LIBERALISATION AND PRIVATISATION OF PAKISTANI ECONOMY: 1977-88

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C E R T I F I C A T E

Certified that the dissertation entitled "LIBERALISATION AND PRIVATISATION OF PAKISTANI ECONOMY: 1977-88" submitted by Mr. CHANDRAMANI SHARMA is in partial fulfilment of **Master of Philosophy** of this University. This dissertation has not been submitted for any other degree to any other University and is his own work.

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TO

MY FATHER

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CHAPTER - I

INTRODUCTION

In most countries, atleast some commercial activities are carried on by organisations whose ownership and control vest in governments or bodies established by governments rather than in private individuals or groups[1]. Nationalisation as a process started between the end of world war I and beginning of world war II. During this period major takeover of commercial concerns in the private sector occured in several countries, particularly in Italy. Immediately after the world war II, the second wave of nationalisation tookplace in the whole of the western Europe. In the United States, regulation consists of governmental functions introduced to control price, sale and production. It happened so because governments' desire to prohibit private decision making that would take inadequate account of 'public interest'. The legal foundation for regulation consists of statutes allowing the government to grant or condition the right of a company to provide service. Certification or licensing

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1. Jack Wiseman - 'Nationalisation', in International Encyclopedia of the Social Sciences. Vol-11 ed., David L. Sills, (London, 1968).

of a common carrier or utility company by a regulatory agency was common place by the 1960s in the transportation, communication and energy distribution industries. By approving the tariffs of the licensed company, the regulatory bodies exercised controls over almost all railroad, trucking, airlines and telephone rates. They also set prices and conditions of sales for electricity and natural gas. But the regulatory mode for achieving public policy objectives in pricing has not been widely used in Europe and Asia; instead most of these industries have been owned and operated by government authorities[2]. More particularly, since the 1970s, the federal authority expanded the scope of regulation to encompass health, safety and the environment. The federal government promulgated rules aimed at making safer automobiles, safer consumer products and a safer workplace. Often these rules required firms to design their product to meet speoified engineering standards.

Generally the word 'Liberalisation' mean liberalising or freeing the economy from control and regulation of the state. In the mid-1970s many countries

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2. Stephen Breyer and Paul W. Macvoy, 'Regulation and Deregulation', in The New Palgrave, Vol-4, ed., Eatwell, J., Milgate, M. and Newman, P., p. 127.

particularly the U.K. witnessed the policy of liberalisation and privatisation in the form of deregulation. This was due to the public dissatisfaction with the regulations imposed by the state combined with the criticisms by the economists on specific regulatory programmes. This resulted in a strong political movement bent upon ending many particular regulatory programmes. Although the campaign began to grow for 'denationalisation' or 'privatisation' of the public sector in the mid 1970s and 1980s, it started with the notion of turning the big public enterprises into small private enterprises. The impetus was quite remarkably redirected in the form of ownership rather than the form of organisation. Following this rule, the industry has been operating more efficiently after deregulation than earlier. Although some firms have faced the threat of bankruptcy, most of these have increased their profitability considerably. In The New Palgrave dictionary Stephen Breyer and Paul W. Macvoy observe:

> "The deregulatory movement has not advanced to the point of widening the coverage of health, safety and the environment regulation given that the rationale for intervention is stronger and marked alternatives to classical regulation less obviously superior. In these latter areas,

regulatory reform pressure' has taken the form of advocating, not total deregulation, but rather less restrictive or less burdensome methods of government intervention aimed at achieving the relevant regulatory end."[3]

Adam Smith, the propounder of *'Laisser-faire'* advocated that public administration was negligent and wasteful because public employees do not have a direct interest in the commercial outcome of their actions. To justify privatisation he concluded: 'No two characters seem more inconsistent than those of trader and sovereign', since people are more prodigal with the wealth of others than with their own.[4] Smith also observed that, in the monarchies of Europe, there was great tracts of crown lands, which he characterized as a mere waste and loss of country in respect both of produce and population.[5] Smith had estimated the productivity of public lands which was only about 25 per cent that of comparable private lands. This was due to the fact that private owners had greater initiative than did the

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3. Ibid., p. 132.

4. Adam Smith An Inquiry into the Nature and Causes of Wealth of Nations, p. 771.

5. Ibid., p. 776.

sovereign to enhance the value of their lands. Adam Smith concluded :

> "The attention of the soverign can be at best a very general and vague consideration of what is likely to contribute to the better cultivation of the greater part of his dominions. The attention of the landlord is a particular and minute consideration of what is most likely to be the most advantageous application of every inch of ground upon his estate".[6]

In consequence, he proposed that, "in every great monarchy of Europe the sale of Crown lands would produce a very large sum of money, which, if applied to the payment of public debts, would deliver from mortage much greater revenues than any which those lands have ever afforded to the crown".[7]

Just as the 1960s and 1970s were characterised by the rapid expansion of public sector in the developing world, in the 1980s there have been widespread attempts by policy makers to curtail the state's economic role. The divestiture or privatisation of public enterprises has featured prominently in these attempts, just as an

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6. Ibid., p. 785.

7. Ibid., p. 776.

earlier generation of policy makers had emphasised direct state intervention to redress perceived failures in the operation of private markets. Privatisation first gained prominence in Great Britain under the impetus of strong support by the international donor community, the need to cut government expenditure in the face of fiscal crisis after the oil shocks of the 1970s and an intellectual and ideological climate increasingly hostile to state intervention in the economy.[8]

Privatisation is defined as "a transfer of ownership and control from the public to the private sector, with particular reference to asset sales".[9] The policy of equity sales, as well as management, leasing and franchising arrangement between a public enterprise and the private sector are considered examples of partial privatisation. Privatisation at its broadest sense, represents a counter movement to the growth of government that has characterised much of the post world war II period in industrial and developing countries. It may

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8. Nicolas Van De Walle, "Privatisation in Developing Countries : A Review of the Issues, <u>World Development</u>, vol-17, No. 5, 1989, p. 601.

9. Richard Hemming and Mansoor M. Ali- 'Privatisation and Public Enterprises'. Occassional Paper No. 56 (Washington D.C., IMF 1988b reprinted in Nicolas Van De Walle. *op. cit.,* n. 8, p. 601.

mean reducing all forms of state control over resource allocation.[10] Generally public enterprises is defined as revenue-generating entities moved and controlled by the state. We will focus the reforms of public sector later in this work.

Then the next question arises what will be the scope of privatisation? It is known that privatisation in most developing countries is, in part, a response to the need for fiscal austerity and is designed to reduce deficits generated by the state enterprises. Pace and scope, in consequence will be determined by the process of implementing more broadly gauged programs of structural adjustment and liberalisation. Part of the adjustment process will surely entail reform of the public sector, which in the long-run may be more consequential than privatisation.[11]

The scope of this work is to see how public sector reform and privatisation is a successful step taken by the government of Pakistan to redress or to reduce their failure. Infact, privatisation is undertaken within the broad framework of structural

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10. Henry Biener and John Waterbury, The Political Economy of Privatisation in Developing Countries',World Development, vol-17, No. 5, 1989 p.617.

11. Ibid., p. 618.

adjustment and stabilisation reforms. Stabilisation reforms are usually associated with International Monetary Fund (IMF) conditionality programs and refer to currency devaluation, credit contraction, and reducing of public sector deficits. The structural adjustment of World Bank (WB) and Stabilisation policy of IMF puts some conditionalities like implementation of certain set of reforms on loans, investment and aid to the receipient country. These reforms include trade liberalisation (moving away from licenses and quantitative restrictions on imports, to reducing the scope and size of tariffs); getting domestic prices in line with world market prices; improving revenues by widening tax bases and reforming the administration of taxes; diminishing government deficits by lowering public expenditure, especially subsidy. The aim of the government is to reduce government deficits to cure inflation. It also aimed for new domestic and foreign investment. These are the very important policies of IMF and World Bank in the form of conditionalities. How such conditionalities have been implemented to liberalise and deregulate the economy will be examined under the study.

We will review the economic policy from 1977 to 1988 in the following chapter which covers the two plan periods of Pakistan i.e. Fifth Five Year Plan (1977-83) and Sixth Five Year Plan (1983-88).

The policy of liberalisation and privatization undertaken by Zia has a lot of significance. During the eleven years of his rule between 1977-78, Pakistan experienced highest growth of 6.5 per cent per annum. This rate is one per cent higher than the rate realised in the ten years of Ayub Khan's rule which is generally described as the 'Decade of Development' in Pakistan. During this period the per capita income, interms of constant 1959-60 prices rose from Rs. 687 in 1977-78 to Rs. 936.6 in 1987-88. This gives an average annual growth rate of 3.3 per cent which is remarkable in the background of 3.1 per cent demographic growth over the period.

When Pakistan was facing balance of payment crisis, budget deficit and shortage of industrial investment, the role of foreign investment cannot be ignored. In this respect Zia's era would be significant because there was a qualitative improvement in the savings and investment of private sector in the country. The policy of decontrol and deregulation which gave certain incentives to the exporters intending to improve the balance of payment situation is the significance of the present study.

The policy of liberalisation and privatisation is vital because it is recognized by most that the allocative and distributive role of market forces had been disrupted in the past by extensive regulations leading to misallocation of resources. The benefits flowing from control, in most cases, have not been substantial. So there is a greater need to free the economy from unnecessary restraints to enable it to attain greater efficiency and growth. Hence, the present study is intended to examine whether the policy of liberalization and privatisation led to better allocation of resources to productive and social sectors.

In the broadest context of liberalisation, it is also important to study different incentives and concessions given by the government to the industrialists for rapid industrialization. Incentives given to the manufacturing sector include tariffs and quota restrictions to protect domestic industries against foreign competition, excise duties and Sales Tax exemptions and various export rebates for encouraging their competitiveness in international markets, duty concessions in import of raw-materials, machinery and components, tax holidays in specific areas and for specific industries, accelerated depreciation allowances, liberal credit facilities at concessional rates of interest and simplification/liberalisation of sanctioning procedures.[12]

While analysing the broad objective of liberalisation and privatisation, the present study will attempt to study the policies of Zia-ul-Haq's tenure in detail. In depth study will be made to analyse the exchange and payment reforms. The pattern of trade policy reforms in the sphere of imports and exports of different goods and services will be analysed extensively. Financial reforms in the area of interest rate will also be discussed broadly. Attempt will be made to study the investment reforms. The nature and scope of privatisation and the respective roles of private and public sectors will also be assessed. Policies with respect to foreign direct investment in Pakistan will also be discussed. To what extent policy changes brought about structural changes in Pakistan's economy will also be analysed. Finally endeavour will be made to analyse the impact of liberalisation and privatisation on investment, saving, GNP growth rate, employment generation, social justice and standard of living.

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12. Economic Survey (Pakistan) 1983-84, Ministry of Finance, Islamabad, p. 9.

As far as the methodology is concerned, this study is both analytical and empirical. To assess macroeconomic performance some mathematical indices such as percentage and ratio analysis will be extensively used to ascertain the nature of change during the period under study as compared to the preceeding period. Ratio analysis such as debt servicing ratio, current account and fiscal deficit to GDP ratio will be used for our analysis.

Chapter-II will be dealing with the fact of policy of Liberalisation and Privatisation (1947-77). This chapter will review the history of economic policy of Pakistan from her independence to the beginning of the Zia-era. It highlights consistency in the economic policy in the fifties and sixties giving much stress to the private sector. The policy reversal by Zulfiqar Ali-Bhutto in the seventies (1971-77) will also be spelt in this chapter.

Chapter-III reviews the policy of Liberalisation and Privatisation (1977-88) which is the main focus of this work. In this chapter different economic policies of the Government such as exchange and payment reforms, trade policy reform, investment reform, monetary and fiscal reforms, etc. will be discussed in detail.

Chapter-IV deals with the impact of liberalisation and privatisation. The impact of liberalisation and privatisation on the main areas like investment, savings, GNP growth rate employment generation, equity and external dependence will be thoroughly examined.

Chapter-V will summarise the major findings of the study. This chapter will also highlight some policy implications.

CHAPTER -II

POLICY OF LIBERALISATION AND PRIVATISATION (1947-77)

Today, Pakistan stands out as a unique example of under developed country attempting to foster economic growth. Economic policies in Pakistan were primarily concerned with accelerating the rate of growth of the gross national product in the first twenty five years of its existence. The goal was sought to be achieved through encouraging rapid industrialisation; creation of a class of entrepreneurs who would earn large profits and have the capacity to save for further investment in country. This was also sought to be achieved through fiscal concessions and other privileges to the industrialist class with a view to promoting rapid growth of the private industrial sector.

This chapter reviews economic policies and performances during 1947-77. In this period, at least three major regimes ruled Pakistan. Although in the fifties and sixties two different regimes ruled Pakistan, there was some consistency in the economic policy. In the seventies there was reversal of the earlier economic policy by Zulfiqar Ali-Bhutto in the name of nationalisation. Here we will discuss these polices in detail.

At the time of partition in 1947, Pakistan started from a scratch and was predominantly an agricultural economy with hardly any large scale industry for economic development. Agriculture contributed over 60 per cent of gross national product, while the manufacturing sector contributed only 6 per cent. Infact, the rate of capital accumulation was very low. Domestic financial institutions were underdeveloped and ineffective to mobilise a sufficient amount of savings. The tax base was narrow, partly because of virtual absence of capitalist sector and mainly because of mass poverty and deprivation. Infrastructural facilities were poorly developed. Except few cities like Karachi, Dacca and Lahore, there were no infrastrcturally developed cities as such and the whole country exhibited low levels of literacy. With the split of Pakistan, post partition India retained the industrial base while Pakistan was deprived of it. More particularly with partition, Pakistan was deprived of industrial markets for its two most important cash crops: cotton in West Pakistan and jute in East Pakistan. Under this precarious economic condition how was it possible to adopt a policy for rapid industrialisation and modernization? One probable answer could have been to nationalise land and develop agriculture sufficiently not only to feed the population, but also provide an economic surplus to finance industrial growth in public sector. But not only this policy was found unacceptable for ideological reasons but also it warranted a much slower rate of industrial growth in the earlier stages than was deemed politically desirable. The other answers could have been, fostering industrial growth through private enterprise. This particular policy was pursued from the very beginning with extra ordinary determination and ruthlessness during the first twenty five years of country's existence.

