South Asia as a Dynamic Partner

PAKISTAN

ECONOMIC SITUATION AND FUTURE PROSPECTS

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ISBN 969-461-061-7

General Foreword to the Series

This publication is part of a Joint Research and Policy Project, entitled "South Asia as a Dynamic Partner: Prospects for the Future", that brought together scholars and policy-makers from South Asian countries for a dialogue on economic development in South Asia through the 1990s. This project was sponsored by the International Center for Economic Growth (ICEG) and the Indian Council for Research on International Economic Relations (ICRIER) with research and coordination efforts from the East-West Center. These institutes are grateful to the Asian Development Bank and the United States Agency for International Development (AID) for their support for this project.

The core of this eighteen-month multi-country, multi-institute project is a two-part research effort. Seven institutes collaborated on this project to analyse how South Asia's recent growth has been affected by policy reform and how development prospects in the region are linked to further policy evolution as well as to increased regional integration and co-operation.[1]

One component of the project is research and publication of five country papers, such as this one, that describe the recent

[1]The participating institutes were Bureau of Economic Research, University of Dhaka, Bangladesh; Centre for Policy Research, India; School of International Studies, Jawaharlal Nehru University, India; Indian Council for Research on International Economic Relations (ICRIER), India; Kobe University, Japan; Institute for Integrated Development Studies, Nepal; Islamabad Council of World Affairs, Pakistan; Pakistan Institute of Development Economics, Pakistan; and Marga Institute, Sri Lanka.

economic history and prospects of each of the Major South Asian countries, with particular attention to past and present liberalisation efforts, obstacles, and results. Issue papers that complement the country papers are being edited for a book volume, addressing broader question of significance for the region. Topics include: (1) the macroeconomic dimensions of accelerating trade, output, and employment growth; (2) the role of multilateral development banks in stimulating growth and external linkages; (3) an analysis of Japan's potential role in South Asia's trade and investment; (4) regional co-operation, both within and beyond the South Asian Association for Regional Co-operation (SAARC); and (5) the political dimensions of growth and economic reform.

With the research element completed, the remaining task is to maximise the policy impact of the project. Most of the research work was done by and for South Asians, so that findings may help sustain the policy reform effort in the South Asian countries. The project's participants are reaching out to the private sector and local governments to encourage consolidation and extension of reforms so that the countries of South Asia can surmount obstacles to higher economic growth. A major conference was held in India to help disseminate the results of the research. And, in his letter to Dr K. B. Lall, the Prime Minister of India observed that the "winds of change are evident in each of our countries with thorough-going economic reforms opening up new vistas for accelerated development. Along with these changes, South Asia is also opening out to the global market and sooner rather later will become an integral part of this market". The conference, held on 25-27 May, 1992, in New Delhi, was attended by over 100 persons. The highlights of this conference were the opening remarks by Eduardo Faleiro, the Indian

Minister of State for External Affairs, followed by William R. Thompson, Vice President of the Asian Development Bank, who spoke of the challenges and opportunities for South Asia in the 1990s.

All of the papers presented at this meeting will be published. The full volume, containing all country and issue papers, will be available soon. The proceedings and summary of the Conference will be widely disseminated among academics and policy-makers within and outside the region. They will be available from: International Center for Economic Growth (ICEG), 243 Kearny Street, San Francisco, California, 94108, USA and Indian Council for Research on International Economic Relations, 40 Lodi Estate, New Delhi, India 110 003.

We (Project Coordinators) are grateful to the Pakistan Institute of Development Economics for undertaking publication of this Country Paper. This publication is expected to speed the process of liberalisation and strengthen dynamic co-operation. It is hoped that the participating Institutes will continue to co-operate with one another in stimulating economic growth and fostering mutual co-operation.

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General Director
International Center
for Economic Growth
San Francisco

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Preface

This paper was written for a specific research project entitled "South Asia as a Dynamic Partner – Prospects for the Future". The project was jointly initiated and directed by Mr K. B. Lall, Chairman, Indian Council for Research on International Economic Relations (ICRIER), New Delhi and Mr Seiji Naya, Research Associate, Institute for Economic Development and Policy, East-West Center, Honolulu.

The organisations which co-sponsored the project are: (i) Indian Council for Research on International Economic Relations, New Delhi, India, (ii) Institute for Economic Development and Policy, East-West Center, Honolulu, USA, and (iii) International Center for Economic Growth, San Francisco, USA.

To quote the initiators of the Project, "the purpose of this project is to bring together scholars and policy-makers from South Asian countries as well as selected participants from East and South-east Asia, Japan, and the United States for a dialogue on economic development in South Asia through the Nineties. The dialogue should include an analysis of how South Asia's recent growth has been affected by policy reform and how development prospects in the region are linked to further policy evolution, as well as to increased regional integration and co-operation. We expect a consensus to emerge, namely, that if the South Asian countries are to realise their potential for development in the context of economic resurgence in the Asia-Pacific region, they will have to play an expanded role in the international economy and adopt appropriate policy measures to this end."

The project was organised around five country papers examining growth prospects and policy reforms in the South Asian economies of Bangladesh, India, Nepal, Pakistan, and Sri Lanka.

In addition, about half a dozen issue papers were also commissioned on various subjects, e.g., regional trade, investment and economic co-operation, role of Japan in the development of countries of South Asia, role of external finance in the development of South Asia, etc.

The five country papers and all the issue papers presented by the authors were discussed in detail and refined in three seminars. The first seminar was held in Kuala Lumpur in the autumn of 1990; the second one was held at the East-West Center, Honolulu, in the summer of 1991; and the final seminar was held in New Delhi in the summer of 1992. The first two seminars were attended by the authors of the country papers and issue papers and the organisers. The third and the final seminar had a wider participation and was attended by policy-makers, corporate managers, and professionals, in addition to the paper-writers, organisers, economists, and development scholars from South Asia and other parts of the Asia-Pacific region.

A full-length volume on the proceedings of the entire conference will be jointly published by the organisers of the project, i.e., the Indian Council for Research on International Economic Relations (ICRIER), the East-West Center (EWC) and the International Center for Economic Growth (ICEG).

The following five participating institutes are publishing their country papers:

(i) Marga Institute, Colombo, Sri Lanka;

(ii) Indian Council for Research on International Economic Relations, New Delhi, India;

(iii) Pakistan Institute of Development Economics, Islamabad, Pakistan;

(iv) Bureau of Economic Research, Dhaka, Bangladesh; and

(v) Institute for Integrated Development Studies, Kathmandu, Nepal.

I take this opportunity to thank the initiators and directors of this research project, Mr K. B. Lall of ICRIER and Mr Seiji Naya of East-West Center. Their experience, guidance, and skill were of invaluable help in the preparation of the papers, in the conduct of the seminars, and in bringing this research project to a successful conclusion.

I would also like to thank the Pakistan Institute of Development Economics, Islamabad, and especially its Director, Professor Syed Nawab Haider Naqvi, whose encouragement and help in the preparation and publication of this paper deserves special mention. Thanks are also due to Dr Zafar Mahmood for his valuable comments on an earlier draft of the essay; and to Professor Aurangzeb A. Hashmi for his excellent editing of the typescript.

Finally, my gratitude to all persons who made the preparation and publication of this paper possible. The responsibility for any possible shortcomings in the final product, however, rests entirely with me.

EJAZ AHMAD NAIK

Islamabad, Pakistan
March, 1993

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Introduction

Pakistan is a unique country. Born with its two halves more than a thousand miles apart, it was the only modern nation of its size whose very identity was based on religion. The country experienced a massive and violent exchange of population with India. It began its national existence short of any manufacturing industries worth the name, and short of cadres of civil servants, technicians, bankers, entrepreneurs. There has been much trauma in the country's political history – three wars with India, three full-scale military coups, political instability, a bloody civil war resulting in the separation of Bangladesh and, since 1979, the influx of three million refugees from Afghanistan.

For all the apparent disadvantages regarding the country's development, Pakistan's economy has grown more rapidly than the economies of its South Asian neighbours. Moreover, compared with the parallel experiences of other low-income countries, there has been a fair continuity of growth through Pakistan's successive regimes. Following are the average annual percentage growth rates of real GDP (at factor cost) of Pakistan in the last three decades:

1960-70	6.8
1970-82	5.1
1982-88	6.5
1988-91	5.4

In spite of this commendable growth, however, there are some very serious anomalies and drawbacks in the country's economy. No Asian country with nearly its growth record has had its bleak record in the development of its social sectors, i.e., education, including literacy, health and population programmes, and the participation of women in the modernisation process.

At the same time, Pakistan has been a reluctant saver. For instance, in 1983, domestic savings in Pakistan equalled only 7 percent of the GDP, compared with 14 percent in Sri Lanka and 22 percent in India. Nor has the low level of internal savings been simply a reflection of ready access to external bilateral assistance; a limited ability to mobilise domestic savings has remained a nagging constraint on economic performance. Pakistan continues to be heavily dependent on the inflow of external resources that may not be sustainable in the long run. Its advance towards financial self-reliance has been, at best, halting.

Running through every aspect of the government's role in development is the need to improve the efficiency of public administration. Pakistan has been fortunate in having a competent civil service but there are signs that, during the past several years, its performance has deteriorated. In many cases, government programmes have failed to have the expected results because of administrative constraints or plain incompetence. Public sector enterprises have suffered from weak financial management and control, seriously undermining their performance and their contribution to development. To a great extent, this deterioration in the standards of competence of government servants was also responsible for the absence of a variety of development-promoting institutions in the country.

Last, but not the least, while the present non-availability of data does not permit a firm judgement about recent trends in income distribution, there would be no theoretical inconsistency in the finding that strong growth over the last 45 years has been coupled with significant inequality – but with a declining trend.

Government's record on equity as a conscious policy objective appears, at the very best, to be erratic.

Chapter I traces the development of Pakistan's economy from 1947 to 1977 and details the web of controls and regulations which characterised the economy. There was a fair amount of government involvement in economic development from the beginning, but the main impetus for growth during the 1950s, especially in industry, came from the private sector. Despite the setback following the end of the Korean boom in 1953, considerable potential existed for import substitution, especially in consumer goods, and the private sector responded enthusiastically to a package of high protective tariffs, reduced tax rates, and generous depreciation allowances. High rates of return were common for industrial investment, especially in textiles, with the result that domestic production of manufactured consumer goods, which stood at 22 percent of total supply in 1952, had risen to 92 percent by 1960.

Economic growth accelerated during the 1960s, with major advances taking place both in the industrial and agricultural sectors. The private sector, as before, was the main engine of growth. Rapid growth led to a substantial increase in real incomes and helped establish confidence in the country's future. Many Pakistanis and outside observers felt that the early problems faced by the country had been overcome, and that the basis for sustained expansion had been established. Unfortunately, this was not to prove the case.

