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Learning from the Past: A Fifty-year Perspective on Pakistan's Development

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INTRODUCTION

In some ways, Pakistan's economic growth since 1947 has been remarkable. The country's economic viability was considered, in some quarters,[1] in serious doubt at its emergence, but it has managed, despite a quadrupling of the population, to bring about significant improvement in the average living standards. Per capita GNP growth, on average around 2 percent per annum over a long stretch of nearly fifty years, has been the best among countries of the subcontinent. This growth has meant an increase in average income of about 150 percent over 1950–96. But Pakistan, like many other developing countries, has not been able to narrow the gap between itself and rich industrial nations which have grown faster on a per head basis. Also, Pakistan has lost substantial economic ground to the rapidly growing economies of East Asia notably China, South Korea, Thailand, Malaysia and Indonesia. In 1960, South Korea's per capita income was only marginally ahead of Pakistan's. In the short period of one generation, Korea had an income level which on purchasing power parity basis five times that of Pakistan in 1995. On the same basis, Thailand and Malaysia enjoyed a per capita income advantage of 200 to 300 percent over Pakistan (Table 2).

Pakistan's lagging behind the more successful developing countries is, however, only one aspect of its disappointing economic performance. More seriously, the pattern of Pakistan's growth has been deeply flawed because it has not ensured either sustainability or a reasonably equitable distribution of growth benefits. While Pakistan

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[1]See Muhammad Ali, *Emergence of Pakistan*, (New York: Columbia University Press, 1967). pp. 332-333. Also Gustav F. Papanek, *Pakistan's Development*, (Cambridge, Massachusetts: Harvard University Press, 1967). pp.1-2.

has enjoyed fairly good per capita GNP growth, it has been much less successful in reducing poverty, increasing the level of human resource development, modernising the industrial sector, and increasing the level of domestic savings. The persistence of a high degree of dependence on external resources, poor level of development of human capital, inadequate long-term investment in infrastructure and serious structural weaknesses in industry and exports have already slowed down growth. Per capita GNP growth rate during 1985–95 was only 1.2 percent per annum, substantially lower than India (3.2), Bangladesh (2.1), and Sri Lanka (2.6). Thus Pakistan as it approached its fiftieth anniversary was faced not only with the worst financial crisis in its history but also a serious, though less clearly perceived, 'growth crisis'. There is a growth crisis in the sense that without major structural changes and further policy reform, significant positive growth in per capita incomes can no longer be taken for granted.

The objectives of this paper are to trace the source of present economic difficulties and to draw lessons from our past experience.

GDP Growth

GDP growth is the most widely used measure of economic performance. By this measure, Pakistan's economy grew at an average rate of over 5 percent over 1949–96, a period of nearly fifty years. Growth was slow during the 1950s averaging 3.1 percent per annum but accelerated to 6.7 percent during the sixties and remained generally close to 6 percent per annum till the early 1990s. As Table 1 indicates, over the three decades, 1960–90, only a handful of East Asian countries enjoyed average GDP growth rates exceeding that of Pakistan's rate of close to 6 percent per annum. Till around 1990, Pakistan's GDP growth rate was distinctly higher than that of other countries on the subcontinent. Pakistan's population growth at 3 percent per annum for long periods of its history has however exceeded that of most developing countries with the exception of Mexico.

On a GNP per capita growth basis, therefore, Pakistan's record appears less impressive; Egypt and Indonesia—countries already having a living standard higher than Pakistan—have grown faster since 1960. The slow down in per capita GNP growth since the mid-1980s has further eroded Pakistan's relative position in the international economy. As the following table indicates, on a purchasing power parity basis, Pakistan is now substantially poorer than other large developing countries with the exception of India and Bangladesh. But both these countries have gained ground relative to Pakistan since 1987.

As Table 3 shows, there were rather wide variations in the growth rate of the economy during the various political periods. Growth was relatively slow not only in the 1950s but also during Zulfiqar Bhutto's years and in the recent period of return to democracy. The two periods of long military rule under Ayub and Zia were periods of

Table 1

Average Annual Growth Rates of GDP and per Capita GNP
(*In Percent per Annum*)

	GDP				GNP per Capita	
Countries	1960–1970	1970–1980	1980–1990	1990–1995	1970–1985	1985–1995
South Asia						
Bangladesh	4.0	3.4	4.3	4.1	0.0	2.1
India	3.7	3.0	5.8	4.6	1.5	3.2
Pakistan	6.7	4.7	6.3	4.6	2.7	1.2
Sri Lanka	4.6	4.6	4.2	4.8	3.4	2.6
East Asia						
China	5.2	6.0	10.2	12.8	5.6	8.3
Indonesia	3.9	7.6	6.1	7.6	4.2	6.0
Korea	8.6	7.2	9.4	7.2	10.1	7.7
Malaysia	6.5	7.9	5.2	8.7	4.1	5.7
Philippines	5.1	5.8	1.0	2.3	0.8	1.5
Thailand	8.4	7.1	7.6	8.4	3.6	8.4
Middle East and North Africa						
Egypt	4.3	8.0	5.0	1.3	4.6	1.1
Morocco	4.4	5.6	4.2	1.7	2.1	0.9
Turkey	6.0	4.0	5.3	3.2	Negative	2.2
Latin America						
Argentina	4.3	2.9	–0.3	5.7	–0.7	1.8
Brazil	5.4	8.5	2.7	2.7	3.3	-0.8
Chile	4.4	2.9	4.1	7.3	-0.5	6.1
Mexico	7.6	6.6	1.0	1.1	2.0	0.1

Source: World Bank; *World Development Reports*. GNP per capita estimates are based on World Bank methodology which takes into account exchange rate movements and thus are not necessarily consistent with estimates derived from national data of GDP and population growth.

Table 2

Purchasing Power Estimates of GNP Per Capita

	Current International $	US=100	
Countries	1995	1987	1995
Bangladesh	1,380	4.8	5.1
Brazil	5,400	24.2	20.0
China	2,920	6.3	10.8
Egypt	3,820	14.3	14.2
India	1,400	4.4	5.2
Indonesia	3,800	9.8	14.0
Malaysia	9,020	22.9	33.4
Korea	11,450	27.3	42.4
Pakistan	2,230	8.4	8.3
Thailand	7,540	16.2	28.0
Turkey	5,580	20.4	20.7
Mexico	6,400	27.8	23.7
Sri Lanka	3,250	10.6	12.1

Source: World Bank , *World Development Report 1997.*

Table 3

Annual Growth Rates of GNP; Population and per Capita GNP
Percent per Annum

Years	GNP	Population	Per Capita GNP
1950–1960	3.1	2.4	0.6
1960–1970	6.7	2.9	3.8
1970–1977	4.4	3.2	1.3
1977–1988	6.4	3.1	3.3
1988–1996	4.3	3.0	1.2

Source: Government of Pakistan, *Economic Survey,* various issues.

exceptional growth. There is no doubt that relatively greater political stability under military rule and strong technocratic management contributed to high growth. However, too much should not be read into these differences in the growth rates by period as they cannot be used uncritically as performance yardsticks. The exceptional growth during the Ayub years was in no small part due to the sharp stepping up of the rate of investment, especially public investment in the 1950s. The slow down of growth during 1970–77 was due in part to the separation of East Pakistan, oil price shocks, poor weather conditions and technical problems which delayed the availability of Tarbela Dam waters. Growth during the Zia period benefited not only from the completion of sizable investments in water, fertiliser, cement and steel undertaken earlier but also from the substantially positive impact of large scale remittances, external assistance for Afghani mujahedin and growth in the narcotics trade. Growth in the period since 1988 has suffered in part because long term investment was neglected under Zia because the large over hang of domestic public debt made the reduction of the fiscal deficit difficult and because the stimulus provided to the economy by large worker remittances continued to wane.

Inflation

As GDP growth slowed down, inflation accelerated in the 1990s. Between mid-1990 and mid-1996 prices as measured by the GDP deflator nearly doubled, indicating an average annual increase of over 11 percent. Since mid-1993, prices have increased over 12 percent per annum. The 1990s have been the worst period of inflation in Pakistan's history with the exception of 1972–77 when prices grew by 15 percent per annum reflecting both domestic monetary expansion and international price pressures. However, notwithstanding the recent surge, inflation in Pakistan has been moderate by developing country standards. Pakistan's average annual inflation rate of 7.8 percent during 1960–95 was marginally lower than other countries in South Asia. Among comparable countries, only China, Thailand and Malaysia have had a better inflation record. It may appear odd that inflation in Pakistan remained moderate for long periods even though fiscal deficits remained sizable for well over two decades. The explanation lies in the fact that large and persistent fiscal deficits could be financed for a considerable time from non-inflationary sources, notably large foreign assistance and very large borrowing from non-bank sources. Reliance on money creation for financing fiscal deficits was relatively limited except during 1972–77 and 1990–96 when credit to the public sector virtually exploded. It is hardly surprising that these were also the periods of high inflation. Still overall increase in price levels over 1950–95 was at least twenty folds compared to a rise in price level of six to seven folds in industrial countries. This had consequences for the foreign exchange value of the rupee, income distribution especially the real salaries of public servants, and the pattern of investment, encouraging as it did the more speculative and less productive investments in land and housing.

Reliance on External Assistance

A fundamental reason why Pakistan was able to avoid both financial crises and high inflation till the 1990s, notwithstanding large and persistent fiscal deficits, has been its extraordinary dependence on external resources for financing investment outlays and the availability of large flows of external assistance on concessional terms for long periods of time. Large foreign assistance also explains to a great extent why growth remained relatively high despite low domestic savings. The heavy dependence on external resources emerged early in Pakistan's history and has shown no significant declining trend.

Table 4

Investment and Savings Rates Selected Years

(As % of GDP)

Year	Investment	Foreign Savings	National Savings
1949-1950	4.0	2.0	2.0
1959-1960	12.5	6.0	6.5
1964-1965	22.1	10.5	10.6
1969-1970	14.6	4.5	10.1
1976-1977	19.3	7.0	12.3
1987-1988	18.0	4.4	13.6
1995-1996	18.2	7.0	11.2

Note: The figures for the years up to 1969-70 refer to West Pakistan (now Pakistan) and exclude East Pakistan. There are no official figures of savings and investments for West Pakistan prior to 1969-70. The author has based his estimates for these years partially on official data from various issues of *Economic Survey* and partially on other sources, notably Mahbub ul Haq, *The Strategy of Economic Planning* (Lahore: Oxford University Press, 1963); Gustav F. Papanek, *Pakistan's Development* and Report of the Panel of Economists in the Reports of the *Advisory Panels for the Fourth Five-Year Plan (1970–75)* (Government of Pakistan, Planning Commission, 1970.) Foreign savings are defined as current account balance-of-payments deficits before official transfers.

Pakistan has continued to rely more heavily on external resources than most other large developing countries notwithstanding large worker remittances. Pakistan's current account balance of payments deficit averaging over 5 percent of GDP during 1974–93 was larger than those in comparable developing countries except Bangladesh, Sri Lanka and Egypt.

Normally deficit levels of 4-5 percent of GDP are not sustainable unless export earnings are rising rapidly, thereby increasing the ability to service debt sharply. Thailand and Malaysia enjoyed very high rates of export expansion during the 1970s and the 1980s and therefore were able to avoid an increase in the relative burden of external debt.[2] Other countries such as Brazil, Mexico and Turkey, which borrowed heavily in the 1970s and ran current account deficits of 4-5 percent of GDP for a decade

[2]The recent foreign exchange crises in Thailand and Malaysia were partly attributable to the fact that these countries allowed the current account balance-of-payments deficits to increase to around 6 percent of GDP during the first half of the 1990s.

without a strong expansion of exports, ran into serious external debt difficulties which sharply curtailed borrowing and net inflows in the 1980s. Egypt also experienced serious debt difficulties in the late 1980s and required debt relief even though a large part of its huge balance of payments assistance had been financed through grant assistance.

In Pakistan's case, as in Bangladesh and Sri Lanka, it was the relatively concessional terms of borrowing, i.e. low interest rates and long maturities of debt, which enabled it to avoid debt-servicing problems for such a long time. The availability of concessional assistance made it possible for Pakistan to run current account deficits on a sustained basis at a higher level than even the rapidly growing economies of East Asia. The scale and terms of assistance have enabled Pakistan to enjoy relative financial stability without having to face strict financial discipline for extended periods especially in fiscal matters.

But the composition of external flows to Pakistan has been changing, slowly but perceptibly, with a reduction in the availability of concessional assistance and relatively more reliance on market term borrowings and private investment flows. While the total external debt trebled from \$10 billion in 1980 to \$30 billion in 1995, the ratio of external debt to GDP had increased from 42 percent to 50 percent and the ratio of debt to exports of goods and services had increased from 209 percent to 258 percent. Reflecting the hardening of terms, the annual debt service ratio (principal and interest payments as a percentage of foreign exchange earnings) rose even more sharply from 18 to 27 percent over the period. More importantly, in the five years 1992–96, nearly one-third of the foreign exchange gap was met from growth in resident and non-resident foreign currency accounts which are short-term liabilities and have proven somewhat volatile. The profile of external liabilities had worsened seriously over time and was the chief cause of foreign exchange difficulties after mid-1996.

