewhere not even all aspects of transportation, communications and power are necessarily monopolies.

Pakistan is using private power generation to deal with a serious shortage. But with prices guaranteed there is no guarantee that competition, or the search for profits, will force increased efficiency and lower prices. Here as in other fields only an honest and competent government can provide some assurance that effective monopoly, whether public or private, will not result in inefficiency and excessive profits.

### **2. Government Provision of Social Services**

In a poor country the market will be even less effective than in a wealthy one in providing basic education and health services to all. In Pakistan, where these services have been neglected, the role of government is all the greater.

But there is little justification for the heavy subsidies of such services for the middle class and the rich. There is already a tendency to have private, full charge educational and health services for the wealthier groups. But the present system is inadequate in several respects:

- (i) there are still massive subsidies for university education and curative health services for wealthier groups;
- (ii) there are inadequate subsidies for the most intelligent of the poor to get quality education, which results in a loss to the nation. This is especially true for girls; and
- (iii) the basic health and education systems are inadequate.

To remedy these defects is an appropriate role for government.

### **3. Reducing Inequality of Opportunity**

This is part of government's broader role in reducing the inequality of opportunity which exists between rich and poor, urban and rural, educated and uneducated, well connected and others. This aspect of the role of government is difficult to discharge well in any country, but its importance needs to be recognised.

### **4. Strengthen Weak Market Incentives**

It should be emphasised that most ESEA countries substantially subsidised non-traditional exports. They recognised that these are infant industries that have

high costs of learning-by-doing and high costs to establish themselves in the world market. The first exporters of any non-standardised good from Pakistan will have high costs and will need to cut prices to break into the market. In doing so they create positive externalities, that is they make it easier for other Pakistani firms to export to the world market.

The high costs of the pioneer exporters include the cost of getting to know the market, establishing contracts, assuring the buyer of quality and reliability, developing specialised shipping and communications channels and persuading buyers that a Pakistani firm can be an appropriate supplier. One only has to think of the problems faced by the first Pakistani firm which tries to export TV sets, or computers, or switching gear, or fashion garments to realise that there will be substantial costs. By the time Pakistan is a major supplier these special costs will have disappeared. Buyers naturally look to Pakistan for footballs or low count yarn. A new firm will have few difficulties in such traditional fields. In economic terms becoming an exporter of a non-traditional good is an activity with strong positive externalities.

All of the ESEA countries used for comparison in this paper recognised these externalities and the infant industry arguments which apply to pioneer exporter. Their governments heavily subsidised manufactured exports, often by undervalued exchange rates and direct subsidies. The latter is much more difficult now, so various other measures have been suggested. Whatever the technique, subsidising infant industry exports is an important role for government.

## **F. THE POLITICAL ECONOMY OF REFORM**

Government needs to be reasonably effective and honest to play this important role in the economy. But there is an equally important reason why good governance is crucial in Pakistan. The country, it has been argued above, faces inevitably painful short-term stabilisation and medium term structural adjustment programmes. To the extent that both are accomplished by increasing production rather than reducing consumption the pain will be minimised, but some pain is bound to remain. Stabilisation, to the extent it involves reducing demand, hurts the great majority and it hurts the poor particularly [Papanek (1996)]. Reforms generally hurt some groups even if they benefit the majority. For government to be able to carry out both stabilisation and reforms several factors help.

### **1. The Importance of Stable Government**

If government does not expect to be in power long enough to reap some of the benefits of stabilisation and reform it will usually be very reluctant to bear the cost. Democratic governments that have carried out reforms have sometimes had a strong

majority in the legislature and were therefore sure of 3–5 years in office (Sri Lanka) or were a “grand coalition” with most major groups represented (Malaysia) or had both very competent economic management and a difficult economic situation which made stabilisation and reform the only viable alternative (India). Other governments have been authoritarian, although authoritarian governments have also utterly mismanaged the economy (Burma, Indonesia until 1966).

Stability not only makes it easier for governments to opt for reforms it also makes it more likely that the reforms will be effective. Incentives do not work well if managers and owners have no idea how long they will last. If policy changes every few months it is unlikely to be effective. Pakistan has suffered from uncertainty now for some time and the economic costs are substantial.

## **2. Allocating Pain and Gain Fairly**

There is good evidence that many people are willing to accept some sacrifice if they believe the pain is being shared equitably [Papanek (1986)]. That requires curbing the conspicuous consumption of the rich and avoiding sharp declines in the income of the poor.

### ***(a) Curbing Conspicuous Consumption***

The income of the rich is not visible, their consumption inside the country usually is very visible. During the kind of period which Pakistan faces it is important that luxury consumption be curbed; it is difficult for people to bear hardship if they see others continuing to live extravagantly. High taxes on luxury goods and services, whether imported or produced domestically, imposed at the same time as other austerity measures can therefore help retain support for reform. Indeed during a stabilisation period even a brief ban can be justified on the import of especially costly cars and other luxuries not produced in Pakistan.

