ECONOMIC POLICY, GROWTH AND POVERTY IN HISTORICAL PERSPECTIVE

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Article published in The Encyclopedia of Pakistan
Oxford University Press, Karachi (2006)

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The study of history, since it reconstructs the past, is essentially conducted from the vantage point of present concerns. Pakistan's present policy challenge is to achieve a level and structure of economic growth that can rapidly reduce poverty. In an attempt to trace the genesis of the problem, this article provides a historical analysis of the emergence of an economic structure that: (a) constrained the capacity of GDP growth to reduce poverty, (b) constrained the potential to achieve a high GDP growth on a sustainable basis.

The policies of various political regimes have not only been distinct but have had a profound impact on institutions and the structure and growth of the economy. Therefore in examining Pakistan's economic history it is useful to periodize it in terms of political regimes rather than simply in terms of five year plans.

The emerging architecture of Pakistan's economy is founded in its institutional structure and the nature of governance. Therefore, in tracing Pakistan's economic history we have indicated, albeit briefly, the relationship between the practice of power by governments, the process of institutional decay and the nature of Pakistan's economic growth process[1].

[1] For a more detailed analysis of the relationship between the practice of political power, the process of institutional decay, and the economic structure, See: Akmal Hussain, Institutions, Economic Structure and Poverty in Pakistan, South Asia Economic Journal, Volume 5, Number 1, January-June 2004, SAGE Publications, London and Delhi, 2004.

I. THE AYUB REGIME (1958-69): GROWTH, INEQUALITY AND LOAN DEPENDENCE

The military coup d'etat, which brought General Ayub Khan into power, established the dominance of military and bureaucracy in Pakistan's power structure. The associated political system while it weakened the nascent democratic institutions of the legislature, press and the judiciary, constituted authoritarian power behind a civilian facade called "basic democracy". The economic strategy of the government, while it induced rapid GDP growth, sharply accentuated inter-personal and inter-regional inequalities, which generated explosive political tensions. These tensions erupted in a mass movement against President Ayub Khan in West Pakistan and a national independence movement in East Pakistan that culminated in the emergence of the new state of Bangladesh.

I.1 Industrial Growth, Inequality and Loan Dependence

The decade of the 1960s is seen by many as the 'golden age' in terms of the high growth rates achieved through the provision of subsidies and tariff protection to industry and an elite farmer strategy in agriculture. It was also a period when the mould was set for the emergence of an economic structure that was to lock Pakistan's economy into increasing income inequality, a narrow and inefficient industrial base, and increasing loan dependence, for the next four decades.

Following the Korean boom in 1953, the government had introduced a policy framework for inducing the large profits of traders in jute and raw cotton to flow into the manufacturing sector. This was attempted through a policy of encouraging the domestic production of consumer goods through a variety of protection measures during the 1950s[2].

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 a wide

[2] Consequently the growth in manufacturing industry during the decade of the 1950s was impressive at 8.1 percent, although overall growth in GNP remained at a relatively low level at 3.4 percent. This was primarily because of slow growth in the agriculture sector (2.3 percent), which was the predominant sector in the economy. See: Shahid Javed Burki: Pakistan, Fifty Years of Nationhood, Vanguard, Lahore, 2004, Table 3.3, Page 100.

range of protection measures for domestic manufacturers. These included high import tariffs on imported consumer goods, cheap credit, and in some cases 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[3], tax rebates, tax exemptions and accelerated depreciation allowances to increase post tax profits.

The magnitude of protection provided by the government to private sector industry was such that it enabled domestic manufacturers to earn large rupee profits on the production of goods that were not internationally competitive. It has been estimated[4] 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. Indirect subsidies such as the Bonus Voucher Scheme combined with the overvalued exchange rate, enabled domestic manufacturers to earn large rupee profits on exports that brought no gain to the economy in terms of foreign exchange.

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 persisted[5]. This set the "mould" for Pakistan's narrow export base (concentration on the low value added end of textiles) and the associated debt problem, which persisted for the next three decades. 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.