The 1970s began with a crisis – the separation of East Pakistan (Bangladesh) in December, 1971. Added to this trauma were some of the major policy changes introduced by the then government which created serious problems of economic management without establishing a new pattern of growth. These major economic policies included a massive programme of nationalisation of all basic industries, banking, shipping, life insurance, and export trade of cotton and rice, etc. These policies undermined the confidence of the private sector, which had been the engine of growth in the 1950s and the 1960s, with the result that private investment in productive sectors dropped sharply. These policies may have fulfilled an important political purpose, following the separation of East Pakistan and war with India, but they did so at the expense of long-term economic stability and growth.

Chapter II covers the period from 1978 to 1988, during which the government took some tentative steps to liberalise the economy and denationalise some minor industries taken over by the government during the early seventies. In the early 1980s, the government began to move towards a more market-oriented economy. In the mid-1980s, some progress was made in liberalising investment and price regulation and in managing the exchange rate in a flexible manner. But slower progress was recorded in trade liberalisation and privatisation of public enterprises.

Though a start was made in the 1980s in the process of policy adjustment, it was clear by the end of the decade that still more effort was needed if the economy was to achieve sustained expansion. The main challenge was to reduce the budget deficit and the large trade deficit, and to cope with the continued need for large capital inflows from abroad, which implied an increasing debt burden. It was realised that among the issues that needed to be faced were those affecting rapid population growth, the farm level factors affecting productivity in agriculture, the structure and competitiveness of industry, the need to redirect social services expenditure, the high rate of illiteracy, the low elasticity of tax revenues, and the problems of public resource mobilisation.

Before the end of 1988, the deteriorating resource position caused a financial crisis. The budget deficit reached 8.5 percent of GDP and the current account deficit doubled to 4.3 percent of GNP. Inflation accelerated to over 9 percent. Foreign exchange reserves fell by half and were equal to only about 3 weeks of imports.

Reacting to this crisis in 1988, the Government of Pakistan entered into a growth-oriented adjustment programme designed to tackle macroeconomic imbalances as well as structural weaknesses of the economy in a medium-term context. This programme was supported by a stand-by arrangement and a Structural Adjustment Facility (SAF) of the IMF, and by the expanded World Bank Adjustment lending in the agriculture, energy, and financial sectors. According to the adjustment programme, viable levels of the fiscal and external current account deficits were to be achieved in four years, i.e., by the end of fiscal year 1991-92.

In Chapter III, which covers the period from 1988 to 1992, the need and the urgency to undertake medium-term reforms to rectify the fast-deteriorating fiscal situation are analysed and discussed. This chapter also gives the details of the medium-term reform programme undertaken by the government in collaboration with the International Monetary Fund and the World Bank.

The main shortcomings which the Structural Adjustment Programme was expected to correct were:

(i) A growing fiscal deficit financed by unsustainable levels of domestic and foreign borrowing;

(ii) an over-extended public sector involved in too many activities and draining fiscal resources;

(iii) poor progress in the social sectors or human resource development, particularly the issues of population control and women's development;

(iv) growing constraints of physical infrastructure (e.g., electricity, telecommunications, roads) and inadequate attention to environmental issues; and

(v) an economy which was over-regulated, was too closed and inward-oriented – with a narrow export base, which needed a more dynamic, internationally competitive industrial sector and a more efficient and sound financial sector.

The Government of Pakistan believes that despite such deep-seated problems that had accumulated over the years, it is possible to accelerate economic growth and put Pakistan on a new development path. It has, therefore, embarked on radical departures from the traditional policy posture by adopting an ambitious agenda of economic reforms which deepens, broadens, and accelerates the process of economic development.

The basic thrust of the new economic reforms is summarised as privatisation, deregulation, and unleashing the potential of the private sector by encouraging greater private savings and investment while maintaining a reasonable degree of macroeconomic stability. At the same time, renewed and determined efforts are to be made for human resource and physical infrastructure development. The public sector would be better able to concentrate in these areas with a gradual reduction in the scope of its development activities. The salient features of the economic reforms are:

(i) Privatisation of nationalised industrial units and banks;

(ii) opening of a number of areas which were hitherto the monopoly of the public sector, viz., power generation, shipping, airlines, banking, investment companies, highways construction etc;

(iii) relaxation and liberalisation of foreign investment;

(iv) relaxation of exchange and payments system;

(v) incentives for export promotion;

(vi) simplification of import regime;

(vii) dismantling of non-tariff barriers;

(viii) liberalisation of industrial policy;

(ix) rationalisation of fiscal and monetary policy; and

(x) development of human resources.

On 30th June, 1992, four years of this medium-term adjustment programme were completed. The implementation of the adjustment measures has so far been uneven. Significant progress has been made in the export sector in spite of the Gulf crisis. The rate of investment has increased and the stock exchange is buoyant. Budgetary deficit, inflation, monetary expansion, and adverse balance of payments, however, continue to be the areas of weakness.

Chapter IV details the long-term social and economic problems of Pakistan, while Chapter V visualises the future prospects of Pakistan's economy till the end of this century. Having completed the four years of the medium-term reforms programme, the government has now committed itself to a new three-year macroeconomic structural adjustment programme for the period 1991-92 to 1993-94. The government has realised that notwithstanding Pakistan's strong economic potential, good growth performance since Independence, as well as the strong policy reforms implemented since 1988, there are a number of key constraints that need to be overcome if per capita income and other development indicators are to continue to improve.

However, the challenge for the government is a difficult one. It is to strike a right balance between supply-side measures to stimulate the economy's growth performance, on the one hand, and restraint on demand to prevent overheating and to contain inflation, on the other. The growth impulses imparted by economic changes have to be accommodated within a framework of macroeconomic stability. This requires restraining the deficits in the budget and in the balance of payments. And while restraining these deficits, adequate resources must be found for the development expenditure necessary to sustain accelerated economic and social progress.

Chapter VI considers the possibilities of economic co-operation among the SAARC countries in the context of political conflicts in the regime. Regional co-operation among South Asian countries can flourish only if causes of friction and confrontation between India and its smaller neighbours are removed and peace prevails in the region. Tension between India and Pakistan is the main obstacle to restoring peace in the region and laying the foundation of regional economic co-operation. The SAARC has provided the framework of regional economic co-operation in South Asia but the progress made by this organisation has been very modest so far. This institutional framework has to be reinforced, because the countries in this region are rich in human and natural resources, which, if fully utilised to the mutual benefit of all member countries, can make this region one of the most dynamic economic forces in the world. It requires, however, a strong political commitment on the part of the governments concerned and a very pragmatic approach to overcome the political obstacles and achieve the goal of regional co-operation. Progress will be slow and halting, but it is a goal worth striving for.

CHAPTER I

Period of Controls, Regulations, and Nationalisation (1947-77)

(a) Early Years (1947-58)

It is necessary to recapitulate briefly the development of Pakistan's economy over the last forty-five years in order to understand its ups and downs and to analyse its strengths and weaknesses. This brief historical account of the economy of Pakistan will enable us to highlight various reforms undertaken by the government from time to time to overcome the economic problems of the country. It will also help us to analyse the impact of these reforms (their success or failure) and to determine what needs to be done in the coming decade to achieve a more rapid economic expansion and place the country's economy on a firm long-term footing.

Since 1947, per capita income in what is now Pakistan has risen from about $83 (1959-60) to $413 (1990-91), still leaving Pakistan as one of the poorest (low income) countries in the world. At its birth, Pakistan possessed a limited endowment of human skills and financial resources, and had severe problems of adjustment following the separation from India. It comprised two wings, East Pakistan and West Pakistan, which were separated by more than 1000 miles of Indian territory, and the economy was divorced from its natural markets and sources of supply. Jute production in the East and cotton in the West were cut off from traditional processing facilities, while the supply of many basic necessities was interrupted and an important market for the surplus wheat was lost. The irrigation system on which West Pakistan's agriculture depended was cut into two and Pakistan was left with virtually no industrial base and with severely limited economic and social services.

There was a fair amount of government involvement in the economic development process from the beginning, but the main impetus for growth, especially in industry, came from the private sector. Many Karachi-based industrialists and traders who migrated from India had brought substantial capital with them. This, together with profits made from the steep increase in cotton and jute prices during the Korean war, formed the basis for investment in a wide range of industries, especially textiles. Despite the setback following the end of the Korean war, considerable potential existed for import substitution, especially in consumer goods, and the private sector responded readily to a package of high protective tariffs, reduced tax rates and generous depreciation allowances. Because of an over-valued rupee, the effective protection for consumer goods was astronomically high though somewhat lower for intermediate and capital goods, so that very high rates of return were common. As a result, domestic production of consumer goods, which stood at 22 percent of the total supply in 1952, had risen to 92 percent by 1960.

The first economic development plan launched in the early 1950s addressed problems of social needs, regional development, and income distribution, but high tariff protection and import restrictions, combined with price controls on agricultural commodities, in practice emphasised growth and served as a mechanism for transferring real income from farmers and consumers to industrial entrepreneurs. The internal terms of trade moved against the farmers and the consumers, and although it helped the savings rate, the distribution of income deteriorated. The levels of savings and investment in the early years were understandably low. In 1950, total gross investment was only 5 percent of the GDP with public sector investment at about 1 percent of GDP. In line with an increase in the savings rate from 5 percent to 10 percent, the investment rate rose to 12 percent by the early 1960s.

The main policies pursued by the government in the early years were unfavourable to agriculture, reflecting the dominance of urban- and industrial-based interests. An annual foodgrain export surplus of Rs 14 million in 1952-54 was turned into a deficit of Rs 220 million by 1957-59 and the value-added in agriculture rose by only 1.3 percent per year. Although the value-added in industry rose by 8.1 percent per year, the GDP increased by only 2.5 percent per year; and since population increased at virtually the same rate, the per capita incomes failed to rise. Thus, while a faltering economy with a precarious outlook had been converted into one that was beginning to grow, and while some promise existed for more rapid growth in the future, there was little to show in terms of improved living standards for the mass of the people by the end of the 1950s.

(b) Years of Growth (1958-69)

Politically, the 1950s were characterised by personal, group, and regional rivalries, and the resulting instability led in 1958 to army intervention under President Ayub Khan. The 1962 constitution introduced a presidential form of government and a national assembly elected by an electoral college (Basic Democrats). Although the ban on political parties was lifted, restrictions remained to create what was called "a new political structure". The role of politicians limited thus, the bureaucracy was given a fairly free hand in acting on the lessons learnt during the 1950s. In brief, these were taken to be that:

1. An economic plan for the country must have the firm and constant support of the government for successful implementation;
2. implementation is impossible without an adequately organised administrative machinery with trained technicians and administrators;
3. too much direct interference in private sector initiative by a heavy-handed government, especially when facing an acute shortage of skilled staff, tends to be counter-productive;
4. the response to incentives encouraging manufacturing had been far beyond expectation; and
5. agricultural sector cannot be neglected for long without hurting production and leading to substantial food imports.

