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Institutions, Economic Growth, and Participatory Development

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1. Introduction

This chapter provides a new perspective, located in institutional economics, on the nature of the structural constraints to achieving sustained economic growth in Pakistan and overcoming poverty. It argues that the fundamental factor underlying the failure so far to embark on the process of sustained economic growth is the economy's rent-based institutional structure and associated patron-client-based governance model.

The institutional structure generates rents for a small coalition of elites by restricting competition and excluding the majority of people from the process of saving, investment, and high-wage employment. The consequent narrow base of economic growth is unequal; it is also incapable of being sustained because of lack of incentives for competitive efficiency and innovation on one hand and a low savings rate and export growth on the other. This chapter argues that sustainable economic growth can be achieved through an institutional change whereby the process of saving, investment, productivity increase, and income generation can be broad-based to include the poor and the middle classes.

Section 2 critically examines the neoliberal view that markets are self-regulating and necessarily produce efficient outcomes. Section 3 analyzes the institutional factors underlying the pattern of economic growth, endemic poverty, and slow growth in both export-based manufacturing and agriculture. Section 4 argues that elite-dominated

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power structures at the local level make markets as well as the provision of public services asymmetric with respect to the rich and the poor. Some of the main institutional factors underlying the asymmetry of markets and the provision of public services such as health, education, and justice are examined briefly. Section 5 presents an alternative approach: creating new institutions through which poverty reduction can be built into the structure of the economic growth process to make it both equitable and sustainable. Section 6 discusses one of the dimensions of this institutional initiative—participatory development—in the context of the nature of poverty and the processes through which the creative energies of the poor can be harnessed. In this new growth process, the poor and the middle classes become active subjects rather than merely passive recipients of an uncertain “trickle-down” effect.

2. A Conceptual Note: Are Markets Necessarily Efficient?

Over the last four decades, the view that markets necessarily deliver efficient outcomes and are self-regulating gained ascendancy in the corridors of power in academia as well as the sphere of public policy. The lessons of the Great Depression of the 1930s were set aside and neoliberal economics became the framework for policy thinking. It prescribed nonintervention in markets on the grounds that market regulation was inefficient, except central bank control of the money supply. This led to policies deregulating markets and fostering privatization, reducing the public sector’s role and allowing the private sector free play.

Hussain (2006) has critiqued the neoliberal view that markets are self-regulating and should be allowed to function unfettered in the context of Pakistan. He argues that the view that “markets are self-organizing and self-regulating” implies “a physiology of markets where the dynamics of the market organism ... are independent of the specific history, institutional framework and the process of cultural change of any particular country.” Yet the process of self-regulation as the neoliberal view suggests is a messy and chaotic business, and “would necessarily occur in the concrete historical and cultural context of a particular country.”

How long the mess would last and what the magnitude of the chaos would be cannot be predicted by “market developers, but would be discovered by the people of that country.” On the basis of earlier research, Hussain (2006) suggests that

what are referred to in the literature as 'market distortions' are not marginal but may be central to the functioning of a significant part of the market space in Pakistan. The asymmetric nature of factor and product markets and the consequent allocative and distributional inefficiency may be organic to the nature of markets as they exist in the specific historical and social context of Pakistan.

Two years later, the world economy was struck by the greatest economic crisis since the 1930s. Under the influence of neoliberal economics, the US Glass-Steagall Act 1933, which forbade retail banks from engaging in risky investment activities such as selling securities, was repealed in 1999 (Skidelsky, 2010, p. 7). Such market deregulation was a key factor responsible for the world economic crisis in 2008. The neoliberal thesis that markets are self-regulating proved to be spectacular folly with tragic consequences for human societies across the capitalist world.

Neild's (2009) seminal study provides a powerful critique of economic orthodoxy, which he calls the general theory of market economics. He argues: "the problem is that competitive endeavour can run wild if it is not prudently constrained and policed by government. The orthodox theory of market economies has failed to provide adequate guidance as to why and how constraint should be applied" (p. 1).

Just as the Great Depression of the 1930s as indeed the current world economic crisis have made clear, markets as they exist are subject to periodic failure not because of "market distortions" but because of the structural imperfections that are organic to their actual functioning. These include individual choice with imperfect information, the absence of an adequate self-correcting mechanism, and the unequal distribution of power where large economic organizations are interlinked. They can make highly risky individual decisions that can have a major impact on the economy as a whole. Investment decisions by individuals and organizations are based on the probability of individual rather than systemic risk, which can lead to greater risk in investment choices than any one individual economic actor is able to estimate. Spence (2009) points out that, in a situation where individual risks are positively correlated and where the distribution of individual risk is changing, estimating systemic risk becomes inherently difficult.

In the case of Pakistan, the neoliberal idea is that incentives for innovation and risk taking will necessarily lead to the emergence of

dynamic entrepreneurs, who will then lead the economy to sustained high GDP growth. As Hussain (2006) argues, this view ignores the possibility that entrepreneurs in Pakistan respond not simply to profit incentives and the presumed discipline of the market, but to a matrix of institutions that embody both formal and informal rules. "The latter are contained in norms and culture that change much more slowly than government policy. The economic elite in the areas that now constitute Pakistan has historically functioned within a patron–client model of governance since the late 18th century" (Hussain, 2006, p. 3). As Ali (2003) suggests, underlying the apparent discourse of modernity is the notion that neither the polity nor the economy has made a fundamental break from the past.

3. Institutional Structure and Unsustainable Economic Growth

3.1. Governance Model and Rents

Central to the problem of unsustainable growth is a governance model where the institutional structure systematically generates rents for the ruling elites. North, Wallis, and Weingast define rents as unearned income that accrues to an economic asset when the benefit from its use exceeds its opportunity cost (2009, p. 19). In Pakistan, power has been historically constituted through rents by establishing patron–client relationships within a structure of dependency. In order to build political support, the ruling elites appropriate and use state resources for arbitrary transfer as rents to selected individuals and groups.

The rent-based model of governance originated under the British Raj in the 19th century, when the exigencies of establishing order required a convivial relationship with the new agrarian elite in the Punjab. This new elite had emerged following the peasant revolts in the late 18th century when the preceding Mughal elite was overthrown and replaced by the leaders of the revolt from among the upper strata of the peasantry (see Ali, 1988, 2003).