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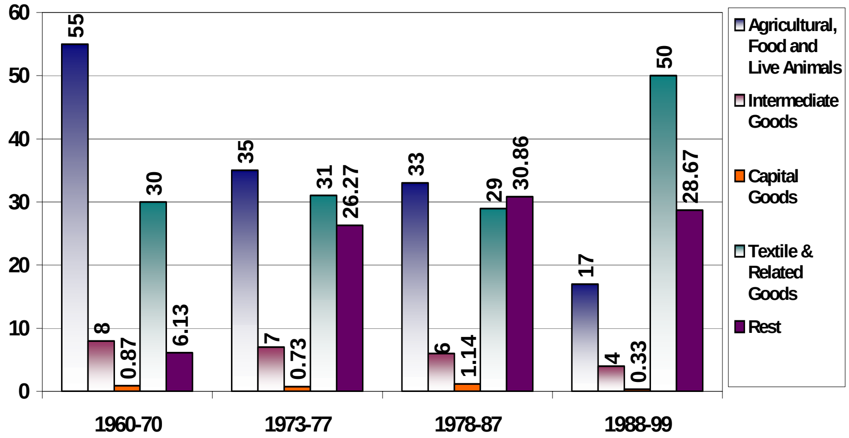
3 The Bonus Voucher Scheme enabled exports of certain manufactured goods to receive in addition to the rupee revenue of their exports, bonus vouchers equivalent to a specified percentage of the foreign exchange earned. The vouchers could be sold in the market (to potential importers) for a price usually 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.

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

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

Chart 1
Period Averages of Exports of Various Commodity Groups as a % of Total Exports of Pakistan



The government during the 1960s adopted a deliberate policy of concentrating national income in the hands of the upper income groups.[6] 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 consumption.[7] Far from raising the domestic savings rate to 25%, the actual savings rate never rose above 12%[8].

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

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6 "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.

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

8 Ibid. Page 133.

million in 1965-70. The rapid increase in foreign aid was accompanied by a change in its composition from grants to higher interest loans[9]. Consequently the debt-servicing burden rose dramatically. Debt servicing as a percentage of foreign exchange earnings which was 4.2% in 1960-61, 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 inter-locking directorates dominated industry, banking and insurance in Pakistan[10]. 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.[11] The insurance industry, although smaller in size than banking, also had a high degree of concentration of ownership. Forty-three industrial families controlling 75.6 percent of the assets of Pakistani insurance companies tended to favour industrial companies owned by the same group.[12]

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9 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.

10 For a detailed analysis of this phenomenon, see: Rashid Amjad: Private Industrial Investment in Pakistan, 1960-1970, London, Cambridge University Press, 1982.

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

12 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. See: L.J. White, op.cit., Pages 74-75.

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.[13] 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.[14] According to one estimate, in 1971-72, poverty in the rural sector was so acute that 82 percent of rural households could not afford to provide even 2,100 calories per day per family member.[15]

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

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

[14] K. Griffin and A.R. Khan, op.cit. Pages 204-205.

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

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 food grain 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 Baluchistan and the North West Frontier Province.[16]

I.2 Agriculture Growth and the Structure of Poverty

The failure to conduct an effective land reform in Pakistan had 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 a doctoral thesis[17] it has been 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.[18] For example in the case of farms in the size class 150

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16 Naved Hamid and Akmal Hussain: “Regional Inequalities and Capitalist Development”, Pakistan Economic and Social Review, Autumn 1974.

17 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, June 1988.

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

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 peasantry[19].

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 today[20].

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

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[19] See: Akmal Hussain, Strategic Issues in Pakistan's Economic Policy, op.cit. Page 187

[20] This phenomenon was first analyzed in a Doctoral Thesis: Akmal Hussain, D. Phil Thesis, op.cit.

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.

the reproduction of rural poverty, even though overall agricultural growth accelerated. 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): GROWTH, NATIONALIZATION AND THE FISCAL CRISIS

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.

