

**PAKISTAN'S ECONOMY IN HISTORICAL
PERSPECTIVE: GROWTH, POWER AND POVERTY**

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INTRODUCTION

Pakistan's economy has experienced relatively high GDP growth rates during the last four years after a protracted period of recession during the decade of the 1990s. The stability of the new political order may well depend on two aspects of economic performance in the years ahead: (a) The question of the sustainability of high GDP growth. (b) The ability of economic growth to rapidly reduce poverty. The first question emerges from the recurrent fiscal pressures that constrain growth. The second is related with constraints that prevent the fruits of growth from substantially reaching the poor. Both constraints are rooted in the structure of the economy. This paper traces the emergence of an economic structure that on the one hand constrains the achievement of a high GDP growth on a sustainable basis and on the other constrains the poverty reduction capability of GDP growth. The emerging architecture of the Pakistan's economy is examined in terms of the relationship between the processes of institutional decay, deterioration in the structure of the economy and the process of poverty. The analysis focuses on the pattern of growth, fiscal deficits and poverty creation in the context of the politics and economic policy of various regimes from the 1950s to the present¹.

Pakistan began life as an independent state with a balance of payments problem (there was only rupees 200 million worth of foreign exchange in the

¹ Some of the research for this paper was used by the author in Chapter 2 of his work embodied in the Pakistan National Human Development Report. Sub sections I.2, II.2, III.2 and IV.3 in chapter 2 of the Report are also included in this paper. See, UNDP, Pakistan National Human Development Report 2003, Poverty Growth and Governance, UNDP, Islamabad, Oxford University Press, Karachi, 2003.

central treasury²) as it faced the challenge of wide spread poverty and inadequate infrastructure. The problem continues to persist today.

I. THE AYUB REGIME: WEAKENING INSTITUTIONAL STRUCTURE, ECONOMIC GROWTH AND SOCIAL CONFLICT (1958-69)

The Constituent Assembly in 1954 made the first attempt to give a constitution to the nation. The failure of this attempt signifies the conflict between the greed for personal power of individual leaders and the imperatives of strengthening institutions: a conflict of interest that was to underlie the process of institutional decay in the next five decades. On October 28, 1954, the Constituent Assembly was scheduled to formally vote on the published draft of Pakistan's first constitution, a draft that had been approved in the previous session of the Constituent Assembly. On this fateful day Governor General Ghulam Mohammad who felt that the draft constitution did not suit his power interests, ordered the police to bar members of the Constituent Assembly from entering their meeting room in Karachi³. The passage of the first constitution was thus aborted. Subsequently a weakened form of parliamentary democracy was restructured from the remnants of the first Constituent Assembly until it was terminated by Ayub Khan's coup d'etat in 1958. The significance of this conflict between individuals and institutions was to resonate through Pakistan's subsequent history. It was summed up in a prescient remark by a social scientist: "Once the first constitution is destroyed, it is doubtful that any succeeding one, no matter how successfully drafted will ever be truly accepted. A tradition which makes it possible for new leaders to replace old documents with others which appear preferable to them not only denies constitutionalism but makes reference to it little more than a sham"⁴.

² Ayesha Jalal, *The State of Martial Rule*, Cambridge University Press, Cambridge, 1990. page 37.

³ Allen Mc Grath: *The Destruction of Pakistan's Democracy*, OUP, Karachi 1996, Page X.

⁴ Lawrence Ziring: *The Enigma of Political, Development*, Westview Press, Boulder, 1980, Page 220. Cited in Allen, Mc Grath: *The Destruction of Pakistan's Democracy*, Op.cit.

The military coup d'état which brought General Ayub Khan into power established the dominance of the military and bureaucracy in Pakistan's power structure. The associated political system concentrated power in the person of Ayub Khan and gave pre eminence in the decision making process to certain sections of the elite in the military bureaucratic oligarchy. Through a series of political measures dissent in the civil society was suppressed and the independence of the judiciary undermined. The economic strategy undertaken by this government, while it accelerated GDP growth, sharply accentuated inter personal and inter regional economic inequalities. Thus the foundations were laid for the rise of provincial and class tensions which were to erupt in a conflict along the rich/poor divide in West Pakistan and a war of independence in East Pakistan. These conflicts led to the downfall of the government and the emergence of independent Bangladesh. In this section, we will briefly examine the political and economic policies of the government that eroded Pakistan's nascent democratic institutions and created explosive regional and class tensions by marginalizing the majority of the population from the political and economic processes. We will indicate how an economic structure emerged in this period that was to lock Pakistan's economy into a narrow and inefficient industrial base, slow export growth and increasing loan dependence in the next four decades.

I.1 Political Repression and Popular Revolt

The fatal flaw of the political system established in the period 1958-69, was that while its support was drawn from a relatively narrow social stratum through state patronage, it did not have an institutional mechanism for accommodating opposition⁵. Power was concentrated in the hands of Ayub Khan who relied on the bureaucracy for running both economic *and* political affairs⁶. The central and provincial legislatures were severely constrained by the narrow scope for parliamentary legislation. The President could also veto any legislation without the legislatures having the power to "over-ride"⁷ his veto.

⁵ See Omar Noman: *The Political Economy of Pakistan, 1947-85*, Routledge Kegan and Paul, London 1988, Page 28.

⁶ See S.J. Burki: *Pakistan: Fifty Years of Nationhood*, Vanguard Books, Lahore 1999, Page 32.

⁷ See S.J. Burki op.cit. Page 32

The system of “Basic Democracy” consisted of elected union councilors (called “Basic Democrats”) from 80,000 constituencies who formed a safe electoral college for electing the President, and were provided access over state resources. The candidates for election to the position of “basic democrats” (B.Ds.) were selected by the bureaucracy which also disbursed state resources to elected B.Ds. for a variety of social and economic functions at the local level. Thus, “Basic Democrats” provided the bureaucracy an institutional mechanism for a patron-client relationship with sections of the rural elite.

While the legislatures were subject to Presidential veto, dissent from individuals and institutions in civil society was suppressed by a series of administrative measures. For example in April 1959 a Martial Law Ordinance was promulgated under which the government could take over any newspaper which in the “opinion of the government” contained material that threatened national security. The government then proceeded to take over the Pakistan Times and Imroze which were two of the most influential English and Urdu daily newspapers respectively. Subsequently control over the press was institutionalized through the establishment of an official body called the National Press Trust. Individuals in academic institutions were prevented from publishing or even verbally expressing dissenting opinions in public. The judiciary which was the last remaining institution, which could provide a check over governmental authority, was also brought under administrative control. This was done by means of the “Law Reforms” which gave the government control over judicial appointments, and subjected judges to political scrutiny⁸.

In a culturally diverse society when the people of Bengal, Sindh and Baluchistan were not significantly represented within state institutions, and when political and cultural expression was suppressed, the tendency for the assertion of linguistic or ethnic identities was intensified. This was reinforced by the growing regional economic inequalities so that by the late 1960s political pressures on the state began to explode: in East Pakistan in the form of the assertion of Bengali nationalism and in West Pakistan in the form of mass street demonstrations against the government.

⁸ All Pakistan Legal Decisions (PLD) 1963, XV, Cited in Omar Noman op.cit. Page 29.

I.2 Economic Growth, Inequality and the Roots of Financial Dependence

Following the Korean boom in 1953, the government introduced a policy framework for inducing the large profits of traders in jute and raw cotton to flow into the manufacturing sector. This was done through a highly regulated policy framework for import substitution industrialization in the consumer goods sector. The policy combined tariff protection for manufacturers of consumer goods together with direct import controls on competing imports. It has been estimated that the average rate of effective protection was as high as 271% in 1963-64, and fell to 125% in 1968-69.⁹ This enabled the emerging industrial elite to make large profits from the domestic market without the competitive pressure to achieve higher levels of efficiency and an export capability.

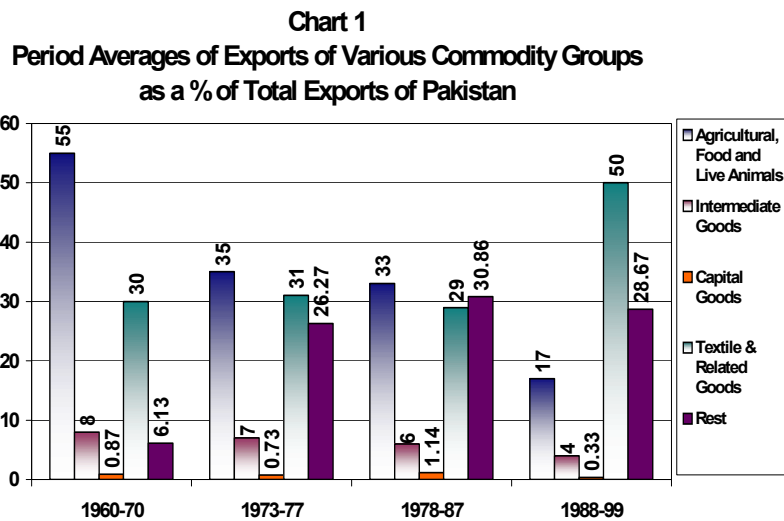
During the 1960s import substitution industrial growth in the consumer goods sector, was more systematically encouraged by the government. This was done by means of high protection rates to domestic manufacturers of consumer goods, cheap credit, and direct import controls on competing imports. At the same time, there was removal of import controls (established earlier in the 1955) on industrial raw materials and machinery. In addition to various forms of protection, new incentives were offered for exports. These included the Bonus Voucher Scheme, tax rebates, tax exemptions and accelerated depreciation allowances to increase post tax profits.

The Bonus Voucher Scheme enabled exports of certain manufactured goods to receive in addition to the rupee revenue of their exports, bonus vouchers equivalent to a specified percentage of the foreign exchange earned. The vouchers could be sold in the market (to potential importers) for a price usually 150 to 180 percent above the face value. Thus the exporter not only earned the rupee revenues from exports but also an additional premium through sale of the bonus vouchers.

⁹ Dr. A.R. Kemal: Patterns of Growth in Pakistan's Industrial Sector, in Shahrukh Rafi Khan (ed.): Fifty Years of Pakistan's Economy, O.U.P., Karachi, Page 165.

The Bonus Voucher Scheme essentially constituted a mechanism for enabling domestic manufacturers to earn large rupee profits on exports which brought no gain to the economy in terms of foreign exchange. It has been estimated¹⁰ that during the 1960s, Pakistan’s main industries (when input costs and output values are both measured in dollar terms) were producing negative value added.

It has been argued that the phenomenon of negative value added in industry was an important reason why during the 1960s, inspite of import substitution and large export volumes, foreign exchange shortages persisted¹¹. This set the “mould” for Pakistan’s narrow export base (concentration on low value added end of textiles) and the debt problem, that remains till to-day. For example (see chart 1), the share of the traditional textile industry in total exports far from falling, in fact increased from 30% in the decade of the 1960s to 50% in the decade of the 1990s.



In a broader perspective, it can be argued that the government through a range of protection measures and concessions in the 1960’s, enabled the emerging industrial elite to make large rupee profits from domestic and export sales, without the market pressures to diversify into high value added industries

¹⁰ Soligo, and J.J. Stern, Tariff Protection, imports substitution and investment efficiency, The Pakistan Development, 1965, Pages 249-70.

¹¹ Sikander Rahim: Myths of Economic Development, Lahore School of Economics, Occasional Paper No.10, February 2001.

or to achieve international competitiveness. Thus, the experience of the 1960s is illustrative of the nature of both government and the economic elite. In the pursuit of securing its power base, the government by means of subsidies, manipulation of tariffs and the exchange rate mechanism, transferred rents to the industrial elite. This reinforced the tradition bound propensity of the economic elite for risk aversion, lack of innovative dynamism and dependence on governmental patronage.

The economic policies and processes during the 1960s, illustrate the sociological propensity of the ruling elite to seek rents from government which in turn reinforced its power through such patronage. These sociological propensities are rooted in the region's history stretching back to the eighteenth century¹². These tendencies persisted in varying degrees for the next four decades. Yet they were at an economic cost that became a growing burden on an increasingly fragile economy: It has been estimated for example that even in 1990-91 by which time the rates of effective protection had been considerably reduced, the increase in the share of manufacturing attributable to protection amounted to 5% of GNP.

As we have seen, the government during the 1960s adopted a deliberate policy of concentrating national income in the hands of the upper income groups.¹³ The economic basis of this policy was the assumption that the rich save a larger proportion of their income and hence a higher national savings rate could be achieved with an unequal distribution of income (the target savings rate being 25% of GDP). In practice while the policy of distributing incomes in favour of the economic elite succeeded, the assumption that it would raise domestic savings over time failed to materialize. It has been estimated that 15% of the resources annually generated in the rural sector were transferred to the urban industrialists and 63 to 85 percent of these transferred resources went into increased urban

¹² See: Government Patronage and Rent Seeking Elites: A Longer Historical View: Pakistan NHDR, UNDP, Oxford University Press, Karachi Pages 48-49.