In the process of establishing colonial power, the British government consolidated the position of the new peasant lineages through revenue settlements that formalized the proprietorship of the new *zamindars* over land. Rent transfers in the form of resource gratification for the new agrarian elite was unprecedented in Indian history, and was accompanied by the British government's development of the canal irrigation system and the associated process of agriculture colonization in the late 19th century. These areas were appropriated by the government as

Crown waste to be utilized or disposed of at administrative or political discretion. Landholdings of between 100 and 500 acres were granted to existing members of the landed elite who were loyal to the Raj. Some particularly favored individuals received much larger holdings (Hussain, 2008b).

Post-independence, the governance model and underlying institutional structure continue to systematically generate rents for the coalition of elites that had emerged. These included the landed elite of the pre-Partition period as well as the military, bureaucracy, and a state-supported nascent entrepreneurial elite. Particular forms of rents have characterized the policy and power framework of each government in the post-independence period. For example, in the first decade after independence, the principal form of rent was the grant of “evacuee” property by the government to selected migrants from India.

During the Ayub Khan period (1958–68), various forms of rent emerged through the regulatory economic policy framework. The modes of rent transfers that were made to a small industrial and commercial elite during this period included: direct and indirect subsidies, protectionist import controls, cheap imported machinery and raw materials through an overvalued exchange rate and subsidized credit to favored entrepreneurs who were granted licenses to establish commercial and industrial enterprises.

During the Z. A. Bhutto period (1973–77), the main forms of rent consisted of lucrative appointments in the nationalized sector to favored individuals, government contracts, and bank loans. Rents were also transferred to loyalists through the new system of “lateral entry” where individuals could be granted direct entry at various levels into the elite Civil Service of Pakistan. Perhaps the largest source of rent transfers to a broad range of upper, middle, and working classes was conducted through the state-sponsored export of human resources to the Middle East (Hussain, 2008b, p. 40).

During the Zia-ul-Haq period (1977–88), a new form of rent generation emerged with the inflow of multibillion-dollar economic and military aid to Pakistan when it was positioned to play a frontline role in the US-sponsored Afghan jihad against Soviet troops in Afghanistan. The Pakistan government acted as a conduit for funds and weapons to support the war, during which a significant proportion of these funds and the sale

of some of the weapons enriched individuals and groups favored by the government.

Under the Benazir Bhutto and Nawaz Sharif governments, the principal form of rent was the alleged siphoning of large funds from public sector banks, insurance companies, and investment institutions such as the National Investment Trust and the Investment Corporation of Pakistan. During the Musharraf government, the government allegedly manipulated stock markets to enrich insiders through the funds of banks and companies in the nationalized sector (Hussain, 2008, p. 39).

3.2. Institutions and the Pattern of Economic Growth

Despite over six decades of economic growth post-independence, mass poverty persists in Pakistan. This is because of an institutional structure characterized by rent generation for the elites; a highly unequal distribution of productive assets; and the exclusion of the majority of people from access to productive resources, capital markets, and high-wage employment. Consequently, the process of saving and investment is restricted to a small consumption-oriented elite coalition that has failed to generate adequate savings and high rates of investment. At the same time, the constrained competition characteristic of such an institutional structure (North et al., 2009, p. 17) while generating rents for the elite creates disincentives for diversifying exports toward high value-added growth. Thus, two key constraints to sustaining high rates of GDP growth have emerged: (i) a low savings rate and (ii) slow export growth.

Table 1 provides evidence on gross fixed capital formation (GFCF) as a percentage of GDP in the private and public sectors under various political regimes during 1960–2010. The table shows that private sector gross investment as a percentage of GDP has remained low for the last five decades under all political regimes, military or civilian. In six out of the eight periods, private sector gross investment was below 10 percent and reached about 14 percent during the Musharraf regime. Total gross investment (private plus public) has also been low, varying between about 12 percent during Prime Minister Yousaf Raza Gillani’s regime to about 18 percent during the Musharraf regime.

Table 1: GFCF as a percentage of GDP and GDP growth rates, 1960–2011

| Average | GFCF as a percentage of GDP | Annual GDP growth |
|---------|-----------------------------|-------------------|
|---------|-----------------------------|-------------------|

| during | Private | Public | Total | rate (period average) |
|-----------|---------|--------|-------|-----------------------|
| 1960–73 | 8.21 | 7.26 | 15.47 | 6.26 |
| 1973–78 | 4.79 | 10.71 | 15.50 | 4.99 |
| 1978–88 | 7.10 | 9.66 | 16.76 | 6.6 |
| 1988–93 | 9.22 | 8.73 | 17.95 | 4.92 |
| 1993–98 | 9.32 | 7.36 | 16.68 | 3.14 |
| 1998–2008 | 11.23 | 3.72 | 14.95 | 6.25* |
| 2008–11 | 10.85 | 1.34 | 12.19 | 2.62 |

* Refers to the period 2002–08.

Source: *Pakistan economic survey* (various issues).

At existing levels of income inequality, Pakistan requires a GDP growth rate of about 8 percent to have a substantial poverty reduction impact. To sustain a long-term GDP growth rate of 8 percent, investment as a percentage of GDP needs to be about 32 percent, given the incremental capital–output ratio (ICOR) of about 4. If Pakistan is to move onto a high-growth trajectory and reach the required investment target of 32 percent, while increasing the growth elasticity of poverty reduction, then a change in the institutional structure for broad-based investment is necessary. This will require institutional changes through which the middle classes and the poor can be enabled to engage in the process of saving, investment, productivity increase, and innovation.

The New Institutional Economics literature shows that a defining feature of developed countries is their ability to sustain per capita GDP growth over long periods, while underdeveloped countries achieve brief spurts of per capita income growth but are unable to sustain it over longer periods (North et al., 2009, p. 6). The evidence shows that a fundamental factor underlying the characteristic failure of underdeveloped countries to sustain high GDP growth rates is their rent-based institutional structure, which inhibits broad-based competition, investment, productivity increase, and innovation.

The history of Pakistan’s economic growth performance shows a structural inability to sustain growth. As Table 1 indicates, growth has occurred in brief spurts followed by sharply declining GDP growth. Relatively high GDP growth rates were achieved mainly during the military regimes when large concessionary capital inflows from the West were available to fuel growth. The average annual GDP growth during the military regimes of Ayub Khan and Yahya Khan (1960–73) was 6.26

percent, which declined to 4.99 percent in the subsequent period of Z. A. Bhutto's government (1973–78).