The Second (1960-65) and the Third (1965-70) Plans placed major emphasis on self-sufficiency in food-grains, improvements in the balance of payments, and an increase in per capita incomes. Overall, plan outlays showed clearly a greater concern for agriculture, with heavy investments being made in irrigation. Public sector participation in industry declined, and it was left to the private sector. A lower proportion of public funds were spent on infrastructure, which had improved greatly since 1947.

While a complex of economic policies and measures contributed to growth in the main production sectors, two aspects of the economic policies in the 1960s stand out.

(i) The introduction of the Export Bonus Scheme (a kind of selective devaluation) in the first half of the 60s, which encouraged industrial exports, once consumer imports had largely been replaced by domestic production.

(ii) The introduction of high-yielding varieties of wheat and rice towards the end of the decade, together with a rapid spread of private tubewells for irrigation. The increased availability of irrigation water with the increasing use of fertilisers significantly accelerated the growth in agriculture production. Government policies, particularly farm support prices, also contributed towards this end. Price controls were replaced by floor prices for agricultural products, restrictions on the movement of food-grains were lifted, fertiliser distribution was placed in private hands, and government intervention through price subsidies and lower export duties on cotton and jute alleviated to some extent the effects of an overvalued rupee on the farm income.

However, by the end of the decade, a number of problems began to emerge which indicated that growth was not as firmly established as had been hoped. Exports began to experience serious difficulties, suggesting that despite the Export Bonus Scheme, industry's ability to compete on world markets had been eroded by an overvalued rate of exchange. Associated with this was a marked slowdown in the rate of increase in private investment. Overall investment declined from 23 percent in 1964-65 to 15 percent of the GDP in 1967-70, compared to the Plan target of 20 percent. The mobilisation of domestic resources fell short of the requirement and the resource gap widened drastically towards the middle of the decade – a major factor leading to the shortfalls in public investment towards the late 1960s.

In retrospect, it is clear that the pattern of growth launched in the early 1960s was predicated on high and continuing inflow of foreign assistance, and that when these inflows were restricted in the period following the 1965 war with India, the government had no adequate response.

This pattern of growth also failed to address the issue of interregional and inter-personnel income distribution. Together with a growing resistance to the policy of "guided democracy" (Basic Democracies), the concern with the social and economic problems led to social and political unrest towards the end of the decade and set in motion the train of events that was ultimately to result in another war with India and in the separation of East Pakistan (Bangladesh) in December, 1971.

(c) Years of Massive Nationalisation (1972-77)

Following the chaotic conditions of 1970-71 and the separation of East Pakistan, a new government under Prime Minister Zulfiqar Ali Bhutto took power in December, 1971 in extremely adverse circumstances – not only economically but also because of a general loss of confidence and purpose. To cope with this very difficult situation and to restore confidence, the new government moved decisively and swiftly, with the aim of changing the "country's political and economic structure, and shaping a 'new Pakistan'." Early in 1972, thirty-one of the largest manufacturing firms (basic and heavy industries) were nationalised, followed by the vegetable ghee industry in 1973. Life insurance and most petroleum distribution companies were nationalised in 1972. Banks and shipping followed in 1974, as did the export trade of Pakistan's two principal export products, rice and cotton. The managing agency system – under which the production, pricing, and other decisions of major firms were co-ordinated, and which created new monopolies – was abolished in 1972. Reforms favourable to labour and to smaller farmers were introduced the same year. In 1973, administrative reforms ended the privileges of the elite civil service. In 1972, the Pakistan rupee was devaluated from Rs 4.76 to one US dollar to Rs 11.00 to one US dollar, and adjusted to Rs 9.90 to one US dollar in February 1973; and the Export Bonus Scheme was terminated.

The years 1971 and 1972 were marked by turmoil and the economy barely grew. Growth in the agricultural sector dropped below the population growth rate due partly to the unfavourable natural conditions, but mainly due to the problems created by government intervention in the supply of agricultural inputs.

Private industrial initiative was paralysed by the fear of – further nationalisation and by constant eroding profit margins in the industries left in private hands. Misled by the artificially high industrial profits of the 1960s and the short-lived export boom of 1972-73 (mainly due to the devaluation of the rupee and the increase in the prices of raw cotton and textile goods), the government assumed that industrial profits could be diverted into investment in new intermediate and capital goods industries in the public sector, and distributed more widely without affecting growth. A series of policy measures increased wages, established security of employment and new fringe benefits (e.g., pension rights for workers), increased the cost of capital, and strengthened the trade unions. The 1972 devaluation increased the costs of imported equipment, materials, and foreign loans, without providing adequate incentives to exports, since it was accompanied by the abolition of the Export Bonus Scheme. The incipient deterioration of the industrial sector inherited from the 1960s, therefore, accelerated; both in the private and public sectors, profits declined, equipment was worked beyond its economic lifetime, efficiency was impaired, and investment in traditional industries, especially in the textiles industry, fell to well below replacement rates.

The continued increase in total consumption contributed to a major decline in domestic savings, which dropped to a low of 4.2 percent of GDP in 1974-75 and averaged only 7.4 percent over the five-year period from 1971-72 to 1976-77. With a continued rapid increase in public investment, the resource gap widened dramatically and averaged nearly 10 percent of GDP during this period. Imports rose and exports declined. The current account deficit rose sharply, though the blow was greatly moderated by rising workers' remittances and massive inflow of concessionary assistance from abroad. Foreign debt outstanding on a disbursed basis stood at $ 3.6 billion by 1977-78, with much of this debt due to Middle Eastern countries on relatively short repayment periods.

Fixed investment fell from a peak of more than 23 percent of GDP in 1964-65 to only 12.4 percent in 1972-73. Subsequently, it rose to 20 percent in 1976-77 as a direct result of the sharp increase in public sector investment in order to safeguard future growth. However, the share of private investment, which had been over 50 percent in the 1960s, fell drastically to just over 30 percent for the period 1972 to 1977. The drop in the share of private investment was caused by the continuing threat of further nationalisation and by declining profit levels.

Public sector investment in industry was, by design, in capital-intensive intermediate and capital goods, and thus severely reduced the employment-creating impact of public investment. Infrastructure investment to expand capacity was chosen rather than improving the utilisation of the existing capacity. The same tendency to misallocate resources was in evidence in the social sectors. For instance, university education received a higher priority and obtained the lion's share of the education budget, as compared to the primary and secondary education. Large hospitals in big urban centres received undue priority over rural health centres. Population continued to grow at 3 percent per year, and no effective programme to control this increase was formulated or funded.

The hopes raised by the significant improvement in the performance of the economy during the 1950s and the 1960s were frustrated by the experience of the early seventies. The disturbed political situation in 1970, leading to the separation of East Pakistan in December 1971, caused a major set back to the economy. The reforms introduced by the government in 1972-77 added a major element of uncertainty in economic relations which could not be removed by subsequent assurances. Nationalisation of a significant part of the industry and of the entire financial system, including banking and life insurance, without adequate forethought and without much preparation, raised serious problems of public sector management. While problems of management were affecting the performance of large-scale basic industries, the nationalisation of agrarian industries (rice-husking mills and cotton ginneries) extended the effect of such policies to smaller industries dealing directly with the agriculture sector, whose performance was already affected by the indifferent implementation of land reforms, faulty government policies, and adverse climatic conditions in the mid-seventies.

During the seventies, the impact of a severe international economic crisis affected Pakistan in common with other non-oil-exporting countries; world inflation due to the rise in energy prices and subsequent emergence of recession, affecting the demand and prices of exports from developing countries, brought about a major adverse movement in the terms of trade of the developing countries. In Pakistan, the response to this international crisis was both inadequate and delayed – partly due to a rising inflow of workers' remittances and relatively easy availability of foreign aid on highly favourable terms, plus the fact that oil prices did not increase very much in Pakistan. Corrective measures requiring hard and unpopular decisions were either not taken, or taken too late, which magnified the problems and made the task of economic management in later years extremely difficult.

At the same time, investment commitments were made for major new projects which preempted flexibility in relation to investment programming. By 1977, the cumulative impact of persistent stagnation in the economy (mainly because of the faulty policies of the government between 1972-1977), combined with enlarged commitments for development projects, non-development expenditures and subsidies, deterioration in the balance-of-payments situation, and unhealthy monetary expansion, had created an economic impasse. In other words, during this period, Pakistan was living beyond its resources.

(d) Web of Controls

It would be worthwhile to recapitulate at this point the system of controls, regulations, and centralised planning which was built over the first thirty years of Pakistan's existence in order to understand how difficult it has been for the government to dismantle this system since 1977.

The creation of Pakistan followed immediately after the end of the Second World War. The war was a period of shortages and scarcity of essential supplies. The system of rationing of essential supplies (e.g., wheat and sugar, etc.) and of administered prices was inherited from the British days. Pakistan was not able to get rid of rationing of sugar till the late seventies, and of wheat till the early eighties; and is still living with some administered prices, e.g., cooking-oil, sugar, fertilisers, drugs and medicines, bus fares, airline fares, etc.

Some of the public utilities like post and telegraph, railways, urban water supplies, and power generation (partially) were already in the public sector at the time of Independence. Some were added later on during the course of 30 years, such as complete nationalisation of power generation and distribution, road transport, seeds and fertiliser distribution, etc.

The Government also inherited from the British days a strict system of foreign exchange control. Under this law, all foreign exchange earned by Pakistan either by export of services or merchandise was required to be surrendered to the government; there was complete restriction on the movement of foreign exchange in and out of the country. Foreign travel by Pakistanis was restricted and was allowed for some specific purposes such as business, education and training, medical treatment, etc. The rupee was linked to sterling at a fixed parity. Later on, the link between rupee and pound sterling was terminated, and a link between rupee and the US dollar was established, again at fixed parity. This link with the dollar continued (with occasional changes in the parity) till 1981, when the fixed-parity arrangement was changed and the value of the Pakistani rupee was fixed on a floating basis – but strictly managed by the State Bank of Pakistan.

Another legacy of the war controls was the restrictive import regime inherited by Pakistan. Under this arrangement, import of goods, commodities, and services was strictly regulated by the Ministry of Commerce. Certain commodities and goods were completely banned for import into the country, while others, which were importable, were subject to quantitative restrictions. The number of goods and commodities which could be imported without any quantitative restrictions was very small. Some goods and commodities could be imported by government-controlled corporations only.

The import regime in Pakistan has been gradually liberalised during the last twenty years or so. The first major step in this direction was taken in 1972, which was a necessary corollary of the massive devaluation of Pakistan rupee in the summer of that year. Subsequent liberalisation of the import regime, especially in the eighties, has been made by the government under pressure from the IMF *and* the World Bank.

