

Analysis of the Political Economy of Industrial Policy in Pakistan

The Role of the State as Entrepreneur and Conflict Manager

January, 2009

**By
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Dedication

To my parents, wife and children!

Analysis of the Political Economy of Industrial Policy in Pakistan
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ABSTRACT

The role of the state in industrial development has historically been important. The state provides political and economic enclave in which industrial policy interventions are designed and implemented. This working paper attempts to apply Institutional Political Economy framework to analyse the political economy of industrial policy in Pakistan. Under the framework, literature on industrialization and the role of the state was reviewed and while using historical analytical perspective, the role of the state as entrepreneur and conflict manager was explored. The study shows that the state has played a significant role in determining the resource allocation and policy instruments to support industrialization. In doing so the state has exhibited suboptimal performance as entrepreneur and conflict manager. Resultantly, the industrial growth and development in Pakistan is slow in comparison with other countries especially South Korea. Therefore, in order to bring a viable economic change in Pakistan, the state must capacitate itself to provide vision for the future, establish and strengthen institutions of economic change coordination, and provide governance structure which can effectively manage political and economic conflicts.

Acknowledgement

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List of Abbreviations

BVS	Business Voucher Scheme
DFIs	Development Finance Institutions
EOI	Export Oriented Industrialization
EPZs	Export Processing Zones
GDP	Gross Domestic Product
GNP	Gross National Product
IMF	International Monetary Fund
IPE	Institutionalist Political Economy
ISI	Import Substitution Industrialization
LDCs	Less Developed Countries
MDGs	Millennium Development Goals
NICs	Newly Industrialized Country
PICIC	Pakistan Industrial Credit and Investment Corporation
SAP	Structural Adjustment Programme
TFP	Total Factor Productivity
WB	World Bank
WTO	World Trade Organization

Chapter 1: Introduction

‘A major economic transformation in (or towards) modern economy requires a state which can effectively perform the roles of the ultimate entrepreneur and the conflict manager’ (Chang and Rowthorn, 1995b, p. 46).

Rapid industrialization for economic and social development needs coordinated encouragement of desirable activities. The state plays a critical role in this process. Many researchers have argued that a primary role of the state in envisioning structural change as well as establishing viable coordination mechanisms, during different phases of industrial development, has been a key feature of the ‘late industrializers’¹ in East Asia (Chang, 2002; Chang, 2003b; Nixon, 2007b; Colman and Nixon, 1994; Amsden, 1989). However, since the early 1980s, many economies have been structurally adjusted and the role of the state shifted from interventionist industrial and economic management towards liberalization. In fact, the neoliberal idea system behind this shift assumes the institutional primacy of the markets for economic change and emphasizes reforms in other institutional arrangements in line with the theoretical assumptions of free market economy (WB, 2002; Henderson, 2007). On the other hand, since late 1980s, there is a reinvigoration of academic interest in the role of the state and designs of industrial policy which contradicts the basic assumptions of neoliberal orthodoxy. The debate discusses effectiveness of interventions by the state in industrial development as well as technological capability enhancement (Lall, 2000). A growing body of knowledge has also argued that direct interventions by the state has played a critical role in the growth of industrial capability of many economies of Western Europe and the USA in the past (Chang, 2003a; Chang, 2003b; Shafaeddin, 1998).

In the context of debates around industrial policy, this working paper analytically explores the political economy of industrial policy and its outcomes in Pakistan. Like other countries of Latin America and East Asia, the state in Pakistan has historically played an important role in distributing access to developmental resources through various policy instruments and institutional arrangements. However, ethnicity, institutional imbalances, income and regional disparities have also been significant mediating factors. These factors have influenced the execution of capital accumulation and distribution policies which ultimately affect outcomes of industrial development strategies (Sayyed, 1995; Noman, 1988). It is also observed that inadequacies of policy instruments, the nature of the state-society relationships, and incapacity of administrative structures have shattered the ambitious dream of Pakistan to transform itself into a miracle economy (Hasan, 1998; Khan, 2000a).