Soon after 1973 there was a purge of radical middle class element from the PPP, and the achievement of a dominant position within the party by the landed elite. Consequently there was an institutional rupture between the PPP and the 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 economic 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.[21]

II.1 Nationalization, Investment and Growth

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[22].

It may be pertinent to point out, 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.[23] 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 attributed[24] 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)

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21 Omar Noman, The Political Economy of Pakistan, 1947-85, Routledge Kegan and Paul, London 1988, Page 79.

22 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-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.

23 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.

24 Ibid, Page 158.

entrepreneurs did not diversify into non traditional industries where there was considerable growth potential.

TABLE 1

PERIOD AVERAGES OF GROSS INVESTMENT* AS A % OF GDP

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

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 2 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 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 grounds[25]. 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.

II.2 Governance and the Emerging Fiscal Crisis

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.

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[25] Omar Noman: The Political Economy of Pakistan, op.cit. Page 80.

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. The bureaucracy was also enlarged and re-structured through the policy of 'lateral entry' which enabled loyalists outside the civil services cadre to be appointed at the upper and middle echelons[26].

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%[27] 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

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[26] 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 1974-75, see: Hafiz Pasha: "Fifty Years of Finance in Pakistan: A Trend Analysis", in Shahrukh Rafi Khan (ed.), Fifty Years of Pakistan's Economy, OUP, Karachi, 1999. Pages 209, Table-3.

[27] Omar Noman, Op. cit. Page 82.

to the educated unemployed and the latter to generate employment for the rural poor through labour intensive projects. Both programmes were marginalized due to budgetary constraints.[28]

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 amongst middle class commercial elements that had followed the nationalization of the small and medium sized food processing units in 1976. These 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): ECONOMIC GROWTH, RELIGIOUS EXTREMISM AND THE PRELUDE TO RECESSION

The various political regimes that came into power were characterized not only by their distinct economic policies, but also by the specific ideologies through which they legitimized themselves for the practice of political power. The Ayub regime propounded modernization and economic development. The Z.A. Bhutto regime donned the mantle of redeeming the poor through socialism. The Zia ul Haq regime sought to institutionalize military rule through the garb of a coercive and obscurantist version of "Islamic" ideology. Indeed the design and implementation of economic policy in various periods was conditioned by the politics of each regime.

III.1 Religious Extremism and Fiscal Space

In the pursuit of this power objective, 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,

[28] Omar Noman, op.cit. Page 122.

Quaid-e-Azam Muhammad Ali Jinnah conceived of Pakistan's polity as democratic and pluralistic with religious belief to be a matter concerning the individual rather than the state.[29]

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[30].

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 suspension of the sensibility of love and reason underlying the religious tradition signified in Pakistan's folk culture[31].

Advocacy for a theocratic social order was conducted through the state controlled television and press[32] and governmental financing of new mosque schools (madrassas)[33]

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29 "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."

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.

30 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. President Zia ul Haq declared: "Democracy means freedom of the Press, Martial Law its very negation". The Daily Dawn, 12th July 1977. 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.

31 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.

32 Omar Noman, The Political Economy of Pakistan, op.cit., Page 124.

33 According to an official report of the police department, a number of madrassas were only providing religious education. Yet as many as 42 percent of them in the Punjab alone, were

in small towns and rural areas many of which were linked with militant religious organizations involved in the Afghan war.

Political and economic 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 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 small though powerful political constituency within state and society, for a theocratic form of military dictatorship.

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.[34]

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actively promoting sectarian violence through a well conceived indoctrination process. As this new kind of madrassas emerged and grew during the Zia regime, so did sectarian violence. For example, the number of sectarian killings increased from 22 during the period 1987-89, to 166 during the period 1993-95 in the Punjab. See, Zia ul Hassan Khan: Rise of Sectarianism in Pakistan: Causes and Implications, Research Paper (Mimeo), Pakistan Administrative Staff College, Lahore, 1995.

34 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.

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 2 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 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).

TABLE 2

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

AverageDuring	Real GDP Growth % (Market Prices)	Domestic Savings as % of GDP	Average Export Growth %	Exports as % of GDP	Trade Balance as % of GDP	Workers Remitances 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.