¹³ "It is clear that the distribution of national production should be such as to favour the savings sectors", Government of Pakistan, Planning Commission, The Third Five Year Plan, 1965-70, Karachi, Page 33.

consumption.¹⁴ Far from raising the domestic savings rate to 25%, the actual savings rate never rose above 12%¹⁵.

The failure of the economic elite to save out of their increased income resulted during the 1960s, in a sharp increase in the requirement of foreign aid. According to official figures, gross foreign aid inflows increased from US \$ 373 million in 1950-55 to US \$ 2,701 million in 1965-70. The rapid increase in foreign aid was accompanied by a change in its composition from grants to higher interest loans¹⁶. Consequently the debt servicing burden rose dramatically. Debt servicing as a percentage of foreign exchange earnings was 4.2% in 1960-61 and increased to 34.5% by 1971-72. The magnitude of this figure did not fall for the next three decades and by the year 2000, it was even higher at 40%.

Given the policy of re-distributing incomes in favour of the rich, it is not surprising that by the end of the 1960s a small group of families with interlocking directorates dominated industry, banking and insurance in Pakistan. In terms of value added 46% of the value added in the large scale manufacturing sector originated in firms controlled by only 43 families.

In banking, the degree of concentration was even greater than industry. For example, seven family banks constituted 91.6 percent of private domestic deposits and 84.4 percent of earning assets. Furthermore, State Bank compilation of balance sheets of listed companies indicates that the family banks tended to provide loans to industrial companies controlled by the same families.¹⁷ The insurance industry, although smaller in size than banking, also had a high degree of concentration of ownership. The forty-three industrial families controlling 75.6

¹⁴ K. Griffin: Financing Development Plans in Pakistan, in K. Griffin and A.R. Khan, Growth and Inequality in Pakistan, Macmillan, London Page 41-42.

¹⁵ Ibid. Page 133.

¹⁶ For example, during 1950-55 grant and grant type assistance constituted 73% of total foreign aid. By 1965-70 this type of assistance had declined to only 9% of total foreign aid. See: Economic Survey, Government of Pakistan, Finance Division, Islamabad, 1974, Page 133.

¹⁷ L.J. White: Industrial Concentration and Economic Power in Pakistan, Princeton University Press, Page 63.

percent of the assets of Pakistani insurance companies tended to favour industrial companies owned by the same group.¹⁸

The major industrial families and entrepreneurs were a fairly closely-knit group. Not only did many of them have caste and kinship relations, but members of the families tended to sit on each other's boards of directors. For example about one-third of the seats on the boards of directors of companies controlled by the forty-three families were occupied by members of other families within the forty-three.

Not only were the forty-three families dominating industry, insurance and banking, but also had considerable power over government agencies sanctioning industrial projects. PICIC (Pakistan Industrial Credit and Investment Corporation) was the agency responsible for sanctioning large-scale industrial projects. Out of the twenty one directors of PICIC, seven were from the forty three leading industrial families and were actively involved in the public sector financial institutions that directly affected their private economic interests.

During the process of rapid economic growth of the 1960s, while an exclusive and highly monopolistic class was amassing wealth, the majority of Pakistan's population was suffering an absolute decline in its living standards. For example, the per capita consumption of foodgrain of the poorest 60 percent of Pakistan's urban population declined from an index of 100 in 1963-64 to 96.1 in 1969-70. The decline was even greater over the same period in the case of the poorest 60 percent of rural population. In their case, per capita consumption of foodgrain declined from an index of 100 in 1963-64 to only 91 in 1969-70.¹⁹ There was an even larger decline in the real wages in the industry: In the decade and a half ending in 1967, real wages in the industry declined by 25 percent.²⁰ According to one estimate, in 1971-72 poverty in the rural sector was so acute

¹⁸ Ibid. Pages 74-75.

¹⁹ N. Hamid, *The Burden of Capitalist Growth, A study of Real Wages in Pakistan*, *Pakistan Economic and Social Review*, Spring 1974.

²⁰ K. Griffin and A.R. Khan, *op.cit.* Pages 204-205.

that 82 percent of rural households could not afford to provide even 2,100 calories per day per family member.²¹

In an economy where there were significant differences in the infrastructure facilities available in the different provinces, there was a tendency for investment based on private profitability to be concentrated in the relatively developed regions. Consequently regional disparities would tend to widen over time. This is in fact what happened in the case of Pakistan. The Punjab and the Sind provinces, which had relatively more developed infrastructure, attracted a larger proportion of industrial investment than the other provinces. In Sind, however, the growth in income was mainly in Karachi and Hyderabad. Thus, economic disparities widened not only between East and West Pakistan, but also between the provinces within West Pakistan.

During the 1960s, the factor which accelerated the growth of regional income disparities within what is Pakistan today was the differential impact of agricultural growth associated with the so-called 'Green Revolution'. Since the yield increase associated with the adoption of high yield varieties of foodgrain required irrigation, and since the Punjab and the Sind had a relatively larger proportion of their area under irrigation, they experienced much faster growth in their incomes, compared to the Baluchistan and the North West Frontier Province.²²

In a situation where each of the provinces of Pakistan had a distinct culture and language, the systematic growth of regional disparities created acute political tensions. Addressing these tensions required a genuinely federal democratic structure with decentralization of political power at the provincial level.²³ Only such a polity and large federal expenditures for the development of the under-developed regions could ensure the unity of the country. In the absence

²¹ S.M. Naseem: Rural Poverty and Landlessness in Asia, ILO Report, Geneva, 1977.

²² Naved Hamid and Akmal Hussain: "Regional Inequalities and Capitalist Development", Pakistan Economic and Social Review, Autumn 1974.

²³ Akmal Hussain, Civil Society Undermined, in: Strategic Issues in Pakistan's Economic Policy, op.cit. Page 374.

of such a polity, the growing economic disparities between provinces created explosive political tensions.

The failure to conduct an effective land reform in Pakistan has resulted in a continued concentration of landownership in the hands of a few big landlords. Thus, in 1972, 30 percent of total farm area was owned by large landowners (owning 150 acres and above). The overall picture of Pakistan's agrarian structure has been that these large landowners have rented out most of their land to small and medium-sized tenants (i.e., tenants operating below twenty-five acres).

In my doctoral thesis²⁴ I had shown that given this agrarian structure, when the 'Green Revolution' technology became available in the late 1960s the larger landowners found it profitable to resume some of their rented out land for self-cultivation on large farms using hired labour and capital investment. Consequently there was a growing economic polarization of rural society. While the landlords' incomes increased, those of the poor peasantry declined relatively, as they faced a reduction in their operated farm area and in many cases growing landlessness.²⁵ For example in the case of farms in the size class 150 acres and above, the increase in the farm area during the period 1960 to 1978, constituted half their total farm area in 1978. In terms of the source of increase, 65% of the increase in area of large farms came through resumption of formerly rented out land. That this resumption was accompanied by growing landlessness of the poor peasantry is indicated by the fact that in the period 1960 to 1973 about 0.8 million tenants became landless wage labourers. Of the total rural wage labourers in Pakistan in 1973, as many as 43% had entered this category as the result of proletarianization of the poor peasantry²⁶.

²⁴ Akmal Hussain: Impact of Agricultural Growth on changes in the Agrarian Structure of Pakistan, with special reference to the Punjab Province, D.Phil. Thesis, University of Sussex 1980. Also see: Akmal Hussain: Strategic Issues in Pakistan's Economic Policy: Technical Change and Social Polarization in Rural Punjab, Chapter 4, Progressive Publishers, Lahore, June 1988.

²⁵ See: Akmal Hussain, D. Phil Thesis, op.cit.

²⁶ See: Akmal Hussain, Strategic Issues in Pakistan's Economic Policy, Progressive Publishers, Lahore, June 1988. Page 187

The polarization of rural society and increased landlessness of the poor peasantry was associated with increased peasant dependence in the face of rural markets for agricultural inputs and outputs that were mediated by large landlords. In the pre “Green Revolution” period, the poor tenant relied on the landlord simply for the *use* of the land but used the government’s canal water, his own seeds and animal manure. In the post “Green Revolution” period however, since the political and social power of the landlord remained intact, the peasant began to rely on the landlord for the *purchase of inputs*. (e.g. HYV seeds, chemical fertilizers, pesticides, the landlord’s tube-well water, for a seasonally flexible supply of irrigation, and credit). Thus, in many (though not all) cases, the dependence of the poor peasant intensified with the commercialization of agriculture in the sense that now his very *re-constitution of the production cycle* annually depended on the intercession of the landlord. At the same time due to the reduction in his operated area following land resumption, the tenant was obliged to complement his income by working as a wage labourer part of the time at a wage rate below the market rate in deference to the landlord’s power. (Conversely, the landlord’s management of the owner cultivated section of his land was facilitated through this tied source of labour supply). This phenomenon persists till to-day²⁷. (It was first analyzed in my doctoral study 1980)²⁸. Finally, the peasant’s income was further constricted as he was obliged to sell a large part of his output at harvest time when prices were low (in order to pay back loans for input purchase). Near the end of the year, when he ran out of grain, he had to purchase his remaining consumption requirements at high prices from the market.²⁹

Thus, the “commercialization of agriculture” in a situation where landlords and the local power structure controlled markets for inputs and outputs, brought new mechanisms for the reproduction of rural poverty, even though

²⁷ For the latest survey evidence, see: Akmal Hussain et.al, Pakistan National Human Development Report, 2003, Chapter 3, Section IV, UNDP, Oxford University Press, Karachi, 2003.

²⁸ See Akmal Hussain, D. Phil Thesis, op.cit.

²⁹ For a more detailed analysis of the squeeze on poor peasant incomes see: Akmal Hussain: Technical Change and Rural Polarization in: Strategic Issues in Pakistan’s Economic Policy, op.cit. Pages 150 to 156.

overall agricultural growth accelerated. As we will see, the high rate of agricultural growth during the Ayub regime could not be sustained in subsequent years. Yet the mechanisms of reproducing rural poverty that had emerged in this period, persisted over the next four decades.

II. THE BHUTTO REGIME: 1973-77

II.1 Power and Patronage

The Ayub regime had instituted policies which resulted in a concentration of incomes in the hands of a nascent industrial elite while real wages declined and poverty increased. In the resultant social tensions, Z.A. Bhutto emerged as a champion of the poor to lead a mass movement for overthrowing the Ayub government. Support for the newly formed Pakistan People's Party (PPP) led by Bhutto came not only from workers and peasants but also from elements of the urban middle classes seeking reform. Conservative landlords also gravitated to the PPP, because of their antagonism to an industrial elite that was appropriating a growing share of economic resources.

The radical stratum of the middle class was dominant in the Pakistan People's Party until 1972. This was evident from the manifesto which was anti-feudal and against monopoly capitalists. The same stratum played a key role in devising a propaganda campaign that aimed to present the manifesto as "revolutionary", thereby mobilizing the support of the workers and peasants. The radical stratum was drawn from diverse social origins and its members therefore related with the party leader as separate factions. The inability of these different radical factions to constitute themselves into a united bloc within the PPP facilitated the purges that came later. By 1972 the balance of social forces within the PPP began to shift in favour of the landlord groups. This shift was rooted in the imperatives of mobilizing popular forces on the one hand and the practice of politics within the traditional power structure on the other. In the pre-election period, the dominance of the urban middle class and its radical rhetoric was necessary if the PPP was to get a mass base for its election victory. After the election, the proclivity of the top party leadership to contain demands for radical change within the existing power structure combined with the dominance of the landed elite within the party, led to a purge of radical elements from the PPP.

Consequently there was an institutional rupture between the PPP and its mass base amongst the workers and peasants. This set the stage for economic measures that were socialist in *form*, while actually serving to strengthen the landed elite and widening the base for state patronage.

One of the most important initiatives of the PPP government was the nationalization in 1972 of 43 large industrial units in the capital and intermediate goods sectors such as cement, fertilizers, oil refining, engineering and chemicals. Just three years later the government nationalized the cooking oil industry and then flour milling, cotton ginning and rice husking mills.

While the first set of nationalizations impacted the “monopoly capitalists”, the second set of nationalizations in 1976 by contrast hit the medium and small sized entrepreneurs. Therefore nationalization in this regime cannot be seen in terms of state intervention for greater equity. Rather the rapid increase in the size of the public sector served to widen the resource base of the regime for the practice of the traditional form of power through state patronage. This involved the state intervening to redistribute resources arbitrarily to those who had access to its patronage.³⁰

II.2 Investment, Growth and the Budget Deficit

Let us now briefly indicate the implications of the economic measures in this period on investment, growth and the budget deficit. Private investment as a percentage of GDP in the Bhutto period (1973/74 to 1977/78) declined sharply to 4.8% compared to 8.2% in the preceding period 1960/61 to 1972/73. (See table 1). The nationalization of heavy industries shook the confidence of the private sector and was a factor in the declining investment. The trend may have been reinforced by a second set of measures during this period. These included a devaluation of the exchange rate which placed large and small scale industry at par with respect to the rupee cost of imported inputs (i.e. the indirect subsidy provided to large scale manufacturing industry through an overvalued exchange rate, was withdrawn). At the same time, direct subsidies to manufacturing were significantly cut down, import duties on finished goods were reduced and anti-

³⁰ Omar Noman, *The Political Economy of Pakistan*, op.cit., Page 79.

monopoly measures along with price controls were instituted. It is not surprising that domestic manufacturers who had been bred on government support, responded by further reducing investment.