This working paper also seeks to contribute to the industrial policy debate using a distinct perspective to analyse Pakistan’s industrial performance. Most of the researches on industrial performance of Pakistan have explored the manufacturing sector growth and development under mainstream tradition of economic analysis (Wizarat, 2002; Kemal, 1978; Kemal, 1999; Ahmad, 2008). More recently, a body of literature on industrialization has emerged which contextualizes the political alignments, accumulation and distribution

¹ Late industrializers are the countries which industrialized later than the UK, the USA, and Germany. Alice Amsden (1989) defines late industrializers as: ‘Countries which industrialize without the competitive asset of being able to monopolize an original technology’.

patterns, and the role of state as an important factor whose typical character influences the pattern and growth of manufacturing sector (Sayyed, 1995; Nadvi and Sayyed, 2004; Khan, 2000b). Therefore, using insights of Institutional Political Economy (IPE) framework, this working paper contributes to this growing body of knowledge on industrial policy debate in Pakistan.

The IPE framework was developed by Ha-Joon Chang to analyze the role of the state in economic change (Chang and Rowthorn, 1995b; Chang, 2002). The framework offers a distinct perspective from other approaches. For example, welfare economics assumes the state to be a social guardian, while for institutional economics the state is an important manager of institutions which direct and determine human behaviour. The neoliberal theory, on the other hand, assumes that any role of the state beyond market facilitation is a structural rigidity (Chang, 1994).

Under the IPE framework, the state is primarily analysed for two fundamental roles in economic change i.e., entrepreneurship and conflict management. As an entrepreneur, the state must provide vision for the future as well as develop viable institutional arrangements in the period of economic and structural transformation, resource allocation, and coordination. As a conflict manager, it should institutionalize the emergent coordination structure, protect the desired new property rights as well as design and execute the public policy agenda. In essence, the state should provide viable governance structures for conflict management and institution building (Chang, 2003a, p. 69-70).

1.1 Objectives of the Study

The main objective of this study is to analyse the political economy of industrial policy in Pakistan. Therefore, arguments and empirical evidence are reviewed with a historical analytical perspective which is embedded in the IPE framework. The study seeks to achieve two main objectives. Firstly, it will possibly contribute as a preliminary country case study in the emerging body of knowledge on Institutional Political Economy in Pakistan. Secondly, it will assist observers of Pakistan to develop understanding of industrialization in the context of social, political, and economic variables. In line with the objectives, the main themes selected for the study include: the mainstream policy orientation and performance of industrialization process in historical perspective, and the role of the state in industrial growth and development in Pakistan.

1.2 Methodology

The research used qualitative and analytical methods of systematic inquiry. Review of literature on the role of the state, Institutional Political Economy, and other mainstream theoretical frameworks was undertaken to articulate theoretical underpinnings and to build background information on main issues of the political economy of industrial policy and development. The issues which emerged from the literature review were used as guideline for inquiry into Pakistan-specific review of literature.

The main sources of data on industrial performance were the analytical works on Pakistan, South and East Asia, and Latin America. In addition, to bring in a sense of 'triangulation' (Jick, 1979, p. 602) in analysis of Pakistan related data, analytical works by researchers such as Dr. Akbar Zaidi, Dr. A. R. Kemal, Dr. Shahida Wizarat, Parvez Hasan, Dr. Khalid Nadvi, and Dr. Asad Sayyed were extensively consulted.

The research used secondary data to analyse facts and drew conclusions from a distinctive perspective of Institutional Political Economy. Though, the use of secondary data and published analysis had obvious advantages such as saving financial cost and time, nevertheless it had gaps which personal interviews with private and public sector employees might have helped to bridge. Another disadvantage was that the research needed to explore some institutional dimensions of coordination within private and public sector but relevant material was difficult to arrange from Pakistan in a short period of time. Therefore, the problems associated with incomplete triangulation could have impaired some analytical aspects of the research.

1.3 Scope of the Study

The study primarily focuses on the political economy of industrial policy of Pakistan for two reasons. Firstly, Pakistan is one of those few developing countries who started with almost negligible industrial base, poor agricultural infrastructure, and inadequate administrative resources. Despite these resource constraints, within a decade, it was able to bring about significant basic structural transformation in the economy i.e., increasing the share of manufacturing in GDP. Secondly, despite initial progress in structural transformation and industrialization, Pakistan was paradoxically not able to establish institutional arrangement for negotiated settlement of conflicts and resultantly experienced decline in industrial performance since the mid 1960s. These apparently contradictory aspects make the country an interesting object of analytical case study which can possibly contribute in understanding of the role of the state as entrepreneur and conflict manager. However, this study does not seek to present a comprehensive overview of Pakistan's sectoral industrial development. Since, the purpose of the research is analysis of political economy of industrial policy only a brief mention will be made about the sectoral composition of industrial output and exports.