Domestic Savings

The persistence of a high level of dependence on external resources has been mainly the result of poor domestic savings performance though as discussed below the relative ease of external financing has also contributed to the low level of savings.[3] Consistently low rates of domestic savings have precluded not only a reduction in the reliance on foreign savings but also have constrained the growth in investment. The national savings rate rose significantly from the extremely low level of 2.5 percent of

[3]The terms 'national' and 'domestic' savings are used here as synonymous. Actually gross national savings = gross domestic savings + net factor income from abroad. Worker remittances raise domestic savings while interest payments on foreign debt reduce domestic savings. Because of the preponderance of worker remittances, the two series diverged in the 1980s, with national savings being considerably higher than domestic savings. By the mid-1990s, with the rise in interest payments on external debt and other investment income payments abroad, the national savings were only marginally higher than domestic savings.

GDP in 1949-50 to 10.5 percent in 1964-5. It improved further in the 1980s, rising to a peak of 16 percent of GDP in 1986-7, as large worker remittances came in. However, by mid-1995-96, the national savings rate had fallen back to 12 percent. Over the long stretch of the last three decades, the marginal saving rate has been below 15 percent.[4] This compares with marginal savings rates in India of over 25 percent and 35 to 40 percent in the many successful East Asian countries like Korea, China and Indonesia during 1973–93. By mid-1990s, East Asian countries were saving 30 to 40 percent of their gross domestic product while Pakistan's savings rate was only half the Indian rate of 24 percent.

Pakistan's inability to raise domestic saving levels over long periods is related to a complex inter-play of forces which have operated ever since partition. There have been political, policy and institutional failures on the broad front of domestic mobilisation of resources. There are at least six factors which have adversely affected domestic savings performance: political conditions and social attitudes, high rate of population growth and resulting high number of dependents as percentage of working age population, relative ease of external resource options, failure of fiscal policies to generate public savings given the pressures of large defence spending, absence of a clear framework for private sector development and poor development of the financial sector.

Before discussing the above elements, it is necessary to touch on the view that insufficient domestic savings reflect merely capital flight and that well-to-do Pakistanis keep the bulk of their savings abroad. This is a highly simplistic and grossly exaggerated view. The ten-percentage point annual difference in terms of GDP between the domestic savings rate of India and Pakistan simply cannot be explained by capital flight. Even if one assumes that the transfer of savings abroad was significant on a sustained basis, the behaviour was influenced by policy variables such as negative real returns on bank deposits, inadequate development of capital markets, and in recent years favourable tax and other treatment provided to foreign currency deposits. Indeed to an extent, the large build up of foreign currency resident deposits since 1991, at an annual rate of 1-1.5 percent of GDP, suggests reverse capital flight.[5]

Political and Social Factors

Political leadership in Pakistan has rarely emphasised the importance of sacrifice and savings for long-term development, and social attitudes have compounded the

[4]The marginal saving rate, as distinct from the average saving rate, is calculated by relating the increment of savings to the increment of GDP or GNP.

[5]Pakistan treats the additions to resident foreign currency deposits as private transfers and thus as national savings (see Footnote 3 above).This is a questionable treatment because it tends to understate the current account balance of payments. The savings available through the accumulation of foreign currency deposits can be withdrawn in foreign exchange.

problem. At a more fundamental level, the low rate of domestic savings denotes low confidence in the future. Increased savings imply postponed consumption, and unless confidence in the future is strong, future consumption is heavily discounted Periods of political uncertainty also adversely affected domestic resource mobilisation efforts. Indeed, it is interesting that the highest rate of marginal savings of over 20 percent was recorded during 1960–65, one of the best periods in terms of political stability. The favouring of consumption over investment and the trend toward conspicuous consumption also had its historical roots in the early years. The combination of the non-devaluation of 1949, which overvalued the rupee, and the use of large windfall gains from the Korean war commodity boom mainly for consumer goods imports including luxury consumer goods such as expensive automobiles definitely created a bias toward consumption. This bias favoured West Pakistan to the extent that it benefited from the surplus foreign exchange generated by East Pakistan. In the process, the growing divergence in the life styles of the well-to-do in the two wings sowed the seeds of political discontent among the Bengali intelligentsia. Once the foreign exchange ran out, the incentives were changed. Almost a total ban was imposed on cotton textiles and other luxury consumer goods imports in 1952 and the rupee was devalued in 1955. Industrial profits rose sharply and were plowed back in large part. Indeed, considering the poor start, the savings performance during the 1950s was fair. But it would have much worse if the US military assistance which started in 1955 had not eased very substantially the burden of defence spending on the government budget.

High Population Growth

Pakistan's population has grown rapidly from around 30 million in 1947 to over 130 million in 1996. The rate of annual growth has averaged 3 percent since 1960. This high rate of growth has meant that the number of children per household was increasing and, therefore, the dependency ratio (the proportion of dependent children to working age population) remained high. In 1995 the dependency ratio was 0.9 in Pakistan compared to 0.7 in India, 0.5 in China and 0.6 in Indonesia. It has been noted[6] that high dependency ratios often are associated with lower household savings and Pakistan was no exception.

Relative Ease of External Options

External resources are an important and necessary supplement to domestic resources in the process of development. In Pakistan, however, the relatively easy availability of external resources has often led to a substitution of foreign savings for

[6]Among others Professors A. K Sen and J. Sachs of Harvard University have argued that high population growth depresses savings. Susan Cochrane and others, *Household Consequences of High Fertility in Pakistan* (World Bank Discussion Paper 111) also found that the number of children negatively affected savings especially in the rural areas.

domestic effort. Since large current account balance of payments deficits could often be financed without too much difficulty, exports and domestic savings did not receive the urgent attention from the government they deserved.

In the years immediately after partition, availability of large sterling balances, surplus of foreign exchange from East Pakistan and earnings from the Korean war commodity boom enabled West Pakistan to run large external deficits. But with the collapse of the Korean boom and a sharp decline in foreign exchange reserves, Pakistan was already in the grip of its first foreign exchange crisis in late 1952.

The signing in 1954 of a Mutual Defence Agreement with the United States opened the way for large scale military and economic assistance. During the three years (1955–58) before Ayub Khan's takeover, economic assistance already totalled $500 million or 2.8 percent of GDP for the whole of Pakistan.

The real value of U.S. military assistance in the late 1950s probably approached that of economic assistance. The strong political alignment with the U.S. through Pakistan's membership in the Central and South East Asian Treaty Organisations and the signing of the Indus Basin Treaty in 1961 between India and Pakistan, under World Bank auspices, on the sharing of waters from common rivers, further spurred foreign aid inflows. By 1964-65 the balance of payments deficit for Pakistan as a whole, financed almost entirely from foreign assistance, had risen to 6.8 percent of GDP. It would seem that Pakistan's planners, under President Ayub Khan's direction, rushed headlong to grasp the opportunities offered by the availability of larger foreign assistance without giving thought to sustainability issues. The Second Plan (1960–65) was quickly revised upwards, and public sector development spending expanded more than 40 percent over original levels. The revised Second Plan's (November 1960) assumption that external assistance would provide 55 percent of the financing for investment outlays and Indus Basin work did not raise any concerns. After the 1965 war with India, both military and economic assistance tended to decline. However, as noted above, economic assistance again increased during the Bhutto years as grants and loans from oil exporting countries in the Middle East were successfully mobilised to finance the much larger oil import bill. This encouraged the postponement of necessary energy price adjustments for nearly a decade with the result that energy consumption was sustained at unrealistic levels and government finances suffered.

Worker remittances, a critical source of financing the balance of payments during the Zia years, were not technically external resources but rather additions to domestic savings. Unfortunately, the large remittances did not lead to a lasting and significant increase in national savings. It was natural that a large part of the income from the remittances was used for consumption. Indeed this growth in consumption contributed significantly to the reduction in the incidence of poverty in the 1980s. But at the macro level a large part of the increment to the pool of national savings was pre-empted by the government for financing larger fiscal deficits. The public savings remained negative throughout the 1980s while public investment declined as a percentage of GDP. There was some reduction in the reliance on foreign savings during 1977–88 because of the flood of remittances but a critical opportunity to strengthen self reliance was missed because of the structural weakness in the public finances.

As worker remittances declined and external deficits increased in the 1990s, Pakistan again postponed tough decisions on domestic resource mobilisation by relying heavily on increase in foreign currency deposits for meeting its foreign exchange needs. This was done through greatly liberalising the foreign exchange regime, which dealt a healthy blow to the psychology of capital flight. There is nothing intrinsically wrong with a liberal foreign exchange system which permits residents to hold currency deposits. However, in Pakistan's case the growth of foreign currency deposits has been promoted through attractive terms and substantial hidden subsidies. The State Bank of Pakistan has incurred substantial losses in local currency on account of foreign exchange guarantees provided to holders of foreign currency deposits. These losses are estimated at Rs 50 billion or well over 2 percent of GNP for the two years 1995 and 1996 and represent a quasi-fiscal deficit which is ultimately a charge on public resources. Without these subsidies, foreign currency deposits would have been much less attractive. The somewhat artificially sustained additions to foreign currency deposits (and large inflows of portfolio investment) enabled continued financing of high levels of current account balance of payments in the 1990s. What was worse, these larger deficits during 1990–96 were not accompanied by any significant increase in the investment level and largely sustained domestic consumption.

Fiscal Policy Failures

Fiscal policies can play an important role in mobilising domestic resources, sustaining directions of development, maintaining price stability and ensuring some redistribution of income in favour of the poor. In Pakistan, effective use of fiscal policies has been greatly hampered by continued inelasticity of the tax system, competition between defence and development and the consequent emergence of large fiscal deficits and the explosive growth in public debt. As a result, public savings have been negligible or negative for long periods. Government current expenditures have continued to exceed current revenues ever since 1970 (even though very inadequate provisions were made for operation and maintenance expenditures), and the growing burden of interest payments has prevented any significant downward adjustment in fiscal deficits during the last decade.

Defence Spending

While the level of tax revenues in Pakistan has also lagged behind other developing countries, it is the high level of defence spending since 1970 that has been a critical factor in Pakistan's inability to generate significant savings in the public sector. Defence spending has always been given high priority. In the first few years after partition, defence spending was equal to 85 percent of central government revenues. In the first half of the 1950s, defence expenditures exceeded development spending by a wide margin. But concern with demonstrating the soundness of Pakistan's finances meant that overall fiscal policies were conservative and recourse to deficit financing or credit creation for the public sector was moderate. But the conflicts among the objectives of a strong build up of defence, adequate allocations for development, balanced regional development between East and West Pakistan and the desire to keep fiscal deficits small had already emerged after the collapse of the Korean boom. Fortunately, the availability of large foreign economic and military assistance removed the competition between defence and development spending; defence spending in the second half of 1950s was in real terms significantly below the level in the first half and had come down to 25 percent of total central government expenditure. With the continued availability of US military assistance, defence spending rose little over 3 percent per annum in real terms in the five years before the 1965 war with India, substantially less than the rate of growth of the economy. But following the war with India, defence allocations were given very high priority as U.S. military assistance was phased out. Real defence expenditures almost doubled between 1960–65 and 1965–70. This took its toll on development, but the government also increased tax efforts to finance additional defence spending. Revenue surpluses remained at 2 percent of GDP almost throughout the 1960s.

After 1970, not only did defence spending increase further sharply as a percentage of GDP, but also government non-development spending was not covered by government revenues. This became a root cause of fiscal imbalance. Defence expenditures in fiscal years 1976 and 1977, the last two years of the Bhutto regime, were one-third higher in real terms than in 1969-70 even though the size of the country had shrunk, thereby eliminating the need for military establishment in the former East Pakistan. As a percentage of GDP, defence expenditures rose to 5.6 in 1976-77 from 3.8 and 2.8 of GDP of unified Pakistan respectively in 1969-70 and 1964-65. At the same time, the government revenue account turned into a deficit which was close to 2 percent of GDP, a sharp contrast to the 1960s when surpluses of 2 percent of GDP had been recorded.

During the Zia period defence spending increased at a real annual rate of over 9 percent per annum, faster than any other period in Pakistan's history except the very early years. It also outstripped growth in development spending by a wide margin. In the final two years of Zia's rule, 1987–88, defence spending constituted 6.7 percent of GDP. At the beginning of Zia's rule, public sector development spending had been more than double the level of defence outlays. A decade later development spending had come down to the same level as defence. Over the period 1988–97 defence spending did decline to 5.1 percent of GDP as financial pressures intensified, but the balance between defence and development further worsened.