In the field of industrialisation, government regulation was quite comprehensive. No industrial unit could be set up or expanded without government permission. (Small-scale industries were exempted.) Foreign participation and collaboration in the industrial projects had to get government approval. Even the location of a new industry needed approval of the government.

The principal government instrument in the management of the economy, however, came with the establishment of the Planning Commission at the federal level, and its gradual evolution over the years into a mini-government within the Government for centralised planning and management of the country's economy. The Planning Commission was established in the early fifties and was entrusted with the task of preparing short-term (annual) and medium-term (five-year) plans for the country. At the height of its influence, the Planning Commission had a finger in every economic pie.

The Planning Commission was not a legacy of the British days. The British Government of India had no centralised planning machinery at the federal level because they were not interested in the development of the Indian Subcontinent, except in terms of building the basic infrastructure such as roads, railways, irrigation systems, telecommunications, power generation on a small scale, postal system, basic education and health care institutions, etc. The agricultural trade was left to the private sector.

On the contrary, the plans prepared by the Planning Commission cover the entire economic field, i.e., for both the private and public sectors. The plans for the public sector are, of course, more elaborate and definitive while the plans for the private sector are more or less indicative.

The plans fix macroeconomic targets and targets for individual commodities and goods and services, and for social sectors for the coming five years – though these targets may be modified by the Planning Commission from year to year while preparing the Annual Development Plans. For instance, targets are fixed in the plan for GDP growth rates, overall rate of savings and investment, mobilisation of fiscal resources (both domestic and foreign) to finance the plan, employment opportunities to be created in the coming five years, rate of growth of exports and imports, flow of foreign aid, etc. Targets are also fixed for different sectors of the economy, i.e., agriculture, industry, electricity generation, mining, and services. Detailed targets are also set for all major items of production such as agriculture crops (wheat, rice, cotton, sugar, grain, fresh fruits, minor crops), and for the supply of inputs such as fertilisers, seeds, pesticides, and agricultural credit.

The Government's management and control of the country's economy reached its zenith in the first half of the seventies, when the then government undertook a massive programme of nationalisation. The government took over from the private-sector owners not only the basic industries (steel, cement, fertilisers, chemicals, etc.), beside Pakistani commercial banks, life insurance companies, shipping, export trade of cotton and rice, and rice-husking and cotton-ginning factories, but it also banned the private sector from participating in these activities.

CHAPTER II

Interregnum (1977-88)

In many ways, the year 1977 was a watershed in the economy of Pakistan. For thirty years an elaborate system of controls, regulations, and nationalisation of the economy had been pursued and developed. After July, 1977, the government undertook a gradual process of decontrol, deregulation, and denationalisation. During the 1980s, this process was slow and halting, but the government adhered to this policy and achieved some modest success.

Immediately after taking over in July, 1977, the new government headed by General Zia-ul-Haq embarked upon a process of policy adjustments to stabilise the economy. This process, which was in the nature of emergency steps, included budgetary measures to increase resources and control expenditures, a slow-down of the huge investment programme in the public sector, and a commission to review the performance of the public sector industrial enterprises. The government also provided a clear definition of the importance it attached to the private sector. The small agricultural processing industries were denationalised and the area of investment open to private investment was greatly extended. Concessional credit facilities, tax rebates, and other incentives were introduced to encourage exports. Considerable improvements were recorded in the labour situation. In agriculture, support prices were maintained at levels comparable to prevailing world prices and a concerted effort to improve input availability to the farmer was undertaken.

The above emergency measures achieved success in stabilising the economy to some extent, but it was obvious that considerable effort was still required and some important policy changes were necessary if the economy was to be stabilised on a long-term basis. Notwithstanding some improvements in output and exports and in the overall management of the economy, financial difficulties persisted. To a considerable extent, these difficulties reflected continuing pressures on resources, despite rapid recovery in output growth and the government's efforts to restrain public investment. The pressures failed to redress the imbalances between saving and investment and between imports and exports – imbalances which manifested themselves in sizeable balance-of-payments and budgetary deficits. It was, therefore, obvious that the adjustment process begun in 1977 had still far to go.

By the end of the eighties, it was clear that, despite sizeable growth in both agriculture and industry, Pakistan's economy needed a major structural transformation. This was so because the generally satisfactory economic performance of early eighties coincided with worsening macroeconomic balances, which inhibited continued strong performance of the economy.

CHAPTER III

The Period of Medium-term Structural Adjustment Programme (1988-92)

Despite rapid growth and some reforms (initiatives) introduced in the period 1978-88, Pakistan economy still retained a number of key structural weaknesses. These weaknesses included:

(i) Very low government savings with an excessive budget deficit, a narrow and inelastic revenue base overly dependent on trade taxes, high consumption expenditures, and inadequate development expenditures;

(ii) a fairly high debt servicing level;

(iii) an efficient financial sector with mostly public ownership, directed credit, segmented markets, and weak commercial banks;

(iv) a highly regulated economy with public ownership, industrial licencing, and price controls; and

(v) a non-competitive and distorting trade regime with import licencing, bans, and high tariffs.

Before the end of 1988, the deteriorating resource position caused a financial crisis. The budget deficit reached 8.5 percent of the GDP and the current account deficit doubled to 4.3 percent of the GDP. Inflation increased to over 9 percent.

Reserves fell by half from $886 to $438 million, equal to less than 3 weeks of imports.

Reacting to the crisis, the Government of Pakistan committed itself to reforms designed to restore the resources balances at sustainable levels over a period of 3 years (later increased to 4 years) and to improve the efficiency of the economy. The reforms (Medium-term Adjustment Programme) was supported by the IMF, the World Bank, the Asian Development Bank, and some bilateral donors.

The key targets of the programme were:

(i) To progressively reduce the overall budgetary deficit to under 5 percent of the GDP and the external account deficit to 2.5 percent of the GNP by the end of the adjustment period (1992), while increasing gross official foreign exchange reserves to more than 7 weeks of import levels which are sustainable over the medium term.

(ii) To reduce the rate of inflation to 6.5 percent by 1991-92 from its level of 10 percent in 1988-89.

(iii) To reduce the debt-export ratio from about 30 percent in 1987-88 to a sustainable level of 24 percent by 1991-92.

(iv) To contain the growth of domestic credit and money supply in line with the growth of nominal GDP at the targeted rate of inflation.

(v) To sustain real GDP growth at 5.2 percent in 1989-90 and 5.5 percent subsequently till the end of the adjustment period.

These objectives and targets of the Adjustment Programme were to be achieved by adopting the policies described below.

Fiscal Policy

The measures included a significant resource mobilisation effort aimed at increasing the elasticity of the tax structure through a phased broadening of the base and a major change in the administration of sales tax, which was to be replaced by a General Sales Tax by the end of the period. Better results were expected through a restructuring of the income tax system, removal of most of the exemptions from the standard customs duties, and a price increase for public utilities and other services – such as water rates for irrigation. The total government revenue to GDP ratio was expected to increase from about 18.0 percent in 1988-89 to 20.2 percent by 1991-92 – though in fact it increased to only 18.5 percent. On the expenditure side, government measures were aimed at reducing the growth of current expenditures and at lowering subsidies, while at the same time ensuring adequate growth in resources for public investment. With the full implementation of expenditure control and rationalisation measures, the ratio of government expenditure to GDP was expected to reduce from 26.1 percent in 1988-89 to 25.0 percent in 1991-92 – in fact it increased to 26.3 percent.

Foreign Trade and Industrial Policies

The first phase of the government's trade reform programme concentrated on replacing non-tariff barriers by tariffs, by reducing the number of banned commodity categories from about 400 to 80 by 1990-91, and by lowering the maximum tariff from 450 percent to 100 percent by the same year. Later, a marked reduction in the effective level of protection could follow.

The government intended to continue to manage the exchange rate flexibility, both to support the ongoing import liberalisation process and to foster export growth, especially that of non-traditional items.

In recognition of the need for reducing the policy-imposed controls or impediments to domestic mobility of resources, further industrial deregulation, especially simplification of investment approvals, was to be affected under the adjustment programme.

Financial Sector Policies

To reduce inflationary pressures and improve the balance-of-payments position, the government was to pursue domestic debt reduction policies while permitting adequate growth in bank credit to the private sector. With the reduction of fiscal deficits and the concurrent decline in borrowing needs, the government aimed at establishing market-based interest rates. This process was expected to begin with the auction of treasury bills in order to set a market bench-mark rate for a range of domestic debt instruments, thus helping to reduce segmentation in the financial market and improve the profitability of commercial banks by gradually relieving their burden as captive institutions for low-cost borrowing by the government. The reform process also aimed at improving the efficiency and profitability of the banking system, through improved and prudent regulation of the banks and the financial institutions, and through financial restructuring of the commercial banks and other managerial reforms.

Sectoral Policies

The sectoral investment strategy and the policy reforms were designed to improve the efficiency of resource allocation through adequate pricing of publically produced or administrated goods and services, restructuring of public enterprises, privatising public investments, and providing complementary current expenditure on operations and maintenance. To protect crucial public investments at times of severe financial constraints, the emphasis was on investment planning and project implementation that defined key ('core') investments in the context of sectoral/core investment programmes. Private sector participation in infrastructure investment in energy, transportation, and social sectors was to be actively encouraged.

Pricing Policies

These policies were related to appropriate adjustments in the prices of key crops in agriculture, improved assessment and collection of water rates, and phasing out of subsidies on some categories of fertilisers, as well as to power tariff adjustments to achieve 40 percent self-financing of WAPDA's investment programme. Natural gas consumer prices were to be gradually increased to reach parity with petroleum product substitutes. Modifications in producer pricing formula in petroleum and natural gas were to provide incentives to private sector participation in exploration and development. Annual adjustments of water and sewerage tariffs and improvement in local tax administration were to be carried out to enable local authorities to raise resources for meeting the increasing demand for urban services.

Timing, Sequencing, and Social Costs of the Internal Adjustment Programme

The medium-term Structural Adjustment Programme, which was the first comprehensive programme to bring about structural changes in the economy in the last forty years or so, was carefully timed and sequenced in general respects: in terms of minimising social costs for those groups that could least afford them; avoiding policy conflicts and reversals; and allowing sufficient time for needed adjustments so that major dislocations and widespread shutdowns were avoided.

In view of the current deterioration in some of the key economic indicators – such as budget and external current account deficits and inflation – the programme placed significant emphasis on macroeconomic adjustment early on, so that with improvement in external and internal balances, structural reforms could proceed without fear of policy reversals. Half of the targeted reduction in the budget deficit – about 4 percent of the GDP in 4 years – was to take place in the first two years of the programme. That is why both the revenue and expenditure control measures for the two years were very tight.