1.4 Structure of the Working Paper

After this first chapter which introduces the working paper, the second chapter provides review of theoretical and empirical literature on the role of state and industrialization. The third chapter elucidates the political economy of industrial policy of Pakistan and develops historical perspective for an in-depth analysis of the role of the state in the following chapter. The fourth chapter thus deals with the role of the state as entrepreneur and conflict manager in the context of industrialization in Pakistan. The last chapter sums up the discussions and concludes debates around the political economy of industrial policy in Pakistan.

Chapter 2: Literature Review

2.1 Theoretical Underpinnings of Industrial Policy and the Role of the State

Industrialization has been seen synonymous with modernization of manufacturing and agriculture sector leading towards improved standards of living (Colman and Nixon, 1994, p. 279). Possible driving factors which prompted national desire for industrialization include realization of low income elasticity of demand for primary products and, in many countries, a post-colonial political sensibility of catching-up with the developed world in the West (Chang, 2003a; Lal, 1997). Therefore, structural transformation from agriculture to manufacturing was a necessary intervention for rapid economic change (Chenery et al., 1986). More recently, however, in the context of Millennium Development Goals (MDGs) labour-intensive industrialization has also been reemphasized for pro-poor growth, employment creation and poverty eradication in developing countries (Memiş and Montes, 2008; Nadvi and Sayyed, 2004).

Looking at from another angle, industrialization can also be described as a process of accumulation, productive investment, and structural transformation which tends to supplement and replace labour with mechanical and electrical processes (Nixon, 2007b). Therefore, industrialization as process of structural transformation needs a suitable coordinating actor for social, technological, and economic reasons. One more compelling reason for a coordinating actor lies in the fact that ‘the capital stock is interdependent in use but independent in ownership’ (Abramovitz, 1986, p. 402).

However, the identification of a feasible coordinating actor is debated more intensely since the late 1970s with the rise of neoliberalism. The debate has, in addition, provided basis for re-examination of industrial development experiences in different parts of the world (Chang, 2003a, p. 24). In this debate, the role of the state is a core issue because the state has historically provided the ‘capsule’ for changing the living standards of people through policy interventions and institutional arrangements (Chang and Rowthorn, 1995a; Memiş and Montes, 2008).

2.1.1 The Neoliberal Perspective

According to the mainstream neoliberal idea system², direct intervention by the state other than to correct market failure, is not required. Similarly, specific industrial policy is deemed to be a regressive intervention and a suspect process of economic change (Chang, 2003a, p.105). It is argued that industrial policy should actually remove distortions from markets which emerge from interventions of the government (Lindbeck, 1981, p. 403). It is claimed that inadequacy and unavailability of policy instruments which can successfully negotiate multiplicity of industrial policy objectives makes the specific industrial policy less useful (Pangestu, 2002, p. 149).

The desirability of a non-interventionist state is also argued on the basis of theories about principal-agent and bureau model problems (Niskanen, 1973), as well as government failure, transaction cost, and rent-seeking issues (Grand, 1991; Krueger, 1974). The main contention

² The neoliberal idea system draws heavily from the neoclassical assumptions. However, about the role of the state it assumes primacy of the markets over other institutions.

is that government failure is a more serious problem than market failure. As a result, under neoliberal idea system, industrial policy must eliminate the state-led directive interventions and expand manoeuvring space for the market-based allocations in an aid to resolve issues of increasing global competition and profits (Glyn et al., 1990; Yu, 1997).

2.1.2 The Heterodox Perspective

The heterodox theoretical perspective³, on the other hand, attempts to dismantle the central claims of neoliberal orthodoxy embedded in the Washington Consensus approach. The central claim of the neoliberal idea system that 'states should not shape industrial development' is, therefore, re-examined both on theoretical and empirical grounds. Therefore, the revisionist literature explores the role of the state and economic bureaucracy in provision of investment coordination and administrative guidance in Japan and other Newly Industrialized Countries (NICs) which made rapid industrialization a reality (Johnson, 1982; Amsden, 1989; Wade, 1990).

Many researchers mention the role of reciprocal subsidies and strict monitoring by the state in East Asia which helped to reduce social waste and management of rent-seeking and principal-agent problems (Amsden, 1989; Wade, 1990; Chang, 1996). Therefore, the so-called 'government failure' argument is re-examined from a diverse range of theoretical perspectives and empirical evidence.