It is also important to tax luxury housing. That can be done effectively by aerial photography, so that taxpayer and tax collector have no contact.

### ***(b) Supporting the Income of the Poor***

There are many costly and inefficient schemes for supporting the income of the poor. If they are not only inefficient but corruptly carried out they will actually be counterproductive. The most effective means is to subsidise food which only the poor consume, such as low quality imported flour in Pakistan.

## **3. Limiting Corruption**

Corruption is usually seen as unfair. It is especially resented if it enriches a few while the majority are suffering during a stabilisation period. There are some



useful lessons from other countries which have curbed corruption (very few come close to eliminating it).

**(a) Reducing the Incentive**

When government officials have great discretionary powers the incentive for corruption is great on both sides of the transaction. By eliminating import licenses Pakistan eliminated one of the most fruitful sources of corruption. Bribery will also be lessened by lower rates of tariffs and taxes and by leaving to the market rather than officials the allocation of loans, land, power, transport, telephone connections and most scarce resources.

Higher pay for government officials most exposed to temptation can somewhat reduce the incentive to be corrupt. When government wages are too low for survival few will be honest. Indonesia provided a handsome allowance to all who collected taxes in order to reduce the incentive to corruption. It helped.

**(b) Increasing the Costs**

If even a few corrupt senior officials lose their job and perhaps go to jail it makes it clear that there are serious costs to corruption. Indonesia combined higher pay for customs and tax officials with greater penalties and fewer opportunities for bribe taking to increase government revenue.

**(c) The Importance of Leadership**

The saying that "the fish rots from the head" is very true. If the Minister is known to be honest and determined to punish those who are not, those under him are much more likely to be honest as well and this spreads through the Ministry. This can be seen most readily in something like tax collection where bringing in an honest and effective director can do wonders for revenue. On the other hand corruption also spreads from the top down very quickly.

**(d) Reducing the Economic Costs of Corruption**

It is a fundamental principle of corruption that the least costly form of bribery is that which only costs what the corrupt person receives. The most costly is that which distorts a major part of the economy in order to yield small benefits to the corrupt. In countries where corruption has done little damage, contracts, loans or other scarce resources are awarded on payment of a bribe only if the contract will be competently executed or the scarce resources used efficiently. That is, the bribe determines who among a groups of reasonably competent competitors receives the contract or resource.

Corruption does more damage if the contract or scarce resource are given to less competent persons only because they give a higher bribe. It is most costly if a monopoly is established so that someone can derive a profit, but that monopoly prevents efficient production from taking place. That is, it is very costly if major distortions are imposed on the economy for the principal purpose of giving an income to a favoured few.

One example from an ESEA country was the establishment of a steel monopoly to protect an inefficient plant controlled by powerful individuals. As a result the country could not develop a canning (tinned goods) industry, because the cost of tinplate was too high. The income derived from this whole exercise by the group controlling the monopoly was probably below \$ 100 million, maybe much below. The cost to the country in income and employment foregone was in the hundreds of millions of dollars. When the monopoly was ended and the former beneficiaries were given a larger amount as commission on government transactions they were quite happy. The country developed a canning industry which promises to contribute significantly to exports. The amount of corruption has not declined, but the country is far better off.

The most damage is done by predatory corruption. That is, if powerful individuals or groups can force successful enterprises to give them a major stake in the enterprise. No one will want to invest money or effort in building any large enterprises if success only means that you lose control of what you have built. The Russian economy is in a shambles in part because corruption has become quite predatory. It is a situation to be avoided at all costs.

***(e) Conclusions: Governance and the Economy***

Ideally Pakistan would have a government of Saints, whose only concern is the well being of the society and especially of the poor. But even a government of sinners can achieve high growth and rapid poverty alleviation, as proved by the ESEA countries, if the leadership expects to be in power for a few years and recognises:

- (i) that good economics very quickly becomes good politics, as people are better off and government disposes of more resources;
- (ii) that government must limit corruption and especially assure that it does not damage the economy beyond the sums acquired by the corrupt;
- (iii) that it needs economic competence, a small group that can develop an integrated programme of stabilisation and reform that is expansionary, that maximises adjustment on the production side and minimises adjustment by reducing consumption; and

- (iv) government needs the courage to implement reforms in its first year in office even if they have some short term costs. The resulting growth will solve many problems, both political and economic. On the other hand, postponing reforms may well force government to impose far greater sacrifices just ahead of the next election.

Reasonably good governance and reasonably competent economic policies can give Pakistan a growth rate of 7-8 percent a year, just as it has in some ESEA countries. Better governance and economic policy than in some of these countries is likely to result in growth of the order of 10 percent and again put Pakistan at the forefront of developing countries where it once was.