It may be pertinent to point out here that the decline in private sector manufacturing as a percentage of the GDP, had already begun eight years before the Bhutto period, after the 1965 war.³¹ So while the nationalization and subsequent economic measures cannot be said to have *caused* the decline in private investment, they certainly intensified it.

The decline in private sector investment in the post 1965 period as a whole, (as opposed to its sharp deceleration during the nationalization phase), can be attributed³² to three underlying factors: (i) foreign capital inflows fell sharply after the 1965 war, (ii) the manufacturing sector in a situation of declining domestic demand was unable to meet the challenge of exports due to high production costs in traditional industries, and (iii) entrepreneurs did not diversify into non traditional industries where there was considerable growth potential. Thus the declining trend in private sector manufacturing investment in the post 1965 period, a trend that persisted right into the 1990s, can be said to be rooted in certain sociological features that characterized most of Pakistan's entrepreneurial elite: (a) its reliance on foreign savings rather than its own thrift, (b) its dependence on state patronage and subsidies of various kinds, and (c) its tradition bound nature, risk avoidance and in many cases lack of innovativeness for breaking new ground.

³¹ See A.R. Kemal: Patterns of Growth in Pakistan's Industrial Sector, in Shahrukh Rafi Khan (ed.). Fifty Years of Pakistan's Economy, O.U.P, Karachi 1999, Page 158.

³² Ibid, Page 158.

We find that unlike manufacturing investment, the decline in the *total* private sector investment as a percentage of the GDP was more than compensated by an increase in the total public sector investment. Thus, the overall investment/GDP ratio during the Bhutto period reached 15.5%, which was slightly higher than in the preceding period (see Table 1). Yet inspite of an increase in the total investment/GDP ratio, the growth rate of GDP declined compared to the preceding period (as table 3 shows, GDP growth during the Bhutto period was about 5% compared to 6.3% in the earlier 1960-73 period). This is indicative of a decline in the productivity of investment (i.e. an increase in the incremental capital output ratio). The question is, what caused the decline in the capacity of investment to generate growth? The answer lies in the fact that not only was most of the investment in the period emanating from the public sector, but that a large proportion of this investment was going into unproductive spheres: Defence and public administration were the fastest growing sectors of the economy (11.4%) while the commodity producing sector was growing at only 2.21% during the period. Even in the productive sector, the lion's share of the

Average During	GFCF(Total) as % of GDP(Current Prices)	GFCF (Private) as % of GDP (Current Prices)	GFCF (Public) as % of GDP (Current Prices)
1960-1973	15.28	8.21	7.26
1973-1978	15.50	4.79	10.71
1978-1988	16.77	7.10	9.66
1988-1993	17.95	9.22	8.73
1993-1998	16.3	9.32	7.36
1998-2000	13.26	8.10	5.31

SOURCE: Economic Survey, Government of Pakistan (G.O.P.), Economic Advisor's Wing, Finance Division, Various Issues.

Note: *GFCF is Gross Fixed Capital Formation

public investment went into the Steel Mill project beginning in 1973. The project using an obsolete Soviet design, involved a technology that was both capital

intensive and inefficient. Consequently, the tendency of declining productivity of investment was exacerbated.

Even in the existing manufacturing industries in the public sector while some industries showed good profits to start with, there was a sharp decline in the rates of return on investment, due to a combination of poor management of existing units and improper location of new units on political grounds³³. Thus, the lowering of GDP growth inspite of an increase in investment in the Bhutto period occurred because of two sets of factors: (a) concentration of public sector investment in the unproductive sectors of defence and administration, and (b) economically inefficient investment decisions in the public sector industries based on political considerations, with respect to technology choice, geographic location, and production management.

Let us now briefly discuss the implications of the political and economic measures of the government during this period for the budget.

The problem of the government's dependence on financial borrowing as we have indicated, started in the Ayub period, when the obligation of maintaining a large military and bureaucratic apparatus combined with the imperatives of providing huge subsidies to both agriculture and industry: For agriculture in the form of subsidized inputs (water, fertilizer, pesticides) as part of the elite farmer strategy; for industry in terms of explicit and implicit subsidies such as an over-valued exchange rate, subsidized credit and tax incentives to an industrial sector that was inefficient and lacked export competitiveness.

In the Z.A. Bhutto period, budget deficits widened further as expenditures on defence and administration increased sharply. Higher defence expenditures were part of the policy of refurbishing the defence establishment. Large expenditures on government administration arose mainly out of the decision to build new para military institutions such as the Federal Security Force.³⁴ The bureaucracy was also enlarged and re-structured through the policy of 'lateral

³³ Omar Noman: *The Political Economy of Pakistan*, op.cit. Page 80.

³⁴ For a more detailed discussion on the nature of changes within the state structure see: A Hussain: *Strategic Issues in Pakistan's Economic Policy*, op.cit., Pages 378 and 379.

entry' which enabled loyalists outside the civil services cadre to be appointed at the upper and middle echelons. The attempt to build a demesne of patronage within the state apparatus had huge financial consequences. For example, defence expenditure as a percentage of GDP increased from 2.7% in 1965 to 6.7% in 1974-75. Similarly general administration as a percentage of GDP increased from 1.1% in 1964-65 to as much as 1.8% in 1974-75³⁵

Apart from the increased expenditures on defence and administration, the budget was additionally burdened by the losses of the public sector industries. The deficits in these industries were generated by their poor performance on the one hand and the pricing policy on the other. Nationalized units under official pressure to suppress price increases inspite of rising costs, were recovering not much more than their operating costs. Consequently, internally generated funds could finance only 7%³⁶ of the investment undertaken, thereby necessitating heavy borrowing from the government.

As government expenditures increased, the ability to finance them from tax revenue was constrained by two factors: (a) The slow down in the GDP growth, and (b) the government's inability to improve the coverage of direct taxation. As a consequence, the deficit increased rapidly. The government attempted to control the rising budget deficit by reducing subsidies on consumption goods and increasing indirect taxation. However even these measures failed to reduce the budget deficit in the face of rising current expenditures. So monetary expansion was resorted to, resulting in accelerated inflation.

The financial constraint following the large non development expenditures, severely restricted the funds available for development, and hence enfeebled the two initiatives that were designed to benefit the poor: the National Development Volunteer Programme (NDVP) and the Peoples Work Programme. The former aimed at providing employment to the educated unemployed and the

³⁵ Hafiz Pasha in Shahrukh R. Khan (ed.), op.cit. Page 209, Table-3.

³⁶ Omar Noman, Op. cit. Page 82.

latter to generate employment for the rural poor through labour intensive projects. Both programmes were marginalized due to budgetary constraints.³⁷

The social consequences of these financial measures were to have a profound impact on the political strength of the Bhutto regime. Withdrawal of subsidies on consumption goods together with higher inflation rates squeezed the real income of the middle and lower middle classes. This served to accentuate the resentment that had followed the nationalization of the small and medium sized food processing units in 1976. Ironically these very urban petit bourgeois elements had in 1968-69 fuelled the anti-Ayub agitation that had catapulted Bhutto into power. They now joined the street demonstrations in 1977 that led to his downfall.

III. THE ZIA REGIME (1977-1989)

III.1 The Rise of Islamic Fundamentalism

Each regime that came into power sought to legitimize itself through an explicit ideology: The Ayub regime propounded the philosophy of modernization and economic development. The Z.A. Bhutto regime donned the mantle of redeeming the poor through socialism. Zia ul Haq having come into power through a coup d'etat, sought to institutionalize military rule through the garb of a coercive and obscurantist version of Islamic ideology.

In the absence of popular legitimacy, the Zia regime used terror as a conscious policy of the government.³⁸ In the pursuit of this policy, the democratic constitution of 1973 was set aside and draconian measures of military courts, arbitrary arrests, amputation of hands and public lashing were introduced. Pakistan's society, by and large, was historically characterized by cultural diversity, democratic aspirations and a religious perspective rooted in tolerance and humanism. This was one of the reasons why the founding father, Quaid-e-Azam Muhammad Ali Jinnah conceived of Pakistan's polity as democratic and

³⁷ Omar Noman, op.cit. Page 122.

³⁸ President Zia ul Haq publicly stated: "Martial law should be based on fear". In the same vein, Brigadier Malik wrote: "Terror struck into the hearts of enemies is not only a means, it is the end itself". See: Omar Noman, op.cit., Page 122.

pluralistic with religious belief to be a matter concerning the individual rather than the state.³⁹

“You may belong to any religion or caste or creed ___ that has nothing to do with the business of the state.... We are starting with this fundamental principle that we are all citizens and equal citizens of one state.... Now, I think we should keep that in front of us as our ideal and you will find that in the course of time Hindus would cease to be Hindus and Muslims would cease to be Muslims, not in the religious sense, because that is the personal faith of each individual but in the political sense as citizens of the state.”

In attempting to restructure such a state and society into a theocracy, the government undertook two kinds of initiatives: First, measures designed to subordinate to executive authority, institutions of state and civil society such as the judiciary and the press, which if allowed to function independently could check governmental power. In the case of the judiciary its essential powers to scrutinize the legality of martial law or the orders of military courts were abolished. The judicial protection against arbitrary detention of a citizen embodied in the right to Habeas Corpus was eliminated for the first time in Pakistan.

In the case of the press, an attempt was made to subordinate it to State authority.⁴⁰ In the pursuit of this policy, press control measures were introduced. The government constituted committees at the district level to ensure that articles repugnant to the ideology of Pakistan were not published. Those members of the press who had refused to acquiesce faced state repression. A number of newspapers were banned and journalists were arrested and given flogging sentences by military courts.

The second set of measures towards a theocratic state sought to inculcate obscurantist views and induced a narrowing of the human mind. It involved a

³⁹ Speech of Mohammad Ali Jinnah as President of the Constituent Assembly, August 11, 1947, cited in Muhammad Munir, from Jinnah to Zia, Vanguard Books, Lahore 1979, Page 29-30.

⁴⁰ President Zia ul Haq declared: “Democracy means freedom of the Press, Martial Law its very negation”. The Daily Dawn, 12th July 1977, cited in Omar Noman, op.cit. Page 124.

suspension of the sensibility of love and reason underlying the religious tradition signified in Pakistan's folk culture⁴¹.

Advocacy for a theocratic social order⁴² was conducted through the state controlled television and press⁴³. Individual and group behaviour and society were sought to be controlled through the enforcement of coercive measures such as the amputation of wrists and ankles for theft, stoning to death for adultery and 80 lashes for drinking alcohol. Apart from this, in 1984 a law was passed to officially give women an inferior status compared to men.⁴⁴ In August 1984 the government began a national campaign involving the direct physical intervention of the state into the personal life of individuals. For example the Nizam-e-Salat Campaign was launched through the appointment of 100,000 "Prayer Wardens" for rural and urban localities. The task of these state functionaries was to monitor religious activities of individuals and to seek their compliance in religious practices.

The institutional roots of "Islamic Fundamentalism" were laid when government funds were provided for establishing mosque schools (madrassas) in small towns and rural areas which led to the rapid growth of militant religious organisations. This social process which later came to be known as "Islamic Fundamentalism" was catalyzed by the Afghan war. As measures were undertaken to start building a theocratic State, and society was brutalized, the isolation of the government from the people as a whole was matched by increased external dependence. Political, economic and military support was sought from the U.S. by offering to play the role of a front line state in the Afghan guerilla war against the occupying Soviet army. Accordingly, Pakistan obtained a package of U.S. \$ 3.2 billion in financial loans and relatively sophisticated military hardware. Moreover, with the support from the U.S., Pakistan was able

⁴¹ The hero Ranjha is celebrated as the synthesis of love and reason, See: Najam Hosain Syed, *Recurrent Patterns in Punjabi Poetry*, Punjab Adbi Markaz, Lahore, Second edition, 1986.

⁴² In the absence of a popular mandate, Zia claimed that his mission to bring an "Islamic Order" in Pakistan had a divine sanction: "I have a mission given by God to bring Islamic Order to Pakistan". Omar Noman, *op.cit.*

⁴³ *Ibid.*

⁴⁴ *Ibid.*

to get additional fiscal space by getting its foreign debt rescheduled, and increased private foreign capital inflows. These official and private capital inflows played an important role in stimulating macro economic growth in this period. They also helped establish a political constituency both within the institutions of the state and in the conservative urban petit bourgeoisie, for a theocratic form of military dictatorship.