A growing body of knowledge also challenges the assumptions which support general and limited industrial policy prescriptions in a free-market economy. The main argument for specific industrial policy emphasizes the firm-level micro-economic targeting as primary ingredient of industrial policy (Shapiro and Taylor, 1990, p. 876). Contrary to a general industrial policy argument, firms are assumed as building blocks for industrial competitiveness in global production networks and value chains (Dicken, 2007). Therefore, the state has to go beyond setting the rules of the game and 'getting prices right', and try to build firms' capacity to successfully enter emerging globalized production systems (Lall, 2003; Lall, 2000).

Similarly, Schumpeterian innovation patterns regard structural change towards industrialization as an inherently disequilibrium process which needs more systemic interventions than a passive system of generalized incentives can offer (Memiş and Montes, 2008). Therefore an important reasoning in this line of argument is about building viable technological capability which requires an active role of the state to protect domestic entrepreneurs and firms against excessive competition with risk-management and sharing of sunk-costs techniques (Lall, 2000; Khan, 2007).

2.2 Empirical Evidence on the Role of the State and Industrial Performance

2.2.1 East Asia

The case of industrial policy success in East Asia is challenging for both the free-market oriented neoliberals and 'export pessimist' Latin American structuralists and dependency

³ Heterodox perspective refers to an umbrella term for non-neoclassical pluralistic shades of economic analysis. It includes, amongst others, feminist, Marxist, post-Keynesian approaches. A mark of distinction is that heterodox economics tries to understand economic phenomena through the lens of history, social dynamics, and the role of institutions.

theorists (Nixon, 2002, p. 68; Yu, 1997). Starting with Japan's initial structural transformation in 1920s, this region shows the possibility and success of entrepreneurial and purposeful interventions by the state (Chang, 1996; Yu, 1997; Memiş and Montes, 2008). The role of the state in establishing sustained export performance through a mix of interventions which directed credit to promote specific domestic industries. For example, 57.9% loans between 1962-85 in South Korea were subsidized and prioritized 'policy loans'. In addition, during the period between 1979-88, the industrial performance of South Korean heavy, chemical, and light industries working under Heavy and Chemical Industrialization (HCI) programme were much higher than many other countries such as Brazil, Chile, Greece, Mexico, South Africa, and Spain (Chang, 1993, p. 135-141).

However, in line with general industrial policy argument, Stiglitz and Charlton (2005, p. 13) identify the catalyst role of state in provision of the physical and institutional infrastructure in East Asian economies. Chang (2003b), on the other hand, convincingly presents empirical evidence about infant industry and protection techniques being historically present which go well beyond provision of facilitative infrastructure. In South Korea, for example, the state has followed specific industrial policy while aligning macro-economic and flanking policies in line with the industrial policy objectives. In addition, the state explicitly directed the firms to invest in long gestation heavy and chemical industries instead of engaging in quick profit yielding consumer goods production (Chang, 1993, p. 137; Amsden, 1989, p. 269-90). Like Brazil for aerospace industry, evidence indicates that other countries of Europe such as France, Austria, and Norway resorted to selective industrial policies (Chang and Grabel, 2004, p. 75).

2.2.2 Latin America

In Latin America, the early phase of ISI increased growth rate in manufacturing sector which on average was 6.5% between 1950-81. This growth rate was higher than many developing countries. During the same period GDP grew by 5.3% per annum and income per capita doubled albeit extreme polarization in income levels. The growth rate was reduced to 1.9% between 1991-2002 and income per capita stagnated (Palma, 2003, p. 125-128). ISI phase helped Latin America develop domestic market, technological infrastructure as well as establishing backward and forward linkages in production systems (Nixon, 2007a). It is argued by Latin American structuralist economists that ISI strategy with an active role of the state helped develop Brazil for the 'economic miracle' of 1960s and the 1970s (Jenkins, 1992).

However, it is also argued that 'export pessimism' of dependency theorists made the 'post-ISI' phase rather an uncharted territory for Export Oriented Industrialization (EOI). EOI required more dynamic response from the political, administrative and capitalist elite. Instead of an innovative response, ISI period was over-stretched which resulted in extreme financial difficulties paving way for neoliberal ascendancy in early 1980s without any recovery of growth rates (Nixon, 2002; Palma, 2003). Interestingly, Latin America's regional share of manufactured world exports, excluding Mexico, has been reduced from 16.9% to 8.9% between 1985-98, however, the share of East Asian increased from 56.9% to 69% for the same period (Lall, 2003, p. 281).