The Structural Adjustment Programme also made an effort to minimise the adverse impact of the profound fiscal measures on the poorest segments of the population. The poor were expected to benefit from the expansion of the essential public services, particularly education and health. Although the fiscal adjustment contained in the programme emphasised resource mobilisation, low-income groups were protected under the new income tax system and food items were initially exempted from the sales tax. Also, the trade policy reforms were not expected to cause any significant labour displacement, given that the existing tariffs were still high and supplemented by higher surcharges. Moreover, with real economic growth at 5.0 to 5.5 percent per year during the adjustment period, employment was not expected to be affected seriously.

To avoid policy conflicts and to ensure greater complementarity, different components of the adjustment programme were also carefully sequenced. Some demand management was essential to sustain the structural reforms contained in the programme, particularly those pertaining to the trade liberalisation and financial sector reforms. In this regard, domestic demand restraints effected through fiscal measures and the flexible exchange rate policy were expected to help contain the growth of imports, while import liberalisation proceeded through the replacement of non-tariff barriers with tariff protection. At the same time, as the budget deficit was reduced – thereby also reducing the government's borrowing requirement – it would be much easier to carry out the financial sector reforms. Further, the programme in domestic deregulation was to be instrumental in the realisation of allocative efficiency benefits expected from trade liberalisation.

The Structural Adjustment Programme also reflected a realistic coordination between domestic tax effort and tariff rationalisation measures. The strategy pursued here was to allow sufficient time for achieving revenue gains expected from the gradual implementation of an expanded domestic sales tax system, while pacing tariff changes in such a manner that they had minimum adverse revenue impact and continued to provide adequate tariff protection in the medium-term as non-tariff barriers were dismantled. Indeed, with the gradual removal of tariff exemptions/concessions, and an expanded coverage of sales tax on imports, as well as the increase in import surcharges, the revenues from import levies were expected to increase considerably.

As a result of the successful implementation of this programme, Pakistan's macroeconomic outlook was expected to improve. The budgetary deficit, balance of payments, debt, and inflation objectives were to be achieved by the following economic changes:

(i) Total investment as a share of the GDP was expected to increase, as public investment recovered from first year's cuts and private investment was stimulated by the reduction in the government's deficit financing and a less regulated environment. The government's investment was to be confined mainly to infrastructure and public services, such as support to private investment.

(ii) The performance of total domestic savings was expected to improve, initially from the government's revenue raising efforts. The private saving rate was expected to decline initially as the impact of tax measures and expenditure restraint was felt. However, it was expected to respond positively over the medium term to better savings and investment incentives.

(iii) Changes in trade policy, the domestic regulatory framework, and the financial sector would contribute towards improving Pakistan's export prospects and opening up the economy. In the absence of major external and domestic shocks, real export growth of 7 percent to 8 percent per annum was projected in the early and mid-1990s with the bulk of this growth coming from manufactured products.

(iv) While real GDP growth was projected at 5.2 percent to 5.5 percent over the programme period, it was expected that the macroeconomic reforms would make it possible to achieve an annual growth rate of 6 percent or better over the long term – the one achieved in the previous decade – with price stability and a sustainable balance of payments. Private consumption per capita would not grow as fast mainly because of a slowdown in the growth of the government's consumption. However, what was important was that the economy's capacity for sustaining high economic growth of the past would be strengthened (as government investment would be directed toward it) by reducing the infrastructural bottlenecks and improving human resource development, while private sector investment would be encouraged and partly devoted to the replacement of outmoded technology in certain industrial sub-sectors.

The medium-term macroeconomic adjustment and structural reform programme constituted a major effort towards establishing financial stability, improving allocative efficiency in real and financial sectors, and strengthening thereby the basis for sustained high economic growth. Its successful implementation, however, required the support of increased external assistance and, more importantly, the government's determination and commitment to proceed with the planned revenue measures over the programme period; continued government vigilance ensured the prevention of expenditure over-runs. Particularly, continued improvement in the government's performance to raise revenue was crucial for the successful implementation of the programme. In this respect, it was important that the planned steps towards the establishment of a General Sales Tax were taken without any delay. To ensure a more effective tax implementation, it was also crucial that measures aimed at strengthening the tax administration were carried out. With an improved fiscal situation, the likelihood of sustaining the structural reforms – especially those related to trade and financial sectors – would be enhanced substantially. Otherwise, both economic and political pressures, for policy reversals were likely to increase.

Because the Structural Adjustment Programme was quite comprehensive, a concerted effort was needed for coordinating its different components and for monitoring macro-level responses of the economy (e.g., budgetary revenues, balance of payments, credit expansion and general price level), so that, when deemed necessary, short-term adjustments could be undertaken to keep the programme on track. It was expected that sectoral output, employment, and investment responses would also provide important clues to the government regarding private sectors' potential adjustment problems, as well as their perception of the changing incentive structure.

To sum up, the reform programme required the government's sustained commitment to adjustments in several different areas. It required freeing the economy from undue government regulation, thereby trusting more to the market for resource allocation and investment decisions. It would help in opening up the relatively protected domestic market to foreign and local competition. It would also require a large resource mobilisation effort and a restraint in expenditure growth until the fiscal deficit was reduced to manageable levels. These changes would hurt vested interests. It would involve significant adjustments in the way private business and government had been operating in the past. It could affect consumer budgets adversely, especially during the transition period.

The Status Quo Scenario

It was feared that instead of implementing the Structural Adjustment Programme, the government might be tempted to maintain the status quo – to avoid fiscal policy reforms, including resource mobilisation, to make only limited efforts in further deregulating the economy and correcting sectoral distortions, and to avoid significant import liberalisation. The budget deficit might well remain at about 8 percent to 9 percent of the GDP, with foreign savings used as a partial substitute for domestic savings to support the growth of the economy.

Maintaining the status quo was feasible for some years, provided the external factors remained favourable and aid flows continued to increase. However, it could not be sustained over the long term. A major difficulty with this scenario is the debt build-up. The debt service ratio would remain at uncomfortably high levels, given the potential instability of foreign exchange receipts. The domestic debt service requirements (with negative impact on interest rates), claims on government resources, credit availability, and inflation are a significant bottleneck as domestic borrowing reaches 7.8 percent of the GDP annually. In addition, government non-bank borrowing requirements would have to be far in excess of today's level of about 5 percent of GDP and of expected feasible limits, requiring a large shift to monetary financing. External debt servicing would increase to 30 percent with more international borrowing. Moreover, the government would need financing on commercial terms at levels far more than Pakistan is able to borrow from the international capital markets on a sustained basis.

In addition, as agriculture and industry became less competitive, the incentives for private investment fell, and the public sector was unable to supply the required infrastructure and the public/social services, it might not be possible to realize the projected growth rate of the GDP. Thus, the growth rate of about 6 percent per annum could be sustained only for a few years under the status quo scenario: subsequently, real growth rates of 3-4 percent per annum are more likely, with attendant problems for growth in consumption per capita and employment, and an undesirable slowdown in the industrialisation process.

Finally, the existing weaknesses in the balance of payments would worsen, affecting Pakistan's credit-worthiness, and its ability to borrow from both official and commercial sources. Even with active export promotion, manufactured growth rates would not be as high as in the adjustment scenario, as firms supply the preferred domestic market first and do not improve their cost structures rapidly enough to compete in the international markets. Import growth would also have to be contained, contributing to the drop in investment and in GDP growth. If export promotion were less successful, import growth were higher, and workers' remittances less buoyant than expected, the net borrowing needs would escalate, pushing the external debt service ratio to well over 30 percent by the early 1990s.

To summarise, it can be safely stated that the adjustment scenario (as against the status quo scenario) was the only feasible scenario for Pakistan in the medium term. This scenario would enable the government to finance a rising investment rate with price and balance-of-payments stability, but this adjustment scenario demanded satisfactory progress in the whole package of reforms. Particularly important is the improvement in government revenue performance and control of current expenditure, so that the overall fiscal deficit could be contained as assumed in this scenario. Similarly, continued deregulation and liberalisation of trade and industry are essential to raise the aggregate savings and investment rates, as well as to avoid bottlenecks in the flow of resources. The monetary policy and financial sector reforms were equally essential requirements for the successful realisation of this scenario. The need to rationalise the level and structure of interest rates in line with market conditions, and to relax and then gradually eliminate the quantitative ceilings on bank credit, deserved special attention as desirable actions.

Implementation of the Medium-term Adjustment Programme

Pakistan has completed four years of this programme. The implementation of the adjustment measures has been slow and uneven. Adverse external developments and slow implementation of the adjustment measures have left Pakistan's economy short of achieving the original targets and objectives of the programme formulated at the end of 1988. The expected stabilisation of key macroeconomic variables has proved difficult to achieve. The GDP growth of less than 5 percent compares unfavourably to the original objective of "over 5 percent" The budget deficits have been above their targets in each year, and the current account deficit is running above the already upward revised target of 5.5 percent of the GDP. Expenditures have come down as expected, but the category that was to increase development expenditure has borne the brunt of cuts. Besides, defence expenditures have continued to grow and to exceed the targeted levels. Public revenue has not grown as envisaged and remained below 20 percent of the GDP, rather than above it – as originally intended. Public revenues are still inelastic with respect to the growth of the domestic economy, and overly dependent on taxation of foreign trade. The current account deficit in the balance of payments would be above 3.6 percent of the GDP in FY 1990-91; compared to the revised target of 3.2 percent (and an original one of 2.3 percent), it was in fact 4.6 percent. Monetary assets, after growing well below the target in FY 1988-89, began to grow faster than the target in FY 1989-90, and they continued this rapid growth in the subsequent years. This has contributed to the rise in inflation not only above the original target of 6 percent but currently threatening to exceed 10 percent per annum in FY 1990-91.

The performance of the economy in the real sectors has also been less than satisfactory. In *agriculture*, the government has reduced its control over the distribution of inputs and decreased input subsidies, in particular the subsidies for fertilisers and credit. Pricing policy, however, is still being used to subsidise the consumer (wheat). Cost recovery for irrigation - water and funding for maintenance have fallen short of the programme objectives. Extension services remain weak and little progress has been made in areas that could help increase the low agricultural productivity. In *industry/trade*, the reforms have taken place but are behind schedule. Despite a reduction of non-tariff barriers and the maximum tariff, Pakistan's trade regime remains heavily protective and inefficient. Increases in import surcharges have offset the tariff reductions and kept the overall import tax at a high 100 percent on average. Despite Pakistan's good endowment of *energy resources*, its dependence on energy imports has increased – because of under-utilisation of domestic resources. This reflects low investment by both the public and the private sector and has resulted in higher utilisation of imported oil as well as continued power shortage. Recently gas and electricity charges have been raised to curb the excessive demand for these types of energy. Implementation of the *financial sector* reforms formulated in 1988 (to reduce the segmentation of the financial market, phase out directed credit, strengthen financial institutions, and improve competition in the system) has been slow, due to changes of government, institutional difficulties, and inadequate preparation. Important elements of the programme, such as the introduction of market mechanisms to manage the government's debt and improvement in the working of the nationalised commercial banks, have been delayed. In early 1991, the government began privatisation of nationalised commercial bank and allowed the entry of new private commercial banks. In March, 1991, the first auction of government securities was held.

