Pakistan and the International Economic Agencies

Ph.D Dissertation

By

Noor Fatima

National Institute of Pakistan Studies
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SUBJECT: EVALUATION REPORT OF VIVA-VOCE EXAMINATION OF MS. NOOR FATIMA, PH.D. SCHOLAR, NATIONAL INSTITUTE OF PAKISTAN STUDIES, QUAID-I-AZAM UNIVERSITY, ISLAMABAD.

The Viva-voce Examination of Ms. Noor Fatima, Ph.D. scholar of the National Institute of Pakistan Studies, Quaid-i-Azam University was conducted on 08-12-2007 at the National Institute of Pakistan Studies. She was examined through questioning on her thesis entitled “Pakistan and the International Economic Agencies”.

We found her answers quite satisfactory. The thesis is a good research work. We unanimously recommend that she may be awarded Ph.D. Degree in Pakistan Studies.

(Dr. Saeed Shafqat)
External Examiner

(Dr. Rashid Ahmad Khan)
External Examiner

(Dr. Ghulam Hyder)
Supervisor

(Dr. Tariq Rahman)
Director

Tel: (office) 051-2896003, 2896014 (Fax) 051-2896004
DECLARATION

I hereby declared that this thesis is the result of my individual research and that it has not been submitted concurrently to any other university for any other degree.

Noor Fatima
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<td>Full Form</td>
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<td>---------</td>
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<tr>
<td>BWIs</td>
<td>Bretton Woods Institutions</td>
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<tr>
<td>CCL</td>
<td>Contingent Credit Lines</td>
<td></td>
</tr>
<tr>
<td>CIA</td>
<td>Central Investigation Agency</td>
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<tr>
<td>EFF</td>
<td>Extended Fund Facility</td>
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<tr>
<td>ESAF</td>
<td>Extended Structural Adjustment Facility</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GATT</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GNI</td>
<td>Gross National Income</td>
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<td>HDI</td>
<td>Human Development Index</td>
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<td>HIPC</td>
<td>Heavily Indebted Poor Countries</td>
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<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
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<td>IFIs</td>
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<td>IMF</td>
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<td>IPPs</td>
<td>Independent Power Producers</td>
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<tr>
<td>KESC</td>
<td>Karachi Electric Supply Company</td>
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<tr>
<td>LSM</td>
<td>Large Scale Manufacturing</td>
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<td>MA</td>
<td>Multilateral Assistance</td>
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<td>NPT</td>
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<td>PL</td>
<td>Public Law</td>
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<td>PPP</td>
<td>Pakistan Peoples Party</td>
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<td>PRGF</td>
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<td>PSDP</td>
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<td>Special Drawing Rights</td>
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<td>STF</td>
<td>Structural Transformation Facility</td>
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<td>TA</td>
<td>Technical Assistance</td>
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<td>UNDP</td>
<td>United Nations Development Program</td>
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<td>WAPDA</td>
<td>Water and Power Development Authority</td>
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<td>WB</td>
<td>World Bank</td>
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<td>WTO</td>
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ABSTRACT

The present thesis analyses the impact of foreign aid on the economy and development of Pakistan with special reference to the role of IMF and World Bank, specifically, it seeks to captures the effects of Structural Adjustment Programs in late 1980s and 1990s.

It also deals with the various development models and critically examines the failures and successes of structural adjustment programs, keeping in view the actual effects of these programs around the world.

A brief mention has been made about the structure and objectives of IMF and World Bank according to their mission statements. It helped in later analysis of their role vis-à-vis the economic situation of Pakistan and other recipient countries.

This study concludes that structural adjustment program have played significant role in Pakistan’s economic development. In this context the economic indicators like GDP, balance of Payment, inflation and poverty reduction have shown downward trends. As the figures in late 1980s and early 1990s show, one can conclude that it was the lean period from economic point of view. Since economy and politics are closely inter-related, the political development effecting the foreign relation with the donor countries have also been analyzed. While emphasizing my own point I have to be objective; but I feel Pakistan’s economic development could have been better if alternative policies discussed in detail in the thesis had been pursued.
INTRODUCTION

Pakistan is heavily dependent on foreign assistance. For the last two decades it has received unusual grants-in-aid and loans from international Financial Institutions (IFIs), like World Bank (WB) and International Monetary Fund (IMF) to meet its financial needs, caused by inadequate domestic financial resources.

Pakistan’s economic performance has been quite impressive from 1950s to 1980s but in late 1980s and 1990s its position became vulnerable. It had started its structural adjustment program in mid 1980s, and it remained controversial whether it was beneficial for Pakistan to approach the IMF and WB for such borrowings or it had other choices also?

It is generally believed that the debt servicing and conditionalities were responsible for slowing down the growth rates from 6 percent in 1980s to 3 percent in 1990s. To make situation worse poverty also increased sharply.

Keeping in view, Pakistan’s precarious economic situation and a greater intrusion of multinationals, it will be instructive to investigate as to how Pakistan has adjusted to reduced role of the state in economic management as required by the neo-liberalist paradigm of economic governance. The economic policies which Pakistan had to adopt for structural adjustment will be evaluated in the light of this change of form.

There is no denying the fact, that economic liberalization may have been beneficial to some extent, but its overall economic impact on Pakistan’s economy remains an open question.
Paradoxically the conditionalities attached to liberalization of the economy, apparently, were directly instrumental in worsening the balance of payment, deficit and external indebtedness.

In this study a modest attempt has been made to enquire into impact of foreign aid on Pakistan’s political economy. The attention is focused on the period 1990-1998, slightly before the present rulers took over the rein of the Government. To understand the changes which occurred during this period a review of the political economy of Pakistan from 1947 to 1990 was also necessary to reach to the present situation. In this regard chapter two and three have been solely devoted to highlight the financial requirement of Pakistan vis-à-vis the aid agencies.

Since economic performance can never be separated from political development, and Pakistan had been passing through a period of economic and political instability, the question is whether Pakistan as a front-line state between the capitalist and the communist worlds till the breaking away of Soviet Union, was a deliberate act on the part of the Western powers. This seems to be the case because the parameters of this relationship changed once Soviet Union ceased to pose real threat to the West.

Though, it is also a fact that there were powerful currents which affected policy formulation over the last 57 years. As a result neither the civilian nor Military governments since 1947 ever bothered to take into account the implication of economic dependency for Pakistan’s healthy growth as an independent state. The borrowed funds, during this period, were not utilized properly and instead diverted towards other areas, rightly or wrongly, as per government priorities. To enhance the favorable impact of foreign aid on the economic development it was necessary to closely monitor utilization
of the fund. But this did not happen because neither the government of Pakistan nor the lending agencies had any effective mechanism of monitoring.

Generally speaking, economic development is closely related to the political scenario, therefore, political ups and downs are made part of this study to give it a comprehensive look. More attention has been paid to governance in its various forms because the political attitudes in economic decision making and method of governance are linked with economic development.

Such a study is all the more necessary for a country like Pakistan where political structure is not very stable and there is always a sort of hide and seek going on between military and civil authority. As the students of political history of Pakistan are well aware, Pakistan is a story of fractured democracy, bad governance and economic destabilization, so research has to take these factors into account. However, within such obvious limitations this study has tried to record and mention important political policies related steps taken to shape the economy. Pakistan is a country where politics and economy have always been put to tests and experimentations. Every new leader is very keen to philosophized in the field of ideology, economy and governance. But it is ironical that most of the governments were dragged by ad-hocism and serious choices were fragmentary.

In most of the cases, there was no viable economic model and circumstances steered the economy from one trap to another. Except the longer period of two Martial Laws and Bhutto’s radicalization of the economy, other periods can be labeled as hang-over of the period of the previous government or an attempt to come out of the management or mismanagement of the previous regime.
So the process of discovery never stops in the changing politico-economic scenario. Such changes also compensate one's curiosity and in finding the fundamental differences, between the modes of governments and economic choices. Consequently the reader would find that proper links have been established in the following chapters, while leaving, from one political climatic zone and entering into the other.

As we know, foreign assistance remained the main feature in determining the course of our economy, so the study has been done about subtleties of conditionalities of various aid packages, particularly from the period 1988 to 1998.

In this regards as a background I have thrown some light on the purpose of establishment of Bretton Woods Institutions and their relationship with the US economic policies, which also apply on Washington Consensus and other devices that referred to neo-liberal economic agenda.

Any research related to Pakistan's economy has some obvious limitations. Not much work has been done to evaluate the impact of international donors in economic development so far. There are few authentic books and reports and papers, published by International Agencies, like World Bank, IMF and Asian Development Bank and other such institutions. As, the whole work is related to facts and figures, one has to rely mostly on the Economic Surveys and Statistical Reports, Five Year Development Plans, of Government of Pakistan and annual reports of State Bank of Pakistan. Independent surveys have hardly been conducted. Though the figures of inflation, Gross Domestic Product, balance of payment are always questioned along with the reliability of the government generated figures, we had no option but to use them.
Some times it happens that the figures provided by other institutions do not match with the figures issued by the Government of Pakistan. As in the present budget the figure about a 10 percent jump in poverty in four year i.e. from 2001 to 2006 is not accepted by the independent economist. A general complaint of research scholars is about the inadequate material found in the libraries for a particular subject and the books of the related to that subject. In this regard libraries are not fully equipped to train and guide the students and research fellows properly.

There are certain other constraints for instance, economic policies today do not produce results the next day. One has to wait to see the long term effect of policies introduced by one regime or another. The impact of the policies on economy is felt long after the government is gone, toppled or removed. The policies introduced by one government do not go through the test of sustainability because of the tenure of the government in Pakistan though constitutionally fixed, but the governments have never remained in office for the full tenure allotted to them through constitution except one regime during 1970s.

We have mainly focused on the IMF and World Bank as the main aid agencies for the purpose of this study, but there were many other institutions that also offered aid to Pakistan. During the research it was realized there are multiple options and criteria to judge the impact of the aid. However, long lasting results of implementation can show certain indicators which can give a comparative study of this program but there is no proper criterion evolved to find an immediate impact of the program, of Structural
adjustment. Though there is some criterion established by the economist which has been included in the book.

**Significance of the Study:**

This study constitutes an effort to evaluate analytically the widely shared view in the developing countries, that the World Bank and IMF’s all-pervasive intrusion into economic management of Pakistan did not help an economic growth. It is hoped that this study would reveal political, economic and social constraints and compulsions that led to present stage of declining economic performance. It seeks to find out clues as to how Pakistan can become self-sufficient and lessen the dependency on foreign assistance. Examples of other countries like China and India, which have opted to remain economically independent and progressing well in economic and social fields nevertheless, would help Pakistan to adopt a new line of approach after having experience of foreign pressure for more then fifty years of its existence.

**Objective of the Study:**

This study has hopes to encourage an informed dialogue about the probable consequence of foreign aid and structural adjustment on Pakistan’s economy. To this end I have presented the relevant literature in support of different points of view on the program.

In the second chapter, the economic picture of Pakistan has been presented at the time of independence. A bird’s eye view is given of industries, agriculture and financial resource along with administrative capability of the government to meet the requirements of a newly independent country. The state of human capital, the salaries and
infrastructure developed during early period of country's inception was very meager. It also covers railways, road and inland water ways, air transport, postal services, etc. We arrive at the conclusion that there was little hope for Pakistan to survive without financial assistance.

The third chapter covers the period form 1947 to 1977, the first period of development after independence. In this chapter the inevitability of foreign aid for newly independent country with reference to Pakistan has been discussed in detail. The chapter starts with the kinds of aid, grants and loans available to Pakistan at the initial stage. Moreover, in the absence of any type of financial resources Pakistan had no option but to ask for aid. The early endeavors in this respect have been explained in details.

Pakistan's economic development during the period 1958-68 has been highlighted as a model for capitalist development and various criticisms in this regards have also been addressed. Moreover Bhutto's socialism, or bureaucratic capitalism has been shown to be retrogressive because it marred the progress towards capitalist development. His nationalization was actually a great blow to nascent capitalism. A full analysis of macro-economic policies has been given in this chapter.

In the fourth chapter, we deal with the sudden changes in economic and political fields that occurred with the military take over for the second time. General Zia-ul-Haq after toppling the elected government of Zulfiqar Ali Bhutto used the weapon of ideology to perpetuate his rule. It has been explained in this chapter how he tried to inject his version of Islamic ideology in all sphere of life and particularly in the economy of Pakistan. An attempt has been made to differentiate between economics as a subject and
Islamic economics as publicized and applied by Zia-ul-Haq. The rate of economic development was however encouraging in this period mainly due to the injection of American aid during the Afghan war.

The last and fifth chapter relates to the period of Structural Adjustment Program (1988-1998). This is the most debated period because Pakistan had become part of the agenda of neo-liberalism and succumbed to the economic policies of the IMF and World Bank. Economically this was one of the worst periods in Pakistan's economic history, as GDP went down, and loans sky rocketed. The unemployment rates and the incidence of poverty also increased sharply. It also effected negatively the payment of debt servicing and the public sector development program. It was also a period of bad governance, marred with four acting Prime Minister, and the then four elected Prime Ministers and going out of the office, mainly due to allegation of corruption, nepotism and misuse of public funds.

The role of foreign aid has also been discussed in detail i.e. merits and demerits of Structural Adjustment (SA) and question of living without structural adjustment along with the comparative studies of the stories of successes and failures of the countries such as India, China, New Zealand and Zambia which opted for SA.

Finally this study ends with the summary of the main findings. It also gives an overall picture of the stand taken to evaluate the various important period of Pakistan's political economic history. Moreover, to explain changes in the economy, various charts and graphs have been exhibited in support of the arguments and for the convenience of the readers. An attempt has also been made to evolve an alternate policy option for development.
CHAPTER-I

THEORETICAL FORMULATION OF ECONOMIC GROWTH

1.1. Economic Growth and Development Concepts

It has been a major concern of the policymakers to understand the developing process of the developing countries and framing the policies accordingly. Therefore, it is significant to have a quick look on the various definition presented by economists for accelerating the economic growth.

Economic growth is regarded as a steady increase in national income and per capita income of the society over time. The terms economic growth and development are used interchangeably as if they were synonymous, but there is a big distinction between the two. Economic growth refers to the increase in an economy's real gross domestic product (GDP) and income over time. Real GDP is the economy's total output of goods and services, usually measured over a period of one year. The amount of achievable economic growth would depend on the human resource acquisition of the economy, technological improvement, amount of capital investment, natural resource endowment and degree of its exploitation, and the managerial know-how existing in the economy.\(^1\)

To reflect economic development, economic growth is defined in terms of increase in per capita real output or per capita income. Development encompasses the process through which societies, or nations, or regions, raise their per capita output and income by improvements and growth in productivity, and how these translate into per capita economic well-being in the society.

Economic growth is regarded as outcome of structural transformation in economy due to economic development. For economic development not only the economic growth

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is important but sufficient structural changes in economy for translating the growth in to development.

Before we move to consider the theories of economic growth and development, it is pertinent to define the developing countries. In the economic terms the developing countries are those with lower middle and upper middle incomes, translated into per capita gross national income, (GNI) between 756 $ US to $ US 9266. The concept of the developing countries is not confined only to per capita national income, but other considerations are also very important such as: level of education, health facilities, Human Resource Development and Human Right status in a country. As defined by Michael P. Todaro, “Nevertheless the characterization of the developing world as sub-Saharan Africa, North Africa and the Middle East, Asia except for Japan, Latin America and Carribean states, East Europe and Central Asia, including the former Soviet Union, the countries in the transition, remains a useful generalization”\(^1\) However for specifying the level of the development various components have been given for portrayal of structural diversity of developing nations. These components are very important considering the socio-economic development and culture of a country. The following components are considered important in the context of the economic development.

1. The size of the country( geographic area, population, and income)
2. Its historical and colonial background.
3. Its endowments of physical and human resource.
4. Its ethnic and religious composition.
5. The relative importance of its public and private sectors.
6. The nature of its industrial structure.
7. Its degree of dependence on external economic and political forces.
8. The distribution of power and the institutional political structure with in the nation.

In the present day world, the development of a country is determined by the UNDP Human Development Index. (HDI) is based on the indicators as discussed in the above Para.

While encapsulating various definition of ‘economic growth’ we can say that economic growth is a positive change in the level of production and services over a

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certain period of time. Nominal growth is defined as economic growth including inflation while real growth is, nominal growth minus inflation. Economic growth is usually brought by technological innovations, human resources and positive external forces. The most accepted definition of economic growth is given by Simon Kuznets\(^1\), which is usually cited by various economists like Michael P. Todaro\(^2\), M.L. Jhingan\(^3\) reads like this:

A long time rise in capacity to supply increasingly diverse economic goods to its population, this growing capacity based on advancing technology and the institutional and ideological adjustments that it demands.

Kuznets has mentioned five broader characteristics features manifested in the growth process of every developed nation.

1. High rate of growth of per capita output and population.
2. High rate of increase in total factor productivity.
3. High rate of structural transformation of the economy.
4. High rate of social and ideological transformation.
5. The propensity of economically develop country to reach out to the rest of the world for markets and raw material.

Economic growth naturally triggers development reflected in macro-economic indicators, growth and development are mutually inclusive and natural bed fellows. The term economic development though refers to some economic structure changes such as change in industrial production, change in occupational structure, change in foreign trade, technological progress, along with change in national income and GDP. Economic development is the basic factor of keeping the pace of economic growth. The objective of economic development is to raise GNP, poverty reduction, greater employment opportunities, equal distribution of income, better health facility etc. In strictly economic terms the traditional development was considered to be the capacity of national economy whose initial economic condition has been more or less static for a long time to generate

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\(^3\) M.L.Jhingan, The Economics of Development and Planning. Konark Publisher Pvt. Limited, Delhi: p.54
and sustain an annual increase in its Gross National Product or GDP at rate of 5 to 7 percent or more. As discussed by Dudley, economic development now also includes and redefines in terms of reduction or eliminating of poverty, inequality and unemployment within the context of a growing economy. Redistribution of growth is not considered to be a very important factor. If one or two of the central problem have been going worse it would be strange to call the result development even if per capita is doubled.¹

1.2. Analysis of Growth and Development Model

Since Adam Smith, the analysis of economic growth was one of the main fields of interest in economic theory. Particularly from the late 1940s to the 1960s, many papers dealing with the explanation of growth were published. The controversy between Post Keynesian authors such as Harrod, Domar, Kaldor and Robinson and members of the neoclassical school such as Solow, Swan, Meade, Arrow or Phelps gave inspiring insights into the process of economic growth. The discussion focused on the question whether the long-run economic growth process would converge to the stability or not. Besides many differences between these two schools of thought, most economists agreed, that technical progress is the main source of per capita income growth. For example, Solow² gave evidence to this statement by applying the concept of growth counting on the development in the USA in the period of 1909-49, and Kaldor³ stressed the key role of technological innovations for economic growth.

Nevertheless, the interest of economists declined in growth theory from the early 1970s due to the economic slowdown after the first oil price shock. They were more interested in the explanation of business cycles, which had been the dominant theme in the interwar period but, after a short boom of multiplier-accelerator models after the war, had almost fallen into oblivion when the historically unprecedented growth process of the 1950s and 1960s had shifted economist's main research areas. The period after 1973

differed from the post-war years not only with regard to the characteristics of the business cycle, but also with respect to the long-run development. The average growth rates of Gross Domestic Product as well as of productivity were significantly smaller after 1973 than before. The so-called productivity slowdown gave new impulses to growth theory although first studies applied well-known approaches to explain this phenomenon as discussed by bombach\(^1\).

The period from 1980s, can be termed as renaissance of growth theory as discussed by Paul Romer's\(^2\) that in this period the economic growth has received greater attention in economic science then ever. New Economic growth theory or endogenous growth theory was developed in this period as a response to criticism of the neo-classical growth model.

The neoclassical approaches were challenged in this time because of its theoretical and empirical shortcomings. The Solovian-type and or Solow growth model\(^3\) which are known as the Neo-classical model of long-run economic growth within the framework of neoclassical economics, cannot explain endogenously steady-state per capita growth. Exogenous technical progress was emphasized by productivity growth in the long-run equilibrium, i.e. per capita income will be constant, if technical progress does not accrue. Savings and investment decisions determine only the level of long-run productivity, but not on its growth rate\(^4\). In contrast endogenous growth theory argues that policy measures can have an impact on the long-run growth rate of an economy, even if they do not change the aggregate savings rate.

Moreover, the neoclassical model also implies that changes in the savings rate will not affect economic growth, but they will increase income levels. The endogenous

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1 G. Bombach, (1985) *Post-War Growth Revisited*. Amsterdam: North Holland
3 Robert M. Solow, (1956), 'A contribution to the theory of economic', Quarterly Journal of Economics 70 65-94. This Neo-Classical model was an extension to the Harrod-Domar model. Solow received the 1987 Nobel Prize in Economics for his work on the model.
growth theory assumes constant marginal product of capital. The endogenous growth theory also implies that higher savings levels will lead to higher economic growth.

This theory tries to overcome this shortcoming by endogenizing the rate of technological progress. Several competing models have been developed by various authors, crucial importance is usually given to the "production" of new technologies and human capital. Firms and individuals have an incentive to invent in order to exploit an advantage over their competitors, thereby improving their own productivity. New growth theory offers endogenous explanations of economic growth by focusing on constant returns to capital caused by externalities.

As emphasized by Lucas\(^1\) and Romer\(^2\) Human capital plays a crucial role for endogenous growth. In this context the efficiency of the education system and productivity of labor has become relevant for economic growth and income distribution. The growth model developed by Galor and Tsiddon\(^3\) reveals the effects of education policy on growth and distribution.

After an overview the theories of economic growth now we will present a comparative analysis of the classic economic growth theories, as per changing economic scenario, with different economic situation in the various regions of the world as new theories are being applied for economic development.

The post–World War literature on economic development has been dominated by four major approaches: (1) the liner-stages-of-growth model (2) theories and patterns of structural change, (3) the international-dependence revolution, and (4) the neoclassical, free-market counterrevolution. First we will take a brief account of these theories of economic development and later we will present the brief account of strategies of the framework of development process, since the regularization of foreign aid as one of economic resources.

\(^{3}\) O. Galor. and D. Tsiddon, (1996), 'Income Distribution and Growth: The Kuznets Hypothesis Revisited', *Economica*, 63: S103-17.01
1.2.1. Linear-Stages Approaches

Following the Second World War the economists in industrialized country were in search of a conceptual apparatus with which they could analyze the process of development in the countries lacking the modern economic structure. In such environment an American Economist Walt W. Rostow presented his doctrine of 'The Stages of Economic Growth'. According to this theory, these stages are not merely descriptive. They are not merely a way of generalizing certain factual observation about the sequences of development of modern societies. They have an inner logic and continuity.¹

Rostow was of the view, that since the advanced economies had all passed the stages of take-off in to self sustaining growth but the underdeveloped countries were still, either in the traditional society or followed a certain set of rule of development. Therefore, he suggested that as a principle and precondition for take-off, the mobilization of domestic and foreign saving in order to generate sufficient investment to accelerate economic growth is necessary.

The economic mechanism that more investment leads to more growth described by Harrod-Domar Growth Model, which suggested that every economy must save a certain proportion of its national income, however in order to grow, it needs a new investments representing net additions to the capital stock. This model has been frequently applied to developing countries growth strategy as two-gap model.²

This model assumes that the savings gap (domestic real resources) and the foreign exchange gap are imbalance in volume and the implication was that one of the two gaps will be dominant factor of the developing countries at a given point of time. This foreign exchange constraint was the basic arguments for economic motivation of external finance

² Sir Roy Harrod and Evesey Domer presented the model 'The Harrod-Domar Growth Model', in early 1950.
(both loans and grants) can play a critical role in supplementing domestic resources in order to relieve saving or foreign-exchange bottlenecks. This is so-called two-gap analysis of foreign assistance.¹

Nevertheless, these stages-of-growth strategies had its inherent constraints for the attaining the sustainable growth. As per the analysis of the Todaro², and description of Rostow, a country which can save 15 percent to 20 percent of GNP could develop at much faster pace as compared to that country which saves less. So in this model development revolved around the saving and investment ratio. New independent countries having low capital formation and want to grow for instance 7 percent a year should generate 21 percent saving investment ratio of national income and who could save only up to 15 percent. This 6 percent gap has to be managed through aid or private investment. In this way, the massive capital and technical assistance was transferred from developed to developing countries.

1.2.2. Structure Change Model:

The model of structural transformation of a primary subsistence economy was presented by W. Arthur Lewis in the mid 1950s.³ This model concentrated on mechanism by which developing economies convert their domestic economic structure to a modern economy, as most of the developing economies were agro based. This model argued for development similar to the Marxist view, that transformation of feudal society into industrial can bring development.

As per the model the over populated rural sector is characterized as underdevelopment sector because it has zero marginal labor productivity, it has the surplus labor which can not be utilized in agriculture as well as the modern urban industrial sector. The transfer of labor from the underdeveloped sector of agriculture and growth of out put in the modern sector is the focus in this model. The velocity of the labor transformation is determined by the rate of industrial investment and capital accumulation in the modern sector. Therefore, the modern sector is considered a key to

the self-sustaining growth and employment expansion from the traditional sector to modern is assumed to continue till all the surplus rural labor is absorbed in the modern industrial sector. The additional labor in Agriculture can also be withdrawn but on high cost because now the marginal product of the rural labor is no longer zero. Therefore, the structural transformation for the economy will keep the balance of economic activity while shifting from one traditional sector to the modern sector.

Though historical growth and development of Europe manifested the success of two-sector model but generally there are strong concerns of the contemporary developing countries on its key assumption that it does not fit in the institutional and economic realities. For instance, the model assumes that the rate of labor transfer and employment generation in the modern sector is determined by the capital formation, but if the capital is reinvested in the labor saving capital equipment rather than duplicating the existing capital, as implied by this model, the total GNP would raise, but it will do little improvement in aggregate social welfare measured.

The second assumption in the model which also found to be divergent to reality is that there is surplus labor in rural area and full employment in the urban areas. Economist based on the empirical research found that there is little surplus labor in rural location.¹ One can conclude that this model needs modification keeping in view the labor saving bias of most modern technological transfer, non-existence of rural surplus, gowing prevalence of urban surplus labor. However, this model was exemplary on a conceptual description of the development process.

1.2.3. The Neocolonial Dependence Model

The Neocolonial Dependence Model is considered to be further product of Marxist doctrine. According to this theory certain elite groups in developing countries such as landlords, military elite groups and bureaucrats enjoy the benefits due to perpetuations of International Capital System of inequality. The multi-national corporation and Aid Agencies like the World Bank or the International Monetary Fund

which always emphasized for the continuation of capitalist system through introduction of reforms do not serve the wider population, but their beneficiaries are the selected persons of the elite classes. Resultantly general reforms efforts are not made and new colonial view of underdevelopment attributes a large part of developing world to continue worsening poverty to the policies of the Industrialist Capitalist Countries. This type of policy they achieve through their extension in the form of the small but powerful groups.

In this context, false-paradigm model is attributed to the international dependence approach. As discussed by Santos.¹ as per this model the adviser/experts from developed countries offers sophisticated concepts, theoretical structure and complex econometric models of development which often lead development countries to an incorrect economic policies.

The dependence theory is criticized on two accounts, they give very good explanation of remaining underdeveloped but these theories do not speak about sustainability of development. In certain case the counter applications of these theories gave negative results. The developing countries should adopt a path which is inclined towards inwardly directed development like China and to some extent India and should keep away as much as possible from developed countries. The classic example of the trap of the dependence theory is Pakistan’s case.

1.2.4 The Neo-Classical Counter-revolution Theory

This theory emerged in late 1990s. This theory focuses on freer markets and dismantling public ownerships and government regulations of economic activity. This theory is supported by the World Bank and International Monitory Fund. For success of this theory they quote the examples of South Korea, Tiawan and Singapore and failures in Africa and Latin America where this theory was not adopted.² Free market approach says that market is alone efficient which signals for investment in new activity ultimately leading to upward growth.

The neo-liberal theory actually is an extension of the market policy of the developed countries where the products of the developing and under developing countries cannot compete in the International Markets and thus indigenous industry is crippled. It is considered another ploy of the developed countries for the continuation of imperialist policies.

1.3. History of Evaluation of Development Doctrine

Here it seems pertinent to present a history of foreign aid with a summary of theories of economic development. In the context of the present study the growth and development has been discussed in the light of development doctrine emerged after World War-II. The term of economic development was incorporated in many different concerns, reflecting changes in theory, existing data system and the world economic environment. Here we will summarize the history of road map, clarifies the interrelationship among development goals, development theories and policies with the potential role of aid. As development concerns have broadened, aid has changed focus form a simple concern with resource mobilization to a much more multidimensional role.

Historically, the development of the third world countries was never a policy objective of the colonial power before Second World War. Till the end of 1940s this priority was not there, because it was inconsistent with the colonial system for underlying division of labor and trading patterns within the colonial blocks. The development strategies were evolved later after the creation of independent states and creation of Soviet Block. End of Second World War marked the new regime for lesser developing countries, from dependent to somewhat more self reliant growth as compared to colonial time. This was also marked by the interest of the scholars, and policy makers to design the better strategies and policies to develop conceptual framework along with the classical economic indicator i.e. increased GDP and controlling balance of payment, there should be equitable distribution of the blessings of the economic growth among the people of a particular country. There should not be a marked difference between the
living standards of the various classes and difference between rich and poor, only that it would be considered a balance strategy of growth.

The post independence economists remained in search of macroeconomic policy framework and model to identify the conditions for growth strategy in Pakistan, to develop a macro-economic framework, growth related issues such as structural transformation, pre-conditions for macro-economic stability, and conditions for favorable distribution of income. The development economists suggested the high-growth and development path particularly during 1990s on the basic assumptions, that high-growth path could not be sustained on a long-term basis without ensuring that economy should not be plagued by large budgetary deficit, insupportable trade imbalances, excessive depreciation of the exchange rate, and high rate of Inflation. Further more that economic growth does increase the level of development as a whole to ensure the social well-being of the common man¹.

As mentioned above development is not purely an economic phenomenon, in ultimate sense, it must encompass more than the material a financial side of people’s lives. It is therefore, perceived as a multidimensional process involving the reorganization and reorientation of entire economic and social system, radical changes in the institutional, social and administrative structure. If we explore the historical and scholarly thinking about development, we need to examine major development theories with the combination of broader strategies of development after Second World War particularly.

The take off stage is defined as the process of development addressed: (1) development objective, (2) existing development theories and models (3) availability of data system for measuring performance and (4) role of foreign aid in achieving this objective. These four elements have interrelationship and interdependence. The following

figure\textsuperscript{1} will illustrates the evolution of development process, integrated with policy, objectives, model of development and role of foreign aid.

\begin{center}
\begin{tikzpicture}
\begin{scope}[node distance=1.5cm,auto]
\node (A) {Development Objective and definition of development};
\node (B) [right of=A] {Development policies and objective};
\node (C) [below of=A] {Development theories and hypotheses of development};
\node (D) [below of=C] {Development models};
\node (E) [right of=B] {Data Systems and measurement of performance development};
\node (F) [below of=E] {The role of and lessons for aid};
\draw [->] (A) -- (B);
\draw [->] (A) -- (C);
\draw [->] (C) -- (D);
\draw [->] (E) -- (F);
\end{scope}
\end{tikzpicture}
\end{center}

*Key interrelationship between development theories, models objectives, data systems, development policies and strategies and the role and lessons for foreign aid.*

This framework gives an overall understanding of process of development, which was modified according to the experience of last five decades. As a matter of fact, this framework remained constant for the last 50 year, only the concept of development strategies has changed.

1.3.1. Development Doctrine During 1950s

If we analyze the policies and issues of development decade-wise as per above framework we would find that the decade of 1950s Pakistan was faced with many economic problems at the time of independence; the economic growth was the main policy issue like all other independent and less developed countries. During this period economist widely believed that through economic development and modernization social

\begin{footnote}
\textsuperscript{1} Discussed by Erik Thorbecke (2000), (Ed), *the evolution of the development doctrine and the role of foreign aid: 1950-2000*, London: Rutledge, p.18
\end{footnote}
inequalities would be eliminated. The main economic rationale of foreign aid was related
to this development doctrine i.e. to provide necessary capital resource transfer to allow
developing countries to achieve a high enough saving rates, to propel them into self-
sustained growth. The role of aid was seen principally as a source of capital to trigger
economic growth. Two other interrelated factors, made aid attractive as an instrument of
growth; first the faith that government could plan successfully making their five years
development plans and second to calculate the amount of foreign aid required to achieve
a target growth rate. During this period the aid was also related with security concerns of
the communist block and the western world.

1.3.2 Development Doctrine During 1960s

During the decade of 1960s the interdependence of modern industrial
development and backward agriculture sector was recognized. The backward sector i.e.
agriculture had to release the sources for industrial sector. This approach emphasized the
role of inter-sectoral linkages in the development process. In a certain sense it extended
the dual economic framework to multi-sectoral activity, without however, capturing the
essential differences in technology and form of organization between modern and
traditional activities.

In Pakistan the economic dualism is reflected in focusing more attention to the
industrial development by the support of agriculture sector. Where it was assumed that
the elite class which is emerging in the shape of capitalist, generally known as 22 families
would ultimately be beneficial for the general masses and they will reap the benefits
which did not come as envisaged because of the half backed development program cut
short after Ayub’s era. This doctrine of ‘functional inequality’ as described by the Dr.
Rashid Amjad, rest on the propositions that in the early stages of capitalist development a
high degree of inequality is necessary in order to promote saving and create
entrepreneurial dynamism. Secondly, that in order to achieve a high rate of growth, since
domestic saving is low, foreign aid has an important role to play in fulfilling this gap. At
the political and economic level there was great uproar between the sharpening of

1 Rashid Amjad, (2003), Pakistan Growth Experience Objectives Achievements and Impact on Poverty
p. 2
division of various classes. Generally it was said that this period was instrumental in creating the elite class of Pakistan.

1.3.3. Development Doctrine During 1970s

During 1970s the framework of development was seriously reviewed by the International Financial architecture, because in 1960s it was revolved around. This doctrine emphasizes on simultaneous objective of growth and poverty alleviation related to integrate rural and agriculture development and paying attention to informal sector i.e. cottage industries, which triggered important potential source of output and employment growth.

In the context of Pakistan, Dr. Rashid Amjad while summarizing the objective and strategy of the regime in 1970s mentioned about two related reforms which did have far reaching influence. First was the labor policy which provided immediate benefits to organized labor and also strengthened their collective bargaining position. The labor acquired benefits in the form of compulsory bonus, cash receipts for profit participation and old age benefits etc. Second, important measure was the reforms initiated to improve the conditions of the peasantry. The important aspect of these reforms was the prohibition of the ejectment of tenets from their holding by the landlords, except under the decision of the court.1

The doctrine of development was also seen in the neo-Marxist literature on underdevelopment and dependencies, that the underdevelopment is innate in a trading system of world power where under developed countries are there to make up backward raw-material for the developed countries. This explains that the multinational corporations are replacing the role of colonial power in exploiting the underdeveloped class. This approach called for the new development process of redistribution of wealth for elimination of most of the private property. The other big identification of 1970 decade was ‘basic need approach’ which emphasizes on fulfilling the requirement of minimum consumption of a family i.e. food, clothing and shelter. Actually the focus on

1 Ibid., p.11
basic needs stem from the perceived failure of development strategies recommended by the International organization and practice by the government in low income countries.

In the context of Pakistan, during the election of 1970, it was witnessed, in the election manifesto ‘Roti, Kapda aur Makan’ (bread, cloth and shelter) as a popular slogan of PPP. Since debt was already accumulating, therefore PPP regime proclaimed that ‘socialism’ would be economy of Pakistan.1 The role of aid in this period was directed to relationship of population growth and employment, relationship of education and labor market, employment and income distribution.

1.3.4. Development Doctrine During 1980s

During 1980s it was realized that debt burden in the development countries is increasing day by day and this debt crises converted the 1980s into ‘lost development decade’ and it was thought before that a development and poverty alleviation program could be resumed in the third world to put its house in order and implement painful stabilization and structural adjustment policies. The main policy objectives of the developing nations became, macro-economic stability, consisting of policies to reduce, budget deficit, balance of payment, devaluation, privatization, deregulation, trade liberalization and institutional changes to support these policies. It was also supported by reliance on market and limiting the role of the government.

Foreign aid packages were related to asking the debtor countries to service at least part of the public and private debt and keep their creditors afloat and encourage the implementation of appropriate adjustment polices to the conditionality attached with them. There is a difference of opinion on the structural adjustment policies also. Third World countries were told that the structural reform were essential to sustain growth and economic stability. Faced with the threat of a cut of external fund needed to service the mounting debts, these countries have no choice but to implement measure demanded by the Bank and the Fund. Structural adjustment loan from the World Bank and IMF were given to developing countries to make their immediate interest payment to western

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1 Hassan Gardazi, Jamil Rashid, (Ed) (1983), Pakistan: The Unstable State, Vanguard Books Ltd. Lahore, p.11
commercial banks and also by having third world economies, focus on production for export, foreign exchange would be gained which would channel into servicing dollars denoting foreign debt.

This decade brought some new terms in the concept of development. The first was the extended role of human capital in development. The second set of contribution was 'new institutional economics' this term emphasizes the increasing political economy's role in the poverty reduction as well as in growth. The 'new institutional economics' based on the public choice theory, which believes that people are free to make choices themselves, and how to influence the individual behavior towards collective action and public goods. A second ingredient of this theory is the 'property rights', means that individuals appropriated over their own goods and services with minimum or no intervention by the state. The study of political economy attempts to answer simultaneously two central questions. (1) How do institutions evolve in response to individual incentives, strategies and choice? (2) How the institutions affect the performance of political and economic system? Therefore the architect of the 1980s development doctrine emphasized both "economic" behavior in the political process and "political" behavior in the market place.

The public-choice theory believes that states use their power to confiscate private property from individuals. Resultantly there is misallocation of resource and reduction in individual freedom. This advocates that the minimal government is the best government.

Many changes in the concept of development as well in economic interpretation of politics came on surface during this decade and were instrumental in the implementation of policy. For some time, the interest of economists was focused upon the question of role of the government to take remedial measure to do away with the market failure and the provision of those 'pure public goods' which government can

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3 This theory is explained in Merilee C. Grindle and John W. Thomas, (1991), Public Choices and Public Policy Change: The political Economy of Reform in Developing Countries, Baltimore Johns Hopkins University Press, 1991.
supply only. Therefore in this decade the economic study of non-market decision making by simply intertwining politics and economics, came in to force to make appropriate institutions and rules of the game for development.

As a matter of fact the policy agenda for third world became the macro-economic stabilization in 1980s, a shift from 1970s which was policy of growth and fulfillment of basic needs. It was replaced by economic stabilization. Nevertheless there was inherent contradiction in the policy for achieving the objective of economic stabilization as on the one side the policy of stabilization, called for a stronger and extended government and on the other the theories of new institutional economics brought the private sector investment in public goods, which minimized the role of the government. Similarly another divergence in the policy appeared when stabilization demanded from the developing countries to improve the balance-of-payments along with liberalization which opened the gates for more imports. Therefore, the imports made it difficult to fill the gap in the balance of payment. These strategies again called for a stronger government to take decision and implement the policy with conflicting measures.

As mentioned above in the objective and strategies of the development doctrine in 1980s, there was fundamental change in the role of foreign aid. Besides declaring the third world as debtor they also started pressurizing for stabilization and structural adjustment through conditionalties attach with loan packages. The broader Structural adjustment program in this decade was emphasized on the following programs.

1. Cutbacks in government expenditure, especially in social spending
2. Roll back or containment of wages
3. Privatization of state enterprises and deregulation of the economy
4. Elimination or reduction of protection for the domestic market and less restriction on the operations of foreign investors
5. Successive devaluations of the local currency in the name of achieving export competitiveness.

The implementation and results of the Structural Adjustment with reference to Pakistan have been discussed in detail in Chapter - V of this study.

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1 Peter Self, (1993), Government by the Market? West view Press, San Francisco, p.31
1.3.5. Development Doctrine During 1990s

The development doctrine in 1990s focused on the role of state vis-à-vis the market and implementation of the structural Adjustment program. It was focused on paying board attention to human capital and alleviation of poverty. Simultaneously the composition of foreign aid switched towards social infrastructure i.e. education, health, water supply and sanitation and economic infrastructure away from productive sectors.

Another feature of this decade was, introduction of ‘Washington Consensus’ a set of economic policies disseminated by many neo-liberal economist, as a formula of economic growth in 1989. This policy introduced, privatization, deregulation; the concept of free market, trade liberalization, and deregulation of financial system, also reforms in fiscal policy, tax system, interest rate, exchange rates, and fiscal measures related to this policy. It was an era of the aggressive assertion of neo-liberalism, and the so called ‘Washington Consensus’ (the term coined originally by John Williamson1 a economist in 1990, from the Institute for International Economics, as International Economic Think tank based in Washington) the transformation of GATT into the WTO, the Davos meetings and the spreading of the concept of the globalization as explained by Immanuel Wallerstein2

There is a parallel view that through Washington Consensus, the neo-liberals are trying to control over the academic trainings of central bankers and diplomats, so as to remove the dimension of political reality, from the investment in international trade, investment and finance. Although most of the International agreement contained promises of commercial reciprocity, the US government has pressed foreign countries to reduce their tariff barriers, while increasing its own non-tariff barriers getting by far best of an unequal bargain.3 Washington's own actions sometimes are inconsistent with its rhetoric of stabilization. However development policy recommendations in 1990s were

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generally seen as offering sound advice for sustained economic growth. The other striking element of development doctrine of this decade was proper mix between the degree of government intervention and reliance on markets. The new institutional economics and public choice theory was materialized. Institutional infrastructure, property rights etc was given prominence to ensure the law and order situation and judicial freedom for the effectiveness of the contracts as that was required for foreign investment in the country.

In this period, institutional capacity to increase predictability under public choice theory was suggested, which urged the restructuring of the institutions. The institutional changes to support the decentralization, certain level of independence in policies, deregulations and delegations of power were emphasized. Peter Self\(^1\) explains that the Public Choice theory primarily deals with four-focused area of the State (1) Political System: market for demand and supply of public goods and service. (2) Voter/ public: Consumers (3) Government, Ruling Political Parties: Providers of Public Goods and Service and (4) Bureaucracy: Tool, instrument for provision of public goods. This approach effected the policy advice and strategies of development in this decade by the donors which ensured that public sector role should be on limited scale, concept of contracting out, monopoly control i.e. multiples providers then than single providers, privatization and deregulation was pursued.

This decade was also marked by a concept of 'adjustment with human face'\(^2\). It became evident by 1990s through the assessment studies that the short term impact of structural adjustment was not as effective as it was envisage earlier. So the Policies supported the prolongation of the Structural adjustment program for alleviation of poverty and more emphasis was given to reduction of poverty human development having adverse effect on the poor and also a conscious reduction in consumption.\(^3\)

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\(^1\) Peter Self, (1993), p. 1-17 
This view established the need of alternative adjustment policies, which could save the poor from the negative impact. It has been argued that the need of new approach of adjustment with human face would protect the vulnerable. The important aspect of achieving adjustment with human face is to restore economic growth in the medium term, for which the major determinants are health, nutrition and education of nation’s children. Therefore keeping the vulnerability in view they have recommended a broader approach to adjustment.

The impact of these policies on Pakistan’s economy were adverse because the decade of 1990, was not considered as a period of economic growth by the economists as discussed in Chapter-V in this study.

This chapter explores the two-way relationships between Economic Growth and Economic Development based on the earlier theories, strategies and doctrine developed after the post war year to 1990s. Here, we show that economic growth is not only a product and end itself but an important input for the economic development.

The chapter analyzes models which estimate the strength of the two-way chains connecting development with the economic growth. Based on the existing growth literature, we explore that there is correlations between the determinants of positive growth and the trajectories running from economic growth to development and find that doctrines play an essential role in explaining growth trajectories. Our findings also pointed out the relevance of endogenous growth models in general, and threshold effect models in particular. We also analyzed the strength and weakness of given doctrine and its strong sequencing implication on achievement of both higher economic growth as well as economic development.

The analysis of doctrine and the development model in last 5 decades in the given situation of Pakistan shows the relationship between models and processes of institutional deterioration, weakening structure of the economy, and rising process of poverty. These indicators were on their rise during the 1990s and began to be manifested in terms of acute poverty.

CHAPTER - II

2. PHYSICAL CAPITAL: AN OVERVIEW OF ECONOMIC BASE AT INDEPENDENCE

Pakistan's economic growth since 1947 had been significant more or less till the sixties, despite the fact that Pakistan was born with a number of serious disadvantages. The government lacked the man-power, institutional capacity and capital to take the economy on the development path. In the early days of independence its economic viability was seriously doubted but it was managed, despite rapid increase in population to bring about significant improvement in the living standards. Before we analyze the economic performance and development of Pakistan, it is important to have an overview of economic structure of Pakistan at the time of independence.

2.1 Area and Population

Pakistan was created in 1947 through the partition of former British India. About 7 million people migrated to Pakistan from India and vice-versa. Pakistan received 23 percent of the territory and 19 percent of the population of colonial India.\(^1\) Administratively Pakistan comprised NWFP with the tribal area in the west, Sindh, British Baluchistan and the Punjab covering a total area of approximately 947,700 sq. kms total with a total population of 7,58,42000.\(^2\) Further division in composition shows that the western part of the country comprised 806,500 square km, which was 85.1 percent of total territory of Pakistan and the eastern part was 141,200 square km. Though considerably smaller in the area the eastern part had 55.5 percent of the whole population of the country. In 1951 it had 420,63000 inhabitants while the population of West Pakistan was 33,779,000. This difference was not only in the figures of population but the ratio of gender also. West Pakistan (present day Pakistan) is a blend of mighty

\(^2\) Census of Pakistan, Government of Pakistan, Statistical Division. 1951.
mountains, deserts and plains. The climate generally is hot with fluctuations of seasonal temperature.

Farming needs the irrigated water for the land. East Pakistan was watered by two of the largest rivers in Asia, Brahmaputra and the Ganges. Generally it is a vast alluvial plain with Lushai Hills. Rain fall is heavy and plants & vegetation is intense due to tropical monsoon climate. Temperature remains mild and favored the rice and jute production in the east.

2.2. Natural Resources

2.2.1. Forest: Pakistan inherited a backward colonial economy at the time of independence. It received only 10 percent of the known mineral deposits of India. Forests occupy important place in an economy, not only required for the firewood but also for building and as raw material for small industries. At the time of independence the total area of forests was 6.1 million acres, out of which 3.2 million acres was in the then East Pakistan. The percentage of forest area in West Pakistan was 2.9 and 9.7 in East Pakistan. The Western part mostly remained dependent upon riverine forests, (classified as a distinct forest group in the west) along with the banks of river in the Indus Basin for meeting the requirement of firewood.

2.2.2. Fuel and Power: Fuel and power is critical for economic development of any economy. In a rural and agro-based economy, fuel and power was required for running tube-wells, irrigation, mills and iron-smithies besides domestic use. An exact survey of the inherited fuel resources could not be made due to absence of systematic surveys however, they were known to be modest. The fuel reserves of coal, oil and industrial fuels were moderate. Coal was mined generally in Punjab salt range, Indus region and mostly Machh area in Balochistan, Cherat Hills in North-West Frontier. Lignite deposits were known to exist in Southern Sylhet and North Tipperah Districts in

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1 S.M.Akhtar, (1951), Economics of Pakistan. Lahore: Publisher United Ltd, , pp.263-264
East Pakistan mainly.\(^1\) Since the Pre-partition days, demand for fuel for brick-kilns increased leading to rise in annual production from coal mines to 390,000 tons in 1946. But due to the departure of the non-Muslims the production and demand both declined immediately after independence. However, later after 1948 when shipments from India became irregular, government took measures to reorganize production which rose to the peak of 599,000 tons in 1952.