2.2.3 Sub-Saharan Africa

The case of Sub-Saharan Africa is significantly different from East Asia and Latin America since both ISI and neoliberal export led growth with 'no industrial policy' strategies have

possibly failed to deliver development. In comparisons between the period before and after 1980s, ISI strategies, on the other hand, are regarded as golden period of Sub-Saharan Africa. For example, in the case of Ghana, after structural adjustment, the manufacturing sector growth stagnated at around 8% and employment declined by 2/3 between 1987-93. This appears to be less impressive performance as compared to 1965 when the share of manufacturing sector in GDP was around 10% (Stein, 2003).

The issues of governance, politics, and institutions of conflict management are thought to be major binding constraints on industrial development in Africa. Therefore, it must not be a surprise that the income per capita in Africa has actually fallen between 1979 and 1999, while share of manufactured goods export in global trade is negligible (Soludo and Ogbu, 2004).

2.3 Pakistan: Industrialization Strategies and the State

2.3.1. Industrialization Strategies

Historically speaking, the first decade (1950-60) started with the strategy of import substitution industrialization (ISI) as was the case in most developing countries of East Asia and Latin America. During the second decade 1960-70, ISI and protection for selected industries continued and de-controlling with pro-business approach was followed (Ahmed and Amjad, 1984; Kemal, 1999). The policies pursued during the first two decades ensured impressive industrial development but, on the other hand, income inequalities and regional disparities increased. The resultant political, social, and economic polarization had numerous implications including dismemberment of Pakistan in 1971 (Zaidi, 2005). The period between 1947 to 1971 is also called a period of rise and fall of industrial policy in Pakistan (Khan, 2000a).

The third decade 1970-80 is marked as a period of nationalization and 'state capitalism' (Hasan, 1998). During this period massive investments were made in the public sector which bore fruits in the subsequent decade (Zaidi, 2005). During the fourth decade (1980-90), Pakistan predominantly followed economic policies of the previous decade excluding nationalisation. However, despite being an important era for industrial policy, it experienced severe resource waste, inefficiency, implementation gaps, and slow increase in employment in manufacturing⁴ (Sayyed, 1995; Kemal, 1999).

The fifth and sixth decades (1990s and 2000s) witness structural adjustment programmes and prominence of neoliberal policies. The agenda for liberalization, privatization, and deregulation while removing barriers to competition and investment for industrial development have been brought in (Zaidi, 2005; Wizarat, 2002, p. 15). However, interestingly, 'the neoliberal reforms have coincided with an unambiguous decline in the manufacturing sector fortunes' (Nadvi and Sayyed, 2004, p. 7).

2.3.2 The State

The state is characterized by erratic, authoritarian, elitist, and partisan behaviour in Pakistan. The post-colonial state had institutional imbalances with a strong and authoritarian civil and military oligarchy vis-à-vis weak political structure and civil society institutions (Jalal,

⁴ In South Korea employment increased from 7 to 14% while for Pakistan it remained 2% between 1970-80 (World Bank 1990, p.3)

1990; Jalal, 1995; Alavi, 1972). As a result, the state, paradoxically, has behaved both as agent of modern institutional development and an agent of dominant classes (Waseem, 1989; Saeed, 1980). Interestingly, the first five year plan of Pakistan earmarked bureaucracy as singularly most important stumbling block in the way of development (Ford and Harvard, 1965).

Push by the state for industrialization is considered a universal phenomena which has occurred in almost all Less Developed Countries (LDCs) as well as now developed economies (Gerschenkron, 1996; Polany, 1957). However, in Pakistan, the processes of structural transformation experienced extremely divisive social, economic, and political issues. One important reason for the structural instability was the discriminatory elitist nature of the state itself (Noman, 1988; Hussain, 1976). Many researchers argue that the state in Pakistan has been less successful in accommodating aspiration of citizen groups. Multiple conflicts have resulted in weakening of administrative capacity of institutional arrangements of the state. It is argued that excessive dependence on foreign assistance has also dismantled the desire for independent development strategies for industrialization (Khan, 2000b; Khan, 2000a).