The slow and uneven implementation of the Structural Adjustment Programme, especially in the fiscal year 1990-91, has been mainly due to the impact of the Gulf crisis on Pakistan's economy. The adverse impact of this crisis on Pakistan's balance of payments is estimated at about $500 million. The most important element in it is the increase in the international oil prices to $ 22.5 per barrel compared to the originally expected $17 per barrel. On the fiscal side, the initial delay in passing on the international oil price increase to domestic consumers put an additional pressure on the government budget. A first important step to contain the negative impact of the Gulf crisis was taken in November 1990, when the government increased prices for petroleum products by an average of 41.7 percent. This increase was partly rolled back by reducing prices by an average of 11 percent in March, 1991.

Notwithstanding these stresses and strains and a difficult international environment, there was considerable progress in 1990-91 and 1991-92 in regard to the liberalisation and deregulation of the economy and accelerating the process of privatisation, especially after the induction of a new government towards the end of 1990. A number of expert committees were set up to recommend the modalities of privatisation.

Major liberalisation, denationalisation, and privatisation steps taken by the government, especially during the last 2 years of the adjustment reforms, are:

(a) One of the five nationalised banks has been sold to the private sector. Another has been sold to the management and staff of the bank.

(b) More than one hundred nationalised industrial units have been advertised for sale to the private sector. More than half of these units had been sold to the private sector by the end of 1992.

(c) The government has allowed the private sector to set up domestic airlines, investment banks, commercial banks, and power generation plants – fields which were previously reserved for the public sector.

(d) The government sanctioning procedures (licencing for setting up new industries) have virtually been abolished.

(e) A bold and far-reaching package of exchange and payments reforms designed to spur growth and improve economic performance has been introduced. It emphasises eliminating counter-productive regulations and creating an attractive environment for higher investment and effective utilisation of entrepreneurial talent. In terms of these reforms, any Pakistani (resident in Pakistan or abroad) and any foreigners can open a foreign exchange account in a bank in Pakistan. No questions are asked at the time of opening this account as to the source of the foreign exchange. All government regulations pertaining to the movement of the foreign exchange in this account in and out of the country have been abolished. This foreign exchange can be remitted or taken abroad without questioning. Foreign currency holders can take loans in local currency against foreign exchange.

Foreign-controlled manufacturing companies can avail of credit facilities for their working capital according to their equity. Companies which export more than 50 percent of their products have no ceilings on their borrowing, which is a powerful incentive in contrast to those firms which primarily cater to domestic requirements and are allowed credits equal to their equity. Banks, insurance companies, airlines, and shipping companies can now remit capital and dividends to foreign investors without approval of the State Bank of Pakistan.

In regard to foreign investment, no approval of the State

Bank of Pakistan is required for the issue of share certificates and foreign banks, like Pakistani banks, are authorised to underwrite upto 30 percent of the shares. Overseas Pakistanis and foreign investors can purchase shares listed on stock exchange and can transfer capital and dividends without any approval, but on payment of the capital gains tax.

Foreign companies can participate in export trade without any hindrance.

For the import of items on the free list, licencing for imports by the Chief Controller of Imports and Exports has been abolished. The L.C. with the bank will suffice.

Dollar Bearer Certificates will be issued and will be allowed as free instruments in the country, and the interest on these will be payable in dollars. This is in addition to the Foreign Exchange Bearer Certificates, which are denominated in rupees.

The principal aim of the government in introducing these reforms (apart from expected positive effects on foreign investment and economic growth) is to strengthen the foreign exchange position of the country, which is in a precarious state at present. The expectation is that Pakistani businessman and industrialists who have (through under-invoicing, over-invoicing and kickbacks) built up sizeable foreign exchange balances abroad, as well as Pakistanis living abroad who keep their savings abroad in foreign banks, will be tempted to transfer these to Pakistan now that all restriction on the transfer of foreign exchange have been eliminated. The expected gains from the liberalisation of foreign currency deposits did materialise in fiscal year 1992, when these deposits increased by US $1.2 billion, thus reducing the current account deficit in that year to some extent. However, the rise in the foreign currency deposits may prove transitory, and may consequently increase vulnerability of the economy to external shocks.

The Government of Pakistan has scrapped the tap system of domestic borrowing and has introduced a market-based system. The issuance of 3-month treasury bills on tap and government treasury receipts of all maturities has been stopped. Instead, the government would auction market treasury bills as registered instruments of 6 months maturity with a character of zero coupon nature. Individuals and institutions (including banks) can participate in the auctions, which would be held every fortnight, as it is a short-term instrument. For long-term borrowing, the government will issue registered Federal Investment Bonds for 3, 5 and 10 years. The auction of these FIBs would be held every quarter. Again, anybody, including banks, can participate in these auctions.

The objectives of reforming the domestic debt management are to trim the government's debt servicing, remove distortions in the rate of return under the present system of borrowing from the banks, and develop a secondary market for government instruments. The new system would pave the way for the development of a monetary market in the country through open market operations and ease quantitative credit controls on the banks. The government also wanted to check disintermediation of the banking institutions and encourage resource mobilisation by the banks.

In overall terms, it can be said that in the four years of the Structural Adjustment Reforms, despite the fact that these years have witnessed unprecedented internal and external pressures and a variety of uncertainties, Pakistan's economy has succeeded in maintaining the growth, albeit at a decelerated pace. The basic soundness of the economy has been clearly indicated by its capacity to advance at a reasonable rate, notwithstanding major and frequent political changes in the country and an inhospitable economic environment. No doubt, the performance of the economy can be much improved by pursuing a sound and consistent strategy aimed at controlling the fiscal deficits of the federal and the provincial governments, stepping up national savings, increasing productivity, improving demand management, stimulating exports, and developing human resources.

It also needs to be emphasised that to ensure stability in the economy and to realise its full potential it is necessary to coordinate the fiscal, monetary, commercial, and exchange rate policies; it is also necessary, periodically, to carry out a sound and objective valuation of major programmes and policies in terms of their effectiveness, in order to attain the articulated objectives. This has become all the more necessary after recent measures of decontrol, deregulation, and greater private sector participation.

CHAPTER IV

Long-term Reforms

To sustain economic growth in the long run and to improve living conditions for all its population, Pakistan has to address a formidable agenda of development issues. First, an increased emphasis on poverty alleviation is needed, both through efforts to increase employment opportunities for the poor as well as provision of basic education and health services. Pakistan also needs to renew efforts to address the problem of high population growth (approximately 2.9 percent per annum). Second, the investment in economic infrastructure needs to be stepped up, particularly to prevent a further deterioration of irrigation, transportation, and other economic infrastructure, and to tackle the problem of power supply. Third, these expenditures require a substantial revenue effort by the government. Fourth, the role of the private sector needs to be extended, to attract investment not only in the industrial sector and the financial system, but also in infrastructure and the social sectors. Fifth, to promote efficiency in production, a more open economy is required; a trade regime that exposes the domestic market to international competition, therefore, needs to be an essential element of Pakistan's development strategy.

It will be seen that policy initiatives under the Structural Adjustment Programme thus represent no more than preliminary steps towards the achievement of long-term development goals. For instance, in the area of trade policy, the government opted for a more cautious reform over the period 1988-92 in view of the urgency of improving the budgetary situation. Reductions in the average level of tariffs, therefore, will be needed in the post-programme period in order to achieve greater neutrality of the trade regime and to promote exports.

Similarly, additional measures would be needed in the financial sector to move closer to a market system of financial intermediation and to adopt some of the more conventional instruments of the monetary policy other than credit controls. In the energy sector, the proposed "Core Investment Plan," pricing policies, and demand management are expected to foster the substitution of domestic energy sources – coal and hydel power – for imported oil products at "least cost".

Likewise, institutional improvements for public sector entities should lead to delinking some of these entities from the budget process, and their eventual divestiture to the private sector as part of the long-term objective of resource mobilisation as well as private sector energy development.

In agriculture, an increased emphasis on productivity gains – through improvements in post-harvest operations, beginning with reviews of public sector marketing and distributing agencies – will be needed. Continued institutional strengthening to enable more effective coordination between agricultural support prices and water sector planning and management is also a long-term priority. Also, in the agriculture sector, attention will have to be given to the development of a viable export strategy for its output, diversification being only one of its goals.

Some key issues go considerably beyond those addressed by the Structural Adjustment Programme. The most pressing among those, over the long term, are in the social sectors, where a long history of neglect has left Pakistan with some of the poorest social indicators in the world. While the Adjustment Programme provides a broad framework for social sector policies, it is vital that specific and sustained initiatives be directed towards improving the internal efficiency, cost-effectiveness, coverage, and quality of services of the existing systems of public education and health; and also towards strengthening their institutional capacity, ensuring financing of expenditure, and promoting the complementarity of the private sector. Decentralisation of decision-making and financial control in the social sectors will ensure a timely response to local needs as well as improve service coverage. Finally, a long-term issue is the development of a comprehensive and feasible population policy that goes well beyond family planning initiatives to reduce fertility, across several fronts. This requires the government's long-term political commitment.

Since the most intractable problems for the long-term improvement in Pakistan's standard of living lie in the social sectors, a brief discussion of these problems will be in order.

Population and Health

Pakistan's population of 120 million makes it the tenth largest country in the world. With a population growth rate of approximately 2.9 percent, which is amongst the highest in Asia, Pakistan's population will double in the next 23 years. Much of this growth is unavoidable, even if actions are taken now to strengthen health services and expand family planning efforts. As yet, there is no sign of any decline in the high fertility levels. The overall age distribution of the population is typical of the countries with high growth rates, with 44.5 percent of the population under 15 years of age. Although the urban population is increasing at the rate of about 4.1 percent per annum, only about 28.3 percent of the population lives in the urban areas. The high rate of population growth, combined with the uneven population distribution, places additional constraints on economic and social development efforts and presents further challenges for the delivery of health and other social services at a sustainable cost.

The country's pattern of health is marked by a high prevalence of infectious diseases owing principally to poor hygienic conditions, inappropriate health practices linked to low education levels, and the limited capacity of health service delivery system. Also, particularly in the rural areas, access of potable water supply and sanitation is poor. Only some 44 percent of the rural population has access to adequate water supplies, and only about 19 percent have sanitation facilities. Pakistan's health indicators reflect these problems. In 1990-91 the estimated infant mortality of 90.5 per thousand live births and child mortality at about 29.5 per thousand children of age 1 to 5 years are still very high.

Despite over thirty years of government-sponsored and donor-supported population programmes for currently married women, the contraceptive ever use rate is at about 21 percent in 1991, which is below levels which would have a demographic impact. The shortcomings of past government population efforts, which were made in a hostile social environment, include (a) frequent changes of administration and organisation, (b) a family planning orientation with weak demand creation, (c) inadequate evaluation and unrealistic target setting, (d) shifting political commitment, and (e) insufficient access to quality family planning services – and particularly the lack of family planning services at health outlets.