Taxation Effort

Whatever the imperatives of national security, sufficient tax and other revenue resources could not be mobilised to cover non-development spending. Quite apart from the inability of Pakistan's tax system to influence equity and the pattern of growth positively, tax revenues have not kept pace with the admittedly large growth in non-development spending. The ratio of taxes to GNP improved only marginally from 13 percent in the mid-1970s to 14 percent in mid-1990s notwithstanding very substantial additional taxation undertaken, especially in recent years. By 1997–98 they had again come down to 13 percent of GDP because of the not fully thought out tax rate reductions in March 1997. The inelasticity of the tax system has persisted as a problem for several decades as the base of income tax collection remains narrow; the level of income and corporation tax revenues at 1.6 percent of GNP in 1987-88 was not only low but also had not increased over the previous decade; the increase to 2.5 percent in 1994-95 was made possible mainly by withholding taxes on interest and other income. Meanwhile the heavy dependence on foreign trade taxes which emerged following the 1972 devaluation has remained largely intact; even in 1995-96 foreign trade taxes including surcharges were over 4 percent of GNP. The average rate of import duty on dutiable imports at 35 percent remained high in 1995-96. This high level of import taxation had a built in bias against exports because it raised the cost of imported inputs for the exporters.

Budget Deficits

Even though development spending has grown rather slowly since the late 1970s, budget deficits have remained large. As Table 5 indicates, fiscal deficits averaged 8 percent of GDP during 1973–77. They declined somewhat in the early 1980s but were again at a high during the final years of Zia's rule. The reduction since then to around 6.0 – 6.5 percent in 1996 and 1997 appears to be exaggerated because of the change in definition of government spending after 1992. By and large there was little fiscal adjustment between the mid-1980s and the mid-1990s.

Reflecting the large fiscal deficit, public domestic debt had increased from Rs 58 billion in mid-1981, to Rs 521 billion in 1988, and to Rs 909 billion in mid-1996, far outstripping the growth in external debt. As a proportion of GDP, domestic debt had increased from 21 percent in mid-1981 to 42 percent in mid-1996. There was a fundamental difference in the way in which fiscal deficits were financed during the 1970s and the 1980s. In the earlier period domestic financing for the budget deficit came primarily from money creation. This led to immediate pressure on the price level

Table 5

Fiscal Deficits as Percent of GDP

Years	Annual Averages
1973–1977	8.1
1978–1983	6.6
1983–1988	7.8
1989–1991	7.5
1992–1994	7.5
1994–1996	6.1

Source: *Pakistan Economic Survey*, various issues.

Note: The fiscal deficits after 1992 are not strictly comparable with earlier figures because of exclusion of net borrowing of major government corporations. One would need to add about 1 percent of DP to deficits after 1992 to make them roughly comparable.

and created forced savings. In the 1980s much greater reliance was placed on domestic non-bank borrowing, and inflationary pressures were contained, but this merely postponed the consequences of large fiscal deficits.

During the second half of the 1980s, central government borrowing from non-bank sources was in excess of Rs. 150 billion or well over 4 percent of GNP. More importantly, government borrowing from non-bank sources absorbed more than one-third private savings during this period. The tapping of private savings to this extent was achieved through offering very attractive interest rates and tax breaks. The tax-free real rate of return on *Khas* deposits was as high was 8 percent during 1985–90, after allowing for an inflation rate of 6 percent per annum. The high guaranteed real return on government debt as well as the sheer scale of government borrowing from non-bank sources crowded out private investment. Private investment in the second half of the 1980s grew by little over 4 percent per annum compared with 6 percent per annum in the first half of the decade.

Because of the explosion of government domestic debt, it is the increase in domestic interest payments which has been the driving force behind the growth in government expenditures and thus fiscal deficits since the early 1980s. Interest payments on government debt had grown from around 1 percent of GNP in the 1970s to nearly 6 percent in mid-1990s while the burden of external debt interest payments remained small (1.2 percent of GNP). The rising interest rate burden along with high defence spending have imparted great inflexibility to the Pakistan budget. Interest costs and defence spending together absorb about two-thirds of total fiscal revenues. At the same time, development and social expenditures are low and they must increase to meet the woeful past neglect of social services and infrastructure. The essential inelasticity of the tax system also greatly complicates the task of the fiscal management. Under the circumstances, the task of reducing fiscal deficit to 4 percent of GNP, considered essential to maintain macro-economic stability is likely to prove extremely difficult. Thus, relative macro-economic stability, which has had a favourable impact on growth in the past, is now threatened because the means through which it was attained were not sustainable.[7]

Pakistan's experience also confirms the importance of two other factors in domestic savings; the role assigned to the private sector and the development of the financial sector and the capital markets. The dominant role that the state has played in the economy and the ambivalence of the attitudes toward the private sector over long periods have hampered savings. The periods in which the private sector was given encouragement were also those with relatively high private savings. After 1952 when the private sector responded to the opportunities for rapid industrialisation, it did reinvest a high proportion of the large industrial profits. Again, in the first half of the 1960s when private investment increased nearly three-fold, the marginal savings rate exceeded 20 percent. In contrast, the domestic savings rate stagnated during 1972–77, when the government's attitude toward the private sector turned almost hostile. Private savings tended to revive during the 1980s as opportunities for private investment were expanded. In the 1990s, however, the growth in private investment at a rate substantially higher than public investment does not appear to have been accompanied by a rise in the rate of private savings. The shift of investment from the public to the private sector was accompanied simply by a greater reliance by the latter on foreign flows.

The financial sector and the capital markets also play a key role in mobilising and raising the level of savings. In Pakistan, financial sector development has been adversely affected by the dominance of state controlled and owned institutions and strong central controls on credit allocations and interest rates till relatively recently. The financial sector reforms after 1990 did achieve a degree of interest rate liberalisation, moderate reduction in credit subsidies and a move toward more market based borrowing. However, because of acceleration of inflation, interest rates on deposits became negative in real terms, and thus there were strong disincentives for financial savings. With only limited progress on privatisation, the control of most large commercial banks remained in the hand of the state and by all accounts the level of political interference in credit allocation decisions increased under the democratically elected governments. The sharp and continuous rise in overdue and bad loans further undermined the health of the banking system and its ability to provide adequate rewards to savers. The permission for residents to hold foreign currency deposits, which enjoy exemptions from *zakat* and income tax, further reduced the rate of growth of domestic

[7]For a detailed analysis of the concepts of sustainable budget deficits and Pakistan's fiscal dilemmas, see Nadeem ul Haq and Peter J. Montiel, "Fiscal Policy Choices and Macroeconomic Performance in the Nineties" in Anjum Nasim (1992) *Financing Pakistan's Development in the 1990s*. Lahore: Lahore University of Management Sciences/Oxford University Press, Karachi. Sadiq Ahmed, *Explaining Pakistan's High Growth Performance over the Past Two Decades: Can it be Sustained?* (World Bank, Policy Research Working Paper 1341, August 1994.)

financial assets. Excluding foreign currency deposits, the ratio of M2 to GDP, an important indicator of the level of financial development, dropped from 40 percent in mid-1988 to 34 percent in mid-1996. The level of financial development in Pakistan not only compares unfavourably with other developing countries but also has shown some deterioration during the last decade. Unless these trends can be reversed through improved efficiency of the banking system, and interest policies and further development of capital markets which provide positive real returns to savers, the savings leakage in unproductive investments such as land speculation, gold hoarding and capital flight will continue.

Foreign Trade Developments

Successful developing countries not only have high domestic saving rates but also have been able to translate high savings into high exports, thus reducing foreign trade deficits over time. Linked with its poor domestic savings performance, export growth in Pakistan has been uneven, and its foreign trade deficit has remained high.

In the 1950s, as the country emphasised import substitution and as agricultural output stagnated, exports actually tended to decline. Strong agricultural growth and spurts of manufactured goods exports resulted in a growth of nearly 8 percent per annum over 1960–93, substantially higher than the growth in GDP of nearly 6 percent over the period. But in recent years exports have tended to stagnate. During the four trade years 1993–96, export volume growth was slightly negative. Nonetheless, greater export orientation of the economy is indicated by the rise in the ratio of exports of goods and non-factor services to GDP from 9 percent in 1960 to 16 percent in 1994.

Successful exporters among developing countries have been able to exploit their comparative advantage in labour intensive manufactured exports. World trade in manufactured goods has witnessed sustained high growth for four decades. High income industrial economies have expanded their manufactured goods imports at a much higher pace than the growth in industrial output. The countries that were able to organise themselves for large scale manufactured exports and avoided anti-export bias in their trade policies were able to take advantage of the expanded opportunities in developed country markets. Countries like Korea, Taiwan, Hong Kong and Singapore have expanded manufactured exports one-hundred fold in less than twenty-five years and have all propelled themselves into developed country status largely on the basis of a strategy that at least initially focused on exports of labour intensive manufactured goods. The performance of other East Asian countries China, Thailand, Malaysia and Indonesia has also been outstanding in this field. China which began its drive for manufactured exports only after 1980 now has manufactured exports of over US $100 billion, very similar to levels in Taiwan and Korea. Malaysia, Thailand and Indonesia together match the manufactured goods exports from China.

Missed Export Opportunities

Seen in the light of these success stories, Pakistan's expansion of manufactured goods exports from US $425 million in 1970 to US $5.6 billion in 1993 looks moderate at best. East Asian countries including the Philippines, and also India, Turkey, Mexico were able to expand manufactured exports faster than Pakistan during the last twenty-five years. Manufactured exports from Pakistan in 1993 were only a fraction of the level of manufactured exports from Korea (US $77 billion), China (US $74 billion), Malaysia (US $31 billion), Thailand (US $27 billion), Indonesia (US $18 billion). It is also interesting to note that in 1970 Pakistan's modest manufactured exports of US $425 million were about two thirds of the level of Korea and were much larger than exports from Malaysia, Thailand, Indonesia and Turkey. Clearly, Pakistan has missed important opportunities in a key growth area, not only in competition with the first round exporters such as Hong Kong, Singapore, Taiwan and Korea, but also in relation to the second round exporters like China, Malaysia, Thailand, Indonesia and, more recently, Mexico and Turkey, which have been expanding manufactured exports impressively since 1980. The danger now is that relative newcomers in manufactured goods like India, Bangladesh, and Eastern European countries, notably Poland and Hungary, will provide stiff competition to Pakistan in the future and will make it difficult for Pakistan in the future to capture a larger market share.

Weak Export Structure

The dependence of Pakistan's exports on raw cotton and cotton yarn remains heavy; these exports accounted for 28 percent of export earnings in 1969–70; a quarter of a century later in 1994-95 they still accounted for about 20 percent of the total. Including cotton cloth and garments, cotton related exports account for one-half of the total compared with 45 percent in 1969–70. This means that the performance of the export sector is greatly tied with the production of raw cotton. The six-fold increase in the quantity of raw cotton and yarn exports from 157,000 tons in 1969-70 to the peak of 961,000 tons in 1991-92 was linked directly to the four-fold increase in production of raw cotton to 2.2 million tons over the period. As raw cotton production fell, on average, by over one-third in the next three years, exports of raw cotton and cotton yarn also fell roughly in the same proportion. Since there is uncertainty that the very favourable raw cotton production trend can be revived, future export expansion cannot rely on raw cotton and yarn exports as in the past.

Within the textile sector, the structure of exports remains weak despite the dramatic rise in export of garments since 1980-81. Exports of cotton yarn have continued to dominate relative to exports of cotton cloth. In the first half of the 1970s, the value of cotton cloth exports were about 85 percent of yarn exports but by the first half of the 1990s they had decreased to two-thirds of yarn exports. It is well known that the value added in cotton yarn exports is quite limited compared to raw cotton exports. The duty on export of raw cotton for long periods provided a large subsidy to producers of cotton textiles especially yarn and thus artificially stimulated profitability of yarn production. Credit subsidies to the mills which have run into financial problems have also sustained uneconomic production. With the phasing out of the export duty on cotton in 1991-92 and indeed with the emergence of the need to import raw cotton, the cotton textile industry can no longer rely on cheap availability of raw cotton. This is the root cause of the crisis being faced by the textile industry. In tackling this crisis, the government needs to ensure that credit subsidies do not perpetuate production which is inherently uneconomic.

In order to improve the structure of exports, the dependence on cotton yarn exports which still account for nearly 20 percent of value of total exports needs to be reduced. Fortunately, ready made garments and hosiery exports have increased over twelve-fold in real terms since 1980-81 and can be counted upon to overtake yarn exports and provide a steady source of growth of export revenues.

Export Policy Failures

There are three basic reasons why Pakistan did not make fuller use of the opportunities offered by the explosive growth in world trade in manufactured goods. In the first place, the development strategy did not emphasise exports sufficiently. Second, the trade policy distortions with relatively high duties on intermediate products discouraged processing for exports. There has been a general anti-export bias resulting from the high cost of inputs required for exports and the relative attraction of the domestic market. Third, in the industrial strategy, there has been an excessive emphasis on processing of domestic raw materials, notably cotton. Policy failures are a fundamental reason why major opportunities were missed in exports and why the structure of export remains so dependent on cotton based exports.