GDP growth accelerated again to 6.6 percent during the Zia-ul-Haq period (1978–88), followed by a sharp decline in the subsequent democratic interludes of Benazir Bhutto and Nawaz Sharif (1988–93 and 1993–98, respectively). Another spurt occurred during the Musharraf period (1998–2008) when GDP growth reached 6.25 percent, declining sharply to 2.62 percent under the subsequent government of Yousaf Raza Gillani (2008–11). It is clear that each of these spurts was followed by a decline in growth. At the end of each high-growth period, the structural constraints of a low domestic savings rate and slow export growth were manifested in fiscal and balance of payments pressures, which induced a subsequent slowdown in GDP growth.

3.3. Low Savings Rate, Taxation, and Inequality

Given the rent-based governance model in Pakistan, the business elite enjoys various forms of financial support from the government (subsidies, cheap credit, import protection, tax exemptions). It is not surprising, therefore, that entrepreneurs—many of whom are also landowners—following the tradition of the landed elite, engage in conspicuous consumption and tend to have a low propensity to save.

Historically, the domestic savings rate in Pakistan has been less than the investment rate, thereby creating a persistent savings gap that has induced growing national debt, particularly during high GDP growth periods. For example, average annual domestic savings as a percentage of GDP during 2001–2007 was 16.5 percent. By contrast, the investment rate required to sustain the target growth rate of 8 percent with an ICOR of 4 is 32 percent (Pakistan, Ministry of Finance, 2007, p. 11, table 1.6). The consequent debt-servicing problem has now become a constraint to growth just as it was in the Ayub period in the 1960s and in the Benazir and Nawaz periods in the 1990s. The low savings rate and consequent dependence on foreign inflows is a major factor in the stop-go pattern of GDP growth in Pakistan's history.

The high debt-servicing requirements resulting from the rent-seeking elite's tendency to consume rather than save, while also avoiding direct taxes, has obliged successive governments to levy high and increasing indirect tax rates. An earlier study on the increase in the incidence of the tax burden shows that the increase in the tax burden as a

percentage of income was highest at 6.8 percent for the lowest income group (less than PRs 700 per month) and lowest for the highest income group (at -4.3 percent, over PRs 4,500 per month). The evidence shows that, over time, the tax burden on the poor has increased and declined for the rich (see Pakistan, Ministry of Finance, 1997, p. 6). Thus, the rent-based governance model and its incentive systems have induced a pattern of elite consumption and government tax policy that reinforces income inequality in the growth process.

Given the highly unequal distribution of productive assets in Pakistan, interpersonal inequality has risen in recent years. The Gini coefficient for income, which was 0.27 in 2000/01 (World Bank, 2005, p. 281), has increased over the last decade; the average for the period 2000–11 is 0.327 (United Nations Development Programme, 2011, p. 137). Even this level of inequality is understated because the top decile of the population tends to understate their income and expenditure to avoid taxes. Shahid Javed Burki has derived improved estimates of inequality in Pakistan on the basis of World Bank data. He suggests that the top 10 percent of the population holds 27 percent of the national income. The richest 18,000 people have an average income of USD 72,700 per capita, which is about 70 times the overall per capita income of USD 1,050 of the population as a whole.

As is now well known, the higher the initial income inequality, the lower the impact of GDP growth on poverty reduction will be. Pakistan's high and rising economic inequality has shaped the structure of the growth process whereby mass poverty persists despite the relatively high trend rate of GDP growth (5.5 percent).

3.4. Manufacturing, Export Structure, and Growth¹

In 1947, Pakistan inherited not only various state institutions with their underlying structures of power, but also the rent-seeking and risk-averse behavioral proclivities of the economic elite.

Pakistan's failure to adequately diversify exports—and hence the slow export growth and consequent perennial pressures on the balance of payments—is a structural constraint to sustaining high GDP growth. Even after 60 years of industrial growth, the percentage of total investment

¹ This section draws on Hussain (2008a).

channeled into textiles and related goods has not declined (it was 41 percent in 1964/65 and 44 percent in 1990/91). In terms of output, 80 percent of Pakistan's manufactured exports consist of textiles and clothing, compared to 12 percent for developing countries and 6.5 percent for the world as a whole (World Trade Organization, n.d.). The persistence of Pakistan's textile-based export structure is an important factor hampering overall export growth. This is because the composition of demand in the global market has changed: world trade in textiles is growing at a much slower rate than nontraditional manufactured exports.

Pakistan's textile industry, which has remained largely at the lower end of the value-added range, emerged in the 1960s as a result of large government subsidies. The institutional structure of policy created disincentives to innovation, productivity, and export diversification. By the 1990s, the structure of state support to industry had been substantially dismantled. However, even then, as late as 1990/91, as much as 7 percent of GDP was transferred by the government to industrialists in the form of subsidies (Kemal, 1999). The diversification of industry into higher value-added exports was constrained by government patronage on one hand and the lack of risk-taking dynamism among most industrialists on the other.

For the manufacturing sector as a whole, the major elements in the current institutional structure that constrain investment and growth are as follows.

- **The continued threat to citizens' lives and property due to persistently poor law and order.** The total number of terrorist attacks and other incidents of political violence in Pakistan increased from 254 in 2005 to 2,386 in 2008. The direct and indirect costs of the war on terror during 2005–08 have been estimated at PRs 2,083 billion, with the average annual cost being 4.34 percent of GDP (Institute of Public Policy, 2009, p. 76, table 4.7).
- **High electricity tariffs and frequent power outages.** These incurred an estimated overall cost to the economy of PRs 1228 billion in 2011–12 which was 6.3 percent of GDP in that year. (Institute of Public Policy, Sixth Annual Report 2013, p. 86).
- **The adverse incentive/disincentive structure within the institutional framework and an inadequate technological base.** These have constrained industry from responding flexibly as the global pattern of demand changes toward higher value-added and knowledge-intensive products.