2.2.3. **Petroleum:** Oil fields in Pakistan were in Attock, Jhelum and Rawalpindi in the Punjab while Pakistan Attock Oil Company and Pakistan Petroleum Ltd. refined the crude oil. The total production of crude petroleum in 1948 was 17.02 million imperial gallons while the diesel oil domestic product was 1.34 million imperial gallons. Petroleum imports were high and only 20 percent requirement was met domestically.

The hydroelectric power potential was estimated at 5-6 million kV.\(^2\) However most of the power stations had to be closed due to poor maintenance and unskilled manpower. In the East the situation was even worse, with generating capacity at 15,600kw. It depended on the Jogerdnager station for 16,000kw. On the thermal side Karachi, Lahore, Dacca, Multan, Rawalpindi, Hyderabad had diesel and steam stations. However, with the expansion in industrial establishment Karachi Electric Supply Corporation raised its capacity by 8,400 Kw.

In natural gas, Pakistan Petroleum Company struck a field in 1953 at Sui with estimated reserves and two half trillion cubic feet. In East Pakistan it was found near Sylhet in 1956 with reserves as big as in West Pakistan.

2.3 **Industrial Units:**

Like other resources, Pakistan inherited backward industrial setup. It received only 9.6 percent of the total industrial enterprises in the subcontinent.\(^3\) In raw materials the resources were plentiful such as that of jute, cotton, oilseeds and bamboo but

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\(^1\) ibid, p.205
\(^2\) Ibid. p.205
\(^3\) S.M.Akhtar, (1951), pp. 263-264
compared to the resources the processing units were limited as Pakistan did not have any significant port like Calcutta and entrepreneur activity was largely in the hands of Parsees, Marwaris who migrated after partition.

Many industrial units situated in Pakistan belonged to Indian monopolists like Tata, Dalmia, and Birla with British investment like the two major oil companies Burma Oil and Attock Oil companies.

The total number of industrial enterprises was 1,414 out of which 335 were in the Eastern side of the country. No supporting industry was available. The existing industrial equipment was obsolete. Industrial production therefore could not contribute more than 1 percent in Pakistan’s first year of national income.¹

The share of small scale industries was a considerable in the new growing economy. Metal works, tanning, leather goods, sports goods, wood work and cottage industries were among the few that belonged to Pakistani owners though again dependent on import of British machinery etc. But after partition it was not able to meet even the basic requirements of industrial commodities and the bulk of them had therefore to be imported from abroad.²

British monopoly in the credit market, financial system and trade kept a hold in banking capital. British dominance in capital market remained and Pakistan’s industry was forced to compete with British commodities, compromising the major part of import under the preferential Tariffs.

2.4. Agriculture

Pakistan’s economy was basically rural and farming was Pakistan's largest economic activity. Nearly 75 percent of the population was dependent on agriculture. Thanks to the world's largest canal irrigation system, built mostly before independence, a quarter of Pakistan’s land was cultivated. The agriculture sector was not only the major

¹The Pakistan Times, August 14, 1950
²Three Years of Pakistan, Karachi, (s. a.); pp.35-36 cited in Gankovsky and Polonskaya, p.102
labor force provider but also the figures of 1950 show 53 percent of GDP were derived from this sector with its share of 80 percent in exports.

The major crops were cotton, wheat, rice and sugarcane. Annual compound Growth Rate on average remained 1.3 percent from 1949 to 1954. However, agriculture was backward and remained so under British rule for two centuries marring development restricting farming to primitive methods that resulted in the lowest output of grain that caused greater famine in 1952-53 due to harvest failure.

Feudal practices in the agrarian system also hindered agricultural growth. Big land holdings were in the hands of feudal lords who dominated the political and economic scenario of Pakistan and are still very powerful. They acted as absentee landlords and took meager interest in the productivity of land. They kept the peasants always in abysmal poverty with small land holdings and division among the family members depressed production. West Pakistan’s 6,000 big landlords possessed more land than its 3.3 million peasant households. Peasants had no legal right on land and where they had the land holdings were too small for efficient cultivation. The economic distribution of the total population in terms of cultivated land; show that 20.1 percent of the total population consisting of West Pakistan and 25.6 percent of the total population was consisted of the agriculture workers to cultivated area.

According to the Census of 1951, out of the total manpower working on the land, 10 percent were landless and 21 percent were tenants and others were 69 percent. Though, there is no figure available which actually shows the percentage of land cultivated by the owners and tenets to evaluate the effects of economic holding as the size of farms and the terms and conditions of cultivation effect performance of land and workers.

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2 Pakistan Agricultural Inquiry Committee Report, (s. a.) pp 12-13
3 Gankovsky, Plohnkaya, p.104
4 Census, Government of Pakistan, 1951 Vol. 1, p.102
Beside these agrarian relation problem, there were administrative and infrastructure problems in marketing agricultural products. The reason was that many regions which for years had remained as single economic and cultural units were divided after partition and became the cause of the division of labor and production in a particular agrarian region. For instance if the raw material producing and labor intensive areas were allotted to Pakistan, the mills were installed in India, as processing units went to India. It had a negative effect on the economy.

Similarly Pakistan comprised the area where iron, steel and other industrial commodities were coming from India. It was one of the major hindrances in the sustainability of growth in this sector. Moreover, if the electric power station were shutdown in India lot of Industrial activity here in Pakistan had to be stopped. In addition to that agriculture sector had to face problems due to the division of irrigation system which was designed to work as a single entity. This is why when we look at the comparative rates of the sectoral growths, find that annual growth on average remained at 1.6 percent from 1949 to 1960 as compared to 7.7 percent in manufacturing during this period.\(^1\)

2.5. Foreign Trade

The trade policy inherited by Pakistan was also part of unified economic structure of undivided India and very much subjected to colonial interests as in manufacturing industries. Trade was also dominated by British monopolies. In 1950 their capital investments were estimated at 1,000 million rupees. The Burma oil company and the Attock Oil Company and other oil companies were owned by the British enterprises. The monopoly rights to work in the local mines and to extract chemical raw materials were held by Powell Duffryn and Imperial Chemical Industries (Export). The extraction and export of chromite was also monopolized by British capital.\(^2\)

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2. Gankovsky and Polonskaya, p.100
Some marginal industrial enterprises owned by the locals who could play significant role in foreign trade were also hampered by the British standing orders and were dependent on the import of British machinery etc. Therefore the British held dominance in the credit as well as in foreign trade. This was the reason for the low manufacturing activity in the first year of partition. Two raw materials, which provided more than three-fourth of the country’s total exports, were cotton and Jute. There was not a single jute mill in the country, despite the fact that East Pakistan was the world’s largest jute-growing area and producing nearly 74 percent of the world’s production of jute. Therefore, manufactured goods had to be imported in exchange for food-grain (wheat and rice). In this regard India was the major trade partner.

Fortunately export trade with India was facilitated by the Stand-still Agreement that permitted trading until 1948. According to an analysis, over one half of West Pakistan’s and 80 percent of East Pakistan’s foreign trade in 1948-49 was with India and one-third of Pakistan’s imports came from India during 1949\(^1\). The exports to India in 1950 constituted over 40 percent of Pakistan’s total exports, which constituted 10.4 percent of the total trade and accounted for 19.0 percent of GDP\(^2\). However there was a considerable disruption of trade flows between India and Pakistan after 1949 when the pound sterling and Indian Rupee was devalued by almost a third. Pakistan’s policy makers decided not to follow suit under the assumption that it would increase the import bill. Resultantly India also suspended the trade with Pakistan, which damaged the trade and economy.

At that early stage, Pakistan did not have any institution for regulating the trade nor was there an effective policy of tax, trade and tariff for regulating financial sector. Major basic needs were met through import of consumer goods and major commodities like, jute, raw cotton, raw wool, skins and tea accounted for about 99 percent of the

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\(^1\) M.A.Rehman, (1963), *Partition, Integration, Economic Growth and Inter-regional Trade*, Karachi: 1963, p.50

export earnings in 1948. After the crisis in 1949 prospects of Pakistan export of jute exports to India slumped.

2.6. Public Finance and Financial Institutions

By any account, institutional capacity for public finance, collecting taxes, dissemination of statistics etc was very much undersized. Initially the assessment of funds and expenditure was difficult, as method of budget presentation and other related information was based on the system developed by the British Raj. As such, there was no consolidated statement of revenues, expenditures and overall deficit of the central government and the provincial government (East and West).¹ This created hindrance in assessing the over all public finance of the country.

Since the areas that formed part of the new state were the economic backwater of the united India, over all tax-to GDP ratio was very low, about less than 4 percent whereas per capita income at the time of independence was also very low at about US $ 80.² This shows taxes share in the national income.

Actually there was no potential for expanding the tax net. There were hardly any mentionable factories for processing cotton and jute so that duty could be levied on them. Even then the processing of these two raw materials was the major source of the income tax but it was only contributing about 1 percent of GDP. Resultantly foreign exchange was very limited and exchange rate was over valued at. Rs. 3.20 to a dollar till 1955. It reduced the rupee value of the imports. Basic consumer goods and capital goods for industrialization were mainly imported which implied that duty rates had to be relatively low. The share of consumer goods in total import was 40 percent in 1947, which fall in later years. Till 1950 there was 0 percent shares in the export in the world Market ³

² ibid., p.204
³ International Monetary Fund: International Financial Statistics, January 1953,
Banks as financial institutions and financial markets play an important role in the economic development of a country. The banking system soon after partition was not organized. There was no Financial Regulatory body in 1947. The State Bank of Pakistan was the Chief Monetary Authority of the country and was established on 1st July 1948 with the principal function of regulating the monetary and credit systems and undertaking money market operations. Prior to that the Reserve Bank of India handled this responsibility. The total number of commercial Banks before partition was 38 out of these only 2 were in Pakistan and 29 were in India while the number of exchange banks was 7. The total deposits of Pakistani banks stood at Rs. 880.00 million whereas the advances stood at Rs. 198.0 million\(^1\).

There was absolute scarcity of capital in the early days. The banking system was almost entirely controlled by non-Muslims. They actually transferred their financial assets before partition to Banks in India causing a big drain of capital out of the country. Moreover the banks, operating branch offices in the part of Pakistan were closed down by the Indian banks. This further worsened the banking system.

At the time of partition only two Muslim Scheduled banks, Habib Bank and Australasia Bank were operating in Pakistan. The en-mass closure of the branches of the commercial banks crippled the banking system in the formative years of Pakistan. A sharp curtailment of credit resulted. The problem of inadequate financial intermediation during the early years was overcome by the creation of a nation-wide system of commercial bank branches. Financial intermediation was required for managing the financial assets of business.

Pakistan had a number of non-banking financial institutions, since the capital market and stock exchange were not fully developed. Several institutions came forward as a part of market a special place was occupied by postal saving banks, insurance and schemes of saving certificates. The Pakistan Refugee Rehabilitation Finance Corporation,

Pakistan Industrial Finance Corporation came forward with the mandate to address the long-term financial support to small industries. In the equity market, there was only one Karachi Stock Exchange established in 1947. It remains as the main center of activity where 80 percent of current trading takes place. The total number of listed companies at KSE was 13 in 1948 which was extremely low, as compared to 81 in 1960 with 1,871 market capitalizations that was zero in 1950s. With this economic background, Pakistan’s Domestic saving rate as percentage of GDP was 5 percent in 1960 whereas India’s corresponding figure was 13 percent.¹

2.7. Transport and Communication Resources

Communication has its own significance in the development process in any country. Transport comprises roads network, railways, air transport and ports etc. whereas communication sector includes postal, telephone, mass media and radio etc. Development in these sectors results in mobility of labor, makes exchange of goods easy between rural and urban areas and stimulates the external trade, provides a sense of integration and access to other areas accelerates investment and reduces the transaction cost of information.

2.7.1. Railways: Railways constituted the major form of transport in the subcontinent at the time of partition and had basic importance in development process in a newly established country in terms of efficient communication. The inherited railway system of Pakistan consisted of railway lines, separated from a larger system covering the whole subcontinent. Inherited capacity in terms of Railway mileage in Pakistan was 4,947 in the Western side and 1,502 in the Bengal-Assam Railway². In terms of material it contained engines, wagons and coaches, which were exhausted already due to excessive use in World War -II. To get the optimum use of resource millions of Rupees were required for its rehabilitation and modernization of its assets. Huge capital was required to invest in maintenance of railway tracks.

² Andrus and Mohammad, p.219
2.7.2. Roads & Inland Waterways: Water ways were important means of transport in East Pakistan as roads for Western side of the country. At the time of Partition Pakistan inherited 20 percent\(^1\) of the total mileage of the roads. Roads were mainly classified as National Highways, Provincial Highways, districts roads and village roads. Good quality roads for military purposes were in NWFP, but the productive areas like Sind and East Bengal did not have good roads. The total number of vehicles (except of Armed Forces) on the road after the partition in Pakistan were recorded at 25,000 inadequate for both volume and load.\(^2\)

Water ways were important means of transport after partition between the West and East Pakistan. By land the difference was 1000 miles and by sea it was approximately 2500 miles.\(^3\) In East Bengal extensive waterway system was developed at the reaches of Ganges and Brahmaputra, while other rivers were having wide fluctuations in flow during the course of year. In the Western part the Indus offered adequate natural facilities however the rate of flow fluctuated during the year. For navigation purpose however East Pakistan had a well-developed system

Ports were required for the internal and external trade since in economic development ports play a key role. After partition Karachi was the only port in the Western part. It had to serve not only as the normal outlet for goods of the country but also serve Afghanistan’s and partially Eastern Iran sea-borne trade. In 1948 there was 1,603 thousand tons inward traffic and 940 thousand tons outward, a total of 2,543 thousand tones. It was a huge task to be managed by one port.

The port of Chittagong was also inline for increasing the capacity but it could not be done. In this port there was 97 thousand tonnes inward traffic and 156 outward, a total of 253 thousand tonnes traffic to be dealt by this port as recorded in 1947.\(^4\) In the

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\(^1\) ibid., p.230  
\(^2\) ibid., p. 238  
\(^3\) Saeed and Kamal Hyder, p.187  
\(^4\) Andrus and Muhammad. P.251
following years, government launched ambitious plans to modernize the port and the water transport.

### 2.7.3. Air Transport:
There was no air transport company at the time of partition in Pakistan. Later on in 1950 three air companies were established. There were five civilian airports in West Pakistan; Karachi, Lahore, Quetta, Hyderabad and Multan and three in East Pakistan; Chittagong, Dacca, and Sylhet. However facilities of international standards were available only at Karachi airport. In 1947 Pakistan became a member-state of the International Civil Aviation Organization and also entered into an agreement with 17 countries, resultantly 12 foreign airlines served Pakistani airports.

### 2.7.4. Postal services:
There were 5,650 post offices in Pakistan in 1947. Mainly mail between East and West of Pakistan was carried out by air. Other than postal services, postal institutions offered facilities for the mobilization of savings in the form of saving deposits, saving certificates and life insurance. The record of financial position in 1947-48 shows that the Postal department had receipts of Rs. 10,026, spent Rs. 14,205 and showed a deficit of Rs. 4,179.¹

### 2.7.5. Telecommunications:

Telephone: There were 242 exchanges in 1947-48. Telephone operations record of 1947-8 shows that there were receipts of Rs.3,728 and total expenditure was Rs. 3,323 showing a surplus of Rs. 405². This sector got great deal of attention in the first five year plan, a telephone factory was established at Haripur and long distance exchanges were established in Dacca, Rawalpindi, Peshawar, Lahore, Rohri and Hyderabad. This made the inland communication faster.

### 2.7.5.1. Telegraph services
were relatively better developed at the time of partition comparable to western countries. The operating results in 1948-49 showed that telegraph system’s receipts were Rs. 8,659, where as expenditure was Rs. 6,410 showing

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¹ ibid., p-258
² ibid., p.260
a surplus was Rs. 2,249. A significant margin was available in sectoral development in next 5 years development plan.

2.7.5.2. Radio. There were only 3 Radio stations, one at Lahore, Peshawar and in Dacca with total capacity of 20 kW with 27 hours daily program. These radio stations were on medium waves and covered only 7 percent of the area. The revenue generation and program effectiveness was dependent upon greater audience and number of Radio sets purchased. Most of the population was living in rural areas, not having either purchasing power or awareness of its importance.

2.8. Human Capital:

At the time of partition, skilled workers, technicians and intellectuals mostly were non-Muslims who left Pakistan. Therefore Pakistan experienced acute deficiency of human capital. There was a shortage of training institutes or skill development for industrial purposes. According to data, only 7 percent people in Pakistan could read and write in 1948.¹ Resultantly the economy already damaged by the breakup of the traditional economic system was further damaged by loss of skilled labor. Small scale industries like rubber goods, knives and tools went through a sever crisis due to lack of skilled labor.

On the one hand there was flow of Muslim refugees from India and on the other hunger and unemployment increased. Growth of relatively unskilled agrarian labor kept the wages miserably low. The industry itself was not much developed and was not able to suck up unemployment in industrial sector. The shortage of skilled workers created disproportion between the skilled and unskilled labor wage structures are linked to the skills and output.

In the early 1950s the real wages in West Pakistan somehow increased to Rs. 150 p.m. but unskilled had to stay at Rs. 30 per month. In 1948 the ratio of skilled workers

¹ Grankovsky, Plonskaya, p.106
accounted for no more than 17 percent of Pakistan’s total earners. The suitability of the competitiveness is the unit labor cost (wage cost divided by the productivity) which measures the cost of a unit of output. Low productivity of labor shows the poor skill contribution. Vocational and Technical education produce skilled labor and till 1940-50 there was no polytechnic or technical college in Pakistan, there were only 5 commercial colleges both for male and female. Government budget allocation for Education was less then 1 percent of GDP and remained lower in the next many coming years. Therefore agriculture was the major employment sector with the low value labor force. If we look at the occupational distribution of the labor force in 1951, we would find that agriculture sector consumed 82.6 percent of the total civilian labor force which was 12.9 millions.

2.9. DEVELOPMENT PLANNING AND ENTRY OF FOREIGN AID IN PAKISTAN

Keeping the above economical and social setup of Pakistan since independence in view, it is obvious that Pakistan inherited a weak economic base to develop the strategies in managing a self-sustaining process of growth. In examining the state of Pakistan economy and resources, the role of development planning and finances became an important subject and was widely discussed in the sub-continent particularly after the World War-II. Though development in Sub-continent was planned considering the post-war projects, but after independence new conditions of development were created in Pakistan. The Government decided to adopt development planning strategy for rapid growth of resources. The Central Government appointed a Board early in 1948 to co-ordinate schemes for development. This mandate was to prepare a six year (1951-57) outline of development, which was incorporated in the Colombo Plan for economic Assistance. Until the replacement by a Planning Commission this board was to approve all development projects. The Six Year Plan was officially described as ‘essentially one

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1 ibid., p.129
3 Anders and Azizli, (1958) p.23
4 Ibid. p., 478
of basic development intended to prepare the country for future advancement. The plan covered mainly the schemes of development of Agriculture, Transport and Communication, Telecommunications, Fuel and Power, Industry, Mining, Social Sector-Housing, Education and Water Supply for Karachi etc. To meet the target an outlay of Rs. 2,200 million was included in the public and Rs. 400 million in the private sector. In addition an outlay of Rs. 450 million was anticipated outside the plan. Of the total investment of Rs. 3,050 million, a sum of Rs. 1,700 million was expected to be provided from internal resources while the balance of payment deficit of Rs. 1,350 was to be financed to the extent of Rs. 150 million from existing Sterling balance while the rest was to be met from external aid.

From 1951 onward, foreign aid started pouring into the country. The economic aid, originating in the 'Colombo plan' led to the formation of the "Aid to Pakistan Consortium" which was set up with the participation of USA, Britain, Japan, West Germany, France, Canada, Belgium and Italy after 1958. The priority projects were Power, Communications and Transport sectors which were essential requirement of the development plan as well for the donor countries, companies for facilitating their economic activities. Pakistan began to receive aid in 1951 and it continued to grow in volume in the coming five years plans.

There is no doubt that rapid economic development in developing countries after the World War-II was made possible with the help of aid and economic assistance. Pakistan like many other developing countries remained deficient in financial resources and has been bridging its resource gap of balance of payment and trade deficit through borrowing from external sources. Keeping in view the above picture of the available and inherited resources at the emergence of Pakistan and further developments, the GDP growth in the coming decades in Pakistan showed that foreign economic assistance had contributed in sustaining higher economic growth of Pakistan. The pace of aid inflow was maintained up to 1980s but later inflows linked to debt repayment issues.

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1 Commonwealth Consultative Committee on South and South-east Asia: The Colombo plan for Co-operative Economic development in South and South east Asia, H.M. Stationery Office, London: 1950, Chapter -V, Para -5
2 Op.cit. p.480
The growth process had both positive and negative effects on the economic development history of Pakistan. The most important element in effectiveness of aid is sustainability of growth which is possible if a country generates its own saving, surplus trade and develops its own technology to have sustainable growth. Unfortunately it has been observed that foreign aid instead of being subsidiary in the development process became the fundamental element of economic growth and also became permanent feature of the development Plans. Resultantly its inability to generate enough resource through taxation and trade gave birth to external debt liability. Since 1970 the debt liability of every Pakistani has risen from Rs. 300 to Rs.1, 750\(^1\). The examination of aid requirement reveals that need of heavy reliance on aid and loan occurred when the country was not able to produce sufficient resource from domestic saving, investment, taxation and trade balance.

The use of aid appropriately was another issue which was not properly addressed. The donor countries used their influence under the umbrella of aid to offer such projects which were in their interest more than the recipient countries. If the project was not of top priority of the recipient country, it was tied up with domestic resources and technical assistance, without giving much consideration to the effectiveness of the projects. Further demand for aid required the country to meet the domestic expenditure, resultantly the country had to continue with the policies of relying on foreign aid and allied conditionality.

Historically, industrial growth remained low in Pakistan therefore, in the coming years imports mostly exceeded export. In 1970s the excess was 46 percent which rose to 135 percent in mid 1980s.\(^2\) Pakistan was receiving heavy aid from US tied to our foreign policy since 1950s. However, in the 1980s the rationality of aid was developed to manage the balance of payment deficit and to maintain higher level of investment. These problems emerged from the cumulative effects of weak economic policies, messed up priorities and weak institutions.

Principally, the purpose of any economic development policy is to get economy on the path of self-sustained growth. The study of aid and development relationship in Pakistan tells a different story. One can conclude safely that the country became more dependent on aid in the last five decades. Keeping in view the narrow industrial base, financial structure and economic output, of Pakistan, the next chapters will examine the economic strategy undertaken by this successive government. The development strategies combined with the political and economic policies of the government will indicate the relationship of economic structure, and role of aid in development of Pakistan.
CHAPTER-III


3.1. Inevitability of foreign Aid:

There is a general consensus among the economists of IBRD and IMF, that foreign aid is the key factor in the growth of a newly independent country. Some economists in IBRD and the Fund even quote Pakistan as the most appropriate example to prove their thesis. As stated in the second chapter, that at the time of independence, Pakistan had no industrial base. There were little resources to meet the current expenditure and trade deficit. Above all, prospects were almost nil for the development of infrastructure.

Financial resources were immediately required for the import of consumer goods, capital goods, industrial raw material and there was no money to pay for the salaries of the government employees. A massive outlay of financial requirement was needed from both domestic and foreign source. Pakistan was a newly independent country but was without known financial and natural resources and marred by deficit on all accounts.

Gustav Papanek says “foreign aid contributed significantly to Pakistan’s growth from the late 1950s, without it the rapid increase in development in 1960s could not have been possible”.

Keith Griffin felt that, in the mid 1960s the entire social and economic system that was build up was heavily supported and sustained through foreign assistance. Rashid Amjad is of the view that the development in Pakistan and the economic system has no

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resemblance to classical capitalism. He calls it a foreign aid-dependent regime where industrial growth was closely linked up with foreign aid.¹

Though country's early economic managers were prepared to develop Pakistan on progressive lines but they had no model to follow. At that time there were strong pulls from both capitalist and socialist systems. Generally speaking, in Pakistan the ruling class favored the capitalist path of development. Dismayed by the position of the domestic resources they had no other choice but to fall in the lap of foreign aid. Most of the others newly independent countries also adopted that path. They were not aware of the intentions of Bretton Woods Institutions and the hidden agenda of the western countries. To a large extent, they were thinking honestly that was the only solution for the economic development of Pakistan. For that matter it was economic order of the day outside the Socialist world. Any association with Soviet Union was not on the agenda, after Liaqat Ali Khan dropped the idea of visiting the Soviet Union and he went to Washington to meet Truman, the President of the United States.

In April, 1948 the government of Pakistan chalked out the industrial policy of Pakistan. It stated that Pakistan would welcome foreign capital investment from a purely industrial and economic objective and not claiming any special privileges. The policy also stated that the Government of Pakistan should ordinarily be given the option to subscribe at least 50 percent of all classes of shared capital and debenture in selected industries.² It was also decided with regard to other industries that an opportunity should normally be given to Pakistani nationals to subscribe at least 30 percent of all classes of shared capital. But if in case it was not coming from the nationals of Pakistan the balance might, with government prior approval, be subscribed by foreign investors. The second industrial policy announced by the government of Pakistan, in 1954, encouraged private investment and clearly allowed repatriation of profits earned on foreign capital brought after April 1, 1954.

Before coming to aid and loans of different types available to Pakistan at that time, let us define what in a nutshell foreign aid means. The term international systems for foreign economic aid comprises various types of loans including those repayable in local currencies, untied loans and loans tied by a country, money grants, commodity grants and exports credits of more than a certain ratio. In simple terms according to Pakistani officials even those firms who come in Pakistan and invest in Coca Cola and other similar products are also providing aid to Pakistan.\(^1\)

3.2. Aid, Grants and Loan available to Pakistan at the Initial Stage

3.2.1. Grant: These were charity funds from church groups acquired through individual efforts. Pakistan was given some generous grants especially by Canada in the early 1950s and the free grant of wheat by the United States also comes under this heading.

3.2.2. Technical Assistance: This type of assistance was provided to Pakistan for technical training to Pakistanis going abroad along with salaries and expenses of foreign experts working in Pakistan. Under the Colombo Plan many Pakistanis got training both technical and academic in western countries. For the establishment of Pakistan Institute of Development Economics (PIDE) Karachi, funds for the experts were provided by the Ford Foundation. The experts came from Harvard University. The role of experts though determined, as far as the parameters of assistance were concerned, but remained undetermined if we study in depth in the larger context. It has been observed that it had many political implications due to certain activities and conditionalities attached to the assistance provided in this manner. In this context the government of Pakistan Peoples Party stated in their election manifesto that if elected they would change the planning strategy. However the role of these experts did not diminish during the Bhutto era. They were generally known as the Harvard group.

3.2.3. Bilateral Loan: These are the agreements between Pakistan and individual donor countries which take the form of tied assistance. First the Loans are used for purchase of donor’s goods. It is known as single and double tying loans for specific goods i.e. Pakistan or any recipient country have to purchase specified goods at the rate quoted by the loaning country, even if those things are available at much cheaper prices elsewhere.

3.2.4. Multilateral Assistance: In the early period foreign aid was channeled through multilateral institutions such as the World Bank and IMF by the donor countries. This is known as multilateral assistance. At that time the share of the World Bank contribution was very small.

3.2.5. Project Aid: The project aid is always given for a specific project by the donor country. It can’t be used for other projects because the aid is to be spent on the project specified in the project aid. Later on the donor country for its own advantage had to provide spare parts for the machinery installed through this aid. Thus the recipient country became permanently dependent on the donor country.

3.2.6. Non-Project or Commodity Aid: Most of the countries particularly United States of America provided raw materials machinery and accessories under this category. The United States used (US Public Law -480) PL-480 under this category. Under PL 480 agreement surplus wheat and cotton were sold to Pakistan on liberal terms. Usually surplus commodities of US Department of Agriculture were sold under this law and the revenue earned through this was used for non-project aid. The United States regulated PL-480 grants and aids under different titles. For instance since 1967-68 the aid under PL-480 titled that was previously repaid in rupee would be replaced with US dollars. Hassan Gardezi and Jamil Rashid say that a different form of aid makes aid management a complicated affair. The donor countries achieved the best results in portfolio management, where each loan was used to counteract losses. A diagrammatic representation of Foreign Economic Assistance/Aid, is attached. (Appendix-I). The other diagram drawn on the structure of “development project Financing and Institutions”, is attached (Appendix-I b), which shows the forms and kinds of the project loan and corresponding Institutions at the Federal, Provincial and local government level in Pakistan.
3.3. The Early Approaches towards Foreign Aid

As it has been explained earlier, Pakistan was in dire need of financial assistance from any quarter, just after independence. During the Quaid-e-Azam’s life a special emissary was sent to the United States for military and economic aid. Mir Laiq Ali forwarded to the State the Department of United States breakdown of Pakistan’s requirement in which Pakistan sought $US 700 million for industrial, $US 700 million for agriculture development and $US 510 million for building and equipping of defense services. Actually US was not interested in the South Asian affairs. At that time the US government thought that Britain was taking care of that area. Though Pakistan in hidden words, tried to seek defense association with United States, the US government did not move and the authorities in the State Department were reluctant to offer any aid. Mir Laiq Ali’s visit though not highlighted in the literature of foreign policy of Pakistan many scholars have mentioned about the presence of Mr. Laiq Ali in those dates in Washington for the negotiations for aid. Dennis Kux also mentions Laiq Ali’s visit to United States in 1947 and in July 1952, he again visited as an adviser to the Ministry of Defense.

The US tended to view the Pakistani exercise as somewhat strange. Not a single representative of the office of the Near Eastern Affairs was in favour of Pakistan and they did not consider it a deserving case. The response to Pakistani’s request was negative considering the United States did not have funds to extend loan of the magnitude contemplated for essential development projects.

The US authorities were of the view that the US Export –Import bank would give consideration to individual projects of moderate scope, which would be approved and disapproved on their merit. They directed Pakistan to address its enquiries for larger loans

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from private investment sources or from the investment banks. Ultimately it was said that the government of United States would pay sympathetic consideration of Pakistan's demand. This decision was taken in the office of Roy L. Thurston on 24, October 1947. ¹

Pakistan continued its insistence and pleaded for aid on various occasions. It is said that on this the State Department plainly replied to Pakistan Ambassador Mr. Isphani, the message was signed by the acting secretary of State Lovett, telling the government that no request can be entertained without prior congressional approval and appropriations and the State Department was not in position to get approval of such a congressional action at this time.

Later on when Liaqat Ali Khan, the first Prime Minister of Pakistan was preparing to visit the United States of America in 1950, the State Department sent the White House a forty one (41) page briefing memorandum that offered a candid and comprehensive snapshot of bilateral relations and US policy towards Pakistan on eve of the Korean War. It said that entire South Asian region was of relatively secondary importance to the United States from military point of view and that its request seemed impracticable because of the United States existing heavy supply of military equipment to other parts of the world which were faced with great potential threats of external aggression than Pakistan. ²

When Liaqat Ali arrived in Washington, it was a great reception, he addressed the congress and attended a formal State dinner in Blair House and a dinner was also hosted by Secretary of State. Liaqat Ali during his visit tried to explain Pakistan's requirement and emphasized interest in US economic aid and business investment. But the US government was still undecided. Though they were impressed by the personality of Liaqat Ali and the media was also pleased by him. There was little bit of surprise in store for Liaqat Ali which unfortunately did not materialize due to an accident.

¹ ibid.
² State Department background memoranda on the visit to the United States of Liaqat Ali Khan, April 14, 1950, President Secretary file HSTL.
The American government wanted to send some armament and explosives to Pakistan without much fanfare but it caught fire and there was terrible explosion which seriously damaged the small port town of South Amboy, New Jersey and the Governor of New Jersey had to declare Martial Law. Further advances in this regard were blocked due to this accident. But before that Liaqat Ali, during his stay in United States, sent various messages to the business community. In one of such meetings he said “I would like to say that except for a few specified industries, we have thrown open the entire field of investment to private enterprise, and we assure the great pioneer of this and other advanced countries of the warmest welcome and of the greatest goodwill on our part and we hope, we shall have their good will and cooperation in return”.¹ If we compare it with the statement of the government’s of Pakistan to attract private investment, there seems to be great similarities even after fifty five (55) years.

Actually America had not made up her mind to supply arms to Pakistan. They wanted some specific agreement and some places for their bases as the State Department policy expressed it, “we recognized that the final political orientation of Pakistani leaders will be influenced by the responses they received to their requests...our response to Pakistan’s requests for military aid should increase its willingness to make bases available to us”² Specifically with regard to military aid, director of the Pentagon office of military assistance prepared a list of equipment which were surplus and it could have been supplied to Pakistan but suddenly Deputy Director of the State Department issued the statement that “it is the view of the department that no further action should be taken by the defense department at the present time”. The reason given was “to proceed with the sale of equipment to Pakistan prior to congressional action on the proposed amendment to section 408-C of the mutual defense system of 1949 would prejudice satisfactory legislative action thereon. Apart from such consideration, the political

¹ Liaqat Ali Khan, Pakistan: The Heart of Asia, Cambridge: Mass.1950, (A collection of speeches in the United States and Canada by the Prime Minister), pp31-34
² Department of State, “Policy statement”, 3 April 1950 No. 30.
situations visa-a-vis Korean War does not permit the US at this time to take affirmative action on the Pakistan requests.\(^1\)

In this situation Pakistan, on its part, was not ready to fully cooperate with the United States of America on the Korean question and refused to provide the assistance requested. So the question of foreign aid for Pakistan remained under consideration till the country joined the SEATO and CENTO.

3.4. Other Channels of Foreign Aid during 1950 to 1977

Pakistan entered into regular foreign aid ambit after the commencement of the Colombo plan in 1950. As already mentioned Pakistan received aid in six broad categories. The following schedule shows the accumulative assistance received from 1951-71.

<table>
<thead>
<tr>
<th>Country/Agency</th>
<th>Grant</th>
<th>Loan</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>40.832</td>
<td>-</td>
<td>40.832</td>
</tr>
<tr>
<td>Austria</td>
<td>-</td>
<td>5.484</td>
<td>5.484</td>
</tr>
<tr>
<td>Belgium</td>
<td>-</td>
<td>13.823</td>
<td>13.823</td>
</tr>
<tr>
<td>Canada</td>
<td>239.012</td>
<td>169.830</td>
<td>408.842</td>
</tr>
<tr>
<td>China</td>
<td>110.369</td>
<td>200.000</td>
<td>310.369</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>-</td>
<td>51.528</td>
<td>51.528</td>
</tr>
<tr>
<td>Denmark</td>
<td>-</td>
<td>14.742</td>
<td>14.742</td>
</tr>
<tr>
<td>France</td>
<td>-</td>
<td>138.754</td>
<td>138.754</td>
</tr>
<tr>
<td>Germany</td>
<td>-</td>
<td>471.247</td>
<td>471.247</td>
</tr>
<tr>
<td>Italy</td>
<td>-</td>
<td>139.734</td>
<td>139.734</td>
</tr>
<tr>
<td>Japan</td>
<td>1.269</td>
<td>328.798</td>
<td>330.067</td>
</tr>
<tr>
<td>Kuwait</td>
<td>-</td>
<td>4.958</td>
<td>4.958</td>
</tr>
<tr>
<td>Netherlands</td>
<td>-</td>
<td>46.151</td>
<td>46.151</td>
</tr>
<tr>
<td>New Zealand</td>
<td>6.810</td>
<td>-</td>
<td>6.810</td>
</tr>
<tr>
<td>Norway</td>
<td>6.027</td>
<td>-</td>
<td>6.027</td>
</tr>
<tr>
<td>Poland</td>
<td>-</td>
<td>11.326</td>
<td>11.326</td>
</tr>
<tr>
<td>Switzerland</td>
<td>-</td>
<td>26.801</td>
<td>26.801</td>
</tr>
<tr>
<td>Sweden</td>
<td>16.527</td>
<td>18.025</td>
<td>34.552</td>
</tr>
<tr>
<td>Turkey</td>
<td>-</td>
<td>3.646</td>
<td>3.646</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>14.435</td>
<td>438.095</td>
<td>452.530</td>
</tr>
<tr>
<td>USA</td>
<td>715.445</td>
<td>1594.115</td>
<td>2309.560</td>
</tr>
<tr>
<td>US Exim Bank</td>
<td>-</td>
<td>241.542</td>
<td>241.542</td>
</tr>
<tr>
<td>PL-480 (Title I, II &amp; III)</td>
<td>257.297</td>
<td>191.800</td>
<td>449.097</td>
</tr>
<tr>
<td>USSR</td>
<td>-</td>
<td>137.914</td>
<td>137.914</td>
</tr>
</tbody>
</table>

\(^1\) The Director, Office of Military Assistance, Department of Defense (Lemnitzer) to the Director, Mutual Defense Assistance Programmed, Department of State, 3 February 1950, Records of the Military Adviser to NEA.
<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Assistance</td>
<td>Grants</td>
<td>%</td>
</tr>
<tr>
<td>Pre-1st Plan</td>
<td>337</td>
<td>216</td>
<td>64</td>
</tr>
<tr>
<td>1st Plan(1955-60)</td>
<td>1,075</td>
<td>578</td>
<td>54</td>
</tr>
<tr>
<td>2nd Plan(1960-65)</td>
<td>2,910</td>
<td>1,105</td>
<td>38</td>
</tr>
<tr>
<td>3rd Plan(1965-70)</td>
<td>2,937</td>
<td>794</td>
<td>24</td>
</tr>
<tr>
<td>1970-71</td>
<td>873</td>
<td>95</td>
<td>11</td>
</tr>
<tr>
<td>1971-72</td>
<td>143</td>
<td>61</td>
<td>43</td>
</tr>
</tbody>
</table>

As shown in the chart above, US has been the largest contributor in assistance to Pakistan. West Pakistan received aid amounting to approximately $US 335.0 million in 1952-69. Out of it, $US 791 million had come by way of PL-480, $US 673 million through non-project disbursement, $US 623 million through guaranteed debt, $US 608 million by way of project disbursement, $ US 515 million through commodity grants and $ US 140 million through project grants and technical assistance.\(^1\) The proportion of grants has been continuously declining. It was 64 percent during 1950-55. During the first 1955-60 the grant was 54 percent and during the second plan period the grant was 38 percent, during third plan period it was reduced to 24 percent and in 1973-74 the grant came down to 5 percent\(^2\). The following table shows the plan-wise break up of grants and loans.

\(^1\) The Dawn, Karachi May 02, 1972.
\(^2\) Pakistan Economic Survey 1977-78 p.117
in the early period grants were more than the loans and later on after the second five year plan particularly, loans registered remarkable increase over grants. As we can see loans in 1977 were 83 percent and grants were only 17 percent of the loans. The reason was that the loaning countries thought that Pakistan had come out of initial economic constraints and as such the continuity of grants was not acceptable to their policy makers. As such they started extending loans which simultaneously increased debt-servicing.

Further, if we look at the composition of the grants and the loans as, given above, we would reach the conclusion that in the beginning bigger amounts of grants than the loans shows the political commitment of the donor countries to their tax-payers that their money was being spent on poor countries in the form of aid. The second reason was the donor countries desire to be in the driving seat for shaping the policies of recipient countries. The other reasons include the favorable trade terms for the donor countries, which they ensured against their grants and loans in this period.
The change in composition of aid from soft to hard-term loans over a period of 20 years considerably increased. In the first five-year plan (1955-1960) grants comprised in 80 percent of the total commitments but dropped to 46 percent during the second plan (1960-65) and continued to decline averaging 32 percent during the third plan (1965-70) and 10 percent during the fourth plan (1970-75). Thereafter further grants declined as aid component in foreign assistance. On the same pattern the terms and conditions also became harder over the years. The terms and conditions were softer in 1960s and 1970s as compared, to 1980s and 1990s. The interest rates were increased and repayment period was also reduced gradually in 1980s and in 1990s. The grant became insignificant over the years and aid became donor driven. Donors wanted to stay in driving seat during formation of restructuring of economy due to the attached conditions with the loan. Commercial rates were also available on heavy interests and with lower maturity period. Higher interest, less repayment period and consequent adjustment to the conditions adversely affected Pakistan’s external debt servicing over the last four decades.

There is a general impression that in Ayub’s period the economic policies were conducive to the economic growth. The main concentration was on the liberalization of trade, inclination towards industrialization and land reforms. As it is summarized by Dr. Ishrat Hussain, Ayub assumed power in the name of improving the living conditions in Pakistan and he felt that accelerating the pace of industrialization would be conducive for achieving this objective. Moreover, Pakistan’s trade regime would have to be altered to meet the needs of the industrial sector. To support industrialization and minimize the influence of the feudal class Ayub took the credit of introducing land reforms by fixing the ceiling of 500 acres for irrigated and 1000 acres for non-irrigated land. In addition, the landlord could still own and cultivate about 2000 acres of irrigated and 4000 acres of non-irrigated lands if they transferred some of the land to the legal heirs and convert some into orchards, nurseries and games preserves. By doing so, 22.3 million acres were acquired by the government. It helped to trigger the green revolution i.e. the use of improved seeds, fertilizers and tube wells along with farm mechanization. Khalid Bin

1 Economic Survey of Pakistan, Government of Pakistan, 2002-03 p. 158
Sayeed says that Punjab was the main beneficiary. According to the farm mechanization report 91.2 percent of the 75,200 tube wells were located in Punjab with 2.7 percent of the private tube wells of Peshawar Division of the Frontier and 1.7 percent in the Khairpur division of the Sind. Concentration of tube wells in the Punjab was matched by concentration of tractor ownership. Out of 16600 tractors in West Pakistan 13,800 were in the Punjab.¹

Traditionally, industrialization has gone through various phases of its development. If we study European model we can easily discern that the mercantile capital developed into finance capital to support the establishment of industrial units, which were coming up due to rapid inventions and development in the scientific field. In Pakistan, to some extent, this model was repeated. The mercantile Memon class and some businessman from Chiniot after earning lot of capital from mercantile activity changed it into finance capital by opening banks. Like Adamjee opened Commerce Bank, Saigols opened United Bank and Colony group Australasia bank. Simultaneously this group started establishing industrial units. In this respect Dawood group can also be mentioned. Because it was one of the major group though did not open a bank. One can compare it with Morgans, Rockefellers and Du ponts of the United States of America in the early period of its development. In that period Pakistan was perhaps one of the few developing countries that openly and officially advocated the capitalist doctrine of "functional inequality" on the familiar plea that government should tolerate some initial growth in income inequalities to reach high level of saving and investment.² The most outspoken advocate of this doctrine was Pakistan’s Harvard Adviser to the Planning Commission, Gustav F. Papanek who espoused the concept of "social utility of greed" by pointing out that income inequalities not only contributed to the growth of the economy but also brought improvement in the living of the lower income group.³

² The second five year plan, Planning Commission, Government of Pakistan, 1960-65 Karachi: p.49
³ Gustav F. Papanek, (1976), p.242
Most of the critics assumed that this policy did not favour common man but promoted the interests of only 22 families who were the main gainers during this period. They controlled 66 percent of the industrial assets, 70 percent of the insurance funds and 80 percent of bank assets.\footnote{The Business Recorder, Karachi: April 25, 1968} This negative criticism by the supporter of the above mentioned doctrine answered saying that at the initial stage the trend is vertical. But later on this vertical trend is changes into a horizontal trend when masses start benefiting from GDP growth. During the 1960s the GDP growth was 6.77 percent which was higher than the GDP in 1970s at 4.84 percent. It got better in the 1980s and was expected to be 5 percent in the 1990s\footnote{50 years, Pakistan, Volume-I, Federal Bureau of Statistics, Statistics Division, Government of Pakistan, Islamabad: June 1998, p.7}. The middle class started flourishing and its impact on the society in terms of liberal atmosphere could be seen in various trends taking shape at that time. The influence of landlords and religious fundamentalists started eroding. It was reflected in the night life of the big cities. During the decades 1959-1970 per capita GDP in terms of 1959-60 constant prices grew only by 17 percent in East Pakistan but 42 percent in West Pakistan.\footnote{Planning Commission, Government of Pakistan, and Report of the Advisory panels for the 4th five year plan 1970-75 Vol.1 Islamabad: 1970, p. 22} It also reflected regional inequality.

In the final analysis the trickle-down policy brought forward substantial results. The chart of accumulated foreign aid shows the volume of aid and grants was much higher in the Second Five year plan and third Five year plans as compared to the first and pre-first five-year plan.

During the first and second plan Pakistan received aid as much as it could absorb. Moreover debt service payments then were small, leaving large net transfers to Pakistan. In the third plan period gross commitments were virtually stagnant at constant prices. This indicated growing return flows of debt services so that net transfers began to decline. The availability of aid declined during the third plan period and there was a short-fall of 24 percent in expected aid. Since the beginning of the fourth plan in 1970 the elements of uncertainty ultimately led to a slowdown in the anticipated foreign aid.\footnote{Pakistan Economic Survey, 1971-71, p-175}
Following table explains the composition of Aid as disbursed in different types

**DISBURSEMENT OF FOREING ECONOMIC ASSISTANCE BY TYPE (GRANTS AND LOANS IN $ MILLION)**

<table>
<thead>
<tr>
<th>Years</th>
<th>Project aid</th>
<th>Non-Food Aid</th>
<th>Food Aid</th>
<th>Balance of Payment support</th>
<th>Total Non project</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 3/1960</td>
<td>406</td>
<td>244</td>
<td>192</td>
<td>-</td>
<td>436</td>
</tr>
<tr>
<td>2nd Plan</td>
<td>1209</td>
<td>420</td>
<td>765</td>
<td>-</td>
<td>1185</td>
</tr>
<tr>
<td>3rd Plan</td>
<td>1811</td>
<td>763</td>
<td>469</td>
<td>-</td>
<td>1232</td>
</tr>
<tr>
<td>4th Plan</td>
<td>2556</td>
<td>1299</td>
<td>785</td>
<td>1090</td>
<td>3174</td>
</tr>
</tbody>
</table>

*Source: 50 years of Pakistan, Government of Pakistan, 1998, p.67*

The change in the composition of aid from grants to loan and the larger inflow of external resources on account of the accelerated development led to an increase in debt obligations of the country. The above table shows that over the period of these years, the project aid was enhanced and due to higher rate of return the debt servicing increased to the extent that IMF had to come in, for the balance of payment support during 4th Plan period. Meanwhile the grace period of loans and credits contracted earlier expired, which also increased debt service liability during the past few years. Along with this development the country has been facing from time to time external and internal economic and non-economic events, which were putting severe pressures on the weak balance of payment position necessitating borrowing on short term to overcome occasional strains. On an average the ratio of debt payment to country’s foreign exchange earning had been 17.3 percent during 1971-7. The following table explains the ratio of debt service from 1971-77.