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 4.79% of the GDP in the Bhutto period to 7.10% 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 3 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.

TABLE 3

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.*

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 2). (iii) Inadequate investment in social and economic infrastructure. As defence and debt servicing expenditure increased, the Annual Development Programme (ADP) through which much of the infrastructure projects were funded, began to get constricted. As table 4 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.

TABLE 4

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.

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. Average annual GDP growth rate declined from 6.3% in the decade of the 1980s to 4.2% in the decade of the 1990s (See Table 5). The sharp decline in GDP growth was accompanied by a dramatic increase in poverty: The percentage of population below the poverty line was 17% in 1987 and rose to 34% in the 1999-2000. At the same time, the seeds of social conflict sown with the breeding of religious militant groups, began to erupt and feed off the growing poverty and unemployment. These armed extremist groups in time began to erode the writ of the State: In the post Zia period this became an important factor in constraining private sector investment and GDP growth, a constraint that continues to remain to this day.

IV. THE DEMOCRATIC INTERLUDE (1989-1999): THE DEEPENING CRISIS OF ECONOMY AND STATE

The decade of the 1990s was marked by democratically elected regimes attempting to practice authoritarian forms of power within an ostensibly democratic order. This was combined with the use of public office for private wealth[35]. These features of governance during the 1990s, intensified to a critical level by the late 1990s, 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. Establishing competent and honest democratic governments to address these elements of the national crisis were necessary for winning greater political space for civilian rule in the undoubtedly constrained democratic structure. As it was the failure to deepen democracy, undermined even its existing fragile form.

IV.1 Economic Growth, Employment and Poverty in 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 growth.

An important factor in the sharp slow down in GDP growth and increase in poverty was the particular way in which the government addressed the fiscal crisis, which reached a critical level during this period. The government having adopted a Structural Adjustment Programme (SAP) under the auspices of the IMF, undertook the necessary reduction in public expenditure through a sharp reduction in *development* expenditure rather than in *unproductive* expenditure. (Development expenditure as a percentage of GDP fell from 7.4% in the 1970s to 3.5% in the 1990s. By contrast the government's unproductive expenditure remained at the same high level (See Chart 3). This severely restricted urgently needed public investment in infrastructure and poverty reduction projects thereby simultaneously slowing down GDP growth and accentuating poverty.

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35 For a detailed analysis and estimates of corruption during this period, see: Shahid Javed Burki: Pakistan, Fifty Years of Nationhood, op.cit., chapter 5.

Similarly the necessary increase in tax revenues was attempted not through an increase in *direct* taxation, but rather through *indirect* taxation. Since indirect taxation has a regressive effect on income distribution the increase in indirect taxation worsened poverty. For example evidence on the incidence of the tax burden by income group in Pakistan following the adoption of SAP, shows that the tax burden as a percentage of income was highest at 6.8%, for the lowest income group and lowest at –4.3%, for the highest income group[36]. Thus the tax burden on the poor increased and on the rich declined.

The particular choice of policy instruments used to pursue the reduction in the budget deficit stipulated in the SAP, thus contributed to slowing down growth and increasing poverty. Apart from this, the *sequencing* of the measures adopted further exacerbated the adverse effect on GDP growth and poverty. For example the increase in interest rates required by the Structural Adjustment Programme was initiated *before* rather than *after* the reduction in the budget deficit. Consequently, as interest rates rose sharply, so did the government's debt servicing burden and thereby an even more drastic reduction in development expenditure[37].

Yet these factors merely accentuated the tendency for declining growth that was rooted in structural factors, which were manifest even in the 1980s[38]. The failure of successive governments to address the deteriorating infrastructure and the emerging financial crisis further exacerbated the unfavorable 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

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36 Overcoming Poverty, The Report of the Task Force on Poverty Eradication, May 1997, Page 6.

37 This was pointed out by Rashid Amjad, in his paper titled: Solving Pakistan's Poverty Puzzle: Who Should We Believe? What Should We Do? Paper presented at the PIDE 19th Annual General Meeting and Conference, 13th–15th January, 2004, Islamabad.