As the government under President Zia ul Haq engaged in a proxy war, some of the militant religious groups together with their associated madrassas were provided with official funds, training and weapons to conduct guerilla operations in Afghanistan. While they helped fight the war in Afghanistan, the religious militant groups were able to enlarge the political space within Pakistan's society as well as in its intelligence and security apparatus. Since the late 1970s with the steady inflow of Afghan refugees into Pakistan and its use as a conduit for arms for the Afghan war, two trends emerged to fuel the crisis of civil society: (a) A large proportion of the weapons meant for the Afghan guerillas filtered into the illegal arms market in Pakistan. (b) There was a rapid growth of the heroin trade⁴⁵. The large illegal arms market and the burgeoning heroin trade injected both weapons and syndicate organisations into the social life of major urban centers. At the same time the frequent terrorist bombings in the Frontier province together with a weakening of state authority in parts of rural Sindh, undermined the confidence of the citizens in the ability of the State to provide security of life and property. Increasing numbers of the under-privileged sections of society began to seek security in various proximate identities whether ethnic, sectarian, biraderi or linguistic groups.⁴⁶

From 1987 onwards sectarian violence mushroomed in the Punjab province (which till then had been relatively peaceful) and later spread across the country. The phenomenon of large scale sectarian violence conducted by well armed and trained cadres was closely associated with the rapid growth of Deeni Madrassas ("religious" schools). While historically, such schools merely

⁴⁵ According to an estimate which is really in the nature of a "guesstimate" the narcotics trade amounted to US \$ 3 billion, See the weekly "The Economist" (London), April 10, 1985.

⁴⁶ Akmal Hussain, Civil Society Undermined, in, Strategic Issues....., op.cit., Page 386.

imparted religious knowledge, in the late 1980s a new kind of Deeni Madrassa emerged, which engaged in systematic indoctrination in a narrow sectarian identity, and inculcated hatred and violence against other sects. In 1998 there were 3,393 Deeni Madrassas in the Punjab alone and 67% had emerged during the period of the Zia regime and after. The number of Pakistani students in these madrassas were 306,500 in the Punjab. Between 1979 and 1994, many of the madrassas were receiving financial grants from Zakat funds. According to an official report of the police department, a number of madrassas were merely providing religious education. Yet as many as 42% of them were actively promoting sectarian violence through a well conceived indoctrination process⁴⁷. The students predominantly from poor families were given free food and lodging during their term at the madrassas. As poverty increased in the 1990s, the burgeoning madrassas provided a growing number of unemployed and impoverished youths with the security of food, shelter and an emotionally charged identity: a personality that felt fulfilled through violence against the other.

As the new kind of sectarian madrassas emerged and grew during the Zia regime so did sectarian violence. As chart 2 shows the number of sectarian killings increased from 22 during the 1987-89 period, to 166 during the 1993-95 period (See Table 2). Thus violence against the other became both the expression and the emblem of the narrowed identity.

⁴⁷ Zia ul Hasan Khan, Rise of Sectarianism in Pakistan: Causes and Implications, Research Paper (Mimeo), Pakistan Administrative Staff College, Lahore 1995.

The mobilisation of these narrow identities involved a psychic disconnection from the well springs of universal human brother hood within the Islamic tradition. Its liberating elements of rationality and love, were replaced in the narrowed psyche, by obscurantism and hatred. Violence against the “other” became an emblem of membership within these identities. Thus, civil society divorced from its universal human values began to lose its cohesion and stability

Chart 2
Casualties in Sectarian Violence

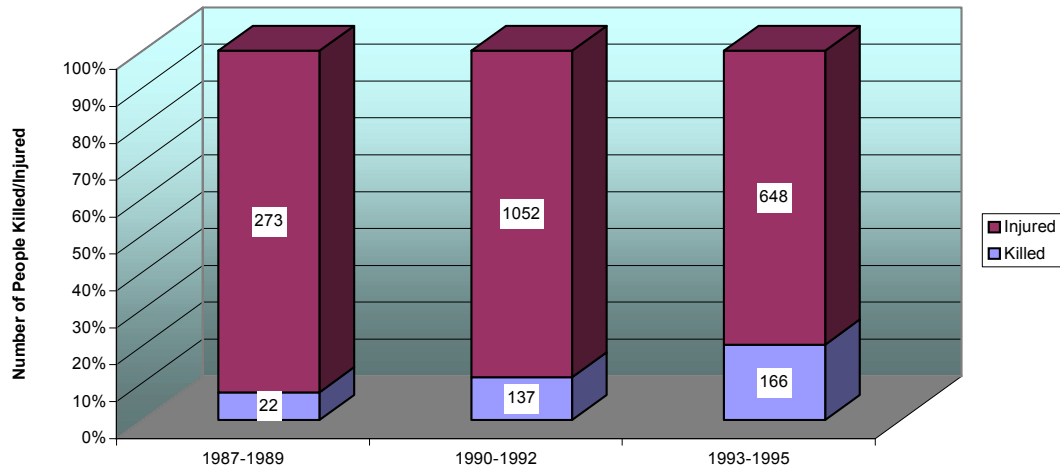


TABLE 2

CASUALTIES IN SECTARIAN VIOLENCE

YEARS	KILLED	INJURED	TOTAL CASUALTIES
1987 to 1989	22	273	295
1990 to 1992	137	1052	1189
1993 to 1995*	166	648	814

SOURCE: Zia ul Hasan Khan: Rise of Sectarianism in Pakistan: Causes and Security Implications. Research paper, Pakistan Administrative Staff College, Lahore 1995.

Note* Figures for 1995 upto October 1995.

III.2 Economic Growth and the Prelude to Recession

The rapidly growing debt servicing burden together with a slow down of GDP growth and government revenues that had occurred at the end of the Bhutto period would have placed crippling fiscal and political pressures on the Zia regime but for two factors: (a) the generous financial support received from the West, and (b) the acceleration in the inflow of remittances from the Middle East which increased from US \$ 0.5 billion in 1978 to US \$ 3.2 billion in 1984. These remittances not only eased balance of payments pressures, but also potential political pressures, directly benefiting about 10 million people, predominantly in the lower middle class and working class strata.⁴⁸

As it was, the easing of budgetary pressures together with good harvests and the construction and consumption booms associated with Middle East remittances, helped stimulate economic growth. As table 3 shows, GDP growth increased from about 5% during the Z.A. Bhutto period i.e. (1973-77) to 6.6% during the Zia period (1978-88). The data show that this acceleration in the GDP growth was induced to some extent by increased investment: The gross fixed

TABLE 3

PERIOD AVERAGES OF THE PERCENTAGE SHARE OF SELECTED MACRO-ECONOMIC INDICATORS IN THE GDP OF PAKISTAN.

Average During	Real GDP Growth % (Market Prices)	Domestic Savings % of GDP	Average Export Growth %	Exports as % of GDP	Trade Balance as % of GDP	Workers Remittances as % of GDP	Debt Servicing as % of GDP
1960-1973	6.26	12.99	16.19	4.57	-5.11		1.28
1973-1978	4.99	7.29	10.31	8.79	-7.27		2.04
1978-1988	6.6	8.15	14.33	9.59	-8.66	7.71	2.44
1988-1993	4.92	12.99	9.19	13.01	-5.00	4.54	3.02
1993-1998	3.14	14.98	5.15	13.50	-3.99	2.55	3.48
1998-2000	4.17		0.16	13.69	-2.33	1.71	2.55

SOURCE: Economic Survey, Government of Pakistan (G.O.P.), Economic Advisor's Wing, Finance Division, Various Issues.

capital formation as a percentage of the GDP increased from 15.5% in the Bhutto period to 16.8% in the Zia period. (Table 1).

There was a strategic shift from the “socialist” policies of nationalization, and the large public sector in the Bhutto period, to denationalization and a greater role assigned to the private sector in the growth process. In this context the Zia regime offered a number of incentives to the private sector such as low interest credit, duty free imports of selected capital goods, tax holidays and accelerated depreciation allowances. These inducements combined with high aggregate demand associated with consumption expenditures from Middle East remittances, and increased investment in housing, created a favourable climate for new investment. Private sector gross fixed investment increased from 7.1% of the GDP in the Bhutto period to 9.2% in the Zia regime (See Table 1). The public sector gross fixed capital formation as a percentage of the GDP however declined slightly from 10.7% in the preceding period to 9.7 % in the Zia period. The data on the manufacturing sector is also consistent with these findings and show a substantial acceleration in the growth of overall manufacturing from 5.5% in the 1970s to 8.21 % in the 1980s. In terms of the composition of investment in the large scale manufacturing sector as table 4 shows, there appears to be a significant acceleration in the investment in the intermediate and capital growth sectors, whose percentage share in the total manufacturing increased from about 43% at the end of the Bhutto period to about 50% in the mid 1980s. (The share fell again in the late 1980s and 1990s). This is consistent with the boom in the construction sector and the secondary multiplier effects in the intermediate and capital goods sectors.

Although the GDP growth rate during the Zia period did increase, yet this higher growth rate could not be expected to be maintained because of continued poor performance of three strategic factors that sustain growth over time: (i) The domestic savings rate continued to remain below 10% compared to a required rate of over 20%. (ii) Exports as a percentage of GDP continued to remain below 10% and did not register any substantial increase (see table 3). (iii) Inadequate investment in social and economic infrastructure. As defence and debt servicing

⁴⁸ As many as 78.9% of emigrants to the Middle East were production workers See: Jillani et.al. Labour Migration PIDE, Research Report No. 126.

expenditure increased, the Annual Development Programme (ADP) through which much of the infrastructure projects were funded, began to get constricted. As table 5 shows, ADP expenditure as a percentage of GDP fell from an average of 7.4% in the Z.A. Bhutto period, to 6.2% in the Zia period.

It is not surprising that when the cushion of foreign loans and debt relief was withdrawn at the end of the Afghan War, the underlying structural constraints to GDP growth began to manifest themselves: Debt servicing pressures resulting from the low savings rates, high borrowings and balance of payments deficits related with low export growth and poor infrastructure, combined to pull down the GDP growth into a protracted economic recession in the 1990s. Similarly the seeds of social conflict sown with the breeding of religious militant groups, began to erupt and feed off the growing poverty and unemployment.

TABLE 4**TOTAL INVESTMENTS IN VARIOUS INDUSTRIES AS A % OF TOTAL INVESTMENT IN ALL INDUSTRIES IN THE LARGE SCALE MANUFACTURING SECTOR OF PAKISTAN.***

Years	Investment in All Consumer Goods	Investment in Intermediate & Capital Goods	Investment in Textile & Related Goods	Investment in all other Industries
1964-65	22.7	25.2	41.1	11.1
1966-67	28.7	30.8	37.3	3.1
1970-71	31.8	27.3	38.0	2.9
1976-77	31.2	22.1	17.9	28.8
1977-78	23.6	43.2	23.7	9.6
1982-83	18.0	49.7	21.5	10.7
1983-84	24.5	57.2	17.9	0.3
1987-88	29.4	21.8	37.4	11.4
1990-91	28.7	24.6	44.4	2.2

SOURCE: Census of Manufacturing Industries, FBS, Statistics Division, Govt. of Pakistan. Various Issues.

Notes:

1. The CMI data represents only the large scale manufacturing sector in the economy.
2. The compilation of CMI data is conducted through mail enquiry supplemented by field visits. The questionnaires are issued to the factories as per list of manufacturing establishments maintained on the basis of monthly statements of registrations and cancellations received from the provincial Chief inspectors of Factories, Directorates of Labour Welfare of the Provinces.
3. Large scale manufacturing industries are those which employ 20 workers or more on any one given day of the year for manufacturing activity.
4. Investments here refer to all fixed assets consisting of land and building, plant and machinery and other fixed assets which are expected to have a productive life of more than one year and are in use by the establishment for the manufacturing activity.
5. Investments for a year include additions made during the year minus any sales of fixed assets during that year. These consist of, both Pakistan made and imports, and assets made for own use.

* Data refers to the figures obtained from the industries/establishments included in the census and does not represent the figures as a whole for the economy of Pakistan.

TABLE 5**ADP AS A PERCENTAGE OF GDP PERIOD AVERAGES**

Average During	ADP as a% of GDP
1972/73 to 1976/77	7.4
1977/78 to 1986/87	6.24
1987/88 to 1996/97	4.26
1997/98 to 1999/2000	3.5

SOURCE: Economic Survey, GOP, Economic Advisor's Wing, Finance Division, Various Issues.

IV. **POLITICIANS, POWER AND PELF: THE DEEPENING CRISIS 1989-1999**

IV.1 **Institutions Undermined: Pursuit of Power**

At the end of the Zia regime a new triumvirate of power emerged that came to be known as the “Troika”. This was an essentially informal arrangement of power sharing in the *actual* as opposed to *formal* conduct of governance, between the President, the Prime Minister and the Army Chief (Chief of Army Staff).

A fundamental feature of the “Troika” was that precisely because the power sharing arrangement was informal, the contention for increasing the relative share of power by each protagonist was inherent to its functioning. Without precisely specified domains of decision making, or even the confidence that each protagonist would pursue a shared perception of “National Interest”, periodic breakdown of the arrangement amongst a given set of members was a predictable feature. This is in fact what happened, so that between 1988 to 1999 an elected Prime Minister was dismissed on four occasions, three Presidents were changed and one Chief of Army Staff (General Jehangir Karamet) was pressurized into resignation.⁴⁹ A second army chief (General Pervez Musharraf) faced dismissal. This was the final act in the dramatic conflict within the informal “Troika”, that brought the curtain down on the formal democratic structure itself: General Musharraf took over power through a coup d’etat on 12th October 1999.