#### REFERENCES

- Acharya, Sarthi, and Gustav F. Papanek (1995) Explaining Agricultural Wage Trends in India. *Development Policy Review*. March.
- Ahmed, Sadiq (1994) Explaining Pakistan's High Growth Performance over the Past Two Decades: Can it be Sustained? World Bank. (Unpublished.)
- Kemal, A. R., Zafar Mahmood, and Ather Maqsood Ahmed (1994) Structure of Protection, Efficiency and Profitability (Executive Summary). Islamabad: Pakistan Institute of Development Economics. February (Unpublished.)
- Noman, Omar (1994) The Social Impact of the Asian Development Bank's Programme Lending: Case Study of Pakistan. (Unpublished paper prepared for the Asian Development Bank's study of Programme Loans.)
- Pakistan, Government of (1993) *Economic Survey 1992-93*. Islamabad: Government of Pakistan.
- Papanek, Gustav F. (1986) *Development Strategy, Growth, Equity and the Political Process in Southern Asia*. Islamabad: Pakistan Institute of Development Economics.
- Papanek, Gustav F. (1989) Growth, Poverty and Real Wages in Labour Abundant Countries. Background Paper for the World Bank. *World Development Report*. (Unpublished, December.)
- Papanek, Gustav F. (1991) Market Government: Lessons from a Comparative Analysis of the Experience of Pakistan and India. *The Pakistan Development Review* 30:4 601-646.
- Papanek, Gustav F. (1996) Indian Economic Reforms and the Poor. (Unpublished Report for USAID and the Government of India.)
- State Bank of Pakistan (1996) *Annual Report 1995-96*. Karachi: State Bank of Pakistan.
- World Bank (1991) *World Tables, 1991*. Baltimore, Maryland: Johns Hopkins University Press.

- World Bank (1992) *World Development Report 1992*. New York: Oxford University Press.
- World Bank (1995) *Pakistan Poverty Assessment*. Report No. 14397-PAK.
- World Bank (1996) *From Plan to Market: World Development Report 1996*. Washington, D. C.: World Bank.
- World Bank (1997) Country Department I, South Asia Region. Pakistan: Recent Development, Policy Issues and Agenda for Change. (March 25).

## *Comments*

When I was asked to be a discussant on Dr Papanek's paper, I was given to understand that it will concentrate on the lessons of the East and Southeast Asian experience on the economic development of Pakistan. Mr Papanek's present paper considerably deviates from that objective. The paper is in fact a very detailed discussion of the economic performance, development strategies and opportunities, income distribution and poverty, human resources development and a host of other economic and social problems faced by the Pakistani economy during the existence of the Pakistani state both as it existed in 1947 and as its truncated form after the separation of Bangladesh. While this is a very ambitious undertaking. It considerably reduces the focus of the paper from shedding much light on the comparability of Pakistani development experience with other Asian developing countries, particularly East and Southeast Asian economies. The paper also addresses the current short-term crisis and stabilisation programmes which Mr Burki's paper is going to discuss later this afternoon.

Instead of discussing Mr Papanek's paper as he has structured it himself, I will try to concentrate on the strategic linkages between the strategies and policies of Pakistan and ESEA countries and how they provide insights into the differences in the economic and social performance. The main feature of the impressive reduction in the time period needed to achieve the doubling of their per capita incomes by the later industrialising countries. Thus, for example, while Japan took over three decades, the Republic of Korea took only a little over one decade to double their per capita incomes. China and other Asian tigers, with double digit growth rates have further reduced this period. Pakistan and other South Asian countries have taken typically two to three decades to double their per capita incomes.

While the growth performance of these economies has been unquestionably accepted as being impressive, the controversy has centred on the basic factors behind their success. Questions have also been raised about the uniqueness of their experience and the replicability of their experience by other countries. The most controversial element in the explanation of the success story of these countries has been the role of the state in promoting their development. Early explanations of this success story largely presented these economies as being a paragon of private enterprise and unfettered market competition. These explanations, which partly reflected the cold war polemics about the superiority of rival economic systems, have since been abandoned in favour of more heuristic explanations that stress the role of market mechanism mainly in relation to the success of these economies in becoming large exporters of manufactures, while recognising that the state played an important role in building the infrastructure and providing the enabling environment.

There is now a better recognition of the role of government intervention in these economies for selectively promoting certain industries as being one of the main ingredients of success. With the demise of the socialist system of centralised planning in the aftermath of the dissolution of Soviet Union and the COMECON economies of Eastern Europe, the East Asian economies now provide the only remaining viable alternative paradigm to western capitalism. It is no wonder that developing economies all over the world, including the transitional economies of CIS and Eastern Europe, are keenly interested in learning about the experience of the East Asian economies. Many are vying, while most are merely dreaming, to become the next Asian tiger or the next “miracle economy”.