- **The adverse policy environment of the past.** Tariff and export incentives have been distorted against those entrepreneurs seeking to improve quality and productivity for export growth (Pakistan, Planning Commission, 2010).
- **A weak enforcement mechanism within the government with respect to trademark regulations and tariffs.** This has led to the widespread dumping of smuggled, poor-quality, and extremely low-priced imported goods from China, which are in many cases counterfeits of branded Pakistani manufactured goods (Pakistan, Planning Commission, 2010).

3.5. Institutional Factors in Slow and Unstable Crop Sector Growth²

In agriculture, the average annual growth rate of major crops declined from 3.34 percent during the 1980s to 2.38 percent in the 1990s. The frequency of negative growth years for some of the major crops has also increased, accentuating the process of poverty creation. In a year of negative growth (i.e., a bad harvest), small farmers operating at the margin have to borrow to meet their consumption requirements, and thus fall into debt. In the following season, in the absence of an investible surplus, they are unable to reconstitute the production cycle and, hence, slip into poverty. Thus, the instability of crop sector growth and increased frequency of negative growth years has become a structural factor in poverty creation.

Underlying this phenomenon are five major institutional constraints. The first is reduced water availability at the farm gate due to poor maintenance of the irrigation system and low irrigation efficiencies of about 37 percent. While the availability of irrigation water has been reduced, water requirements at the farm level have risen due to increased salt deposits on the topsoil and the consequent need for leaching.³ The resulting large water deficit means that farmers even in the irrigated areas are dependent on rainfall. Given the vicissitudes of weather—particularly due to global warming, which has caused wide variations in the timing, location, and quantum of rainfall—rain does not always fall in the right

² This section draws on Hussain (1999).

³ About 33 million tonnes of salts are annually brought into the Indus Basin irrigation system, out of which 24 million tonnes are retained (see Pakistan, Finance Division, & Pakistan, Planning Commission, 2001, p. 23).

quantity at the right time for water-deficit farmers. Consequently, there is greater instability in crop sector output than before (Hussain, 1999).

What makes the improved efficiency of irrigation even more important is that the extensive margin of irrigated acreage has been reached, so that future agricultural growth will have to rely on improving the efficiency of water use and other inputs. Thus, the rehabilitation of Pakistan's irrigation system to improve irrigation efficiency has become a crucial policy challenge for sustainable agriculture growth.

It is well known that high-yielding seed varieties gradually lose their potency through reuse, the changing microstructure of soils, and the changing ecology of micro-organisms in the topsoil. The average age of wheat seed in Pakistan is 11 years compared to 7 years in all developing countries (Hussain, 1999). Therefore, breeding more vigorous seed varieties adapted to local environmental conditions and diffusing these among farmers through an effective research and extension program is necessary.⁴

The possibility of declining yields per acre related to global warming indicates a new dimension of the imperative of improving research capability in the crop sector. Given the sensitivity of wheat seed to temperature increase, even a two-degree-centigrade increase in average summer temperatures could mean an absolute yield decline of between 10 to 16 percent during the 21st century.⁵ With a 2.8 percent population growth rate, a decline of 10 percent in yield per acre associated with global warming could mean serious food deficits and high food inflation rates for Pakistan, with greater adverse consequences for the poor. Indeed, the United Nations' Intergovernmental Panel for Climate Change (2007) predicts a 30 percent decline in the yield per acre of food crops in South Asia. It is, therefore, necessary to develop heat-resistant varieties of food grains through an institutional framework for collaboration between agriculture research centers across South Asia

⁴ Yet there is no organized seed industry in Pakistan to meet farmers' needs for the supply of vigorous varieties of seed, even for the major crops. Compared to India, there was a sharp decline in total factor productivity growth in Pakistan after 1975, which can be attributed to the poorer level of research and extension in Pakistan (see Rosegrant & Evenson, 1993).

⁵ If atmospheric carbon doubles, average summer temperatures in Pakistan are expected to increase by 1.5 to 4.5 °C (a base average of 2.5 °C) over the next 70 years. This could lead to a decline in wheat yields from 10 to 60 percent, depending on the type of wheat seed, planting time, and related atmospheric/weather conditions (see Qureshi & Iglesias, 1992).

One of the most important constraints to sustainable growth in the crop sector is soil degradation resulting from improper agricultural practices such as: (i) lack of crop rotation and the resultant loss of humus in the topsoil, (ii) the stripping of topsoil and resultant loss of fertility associated with overgrazing, and (iii) water erosion along hillsides and riverbanks due to the cutting down of trees and depletion of natural vegetation. According to one estimate, over 11 million hectares have been affected by water erosion and 5 million hectares by wind erosion (Mian & Mirza, 1993).

4. Institutions, Markets, and Public Services

This section examines four features of the power structure that makes markets asymmetric to function adversely against the poor.

4.1. Power, Tenancy, and Tied Labor

In areas where landowners control the local state apparatus as well as the credit market, poor tenants are locked into a nexus of power and debt bondage with their landowners. Consequently, the tenants are obliged to work part time on landowners' farms as laborers either at less than market wage or no wage at all. The Pakistan National Human Development Report (PNHDR)'s survey data shows that 51 percent of tenants get locked into debt dependence on their landowner; out of these, 57 percent are obliged to work as laborers on the landowner's farm without wages, while 14 percent work for a wage below the market rate (Hussain, Kemal, Ali, Hamid, & Mumtaz, 2003, p. 63, table 14). This structure of power and dependence creates distortions in the labor and capital markets, which systematically deprive the poor of their actual and potential income. The consequent inefficiency in the allocation of labor and capital resources constrains agricultural growth, increases inequality, and engenders persistent poverty (see Table 2).

Table 2: Loan dependence on landowners and labor exploitation of the poor peasantry

| Status | Extremely poor | Poor | Nonpoor | Total |
|--------------------------------------|----------------|------|---------|-------|
| Loan from landowner (%) | 50.8 | 29.4 | 11.7 | 34.4 |
| Work for landowner against wages (%) | 14.0 | 24.3 | 5.1 | 16.9 |
| Daily wages (PRs) | 28.0 | 43.6 | 60.0 | 40.0 |
| Work for landowner without wages (%) | 57.4 | 38.5 | 25.4 | 43.5 |

Source: National Human Development Report 2003; Poor Communities Survey of Pakistan 2001 (Pakistan Institute of Development Economics).