**Debt service ratio ($ Million)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Foreign exchange</th>
<th>Debt service</th>
<th>Debt service ratio to Foreign exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971-72</td>
<td>819</td>
<td>122</td>
<td>14.9</td>
</tr>
<tr>
<td>1972-73</td>
<td>1065</td>
<td>193</td>
<td>18.1</td>
</tr>
<tr>
<td>1973-74</td>
<td>1388</td>
<td>197</td>
<td>14.2</td>
</tr>
<tr>
<td>1974-75</td>
<td>1519</td>
<td>248</td>
<td>16.3</td>
</tr>
<tr>
<td>1975-76</td>
<td>1813</td>
<td>367</td>
<td>20.2</td>
</tr>
</tbody>
</table>
The above figures show that our debt servicing was increasing from 1970s onward. The increasing debt burden and cost of servicing the debt became the single most important issue in the country. Economic policies of this period failed to fill the gap in the balance of payment, budget deficit. From then on, the social and human development sector was marginalized. Though Pakistan was relying on foreign assistance since the 1950s resource generation could not equal with the resource consumption. The magnitude therefore of the resource gap kept increasing as shown in following table.


<table>
<thead>
<tr>
<th></th>
<th>Saving as percentage of Investment</th>
<th>Resource Gap (Investment and Gap) Million Rs.</th>
<th>Resource Gap Percentage of GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-70</td>
<td>56.8</td>
<td>3,257</td>
<td>6.8</td>
</tr>
<tr>
<td>1970-71</td>
<td>54.5</td>
<td>3,568</td>
<td>7.1</td>
</tr>
<tr>
<td>1971-72</td>
<td>66.5</td>
<td>2,566</td>
<td>4.7</td>
</tr>
<tr>
<td>1972-73</td>
<td>83.5</td>
<td>1,428</td>
<td>2.1</td>
</tr>
<tr>
<td>1973-74</td>
<td>53.2</td>
<td>5,431</td>
<td>6.2</td>
</tr>
<tr>
<td>1974-75</td>
<td>36.5</td>
<td>11,560</td>
<td>10.2</td>
</tr>
<tr>
<td>1975-76</td>
<td>58.8</td>
<td>9,386</td>
<td>7.0</td>
</tr>
<tr>
<td>1976-77</td>
<td>62.0</td>
<td>10,408</td>
<td>6.7</td>
</tr>
<tr>
<td>1977-78</td>
<td>80.1</td>
<td>5,968</td>
<td>3.2</td>
</tr>
</tbody>
</table>


It is reflected in the above table that domestic savings were not adequate to fulfill the investment requirement and had led to increase in debt since 1970s. In 1950s and 1960s approximately 70 percent of the foreign aid was non-refundable as it comprised grants assistance and only 30 percent were loans and credits. During this period 80 percent of the aid was diverted towards development and only 20 percent for non-development. If the borrowed resources had been properly utilized for development, by investing more and enhancing productive capital, there would have been reduction in budget deficit and debt servicing. But during the 70s Pakistan’s revenue expenditure shows that the percentage of development expenditure from foreign resources was reduced as compared to non-development expenditure from domestic resources (as shown in the
Pakistan revenue and expenditure

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>External Resources</td>
<td>68.97</td>
<td>50.87</td>
<td>69.34</td>
<td>62.43</td>
<td>41.11</td>
<td>38.56</td>
</tr>
<tr>
<td>as a percentage of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>development expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-development</td>
<td>92.85</td>
<td>82.31</td>
<td>92.12</td>
<td>86.82</td>
<td>71.22</td>
<td>72.47</td>
</tr>
<tr>
<td>expenditure as a</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>percentage of domestic</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>resources</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


above table). This diversion of non-development expenditure basically led to increase in the overall volume of the aid as percentage of GNP during this decade as compared to 1950s and 1960s though in 1970s the ratio of foreign aid reached up to 11 percent of GNP as shown in the following table.

Foreign Aid Commitments:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Aid (Rs. Million)</td>
<td>5</td>
<td>472</td>
<td>1,068</td>
<td>3,105</td>
<td>3,577</td>
<td>3,577</td>
<td>13,902</td>
</tr>
<tr>
<td>Proportion of GNP (%)</td>
<td>0.02</td>
<td>2.1</td>
<td>3.4</td>
<td>7.5</td>
<td>5.8</td>
<td>5.9</td>
<td>10.5</td>
</tr>
</tbody>
</table>

Source: Fifty Years of Pakistan, Government of Pakistan (1998)

Not only the proportion of aid to GNP increased during 1970 but the loan repayable in foreign exchange also increased from 30 percent to 85 percent from the pre-plan period up to 1978, in terms of repayable loan in foreign exchange as shown in the following table.

Commitments of External Assistance (US$ Million)

<table>
<thead>
<tr>
<th>Period</th>
<th>Grants Total Assistance Amount</th>
<th>Loans repayment in foreign exchange % Share</th>
<th>Amount</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-Ist plan</td>
<td>337</td>
<td>216</td>
<td>64</td>
<td>101</td>
</tr>
<tr>
<td>First Plan</td>
<td>1,073</td>
<td>578</td>
<td>54</td>
<td>221</td>
</tr>
<tr>
<td>Second Plan</td>
<td>2,757</td>
<td>1,105</td>
<td>40</td>
<td>1,559</td>
</tr>
<tr>
<td>Third Plan</td>
<td>2,746</td>
<td>704</td>
<td>26</td>
<td>2,042</td>
</tr>
<tr>
<td>Five Years (1970-75)</td>
<td>4,944</td>
<td>375</td>
<td>9</td>
<td>3,569</td>
</tr>
<tr>
<td></td>
<td>1975-76</td>
<td>1976-77</td>
<td>1977-78</td>
<td></td>
</tr>
<tr>
<td>-----</td>
<td>---------</td>
<td>---------</td>
<td>---------</td>
<td></td>
</tr>
<tr>
<td></td>
<td>958</td>
<td>1,115</td>
<td>979</td>
<td></td>
</tr>
<tr>
<td></td>
<td>102</td>
<td>187</td>
<td>151</td>
<td></td>
</tr>
<tr>
<td></td>
<td>11</td>
<td>17</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td></td>
<td>856</td>
<td>928</td>
<td>828</td>
<td></td>
</tr>
<tr>
<td></td>
<td>89</td>
<td>83</td>
<td>85</td>
<td></td>
</tr>
</tbody>
</table>

Source: Fifty Years of Pakistan, Government of Pakistan.

The above chart clearly indicates that grants were reduced, loans increased on hard terms, repayable in foreign exchange and the share of 30 percent increased to 85 percent by 1977-78. Since domestic resources were not diverted toward development therefore, investment in manufacturing and exports were affected. The inability of export revenue to rise sufficiently to serve debt repayment meant that a substantial proportion of foreign loan was used to pay back past debts. For example almost 60 percent of aid disbursement between 1974 and 1980 was returned to donors in the form of debt servicing.¹

Actually the rising debt servicing is a problem for all underdeveloped countries that are dependent on loans because of lack of natural resources for foreign exchange earning. The countries that export oil have better foreign exchange reserves. They do not, have to borrow loans from developed countries and thus the question of debt servicing does not arise. During this period even fertilizer was imported. This deficit could not be met through foreign trade, so the result was a large legacy of debt and mounting debt servicing.

3.5. The Politico-Economic situation after creation of Bangladesh

The political situation after 1970 election was chaotic due to civil war and secession of Bangladesh. There was complete political uncertainty. There were 90,000 prisons of war in India. Bhutto had taken over after the fall of Yahya and Western countries were not sure about the political inclinations of Z.A.Bhutto. The situation remained like this till the Western countries understood the political trends in Pakistan. The erratic flow of aid was due to this situation. That affected economy in the early period of 1970s.

The secession of the eastern part of the country, now Bangladesh in 1971 had quite a negative impact on both industrial and agricultural production. West Pakistan had to search for other markets for goods which were previously consumed in East Pakistan. The most important factor, which affected the GDP growth and that was strongly felt by economists while analyzing this period, was the nationalization program of Pakistan Peoples Party. Ayub’s period was considered to be pro-industrialists. Bhutto described the economic strategy under Ayub as “a monstrous economic system of loot and plunder which the regime lauded as a free enterprise”. However certain economists have disputed these opinions. The studies by economists show that the Ayub era was a period of substantial economic development as compared with the stagnant fifties. This argument is based on the rapid growth in GNP, which was based on impressive aggregate performance by both the industrial and agriculture sectors, is shown in following chart.

**Average Annual Growth rates of Key sectors, 1960-70 (%)**

<table>
<thead>
<tr>
<th>Growth Rates</th>
<th>1959-60 to 1964-5</th>
<th>1964-65-1969-70</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per capita income</td>
<td>3.5</td>
<td>3.7</td>
</tr>
<tr>
<td>Agriculture</td>
<td>3.7</td>
<td>6.3</td>
</tr>
<tr>
<td>Large scale</td>
<td></td>
<td></td>
</tr>
<tr>
<td>manufacturing</td>
<td>16.9</td>
<td>9.9</td>
</tr>
</tbody>
</table>


The growth of large-scale manufacturing during the 60s was, however, attributed to the measures taken by the Ayub Government to liberalize the economy towards to have more market-oriented economic strategies. The Private Sector broadly was encouraged and economy was getting out of bureaucratic controls of the 1950s. The control over industrial investment was relaxed and a number of imported items were put under the free list. Private investment was encouraged for giving the boost to the industries and economy. The World Bank closely associated with economic policy formulation during the Ayub area, noted the effects of policies with some satisfaction, “Pakistan’s economic policy had an impact on industrial growth in many different ways and had generally been highly favorable to such growth”.

---

1 A.H. Rizvi (1972), *PPP-The First Phase*, Progress Publications, Lahore, p.7
3 Quoted in Omar Noman, op.cit., p.37
There is another point of view which says that this period increased the unequal
distribution. According to Burki “my own estimate is that while inequality increased, the
incidence of poverty declined significantly. It could not have been otherwise. There is
empirical evidence ...to suggest that rapid economic growth, even with some worsening
in income distribution, reduces the numbers living below the poverty line”.¹ Private
Sector attraction of investment actually provided a chance for infrastructure development
mostly on rural side, which provided employment to the surplus and unskilled labor,
which ultimately led to the investment of domestic resources in development. Though,
government sought more foreign capital in terms of aid in this period to supplement
inadequate domestic resources.² It is generally accepted that the role of private sector
and Ayub’s industrial and agricultural policy of “green revolution” had positive effects
on economic growth during this period. Whereas Dr. Mahbubul Haq, the then Chief
Economist of the Planning Commission, disagreed with this concept in 1968 and claimed
that Pakistan’s economic growth had done little to improve the standard of living of the
of common man and that the “trickle-down approach to development” had only
concentrated wealth in the hands of “twenty two industrial families”.³ He argued for
intervention in the economy to stop the concentration of wealth in a few hands. There
was another argument that this estimate of concentration of wealth and inequality of
distribution was over-estimated and exaggerated by Mahbubul Haq in his writings and
speeches, through which he introduced the concept of the “bottom 40 percent in
development thinking.”⁴

With this background the large-scale nationalization of industries and financial
institutions was pursued in 1972 by the PPP regime which was aimed at clipping the
wings of the industrialists. Bhutto’s government nationalized 31 large manufacturing
plants in eight major industries. The industries affected included iron, steel, basic metals,
heavy engineering, motor vehicle and tractors, chemicals, petrochemicals, cement and
public utilities.

¹ Shahid Javed Burki, ‘Growth, Poverty & Politic’, An Article published in the daily Dawn August 31,
2004  
² Omar Noman, (1988) p.36

³ The speech of Mahbubul Haq, published in, “Pakistan : Role of Government”, Pakistan Information
Yet the nationalization was not as big as it appeared, as argued by Omar Noman, that the takeover was confined to capital and intermediate goods sectors, which meant that only 20 percent of value added of the large-scale industries were nationalized as most of the privately owned industrial units were in the consumer goods sector, therefore unaffected by the nationalization\(^1\). It appears that government still wanted to encourage the private sector and giving the impression of mixed economy, but this notion was offset by subsequent nationalization of domestically-owned life insurance companies, banks, shipping companies and firms engaged in oil distribution etc. This action actually harmed the harmonious interaction of public and private sector relationship and balance. This ultimately also shattered the investor’s confidence as the state became major player in the market. Public sector interventions increased in the industrial sector. Resultantly private investment fell to less than a quarter of the projected figure\(^2\).

Following chart shows the private investment in the country as percentage on constant factor for this period. The result was decreased private investment in the country in this period.

### National Accounts Indicators

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Private Investment-Growth rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>1.23</td>
<td>1.09</td>
</tr>
<tr>
<td>1971-72</td>
<td>2.32</td>
<td>0.42</td>
</tr>
<tr>
<td>1972-73</td>
<td>6.80</td>
<td>5.08</td>
</tr>
<tr>
<td>1973-74</td>
<td>7.45</td>
<td>3.6</td>
</tr>
<tr>
<td>1974-75</td>
<td>3.88</td>
<td>35.63</td>
</tr>
<tr>
<td>1975-76</td>
<td>3.25</td>
<td>24.50</td>
</tr>
<tr>
<td>1976-77</td>
<td>2.84</td>
<td>19.99</td>
</tr>
<tr>
<td>1977-78</td>
<td>7.73</td>
<td>11.94</td>
</tr>
</tbody>
</table>


It appears that private investment slowed down after the first stage of nationalization of industrial units but further deteriorated after the second stage of nationalization of financial institutions, banks and other private sector industry during 1974 and 1976. Private sector investment in large-scale manufacturing as percentage of total private investment declined drastically from 29 percent in 1970-71 to 12 percent in

\(^1\) Omar Noman, (1988) p.36
\(^2\) Pakistan Economic Survey, Government of Pakistan, 1974
1977-78\(^1\). The overall growth rate in 1970 of Large-Scale Manufacturing fell to 4.8 percent from 13.4 percent in 1960.\(^2\) The public sector expanded further under the Bhutto’s government. The effects of state interventions in the private sector were manifested further in the following figures which show that investment undertaken by public sector increased manifold where as on the same ratio the private investment fell as relative share of investment in the country.\(^3\)

**Relative share of Public and Private Sector in total Investment**

![Chart showing relative share of public and private sector in total investment.](chart.png)

The breakdown of private investments and Public investment show that public sector investment was 5 percent and while private investment was 95 percent. The change in ratio of private and public is obvious from the above chart that public investment was 80 percent and private only 20 percent in 1977-78. Similarly private sector investment of

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\(^1\) Ahsan Iqbal, *Pakistan’s Economic Outlook: Past, Present and Future*, Ministry of Planning and Development, Islamabad: p.54


\(^3\) Complied from the Economic Survey 1979, Government of Pakistan.
in industrial sector also fell as shown in the following graph.

![Industrial Investment 1970-71 to 1977-78](image)


The reduction of private sector investment also affected Large scale Manufacturing (LSM) which has a strong potential for economic growth, as during the 1970s LSM growth as percentage of GDP was 4.8, whereas it was 13.4 percent in 1980s.\(^1\) Private sector investment in LSM as percentage of private sector investment declined nearly 29 percent during 1970s.

The above trend leads us to note that the harmonious relationship between the public and private sector investment was distorted. The analysis\(^2\) of the policies suggests that Bhutto’s ‘socialism’ did not bring any radical changes in Pakistan’s capitalist-oriented development, except for introducing a bias against large industrialists and reasserting the power of big landlords who now benefited from the investment funds diverted through nationalized financial institutions. The nationalization program particularly, in its second phase, was neither efficient in the corporatist sense nor was it a part of serious commitment to socialism.\(^3\) The extended role of Public Sector led to poor performance. The unskilled laborers were accommodated in these industries with the political support which affected the quality of production.

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\(^1\) Various issues of Pakistan Economic Survey, Government of Pakistan.


\(^3\) Omar Noman( 1988) p. 70
The nationalized industry was used to borrow funding from government for operating cost. Moreover, the policy to divert resources to defense and administration in this period caused the fiscal deficit. On the other side government was not successful in attracting much investment as compared to 1960s, which increased the public sector investment manifold in over all investment ratios. Therefore, resource gap was basically the cause of the rise of aid flows during this period as government had to rely on foreign capital to finance the fiscal deficit. Resultantly the proportion of GNP to foreign aid was 10.5 percent in 1977 as compared to 7.5 percent, in 1964. The domestic resources to supplement the investment were inadequate, as these resources went into mostly non-development sector. As a result 60 percent of the development expenditure (as shown in the table above) was met through foreign aid, which caused increase in accumulation of debt.

The financial institutions particularly the World Bank during this period had been critical of the economic reforms of PPP regime. The Bank was concerned about domestic resource mobilization and diverting it to the development sector. Reducing the government and social sector expenditure was demanded as a pre-condition of further loans in 1974-75. This was the reason that most of the social project in health, education and social welfare were under-funded by the Bank. Finally it led to deadlock between the Bank and PPP regime for further funding in the social sector. The then Government refused to accept Bank’s conditions for restriction of public sector and government spending which resulted in the rise of inflation in 1970s as Bank did not support the capital goods sector. The terms of trade were more favorable to agriculture then industrial sector during this period that ultimately contributed to the rise of inflation in the 70s. Following table shows the increasing trade deficit in this period. The resource gap and trade deficit increased over the years.

**Balance of Trade (Million $)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports</th>
<th>Imports</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1972-73</td>
<td>817.3</td>
<td>797.2</td>
<td>(+)20.1</td>
</tr>
<tr>
<td>1973-74</td>
<td>1,062.4</td>
<td>1,362.5</td>
<td>(-)335.1</td>
</tr>
<tr>
<td>1974-75</td>
<td>1,039.0</td>
<td>2,113.6</td>
<td>(-)1,074.6</td>
</tr>
<tr>
<td>1975-76</td>
<td>1,136.6</td>
<td>2,067.2</td>
<td>(-)930.6</td>
</tr>
<tr>
<td>1976-77</td>
<td>1,140.8</td>
<td>2,234.5</td>
<td>(-)1,183.7</td>
</tr>
<tr>
<td>1977-1978(July-March)</td>
<td>863.3</td>
<td>1,974.5</td>
<td>(-)1,111.2</td>
</tr>
</tbody>
</table>

Source: Complied from Economic Survey, Government of Pakistan, 1977-78
The trade after 1970-71 was imports oriented, which disturbed the trade balance. The terms of trade were more favorable to agriculture than the industrial sector unlike during the last regime. The economic policies of the regime were not much concerned with economic reforms but were mostly oriented to bringing basic changes in the economic system by destroying the power of the capitalists in the process of building Bhutto’s brand of socialism.

Apparently, the agriculture policy was committed to reduce the size and holding of the land. But the ceiling of individual holdings was lowered to 12,000 ‘produce-index-units’ or 150 irrigated and 300 un-irrigated acres.\(^1\) Further policy changes were brought to achieve pro-agriculture development. It included substantial increases in procurement prices, subsidy given to the industrialist were removed under devaluation in 1972. In order to promote entrepreneurial farmers, the ceiling on holdings was subject to certain incentive-related exemptions. Generous tax deduction was allowed for purchase of agriculture machinery\(^2\). The subsidy on inputs like seeds and fertilizers was also given in this period by the Integrated Rural Development Program.

However, these policies did not prove their success. Rather these measures helped to strengthen the growing economic power of the landlords who had been increasingly relying on government funds for modernizing agriculture.

Some of the economists however, agreed that the concept of social democracy does not really attack the class system; rather it helps in maintaining the status-quo. Such

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\(^1\) Hassan Gardezi and Jamil Rashid, (1983), p.12
\(^2\) Omar Noman (1998) p. 93
policies are actually considered as the revolt of professionals against capitalism. The agriculture policy was heavily criticized on the basis that the rural landed gentry still continued to enjoy the class privileges, except that they had to part with just a token of land. They rather became a burden on public funds through the financial institutions, on account of import of agriculture machinery.

The above chart of balance of trade (1972-1977) and figures on foreign trade shows that Pakistan was having a deficit in balance of trade continuously. Trade deficit in 1976-77 stood at $ 1,183.7 million as compared to $ 930.6 million in 1975-76 while exports increased only 0.4 percent in 1976-77 as compared to 9.4 percent in 1975-76. The dimension of the inflow of aid significantly changed during this period as well. The average annual foreign economic assistance to Pakistan was around US $ 600 million in the late 1960s that rose to US $ 1200 million rose up to early 1970’s.

The deficit in trade was due to less exports vis-à-vis higher imports. The widening gap was not surprising, keeping in view the prevalent policy of the regime. Actually exports must grow faster then imports for development. The import and export as details given in the chart above, shows that Pakistan’s economic performance was going against the strategy of development. The only alternative to increasing exports was to make radical changes in the policy of industrialization to make it more capital intensive and to encourage private sector to compete but this factor was ignored. The raw materials for use of the capital goods industries was allowed only on Cash-cum-Bonus basis while finished capital goods were allowed on license. The Industrial Development Bank of Pakistan and other government institutions normally sanctioned loans only for foreign exchange components of the project.¹ Capital intensive industries were encouraged as opposed to consumer goods industries, in the previous regime, but it implied that firms would have high cost, and high-tech machinery. Since the nationalized financial institutions were given the facility of credits, therefore the investors preferred to import machinery rather the buying domestic machinery without credit. Moreover the mass of production is labor intensive and relied upon large amount of capital, which was not

available at that time. On the other hand since basic industries like fertilizer, cement and capital goods and investment were in public sector. The project were financed though the foreign assistance to fill the saving-investment gap. If we look at the export part, the sector was damaged due to overvalued exchange rate in 1972. Pakistan terms of trade deteriorated and there was an increase in traditional export area i.e. cotton, rice etc., which brought stagnation in export. Pakistan’s export receipts remained stagnant at around US $1000-1200 million during 1975-77\(^1\). Only manufacturing exports increased due to Bonus Voucher Scheme, but since it was hard to find manufacturing goods market due to highly protected industries of the developed countries, the rise in manufacturing export could not continue for a longer time. Thus the rising imports and declining exports extended the deficit in balance of trade for which Pakistan enhanced its foreign aid receipt to finance the trade, current account balance and saving & investment gap. That was the time when Pakistan moved from self-reliance towards “debt trap”. Pakistan’s reliance on foreign assistance increased and conditions of loan also became harder. Net inflow of aid increased along with debt servicing. The following table of net inflow of aid would reflect the rising trends in quantum and the other table shows the increase in debt servicing accordingly.

### Net Inflow of Aid

<table>
<thead>
<tr>
<th>Particulars</th>
<th>1974-75</th>
<th>1975-76</th>
<th>1976-77</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Disbursement</td>
<td>1135</td>
<td>1122</td>
<td>961</td>
</tr>
<tr>
<td>Debt Service</td>
<td>248</td>
<td>368</td>
<td>369</td>
</tr>
<tr>
<td>Net Transfers</td>
<td>887</td>
<td>754</td>
<td>592</td>
</tr>
</tbody>
</table>

*Source: Economic Survey, Government of Pakistan, 1977-78*

### Debt Service Ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>Foreign Earnings</th>
<th>Exchange</th>
<th>Debt Servicing</th>
<th>Debt service ratio to foreign</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971-72</td>
<td>819</td>
<td>122</td>
<td>14.9</td>
<td></td>
</tr>
<tr>
<td>1972-73</td>
<td>1,065</td>
<td>193</td>
<td>18.1</td>
<td></td>
</tr>
<tr>
<td>1973-74</td>
<td>1,388</td>
<td>197</td>
<td>14.2</td>
<td></td>
</tr>
<tr>
<td>1974-75</td>
<td>1,519</td>
<td>248</td>
<td>16.3</td>
<td></td>
</tr>
<tr>
<td>1975-76</td>
<td>1,813</td>
<td>367</td>
<td>20.2</td>
<td></td>
</tr>
<tr>
<td>1976-77</td>
<td>2,028</td>
<td>369</td>
<td>18.2</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Economic Survey, Government of Pakistan, 1977-78*

The above table (net flow of aid) shows that flow of external aid during this period in the country had increased. The accumulation of debt as shown (debt service ratio) reflected constant rise in debt servicing. In the year 1975 to 1977 Pakistan had 18-20 percent debt ratio. In 1976, foreign debt of Pakistan rose to US $ 7.5 billion as against US $ 3.5 billion in late 1971.\footnote{M.Tariq Waseem (1978) p.156} The borrowing was almost double than received previously by Pakistan.

It is pertinent here, to mention that it was not only Pakistan, but during 1960s and 1970 the overall borrowings ratio of all the developing countries had increased. The development policy of under-developed countries was also prone towards foreign aid; the doctrine of growth and development was linked with the foreign aid. The role of aid changed gradually with time. It changed its focus from resource mobilization to a multidimensional role. While during this period Pakistan was passing through the economic crises of various economic deficits, the other countries in the region were not going through such an ordeal as intensely as being by Pakistan. In the next section the example of parallel development path are being given to show how the other countries were addressing this situation.

3.6. Parallel path of development- Success Stories

Keeping aside, much theorization of Western economists, there are significant examples of development without foreign assistance. Though, these examples are being quoted from parallel systems of development, but still are important due to being in the neighborhood of Pakistan. China and India adopted the path of development without relying much on foreign aid. India after 1947 and China after 1949 adopted the policies of self-reliance though later on Indian economists deviated from this path to a certain extent but China did much to keep herself on this path.

The newly independent countries were faced with difficult tasks, one of these being the need to contend with the domination by foreign monopolies or create a parallel economic structure to compete with and confront the foreign monopolies. Actually to
regularize the policy of economic subjugation of the newly independent countries. Western powers convened a conference at Bretton Woods, on July 1, 1944. During this conference articles of agreement for the Institutions of the International Bank for Reconstructions (IBRD) and agreement concerning International Monetary Fund were elaborated. The Articles of agreements for the World Bank came into effect in December 1945. Although it was said that World Bank officially was as an International inter-governmental organ, their founders were above all concerned with providing a "Safe Bridge over which private capital could move into International field." The Article of agreement also included International guarantees for World Bank and also the loans for which the WB could act as guarantor. The Articles of agreement stipulated that the Bank would grant loans in cases where the borrower would be unable to obtain from the private sources under reasonable conditions.

The structure of the World Bank as noted down in the Article of the Agreement also serves to consolidate the capitalist system under the United States supremacy. For its operations, the World Bank sends missions to the developing countries and also establishes its missions there. Since 1949 the World Bank has used mission of this kind to investigate Colombia, Nicaragua, Haiti, Guatemala, Honduras, Iraq, Sri Lanka, Jamaica, Guinea, Kenya, Nigeria, Sudan, Jordan, and many others including Pakistan. The WB missions have not imposed their advice on these countries but agents of the monopolies in the countries have put their recommendations into practice. It also appears in the program of the IMF as conditionality. To quote an example on May 08, 1964 for instance the WB granted Ethiopia a loan of US $ 23.5 million for a period of 25 years at an annual rate of interest of 5.5 percent. This Loan involved the participation of the Irving Trust Company, the Chase Manhattan Bank, and the Kommerz Bank AG, the first Pennsylvania Banking and Trust company and other private banks.

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1 Policy and Operation of the World Bank, pp.3-5 cited by Vasily Vakhrushev (1973), Neocolonialism: Methods and Maneuvers. Moscow: Progress Publishers,
2 Ibid.
3 World Bank .IDA. Annual Report, 1963-64, p.23
While the first loan granted by the World Bank totaling US $ 497 million\(^1\) took the form of emergency aid for four countries of Western Europe, it is revealing to note that the World Bank did not investigate the conditions for granting loans to these countries, as now it is its practice in respect of developing countries. In 1947 it granted reconstruction loans to France, Netherlands and Denmark to finance their import from the United States without having recourse to this humiliating procedure.

Coming to our discussion of success stories, first of all let us discuss the Indian model of development. Unlike Pakistan, India had large business conglomerates like Birlas, Tatas, Singhanias, Dalmia-Jains etc with interest in different areas like trade, banking, and transport industry and so on. Such conglomerates like the Zaibatsu in Japan or Chaebon were extremely important in enabling late entrance towards capitalism to successfully compete with the already established foreign capital and especially the multi-national corporations.

3.6.1. India’s Case:

India had broad societal consensus on the nature and path of development to be followed after independence. For examples the Gandhians, the Socialists, the Capitalists as well as the communists were all more or less on the following agenda of development: A multi-pronged strategy of economic development based on self reliance; rapid industrialization based on import substitution including capital goods industries; prevention of foreign capital domination; land reforms involving abolition of Zimandari, tenancy reforms, introduction of cooperatives, especially service cooperatives for marketing, credit etc. The growth model was to be reformist with welfare, pro-poor orientation in favor of the most oppressed classes of the Indian society. The State was to play a pivotal role in promoting economic development through direct State participation in the production process that is through the public sector.\(^2\)

India had one advantage over newly independent countries having small but independent Industrial base, (Indian owned and controlled) that had emerged in India

\(^1\) ibid.
between 1914 and 1947. This was achieved amongst other things by the Indian Capitalist class seizing the opportunities created during this period by the weakening of the foreign stronghold during the two world wars and great depression of 1930s. By the time India gained political independence in 1947, Indian entrepreneurs had successfully competed with European enterprises in India and with foreign imports, in the processes capturing about 75 percent of the market for industrial produce in India. Indian capitalists had also dominance over the financial sphere i.e. banking, life insurance etc.¹

Nehru was both democratic and socialist but he wanted consensus in every decision the Cabinet would take. So he came out of the web of orthodox Stalinist type socialism. Planning for Nehru was consensual and not commands oriented even if it meant toning down many of his objectives. The Planning Commission of India, in early days emphasized on the establishment of heavy industry for self-reliance which Nehru approved. This shift in favor of heavy industry was to be combined with promoting labor intensive small and cottage industry for the production of consumer goods. This as well as labor-absorbing and capital-creating community projects in agriculture promoted by community development program and agriculture cooperatives were seen as immediate solution towards the self sufficient economic system.

India by adopting such measures made rapid advancement towards consumer goods industry like textiles particularly during 1951-79 as shown in the table below:

**Indices of Industrial Production in India²**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>General</td>
<td>55</td>
<td>109</td>
<td>153</td>
<td>186</td>
</tr>
<tr>
<td>Textiles</td>
<td>80</td>
<td>103</td>
<td>106</td>
<td>110</td>
</tr>
<tr>
<td>Basic Metals</td>
<td>47</td>
<td>119</td>
<td>209</td>
<td>144</td>
</tr>
<tr>
<td>Machinery</td>
<td>22</td>
<td>121</td>
<td>373</td>
<td>208</td>
</tr>
<tr>
<td>Electrical</td>
<td>26</td>
<td>110</td>
<td>405</td>
<td>162</td>
</tr>
</tbody>
</table>

Though India adopted the method of private and public sector development but she was not out of debt trap. In the early years India leaned more towards socialist


68
countries for military and consumer items but later on India diverted its sources towards other countries and the following chart shows the trend from 1982-1990.

**External debt of Government of India**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>External Debt</td>
<td>12,328</td>
<td>13,682</td>
<td>15,120</td>
<td>16,637</td>
<td>18,153</td>
<td>22,299</td>
<td>23,223</td>
<td>225,239</td>
<td>28,037</td>
</tr>
</tbody>
</table>

(These represent mainly non-negotiable non-interest bearing securities issue to international financial institutions like the International Monetary Funds, International Bank for Reconstruction and Asian Development Bank)

During the early period the overall economy performed impressively. Indian GNP grew at an average rate of 4 percent per annum in 1951 and 1964-65. This was roughly four times the rate of growth achieved during the half century of colonial rule. The rate of growth achieved by India after independence compared favorably with the rates achieved by the advance countries at the comparable stage during their early development. To quote the eminent economist professor K.N.Raj “Japan is believed to be a country which grew rapidly in the later part of 1890s and the first quarter of the 20th century, yet the rate of growth of national income in Japan was slightly less than 3 percent in the period 1893-1912 and did not go up to more than 4 percent per annum even in the following decade. Judging by criteria such as these the growth rates achieved in India in last decade and half 1950-65 was certainly a matter of some satisfaction.²

According to a comparative analysis if we take on account of average foreign aid to per capita debt during the years 1958-59 received by the developing countries, it shows that India had US$1.2 billion as compared to Pakistan which was US$3.8 and this debt was on higher side i.e. US $16.5 for Chile.³ According to Ronald Segal, after 1957 beside United States of America, which were contributing 44 percent of the loan, India started receiving loans and grants from other donors. But later on Great Britain, West Germany, Australia, New Zealand, Norway, Japan and USSR also joined. Till then the share of the

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World Bank was 16 percent, USSR 18 percent and all others 22 percent but ultimately in the last analysis India could not get the loan to the extent which was needed for boosting her economy, because the Indian foreign policy was the main hindrance in opening the gate of foreign aid from the western countries.

3.6.2. China’s Case

The Chinese embarked upon an ambitious program of economic development concentrating on rapid industrialization. They emphasized on savings and forced to maintain the standard of living at a minimum level in order to collect as much as possible of small economic surplus to invest in the development projects. The slogan was the "small betterment of today must be subordinated to the big betterment of tomorrow". The task of acquiring investment capital was one of the fundamental problems of China’s development.

China was cut off to a large extent from the major sources of foreign investment and loans and was attempting to rely primarily on its own limited resources. During the initial stages of its industrialization most of the capital equipment, acquired for building new factories, expanding existing ones, and even maintaining old plants, was to be imported from abroad. China’s machine industries were still underdeveloped, the larger center of such industries in the past was Manchuria, and in 1945-46, Soviet troops removed 70 to 80 percent capacity of Manchuria’s metal working industries. To meet the requirement and develop its own resources, China laid the foundations for nationalizing the economy. By October 1952 nationalization extended to about 80 percent of the heavy industry and 40 percent of light industry, the government operated all the railways and about 65 percent of the steamships plying in home waters. It controlled all loans and deposits through the people’s bank finally state trading companies were responsible for about 90 percent of imports and exports for about half of the wholesale trade and for about 30 percent of the retail trade.¹

¹ Summary contained in the Economic Bulletin for the Asia and the For East November 1953, p.19
Moreover, the agrarian reform law which was promulgated on June 30th 1950 confiscated the land of landlord class for distribution to the landless and poor peasants. Thus the landlord as a class in the society was abolished and land ownership system of feudal exploitation was transferred into a system of peasant land ownership. At that time landlords and rich peasants who constituted less then 10 percent of the rural population possessed approximately 70 to 80 percent of the land. It was a basic structural change in the present society of China.

For foreign aid China decided to lean on one side by allaying itself completely to the soviet block. But Soviet Union did not offer free grants to Communist China and the only economic development loan made available in 1953 was US $ 300 million i.e. US $ 60 million a year. It was on low interest rate of one percent annually but was to be repaid in 10 yearly installments to be completed in 1963. According to one American estimate in order to industrialize at the pace, Japan had achieved during the early stages of its development, China would need foreign loans totaling over US $13 billion in the first 10 years.¹ Now communist China was attempting to accomplish the task largely on its own, with relatively little financial assistance even from the Soviet bloc. The trade agreement announced at the end of March 1953 provided for deliveries of Soviet equipment for a number of China's industries to be paid for with Chinese metal, food and raw material. A more extensive agreement in September was signed, which provided for Soviet aid over a five year period in the construction of fourteen large units of Chinese heavy industries. Another agreement on economic assistance was signed in 1955, which provided an additional loan of 520 million (Rubles).² Except this the whole development effort of China was financed through to a larger extent by indigenous resources and through the hard work of the peoples of China.

3.7. Pakistan Perspective

These two examples of the newly independent countries show different pattern of development. China was adopting the socialist path while India was inclined towards a

mixed economy i.e. leaning on public and private enterprises. But on the other hand Pakistan was not sure what path to adopt for its development except non-socialist pattern and as such dependence over foreign aid came as a natural course of its economic development. Foreign economic assistance to Pakistan started from 1950 and by June 1977 assistance of $US 13.289 billion had been committed. Out of this $ US 3.267 billion were in the form of grants and US $ 10.022 billion as loans and credits carrying repayment liability.

According to the broader policies mentioned above Pakistan also shifted its development direction from lower stages of economic growth to higher ones i.e. high investment in infrastructure development like irrigation, power, transport and tried to have import substitutions such as fertilizer, cement, steel and capital intensive industries. According to some economists, "Pakistan was following the footsteps of India particularly in relation to import substitution." It was successful for India and not for Pakistan because India had a bigger market while Pakistan's market shrank after the separation of East Pakistan impacting her foreign exchange earnings. This actually widened the trade gap than the resource gap as mentioned in the above table. Since the industrial sector was not able to produce the required foreign exchange due to shortage of skilled labor, Government tried to boost from back-up to a partner sector. The massive devaluation of 1972 was targeted at improving agriculture sector and the trade deficit. The substantial devaluation of the rupee to $ 1= 11, at one stroke deprived the industrialists of the subsidy from the overvalued exchange rates. This reform along with increase in procurement prices of agriculture goods (which went up by almost 100 percent in this period), altered the pro-industrial bias to a pro-agriculture growth strategy.

The other advantage of this massive devaluation was in recovering the trade deficit as it improved the volume of trade by making export commodities competitive and cheaper. Still it helped the agriculture sector. Following table shows better agriculture terms of trade after devaluation.

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2 Personal interview with Mr. Fazalullah Qureshi, Former Federal Secretary of Planning Ministry Islamabad.

72
Agriculture Terms of Trade ¹

1959/60= 100

<table>
<thead>
<tr>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Agriculture Price Index</td>
<td>117</td>
<td>125</td>
<td>164</td>
<td>217</td>
<td>257</td>
<td>283</td>
</tr>
<tr>
<td>Manufacturing Price Index</td>
<td>102</td>
<td>119</td>
<td>146</td>
<td>180</td>
<td>238</td>
<td>271</td>
</tr>
<tr>
<td>Terms of Trade Index</td>
<td>115</td>
<td>106</td>
<td>112</td>
<td>121</td>
<td>108</td>
<td>104</td>
</tr>
</tbody>
</table>

Though Pakistan always had trade deficit but due to devaluation a nominal increase in export was manifested in 1975-76 from $US1,136.6 million in 1974-75 to US $ 1,140.8 million in 1976 or an increase of 9.4 percent in 1975-76². However the trade deficit has been increasing since.

Nevertheless the trade policy in this period responded to country’s requirement of external funds boosting exports towards surplus in trade. However due to being uncompetitive in world market Pakistan could not meet the higher unit value of some exports that continued to pressurize the terms of trade. Therefore the trade gap remained around US$ 1100 in this period.³ The balance-of-payment and structural imbalances continued to persist.

The history of aid and development strategy showed that countries relying on foreign aid, for their development had to follow to the wishes of the donor agencies. In case of Pakistan, its reliance on foreign aid in gross terms has increased by almost 100% from an average of US $600 million to US $1200 million per annum⁴. The major cause, as identified above, was the trade and balance-of-payments deficit. The large deficit was to be financed by the foreign aid and in turn it increased the volume of debt servicing. Nonetheless it cannot be taken to mean that we could have survived without aid flow, as public sector investment from the domestic capital was much less than the foreign capital, and thus reliance on foreign aid was a necessity.

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¹ IBRD, 1977, p.43
³ Ibid. p.105
It is also important to note that without foreign aid an emerging economy could not generate its own resources without depending on the foreign aid and having surplus in the domestic and foreign exchange capital. It goes without saying that in the recipient countries the interest of the donors played a pivotal role in allocations for project and aid.

In case of Pakistan the figures analyzed above show that the largest maximum part of public funding in manufacturing and investment was financed by aid. But the real point is that aid requirement increased due to higher need targets with the passage of time. Although the there are instances in 1975-76 when total investment declined, yet the amount of foreign aid increased.\(^1\) The following table shows the ratio of investment finance by foreign aid and the domestic resource percentage of aid.

**Investment by Foreign and Domestic Resources**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Investment( Rs. Million)</th>
<th>Foreign Aid %</th>
<th>Domestic Resources %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>11.348</td>
<td>48.5</td>
<td>51.5</td>
</tr>
<tr>
<td>1974-75</td>
<td>12156</td>
<td>62.7</td>
<td>37.3</td>
</tr>
<tr>
<td>1975-76</td>
<td>22.500</td>
<td>45.4</td>
<td>54.6</td>
</tr>
<tr>
<td>1976-77</td>
<td>28,000</td>
<td>43.7</td>
<td>56.3</td>
</tr>
</tbody>
</table>

*Source: Compiled from Pakistan Survey, Government of Pakistan. 1976-77, p.138*

As compared with above figures of investment financing, *if* we take the figures of the aid flow, as mentioned above, the average annual increase is 100 percent. In addition to investment financing, the revenue financing was done through aid. Therefore the decade of 1970s is marked by growing dependence on foreign resources to balance the trade deficit. While explaining the economic performance of Pakistan in 1970, Dr. Ishrat states that capital and current accounts must move in opposite directions. The economy became dependent on large flows of foreign capital which translated into a growing debt burden for the economy.\(^2\) Although foreign resources eased in many constraints but the deficit financing beyond a limit created more problems of resources instead of giving relief to the economy and it became a permanent feature of the economy. Two other major factors in this period which caused deficit economy were sudden rise in oil prices and international inflation. The external debt of non-oil developing countries jumped

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\(^1\)ibid., p.158  
from US $171 billion at the end of 1976 as against US $93 billion at the end of 1973. This represents a rise of US$78 billion caused by severe international recession and an unusual increase in oil prices. Pakistan incurred an additional liability of US$3.5 billion during 1973-76 as against the same amount borrowed in all the preceding years.¹

We may conclude that this was the period when the need of dual economy and functional inequality was emphasized by the International institutions as a doctrine of growth and need of aid was established accordingly. An industrial elite emerged in the shape of 22 families in Pakistan, they were able to capitalize their profits mainly due to two reasons. Firstly, that there was no healthy competition for their industrial products in the domestic market and secondly as economic policy measure during the 1960s government encouraged the import substitution for industrial growth in the consumer goods sector. Industrialists were given tariff protection, tax exemptions and tax rebates to protect the import goods. Though these policy measure brought country on the path of growth and healthy GDP, but the elite group failed to contribute in the savings beside the large manufacturer were subsidized by the government, therefore, the saving/investment gap persisted which established and escalated need for foreign aid.

Therefore the analysis of the growth of 1960s is combined with the question of performance and flow of foreign aid, as in the presence of the narrow industrial structure the role of aid becomes critical. Later on pros & cons of Bhutto socialism or bureaucratic capitalism has been elaborated. His nationalization has been considered as a great blow to nascent capitalism. A full analysis of macro-economic policies of Bhutto regime shows the negative effects on savings, investment, GDP growth and the fiscal deficit. The trust of investors was shaken and resultantly was private investment fell as a percentage of GDP in this period. Other economic policy measure such as reduction in the direct subsidies to manufacturing, import duties had a negative impact on domestic manufacturers which led to the further reduction of investment. The economic analyst² has argued that the nationalization and subsequent economic measures taken in Bhutto’s period is not the only responsible factors for the declined of private investment, though they had intensified it due to three underlying factors: (i) foreign capital inflows fell sharply after the 1965 war, (ii) the

¹ M. Tariq Waseem (1978) p.157
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.

However the chapter has analyzed that the public sector was expanded without significant investment and growth strategies along with the expenditures on defence and administration, Resultantly, GDP growth fell down, fiscal deficit increased, revenue generation capacity decreased, thereby necessitating heavy borrowing of foreign aid.

The chapter also described the history of aid flow to Pakistan, their linkages with the economic planning, the role of foreign aid in the balance of payments and external indebtedness and its shared links with aid and trade & investment and over all structure of the economy. The author concludes that the flows of aid have been particularly significant during this period as in gross terms it was increased by almost 100% per annum. This increase was ultimately prime cause of the change in the composition of the loan and grant. The ratio of grants was reduced as compared to loan. The increase in loan, later on reflected negatively in the future shape of the economy of the coming years as the magnitude of this increased flow did not fall till 1999, as we will discuss in the next chapter.
CHAPTER -4

4. PAKISTAN UNDER SHADOW OF GLOBAL POLITICS 1977-90

4.1. Military take over in the garb of Islamization.

General Zia-ul-Haq the Army Chief deposed Prime Minister Zulfiquar Ali Bhutto on July 5th 1977 and took the reins of power in his hands dissolving the Cabinet and the elected parliament. This was not for the first time in the history of Pakistan. Before that also Army Chiefs dissolved civilian governments twice, in 1958 and 1968. To justify their action, Ayub Khan introduced the system of basic democracies and Zia-ul-Haq took shelter in the bunker of ideology.

4.1.1. Ideology and State

The word ideology has always been used in Pakistan as a lethal weapon. It therefore becomes imperative to define ideology in its true historical perspective, so that later on, it becomes easier when we come to discuss the ideological weapons used by the
state apparatus. Before proceeding further here it becomes pertinent to quote K.K.Aziz on this issue:

"And above all social change hangs the sword of ideology...drawn but undefined cutting but unrecognizable, relentless but furtive...In fact no one knows what the ideology is (or even what an ideology) but everyone is warned against doing anything against it...This hazy view of ideology disqualified it from acting as the governing mechanism or the master switch of social change".¹

Let us define ideology with special reference to state apparatus in Pakistan. The term "ideology" was first coined by Destutt de Tracy in 1796. He used it to designate the science of ideas, which he hoped to establish along the lines laid down by Cabanis as a component and supplement of physiology. His elements of ideology aimed to cover a vast area, encompassing a ‘history of the means of knowledge’ divided into three parts: the formation of ideas, or ideology properly so called; the expression of ideas or grammar; and the combination of ideas or logic. Its main part was to consist of an application of these means of knowledge to the human will, which would give a theory of human action, a political economy.²

To simplify this definition in the modern sense of the western knowledge, "ideology is a body of ideas used in support of an economic, political or social theory or way of thinking of a class, culture or individual"³. This definition is more or less the same in Webster and Oxford dictionaries. In other words, we can say, such a system of views, which is an interpretation of the historical process and justification of a particular social and state system which, with the utmost clarity, expresses the interest of a definite class and the fundamental features of all the forms of the social consciousness of this class, constitutes ideology in the narrow sense of the word.

All the state apparatuses function at two levels i.e. at repressive and ideological level. The repressive state apparatus perpetuates the interests of ruling class by physical force i.e. subjugating all other classes and dissenting groups through

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repression where all other means fail to gag the voices of budding of a new social order. The ideological State apparatus penetrates in a given formation through the religious apparatus, the education apparatus, the family apparatus, the communication apparatus, the cultural apparatus and political apparatus. The application of these apparatuses is simultaneous, each complementing the other and thus serving the interest of the ruling class.

Before going into the detail of each apparatus, let us elaborate how the ideology of a ruling class plays the hegemonic role. The ruling class makes it all pervasive, permeating it in the common sense and popularizing by new theories which suit their class interest. They inject them into every sphere of the society by introducing their own philosophy, culture and morality and render them unchallengeable. A class of intellectuals, permeated with ruling class ideology, is patronized to unleash the propaganda of this class. In various periods of Pakistan's history the State apparatus has played the major role in dissemination of ruling class ideology. The religious apparatus has played the key role in hypnotizing the minds of innocent people especially in the context of Pakistan.

Since independence of Pakistan, Islam has played the key role in the ideology of Pakistan. Though Quaid-e-Azam, in all other aspects of his life was a secular person but he used the Islamic weapon as a strategy to attract the Muslim voters of North Western India. While the liberals try to prove Quaid-e-Azam as a secular leader of a Muslim state, the Islamic fundamentalists try to prove that his two Nations theory was based on his love for Islam and for the reference they actually quote the interview of Quaid-e-Azam of 1943 which he gave to Beverly Nicholas. Beverly asked the Quaid-e-Azam the question “When you say the Muslims are a Nation, are you thinking in terms of religion?” He replied, “Partly, but by no means exclusively. You must remember that Islam is not merely a religious doctrine but a realistic and practical code of conduct. I am thinking in terms of life, of everything, important in life. I am thinking in terms of our history, our heroes, our art, our architecture, our music, our laws, and our jurisprudence. In all these things our outlook is not only fundamentally different, but often radically antagonistic to the Hindus. We are different being. There is nothing in life that links us
together. Our names, our clothes, and our food, they are all different: our economic life, our educational idea, our treatment of women, and our attitude to animals, we challenge each other on every point of compass”.