The government headed by Prime Minister Nawaz Sharif in its second term came with a two third majority in the National Assembly. This parliamentary strength could have been used to deepen democracy by reviving the economy, establishing transparent governance, bringing extremist militant groups within the law, and ensuring the independence of the judiciary⁵⁰. Instead

⁴⁹ The contention for power expressed itself in some cases in terms of the appointment and dismissal decision of key positions in the military. The contention also occurred on the issue of the legally correct application of Article 58 2(b) under which the President could dismiss the government and dissolve the national assembly “if in his opinion a situation has arisen in which the government of the Federation cannot be carried on in accordance with the provisions of the Constitution”.

⁵⁰ As the UNDP Human Development Report 2002 points out: “Whether the judiciary can maintain its independence is often the litmus test for whether democratically elected rule can avoid turning autocratic.”

an attempt was made to enhance the relative power position of the Prime Minister within the structure of state institutions.

A systematic attempt was made to undermine and control institutions such as the Presidency, the Parliament, the Judiciary, the Press and (in the end) the Army, in order to lay the basis of authoritarian power within the democratic structure.

An attempt was made not only to weaken the office of the President and relegate it to a purely ceremonial role but also to control members of the ruling party in parliament. This was done by passing the constitutional amendments thirteen and fourteen. Under the thirteenth Amendment the dreaded Article 58-2 (b) was withdrawn. (This article of the constitution gave the President powers to dismiss the government and hold fresh elections in case of extreme misgovernance). Under the fourteenth amendment the ability of elected members of the majority party to vote or even speak against the official position of the majority party in Parliament, on any legislative issue, was also withdrawn.

Conflict between the government and the Judiciary soon followed. Tensions between these two institutions began when the government asserted its claim to judicial appointments, a claim that was resisted by the Chief Justice of the Supreme Court on grounds of the independence of the judiciary.⁵¹ A political campaign against the Judiciary was launched during which disparaging remarks were made against it, both inside and outside the parliament. Subsequently, the Supreme Court decided to hear a writ petition for contempt of court against the Prime Minister and some of his associates, which if it had been decided against the Prime Minister, could have resulted in his disqualification. According to independent observers, an attempt was then made to “engineer a division within the apex court”.⁵²

⁵¹ The Chief Justice of the Supreme Court at the time, Sajjad Ali Shah, later stated: “the independence of the judiciary can be maintained only when the Chief Justice has some kind of control over the appointment of judges.....the appointment of judges should not be made by executive for political reasons.....”. See: Interview, published in the monthly Herald, January 1998, Page 48.

⁵² Cover Story, the monthly Newsline, December 1997, Pages 24, 25.

In spite of the consequent division and conflict amongst judges of the Supreme Court, the Chief Justice resolutely went ahead with the trial of the Prime Minister. On the day fixed by the Supreme Court for the hearing, the ruling Pakistan Muslim League (PML) transported thousands of its supporters to stage a protest against the Chief Justice. The charged mob⁵³ broke the gate of the Supreme Court building and ransacked it, forcing the Supreme Court Judges to abandon the trial and retire to their chambers.

The unprecedented mob attack on the Supreme Court by a ruling political party brought in its wake a major constitutional crisis. President Leghari accused the Prime Minister of inciting the attack and warning that “he would not allow the law of the jungle to prevail”.⁵⁴ The Prime Minister retaliated by moving an impeachment notice against the President in Parliament and also sending him a summary advising him to sack the Chief Justice. The President was now faced with the choice of getting impeached or signing what he regarded as an illegal order against the Chief Justice. In a situation where the Army appeared unwilling to step in to resolve the crisis, the President decided to resign.⁵⁵ Thus, the powers that were earlier distributed between the Chief Justice, the President and the Prime Minister, were now concentrated in the hands of the Prime Minister.

After the Judiciary the next target became the Press. The Government began to harass journalists who had exposed a series of corruption scandals.⁵⁶ This harassment reached a dramatic stage when the Jang Group of newspapers (one of the largest in the country) which had been critical of the Prime Minister, was targeted by his regime. The publisher of the Newspaper was specifically

⁵³ The mob attack, was evidenced in the video record of the court. This was also widely reported in both the international and national press. See for example: Monthly Newline, December 1997, Page 26.

⁵⁴ Newline op.cit. Page 26.

⁵⁵ The indication that the Army had decided to stay aloof came when the Army ignored requests by both the Chief Justice and the President to provide physical security to Chief Justice Sajjad Ali Shah following the mob attack on the Supreme Court.

⁵⁶ The editor of the Friday Times, a respected liberal weekly newspaper, Mr. Najam Sethi reported that his printers were served with notices threatening closure. Thugs were sent to soften him up and rape and kidnapping threats were made to his wife and children. See: The Friday Times, October 9-15, 1998.

pressurized to dismiss nine journalists from its staff, whom the government found “unacceptable”.⁵⁷

The Press in Pakistan received another shock when the regime abducted the editor of an influential weekly newspaper, the Friday Times in a midnight raid on his home.⁵⁸

After enhancing the power of the Prime Minister relative to some of the other institutions, focus now shifted to the Army. The Chief of Army Staff, General Jehangir Karamet, voiced the Army’s concern at the deteriorating economic, political and law and order situation in a letter to the Prime Minister. As the contention for power within the State structure continued, the underlying crisis worsened. On October 5, 1998 in his annual address at the Pakistan Navy War College in Lahore, General Karamet expressed his worries publicly as a prelude to stepping down rather than initiating military intervention. He argued that Pakistan could not afford “the destabilizing effects of polarization, vendettas and insecurity driven expedient policies”.⁵⁹ The Prime Minister responded by indicating his intent to order premature retirement of the Army Chief. General Karamet chose to leave gracefully and tendered his resignation.⁶⁰

⁵⁷ Income tax notices were served, the Jang Group’s bank accounts were frozen, newspaper godowns sealed, its journalists threatened and sedition cases lodged. That the government’s conflict with the Jang Group did not hinge merely on the non-payment of income tax, became apparent when an audio tape of a telephone conversation between Nawaz Sharif’s top aides dealing with the Press and Mir Shakil ur Rehman (the Jang Group’s chief editor) was revealed. One of the government’s aides issued clear threats on the phone and the policy that his newspapers should follow. This audio tape was played to a public audience at the Lahore Press Club. Also See: The Friday Times, February 5-11, 1999: Ejaz Haider: Press Government or State-Society Struggle? Editorial: Well Fought Shakil-ur-Rehman.

⁵⁸ The daily News, Tuesday, May 11, 1999, Front Page. The editor’s bedroom was broken into, at 2:45 a.m., by a security agency of the civil establishment, and he was handcuffed, dragged out of bed and taken away without a warrant of arrest.

The democratic elements in civil society, were outraged both by the manner of Mr. Sethi’s “arrest” and the subsequent failure of the government to bring him to trial before a court of law. Apart from Mr. Sethi’s case, which got wide publicity, there were other less famous cases of journalists being persecuted for expressing a dissenting opinion. In spite of attempts at intimidation and illegal detention of the journalists, the press withstood the pressure and emerged a stronger institution.

⁵⁹ Quoted in the article titled: General Discontent, by Zafar Abbas, in the monthly Herald, October 1998, Page 44.

⁶⁰ Zafar Abbas, op.cit. Page 45.

Not long after the appointment of the new COAS General Musharraf, tensions between the Prime Minister and the Army intensified. In August 1999, matters came to a head when an attempt was made to appoint a new Army Chief without consulting with the existing one. Having given appointment orders to a new Army Chief (General Zia ur Rehman) while the existing one was in Colombo on an official trip, action was initiated (unsuccessfully as it turned out) to prevent the landing in Karachi of the PIA aircraft on which General Musharraf was returning. This brought to a dramatic head, the confrontation between the Prime Minister and the Army. The Army swiftly launched a coup d'etat that brought the military government of General Pervez Musharraf into power.

It is perhaps indicative of the gravity of the national crisis, that there was no significant public protest at the overthrow of the popularly elected government.

The Supreme Court in its validation of the military take-over referred to the crisis explicitly: "On 12th October 1999 a situation arose for which the constitution provided no solution and the intervention of the Armed Forces through an extra constitutional measure became inevitable which is hereby validated..."⁶¹ In establishing the grounds of its verdict, there were three key elements in the Supreme Court judgment:

- (1) ".....all the institutions of the state were being systematically destroyed and the economy was in a state of collapse due to the self serving policies of the previous government....."⁶²
- (2) "..... a situation had arisen where the democratic institutions were not functioning in accordance with the provisions of the constitution....." and ".....there was no real democracy because the country was by and large under one man rule"⁶³

⁶¹ Text of the Supreme Court Verdict in the Military Take-over Case published in the daily Dawn, 13th May 2000 Page-5.

⁶² Ibid.

⁶³ Ibid.

- (3) “..... An attempt was made to politicize the Army, destabilize it and create dissension within its ranks, and where the judiciary was ridiculed.....”⁶⁴

Governance during the late 1990s intensified to a critical level the three key elements of the crisis that threatened the state: (i) A collapsing economy. (ii) The threat to the life and property of citizens resulting from rampant crime, and the emergence of armed militant groups of religious extremists. (iii) The erosion of many of the institutions of democratic and effective governance.

Given the dynamics of Pakistan’s power structure and the greater strength of the military relative to other institutions within it, when a democratic regime fails to deliver on these issues, power would be expected to flow to the military.⁶⁵ In spite of the adverse international environment for a coup d’etat, in October 1999, power did flow to the military when the crisis of the state had reached a critical level and the democratic government was seen to be exacerbating rather than resolving the crisis.

IV.2 Public Office for Private Wealth: The Macro Economics of Corruption

Whatever the institutional weaknesses in the democratic edifice of 1989, it was brought down by the individualized pursuit of power and the use of public office for private gain. The establishment of honest and competent governance, and the strengthening of institutions could have preserved democracy. The relative strength of the Prime Minister within the power structure essentially depended on demonstrating that the government was turning the country around from its descent into economic collapse, religious extremism and the break down of law and order. It was delivering on these counts that could have deepened democracy by winning greater legitimacy and space to the undoubtedly constrained democratic structure. As it was, the failure to deepen democracy undermined even its existing fragile form.

⁶⁴ Ibid.

⁶⁵ For an analysis of these dynamics, see: Akmal Hussain: *The Dynamics of Power: Military, Bureaucracy and the People*, in K. Rupasinghe and K. Mumtaz (ed.): *Internal Conflicts in South Asia*, Zed Books, London (1996).

During the mid 1990s, large amounts of funds were siphoned off from public sector banks, insurance companies and investment institutions such as the National Investment Trust (NIT) and the Investment Corporation of Pakistan (ICP). The evidence was found in the non-performing loans, which the state controlled financial institutions were forced to give to the friends of the regime, in most cases without collateral⁶⁶. During this period the NIT and ICP were forced to lend to patently unviable projects which were then quickly liquidated. The purpose of such lending apparently was not to initiate projects but to transfer state resources into private hands. The case of an oil refinery in Karachi and a cement plant in Chakwal have been quoted as examples of infeasible projects funded by the NIT on political grounds and both projects declaring bankruptcy⁶⁷.

Burki and Pasha have estimated that the overall cost to the country of corruption at the highest level of government, was 20% to 25% of the GDP in 1996-97, or approximately US \$ 15 billion⁶⁸. The estimate includes the losses incurred due to corruption in public sector corporations such as the Pakistan International Airlines, Sui Northern Gas, Pakistan State Oil, Pakistan Steel, Heavy Mechanical Complex, the Water and Power Development Authority, and the Karachi Electric Supply Corporation. The losses of these public sector corporations had to be borne by the government and constituted a significant element in the growing budget deficits. Financing the budget deficits through the banking sector meant reducing the credit available for genuine private sector investment.

Occurring at a time when GDP growth had already begun to fall below its historical trend rate, widespread governmental corruption may have been a significant factor in intensifying the slow down in investment, increasing the economic burden on the poor and perpetuating the inadequacy of basic services during this period.

⁶⁶ See: S.J. Burki. op.cit. Page 174.

⁶⁷ S.J. Burki, op.cit. Page-175.

⁶⁸ S.J. Burki, op.cit. Page 174.

The World Bank in its recent literature has focused on the link between good governance and greater and more equitable development.⁶⁹ Conversely it can be argued that widespread corruption in Pakistan during the 1990s adversely affected investment and growth in at least three ways: (1) The uncertainty and lack of transparency in government policy and the loss of time and money associated with governmental corruption would create an unfavourable environment for private sector investment. (2) Widespread corruption implied that following an investment decision, the investor would have had to pay bribes at various stages of project approval and implementation thereby raising project cost. A significant proportion of private sector savings directed at new projects would flow to corrupt government officials rather than into productive investment. The consequent decline in the overall productivity of capital in the economy would lead to lower GDP growth for given levels of investment. Evidence shows that such a decline in the productivity of capital did indeed occur in the 1990s. Recent estimates show that in Pakistan's manufacturing sector, the productivity of capital has been declining since 1992-93.⁷⁰ (3) Since banks and investment finance institutions were being forced to lend on political grounds and there were substantial defaults as a result, it is clear that a significant proportion of banking capital was being transferred as rents to corrupt individuals. This would adversely affect private investment in two ways: (a) There would be lesser credit available for investment. (b) Due to the increased "transactions cost" of banks following defaults, the interest rate for private investors would increase.