4.2. Power and the Double Squeeze on the Peasantry

In landowner-dominated areas, a landowner's power affects the disposal of the produce by poor farm households, which has direct consequences for their food consumption. As Table 3 shows, under asymmetric tenure arrangements, extremely poor farmers are obliged to pay a larger proportion of their farm produce to the landowner as rent compared to other categories of the peasantry. For example, the extremely poor have to pay 28.21 percent of their production value to the landowner compared to 13.39 percent by poor households and only 8.41 percent by nonpoor households. Consequently, the extremely poor are forced to keep only 39.59 percent of their crop output for household consumption, compared to 48 percent by the poor and 54 percent by the nonpoor.

Table 3: Disposal of crop harvest by income class

| Economic status | Total production value | Paid in kind to labor | Paid as rent | Paid to landowner under share cropping agreement | Given to relatives | Crop sold | Crop kept for own use/total production value*100 |
|-----------------|------------------------|-----------------------|--------------|--|--------------------|-----------|--|
| | | | | | | | |
| Extremely poor | 13,864 | 1.45 | 1.10 | 28.21 | 0.09 | 29.57 | 39.59 |
| Poor | 22,538 | 2.76 | 1.40 | 13.39 | 1.06 | 33.27 | 48.12 |
| Nonpoor | 37,626 | 4.70 | 0.83 | 8.41 | 1.61 | 30.02 | 54.43 |

Source: National Human Development Report 2003; Poor Communities Survey of Pakistan 2001 (Pakistan Institute of Development Economics).

The evidence suggests that poor tenant households face a food deficit near the end of the year due to the relatively small crop share they have been able to retain. As they run out of their household stock of food grain, they are obliged to purchase grain in the market at the year's end when market prices are relatively high.⁶ Such households then need to borrow for food consumption. The PNHDR evidence supports this

⁶ An analysis of the mechanisms of poverty generation in the rural areas (with special reference to the Punjab) was first conducted on the basis of a 1978 field survey. See Hussain (1988, chap. 5, pp. 101–176).

argument, and shows that extremely poor households borrow to meet their food consumption needs (Hussain et al., 2003, chap. 3, table 1).

Poor farm households are thus placed under a double squeeze. In the first instance, they are obliged to give up a relatively large proportion of their crop output as a crop share to the landowner. The second squeeze is a result of seasonal variations in the market price of grain, which forces extremely poor households to purchase a relatively large proportion of their food consumption requirements from the market near the end of the production cycle, when prices are high (Hussain, 2004, pp. 76–77).

4.3. Adverse Changes in Tenancy Arrangements and Poverty

As the evidence suggests, since the majority of the rural poor are tenants, any deterioration in tenancy arrangements would be expected to accentuate their poverty. The weakening relative power position of poor tenants means that tenancy arrangements have changed adversely for them. They now have to bear a higher proportion of input costs than their landowners on tenant-operated farms. As Table 4 shows, tenants' contribution to input costs (for each of the major crops)—such as tractor rental (see Hussain et al., 2003, p. 64, table 16), hired labor, and seed and fertilizer—increased during 1990/91 to 2000/01.

Table 4: Tenants' contribution to inputs (percent)

| Economic status | 1990/91 | | | | 2000/01 | | | |
|-----------------|---------|-------|------|------------|---------|-------|------|------------|
| | Tractor | Labor | Seed | Fertilizer | Tractor | Labor | Seed | Fertilizer |
| Extremely poor | 36.3 | 13.8 | 24.8 | 26.0 | 43.5 | 28.5 | 31.0 | 31.8 |
| Poor | 29.5 | 18.8 | 22.8 | 24.5 | 41.3 | 30.5 | 34.5 | 34.0 |
| Nonpoor | 39.8 | 25.8 | 28.8 | 27.3 | 44.5 | 32.8 | 38.8 | 34.5 |
| Total | 34.3 | 22.5 | 24.8 | 25.5 | 42.8 | 30.3 | 34.0 | 33.3 |

Source: National Human Development Report 2003; Poor Communities Survey of Pakistan 2001 (Pakistan Institute of Development Economics). For crop-wise figures, see Hussain et al. (2003, p. 64, table 16).

The above evidence suggests that the adverse changes in tenancy arrangements with respect to tenants' input contributions have become a significant structural factor in generating poverty. While the financial burden on poor tenants has thus increased, their lack of control over the timing of water application, combined with adulterated inputs, keeps the yield per acre low, thereby further squeezing their net incomes.

4.4. *Asymmetric Markets for Inputs and Outputs*

Hussain et al. (2003) argue that local elite power structures in rural areas distort markets in favor of the rich and against the poor. Poor peasants face input and output markets in which they have to pay a higher price for their inputs while receiving a lower price for their outputs than large farmers. The study shows that the latter lose as much as one third of their income due to asymmetric markets (pp. 65–68).

4.5. *Poverty and Illness*

Hussain et al. (2003) show that 65.1 percent of the extremely poor and 55.6 percent of the poor in the PNHDR's sample survey suffered from ill health due to inadequate diets and lack of access to safe drinking water and sanitation facilities. The data also shows that poor respondents reporting sickness at the time of the interview had, on average, been unwell for 95 days of the year (see table 5).⁷

The prevalence of disease among those who are slightly above the poverty line is a major factor pushing them into poverty. Those who are already poor are pushed deeper into poverty as a result of loss of income due to absence from work and high medical costs incurred by illness. Thus, unequal access to public health facilities and the relatively high prevalence of disease among the poor becomes a structural factor that accentuates both poverty and inequality (Hussain et al., 2003).

Table 5: Profile of the poor who are sick (household head only)

| Economic status | Sick at the time of survey (%) | Number of days of current sickness (mean) | Treatment expenses (PRs) | Patients traveling over 6 km for treatment (%) |
|------------------------|---------------------------------------|--|---------------------------------|---|
| Extremely poor | 65.1 | 94.9 | 1,885 | 49.4 |
| Poor | 55.6 | 27.4 | 497 | 29.5 |

⁷ They also relied predominantly on private allopathic medical practitioners due to lack of access to and the poor quality of most government hospitals. Private medical clinics, like government hospitals, have grossly inadequate diagnostic facilities and often poorly trained staff. The result is that when the poor fall ill, they suffer for a protracted period and are locked into a source of medical treatment that, despite being expensive, is frequently ineffective (see Hussain et al., 2003).