The second turning factor which led to the ideology of Pakistan was the objectives Resolution, which was approved on March 12th 1949, nearly six months after the death of the Quaid-e-Azam. Mr. Liaqat Ali Khan, the first Prime Minister, moved the Objective Resolution embodying the main principles on which the Constitution of Pakistan was to be based. Its first paragraph is all comprehensive, where it is written:

WHEREAS the sovereignty over the entire universe belongs to God Almighty alone and the authority which He has delegated to the State of Pakistan through its people for being exercised within the limit prescribed by Him is a sacred trust.

This first clause is supported by two other clauses which gave clear cut suggestions towards Islamic parameters of the constitutions:

Wherein the principles of democracy, freedom, equality, tolerance and social justice, and as enunciated by Islam, shall be fully observed:

Wherein the Muslim shall be enabled to order their lives in the individual and collective spheres in accord with the teaching and requirements of Islam as set out in the Holy Quran and the Sunna:

After many decades of its adoption it was made part of the constitution of Pakistan by General Zia. Immediately after coming to power, Zia made it abundantly clear in his public statements that without Islamic Ideology the very existence of Pakistan would become meaningless. In one of his interviews he said “As far as Pakistan is concerned there is no doubt that it is a fortress of Islam: the only individual country which came into existence because of Islam, alone example in the whole world and, from that point of view it is not the fortress, the bastion of Islam not only in this particular part of the world. If God created this country then God is going to look after this country. From that point of view whether it’s me at the helm of affairs or somebody else, I am sure we will be, Inshallah able to withstand pressure from those who are against Islam”.

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In that interview he also said that, "And I have a firm conviction that God made us to do what we did on the day of 5th of July, it must be in the interest of the country, in the interest of Islam and this must succeed. Otherwise why should I have come into this process or what I have done...there must be something which God eventually wants me to do. May be it is up to me or if He destined me to perform this I will do that".¹

About ideology many Muslim scholars have different views. Dr. Fazalur Rehman, a noted Muslim scholar, was of the view that Pakistan was a non-ideological state. In his opinion while in the communist and socialist countries ideology came into existence before emergence of the State, in the case of Pakistan he said that the State was created without any articulated ideology.²

As it has been said earlier the re-imposition of military rule needed some legitimacy and support of ideology and as such enforcement of the Laws of the Shariah was a convenient way to do so. The military rule also suited the landed, industrial and commercial interest, because in an Islamic system their right to hold property was granted by religion. Changes in the laws of the country was the focal point of President Zia’s first stage of Islamization and within eight months of the assumption of Authority, he initiated the first phase of reforms and accordingly laws were introduced pertaining to adultery and fornication, gambling and alcoholism, introduction of prayers and provision of facilities of prayers in government offices, collection and distribution of Zakat and Usher, Shariah Courts, establishment of International Islamic University at Islamabad, making the certificates and degrees issued by religious institutions equivalent to those issued by other universities and colleges and making them acceptable for attaining jobs, banning alcoholic drinks from government messes and government receptions, honoring and respecting the Ulema and religious leaders, observing Islamic etiquettes during private and formal congressional assemblies and trying to clean up the governmental media departments such as Radio, TV and Press and the Press Trust of atheistic and anti-Islamic persons and making them abide by the Islamic and Pakistani view point and lastly, holding elections on non-party basis.

¹ General Muhammad Zia-ul-Haq’s Interview to Foreign Media. Vol.I (March-December), Ministry of Information, Islamabad, pp.127-128
The above laws were enacted through Martial Law regulations, because the constitution of 1973, though not abrogated, had been suspended for indefinite period and National and Provincial Assemblies were not working. President Zia chose the birthday of the Holy Prophet to announce the first package of reforms. He said the process of Islamization of laws, simply means that men are being summoned to obey the decrees of Allah Almighty.¹

The Hudood Laws were also introduced. They captured world attention and many comments were made on these laws which according to the modern societal requirement were not appropriate. The most objectionable laws were amputation of the right hand from the joint of the wrist in case of first theft and second time amputation of his left foot up to ankle. The other laws promulgated on February 10, 1979 fixed at 18 and 16 for female. Zina or adultery was defined as willful sexual intercourse when a man and women are not married. If adultery is committed between the married, the culprit will be stoned to death, and if it is between unmarried man and women, the punishment is whipping of one hundred stripes. On July 10th 1979 the prohibition order for import, export manufacture or processing of any intoxicant was issued. The Qanoon Sharia order 1986 which repeals the Evidence Act of 1872 introduced specific measure to Islamize the critical part of Pakistan’s legal system. According to this Ordinance the courts were to determine the eligibility of a witness to give testimony both in the civil and criminal cases. The Judges were to examine each witness according to the conditions laid down in the Quran. Among these conditions judiciousness of the witness appearing before a court was given a prominent place. In certain cases the Islamic law demanded the past history and character of the witness, and the new law expected judges to take this matter into consideration also. All these changes in the legal system made the implementation of laws very complicated, because in Pakistan many laws were ‘invoked simultaneously’ along with Pakistan Penal Code. Shariah Laws were introduced while in certain remote areas Punchiyat and Jirga were also traditionally taking decision about societal matters.

Above all, he created a nominated Majlish-e-Shoora consisting of 350 members in place of Parliament or National Assembly. And it was stripped of all usual

legislative prerogatives associated with law-making. To make it more profound and incorporated in the legal system, the ordinance also authorized to each Court, a bench of three Muslim judges, to constitute a Shariat Court. Appeals from the Shariat Bench of the High Court were to be heard in the Supreme Court, where the Shariat Appellant Bench consisting of three judges was created. The Shariat benches were empowered to listen to petitions put before them, in respect of existing laws and decide about their record to the Islamic injunctions. These decisions, according to the law, were final unless reversed by the Appellate Shariat Bench in the Supreme Court.

If we analyze the creation of the Shariat Bench critically its verdict about Islamic Laws was final. In this respect they had adopted the role of the legislature, because basically it is the duty of the legislature to make laws. The courts can only interpret the law. But Shariat Benches were required to amend laws which were tantamount to law-making.

Here some space may be given to the structural matrix of Pakistan's society in the various phases of the militarism. Militarism does not constitute a mode of production despite its all prevailing trappings which engulf a substantial part of the socio-political space. One may agree with Hamza Alvi where he presents the concept of over-developed state. He says that there is wide-spread tendency on the part of regimes and peripheral capitalist such as Pakistan to acquire an authoritarian character and proliferate military dictatorship. Even the economically dominant classes have to be content with it as such. The administrative arm of the state is deployed against them even while upholding their fundamental interests. In these cases progressive and the dominant class does not rule but we find a very considerable accretion of power of controls and regulations over economically dominant classes by civil and military bureaucracy. According to him this is an over development of the State.¹

To consolidate his power Zia started making radical changes in the civil bureaucracy. Generals and Officers of the ranks below Generals were appointed in the

Ministries and other important places. They started overseeing the main functions of the various ministries. This trend though previously was also seen in the era's of Ayub Khan and Yahya Khan but in the time of Zia-ul-Haq the over crowding of the Ministries with military officials was never seen before. And to accommodate more military men the military courts were created in which the military officers acted as judges to announce punishment and decide the fate of the so-called criminals.

It was also in the time of Zia-ul-Haq that journalists were whipped. And this was also not seen before in the history. Four journalists were indicted for the crimes and they were whipped within hours after the judgment was announced.

4.2. The United States political and economic ties with President Zia-ul-haq: Impact of Soviet intervention in Afghanistan

When Zia-ul-Haq came into power the US relationship with Pakistan were centered on three things i.e. nuclear issue, human rights and restoration of democracy. President Jimmy Carter and his administration looked on India with favor and on Pakistan with concern. The US government was insisting on altering the course on the nuclear issue. This was the issue on which Zia played very cleverly. He was not ready to stop the processing of the nuclear bomb. Time and again the US authorities asked the Pakistan Government to stop further progress on the enrichment of uranium but on orders of Zia-ul-Haq it went on secretly while the United States was told that the progress towards nuclear program was for peaceful means. Moreover, when State department nuclear specialist Joseph Nye visited Islamabad in September 1977 he brought only sticks after Washington had withdrawn the principle carrot, the offer of A-7 attack bombers. Nye warned Pakistan that if they persisted with the French fuel reprocessing projects, United States would have to cut off economic assistance under Glenn amendment to the Foreign Assistance Act. This amendment barred United States aid to countries that had not signed the Nuclear Non-Proliferation Treaty (NPT), but that imported nuclear fuel and reprocessing technology.

Zia was not ready to listen to State Department and refused to bend. The US government proceeded to suspend economic assistance. With aid levels running at US$
50 million annually, considerably less than during the halcyon days of the 1960s, the economic blow was not enormous. But French President Valéry Giscard d’Estaing informed Washington that it would not be unhappy if the reprocessing plant project were terminated. For Washington the French action appeared to mark an important non-proliferation victory and to remove the major source of friction in bilateral relations with Pakistan. The United States immediately responded with US $69 million for the coming fiscal year program.¹ But US was keenly monitoring the nuclear program of Pakistan and came to know that after French reprocessing Plant project was dropped, Pakistan was adopting a parallel and difficult path towards making a bomb i.e. uranium enrichment process.

When US ambassador Hummel approached Zia for a response on this issue, Zia responded with a straight face “that is absolutely ridiculous, your information is incorrect we have to clear this up. Tell me any place in Pakistan you want to send your experts and I will let them come and see”². The Ambassador was skeptical that Zia would follow suit. As it was proved, later on, Hummel was right in assessing Zia’s mood at that time and Zia never told the true story to the American diplomats although Americans were fully aware of the progress of the nuclear program.

Carter was also not happy with the response of Zia on the appeals made to spare Bhutto’s life. On April 06, 1979 just two days after Bhutto’s execution the State Department confirmed that US had once more suspended the aid to Pakistan because of the nuclear program. Again a month earlier after the US intelligence community had concluded that Pakistan was covertly pursuing the enriched uranium path towards nuclear explosive capability, Zia assured Warren Christopher that the program was entirely peaceful, but refused to rule out a peaceful nuclear test. They suspended economic aid for the second time and no announcement was made.³

¹ U.S to Renew Aid to Pakistan, Washington Post, August 25, 1978
Zia continued with the policy of progress on the nuclear project and the US attitude towards Pakistan was not very kind. During this period Agha Shahi had discussion with Secretary Vance. The Secretary asked for three commitments i.e. Pakistan would not transfer nuclear technology to other countries, that it opens nuclear facilities to international inspections and third that it would not test a nuclear device. Shahi gave Vance satisfaction only on the first item. He said that Pakistan would refuse to permit inspection in Kahuta and other nuclear installation until India similarly opened its nuclear facilities to inspection. On the question of testing the envoy stated that Pakistan has not yet reached that stage and would review the pros and cons after it attained the necessary capability to explode a device.¹

On Charismas eve on 1979, the scenario radically changed. Soviet Army marched into Afghanistan on the excuse of ousting the head strong Hafiz Ullah Amin and install reliable Barbak Karmal. With the Soviet soldiers at the Khyber Pass the traditional gateway for invasion of South Asia, Pakistan had become a front line state. Pakistan immediately took the following actions: that Pakistan would oppose the Soviet action publicly, would provide shelter to Afghan refugees, would offer public support for the resistance and would provide clandestine military assistance to the insurgents, while denying that it was doing so.

United States came to offer a big amount to Pakistan. In first go they requested Congress for $US150 million in aid and credits for Pakistan, consideration of debt relief which Islamabad wanted and waivers of legislation barring economic and military aid because of the nuclear program. Later on, after discussion with Pakistan’s diplomats in Washington they offered $US 400 million of military and economic aid for the coming two years. President Carter however, specifically turned down the provision of aircraft, which Pakistan requested. Zia dismissed the proposal as peanuts, he said “I have not heard it officially but if it is true what has been in the press then it is terribly disappointing. Pakistan will not buy security for $US 400 million. This amount will buy

¹ Interview with Agha Shahi, The former Foreign Minister dated January 26, 1996. cited in ibid. p. 241
greater animosity from the Soviet Union, which is now much more influential in this region than the United States."\(^1\)

The remarks of Zia about American aid created lot of commotion not only in the press, but in the US administration. They tried to appease Pakistan and in a State of the Union message, President Carter spelled out the Carter doctrine under which among other things Soviet attack against the Persian Gulf would be regarded as an attack on US vital interest. He reaffirmed the security of Pakistan and declared, "The United States will take action consistent with our laws to assist Pakistan resist any outside aggression."\(^2\) On March 05, Agha Shahi declaring that his country was not interested in $US 400 million proposals specifically disassociated from any US initiatives to introduce the relevant ratification in US congress. Shahi added it was felt on our side that acceptance of the US offer unless substantially modified would detract from rather enhance our security. But both Zia and Shahi declared that even though Pakistan was no longer seeking military aid, from United States, it was interested in economic assistance especially in debt relief.\(^3\) On October 3\(^{rd}\) 1980 Zia went to attend the UN General Assembly session in New York and had a meeting with President Carter. But after long discussion with the State Department and White House, the United States and Pakistan were unable to reach a satisfactory conclusion on economic and military aid. It was deliberate on the part of Zia because he never wanted to negotiate and finalize the package of aid with the Carter administration and the Democratic government, because he foresaw, that the Democrats were going to loose in the coming elections and he was gaining time to negotiate with the Republicans and was waiting for Reagan to step into the White House.

### 4.3. Shifting Alliance and aid packages

Both governments carried on transfer of information meaning cooperation between ISI and CIA. In December 1979 Jimmy Carter approved a broader covert action

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3 Kux, (2001) p. 251
program that instructed the CIA to provide military weapons and ammunition in addition to non-lethal supplies and support for the Afghan and anti-communist fighters. After the installation of Ronald Reagan as President on 21st January 1981, the relationship between the two governments radically changed. The Reagan administration put together a package of economic and military aid of $US 3.2 billion to be allocated over a five years period. State department memorandum described the purpose of the aid as to gain Pakistan’s confidence in our commitment to its security and provide reciprocal benefits in terms of our regional interest.¹

Later on the US Congress waived the sanctions against Pakistan, imposed earlier because of Pakistan’s nuclear program. Soon after President Reagan came to office Pakistan government began to receive US aid once again. The five-year aid package was followed in 1986 by commitment of $US 4.02 billion were to be distributed during the next five years.² Deputy Assistant Secretary of State Jane Coon, the state department’s senior South Asia Specialist, sensed that there was in fact, tacit understanding that the Reagan administration could live with Pakistan’s nuclear program as long as Islamabad did not explode a bomb.³ In addition to that Gen. K.M.Arif told Haig “we would not like to hear from you the type of government we should have.” The secretary of State replied, “General, your internal situation is your problem”⁴. Pakistani administration was quite happy about the new development of the relationship and they also realized that Reagan administration was fully aware of the security concerns of Pakistan. The Foreign Minister Agha Shahi told the press, “I believe we have moved forward in developing Pakistan-American friendship on a durable basis”.⁵

Most of the supplies sent by the Americans to Mujahadin were routed through ISI. This supply line was controlled by General Akhtar Abdul Rehman who was the Chief of ISI. When Prime Minister Junejo took over, there was hope for a negotiated settlement of the Afghan problem but Zia was not in favor of peace in Afghanistan, he wanted United States to remain engaged for a longer period, so that the aid coming from

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¹ ibid. pp.256-257
² Husain Haqqani, (2005), Pakistan: Between Mosque and Military. Lahore: Vanguard publications, p.188
⁴ Kux interview with General K.M.Arif, cited in ibid.
⁵ “Pakistan Reports U.S, Pakistan Progressing on New Aid Plan”, Washington post, April 22, 1981
the United States and his own position should be secure. But after the Geneva accord, Zia was on a weaker wicket. On April 14, 1988 the Geneva Accord was signed. It was mutually signed by Shevardnadze, Shultz, Noorani and Afghan envoy Abdul Wakeel, under the approving eye of UN Secretary General Perez de Cuellar. There was grim and somber mood at the time of signing as Riaz Khan wrote there were no smiles and little deliberations. Zia's era ended on August 17, 1988 when he died in a plane crash. Ghulam Ishaq Khan, chairman of the Senate became the acting president of Pakistan.

### 4.4. Effects of Afghan War on Economy and Aid.

Zia was lucky in the sense that two external factors came to the country's economic rescue. First of all the soviet invasion on Afghanistan bailed out Pakistan's foreign policy because before that country's political and economic relationship with United States was not according to the wishes of the rulers. The Carter administration was not budging an inch from its stand on democracy, human rights and nuclear issues. In the back-drop of it, they were also reluctant to give some exemption from various amendments which were hindering the assistance to Pakistan. But after the Afghan war the US could not move ahead without the logistical and political support of Pakistan. Zia-ul-Haq availed this opportunity and fully exploited the weaknesses of the United States. He did not positively respond on nuclear and issue of democracy. He told them in plain words that US should not worry unless Pakistan explodes a bomb while the system of government was their own affair.

The aid which was being given by the United States at around $US 69 million immediately rose to around $US 1 billion annually, if we take into account the response of the US allies also particularly Saudi Arabia. Moreover the remittances started flowing in from the Middle East and in 1977 it was $US 1.15 billion and rose to highest ever $US 2.8 billion in 1982-83\(^2\) which was a good sign for balancing the trade deficit and dealing

\(^1\) Riaz Khan, Untying the Afghan Knot, p. 84 cited by Kux, ibid. p.290
\(^2\) Economic Survey of Pakistan, 1988-89, Statistical Appendix p.15
with the debt servicing. The comparative progress in the receipt of foreign remittances from 1972-73 to 1988-89 is as under.\(^1\)

<table>
<thead>
<tr>
<th>$ US (Million)</th>
<th>July-March</th>
</tr>
</thead>
<tbody>
<tr>
<td>136.00</td>
<td>1156.33</td>
</tr>
</tbody>
</table>


The following graph is showing the comparative bars for these years.

![Comparative Study of Home Remittances from year 1972 to 1989](image)

According to an analyst while Zia, mostly lived off Bhutto’s legacies. He also showed political acumen in controlling the situation at home and abroad and projecting himself as indispensable to Washington\(^2\). There were certain internal and external factors which helped Zia to buttress Pakistan’s economy until 1981, the economy galloped speedily because Zia’s accession to power coincided with export performance due to an upswing in world trade. The value of Pakistani export increased from $US 1.1 billion to $US 3 billion by 1981.\(^3\) In constant dollar terms it was an increase of over 70 percent. He also introduced structural adjustment programs tailored to IMF and World Bank prescription compared to the economy in Bhutto’s last years.

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\(^2\) Ishrat Husain, (1999). p.296
Many others have also evaluated the period up to 1981-88 as economic landmark in the era of Zia. Akbar Noman observed, "according to World Development Report, 1990 during 1980-88 Pakistan GDP growth rate of 6.5 percent was exceeded only by that of Korea, China and Hong Kong...The growth of real wages Pakistan in manufacturing during 1980-88 was just about the fastest in the World. At 6.2 percent a year it surpassed only by Thailand (7 percent) and equaled only by Singapore." For the period 1978-86 S.N.H.Naqvi and Khawaja Sarmad show GDP growth rate as 7 percent.

According to the World Bank, manufacturing grew at an annual average rate of 9.5 percent between "1977-1986", and investment in manufacturing grew on an average of 18.2 percent while total private industrial sector expanded at the rate of 15.6 percent per annum. Akbar Zaidi is of the view that this is indeed a very impressive performance by any standard whether in comparison to the performance of the Ayub regime or the newly industrialized countries in the same period.

But despite this rosy picture of the general indicators of the economy in Pakistan, the trade balance was continuously showing deficit on the higher side. In 1977 at current prices it was $ US1184 million and in two years time touched US $ 2375 million. It reached the highest level in 1984-85 i.e. US $3415 million. But it came down to $ US 1870 million in 1987-88. There was some consolation as remittances coming from abroad offset some of the deficit. The trade deficit during 977-88 is shown below:

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Source: Compiled from the figures published in Economic Survey, Government of Pakistan, 1988-89

If we compare it with Bhutto's period i.e. from 1971-77, the trade deficit was minimal up to 1975 but increased in the last two years. It was US $47 million in 1971-72 and it was surplus in 1972-73 by US $20 million, a rare event in Pakistan's economic history. Later on trade deficit increased to US $336 million in 1973-74 and reached to the maximum of US $1499 million in 1977-78.¹

As discussed earlier the period from 1977-1981 was good in various terms but it was affected by an international recession in 1981-82 and consequently declining trends in trade made earnings fall sharply. The OPEC oil shock further hurt Pakistan economy with the import bill increasing rapidly as described by Ishrat Hussain. In January 1982 the exchange rates was detached from the $US where it has been since 1972 and put on a managed float. The rationale given for the change was the traditional one i.e. the balance of payment situation was worsening year by year. Pakistan finally decided to experiment with flexible exchange rate and adopted the managed float system. The large remittances and foreign aid flows allowed the policy makers to pursue the relatively easy, soft option growth without addressing the problem underlying the balance of payment. The narrow base of the country's export remained unaltered during this period, while import expansion remained unabated.² The balance of payment issue became more complex after international recession and the figures of trade balance show a negative trend as indicated above.

¹ ibid.
² Ishrat Hussain, (1999) pp.296-197
The downward trends in balance of payment originated due to deficit in the fiscal account, rising imports and heavy draw-down of reserves. The most important factor was the sharply declining foreign remittances, as Pakistan had relied heavily for balancing its fiscal account and foreign exchange on the remittances, which reached to $2.9 billion in 1982-83 and by 1987-88 these had come down to US $2 billion exports could not keep this pace of growth.

Capital formation is one of the major factors of economic development. Higher rate of capital formation with sufficient stock of both material and human capital help in reducing the demand of foreign goods and in solving the problems of adverse balance of trade and reducing the foreign debt. The most important element of capital formation is higher saving rate and equally a higher investment rate to increase the material stock. But this was not so in the policy followed during this period. The Gulf boom though had supported the macroeconomic performance, but it had also brought changes in consumption pattern. On the one side it helped to support the balance of payment and on the other hand, it had undermined the saving and investment balance. The Gulf-induced income visibly affected the consumption pattern in order to improve the social status. Families shifted their consumption more on the imported luxury goods, which led to increase of import of consumable items. The composition of the import shows that import of electronic items, cars etc. distorted the trade balance as well as the consumption pattern. On the one side consumption of the luxury items was increasing and on the other side the saving and investment ratio was deteriorating. The study of import and export and trade balance indicates the following figures during this period.

![Export, Imports and Trade Balance Chart](chart.png)

The above figures clearly show that during the period 1980-1988, the terms of trade deteriorated, export decreased and import increased constantly and remained negative in balance during all these years, which burdened the fiscal balance and worsened foreign exchange reserves in the country.

This was the general trend of trade and consumption pattern. We now look at the figures for the classification of the imports, which would reveal the details of the consumption pattern as given in the following figure

The above figure clearly indicates that there was constant increase in capital goods and accordingly the rise in imports. Similarly the comparison of the consumer goods (other than the industrial raw material) shows that though it remained a little less as compared to capital goods but still import of consumer goods increased during these years on a constant basis.

If we further consider the figures indicated for classification of the import items, it reflects that most of the increase in consumable items was in electrical goods, machinery (non-electrical), iron and steel etc and petroleum products, which was the luxury consumption. The major part of the population was left far behind in the human development chart, specifically in the sector of poverty, as shown below:

The above figures indicate that the major rise in imports was of petroleum and products related to it. Then it was machinery, though the overall all increase in the imports was seen in all consumer and capital items during this period. It adversely affected the macro-economic indicators and put pressure on the class that was traditionally not meant for such consumption. It had adverse impact on the domestic savings as well. Therefore, the gross domestic savings as proportion of GNP fell from 15 percent in 1972-73 to 6 percent in 1978-79 and it went further down to 5 percent in 1982-83. The development program of the six plans period had to be abandoned due to the inability of the government’s domestic resource financing. According to the World Development Report, Pakistan had 5 percent saving rates of the GDP while India had 25 percent and Singapore had 40 percent. In the year 1988-89 the domestic saving rates of Pakistan further fell to 10.2 percent. This again is much lower in the international arena if we compare it with India 21 percent, Indonesia 24 percent and Thailand 25 percent.

The lower saving rates affected the investment trend, another important factor for development planning of Pakistan. Following figures of total consumption and total investment would explain the gap between the two:

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1 Economic Survey, 1983-84. Government of Pakistan
Pakistan's saving and investment level remained low after 1980-81. Its trade balance touched the highest negative trend during 1981-1986. The trade deficit for the year 1981-82 was $US -3,450 million which rose again to $US -3,552 million which amounts to almost 3 times more than the year 1976-77. Similarly current account deficit increased from $US -1,051 million in 1976-77 to $US -1,682 million in 1987-88.\(^1\) The revenue and expenditure statements reflect that overall fiscal deficits rose to 8.1 percent on an average over 1986-1987 to 1987-88.

However, at the same time if we look at the growth rate of GDP and other sectoral growths, we would find impressive performance in GDP as well as some of the other sectors. The real GDP in the 80s grew at an annual average rate of 6.5 percent helped by the major sector of agriculture and manufacturing output as shown in the following table of economic growth indicators:

**The Economic Growth and Sectoral Performance\(^2\)**

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Large-Scale Manuf.</th>
<th>National Saving Rate</th>
<th>Investment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970s</td>
<td>4.8</td>
<td>2.4</td>
<td>5.5</td>
<td>4.8</td>
<td>11.7</td>
<td>17.4</td>
</tr>
<tr>
<td>1981-82</td>
<td>7.6</td>
<td>4.7</td>
<td>13.8</td>
<td>15.7</td>
<td>13.2</td>
<td>17.9</td>
</tr>
<tr>
<td>1982-83</td>
<td>6.8</td>
<td>4.4</td>
<td>7.0</td>
<td>6.6</td>
<td>15.3</td>
<td>17.0</td>
</tr>
<tr>
<td>1983-84</td>
<td>4.0</td>
<td>-4.8</td>
<td>7.9</td>
<td>7.7</td>
<td>13.8</td>
<td>16.7</td>
</tr>
<tr>
<td>1984-85</td>
<td>8.7</td>
<td>10.9</td>
<td>8.1</td>
<td>8.0</td>
<td>12.0</td>
<td>17.0</td>
</tr>
<tr>
<td>1985-86</td>
<td>6.4</td>
<td>6.0</td>
<td>7.6</td>
<td>7.3</td>
<td>13.8</td>
<td>17.4</td>
</tr>
<tr>
<td>1986-87</td>
<td>5.8</td>
<td>3.3</td>
<td>5.7</td>
<td>4.7</td>
<td>16.8</td>
<td>18.0</td>
</tr>
</tbody>
</table>


### 4.4.1. Poverty trend.

Many studies have been made for the assessment of poverty in Pakistan and most of them have used the calorie intake criterion. There is general consensus among these studies that rural poverty increased while urban poverty decreased in the 1960s and that in the next two decades poverty has declined to some extent. However, no real consensus emerged on the trend in 1980s and 1990s. The trend in the 1990s will be discussed will be covered in the next Chapter.

Poverty is traditionally defined as insufficient income to meet specific needs. After specifying the needs we can arrive at the number of people who fail to meet that criterion. The definition and the factors which perpetuate poverty include the following:

It includes discrimination across various dividing lines; the distribution of political and economic power in the country, the distribution of income earned from physical and human capital, possible biases towards the market return and the contribution of government policy towards the aggravation of such biases. By calling into
question the underlying social and economic structures, the resulting perspective will help identify policies and actions to address the poverty issue.¹

Usually food is taken as a basic indicator for determining poverty because adequate food satisfaction has priority over other needs and that need somehow, can be taken by maintaining a proper relationship between food consumption and total consumption. Following the above procedure the poverty line is determined by finding the total consumption expenditure of households that spend the stipulated amount on food. Such a level of expenditure when converted into constant prices of the particular year is used to determine the number of proportion of people lying below the poverty line. There was an increase in poverty in 1960 as all studies² confirm a decline in poverty since 1970. Other analyses have confirmed that this decline continued throughout the 1980s. Poverty is said to have fallen rapidly and unambiguously between 1984-85 and 1987-88. One can say that the rate of poverty reduction fell in late 80s and poverty did not rise significantly as shown in the following table.³

|------------|---------|--------|---------|---------|---------|---------|

Different methods have been applied by economists to measure poverty in Pakistan. It is not a simple phenomenon, not just based on such as head-count ratio based on poverty line because it does not capture all the dimensions of poverty. However here we are more concerned with the general trend of poverty. The ‘Poverty of opportunity’ approach only discusses three dimensions. The Mahbub-ul-Haq Centre for Human Development has developed a broad index that takes into account deprivation in education, health and income opportunities. Trends in index during this period according to three indices on which it is based i.e. poverty of opportunity of health, education and income as presented in following table shows that poverty declined through this period.

Trends in Poverty of Opportunity Indices

<table>
<thead>
<tr>
<th>Year</th>
<th>Poverty of Health opportunities %</th>
<th>Poverty of education opportunities %</th>
<th>Poverty of income opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>55</td>
<td>77</td>
<td>40</td>
</tr>
<tr>
<td>1980</td>
<td>46</td>
<td>73</td>
<td>38</td>
</tr>
<tr>
<td>1985</td>
<td>42</td>
<td>67</td>
<td>25</td>
</tr>
<tr>
<td>1990</td>
<td>36</td>
<td>62</td>
<td>20</td>
</tr>
<tr>
<td>1995</td>
<td>30</td>
<td>58</td>
<td>30</td>
</tr>
<tr>
<td>Reduction 1980 to 1995 (%)</td>
<td>35</td>
<td>21</td>
<td>21</td>
</tr>
</tbody>
</table>


The trends shown in the index however reflect that though the overall poverty level was falling, more people were being denied basic human opportunities than just shortfall in income. For human development, poverty of opportunities to education, health, economic assets and social exclusion, are critical and not poverty of income only, as income is the result and opportunity is the cause. In such a situation GDP growth is not considered as pro-poor growth.

Income distribution itself is another tool to measure the trend of poverty. It shows the behavior of income distribution that is measured in terms of household income share of the lowest and top 20 percent during this period as shown in the following table.

### Household income distribution in Pakistan

<table>
<thead>
<tr>
<th>Year</th>
<th>Household Lowest 20%</th>
<th>Income middle 60%</th>
<th>Share Higher</th>
<th>Ratio of Highest 20% to lowest 20%</th>
<th>GDP Growth Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-84</td>
<td>7.4</td>
<td>47.6</td>
<td>45.0</td>
<td>6.1</td>
<td>5.5</td>
</tr>
<tr>
<td>1984-85</td>
<td>7.3</td>
<td>47.7</td>
<td>45.0</td>
<td>6.2</td>
<td>8.7</td>
</tr>
<tr>
<td>1985-86</td>
<td>7.6</td>
<td>48.4</td>
<td>44.0</td>
<td>5.8</td>
<td>6.4</td>
</tr>
<tr>
<td>1986-87</td>
<td>7.9</td>
<td>48.5</td>
<td>43.6</td>
<td>5.5</td>
<td>5.8</td>
</tr>
<tr>
<td>1987-88</td>
<td>8.0</td>
<td>45.3</td>
<td>43.7</td>
<td>5.5</td>
<td>6.4</td>
</tr>
</tbody>
</table>


The gap of income distribution during 1980s as compared to 1970s, some how increased. The percentage of the lowest 20 percent households increased over the years
but still it remained low as compared to the growth of GDP. The data for the years 1980s show that the growth in GDP did not have a positive effect on the distribution of income. The growth was weakly associated with income distribution.

**4.4.2. Inflation**

This is the considered opinion of the economists and it has been historically proved also that inflation rate remained low in Pakistan. In 1960s it was 3.3 percent and rose to 11.9 percent in 1970s and fell again to average of 7.5 in 80s. On the other hand they are not agreed on the reasons and causes of inflation. Akhtar Hussain while examining historical trends concludes that in Pakistan, real money balances are found to contribute to the acceleration of inflation. Issue of govt. also exerts negative effect on the acceleration of inflation.¹ According to Naqvi, money supply does not exert changes in the price level. The very small size of the coefficient of the money supply variable and its statistical insignificance contradicts the simplistic notion held by some people in Pakistan that inflation is a purely monetarist (or monetary) phenomenon.²

Pasha has covered all the reasons for high inflation in recent years. These include the following:

1. Increase in the price of food, raw material, fuels and manufacturing goods
2. Inflationary expectations.
3. The Growth of money supply in relation to GDP
4. Increase in sales and excise taxes
5. Currency depreciation
7. Higher agricultural support prices
8. Increase in the prices of utilities
9. Production losses due to power and infrastructural bottlenecks.
10. Increase in wages and salaries
11. Insufficiently tight financial policies with high budget deficit financing.³

If we analyze the different trends of inflation in the different periods of economic history of Pakistan we will come to the conclusion that all these factors

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² ibid.p.27
mentioned above have played their role in high inflation of Pakistan. The comparative study of the inflationary rate show that there is radical fluctuation in the rate of inflation, moreover it was three times bigger then it was in 1960s but almost equal to 1970s if we compare it with 1980-81. But for the next four years 1984 onwards it came down as per following table

<table>
<thead>
<tr>
<th>Years</th>
<th>1980-81</th>
<th>1984-85</th>
<th>1987-88</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation Rate</td>
<td>10.4</td>
<td>5.7</td>
<td>6.3</td>
</tr>
</tbody>
</table>


The average rate of inflation in different decades emerges as follows:

**Average Inflation Rate in three Decades.**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Inflation rate</td>
<td>3.3</td>
<td>11.9</td>
<td>7.5</td>
</tr>
</tbody>
</table>

It shows that the inflation rate which was double digit in 70s lowered down to single digit in 1980s. It was due to the reason that Public Sector deficit was financed through a combination of concessional foreign borrowing, foreign aid and domestic loans from non-banking sector on low and subsidized interest rate thus avoiding inflation.

In my opinion the above mentioned view of Ishrat Hussain, in combination with introduction of bonds by the government at various stages controls the inflationary rate from enhancement. The reason being the money in market or in circulation is utilized and by doing this, government avoids issuance of new currency notes and domestic borrowing on high interest rates. The market spills over with local currency if the measure noted above is not introduced. So this was also one of the reasons for the decrease in of inflationary pressure in the 1980s.

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1 Akbar Zaidi (2000) p. 287
2 Ishrat Hussain (1999) p.308
Akbar Zaidi also subscribes to this view by saying that macro-economic policies play a critical role in determining the rate of inflation. For example growth of money supply in access as compared to the increase in the real output, results in an increase in the price level. Similarly lack of fiscal measures contributes to demand pressure and thereby fuels inflation.¹

4.4.3. Budget deficit, Foreign Aid inflow and Debt Servicing.

We have already mentioned in this chapter that countries like Pakistan were dependent mainly on foreign aid to meet the budgetary deficit. The economists in the various governments adopted different measure along with foreign aid to fill the gap. Pakistan always struggled to meet their budget deficit as shown in the following figure according to which in the mid 80s and till 1988 the percentage of the overall deficit vis-à-vis GDP had increased.

**Budget Deficit as percentage of GDP²**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>6.3</td>
<td>5.3</td>
<td>7.1</td>
<td>6.0</td>
<td>7.7</td>
<td>7.6</td>
<td>7.7</td>
<td>8.6</td>
</tr>
</tbody>
</table>

As shown above there is a steady increase in budget deficit as percentage of GDP from 1981-82 to 1987-88 which shows approximately a 3 percent increase. Actually in 1978-89 some forms of conditionalities for loans had become a permanent feature in the economic landscape of Pakistan. Pakistan and IMF signed Trust Fund Loan for 1979-80 and in the following years Pakistan negotiated a three year's Extended Fund Facility (EFF) from 1980-83.

In 1983-84 the IMF had offered another structural adjustment loan but government refused because its foreign exchange reserves had crossed over to 2 billion mainly due to large remittances of overseas workers. As an alternative a series of sectoral

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¹ Akbar Zaidi. (2000) p.294
loans for agriculture, industry, energy and financial sector were negotiated with the World Bank.¹

As revealed in the table below, the Pakistan debt stock more than doubled from $US 11.04 billion to $US 22.35 billion. In terms of its share of GDP the debt stock increased from 40.62 percentages in 1981, to 48.04 in 1988.

**Debt Stock and Share of GDP ($ US Million)**

<table>
<thead>
<tr>
<th>Year</th>
<th>External Debt</th>
<th>External Debt to GDP Ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>11,414</td>
<td>40.62</td>
</tr>
<tr>
<td>1982</td>
<td>12,294</td>
<td>48.70</td>
</tr>
<tr>
<td>1983</td>
<td>13,251</td>
<td>46.20</td>
</tr>
<tr>
<td>1984</td>
<td>14,165</td>
<td>45.20</td>
</tr>
<tr>
<td>1985</td>
<td>15,074</td>
<td>48.34</td>
</tr>
<tr>
<td>1986</td>
<td>16,155</td>
<td>50.67</td>
</tr>
<tr>
<td>1987</td>
<td>17,017</td>
<td>51.06</td>
</tr>
<tr>
<td>1988</td>
<td>18,434</td>
<td>48.05</td>
</tr>
</tbody>
</table>

*Source: State Bank of Pakistan, Annual report various issue various issue*

The external debt has to be repaid in foreign exchange. Indicators of inflows and outflows are therefore most critical to show the persistence of external debt crises. The inflow of the loans during this period shows enormous increase as indicated in the chart below.²

![Inflow of Foreign Loans (1979-80 to 1987-88)](chart)

*Source: Compiled from Economic Survey 1988-89 p.121*

The comparison of the aid inflow shows that from the year 1979-80 to 1987-88 it increased almost four times. In the same ratio the interest on foreign debt increased from Rs. 2,375 million in 1979-80 to Rs. 8,245 million in 1987-88. Since increased

² Compiled from Economic Survey 1988-89 p.121
foreign loans required more foreign exchange for debt servicing, Pakistan’s economy could not sustain this burden for long. As mentioned above the graph of foreign aid was constantly on the rise and the foreign exchange earning was less. It was not possible to meet the requirement of debt servicing. The figures of the foreign exchange earning and ratio of debt servicing /foreign exchange earning percentage are shown in the following table.

**External Debt servicing and foreign exchange earning.**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total debt servicing earning</th>
<th>Foreign earnings</th>
<th>Exchange</th>
<th>Debt servicing/Foreign Exchange earning (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>1070</td>
<td>4937</td>
<td></td>
<td>21.67</td>
</tr>
<tr>
<td>1986</td>
<td>1339</td>
<td>5665</td>
<td></td>
<td>23.64</td>
</tr>
<tr>
<td>1987</td>
<td>1465</td>
<td>5965</td>
<td></td>
<td>24.56</td>
</tr>
<tr>
<td>1988</td>
<td>1595</td>
<td>6468</td>
<td></td>
<td>24.66</td>
</tr>
<tr>
<td>1989</td>
<td>1657</td>
<td>6558</td>
<td></td>
<td>25.27</td>
</tr>
</tbody>
</table>

*Source: State Bank of Pakistan, annual report and Economic Survey, 1988-89*

The above table shows that debt servicing as percentage of foreign exchange earning was constantly on the rise after 1985 which affected the foreign exchange reserves and increased budget deficit required more foreign aid. Consequently due to growing debt servicing the net inflow of resources as percentage of gross disbursement declined as shown in the following table:

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Disbursement (repayable)</th>
<th>Principal (repayable)</th>
<th>Interest on repayable</th>
<th>Total</th>
<th>Net transfer</th>
<th>Net transfers as % of gross disbursement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-80</td>
<td>1470</td>
<td>350</td>
<td>234</td>
<td>584</td>
<td>886</td>
<td>60</td>
</tr>
<tr>
<td>1980-81</td>
<td>861</td>
<td>360</td>
<td>243</td>
<td>603</td>
<td>258</td>
<td>30</td>
</tr>
<tr>
<td>1986-87</td>
<td>1268</td>
<td>723</td>
<td>378</td>
<td>1101</td>
<td>167</td>
<td>13</td>
</tr>
<tr>
<td>1987-88</td>
<td>1660</td>
<td>691</td>
<td>426</td>
<td>1117</td>
<td>543</td>
<td>33</td>
</tr>
</tbody>
</table>

*Source Economic Survey of Pakistan 1988-89*

The above table reveals that a considerable ratio of the disbursement loan was to be repaid as debt servicing and interest on the principal loan. Ultimately the percentage of net transfer of gross disbursement fell from 70 percent in 1970-71 to 13 percent in 1986-87. It shows that increasing debt liability ultimately led to increase in the debt servicing, which tremendously reduced the net transfer of gross disbursement.

Actually major budget expenditure or deficits were being met through the foreign loans. The government borrowed more from foreign and domestic banks. Deficit
financing was due to less tax revenues, reduction in foreign remittances and reduced private investment as compared to the early 1980s. The picture will emerge more clearly from the figures given below, showing the budget deficits and their financing from domestic and external borrowing.

The above table (details of revenue expenditure and debt) reveals the disturbing fact that the increase in expenditure was constantly on the rise compared with the actual available revenues. As a result, total deficit continued to rise. This actually built pressure on debt servicing, public sector development spending, infrastructure and social growth. Consequently the budget deficit had to be financed from domestic and external borrowing. When foreign exchange earnings decline, the deficit finance is to be arranged out of the borrowed loan which is repayable in foreign exchange. As shown in the table (Debt Financing) the capacity for larger generation of revenues kept progressively declining. Ultimately the debt ratio to debt services payments increased. Total foreign loans rose from $US 2,660 million in 1979-80 to US $ 10,046 million
which was 12.5 percent of exports (goods + services) in 1987-88. The liability of debt servicing rose accordingly and total debt servicing which was Rs. 10,474 million in 1979-80 reached to Rs. 49,446 in 1987-88, which was 17.5 percent of the export earnings (goods + services).¹

This obviously meant that either Pakistan needed to enhance export oriented foreign exchange for deficit financing or she had to depend on internal and external borrowing. The trade was growing negatively as imports were more then exports, as discussed earlier. Due to changed consumption trends there was an increase in imports, which rose from Rs. 54,578 million in 1979-80 to Rs. 138,556 million in 1987-88. This increase was more than double in imports whereas exports were only Rs. 87,162 million in 1987-88. This shows a substantial reduction in exports while it was not possible to reduce the imports bill, given our industrial structure and consumption pattern.

Acquisition of loans to finance the deficit and to repay the previous loans was the only option left. Table shows, how the major portion of the deficit financing was met from domestic non-bank borrowing. It impacted not only debt repayment but also interest on the initial amount in the shape of debt servicing.

The figures of debt payment and interest on the debt reveal that interest rate on foreign debt rose from 1.0 percent of GDP in 1979-80 to 1.2 percent in 1987-88, with the increase of the amount of debt the interest rates were marked higher than the earlier period. Similarly the interest on domestic loans rose from 1.1 percent in 1979-80 to 3.1 percent in 1987-88. And if we look at interest rate as percentage of export, it is even more on the higher side. The interest on foreign debt rose from 4.9 percent in 1977-78 to 5.9 in 1987-88. This reflects an ultimate increase in debt servicing which rose from 16.4 percent in 1979-80 to 17.5 percent in 1987-88 of GDP. These figures show that debt financing in this period was mainly dependent on foreign and domestic borrowing. As a matter of fact, as shown above, the government borrowing was not only for the development planning but for the current expenditure also. It meant a cut in social sector development and

¹ Figures calculated from Economic survey, 1988-89. p.121
development plans of employment, education and literacy. It also reveals that the higher GDP growth rate which was achieved in the 80s undermined long term development.

Though aid resources made a considerable contribution in deficit financing during this period, but to get the real benefit of the aid it had to be linked up with growth of investment and trade to earn more foreign exchange to reduce the dependency on aid sources. Though the development in terms of GDP growth was impressive in the period, the remittances fell and foreign aid increased. It is significant to note that the largest beneficiary of such development was the class of rural rich as government was not able to tax agricultural income.

![Graph: Commitments of Foreign Aid and Grants($ million)](image)

*Source: Seventh Five year plan, Government of Pakistan. 1986.*

If we look at the commitment of foreign aid as well as grants as shown in the above table it is revealed that overall foreign economic assistance was increasing over the years while the ratio of grants was declining as compared to the loan, in the context of terms of assistance. Due to increasing debt burden and rising interest on it, net transfers as percentage of gross disbursement decreased substantially from 95 percent in 1960-61 to 30 percent in 1980-81 and further fell to 13 percent in 1986-87. The harder terms of loan i.e. higher interest rates, lesser amortization years and more loans than grants worsened the debt servicing percentage of GNP from 1.8 in 1975-76 to 2.6 in 1985-86. However during the same period the outstanding debt as percentage of GNP declined
over the years as it was 42.7 percent to 32.2\(^1\). The volume of aid disbursement as compared to commitment was also declining as given in the table\(^2\) below.

![Committed and Disbursement of Loans and Grants (US $ Million)](image)

*Source: Seventh Five year plan, Government of Pakistan, 1986.*

As a result of growing debt-servicing, net disbursement of loans and grants, long and short term, was declining tremendously as shown above. The gap between the commitments and disbursement of loans was lesser from 1978 to 1981 as compared to the later years of the 80s and that widened in 1987-88. Consequently, it burdened the cash and gold foreign exchange reserves, which at $US2,770 million in 1983 fell to $US 1,258 million. This reduction of foreign exchange reserves pressed the government for more reliance on external debt and increased debt servicing, because it had its limitation in domestic resource mobilization due to lesser tax revenue and negative terms of trade.

### 4.4.4. Tax Revenue

Pakistan’s constant fiscal deficit, ever increasing debt burden and rising debt servicing is the perpetual economic problem. Fiscal policy plays a central role in the taxation and expenditure issue of the country. When government expenditure is in excess, the real issue revolves around the ratio of income to revenue. Lesser amount of revenue is the basic cause of the other variables such as low savings and low investment rate, ultimately affecting the revenues. The high inflation rate in Pakistan is not mostly due to excessive creation of money but low saving rates which is due to financial repression, insufficient financial structure and changing pattern of consumption. In addition, the


\(^2\) ibid
political factors of particular governments, governance issues and public expenditure trends are also major determinants in revenue generation.

Tax structure and economic policy vary from country to country. Pakistan has a well defined constitutional framework which determines the nature of resource mobilization and responsibility of three tiers of the government i.e. Federal Government, Provincial and Local Government. Tax revenues are generated mainly from two sources, direct taxes, and indirect taxes comprised of production, sales and consumption. In the context of economic development, the issue of taxation is important with its distributional implications. The issue of collection of tax through direct and indirect tax became relevant in the context of the priority of the policy of poverty reduction, growth and income distribution.

The lower income groups would ultimately be more affected by tax burden if it is based on the indirect collection policy, because it will ultimately increase the price of the commodities and affect the overall CPI and purchasing power. In this context, Ishrat has pointed out that the tax-GDP ratio of 14-15 percent of Pakistan is the lowest among countries of identical income levels. More importantly it is derived largely from indirect taxes, custom duties, excise taxes, and sales tax whose indices fall proportionately on all income classes. Direct taxes account for 2-3 per cent of GDP and the coverage extends to only one million people.¹

Actually the budget deficit which rose for the first time to 7.1 percent of GDP, the government was not able to take fiscal measure to mobilize domestic resources. That led to further increase in fiscal deficit. It is opined that the manner in which fiscal performance was improved (during the period of 1983-88) merely deferred hard policy decision. (For which the taxation policy is the major element) The improved fiscal performance was not due to better revenue collection but was achieved because of

¹ Ishrat Hussain (1999). P.380
artificial and sustainable cuts in expenditure... The expenditure restraint led to a share reduction in the expansion of development expenditure\(^1\).