Corruption during the 1990s, may have not only slowed down investment and growth but also increased inequality and the economic burden on the lower income groups. This happened in three ways: (1) Increased corruption and mismanagement in government meant that for given levels of development expenditure, there were fewer and poorer quality of public goods and services. This was clearly manifested in the deterioration of the irrigation system with lesser water available at the farm gate⁷¹, as well as a reduced availability and

⁶⁹ Governance and Development World Bank, Washington DC. Page 3.

⁷⁰ See: Nomaan Majid. Pakistan: An Employment Strategy, ILO/SAAT, December 1997.

⁷¹ Out of the 93 MAF of water extracted from the rivers as little as 31 MAF reached the farmer, i.e. 67% of the water was lost due to deterioration in canals and water courses.

quality of health, education and transport services provided by the government. (2) The total development expenditure (as a percentage of GDP) itself fell sharply during the 1990s, partly due to budgetary constraints induced by low revenues. The problem of the narrow tax base was accentuated by the massive leakage in the tax collection system due to corruption. According to one estimate this leakage amounted to 3 percent of the GDP, about twice the level ten years earlier.⁷² The consequent low revenues, combined with slower GDP growth and high levels of government's current expenditure, led to unsustainably high levels of budget deficits. (3) Since the government was unable to plug the leakage in the tax collection system, or reduce non development expenditure, it had to resort to increased indirect taxation to deal with the fiscal crisis. Evidence on the incidence of taxation during the late 1980s and early 1990s shows that the tax burden as a percentage of income was highest at 6.8 percent for the lowest income group (less than Rs.700 per month) and lowest at minus 4.3% for the highest income group (over Rs.4,500 per month)⁷³. Thus, the burden of governmental mismanagement and corruption was passed on to the poorest sections of society.⁷⁴

IV.3 Economic Growth, Employment and Poverty in the Decade of the 1990s

During the decade of the 1990s, political instability, historically unprecedented corruption in governance, and the worsening *law and order* situation perhaps had a significant adverse effect on private investment and GDP

⁷² Shahid Javed Burki: Governance, Corruption and Development: Some Major obstacles to Growth and Development, The Banker, Lahore Spring 1998.

⁷³ See: Overcoming Poverty, Report of the Task Force on Poverty Alleviation, May 1997.

⁷⁴ Corruption by successive governments during the 1990s was not only a factor in undermining the economy, and intensifying the deprivation of the poor, but also in eroding the very legitimacy of the political system.

Prime Minister Benazir Bhutto's government in August 1990, and Nawaz Sharif's government in April 1993 were both dismissed by President Ishaq Khan under Article 58.2(b) of the constitution on charges of corruption and economic mismanagement. In July 1997, during her second tenure as Prime Minister, Bhutto's government was dismissed on similar charges, this time by President Farooq Leghari who had been her close political associate. President Leghari in his dismissal order charged that the corruption under Benazir Bhutto's government had seriously damaged state institutions. Furthermore, he believed that mismanagement and corruption had brought the entire political system "close to collapse". (S.J. Burki, Pakistan: Fifty Years of Nationhood, op.cit. Page 171).

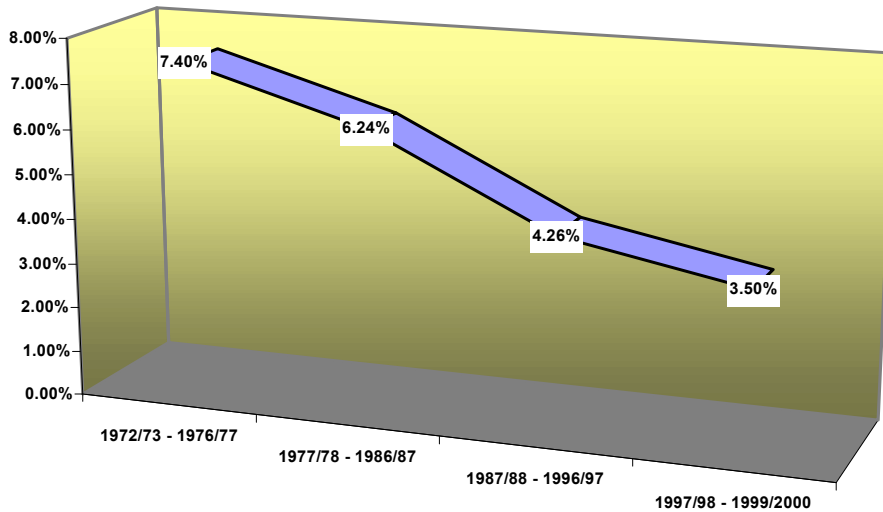
growth. Yet these factors merely accentuated the tendency for declining growth that was rooted in structural factors, which were manifest even in the 1980s. The failure of successive governments in this period to address the deteriorating infrastructure and the emerging financial crisis further exacerbated the unfavourable environment for investment. As table 1 shows, total investment (as a percentage of GDP) declined from 17.9% in the period 1988-93 to 16.3% in the period 1993-1998. The decline in the overall investment was due to the fact that while the private sector investment did not increase (it remained around 9%), the public sector investment declined sharply from 8.7% at the end of the 1980s to 5.3% at the end of the 1990s. The decline in the public sector investment was to an extent due to “budgetary constraints”: successive governments being unable to reduce their unproductive expenditures chose instead to reduce development expenditure which fell from an average of 7.4% of GDP in the Z.A. Bhutto period (1973-77) to only 3.5% of GDP in last Sharif regime, 1997-98 to 1999-2000 (See Table 5). The chart 3 shows development expenditure as a percentage of GDP in various periods. This percentage falls from 7.4% in the Z.A. Bhutto Regime to 3.5% in the last Nawaz Sharif regime. By contrast, chart 4 shows that unproductive expenditure on government remained at a high level.

The sharp decline in the investment and the GDP growth for such a protracted period in the 1990s though unprecedented in Pakistan’s history, had nevertheless been predicted. My study in 1987 had argued that the high growth experience of the preceding three decades may not be sustainable in the next decade due to structural constraints rooted in the deteriorating infrastructure, low savings rates and slow export growth.⁷⁵

⁷⁵ Akmal Hussain in his 1987 study predicted:“.....if present trends continue, we may be faced with the stark possibility that high GDP growth may not be sustainable over the next *five years*.....” (Emphasis added). See: Akmal Hussain: Strategic Issues in Pakistan’s Economic Policy, Progressive Publishers, Lahore 1988, Page xviii.

Declining growth in the next decade could be predicted because: “..... the strategic variables and sectors through which growth is sustained over time seem to show a declining trend: For example the growth rate of fixed investment, the domestic savings rate, the growth rate in the value of exports, and finally the weight of the commodity producing sectors in the economy.....”, Akmal Hussain, op.cit. Page-4.

Chart 3
Development Expenditure (ADP) as a Percentage of GDP in Various Periods



While GDP growth declined during the 1990s (from 6.3% in the 1980s to 4.2% in the 1990s), employment growth has continued to remain at a low level of 2.4% since the 1980s. This indicates that the employment problem persisted during the 1990s. At the same time the growth of labour productivity declined (see Table 6), which would be expected to push real wages downwards. The available evidence shows that this is indeed what happened in the 1990s: an ILO study suggests that real wages of casual hired labour (which is the predominant form of hired labour in Pakistan) declined in both agriculture and industry, during the 1990s.⁷⁶

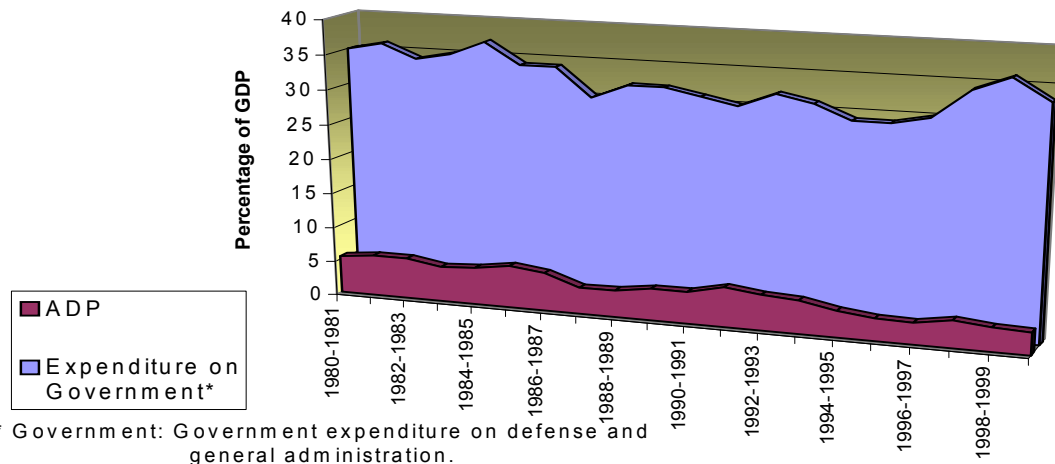
⁷⁶ Nomaan Majid: ILO/SAAT, op.cit. Pages 34, 35.

TABLE 6**GROWTH OF GDP, EMPLOYMENT AND PRODUCTIVITY IN TWO DECADES**

GROWTH	<i>Percent</i>	
	1980s	1990s
1. GDP GROWTH	6.3	4.2
2. EMPLOYMENT GROWTH (TOTAL)	2.4	2.4
(i) Agriculture	1.9	1.6
(ii) Manufacturing	1.4	-0.4
3. PRODUCTIVITY GROWTH (TOTAL)	3.9	1.8
(i) Agriculture	2	1.7
(ii) Manufacturing	7	4.6

SOURCE: NOMAAN MAJID, PAKISTAN: AN EMPLOYMENT STRATEGY, ILO/SAAT, DECEMBER 1997 (Mimeo), TABLE A5, PAGE 58.

Chart 4
Expenditure on Government* Compared to Development Expenditure (Percent of GDP)



An examination of the evidence on employment elasticities in various sectors shows that the employment elasticity in the manufacturing sector declined sharply from 0.17 in the 1980s to minus 0.10 in the 1990s, while in agriculture it declined only slightly. However employment elasticities in construction and trade increased substantially over the two decades (see Table 7). This evidence of declining employment elasticities in agriculture and manufacturing when combined with the evidence of declining output growth in these two sectors, suggests a crisis of employment and poverty emerging during the 1990s.⁷⁷ The fact that there were slower economic growth rates, declining employment elasticities and falling real wages in both agriculture and industry during the 1990s, had an important implication for the mechanism of poverty creation: It meant that increasingly, the second family members of households on the margin of poverty could not get adequate wage employment. This could have been a significant factor in pushing increasing numbers of households into poverty.

⁷⁷ Agriculture and manufacturing have historically absorbed the bulk of the employed labour force in Pakistan. For example in 1969-70, 72.6% of the total employed labour force was employed in these two sectors. By the mid nineties this percentage fell, but was still over 60%.

TABLE 7**EMPLOYMENT ELASTICITIES OF OUTPUT BY SECTORS IN TWO DECADES**

EMPLOYMENT ELASTICITY	<i>Percent</i>	
	1980s	1990s
Agriculture	0.49	0.48
Manufacturing	0.17	-0.10
Construction	1.05	1.81
Electricity & Gas	-0.39	0.32
Transport	0.48	0.14
Trade	0.37	1.22

SOURCE: NOMAAN MAJID, PAKISTAN: AN EMPLOYMENT STRATEGY, ILO/SAAT, DECEMBER 1997. PAGE 48

A second important dimension of the dynamics of poverty creation in this period was located in the increased fluctuations in agricultural output which was pointed out in a recent study.⁷⁸ It indicates that under conditions of declining input productivity, when higher input/acre is required to maintain yields, the subsistence farmers with fewer resources are likely to suffer a greater than average decline in yields compared to large farmers. At the same time, due to lack of savings to fall back on, they are relatively more vulnerable to bad harvests under conditions of unstable growth.⁷⁹ Consequently, slower and more unstable growth during the 1990s could be expected to be accompanied by growing poverty and inequality. The evidence shows that this is precisely what happened during the 1990s: The Gini coefficient, which is a measure of the degree of inequality, increased from 26.85 in 1992-93 to 30.19 in 1998-99. Similarly the percentage of the population below the poverty line (calorific intake basis) was 26.6% in 1992-93, and increased to 32% in 1998-99⁸⁰.

⁷⁸ Akmal Hussain: Employment Generation, Poverty Alleviation and Growth in Pakistan's Rural Sector: Policies for Institutional Change, ILO/CEPR, Mimeo, 1999. This study analyses the structural factors that slowed down agricultural growth and increased its variability from year to year.

⁷⁹ Ibid. Page 4.

⁸⁰ Federal Bureau of Statistics, Government of Pakistan, April 2001, (Mimeo).