In the current policy scenario, it seems that Pakistan is bracing with difficult options for industrial development. Moreover, there seems to be little commitment to re-discover specific industrial policy going beyond privatization, deregulation, and liberalization idea system (MOF, 2008). The need for industrial policy has, however, been argued in the context of industrial credit and pro-poor change (Nadvi and Sayyed, 2004, p. 28).

From the above mentioned theoretical and empirical literature review, it appears that in Pakistan, the state has some special characteristics as well as social and political situations. It is possible that the character of the state might have influenced the industrial performance. Therefore, the role of the state can be analysed using Institutional Political Economy framework. The framework, as mentioned in Chapter 1, analyses the role of the state as entrepreneur and conflict manager. The next chapter analyses the political economy of industrial policy in Pakistan.

Chapter 3: The Political Economy of Industrial Policy

Introduction

Industrial performance in Pakistan is visibly inconsistent and shows episodes of rise and fall of the manufacturing sector fortunes. Starting from the classical Import Substitution Industrialization (ISI) period to reach export led growth strategies, this chapter explores the industrial performance in a chronological order and uses historical analytical approach⁵. The history of the political economy of industrial policy development is divided into decades starting from the birth of Pakistan in 1947 and also compares Pakistan's strategies with other countries specially South Korea. This chapter also attempts to bring out salient features of mainstream industrial strategies for a detailed analysis of the issues in the next chapter.

3.1. Transforming the Economy - The First Decade:

3.1.1. Towards Industrialization for Development

Pakistan adopted industrialization as a main pillar of development. Severe deficiencies in economic, industrial, and human resources, characterized Pakistan in 1947 at the time of independence from the British raj. Structural transformation of a predominantly agricultural, inefficient and low performing economy was needed and the early economic managers decided to favour processes of industrialization in the early 1950s (Lewis, 1969; Wizarat, 2002).

The most compelling reason for industrialization was falling export prices of raw agricultural commodities and deterioration of the balance of payment situation. Therefore, the government developed trade policy instruments, economic incentives, and profits which facilitated industrial activity and discouraged other investment alternatives such as trade (Zaidi, 2005). Broadly speaking, Pakistan's industrial orientation of ISI possibly shows some similarities with Brazil's pre-World War II industrialization efforts under Getulio Vargas. However, unlike isolationism of Brazil, under the influence of dependency theorists, Pakistan was emerging from its unique post-colonial experience and breakdown of custom union with India in 1949 which massively influenced on composition of foreign trade (For details on Brazilian Industrialization, see (Hewitt, 1992).

3.1.2. The Role of State in Industrial Development

The state took a lead role in industrialization as was the case in Brazil and later in South Korea. In Pakistan, however, the basic strategy for industrialization was to use the public sector for capital accumulation and investment and then transfer the productive resources to the private sector (Ford and Harvard, 1965; Papanek, 1967). In the absence of any significant large scale industry, the early industrial policy identified cotton and jute as the main primary exportable commodities along with the development of local consumer goods

⁵ Historical analytical approach is embedded in the Institutional Political Economy framework because it analyses the social, political, and economic factors in the light of history and institutions.

sector. Interestingly, Pakistan was producing 75% of the world's production of jute without having a single jute mill and 1.5 million bales of cotton with a few textile mills (Lewis, 1969; Nadvi and Sayyed, 2004). The strategy worked and the country started making progress towards industrialization. Between 1947-58, Pakistan achieved around 3% of economic growth rate while industry grew at the rate of 23.6% between 1949-54 and maintained growth rate of 9.3% by 1960 (Sayyed, 1995; Zaidi, 1999).

3.1.3. Strategy for Industrialization and Performance

Pakistan, during the first decade, used the policy of Import Substitution Industrialization (ISI) which has been called a classical and fairly successful period of ISI. The strategy laid the basis for rapid growth in manufacturing sector for the subsequent decades and helped create exportable surplus as well (Nadvi and Sayyed, 2004; Zaidi, 2005). The state intervened for creation and distribution of rents as well as tried to influence investment decisions in line with industrial priorities through licensing system, facilitating import of capital and intermediate goods with overvalued exchange rates. Policies such as protection against import of consumer goods along with provision of fiscal subsidies and availability of credit provided an environment in which high profits⁶ in industrial sector were possible in the early 1950s (Zaidi, 1999; Ahmed and Amjad, 1984).