First we will look at the over all revenue and expenditure and deficit during this period to see the position of the total revenues as percentage of GDP and then the contribution of tax revenue towards the GDP.

**Public Finance: Consolidated, 1979-88 (% of GDP)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenue</td>
<td>16.4</td>
<td>16.9</td>
<td>16.0</td>
<td>16.3</td>
<td>17.2</td>
<td>16.4</td>
<td>17.5</td>
<td>18.1</td>
<td>17.3</td>
</tr>
<tr>
<td>Tax Revenue</td>
<td>13.9</td>
<td>14.0</td>
<td>13.3</td>
<td>13.5</td>
<td>12.8</td>
<td>11.9</td>
<td>12.3</td>
<td>14.5</td>
<td>13.8</td>
</tr>
<tr>
<td>Non-Tax Revenue</td>
<td>2.5</td>
<td>2.9</td>
<td>2.8</td>
<td>2.8</td>
<td>4.4</td>
<td>4.5</td>
<td>5.2</td>
<td>3.7</td>
<td>3.5</td>
</tr>
<tr>
<td>Expenditure</td>
<td>23.3</td>
<td>22.9</td>
<td>21.9</td>
<td>23.9</td>
<td>23.8</td>
<td>24.7</td>
<td>26.1</td>
<td>26.7</td>
<td>25.9</td>
</tr>
<tr>
<td>Over all deficit</td>
<td>6.3</td>
<td>5.3</td>
<td>5.3</td>
<td>7.0</td>
<td>6.0</td>
<td>7.8</td>
<td>8.1</td>
<td>8.2</td>
<td>8.5</td>
</tr>
</tbody>
</table>

*Source: Economic Survey, Government of Pakistan, 1988-89*

The above table shows that total revenue was not growing substantially and remained at an average 17 percent of GDP during the decade of 1980s, while the tax contribution in revenue remained in the range of 13 percent of GDP. Similarly the ratio between tax and non-tax revenue also did not improve and remained unchanged over this period. However the overall expenditure increased over the years as percentage of GDP from 23.3 percent in 1979-80 to 26.7 percent in 1986-87, which shows the increasing gap of fiscal deficit also. Before looking at how expenditure trends were effecting development and non-development, we shall examine the level of contribution of direct tax and indirect taxes in the revenues of this period given in the following figure.

---

The figure shows that government revenue receipts through direct taxes are much less than through the indirect taxes that can be seen gradually growing till 1988. As discussed above Pakistan achieved impressive growth in GDP in these years at an annual average of 6.5 percent. As a matter of principle, the share of taxes particularly the direct taxes share in GDP should rise as GDP grows but as in Pakistan’s taxation structure this does not happen. The tax regime in Pakistan has been quite poor in mobilizing domestic resources. Also taxes play an important role in the growth of GDP and fiscal balance. If we look at the Tax/GDP ratio as indicated below of both indirect and direct taxes, the comparison shows that direct taxes have not shown much change, although indirect taxes have been increasing.

This comparison of different decades from 60s to 1980s explains that as compared to direct taxes, the indirect taxes have contributed up to 86.8 percent in of total tax revenue while the share of direct taxes has been 13 percent. The indirect taxes comprised income taxes etc, the share was much less than the taxes from custom duty,
import duty, sales taxes and excise duty, which affect the broader range of the classes and also explain the changes in consumption trends. This is clearly visible from the above table that the more the economy grows the more consumption rates increase with it and consequently the ratio of indirect taxes. That is the reason why the contribution of direct taxation to the revenues has fallen. Other then consumption trend, imports has increased. The fiscal policy instrument of taxation was used for selective tax incentives, discretionary exemption from custom duties and income tax etc which had been a practice in different forms during different governments.

As shown in the percentage of direct and indirect taxes above, during this period the indirect taxes increased due to government’s inability to tax agriculture, because of the pressure of the landlords and powerful lobbies in civil and military establishments. The military government remained shy on direct tax collection, and had been giving substantial income tax concession to get political support for the legitimacy of the government. These concessions then had to be borne by the salaried and poor people by paying more indirect taxes for social services, public utilities, sales tax and excise duty etc. This actually burdened the lower income group and gave relief to the rich classes. Kemal’s analysis of indices of direct and indirect taxes and impact on poverty, reveals that over the ten year period 1987-88 to 1997-98, the tax burden on the poorest groups had increased by 7.4 percent while it had declined by 15.9 percent for the rich class.¹ This is the accumulated effect of the past tax policy during 1980s.

The concessions given to industrialists and landlords ultimately provided political support to government of the day. Ishrat has opined that these concessions deprived the State of income that was transferred to the firm or the entrepreneur who made the investment. The source of the investment was at least money that belongs to the government in the form of tax payment, but the income produce by the entire investment belonged to firms or the entrepreneurs. The firm did not care if the investment yielded

positive economic returns as long as it got good return on that portion that was its own capital.¹

In such cases, the government receipts of finances through direct source are constantly declining and the indirect source creates unequal economic distribution and inefficient resource allocation which gives financial gains to the individual firms and entrepreneurs but more public funds which ultimately affect the public expenditure.

If we look at ratio of government expenditure as shown in the following table, on development and non-development activities to know the public spending with more details we would find that with such low level of tax revenue the public expenditure was not pro-poor.

![Current and Development Expenditure (As % of total expenditure)](image)

*Source: Government of Pakistan, Economic Survey, 1988-89*

The above figure shows that non-development expenditure of the government increased tremendously as percentage of total expenditure from 1981 to 1988. The most disturbing element is the proportionate reduction of development expenditure and this expenditure cut has continued to fall over the period from 1980-88. If we go further in detail of the non-development expenditure and its ratio as per following table, ² we will find that the major portion of non-development expenditure comprised of the defence spending which was constantly on the rise in these years. The next major portion of non-development expenditure was payment on loans and then general administrative expenditure. The least spending portion was on the subsidies which remained at the lowest level in the spending of non-development budget.

¹ Ishrat. (1999) p.381
² Economic Survey, 1988-89
**Source:** Economic Survey, 1988-89

It shows the reduction in the subsidy and social sector which does not reflect the pro-poor fiscal policy. The analysis of this proportion of spending by the economists reflects that the defense expenditure and debt servicing pre-empt a very significant proportion of the budget leaving very little for redistribution purposes.¹

On the proportion of expenditure, Akbar Zaidi is also of the view that “it seems that Pakistan’s was on economy of defense, with more than half of total expenditure being spent on defense from 1947 to 1971. The same was 40.02 percent of the total current expenditure in 1982-88. Omar while agreeing with the alarming situation is, of the view, that government devotes nearly 30 percent to defense (in 1984). No military government in the world allocated such a large share of central government resources to defense. A disproportionate share of the resources is diverted from the productive and social sectors, adversely affecting both economic growth and social welfare. According to the World Bank report² Pakistan’s expenditure on defense is almost second largest in the region (Sri Lanka, China, Kenya, Iran, Turkey, India, Pakistan and Israel) as shows the comparison below.

---

It shows that after Israel (the last bar) Pakistan is the largest in spending on the defense which distorts the funds of development budget. If we compare the same countries in the region with the trends in Human Development, rank-wise and per capita income-wise keeping in view the proportion of defense spending and development expenditure in mind, we would find the following position.

<table>
<thead>
<tr>
<th>Country</th>
<th>HDI Rank(1985)</th>
<th>Human Development Index(value)(1985)</th>
<th>GDP Per Capita( US $) 1985</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sri Lanka</td>
<td>90</td>
<td>0.671</td>
<td>401</td>
</tr>
<tr>
<td>China</td>
<td>98</td>
<td>0.588</td>
<td>210</td>
</tr>
<tr>
<td>Kenya</td>
<td>136</td>
<td>0.521</td>
<td>354</td>
</tr>
<tr>
<td>Iran</td>
<td>95</td>
<td>-</td>
<td>3,275</td>
</tr>
<tr>
<td>Turkey</td>
<td>86</td>
<td>-</td>
<td>1,478</td>
</tr>
<tr>
<td>India</td>
<td>132</td>
<td>0.475</td>
<td>365</td>
</tr>
<tr>
<td>Pakistan</td>
<td>138</td>
<td>0.414</td>
<td>354</td>
</tr>
<tr>
<td>Israel</td>
<td>23</td>
<td>-</td>
<td>8,109</td>
</tr>
</tbody>
</table>


The above table of HDI shows that despite highest spending after Israel Pakistan is the lowest in the HDI rank that is at No.138, lowest in the index value of HDI, and in per capita income also it is the lowest next to China. Here the purpose of the correlation of allocation of the percentage of defense budget and Human development is to establish that such high allocation which though seems to be lesser in terms of percentage of GDP but as percentage of development budget numerically this spending is on the higher side. This allocation is at the cost of social sector and development budget, as a country’s development budget is directly linked with growth and poverty reduction.
through the employment creation, basic infrastructure development, minimum food availability and reduction of vulnerability of the marginalized class of the society. Public Sector Development Program (PSDP) as share of GDP declined from 7.7 in 1985-86 to 3.2 percent in 1988-89. This trend of reduction of PSDP allocation had serious impact on country’s growth and development.

The sectoral preference in the non-development program shown in the above table indicates that the least attention in current expenditure was paid to the subsidies area. The subsidies have their impact on prices of fertilizer, tube-well, pesticides etc. Lesser subsidies, may effect adversely on the small farmers, as they buy agriculture input on higher cost, and their overall performance depends on that. Whereas the subsidized agriculture keeps the price of agriculture production cheap, otherwise prices of these commodities will go up due to higher input cost.

The nature of public finances, as discussed above manifests that Pakistan’s economy was highly dependent on foreign and domestic loans and that despite higher GDP, improved performance in industrial sector as compared to 1960s , more in-direct taxes then direct, development expenditure remained less than non-development budget. It shows the negative trend in the Pakistan economy which actually reflected adversely in the coming decade. All indicators lead towards three Ds, Defense, Debt and Development. Defense was increasing, as well as the debt while the axe fell on development.

To conclude, this chapter is focused on the period of General Zia-ul-Haq , his version of Islamic ideology and flow of economic aid through US for fighting their proxy war in Afghanistan. The rate of economic development was however encouraging in this period mainly due to injection of American aid.

The attempt is also made to assess the initiative taken by the regime to restructure state and society into a theocracy. The economic analysis of this period show that growing debt burden was reduced and the GDP growth picked its pace due to the foreign financial support after the Afghan war and second major source of fiscal balance was the unprecedented increase in the foreign remittances. Though these factors impacted positively on the economic performance of the country, but it was combined with the significantly increase of defense and non-development spending in this period.
Consequently, the saving/investment gap increased, social sector development program reduced, export ratio to GDP reduced, which again burdened the fiscal balance. This is the reason why that by the end of 1988 the debt ratio was increased to 50% of GDP combined with increased debt servicing and inflation rate. Later, when the flow of remittances decreased and financial support was reduced the economy was under great pressure and again heavy borrowing was required to maintain the fiscal deficit during the decade of 1990s, as discussed in the next chapter.
CHAPTER-V


5.1. Political Instability- Fractured Democracy and Surrogate Government

The period under consideration (1988-1998) was a period of political instability, under the surrogate governments, and it symbolizes the worst example of a fractured democracy. In this period, Pakistan went through four Prime Ministers and four caretaker Prime Ministers within a short period of 10 years. No Government that took the reins was able to show its mettle because of the short duration, they were allowed to rule. Every arrangement, though apparently seemed to be very lavish in planning, was left half-baked due to the fractured rule.

The economy i.e. picture of this period was painted by foreign elements. Its main feature was structural adjustment. We can easily say that it was an era of structural adjustment with lot of promises and no substantial gains.

Ms. Benazir Bhutto was sworn in on December 1st, 1988 and declared that she would free political prisoners, revive student and labor unions and remove government controls on the press. She gave credit to Ishaq Khan and the military leadership for accepting her as Prime Minister after years of opposing her. Difficulties between the civil military bureaucracy and the political leadership began to surface within a few days of Bhutto’s inauguration. Phone calls were being tapped, files were being misdirected, and The PM’s own servants were being black mailed by General Hamid Gul’s ISI. British journalist Cristina Lamb wrote of the atmosphere in the Prime Minister House.¹

From day one Benazir Bhutto tried to topple the Government of Nawaz Sharif who was well placed as Chief Minister of Punjab. In doing so Benazir got the sympathy

of General Baig, who played neutral in this game, but President Ghulam Ishaq Khan was not happy. Just after taking oath, in her first speech and press conference, Benazir had promised accommodation for opposition parties. Lawrence Ziring in one of his article commented on this situation: the political infighting that characterized the Pakistan scene since Ms. Bhutto was selected to lead the Government has been nasty and bitter and not without cost. Although there is considerably more political expression, there is also increasing difficulty in tackling the problems at hand... matter of social justice remained to be addressed and repeal of fundamentalist laws considered degrading to women. The economy has been allowed to drift and economic dislocation has burdened the middle class along with the poor.... But the failure to confront this matter is also structural limitations and financial constraints.¹

Benazir Bhutto before her installation as Prime Minister of Pakistan had no experience of handling political affairs, which were very much complicated in case of Pakistan. Neither was she schooled in foreign affairs, like her father, though she accompanied his father on certain visits abroad. She was a student when her father was thrown out by Gen. Zia-ul-Haq and during Zia period she was mostly confined to the prison house. She was also not able to create a good relationship between the federation and the provinces. Ms. Bhutto’s drawbacks can be listed in summary as follows:

From the start the Federal government failed to establish a working relation with the provinces. Relations with Balochistan Provincial Government were tense through out Ms.Bhutto regime. Growing political confrontation with Nawaz Sharif brought relationship with Punjab to a low point; and major cities of Ms. Bhutto’s own province of Sindh suffered from the worst violence since independence. In addition, frequent allegations of corruption surrounded both the PPP and the Bhutto family. But more important, Benazir frequently challenged the military either directly or indirectly. Gen. Hamid Gul who had been directing the all powerful ISI was replaced by a retired General

and later on Bhutto pre-empted the President by announcing that the chairman of Joint Chiefs of Staff Admiral Sirohi, was due to retire\textsuperscript{1}.

On the other hand Nawaz Sharif was not daunted by the aggressive designs of Prime Minister Benazir Bhutto and stood firmly to retaliate mustering up the support in the National Assembly to topple Benazir, by a vote of no-confidence. He tried his best but did not succeed and Benazir took that shock like a statesman and again reiterated to cooperate with opposition on various important issues emanating from federation and province’s relationship. But it was a temporary gesture and later on she again adopted the same behaviour of intimidating the provincial governments and their leaders. In such an exercise there was a lot of material for the President Mr. Ghulam Ishaq Khan, to apply the constitutional clause of 52-b but he was waiting for the appropriate time.

President of Pakistan had the discretionary power to appoint the Prime Minister, particularly in event of a divided verdict, where no party had absolute majority. Using that discretion Ghulam Ishaq Khan had invited Benazir Bhutto to take oath as Prime Minister. This act of his was a sort of pre-emption for the coming election of President. Because he thought he had unconditional support of IJI and by nominating Benazir, he would also have the support of the PPP for becoming president for the next term, he succeeded in his plan. Later on, when there were lot of conflicts on the major issues between President and the Prime Minister he was preparing to sack Benazir. Benazir was not seen as a true patriot either by the President or the armed forces.

According to Armitage, the US Assistant Secretary of Defense for International Security Affairs, the military leadership was ready to accept Benazir Bhutto as long as she did not meddle with promotions and other internal military matters. The US

\textsuperscript{1} Sameena Yasmin, (1994), ‘Democracy in Pakistan: The third dismissal’, \textit{Asian Survey}, Vol. 34, No. 6 June, p.573
Ambassador Oakley indicated that there was further understanding that she will not become heavily involved in the Afghanistan and nuclear question.¹

Ghulam Ishaq using his discretionary powers dissolved the National Assembly on August 06, 1990, under Article (58-2) (b) of the Constitution and in consequence thereof the Prime Minister and the Cabinet ceased to hold office forthwith. Ghulam Ishaq declared that Benazir had lost the capability to govern, was unable to stem domestic violence, and was involved in nepotism as well as corrupt practices by both family members and associates. President also announced Ghulam Mustafa Jatoi to form a caretaker government. He also said that the superior judiciary has been publicly ridiculed and its integrity attacked and attempts were made to impair its independence.

Ghulam Mustafa Jatoi was a hand- picked man and he was a pawn in the hand of armed forces and the President. After getting rid of Benazir Bhutto, the establishment wanted to push their own man towards the Prime Ministership. Politically Nawaz Sharif was the obvious choice. There was some soft corner of the president for Ghulam Mustafa Jatoi to hold the post even after the elections. The General Elections as scheduled were held in October 1990. Islami Jamhuri Itihad (IJI) won 105 seats in the National Assembly, the Pakistan Democratic Alliance which also included Pakistan Peoples Party captured only 45 seats in the National Assembly. The results were according to the wishes of the President and its composition was already in the mind of armed forces and Ghulam Ishaq Khan.

President had played a major role in this and he even made a speech on television on the eve of the elections, in which he asked the people to vote against the Peoples Democratic Alliance. It was alleged that Ishaq had appointed the Election Commissioner to ensure the defeat of PDA candidates²

² How elections were stolen, the PDA while paper on Pakistan election 1990, published by Pakistan Democratic Alliance, Islamabad September 1991.

Mr. Nawaz Sharif took over as Prime Minister in November 1990. He was an elected Prime Minister with 153 seats which meant two-third majority in the Parliament. As explained by Hamid Khan he promised to introduce fundamental changes in economic policies, thus paving the way to greater prosperity. In his early speeches he emphasized the following policy issues:

i. Pakistan would maintain friendly relation with all its neighboring countries specially with Peoples Republic of China, Turkey, Iran, Saudi Arabia, Gulf countries, Bangladesh and of course the United States of America.

ii. Government would endeavor to secure the right of self-determination for subjugated Kashmiri Muslims according to the United Nations Resolution.

iii. Good neighboring relationship with India.

iv. Pakistan would endorse and give full support to the rights of the Muslims all over the world.

v. Due to power, and oil crisis it would be incumbent on Pakistan to further its peaceful nuclear program because massive industrialization could not be accomplished without peaceful nuclear energy program.

vi. A wide ranging national re-construction program would be undertaken.

vii. De-Nationalization of the sick industries would be undertaken for economic uplift.

Initially Nawaz Sharif was very cautious in handling the power politics but he made no effort to interfere with the basic policy tripod upheld by Pakistan Civil- military complex. But slowly he started making inroads in to the prohibited areas by dislodging certain key men in the agencies and appointing his own confidants. One of his acts was to appoint Brig. Imitaz Ahmad as Chief of Intelligence Bureau. For isolating the President he started designing new political alliances. These two things were not liked by the President and the armed forces.

According to American reporter Steve Coll in Pakistan there existed political culture of shadow games. Intelligence agencies were part of the everyday vocabulary and no one of prominence believed that his or her telephone was not bugged.

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The problems with President and the armed forces particularly at home, in relation to Afghan policy and the United States multiplied with the sudden death of Army Chief Gen. Asif Nawaz in 1993 which resulted in a “month of political turmoil”.¹ His wife alleged that he did not die a natural death and hinted that the Prime Minister might have been involved in the conspiracy to poison her husband.² After this when President appointed Gen. Abdul Waheed as Army Chief without consulting Nawaz Sharif, the rift was widened. On April 17, 1993 Nawaz openly started criticizing Ishaq and threatened to act in future without consultation with the President.³ In retaliation Ghulam Ishaq on April 18, 1993, ordered the dissolution of National Assembly and dismissed the Prime Minister and his Cabinet. A care-taker Prime Minister was installed.

He justified this dissolution by saying that the country was facing constitutional, political and economic crisis. The situation around Pakistan and internationally was more unsatisfactory. The former Prime Minister dared to jeopardize the highest constitutional office, national integrity, prestige and honor of the country. Most of the federating units were not satisfied and protested against the role of the federal government. People were complaining about non working of National Finance Commission. Prime Minister also paralyzed administrative machinery by distorting the chain of commands. The economy was led towards a deep abyss and was reaching a point of no return. National wealth concentrated in few hands and sensitive departments like PTCL and PIA, WAPDA and Railways, which constituted the backbone of the national economy, were being de-nationalized. We will discuss the economy in a separate section of this chapter.

5.3 Towards second term of Benazir

After the dissolution of the Nawaz Sharif government, something amazing started happening. To the total disbelief of the government men in Pakistan, Balakh Sher Mizari was made the care-taker Prime Minister. Benazir also accepted to cooperate with

³ Hamid Khan (2001) p. 725
Ghulam Ishaq Kahn and her husband, Asif Ali Zardari, against whom several cases of corruption were initiated by President Ghulam Ishaq Khan, was accommodated in the cabinet and Ghulam Ishaq Khan himself took the oath. Not only Asif Zardari but many other PPP men were appointed as Federal Ministers and Advisers. It was the biggest Cabinet ever seen in Pakistan. Hamid described that “the care-taker Cabinet became specter of the unethical, ad-hoc government without any care or considerations for principles or even basic dignified behavior. The Supreme Court ended this political feast amongst strange bed fellows by restoring the dismissed Federal Government and by setting aside the order of dissolution of National Assembly”.\(^1\) But after re-entry of Nawaz Sharif the relationship between the President and Nawaz Sharif were strange to the extent that the functional relationship between the two were almost blocked and it started affecting adversely the structure of governance.

By this time the armed forces also intervened and it was mutually agreed that both President and Prime Minister would step down. On July 18, 1993, the Prime Minister advised dissolution of National Assembly and then resigned. The President passed the order of the dissolution of National Assembly and stepped down. The Chairman of Senate Wasim Sajjad took over as acting President.

Mr. Moeen Qureshi a retired bureaucrat, who had served in IMF and World Bank at senior positions, was appointed as care-taker Prime Minister. Although he came for 90 days but he took some steps which had far reaching effects. He published the list of the defaulters of the bank loans and of the tax dodgers and imposed nominal tax on agriculture income which was unprecedented. He through ordinances, made State Bank of Pakistan, Radio Pakistan and Pakistan Television Corporation autonomous. He also cut down the size of the extended administrative machinery and discretion of the Prime Minster and the Chief Ministers for allotment of plots and land. He made all efforts which he could in 90 days to make the Pakistan Economy stand on its feet.

\(^1\) Hamid (2001) p. 758
The next general elections were held on schedule on October 6th 1993. PPP won 86 in a house of 201 constituencies and PML Nawaz got 72 seats. Benazir was elected Prime Minister on October 19, 1993.

During this period, Prime Minister Benazir’s relationship with Provinces and senior Judiciary were not very comfortable. There was highest sort of corruption in which Benazir family itself was involved. The disclosure of purchase of Rockwood Mansion in Surrey for 2.7 million Pounds caused a storm of criticism against her.

On the Economic side there was total mismanagement, rupee value was being repeatedly decreased and balance of payment was becoming increasingly adverse. The International Monetary Fund (IMF) continued to pressurize for imposition of agriculture tax, reduction in military expenditure, removal of regular import duties, slashing of tariff and management of flexible exchange rates. For further support to the Government of Pakistan, President Leghari also filed a reference No. 2 of 1996 for securing the independence of the Judiciary. The situation further deteriorated after the murder of Murtaza Bhutto on September 30th 1996 in which according to some quarters Asif Zardari was allegedly involved.

After considering the situation, President Farooq Leghari dissolved the National Assembly on November 4th and appointed Mr. Miraj Khalid as Care-Taker Prime Minister. The elections were held on February 3rd 1994. PML Nawaz obtained more than two-third majority in the National Assembly. Consequently Nawaz Sharif the leader of PML was elected as Prime Minister.

The first thing he did after getting elected as Prime Minister was to end the 8th amendment. The constitution’s 13th amendment Act, 1997 was moved and passed in a matter of minutes on April 4th 1997. The most significant amendment was the omission of Article 52(b) of the constitution vesting discretion in the President to dissolve the National Assembly. This was the significant constitutional amendment. Once again the President became the titular head with all the ceremonial powers. He also passed the 14th
amendment for eliminating the defection clause and political horse-trading to stop the defection of members to other parties. Nawaz Sharif, like Benazir, also started grappling with the power of the apex court and chief Justice, Sajjad Ali Shah, was not coming to terms with Nawaz Sharif. One of the most tragic incidents which happened in the history of the Supreme Court was when those members of Muslim League along with elected MNA’s attacked the Supreme Court building and Civil and Military administration kept quite and did not move to interfere. This was the most astonishing act in the history of Pakistan. After the attack on the building then Chief Justice wrote to the President requesting army protection.

In response to the letter of Chief Justice, the President wrote a letter to the Prime Minister asking him to provide army protection to the Chief Justice. The advice was ignored by the Prime Minister, the Chief Justice wrote directly to the Chief of Army Staff, but nothing happened.¹

The row between Nawaz Sharif and Chief Justice reached to the extent that ultimately through court order Sajjad Ali Shah was removed from the office and on December 23rd 1997 the Federal Government de-notified Justice Sajjad as Chief Justice and appointed Justice Ajmal Mian as Chief Justice of Pakistan. In the meantime President Leghari also resigned on December 02, 1997 after blaming Nawaz Sharif of constitutional crisis. Later on, after considering many option for selecting a President, the Federal Cabinet on December 15, announced Justice (R) Muhammad Rafiq Tarrar, as a candidate for President. Ultimately he became President of Pakistan.

Two important things happened in the last period of Nawaz Sharif, after nuclear test by India on May 11, 1998 followed by two more on May 13, Nawaz Sharif also decided to detonate the nuclear device. There was much pressure from the western power on Nawaz Sharif not to follow India in this regard, but Pakistan did it on 28th and 30th of May 1998.

¹ ibid., p.827
The American President Clinton was also not very happy, on these actions of India and Pakistan. An angry Clinton stated, "I want to make it very clear that I am deeply disturbed". 1 After India's test, though he dispatched Deputy Secretary of State Talbot to Islamabad, to stop Nawaz Sharif for detonating the device. The envoy promised the delivery of F-16 and resumption of economic and military aid and argued that Pakistan would gain the moral high ground internationally by not testing, thereby focusing global disapproval on India.

President Clinton also spoke with Sharif four times by telephone. President Clinton remarked after the explosion by failing to exercise the restraint in responding to the Indian test Pakistan had lost a truly priceless opportunity to strengthen its own security to improve its political standing in the eyes of the world2.

Another blow to the Nawaz Shairf government came after government announced freezing of all foreign currency accounts and local banks regardless whether they belonged to residents or non-residents. This was in violation of the guarantee given to foreign currency account holders under the protection of Economic Reforms Act, 1992. This step completely destroyed the credibility of the government and economy of the country.

The government failed on many accounts. It failed in sustaining political alliances. It also failed to check terrorism and deteriorating law and order situation, Nawaz had a bad equation with Judiciary and the economic policies were leading towards complete failure. He was also concentrating power in his own hands and the writ of the constitutional governance was in jeopardy. He had also very bad relationship with the army. Differences between the Prime Minister and armed forces became public after the Kargal incidence. This was the time when he thought of removing General Musharaf, as Chief of the Army Staff which backfired and General Musharaf ousted Nawaz Sharif.

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2 Kux (2001) p. 346
These circumstances which are well known and there is no point in discussing those things in detail.

This period can be summed up in the words of Dr. Mahboob-ul-Haq the period (1988-97 (99) began with first multi-party elections since 1970. It had witnessed a high turn over of elected and intervening Care-Taker regimes, Pakistan slow marched to democracy was chequered by ten regimes in nine years. Such a high velocity of political circulation is hardly conducive environment to sustain an economic consensus.¹

The economic achievements of this decade 1988 to 1998 would be discussed in the following section of this chapter.

5.4. Economy under siege

Various governments during this period were not much free to formulate economic policy. Though it was not something unusual in case of Pakistan, but from 1988 onward, the pressure of the world financial institutions was much pronounced, even to the realization of the common man. S.M.Naseem says that during most of the 1990s Pakistan’s economy was in a virtual state of siege. The early years of the decade had held out considerable hope that the nation’s economy would enter into a phase of economic growth, will usher an era of democracy and open economic policy and it was hoped to take advantage of a number of favorable trends in the world economy.²

There is a general consensus that regional atmosphere was also conducive for economic growth but the governments failed to deliver. Shahid Javed Burki paints the scenario like this: “In 1999 the economy was in shambles, the political system was in disarray, dozens of Islamic groups that spouse all kinds of radical causes were on the loose. The law and order situation was fast deteriorating and a worried world had begun to fear the worst. A number of foreign analysts had already begun to call Pakistan a

¹ A profile of Poverty in Pakistan, Mahbub-ul- Haq Center for Human Development Islamabad, in collaboration, February 1999, p.119
‘failed state’ those who were a trifle more generous were prepared to settle for the description of a failing state.” 

It was a period of structural adjustment, whatever was done on the economic field, during this era, can be easily bracketed into the phase of structural adjustment, whether it was liberalized trade, privatization, deregulation and financial policy adjustments. Before we go for structural adjustment program in Pakistan and its impact on our economy, we need to define structural adjustment and its composition as an instrument of economic policy.

5.6. The International Financial/Aid Organizations

Financial integration in the international market is often viewed as imposed forcibly by such institutions as the World Bank (WB) and International Monetary Funds (IMF). The Frequency of economic crises in late 1980s had drawn attention to the framework of involvement of International Monetary Fund and World Bank more than ever. These institutions were conceived as part of the International Financial Architecture at the Bretton Woods International Monetary conference, on the system of “fixed but adjustable par values”, in 1944. This historic conference held at the Mount Washington Hotel in Bretton Woods, New Hampshire created the International Monetary Funds, and the World Bank. That is why these are called Bretton Woods Institutions (BWIs).

The financial integration in the international market was further emphasized by the Washington Consensus through the commonly shared themes of World Bank and IMF for prudent macroeconomic adjustment policies, outward orientation of economy, and free-market capitalism. Williamson coined this phrase ‘Washington Consensus’ in

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1 Shahid Javed Burki, Grave Challenges Ahead, The Dawn, November 15, 2205
1990.¹ It urges a set of policies promulgated by many neo-liberal economists as a formula for promoting economic growth in many parts of the Latin American countries as well as other developing countries. The primary focus was to set one’s house in order and submitting to the conditionalities attached with the financial help. The organization of these Institutions is as under:

5.6.1. The Organization: The World Bank is a vital source of financial and technical assistance to developing countries around the world. This is not a bank in the common sense. It is made up of two unique development institutions owned by 184 member countries—the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Each institution is supposed to play a different but supportive role in the mission of global poverty reduction and the improvement of living standards. The IBRD focuses on middle income and creditworthy poor countries, its objective is poverty reduction. WB describes the lending instrument and the International Development Association (IDA), which together constitute the World Bank²

The IMF is an international organization of 184 member countries, established to promote international monetary cooperation, exchange stability and orderly exchange arrangement, to foster economic growth and to provide temporary financial assistance to countries to ease out balance of payment problems. Decisions at the World Bank and IMF are made by vote of the Board of Executive Directors, which represents member countries. Furthermore, the President of the World Bank by tradition is an American, and the IMF President is a European.

5.6.2. Voting Power and Influence: The voting Power at the WB and IMF is determined by the level of a nation’s financial contribution. These Institutions obtain funds from the world’s advance countries such as the United States, and use these resources to make loans to less developed countries for their development³. The country’s

² The World Bank. www.wb.org
³ N.Gregory Mankiw (1997), Principles of Economics. New York: Harvard University, the Dryden Press, p.528
influence on decisions is determined by the size of its economy. A variety of economic factors are considered in determining quotas; these include member’s GDP, current account transaction, and official reserves etc\(^1\). Upon joining of the country it is assigned an initial quota in the same range as comparable in economic size and other characteristics. The seven largest industrialized countries (G-7) hold a total of 45 percent. Therefore the biggest contributor of IMF and WB is United States; it has around 17 percent of the total in case of the Bank and of the voting power. It has a quota of special drawing rights of 37,149.3 in the IMF. The smallest member is Palau, with the 0.013 percent of the total voting power. The Palau, quota of SDR is 3.1 million. The G-7 and particularly United States have a dominant voice and have at all time exercised an effective veto. Therefore, IMF and WB foster the interest of the world’s richest countries.\(^2\).

5.6.3. Developing countries Role: The issue of developing countries representation in International Financial Institutions is very important, as the structure of these international institutions established long ago, does not represent the current economic realities of the emerging and developing economies. The developing countries have relatively little power within these institutions, which has its impact on the success or failure of the program. Culpeper however argued that the BWIs were deliberately designed to give economically more powerful members a greater voice and vote in these organizations.\(^3\)

The ownership of the programs by the recipient country is an important element for the program’s success, though the BWI’s terms the most successful programs as those which have ownership of the countries\(^4\). The country ownership is ideal, but unfortunately their voice is not being heard, in financial architecture and poverty reduction debates, while rich governments are being heard very clearly. Nevertheless, there is increasing concern about enhancement of the voice of the poor in these agencies.

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\(^1\) IMF Quotas and Quota Reviews, A Fact Sheet. (on line) [www.imf.org](http://www.imf.org/) and [www wb.org](http://www wb.org/)


On the one hand, spectacular manifestation of globalization – rapid expansion of international private capital flow, investment and loans from one country to other are posing challenges to these agencies, on the other, the poor country’s silence at these institutions results in lack of power in the global economy. It allows G7 to foster influence in these institutions which suits to their own interests. It appears that they are the one who dictate the agenda to these agencies. Consequently the reform proposed by these agencies is considered as irrational and raises questions such as:

Who is involved in debates and the process?  
Who sets the agenda and whose interests are taken into account?  
To what extent should the IMF involve, and be accountable to civil, society?

The governance structure of these agencies, gives a wider set of actions to get involved in the policy areas of the developing countries. IMF in its short term actions has proposed to increase the capacity of the developing country’s Executive Directors to represent constituents by increasing resources and staff in their delegations\(^1\). A report on the reform of the WB and IMF commissioned by the US congress has also provided for reforms in the representation of member countries in the decision-making and governance structure of the institution of Bretton Woods.\(^2\) It has also been argued that the best prospects for economic reform reside at the national level, not within the unaccountable, colonial, supra-national institutions like the International Monetary Fund and the World Bank.\(^3\)

5.6.4. The Core Mission and Overlapping Jurisdiction

**World Bank:**

The World Bank’s original function was financing of reconstruction in war-torn countries and development in developing countries\(^4\). The Bank’s initial role to finance post-war reconstruction has changed over time. With the creation of the International Development Association (IDA) in 1960 there were new tasks of granting

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\(^2\) Solimano (2000)


\(^4\) Ahluwalia. (1990)
financial assistance to poor developing countries. The terms of the loans were ‘soft’. As it were partly interest-free, long maturities and long grace periods. The WB’s traditional support-focused areas (till 1999) were development and reforming Public Institutions, strengthening governance, civil service reform, public expenditure management, legal and judicial reform. Institutional issues were important in all sectors. However Bank’s evaluation of the programs and the quality assessment consistently indicated weak performance in the Bank’s portfolio of public sector management, projects and institution-building components of projects in other sectors. Traditional applications of the Bank’s lending instrument are Structural Adjustment loans (SALs), Technical Assistance (TA) loans and Investment loans. These types of loans are specifically designed to facilitate a long-term focus on institution-building and to link disbursements more closely with government’s needs and with improvements in monitorable indicators of institutional performance, outputs, and outcomes, mostly in poverty reduction.

Program-based lending and project lending was focusing more on social sector development goals. Till 1990s the Bank religiously followed its internal rules and restraints, the concept of ‘voice, competition and partnership’ have emerged in recent years. The Bank in its strategy report, keeping in view the experience, has released that it needs to start with a thorough understanding of what exists on the ground and emphasize ‘good fit’ rather than any one-size-fits-all notion of ‘best practices’... we need to work with our clients and other partners to develop and apply analytical tools to do this effectively”.

Most of the Bank’s traditional categories, directly addressed the following sectors:

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2 Public institutions are defined as any institutions that shape the public policy and functioning to be carried out. The role of Public Institutions was viewed in context of neoliberalism which says that the developing counties (public institutions) need the discipline provided by international institutions, to create an institutional structure and increases capacity of public servants. (For detail see: HA-Joon Change and Ilene Grabel 2004).
4 Ibid.
i. **Public Expenditure Management**: Redirecting of government spending for better development outcome, improvement in service delivery.

ii. **Tax Policy and Administration**: Increased public resources for development purpose.

iii. **Administrative and Civil Service Reform**: Improved services delivery

iv. **Legal and Judicial Reform**: Improved security in person and property, promotion of economic opportunity.

v. **Anti Corruption**: Empowerment of the poor to hold the government accountable for its actions and use of resources

vi. **Public Enterprise Reforms**: Increased resources available for development purpose.

vii. **Sectoral Institution-building**: Improved service delivery

Traditional application of the Bank’s lending instruments has sometime been inadequate to support effective public sector reforms. It needs to ensure lending enhancement in institution building. The strategy papers of the Bank support the traditional approach, but with broader, long-term, support to the countries committed for institutional reforms.

**The International Monetary Fund (IMF)**

The IMF’s principle role in the period 1944-1973 was to be a monetary institution promoting and monitoring an open and stable international monetary framework within an approach of fixed exchanged rates. IMF was to be the guardian of the par values system and to oversee its operation, ensuring that countries complied with the commitments undertaken by them. It was considered to provide short-term finance, subject to appropriate macroeconomic conditionality, to help countries deal with temporary balance-of-payments problems in a manner, which would not be “destructive of national and international prosperity”.¹ The basic idea was that the IMF should help to stabilize parties which could be changed only in case of fundamental disequilibrium in the current account. Short-term loans were assumed to facilitate real economic adjustment. The central objective of IMF-support has typically been to reduce the external imbalances². The main distinction between the IMF and the World

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¹ Ahluwalia. (1990)
Bank is that the latter is engaged in project lending for poor countries, The IMF has been broadly dealing with: Current account adjustment Capital account imbalances.¹

5.6.4.1. The IMF Purpose

Generally the purpose of the International Monetary Fund is:

i. To promote international monetary cooperation through a permanent institution, this provides the machinery for consultation and collaboration on international monetary problems.

ii. To facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

iii. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

iv. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

v. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

vi. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its policies and decisions by the purpose set forth in this Article.²

5.6.4.2. Overlapping Jurisdiction

At the time of foundation of BWIs the concept of the role of collective action was not clear as, it is today. Today's World Bank's core mission remains the

² From Article I of the IMF's Articles of Agreement
promotion of economic growth and the eradication of poverty. In the context of global
financial governance the objective the Bank instrument, used to pursue have changed
over the years as discussed above.

Traditionally, the IMF focused on current account imbalances. Since the
late 1990s IMF has increasingly played an active role in implementing rules of prudential
supervision because in the present wave of globalization, private capital flows have
become the most important source of finance for economic growth while at the same time
they are liable to volatility and crisis. Therefore, IMF and World Bank have an important
role to play in making globalization work better.

Over the years of the Bank’s history, the balance of its effort has shifted
from large scale, growth-oriented programs to project programs, and policy advice which
more explicitly incorporates the poverty reduction goal.¹ World Bank instruments as
resource for development component of lending includes: investment lending, adjustment
lending, other non-project lending and World Bank guarantees. The Bank has learned that
individual projects are not enough without institutional development to achieve poverty
reduction. The other instruments are tailored to the borrower’s specific needs like
technical assistance loan, financial intermediary loans, and emergency loans etc.

The core mission of IMF continues to be quite distinct; macro-economic
stabilization in general. But like the Bank, Fund also has changed its strategies of
assistance to countries that are passing through transition of economy through its
structural adjustment facilities. In the past twenty years, the IMF has introduced two new
loans facilities. One is the Extended Structural Adjustment Facility (ESAF); the other is
the Structural Transformation Facility (STF) to assist former members of the communist
bloc, including Russia and states of the former Soviet Union. Both have facilities to
extend the conditional lending procedures in new directions². ESAF is a facility to be
granted when the original target of the Structural Adjustment is not achieved, and the

F577-F597, USA, Royal Economic Society.
² Allen H.Meltzer, (1999), “What’s Wrong with IMF and What would be Better”, Public Policy Inquiry,
International Monetary Fund, Reforms Proposal, Hoover Institutions: The Independent Review.
program is too extended. ESAF offers medium-term loans at an interest rate of 0.5 percent with repayments up to ten years. The borrower agrees to make structural adjustments such as fiscal reform, privatization, and trade liberalization. A recent IMF—World Bank study concludes that “the results of ESAF loans have been largely negative in terms of reducing budget deficits and inflation and mixed in terms of producing external viability and promoting per capita growth” ¹

The IMF has also developed a number of loans as an operational instrument to address the specific circumstances for member countries, such as Poverty Reduction and Growth Facility (PRGF) and Non-concessional loans, through five main facilities: Stand-By Arrangements (SBA), the Extended Fund Facility (EFF), the supplemental Reserve Facility (SRF), the contingent Credit Lines (CCL) and Compensatory Financing Facility (CFF) ²

Except for PRGF all facilities are subject to the IMF’s market-related interest rate, as the “rate of charge” and some have the rate premium, as a “surcharge”. The rate of charge is currently about four percent. This surcharge is used as an instrument to discourage large loans. Like the WB, IMF provides emergency assistance to countries that have experienced a natural disaster or any kind of crises. First the IMF provides loans to cover immediate obligations to foreign creditors as the Bank does not lend to troubled economies unless they have loan agreement with IMF. In this way IMF plays role of a “gatekeeper” while the World Bank has direct plays role in economic growth, for achieving that common goal.

5.7. Governance of IMF and World Bank-Institutions.

The Bretton Woods Institutions are designed to facilitate collective action at the global level. They are playing their role on the understanding that market often fails ³ and there is a need of global public goods to be addressed at an international level.

³A situation in which a market left on its own fails to allocate resources efficiently, as discussed by Raymond (1998) p. 10.
Modern analysis of collective action begins with a discussion of market failures, and whether public interventions can improve matters, and how those interventions can best be designed.¹ In this context the public sector not just has to focus on the market failure, but also on the capacity of political institutions to increase their capacity to address these failures. Bretton Woods Institutions are political institutions.² They are indirectly accountable to the people of the world through the representatives of their governments (the executive directors). The institutions are not directly accountable to the Chief Executive of their ‘shareholder’, countries: the IMF is accountable to ministries of finance and central banks, while the World Bank is accountable to ministries of finance or economic ministries. Democratic accountability has been further weakened as central banks are achieving greater independence, often with the encouragement of the IMF itself.

World Bank in the context of its core mission of development requires it to work actively with a large number of ministries other then the finance such as education, health, labor, judicial system etc, for reforms and development projects. While the IMF works with the Ministry of finance, economics and central banks only to oversee the member countries macroeconomic and financial sector policies. The IMF looks mainly at the performance of an economy as a whole—often referred to as its macroeconomic performance. This comprises total spending (and its major components like consumer spending and business investment), output, employment, and inflation, as well as the country's balance of payments—that is, policies relating to the government's budget, the management of interest rates, money, credit, and the exchange rate—and financial sector policies, including the regulation and supervision of banks and other financial institutions. In addition, the IMF pays due attention to structural policies that

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¹ For general articulation of this view, see :

² Joseph E. Stiglitz (1999)
affect macroeconomic performance—including labor market policies that affect employment and wage behavior. The IMF advises each member on how its policies in these areas may be improved to allow the more effective pursuit of goals such as high employment, low inflation, and sustainable economic growth—that is, growth that can be sustained without leading to such difficulties as inflation and balance of payments problems.\(^1\) In order to look in to the course of macro-economic policy, IMF delegation visits every member country every year within the Article –IV regarding consultation.\(^2\) It is mandated under the IMF Charter. Under this Article the IMF assess whether a country’s economic development and policies are consistent with the achievement of sustainable growth and domestic stability.

Differences in governance structure and relation with borrowing-country counterparts clearly affect the policy prescription offered by the two institutions. They have sometime different priorities and between these priorities, it becomes difficult for the countries to make hard choices. As when one policy is *pursuing stabilization* and containing inflation as a precondition for growth, on the contrary the development ministry works on development projects which need equity and sustainability. Nevertheless, the most important aspect is that any major policy shift is preceded by a discussion between the two institutions *that draw on the diverse viewpoints*.

### 5.8. Policy Reforms- Approaches of the World Bank and IMF

The prevalent acceptance of Washington Consensus was a reaction to the macro-economic crisis that hit much of Latin American countries during 1980s. In this decade many developing governments could no longer sustain high level of public spending particularly on development without putting a match to high inflation. This is to *promote* economic growth and to help transitional economies to introduce various market-oriented\(^3\) economic reforms. In the broader framework Williamson identified

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1 International Monetary Funds, A Fact Sheet, IMF [online]
3 Market oriented reforms are considered most crucial for liberalizing a centrally planned economy to market Economy in the development economies. The Market generally is defined as “an economy that allocates resources through the decentralized decisions of many firms and household as they interact in market for good s and service” (N.Gregory Mankiw: 1997). The literature on development economies
following economic policy reforms, which are sought by Washington Consensus to integrate with the approaches of the Fund and the Bank: ¹

a. **Fiscal Discipline**
Long viewed as a central element of many high-conditionality programs negotiated by International agencies with members wishing to borrow.

b. **Public Expenditure Priorities**
c. Fiscal Deficits can be reduced through either increased revenues or reduced expenditures; strong consensus prevail in subsidies, education, health and public infrastructure investment

d. **Tax Reforms**
Wide consensus that tax reforms should create a broader tax base with marginal tax rates that are moderate. Developing countries should consider levying tax on interest income, on assets held abroad to discourage “flight capital”.

e. **Exchange Rates (First element of outward-oriented economic policy)**
Exchange rates can either be determined by market forces or formulated on the basis of whether their level seems consistent with macroeconomic objective.

f. **Trade Policy (Second element of outward economic policy)**

describes that a free market is characterized by full price flexibility. The market system will properly work only in the case of so-called individual good i.e. piece of bread etc. Institutional reforms are required to erect a system of market-related rules, laws and institutions (as emphasized in the Washington consensus) without it markets cannot fulfill their role with regards to allocating factors and distributing goods and services. For more details on this see:


For more features on the subject see:


Consensus urges import liberalization with reduced dependence on licensing and use of only moderate general tariff in the range of 10 to 20 percent. Timing also required proper consideration.

g. **Foreign Direct Investment**
Receptive attitude for promotion FDI should be pursued.

h. **Privatization and Deregulation**
To abolish barriers to entry and exit. Relieves both short and long-term pressure on governmental budgets.

i. **Secure Property Rights**
Promotes competition and reduces corruption

Given the above policy areas, it is obvious that there are overlapping mandates for the Bank and Fund. Fund financing also moved closer to Bank financing due to the introduction of conditionality for low-income countries, while the Bank also moved closer to Fund-type-activity by shifting from its earlier exclusive focus on project financing to governance reforms etc. One of criticisms of adjustment programs is that they are some-times inappropriately designed. A justification of adjustment lending is that it can support reform to strengthen economy but the designed of reforms in one area can conflict with goals/objective with other area. This creates a complex interaction between policies and goals of different economic sector as shown in following figure -II, for instance devaluation may improve the external accounts but may increase the budget deficit.¹ It has ultimate effect on implantation of program, which is mostly inadequately implemented.