The growth of large scale industrial sector was mainly the result of favourable government economic policies. Industrialisation in Pakistan during the fifties and sixties was carried out mainly by the private sector and by a class of industrial entrepreneurs who were originally traders and settled in places like Karachi, Lahore, Dacca after partition. Infact, the first industrial policy resolution announced in 1948 stated that, free enterprise would be encouraged and the private sector would be mainly entrusted with the task of initiating and carrying through the process of industrialisation.[1] The prominence given to

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1. B.M. Bhatia, Pakistan's Economic Development 1948-88 : Freedom to Bondage, (New Delhi, 1989), p. 85.

industrialisation was symbolised by the controversial decision of not devaluing the rupee in 1949. The devaluation of the pound had been folowed by a similar re-adjustment of the Indian rupee. Pakistan's decision was principally motivated by the favourable impact of an overvalued exchange rate on industrial sector. The cost of importing machinery would have been higher had Pakistan devalued. Heavy tariff protection was also given to infant industries.[2] Not only this decision reflected the philosophy of buying cheap but also selling dear - the cornerstone of mercentalist policy. To earn more revenue from export sector, Pakistan's motivation behind the non - devaluation decision was to be able to sell raw-jute to Indian industry at a higher price. Government adopted the method of providing incentives to entrepreneurs alongwith particular guidance to boost private sector. Its 1953-54 Economic Report declared that fiscal policy was designed to provide powerful incentives to private enterprise and investment in

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2. Omar Noman, The Political Economy of Pakistan 1947-85. (London, 1985) pp. 15-16.

3. The Economic Report : 1953-54 (Karachi, Govt. Printing Press, 1953) P. 57 reprinted in H. Gardezi and J. Rashid, The Roots of Dictatorship: The Political Economy of Practorian State (Karachi, 1983) p. 7.

industry.....[3] These incentives were of the form of bounties and subsidies to traders and manufacturers, tax concessions and the establishment of industrial parks. The governments paternalist role, it claimed was aimed at assisting, guiding and controlling industrial development through wise import and capital issue policies, selective tax incentives and other salutory devices.[4] As an incentive, direct taxes were also reduced to the minimum level while the indirect taxes bearing hardest on the masses were increased.

One step taken by the government in early years to promote private industrial enterprise was the setting up of the Pakistan Industrial Development Corporation (PIDC) in 1952. This was a semi-autonomous state agency charged with the responsibility of providing industrial development by financing and equity participation in private ventures as well as starting its own projects.[5] Most of these own projects were then handed over to the private sector, either through a public issue of shares or a partnership arrangement. Infact, PIDC had established a number of jute mills in East Pakistan and a

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4. Bhatia, *op. cit.*, n.1, p.81.

5. The First Five Year Plan : 1955-60 (Karachi, Govt. of Pakistan, May 1956) reprinted Gardezi and Rashid, *op. cit.*, n.3, p. 7.

variety of industrial units in West Pakistan, which were later on handed over to the private sector. To put it more precisely, of the forty three large industry projects completed by West Pakistan Industrial Development Corporation in first thirteen years of its existence, twenty-four were converted into public limited companies and nineteen were turned over to private management.[6] Infact, development strategy during the fifties was very heavily biased towards promoting industrial growth in Pakistan. The government's pro-industrial stand was clearly spelt out when the first budget speech of finance minister declared:

> "It is utmost importance that encouragement should be given to new industries. Pakistan is at present mainly an agricultural country and in rapid industrial development lies our chief hope of increasing prosperity and a higher standard of living for people...new industries will be warmly welcomed and that so far as our resources permit, they will be given every possible financial consideration".[7]

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6. Pakistan Economic Survey, 1964-65 (Rawalpindi, 1965) p. 34, reprinted in Bhatia, *op. cit.*, n.1. p.81.

7. Govt. of Pakistan: Fiscal Policy in Pakistan, p. 31. reprinted in Viqar Ahmed and Rashid Amjad, The Management of Pakistani's Economy : 1947-82, (Karachi, 1985), p. 73.

With the advent of Korean war, the industrialisation drive was given a considerable boost. This led to a boom in raw material prices in foreign markets, especially raw jute and raw cotton particularly between 1950 and early 1952. The Korean boom benefitted greatly the newly established trading classes. During this period, Pakistani traders brought raw materials from agricultural sector, like jute and cotton at cheap prices and sold them in the foreign markets at very high prices making large profits. The fortuitous growth in export revenues supported government policy, which had been geared towards chanelling merchant capital into the industrial sector.[8]

This Korean boom which lasted from mid 50 to early 1952, collapsed in the rest of the decade. With the end of Korean boom, the government fearing a foreign exchange crisis as export prices fell, imposed severe controls. Infact, these control on both imports and exports were then maintained throughout the fifties. As a result of this imposition, particularly over the import of consumer goods, the prices of these goods increased sharply in the domestic market. This changed the terms of trade infavour of industry and against the agriculture

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8. Noman, *op. cit.*, n.2, p.16.

sector. This led to a sharp increase in the profitability of the industrial sector. The imposition of controls on imports, provided erstwhile traders with the ideal opportunity to produce consumer goods domestically, importing machines for the purpose from the surpluses that had been accumulated during the Korean boom.[9] Hence, this boom converted merchant capital into industrial capital in the fifties.

Ever since the end of Korean boom, in the early 1952, the balance of payment position had deteriorated and pressure to devalue the currency had been rising. As we have described earlier, the government, resisted devaluation mainly to provide capital goods to the industrial sector at cheap prices and tried to relieve the pressure on balance of payments situation by imposing import controls. The foreign exchange resource, which had been built up during the boom, were being exhausted and by 1955 the government was beginning to feel the strain. Due to this strain, in July 1956, Pakistan devalued its rupee by 30 per cent in relation to the pound sterling. This devaluation was also justified by stating that the first phase of industrialisation was over and, with the exhaustion of home market, there was a

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9. Ibid.,

need to move into the export market.[10] However, there was some improvement in exports but imports, which were earlier being curtailed by government control, saw no fall. In 1955-56 the balance of trade showed surpluses and the government took this to mean the success of the devaluation decision.[11]

Just after assuming power in 1958, General Ayub Khan, the first Martial Law Administrator of Pakistan, blamed the previous government for the generally adverse economic condition on management and corrupt and unfair practices by the private sector in industry and retail trade. Immediately after the imposition of Martial Law, Ayub Khan proceeded to correct the considerable disarray that had come to characterise the economy. Government officials were dismissed for corrupt practices. Businessmen and politicians were jailed for blackmarketing, hoarding and smuggling. New price control measures were introduced and rigorously enforced.[12] The government not only adopted very stringent monetary and fiscal policy like reducing deficit financing, but also introduced strict price and

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10. Ahmed and Amjad, *op. cit.*, n.7, p. 70.

11. Ibid.

12. Bhatia, *op. cit.*, n.1, p. 61.

profit control in the form of administered prices and profit margins. It also envisaged harsh punishments for blackmarketing, smuggling and hoarding, and measures against tax evasion. The initial impact of these controls were favourable and the general price index registered a fall in the early months after Martial Law. But the government soon found that it was an impossible task to administer prices and profit margin for the wide range of goods sold and produced in the economy.[13] Realising this problem, the government began to dismantle the control system and moved towards a general policy of de-control which we will discuss in detail in the following.

From June 1960 to June 1965, during which the government of Pakistan launched its Second Five Year Plan Ayub Khan introduced the policy of decontrol. The plan embodied the basic objective of the government and laid out the broad framework under which economic development was to proceed during this period. The important strategy which gave impetus to the private sector are the followings.

One of the major criticism of the growth strategy pursued in the fifties was the existence of

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13. Ahmed and Amjad, *op. cit.*, n. 7, p.80.

'direct controls', especially on imports (which were mainly on license), and the undertaking of new investments in the industrial sector. Also from time to time, the government had imposed strict control on prices of domestically produced manufactured goods. These controls were considered to be both economically inefficient as well as a source of corruption..[14]

To correct this, during the second phase, Pakistan entered a new stage of economic planning under the philosophy of *Laissez-faire*. The policy implications of *Laissez-faire* were based on the following basic propositions. In the service of the ruling class, the state machinery would (1) guarantee the freedom to compete in the market place;(2) look after national defence; and (3) establish those public institutions which were not in the self-interest of individuals to create.[15]

True to the policy of Adam Smith's *Laissez-faire*, Ayub regime introduced the policy of decontrol over the economy. The long term policy of the new government was one of decontrol rather than control, and to give encouragement to private enterprise to expand its

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14. Ibid., p. 83

15. Gardezi and Rashid, *op. cit.*, n. 3, pp. 8-9.

activities.[16] It dismantled control on prices and profit margins, it 'liberalised' imports and made it much easier for those wishing to undertake new investments in the industrial sector. The main form of import liberalisation was the shifting of a number of items from licence to selective importers to more easy accessibility to licences for imports as well as direct imports on bonus. Infact in 1964 a number of selected items was placed on the free list i.e., could be imported without permission. Similarly the government published the Industrial Investment Schedule and anyone wishing to invest in industries and projects on it needed no official sanction.[17]

In the whole period of Ayub Khan, this particular period ranging from 1960 to 1965 is regarded as the pro-industrial bias of its growth strategy. This was done so by making available machinery and imported inputs at the cheap overvalued exchange rate to the industrial sector. The strategy also kept agricultural input prices below the 'world prices' which made domestic raw materials available to the industrial sector at very cheap prices.[18] Rapid industrialisation and

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16. Bhatia, *op. cit.*, n.1. p.61.
17. Ahmed and Amjad, *op. cit.*, n. 7, p. 83.
18. Ibid.

growth of exports took place due to the specific government policies. Various types of encouragements were offered to the private sector to expand itself and increase industrial production. The broad policy framework used to promote the growth of the capitalist sector in the economy were tariffs, quantitative restrictions, cheaper credit, tax concession, regulation of foreign exchange allotment and industrial licensing. To encourage import substitution, Pakistan followed a highly protective industrial policy. Incentives were provided in the form of a highly graduated tariff structure; import licensing, and quantitative restrictions on imports.[19] The import licences was issued to them liberally to encourage import of machinery and raw materials. At the sametime, elaborate stimuli were provided to encourage the export of manufactured goods. These included the rebates of custom and excise duties on export-goods, credit guarantees to exporters and tax holidays to industries which exported a proportion of their goods. The centre-piece of the incentives programme was the Export Bonus Scheme in operation from 1959 to 1972, which created a system of multiple exchange

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19. Iqbal and Adams, Exportes, Politics And Economic Development in Pakistan (New Delhi, 1987) p. 11

rates to favour manufactured exports. The Export Bonus Scheme provided an exporter with a proportion of the foreign exchange his export earned. A Pakastani exporter received a voucher against which he could import goods equivalent to 10-40 per cent of the value of exported goods. The voucher was transferable and could be sold at a price determined in the market.[20] Domestic producers were given a sheltered market through tariffs and quantitative restrictions. The tax concessions, like direct taxes, including corporate taxes, were kept low taking into confidence that profits earned by the industrialists would be reinvested in the manufacturing units. The underlying assumption in adoption of these polices was that for an underdeveloped country like Pakistan with low rates of savings and investment and paucity of capital, this was the most significant strategy for development.[21]

What we find in this period is that, state through liberalisation and by bringing the private sector to the forefront, had assured enough freedom to people to invest in the economy. "The creative energies of the people," the Second Five Year Plan document Stated, "can

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20. Ibid.

21. Bhatia, *op. cit.*, n.1 p. 62.

be best harnessed to the needs of development if policies of economic liberalism are pursued".[22] It was neccessary, therefore, that "private investment in industry ...is given maximum encouragement" and that the plan places greater reliance on the market mechanism and fiscal and monetary polices" [23] than on direct investment by the state in the public sector.

Infact, the Second Five Year Plan relied much responsibility on the private sector for economic development. An interesting feature of the plan was the growth in private sector investment, which rose from Rs. 1,720/- million in 1959-60 to Rs. 3,320/- million in 1964-65 (at 1959-60 constant factor costs). The annual compound growth rate of private sector investment during the plan period was 9.9 per cent.[24] But the public sector investment during this period was of course much higher. This was only due to the greater responsibility that the public sector was assigned, by way of creating basic infrastructure for private sector without which the latter was unwilling to invest.

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22. Pakistan Govt. Planning Commission. The Second Five Year Plan : 1960-65 (Karachi, June 1960) reprinted in Bhatia *op. cit.*, n.1, pp. 62-63. 23. Ibid., Pakistan, p.5.

24. Bhatia *op. cit.*, n.1, p. 64.

The export bonus scheme proved effective and, in the first three years of its operation, net exports of the commodities covered by the bonus voucher increased by an estimated 40 per cent mainly in cotton and jute products. A number of other measures like the 'Export Guarantee Scheme', 'Pay as you Earn Scheme', and the establishment of an Export Promotion Bureau in addition to an Export Promotion Council were introduced to stimulate exports.[25] However, these schemes gave enough dividends in Pakistan during Ayub Khan's regime.

Infact, the decontrol policy contributed significantly to the upsurge of industrial production and private sector investment. However, it also created problems since it become difficult for the government to keep track of industrial investment sanctioned and in many cases greater investment tookplace in certain industries than was originally planned.[26]

The economic performance in the period from 1965 to 1970 was considerably different from that of other years. The problems which the economy faced were bad harvests, increase in defence expenditure, and a slowing down of foreign loan inflows into the economy

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25. Ahmed and Amjad, *op. cit.*, n.7. p.84.

26. Ibid., p. 86.

which resulted in the rise of price level and hence inflation. Due to this precarious condition, the government was forced once again to re-impose the policy of control. However, because of very good agricultural harvest in 1967-68 and a stringent monetary policy, the government was able to bring prices under control and there as a large decline in general price level. But the overall strategy of Ayub Khan resulted in social and economic tension which led to his downfall and a reimposition of second Martial Law in the spring of 1969.

Despite the GNP growth rate of 5.5 per cent over the Ayub Khan period which is known as `Decade of Development' in Pakistan, in the autumn of 1968 widespread resentment and disturbances started throughout the country. and the last six months of President Ayub Khan's rule marked the turning point in the economic history of Pakistan. The downward trend started in the last quarter of 1968 which witnessed a violent upsurge of popular resentment against Auyb Khan's rule resulting in widespread riots.[27] This period of *Laissez-faire* economics resulted such small distortions in the relations of production that the masses in both parts of

27. Bhatia *op. cit.*, n.1, p.71.

the federal union suffered heavily and eventually rose in revolt against the Ayub regime. The workers resented the decline in real wages at a time when industrial expansion was proceeding at a rapid pace. The small farmers felt that the initial programme of the Green Revolution had worked against them, and that large scale agribusiness farming threatened their survival.[28] Although a combination of regional, political, economic and social factors were responsible for these disturbances; there was little doubt that the economic factors were perhaps the most important.

Some of the economic factors which led to the fall of Ayub Khan are discussed below :

The economic policy of Ayub Khan heightened the income inequalities between East and West Pakistan and resulted in worsening of the income distribution within each region.[29] The major gains of economic development was confined to West Pakistan and not only had there been little development in Eastern wing but also there was a transfer of resources from the East Pakistan to the West Pakistan. There was also a common feeling in Pakistan that income inequalities had increased during the

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28. Gardezi and Rashid, *op. cit.*, n.5, pp. 10-11.

29. Iqbal and Adams, *op. cit.*, n. 19, p. 13.

sixties. By 1968, some twenty eight family groups were in control of 66 per cent of all industrial assets, 70 per cent of insurance, and 80 per cent of bank assets.[30] There was a considerable increase in the level of conspicuous consumption and wasteful expenditure on extravagant and lavish housing and other consumer durables by the richer classes in the country.[31] Actually the extent of inequality was not much worse, but what is important is that there was abject poverty in Pakistan, and in the face of this abject poverty, the conspicuous consumption of the richer section of the society stirred considerable tension and finally led to an outbreak of unrest in the country.