In the period immediately after partition, import substitution was rightly emphasised. However, with the approaching of self-sufficiency in cotton textiles in the second half of the 1950s, export development had become vital. However, continued availability of the protected market in East Pakistan, now Bangladesh, and the availability of large scale foreign assistance, diluted this urgency. Pakistan was, however, not unique among developing countries in attaching low priority to export development in the early period. The target for export growth during both the First Plan (1955–60) and the Second Plan (1960–65) was only 3 percent per annum, in nominal terms. The pessimism about exports were probably linked to low expectations about agriculture and the widespread view at the time that there were serious international demand limitations on manufactured good exports. The strategic failure was not to learn from the manufactured goods exports experience of Korea, Taiwan, Hong Kong, and Singapore in the 1960s, Thailand, Philippines, Malaysia, and Indonesia in the early 1970s, and China and Turkey in the 1980s.

Even though manufactured exports from Pakistan did rise sharply in the 1960s, this growth was to a large extent artificial because it was achieved through very high rates of effective subsidy on cotton textile exports which largely substituted for raw cotton exports. The export bonus scheme introduced in January 1959 as a temporary expedient to boost exports, perpetuated a system of multiple exchange rates which lasted till 1972. This system caused major economic distortions which acted against the normal process of industrial deepening and structural change. It is interesting to note that the massive formal devaluation that was undertaken in May 1972 failed to remove the basic anomalies that had crept in Pakistan's trade and exchange system in the 1950s and the 1960s, partly because they were so deeply rooted and had lasted so long. Because the wedge between the effective export and import exchange rate remained large, policies continued generally to favour import substitution and discriminate against exports. Even though manufactured goods exports received a higher effective exchange rate than primary products because of the heavy taxation on the latter, it was not enough to offset the relative attractiveness of the domestic market resulting from a high degree of effective protection to industry. The heavy foreign trade taxation was soon confined to imports and this heavy taxation of imports clearly made exports of manufactured goods based on imported raw materials uncompetitive. The system of export rebates has never been greatly effective in Pakistan. The high rates of import duty have persisted; the average rate of duty on dutiable imports remained around 35 percent in 1996. Selective export subsidies and substantial real devaluation of the rupee, during the Zia years, did help to expand manufactured exports after their extremely disappointing performance in the 1970s. But the fundamental reliance on cotton textiles and related exports persisted, and they remained heavily dependent on the subsidy on domestic sales of raw cotton.

Agricultural Performance and Policies

Overall economic growth has been and continues to be influenced greatly by trends in agriculture. Periods of high agricultural growth have generally also been periods of high GDP growth.

In the 1950s when large scale manufacturing growth, starting from a small base, recorded phenomenal growth rates of 20 percent per annum, the overall economy stagnated because agricultural growth was poor (1.4 percent per annum). The push for industrial growth was clearly over done in the early years. More balanced policies would have moderated inefficiencies in the use of resources resulting from excessive protection and also moderated the income inequalities both among economic groups between the regions that resulted from a very steep rise in industrial profits.

The 1960s saw a surge in the agricultural growth rate to 5 percent per annum, exceeded internationally only by Malaysia and Thailand. This improvement was the result of significant investment in water resources, both in public and the private sector, improved incentives for farmers and a remarkably coordinated and effective government response to the opportunities offered by the availability of improved varieties of wheat and rice after 1967. These key factors were responsible for the dramatic turn around in agriculture which provided important underpinnings for the expansion of domestic industry and exports.

Again during 1977–88, the recovery in agricultural growth to nearly 4 percent per annum from a dismal 2 percent during 1972–77 was an important element in overall expansion. Agricultural production during this period was helped by large augmentation of irrigation water supplies from Tarbela and the dramatic increase in the domestic production and use of fertilisers. The remarkable expansion in cotton productivity during the 1980s and early 1990s, linked both to better seeds and to liberalisation of pesticides, also continued to sustain agricultural growth which remained at 4.5 percent per annum during 1988–96.

As Table 6 indicates, Pakistan's agricultural growth rate over 1960–93 of around 4 percent per annum was exceeded only by Malaysia and Thailand. However, on a per

Table 6

Agricultural Growth Rates, 1960–95
(In Percent per Annum)

Countries	1960–1970	1970–1980	1980–1995	1960–1995
South Asia				
Bangladesh	2.7	0.6	2.2	1.9
India	1.9	1.8	3.1	2.4
Pakistan	4.9	2.3	3.9	3.7
Sri Lanka	3.0	2.8	2.3	2.7
East Asia				
China	0.8	2.6	5.4	3.2
Indonesia	2.9	4.1	3.3	3.4
Korea	4.4	2.7	2.3	3.0
Malaysia	5.5	5.0	3.4	4.5
Philippines	4.3	4.0	1.2	2.9
Thailand	5.6	4.4	3.7	4.4
Middle East				
Egypt	2.9	2.8	1.7	2.3
Morocco	4.7	1.1	2.4	2.7
Turkey	2.5	3.4	1.2	2.2
Latin America				
Argentina	1.8	2.5	0.8	1.8
Brazil	n.a.	4.2	3.1	3.5
Mexico	4.5	3.2	0.5	2.4

Source: World Bank, *World Development Reports.*

capita basis, agricultural output growth in Pakistan of less than 1 percent per annum since 1960 does not compare favourably with most East Asian countries including China and Korea. Still, Pakistan's agricultural record has been clearly better than that of India, Bangladesh and Egypt. The more serious issue appears to be that, as in exports, the past pattern of agricultural growth, does not appear sustainable.

Sources of Agricultural Growth

To a considerable extent, the increase in agricultural output has come from the expansion of cropped areas due to enormous increases in availability of inputs, especially water. The improvements in efficiency[8] have been relatively limited and yields per hectare have shown only modest increases over long periods. The important exceptions were the dramatic increase in cotton yields during the 1980s and wheat and rice yield improvements in the second half of the 1960s. The doubling of cotton production between 1982-83 and 1990-91, mainly through productivity improvements achieved through new varieties and de-control of pesticides, underpinned the strong agricultural performance in the 1980s. Without the spectacular growth in cotton, agricultural growth in the 1980s would have been disappointing. Unfortunately, cotton production has suffered in recent years due to viruses; production in 1997-98 was nearly 30 percent below the peak reached in 1991-92.

Pakistan's reliance on an extensive pattern of development in agriculture becomes clear from the large increases in area under irrigated crops by 1.8 percent per annum since 1950-51. This increase in area has been in turn been made possible a large increase in availability of water. Between 1960-61 and 1990-91, the availability of water for *rabi* crops trebled, while supply for *kharif* crops more than doubled. The overall increase in water availability over 3 percent per annum over the three decades was attributable both to the extensive use of private tubewells to exploit ground water resources and large public investments in water storage and irrigation. The construction of Mangla and Tarbela Dams and the large-scale Indus Basin replacement works in the 1960s and early 1970s not only reduced the variability in water availability but also added to total supplies from the irrigation system.

Sustainability of the past pattern of agricultural growth is in serious doubt because Pakistan cannot expect major increases in water availability in the foreseeable future.[9] No investments in storage of water are underway at moment and, in any case, large projects like Kalabagh Dam would take a decade to complete once initiated.

[8]The best measure of productivity is total factor productivity (TFP) which isolates the effect of input growth on output expansion. Two recent studies find that TFP has stagnated or even declined in post-Green Revolution Pakistan, i.e. the period since the mid-1970s. The studies are cited in Byerly, Derek (1994) Agricultural Productivity in Pakistan: Problems and Potential. Prepared for the World Bank, Washington, D. C., Agricultural Sector Review.

[9]For an analysis of the constraints facing Pakistan's agriculture, see Rashid Faruquee, *Pakistan's Agriculture Sector.* World Bank Policy Research Working Paper 1407, (January 1995).

Ground water development through private tubewells may be reaching a saturation point. Similarly, the spurts of wheat and rice yields made possible during the green revolution and the exceptional improvement in productivity of cotton during the last decade may not be easy to repeat. Future agricultural growth will have to come from improving the efficiency use of major inputs such as water and fertiliser as well as greater agricultural diversification. More effective use of water resources would require substantial increases in water charges coupled with investments in improvement of delivery efficiency of the irrigation and appropriate on-farm investments in land levelling etc. At present, water charges cover less than 50 percent of operations and maintenance costs of the irrigation system let alone recovery of capital cost. Thus, there are insufficient incentives to conserve water and undertake on-farm investments. Improvement in the technical efficiency with which agricultural inputs are used would also require strengthening of human resource base in agriculture. The low level of literacy and investments in education appear to have been a major drag on agricultural productivity. Finally, there is considerable room for better resource allocation within agriculture. Valuing inputs and outputs at international prices, cotton, wheat and *basmati* rice are among the most efficient crops for Pakistan.[10] In contrast, sugarcane production is inefficient. The estimates of effective protection indicate that there is substantial negative protection for wheat, rice and cotton and high positive protection for sugarcane. Correcting the price distortions which result mainly from the system of agricultural support prices would lead to shifts away from sugarcane to wheat, rice and cotton. The system of output prices also resulted in transfer from agricultural producers of over 6 percent of gross agricultural product in the recent past.[11] These transfers were only partly offset by subsidies on inputs, including irrigation, fertiliser and credit. On a net basis, agriculture is no longer more heavily taxed than other sectors, though the implicit net taxation of agriculture was heavy in the 1980s. But the important point is that keeping output prices below world prices and offsetting this by input subsidies was a particularly inefficient and inequitable way of transferring resources from agriculture.[12] Input subsidies lead to a wasteful use of scarce resources while depressing output prices discourages production. Further reform of the trade and taxation regime for agriculture can have positive output and revenue effects while mitigating the inequities of the present system which discriminates against the small farmers.

Large-scale Manufacturing Growth

Large scale manufacturing has had a more chequered history than agriculture.

The extraordinary high rate of manufacturing growth in the fifties was due

[10]Longmire, Jim and Pascale Debord (1993) *Agricultural Pricing and Comparative Advantage in Pakistan: An Update to 1991-92*. Prepared for the World Bank, South Asia Regions, Agricultural Operations.

[11]Estimate for 1992-93. Tayyeb Shabbir (1994) *Agricultural Prices in Pakistan.* Prepared for the World Bank. The estimates for earlier years were much higher.

[12]The World Bank (1994) *Pakistan: A Strategy for Sustainable Agricultural Growth*. Washington, D. C.: The World Bank.

principally to two factors: (i) the abnormally low level of manufacturing activity that Pakistan had at partition, relative to what one would expect from a country of Pakistan's size and income level and (ii) government policies which ensured a very high rate of profit in manufacturing through high domestic protection. A good deal, though not all, of the protection initially afforded to industry could be justified on grounds that industry was in its infancy. The excessive protection afforded to industry and extensive quantitative restriction on imports resulted not so much in the wrong industries being established but rather excessive profits being generated for the industrialists at the cost mainly of urban consumers and the rural population. Lower agricultural growth and a widening income gap between the rich and the poor were the real consequences of excessive protection to industry.

But by the early 1960s, there was a need to expose traditional industries such as textiles to more external competition and to stress both exports and development of intermediate and capital goods industries. This required an exchange rate adjustment as well as scaling down of protection for final consumer goods industries. This was not done. Instead, through a combination of a complicated multiple exchange rate scheme and continued reliance on an extensive system of import controls, Pakistan managed to provide its industrial sector the double advantage of substantial protection against imports and substantial incentives for exports. While the Export Bonus scheme was instrumental in a very sharp increase in manufactured goods exports, this growth was achieved at a very high economic cost. The effective rate of subsidy on export of manufactured goods in 1967-68 was well over 100 percent and even higher for cotton textiles. The increase in cotton textiles, especially yarn exports, to a large extent substituted for raw cotton exports. Given the large profit margins in standard cotton textiles there were few pressures for moving into areas of greater value added such as garments or mixed textiles and even less for moving into intermediate products or capital goods; imports could come in at the over-valued exchange rate. Under this protected regime, large scale manufacturing growth was at 16 percent per annum during the first half of the 1960s and remained at 10 percent in the second half of the 1960s notwithstanding the emergence of foreign exchange shortages. But in economic terms, the lack of incentives for improving efficiency and introducing structural change proved costly. Also the incentive system continued to discriminate against agriculture. In social terms, the high burden of industrialisation on the consumer and high unearned industrial profits may have contributed to the unrest in the late 1960s.

Bhutto's experiment with socialism dealt a major blow to large scale manufacturing development in the private sector. Even though the nationalisation in the industrial sector in January 1972 affected less than 20 percent of the value added in the manufacturing sector, the indiscipline and labour militancy resulting from the new labour policy, the nationalisation of commercial banks and the generally hostile attitude of the government towards the private sector resulted in a precipitous drop in private investment in medium and large scale industry. By 1976-77 real private investment in this sector was only about 40 percent of the level in 1969-70. However, under Bhutto the public sector undertook very large industrial investments including the steel mill, fertiliser and cement plants and several sugar and textile mills. Public sector investment in industry rose nearly ten-fold in real terms between 1969-70 and 1976-77. But this sizable investment was concentrated in long gestation projects which involved relatively little job creation and in the case of steel mills was to prove of dubious value. The immediate effect of Bhutto's policies was that large scale manufacturing grew only by 2.8 percent per annum during 1972–77 following an actual fall (6 percent) during 1970–72, reflecting disruption caused by political disturbances and the eventual separation of East Pakistan.