V. THE MUSHARRAF REGIME AND AFTER⁸¹

The multifaceted crisis of economy, society and state, as we have discussed, reached a critical point by the end of the 1990s. The collapse of the formal democratic structure within which the contention for power by the informal “Troika” had been conducted, created the space for yet another military intervention in Pakistan’s politics in October 1999. In view of the gravity of the crisis the Supreme Court validated the military take over and gave General (later President) Musharraf permission to run the government for upto three years and hold general elections by October 2002.

During the extra constitutional interregnum President Musharraf’s government formulated a comprehensive set of reforms aimed at addressing the crisis of poverty, reviving the economy and establishing the institutional basis of good governance. At the same time through a number of constitutional amendments the political system was restructured. The powers of the President were enhanced and a National Security Council was established to ensure that the newly elected government maintains the “continuity” of reforms initiated by the military government. The new political dispensation signified the institutionalization of military power within the political structure. What was previously an informal presence in the conduct of governance now became formal. It therefore embodied a shift in the balance of political power from the civilian to the military domain within the political system. This shift was the result as much of the failure of democratic governments to pursue public interest in the 1990s, as it was by the military to maintain its influence in politics.

V.1 The Nature and Dynamics of the Musharraf Regime

The coup d’etat which had brought General Musharraf into power in October 1999, had occurred on the crest of a contention for supremacy within the

⁸¹ This section is drawn from the author’s work embodied in two of his recent research studies: (i) Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan, The Asia Foundation, Islamabad (Mimeo), 14th April 2008. (ii) Institutional Imperatives of Poverty Reduction, Institute of Public Policy, Beaconhouse National University, Lahore (Mimeo), 17th April 2008.

power structure between an elected civilian government and the military⁸². The institutional imbalance wherein the judiciary lacked independence enabled General Musharraf to get a verdict from the Supreme Court validating his unconstitutional military intervention. Imbalance within the institutional structure between the judiciary, legislature and the executive emanated partly from the tendency of the military to dominate the government with scant regard for institutional balance, and partly by the proclivity of elected civilian governments to undermine judicial independence⁸³. Both tendencies arose because of the absence of informal norms which would induce the various protagonists to exercise their power within the formal constraints of the constitution. The consequent institutional instability was illustrated in the grounds of validation by the Supreme Court of the new military government: With reference to the preceding civilian government of Prime Minister Nawaz Sharif the Supreme Court declared that "...there was no real democracy because the country was by and large under one man rule..." and that "...democratic institutions were not functioning in accordance with the provisions of the constitution..."⁸⁴. It was this institutional imbalance that was to once again result in conflict in March, 2007 after a brief period of stable government.

As General Musharraf embarked on constructing a new political edifice he simultaneously acquired the offices of Army Chief and President. This metaphor of the dual office signified the dominance of the military not only in the power structure but in the institutional framework of governance. Furthermore he created the National Security Council (in which the heads of Army, Navy and Air-force were permanent members). The NSC was another indicator of the institutionalization of the military's role in governance. In earlier years national security policy was conducted by the Defence Committee of the Cabinet which was headed by the elected Prime Minister and in whose meetings Service Chiefs

⁸² See Akmal Hussain, Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan, The Asia Foundation, Islamabad (Mimeo), 14th April 2008. Chapter 2, Section VI.

⁸³ Ibid.

⁸⁴ Text of the Supreme Court Verdict in the Military Take-over Case published in the Daily Dawn, May 13, 2000, Page-5.

attended by invitation. By contrast the National Security Council now superseded the Defence Committee and became the supreme body for conducting national security policy. Since national security affairs covered a wide range of sectors in both foreign and domestic policy, the NSC effectively acquired oversight functions over the government.

In the October, 2002 elections the government engineered the exile of the leaders of the two mainstream moderate political parties, Ms. Benazir Bhutto of the PPP and Mr. Nawaz Sharif of the PML-N, and thereby constrained the success prospects of these parties. By contrast the government facilitated the participation of the religious parties such as the JUI (F) and the Jamaat-e-Islami. The religious parties came together in an alliance (MMA) and were able to win the election in the NWFP and formed the provincial government. In the center, the ‘king’s party’, the PML(Q) acquired a majority with the support of an ethnic party with strength in the major cities of Sindh. The federal government through the support of the MMA was able to pass the 17th amendment to the constitution which enabled General Musharraf to hold the dual offices of Army Chief and President for a limited period and concentrated power in the office of the President rather than the Prime Minister as envisaged in the parliamentary democratic framework of the 1973 Constitution. Thus a new political structure was created within which the military acquired a dominant role and in which the role of the Prime Minister and the Parliament was restricted.

V.2 The Search for Legitimacy: Security and the Economy

President General Musharraf sought legitimacy for his political structure through two strategic initiatives: (i) The decision to join the U.S.-led coalition in the “war against terror” (ii) Using the fiscal space afforded by this action, to achieve domestic political support through a strategy of “Growth with Poverty Reduction”. Both these strategic initiatives were to meet with only limited success.

The MMA government in the NWFP which had been expected to politically defuse the burgeoning influence of militant extremists in fact began to provide a protective political umbrella to them. In a dramatic demonstration of their power and outreach the Taliban and Al Qaeda elements provided the

military support to enable Abdul Aziz, the Khateeb of Lal Masjid (located in the heart of Islamabad) to convert the mosque into an armed fortress. From this redoubt Abdul Aziz and his gang of militants and madrassah students challenged the State: They gave an ultimatum to the federal government to impose Shariah Law in Pakistan. At the same time madrassah students from Lal Masjid formed vigilante groups and began to coerce and intimidate shopkeepers to stop selling CDs and videos and women to stop going to work, to cease driving and observe *pardah*. They also started kidnapping women who they thought were engaged in immoral activities and placed them in detention within the Lal Masjid compound. When security officials attempted to restrain this vigilante action a number of them were also kidnapped and imprisoned in the Lal Masjid. The government after protracted negotiations with the Lal Masjid militants finally launched a military operation against an enemy who turned out to be battle hardened, highly skilled and well equipped. They were defeated through the heroic action of Pakistan's elite commando group (SSG) from the 111 brigade. However, the militants were able to give a spectacular display of their military power and political outreach: As the sound of automatic gun fire and explosions shook Islamabad, the battle was covered by world media.

The Al Qaeda appear to have formed an alliance with the domestic Taliban, and have turned their attention to Pakistan. As the scale and intensity of their guerilla attacks increased they began to enlarge their territorial control over Pakistan's periphery first in the tribal belt of Waziristan and then in the settled towns of Swat and NWFP. They simultaneously began to launch suicide attacks against military personnel and installations as well as political leaders in the heartland of the country. These suicide attacks were apparently designed to demonstrate the outreach of Al Qaeda-Taliban and at the same time to undermine confidence in the ability of the government to protect its soldiers and citizens. The growing success of militant extremist groups who had emerged as rival powers to that of the state within its territorial domain, created a crisis of state authority.

The crisis of state authority reached a new level of severity and acquired a tragic dimension with the assassination of the charismatic Benazir Bhutto. She

was a symbol of courage and the hope of successfully combating the militant threat within a democratic polity. Her assassination sparked sustained and widespread rioting across the country with a breakdown of law and order in a number of towns in the Sindh province. The crisis of state authority has deepened in three ways: (a) The ability of Al Qaeda-Taliban to kill the key political leaders they choose to target and to destabilize the country has been demonstrated dramatically; (b) The credibility of the state apparatus to provide security to the country's leadership and to maintain order has been further undermined; (c) The political structure constructed by President Musharraf within which elections were to be held and the war against Al Qaeda-Taliban was to be conducted, has been weakened to a critical level.

V.3 **Economic Growth and Poverty 1999-2007**

The most important feature of economic performance during the Musharraf regime was that in spite of relatively high GDP growth rates during the period 1999 to 2005 there was no significant reduction in poverty. In the subsequent years as food inflation accelerated sharply, so did poverty. For the period 1999-2007 as a whole the evidence suggests that even though the GDP growth rate was relatively high (averaging at 5.8 percent), the percentage of population living below the poverty line in fact increased from 30 percent in 1998-99 to 33.8 percent in 2007-08⁸⁵. In this section, I will briefly examine the issue of growth sustainability and provide evidence from my recent study of poverty trends during the Musharraf period.

V.3.1 *The Question of Growth Sustainability*

I had argued in the year 2006 that the high GDP growth observed in the preceding three years was not likely to be sustainable in the future because the strategic parameters and the institutional structure that sustain GDP growth were not favourable⁸⁶. Unfortunately this prediction proved correct and Pakistan's GDP growth began to decline in 2007.

⁸⁵ Akmal Hussain, Institutional Imperatives of Poverty Reduction, Institute of Public Policy, Beaconhouse National University, Lahore, 17th April 2008 (Mimeo). page 25.

⁸⁶ Akmal Hussain, Is GDP Growth Sustainable, The Daily Times, 1st May 2006.

Pakistan's pattern of GDP growth is historically characterized by a stop-go pattern, with about six percent GDP growth achieved during periods of military governments when there were large and concessionary foreign capital inflows that filled the gap between the low domestic savings rate and the target investment rate. During periods of elected civilian governments GDP growth rate has been much lower as foreign capital inflows declined. With an incremental capital output ratio (ICOR) in Pakistan at 4, to sustain a GDP growth of 6 percent, would require an investment rate of 24 percent (investment as a percentage of GDP). In the Musharraf period the investment rate averaged at 17 percent. At the same time the domestic savings rate in Pakistan has averaged at around 12 percent which means that the large gap between savings and investment has to be financed through loans, official development assistance or foreign private capital inflows.

The second strategic parameter for growth sustainability is an export structure that is capable of an export growth high enough to finance the high import expenditures associated with high GDP growth rates. In Pakistan's case the export structure is still predominantly dependent on the textile industry at the lower value added end of the manufacturing spectrum. With low income elasticities of demand the textile industry in Pakistan has historically proved incapable of bearing the burden of generating the foreign exchange earnings necessary to finance the import requirements of high GDP growth⁸⁷. Consequently, each period of high GDP growth in Pakistan has ended with intense balance of payments pressures which have forced a slow down in the subsequent period. The same pattern has recurred during the Musharraf period in which after a period of high growth, severe balance of payments pressures have slowed down GDP growth this year (2007-08).

The inadequacy of social and economic infrastructure, characterized by 91.7 percent of the labour force being unskilled and poor physical infrastructure

⁸⁷ For a detailed discussion of this issue, See, Akmal Hussain, *Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan*, op.cit. pages 89 to 100.

in both the rural and urban areas has now emerged as a significant constraint to sustainability of both agriculture and industrial growth⁸⁸.

The institutional structure is primarily oriented towards rent generation and rent appropriation by an exclusivist elite which prevents most of the population from participating in the process of economic growth. This factor combined with the inherent instability of the institutional structure of governance is another important factor that constrains growth⁸⁹.

V.3.2 *The Question of Poverty Reduction*

The Musharraf government claimed that it had reduced the percentage of population below the poverty line, from 34 percent in the year 2000-01 to 23 percent in the year 2004-05, i.e. a reduction of 11 percentage points. If true, this would mean that almost one third of Pakistan's poverty problem had been eliminated within a period of four years.

We will examine the Musharraf government's claim of a huge poverty reduction by first analyzing the sources of GDP growth during the period and then putting the government's poverty estimates to scrutiny, on the basis of a recent study done by Haris Gazdar, Asad Sayeed and Akmal Hussain⁹⁰.

An analysis of the sources of growth during the period 2000-01 to 2004-05 shows that the composition of growth during the period was pro rich rather than pro poor. It was fueled mainly by the services sector, (particularly banking and communications) which contributed 60 percent of GDP growth during the period and the manufacturing sector primarily manufacture of automobiles, luxury consumer electronics, cement and textiles, which contributed 30.4 percent of GDP growth during this period. (Gazdar, Sayeed and Hussain, 2008). It is clear that GDP growth during the period was overwhelmingly pro rich since none

⁸⁸ Ibid.

⁸⁹ Akmal Hussain, *Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan*, op.cit.

⁹⁰ Haris Gazdar, Asad Sayeed and Akmal Hussain, *Growth, Poverty and Conflict: 1999-2007*, Chapter 3 in Akmal Hussain, *Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan*, 2008, op.cit.,

of the sectors which mainly constituted the growth was either producing goods for the poor or directly providing employment to them. In fact the labour force survey data of the government shows that unemployment rates rose sharply from 6.1 percent in 1999 to 8.3 percent in 2004⁹¹. Therefore the nature and composition of GDP growth during this period could not be expected to have substantially reduced poverty.

Let us now scrutinize the poverty estimates of the government. With respect to the estimation procedure it is important to understand that the magnitude of change in the incidence of poverty depends on two factors: (a) The base year used for comparison at two points in time. (b) The inflation rate used as a deflator to estimate changes in the consumption over time at constant prices. Now, regarding the first factor the government's estimate of poverty reduction uses the year 2000-01 as the base year which is a year of bad harvest, and compares it to the year 2004-05 which is a good harvest year. Clearly comparing a drought year with a good harvest year will, *ceteris paribus*, exaggerate the magnitude of poverty reduction. It is therefore more appropriate to compare the year 1998-99 with the year 2004-05.