During the sixties when there was rapid industrialisation leading to high profits for industrialists, the level of real wages failed to show any significant increase. There was a massive labour unrest in the winter of 1968-69 and widespread strikes throughout the period by labourers and their organisations. In early March 1969, labourers took the lead in urban confrontations with the government. There

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30. Mahbubul Haq, The Strategy of Economic Planning : A case Study of Pakistan (London, 1963) p.6.

31. Ahmed and Amjad, *op. cit.*, n. 7, p.90.

were massive demonstrations in Karachi and Lahore. On March 17, 1969, a general strike was observed in which two and one-half million workers participated. By March 20, virtually all workers in factories in Karachi, comprising 40 per cent of Pakistan's industrial capacity were on strike. In Lahore, the mill workers attempted to burn the Kohinoor Textile Mills.[32] The rally spread to the Eastern wing where they took the form of a separatist movement.

In West Pakistan, the social and economic resentment of the people gave rise to a populist movement in the form of the Pakistan Peoples party (PPP) under the leadership of Zulfiqar Ali-Bhutto. His ideology demanded social justice for the masses and destruction of economic and political power of the industrialists. The PPP in its election manifesto, assured for the creation of a new, equitable social order through a series of reforms affecting almost every sphere of life. This egalitarian approach of the PPP had great appeal for the majority of the population who did not share the gains of economic development in sixties. The continuous protest against

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32. Khalid Bin Sayeed , Politics in Pakistan: The Nature and Direction of Change. (New york : 1980) p.149.

Ayub Khan forced him to step down from his office on 25 March, 1968. He was replaced by Yahya Khan, the then commander in Chief of the armed forces who did not rule effectively enough to place his stamp on the political economy of Pakistan. During his three years of rule (1969-71) Yahya Khan could not bring any major economic change.

Despite the change of leadership (from Ayub Khan to Yahya Khan) social and political unrest still continued. Elections were held with universal adult sufferage in December 1970. Under the leadership of Bhutto, PPP won in the West Pakistan while in the Eastern wing Awami League led by Sheikh Mujibur Rehman won decisively. In East Pakistan, there ensured bitter resentment and opposition to the government and demands for separation became more insistent. The government's attempt to supress political disturbances through military action resulted in a bloody civil war in March 1971. In November 1971, the Indian army moved into Pakistan to help Bengali nationalists by way of fighting a war and this resulted in breaking Pakistan into two separate states. The failure of Pakistani army in the war of 1971, created a situation in which there was little choice except to hand over the West Pakistan to

Zulfiqar Ali-Bhutto. In December 1971, Bhutto assumed power as the President and in April 1973, he became the Prime Minister under the new constitution and remained in power till 4th July 1977. Now we will review the overall management of the economy by the government under the leadership of Pakistan People's Party (PPP) with its emphasis on structural change and redistribution of income.

The development strategy of Bhutto underwent a qualitative charge. The economic policy of Bhutto was a total drift from the policy that was followed by his predecessors as well as by his successor. He reversed the policy of liberalisation and privatisation that was followed by Ayub Khan. He brought the philosophy of nationalisation to the economic development of Pakistan for the first time. The election manifesto of the PPP which assumed power in 1971 had promised to give a socialist orientation to economic polices. Infact, the previous government's economic policy of privatisation had reduced the peasants and urban workers to a state of dire poverty inspite of record rates of increase in the gross domestic product in the 1960s. Besides, the country had also accumulated an enoromous foreign debt. In this situation, Bhutto proclaimed that Pakistan was indeed of a socialistic pattern of economy. Bhutto kept his promise according to his election manifesto by bringing nationalisation into Pakistan economy.

The nationalisation policy of Bhutto canbe seen in two phases. The first phase of nationalisation began in January 1972. Within one month of assuming control of the government, it took over thirty-one industrial units, which fell under ten categories of basic industries. The industries included iron and steel, basic metals, heavy engineering, motor vehicle and tractor assembly, heavy and basic chemicals, petrochemicals, cement and public utilities.[33] The nationalisation was not as extensive as it may appear. The takeover was confined to capital and intermediate goods sector, which meant that only 20 percent of value added of the large scale manufacturing sector came under public ownership. Most of the privately owned industrial units were in the consumer goods sector and were therefore, unaffected by the nationalisation.[34] In this first phase, the nationalisation policy was at curbing the growth of large scale monopoly capital. Infact, this policy did not aim at threatening the structure of private enterprise. Indeed, government policies were encouraging smaller

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33. Iqbal and Adams, *op. cit.*, n. 19, p.24.

34. Noman, *op. cit.*, n. 2, pp. 75-76.

entrepreneurs, and appeared to be rectifying the imbalances of the Ayub era. State intervention under PPP was not part of a process culminating in socialist ownership of all the means of production. Public ownership was aimed at creating a mixed economy with the state concentrating on heavy industries and curbing the growth of excessive inenqualities.[35]

The second phase of nationalisation which began in 1973 and went upto 1976, destroyed the relatively harmonious interaction between the pubic and private sectors. The nationalisations in this phase reflects an adhoc political response to the various situation that the country was facing. In August 1973, floods swept across Pakistan, the first natural calamity of this nature to have struck West Pakistan for two decades. An immediate consequence was a severe shortage of consumption goods in the flood affected areas. For example, the price of cooking oil trebled partly because of hoarding.[36] Due to this, in 1973, the government nationalised the cotton and rice exporting sector, vegetable oil (vanaspati) industry, petroleum marketing and maize shipping. In 1976, the government nationalised

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35. Ibid., p. 76.

36. Ibid., pp. 76-77.

the cotton ginning and rice milling units, even though the firms were small and government's stated objective was to move against only the big industrialists. Nationalisation of Pakistan Scheduled Banks took place on 1st January 1974 with the following objectives:

- To enable the government to use the capital concentrated in the hands of a few rich bankers for the rapid economic development of the country and the more urgent social welfare projects.

- To distribute equitably bank credit to different classes.

- To coordinate the banking policy in various areas of feasible joint activity without eliminating healthy competition among banks.[37]

In March 1972, the management and control of thirty two Life Insurance Companies had been taken over, with the object, among other things, to remove the interlocking of life insurance with private ownership of major industrial groups.[38]

True to the socialist pattern of economy, Bhutto brought land reform in March 1972. The ceiling on agricultural holdings was reduced from 500 irrigated or

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37. Bhatia, *op. cit.*, n.1, p. 83.

38. Ibid.

1000 unirrigated acress of land to 150 irrigated or 300 unirrigated acres. Further cuts in these limits were announced on January 5, 1977. The first land reform did not lead to any large scale redistribution of land. The limits were fixed in terms of individual and not family holdings, with the result that most landlords were able to retain control of their land by transferring ownership to relatives. By March 1977, the government had taken over 1.7 million acres of land, but out of this only 57 per cent had been distributed.[39]

In the sphere of labour reform, monetary as well as non-monetary benefits for workers was improved. The minimum wage rate was increased for labourers and large share of profits went to labour. Non-monetary benefits like pensions, medical care and welfare funds were raised to be paid by the employer to the labourer.

The most important measures taken in May 1972 was the devaluation of rupee by 56 per cent. One of the criticisms faced by the Ayub and Yahya government was their unwillingness to devalue the rupee, despite the exchange rate's patent unreality and distortive effects on exports and investment decisions. Its value was

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39. Govt. of Pakistan Finance Division, Pakistan's Economic Survey: 1987-88, Islamabad, ch-3, reprinted in Iqbal and Adams, *op. cit.*, n. 19, p.29.

changed from Rs. 4.74 to $ 1 to Rs.11 to $ 1. The import licensing system was simultaneously abolished.[40] This policy aimed at correcting the excessive incentives to import substitution and in making production more competitive. The old exchange rate had discriminated against agricultural exports since they earned fewer rupees per dollar value than did industrial exports. This change in incentives would favour investment in agriculture. The balance of trade would also benefit from the devaluation since imports would become more expensive and exports would be more attractive.[41] One more policy implication of this devaluation and scrapping of import licensing was aimed at reducing the power of big industrialists and to help the emergence of small manufacturers. The logic behind the abolition of import licensing system was that it made inputs uniformly expensive for all manufacturerers since each had to pay the same amount in rupees for a dollar worth of imported capital equipment. The small scale producers who had suffered under the licensing system were expected to gain out of this policy.

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40. Iqbal and Adamas, *op. cit.*, n. 19, p.30.

41. Ibid.

Significantly, no foreign capital was nationalised, and in 1976, the National Assembly passed a law, the first such in Pakistan's history, specially exempting foreign capital from future nationalisation. Equally significant was the liberal compensation paid to the expropriated capitalists. The Habibs, the leading monopoly house in Pakistani banking for example received Rs. 36.31 for each share originally valued at Rs. 5/-. In the manufacturing sector, the key purpose of these so-called nationalisations was to absorbs the loss of the private sector in units and branches which were uneconomical.[42]

The assumption of control over the bank was a major reform. Prior to 1971, 84 per cent of the investment in industry was financed by bank credit. Through nationalisation, the government could direct credit to the sectors of its choice and let the large industrial units to languish for want of money-capital. The government was free to use commercial credit for its own deficit financing. In addition to accelerating credit creation, the nationalisation of the commercial banks led to the expansion of banking in the rural areas, thereby benefitting the upper segments of the agrarian

42. Gardezi and Rashid, *op. cit.*, n.3, p.110.

structure.[43]

The January 1972 nationalisation had mainly affected the `top twenty two families' that had concentrated wealth and income during Ayub's period. Besides, the 1972 nationalisation policy affected the cooking oil industry controlled by medium sized capitalists. The fatal blow to private sector was struck in July 1976 when the government arbitarily and unexpectedly nationalised flour mills, cotton ginning and rice husking mills. Through nationalisation the government dismantled the intermediaries and directly undertook the marketing of agricultural output.

Due to Bhutto's nationalisation policy, there was a decline of large scale manufacturing while the small and medium scale manufacturing developed. During 1974-75 to 1976-77 there were three years of negative growth of large scale manufacturing largely due to the decline of textile industry, which controlled 23 per cent of value added by manufacturing. The textile industry was affected by the government's antagonistic attitude, by poor cotton crops, and by weak foreign demand.[44]

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43. Iqbal and Adams, *op. cit.*, n. 19, p. 24.

44. Ibid., p. 35.

Besides textile industry, other large-scale industries also failed to show any spectacular growth due to heavy government regulations. The small scale sector went ahead with high growth rate due to the favoured policy of Bhutto. Since the small scale sector was not targeted for nationalisation or any other form of state intervention in the early 1970s, it attracted relatively more private investment and hence high growth rate.

In the area of importation, there was a structural change by way of declining the share of consumer goods and increasing the share of industrial raw-materials. Capital goods imports have remained about one third of total imports. The share of consumer good imports has varied inversely with domestic production of wheat and edible oil. As Pakistan's production of these commodities has increased, the share of consumer-good imports dropped from 29 per cent in 1972-73 to 15 per cent in 1976-77. The share of industrial raw materials increased from 40 per cent to 46 per cent over the same timespan, reflecting sharp increase in the fuel import bill.[45]

Throughout the whole period of Bhutto's rule, while people were expecting a high economic growth that

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45. Ibid., pp. 45-46.

was promised by the government, there was almost a continuous deterioration in the actual economic situation. At the end of his rule, growth rate had touched almost the lowest point ever reached since independence.

The growth rate of the gross domestic product in real terms was 0.1 per cent in 1970-71 and 1 per cent in 1971-72. It shot up to 7 per cent in 1972-73 but declined to 6.8 per cent in 1973-74 and 1.9 per cent in 1974-75. It went upto 3.7 per cent in 1975-76 but fell precipitately once more to 1.4 per cent in 1976-77. The high growth rates in 1972-73 and 1973-74 were accounted for largely by the export boom caused in those years, largely by the devaluation of the rupee by 56.8 per cent on 11 May 1972 which was accompanied by a radical simplification of the external trade negotiations. Taking the ten-year period from the last quarter of 1968 to the last quarter of 1977 as a whole, the trend in the national income growth rate can thus be regarded as consistently downward.[46]

The poor performance of the economy during the period under Bhutto can be attributed to the economic reasons : stagnation of investment in the private sector

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46. Bhatia, *op. cit.*, n. 1, p. 72.

and inflation. Following the anti-Ayub movement in 1968-69, private businessmen and industrialists were frightened by the policy of Bhutto. Since 1968-69, businessmen had stopped making any long term investment. In the six years, 1972 to 77, the total private investment in large and medium scale industries was barely Rs. 5,750/- million or less than Rs. 1,000/- million a year on an average.[47] Public sector investments showed a significant rise during the period but, to the extent that private investment declined, it could not maintain the aggregate rate of investments in the industrial sector on a sound level. Closely allied to this was the problem of inflation which was both cause and effect of the continuously widening gap between investment and the domestic rate of saving. After the initial rise in prices, for the first ten years following independence, prices remained remarkably stable. Inflation raised its head in 1965 and continued unabated throughout Bhutto's period.[48] The peak was reached in 1973-74, when the inflation rate rose to 30 per cent. Besides the external factor of rise in price of oil, the internal factors which were responsible for this were,

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47. Ibid., p. 75.

48. Ibid.

rapid expansion of money supply and slow growth of commodity sectors.[49]

Before the Bhutto's strategy of development could have any positive impact, he was dethrowned by General Zia-Ul-Haq. Ayub's strategy had already created any vested interests who opposed Bhutto's policy actions. The landlords and civil military bureaucratic elite who had ruled the country from very beginning also felt alienated and thought that they were being deprived of the privilege they had enjoyed all along. Civil disorder mounted rapidly. Their opposition combined with that of other sections of the society and hostility of external influences brought about the downfall of Bhutto before the development strategy introduced by him could find a chance to show results. General Zia-Ul-Haq and the military intervened after mid night on July 5, 1977, locking up Bhutto and eight colleagues and an equal number of Pakistan National Alliance (PNA) leaders. Charges of various kinds of corruptions were quickly and publicly levied against Bhutto and his government. He was arrested and indicted for complicity in the murder of Nawab Muhammad Ahmad Khan in November 1974, and finally hanged in April 1979.

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49. Noman, *op. cit.*, n. 2, p. 87.

Bhutto's period is significant in that he attempted to reform Pakistan's economy by curbing the power of bureaucratic and political elites. However, his reform measures were very partial and is alleged to have been politically motivated. A reversal of Bhutto's policies and a move towards liberalisation and privatisation of Pakistan's economy tookplace once General Zia-Ul-Haq took over power in 1977. This is highlighted in the next chapter.