**Figure –II  How Adjustment Policies Interact**

¹ As discussed by Vinod Thoma and Ajay Chhibber, (Eds.), (1989), A monograph published by The World Bank Washington DC. p.4
The performance of adjustment programs, and evaluation of policy reforms and assessment of design and implementation of adjustment operation, revealed to the World Bank that it could have little impact on development if it continued to focus only on project lending.\(^1\) Therefore, the Bank began shifting its loans toward structural adjustment and sectoral adjustment loans in 1980s, while continuing project lending, two-third of the Bank’s lending now goes for structural and sectoral adjustments which is not

much different from IMF\textsuperscript{1}. However as mentioned above World Bank respects the IMF's unofficial gatekeeper role, and generally does not make loans to countries that have not received the IMF seal of approval.

In 1996, the IMF and the World Bank designed a framework to provide special assistance for heavily indebted poor countries to pursue IMF and WB supported adjustment and reform program\textsuperscript{2}. This program is called the Heavily Indebted Poor Countries (HIPC's) program to provide faster, deeper and broader debt relief and strengthen the links between debt relief, poverty reduction and social policy.

Since adjustment lending resembles the balance of payment, its financing creates an obvious overlapping with the Fund, and even with the possibility of conflict of interest between two institutions. To avoid conflict it has been clarified by both organizations that Structural Adjustment Loans (SALs) would deal with policy issues other than fiscal policy and exchange rate, which fall under the core jurisdiction of the Fund. Fund recognized that its ESAF programs have been firmly grounded in appropriate structural policies which could bring about sustainable growth\textsuperscript{3}. In this way the Fund supports the Bank’s growth-oriented programs.

However developing countries remain concerned with their broader consensus that the policy should not degenerate into “one size fits all” approach. These institutes must tailor programs to suit the circumstances and constraints of the individual country. This created difference on these issues between the Bank and Fund. Particularly, Fund typically placed much greater emphasis on fiscal balance, calling for relatively quick reduction in the fiscal deficit, in the same manner the Bank focused much more on efficiency-enhancing reforms. However, it is not surprising that there may be a major difference in views, concerning economic policy, as if one policy may be good for stabilization today through IMF while another may hinder long-term development later.

\textsuperscript{1} World Bank.(1993)
\textsuperscript{2} International Monetary Fund, Debt Relief under the Heavily Indebted Poor Countries (HIPC) Initiative, A Fact-sheet., (2002) http://www.imf.org/external/
\textsuperscript{3} Ahluwala.(1990)
Nonetheless the issues of lack of coordination, between the Fund and the Bank came into light at the time of the East Asian crisis. According to Ahluwalia there were significant difference between the crises of the 1990s and earlier payment problems suffered by developing countries, and these differences have important implications of the role of the two institutions in the future. These crises pose new challenges for cooperating in handling the older types of payments problems, and call for somewhat new policy responses.

Welfens takes an account of cooperation of these two agencies. He found inconsistencies in the nature of cooperation between these two agencies. The most obvious conflicting policy was found during the Asian crises, which made it difficult for the countries to adopt consistent reform policies. The major inconsistency was in the critical area of fiscal policy and financial sector reform an essential component for transforming economies. Another problem reflected in the analysis is the gap of communication between these agencies. Despite the fact that the headquarters of the two are in one and same place, the staff has no coordination. At the broader regional level also these two agencies lack coordination.

Though, the Bank and the Fund have to work in their own domains, they clearly define their areas of responsibility, but given the Fund's core mission i.e. stabilization and macroeconomic issues, takes them far from each other's domain. Issues of macroeconomics and microeconomic are intertwined. Though, their agreement is not frequent they differ mainly on privatization, agriculture, trade policy and aid coordination. But still there are wider areas of cooperation available for both of them. Stiglitz pointed out that two institutions do not always speak with one voice, though it is not surprising in a given mission but it is disturbing, as presumably there is only one truth and these agencies are supposed to lead the less developed countries towards that truth.

Both the institutions realize the fact that well coordinated efforts and policy advice can make a difference in the development. IMF in its analysis says that World Bank and IMF management realize that this requires a shift in the organizational cultures

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2 Stiglitz (1999)
and attitudes both in these organizations and in partner institutions. This shift is taking place. By coordinating early and maintaining open lines of communication with country authorities—particularly by providing available diagnostic information—the World Bank and IMF can ensure that they help countries in a timely and comprehensive way. Each institution must focus on its areas of expertise. Thus, World Bank staff takes the lead in advising on social policies involved in poverty reduction, including the necessary diagnostic work.¹

The IMF advises governments in areas of its traditional mandate, including promoting prudent macroeconomic policies. In areas where the World Bank and the IMF both have expertise—such as fiscal management, budget execution, budget transparency, and tax and customs administration—they need to coordinate more closely.

5.9. IMF and World Bank Programs

Since the 1980s the debt situation has steadily worsened, to the extent that now total debt of the developing world equals about one half of their combined GNP and nearly twice of their total annual export earnings.² Because of this striking debt-service burden, the governments have virtually no bargaining power and they have to accept the conditions of the adjustments imposed by the Fund and Bank against the agreed loans. Therefore, in a complex economy, adjustment is considered to be inevitable.

Structural and sector loans are the most commonly used adjustment instruments.³ Through such instruments these institutions make themselves involved in the global economy. Both Fund and Bank consider structural adjustment (SA) on poverty reduction affects growth. Though there are different arguments on the effects of structural adjustment on the economy, for Easterly there is no direct effect of structural adjustment on growth. The poor benefit less from output expansion in countries with many adjustment loans than in countries with few adjustment loans. The soundness and

viability of SA is exclusively based on the principles of free market economy, being projected as a sure road to economic globalization.

5.9.1. Structural Adjustment Policies and Programs

The World Bank organized its program to introduce structural adjustment lending in 1980 and the Fund started its Structural Adjustment Facility in 1986, since then the Bank and Fund have developed collaboration and have routinely worked together on adjustment programs.

The IMF staff, foreseeing macroeconomic projection and policy design, was focused on rebuilding their international reserves, stabilizing their currencies and continuing to pay for imports without having to impose trade restrictions or capital controls. The Fund does not provide assistance for sectoral projects like the Bank. In this regard, Thomas has argued that the intention was to cushion directly the effect of external shocks and to encourage other external lenders. World Bank has explained structural Adjustment as under:

The aim of Structural Adjustment Loans (SALs) and Sector Adjustment Loan (SECA Ls) is to support programs of Policy and Institutional change necessary to modify the structure of an economy so that it can maintain both its growth rate and the viability of its balance of payments in the medium terms.

5.9.2. Types of Adjustment Loans of World Bank

The adjustment loans provide quick-disbursing assistance to countries with external financing needs, to support policy and institutional reforms needed to encourage the sustained and equitable growth that are essential for poverty reduction. There are several different types of adjustment loans:

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2 Ajay Chibber, Thomas Vinod, (1989), Adjustment Lending: How it has worked, How it can be Improved, Washington DC: The World Bank, p.1
4 The World Bank,(2001), Adjustment Lending Retrospective: The final Report, p.8
i. Structural adjustment loans (SALs) support reforms that promote growth, efficient use of resources, and sustainable balance of payments over the medium and long term.

ii. Sector adjustment loans (SEALs) support policy changes and institutional reforms in a specific sector.

iii. Programmatic structural adjustment loans (PSALs) consist of a multiyear framework of phased support for a medium term government program of policy reforms and institution building. The PSAL involves a series of adjustment loans over three to five years, each building on the preceding one(s) that provide funding for the government’s medium-term reform program. The medium-term framework typically focuses on capacity and institution building in the public sector—strengthening governance, budgetary processes, and efficiency of service delivery—and on sustained, sequential structural and social reforms.

iv. Special structural adjustment loans (SSALs) provide support for structural and social reforms to creditworthy borrowers approaching a possible crisis, or already in crisis, and with exceptional financing needs. By taking advantage of windows of opportunity for such reforms, these loans help countries prevent a crisis or, if one occurs, mitigate its adverse economic and social effects. Thus, the main justification for a SSAL is the structural origin of a crisis and its major social consequences. The Bank and the borrower reach agreement on structural, social, and macroeconomic policy reforms. SSALs are part of an international support package.

v. Sub national adjusting loans (SNALs) support policy changes and institutional reforms at the sub national level (provinces and states), with a focus on the sub national incentive and regulatory framework, institutional capability, and sub national expenditure programs and mitigation of social costs.

Apparently, structural adjustment is a process of market-oriented reforms in policies and institutions for restoration of balance of payment, reducing inflation and creating the conditions for sustainable growth, in per capita income. SA was originally designed to provide support for macroeconomic policy reforms, including reforms in trade policy and agriculture. They support the policy and institutional changes needed to create an environment facilitating the sustained and equitable growth. According to the Bank, over the past two decades, adjustment lending has accounted, on average, for 20 to 25 percent of total Bank lending.

Many developing countries are still at the very initial stage of integrating with the global economy. The Bank and the Fund take the responsibilities for adjusting them in the globalization process. In response to the changing borrower needs, both the

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Bank and the Fund have developed a new and varied approach. The main focus is on more “providing help for self-help”\(^1\).

Another change in of lending initiative was taken in September 1996. IMF and World Bank launched a program known as “Heavily Indebted Poor Countries” (HIPC) Initiative\(^2\). Central to this initiative is the fostering of the effort toward macroeconomic adjustment and structural and social policy reforms. This program is to provide exceptional assistance to the poor countries to reduce their external debt burden to sustainable levels. Key features of IMF lending are as under:\(^3\)

i. The IMF is not an aid agency or a development bank. It lends to help its members tackle balance of payments problems and restore sustainable economic growth. The foreign exchange provided, the limits on which are set in relation to a member’s quota in the IMF, is deposited with the country’s central bank to supplement its international reserves and thus to give general balance of payments support. Unlike the loans of Bank, IMF funds are not provided to finance particular projects or activities.

ii. IMF lending is conditional on policies: the borrowing country must adopt policies that promise to correct its balance of payments problem. The conditionality associated with IMF lending helps to ensure that by borrowing from the IMF, a country does not just postpone hard choices and accumulate more debt, but is able to strengthen its economy and repay the loan. The country and the IMF must agree on the economic policy actions that are needed. Also the IMF disburses funds in phases, linked to the borrowing country's meeting its scheduled policy commitments.

iii. IMF lending is temporary. Depending on the lending facility used, loans may be disbursed over periods as short as six months and as long as four years. The repayment period is 3½-5 years for short-term loans (under Stand-By Arrangements), or 4½-10 years for medium-term financing (under Extended Arrangements); but in November 2000, the Executive Board agreed to introduce the expectation of earlier repayment-over 2½-4 years for Stand-By Arrangements and 4½-7 years for Extended Arrangements. The repayment period for loans to low-income countries under the IMF’s concessional lending facility, the PRGF, is 10 years, with a 5½-year grace period on principal payments.

iv. The IMF expects borrowers to give priority to repaying its loans. The borrowing country must pay back the IMF on schedule, so that the funds are available for lending to other countries that need balance of payments financing. The IMF has in place procedures to deter the build-up of any arrears, or overdue repayments and interest charges. Most important, however, is the weight that the international community places on the IMF’s status as a preferred creditor. This ensures that

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\(^3\) International Monetary Funds. www.imf.org.
the IMF is among the first to be repaid even though it is often the last lender willing to provide a country with funds, after the country's ability to fulfill its obligation has clearly come into question.

v. Countries that borrow from the IMF's regular, non-concessional lending windows—all but the low-income developing countries—pay market-related interest rates and service charges, plus a refundable commitment fee. A surcharge can be levied above a certain threshold to discourage heavy use of IMF funds. Surcharges also apply to drawings under the Supplemental Reserve Facility. Low-income countries borrowing under the Poverty Reduction and Growth Facility pay a concessional fixed interest rate of 1/2 percent a year.

vi. To strengthen safeguards on members' use of IMF resources, in March 2000 the IMF began requiring assessments of central banks' compliance with desirable practices for internal control procedures, financial reporting, and audit mechanisms. At the same time, the Executive Board decided to broaden the application, and make more systematic use, of the available tools to deal with countries that borrow from the IMF on the basis of erroneous information.

vii. In most cases, the IMF, when it lends, provides only a small portion of a country's external financing requirements. But because the approval of IMF lending signals that a country's economic policies are on the right track, it reassures investors and the official community and helps generate additional financing from these sources. Thus, IMF financing can act as an important lever, or catalyst, for attracting other funds. The IMF's ability to perform this catalytic role is based on the confidence that other lenders have in its operations and especially in the credibility of the policy conditionality attached to its lending.

Highlights—The Journey of IMF Lending.¹

(On next page)

¹ Based on the IMF Survey of several years, Working papers, Country Report, Policy discussion papers.
<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
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<tbody>
<tr>
<td>1934</td>
<td>The Articles of Agreement of both the IMF and the World Bank are drawn up at the Bretton Woods Conference.</td>
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<td>1945</td>
<td>The IMF’s first 29 members sign the Articles of Agreement.</td>
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<td>1947</td>
<td>France is the first country to draw funds from the IMF, followed in the same year by the Netherlands, Mexico, and the United Kingdom.</td>
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<td>1952</td>
<td><strong>Stand-By Arrangements</strong> were introduced in 1952. Belgium was the first user when it sought $50 million from the IMF to bolster its international reserves. The term &quot;stand-by&quot; means that, subject to conditionality, a member has a right to draw the money made available if needed. In most cases, the member does in fact draw.</td>
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<td>1963</td>
<td>In 1963, the IMF set up a <strong>Compensatory Financing Facility</strong> to help member countries that produce primary commodities cope with temporary shortfalls in export earnings, including as a result of price declines. An additional component to help countries deal with temporary rises in cereal import costs was added in 1981.</td>
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<td>1970s</td>
<td>At the time of the energy crisis in the 1970s, when oil prices quadrupled, the IMF helped recycle the foreign currency surpluses of oil-exporting countries through a temporary <strong>Oil Facility</strong>, in effect from 1974 to 1976. It borrowed from oil exporters and other countries in a strong external position and lent to oil importers to help finance their oil-related deficits.</td>
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<td>1974</td>
<td>In 1974, the <strong>Extended Fund Facility</strong> was established to provide medium-term assistance to members suffering balance of payments problems related to structural weaknesses in their economies, requiring structural reforms over an extended period. The length of extended arrangements is typically three years, with possible extension for a fourth year. The first EFF arrangement was with Kenya in 1975.</td>
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<td>1980s</td>
<td>In the 1980s, the IMF played a central role in helping resolve the Latin American debt crisis, working with national governments and the international banking community. The IMF helped debtor countries design medium-term stabilization programs, provided substantial financing from its own resources, and arranged financing packages from creditor governments, commercial banks, and international organizations.</td>
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<td>1989</td>
<td>Since 1989, the IMF has actively helped countries in central and eastern Europe, the Baltics, Russia, and other countries of the former Soviet Union transform their economies from centrally planned to market-oriented systems. It has worked in partnership with these countries to help stabilize and restructure their economies—including, for example, helping them build the legal and institutional framework of a market system. To provide additional financing to support the early stages of transition, the IMF established a <strong>Systemic Transformation Facility</strong> in 1993, which lapsed in 1995.</td>
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<td>In 1994-95, <strong>Mexico</strong> faced a severe financial crisis when a shift in market sentiment led to sudden, large capital outflows. Mexico quickly adopted a strong and ultimately successful program of adjustment and reform. In support of the program, the IMF swiftly approved its largest loan to date of $17.8 billion. It also led the IMF to set up the New Arrangements to Borrow (NAB) to ensure the IMF would have sufficient funds to respond to major crises in the future.</td>
<td>In 1996, the IMF and the World Bank jointly launched the Initiative for the Heavily Indebted Poor Countries, known as the <strong>HIPC Initiative</strong>, with the aim of reducing the external debt of the world's poorest to sustainable levels in a reasonably short period. The Initiative was enhanced in 1999 to provide faster, broader, and deeper debt relief. At the same time, the IMF replaced its concessional Enhanced Structural Adjustment Facility (introduced in 1987) with the Poverty Reduction and Growth Facility, which gave more explicit attention to poverty reduction (see page 46, &quot;A New Approach to Reducing Poverty in Low-Income Countries&quot;).</td>
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<tr>
<th>2000</th>
<th>2004</th>
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<td>In November 2000, the IMF’s Executive Board concluded a major review of IMF financial facilities to assess whether the ways in which IMF financial assistance is provided to members needed modification. This effort produced a significant streamlining through the elimination of four facilities. A number of other important changes were implemented that should allow IMF facilities to play a more effective role in supporting members' efforts to prevent and resolve crises and to help ensure a more efficient use of IMF resources.</td>
<td><strong>IMF sets up Trade Integration Mechanism</strong> to help cushion the short-term adverse impact of trade liberalization on small developing countries as they embrace a more competitive international environment.</td>
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</table>
5.9.3. The component of Technical Assistance and Training as lending Instrument:

The Fund is best known for its policy advice and its policy-based lending to countries in times of economic crisis. IMF also shares its expertise with member countries on a regular basis by providing technical assistance and training in a wide range of areas, such as central banking, monetary and exchange rate policy, tax policy and administration, and official statistics. The objective is to help strengthen the design and implementation of members economic policies, including those which by strengthen skills in institutions like finance ministries and central banks. Technical assistance complements the IMF's policy advice and financial assistance to member countries accounts for some 20 percent of the IMF's administrative costs. The IMF began providing technical assistance in the mid-1960s when many newly independent countries sought help for setting up their central banks and finance ministries. Another surge in technical assistance occurred in the early 1990s, when countries in central and eastern Europe and the former Soviet Union began their shift from centrally planned to market-based economic systems. More recently, the IMF has stepped up its provision of technical assistance as part of the effort to strengthen the architecture of the international financial system. The IMF provides technical assistance and training mainly in four areas:

i. strengthening monetary and financial sectors through advice on banking system regulation, supervision, and restructuring, foreign exchange management and operations, clearing and settlement systems for payments, and the structure and development of central banks;

ii. supporting strong fiscal policies and management through advice on tax and customs policies and administration, budget formulation, expenditure management, design of social safety nets, and the management of internal and external debt;

iii. Compiling, managing, and disseminating statistical data and improving data quality; and

iv. Drafting and reviewing economic and financial legislation

It is apparent from the above, that the IMF is a monetary, not a development, institution, but it has an important role to play in reducing poverty in its member countries. Sustainable economic growth, which is essential for eradicating poverty, requires sound macroeconomic policies, and these are at the heart of the IMF's mandate.

For many years, as shown in the journey chart the IMF has helped low-income countries implement economic policies that foster growth and raise living standards through its advice, its technical assistance, and its financial support. These facilities may have contributions to the development effort in low-income countries, but despite substantial assistance from the IMF in many of these countries it did not achieve the gains needed for lasting poverty reduction. This prompted an intense reexamination of development and debt strategies in recent years by governments, international organizations, and others. It was agreed that more was needed to be done.

At the joint annual meeting in 1999 of the IMF and the World Bank, Ministers from member countries endorsed a new approach. They decided to make country generated poverty reduction strategies the basis of all IMF and World Bank concessional lending and debt relief. This embodied a more country-driven approach to policy programs than in the past. Economic adjustment is not only the source of funding but also of a steady growth. The policy designs, implementation and ownership both from the Bank and the respective countries are supposed to help in stabilization and adjustment program. The striking element in the lack of ownership of the program is inadequacy of interactive approach and voting power in these agencies of the developing countries. For a better understanding of the realistic country conditions, it is important for the success of the program that developing countries get more voting and power of expression.

The difference in the two types of lending is short term and long term i.e. stabilization and structural adjustment program. Under the HIPC Initiative, debt reduction is provided to support policies that promote economic growth and poverty reduction both. IMF, working in collaboration with the World Bank, ensures that the resources provided by debt reduction are not wasted\(^1\). The experience of the WB also shows that debt reduction alone, without the right policies, would bring no benefit in terms of poverty reduction. And policies to reduce poverty need to be supported by debt relief. Success in promoting broadly shared growth and, especially, helping to ensure that the poor are not left farther behind, it is a collective responsibility of the entire international community.

The IMF is striving to make its contribution, as part of its efforts to ensure that globalization works for the benefit of all. It has considerable overlapping, and paradoxically sometime one program may undo the others program's potential benefits. Therefore there is strong need of communication and coordination between these two agencies. Before we go for discussion of SA programs in Pakistan, we will define the conditionality first.

5.10. What is Conditionality?

Conditionality in the context of international economic development is a condition attached to a loan or to debt relief, typically by the International Monetary Fund or World Bank. This may involve controversial and uncontroversial requirements to enhance aid effectiveness, such as anti-corruption measures, but they may involve highly controversial ones, such as austerity or the privatization of key public services, which may provoke strong political opposition in the recipient country.¹

Conditionality is designed to include policy measures that are critical to program objectives or key internal data targets that would ring a warning bell if policies are off the track. In the 1980s the conditionality was rare with the IMF lending, but in 1990s it was increased much more. Conditionality is defined as "an explicit link between the approval of the Fund’s financing and implementation of certain aspects of the Authorities policy program"². The increasing numbers of conditionalties are the result of years of experience of lending by IMF. The more it has IMF has associated itself with the Bank’s objectives of economic growth, the more it has increased the structural conditions. There are three main types of structural conditions: (i) Prior action; which is preconditions for

¹ For more details see the description of aid, conditionalties given by:


IMF supported programs (ii) Structural Performance Criteria; fulfillment is a pre-condition for the continuation of the program. (iii) Structural Benchmarks: this is agreed with the authorities and monitored by the Fund’s staff.\(^1\) IMF structural conditions are more focused necessarily on the fiscal area. In fact the fiscal structural element has been most frequent as part of IMF conditionality.\(^2\)

If we look at the merits of the conditionality, it is often viewed as policy packages in line with what is often called “neo-liberalism”\(^3\), a far reaching version of the “free” trade agenda. As the terms are explained in the footnotes, the central goal of structural adjustment would be summarized as: to open up the developing countries economy, shrink the size and role of the respective governments, and rely on market forces to distribute resources, and services and to integrate countries into the global economy. As mentioned above the key structural adjustment policies include: privatizing government-owned enterprises, slice government spending building an export promoting oriented economy, liberalized trade and investment, raising interest rates, increasing taxes, eliminating subsidies.

In the context of the above mentioned structural reforms and commitments of both IMF and the Bank, they both share the pledges to ‘free trade’ and binding developing countries into the global economy. In November 1999, the IMF and the

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\(^1\) For qualitative assessment see International Monetary Funds, (2001)

\(^2\) Ibid.

\(^3\) The term ‘neoliberalism’ refers to the contemporary adoption of the free-market doctrines associated with the classical ‘liberal’ economist such as Adam Smith and David Ricardo. The term Washington Consensus (as discussed in the definition of this terms above) is often used synonymously with neoliberalism because Washington based IMF and World Bank are forceful advocates of these reforms and part of their policy reforms and adjustments programs. It has three chief Components: i. elevates the role of markets in economic governance, ii. Mediating of flows and capital, free trade, market determined exchange rates etc. It is now two decades that neoliberalism demonstrates its delivery through the IMF and WB programs as the neoliberal revolution began in the 1980s and continues to unfold today. (For more details discussions see. HA-Joon Change and Ilene Grabel (2004) and G. DeMartino (1999)

\(^4\) The term ‘free trade’ as per text book approach (N.Gregory Mankiw:1997, p.53) explains that economist today believes that poor countries are better off pursuing outward-oriented policies that integrate these countries into the world economy. It is critical assessment of the free trade it is considered as a complementary step of the neoliberal economic agenda- free trade refers to trade that is unimpeded by tariffs or other types of government restriction. In The neoliberalism view, free trade offers developing countries the opportunity to attain higher rates of output and employment growth. This case is based on the universally accepted theory of comparative advantages that if the government does not ‘distort’ trade a country will specialize in the production and export of those goods for which it is best suited, given its endowments of land, labor and capital. The rejection of this view is well debated on the basis that free trade is not optimal for developing countries, particularly when they are engaged in trade with industrialized. (For more detail discussion see: HA-Joon Change and Ilene Grabel (2004) and D.Evans, (1989)
World Bank announced a new “coherence agreement” in which they pledged to coordinate future activity.¹

5.11. Structural Adjustment in Pakistan

5.11.1 Liberalization of Trade in Pakistan

Under the first major structural program, which began in 1988, the government of Pakistan was committed to make extensive changes in its trade regime by improving the tariff structure and reducing the number of items, in the banned and restricted list, creating a better set of export incentives and the maximum ad- valorem on all imports reduced from a range of 150 percent to 225 percent to 125 percent. The major component with the IMF agreement, which related to foreign trade, was as under.

The emphasis on the removal of non-tariff barrier(NTBs) and their replacement by tariff, with the objective of reducing the number of banned commodity categories from about 4000 to 80 by FY91(1990/1), leaving only those on account of religion, security, reciprocity, and international agreements. Also on the import side, the adjustment program contains tariff measures as well, including the reduction of the maximum tariff to 125% in FY89 and further to 100 Percent by FY91, tariff alteration with the degree of processing, and gradual removal of most tariff exemptions and concessions, except the duty drawbacks afforded to exports and exemptions granted to some key industries. Phasing out tariff exemptions will help the mobilization effort and also constitute an important step in the process of streamlining the tariff structure. On the export side, the adjustment program continues to emphasize export promotion by replacing the previous uniform income tax rebate system with a graduated one that encourages higher valued exports. By permitting export house to retain a small part (5%) of the foreign exchange earning and by allowing the private sector a greater involvement in exporting rice and cotton.²

Other steps in this direction were opening of foreign currency deposit for residents and non-residents. The procedure was liberalized and banks paid higher interest rates. In March 1991, import licensing was abolished except for the commodities on the negative list. Items on the list of banned and restricted imports were cut down. By 1993 a number of important steps, based on the Structural Adjustment Program, had been taken.


Under the directions of World Bank, the government in 1993 announced a new trade reforms package, the main feature of which was as follows\(^1\).

1. Maximum tariff levels will be set at only 35 or 50 per cent with six slabs of 10, 15, 25, 35, 45 and 50 percent. Existing tariff rates will apply to motor vehicles, alcoholic beverages, POL, Wheat, fertilizers, pesticides and life saving drugs.

2. Tariff reduction will be phased and gradually over a three year period.

3. Many concessions and exemptions present in the existing tariff regime will be withdrawn gradually.

4. Tariff structure will represent a cascading of nominal tariffs with progressive stages. Locally produced goods will be subject to higher tariff rates compared to goods not produced domestically.

5. Tariffs on machinery and equipment will be 10 per cent unless this machinery is produced locally.

6. High-priority domestic industries (such as engineering and chemicals) will receive nominal protection of 50 percent.

7. Raw materials and intermediate goods predominantly used in the production of exports would be subject to zero rate duty.

8. Existing import license fee, surcharge and goods relief surcharge will be merged with statutory tariff rates.

The economists have strongly criticized the liberalization of economy in Pakistan after 1990. They adopted this attitude, not due to some bias against liberalization, but they felt and noted the negative impact on the economy of Pakistan after the policy of liberalization was implemented. It had its strongest effect on large scale manufacturing where growth rates went down. The investment in the manufacturing sector declined from annual growth rates of 10.3 percent per annum in the 1980s down to 2.3 percent during 1991-98. Asad Sayeed says that instruments of liberalization used in Pakistan are usually a neo-liberal prescription to an ailing economy and he described some of these instruments. Most of them we have already discussed in the previous paras but he had also mentioned interest rate liberalization, exchange rate liberalization, tariff reduction in the budget deficit and privatization. He is of the view that liberalization of the economy

has been generally negative for the economy and specifically for the manufacturing sector, it is an established fact. He quotes that first documented commitment to liberalization came three years before liberalization was actually initiated on December 1988; the Care Taker Finance Minister Dr. Mahbubul Haq signed a structural Adjustment Loan Agreement. He brings Akbar Ziadi in his support who says Pakistan’s economy at the time of initiation of 1988 program was relatively in good shape and did not suffer from the problem faced by most African and Latin American countries with rampant inflation, low or negative growth and large external debt etc.¹

The experiment of IMF in the Latin American countries and their feedback is not so encouraging. Some of the economists feel that there was no need for an IMF agreement when it was signed in 1988. It is quite ironical that former World Bank Chief Economist Joseph Stiglitz famously scorned the IMF economists in these words “Second rate economists from first rate Universities”. They measure performance against a remarkably reactionary economic dogma. But on the other hand the IMF people say, “The IMF and we are here to help”². But when we see International Monetary Fund Program triggered riots in Bolivia, general strike in Nigeria, renunciation as a ‘Death Plan’ in Haiti, then these argument seem to be falsified.

5.11.2. Privatization and Deregulations

The first step of privatization was taken in 1990. It was one of the major components of the Structural Adjustment Program. To implement this program Nawaz Sharif established investment and deregulation committee to identify the enterprises to be privatized and to make recommendations as to how this process should take place.

Benazir also paid lip service to privatization and major manufacturing unit was privatized. At the time of privatization in 1991 the share of public sector in total industrial investment was 17.90 percent although the public sector by no means was predominant either in investment or value added manufacturing. Certain industries in the

public sector had a large market share. Between 1991 and 1998, 88 out of 109 industrial units in the public sector were privatized.¹

Earlier the committee had identified 109 industrial units to be privatized along with four of the five nationalized commercial banks, which had 88 percent total deposits with them. The committee was dissolved and replaced by Privatization Commission in January 1991 to get a clear picture of the process of privatization of the state-owned enterprises. The following table will help to understand the progress.²

<table>
<thead>
<tr>
<th>Units</th>
<th>Total</th>
<th>For sale</th>
<th>Sold</th>
<th>Management Transferred</th>
<th>Total</th>
<th>Received</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Banks</td>
<td>5</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>5122</td>
<td>2135</td>
</tr>
<tr>
<td>Industrial Units</td>
<td>124</td>
<td>105</td>
<td>67</td>
<td>47</td>
<td>8219</td>
<td>3896</td>
</tr>
<tr>
<td>Automobile</td>
<td>15</td>
<td>10</td>
<td>8</td>
<td>5</td>
<td>1043</td>
<td>583</td>
</tr>
<tr>
<td>Cement</td>
<td>15</td>
<td>15</td>
<td>11</td>
<td>8</td>
<td>4658</td>
<td>2253</td>
</tr>
<tr>
<td>Chemicals &amp; Ceramics</td>
<td>14</td>
<td>12</td>
<td>5</td>
<td>5</td>
<td>1030</td>
<td>431</td>
</tr>
<tr>
<td>Engineering</td>
<td>12</td>
<td>9</td>
<td>4</td>
<td>4</td>
<td>141</td>
<td>58</td>
</tr>
<tr>
<td>Fertilizers</td>
<td>7</td>
<td>5</td>
<td>2</td>
<td>1</td>
<td>457</td>
<td>183</td>
</tr>
<tr>
<td>Ghee &amp; Vegetable Oils</td>
<td>23</td>
<td>23</td>
<td>15</td>
<td>9</td>
<td>626</td>
<td>250</td>
</tr>
<tr>
<td>Roti Plants</td>
<td>17</td>
<td>17</td>
<td>13</td>
<td>11</td>
<td>99</td>
<td>60</td>
</tr>
<tr>
<td>Rice Mills</td>
<td>8</td>
<td>8</td>
<td>7</td>
<td>4</td>
<td>165</td>
<td>78</td>
</tr>
<tr>
<td>Mics</td>
<td>13</td>
<td>6</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>129</td>
<td>109</td>
<td>69</td>
<td>49</td>
<td>13341</td>
<td>6031</td>
</tr>
</tbody>
</table>

Many reasons were given for the slow pace or dampening of privatization. Besides bureaucratic complications and slow pace of the process the operational and financial state of the units to be sold was also not good. Many companies on the list were either bankrupt or near bankruptcy. In some of the units and banks, the size of the employees was not economical and there were many political entrants causing extra-administrative expenses. The question was the weaning of the employees and whether they were to be ousted before the privatization or after the privatization. The new owners were reluctant to drag the extra burden with them. The government quarters were not willing to axe them with their own hands. Then there was the problem of methodology,

transparency of the transaction, which was found to be unsatisfactory. This was the reason why former Prime Minister and former Finance Minister, were cautious against the hasty privatization of large public sector units. President Farooq Laghari also joined the chorus. Addressing the two-day Asia Pacific Privatization Conference in Islamabad, he said, “We cannot allow distress sale of our national assets and wanted privatization to take place in the best possible financial and legal environment.”

By the late 1995, telephone and telegraph sector had been privatized and of the two banks the Allied Bank Ltd was sold to its employees and Muslim Commercial Bank to a private business house. The balance sheets of the Banks show that newly privatized banks have rapidly improved their performance. When it was happening various financial agencies were evaluating our performance of privatization and liberalization. In one of the reports World Bank made the following interesting observation about the banking sector:

It has been a problem for potential investor to gain access and sufficient information about the quality of the assets of the Banks. Whereas domestic investor seems to be able to overcome this robust foreign investor that required the information is presented. According to internationally recognized standards quality and quantity of the data seemed to be unsatisfied. This obstacle will be especially important for Habib Bank, which as the largest financial institutions to be privatized probably cannot be sold exclusively to domestic investor. However government remained committed to privatize all state-owned banks except the National Bank of Pakistan.

After discussing the era of structural adjustment in Pakistan, the indicator representing the growth would be presented to show that the era of liberalization was not as supportive as visualized and pressurized by World Bank and IMF economists. In certain respects they would present a negative picture of the economy as already elaborated above.


In the context of Pakistan, we will concentrate on that portion of Structural Adjustment which deals with balance of payment position, cutting the fiscal deficit,

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1 The daily Dawn, Economic and Business Review” Karachi- January 20-26, 1996
3 Ibid.
lowering inflation and increasing growth, trade policy, fiscal policy, public enterprises, financial sector, industrial policy and agriculture.

Pakistan has long association with IMF, the first loan was extended in 1958 and later on in 1965 and 1968 in the time of Ayub Khan. During the period of first government of PPP four stand-by loans were granted but the real problem started after mid 70s when IMF started intervening in all the sectors of the economy and governance of the underdeveloped and third world countries. Details of this arrangements and conditionalities will show that they even interfered in the sewerage system, gas prices, taxation and government fees, toll tax on the roads etc.

In the 1980s Pakistan entered into a long-term extended fund facility for a period of 3 years. It was worth SDR-1.27 $ billion, three times the entire amount lent between 1947-1980. This 3-year agreement was cancelled after one year. A new agreement worth the undrawn amount was signed. But when Benazir came into power she ratified the already agreed program which ran from 28 December 1988 to 27 December 1991 as pointed out by Akbar Zaidi. Her selection as Prime Minister was a pre-condition of the ratification of the program. After her ouster, Nawaz Sharif had to follow it through.¹

The key objective of SA in 1988 over the period of three years can be summarized as under:

i. Budgetary deficit to be reduced from 6.5 percent in 1988-89 to 5.5 percent in 1989-90 and 4.8 percent in 1990-1991.

ii. To restrict the rate of inflation from 10 percent in 1988-89 to 6.5 percent in 1991.

iii. External current account deficit from 3.4 percent of the GDP in 1988-89 to 2.6 percent in 1991.


vi. GDP growth at about 5.2 percent in 1988-89 to 5.5 percent in 1991.

¹ Akbar Zaidi( 2001) p. 315
For bringing down the fiscal deficit from 8 percent to 4.8 percent resource mobilization was emphasized with major tax measures. This program also suggested increased charges for higher education and health. Reduction in current expenditure of the government was also part of its program. It was also said that social sector should be given increased funds i.e. from 7 to 7.4 percent. In trade they emphasized on reducing the banned commodity from 400 to 80. All non-tariff barriers would be replaced by tariffs and reduction of tariff rate to 125 percent. The conditionality for the financial sector has been discussed in the Privatization section above. The government was asked to pursue a cautious domestic credit policy so that inflationary pressure was curtailed and its perceived improvement in the balance of payment was not jeopardized. Money expansion was to be kept in line with nominal GDP growth.

According to the World Bank and IMF annual report 1980 to 1991 Pakistan is one of the top countries that got most of the adjustment loans of different kinds i.e Stand by Arrangement (SBA) Extended Fund Facility (EFF) Structural Adjustment Facility (SAF) Enhanced Structural Adjustment Facility (EASAF). During this period Pakistan got a maximum 18 loans only exceeded by Mexico which got 19 and followed by Jamaica which got 17 loans during this period. In cooperation with IMF, Pakistan got 8 SPA, 2 EFF, 1 SAF and in cooperation with World Bank Pakistan got 7 Adjustment Loans.  

As we have already mentioned SA program did not meet total success. Most of the targets were not met and GDP remained stagnant and external debt increased from 44 percent to 46.5 percent of GDP. Trade liberalization encouraged the import of goods and services, exports increased sharply by 11.6 percent per annum in US $ term and 14.4 percent by volume mainly due to increased exports in cotton products, synthetic textile and leather products. Gross external reserves increased due to large private capital inflows. There was noticeable increase in Direct Foreign Investment (FDI) and Foreign Portfolio investment. Industrial value added grew by 6.3 percent; large investments were made in all major energy sources. Cotton industry dominated, with output of cotton yarn increasing at an average rate of 15 percent.

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Despite all this progress, the key indicators do not present a very encouraging picture except for gross domestic growth and gross national savings which show substantial increase. GDP just managed a 5.5 percent increase, gross domestic investment marginally increased, inflation was away from the target, and the current account deficit was not up to the mark. So these indicators provide a summary position of the achievements of the SA program which is far from the targeted figures and Akbar Zaidi explains. The structural program despite the entire program and fanfare has not been much of a success.\(^1\) The World Bank’s own opinion about the program is as under:\(^2\)

While performance during the adjustment period has been strong in GDP and export growth and in structural reforms to encourage private sector economic activity, it has been weaker in achieving a sustained reduction in the fiscal deficit and in improving external sector balance. The financial imbalances, especially persistently large fiscal deficits, raise concern about their potential adverse effects on growth performance. Similarly concerns are also raised by the lack of significant improvement in poverty and social sector indicator.

Most quantities targets fixed under SA program were not met as shown in the table\(^3\) given below:

<table>
<thead>
<tr>
<th>Item</th>
<th>1987/8 actual</th>
<th>1988/9 actual</th>
<th>1989/9 actual</th>
<th>1990/1 actual</th>
<th>SAP target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenue</td>
<td>18.4</td>
<td>18.9</td>
<td>19.5</td>
<td>16.5</td>
<td>20.8</td>
</tr>
<tr>
<td>Tax and non-tax revenue</td>
<td>17.3</td>
<td>18.1</td>
<td>18.5</td>
<td>15.5</td>
<td>19.7</td>
</tr>
<tr>
<td>Total expenditure</td>
<td>26.9</td>
<td>26.6</td>
<td>26.1</td>
<td>25.2</td>
<td>25.6</td>
</tr>
<tr>
<td>Deficit</td>
<td>-8.5</td>
<td>-7.7</td>
<td>-6.5</td>
<td>-8.7</td>
<td>-4.8</td>
</tr>
<tr>
<td>Deficit financing</td>
<td>8.5</td>
<td>7.7</td>
<td>6.5</td>
<td>8.7</td>
<td>4.8</td>
</tr>
<tr>
<td>For memorandum</td>
<td>-1.7</td>
<td>-1.4</td>
<td>0.1</td>
<td>-2.3</td>
<td>2.0</td>
</tr>
<tr>
<td>i. Public savings</td>
<td>-3.8</td>
<td>-3.0</td>
<td>-1.2</td>
<td>-4.5</td>
<td>0.6</td>
</tr>
<tr>
<td>ii. Primary balance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: World Bank, Pakistan: Country Economic Memorandum FY 93, Progress under the adjustment program No. 11590-Pak Washington, 1993.p.31*

The above table of public finance shows that the target of SA program was not met. Revenue area remained weak and could not see much improvement, and further declined in 1990/1. Deficit also remained much higher then targeted figures; public savings further declined in 1990s as compared to 1987/88.

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\(^1\) Ibid. p. 320

\(^2\) World Bank, Pakistan: Country Economic Memorandum FY 93, Progress under the adjustment program No. 11590-Pak Washington, 1993. p.31

\(^3\) Ibid., p.14

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The other economic indicators which are believed to show the health of economy are; GDP growth rates, budget deficit as percentage of GDP and inflation rate present a consolidated picture as under: (these indicators in comparison to the last decade are discussed in the following section also indicating the overall growth).

**Summary of key indicators and program targets, 1987/8 to 1991/2**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>7.6</td>
<td>5.0</td>
<td>4.5</td>
<td>5.5</td>
<td>7.8</td>
</tr>
<tr>
<td>CPI</td>
<td>6.3</td>
<td>10.4</td>
<td>6.1</td>
<td>12.7</td>
<td>9.6</td>
</tr>
<tr>
<td>Tax Revenue/GDP</td>
<td>13.8</td>
<td>14.4</td>
<td>13.9</td>
<td>12.8</td>
<td>13.7</td>
</tr>
<tr>
<td>Public Savings/GDP</td>
<td>-1.7</td>
<td>-1.4</td>
<td>0.1</td>
<td>-2.3</td>
<td>-0.3</td>
</tr>
<tr>
<td>Current Account</td>
<td>-4.4</td>
<td>-4.8</td>
<td>-4.7</td>
<td>-4.3</td>
<td>-3.1</td>
</tr>
<tr>
<td>Gross reserves (weeks of imports)</td>
<td>3.0</td>
<td>3.0</td>
<td>4.0</td>
<td>3.3</td>
<td>5.6</td>
</tr>
<tr>
<td>Total Debt/GDP</td>
<td>44.4</td>
<td>47.4</td>
<td>49.4</td>
<td>45.5</td>
<td>46.5</td>
</tr>
<tr>
<td>Public Servicing debt</td>
<td>26.9</td>
<td>24.0</td>
<td>24.5</td>
<td>21.5</td>
<td>22.5</td>
</tr>
</tbody>
</table>

*Source: World Bank, Pakistan: Country Economic Memorandum FY 93, Progress under the adjustment program No. 11590-Pak Washington, 1993.p.35*

If we examine the above table, we find that under the structural adjustment program, during this period, the GDP was managed only up to 5.5 percent, which was supposed to be increased. However national savings have increased substantially. Despite adjustment reforms in trade liberalization and financial sector, the indicators do not present much improvement in tax revenue, current account and public debt.

As we have seen most economic indicators are not presenting a positive picture of the success. But IMF and World Bank perceive different picture. They feel that some positive developments have taken place, especially in pricing, trade liberalization etc, but government failed in lowering the inflation and budget deficit and linked it with the governance issue. For them it was more of management and governance issue of reforms that went wrong somewhere. Otherwise according to Mr. William McCleary of the World Bank, reforms in Pakistan have been sustained because of the government’s incremental and flexible approach and because continued strong economic performance has obviated the need for reversals. He believed that the Bank and IMF had played significant and positive role in the development of the economy in 1980s, as the economy became more open and outward oriented in the 80s. He also recognized that some of the
targets are not met, for example the saving-investment balance remained lower than expected. Similarly there was increasing budget deficit, problems in the mobilization of resources and controlling government expenditure.¹

Actually it appears that the World Bank and IMF have done their evaluation of the 1988 SA program on the macro level as it is easier to analyze the public finance figures annually, rather than going into micro-economic impacts. The economic studies in Pakistan on the micro-economic impact of SA program of 1988, show that the impact on labor and the poor has been severe. The increasing inflation mostly hurt the poor and cuts in government hiring in order to release pressure on government expenditure increased unemployment. The withdrawal of large subsidies also had similar deleterious consequences².

Poverty estimation is another concept to evaluate growth and has been widely discussed by economists in the context of structural adjustment impact on Poverty. Different studies have different methodologies in assessing poverty. The major difference in the trends of poverty is between the period of 1987-88 to 1993-4. For this period Jafri has estimated the declining trends in 1980s that continued in the early 1990s with an insignificant increase in poverty during 1993-94 as under:³

<table>
<thead>
<tr>
<th>Year</th>
<th>Pakistan</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987-88</td>
<td>29.2</td>
</tr>
<tr>
<td>1990-91</td>
<td>26.1</td>
</tr>
<tr>
<td>1992-93</td>
<td>26.8</td>
</tr>
<tr>
<td>1993-94</td>
<td>28.7</td>
</tr>
</tbody>
</table>

The World Bank also agrees with the finding of the measurement of poverty as shown by Jafri.⁴ However Kemal differs with the above result of Jafri and World Bank and is of the view that there is no real consensus regarding trends in poverty after 1987-88. However, there is an emerging consensus that poverty has increased in the 1990s.

Kemal has based his argument on the following findings of the trends of the increasing poverty as under:

**Trends in the incidence of Poverty (head-count ratios, % poor population)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-85</td>
<td>24.47</td>
</tr>
<tr>
<td>1987-88</td>
<td>17.32</td>
</tr>
<tr>
<td>1990-91</td>
<td>22.1</td>
</tr>
<tr>
<td>1992-93</td>
<td>22.40</td>
</tr>
<tr>
<td>1996-97</td>
<td>31.00</td>
</tr>
<tr>
<td>1998-99</td>
<td>32.60</td>
</tr>
</tbody>
</table>

Ishrat while commenting on the debate of structural adjustment of IMF and World Bank in terms of broader policy says that “No wonder, we have got ourselves in a debt trap in the last ten years while the economic growth rates have declined, inflation has resurfaced, exports have stagnated and our reserves remain at a paltry level of a few weeks of imports. I do not think any economist of any persuasion or any international institution would endorse the way we have managed our economy during the last ten years...I would only submit that the caricature of Structural Adjustment program as spreading of “free market” ideology and doing away with the state has confounded and confused what can otherwise be a very rich debate on the crucial, essential complementarities between the private-public-community partnerships and the sequencing and phasing of reforms to minimize the adverse social consequences of these actions.

The view that Structural adjustment of Pakistan relate to 1988-91, 1993-96 and 1997-2000 period, had negative impact on poverty and efficiency of growth has also been endorsed by Kemal as the 1988 agreement focused on controlling the persistently rising budgetary deficit to an unsustainable level of 8.5 percent of the GDP in 1987-88.

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Budgetary deficit did not decline to 6.5 percent of GDP in 1989-90, it increased to 8.7 percent of GDP in 1990-91 because of the failure of the government to curtail the expenditure. (This view has also been shared by Mr. McCleary of WB as referred above that the government expenditure pattern could not change during the period of adjustment). Kernal further analyzed that the impact of the program signed in 1992-93, aimed at reduction in deficit from 8.0 percent of debt servicing to 4.0 percent in three years but budgetary deficit never went down, below 6.0 percent of GDP. The program signed in 1997 also called for a reduction in the fiscal deficit to 4 percent, but increased to 7.7 percent in 1997-98.¹

All structural adjustment and stabilization programs targeted tariff reduction. It was assumed that reduction of tax revenues from direct sources would be compensated through indirect sources. As discussed earlier the volume of indirect taxes was increasing as compared to direct taxes as percentage of total revenue since 1980s because the investors were given incentives of lesser direct taxes. The SA program impact was exemplary for IMF to refer to other countries till 1995-1996; it was the period of second adjustment program i.e. 1993-1996. IMF was displeased when the budget of 1995-96 was announced with tariff rate cut by only 5 percent and not 20 percent as expected by IMF, reducing the maximum tariff rate to 5.6 percent. The budget deficit target was set at 5 percent to GDP, whereas IMF insisted on 4.5 percent, and it was another disappointment for IMF. It did not like government effort to assert its independence. Therefore the Fund froze the remaining tranche of the ESAF (Extended Structural Adjustment Facility) which was signed in February 1994 and was to expire in February 1997. It was frozen in 1995. However, later, the government in the coming 3 months imposed more taxes, devalued the currency and promised IMF it would not displease the Fund if the frozen tranche is restored.