With respect to the second factor, the government's poverty estimate uses an inappropriate inflation rate based on the consumer price index, which only covers 16 urban centers. It does not take account of prices in the rural areas where the majority of the poor reside. Indeed inflation rate data based on both urban and rural areas was available from the Pakistan Living Standard Measurement (PLSM) survey. The PLSM data of course shows a much higher inflation rate. The government instead chose the CPI index for inflation which would yield an artificially low inflation rate and thereby a much higher magnitude of poverty reduction. Mr. Talat Anwar in an earlier study has attempted to correct the biases in the official poverty estimates by using the year 1998-99 as the base year and the inflation rate drawn from the PLSM data. His estimate shows that during the period 1998-99 to 2004-05 poverty declined by only 1.8 percentage points, from

⁹¹ See, Akmal Hussain, *Institutional Imperatives of Poverty Reduction*, op.cit. Table 6, page 23.

31.1 percent in 1998-99 to 29.3 percent in 2004-05⁹². The estimate of Gazdar et.al., which excludes the Sindh Sub-sample on grounds of serious inconsistencies, yields a poverty reduction estimate of only 0.6 percentage points with poverty declining from 31.3 percent in 1998-99 to 30.7 percent in 2004-05. The World Bank poverty estimates which also use the PLSM data for the inflation rate yield a poverty reduction of 0.8 percentage points over the period 1998-99 and 2004-05⁹³.

One can conclude therefore that, *there has been no significant poverty reduction during the period 1998-99 to 2004-05*. This conclusion is consistent with the sources of growth analysis based on national income data.

Let us now consider the incidence of poverty in the subsequent period, 2005-08. The following table 8 which is drawn from my recent study, provides for the first time an estimates of the incidence of poverty in the post 2005 years together with projections for the period 2008-12⁹⁴.

⁹² Talat Anwar, Measurement of Absolute Poverty and Governance in Pakistan: 1998-99 and 2004-05, paper presented in the PIDE-PSDE, 22nd Annual General Meeting and Conference (19-21 December 06).

⁹³ Akmal Hussain, Institutional Imperatives of Poverty Reduction, op.cit. Table-7, page 26.

⁹⁴ Akmal Hussain, Institutional Imperatives of Poverty Reduction, op.cit pages-24 to 25.

Note: The poverty estimates for the period 2005-08 have been made, using the figure for elasticity of poverty with respect to food inflation made by Sajjad Akhtar and Mansoor Ahmed: Modeling Poverty Trends in Pakistan: Some Additional Empirical Evidence, Social Policy and Development Center, Karachi, 1999.

TABLE 8
INCIDENCE OF POVERTY, 1999 TO 2012

Year	Head Count Ratio World Bank Estimates	Impact of Food Inflation On Poverty	
		Head Count Ratio	Number of Poor
	(%)	(%)	Million
1998-99	30.00	30.00	40.35
2001-02	34.40	34.40	50.21
2004-05	29.20	29.20	45.48
2005-06		28.68	45.74
2006-07		29.47	48.12
2007-08		33.81	56.55
2008-09		36.11	61.84
2009-10		38.41	67.35
2010-11		40.71	73.10
2011-12		43.01	79.08

Estimates: By Akmal Hussain and Ahsan Shah

Note: The estimation procedure for the levels of poverty in various years assumes no change in the distribution of income in the period 2005 to 2008. To the extent that income distribution in this period has become more unequal, the poverty levels would be higher than those given in the table.

Sources:

- (i) Incidence of poverty figures (Head Count Ratios) for the period 1998-99 to 2004-05 are given in the World Bank Report, Pakistan: Promoting Rural Growth and Poverty Reduction, World Bank, 2007, page 9.
- (ii) Incidence of poverty figures for the years 2005-06 to 2007-08 have been estimated by Akmal Hussain and Ahsan Shah, as are the projections for the years up to 2008-12. The food inflation used for estimating poverty in the future (2008-12) is the average for the years 2004-05 to 2007-08. The food inflation rates for the years 2004-05 to 2006-07 are obtained from the Pakistan Economic Survey 2006-07.
- (iii) Population estimates are made on the basis of the population growth rate given in, World Development Report, Equity and Development, World Bank, 2006, page 293.
The number of poor for the years 1998-99 and 2001-02 are based on the population figures given in the Pakistan Economic Survey 1999-2000 and 2001-2002.
- (iv) The poverty elasticity with respect to food inflation is obtained from Sajjad Akhtar and Mansoor Ahmed, Modeling Poverty Trends in Pakistan: Some Additional Empirical Evidence, Social Policy and Development Centre, Karachi, 1999.

The table 8 shows that in the year 2005-06 poverty continues to decline slightly as high GDP growth is maintained and food inflation kept under control. However after this poverty begins to increase gradually as food inflation increases. The upward trend in poverty accelerates subsequently as GDP growth slows down and food inflation rises sharply. By the year 2007-08 the poverty level reaches 33.8 percent which is about the same level as the high point of 2001-02. The absolute number of poor increased from 40.35 million in 1998-99 to 56.55 million in the year 2007-08. Thus about 16 million people were pushed into poverty during the Musharraf regime.

On the basis of evidence presented in table 8 it can be concluded that the poverty reduction achieved during the period 2001-02 to 2004-05 was neutralized by the high food inflation rate and the slow down of GDP in the later years. *For the Musharraf period as a whole, 1998-99 to 2007-08, the incidence of poverty has increased by 3.8 percentage points from 30 percent in 1998-99 to 33.8 percent in 2007-08, with an additional 16 million people entering the category of poor over the period.*

The economic strategy of the Musharraf regime did achieve high rates of GDP growth. However the pro rich nature of the GDP together with high food inflation rates resulted in increased poverty, inequality and unemployment. Furthermore the services of health and education which are crucial for the welfare of the poor could not reach adequate coverage or quality in the absence of adequate service delivery mechanisms. Thus the high GDP growth in the Musharraf period was perceived to have brought affluence to the few without benefiting the poor significantly. Consequently, just as the Musharraf government was celebrating the success of its economic policies, there was growing resentment amongst the middle classes and the poor, as in the period at the end of the Ayub regime⁹⁵. In the elections that followed the “king’s party”, the PML (Q), which Musharraf was supporting, was routed. The people had given their verdict on the Musharraf government’s claims of economic success and substantial poverty reduction.

⁹⁵ Akmal Hussain, Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan, op.cit. page 114.

V.3.3 *Power Dynamics and Institutional Instability*⁹⁶

As elections approached, an institutional crisis erupted in March 2007 following the attempt by President Musharraf to remove Chief Justice Iftikhar Chaudhry from his office in order to secure a second term for himself. There was an unprecedented citizens' protest movement led by lawyers. It culminated in the re-instatement of the Chief Justice by the judiciary on July 20th, 2007 following a historic assertion of independence by a battered Judiciary. However, the success of the citizens and the Judiciary in establishing the institutional balance envisaged in the constitution, was short lived. By the end of October 07, the government began to fear that the Supreme Court headed by Chief Justice Iftikhar Chaudhry was likely to give a judgment disqualifying General Musharraf from being a candidate for the Presidential election. On November 3, 07 Musharraf in his position as Army Chief issued a proclamation suspending the Constitution, withdrawing fundamental rights of citizens and initiating draconian measures to gag the media⁹⁷. At the same time General Musharraf gave himself powers as President to amend the constitution by executive order. He subsequently modified the Army Act as a result of which civilians could be court marshaled with charges of sedition for offences such as expressing an opinion.

In a historic suo moto judgment the Supreme Court on the day of the proclamation of the emergency, declared it unconstitutional and without legal effect. The Judges of the Supreme Court were promptly sacked and placed under house arrest. As in March 2007, once again the unconstitutional action of General Musharraf was met with countrywide protests by lawyers, journalists and small groups of citizens, including human rights activists, academics, professionals, and (for the first time in the citizens' movement), university and high school students.

General Musharraf established his political structure on the basis of an initial suspension of the Constitution following the coup d'etat of October 1999. He dismantled the political structure through a second suspension of the

⁹⁶ This sub section is drawn from Akmal Hussain, *Power Dynamics, Institutional Instability and Economic Growth: The Case of Pakistan*, op.cit. pages 114-115.

⁹⁷ See the Daily Times, November 4, 2007, Page A4, for the texts of Proclamation of Emergency, The Provisional Constitutional Order and the Press Ordinance respectively.

Constitution in November 2007. The first suspension was triggered by a conflict with an elected civilian executive, while the second was triggered by a conflict with the Judiciary. The recurrent suspension of the constitution dramatically demonstrates the disequilibrium within the power structure. While the military seeks to achieve pre-eminence within the power structure and dominance over governance, the Constitution stipulates the subordination of the military to elected civilian authority. It is this incongruence between the formal rules of the constitution and the internal dynamics of the power structure that generates institutional instability: The recurrent conflict between the military, the executive and the judiciary. Achieving institutional stability and enforcing the formal rules embodied in the Constitution will require the establishment of the necessary informal norms. Such a change in the institutional *set* would be based on a political process in civil society through which a balance in the underlying power structure can be achieved.

CONCLUSIONS

In this paper we have traced through various political regimes, the dynamic interaction between the processes of deterioration in the institutions of governance on the one hand and the structure of the economy on the other. The purpose was to understand the emergence of the process of increasing poverty, the tendency for loan dependence and unstable GDP growth.

The Ayub regime was characterized by denial of political rights to the people and economic policies that induced acute social and regional economic disparities. The resultant political tensions exploded into a civil war and the emergence of independent Bangladesh. We saw how the mechanisms of rural poverty observable to-day, were rooted in the increased peasant dependence on the landlord, and asymmetric markets for inputs and outputs that resulted from a particular form of agricultural growth during the Ayub period. The analysis also showed how the tendency for the economy's loan dependence so manifest to-day, may have originated in the policies of the Ayub regime. The government by providing state subsidies locked the economy into an industrial structure which was dominated by low value added industries, incapable of generating adequate foreign exchange for the country.

The structural constraints to fiscal space were exacerbated as successive governments engaged in financial profligacy, and allocation of state resources based on considerations of political patronage rather than economic efficiency. Nationalization of industries during the Z.A. Bhutto period enlarged the domain of power and patronage for the regime. However the consequent growing losses of nationalized units laid the basis of subsequent fiscal haemorrhaging of the government. The sharply rising budget deficits during the Z.A. Bhutto period were accentuated by a huge increase in expenditures on the State apparatus as part of the attempt to build a domain of patronage and power within the State structure.

The military regime during 1977 to 1987 sought to establish dictatorial rule by means of an obscurantist and retrogressive version of religious fundamentalism. State resources were used for the first time to foster armed

groups of religious extremists and to finance religious seminaries (madrassas) many of which, systematically indoctrinated young minds to hate and kill. The politics of the Zia period therefore laid the basis of the emergence of armed militant groups in society and sectarian violence which was to undermine the process of investment and growth as much as the institutions of governance. During the Zia regime State funds were directed to establishing a theocratic State instead of urgently needed investment in the maintenance of the irrigation system and technical training of the human resource base. Consequently, when the cushion of foreign financial assistance was withdrawn after the Afghan war, investment and growth declined, budget deficits increased sharply, and poverty intensified.

The decade of the 1990s was marked by democratically elected leaders using public office for private gain. The resultant misallocation of national resources during this period accentuated the fiscal crisis. We have analyzed how the widespread corruption during this period was an important factor in not only reducing private sector investment, but also reducing the productivity of capital, thereby sharply slowing down GDP growth. During this period the structure of GDP growth also underwent further adverse changes as both capital and labour productivity fell sharply, together with declining employment elasticities. A reduction in capital productivity led to slower growth, while reduction in labour productivity led to falling real wages. As both GDP growth and real wages fell, poverty tended to increase. This tendency was reinforced by declining employment elasticities. Thus, bad governance and associated adverse changes in the structure of the economy, in this period, laid the basis for a rapid increase in poverty and unemployment.

We have seen how the military regimes of Ayub Khan and Zia ul Haq laid the structural basis for the deterioration in both the polity and economy of Pakistan. We have also seen that the democratically elected regimes in various periods not only sought authoritarian forms of power within formally democratic structures, but also accelerated the process of economic decline. The crisis of poverty and human development in Pakistan therefore is located as much in the

deterioration of institutions and the economy, as it is in the failure of individual leaders to pursue public interest rather than their own.

The military regime of President Musharraf institutionalized the role of the military in the political structure. Musharraf sought legitimacy through a strategy of growth with poverty reduction and establishing law and order through the 'war against terrorism'. Both these attempts met with inadequate success. While the law and order situation worsened dramatically, so did the poverty levels, even though GDP growth rates were high. Rising poverty, high rates of food inflation, growing unemployment and shortages of basic items such as wheat, gas and electricity combined to undermine the political structure constructed by the Musharraf regime. Pakistan's moment of crisis is pregnant with the potential of civil society and political parties together reconstructing a democratic order based on subordinating the military to elected civil authority and thereby establishing constitutional stability and the rule of law. It is within such a democratic polity that both political and economic stability can be achieved to enable development for the people and by the people.

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