CHAPTER-III

POLICY OF LIBERALISATION AND PRIVATISATION (1977-88)

It is widely accepted that the government sponsored corporations of Pakistan performed poorly in terms of macro-economic aggregates. The maximum average rate of return on equity realised in any year so far is roughly one-half of the interest rate at which the government borrows from the local capital market to finance investments in these corporations. The difference between the interest rates which the government has to pay on its debt and the return on its equity in these corporations has put severe pressure on the budgetary resources. The low return on equity also raises the questions about the efficiency of public sector operations. Therefore, it is no wonder that in an international environment where privatisation is considered to be the panacea for improving efficiency, Pakistan has also embarked on similar programmes[1].

The policy of privatisation is intended to improve the allocation and utilization of resources, reducing fiscal deficits and providing funds for badly

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1. A.K. Kemal, "Privatisation: The Experience of Pakistan", in V. Kanesalingam, ed., Privatisation: Trends and Experiences in South Asia. (New Delhi, 1991) p. 132.

needed physical social infrastructure, fostering more competition and broad basing the ownership of equity capital. Besides, privatisation may not be restricted to just the divestiture of public assets. As a matter of fact, divestiture polices must be viewed in the context of general economic liberalisation. It is in this regard, that the attempts to de-regulate and de-control economic activities including the easing of investment licensing, the liberalising of import regimes, the lifting of price controls and the abandonment of the system of cost plus pricing with a view to improving both allocative and production efficiencies assume great significance.[2]

With the change of government in 1977, came a change in economic strategy. The government of General Zia concluded after a careful examination that in a rapidly industrialising economy, the public private debate relates to only a marginal issue. By denationalising the small agro-based units that should never have belonged to the public domain and opening nearly all spheres of economic activity to private sector, a start was made to provide a rational basis for

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2. Ibid., p. 133.

choice in individual cases. Under the Fifth Plan, which is the beginning of Zia-era, the government sought to reverse previous polices by assigning to the private sector the leading role in industrial development. The Fifth and Sixth Plan under the aegis of General Zia promoted the strategy which was export as well as import substitution oriented and restricted the public sector investment program in favour of an expanded role for the private sector. It was also felt that the realisation of growth potential in the national economy was a tremendous challenge which could not be met without the active participation of the private sector. Therefore, a greater reliance was placed on this dynamic sector.

The major element of the policy of liberalisation and privatisation is the restoration of private sector confidence and motivation in order to revive investment in industry and agriculture. This was done by [a] denationalisation of certain public sector projects; [b] protection of the rights of investors and demarcation of spheres of activity between the public sector and private sectors; [c] offering a package of fiscal and other incentives and [d] relaxation of economic controls[3]. Infact, deregulation was the `primum

3. V. Ahmed and R. Amjad, The Management of Pakistan's Economy: 1947-82, (Karachi, 1985), p. 100.

mobile' of Zia's economic policy and indeed the liberation of productive and innovative private energies critically depends on the breadth and depth of deregulation.

To encourage the private sector the government : (1) denationalised most agricultural processing and few industrial units; (ii) introduced safeguards against nationalisation; (iii) widened areas open to the private sector; (iv) restricted public sector industrial investment to the completion of ongoing projects; (v) adopted a more liberal trade policy; and (vi) introduced a wide range of industrial incentives.[4]

In December 1977, the government devised a formula for the demarcation of spheres of industrial activity for the public and private sectors. Only those industries were to be placed in public sector which are basic, in which the private sector showed no interest or whose nationalisation was in the national interests.[5] To put it clearly, the Fifth Plan stressed the completion of ongoing projects and the consolidation of earlier investments in the public sector while encouraging

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4. World Bank: Pakistan: Review of Sixth Five Year Plan, (Washington DC. U.S.A., 1984), p. 56.

5. Government of Pakistan: Pakistan Economic Survey, 1979-80. p. 43.

private investments to increase substantially and to play their full role in the development of the country. New investments in the public sector were restricted to balancing and modernization of existing facilities and taking up only those new projects which were absolutely necessary for creating links to enable existing projects to utilize their capacity fully.[6] Infact, the Zia-government was anxious to reduce its commitments to the public by completing ongoing projects as soon as possible (for example 88 per cent of the federal government programmes in industry in 1980-81 had been allocated for ongoing projects) and also by the reducing the involvement of the public sector in areas which could be taken up by the private sector. The overall policy was based on a consolidation of the existing structure rather than an expansion into new areas.[7]

In october 1978, an Implementation Committee was set up to suggest measures for improvement in state-managed units. The Committee, while recommending large-scale merger of companies under various corporations, stated that the recommendations of the committee for disinvestment and merger of companies/units etc. should

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6. Govt. of Pakistan: Sixth Five Year Plan, 1983-88, p. 158.

7. Ahmed and Amjad, *op. cit.*, n. 3, p. 101.

be implemented in phases to avoid administrative and other problems. Following these recommendations, the "Transfer of Managed Establishments Order No.12 of 1978" was promulgated enabling the return to the former owners of such establishments which the government deemed fit. As a result, two companies, i.e., Nowshera Engineering Co. Ltd. and Lahore Engineering and Foundary Ltd. were transferred to their former owners. Also, in February 1980, President Zia appointed Karl Schiller, an uncompromising market economic adherent and Bonn's former economies affairs minister as his economic adviser. In the report submitted in october 1980 Schiller recommended a number of liberalisation measures and a gradual transition to a social market economy system like that of West Germany. He specially urged a 20 per cent devaluation of the Pakistan rupee, denationalisation of various enterprises, discontinuation of Government credit planning and a reduction in the quantum of defict financing. The committee also recommended the elimination of government subsidies on wheat, kerosene and fertilizer, liberalisation of import and investment production and commodity distribution and the continuation of high interest rates to combat inflation which finally brought down inflation rate to 12 percent in 1980.[8]

Infact, the Fifth and Sixth Plans of Pakistan were based on a new compact between public and private sectors and on the assumptions of significant deregulation of the economy. More particularly, the Sixth Plan emphasized that the public sector should create the physical and human infrastucture that is needed for private initiative to materialize. It reserved the right to enter as an investor of last resort in the sphere in which private sector is unwilling to come in because of the large size of investment or new technology or uncertain markets. However, both in agriculture and industry, the directly productive activities and services were reserved exclusively for the private sector. Private initiative was also encouraged in providing physical infrastructure in association with public sector-such as in construction of highways, airports terminals, energy development and telephone services as well as in education, health and other social services. According to the the Sixth Plan framework, private investment is projected to increase at over twice the rate of public

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8. Ramesh, Jairam, "Pakistan Economy Doing Well Under Zia"; Times of India. New Delhi- 18th Nov.18, 1981.

investment. In industries, over 90 per cent of the new investment was expected from the private sectors by the end of the Sixth plan period as against 24 per cent at the beginning of the Fifth Plan. By 1987-88 the private investment will be 8 per cent of GNP, compared to 4-9 per cent in 1982-83[9]. Operational policies would be designed to provide the necessary foriegn exchange resources and domestic credit to realise this major shift in the investment role of public and private sectors. The public sector would create infrastructure in industrial estates which would prove to be a far more attractive incentive than many fiscal concessions. The public sector would also play a promotional role to ensure that the private sector becomes more efficiency-conscious and competitive rather than to continue to survive within a highly protected market[10].

To increase the ratio of private investment, a number of export incentives were instituted. Import and foreign exchange rules were liberalised, sanctioning procedures simplified, and a Government guarantee against further nationalisation was introduced. The size limit for units not requiring any sanction was raised.

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9. Development Potential of Pakistan, (Analyst); <u>The Pakistan Times</u>; June 9, 1983.
10. <u>Ibid</u>.

Complete and partial exemption from custom duty was granted for machinery imported for industries (i) of national interest (ii) located in less developed areas and/or (iii) requiring balancing, modernisation and replacement. Other incentives included tax holiday, accelerated depreciation, excise duty exemptions and export rebates. A wide area of industrial activity was thrown open to foreign investors and foreign investment was particularly encouraged in industries which required sophisticated technology and were highly capital intensive. A separate law was enacted to provide complete security to foreign capital and complete freedom was provided for repatriation of foreign capital and dividends from Pakistan any time. Infact, a system of credit allocation for private sector was organised with the participation of a variety of institutions. Bankers equity was set up to play a catalyst's role in overcoming financial problems at the initial stage of project. NDFC has been allowed by an amendment of its charter to finance private sector projects.[11] These were some of the broad economic policies so far as the policy of liberalisation and privatisation is concerned to which this chapter will address in more detail.

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11. Govt. of Pakistan; *op. cit.*, n.6, p.158.

The Fifth Five Year Plan of Pakistan which is the legacy of General Zia-Ui-Haq formulated the following measures. (i) Denationalisation of agro-based industries (cotton ginning, rice milling, flour mills).

(ii) Clear demarcation of activities between public and private sectors and opening up of nearly all spheres of activity to the private sector.

(iii) Government's willingness to examine any request for denationalisation on case-by-case basis,

(iv) Promulgation of Transfer of Managed Establishment Order empowering the government to offer to the former owners of nationalised industries the share of proprietory interest in the acquired units;

(v) Promulgation of Rights in Industrial Property Order. This Order provides safeguards against any arbitary take-over of industrial property by the government.[12]

The Sixth Five Year Plan was conceived within the framework of a significant deregulation of existing economic controls and regulations so as to free the energies of private individuals and organised sectors to participate fully in economic development. While retaining the objectives of Fifth Five Year Plan, it specified some of the policy initiatives for industrial

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12. Ibid., p. 91.

development as:

(i) Increase in investment section limit for non-specific industries from Rs. 60 million to Rs. 300 million in 1984 and further to Rs. 500 million in 1987;

(ii) reduction of tariffs on a number of raw materials, intermediate and capital goods;

(iii) establishment of an Industrial Incentives Reform Cell (IIRC) to make recommendations on fiscal anomalies and effective protection.[13]

A number of incentives have been offered to the private sector, the most important of which is the tax-holiday introduced in March 1978 aimed at encouraging industrial activity in some of the relatively backward regions.[14]

The commercial policy framework as a part of liberalisation was directed towards the following;

(i) Rationalisation of tariffs structure to dovetail to the objectives of providing signals and incentives for resource allocation into desired investment avenues;

(ii) Exchange rate, helped by the severance of rupee-dollar link had become a potent and flexible tool of development policy;

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13. Govt. of Pakistan: Seventh Five Year Plan: 1988-93; p.179.

14. Ahmed and Amjad, *op. cit.*, n. 3, p. 101. 15. Govt of Pakistan: Sixth *op. cit.*, n. 6, p. 168.

(iii) Foreign exchange availability to investors would be augmented by the institution of an investible fund of reasonable size; and

(iv) Interest rate on long-term loans for capital formation would reflect costs which can be borne by various industries and not the short term concern for monetary stability.[15]

To boost exports, the government of Pakistan had taken a number of measures. Infact, the export policy since Zia came to power was so designed as to increase the country's foreign exchange earnings at an accelerated pace, strengthen the competitive ability to export products in foreign markets, diversify exports in terms of commodities and to encourage export oriented industries. At the time of coming to power it was felt that promotion and growth of exports was a high priority objective. That is why the government pursued a production augmenting and export generating strategy and offered large number of incentives to the export sector. It severed the link of the rupee from the rapidly appreciating dollar in an attempt to restore the competitiveness of Pakistan's export; it strengthened its demand management and supply side policies so as to

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15. Govt. of Pakistan: Sixth *op. cit.* n.6, p. 168.

stimulate, through adjustments in incentive prices and improvements in efficiency, the productive base of the economy. For the year 1982-83, exports are expected to rise by close to 10 per cent in current prices, since export unit values are expected to be below long-term trends, this implies that exports may be about 12 per cent ahead in volume terms.[16]

In the sphere of export promotion, another major incentive was the grant of compensatory rebates ranging between 7.5 to 12.5 per cent on the export of a number of industrial goods.[17] In the last year of General Zia's reign the government decided as part of its new trade policy to allow private traders to buy supplies of cotton for export directly from the producer rather than from the State Cotton Export Corporation (CEC), as had been the case. As a result CEC's complete monopoly was lifted. Apart from creating competition for the farmer's crop, this was expected to allow the mobilisation by increased working capital[18] Exporters still enjoyed a number of incentives including an Export Finance Scheme, under

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16. Ibid., p.67.

17. Govt. of Pakistan: Pakistan Economic Survey 1982-83 p.47.

18. "Economist Intelligence Unit: Country Profile" No. 2, 1988, p. 17.

which the commercial banks grant finance at concessional rates and an Export Credit Guarantee Scheme. An Export Processing Zone (EPZ) exists at Karachi. Companies operating in this zone were exempt from custom duties and excise and sales taxes.

In 1952, when Pakistan faced foreign exchange constraints, it had pursued strict foreign exchange regulations. Exporters were depositing foreign exchange with the State Bank while importers required an import licence to obtain foreign exchange. Likewise, prior approval was needed to obtain foreign exchange for foreign travel upto 1984. The allocation of foreign exchange did not exceed $30. However, on the recommendation of the Deregulation Committee, the availability of foreign exchange for travel has been eased. But the main liberalisation in foreign exchange market has been effected through changes in the import policy.[19]

Import licenses were needed upto 1983/84 for only those products which were specified either on the free list or the tied list. Besides, import licenses issued under the tied list could be used for imports from only those countries which have been explicitly mentioned

19. Kemal, *op. cit.*, n. 1, p.145.

on the tied list, otherwise not. A dramatic import liberalisation took place in 1983/84 when the system of 'negative list' was adopted in which certain products were listed which could not be imported. But with the passage of time, the number of products on the negative list has been reduced. i.e, imports of more products has been allowed. Infact, most of the goods produced in the country continue to be on the negative list. This provided excessive protection even where tariff rates may have been low. Also, in the sphere of import liberalisation a number of concessions in import duties were given. Procedures for issuing and extending import licenses have also been simplified and relaxed. The delinking of the rupee in January 1982 thereby permitting depreciation of the overvalved currency, also enabled the liberalisation of imports.

The foreign exchange market has been further liberalised through issuance of foreign exchange bearer certificates in 1985. The certificates can be bought against foreign exchange outside the country and cashed both within and outside the country. This has been a major step forward in the deregulation of the foreign exchange market and has significantly eased the capital flows.

As for fiscal reform is concerned, this was the state of Pakistan economy:

On the taxation side, agricultural incomes were excluded from the purview of income tax. Thus, it is applicable only to part of the economic base. Despite a systematic and highly successful effort during the Fifth Plan to detect hidden incomes and to enlist tax-payers, the number of income tax-payers, in the country is still only around 800,000. The high marginal rate of tax in upper income brackets co-exist with a wide array of rebates and reliefs, reducing average income tax actually paid to the government to quite low levels.[20] Thus the tax structure of Pakistan become highly elastic. During the Fifth Plan, income tax collections increased on average at 25 per cent (28 per cent in relief measures are excluded) per annum against 20 per cent increase in non-agricultural money incomes. However, it remains a small part of the tax system. Collections under income tax account for only 18 per cent of the total tax revenue, a mere 2 per cent the GNP.