Source: National Human Development Report 2003; Poor Communities Survey of Pakistan 2001 (Pakistan Institute of Development Economics).

4.6. Education, Poverty, and Growth

The relatively low levels of literacy, high-school enrolment rates, and poor quality of both school-level and higher education in Pakistan compared to other South Asian countries indicates the low priority given to education. This is understandable in a country where the allocation of public resources and the institutional framework for translating them into outcomes are determined by a ruling elite dominated by the military, bureaucracy, and landowners.

This power structure affords greater priority to expenditures on the military, bureaucracy, and transfer of public resources as rents to various strata of the elite and its dependents. Building an institutional framework for higher education based on high-quality research is also not a high priority. Education requires resources and institutional mechanisms for high-quality teaching, research, and the infrastructure facilities to pursue these activities. At the same time, it is necessary to have an environment of intellectual freedom to pose and pursue new questions and to engage in critical thinking. This is inimical to a rent-based power structure that relies on authoritarian rule, whether in military or civilian form.

Although the literacy rate has increased sharply from 46 percent in 1999 to 54 percent in 2006, the gender gap remains high (23 percentage points) and has not changed significantly over the period.⁸ The gross primary school enrolment rate at about 70 percent has remained unchanged over the last two decades in spite of the multibillion-dollar Social Action Program of the 1990s. At the same time, almost 25 percent of the total population (over 40 million) consists of adult illiterates. Due to the relatively low school enrolment rates, the number of adult illiterates is expected to rise during the coming decade, thereby increasing poverty even if greater employment opportunities become available. In Pakistan, 91.6 percent of the labor force is unskilled (Majid, 1997, pp. 34–35), with low productivity and poor adaptability to technical change. This constitutes a significant structural constraint both to growth and poverty reduction.

⁸ Estimates based on Pakistan, Ministry of Finance (2007, pp. 161–174).

The survey evidence in the PNHDR shows that one of the key factors that can pull a poor household out of poverty is the presence of a second earner. The data indicates that the magnitude of the second earner's income depends on his/her level of education (Hussain et al., 2003). The poor coverage and quality of school education and vocational training in Pakistan thus constitutes a significant structural constraint to growth as well as poverty reduction. The extremely poor quality of higher education in most Pakistani universities and control of some of them by obscurantist and coercive religious groups is as much a constraint to equitable growth as it is to building an enlightened, pluralistic, and democratic polity.

4.7. Poverty, Justice, and Citizens' Security

The poor live in urban or rural localities that are inadequately policed. In case of theft or violence against their person, the cost of seeking redress through the judicial system is, in most cases, unaffordable; where undertaken, the expenses in terms of time and money lock the poor into permanent debt. This also engenders endemic poverty, reinforces inequality, and thereby constrains economic growth (see Table 6).

Table 6: Frequency of disputes and resolution, and cost of resolution by economic status (cases reporting disputes only)

| Economic status | Distribution of reported disputes (%) | Amount spent on mediation (mean) (PRs) | Percent of reported disputes resolved |
|------------------------|--|---|--|
| Extremely poor | 17.1 | 18,333 | 38.5 |
| Poor | 48.7 | 12,074 | 59.5 |
| Nonpoor | 34.2 | 18,264 | 80.8 |
| Total/average | 100.0 | 15,123 | 63.2 |

Source: National Human Development Report 2003; Poor Communities Survey of Pakistan 2001 (Pakistan Institute of Development Economics).

5. Building Poverty Reduction into the Structure of the Growth Process

The preceding section has identified some of the structural factors underlying endemic poverty and unstable growth. This section presents a set of institutional initiatives that can be undertaken to initiate the process of pro-poor growth, helping to overcome the structural constraints to sustained and equitable growth. These include: (i) providing land to the landless as part of a new small farmer-based agriculture growth strategy,

(ii) mainstreaming the poor by establishing large corporations owned by the poor but run by professionals, and (iii) overcoming the institutional constraints to the rapid growth of small-scale enterprises (SSEs). These three initiatives are only outlined in this section, since they have been discussed at length in Hussain (in press). A fourth initiative, participatory development, is elaborated in Section 6 of this chapter.

Pro-poor growth can be defined as a process that directs a disproportionate share of the increase in national income toward the poor. Going beyond this, restructuring the growth process in favor of the poor involves empowering them to participate in the economic, social, and political decisions that affect their material conditions.

Designing a policy for pro-poor growth involves addressing the structural features of Pakistan's growth process that constrain its capacity at the macro-level for poverty reduction (see Sections 3 and 4). Therefore, at the macro-level, a pro-poor growth policy should aim to achieve increased employment elasticities and lower ICORs by increasing the weight in GDP of microenterprises, and the output of small farms and small-scale manufacturing enterprises. The strategy would also feature institutions that could take to scale a localized process of capital accumulation through participatory development.

5.1. Land for the Landless

One of the most important factors in endemic poverty in rural areas (where the majority of Pakistan's poor reside) is that millions of households do not own any land or that their ownership of this productive asset is less than the critical level required for subsistence. The data shows that poor peasants who do own land have, on average, 2 acres, while larger farmers are able to rent additional land. Poor farmers either rent out their small owned holdings for a pittance or are obliged to sell their land altogether (Hussain, 2008a). For example, according to the PNHDR's sample survey, as many as 76.5 percent of extremely poor farmers and 38.9 percent of poor farmers sold their land over the period 1990–2000 (Hussain et al., 2003). The evidence shows that the poor have to sell their land to meet urgent consumption needs related to health expenditure, crop failures, and weddings. Thus, lack of access to this vital productive asset is an important structural factor in endemic poverty.

Farms smaller than 25 acres constitute about 94 percent of the total number of farms and about 60 percent of the total farm area. This sector

has untapped potential for increasing the yield per acre on cropland and increasing the output of milk and livestock products. As discussed elsewhere, a new small–medium farmer-based agriculture growth strategy could be initiated to transfer the existing 2.6 million acres of state-owned land to landless peasants (see Hussain 2008a, in press). This could be supported by the establishment of a small–medium farmer-owned corporation through a public–private partnership that would provide them with the following facilities: land development; access to high-quality seeds, fertilizers, and marketing services; extension services to improve the application efficiency of irrigation; and new technologies for high value-added crop farming such as tunnel farming.