The Benazir government then announced to the public that it’s their government’s victory that IMF was ready to restore its loan, but did not mention the cost of submitting

to IMF. However it was apparent that economy was growing well and the Fund was happy over the state of economic affairs in Pakistan.¹

In 1996, based on the experience of IMF with the recipient countries, the Bank gave a clear message in a consortium meeting held in Paris in 1996, that Islamabad would get US$2.7 billion if the 1996-97 national budget was published according to the desire of the IMF. Any deviation from the conditions set out by IMF would result in cutback in foreign aid. Pakistan assured the donors that it was working on a new structural adjustment program with the IMF, using the recent $US 600 million standby arrangement as a ‘stepping stone’ to secure a wide-ranging deal. It had also cautioned against ‘exaggerated expectations’ of how rapidly the social changes be accomplished. V.A Jafery, Finance Adviser of the Prime Minister said “After last year’s experience donors are making an explicit link. They are saying that if you do as planned, you will get the funds; if you deviate, the commitment might be lower. If the reform process is slowed, then there will be a reduction in commitment. V.A Jafery further explained the area of expectation by IMF i.e. reduction in budget deficit, tax reform, lowering of most tariffs and watch over development spending.”²

This brings us closer to the conclusion that developing countries like Pakistan are dominated by vested interests which compromised by implementing the conditionality and accepting adverse effects on poverty silently. Later on, in October 1997, the Nawaz Sharif Government signed another agreement with the IMF worth US$ 1.6 billion as an enhanced Structured Adjustment Facility, which shows the influence of the IMF and World Bank in Pakistan’s economic policy.

What concerned most of the economists in the context of micro-economic impact of structural adjustment, was the tax structure reforms in terms of their impact on poverty trends directly affecting the lower, middle and upper households. The shift of direct import-related tax to indirect taxes had affected the poor. The tax structure prior to the adjustment era was considered as progressive.³ But it is significant to note that after the

¹ Akbar S. Zaidi discussed in his article, The IMF shows its displeasure, The Herald, March 1996.
² The daily DAWN, April 25, 1996
adjustment period it was considered as regressive since over the period of ten years form 1988 to 1998 the tax burden on the poor had increased by 7.4 percent while it had declined by 15.9 percent for upper crust of tax payers.

The percentage increase in Tax burden by Income Groups

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Average Income of the group( Per month)</th>
<th>1987-88 to 1990-91</th>
<th>1988-89 to 1997/98</th>
</tr>
</thead>
<tbody>
<tr>
<td>GI</td>
<td>489</td>
<td>5.8</td>
<td>7.4</td>
</tr>
<tr>
<td>GII</td>
<td>656</td>
<td>4.7</td>
<td>6.0</td>
</tr>
<tr>
<td>GIII</td>
<td>758</td>
<td>2.0</td>
<td>-0.7</td>
</tr>
<tr>
<td>GIV</td>
<td>909</td>
<td>2.2</td>
<td>-0.6</td>
</tr>
<tr>
<td>GV</td>
<td>1259</td>
<td>1.3</td>
<td>-1.7</td>
</tr>
<tr>
<td>GVI</td>
<td>1744</td>
<td>0.6</td>
<td>3.6</td>
</tr>
<tr>
<td>GVII</td>
<td>2239</td>
<td>-0.2</td>
<td>-5.9</td>
</tr>
<tr>
<td>GVIII</td>
<td>2748</td>
<td>-1.2</td>
<td>-8.0</td>
</tr>
<tr>
<td>GIX</td>
<td>3246</td>
<td>-1.8</td>
<td>-8.1</td>
</tr>
<tr>
<td>GX</td>
<td>3736</td>
<td>-1.2</td>
<td>-8.8</td>
</tr>
<tr>
<td>GXI</td>
<td>4246</td>
<td>-2.1</td>
<td>-12.5</td>
</tr>
<tr>
<td>GXII</td>
<td>7770</td>
<td>-3.3</td>
<td>-15.9</td>
</tr>
</tbody>
</table>

The above chart shows that the shifts in taxes derived from indirect taxes. Mostly those who fall under indirect taxes were salaried people and wage earning employees. The tax ratio from self-reliant tax payers was lesser than the estimated amount due to tax-evasion, exclusion from tax net and corruption in the tax administration. The other reason of small base of tax from higher income group is the policy of the concessions, discretionary powers, exemptions from custom etc. It resulted in tax disparity increasing between the rich and poor.

5.13. Key Indicators determining the trends of the economy.

In the context of political economy, the stability of the government is seen in contrast to macro-economic policies adopted by the government. Economic policies are

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the main key ensuring the process of economic growth and development, as well as success of the regime.

Why this decade was so bad economically vis-à-vis the previous decade and what kind of economic impact of International Monetary Organizations had on the health of economy, during the period of 1988-1999 through structural adjustment, will be manifested through facts and figures of economic growth as discussed in this section.

5.13.1. GDP Growth

As discussed in other chapters, decade-wise performance shows that 1980s witnessed better annual GDP growth at 6.4 percent, followed by the 1960s, at 6.0 percent. But in 1980s it was largely due to reliance on foreign inflow of loans and aid. That resulted in growing stock of debt and debt servicing. The increase in debt and deficit budget and balance of payment brought many structural problems in the domain of public finances. By the decade of 1990s and particularly after 1992 the country was exhibiting classical symptoms of a debt trap, falling rates of investment, and macro-economic instability. The following figure of annual GDP growth of the two decades will show the growth pattern.

![GDP Growth Rate 1980-81 to 1997-98](image)

*Source: Economic Survey 1997-98, Finance Division, Government of Pakistan*

The above figures show that growth rate after the late 80s started falling and then the reinforcement of this trend as shown above is observed after 1992 to 1998. The average annual aggregate growth rate declined for the decade as a whole to 4.6 percent and it dropped further to 4.3 percent annually in financial year 1995-99. The constantly rising debt and debt servicing were leaving little quarter for development.
5.13.2. Budget Deficit

The combination of lower GDP and fiscal indiscipline resulted in current account and fiscal deficits in the 1990s. The following figures of the current account and fiscal deficit in comparison to late 80s, till mid 1990s would endorse the argument.

<table>
<thead>
<tr>
<th>As % of GDP</th>
<th>1988-89</th>
<th>1992-93</th>
<th>1995-96</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance of Payment deficit</td>
<td>4.83</td>
<td>7.14</td>
<td>6.3</td>
</tr>
<tr>
<td>Budget Deficit</td>
<td>7.4</td>
<td>8.0</td>
<td>5.6</td>
</tr>
</tbody>
</table>


This fiscal deficit is the mother of all evils afflicting the economy. The variation in balance of payment from year to year shows the worsening export performance from the 80s to late 1990s. Similarly greater foreign debt to finance the budget deficit and current account deficit had implications for changes in public finances of the country.

5.13.3. Inflation.

The CPI, (inflation rate) is also another indicator of economic performance. After the decade of 80s, the inflation rate on average annual basis in Pakistan remained persistently in double digits.

*Source: Fifty Years of Pakistan, Government of Pakistan.*

The above figure reveals that the average rate of inflation was 7.3 percent for 1980s, while it went up to 11.0 percent average from 1990-93 and still higher during 1994-97 period i.e. 11.7 percent. This reflects poor fiscal management and important shift of capital inflow in the country as well as increasing consumption pattern. The high inflationary pressure erodes purchasing power and affects adversely on households dependent on fixed salaries.
5.13.4. Debt Burden

Pakistan had been going through an escalating debt burden since the start of 1980s which resulted in inadequate policy effort in 1990s towards controlling the growing magnitude of debt trap with its associated symptoms as indicated above. The total debt stock rose sharply from US$ 3.1 billion in 1970 to almost US $10 billion in 1980. An overview of debt in 1990s shows the following positions.

<table>
<thead>
<tr>
<th>Year</th>
<th>External Debt</th>
<th>External Debt to GDP ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>18434</td>
<td>48.04</td>
</tr>
<tr>
<td>1989</td>
<td>20350</td>
<td>50.80</td>
</tr>
<tr>
<td>1990</td>
<td>22354</td>
<td>56.01</td>
</tr>
<tr>
<td>1991</td>
<td>24191</td>
<td>53.15</td>
</tr>
<tr>
<td>1992</td>
<td>15159</td>
<td>51.80</td>
</tr>
<tr>
<td>1994</td>
<td>29418</td>
<td>56.41</td>
</tr>
<tr>
<td>1995</td>
<td>30847</td>
<td>50.57</td>
</tr>
<tr>
<td>1996</td>
<td>32723</td>
<td>51.29</td>
</tr>
<tr>
<td>1997</td>
<td>33864</td>
<td>53.74</td>
</tr>
<tr>
<td>1998</td>
<td>35715</td>
<td>57.62</td>
</tr>
</tbody>
</table>

Source: State Bank of Pakistan, Annual Report, various issues.

The above table reveals that external debt rose from 19 billion in 1988 to US $35 billion in 1998, increasing two-fold in 10 years. However the debt stock in 1990s was less than 1980s. The growth rate of debt stock from 1981-90 was 7.75 percent while the percentage from 1991-98 was 5.74 percent. The composition of aid is a major factor for the lesser debt stock comparatively. During 1990s the substantial amount, which was in grants in earlier period, declined and substituted with hard terms loans and payment in foreign currency with higher interest rates. The total debt servicing as percentage of GDP in 1990-91 was 7.2 percent which increased to 9.0 percent of GDP in 1995-96. The share of grant which was 9 percent during 1996-97 was likely to decrease further to 6 percent of the total commitments in 1997-98 due to its lesser availability from the donors⁷.

If we look at the disbursement of aid by use, we will find that the Project Aid disbursement was much higher in ratio as compared to non-project aid. The chart given below shows the percentage of Project Aid to Non-Project Aid, and it reveals that the percentage of project Aid was much higher than the non-project

---

Aid. Gradually the percentage of project aid disbursement as compared to non-Project Aid in 1990s but was higher in ratio.

![Disbursement of Project and Non-Project Aid](image)

Disbursement of Project Aid and Non-Project Aid and percentage Share ($Million)

<table>
<thead>
<tr>
<th>Year</th>
<th>Project Aid</th>
<th>Project</th>
<th>Non-Project Aid</th>
<th>Non-Project</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986-87</td>
<td>1006</td>
<td>83.0</td>
<td>205</td>
<td>17.0</td>
<td>1225</td>
</tr>
<tr>
<td>1987-88</td>
<td>1223</td>
<td>84.0</td>
<td>219</td>
<td>16.0</td>
<td>1442</td>
</tr>
<tr>
<td>1990-91</td>
<td>1408</td>
<td>65.3</td>
<td>748</td>
<td>34.7</td>
<td>2156</td>
</tr>
<tr>
<td>1991-92</td>
<td>1766</td>
<td>71.5</td>
<td>705</td>
<td>28.5</td>
<td>2471</td>
</tr>
<tr>
<td>1992-93</td>
<td>1895</td>
<td>76.0</td>
<td>598</td>
<td>24.0</td>
<td>2493</td>
</tr>
<tr>
<td>1993-94</td>
<td>1961</td>
<td>78.9</td>
<td>588</td>
<td>23.1</td>
<td>2549</td>
</tr>
<tr>
<td>1994-95</td>
<td>2079</td>
<td>80.0</td>
<td>521</td>
<td>20.0</td>
<td>2600</td>
</tr>
<tr>
<td>1995-96</td>
<td>2151</td>
<td>83.9</td>
<td>414</td>
<td>16.1</td>
<td>2565</td>
</tr>
<tr>
<td>1996-97</td>
<td>1821</td>
<td>81.5</td>
<td>412</td>
<td>18.5</td>
<td>2233</td>
</tr>
<tr>
<td>1997-98</td>
<td>1552</td>
<td>55.4</td>
<td>1249</td>
<td>44.6</td>
<td>2801</td>
</tr>
<tr>
<td>1998-99</td>
<td>1620</td>
<td>66.3</td>
<td>822</td>
<td>33.7</td>
<td>2442</td>
</tr>
</tbody>
</table>

As per the above figures the Project Aid again increased from 1993-94 to 1996-97. However, non-project aid increased in late 1990s. To bring the country back to a sustainable debt burden, appropriate policy of supply side economy was introduced. Series of reforms, deregulations, privatization and liberalization of economy were introduced on the behest of IMF and World Bank during this decade.

**5.13.5. Fiscal Policy and Development Expenditure**

Pakistan's fiscal deficit was 8.5 percent in 1988 and 7.4 percent in 1989. On the other side, the increasing debt-servicing requirement also had a pressure on fiscal account. The IMF required Pakistan to reduce the fiscal deficit to 5 percent under the structural adjustment program. This expectation put a constraint on Public Sector
Development Expenditure (PSDP) leaving limited resources for the development plans. Had the revenue generation efforts been successful, the cut in Development Sector would not have been required but, at the same time the efforts in tax revenue were not successful. Before we go to Public Sector Expenditure sector-wise, we look at the following table to know the trends of the revenue, current expenditure and development expenditure.

**Revenue and Expenditure Trends- 1988 (FY) to 1998(FY)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Revenues(as % of GDP)</th>
<th>Tax Revenues(as % of GDP)</th>
<th>Total Expenditure(as % of GDP)</th>
<th>Development Expenditure(as % of GDP)</th>
<th>Interest Payments(as % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988(FY)</td>
<td>17.3</td>
<td>13.8</td>
<td>26.7</td>
<td>6.9</td>
<td>6.9</td>
</tr>
<tr>
<td>1989(FY)</td>
<td>18.0</td>
<td>14.3</td>
<td>26.1</td>
<td>6.2</td>
<td>5.0</td>
</tr>
<tr>
<td>1991(FY)</td>
<td>16.9</td>
<td>12.7</td>
<td>25.7</td>
<td>6.4</td>
<td>5.5</td>
</tr>
<tr>
<td>1994(FY)</td>
<td>17.5</td>
<td>13.4</td>
<td>23.4</td>
<td>4.6</td>
<td>5.8</td>
</tr>
<tr>
<td>1997(FY)</td>
<td>15.8</td>
<td>13.4</td>
<td>22.3</td>
<td>3.5</td>
<td>7.1</td>
</tr>
<tr>
<td>1998(FY)</td>
<td>16.0</td>
<td>13.2</td>
<td>23.7</td>
<td>3.9</td>
<td>8.2</td>
</tr>
</tbody>
</table>


The above table reveals that there was a trade-off between the development expenditure and the interest payment. The development expenditure gradually declined from 6.9 percent of GDP in 1988 to 3.5 percent 1997 whereas the interest, which was 6.9 percent of GDP in 1988, reduced in 1989 and 1991 to 5.5 percent but gradually increased from 5.5 percent in 1991 to 8.2 percent in 1998. This increase was due to constant borrowing of the Government of short-term loans for balance of payment, which was the main factor of reduction in the development sector expenditure.

If we analyze development planning and public expenditure shifts in the last three plan periods, we will find the following shifts in the sectoral priority.

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Source: Economic Surveys of Pakistan- various issues

The above figure reveals the Public Sector expenditure shift from previous planning- to next plan year. The priority shift that shows in agriculture spending was reduced drastically from 9.7 percent to 0.8 percent. Similarly, Water sector also received lesser priority in spending and reduced from 10.3 percent to 0.1 percent, Transport & Communications sector was also lower in priority and its expenditure was lower from 23.0 percent to 17.3 percent. However the energy sector was given the priority. It had gone up from 25.3 percent to 40.2 percent in 1993-96 plan periods. The energy sector expenditure has gone extraordinarily high and public sector spending shows that it was because the energy sector is considered as a growth-wheel. Industry sector was the major consumer of the energy. Since there was no small privatized company to fulfill the requirement of the industrial sector, therefore the burden of high spending was on the public sector, the reason being that power rates were cheaper in early 1990s and later when the private investment of Independent Power Producers came in the country the electricity became expensive.

We could see many advantages and disadvantages of this Privatization policy in Power Sector. Foreign investment in the power sector was attracted on a very pro-investment packages, which were offered on a ‘cost plus’ approach basis. Consequently 19 companies came offering 3,500 MW capacities. WAPDA and KESC had to purchase power from these companies on expensive rates. From 1988 we had excess capacity but KESC and WAPDA’s own plants were underutilized and they were buying it on expensive rates from IPPs. Then the drawback of this policy became more evident, particularly with regard to the absence of International Competitive Bidding procedures, poor planning of the location of power plants as the poor physical location of power
plants put pressure on electricity transmission system and ultimately the country’s infrastructure. Though later the government pressurized the IPPs for lowering tariff but the issue of managing the IPPs and other private investment in the sector emerged as weak governance issue and ultimately affected the sector negatively and investment in this sector was significantly reduced. However, funding agencies like ADB showed their concerns and advised the government that issue of lowering the tariff should be resolved amicably under the market economy strategies\textsuperscript{1}. Nevertheless 1994 policy was influential in lowering the power shortage with constant upward power tariff. Though privatization of power sector which was still not completed, remained a great concern of public policy, it made per unit cost very high. WAPDA which previously was a profit earning organization went into loss. Though, impact of higher rate of power generation did not actually reach the people, as government was subsidizing electricity. Apparently it looked like that the per unit cost did not affect the consumers, but indirectly the subsidy put pressure on the budget and ultimately it caused budget deficit. However the little increase of PSDP in some social sector has had little impact on overall growth.

5.13.6. Subsidies

Actually the subsidies have a paradoxical impact on the economy. On the one hand the subsidies in the period of structural adjustment provide the safety net to the poor. When income distribution is unfair, the subsidies can be a source of cheaper services and items. The elimination of subsidies tend to increase the prices of fertilizers, pesticides, tube wells etc, which make the production cost high. But on the other side if the subsidy is not given by the government, consumers are badly affected. Though subsidies also give a false picture of the economy and government has to bear the fiscal deficit, but at the same time subsidizing is essential to save the people from higher cost of production. Politically and economically, subsidy is targeted to help the poor, small farmers but entrepreneurs are benefiting from the subsidies. But the political influence and financial institution’s role facilitated the bigger landlords. The real beneficiaries were the bigger landlords and public enterprises like WAPDA, PIA or Pakistan Steel Mill

\textsuperscript{1} Discussed by Mr. Marshuk Ali Shah, Private Sector Investment in the Energy Sector: Case of Pakistan, A paper presented by Country Director, Pakistan Resident Mission, Asian Development Bank, Karachi, Pakistan. February 07, 2002
which were running in losses. That is the reason that the subsidies ratio increased from 0.82 percent of GDP in 1980-81 to 1.49 in 1987-88. and it continued in coming years. The subsidies given to the public entrepreneur is the part of current subsidies. The subsidies given to the fertilizer industry, in the form of reduced prices of inputs, are the development subsidies. However subsidies on wheat, sugar and edible oil are the poverty related subsides as the expenditure on these items is estimated to constitute over a third of total household expenditure for the lowest income brackets.¹

5.1.3.7. Public Investment

Investment is the driving force for GDP growth. Growth in GDP will be low if investment is declining. The 1990s decade is characterized by privatization and deregulation policies that attracted private investment in the country and it was required under structural adjustment program for stabilizing the balance of payment problem in early 1990s:²

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Investment</th>
<th>Private Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987-88</td>
<td>8.5</td>
<td>7.4</td>
</tr>
<tr>
<td>1988-89</td>
<td>8.7</td>
<td>8.0</td>
</tr>
<tr>
<td>1992-93</td>
<td>9.0</td>
<td>10.0</td>
</tr>
<tr>
<td>1997-98</td>
<td>4.9</td>
<td>9.6</td>
</tr>
</tbody>
</table>

The above table shows the trends of investment in 1990s. From 1987-88 to 1995-96 public investment ratio as percentage of GDP remained almost the same. However, it only fluctuated from 8.7 to 8.1 percent. But after 1995-96 it suddenly dropped and fluctuated from 6.8 to 4.9 in 1998 while private investment increased from 7.4 in 1987-88 to 9.6 in 1997-98. It even touched 10 percent of GDP in 1992-93.

During 1996-97 the GDP growth was only 1.93 though the private investment in that period was to the maximum level. It was rather higher in 1987-88 when it touched the figure of 6.44 percent of GDP. The lower ratio of public investment as compared to private investment shows budget constraints in investment. Due to this constraint and

deficit problem the public sector investment started deteriorating and public sector industrial unit showed downward trend in production and other management affairs. It was the time when IMF and World Bank started pressing for privatization through structural adjustment, and they took the refuge apparently in the downwards trends in the functions of the public sector units.

Actually low saving rates as compared to investment was a principal factor for accumulation of debt burden. It also affected the public debt stock which doubled on average after every four years since 1980s. The declining rate in savings since 1980s led to lower investment rate as well it compelled Pakistan for more debt. Though private savings as compared to national savings increased in the last two decades, but since the government savings were normally in the minus, it offset benefits for the private savings in investment as well. The following chart will explain details of savings and investment ratio in Pakistan:

### Saving and Investment Rates (Selected Years - % of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment</th>
<th>National Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949-50</td>
<td>4.1</td>
<td>2.0</td>
</tr>
<tr>
<td>1959-60</td>
<td>12.5</td>
<td>6.5</td>
</tr>
<tr>
<td>1969-70</td>
<td>14.6</td>
<td>10.1</td>
</tr>
<tr>
<td>1980-81</td>
<td>17.3</td>
<td>13.9</td>
</tr>
<tr>
<td>1989-90</td>
<td>18.1</td>
<td>13.6</td>
</tr>
<tr>
<td>1995-96</td>
<td>19.0</td>
<td>11.8</td>
</tr>
<tr>
<td>1998-99</td>
<td>15.0</td>
<td>11.1</td>
</tr>
</tbody>
</table>

The World Development Report reveals higher government consumption as compared to private consumption ratio during the decade 1970-80 to 1980-92 and lower domestic investment during the same period if we look at annual growth rate of consumption and investment. The general government consumption in 1970-80 was 4.1 percent annually which grew to 8.4 percent annually and in ten years period the consumption was double. The private consumption was growing by 4.2 percent annually during 1970-80 and it remained up to 4.6 percent annually it meant it grew only 0.4 percent during 1990s. Similarly if we look at the figures of gross domestic investment we would find that it

---

was 3.7 percent growth annually during 1970-80 and it increased only up to 5.6 percent in 1980-90 hardly 2 percent improvement in ten years. This analysis shows that the government expenditure on non-development had been rigidly followed and failed to mobilize the revenues and investment during this decade.

5.13.8. Expenditure

The priorities of the government were also not rationalized. Since the 1970s not a single budget was presented where development expenditure was more than the non-development expenditure. It gradually increased to alarming proportions. If we start to analyze from 1975-76, the development Budget was Rs. 12.4 billion, while non-development Budget was Rs. 19.9 billion.\(^1\) There was a difference of Rs 7.5 billion, but in 1987-88 the development budget was Rs 46.7 billion, while the non-development budget was Rs.133.6 billion the difference was of Rs. 86.9 billion. While in 1997-98 the development-budget was Rs. 104.1 billion, and non-development was Rs. 529.9 billion the difference increased up to Rs.425.8 billion.

The major cause of the increase in non-development budget was due to the obvious factors which cannot even be discussed in parliament, but at the same time everybody knows where it was being spent. Of course in a country like Pakistan the security has priority over everything else. Generally it happens that the non-development budget erodes the spending on social sectors due to factors mentioned above. It affects social sector spending as we can see that in 1997-1998 the expenditure on education was 2.25 percent of GNP, less than 0.25 percent then the previous year 1996-97.\(^2\)

5.13.9. Flow of Remittances

Flow of remittances was also a source of better health of the economy. Remittances from overseas in 1980s played a very important role in improving the macro-economic condition in Pakistan. In fact 83.46 percent share of the total remittances were only form the Middle East in 1982-83 which amounted to $ US 2408.44 million

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\(^1\) 50 years of Pakistan, Federal Bureau of Statistics; Economic Survey Statistical Supplement 2001-02 and Economic Survey 2002-3
\(^2\) Economic Survey 1997-98 Government of Pakistan
whereas, the total remittances were US $2885.67 million.\(^1\) This was due to construction boom in the Middle East, which had fuelled the migration in the 1980s, but later on migration was slowed down in 1990s and fluctuated around $US 1.4 billion through the 1990s. Following figures show the trend of remittances during 1990s.

![Trends of Remittances](chart)

**Source:** *50 years of Pakistan, Federal Bureau of Statistics; Economic Survey Statistical Supplement 2001-02 and Economic Survey 2002-3*

The above figures explain the trend of remittances in the last decade compared with one financial year (1982-83) when the remittances in Pakistan remained very high and no such precedent in history is available of such high flow of remittances in Pakistan. The poor families benefited from this increase and as per study approximately the 11 percent of population got an 8 times average increase\(^2\). This income was source of improved foreign exchange and helped in the balance of payment problem. Foreign exchange reserves improved from US $431 million in 1977 to US $2,758 million. The income distribution improved and flow of remittances saved Pakistan from foreign debt burden to the some extent. However as shown in the figure above the remittances sharply fell from 1988 onward in 1990s due to challenges of globalization. The job opportunities to Pakistani labor force were reduced because it was mainly unskilled and could not bear the pressure of competitiveness. This ultimately affected foreign exchange reserves and the balance of payments. The foreign exchange reserves fell from US $2,758 million in 1983 to US$ 1,977 million in 1997.

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1. Ibid.
If we look at the balance of payment situation compared to early 1980s and during 1990s, the following graph will explain the difference.

![Balance of Payment trend in US $ Million](image)


The above figures explain that the negative trend of the balance of payment was much less i.e. US $ -517 million in 1982-83 and that was the time of highest flow of remittances. It became worst in 1995-96 and 1996-97 when balance of payment grew negatively to US $ -4575 million and -3845 million respectively. However somehow it got better in 1997-98 and that was due to foreign aid inflow for improvement in the balance of payment. This shows that the remittances played a significant role in the macro-economic conditions of Pakistan.

### 5.13.10. Per Capita Income and Income Distribution

Since the ultimate objective of economic development is to improve the living standard of the people, the growth indicators discussed above show their impact on the living standards of the people directly or indirectly. The per capita income is the direct indicator of the impact of all macro-economic policies. If we look at the real income, we will find the following figures.

![Per Capita Income Growth (%)](image)

The annual per capita income for two financial years 1986-87 and 1987-88, annually grew at 1.6 percent and 1.5 percent, while annually only in one financial year of 1990-91 per capita grew satisfactory i.e. by 4.0 percent as compared to the rest of the period of 1990s. The average growth rate of GNP for the first five years of 1990 was 1.5 percent whereas for next five years the growth remained at 0.5 percent, which is unsatisfactory as compared to the last decade. Even there has been negative trend in growth for the year 1992-93 and 1996-97 and while 1997-98, the growth rate was zero percent.

At household level the GDP growth and per capita has the impact on the percentage of income and resultantly income distribution and income inequality, which created the gap between the rich and poor. The pattern of income distribution is also measured by the ratio of highest 20 percent to lowest 20 percent of household income, which gives the picture of the income gap. The trends in income distribution is presented in the following table.

<table>
<thead>
<tr>
<th>Year</th>
<th>Lowest 20%</th>
<th>Middle 20%</th>
<th>Highest 20%</th>
<th>Ratio of highest 20% to lowest 20%</th>
<th>GDP Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>7.4</td>
<td>47.6</td>
<td>45.0</td>
<td>6.1</td>
<td>5.5</td>
</tr>
<tr>
<td>1987-88</td>
<td>8.0</td>
<td>45.3</td>
<td>43.7</td>
<td>5.5</td>
<td>6.4</td>
</tr>
<tr>
<td>1993-94</td>
<td>6.5</td>
<td>46.3</td>
<td>47.2</td>
<td>7.3</td>
<td>4.5</td>
</tr>
<tr>
<td>1999-99</td>
<td>6.0</td>
<td>44.1</td>
<td>49.7</td>
<td>8.0</td>
<td>4.2</td>
</tr>
</tbody>
</table>


Since economic growth was relatively better in 1980s, and it can be derived from the above table that the share of income of lowest 20 percent increased from 7.4 percent to 8.0 percent and percentage of middle 20 percent declined from 47.6 to 45 percent in 1988, however in the 1990s the percentage share of lowest 20 percent declined from 8.0 to 6.0 percent in 1999 and highest 20 percent increased from 5.5 to 8.0 percent. It shows that income gap declined in the 1980 and increased during 1997-98. This is the reflection
of income inequality that increased during this decade. On the one side the economic growth is complementary for the equitable economic distribution and on the other, equitable economic distribution is also a factor of economic growth. The foundations of this economic disparity are based on the fragile macro-economic policies, poor economic management and huge and persistent foreign debt and debt servicing.

The extent of poverty is also measured through different approaches based on the poverty line that is fixed officially in terms of Rupees and Calories. The following Head Count Index based on the Household income expenditure survey estimated the poverty ratio as under:

![Head Count Index]

*Source: Draft PRSP (Summarized Version) PRSP Secretariat, Ministry of Finance, Government of Pakistan, May 2003, P.5*

It can be inferred from the above index that poverty started increasing from 1992-93 onward to 1997-98 up to 32.1 percent. If we look at the calories requirement approach, adopted by Planning Commission of Pakistan, poverty line was Rs. 650 per capita per month¹, the poverty gap which was 3.6 percent in 1992-93 increased to 4.4 percent in 1993-94 and again it was reduced in 1996-97 to 3.5 percent. However it increased again with much higher gap that was 5.8 percent in 1998-99. This explains that the economic development slowed down in 1990s, poverty increased and gap between rich and poor increased as compared to 1980s.

The analysis above brings us to the conclusion that the momentum gained in the fight against poverty during the period of 1980s was lost during the sluggish economic development in 1990s.

5.14. Structural Adjustment - A reflection of bad governance

Views are mixed about the application of structural adjustment in Pakistan in different quarters. Akbar Zaidi questions the need of Structural Adjustment in Pakistan. The experience of the Latin American countries leads to the conclusion that the result of the structural adjustment has been negative. In the 1990s, the IMF and World Bank were following a neo-liberal agenda started by Americans neo-liberal economists and applied by the US government. Economist coined the expression ‘Washington Consensus’ to refer to a less than 10 policy areas in which decision makers worldwide accepted a neo-liberal agenda i.e fiscal discipline, public expenditure priority, tax reform, financial liberalization, comparative exchange rates, trade liberalization, foreign direct investment, privatization, deregulation and property rights.¹

It is not surprising to note that the agenda mentioned in the Washington Consensus is similar to the agenda which the IMF and World Bank had offered to underdeveloped countries for the program of structural adjustment and it has been discussed earlier in this chapter. It means that the World Bank and the IMF were following the neo-liberal policy of the American think tanks to protect the interest of the multi-nationals based in America and in Western Europe. One should also realize that the President of World Bank is always a United States citizen but some time they are also related to defense department. We can quote the example of Macnamara and Paul Wolfowitz.

According to other economists, the role of the IMF was not as bad as it was publicized but it is the handling of the program by the various governments in Pakistan, which gave the impression that it has badly affected our growth and could not control inflation and other related indicators. Ishrat says that the “policies of both Benazir Bhutto and Nawaz Sharif governments have been in the right directions. What has been missing

is the lack of consistency in the implementation and poor governance which have created a crisis of credibility...the ruling elite in countries like Pakistan are quite happy to receive the finances which accompany the IMF–Bank program but are most reluctant to implement the measures that come as part of these programs.¹

However, if we critically analyze the role of the IMF in guiding the economy of a country we will find that it snatches the choice from the local governments to choose on priority basis from wide-ranging options. By adopting the agenda of the structural adjustment, the economy lives in water-tight compartments where blame is thrown on the shoulder of the IMF and World Bank even if the program is implemented by the respective government functionaries.

In the previous history of economic management Pakistan was tuned to foreign aid packages for adjustment in budget deficit. After getting foreign aid to make up the budget deficit, the governments usually slept and did not wake up to materialize indigenous resources and used foreign aid as tranquilizers. It put the economy on ad-hocism and by doing this long term planning was ignored. Aid became a permanent feature of the economic management of the country.

In certain cases whenever a government wants to implement its program independent of what structural adjustment required for example in 1995-96, the budget was soft and not as strict as widely anticipated under the rules of the IMF. For example tariff was cut by only 5 percent and not 20 percent as, it was required. The IMF was not pleased and the fund was frozen and government had to come down to its knees to please the IMF and budget measures were revised accordingly.

Akbar Zaidi, is of the opinion that in whatever mess the Pakistan’s economy find itself it, is not due to the meddling and influence of the IMF, but largely of our own creation. In order to ensure their extended survival, governments do not touch controversial issues such as agriculture income tax and military spending. Instead they

¹ Ishrat (2004) pp. 159-160
rush to the IMF for financial assistance continuing to delay the day of reckoning... It is the government that is responsible for the state of Pakistan’s economy and it should be accountable to its people.\(^1\) The defenders of structural adjustment program in World Bank feel that it mostly depends upon the governments and how it implements the program. If we analyze various allocations in the government budget there are certain items which remain constant in devouring the major portion of the budget. It is clearly indicated in the allocation of the budget for defense. Despite various pressures from inside and outside, the defense budget remains a top priority of the governments.

Kemal has also concluded that debt crises emerge because the loans are not properly utilized vis-à-vis the donor agenda while corruption, capital flight and the adverse affect of loans from domestic savings further complicate the situation. Moreover, as part of the S.A. program Pakistan has significantly reduced the custom duties and it was major source of revenues and it has resulted in substantial fall in tax revenue. The direct taxes were reduced in the hope that it will stimulate the investment and production level, but due to a number of factors, the investment instead of rising, has fallen. Therefore, the entire program of adjustment for raising taxes and reduction of public expenditure failed. Not only the sales tax base has been enhanced, the sales tax rates have also been raised. The sales tax structure that was progressive has thus turned regressive.\(^2\)

5.14.1. The Element of Corruption:

Since 1996 the WB supported more then 600 anti-corruption program and governance initiative developed by member countries. The WB anti-corruption strategy has four components.\(^3\)

1. Preventing fraud and corruption with in Bank Financed Project
2. Helping countries that request the Bank’s support in the efforts to reduce corruption
3. Taking corruption more explicitly into account in the Country Assistance Strategy ,Country Landing

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\(^1\) Akbar Ziai (2001) p.329


\(^3\) Transparency International: the global coalition against corruption [online] www.transparency .or/global
Consideration, the Policy Dialogue, the choice and design of project
To help to move from systematic corruption to an environment of well performing government that
minimizes the corruption's negative effect on development.

Transparency International has tended to focus on corruption in the public sector
and define corruption as the abuse of public office for private gain. The CPI makes no
effort to reflect private sector fraud. The surveys used in compiling the CPI tend to ask
questions in line with the misuse of public power for private benefits, with a focus, for
example, on bribing of public officials, taking kickbacks in public procurement or
embezzling public funds, etc. Many experts on corruption seek to make further
distinctions within this broad definition, as they note both administrative corruption (e.g.
illicit payments to tax inspectors) and political corruption (e.g. bribes to politicians).

The Transparency International annually published corruption perception Index,
(CPI) which was first released in 1995. It is known as the best tool for knowing
corruption prevalent in a country. CPI ranks more then 150 countries, in terms of
perceived levels of corruption as determined by expert assessment and opinion surveys.

The CPI index as shown down reflect that Pakistan got 2.7 score as on a
benchmark score of 10.0 score. If we compare it with other regional countries we will
find that India got 2.9 score slightly better then Pakistan whereas Denmark got 10.0 score
reflecting the element of corruption as almost nil.\footnote{The rank relates solely to the results drawn from a number of surveys and reflects only the perceptions of business people that participated in these surveys. The column 1998 CPI Score relates to perceptions of the degree of which corruption is seen by business people--a perfect 10.00 would be a totally corruption-free country. Please note the hints on how to compare the two indices}

Actually the evidence of widespread corruption in several countries receiving
IMF assistance raises questions about the relationship between such assistance and
corruption and there are a number of reasons to believe that under certain conditions,
government-to-government assistance can actually promote corruption. According to
IMF the research suggests that the more pervasive is the public sector's role in the
economy, the more likely is corruption to flourish. Foreign assistance, however well-intentioned, can promote the very conditions fostering corruption. Such aid can strengthen existing public sector bureaucracy, result in larger government spending and a larger public sector (relative to the private sector), entrench corrupt status quo elite, and foster delay in reforming existing corruption.¹

World Bank has identified corruption as the single greatest obstacles to economic and social development. The International Monetary Fund (IMF) and the World Bank have announced that "organized corruption is the greatest obstacle preventing development and a high-level struggle should be launched against it."² In case of Pakistan, most of the government were dissolved by the Presidential Order in which the corruption were main allegation against the mal-practices of the previous governments.³ Mostly the element of corruption is found in government departments related to tax collection and law enforcing in the form of bribes, harassment, hassles, red tape and delays. The tax administration viewed this as severe constraint for allocation of revenue. Labor regulators are seen as petty and time-consuming rent seekers. However in the context of our present study we are concentrating on corrupting which is linked to International aid and lending policies, as corruption is in larger part an economic issue. It affects the competitiveness of the economy and the efficiency of development projects. Aid agencies may directly support anticorruption efforts, such as civil service reform and the budgetary and financial management systems as discussed above. Yet other types of reforms such as project designed to improve economic performance, may produce new forms of corruption. Mainly, Project selection, Project design, Procurement, Implementation: Financial management and Project evaluation are corruption prone areas.


³ Manzoor Ijaz 'A Primer on the Perils of Foreign Aid', Wall Street Journal, October 2, 1996.
Some of the factors which help corruption are bribery per se but it inflates contracting cost in the loss of equipments and other inputs. The officials related to certain projects show their interest in particular project that produce personal benefits for the politicians and profits for the firms. It has been also observed in the study that some projects with strong support from a country’s ruler were not supported because of the apprehensions of the corruption.

According to the Transparency International, corruption can negatively affect the selection of development projects. It may also encourage the selection of uneconomical projects because of opportunities for financial kickbacks and political patronage. Procurement system is also a sensitive area which promotes corruption. Tenders are accepted without proper mechanism of checking of the prices in the market. Things are bought at inflated rates and commissions are accepted not only by the local officials but by the aid giving agencies which sometime make this mandatory for a country that the things would also be supplied by the aid agencies on the higher cost. Corrupt practice at the implementation stage of development projects can be very costly and mostly the cause of cost and over all budget increased. Corruption of the projects also includes contract amendments, over billing and/or underpayment, the provision of equipment or goods of lower then specified quality, as well as outright theft of materials, equipment or services. Expenditure leakage refers to the corrupt diversion of allocated project funding. This often involves various actors in the funding distribution chain and can lead to significant reductions in aid levels received by end-users. In extreme cases, aid may only reach those willing and able to pay to receive it. Similarly corruption at the stage of project evaluation can be used as a means to distort the evaluation of development projects, thus ensuring the continued flow of development resources for potential diversion. Kick-backs can be given to persuade recipient government officials and/or aid agency staff to turn a blind eye to sluggishly implemented projects, unfulfilled contract requirements, undelivered aid and other instances of malpractice.

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If changes are made in the procurement system i.e. ‘integrity pact’ by the potential bidders, it can minimize the level of corruption. Transparency International has also recommended this practice and Ecuador has experimented with it successfully. This pact can also be supported by punitive action, if the supplies and works are not according to the specifications.

Based on research report by Professor Rose-Ackerman\(^1\) for the World Bank ‘Pakistan 2010 Report’ and other analysis\(^2\) it can be said that corruption in Pakistan is pervasive and entrenched. Cross-country surveys commonly rank Pakistan as worse than average in terms of its level of corruption and red tape\(^3\). Overall political risk is in the middle range, better than some nations in Africa and the Middle East but among the highest in Asia\(^4\).

Most of the indices issued by the Transparency International and other observers like World Bank and the IMF have highlighted corruption related to politicians and government. In Pakistan, most of the governments have been dissolved by the Presidential Order in which corruption was the main allegation. Since the inception of SA program in mid 80s the Government of Moeen Qureshi and Miraj Khalid, picked various cases of corruption in the bureaucracy and the members of the ruling class. As a consequence both WB and foreign agencies started tying their foreign aid to progress against corruption in recipient countries.

The American critics say that the developing countries waste resources through corruption. In this regard certain cases of corruption at the higher level are quoted, i.e. Prime Minister Benazir acquired a 355 acre, $ 4 million Palace in England known as Rockwood state. Her Husband was also associated in a deal to buy fighter planes involving unexplained $ 600 million overcharged. A formal Admiral of the navy was also

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involved in sub-marine deal with France\textsuperscript{1}. The other glaring example is the negotiations and deals between the Independent Power Producers (IPPs) and the government under the Power Sector restructuring program encouraged by the World Bank and IMF for enhancing the capacity of power production in Pakistan where contracts entailed provision for purchasing large quantity of electricity at very high price. There is a long history of such unfair contracts which western governments have used their muscle to enforce\textsuperscript{2}.

From the above discussion, one can conclude that aid allocations ought to take corruption into account. It has been observed during this study that corruption at macro-level can be indicated in various projects, but to go into the details of a specific or particular project the data availability seems to be absent. In such a situation it becomes very difficult to pinpoint the individual and correct amount of corruption in management of the projects execution through aid and foreign assistance. In Pakistan the politico-legal system is such that the governance indicators i.e. voice and accountability, government effectiveness, regulatory quality, rule of law, and corruption, among these, special emphasis is given to corruption; countries scoring below the median on this indicator would be ineligible for foreign assistance. These governance measurement parameters are not realized in those parameters which are applicable for the western countries, so some time the courts in Pakistan take years to prove a single case of corruption and in most of the cases the mechanism to substantiate allegations of the corruption is not effective.

5.15. The Dissenting Voices about structural adjustments

Most of the nationalist and left oriented economists associate anything coming from the IMF and World Bank with the policy dictated by the United States of America and as such it is not acceptable to them. Moreover, there were many bad examples where structural adjustment did not carry the desired positive results and it supported their opinion about its failure. But after 1980s and in 1990s there are certain examples of success stories in Africa and in Latin American countries. Those who support the success story think that foreign aid to developing countries has been criticized as wasteful and

\textsuperscript{1} Manzoor Ijaz (1996), 'A Primer on the Perils of Foreign Aid', \textit{Wall Street Journal}, October 2, 1996.
even counter productive. Careful examination of the recent experience shows, however, that it can be an effective investment when recipient economic policy are sound before aid is provided.¹

In Africa and Asia constantly good performance would be Botswana or Indonesia and poor performance would be Tanzania and Zambia before 1993. Bolivia and Ghana are considered to be success stories after 1993. We can also quote Bolivia, El Salvador, Honduras and Mali as good examples. We give below the success and failure stories of the some countries which accepted structural adjustment programs along with the mixed response on various economic indicators.

5.15.1. Ghana’s Case

Ghana received very little aid during the period it had poor policies. But donor’s support has been strong since it reformed. The case study of Ghana generally found that foreign financing and structural adjustment has helped in consolidating a good reform program. The Ghanaian case demonstrates that domestic socio-political dynamics may facilitate the purist view of adjustment and democratization. These dynamics revolved around the general receptivity to adjustment by critical societal groups and the strength of associational groups, the absence of viable alternatives and continued support by the international community for structural adjustment as observed by Kwame Boafo-Arthur²

In Ghanaian case, for instance the prior pursuit of adjustment under a dictatorial government as well as, post transition political dynamics go a long way towards explaining the continued pursuit of adjustment under democratic government. In order to uplift the economy, the IMF and World Bank economic recovery program was launched in 1983. The first phase of the program from 1983-86 was the stabilization phase. That is halting the decline especially in industrial and export commodity production sector. The second phase was 1987-89 of the structural adjustment and development phase that focused on development and growth with special emphasis on the social services. With

reference to the level of implementation and macro-economic out-turn as Gibbon states that adjustment in Ghana has been more successful.\(^1\) This is based on the fact that as a result of the implementation of structural adjustment, the economy witnessed appreciable macro-economic outrun. The GDP per capita increased about 2 percent between 1983-1987 and Coca production increased by about 1/3 between 1982-86, while domestic finance was controlled and revenues collection increased sharply. A World Bank report published in 1993 titled “Ghana; 2000 beyond”, also quote the positive impact of adjustment on the Ghanaian economy. Among other favorable comments is that Ghana’s adjustment program by any yardstick is one of the most successful. A decade of stabilizing policy has yielded it, among other results, a broad budget balances a strong and a reasonable external position.

Other studies also point out that inflation was drastically reduced. According to Kusi Newman, from high 122 percent in 1983, it was reduced to an average of 32 percent in 1990.\(^2\) The impact of structural adjustment on macro-economic indicators is reflected in the following chart.\(^3\)

**Macroeconomic indicators: Ghana 1978-1990**

<table>
<thead>
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</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>9.8</td>
<td>-1.7</td>
<td>0.6</td>
<td>-2.9</td>
<td>-2.5</td>
<td>-3.9</td>
<td>-2.0</td>
<td>-3.7</td>
<td>-2.2</td>
<td>-5.7</td>
<td>-8.4</td>
<td>-9.8</td>
<td>-10.8</td>
</tr>
<tr>
<td>Current Account Balance</td>
<td>-3.0</td>
<td>1.0</td>
<td>-1.2</td>
<td>-12.0</td>
<td>-4.8</td>
<td>-1.1</td>
<td>-2.7</td>
<td>-1</td>
<td>-3.5</td>
<td>-4.6</td>
<td>-5.1</td>
<td>-6.0</td>
<td>-8.2</td>
</tr>
<tr>
<td>Export of GNFS</td>
<td>8.4</td>
<td>11.2</td>
<td>8.5</td>
<td>4.8</td>
<td>3.3</td>
<td>6.1</td>
<td>7.4</td>
<td>9.6</td>
<td>19.2</td>
<td>20.6</td>
<td>18.4</td>
<td>16.9</td>
<td>15.4</td>
</tr>
<tr>
<td>Import of GNFS</td>
<td>9.7</td>
<td>11.2</td>
<td>9.2</td>
<td>5.3</td>
<td>3.0</td>
<td>9.3</td>
<td>7.7</td>
<td>11.7</td>
<td>22.5</td>
<td>23.6</td>
<td>24.3</td>
<td>24.5</td>
<td>24.0</td>
</tr>
<tr>
<td>Physical deficit</td>
<td>-9.0</td>
<td>-6.4</td>
<td>-4.2</td>
<td>-6.5</td>
<td>-5.6</td>
<td>-2.7</td>
<td>-1.8</td>
<td>-2.2</td>
<td>0.1</td>
<td>0.5</td>
<td>0.4</td>
<td>0.7</td>
<td>0.2</td>
</tr>
</tbody>
</table>

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\(^3\) Adopted from Jare Behman and T.N. Srinivasan, (Editors), Hand book of development Economics. N.H, Elsevier New York, 1995 p. 29
5.15.2. Different Countries- Negative Impact

The negative impact of the structural adjustment can be illustrated in the following countries between 1980s and 1990s as under:1

<table>
<thead>
<tr>
<th>Country</th>
<th>Per Capita Growth Rate%</th>
<th>Terms of Trade growth %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Niger</td>
<td>-2.3</td>
<td>-1.1</td>
</tr>
<tr>
<td>Zambia</td>
<td>-2.1</td>
<td>-2.6</td>
</tr>
<tr>
<td>Mali</td>
<td>-0.1</td>
<td>-0.6</td>
</tr>
<tr>
<td>Pakistan</td>
<td>2.7</td>
<td>-3.3</td>
</tr>
</tbody>
</table>

The above picture shows that in certain areas there was a mixed response of structural adjustment but mostly they gave a negative picture in per capita growth rate and terms of trade growth particularly the Niger, Zambia, Mali and Pakistan though it had the highest growth in adjustment loans but consistently ran large budget deficits that left it with major public debt crisis by the end 1990s.