The collection of excise duty was also relatively small in Pakistan. Infact, in Pakistan emphasis has remained on few industries in the import

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20. Government of Pakistan: Sixth *op. cit.*, n.6, p. 51.

substitution category. When these industries develop from self-sufficiency to an export stage, there would not be any significant increase in excise duty collections. In Pakistan both the nature of industrialisation and specific duty rates make it less elastic for the future than is normally expected. Sales tax is largely in the nature of a surcharge on import duties and excise duties. It has not yet acquired the character of on independent consumption point tax.[21]

This unique nature of tax structure places a heavy reliance on custom duties as the main source of tax revenue in Pakistan. Roughly 38 per cent of the tax revenue is directed from custom duties. If the indirect taxes offering custom duties (including sales tax as the surcharge on import duties) are also taken into account, the proportion will be as high as 45 per cent.[22]

In the area of expenditure, there is high rigidity because of the geo-political compulsions to carry a high defence burden. Since early fifties the defence budget has claimed nearly half of the revenue resources mobilised by the federal Government.

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20. Government of Pakistan: Sixth op. cit., n.6, p. 51.
21. Ibid., pp. 51-52.

During the Fifth Five Year Plan, the average ratio of defence expenditure to tax revenue of the Federal government was about 42 per cent. Another strong claimant for federal government resources is debt servicing which now accounts for about 30 per cent of the total expenditure charged to the revenue. Only about one-quarter of the limited resources mobilised by the government are available for meeting all other expenditures.[23] This type of expenditure if allowed for all the time to come will, lead to precarious state of economic affairs for Pakistan. Therefore, in such a situation, extra care has to be exercised to limit acceptance of commitments for expenditure which may tend to grow at unpredictable rates. Subsidy on items of consumption or even production and investment subsidy represent such an expenditure commitment. Encouragement of use (often wasteful) of subsidized items combined with the resistance against change of price even when subsidy margin is widening results in a high rate of growth in subsidy expenditure.

The subsidies in Pakistan covers agriculture, irrigation water (canals), industries, transport and

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22. Ibid., p. 52.

energy sectors. The subsidies on social sectors which are huge also includes education, health and water supply - some desirable, some wholly unmanageable - leading to a limited expansion of these sectors and their poor maintenance. It should be an essential item of the agenda for financial restructuring that strenuous efforts are made to eliminate a large part of the subsidy expenditure, both of open and concealed variety with the reduction in the rate of inflation in the world economy and in Pakistan. This task may be more manageable than it was in the Fifth Five Year Plan.[24]

The Sixth Five Year Plan of Pakistan underly fiscal policy as one of its over-riding considerations especially in the spheres of improvement of incentives for investment. The Sixth Five Year plan's actions were intended to be taken in the following areas:

(i) compensatory rebates system was to be further streamlined, and,

(ii) corporate tax structure was to be geared to the need of mobilising investible funds.[25]

Prudent monetary and credit policies have

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24. *Ibid.*, p. 54.

25. *Ibid.*, p. 168.

already begun to furnish the elements of a stable financial environment for investment decisions. The Sixth Plan, would attempt to harmonise the objectives of growth and stability. Further the cost and availability of credit to private sector would be governed by the large weight assigned to private industrial investment.[26]

Foreign private investment in Pakistan has never assumed a significant proportion in the country's overall investment. In a world where technology, knowledge, marketing and finance keep touching ever new heights of sophistication, an important quick course left to developing countries for starting this strategic knowledge stream is by learning from foreign investors.

The government has consistently followed a liberal policy towards foreign private investment particularly in industries which required sophisticated technology or are highly capital intensive. Full legal security is provided to foreign capital. There has not been a single case of expropriation or nationalisation of foreign investment. In case of joint ventures flexibility has been provided in foreign and local participation ratio. These incentives and efforts have started attracting foreign investers. A 33 member delegation of

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26. Ibid., p. 169.

overseas Private Investment Corporation led by the Executive Vice President of OPIC, visited Pakistan from 20th to 29th April 1983, on the invitation of the President during his visit to the USA in December 1982. The main areas in which interest has been shown by American entrepreneurs are fertilizers, live stock and poultary farming, animal feed, milk bottling, viscose rayon and man-made fibres, cold storage products, manufacture of water-logging and salinity control equipment, points, solar energy products, telecommunications, oil and gas drilling and exploration, radical diagonostic products. They also announced a list of 22 joint venture projects.[27]

Good economic performance is the best inducement that a government can offer to the foreign private investor. Pakistan has fared well in the Fifth Five Year Plan on this account. It has put its economic and financial house in order during a period in which developing giants were defaulting on contractual liabilities. The other attractions to foreign investors have traditionally been cheap raw materials, cheap labour and cheap energy. In case of raw-materials,

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27. Govt. of Pakistan: Pakistan Economic Survey, *op. cit.*, n. 17, pp. 57-58.

Pakistan has its unexploited mineral potential, particularly copper and the high value added crops to offer. Labour may not be cheap compared with similarly placed economies, but it cannot be an inhibiting factor as even the existing foreign firms have usually offered higher wage rewards. Energy is not likely to remain cheap, though its exploration and development will itself be big area of attraction in the Sixth Plan.[28]

The policy and incentive-mix that exists at the outset of the Sixth Plan includes no-nationalisation commitment, unambiguous repatriation and royalty rules and avoidance of double taxation.[29] To increase the weight of foreign investment in the overall private investment, the Sixth Plan undertook these following efforts:

(1) The foreign investor will enjoy the organisational flexibility of entering an investment field direct or collaborate with the public or the private sector;

(2) Portfolio investors from abroad will now be able to provide finance directly to the receipient private investor;

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28. Ibid., p. 100.

29. Ibid., p. 169.

(3) The major receipient sector will be energy, mining, construction and agriculture for exporting high-value added output. The major location of manufacturing investment will be Export Processing Zones.[30]

Through the mechanism of deregulation and decontrol the government under Zia had given lot of incentives to repatriate the wealth and income of the Pakistanis working abroad. The sole objective behind this policy was to increase the balance of payments position as well as improvement of the investment for industrialisation in the country through workers' remittances. Now Non-Resident Pakistani will face fewer restrictions on the import of items otherwise banned under the earlier trade policy, notably second hand machinery.

The government of Pakistan also tried to turn the remittances into savings. For this, it has adopted a number of measures. These include offering the emigrant a portfolio of schemes where he can put in his money depending upon his preferences and requirements. These schemes would include many of the financial instruments that are available in Pakistan but are not so readily

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30. Ibid., p. 101.

available to Pakistanis abroad. In addition, new schemes would be devised through which the emigrant when he returns, would be able, if he is inclined to receive not only the capital he has put in, but land and other facilities including credit for setting up small and medium industries. These facilities will be offered in a coordinated, one-window operation in the countries where large emigrant population exists. Import of machinery under Non-Repatriable Investment has already been liberalised. Sizeable imports have been arranged under this scheme.[31]

For the execution of the private sector industrial projects, credit is most important. The Governor of the State Bank of Pakistan headed by the Credit Consultative Committee marked broad allocation of overall credit availability between public and private sectors and within the private sector for various priority needs. Infact, this refers mainly to the credit from the banking institutions. The credit requirements of the private industrial sector are of more diverse nature and require coordination among various institutions operating in this field. Credit arrangements for sanctioned projects are decided for the individual

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31. Govt. of Pakistan: Sixth *op. cit.*, n.6, p. 62.

projects through specially organised consortia. Broad general issue arise from improving the organisation and flow of credit from various sources to the industrial sector. There is no existing forum to feed back the monitoring and examination of the issues which keep arising. It is suggested in the Sixth Plan that the State Bank should set up an Industrial Credit Cell, along the lines already set up for agricultural credit. An Advisory Council for industrial credit should also be established for discussion of the relevant issues and for facilitating the supply of credit for private investment.[32]

Out of the two plan periods of Zia's regime, Sixth Five Year Plan specified the detailed policy objectives of balance of payments. Infact, it envisaged a considerable strengthening of Pakistan's balance of payments position. Based on a decisive shift in the production and export of high value added items, and the accelerated development of agro-industrial potential for export markets, exports were projected to grow by 15 per cent per year in current prices, from $ 2,504 mn in the base year to $ 5,036 million in 1987-88 or by 8.5 per cent per year in volume terms. Imports were expected to

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32. Ibid., p. 170.

rise by a relatively modest 12 per cent per year; or 5.5 per cent per year by volume, on the assumption of eliminating the imports of food items in which near self-sufficiency had been achieved and the possibilities of recurring substantial import savings across a large number of others items.[33] Reflecting the uncertainties of the demand for labour in the Middle East, the plan had anticipated a marked slow down in the flow of worker's remittances to a growth of only 10 per cent per year in current prices, almost half the rate achieved during the Fifth Plan. On these assumptions a cumulative current account deficit of $ 6.0 bn was expected over the plan, or an average of $ 1.2 bn per year (2.7 per cent of GNP).[34]

On capital account, the plan had assumed that the substantial build up of the commitments of external assistance in the last year of the Fifth Plan would continue and allow real net aid inflows to rise by 3.5 per cent per year. In addition, the plan also envisaged the possibility of supplementing these official flows by prudent amount of commercial borrowing for selected high-priority development projects. Overall, the Sixth Plan

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33. Govt. of Pakistan: Seventh *op. cit.*, n. 13, p. 63.

34. Ibid.

had envisaged that these developments would tend towards a gradual strengthening of Pakistan's foreign exchange reserves position with gross foreign exchange reserves rising to the equivalent of three months import of goods and service by the terminal year 1987-88.[35]

The Sixth Five Year Plan comprehensively underlined the following strategy so far balance of payment is concerned:

(i) The management of a flexible exchange rate, with supportive policies, aimed at maintaining the competitiveness of Pakistan's exports and restraining non-essential imports;

(ii) a major adjustment in the structure of incentives facing industry so as to improve the allocation of resources and secure incentive differentials in favour of those products and sectors where Pakistan retains - or can acquire - a strong dynamic comparative advantage for efficient import replacement and/or rapid export expansion;

(iii) a phased liberalisation of access to imports to improve economic performance through greater access to imported inputs and technologies while at the same time,

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35. Ibid.

exposing industries to international competitive pressures;

(iv) a bold programme of deregulation combined with a lifting of the constraints on finance and infrastructure to stimulate private initiative and attract overseas investment in key trade-related sectors;

(v) in agriculture, a selective adjustment in output incentives and a strengthening of institutions so as to move 'up markets' into new crops and higher value added products for exports; and

(vi) in the energy sector, continuing adjustments in domestic prices and intensified conservation efforts to limit the demand for energy and oil imports while concurrently providing incentives for accelerated exploration and development of domestic energy resources.[36]

As far as the policy of currency, trade and investment regulation is concerned, the following steps had been taken by the Zia-Government.

Since the early 1980s there has been considerable liberalisation of trade and investment policy in keeping with the general principles set out in

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36. Govt. of Pakistan: Sixth *op. cit.*, n.6, pp. 71-72.

the Industrial Policy Statement of June 1984.[37] The deregulation process was introduced by the Industrial Policy Statement of 1984 which issued a 'specified list' of 23 industries requiring government sanctionsing. The sanctioning in other cases was required only if investment exceeded Rs. 300 million. The limit was further raised to Rs. 500 million and then to Rs. 700 million.[38]

There were significant changes in the exchange rate policy. Faced with severe balance of payments problems and an appreciating real exchange rate during 1981-82, the government abandoned the fixed peg with the US, dollar ('delinking' was the term used) and adopted a more flexible exchange rate policy that allowed for frequent small changes according to an undisclosed rule. With delinking, the rupee depreciated by nearly 20 per cent in 1982-83 and by a further 11 per cent in the following year correspondingly the real effective exchange rate depreciated by 11 per cent and 4.6 per cent in those two years.[39] The impact of the exchange rate

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37. "Economist Intelligence Unit, Country Profile, 1986-87. Annual, p. 42.

38. Kemal, *op. cit.*, n. 1, p. 141.

39. Mohsin S. Khan, "Macro Economic Balances"; W.E. James and S. Ray, ed; "Foundations of Pakistan's Political Economy: Towards an Agenda for 1990s. (New Delhi, 1992), p. 170.

policy was evident in the current account position. In 1982-83 the current account deficit was.only 1.5 per cent of GNP - the lowest it had been since 1972. The strongest impact of the change in exchange rate policy was on workers remittances, which rose by nearly $ 700 million (an increase of nearly 30 per cent over the 1981-82 level.[40] The nominal rate of depreciation slowed down in 1984-85, and the real exchange rate appreciated slightly. There was a deterioration of the current account position and remittances fell by almost $ 300 million. To counter this, the government accelerated the nominal rate of depreciation in 1985-86, and the resulting real depreciation helped to reduce the current account deficit and raise remittances. The government continued to allow the rupee to depreciate thereafter, further stimulating exports and remittanecs.[41]

The Government of Pakistan after believing for many years that exchange rate had little or no effect on trade flows, remittances, and the current account, changed its mind in 1980s and began to use the exchange rate mechanism as a tool for correcting external imbalances.

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40. Ibid.

41. Ibid.

After giving all sorts of incentives and inducements, private investment is projected to increase at over twice the rate of public investment. In industries 85 per cent of the new investment is expected from private sector by the end of the Sixth Plan period as against 24 per cent at the beginning of the Fifth Plan.[42]

While a major liberalisation of private sector is contemplated in the Sixth Plan, policies are also being formulated to ensure that:

(i) Social interests do not become a casualty in any new liberalisation drive. For instance, special credit programmes for small farmers and small industrialists have been designed to ensure that the small investor is fully protected and encouraged rather than wiped off by the relentless forces of the market;

(ii) It was contemplated that private sector could become efficiency conscious and competitive rather than continue surviving within a highly protected and sheltered market. The profits of privileged access to scarce resources or licenses or permits would be replaced by profits of efficiency and new technology. The private sector should be free to live by the logic of the market so long as it was prepared to die by the logic of market and did not

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42. Govt of Pakistan: Sixth *op. cit.*, n. 6, p. 14.

run to the government for rescue each time it got into trouble or becomes commercially sick;

(iii) The government sector would increasingly play a promotional rather than a regulatory role. It would encourage the introduction of new technology and efficient practices by streamlining the price and fiscal signals given to the private sector.[43]

Having mentioned the above policies of liberalisation and privatisation the Fifth Plan aimed to stabilise the economy, to restore rapid but balanced growth, to develop the more backward regions and improve health, education and water supply facilities, and to improve the situation of the poorest sections of the community. Real GDP was targeted to grow by 7.0 per cent on average with 6.0 per cent growth in real agricultural output and 12.0 per cent growth in real manufacturing output.[44] The Sixth Five Year Plan covering 1983/84 to 1987/88 proposesd continued growth in excess of 6 per cent per annum. The Plan's principal objective were to achieve a major break through in agricultural production, an expanding foothold in export markets for agricultural products, and rapid development of public services that are critical for the country's long term progress. The

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43. Ibid.