Even the World Bank which published a landmark study on the subject two years ago, has grudgingly accepted the challenge to its orthodoxy posed by these economies, while casting serious doubt about its replicability and cautioning developing countries about the perils of deviating from the Washington consensus that emerged in the mid-eighties in the wake of the Latin American debt crisis. The only mitigation of its orthodoxy comes in the form of giving up the narrow insistence on “getting the prices right” to a plea for the recognition of “basics” or “fundamentals”—however, the interpretation of those terms remains a yet unresolved issue.

The East Asian Miracle Report does acknowledge that “In most of these East-Asian countries in one form or the other the government intervenes—systematically or through other channels”. However, the Report does not consider this to be the main explanatory factor of the miracle that these economies have performed. Indeed, at one point, it dismisses the claim that there is anything “miraculous” about their superior record of growth, which attributes “largely due to superior accumulation of physical and human capital”. This, however, begs the question. The real question in the debate seems to be whether government intervention did or did not facilitate this superior accumulation of physical and human capital. The East-Asian miracle, as evidenced by the consistently high rate of growth of these economies and the accompanied high savings and investment rates as well as in their emphasis on human resource development and export growth, was inseparably linked with the micro-level social and economic institutions that exhibit pervasive state intervention.

Dr Papanek’s paper gives insufficient attention to these institutional mechanisms which have sustained growth in the East Asian economies and whose absence or weakness in Pakistan has been responsible for the sporadic, unbalanced and non-self-perpetuating. What needs to be explored and analysed is which of East-Asia’s supporting institution has served investment, human resource development and exports most effectively and how these institutions could be replicated in Pakistan with appropriate modification in its national context. Surprisingly, Dr Papanek’s detailed paper on Pakistan’s development experience fails to mention the

weak performance on land reforms, which, contrasts with the radical land reforms in East Asia that laid the foundation of East Asia's high growth.

The East-Asian lessons that really need to be learnt by developing countries such as Pakistan is the need for governments to intervene effectively in the accumulation process and in the adaptation of technological innovations. The lesson from East-Asian economies is not simply that in order to be successful in competitive export markets the developing countries need to lower their wage rates (which many of them may be unable to do as wages are already below subsistence level), but also to raise productivity by subsidising capital in selected industries. East-Asia subsidised domestic investment credit and negative real interest rate on foreign loans during the critical development decade. It continues preferential credit and R&D support as a measure of protection for struggling industries. Pervasive administrative guidance and entrepreneurship as well as their high commitment in human resource development and the promotion of a viable education system are among the many lessons that Pakistan needs to be encouraged to learn from the experience of the successful East-Asian economies.

Above all, the reciprocal principle of never giving anything away to business without stipulating a monitorable performance standard in scale as emphasised by Professor Alice Amsden in her book "Korea, Asia's next Giant". This highlights the essential difference in the role of state intervention as practised in East Asia, in contrast to that in other developing countries, especially South Asia. While, contrary to the common perception, there is no significant difference in the *size* of the public sector in the economies of East Asia and South Asia, there is a marked difference in the *quality* of such interventions.

The East Asian economies have used government intervention as an strategic instrument in promoting economic development, rather than as an ubiquitous means of interference in private economic activity, which characterises its usage in Pakistan. The strategic instruments adopted by the East-Asian economies have been used, in close concert with the private sector, in choosing the industries to be promoted and the incentives to be provided to ensure their competitiveness in export markets. The continuation of these incentives have, however, depended on the performance of these industries and have not been granted to promote rent-seeking and the perpetuation of their infant industry status. In Pakistan, on the other hand, government interventions have consisted in granting favour to vested interests and without regard to any performance criteria. This has resulted in emergence of perpetually "sick" industries from which the governments have been unable to withdraw financial support. As a result, these industries, which exist both in the private and the public sector, have contributed to a significant portion of rising government expenditures in these countries. Such industries have also stood in the way of any significant restructuring of the economy from its existing pattern.

The structural transformations achieved by the economies of East and Southeast Asia is the real reason behind their economic resilience and fast growth. No doubt they too accepted structural adjustment packages of the IMF and the World Bank in the seventies and eighties to overcome the external shocks. But these were utilised towards effecting long-term changes in the economy. In Pakistan, on the other hand, the continuous devaluation since the late 1950s and massive doses of external assistance have not resulted in any major restructuring of the economy, which continues to be heavily dependent on the production and export of cotton and its low value-added manufactures, while those countries which do not produce cotton, such as Thailand and even Bangladesh have become leading exporters of cotton manufactures and garments.

**S. M. Naseem**

House 14/A, Street 2,  
F-8/3,  
Islamabad.