Overall manufacturing sector growth during 1977–88, the Zia years, recovered to 9 percent per annum, compared with 3.7 percent growth recorded during 1972–77. Several factors were behind the rapid industrial expansion. First, the very large public sector investments in industry which were started under Bhutto and continued in the early Zia period resulted in major increases in steel, cement, fertiliser, and vehicle production. Second, the investment climate for the private sector was improved by providing guarantees against future nationalisation, clearer demarcation of activities between the private and public sector, relaxation of investment controls, and additional tax concessions. While there was no wholesale de-nationalisation, nationalised enterprises were transferred to former owners on a case by case basis. Third, the incentives for manufactured goods exports were strengthened by the introduction of flexible exchange rate policies and strengthening of export rebates and subsidies. As a result, private sector investment grew rapidly and by the late 1980s had risen to over 90 percent of total industrial investment in contrast to a little over 25 percent in 1976-77.

The revival of private industrial investment was particularly important for addition to capacity in traditional industries such as cotton textiles which have a quick pay off. The rapid growth of raw cotton production also stimulated the cotton textile industry. Unfortunately, the structure of incentives continued to favour relatively simple and limited value added processing, notable cotton yarn production. Continued export taxation of raw cotton ensured availability of the raw material at well below international prices and therefore large profits could be made in yarn production without much benefit to the economy. The weakness in the industrial structure was reflected in the pattern of exports. Just as in the 1960s, the manufactured exports' boom of the 1980s was narrowly linked to the expansion of raw cotton and excessive incentives for cotton textiles. As a result, the share of cotton and cotton based exports actually increased very sharply from around 40 percent in 1979-80 to nearly 60 percent in 1989-90. The export difficulties being experienced in the mid-1990s were directly related to the weakness in the structure of exports that developed in the 1980s. As raw cotton production stumbled after 1992 and as unsustainable incentives for cotton textiles were withdrawn, the uncompetitiveness of a large segment of this important industry became more obvious.

Large-scale manufacturing growth was only 4.8 percent per annum during 1988–96 and slowed down further to 3 percent per annum after 1994. The slow down in manufacturing was notwithstanding a more than doubling of private real investment in large scale manufacturing (while public investment remained constant) over 1990–96. It reflected not only the structural problems in cotton textiles but also the poor performance in manufactured exports and greater inroads by imports. The latter two were due to the failure to adjust the value of the exchange rate in a timely fashion to offset the effect of higher domestic inflation on the competitiveness of exports and to cushion the impact of import liberalisation measures after 1990 on industry. The main point is that even more than in agriculture, future growth in manufacturing had become more problematical in the 1990s.

Distribution of Growth Benefits

Economic growth is not an end in itself. It is merely a means to improve consumption standards, human welfare, and quality of life. The wide distribution of gains from economic growth is thus a critical test of economic performance. The distribution of growth benefits can be looked at in several ways, which are closely related but nevertheless distinct. These inter-related aspects include the impact of growth on job creation, the effect of rising average incomes on incidence of absolute poverty, and the access of the general population to social services, such as health, education and safe water supply which contribute to the level of human development. In an overall sense, the distribution of growth benefits can most clearly be seen through change in the pattern of income distribution.

How does Pakistan fare on the distribution of growth benefits? How widely has prosperity been shared among the population? Our analysis suggests at best a mixed performance based on the following six broad conclusions: (1) Though income distribution has tended to improve during periods of high growth and benefited from large worker remittances in 1980s, the overall trend appears to be toward widening income disparities. (2) There has been a definite reduction in the incidence of poverty over time but because of the enormous growth in population, the total number of poor now estimated at over 40 million has shown a dramatic increase of 125–150 percent since partition. (3) Meaningful job creation has not kept pace with the growth in the labour force. The high share (50 percent) of the labour force still employed in agriculture and the small share of modern sector employment (less than 20 percent) suggest a great deal of under employment or employment at very low wages. (4) Inadequate progress in tightening the labour market is also reflected in the average real wages growth, estimated at 1.2–1.5 percent per annum over 1950–95, lagging behind the rate of increase in per capita incomes of 2 percent per annum. (5) Furthermore, with the slow down of emigration after the early 1980s, real wages have tended to stagnate since 1985. (6) In terms of human development, Pakistan has fallen far behind other countries on the subcontinent, notwithstanding its better economic growth.

In discussing Pakistan's record on equity and the six points above, it is necessary to analyse the role of policies which prevented better results and to examine the implication of the present position for future development. Even though there are problems with the availability and the reliability of income distribution data, it is useful conceptually to begin the analysis with the main elements affecting income distribution in Pakistan. Early data on Pakistan's income distribution are not available. However, several factors suggest that incomes were not very unequal at partition notwithstanding the very large concentration of land holdings among the large landowners. In comparison with India, for instance, industrial development was limited, and both the entrepreneurial and professional incomes were not large. On the other hand, the phenomenon of landless labour did not exist on a large scale except in Sindh. It appears that income distribution in Pakistan has become more unequal overtime as a result of a number of factors. The degree of inequality in agriculture has not lessened even though the land distribution has improved somewhat. The rise of the industrial class has substantially added to inequality, especially because protected industry has enjoyed high profits the government policies have not had much success in taxing corporate profits or re-distributing incomes through fiscal means. Strong reliance on economic controls for large periods of Pakistan history has meant large economic rents for groups with access to foreign exchange, credit and trade and investment permits. Real estate development and especially the very steep rises in the prices of urban land have meant large windfall gains for property owners who more often that not acquired land initially on the basis of allocation rather than market purchase. On the other side of the income spectrum, there does not appear to have been an increase in the share of wages in national income. Wage employment has risen only moderately. Real wages of unskilled workers have risen but over long periods have lagged behind the growth in per capita incomes. The data suggest that since partition real wages have more than doubled indicating an average annual growth of 1.5 percent. Even if some allowance is made for the understatement in the official price statistics, wages would appear to have grown at least 1.2 percent per annum. There has been no tightening of the labour market; indeed open unemployment, though still low at around 5 percent of labour force, has crept up from around 2 percent at the end of 1960.

Income Distribution Movements

The data on household income distribution, available since 1963-64, supports the hypothesis of at least a moderate increase in inequality. The household income share of the lowest 20 percent, though it has fluctuated over time, was at 5.7 percent in 1990-91—lower than the 6.4 reported in 1963-64 and substantially lower than the peak of 8.2

percent in 1968-69. Over 1964–91, the ratio of highest 20 percent to the lowest 20 percent increased from 7.1 to 8.6.

The income distribution data also reveal that periods of substantial improvement, 1964–71 and 1979–88, were followed by periods of deterioration, 1971–79, and 1988–91. While the data on income distribution based on household income and expenditures survey is not very reliable as an indicator of the degree of income concentration, since it definitely understates incomes of high income groups the fluctuation over time does make some sense in terms of economic aggregates. The reduction in the income inequalities in the 1960s can be explained by the high growth rates of both agriculture and total output. There was a definite trickle down effect of high growth. The deterioration in income distribution during 1970–79, notwithstanding the rise in real wages in urban areas, probably reflects poor agricultural performance.[13] The recovery in the share of the bottom 20 percent income receivers by 1988 was no doubt influenced by high growth and worker remittances during the 1980s. It is not altogether surprising that income distribution data show worsening after 1988 because in this period growth slowed down, inflation accelerated and real wages tended to fall.

Poverty Incidence

But while the relative income share of bottom 20 percent or 40 percent of the population may have tended to drop over time, there is little doubt that absolute income and consumption per head have increased broadly. According to a recent World Bank report on Pakistan Poverty Assessment, in spite of the rapid pace of population growth, there has been a sharp decline in the incidence of consumption poverty from 46 percent in 1984-85 to 34 percent in 1990-91. The report suggests that there was also a decline in poverty incidence between the early 1970s and the early 1980s due to a rise in real wages. This implies that the absolute poverty incidence was over 50 percent as late as the early 1970s. This is broadly consistent with other studies. Naseem (1986:180) suggests that the incidence of poverty in rural areas dropped from 54 percent in 1963-64 to 46 percent in 1969-70 but had increased to 55 percent by 1971-72.[14] Irfan and Amjad estimate rural poverty incidence at 54 percent in 1969-70 declining to 41 percent in 1979.[15] However, the price deflators used in their study somewhat under state inflation the 1970s and thus under state the extent of poverty in 1979-80.

Since 70 percent of the population still lives in the rural areas, sustained agricultural growth has been an important factor in poverty alleviation. The dramatic rise in the production of cotton after 1983-84 was a critical factor in the rise in real wages of

[13]Jawaid Azfar, M. Haq and Baqai (eds). p. 49.

[14]S. M. Naseem, "Rural Poverty and Landlessness in Pakistan". In Mahbub ul Haq and Moin Baqai (eds) *Employment, Distribution and Basic Needs in Pakistan.* Lahore: Progressive Publishers.

[15]M. Irfan and Rashid Amjad, "Poverty in Rural Pakistan". In Haq and Baqai (eds) *Employment, Distribution and Basic Needs*, p. 225.

agricultural workers in the Punjab till the early 1990s. The role of out migration in raising real wages in the 1970s and supplementing incomes through remittances from abroad has also been a key factor in reducing poverty though its impact is difficult to quantify. The net current private transfers from abroad which rose from around 2 percent of GDP in the early 1970s to the peak of 9 percent in the early 1980s dropped to 4.5 percent of GDP during 1992-93 to 1994-95 and this declining trend is likely to continue. The contribution of these factors which have been important in the past in poverty reduction may be more limited in the future.

While the poverty reduction has been notable, the incidence of poverty—about one-third of the population—is still high especially compared to East Asian countries. Also, there can be little satisfaction that poverty in Pakistan has dropped faster than in other developing countries, except East Asia. The fact is that per capita growth in Pakistan has also been substantially higher than in most other developing countries outside East Asia. It can be argued that with better economic policies, Pakistan would have enjoyed not only higher growth but more equitable growth. In any case, the preponderance of poverty in society cannot be dismissed lightly. The number of poor is large and has been growing. The incidence of poverty in West Pakistan[16] at independence did not exceed 60 percent of the population; the estimates for India place poverty incidence at 55 percent.[17] So at the most the number of absolute poor in the present day Pakistan was around 18 million in 1947. With the current poverty incidence, as estimated by the World Bank at around one-third, the number of poor presently are well over 40 million. This widespread poverty is a root cause of social problems and tensions. And the huge increase in the absolute number of the poor may explain the breakdown of law and order in the country.

Human Development

Low income and consumption levels are only one aspect of poverty. As is well known, the human development indicators for Pakistan are abysmal and compare very unfavourably with the average low income economies. The literacy rate in Pakistan was 36 percent in 1993 compared with 60 percent for low income economies. Female literacy was only 21 percent compared with 33 percent in India. Life expectancy at birth and infant mortality rates in Pakistan also compare unfavourably with other low income economies. The lag, however, is most serious in education. The Gross primary enrolment ratio in 1987 at 46 percent was only moderate higher than in 1970 (40 percent). Since then there has been a distinct improvement. Even so Pakistan's gross

[16]It appears highly unlikely that poverty was reduced in the 1950s because per capita income growth was negligible and agricultural growth was poor. It can thus be assumed that poverty incidence in 1947 was not much higher than the reported estimates for the early 1960s of around 55 percent.

[17]*The Economist* (London) (August16–22, 1997) indicates that the population in India below the poverty line in 1947 was 55 percent of the total but had dropped to 39 percent by 1987-88, and declined further to 37 percent in 1993.

enrolment ratio of 65 percent in 1993 compared quite unfavourably with that of Bangladesh.

Why has Pakistan lagged so far behind other developing countries including India and Bangladesh in social and human development? Initial conditions, high population growth, low priority given to human resource development by governing elites, excessive focus on urban areas and higher education at the cost of the neglect of rural areas and primary education, ineffective use of resources, poorly implemented plans, excessive centralisation, and pre-occupation with short term goals have all contributed to one of the stark failures in Pakistan's development. The policy failures were compounded over time and performance in some cases actually deteriorated. For instance, in basic education there was less progress in the 1980s than either in the 1950s or the 1960s. In social policies, as in other policy areas, Pakistan was not quick to learn from experience and as a result, did not take timely corrective actions.

The first point that needs to be emphasised is that Pakistan faced at partition in 1947 very poor initial conditions. Total primary school enrolment in West Pakistan in 1948-49 was only 0.6 million, indicating a gross primary enrolment ratio of only about 15–20 percent compared to 30 percent in East Pakistan. Only 5-6 percent of school age girls were in primary school. Starting from this low level, primary school enrolment grew by over 10 percent per annum to 1.89 million in 1959-60. It expanded almost as fast during the period of the Second Plan to 3.0 million in 1964-65, and the primary school enrolment ratio improved to 36 percent. However, after the 1965 war with India and increased defence spending, the education sector faced a sharp cut in expenditure and primary education was cut disproportionately. Primary school enrolment growth slowed down to 5 percent per annum during the Third Plan and surprisingly enough the rate did not recover significantly during the Bhutto years. During the Zia years (1977–88), primary school enrolment slowed down to 3.2 percent per annum only slightly faster than the rate of population growth. Clearly the momentum in primary education that was lost in the mid-1960s was never quite regained.