44. Economist Intelligence Unit, *op. cit.*, n. 37, p. 11. 11.

public sector program emphasizes the provision of basis social services and the development of the country's less developed areas. The objectives were to be supported by higher rates of investment and saving.[45]

Another significant feature of the plan was the expanding role assigned to the private sector. With investment projected to increase more than twice as rapidly as public investment, and the involvement of public sector in manufacturing projected to decline sharply, the attainment of the overall targets of the plan would depend to greater extent than in the past on the performance of the private sector. Consequently, policies toward the private sector would be as important as the government's expenditure/revenue decisions. As is recognised in the plan, major actions in pricing, deregulation, tariffs and import liberalisation and other incentives would be needed to induce the private sector to play the increased role expected of it in agriculture, industry, energy and services.

These were some of the policies so far as liberalisation and privatisation adopted during General Zia-ul-Haq's reign. The impact of these policies will be observed in the next chapter.

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45. World Bank: Pakistan: Review of Sixth *op. cit.*, n. 4, p. 17.

CHAPTER - IV

IMPACT OF LIBERALISATION AND PRIVATISATION

By the time Martial Law was imposed in July 1977, Pakistan's economy had been bankrupt for sometime. At the end of June 1977 for the first time in the history of Pakistan net foreign assets of the banking system were negative by Rs. 566 million (US $ 57 mn). In 1976-77, although the investment rate had risen to 19.3 percent of GDP and the surplus on consolidated revenue budget to Rs. 1.7 bn, the deficit on the current account of the balance of payments was above US $ 1 billion (or 6.7 per cent of GNP); the rate of growth of GDP had fallen to 2.8 per cent, so that per capita GDP growth had been negative; while consumer prices had risen by 11.8 per cent.[1] Under these background, General Zia-Ul-Haq came to power by imposing Martial Law and tried to reverse this trend by way of adopting the policy of liberalization and privatisation.

The growth rate of economy, during 11 years of Zia's rule touched a new high of 6.5 per cent per annum. The per capita income, in terms of constant 1959-60

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1. Government of Pakistan: Seventh Five Year Plan 1988-93, (Planning Commission) p.1.

prices rose from Rs. 687 in 1977-78, the first year of Zia's rule to Rs. 936.6 in 1987-88, the last year of his rule. This gives an annual growth rate of 3.3 per cent which is remarkable in the background of 3.1 per cent demographic growth rate over the period. By the end of the period a per capita income of around US $ 380, Pakistan appeared ready to enter middle income countries group in the World Bank's development tables listing 129 countries.[2]

The basic underlying strategy of the Fifth Plan (which starts with Zia-era) was the need for rapid economic growth to generate the resources to sustain high levels of consumption and investment. Thus, per capita consumption was to grow by 3.4 per cent p.a, total consumption by 6.5 per cent p.a, and while import growth was to be reduced to 6.3 per cent p.a, thus improving the trade balance.[3]

Infact, these assumptions were highly optimistic. Starting from a tight initial resource position, several unforeseen events combined to squeeze Pakistan's resources still further: (a) a severe decline

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2. B.M. Bhatia, Pakistan.s Economic Development 1948-88: Freedom to Bondage (New Delhi, 1989) p. 241.

3. World Bank; Pakistan: Review of the Sixth Five Year Plan, (Washington DC., 1984), p. 1.

in the internal terms of trade ; (b) world recession; (c) the Afghan crisis, which necessitated increased outlays for defence and refugee assistance; and (d) the continued decline in net foreign aid inflows. In addition, major cost overruns were experienced in several large public sector projects and the cost of fertilizer subsidies escalated more rapidly than had been expected.[4] In Pakistan, the shortage of resources and high budget defécits, necessitated a cutback in planned investments and hence reduced to public development expenditures.

These cutbacks led to increasing energy shortages, delayed progress in improving agricultural and irrigation services, and led to sharp cut in social sector programs.

Nevertheless, the Fifth Five year Plan was also noteworthy for a number of achievements. Although the growth in national output, agriculture, industry and exports were below plan targets, all were substantially above the rates achieved during 1970-78 and very respectable compared to the experience of most LDCS over the same period. Infact, GDP (at market prices) grew at 6.3 per cent p.a. as compared with the plan target of 7.5 per cent p.a,. Given the difficult external circumstance

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4. Ibid., p.2.

that Pakistan faced, this represents a very respectable performance, especially when compared with that of most other LDCs during that time. The Fifth Plan growth also represents a distinct improvement over the financial year 1973 to 1978 period, when services were the leading growth sector. During the Fifth Plan the commodity producing sectors grew at 6.1 per cent p.a. and services at 5.9 per cent p.a. while the corresponding average for the preceeding five years were 3.6 per cent and 6.9 per cent respectively.[5]

The Fifth Five Year Plan consolidated investment and growth, brought down the rate of inflation, and restored domestic and external financial stability. Although the net foreign assets of the banking system turned negative again in 1981-82 due to adverse balance of payments developments, it remained positive in the remaining years of the Fifth Plan. But at the end of the Fifth Plan period the net foreign assets of the banking system stood at Rs. 6,518 million (US $ 511 mn). In 1982-83, the deficit in the current account of balance of payments had fallen to US $ 558 million (or 1.8 per cent of GNP); the investment rate, to 17.4 per cent of GDP but the rate of growth of GDP had risen to 6.7 per cent,

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5. Ibid.

while the rise in consumer prices had slowed down to 4.2 per cent.[6] The Sixth Five Year Plan of Pakistan also had the policy objective to boost the private sector in economic activities. As a result of government policy to leave industrial investment largely in the hands of the private sector, the share of public sector in total manufacturing investment decreased from 49 per cent in 1982-83 to only 9.5 per cent in 1987-88. On the otherhand the share of private sector in total manufacturing investment increased from 51 per cent of total in 1982-83 to 90.5 per cent in 1987-88, with an annual growth rate of 20.5 per cent.[7] Although in the Fifth Five Year Plan the actual growth rate in manufacturing of 9 per cent is less than the target of 10 per cent, it is remarkable in the background of 3.8 per cent achieved during 1973 to 78. Those are some of the gross macro-economic indicators that were achieved during 11 years of Zia's rule which followed from his policy of liberalisation and privatisation. This chapter will address these macro-economic indicators in detail.

In June 1983, the Fifth Five Year Plan of Pakistan was completed. It has been assessed that this

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6. Government of Pakistan, *op. cit.*, n.1, p.2

7. Ibid., p. 180.

plan was successful in consolidating the over-stretched development programmes in the public sector and in sharpening development priorities and re-introducing plan discipline. Despite the deepest world recession in last few years and faltering economies in the developing world during this period, it should be a matter of some satisfaction that policies of financial discipline and better economic management during the Fifth Plan have succeeded in:

- maintaining a consistent GDP growth of over 6 per cent a year;
- converting huge food deficits into a modest food surplus;
- lowering the inflation rate from an average of 16 per cent five years ago to around 5 per cent in the year 1982-83,
- consolidating over-extended investment programmes and sharpening our investment priorities;
- accelerating the development of less-developed regions, particularly Baluchistan, which witnessed an acceleration of five times in its development expenditure over this period;
- reviving industrial growth rate to over 9 per cent a year and liberalising some of the industrial controls and incentives;

-electrifying more villages during the last five years than in the previous 30 years; and

-extending social safety nets for the poorest 20 per cent of the population, both by the introduction of *Zakat* system and because of a major inflow of remittances to lower income groups.[8]

As far as the macro-economic indicators like investment and savings is concerned, both fell short of their plan targets. While the Fifth Plan projected that gross fixed investment would rise to 19.2 per cent of GNP by 1983 (as compared with 15.8 per cent in 1978), the investment ratio actually fell to 13.4 per cent and averaged only 14 percent over the entire plan period (Table 4.1). Public sector performance was responsible for most of this short fall; whereas the plan had projected public investment to rise at 10.3 per cent, it only grew at 0.6 per cent p.a.. Private investment growth at 6.3 per cent p.a also fell short of plan targets (10.7 per cent p.a.) but nonetheless represented a responsible recovery from the decline that had characterised the previous five years.[9]

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8. Government of Pakistan Sixth Five Year Plan 1983-88. p.7.

9. World Bank, *op. cit.*, n. 2, p.4.

Table 4.1 Fifth Plan Savings and Investment (per cent share in GNP

	1978	1983	Fifth Plan Average
Gross Domestic Investment	16.4	15.5	15.7
Gross Fixed Capital Formation	15.8	13.4	14.0
Private	4.8	4.9	4.8
Public	11.0	8.5	9.2
Gross National Saving	13.2	14.1	12.1
Private	11.4	12.5	9.8
Public	1.8	1.6	2.3

Source: World Bank, Pakistan: Review of Sixth Five Year Plan, p.4.

The Fifth Plan projected a rise in the national savings rate from about 13 per cent to about 16 per cent by the end of the period. Increased private and public savings were both supposed to contribute to this performance. However, savings showed no tendency whatever to rise and over the period averaged well below the plan target levels. These are some extenuating circumstances regarding poor savings performance. The Afghan crisis led to larger government outlays for refugee support and defence than had been forseen at the time of the Fifth

Plan's formulation. In addition, the 30 per cent decline in Pakistan's external terms of trade made savings lower than they would have been. On the other hand, the performance of migrant remittances had been much more favourable than anticipated but had no discernible effect on saving propensities.[10] The Sixth Plan objective was to raise fixed investments rate of private sector to 25 per cent, public sector investments rate to 15.7 per cent, and overall fixed investment rate to 19.4 per cent. The actual achievement fell far short of the targets in all the three, the respective figures being 14.5, 11 and 12.4 per cent.[11]

In the study made by B.M. Bhatia on saving and investment, it is concluded that both were distressing throughout Zia-period. In the fourth decade of the country's independence and development effort, the investment and savings remain what usually are at the point where a developing country begins its growth process.[12] This poor growth rate of saving and investment is depicted in the table 4.2

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10. Ibid., p. 5.

11. Bhatia , *op. cit.*, n. 2, p. 249.

12. Ibid., p. 251.

Table 4.2

Investment and Savings as Per cent of GNP (Market Prices)

	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88
Investment	16.7	16.6	17.1	15.8	16.4	15.7	15.3	15.4	15.3	16.1	15.7
Foreign Savings	3.1	5.2	4.4	3.4	4.5	1.6	3.0	4.5	3.4	1.9	2.4
National Savings	13.5	11.3	12.7	12.4	11.8	14.0	12.4	10.6	11.9	14.1	13.3
Public Savings	1.7	1.0	2.0	3.9	3.1	1.1	1.8	0.3	1.5	0.3	0.2
Private Savings	11.9	10.3	10.7	8.5	8.7	12.8	10.5	10.2	10.4	13.7	13.1
Domestic Savings as Percent of GDP	7.6	4.8	5.9	5.2	4.8	4.7	4.1	3.5	5.2	9.0	9.4

Source: B.M. Bhatia, Pakistan Economic Development 1948-88: Freedom to Bondage, p. 252.

This data depicted in the table suggest that Pakistan has not begun seriously the development process and in terms of its economic structure it remains as underdeveloped as it was at the time of its birth.

One more way of looking at savings and investment is that there is a high gap between investments and savings. That apart,. investment as per cent of GNP (Current prices, as data available) are lower over the whole period of Zia. The table 4.3 shows investment and savings rate in Pakistan from 1976-77 to 1987-88.

Table 4.3

Investment GNP Ratio and Savings/GDP Ratio

Year	Investment as % of GNP (current prices)	Savings as % of GDP (Current prices	Investment-Saving gap as % of GDP
1976-77	17.7	8.5	9.2
1977-78	16.7	7.6	9.1
1978-79	16.6	4.8	11.8
1979-80	17.1	5.9	11.2
1980-81	15.8	5.2	10.6
1981-82	16.4	4.8	11.6
1982-83	15.7	4.7	11.0
1983-84	15.3	4.1	11.2
1984-85	15.4	3.5	11.9
1985-86	15.3	5.2	10.1
1986-87 (Revised)	16.1	9.0	7.1
1987-88	15.7	9.4	6.3

Source: Pakistan Economic Survey 1987-88, p. 19.

It is seen from the table that annual investment rate throughout Zia's rule remained lower than in the last year of Bhutto's regime and the savings rate actually came down significantly and remained lower than in Bhutto's time, except the two last years of which the data given is based on provisional estimates and is liable to downward revision in final estimates.'[13] Infact, a part of this investment savings gap was made up by the overseas Pakistani's through remittances, but for the rest the country had to depend on foreign savings or borrowing from abroad.

The measures taken by the government led to a gradual recovery of private sector output and investment. During the Fifth Plan manufacturing output increased by 9 per cent p.a. with major increase in fertilisers, tractors, vegetable oil, sugar, cement and mild steel products (Table 4.4). Private manufacturing grew by 8 per cent p.a in real terms but the growth rate was considerably below plan target of 17 per cent p.a.. Total public sector manufacturing investment reached the plan target but, due to shortfalls in private investment, the ratio of public to private investment remained at 60/40 compared to 52/48 as forecast in the plan. Total investment in the manufacturing sector declined as a proportion of GDP from 5.3 per cent in 1977/78 to 4 per cent in 1982/83 because of the decline in public sector investment and inefficient growth in private sector investment.[14]

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13. Ibid., p. 245.

14. World Bank, *op. cit.*, n. 3, p.56.

Table 4.4

Performance under the Fifth Plan and Sixth Plan Targets

	Fifth Plan		Sixth Plan
	Targets	actual	Target
Real Annual Growth			
Manufacturing output	10.0 %	9.0 %	9.0 %
Mining output	N. A	8.7 %	7.5 %
Manufactured exports	N.A.	8.0 %	11.0 %
Private manufacturing investment	17.0 %	8.0 %	22.0 %
Investment Program (Rs. billion)			
Manufacturing Investment	40.0(a)	35.0(a)	82.5(b)
Private	19.0(a)	14.0(a)	62.0 (b)
Public	21.0(a)	21.0(a)	20.5 (b)

(a) constant FY 77 prices

(b) current prices. In current prices, the Fifth Plan actual were Rs. 48.2 billion with Rs. 20.8 billion in private and Rs. 27.4 billion in public investment respectively; N.A = Not Available

Source: World Bank, Pakistan: Review of Sixth Five Year Plan, p. 56.

The overall impact of the policy of liberalisation and privatisation on fiscal and monetary situation is mixed in nature. As far fiscal performance is concerned, it has improved considerably over the Fifth Plan period. The overall budget deficit and government borrowing from banking system, which stood at 8.8 per cent and 4.3 per cent of GDP in the first year of the plan fell to 6.4 per cent and 1.7 per cent respectively by the final year (Table 4.5).[15] Throughout the period, this improved performance lowered government resort to domestic credit markets.

Infact, this improvement of fiscal performance is the resultant of expenditure restraint rather than better revenue performance. Current expenditure barely kept pace with the increase in GDP (Table 4.5); moreover, given the rise in defence and debt service expenditures, the real expansion in current outlays for economic and social services has barely kept pace with population growth and was much less than is required for the operation and maintenance of public productive assets. At the same time, the expansion of public development expenditures has been curtailed and their share in GDP has fallen sharply.