Table 3.1 shows the annual growth rates in the manufacturing sector and agriculture. The data shows that priority was industrial development and Pakistan witnessed decline in agriculture growth. Decline in agriculture growth resulted in food shortages and political unrests and serious fallouts (Hasan, 1998).

Table 3.1

Annual Growth Rate - 1950-58 at 1959/60 factor cost (% per annum)			
Year	Agriculture	Manufacturing	
		Large Scale	Small Scale
1950/1	2.6	23.5	2.3
1951/2	-9.1	18.7	2.4
1952/3	0.2	23.6	2.2
1953/4	13.6	28.7	2.3
1954/5	0.8	24.1	2.3
1955/6	2.1	17.5	2.3
1956/7	2.3	8.1	2.3
1957/8	1.9	4.9	2.2

Source: Zaidi (2005), Table 6.1 in the source

3.2 The So-called Decade of Development – The Second Decade:

The second decade 1958-68 was celebrated as the decade of development by the government of Pakistan. The first five years of the decade witnessed around 17% rate of growth in large scale manufacturing sector which ended in 10% rate of growth in overall manufacturing. However, the manufacturing output was around 13% between 1960-70 (Zaidi, 2005). Growth in agriculture was a key difference from the previous decade, owing to

⁶ Ahmed and Amjad (1984) show that 50-100% return on industrial investment was possible during early 1950s..

the application of Green Revolution high yielding varieties and improvement in water storage and distribution resources (Papanek, 1967; Hasan, 1998).

The below given table 3.2 shows the growth rates of agriculture and manufacturing sector. However, as in the case of previous decade, the small scale industries did not show robustness in growth as compared to the large scale industries which possibly had income distribution implications towards the end of the decade.

Table 3.2

Annual Growth Rate - 1958-70 at 1959/60 factor cost (% per annum)			
Year	Agriculture	Manufacturing	
		Large Scale	Small Scale
1958/9	4	5.6	2.3
1959/60	0.3	2.7	2.3
1960/1	-0.2	20.3	2.9
1961/2	6.2	19.9	2.9
1962/3	5.2	15.7	2.9
1963/4	2.5	15.5	2.9
1964/5	5.2	13	2.9
1965/6	0.5	10.8	2.9
1966/7	5.5	6.7	2.9
1967/8	11.7	7.6	2.9
1968/9	4.5	10.6	2.9
1969/70	9.5	13.9	3

Source: Zaidi (2005), Table 6.6 in the source

3.2.1 Decontrolling and Early Liberalization

During 1960s, the government changed a number of control mechanism and took pro-business measures. Imports were made easier with relaxed foreign exchange pressure due to foreign aid. The decontrolling and facilitation of industrial growth possibly generated surplus which led to increase in manufactured exports (Hasan, 1998). In 1965 exports from Pakistan were more than South Korea, Turkey and Indonesia combined (Zaidi, 2005). According to another estimate, in 1968, Pakistan's export to OECD countries were more than Indonesia, Thailand, Turkey and Malaysia put together (Noman, 1992; Nadvi and Sayyed, 2004). However, owing to various lingering issues of governance and institutional atrophy export growth could not keep pace and lagged behind other countries⁷.

3.2.2 Strengthening and Expanding ISI

The government made attempts to strengthen ISI for intermediate and capital goods and export oriented industrialization (EOI) for primary and secondary goods. The Bonus Voucher Scheme (BVS) helped maintain two exchange rates for controlled imports and incentive for exports (Nadvi and Sayyed, 2004). Within three years of introduction of BVS in 1959, rapid increase in exports of jute and cotton was reported. Nevertheless, this intervention of the state was held responsible for derailing the long term industrialization processes (Zaidi, 2005; Ahmed and Amjad, 1984).

⁷ For comparison amongst countries see table 3.6 in this chapter.

During the first half of the decade Pakistan witnessed better rate of growth in investment goods sector as compared to the intermediate and consumer goods. This was possibly because the emphasis of ISI strategy included the investment goods sector as well (Zaidi, 2005, p. 100). The table 3.3 shows the trend in rates of growth in consumer, intermediate and investment goods. Wizarat (2002), however, argued that the too much expansion of ISI caused fall in productivity growth in industries.