5.2. Mainstreaming the Poor through Equity Stakes⁹

One institutional change that could bring the poor into the mainstream market economy would involve establishing professionally managed public limited companies in which the poor have a substantial equity stake (for a more detailed discussion of the institutional framework of such an initiative, see Hussain, in press). This concept was first propounded by Professor Rehman Sobhan and successfully tried out in the diversification process of the Grameen Bank in Bangladesh. It was also tried out in India by Dr Verghese Kurien who set up Amul (originally a cooperative), which is owned entirely by the poor and is now one of the largest manufacturers of milk products in South Asia's corporate sector.

In Pakistan's case, there may be considerable potential for developing livestock and milk production by the rural poor and supplying these products to large private sector corporations for the manufacture and export of milk and meat products. The private sector corporations that would buy their inputs from the poor could also be owned substantially by the poor. The equity stake to the poor could be achieved initially through the provision of loans to be paid back from the corporations' dividends. Similar public limited companies owned by the poor and run by competent professionals could also be established in key mainstream sectors of the economy such as energy, telecommunications, and electronics.

⁹ This section draws on Hussain (in press).

5.3. *Institutions for Stimulating Growth of SSEs*

SSEs in small towns and peri-urban localities of Pakistan have considerable growth potential because of their highly skilled technicians and innovative entrepreneurs. However, their growth is constrained by the following institutional factors: (i) lack of institutional linkages for subcontracted work with the large-scale manufacturing sector; (ii) lack of access to specialized fabrication facilities such as forging and heat treatment, which are necessary for the dimensional control of high value-added metal products; (iii) lack of expertise in establishing quality control procedures for the production of bulk orders; and (iv) lack of access to credit facilities and working capital with which to purchase high-quality raw materials.

These constraints could be overcome by facilitating the establishment of common facilities centers in the private sector. These could provide services such as linking SSEs with the large-scale manufacturing sector through marketing services; specialized fabrication facilities on a rental basis to SSEs; specialized training in production management and quality control; and access to credit for the purchase of high-quality raw materials and specialized equipment (see Hussain, 2009a, pp. 26–30; in press).

6. Sustaining Growth Through Participatory Development

6.1. *The Nature of Poverty and Human Potential*

Like all human beings, the poor, too, have creative potential. Denied the minimum food and basic necessities, such as health and education; excluded from access to investible resources, training and high-wage employment; and living in atomized communities, the poor in Pakistan are, however, unable to actualize their human potential.¹⁰ The process of experiencing human potential as indeed of overcoming poverty involves a new relation with the community and oneself. It is when fragmented communities are reconstructed and organized to enable individuals to gain equitable access to markets, skill training, and credit that the poor can transform their condition. It is through creative thinking

¹⁰ Aristotle (1980, book 1, section 5) proposed that *human functioning* is the real object of value. The implication of this formulation for public action today in the context of poverty is that maximizing value in society requires enabling the maximum number of people to actualize their human potential.

and action in harmony with the community for a better life that the poor experience their human potential.

The process of rediscovering community identity, acquiring new skills, upgrading their knowledge, and being able to take initiatives to improve their economic condition together with others, gives the poor new power over the social forces that shape their lives. This consciousness allows them to shift out of their self-perception of passive victims to active subjects able to initiate individual and collective interventions to overcome their poverty.

This consciousness of their potential to bring about change and the institutional capacity to actualize it constitutes empowerment: it gives the poor the ability to undertake a sustained increase in incomes by breaking out of the nexus of elite power that has locked them into a structure of dependence at the local level and systematically deprives them of a significant proportion of their incomes (see Section 3).

6.2. Participatory Development: Individuals, Communities, and Markets

Participatory development involves a dialectical relationship between the formation and progressive strengthening of group identity on one hand and the improvement of the individual household's material conditions on the other.¹¹ Community organizations (COs) change the balance of power at the local level in favor of the poor by giving them improved access to markets. As a CO emerges, it enables individual members to acquire skill training, achieve productivity increase, and obtain credit and access to product markets to systematically increase their household incomes, savings, and investment. Thus, a localized process of capital accumulation begins that is sustained by the leverage over markets and public sector services that COs enable.

This interaction between the individual, CO, and markets helps to strengthen group identity with each successful income generation project at the individual level. Strengthening the CO becomes, in turn, the basis of more complex and diversified projects. These can range from individual

¹¹ The discussion on participatory development in this section is based on the author's experience of organizing poor rural communities in nine districts of the Punjab in 1998, when, as the first chief executive officer of the Punjab Rural Support Program, he helped to initiate and establish the program on the basis of the methodology of participatory development. For a field report, see Hussain (2009b).

microenterprise projects to collective projects with spinoffs for individual welfare such as localized irrigation projects and the development of community schools and basic health services (Hussain, 1994).

6.3. Process of Participatory Development: Dialogues, Communities, and Consciousness

The process of participatory development begins usually with an external facilitator or development nongovernment organization (NGO) that initiates a series of dialogues with a particular community. The dialogues are meant to identify a set of feasible income generation projects that can be undertaken by individual households, possible sources of local resource generation, and the community's preferences with respect to collective projects for the provision of skill training, education, and health facilities. At the same time, these dialogues aim to rekindle the awareness that individual welfare can be more effectively pursued through the formation of a CO.

The size of any one CO is usually between 25 to 30 members, each from a different household, and the formal rules of this organization stipulate a weekly meeting of all the members, with a written record of the minutes. At these meetings, members identify projects, monitor implementation, help resolve teething troubles, and commit to supporting households that are facing problems of access to markets and public services in the pursuit of their individual income generation projects. External expertise is also brought to bear by the CO during these meetings, to facilitate household-level microenterprise projects or community-level social and physical infrastructure projects. Thus, the participation of members of a community is not through "representatives" who act on their behalf; rather, each member of the organization is actively involved in project identification, formulation, implementation, and evaluation.

The Punjab Rural Support Program (PRSP), established in 1998, is testament to the efficacy of participation through the institutional structure of a CO. Following dialogues with a peri-urban community near Gujranwala, the households agreed to form a CO with the proposed institutional structure if some of them could acquire their own weaving machines (*khaddis*) for producing cotton mats (*durris*). These households were already producing *durris* on an outsourcing basis for an urban entrepreneur who provided the machines and thread but purchased the output at an extremely low price to maximize his intermediary profit. This arrangement yielded only PRs 3,000 per month to the producers.