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15. Ibid., p. 5.

Table 4.5

Consolidated Public finances,1978-79 /82-83 (million Rupees)

	1978-79	1979-80	1980-81	1981-82	1982-83 (revised)
Revenue	31,427	39,350	47,002	51,930	60,075
Tax	25,093	32,507	38,846	43,003	49,924
Non-tax	6,334	6,843	8,156	8,927	10,151
Autonomous bodies	975	1,464	2,019	1,909	2,286
Expenditure	49,717	55,477	63,639	71,013	85,993
Current	29,232	33,672	37,839	44,544	57,738
Development	20,485	21,805	25,800	26,469	28,255
Overall deficit (-)	17,315	14,663	14,618	17,174	23,632
Financing					
External resources (net)	6,711	6,951	7,741	5,345	5,702
External resources (gross)	9,216	12,555	11,374	11,263	14,974
Debt repayment (external)	2,505	5,604	3,633	5,918	9,272
Domestic non-bank (net)(a)	2,102	1,407	4,522	6,313	11,739
Domestic bank borrowing (net)	8,502	6,305	2,355	5,516	6,191
			Percentage of GDP		
Memorandum items:					
Revenue	16.0	16.7	16.7	16.1	16.3
Tax	12.8	13.8	13.8	13.3	16.6
Non-tax	3.2	2.9	2.9	2.8	2.8
Expenditure	25.3	23.6	22.6	22.0	23.4
Current	14.9	14.3	13.4	13.8	15.7
Development	10.4	9.3	9.1	8.2	7.7
Overall deficit	8.8	6.2	5.2	5.3	6.4
Domestic Bank	4.3	2.7	0.8	1.7	1.7

(a) Includes national savings scheme.

Source: World Bank, Pakistan: Review of Sixth Five Year Plan,p.6.

Over the Fifth Plan period, government revenues have remained about 16 per cent of GDP. Given the inelasticity of most tax revenues with respect to changes in national income, the stability in this ratio has been achieved through adhoc discretionary measures (eg, changes in tax rates, introduction of new taxes, improvement in tax administration) introduced with each year's budget. In addition, public corporations and public and semi-public bodies on average have typically self-financed only about 10-15 per cent of their investment programmes during the Fifth Plan, the remainder coming from the government budget or from domestic and foreign borrowings.[16]

Although, overall budget deficit and government borrowing from the banking system, which stood at 8.8 per cent and 4.3 per cent of GDP in the first year of the plan, fell to 6.4 per cent and 1.7 per cent respectively, by the final year of plan the story of fiscal imbalance did not end. Infact, this 6.4 per cent of budget deficit by the end of the plan connotes the fact of fiscal imbalance. Pakistan's budgetary situation was marked by imbalances between public expenditure and revenues of the state. This resulted the country in growing debt burden both domestic as well as external and continuous generation of new

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16. Ibid., pp. 5-6.

inflationary pressures in the economy due to deficit financing. From rather large amount of Rs. 14663 million representing 6.3 per cent of GDP in 1979-80, the budget deficit rose to a whopping Rs. 53,649 million (revised estimates) in 1986-87 which represented 8.8 per cent of GDP that year. The increase in public expenditure was not so much caused by the rise in development expenditure as by the growth of unproductive current expenditure comprising expenditure on defence, civil administration, interest payment on public debt and subsidies on food, fertilizer, sugar, edible oil and export promotion. Expenditure on current account swelled from Rs. 32, 824 million in 1979-80 to Rs. 124,592 million (budget estimates) in 1987-88 or 3.8 times. In contrast, the increase in development expenditure from Rs. 21805 million to Rs. 48130 million during the same period was 2.2 times.[17]

In order to finance this growing expenditure heavy reliance was placed on borrowing and deficit financing rather than increasing the size of the tax revenue. The tax revenue as percentage of GDP actually showed decline from 13.9 in 1979-80 to 10.8 per cent (revised estimates) in 1986-87 while internal debt increased from 20.9 per cent of GDP in 1980-81 to 40.9 per cent GDP in 1986-87.[18]

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17. Bhatia, *op. cit.*, n. 3, pp253-254.

18. Ibid., p. 254.

Table 4.6 Presents the profile of Pakistan's changing budgetary position since 1979-80 to 1987-88.

Table 4.6

Summary of Public Finance (Rs. Million)

	1979-80	1981-82	1983-84	1985-86	1987-88 (R.E.)	1987-88 (B.E.)
1. Total Revenue Growth	38502	51930	72290	89877	99550	114639
Tax Revenues	32507	43003	53646	43083	65835	78124
Non-tax Revenues	5995	8927	18644	26794	33715	36425
Surplus of autonomous bodies	1464	1909	2565	2942	2788	5158
2. Total Expenditure of which	54629	71013	100002	134463	155987	172722
Current	32824	44544	71945	94686	111518	124592
Development	21805	26469	28057	39777	44469	33630
3. Overall deficit	14663	17174	25147	41644	53649	52894
4. Financing (Net)	14663	17174	25147	41644	53649	52894
External (Net)	6951	5345	5001	8584	11327	11607
Domestic (Net) Non-Bank	1407	6313	12280	26962	30575	33643
Banking borrowing system (Net) borrowing	6305	5516	7866	18735	11747	7644

As percentage of GNP at Market Prices

Total Revenue	16.4	1.61	17.3	16.4	16.4	16.7
Tax Revenue	13.9	13.4	12.8	11.5	10.8	11.4
Expenditure	23.3	22.1	23.9	24.6	25.6	25.2
Overall Deficit	6.3	5.3	6.0	7.6	8.8	7.7

Source: At the back.

Source: B.M. Bhatia, Pakistan's Economic Development 1948-88: Freedom to Bondage p. 255.

From the table 4.6, mentioned above, the following observations may be made. Firstly, total revenue failed to cope up with rising expenditure which caused the budget deficit to rise steeply over the period covered by the table. While expenditure as percentage of GDP increased from 23.3 per cent in 1979/80 to 25.6 per cent in 1986-87, total revenue remained stationary throughout around 16.5 per cent of GDP whereas the ratio of tax revenue to GDP actually declined from 13.9 per cent in 1979-80 to 10.8 per cent in 1986-87. Secondly, steep increase in current expenditure caused the public expenditure to increase. The increase in development expenditure was comparatively small. Infact, the proportion of development expenditure in total expenditure fell from 39.9 per cent in 1979-80 to 29.6 per cent in 1985-86 and 19.5 per cent in 1987-88. Thirdly the mounting deficit had to be met by external and domestic borrowing on the hand and from the banking institutions which means deficit financing on the other. The former increased the public debt with debt service changes while the latter generate and intensified the inflationary pressures and caused rise in prices in the economy. This kind of situation made people to suffer from inflationary rise in prices and nation had to experience heaviys burden of debt not for meeting development expenditure, but for meeting current unproductive expenditure.

Finally, the widening expenditure-revenue gap points to the conclusion that the authorities throughout the period under review adopted the policy of drift and did not show the least desire to mobilise resources for meeting the mounting expenditure. They mortaged the future of the country to live well in the present.[19]

Between 1979-80 and 1986-87 while the total expenditure increased by 186 per cent, current expenditure went up by 240 per cent which shows that the government during this period was more concerned with raising its consumption expenditure than with increasing development expenditure which during this period went up by 10.3 per cent only. Within the current expenditure category, the increase during this period, in defence was 217 per cent, interest charges by 369 per cent, General Administration by 229 per cent and subsidies 101 by per cent. These four heads of expenditure accounted for 71 per cent of total current expenditures leaving 29 per cent of the gross current expenditure to be spent on education, health, and other developmental and social welfare activities so crucial to promoting welfare of the poorer sections of the society.[20]

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19. Ibid.

20. Ibid., p. 256.

The highest percentage increase in expenditure on a single item was that on interest. Expenditure on interest during 1979-87 increased by 369 per cent compared to 217 per cent increase in defence expenditure. This is because from the very outset, Zia's regime had decided to live on credit and meet the budgetary deficits by borrowing rather than going in for the unpleasant task of mobilising resources through increase in taxation. This inevitably led to mounting of debt and with it that of interest charges. Table 4.7 shows the growth of internal public debt of Pakistan in the eighties".[21]

Table 4.7

Internal Debt Outstanding (At end of Period) (Rs. Million)

	1980-80	1985-86	1986-87	End of March 1987	End of March 1988
Parmanent Debt	13758	58229	68609	63923	64121
Floating Debt	31688	87265	104886	104899	115994
Unfunded Debt	12641	57625	74982	66401	92351
Total	58087	203119	248477	235223	272466
Total Debt as percentage of GDP (Market Prices)	20.9	37.1	40.9	38.7	39.7

Source: B.M. Bhatia, Pakistan's Economic Development 1948-88: Freedom to Bondage, p. 258.

21. *Ibid*.

The monetary growth has been sharply reduced and inflationary pressures contained through most of the Fifth Plan. In each of the first four years of the plan, the growth of money supply fell reaching a 9.7 per cent rate in 1982, substantially lower than that of the first plan year (20 per cent) or the mid 1970s (about 23 per cent). In 1983, a balance of payments surplus and government commodity operations to support farm prices, coupled with a failure to take budgetary or other credit measures to off set these influences, lead to a 26 per cent expansion of the money supply.[22] With the exception of 1983, inflation rate declined throughout the plan reaching 6 per cent in the final year, lower than the first year of the plan (8.4 per cent). The improved price performance during the Fifth Plan took place in an environment where government was beginning a major rationalisation of energy prices and the reduction of subsidies on food consumption and farm inputs, which necessitated substantial changes in the prices charged for power, petrol, natural gas, and agricultural products.[23]

An evaluation of the balance of payment

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22. <u>World Bank</u>, *op. cit.*, n.3, p.7.

23. <u>Ibid</u>.

performance during the Sixth Plan suggests that in contrast to the anticipated strengthening of the external position, Pakistan's balance of payments came under some pressure. Despite impressive trade performance, the current account position weakened, covering 3 per cent of GNP, largely on account of the fall in worker's remittance flows which led to a sharp erosion of Pakistan's surplus on its invisible account. On the capital account, shortfall in external assistance and other capital flow, and higher debt service payments (including repurchases from the IMF), are expected to lead to awakening of Pakistan foreign exchange reserves position.[24] More particularly, Pakistan's balance of payment situation during Zia's regime was characterised by (i) a further widening of the already big trade gap; (ii) a massive increase in inflow of foreign assistance; (iii) a sharply rising burden of debt servicing charges on foreign loans; and (iv) an exhilarating large increase in home remittance from expatriates abroad.[25]

In the period 1977-78 to 1980-81, exports increased sharply in response to higher prices brought about by the uprising in world trade, as well as

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24. Government of Pakistan: Seventh *op. cit.*, n.3, p. 63.

25. Bhatia, *op. cit.*, n. 2, p. 258.

increased production. Even though the terms of trade had started to weaken, in 1979-80 there was no immediate impact on exports. In contrast to the poor performance of earlier years, exports of rice and raw cotton grew faster during this period than did those of its principal competitors. Non-traditional exports, such as carpets, tanned leather, surgical equipment, and sports and engineering goods, also grew at a rapid pace. The picture changed quite dramatically in 1981-82 when export earnings declined by over 17 per cent. This was in part due to the previous fall interms of trade, and in part to the loss of international competitiveness. The real exchange rate appreciated by over 10 per cent in 1981-82. The subsequent change in exchange rate policy helped to get the export growth rate back upto around 2 per cent per year in 1982-83 to 1984-85. In 1985-86 exports grew of nearly 20 per cent and exports continued to grow at an average of 20 per cent between 1985-86 and 1987-88 in nominal terms.[26]

While the average rate of growth of exports may have been reasonable, imports have grown at a much faster rate. From 1977-78 to 1980-81, imports expanded at an

26. Mohsin S. Khan, "Macro Economic Balances" in W. James and S. Roy ed., Foundations of Pakistan's Political Economy: Towards an Agenda for 1990s. (New Delhi, 1992), P. 152.

Table 4.8

Balance of Payments, 1972-73 to 1987-88 (US $ Million)

	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88
Exports	1283	1644	2341	2799	2319	2627	2669	2457	2498	3498	4362
Imports	2751	3816	4857	5563	5769	5616	5993	6009	5984	5792	5119
Trade balance	-1469	-2172	-2516	-2764	-3450	-2989	-3324	-3552	-3042	-2294	-2557
Non-factor services	-181	-205	-238	-254	-176	-189	-275	-305	-376	-287	-553
Investment income	-181	-233	-231	-261	-320	-420	-442	-506	-640	-695	-828
Private transfer	1226	1496	1895	2242	2412	3081	3044	2687	2822	2557	2256
Worker's remittances	(1156)	(1397)	(1748)	(2095)	(2225)	(2886)	(2737)	(2446)	(2595)	(2278)	(2013)
Current account balance	-605	-1114	-1140	-1037	-1534	-517	-997	-1680	-1236	-719	-1682
Private capital	128	163	174	261	364	673	265	108	257	320	330
Public capital	811	743	1365	811	605	522	652	586	939	656	1242
Allocation of SDR	-	38	39	37	-	-	-	-	-	-	-
Errors + ommissions	-20	-17	15	-25	-15	20	-6	-31	-26	7	-30
Change in reserves (- = income)	-315	185	-453	-45	580	-698	86	1017	-434	-264	140

Source: Mohsin S. Khan, Macro-Economic Balances, in W. James and S. Roy, ed.,- Foundation of Pakistan's Political Economy; Torwards on Ag

Agenda for 1990s.

average rate of 27 per cent. Most of this increase was due to imports of intermediate goods as government relaxed controls on imports of these items. In the 1980s the growth rate of imports fell dramatically, and between 1985-86 and 1987-88 grew at an average rate of 14 per cent.[27]

The trend in exports and imports resulted in a substantial widening of the trade balance deficit overtime. The deficit rose from $ 1.5 billion in 1977-78 to over $ 3 billion in 1985-86. A large portion of this deficit was covered by worker's remittances, especially from the Middle East which rose from about $ 1,156 million in 1977-78 to nearly $2.6 billion in 1985-86 (see table 4.8). The worker's remittances accounted for about 90 per cent of exports. Following the second oil shock, there was another surge in remittances, and in 1982-83 they had reached $ 2.9 billion, actually surpassing export earnings for that year. Since then, the flow has been declining as activity in Middle East countries slowed down after the fall in oil prices. Even so, by 1985-86 worker's remittances were close to 90 per cent of export of goods. Exports grew more rapidly than imports from 1985-86 to 1987-88. However, remittances continued to decline resulting in continued pressure on

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27. Ibid p. 159.

the balance of payments.[28]

The GDP growth rate of 6.5 per cent per annum, in part, was bolstered by the massive amount of foreign assistance received by the country in the wake of Russian intervention in Afghanistan in December 1979. While no information is available on the exact inflow of military aid into the country from USA, economic assistance rose from an average annual disbursement of US $ 770.6 million in five years preceeding the beginning of his rule to US $ 1201 million in the first 10 years of General Zia's rule. The spurt in the inflow of foreign assistance helped to boost up the growth rate but at the cost of increasing debt burden of the country. The external outstanding debt of Pakistan which stood at $ 6.34 billion at June-end 1977, rose to $ 12 billion at June end amount in ten year period. Correspondingly the debt service charges rose from $ 311 million on 1976-77 to $ 1.1 billion in 1986-87which is slightly more than 3.5 times the amount at the start of General Zia's rule.[29] The seeming prosperity of Pakistan during Zia's reign was thus obtained by mortgaging its future. The consequences of that policy were seen clearly by 1987-88 when the

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28. Ibid.