This intensive adjustment lending group including some notable disasters, such as Zambia received 18 adjustment loans but had sharply negative growth, large current account and budget deficit, high inflation, high black market premium, massive real overvaluation and a negative real interest rate.

New Zealand- A mix Result

New Zealand is the classic case of the mix response of the implementation of the structural adjustment. Although New Zealand was not underdeveloped to the extent that structural adjustment was badly required, like some African, Latin American and Asian countries but still after adopting the program we can see that positive and negative effects in their overall impact as under:

Macroeconomic performance of the New Zealand 1983-19931

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The above results show a mix outcome of adjustment program. Adjustment period was long, and if we look at real GDP, it was nearly unchanged between 1984-1992. Growth rate of 3 percent in 1993 it was the result of 8 years of adjustment, while previously, in 1984, it was more then 8 percent. The adjustment policies in the early years did not have good impact on employment. Inflation rate remained high side. The monetary policy was tightened in 1987, the interest rate on loans increased, and the currency appreciated. The Growth slowed down and inflation touched the double digit. However, inflation came down rapidly after 1990 due to tight monetary policy. After the nine years of persistent reform, the New-Zealand economy has been transformed. The

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economy was deregulated through extensive privatization. However after 1993 the pace of reform has become slow again.

5.16. Lost Economic opportunities- Pakistan

In Pakistan’s case there were many factors, like fractured governments and wrong economic policies which led to the failure of the structural adjustment programs. Pakistan accepted the package of structural adjustment due to political expediency. All indicators related to growth of GDP and other factors show that Pakistan’s economy was doing well, at the time of accepting the verdict of IMF. It was the IMF which created the bogey of economic failure. Since the governments were changing rapidly during this period the economic pundits of the incumbent governments thought of balancing the trade deficit and budget deficit by asking for more loans from the IMF. Actually Pakistan never tried to develop the heavy industry or industry related capital goods which could create more work and trigger economic activity. So they have had to depend on imports related to this industry. Moreover the policy of the Western capitalist countries was also not in favor of developing heavy industry. They wanted to avail the opportunity for introducing multinationals for marketing their consumer goods. If we analyze the consumer items introduced by the West in large scale, we will find only beverages, food stuffs, biscuits, coca cola and chains of Pizza Huts and McDonalds etc.

In the later part of 1990s the foreign banks also introduced credit cards which were the main factor responsible for spreading consumerism in Pakistan. People went into a spree for buying cars, items of domestic like electronic appliances etc. It also affected the savings pattern, because in the absence of these comforts people used to save something for rainy days, but people, who were in the lower middle class, suddenly started taking loans.

There are certain economists like Akbar Zaidi who have discussed sudden emergence of the middle class in Pakistan, but there is no substantial basis for this claim. The birth of the middle class in Europe is related to industrial revolution. In Pakistan we
have not seen any industrial revolution, so the so-called middle class has developed out of illegal businesses related to smuggling, corruption and narcotics. In this way the middle class has not developed in the traditional European sense. The government policies also put heavy burden on the poor classes by promoting indirect taxes and taxes on poor increased during this period up to 10.3 percent and the richest group suffered only 4.3 percent effect.¹ Moreover, government withdrew the subsidies on sugar, wheat and edible oil. This withdrawing of the subsidy made the poor, poorer and finally ban on recruitment and freezing of wages worsened the job market. Pakistan’s youth did not know what to do. This had serious societal effects as the youth were driven to ideologically fundamentalist parties which promoted extremism in society.

**Evaluation of Structural Adjustment Program - Certain Handicaps.**

The evaluation of structural adjustment program is commonly made on the basis of the broader macro-economic indicators i.e. Gross Domestic Product (GDP), Investment rate, current account balance, ratio of debt and tax revenue collection etc. But so far no specific method has been evolved to judge the impact of implementation of structural adjustment program in a single country or a group of countries. Economists and the political scientists are working on it to find some method which can be applied scientifically on all the structural adjustment programs(SAP) initiated by the IMF and World Bank, but still there are two or three methods which are used by economists to evaluate the impact of the programs.

Firstly, the performance is examined two or three years after the initiation of the program but it is likely to reveal little about its eventual benefits. Rather it probably picks up mainly the short term avoidable and unavoidable costs of stabilization as mentioned by Corden.²

¹ *The daily Nation* March 7, 1995

The second element to consider in the evaluation are indicators like the rate of growth of GDP; the ratio of saving to GDP; the ratio of export to GDP; the inflation rate and the current account deficit relative to GDP. The last two indicators would show sustained stabilization.

The third factor is the known program determinants of performance. These are the external environment policy and the institutions in place during the program period. As in case of Pakistan we can very conveniently include the manner of governance i.e. inconsistency is of democratic rule or fractured democracies, judicial system and previous economic policies that were not commensurate with the demands of economic development. In other countries also the external factor would be more or less the same.

The World Bank\(^1\) has also adopted a method of evaluation, by using both cross-sectional data and country study. The cross-sectional work concluded that the 30 countries receiving adjustment lending before 1985 performed better on average by the end of 1987 then those not coming in the ambit of adjustment. When the method of World Bank is being discussed it should not be taken for granted that one is justifying this method. But it is mentioned simply to present the point of view of the World Bank in this regard. The WB usually applied two methods for evaluation i.e. before and after the aid and controlled group. They used 8 indicators for the studies, the GDP growth, the ratio of investment to GDP, the ratio of current balance to GDP, export growth, the ratio of the budget balance to GDP, the inflation rate, the ratio of external debt to exports, and the ratio of debt service to exports. The control group showed that the 30 countries which received adjustment lending performed better than 63 others that did not.

Finally even in the crisis ridden program the IMF did not come to rescue immediately because they had no standard criterion for evaluation or as Stiglitz says: “IMF’s structural adjustment policies the policy designed to help a country adjust to crisis as well as to more persistent imbalances led to hunger and riots in many countries;

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and even when results were not so dire, even they manage to eke out some growth. For a while often the benefits went disproportionately to the better-of, with those at the bottom some time facing even greater poverty. What astounded, however was that those policies were not questioned by many of the people in the IMF by those who were making the critical decision.¹

The results of structural adjustment presented by World Bank are questioned by many parallel economists who do not accept the conclusions of the capitalist-oriented system so easily. They emphasized that the structural adjustment programs, in various countries, totally closed their eyes towards social action program. As mentioned by Jennifer Bennett² in the case of Pakistan, during the SAP period of 1987-9991, the thin slice social expenditure was further trimmed, declining from 3.4 percent in 1987-88 to 2.8 percent in 1991. (For details A summary and time-frame for structural adjustment policies, 1988-1991 is attached as Annex-II)

As in case of Pakistan, some times it happened that while certain indicators mentioned in the conditionality of the Structural Adjustment did improve, but at the same time it played the negative role for other indicators, like prices of consumer goods, unemployment, investment and inflation. During the period of SAP in Pakistan the common realization among the lower classes was that the prices of consumer items along with real estate sky-rocketed, while these were not exhibited to that extent in the economic surveys of Government of Pakistan.

Since it has become a chapter of past history and no viable substitute has been proposed by any government one can just only comment, while evaluating the performance during the period, as it has been done in the present chapter.

This chapter relates to the period of SA program i.e. 1988-98 when Pakistan had become part of the agenda of neo-liberalism and succumbed to the economic policy of the IMF and WB. This period was economically the worst period of Pakistan economic

history as GDP went down, and loan sky rocked and along with unemployment incidence of poverty also increased sharply. The debt effected the Public sector development program, and there was coming and going of the Prime Minister, mainly due to corruption, nepotism and misuse of public money. In this chapter we have discussed the political regimes as well as their socio-political policies, which challenged the fiscal health of the country. We have observed, as manifested in different charts and figures that institutional and structural basis of the economy deteriorated.

We have traces the history of SA and conditionalities of IMF and WB through their programs and discussed that Structural Adjustment Program (SAP) i.e. trade liberalization, privatization, deregulations, tax enhancement etc was not just an instrument of economic reforms but it was structured to maneuver the political objective at International and National level through the elected regimes during this period in Pakistan. It has been manifested in the different figures and charts that during this period not only the investment as percentage of GDP declined but also public sector investment declined sharply due to budgetary constraints. The poverty was on the rise in this decade as the development expenditure as percentage of GDP decline compared to part decade spending. Similarly the government expenditure as compared to social spending also increased manifold. During SA period social expenditure was very low in the priority of public spending due to the conditionalities of the loan. The debt burden, debt servicing as well as fiscal deficit and corruption rose unprecedented in the history of Pakistan in the period. The development and growth achieved during the decades of 60s and 80s was lost in 1990s.
CONCLUSION/ FINDINGS

What has been discussed in the four chapters of this thesis is sufficient to prove that at the time of inception of Pakistan, the economic problems could not be resolved without foreign economic aid or assistance.

Pakistan, unlike India was without any industrial base or resources to meet the challenges of a newly independent country. The bureaucracy was not fully trained to work independently though, some of them had training under the British. It was a combination of feudal politicians and a group of ICSs officers who were assigned the task to run various ministries. Moreover, Quaid-i-Azam, Mohammad Jinnah was not keeping a good health and his constant supervision was also not available. So from the very beginning, the rulers of Pakistan were in search of foreign assistance to build the newly independent country.

As it has been discussed that there were two camps to follow i.e. either the Socialist or capitalist country. Opting for the capitalist camp was a Hobsonian choice so the tour of first Prime Minister, Liaquat Ali Khan to the United States, set the ball rolling to fall in the lap of the Western camp. It was for the first time that Pakistan asked for foreign aid which was not forthcoming immediately.

The overall survey of the economic development and the graph of loans and debt servicing indicate that Pakistan could not take off while solely depending on the single path of foreign aid mainly from the Western block. In early years the aid program was dominated by bilateral assistance. The United States contributed 80 percent of the aid inflows. Most of the aid came in form of grants that was 85 percent. Aid/grants were over 50 percent of total public sector development expenditure in the First Plan¹. The loans and the debt servicing continued to multiply but Pakistan could not enter into the group

of developed countries. Per capita income, the graph of poverty and human development indicators show that we are still bracketed in the category of poor countries.

The indicators that we have developed are based on the statistical data given in different issues of the Economic Surveys of Pakistan, show the trend of economy during the period of Structural Adjustment and the period previous to introduction of SA. (The macro-economic indicators show (the trend as summarized in the table Annexed-III)

Actually when we talk about 1990s we are focusing on SA period, the GDP growth during this period was lower than the previous years i.e. from 1960 onward. It was 6.77 in 1960s and 6.45 in 1980s which came down to 4.9 percent in 1990s. The fiscal deficit had also gone up i.e. from 2.1 percent in 1960s and 6.9 in 1990s. Same is the case of rate of inflation which rose to double digit in 1990s as compared to 3.83 in 1960s and 7.34 in 1980s. The total investment ratio also went down slightly in 1990s as compared to 1980s when it was US $18.07 and in 1990s it came down to US $18.03. Similarly the debt burden was US $ 19 billion in 1980s, which rose to US $ 30 billion in 1998/1999, which was a big jump. The rise of foreign debt and debt servicing also reflect in 1988/89. The payment of foreign debt as percentage of GDP was 2.0 while in 1998/99 it was 4.2 and similarly the debt servicing as percentage of GDP in 1988/89 was 7.2 which went up to 11.7 in 1998/99, which is a big jump

According to Omar Noman, aid has neglected key sectors of education, health and investments. Though they imposed many conditionalities but none have linked their lending to mandatory primary education. Later on by the late 1980s the views of many donors have changed in the face of obvious evidence of the consequences of earlier neglect of social investments. In the modern era it has been proved that investment in human capital is the key to development but least attention was paid to this sector till 1980s.

The SA period also cast its shadows on different key sector of development of social sectors. Accordingly the trend shows the shift in the priority of the budget allocation of the key social sectors as percentage of GDP. For instance, in education, in
the plan period of 1988/93 it was 7.3 percent of total amount of the plan while in 1993/96 it came down and three years figures tell us that it was reduced to only 1.3 percent. In health sector it came down from 3.8 to 0.7 percent.

The role of the IMF and World Bank has been crucial in the macro-economic development of Pakistan. If we look at the development under structural adjustment (SA) program, the IMF reports also support our argument of role played by structural adjustment in shaping the economic indicators, which are not very encouraging. The report on the achievement on selected macro-economic indicators and their performance particularly during SA period summarizes as under:¹

Pakistan failed in all of the areas associated with good governance since 1947, in general, and in 1990s in particular. The civilian government played havoc with the governance indicators. Week governance has been an important source of macro/economic difficulties in 1990s. It contributed to slowing Pakistan’s economic growth, reduced the effectiveness of public expenditure, weakened the overall macro/economic management, undermined investors confidence, encouraged tax evasion, loan defaults and non/payment of utility bills, and fostered corruption. Furthermore, key governance problems included poor fiscal performance, mismanagement of domestic and external debt, social exclusion of the poor, women and minorities from access to basic services, poor public sector performance, and ineffective inter/governmental relation between the federal government and the provinces, marginalization of local governments, and a loss of trust by the common citizenry in public institutions especially in the administration of justice and police.

It will not be out of place, here, to mention that political stability and economic sustainability were ever identity of Pakistan’s polity. From the beginning there were many ruptures and governments were toppled according to the wishes of the so called establishment and there was no continuity of a stable economic policy. It snow balled into a diabolic form till 1990. Many economists like the institutions of World Bank and IMF have pointed towards this sate of affairs. Dr. Ishrat Hussain also is of the same view, when he says “that the distinguished feature of the decade of 1990 was the worsening of the governance standards. In 1996 Pakistan was ranked the second most corrupt country by Transparency International. Governance indicators for 1997-98 in Kaufman et al study amply substantiate the poor governance record of Pakistan for this

period. Unfortunately the Social Action Program supported by multilateral and bilateral donors, which was supposed to improve, health, education, family planning, water supply and sanitation had also met the same fate. The civil service was politicized, all projects, misuse and misappropriation of public resources, wide-spread evasion of taxes, and theft of electricity and irrigation water were in vogue. Politically directed Bank loans which were never repaid, became norms by which the country was governed.¹

This observation of Ishrat Hussain supports our view on this point discussed in last chapter. The 1990s was economically the worst decade in the history of Pakistan, considering the economic and political indicators as the external debt jumped up to $ US30 billion from $ US 18 billion during this period. The economic policies were not according to the laid down principles of success and our governance was not complementary to the theories of economic development.

**Alternative Policy Recommendations**

Economists at various levels have discussed the possibility of having an alternate to the IMF and World Bank dependencies. So far they are groping in the dark. They have started on these lines in the middle of a stormy stream as the implementation on structural adjustment policies started almost 18 years ago. Those states which accepted the agenda of structural adjustment are still licking their wounds and that they have not been able to come out of the vicious economic circle. Despite, earnest wishes of shedding this load, still they have to knock at the door of IMF and World Bank time and again.

Though Akbar Zaidi, Parbhat Patanaik and Chandrashekar has proposed certain measures and alternate course of action, but those are too restrictive and only possibility of their implementation is in a state, where economy is centrally controlled and economic

managers have grip on the laws designed to make some progress towards this directions. They are also apprehensive about the restriction on flow of finance capital and positive balance of payment position. As it is feared that globalization of finance is such a strong process that direct regulations may prove ineffective and stemming illicit flows. Moreover they also feel that all such measures should be buttressed by a sound balance of payment position through a sound trade performance. We also agree with them that it all depends on socio-economic structure and the mode of governance of a particular country. But nobody can present a total success story of the countries which remained in the ambit of capitalist system or lived under tutelage of the western capitalist economic system. However one can find exception in the non-capitalist world before the dissolution of Soviet Union.

As explained earlier the IMF was designed to provide the United States with complete control over its intervention. Samir Amin¹ points out that “in its relation with third world the IMF did not pursue the objective of either preventing debt from excessive level or subsequently at reducing this debt. Its job is to manage the debt by imposing structural adjustment designed for this exclusive purpose (Servicing the Debt) even they are detrimental to economic growth”. We can add that even at the cost of social action program.

As you know under this program previously reduction of the deficit, cutting subsidies and financial sector reforms were focused. It did not produce any positive results as shown in our various analyses of the figures. But later on the program was extended to other areas of governance, democratic order, poverty alleviation and austerity. This process seemed to continue unabated with agreement in 1993 and 1997. Privatization, trade liberalization and financial sector reforms were the focal points for the loan agreements and they are continued pressing for such policies till even today. We were netted in the mounting debt servicing and consequently demanding for more loans and Pakistan was labeled as one of the classical example of debt trap when the challenge was how to repay the debt and keeping the economy going.

Servicing debt is given the priority over all situations because of the policies of the IMF. One can see the silver lining only in the transformation of IMF into genuine world central bank, that would promote adjustment of course, but adjustment for all as part of strategy for growth and development. But would G/7 countries allow it? It is a great question mark. It seems to be utopia in the present world scenario.

The other possibility is related to genuine use of loans provided under the agenda of structural adjustment. It is related to specification of the programs and serious monitoring of the use of money through ownership of borrowing country. But it differs from country to country according to the prevailing conditions. This requires the mode of governance, stability of democratic institution and strong institutional capacity for its implementation and assurance of transparent and accountable execution of the loans for projects.

But there are proposals on the other pole presented by the US network for global economic justice,¹ they have demanded immediate suspension of the policies and practices of the IMF and World Bank Group which have caused wide spread poverty, inequality and suffering among the world’s peoples and damaged to the world environment. They further demanded for the creation of neutral and credible “truth Commission” composed of the individuals with demonstrated commitment to poverty eradication and health of world ecosystem, to investigate the action and impacts of the IMF and World Bank policies. They have also demanded the cancellation of all claimed debt without imposing any form of external conditionality and immediately cease imposing economic measures known as structural adjustment or any other macro-economic reforms as conditions of loans, credits or debt relief along with poverty reduction strategy papers.

It reflects the point of view of parallel theoreticians who are critical of the agenda of the IMF and WB. According to them both of these institutions are towing the policy


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measures propounded by Washington Consensus and the multinationals of the Western world. It is very close to the point of view taken in this thesis that the apparent objective of the World Bank and IMF is not so transparent; it has its own hideous agenda which smacks of something wrong. So there is another proposal for opening up the meetings of IMF and WB, so that people can evaluate what is going on between the lines.

In case of Pakistan, the economic structure, institutions and factors supporting economic development, were in decay, the decade from 1988-1998 is considered to be a period where SA impacted negatively on governance and economy. If one has to see Pakistan as a model for the true implementation of structural adjustment programs there is nothing except disappointment due to a multiplicity of factors mainly of our own making. We could have done slightly better in other sectors beside balance of payment and poverty alleviation in the presence of stable government and good governance. But it proved otherwise. While the SA program entailed the changed relationship between the government and economy and polity. It was not a total withdrawal of the state so much as a change in the character of the association. It was also believed that a retreat of state and exposure of the economy to the discipline of the market economy would cut out arbitrariness of decision and allied mismanagement and corruption but instead, during the period of SA there was an increase in the level of corruption and arbitrariness at unprecedented levels.
## Summary and time-frame for structural adjustment policies, 1988-1991

<table>
<thead>
<tr>
<th>Policy area of</th>
<th>Year of strategies and measures</th>
<th>Timing measures</th>
<th>implementation</th>
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<tbody>
<tr>
<td><strong>FISCAL POLICY</strong>&lt;br&gt;Overall deficit</td>
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<tr>
<td><strong>Revenue</strong></td>
<td>Major improvements in overall revenue performance and tight control of expenditure growth. Begin to implement a tax reform directed expanding the tax base and at increasing tax elasticity; continue the strengthening of tax administration. Extension of sales tax on about 22 per cent of domestic industrial production. Extension of sales tax on 30 per cent of domestic Industrial Production. Increasing in telephone charges. Extension of ad valorem excise on certain services such as Travel. Annual revision in those excises which are specific rates so that there is revenue elasticity. Initiate a programme of action to prepare for the introduction of a general sales tax by 1 July 1990. Proceed with the implementation of the programme of the action. Effective implementation of the general sales tax. Guideline issued to income tax panels to set criteria for Initiating prosecution against tax evaders. Maintain income and profit tax exemption limits at current levels. Review experience of self-assessment procedure for taxpayers earning less than RS 100,000. Removal of most exemptions for the standard customs duties, except for duty drawbacks for exports and incentives for industries as given in the 1988/9 budget. It is the authorities' intention that these exemptions will not be extended beyond 1990/1, except for backward areas as defined in the 1988/9 budget. Continue implementation of tax reform.</td>
<td>1988/9-1990/1</td>
<td>By 1 July 1988 1989/90 1989/90/1 September 1988 1988/9-1989/90 1988/9-1990/1 1989/90-1990/1 1989/90/1 By 1 July 1989 1990/1 1989/90/1 By 31 October 1988 1989/90/1 By 1 July 1989 1990/1 1989/90/1 By 1 July 1989 1990/1</td>
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<tr>
<td><strong>Expenditure</strong></td>
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<tr>
<td><strong>MONETARY POLICY AND FINANCIAL REFORM</strong></td>
<td>Substantially reduce cash and economic subsidies through price adjustments; rationalize government expenditure for certain major commodities; implement tightened expenditure control procedure, including a quarterly expenditure reporting and control system. Tightening of control over provincial expenditure through containing federal transfers to and borrowing by provincial government within the agreed target. Continue to strengthen expenditure control procedures Regarding spending by ministries.</td>
<td>1988/9-1990/1</td>
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<td>1988/9-1990/1</td>
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<td>1988/9-1990/1</td>
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<tr>
<td>Action</td>
<td>Time Period</td>
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<td>Limits the rate of domestic credit expansion to significantly less</td>
<td>1988/9-1990/1</td>
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<td>Than the growth of nominal GDP at the target inflation rate in 1988/9</td>
<td>1990/1</td>
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<td>and to the growth of nominal GDP, at the targeted inflation rate, in</td>
<td>1988/9-1990/1</td>
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<td>1989/90-1990/1.</td>
<td>1990/1</td>
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<td>Continue to maintain global ceilings in the annual rate of expansion</td>
<td>1988/9-1990/1</td>
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<td>of domestic credit.</td>
<td>1990/1</td>
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<td>Eliminate mandatory margin requirement for opening import letters of</td>
<td>1989/9</td>
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<td>credit.</td>
<td>1990/1</td>
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<tr>
<td>Start to implement policy by rationalizing rate structure for the</td>
<td>1988/9-1990/1</td>
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<td>National Savings Schemes (NSS) and issuing auctioned debt</td>
<td>1990/1</td>
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<td>Instruments, beginning with pilot auction of Treasury Bills.</td>
<td>1989/90</td>
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<td>Establish appropriate public debt management organization in</td>
<td>1989/90</td>
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<tr>
<td>State Bank of Pakistan (SBP) and establish co-ordination</td>
<td>1988/9-1990/1</td>
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<td>Mechanism with Ministry of Finance (MOF).</td>
<td>1989/90</td>
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<tr>
<td>Maintain maximum ceiling of 20 per cent in rates of return</td>
<td>1988/9-1990/1</td>
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<td>(ROR) on non-investment financing by commercial banks.</td>
<td>1990/1</td>
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<td>Move towards market-oriented rates of return of concessional credit</td>
<td>1988/90</td>
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<td>schemes.</td>
<td>1989/10-1990/1</td>
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<td>With in the credit budget, the rate of mandatory allocations (</td>
<td>By November 1988</td>
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<td>to agriculture, fixed investment to industry, small businesses and</td>
<td>1989/90</td>
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<td>industries, and Tobacco marketing, excluding special credit</td>
<td>1989/9-1990/1</td>
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<td>Programmes from foreign lending institutions) to the allocation for</td>
<td>By November 1988</td>
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<td>private sector credit in respect of commercial banks will be limited</td>
<td>1989/90</td>
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<td>to the level in the level fixed in the excluding budget for 1988/9 in</td>
<td>1989/90</td>
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<td>a net basis, excluding special credit programme for foreign lending</td>
<td>1989/90</td>
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<td>institutions.</td>
<td>1988/90</td>
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<tr>
<td>Prepare a strategy statement and to programme to introduce open</td>
<td>1988/9</td>
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<td>market operations.</td>
<td>1989/90</td>
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<tr>
<td>Prepare a draft programme and a timetable aimed at reducing</td>
<td>1988/9-1990/1</td>
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<td>automatic SBP refinace for special lending programmes and</td>
<td>1989/90</td>
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<td>substituting it with other resources.</td>
<td>1990/1</td>
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<tr>
<td>Prepare improved prudential regulations for supervisions of banks and</td>
<td>By January 1989</td>
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<tr>
<td>other financial institutions, including improved procedures for</td>
<td>1989/90</td>
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<tr>
<td>accounting and auditing.</td>
<td>June 1989</td>
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<td>initiate legislation in order to unify supervision of financial</td>
<td>1988/9</td>
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<tr>
<td>institutions under SBP.</td>
<td>1990/1</td>
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<tr>
<td>Establish credit information bureau with in SBP.</td>
<td>By January 1989</td>
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<tr>
<td>Completion of comprehensive portfolio audit.</td>
<td>1989/90</td>
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<tr>
<td>Formulation of a programme for capital build-up.</td>
<td>1989/90</td>
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<tr>
<td>Sanction private investment banks which satisfy criteria of the</td>
<td>1988/9</td>
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<tr>
<td>Government of Pakistan.</td>
<td>1989/90</td>
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<tr>
<td>Initiate legal amendments and prepare implementation circulars with</td>
<td>1988/9</td>
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<td>regard to performance evaluation and restructuring of Pakistan</td>
<td>1889/9</td>
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<tr>
<td>Banking Council and NCBs.</td>
<td>1988/9</td>
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<tr>
<td>Eliminate official setting of share prices.</td>
<td>1889/9</td>
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<tr>
<td>Prepare measures to strengthen supervisory role of Corporate Law</td>
<td>1889/9</td>
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<tr>
<td>Authority (CLA) over stock exchange to increase public confidence.</td>
<td>1889/90</td>
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<tr>
<td>CATEGORY</td>
<td>DESCRIPTION</td>
<td>TIMEFRAME</td>
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<tr>
<td>Change Stem</td>
<td>Continue pursuit of a flexible policy consistent with maintaining External competitiveness and facilitating trade liberalization. Policy to be guided by quantitative assessment of specified indicator, including growth in export receipt and net international reserves. Take measures to narrow the premium between the market price of Foreign Exchange Bearer Certificates and the official exchange rate by increasing allowances for invisible transactions unifying related procedures. Continue to implement flexible market rates for forward cover, with exchange rates premium that distinguishes between different currencies; annual review to ensure flexibility is maintained. Accelerate phasing out of existing agreements with Fund Members in order to terminate bilateral agreement during Programme period.</td>
<td>1988/9-1990/1</td>
<td>Phasing down during 1988/9. Modify arrangements for China, Hungary, Poland, and Islamic Republic of Iran by July 1990 with a view to achieving convertibility of foreign exchange balance at the end of specified period.</td>
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<tr>
<td>Internal Debt Management</td>
<td>Limit contracting of loans of 1-12 years and 1-5 years' maturity. Limit public and publicly guaranteed debt of 1 year or less, including debt of domestic banking system. Computerize the collection of information on public and publicly guaranteed debt by Economic Affairs Division (Ministry of Finance and Economic Affairs) and private debt by the State Bank of Pakistan. Greater co-ordination between agencies collecting debt data to facilitate analysis and policy formulation.</td>
<td>1988/9-1990/1</td>
<td>Debt information data on computer by 1 July 1989</td>
</tr>
<tr>
<td>Agriculture Investment</td>
<td>Assure adequate funding for a three-year core investment programme covering high-priority projects in agriculture/irrigation. Complete study of water sector to refine investment priorities and improve sectoral planning capability. Implementation of this programme</td>
<td>1989/90-1990/1</td>
<td>September 1989</td>
</tr>
<tr>
<td>Agricultural Output Prices</td>
<td>Review and adjust prices annually for key crops to keep these prices in line with trends and levels in world prices and exchange rate changes. Implementation of annually agreed work programme for APCOM, including training and technical assistance requirements. Complete study of the cost structure of RECP to provide basis for recommendations for efficiency improvements.</td>
<td>1988/9-1990/1</td>
<td>1989/90 (at beginning of each crop year) 1988/9-1990/1 (by 1 October of each fiscal year) By end - February 1989</td>
</tr>
<tr>
<td>Industry and Trade</td>
<td>Assure that the economic subsidy for nitrogenous fertilizer will not reappear.</td>
<td>1 July 1998</td>
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<td>Implement an agreed schedule of reductions of economic subsidies, with a view to eliminating the subsidy for phosphatic fertilizers by 1 October 1991 and the subsidy for potash fertilizer by 1995.</td>
<td>1988/9/1990/1 (price adjustment by 1 July or in the course of each fiscal year)</td>
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<tr>
<td>Irrigation</td>
<td>Annually identify and establish a programme of optimum O&amp;M allocations for various types of irrigation facility.</td>
<td>1988/9/1990/1 (price adjustment by 1 July or in the course of each fiscal year)</td>
<td></td>
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<tr>
<td>Operations and Maintenance</td>
<td>Improve assessment and collection of water charges, on the basis of the implementation plan.</td>
<td>1988/9-1990/1</td>
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<td></td>
<td>Begin phasing out of all public tube wells in fresh groundwater areas, except Such Rohi and Ghotki, and refrain from installing or replacing public tube wells for public operators in these areas.</td>
<td>1988/9-1990/1</td>
<td></td>
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<tr>
<td>Industry and Trade</td>
<td>Complete the implementation of the remaining recommendations of the Deregulation Commission.</td>
<td>By 1 July 1989</td>
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<tr>
<td>Deregulation</td>
<td>Government will not expand the list of specified industries.</td>
<td>1988/9-1990/1</td>
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<td></td>
<td>Annual inflation adjustments to the investment sanctioning limit of Rs. 700 million as of 1 July 1988</td>
<td>1988/9-1990/1</td>
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<tr>
<td>Public enterprises</td>
<td>Diversification of public enterprises. Develop corporate rationalization/restructuring programme for the remaining enterprises. Meanwhile, continue application of 'signalling system', institute complete autonomy and accountability, and introduce medium-term corporate planning.</td>
<td>1988/9-1990/1</td>
<td></td>
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<tr>
<td>Import policy</td>
<td>Replace non-tariff barriers (except for well - specified reasons such as religion, and security, reciprocity, and international agreements) by tariffs; and rationalize the tariff structure with a view to reducing the average level and dispersion of the rates. Lowering of the maximum tariff rate from 150 per cent to 125 per cent, and rationalization of the tariff rate structure.</td>
<td>1988/9-1990/1</td>
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<td></td>
<td>Removal of 162 categories of items (of the 1987/8 IPO basis) from the negative list thereby reducing the number of banned items to 216, 55 categories of items (on the 1987/8 IPO basis from the restricted lists, and elimination of the list of items importable by specific industries.</td>
<td>1988/9-1990/1</td>
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<td>20 per cent increase in value ceiling on imports of machinery and millwork against cash licenses, and the doubling of the ceiling imports by actual user to Rs10,000</td>
<td>1988/9-1990/1</td>
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<td>Imposition of customs duty on items (i.e. air conditioners and refrigerators) covered under Transfer of Residence Allowances</td>
<td>1988/9-1990/1</td>
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<td></td>
<td>Further rationalization of the tariff structure.</td>
<td>1988/9-1990/1</td>
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<td></td>
<td>Further removal of approximately 70 categories of items from the negative list (on the 1987/88 IPO basis) and further reduction in the rationalization of the restricted list.</td>
<td>1988/9-1990/1</td>
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<td><strong>ENERGY Investment and Institutional Work</strong></td>
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<td><strong>In the context of the seventh Plan, formulation and implementation of medium-term energy investment programme based on least-cost principals.</strong></td>
<td>1 July 1988</td>
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<td><strong>Continued reliance on core investment program and sporting financing arrangements to assure appropriate levels of investment.</strong></td>
<td>1988/9-1990/1</td>
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<td><strong>Implementation of programme to separate WAPDA’s distributions functions from its generations and transmissions functions.</strong></td>
<td>1990/1</td>
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<tr>
<td><strong>Agreement on framework for allowing private generation of power and sales to the national grid.</strong></td>
<td>1 July 1988</td>
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<td><strong>Implementation of this programme.</strong></td>
<td>1988/9-1990/1</td>
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<tr>
<th><strong>Pricing, Resource Mobilization, and Demand Management</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annually adjust power tariff as required to achieve 40 per cent self-financing of agreed WAPDA investment programme. Investment programme in for determining self-financing requirements has been changed for a retrospective to a Prospective basis.</strong></td>
<td>1988/9-1990/1 (adjustment at the beginning of each fiscal year)</td>
</tr>
<tr>
<td><strong>Completion of load research and management study and implementation of main recommendation of the study.</strong></td>
<td>By 1 July 1989</td>
</tr>
<tr>
<td><strong>Shift away from cost-plus formula to increase to incentive for efficiency and to encourage new private sector investment in the refinery sub-sector.</strong></td>
<td>1986/9-1990/1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Petroleum</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Press through to consumers increase in the cost of domestic and important petroleum above the average level assumed for the budget for as well as effects of the depreciation of rupee. Review domestic product prices in international oil prices should decline.</strong></td>
<td>1988/9-1990/1 (by 1 July or in the course of each fiscal year, as required).</td>
</tr>
<tr>
<td>Gas consumer Prices.</td>
<td>Annually adjust the prices for gas supplied to domestic House hand consumer, with a view to reaching 100 per cent of the border prices of fuel oil by 1992/3.</td>
</tr>
<tr>
<td>Resource departmental</td>
<td>Implement agreed gas producer pricing formula and discount for new concessions as necessary if low world prices inhabit exploration and development.</td>
</tr>
<tr>
<td>PUBLIC SECTOR INVESTMENT PROGRAMM</td>
<td>Review of annual public expenditure programme.</td>
</tr>
<tr>
<td></td>
<td>Implementation of annual public expenditure programme in line with available resource and with Seventh Pan objectives.</td>
</tr>
<tr>
<td>INFRA-STRUCTURE</td>
<td>Formulation and implementation of annual priority investment programme to ensure inappropriate levels of investment, in the Context of the Seventh Plan. Adjust water and sewerage tariff annually.</td>
</tr>
<tr>
<td>Urban Infrastructure</td>
<td>Implementation of the improved system in Lahore. Training of local Government staff and introduction of monitoring system as well as accounting services through training of staff and provision of technical assistance to augment local administration.</td>
</tr>
<tr>
<td>Transporations</td>
<td>In the context of Seventh Plan, implantation of a public expenditure programme for transport sector. Begin implantation of an investment programe for modernization of container falsities, with an improving efficiency of freight handling and movements.</td>
</tr>
<tr>
<td></td>
<td>Start implementation of a programme for restructuring Pakistan Railways. Amend rules/regulations to permit resident companies to engage in international freight facilities. Deregulate bus fares; permit import of range of truck types and size. Improve balance between new investment, maintenance and rehabilitation; introduction modern planning and construction methods.</td>
</tr>
<tr>
<td>International Changes</td>
<td>1988/9-1990/1</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------------------</td>
<td>---------------</td>
</tr>
<tr>
<td>plans for improvements.</td>
<td></td>
</tr>
<tr>
<td>Phased expansion of network.</td>
<td></td>
</tr>
<tr>
<td>Complete review of current organization and management</td>
<td></td>
</tr>
<tr>
<td>Procedures and develop strategy for private sector participation.</td>
<td></td>
</tr>
<tr>
<td>Begin to implement recommendations.</td>
<td></td>
</tr>
<tr>
<td>Continue implementation of recommendations.</td>
<td></td>
</tr>
</tbody>
</table>

1 Information on the year of implementation has been obtained from various issues of Pakistan Economic Surveys and Annual Report of the State Bank of Pakistan.

**Appendix – II (b)**


<table>
<thead>
<tr>
<th>Fiscal Policy</th>
<th>Overall deficit Revenues</th>
<th>Direct Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Prudent demand management, higher budgetary revenues and expenditure curtailment. Reform of direct taxation will focus on reducing the wide-ranging exemptions and concessions. Extend coverage to the agriculture sector, through the imposition of the wealth tax; and provincial income taxation. Containment of the basic personal exemption and provisions concerning employee benefits. Unification of the corporate profit tax. Reduction of the tax-holiday provisions.</td>
<td></td>
</tr>
<tr>
<td>Tariffs</td>
<td>Transforming the current mechanism of taxation on supplies, contracts, imports and exports from final discharge of the tax liability into an advance payment of the regular income tax. Trade taxes will continue to be rationalized through (1) adoption of a simplified structure based on a maximum of 4-5 bands with products allocated according to efficiency. Consideration (2) a simultaneous reduction in the value of imports subject to exemptions and concessions, and (3) a consolidation of the various imports taxation elements through their incorporation in the basic rates. Lower than maximum tariff rate to 80 percent excluding iqra surcharge and imports licence fee.</td>
<td></td>
</tr>
<tr>
<td>Indirect taxes</td>
<td>Removing exemption from iqra surcharge. Elimination of exports taxes. Initiate an import inspection programme to strengthen revenue performance. Converting GST in to a broadly based VAT, through a significant expansion in the number of registered firms, and extension of horizontal and vertical coverage. To this end, the number of items subject to GTS.</td>
<td></td>
</tr>
<tr>
<td>Federal non-tax revenue.</td>
<td>All specific rates and assessment based on official prices and the lower rates of manufactures that do not claim tax credit will be eliminated. Extension of GST to trading and services sector by July 1995. Administered prices of petroleum, gas and electricity will be targeted to improve non-tax revenues.</td>
<td></td>
</tr>
<tr>
<td>Provincial non-tax revenue</td>
<td>Petroleum prices to be adjusted with international prices and exchange rate. Replacement of surcharge with ad Valorem excise and sales tax. Higher water-user charges. User charge on social services.</td>
<td></td>
</tr>
<tr>
<td>Expenditures</td>
<td>Redirect the structure of expenditure to ensure the effective delivery of key public services. Contain defence expenditure consistent with the security needs of country, i.e. to reduce it below the 1993/4 share of GDP. Reduce non-development expenditure to below the 1993/4 share of GDP. Fund operations and maintenance expenditure of roads, railways, irrigation and drainage, water supply and sanitation. Increasing provincial expenditure on social services including ensuring funds for full staffing of school and health facilities.</td>
<td></td>
</tr>
<tr>
<td>Federal current expenditure</td>
<td>Reducing overstaffing and administrative inefficiencies in the federal ministries. Increase in development expenditure on energy, irrigation and drainage, transport infrastructure and population at the federal level. Basic social services in the context of SAP will be emphasized at the provincial level. Continue formulating annually a ‘core’ investment programme composed of projects of high priority.</td>
<td></td>
</tr>
<tr>
<td>Development expenditure</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Reduce the share of block allocations in development expenditure in order to strengthen the investment.

**MONETARY POLICY AND FINANCIAL REFORMS.**

- Increasing reliance on instrument of monetary control.
- Reduction in the scope of mandatory concessional credit facilities.
  - Increasing concessional rates to 11% with full market levels by 1994/5.
  - Freeing rate return on deposits and loans on trade and investment related modes of Financing.
  - Adjusting the premia on foreign exchange cover.
  - Eliminating differential taxation of financial instruments and institutions.
- Widening and deepening the market for government debts.
- Market determination of yields of government auction.
- Enhancing institutional capabilities of SBP.
- Undertake liquidity programming.
- Strengthening prudential regulations.

**EXCHANGE AND TRADE REGULATIONS.**

- Eliminate the restricted list. Ensuring that the negative list covers only items subject to religious, security, health and reciprocity considerations.
- Consolidating and reducing, consistent with GATT obligations, the maximum rate, average rate and dispersion of imports duties, with corresponding adjustment in intermediate rates.
- Removing restrictions on the provision foreign exchange for certain invisible payments and machinery goods.
- Replacing non-tariff barriers by tariffs.
- Greater nominal rate stability in the context of tighter financial stability, leading to current account convertibility and higher inflow of foreign private investment.

**DEREGULATION AND PRIVATIZATION**

- Continue to deregulate investment and prices and encourage private investment.
- Progress further in privatizing industrial units and expending the process to new ears such as services and infrastructure.
- Expend privatization efforts to Pakistan Telecommunication Corporation (PTC) and water Power Development Authority (WAPDA) and establish regulatory framework for these Bodies.

**INVESTMENT POLICIES**

- Review the effectiveness of tax incentives granted to promote investment.
- Further simplify and clarify investment approval procedures and regulations, especially at the provincial and local level.

**POVERTY REDUCTION AND SOCIAL SERVICES**

- In the context of Social Action Plan (SAP), expend the coverage and equality of primary Education, primary health care, and rural water supply.
- Allocate at least 10 per cent of total recurrent education expenditures to education materials and other non-salary inputs.
- Increase school participation rate of females.
  - Permitting mixed primary education.
  - Construction of girl's schools.
  - Expending the recruitment of female teachers.
  - Providing better health care and mothers and children.
    - Decentralizing and strengthening management.
    - Reallocating recurrent budget expenditures towards non-salary items.
  - Controlling population growth rate.
    - Integration of family planning into basic health services.
    - Launching of a more explicit population information campaign.

**ENVIRONMENT**

- Programme and projects to tackle water logging and salinity and undertake reforestation.
- Further progress in improving regulations and standards for air, water, and waste, Contamination.
| **EXTERNAL FINANCING REQUIREMENTS** | **Source:** Applied Economics: (1994), Research Center, Economic Reforms and the environment in Pakistan, Karachi.

|**Agriculture**| Concentrate on water resource management, input and output pricing and agricultural Support services.
- Privatize public tube wells in groundwater areas.
- Move towards full cost recovering for on-farm irrigation works and drainage systems through higher user charges.
- Promote private sector participation in rice and cotton exports and wheat imports
- Eliminate subsidy on potash fertilizer by October 1995.
Increase the role of the private sector in the provision of the infrastructure through privatization of state-owned companies, e.g. WAPDA, PTC.
Fund operations and maintenance activities adequately.
Increase tariffs and fees charged for public services and improve assessment and collection procedures to achieve gradually full cost recovery.
Strengthen institutions and reduced their operating costs.
Restrain energy demand growth through demand management measures including pricing policies.
Accelerate the development of domestic energy resources as part of least-cost energy investment programme.
Strengthen the operation and management of the sector institutions, including building up their environmental managerial capability.
Accelerate the process of restructuring and privatization of the energy sector.
Rationalize energy prices. Petroleum to be priced at equivalent border prices.
Electricity and gas to be priced at their economic cost of production. Adjust gas tariff as appropriate.
Rehabilitate the transmission and distribution systems that contribute to power losses and load shedding.

| **Energy** | Encourage non-debt creating flows (foreign direct and portfolio investments) and improve the maturity profile of existing foreign liabilities.
Consider the possibility of placing a sovereign risk bond issue on the euro-market.
### MACRO-ECONOMIC INDICATORS AND TRENDS

<table>
<thead>
<tr>
<th>Selected Economic Indicators</th>
<th>1960s</th>
<th>1970s</th>
<th>1980s</th>
<th>1990s</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Growth</td>
<td>6.77</td>
<td>4.84</td>
<td>6.45</td>
<td>4.59</td>
<td>Negative</td>
</tr>
<tr>
<td>Fiscal Deficit</td>
<td>2.1</td>
<td>5.3</td>
<td>2.1</td>
<td>8.9</td>
<td>Negative</td>
</tr>
<tr>
<td>Inflation</td>
<td>3.83</td>
<td>12.33</td>
<td>7.34</td>
<td>10.39</td>
<td>Negative</td>
</tr>
<tr>
<td>Remittances (US $ Million)</td>
<td>136</td>
<td>1156.93</td>
<td>2885.67</td>
<td>1896.99</td>
<td>Negative</td>
</tr>
<tr>
<td>Total Investment (% of GDP)</td>
<td>13</td>
<td>17.1</td>
<td>18.07</td>
<td>18.03</td>
<td>Slightly negative</td>
</tr>
<tr>
<td><strong>Other Indicators (Selected Years)</strong></td>
<td>1972-73</td>
<td>1977-78</td>
<td>1982-63</td>
<td>1998-99</td>
<td>Trends</td>
</tr>
<tr>
<td>External Debt(without the debt servicing) US $ Billion</td>
<td>2 billion</td>
<td>6 Billion</td>
<td>11 billion</td>
<td>30 billion</td>
<td>Negative</td>
</tr>
<tr>
<td>Balance of payment US $ Million</td>
<td>+20</td>
<td>-1499</td>
<td>-3450</td>
<td>-2085</td>
<td>Positive</td>
</tr>
<tr>
<td>Foreign Exchange Reserves US $ Million</td>
<td>463</td>
<td>1010</td>
<td>1460</td>
<td>1737</td>
<td>Positive</td>
</tr>
<tr>
<td>Value of $ in Rupees</td>
<td></td>
<td></td>
<td>15.1(1984-85)</td>
<td>46.79</td>
<td></td>
</tr>
</tbody>
</table>

### Public Sector Expenditure under several five year plans (Rs. Billion)

<table>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Public Sector Expend in area under five year plan (Rs. Billion)</td>
<td>4.86</td>
<td>10.61</td>
<td>13.20</td>
<td>13.54</td>
<td>153.21</td>
<td>244.35</td>
<td>349.90</td>
<td>762.40</td>
<td>Upward in terms of Rupee allocation</td>
</tr>
</tbody>
</table>

### Public Sector Expenditure in key social sectors under five year plan (Rs. Billion)

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Education and Man Power</td>
<td>0.23</td>
<td>0.46</td>
<td>0.56</td>
<td>3.44</td>
<td>5.64</td>
<td>14.27</td>
<td>25.70</td>
<td>9.82</td>
<td>Upward in terms of Rs. Only</td>
</tr>
<tr>
<td>Health and nutrition</td>
<td>0.08</td>
<td>0.17</td>
<td>0.28</td>
<td>2.38</td>
<td>4.58</td>
<td>10.36</td>
<td>13.30</td>
<td>5.20</td>
<td>Upward</td>
</tr>
<tr>
<td>Population Welfare And Women Development</td>
<td>0.01</td>
<td>0.24</td>
<td>0.82</td>
<td>0.60</td>
<td>0.68</td>
<td>3.50</td>
<td>11.20</td>
<td>Upward</td>
<td>Upward</td>
</tr>
</tbody>
</table>
Public Sector Expenditure shifts in key social sector areas spending under the given period (% of plan period)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Education and Man Power</td>
<td>4.8</td>
<td>4.4</td>
<td>4.3</td>
<td>4.8</td>
<td>3.7</td>
<td>5.9</td>
<td>7.3</td>
<td>1.3*up to 1996</td>
<td>Negative in 1990s</td>
</tr>
<tr>
<td>Health and nutrition</td>
<td>1.6</td>
<td>1.6</td>
<td>2.1</td>
<td>3.1</td>
<td>3.0</td>
<td>4.3</td>
<td>3.3</td>
<td>0.7</td>
<td>Negative</td>
</tr>
<tr>
<td>Population Welfare And Women Development</td>
<td>-</td>
<td>0.2</td>
<td>1.1</td>
<td>1.1</td>
<td>0.4</td>
<td>1.0</td>
<td>1.0</td>
<td>1.5</td>
<td>Negative</td>
</tr>
</tbody>
</table>

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