A great deal of responsibility for failures in basic education can be traced back to the decision to nationalise private educational institutions in 1972 under Zulfiqar Ali Bhutto even though the primary schools were not effected. As a direct consequence of the nationalisation decision, the management capacity of the government was over extended, the competition for resources within the education sector deepened the urban and higher education bias and thus the quick development of basic education and literacy was hampered. It is interesting to note that total government expenditure on education actually increased from 1.6 percent to 2.0 percent of GNP over 1972–77 and further to 2.7 percent over 1977–88. But only about one-third of education expenditure was directed to the primary level under Bhutto, and this proportion was even lower during the Zia years. It is also significant that the neglect of basic education under Zia occurred despite the brave noises made about its priority in 1983 in the Sixth Plan

(1983–88). Obviously, the plans were not monitored closely. The cuts in spending continued to fall heavily on the social sectors. The introduction of *iqra* surcharge on imports earmarked for on education in 1985-86 budget did raise education expenditures but evidently had only limited impact on primary education spending. The structural issues in education arising from the 1972 nationalisation were not tackled in the 1980s. The Zia government did allow new private schools but did not address the broader question of the role of private sector in education even though the deterioration in the quality of public education had become quite evident. The Sixth Plan was silent on the subject of private education.

Another underlying problem has been that higher education has continued to pre-empt a large share of public education expenditures. However, the large and growing subsidies to the urban middle class have ultimately been self defeating because the quality of higher public education has dropped precipitously. For nearly five decades after independence, fees for the government colleges and universities did not increase much if at all even though the general price level had increased over 20 times. The low cost recovery has contributed to the financial problems in higher education. Notwithstanding the large share of public education resources devoted to higher education, the number of teachers in higher and professional education grew only four-fold over 1965–95 while enrolments expanded over six-fold. The declining quality of public education has led to a shift to the private educational institutions where the fees are fifty to one hundred times those charged by public colleges and universities. A much higher rate of cost recovery may help to improve the efficiency of both public and private sector institutions by increasing effective competition between the two which is sadly lacking at present.

Inefficient use of resources has also adversely affected the education system, especially at the primary level. Spending on buildings has taken priority over number of teachers or other aids to education. Drop out rates are high. The increasing politicisation of educational allocations especially under the democratic regimes has meant that the site selection for schools and hiring of teachers has not always been based on merit.

In the ultimate analysis, the failure to make primary education universal even after fifty years of independence is a societal failure resulting from feudal dominance in rural areas, the urban middle classes' pre-emption of resources, high level of defence spending and lack of sufficient demand for basic education, especially girls' education. Had the demand for primary education been very strong it would not have been possible for politicians and technocrats to ignore this sector for so long. In the case of boys, the opportunity cost of time spent in school and in the case of girls, cultural attitudes especially in rural areas have hampered growth of primary enrolment. In 1993 female primary enrolment ratio at 49 percent still compared unfavourably with the boys ratio of 80 percent. In the rural areas less than one-third of primary school age girls were in school.

Long-term Consequences of Neglect of Basic Education

The neglect of basic education will continue to have consequences for Pakistan's growth and political stability for the next several decades. According to the 1951 census the literacy rate was around 20 percent. Since then the literacy ratio has increased to 36 percent. But over the period the number of illiterate persons (10 years or older) has trebled from less than 20 million to over 60 million. This absolute number is likely to grow further well into the 21st century even if universal primary education is achieved during the next fifteen years.

The low level of educational attainment has clear consequences for future growth since the lack of skills would hamper growth in productivity. The political and social consequences of persistence of high level of illiteracy could be even more serious since they will stand in the way of a movement to a meaningful democracy. The lag in the education of women would also continue to limit the effectiveness of efforts at population control. Clearly Pakistan's inability to slow down the rate of population growth has effected the growth in per capita incomes adversely. Indications are that it will not be easy to slow down the future rate of population growth quickly. The present fertility rate in Pakistan of 5.2 compares very unfavourably with that of Bangladesh (3.5) and India (3.2), which have already succeeded to slowing down population growth considerably. In Pakistan, very high rates of illiteracy among women (77 percent) and the low rate of participation of women in the labour force limit the demand for family planning services. The desired family size is still 4 in Pakistan as compared with the desired family size of 2 in Bangladesh.[18] Unless there is a dramatic improvement in women's education (and status in the society), population control efforts will not be successful even if the family planning services can be made available more effectively than in the past.

Employment

Job creation is a major source of income generation. Labour force growth in Pakistan over the last thirty years has averaged 2.6 percent per annum, lower than the population growth of 3 percent per annum partly reflecting the growing number of young people who are either studying or still not of the working age. The growth in employment has by and large kept pace with the growth in the labour force though in the last decade the rate of open unemployment has crept up. But as economic growth slowed down, employment growth also declined to 2.4 percent per annum during 1985–95 from the peak of 2.9 percent in 1975–85. Close to 40 percent of the increase in jobs, i.e. over 6 million jobs, during the last thirty years has been in agriculture. The share of agricultural employment in the total has dropped only slowly from 60 percent in the

[18]These numbers were quoted at an Islamabad conference (April 1997) by Attiya Inyatullah, a leading figure in family planning in Pakistan.

mid-1960s to 50 percent in mid-1980s. Jobs in manufacturing and mining have increased very slowly; less than a million jobs have been added in the last twenty five years and the share of manufacturing employment has decreased from over 15 percent in the late 1960s to less than 11 percent in mid-1990s. Further, most of the increase was in small-scale manufacturing. Of the 11 million jobs created during last thirty years outside agriculture, over 8 million have been in construction, trade and other sectors. It would appear that the bulk of growth in jobs has been in the informal sector where wages are low. Evidence about relatively high paying jobs in the modern sector is less clear. In any case, the large scale organised sector has not been in the lead in providing employment. This cannot but have adverse effects on the growth of future employment. Had export led manufacturing growth been emphasised, labour intensive industries would have shown not only higher growth rates of output but also higher rates of job growth. In a real sense, the neglect of opportunities for exports of labour intensive manufactured goods limited the possibilities of a more broad based income and employment growth.

One can conclude, therefore, that while Pakistan has succeeded in attaining a significant growth in living standards notwithstanding a nearly quadrupling of the population, it has failed in dealing with the social consequences of the unprecedented growth in population in basic education, job creation and poverty alleviation. The large increase in the absolute number of poor, illiterate and potentially unemployed poses a threat to the social and political order. The dangers inherent in the situation are only dimly perceived. Deepening and broadening of social programmes to ensure a more equitable distribution of growth benefits than in the past is clearly necessary, but sustained economic growth which has provided a fundamental source of societal cohesion so far may in itself been in danger because of the weaknesses in the policies of the past.

Past Growth and Future Sustainability

Three factors stand out in explaining Pakistan's high growth rates in the period up to the early 1980s: (1) a sharp increase in investment levels especially in the 1960s. (2) the low initial level of industrial development which made relatively quick productivity gains from structural change possible and (3) robust agricultural growth after 1960 assisted both by large investments and major technological breakthroughs.

Fixed investment in Pakistan rose dramatically from less than 4 percent of GDP in 1949-50 to 11.5 percent in 1959-60 and further to nearly 21 percent in 1964-65. Even though the investment rate declined to 14.3 percent of GDP by 1969-70, it had recovered to 18 percent rate by 1976-77. Notwithstanding the drop in the latter part of the sixties, real investment for the decade as a whole was nearly three times its volume in the 1950s. The remarkable rates of growth of fixed investment of 15 percent per annum in the 1950s and over 20 percent per annum in the first half of the 1960s were key factors underpinning growth in the 1960s.The effect of the decline in the investment rate in the second half of the 1960s was more than offset by the remarkable gains in agricultural productivity under the green revolution.

Large long-term investments in water and power initiated in the 1960s and continued in the early 1970s sustained growth well into the 1980s. Investment in the multipurpose Tarbela Dam, full benefits from which accrued in the late 1970s and early 1980s partly because of technical difficulties which caused delays, had high economic returns. The rise in international oil prices after 1973 sharply increased the cost of thermal power, the alternative to hydroelectric power and therefore considerably enhanced the gains attributable to power generation from Tarbela. Public policies of the Ayub era which mobilised large volumes of external assistance and directed a large part of it toward public investments in infrastructure deserve a great deal of credit for Pakistan's continuing high growth into the early 1980s. Industrial growth was rapid in the 1950s and 1960s because there was a lot of catching up to do. Following the early disruption of the economic and trading relationship with India after independence, the availability of both large markets for mass consumption goods in East and West Pakistan as well as of agricultural raw materials needed, combined with strongly supportive government policies to sustain industrial growth in West Pakistan. While there was not a great deal of experience with manufactured goods production, the technology of the early industries was relatively simple. Government policies which ensured a very high rate of profit in manufacturing after 1952 provided vital support for the industrialisation process but were by no means the only cause of the high rate of industrial growth.

Sustained annual agricultural growth of about 4 percent since 1960 has been the third critical element in Pakistan's past growth. While the agricultural sector has not been able to ensure self sufficiency in food grains or keep the large deficit in edible oils from growing steadily, it has yielded modest increases in per capita food grains production and large increases in raw cotton output which has sustained domestic cotton based industries and exports. The agricultural growth could have been even higher if the government policies had not discriminated against agriculture for most of Pakistan's history.

The expansion of agricultural output has been linked closely to large expansion in irrigation water supply resulting from massive public investments in water resource development and to a lesser extent from increase in private tubewell development. The two technological breakthroughs in agriculture from high yielding varieties of wheat and rice in the late 1960s remarkable improvement in yields and productivity in raw cotton during 1984–91 have also contributed strongly to agricultural growth. The combination of public policies and private entrepreneurship appear to have maintained the momentum in agriculture notwithstanding setbacks in raw cotton production after 1991.

It would thus appear that till the early 1980s, the record of Pakistan's growth can be explained rather well in terms of traditional factors in growth, rapid increases in capital stock, availability of large domestic markets and fortuitous availability of new technologies in agriculture. The continuation of growth throughout most of the 1980s, notwithstanding a stagnation in the fixed investment rate at around 16-17 percent of GDP, may appear more puzzling. During this period a tremendous boost to economic activity was provided by the sharply rising worker remittances which at their peak in 1982-83 totalled nearly $3 billion, or about 10 percent of GNP. Domestic spending related to inflow of worker remittances, external assistance for Afghani mujhahedin, and the narcotics trade especially pushed up the growth rate of the service sectors of the economy and tended to sustain overall economic activity till the late 1980s. These influences and the doubling of raw cotton production over 1980–1990 helped to offset the dampening effect of the stagnation of the fixed investment rate at around 17 percent during 1977–88. But to an extent, growth was achieved at the cost of neglecting longer term investments in both human capital and infrastructure. Serious shortages of infrastructure especially in the energy, transport and urban development sectors had developed already by the mid-1980s. While the congestion on roads and power shortages leading to large scale load shedding may not have adversely affected growth immediately, they did have an impact on the quality of life. Insufficient attention given to longer term requirements of water, energy and transport sector also meant that towards the end of 1980s, there were few large projects in the pipeline which would have normally helped the momentum of growth in the 1990s.

In any case, the GDP growth rate has clearly been on the decline since the mid-1980s; the average annual growth rate of 4.9 percent during 1988–1996 compared unfavourably with the peak rate of 6.7 percent during 1977–83. The decline in remittances and the rise in net investment income payments (including interest on external debt) has meant that the GNP growth rate which adjusts for net factor income from abroad has fallen more sharply. Indeed the per capita GNP during 1988–96 grew only 1.2 percent per annum, in sharp contrast to the record annual growth of 4.4 percent in 1977–1983.

Prolonged stagnation in the investment rate, serious weaknesses in export and industrial structure and continued neglect of human resource and infrastructure development have been the principal factors behind the slow down of the growth in the 1990s. Major policy efforts at structural reform have been made during recent years: relaxation of investment controls on both domestic and foreign investors, liberalisation of foreign exchange and trade regime, alignment of prices of agricultural output and inputs more closely to international levels, reduction in credit and energy subsidies and initiation of privatisation of public sector assets in industry, banking and telecommunications and energy. But these did not yield the desired results because either they did not go far enough in correcting economic distortions in the economy or were in the early stages of implementation. For instance, only limited progress was made in privatising financial, telecommunications and the energy sector. The delay in the privatisation of large state owned banks was particularly costly because credit allocation decisions became more susceptible to political pressures under the democratically elected governments. Movement toward dismantling high tariffs was slow, the anti-export bias of the policies remained unchanged and the slow pace of adjustment of the nominal exchange rate hurt export development. More basically, structural reform measures were under-cut by the absence of strong efforts to reduce macro-economic imbalances, deteriorating effectiveness of resource use in the public sector and the growing abuses in the largely public sector controlled financial system. The worsening of the macro-economic situation was highlighted by the growing foreign exchange crisis after mid-1996 and reflected both low private savings and the persistence of large fiscal deficits.