Although efforts to increase primary health care and to expand rural health programmes have taken place since the seventies, in practice, higher priority has continued to be given to hospitals, medical schools, and curative services. Moreover, urban areas have tended to control and consume nearly two-thirds of public resources available for health care.

The bias against primary health care has been compounded by poor manpower planning in the health sector, which has resulted in a relative oversupply of physicians and the lack of primary health care and paramedical personnel. The doctor-nurse ratio of 4:1 is the reverse of what it is in most countries, and what it should be.

Thus, radical Health Policy and Population Planning initiatives are needed to address the problems in this sector. To begin with, efforts should be focused on sharply expanding the effectiveness and coverage of primary health care facilities especially in the rural areas. This will require efforts to:

(i) Review the existing health care initiatives – to ensure that they are adequately focused and targeted to address the country's health care needs;

(ii) tackle serious shortages of primary health care workers, especially females;

(iii) allocate additional funding to health care programmes with a view to correcting the current bias towards urban/curative care;

(iv) explore ways to expand private sector/NGO involvement in the provision of primary health care; and

(v) review, in the field of population policy, the present system of a separate service delivery system with the Ministry of Population Welfare – also to address the shortcomings of past efforts while ensuring strong political commitment to the programme.

Education

Pakistan faces some of the most acute educational problems in the developing world. The country's estimated adult literacy rate is 34 percent in 1990-91. While it has improved over time, it still ranks among the lowest in the world; particularly, few countries record a poorer literacy rate for rural females than Pakistan's 7.3 percent in 1981 though it has improved somewhat since. Educational facilities are unevenly distributed, generally serving urban areas, and gross participation rates compare unfavourably with neighbouring countries. Even with such a low coverage, 30 percent of the primary classes meet in the open air in "shelterless" schools, and 70 percent of the schools have no sanitary facilities. Even more striking is the percentage of females in total enrollments: 32 percent for primary, 27 percent for secondary, and 13 percent for higher education. These figures are among the lowest in Asia. The long-term impact of these figures is reflected in the low level of women's participation in the country's socio-economic development, and in the related problems of high population growth, malnutrition, and diseases.

The efficiency and effectiveness of the educational system are also extremely poor. Drop-out rates at all levels, including university, are high, thus leading to small class sizes and higher unit costs. It is estimated that only 40 percent of the students enrolled in class I complete the full cycle, which is one of the lowest completion rates in Asia. At the same time, serious teacher shortages further compound the problems of low participation and poor efficiency. Despite the need for a sharp expansion in coverage, especially at the primary level, enrolment in teacher training institutions is declining. Given the already low level of female students, the drop in female enrolment at teacher training institutions is especially alarming.

If Pakistan is to tackle the country's serious education gaps effectively, it must focus on seven interdependent objectives/issues. These are:

(i) Increasing participation for all;

(ii) increasing access to education for females;

(iii) enhancing the quality of education;

(iv) rationalising the structure of education;

(v) improving the management of education;

(vi) increasing and re-allocating financial resources within the sector; and

(vii) improving implementation capacity.

To sum up, what the Government of Pakistan needs is an integrated plan of action which, recognising the crucial importance of improving the effectiveness and coverage of programmes and policies in the social sectors, focuses attention on basic services within the education sector, and addresses both economy-wide policies and the demand-and-supply issues at the sectoral level. At the same time, the plan of action must establish realistic and quantifiable targets, and must be part of a consistent and coherent programme of development for all key sectors.

CHAPTER V

Future Prospects

Economic performance in a developing country like Pakistan is influenced by, among other factors, the changes in global environment, the strength of the economy itself, and the effectiveness of public policies. While much uncertainty attaches to any projection of the international environment, it remains important to have plans on a consistent set of anticipated developments. Whereas the demographic composition of the population in Pakistan is more or less determined for the rest of the decade, public policies have to ensure that a social and political framework conducive to economic development is provided, the government's own investment programme is cogent and well coordinated, and the policy framework is conducive to appropriate private sector activity.

The international environment has an important bearing on economic planning in Pakistan. In view of the low savings rate of the economy, Pakistan's ability to formulate and implement medium- or long-term development plans is dependent on the availability of concessional loans and grants from abroad. Moreover, Pakistan's geo-political circumstances call for a substantial diversion of resources towards the maintenance of a credible defence. As a result, international relations have an important bearing on economic planning.

The withdrawal of Soviet forces from Afghanistan following the signing of the Geneva Accords and the collapse of communism in Eastern Europe, and the demise of the Soviet Union promise continued progress towards the likely reduction of East-West tension, and an easing of pressures for expenditure on defence and on Afghan refugees in due course. Pakistan's relations with the Muslim countries and with China have always been good. The crisis in the Gulf, caused by the Iraqi invasion of Kuwait, created a new complication in the global environment for Pakistan. It resulted in a substantial fall in workers' remittances from the Gulf – especially from Kuwait and Iraq – (affecting adversely Pakistan's balance of payments), and increased foreign exchange costs for imported oil and POL products (having unfavourable repercussions both on balance of payments and budgetary deficit). As this crisis has ended, we are hoping for a full resumption of economic activities and for an increase in the pace of growth in a region which is of vital importance to Pakistan for more than one reason.

There is a trend towards a greater and more independent role for Japan in world affairs, especially in international economic relations. Pakistan expects that the sources of capital inflow would be more diversified in the coming years, with Japan becoming a major source of capital and technology. It is also expected that bilateral relations with India would improve in the context of the efforts which are underway through the SAARC and through bilateral contacts. Accordingly, Pakistan assumes an area of reduced tensions in the region, as it will be conducive to greater trade and investment activity.

Developments in the world economy affect Pakistan's trade prospects (access to export markets and the terms of trade), remittance flow, and the availability and terms of foreign loans. They also influence the prospects of direct foreign investment and transfer of technology.

Despite the persistence of present imbalances in the world economy, the Government of Pakistan's assumption is that the industrialised countries would continue to show modest growth with low inflation in the coming decade. This perception has been reinforced by several developments: the strong commitments toward recognising and reducing currency misalignments; the initiatives taken to reconcile adjustment and growth in highly indebted developing countries; and the US Government's commitment to balance the budget. These appear to be potential sources of stability. In industrial countries, monetary policies also have been gradually adjusted to support better growth. Pakistan's future planning is based on the assumption that greater international economic co-operation in the monetary, trade, and financial sectors and pressures for further substantive progress in easing the debt problem of the developing countries would generally produce a favourable environment for economic growth in developing countries.

However, the projected improvement in world economy in the 1990s would be modest and barely sufficient to reduce employment in the industrial countries. The slow pace of worldwide economic activity is due, in part, to the technological, institutional, and demand-related developments in the industrial nations, and partly due to the weight of restrictions sparked by protectionist concerns. Developing countries like Pakistan attempting to adopt a sharper outward-looking stance will have to implement aggressive trade and industrial policies to overcome the weak demand for traditional items. They need to diversify in terms of upscale products and new markets – the latter aimed at securing a greater share of the rapidly growing trade in manufactures within the developing countries.

The flow of technological innovations is expected to accelerate in the 1990s with meaningful implications for industry and employment as well as in living standards. High-technology industries such as electronics and informatics will emerge as the leading sectors in the industrial countries, while comparative advantage in some of the chemical and heavy industries will move in favour of the new industrialised countries. Certain types of machinery, metal products, petro-chemicals and supply of parts for electrical, electronic, and automotive industries should emerge as growth industries for an industrial newcomer like Pakistan, since they involve relatively moderate technology, scale, and marketing barriers.

Pakistan must and would try to expand its industrial sector, increase manufacturing value-added, and widen its export possibilities through increased competitiveness in world markets. This will require a firm commitment to efficient and stable growth, increased financial assistance to sustain the adjustment efforts, and the benefit of a fair international trading environment.

Even if all the components of the medium-term adjustment programme, and of the long-term social and economic policy framework, are implemented by the government with reasonable success, the socio-economic character of Pakistan over the next decade is not likely to undergo any dramatic changes; these will be marginal. Agriculture will continue to play an important role in the overall structure of the economy. Agricultural production will remain dominated by wheat, cotton, rice, and sugarcane. The composition of agro-based exports and imports is not like to undergo any substantial changes. Despite the emphasis on import substitution, Pakistan will continue to import agro-based products like edible oil, tea, rubber, milk, spices, and probably meat by the end of the decade. Cotton, cotton products, and rice will remain the major agricultural exports of Pakistan.

In the manufacturing sector, a significant shift in the production structure is expected with engineering and electronics industries claiming a relatively larger share in investment and output. The new industries likely to be set up will be capital-intensive and, thus, will have a direct repercussion on employment. Labour costs, together with the cost of energy (fuel and electricity), will be the major determinants of production costs. In a large number of cases, Pakistan will continue to depend on the import of technology and know-how.

Relative to agriculture and manufacturing, the prospects of import substitution in the energy sector are much brighter. The proven reserves of natural gas and coal are enough to meet the country's requirements for another thirty years or so. The prospects of crude oil discoveries are bright. Pakistan is expected to meet about 50 percent of its requirements of crude oil through domestic production by the end of the decade.

The structure of Pakistan's economy envisaged over the next decade (especially in agriculture and manufacturing sectors) is likely to increase the demand for skilled, professional and technical manpower. Therefore, unless, the government takes immediate and effective steps to shift the emphasis in favour of technical education and skill development through the expansion of technological training programmes, all efforts to transform Pakistan from a low-income developing country into a middle-income country before the end of the century may prove futile.

Pakistan's resource endowment is substantial. The potential of the Indus Basin System for increased agricultural production is considerable, and evidence from the past has shown that a vigorous industrial sector is possible. The economy is sufficiently large to provide a market for a wide range of industrial products and to create a base from which a successful export drive could be achieved. However, it is evident that efforts so far made by Pakistan to tap this potential have met with limited success, and that while both internal and external developments beyond Pakistan's control have greatly exacerbated the country's economic difficulties, the explanation for the 'stop-go' performance of the country during the last forty-five years is also to be found in the policies which the Government of Pakistan has followed from time to time.

CHAPTER VI

Regional Co-operation among South Asian Countries

In the interdependent world economy of the late twentieth century, regional co-operation constitutes a major development policy approach not only among the developing countries but also among the developed world. The most successful of this form of co-operation among developed countries is, of course, the European Economic Community (EEC); and among the developing countries, the Association of South East Asian Nations (ASEAN). The latest attempts at this form of co-operation are the North American Free Trade Area (NAFTA) linking the USA, Canada and Mexico, and the South Asian Association of Regional Co-operation (SAARC) linking the seven countries of India, Pakistan, Bangladesh, Nepal, Sri Lanka, Bhutan, and the Maldives. This chapter examines the objectives, benefits, modalities, chances of success, etc., of regional co-operation in South Asia in the context of the developing countries, keeping in view the past history of such attempts and experiments.