Facilitated by the PRSP, the CO members provided the social collateral to obtain microfinance to purchase the machines and thread. The independent household production of durrus more than doubled their income when they sold their product in the market. The CO ensured 100 percent payback on the loans that individual members had been granted.

Similarly, in a village near Multan, the PRSP's dialogues resulted in the formation of a women's CO for the production of bamboo sunshades. The CO was linked up with trainers who helped members to learn the craft. They were then facilitated through the CO in selling their product in the nearby market at a lucrative price. In both cases above, the weekly CO meetings helped to identify the project, assess its feasibility, facilitate implementation, and encourage members to save from their increased incomes as a basis for enlarging their project.

In each of the provinces of Pakistan, peasants may be poor, but they have inherited a rich cultural and philosophical tradition that is reflected in their forms of apprehending social life, their poetry, and folklore. Through their forms of love and social action, these peasants express their dreams and make their history.

The consciousness of the poor peasantry has been deeply influenced by Sufi saints. This emerges in their folklore and images of contemporary language use, for example in the Punjab. A central experiential reference point is love (*ishq*), as a mode of self-actualization. The peasants understand self-development as inseparable from nurturing the ability to love: It is a process of transcending the ego through a connection with the other. Says Shah Hussain, the 17th century Sufi poet:

You are the woof and you the warp

You are in every pore

Says Shah Hussain Faqir

Naught am I, all is you.

Accordingly, the more developed a person's consciousness, the more he or she locates himself in the collective being of the community, which Shah Hussain has expressed as follows:

The Faqirs have their being

in the coming together of the community

For their consciousness is in full bloom.

In the peasantry, the consciousness of the Sufi tradition is woven into language use, and is manifest in the cadences of their speech as much as their silences.

Najam Hussain Syed, the great contemporary Sufi poet, refers to this subliminal consciousness of the peasantry as:

Somewhere on the slopes of silence

Beat the drums of the unsaid

and again as:

Far on the banks of memory falls

Your shadow, Ranjha.

In the process of participatory development through dialogue and action, there are moments when this counter-consciousness of love and relatedness of integrity and creative action, comes into play as a material force in the process of social and economic change. The challenge in the dialogues undertaken by the PRSP was to bring about this gestalt switch in consciousness, through word, gesture, and work procedures.

6.4. Institutional Challenges in Taking Development NGOs to Scale

If participatory development is to make a significant contribution to achieving inclusive growth in Pakistan, then COs need to be replicated at the necessary speed and scale and at a feasible resource cost to be able to have a national impact in the foreseeable future. Over the last few decades, development NGOs in Pakistan have used various versions of community participation, ranging in size from community-based organizations at the village or *mohallah* level to the union council level, such as the Pakistan Institute for Environment-Development Action Research (PIEDAR). Some NGOs have scaled up to the district or multidistrict level (the Kashf Foundation and Akhuwat). Others include large top-down government-initiated NGOs at the provincial level—such as the rural support programs in Punjab, Sindh, and Balochistan—and even the national level (the National Rural Support Program). Some development NGOs have grown

rapidly, others slowly; some unleash communities' creative energies by enabling them to be autonomous, while others are more bureaucratic. Similarly, some development NGOs are cost-effective while others, particularly government-created top-down ones, have prohibitively high overheads.

In the case of some large top-down government-created NGOs, questions with regard to key issues of feasibility persist. High overheads create a continuing dependence on government and donor funds. The inaccurate targeting of the poor with respect to credit and organizational support poses a problem. Moreover, the pace at which poor populations are covered is so slow and the cost of social mobilization so high, that the prospect of covering a substantial proportion of the poor can become impossible within a realistic timeframe and given the government's resources.

The central challenges in achieving scale in participatory development are as follows. First, it is important to retain the autonomy of each CO and its institutional mechanisms for nurturing community consciousness and ensuring participation in project identification, implementation, and monitoring. Second, rapid multiplication should occur without falling prey to the formation of a centralized top-down bureaucracy that tends to stifle the CO's autonomy while being expensive. Third, COs need to become financially independent of donors and the government by keeping their overheads to a minimum and achieving economies of scale through reduced administrative (social mobilization) costs as the organization grows.

7. Conclusion

This chapter has examined the roots of Pakistan's problem of achieving sustained growth in terms of the economy's institutional structure and the country's model of governance. The constraints to sustained growth that take the form of a low domestic savings rate and incapacity for adequate foreign exchange earnings are located in the institutional structure. A growth process that is narrowly based on a group of elites—generating rents for them by excluding the majority of people—creates inequality, persistent mass poverty, and disincentives for saving, efficiency, innovation, and international competitiveness.

The patron–client model of governance originated when, in the process of establishing the British Raj in the 19th century, the new agrarian

elite that had emerged following the peasant revolts against Mughal rule in the 18th century, was consolidated. This was done through revenue settlements that formalized the proprietorship of the new zamindars and rent transfers granting land to loyal zamindars during the development of the canal irrigation system. The chapter has also discussed the various forms of rent generated by successive governments in Pakistan post-independence to show how the patron–client model of governance inherited from the Raj, persisted.

Additionally, the chapter has examined the institutional factors underlying slow growth in manufactured exports and unstable growth in agriculture. It has analyzed the structures of power, tenancy, and tied labor that systematically deprive the poor peasantry of a large proportion of their income. The evidence shows how illness, lack of education, and lack of access to justice play an important role in perpetuating poverty, inequality, and slow growth.

If growth is to be sustained and poverty reduced rapidly, then the process of investment and productivity needs to be broad-based to include the poor and the middle classes in both the agriculture and manufacturing sectors. This can be achieved through a new small farmer agriculture growth strategy to provide land to the landless together with ancillary services for land development, high-quality seed, improved irrigation efficiency, and access to new farming practices and technologies. At the same time, the growth of small and medium enterprises in the manufacturing sector can be accelerated by establishing common facilities centers in the main regional growth nodes.

Finally, the chapter has analyzed the nature of poverty and the possibility of overcoming it in terms of institutions that could actualize the human potential of the poor through participatory development. In this context, the chapter has discussed the main features of participatory development and the challenges of taking it to scale to show how the development of community consciousness can play a vital role in transforming the material conditions of the poor.

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