29. Bhatia, *op. cit.*, n.2, p. 242.

total aid at $ 1145 million disbursed to the country fell short of debt service payments that year at $ 1154 million. In otherwords, by the time General Zia died, reverse flow of capital had started from the country as a result of the temporary prosperity he had brought to the country during his rule.[30]

Due to heavy external dependence, Pakistan's external debt liabilities have mounted steadily during Zia's. This can be seen from Table 4.9.

Infact, in Pakistan, the rapid increase in debt during Zia's period casued heavy debt servicing compulsions. In developing debt situation a stage was reached where the country was forced to ask for more and more external assistance to discharge its current debt servicing obligation. Of late it had started resorting to short-term borrowing which carry higher rates of interest help to increasing the debt servicing burden still further. Taking short-term borrowing and use of IMF facility into account the external debt burden of the country stands much higher than the figure given in Table 4.9 would suggest. Thus for instance, in 1986 the World Bank figure for total outstanding debt of Pakistan that year is $ 13620 million as against $ 11108 million which

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30. Ibid.

Table 4.9

Total Outstanding External Debt of Pakistan (US $ Million)

At The End of	Outstanding Debt
1976-77	6341
1977-78	7189
1980-81	8755
1981-82	8799
1982-83	9312
1983-84	9469
1984-85	9732
1985-86	11108
1986-87	12022
1987-88 (Revised estimates)	12443

Source: B.M. Bhatia, Pakistan Economic Development 1948-88: Freedom to Bondage, p. 263.

is the official figure for the same year given in Pakistan Economic Survey.[31] Hence the actual burden must be higher than what is admitted in official documents.

As far as employment position in concerned during Zia-era, the situation is assessed as below.

31. Ibid., p. 263.

Pakistan has a large population (of more than 100 mn, not only among the largest in the world, but also growing at one of the highest rates in the world), and at literacy rate, not much above the lowest in the world. The rate of participation in the educational institutions is low. More over, there is very small base for training and skill formation because academic institutions suffer from growing admissions and declining standards. Another problem is the incompatibility of the labour force with emerging skill requirements of the economy. This stems from: (a) the absence of formal institutional mechanism to plan, co-ordinate and monitor supply in accordance with observed and potential needs of the economy,(b) neglect of employment considerations when setting sector-specific production targets, and (c) an inadequate data base for man-power planning.[32]

In this predicament, a high economic growth rate based on expansion and growth in the agriculture and industry has provided employment to absorb a large part of the additions to the labour force. But there are indications that in recent years man power supply has been increasing faster than the rate of job creation of the economy.[33]

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32. Govt. of Pakistan, *op. cit.*, n. 1, p. 89.

33. Ibid.

The 1981 census recorded 27.6 per cent of the total population and 40.2 per cent of the population aged over ten years are being in the labour forces. This low participation rate also reflects the very low percentage of women aged over ten in the labour force (2.1 per cent according to the 1981 census). Unemployment is officially estimated at 4 per cent but as much as a quarter of the labour force is unemployed (defined as working less than 35 hours a week). Only 27.4 per cent of the employment labour force are wage earners, an indication of the extent to which unpaid family help is used in the rural areas and the heavy preponderance of casual and self-employed in informal services occupations in the urban areas. Surprisingly, the percentage of wage employees (167 per cent) in the urban areas was markedly lower than in the rural areas (48.8 per cent).[34]

Since 1973 in particular, large number of Pakistanis have emigrated to the Middle East and their remittances have become one of the main-stay of the economy with their value approaching that of exports. The precise number of overseas worker is not known. It was officially estimated that 2.5 million Pakistanis (about

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34. Economist Intelligence Unit: Country Profile, 1986-87. p. 16.

10 per cent of labour force) were working in the Middle East in 1984, though unofficial estimates were as high as 4 million.[35] This migration of workers reached its peak in 1982/83. After 1982/83 there was substantial cutback in development spending in the Middle Eastern Countries due to completion of a number of construction projects which reduced demand for overseas labour combined with the weakening of oil price.

The Sixth Plan had, however, witnessed considerable improvement in the demand for labour in domestic market. The high rate of economic growth helped to create employment at sufficiently high rate to absorb a large part of the additions to the labour force. Total employment was expected to increase by 3.3 million (from 26.5 million in 1983 to 29.8 million in 1987-88), or at an annual rate of 2.4 per cent. According to the Labour Force Survey (LFS) of 1986-87, employment has grown at an annual rate of 2.6 per cent and is likely to exceed the plan target.[36]

The Labour Force Survey (LFS) for 1986-87 indicates that despite these developments, open unemployment remained unchanged at around one million in

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35. Ibid

36. Govt. of Pakistan, *op. cit.*, n.1, pp. 89-90.

absolute numbers and declined from 3.9 per cent to 3.1 per cent of the labour force. The main reason for this apparent improvement in the rate of unemployment is the decline in labour force participation rate from 30 per cent in 1983 to 29 per cent in 1987. This implies that an increasing proportion of potential workers are not seeking jobs.

The government responded to the emerging unemployment situation in the country during the Sixth Five Year Plan mainly by focussing on the employment situation of the educated. Firstly, the emphasis on education and health in the Prime Minister Junejo's Five point programme led to an improvement in the employment opportunities for educated man- power. Secondly, special programmes were launched to remove the backlog of unemployment among doctors and engineers. Thirdly, a National Employment Fund was created in 1986-87 which contributed considerably to the financing of projects directed towards reducing unemployment in the country. Due to the resource constraints, however, the Employment Fund was allowed to lapse and was not renewed in 1987-88. However, the existence of the Fund for a brief period did encourage the development of new schemes. In addition, the development of the Youth Investment Prommotion Society (YIDS) with programmes directed towards financing self-employment was the most promising new initiative. The government also set up a National Man-power Commission in August 1987, to develop a comprehensive long-term strategy for man-power development.[37]

The kind of unemployment situation was precarious during the Sixth Plan. Quite often, it was considered highly necessary to create public sector jobs for the trainned professionals. However, as experiences has shown, it is clear that public sector can not absorb the huge unemployed labour force. Unemployment levels in Pakistan during Zia's reign was so much that a job creation center for only few thousand professionals will not remove the problem substantially. What infact was needed was a comprehensive and basic program for employment generation in the economy.

The concept of disinvestment sought under the policy of liberalisation and privatisation did not succeed in Pakistan due to under-developed capital market and political considerations. Despite the pronouncements by the government, privatisation process in Pakistan was quite low. Investment controls over the big projects continued. Similarly, the import regime remained restrictive despite liberalisation of import policy over the Zia period. Nevertheless, the main failure has been in the

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37. Ibid., p. 90.

denationalisation and disinvestment of the public sector corporations. Pakistan found it very difficult to denationalise and disinvest public sector units because of the small and under developed capital markets and the fact that investors have a short-run view. The investors would like to buy the profit earning units rather than the loss making units even at reduced prices. While the government would like to divest shares of profit-making units, its attitude is ambivalent; it wants to divest minority shares but retain the management. It reduces the profitability of divestiture as the private sector shows less interest in firms where it may have a limited control.

CHAPTER - V

CONCLUSION

After the birth of Pakistan, there broke out an Indo-Pak war that brought about lot of hardship to the new born country which had been struggling hard to construct its economic edifice. The development strategy adopted by the ruling elites during its first decade of existence was aimed at giving a dominant role to the private sector. The setting up of Pakistan Industrial Development Corporation (PIDC) in 1952 was a major step taken by the government to boost the private sector. This was a semi-autonomous state agency charged with the responsibility of promoting industrial development by financings and equity participation in the private ventures as well as launching its own projects. Most of its own projects were handed over to the private sector, either through public issue of shares or a partnership arrangement. Besides, the Government had adopted various incentive schemes to entrepreneures. The fiscal policy of 1953-54 was designed to provide powerful incentives to private enterprise in the form of bounties and subsidies to traders and manufactures, tax concessions and establishment of industrial parks.

During the first ever Martial Law period between 1958-1969 imposed by Ayub Khan brought forth a new era of privatisation in Pakistan. It dismantled controls on prices and profit margins; it liberalised imports and made it much easier for those wishing to undertake new investment in the industrial sector. Import licenses were issued to the private sector liberally to encourage imports of machinery and raw-materials. In the sphere of exports elaborate stimuli were provided to encourage the export of manufactured goods, and also incentive in the form of custom and excise duties were provided on inputs for exported goods, credit guarantee to the exporters, and tax-holidays to industries which exported a proportion of their goods. The Export Bonus scheme (EBS) was adopted to favour manufactured export.

Infact, this policy contributed significantly to the upsurge of industrial production and private sector investment. However, it also created problems such that it became difficult for the government to keep track of industrial investment sanctioned and in many cases greater investment took place in certain industries than was originally planned. Due to these precarious conditions- problems of bad harvest, increase in defence expenditure and slowing down of foreign loan inflows, the government felt to impose the policy of control. But, in 1967-68 the government was able to bring price under control through its monetary policy. However, the overall strategy of Ayub Khan resulted in social and economic tensions which led to his fall in 1969. Yahya Khan, the second Martial ruler of Pakistan more or less followed the economic strategy of his predessors.

The development strategy under the Prime Ministership of Zul-fiqar Ali-Bhutto from 1971 to 1977 underwent a qualitative change in favour of public sector. He had reversed the policy of Ayub Khan by initiating the policy of nationalisation for the first time in the economic history of Pakistan. In the first phase of nationalisation which began in January 1972, the Government took over thirty-one industrial units which fell under the ten categories of basic industries. The industries which were brought under the public sector were none but iron and steel, basic metals, heavy engineering, motor vehicle and tractor-assembly, heavy and basic chemicals, cement, petrochemicals and public utilities. Besides, in March 1972 the management and control of thirty two Life Insurance Companies were nationalised.

The second phase of nationalisation started in 1973 with the taking over of cotton and rice exporting sector, vegetable oil (Vanaspati) industry, petroleum marketing and maize shipping. On 1st January 1974 the nationalization of Pakistan Scheduled Commercial Banks also took place. The nationalisation of consumer and service sector which have crucial significance in the

Pakistan Economy were counted as a major development. During the 1970 election, the Pakistan People's Party (PPP) had promised a socialist pattern of the economy. This was the fulfilment of his election manifesto. Throughout the Bhutto's regime while people were expecting a higher economic growth, there had been almost a continuous deterioriation in actual economic situation. At the end of his rule, growth rate had reached lowest point of 3.5 per cent, evenr reached since its independence. This strategy of Bhutto did not continue after 1977. This was so because, Ayub's strategy had already created some interest groups in the economy who strongly opposed Bhutto's policy. The landlords and civil-military bureaucratic elite who had ruled the country since independence also felt alienated and thought that they were being deprived of the privilege they had enjoyed all along. Civil disorder mounted rapidly. Their opposition combined with that of the hostility of the external influences of MNCs brought about the downfall of Bhutto.

The Pakistan economy entered into a new phase of development strategy under the military leadership of General Zia-ul-Haq. He adopted the policy of privatisation as a model of his growth strategy. The policy was intended to improve in the allocation and utilisation of resources by reducing fiscal deficits and providing for badly needed physical and social infrastructure, and fostering more competition and broad basing the ownership of equity capital. To encourage private sector the government denationalised most agricultural processing and few industrial units, introduced safeguards against nationalisation, widened areas open to the private sector, restricted public sector industrial investment to the completion of ongoing projects, adopted more liberal trade policy and introduced a wide range of industrial incentives.

A wide area of industrial activity was thrown open to the foreign investors and investment was particularly encouraged in industries which required sophisticated technology and were highly capital intensive. Moreover, separate laws were enacted to provide complete security to foreign capital and freedom was provided for the repatriation of capital and dividends. Commercial policy and foreign exchange regulations were also liberalised. Besides the government had taken some steps to have fiscal reform and to boost exports.

The privatisation policy of General Zia-Ul-Haq had considerable impact on various spheres of Pakistan economy. During his tenure Pakistan could achieve the highest GDP growth rate of 6.5 percent per annum. The percapita income also increased at an annual growth rate of 3.3 percent. By the end of the period, with a percapita income of US $ 380, Pakistan entered into the middle income countries group of the World Bank's development tables. It was reviewed that, in the Fifth Plan which covers Zia-era, although the growth in national output, agriculture, industry and exports were below targets, they were substantially above the rates achieved during 1970-78. It was a respectable growth compared to the experiences of most Less Developing Countries (LDCs) over the same period. However, it is to be noted that the impressive performance of Pakistan economy during Zia's era was influenced by the massive amount of foreign assistance flown into Pakistan in the wake of Soviet intervention in Afghanistan.

In the Fifth and Sixth Plan periods, the aggregate private and public savings and investment fell short of the plan targets. This resulted in high investment saving gap in Pakistan from 1977-78 to 1987-88. As far fiscal policy is concerned, although budget deficit has fallen to some extent, still there were fiscal imbalances throughout his period. There had always been a gap between the revenue and expenditure, particularly unproductive expenditure. The highest percentage increase in expenditure on a single item was that on interest. Expenditure on interest during 1979-87 increased by 369 percent compared to 217 percent increase in defence expenditure.

General Zia had effectively implemented monetary policy to control inflation throughout his period. With regard to balance of payments, it improved from 1977-78 to 1980-81. But the picture changed quite dramatically in 1981-82 when export earnings declined by over 17 percent. The trend in exports and imports resulted in a substantial widening of the trade balance deficit overtime. The balance of payments position was more precarious towards the end of his period. During Zia's reign there was also high external borrowing which increased the debt burden of the country. As far as employment condition was concerned, the situation was not good. The high growth rate of population was one of the factors which was responsible for influencing the unemployment situation. Besides, the return of most of the Pakistani workers from the Middle East aggravated the unemployment situation.

To summarise, the process of liberalisation and privatisation in Pakistan undertaken during 1977 to 1988 resulted in limited success. Eventhough some major policy formulations such as licensing procedure had been simplified, import policy had been liberalised and price controls had been abolished, still it had been very difficult to disinvest. Although some investments have been made free from licensing, almost all the big projects needed to be approved by the government. Further due to the existence of underdeveloped capital market and also due to political considerations, Zia's policy of disinvestment was not quite successful. Even after the liberalisation of import policy, domestic industries had no choice but to remain under the protection of the government. Therefore, it may be concluded that the policy of liberalisation and privatisation in Pakistan need to be pursued further till her economy achieves a significant improvement.

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