Regional co-operation among developing countries is expected to contribute to progress toward global approaches to the restructuring of the international economic order by reinforcing the self-reliance of the developing countries and creating conditions for mutually beneficial economic relations among them. This form of co-operation is also expected to enhance the flow of regional trade, reduce the dependence of the developing countries on external aid, and mobilise the natural and human resources of the developing countries for their own development, contributing thereby to stability and peace in their own region and the world at large.

The social and economic benefits of regional co-operation are so many and so obvious that it is not necessary to elaborate them in detail here, but what is important and needs to be emphasised is to identify:

(i) The pre-requisites for a successful and lasting form of co-operation at the regional level; and

(ii) the factors which have frustrated such co-operation in the past.

Chances of success of regional co-operation are enhanced if the participating countries are reasonably homogenous in regard to:

(a) The level of already attained development and potential for development;

(b) social and economic systems;

(c) general development policies;

(d) culture and language;

(e) legal and judicial systems; and

(f) foreign policy.

Consequently, countries which are potential partners in regional co-operation need to be identified on the basis of social, economic, and political realities, geography, culture, assurance concerning the safeguarding of their sovereignty and independence, and relations with foreign factors and interests.

The most successful instance of regional co-operation in Asia is undoubtedly ASEAN, with Indonesia, Malaysia, Thailand, Singapore, the Philippines, and Brunei as members. Pakistan, Iran, and Turkey made a significant attempt at regional co-operation by establishing the Regional Co-operation for Development (RCD) in 1963. After the Iranian Revolution of 1979, and the potential developments in Afghanistan, RCD became defunct and was replaced by the Economic Co-operation Organisation (ECO) among these three countries. Very recently, 6 Central Asian republics of the former Soviet Union have also joined the ECO.

Pakistan is also a member of another experiment of regional co-operation called the SAARC, since 1983. To date, the SAARC has identified agriculture and rural development, meteorology, telecommunications, science, technology, health and population activities, transport and postal services, as well as sports, arts, and culture as areas of co-operation. These areas were chosen after considerable preparatory work which has facilitated the launching of an Integrated Programme of Action and a rapid transition from the stage of technical studies to that of implementation. The programmes of SAARC co-operation are recent and the results are as yet modest, but they cover important aspects of planning, including infrastructure development.

Though in the last SAARC summit at Dhaka the unforeseen 10 percent tariff reduction agreement has been deliberated in principle, generally speaking, trade and investments have been deliberately excluded from areas of SAARC co-operation. This, at least initially, was perhaps the right decision though it limited the scope of co-operation. Past experience of regional co-operation in various areas of the world has shown that experiments of regional co-operation among developing countries linked to trade and investment policies only have mostly failed. Such failures were due not only to a lack of political will to implement the agreed measures but also to the fact that entering regional agreements was too costly for some less developed countries. The skewing of benefits typical of regional co-operation in the historically prevalent forms limited to trade and investment is due, ***inter alia***, to the fact that the freeing of trade together with the freeing of the movement of the factors of production on the basis of pure market mechanisms tends to favour the more advanced areas at the expense of the less developed areas.

The SAARC has laid the foundation of regional co-operation in South Asia and it needs to be reinforced. This region has great riches in human and natural resources, which, if fully utilised to the mutual benefit of all member countries, can make this region one of the most dynamic economic forces in the world. It has a population of more than one billion, almost equal to that of China. It is one of the biggest producers of important agricultural crops, i.e., wheat, rice, cotton, and jute. It has sizeable mineral resources, such as coal, iron, chrome, and gypsum. Though an importer of energy, it has vast oil and gas resources. The human reservoir of skilled workers, managers, scientists, and technicians is impressive too. Most of the region has a good system of physical infrastructure in the shape of roads, rail, sea, and air links. The problem of language is minimal; English is understood and spoken all over the region.

What are, then, the obstacles to successful co-operation among the South Asian Countries? Unfortunately, political disagreements between the member countries are the biggest roadblocks to the implementation of South Asian regional co-operation. In most of the cases, these disagreements stem from long-standing regional and ethnic conflicts. Can the governments in South Asia detach issues of economic co-operation for development from their current political conflicts? Can conditions of trust and co-operation be created which overcome the unwillingness of the South Asian governments to co-operate in the joint regional interest? It is difficult to make any prediction in this regard, but a serious effort must be made by the seven governments of the region. This requires, above all, a strong political commitment by the governments of the participating countries, based on a clear consensus regarding the objectives to be attained through regional co-operation – which must ensure distribution of the benefits equitably, contribution to the development of each participating economy, enhancement of the economic weight and negotiating power of the group as a whole, and achievement of a higher measure of self-reliance at the regional level than any state can achieve on its own.

The process of achieving regional co-operation among South Asian countries will be difficult and complex for several reasons – the main one being the political disagreements and conflicts. The process towards consensus would be slow and ponderous and beset with pitfalls. Yet progress is always possible given the required level of political will and a pragmatic manner of proceeding. There are no universal models to follow, only general objectives to pursue through practical and realistic solutions. Recognising the obstacles as well as the benefits of regional co-operation, the governments of the South Asian countries need to strengthen their joint institutional mechanisms and endow them with resources needed for effective functioning. These mechanisms or organisations need to analyse current patterns of trade, existing technical and financial co-operation arrangements, complementarities, differences, factors of competition, and duplication. They also need to assess the available institutional infrastructure for implementation and monitoring of schemes of co-operation. At this stage, one can only suggest a broad agenda for research and studies which may lead, in due course of time, to an effective regional co-operation among South Asian countries. This agenda should include:

(i) Information and communication links with each other with regard to experiences, operational modalities, and available capacities for joint investments;

(ii) advisory and consultancy series for private and public sector enterprises and investors;

(iii) coordinated economic policies in granting region wide preferential treatment, market access, and access to capital for investors;

(iv) institutional arrangements and operational mechanisms for the equitable distribution of costs and benefits;

(v) institutional co-financing according to specific criteria of joint ventures;

(vi) educational and training programmes;

(vii) research and development capabilities to ensure the availability of the specific managerial skills required for successfully tackling regional investments and joint ventures; and

(viii) a regional project development mechanism designed to provide consultancy services for the preparation of projects and feasibility studies.

The above regional arrangements are important; however, neither their intrinsic complexity nor the organisational difficulties must be underestimated in their practical realisation.

The essence of co-operation among South Asian countries is necessarily political even if its substance is economic. Purely economic consideration can prove to be restrictive to the lowest common denominator of immediate interest that the different national economies of the region can discover among themselves. A determined exercise of political will can overcome the narrowness of a purely economic approach and evolve co-operation at the level of conscious national and regional policy. This calls for a gradual yet systematic and pragmatic approach. All the relevant opinions of the different member countries must be assured of a hearing, and sufficient room must be left for negotiation and compromise, paving the way towards consensus. A broad political consensus should lead through gradual stages to some appropriate framework of economic and political co-operation. No matter how remote such a possibility may appear to be at this time, it should be the goal of all nations of South Asia – and it should never be lost sight of.

CHAPTER VII

Summary and Conclusions

Pakistan, which came into existence in 1947 with limited endorsement of financial resources and human skills, and with severe problems of adjustment following the traumatic separation from India, has made impressive progress in all sectors – industrial, agricultural, and services sectors – in the last 45 years. Since 1947, the per capita income in what is now Pakistan has risen from about $83 (1959-60) to about $413 (1990-91) but still leaving Pakistan as one of the low-income countries in the world.

To sustain economic growth in the long-run and to improve living conditions for all of its population, Pakistan has to address a formidable agenda of development issues. First, increased effort on poverty alleviation is needed, through efforts both to increase employment opportunities for the poor as well as provide basic education and health services. Pakistan also needs to renew efforts to address the problem of a high population growth rate. Second, investment in economic infrastructure needs to be stepped up, particularly to prevent a further deteriorating irrigation, transportation, and other economic infrastructure, and to overcome the shortage of power supply. Third, those expenditures require a substantial effort by the government to mobilise additional resources. Fourth, the role of the private sector needs to be expanded to attract investment not only in the industrial sector and the financial sector, but also in infrastructure and the social sectors. Fifth, to promote efficiency in production, a more 'open' economy is required. A trade regime that exposes the domestic market to international market competition has to be an essential element of Pakistan's development strategy. The reform programme undertaken by the government in 1988 includes many of the policy measures mentioned above, and is an important phase in the reform of Pakistan's economy. While the overall objects and targets of the existing programme remain valid, some stringent and quicker action is required in public finance to reduce inflationary pressures and to avoid a further increase in the country's debt service burden. Reducing the budget deficit depends heavily on improved revenue performance, which would also be required to step up development expenditures. Short-term stabilisation structural reforms and long-term development are thus linked; and by taking structural reform measures quickly, the government would contribute to establishing the macroeconomic environment and improving the scope of future development.

Regional Co-operation

Pakistan occupies a unique position among the South Asian countries in the sense that it faces both East and West. It has very strong links with the countries in the Gulf and the Middle East because of its religious and cultural ties with the Muslim countries in that region. And it cannot ignore its ties with the countries in the South Asian region, because of its geography, history, and cultural links with the Subcontinent. Pakistan is willing and ready to enter into any regional economic co-operation arrangement which is mutually beneficial to all the participating countries, provided it ensures its territorial integrity, its political and economic independence, and its social and cultural values. With its western neighbours (Iran and

Turkey), Pakistan entered into a regional co-operation agreement called Regional Co-operation for Development (RCD) as early as 1964. The RCD came to an end with the Iranian Revolution in 1979, but was replaced by its successor – the Economic Co-operation Organisation (ECO), recently expanded by the inclusion of 6 Central Asian republics of the former Soviet Union. The progress made by the RCD and the ECO has been modest but Pakistan's almost uninterrupted continuation of the regional co-operation efforts for the last 25 years or so is a clear manifestation of its will to work with its neighbours for regional economic co-operation. It also shows that so far as Iran, Turkey, and Pakistan are concerned, the political environment is there to co-operate for economic development on a regional or sub-regional basis. Unfortunately, this kind of suitable environment does not exist among the South Asian countries. There are too many points of friction and confrontation between India and its smaller neighbours. The sheer size (area, population, resources, and level of industrialisation) of India acts by itself as a hurdle towards achieving any arrangement of regional co-operation in South Asia. In spite of all these difficulties, the seven governments of the region have been able to set up the framework of regional co-operation in the form of the SAARC. This framework needs to be strengthened and expanded. India being by far the biggest country in the region should lead the way and suggest the ways and means of removing the causes of friction in the political field and of allaying the fears of its smaller neighbours in the economic sphere.