The forces which were behind the slow down of economic activity in the recent past are likely to persist unless major policy initiatives can reduce the macro-economic imbalances and bring about significant shifts in the pattern of development. That radical departures from the past patterns of development and development policy are necessary can be summed up in six points which confirm that the future cannot be like the past.

First, Pakistan cannot hope to recover a 6 percent GDP growth rate with the present fixed investment rate of around 17 percent of GDP because the past neglect of major infrastructure investments in energy, transport and water sectors needs to be rectified. If Pakistan wants to move towards a 7 percent growth rate, highly desirable for generation of adequate employment and sustained poverty alleviation, the investment rate would have to be raised gradually to 25 percent of GDP over the next decade or so.

Second, even the maintenance of a fixed investment rate of 17-18 percent of GDP, over the next three years would require a very large domestic savings effort because the present reliance on foreign savings is totally unsustainable. The current account balance of payments which reached a peak of 7 percent of GDP in 1995-1996 needs to be brought down to 4 percent of GDP over the next two years because of the need to limit recourse to short term borrowing including foreign currency deposits and to avoid major external payment difficulties in the future. This means that all of the increase in domestic investment must be financed from national savings. To reverse the declining growth rate and to achieve financial stability, Pakistan needs to raise its marginal savings rate from 15 percent to 30–35 percent during the next few years. It would then need to sustain the marginal domestic savings rate at that level if it wanted to achieve acceleration in growth to 7 percent level. Given that Pakistan must reduce both the absolute and relative level of net foreign inflows in the next few years, investment growth would depend solely on domestic resource mobilisation. If the domestic saving rate cannot be stepped up sharply, there cannot be much hope for reviving the growth rate even to the 6 percent level. This is a fundamental difference from the past, when foreign resources often could be substituted for domestic effort.

Third, an exceptional domestic saving effort would have to be matched by an exceptional export performance (and selective import substitution, notably in food grains and edible oil) to strengthen the balance of payments. Pakistan needs a big push in manufactured goods exports but will have to achieve it while reducing dependence on cotton textile exports generally and cotton yarn exports particularly because the profitability of a segment of the textile industry is uncertain. Improvements in the structure of manufactured goods exports could prove to be even more important for the long run than increases in volume.

Fourth, in agriculture as in industry, there is need for both greater diversification and higher productivity. The past pattern of development in agriculture in which large additions to the irrigation water supply could be taken for granted and the major crops, wheat and cotton remained dominant is not replicable. Future growth in irrigation water availability will not be more limited and the technological breakthroughs in varieties of wheat, rice and cotton are not likely to be repeated.

Fifth, the necessary emphasis on productivity and efficiency improvements both in agriculture and industry means that human resource development can no longer be neglected. Without adequate skill formation and investment in human capital, the drive to increase exports will also not be successful.

Finally, the distribution of growth benefits needs to be more equitable than in the past in order to improve general welfare and reverse the trend toward increasing the number of illiterates and poor in the society, who pose a great threat to political and social stability.

Policy Performance

The policy shifts which are needed to restore growth and a more viable pattern of development in the future are indeed obvious. Here we must return to the question of the past policy performance, nature and causes of policy failures, and the dynamics of decision making in the various political periods. A central conclusion that emerges from the foregoing discussion is that in many critical areas, notably, domestic savings, exports, and social development, policy performance did not improve over time, lessons were not learned from experience and the institutional capacity for policy making and implementation progressively weakened. In retrospect, the biggest development policy failure was in the area of domestic savings. That the saving performance was deteriorating is clear from the fact that the domestic savings rate in 1996 was no higher than two decades earlier and that the proportion of investment that was financed from external flows was larger in 1996 than in 1970. In exports, the apparently satisfactory expansion of the 1980s was greatly supported by subsidies on the domestic sales of raw cotton and masked serious problems in the structure and the competitiveness of exports. As these subsidies were phased out and as the foreign trade regime continued to discriminate against exports, export volume growth had slowed to 1 percent per annum during 1994–1996. In education, another problem area, there was less progress in the 1980s than either the 1950s or 1960s. Finally in the area of governance, public institutions have been greatly weakened over time and the general effectiveness of public spending has declined especially in the period after 1988.

Several factors help to explain why economic and social policy performance has deteriorated over time. In the final analysis, responsibility for broad economic direction rests with the political leadership. In Pakistan's case, especially in the period after Ayub Khan, successive political leadership lacked a clear economic vision, a sense of strategic direction and a strong commitment to economic development. Because annual growth remained high and there never was a serious financial or economic crisis, longer term structural adjustments could often be ignored. The relatively easy availability of external sources for funding investments also enabled Pakistan not to face hard choices between present and future consumption. The dynamics of policy making were also greatly influenced by the powerful top layers of bureaucracy. The remarkable continuity in economic leadership at the top civil service levels while imparting a measure of stability to policy making and ensuring a reasonably efficient day to day management also hindered any radical departures from past policies. But as the general effectiveness of government institutions like the Planning Commission declined, the top economic managers found themselves to be working without adequate staff support. In the 1970s, as planning was de-emphasised and economic policy making became more ad hoc, there was an exodus of well trained and experienced government economists from Pakistan. Unfortunately the strong development of the economics profession in the government under Ayub was not matched by similar growth in the universities. One reason was the pre-occupation of foreign advisors with strengthening of the planning bodies. By and large,[19] the academic institutions did not receive large-scale financial and institutional support to create a research-friendly environment.[20] More fundamentally, the failure of the academia to attract the best and the brightest among the economists (and other professions) early on was related to the value system in the society which favoured government positions for their power and prestige and did not attach the same importance to intellectual endeavours and analytical pursuits. As a result, the universities were not able to fill the gap caused by declining economics capacity in the government.

In these circumstances, the role of international organisations like the World Bank and the IMF, in giving economic advice and setting up policy agendas, grew enormously. But foreign advice can be best utilised only if the indigenous institutions are

[19]The exception was the Pakistan Institute of Development Economics (PIDE), which was strongly supported by the Ford Foundation in the late 1950s and the early 1960s.

[20]Nadeem ul Haque and Mahmood Hasan Khan, *The Economics Profession in Pakistan*: *A Historical Analysis* (unpublished paper).

strong. Furthermore, the external conditionalities were not strictly enforced and could not have, in any case, served as a substitute for strong political will and decisive political leadership. The constraints on policy making were also growing because over time, the vested interests—notably the industrialists, large landowners and urban elites—became more powerful as their wealth grew and their ability to influence distorted but complex systems of taxes and subsidies became stronger. Finally, under the long period of military rule under Zia, the lack of participation in the political processes and limited freedom of the press kept national issues from being debated. National public opinion could thus never be mobilised, and there was no real consensus on development priorities or direction of development.

Our review of economic policies during various political regimes suggests that while there were major policy mistakes in the 1950s and 1960s, there were also solid policy accomplishments and strong institutional growth. The foundations for much sustained growth in the subsequent two decades was laid during the sixties. Economic policies during the 1970s weakened the basis of long term growth by crippling the private sector and weakening the public sector development institutions. Policies of the 1980s did little to restore the fundamentals for high long term growth and did not halt the institutional decline that set in after 1970. Genuine policy reform efforts in the 1990s were stymied by the growing power of vested interests, further decline in effectiveness of government machinery and a general inability to enforce financial discipline.

Governance Problems

A discussion of economic policy performance cannot be complete without a reference to the problems of governance which have seriously hindered economic management especially in the period since the mid-1980s. Some of these problems, increasingly weak institutional capacity, reduced effectiveness of public spending, growing abuse of resources in the public sector financial institutions, have already been mentioned above. Worsening performance of public sector institutions in allocation and use of funds has been accompanied by increasing difficulty of resource mobilisation. That the tax collection machinery is not very effective and tax evasion has been increasing is clearly demonstrated by the stagnant ratio of tax revenues to GDP notwithstanding huge additional taxation undertaken in the 1990s. Apart from tax evasion, the diversion of public resources is also reflected in default on bank loans, unpaid utility bills, and theft of electricity and other services provided by public sector entities. The growing scale of this diversion of resources has been made possible only by a general rise in the level of corruption among public officials and a general deterioration in the quality of public servants not unrelated to a sharp decline in their real wages.

The current governance problems have several causes. At a general level, increasing breakdown of law and order and the failure of the legal system to provide timely recourse have undermined the authority of the state. The rapid expansion of illegal activities such as narcotics trade, increasing size of the informal economy and relatively slow growth of the modern sector have adversely affected tax collections. The widespread perception among the public that the top leadership was not honest and dedicated has contributed to a decline of moral values. The present governance problems have also their roots in the pattern of economic development over the last fifty years. The uneven distribution of growth benefits and increasing dualism in the society are reflected in the sharp contrast between the growing numbers of poor and illiterate on the one hand and increasing sophistication and wealth of the elites and upper-middle classes on the other. The divergence[21] in the lifestyles between the rich and the poor is normal in the early stages of capitalist development. In Pakistan, however, this divergence appears to have become especially pronounced in recent years as economic growth slowed down, real wages tended to fall and the incidence of poverty probably increased. Equally important, the government policies which have neglected the social sectors and bestowed unearned benefits on industrialists and entrepreneurs have aggravated income disparities. It is not, therefore, altogether surprising that tensions within the society have grown over time and have begun to erupt with increasing frequency in ethnic, sectarian and random violence.

While an improvement in the law and order situation is necessary for stimulating investment and growth, the pattern of future growth must seek to ensure that some of the underlying causes of tensions in the society, i.e., poverty, illiteracy, and growing income disparities, are removed or mitigated over time. As Pakistan looks to the future, the growth and governance agendas appear to be inter-twined. Without an improvement in the quality of governance and a reversal of the decline in public institutions it will be difficult to revive economic growth. But the challenge also is to revive economic growth in a manner and with a set of polices that will correct the imbalances of the past, seek to restore greater harmony in the society and help deal with the governance issues such as corruption and law and order.

Learning from the Past

The economic issues that Pakistan now faces are very real and can be traced to the failures of past policies and lack of institutional development. Relatively, high growth has not ensured sustainability or a fair sharing of growth benefits. Though the

[21]This divergence is reflected, among other things, in the educational opportunities for the various classes. As a general rule, the lower-income groups cannot afford the better-quality private schools for their children and have to be content with cheap but poor-quality public schools. In the rural areas, even access to public primary education cannot be taken for granted. On the other extreme, probably a large majority of the students from upper-middle and high-income families go abroad for college-level education.

income distribution statistics do not fully reflect this, wage, employment, poverty and access to the social services figures clearly suggest that higher income groups have enjoyed disproportionate benefits from the high overall growth. Equally seriously, they have not contributed adequately either to domestic savings or government revenues. As a result Pakistan has a low rate of investment in physical and human capital but has an extraordinary dependence on external resources for even this low level of investment.

Clearly the future cannot be like the past. Because of stagnant investment levels, inadequate human resource development, structural weaknesses in industry and exports, limited prospects for additions to irrigation water availability in the near future, and the urgent need to reduce net foreign inflows to avoid a major debt crisis, high growth rates of GDP cannot be taken for granted. At the same time the growing divisions in the society make it imperative that policies give more attention to basic education, job creation and poverty reduction. A broad national consensus on economic strategy and development priorities is needed if the massive domestic resource mobilisation which is required is to be successfully undertaken. But this consensus will not be achieved, if the general public is not convinced that the benefits of future growth would be more equitably shared than in the past.

In seeking to restore growth and ensure a more viable pattern of growth, future policies must also draw on the lessons of the past. These lessons relate not only to economic management but also to, domestic politics, foreign policy, population dynamics and governance issues. First, the Pakistan experience does not belie the conventional wisdom that political stability and strong governments are conducive to the process of economic growth in developing countries. While the growth has been more or less steady throughout, the periods of most rapid growth were also the periods of relative political stability. Second, the strained relations with India have had a profound negative effect on economic and social development because of the competition between defence and development which has dominated resource allocation decisions for much of Pakistan’s history, the exception being the period 1954-65 when large scale US military and economic assistance greatly relieved the pressure on the fiscal position. Third, the failure to bring down the population growth rate has not only lowered the overall increase in per capita income but has also worsened the gap between the rich and the poor, limited the progress in social development and contributed to the difficulties of governance. In economic policy areas, the major lessons from the past are: the neglect of both domestic savings and exports has been very costly and has perpetuated both the heavy reliance on foreign savings and a low rate of investment, the lack of a clear, consistent and supportive framework for the private sector has hampered the development of modern industry while the structure of incentives and trade policies have favoured both import substitution and low value added activities, the eroding strength of public institutions and state owned entities especially banks have reduced the effectiveness of the public spending and distorted private sector investment decisions. Some of the failures of economic policies such as the low rate of domestic savings and persistently high fiscal deficits were closely linked to the broader issues of foreign policy and defence spending. But others, like the perpetuation of anti-export policies, the failure to evolve an effective tax machinery, the declining effectiveness of public expenditures (development and non-development), and the neglect of human resource development, were very much in purview of domestic policy.