38 A 1987 study by Akmal Hussain 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 deteriorating infrastructure, low savings rates and slow export growth: "…….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, op.cit., Page xviii.

public sector investment declined sharply from 8.7% at the end of the 1980s to 5.3% at the end of the 1990s.

While GDP growth declined during the 1990s (from 6.3% in the 1980s to 4.2% in the 1990s), employment growth 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 5), which served to push real wages downwards[39].

TABLE 5

GROWTH OF GDP, EMPLOYMENT AND PRODUCTIVITY IN TWO DECADES

Percent

GROWTH	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.

39 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. See: Noman Majid: Pakistan: An Employment Strategy, ILO/SAAT, December 1997, Pages 34 and 35.

Chart 2
Development Expenditure (ADP) as a Percentage of GDP in Various Periods

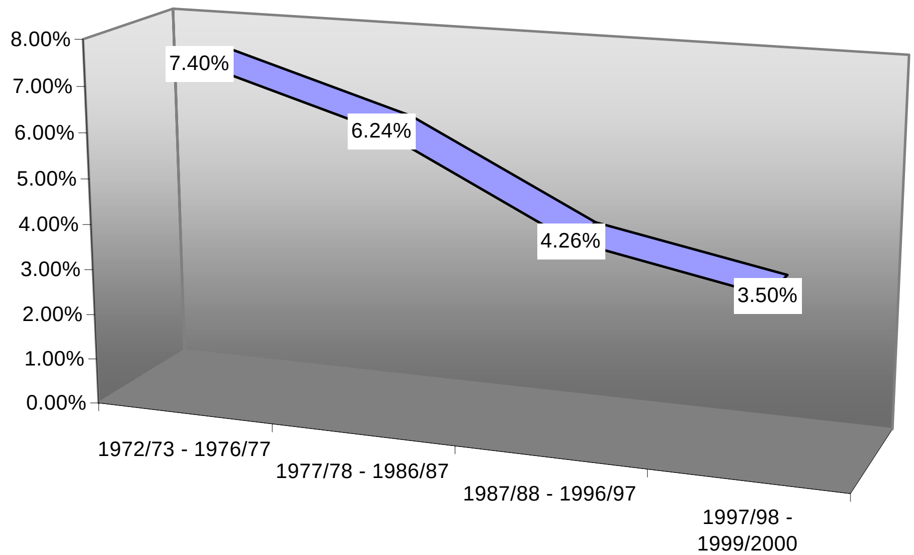
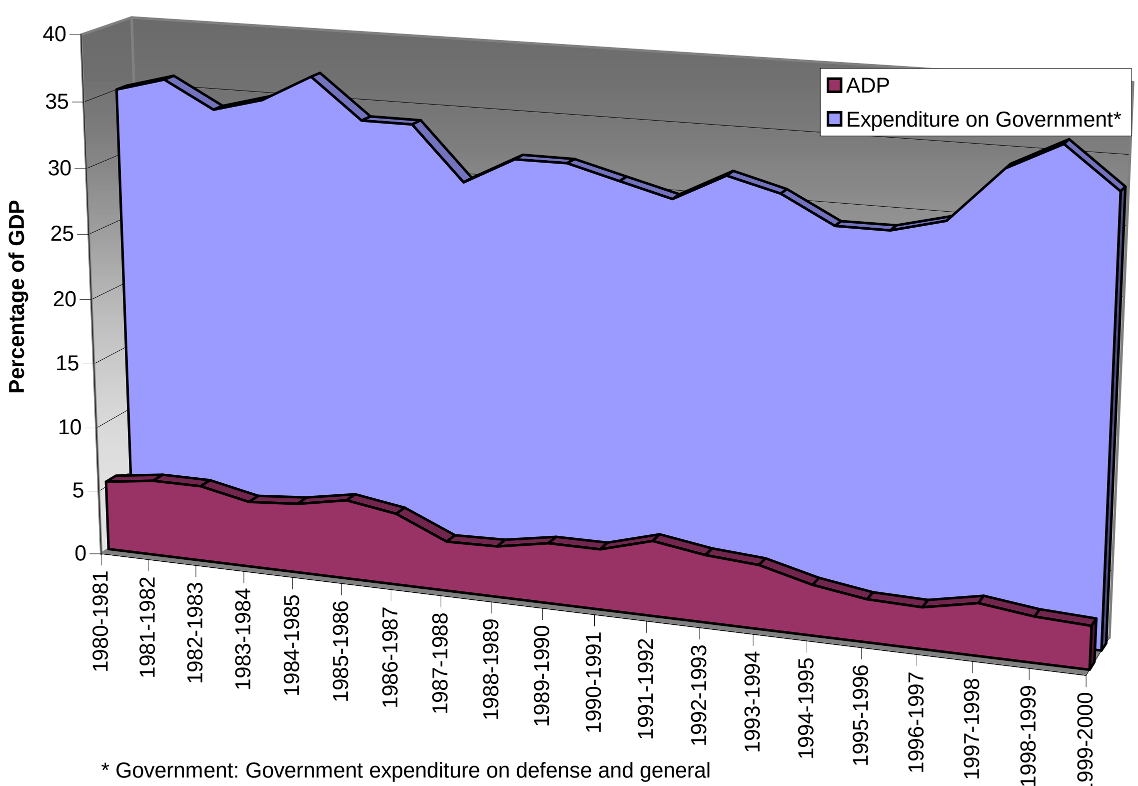