Whether Pakistan can learn from its mistakes and set in motion the societal changes and policy adjustments to deliver a more balanced and equitable growth for its rapidly growing population during the next half-century remains a critical question. The massive majority with which the new Nawaz Sharif government was voted into power in February 1997 created at least the pre-condition for political stability which had been greatly lacking for quite some time.

But the economic record in the first year of the new government is far from reassuring. The government provided tax relief before strengthening the tax administration and ensuring the broadening of the tax base. The result has been a drop in the already low tax-GDP ratio. The government also showed inadequate appreciation of the structural constraints on economic growth, pinned its hopes on a quick economic turn-around, and did not prepare the public for the need for greater domestic savings, more self-reliance, and a period of painful adjustment. Finally, in creating a pro-business and pro-growth environment, the government was not seen as matching the interests of the rich against the poor. The challenges of job creation, poverty alleviation, and human development will be helped by a recovery in economic growth, but as the past experience suggests, growth alone will not ensure a reasonable distribution of income, adequate employment growth, or rapid social development.

Comments

1.

The paper is quite comprehensive and examines the growth of GDP, agriculture and manufacturing sector, fiscal and monetary policies, exports, imports, balance of payments, rate of inflation, etc. It is an interesting study and points out various distortions in the economic system but suggests very little as to how we can learn from the past mistakes. Why the economy performed so differently across different time-periods and what was its relationship with the respective policies have not been explored in the study.

The study mentions that Pakistan has not been successful in eradicating poverty. This is a sweeping statement especially in view of the fact that there has been a continuous decline in poverty upto 1987-88. It is only during the last decade that poverty has started rising. Why poverty declined in the earlier period and rose during the last decade, and whether the trickle-down theory led to reduction in poverty or safety-nets in the private sector or some other policies were instrumental in the eradication of poverty need to be analysed.

The study highlights the need for structural changes in the economy for sustainable growth. While there is hardly any disagreement about the need, the paper fails to specify clearly the structural problems and the ways in which it can be efficiently achieved.

A number of measures which might have resulted in higher growth during the Zia period have been mentioned by the author. However, improvement in productivity, especially in the public sector manufacturing industries, has been completely ignored.

Dr Hasan points out that social unrest against Ayub Khan was due to the fact that the investment rate had started falling. While private investment did fall, and could have resulted in a decline in output and employment, and in turn to unrest at a later stage, the unrest was essentially a reaction to the failure of growth to trickle-down to the masses. The wage rate had remained consistently low, and up to the mid-60s it had even been falling.

Dr Hasan makes the very interesting observation that fiscal deficit may have been higher by another 2 percentage points if the quasi deficit arising from the loss on forward cover to foreign currency accounts was accounted for. While the argument that it necessarily burdens the economy is correct, it must have not led to an increase in quasi deficit; the loss due to foreign currency accounts is already captured in the fall in the State Bank’s profits which become part of non-tax revenues to the government.

No doubt, the defence expenditure in the Zia period had gone up. This is also a fact that development expenditure had also gone down over time. However, Dr Hasan overdraws the case because the decline in development expenditure has been far less than that has been suggested because a number of corporations which are financing their own expenditures were earlier part of the Public Sector Development Programme (PSDP). Dr Hasan himself takes note of this problem when he addresses the budget deficit and says that a reduction in the budget deficit has been overstated. It would have been interesting to see to what extent the fiscal deficit declined if such corrections were made.

Slow growth of exports has been attributed to missed opportunities. But why these were missed and why the structure of export remains dependent on cotton-based exports has not been examined. It is suggests that it has been due to policy failures, but which policies failed and how those should be rectified has not even been mentioned.

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2.

It is indeed a great pleasure for me to be invited as a discussant on the paper by Dr Parvez Hasan who has had a distinguished career as a planner and development economist both within and outside Pakistan. He is among a small group of Pakistani economists who, after having gained prominence in policy-making roles in their own country in the first two decades of development, were called upon by international institutions to take up assignments in the formulation of development policies for other developing countries. It was a tribute as much to their personal attainments as to the prospects of Pakistan's development in the late 1960s and early 1970s. It has been my privilege to have known Dr Parvez Hasan since the early 1960s, when he began his career at the State Bank in Karachi and later joined the Planning Commission. Later, in Pakistan, he served as the Chief Economist of West Pakistan. Although our career paths never crossed, we do have the affinity of having Yale as our common alma mater.

Dr Hasan has given us an extremely well-woven, almost kaleidoscopic, account of the policy dilemmas, challenges, successes, and disappointments faced by Pakistan in the last fifty years. As someone who has directly or at least closely participated in decision-making at the policy level during many of those years—especially the period which was among the most promising in Pakistan's development—his account is both authentic and poignant. It reminds us of the past glories and achievements of Pakistan's development and underlines the regrets about things that could have been if Pakistan had persevered in pursuing the policies that held it in good stead in the difficult period of its initial struggle for existence and in showing the determination to carve out a place for the new nation against tremendous odds. Having acquired an international perspective after working at the World Bank for over two decades, much of which were spent in handling the problems of East Asia, Dr Hasan seemingly feels that Pakistan's economic fundamentals were much better than those of the latter, and had Pakistan followed some of the policies especially in regard to savings mobilisation and export growth that were pursued by *them*, it would certainly have achieved no less spectacular results. While this may be cavilled about by many on the grounds that East Asia's initial conditions in terms of literacy rates, land reforms, and other institutional factors were far better than Pakistan's, the role of policy environment remains important.

Nevertheless, Dr Parvez Hasan's detailed analysis of Pakistan's development over the last five decades and his comparison with other developing countries brings out the important fact that Pakistan's potential for growth is much higher than it has been possible for it to achieve in the last five decades, especially during the last decade or so. Even more, the paper regrets the flawed pattern of Pakistan's growth, which has now reached a proportion which makes growth unsustainable without recourse to the correction of major structural imbalances. Dr Parvez Hasan perceives the persistence of a "growth crisis" which in the past was somehow easily ignored, notwithstanding the lack of political stability and the poor record on social and human development.

Dr Hasan's catalogue of successes and failures of Pakistan's economic development may not be shared by everyone in its detail, nor perhaps would there be consensus on their underlying reasons, yet his assessment of Pakistan's past record and future prospects is undeniably cogent and well-argued. Shortage of time prevents me from doing full justice to his detailed analysis and, therefore, I will necessarily have to be selective in my comments.

Although Dr Parvez Hasan seems to subscribe to the widely-held and rather dangerous notion that in the case of Pakistan, democracy and development are negatively correlated, he is careful to qualify that it is empirically difficult to attribute the growth in one period to the decisions taken solely in that period and to ignore the cumulative effects of decisions taken in earlier periods, and therefore implies that such an association could be spurious. What he, however, fails to stress equally is that the legacy of negative effects of high growth achieved during periods of martial law (or variations thereof) always left a burden of institutional decay and disruption that held back the progress in development in the succeeding periods of democratic rule. With the sword of Democles of military intervention (or its surrogate) hanging over the politicians' heads, there was little time for institutional development and almost total preoccupation of the incumbent governments with survival in the perilous game of musical chairs, which has been played with disgusting regularity during the last decade.

If Pakistan's political development had taken place more smoothly and democratic institutions of governance had been allowed to take firmer root, perhaps the sacrifice of a few percentage points in growth over the two "golden decades" would have been worthwhile in the long-term perspective. In contrast, India's slower growth until the early 1990s, which has been termed as the "Hindu" growth rate, can at least partly be attributed to India's greater, though by no means spectacular, success in institutional, social, and human development. No wonder, therefore, that in the development race the cumbersome Indian tortoise has in recent years surprised the erstwhile sprightly Pakistani hare. Even Bangladesh, whose chances of survival as an independent country were discounted by its many detractors among us at the time of its independence, as much as were Pakistan's prospects 25 years earlier, has begun to look like a more credible prospect as a South Asian tiger than us.

THE COST OF HIGH GROWTH

Pakistan's abiding rapture with growthmanship has cost it dearly in terms of other desirable attributes of development. Income distribution, poverty alleviation, human resource development, domestic savings mobilisation, external debt redemption, and diversification of the industrial and export base have all suffered in the unrestrained pursuit of growth objective, which itself is now in jeopardy. By putting these other issues on the back burner and hoping that the trickle-down effect or some other fortuitous circumstance will take care of these issues, the planners grossly underestimated the problems that they were going to face.

At the end of the 1960s, some degree of self-doubt and disillusionment began to be articulated even by the country's leading growth protagonist, who voiced apprehensions about the emergence of "twenty-two" families. In February 1972, at the last meeting of the now defunct Pakistan Economic Association, a number of papers on income distribution and unemployment were presented, including, notably, one by the late Jawed Azfar. At about the same time, I, as a little known academic from one of Pakistan's universities (which Dr Parvez Hasan rightly points out were badly neglected), published a paper on poverty in Pakistan, which Dr Hasan's paper graciously takes note of, although it has been superseded by much more recent and technically superior research. Unfortunately, the political regime that succeeded Ayub Khan was strong in populist rhetoric and obsessed with power but very weak in economic and social planning. It hardly had the time to heed or had use for any kind of research or advice. The infrastructure of macroeconomic management weakened through political interference and the regime's increasing political alienation from the West—which also caused a large-scale exodus of economic and other technical experts, including Dr Parvez Hasan himself. Thus a major opportunity to change the course of our short economic history and steer the economy on a more balanced pattern of development was missed.

While Bhutto's regime made a number of inexcusable mistakes, including that of following across-the-board nationalisation of industries and financial institutions, it must be credited with, as Dr Hasan's paper rightly does, with initiating a number of infrastructure and heavy industry projects, which were neglected in the past and which had a positive impact on growth in the 1980s. The period 1977–85 is acclaimed as a second period of high and stable growth in Pakistan. However, ironically, this was also a period in which the cause of long-term development suffered the most. As a result of the military regime's need for legitimising its existence, decision-making became increasingly *ad hoc* and devoid of long-term perspective, a point Dr Parvez Hasan's paper does not fail to acknowledge. In addition, democratic institutions were frozen or disrupted, debate and dissent were stifled, and extremist religious tendencies were encouraged. The prolonged and deep involvement in the Afghan conflict and the infusion of drugs and Kalashnikovs into our economy and political culture had debilitating effects on our longer-term development, institutions, and values, which continue to be felt even more than a decade after that period. Growth and investment during the Zia period was stimulated by a large inflow of remittances and foreign aid inflows with little impact on the domestic production structure.

During the last decade or so, and until last February, Pakistan has seen a period of high political instability. In the last ten years, we have had almost as many Prime Ministerial changes and half as many caretaker government and four elections. To what extent this political instability has contributed to the slowing down of our growth rate in the same period is difficult to say, although it is unlikely to have been marginal. The elected governments that have since been in and out of office have faced an incredibly difficult task as each successive government has tried to outdo its predecessor in making promises that can hardly be fulfilled and then deciding to decamp with the loot when the end was in sight. On a more serious level, each has inherited an increasing set of unsolved problems, especially the core problem of rising fiscal deficits and the associated problem of servicing the external debt burden. The governments have been caught in a vicious circle in which the lack of resources leads to its diminishing credibility as an agent of economic and social change, which in turn makes it more ineffective in mobilising the needed resources for development. Elected governments do have political constituencies and need to spend money to honour their electoral pledges. Unfortunately, in Pakistan this has not been done in a transparent or judicious way. Although the populist agenda which was introduced in the early 1970s has gained wide political endorsement and even donor support, the funds spend on the social sector, poverty alleviation, and human resource development programmes have largely leaked through to unscrupulous political power-brokers and the country has seen little improvement in its leading social indicators. The increased involvement of the NGOs and social activism have, to some extent, improved the access of the poor to basic social facilities. However, the danger of emergence of a new non-governmental bureaucracy, which would in time become as far removed from the problems of the poor as the more traditional one, can not be ruled out. These and other problems under the now popular rubric of governance are, however, not adequately discussed in Dr Hasan’s paper.

The last decade of Pakistan’s existence has also been a period in which as many as four structural adjustment programmes have been negotiated and none of them has run its full term so far because of the government’s inability to meet the conditionalities. Dr Hasan’s paper does not go into the problems of structural adjustment faced by Pakistan during the last decade, and the reasons why such efforts have failed. He does, however, make the very significant point that the role of international organisations like the World Bank and the IMF to give advice and set up policy agendas has grown disproportionately to the growth in the indigenous capacity to critically receive such advice. Indeed, the world over, as most recently illustrated in the tough negotiations of the IMF with Korea, the capacity to negotiate with these agencies is becoming a critical factor in ensuring the prospects of growth under structural adjustment programmes. This requires not only an able Finance

Minister and one or two competent deputies, which we do fortunately have at the moment, but also an entire infrastructure of teaching and research in the complex problems of a globalised economy. Pakistan's continued neglect in developing such a capacity at all levels has eroded what exists to an intolerably low point. It calls for an all-out effort to remedy the situation. By raising this important issue in his paper at this forum, Dr Hasan has done a great service to the economics profession, and I hope, Mr Chairman, you, whom the profession regards as one of its own, will urgently take measures to remedy the situation, especially with the strong possibility of your assuming the highest office in the land.

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