Chart 3
Expenditure on Government* Compared to Development Expenditure (Percent of GDP)



* Government: Government expenditure on defense and general administration.

Evidence on sectoral employment elasticities shows that employment elasticities in both agriculture and industry declined during the 1990s. Thus the adverse effect on poverty of slower GDP growth rates in the 1990s was accentuated by this structural constraint to employment generation in agriculture and industry. Another structural dimension of the process of poverty creation in this period was located in the increased fluctuations in agricultural output which was pointed out in a recent study.[40] 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.[41] 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 1998-99[42].

V. POSTSCRIPT: THE MUSHARRAF REGIME AND THE ECHOES OF HISTORY

The multifaceted crisis of economy, society and state had reached a critical point by the end of the 1990s. This set the stage for the collapse of the formal democratic structure within which the contention for power between the military and elected political leadership had been conducted during the 1990s. President Musharraf’s government formulated a comprehensive set of reforms aimed at reviving the economy, and establishing the institutional basis for improved governance. At the same time through a number of constitutional amendments the political system was restructured. The powers

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40 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.

41 Ibid. Page 4.

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

of the President were enhanced even as he retained the post of COAS, and the National Security Council was created to ensure "political stability" and "continuity" of economic reforms. Thus the new political dispensation signifies the institutionalization of military power within a political structure in which an elected government also has a role to play.

During the regime of President Musharraf, economic policies combined with the changed international environment following 9/11, have enabled a substantial improvement in macro economic indicators: The GDP growth rate has accelerated to over 6 percent in the last two years, the debt servicing burden has become tolerable, the budget deficit has been brought down substantially and State Bank reserves have reached record levels. However, inspite of the recent sharp acceleration in GDP growth there has been no significant reduction in poverty. At the same time the question remains of whether this high GDP growth can be sustained. This is because recent high GDP growth has been predicated essentially on the large scale-manufacturing sector, and within this sector it is relatively narrowly based in the growth of just three industries: (a) Consumer durables particularly automobiles, (b) Construction, (c) Textiles.

Three economic challenges confront the country: (1) To restructure the economic growth process so as to enhance its capacity for poverty reduction, (2) To broaden the basis of GDP growth and make it sustainable, (3) To establish the writ of the State, a viable democratic structure and a culture of tolerance. These are necessary conditions for achieving a substantial and sustained increase in private sector investment, both domestic and foreign. They are equally necessary for building a future for the people of Pakistan that is better than the past.

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