Table 3.3

Rate of Growth of Manufacturing Output 1960-70			
(% per annum)			
Industries	1960-65	1965-70	1960-70
Consumer goods	10.6	9	10
Intermediate goods	12	8	9
Investment goods	20	8	13

Source: Zaidi (2005), Table 6.7 in the source

3.2.3. Political Fallouts of Industrial Policy

Contrary to the government's claim of 'decade of development, some researchers call it 'controversial sixties' (Ahmed and Amjad, 1984). Therefore, owing to a popular perception about increase in inequality, low priority to social justice, social exclusion, and sugar shortages, a political labour movement against the regime caused downfall of the Ayub regime in 1969 (Nadvi and Sayyed, 2004; Zaidi, 2005; Sayyed, 1995).

It appears that the policy instruments and emphasis on ISI which Pakistan adopted were surprisingly similar to what South Korea and Brazil later designed after the military coups in 1961 and 1964 respectively⁸. However, the results, owing to the role of the state and political economic fallouts were different in the subsequent decades. South Korea kept on moving up the industrial ladder and Brazil had to change the policy orientation in the late 1970s. Pakistan underwent political upheavals in 1971 which affected the structure of economy in a fundamental way. In 1972, after dismemberment of Pakistan in 1971, the 'otherwise successful' industrial policy and growth strategy was abandoned (Wizarat, 2002, p. 14; Khan, 2000a).

3.3 Nationalization and Investing in Public Sector - The Third Decade:

The independence of East Pakistan, in fact, created a new Pakistan as well. The primary reason was significant shifts in patterns of trade and industrial development. Before December 1971, around 50% of West Pakistan's products were exported to the East Pakistan and 18% of its imports were from the Eastern wing (Zaidi, 2005). The Eastern wing was no longer part of Pakistan. On the political front, a civilian and democratic setup settled in power which promised to address the issues of inequality.

3.2.1 Response to Concentration and Nationalization

The revelation by Dr. Mahbub ul Haq that 22 families and business houses have accumulated 66% of industrial assets owing to the wrong economic policies of the previous decades had created a charged environment against the private capital. In another estimates it was

⁸ For details of policy interventions in South Korea and Brazil see Jenkins (1992)

revealed that around 65% of loans from Pakistan Industrial Credit and Investment Corporation (PICIC) were given to thirty-seven monopoly houses while 70% of this disbursement was siphoned off by thirteen big business houses (Zaidi, 2005, p. 102; Ahmed and Amjad, 1984; Amjad, 1982, p. 12).

Therefore, the civilian regime while acting on its election manifesto against inequality, nationalized the industrial and financial sector (Hasan, 1998). Industries related with capital and intermediate goods were the first targets and by the middle of the third decade banking and insurance sector were also brought under public sector. The regime strategically tried to break the nexus between financial and industrial capital. As result of such policies, with some exceptions, it is popularly believed that socialist populism under nationalization schemes precipitated a long term downturn in the economy and retarded the pace of industrialization⁹. Others dispute such claims since decline in private investment had already started before 1972 (Ahmed and Amjad, 1984; Zaidi, 2005).

3.2.2 Economic Performance

During 1970s, bad luck factors such as bad harvest, floods, and oil shock¹⁰ of 1973-74 were significant reasons behind a perceived economic decline. Economic performance of the regime in comparison with 1950s was not dismal (Zaidi, 2005; Burki and Laporte, 1984). Zaidi (2005, p. 104) argues that contrary to popular perception, growth rate of overall GDP were higher than 50s, agriculture growth was almost equal, though there was some decline in the manufacturing sector. In the case of Brazil, the oil shock is also cited as bad luck factor precipitating balance of payment crisis and industrial decline after the 'miracle' between 1964-74 (Hewitt, 1992).

The growth rates during this period are given below. An interesting point is that the rate of growth in small scale sector increased from previous decade average of 2.7% (see table 3.2) to more than 7% during 1970s:

Table 3.4

Annual Growth Rate - 1971-77 at 1959/60 factor cost (% per annum)			
Year	Agriculture	Manufacturing	
		Large Scale	Small Scale
1971/2	3.5	-6.8	7.2
1972/3	1.7	11.9	7.3
1973/4	4.2	7.5	7.3
1974/5	-2.1	-1.7	7.3
1975/6	4.5	-0.5	7.3
1976/7	2.5	-0.2	7.3

Source: Zaidi (2005), Table 6.13 in the source

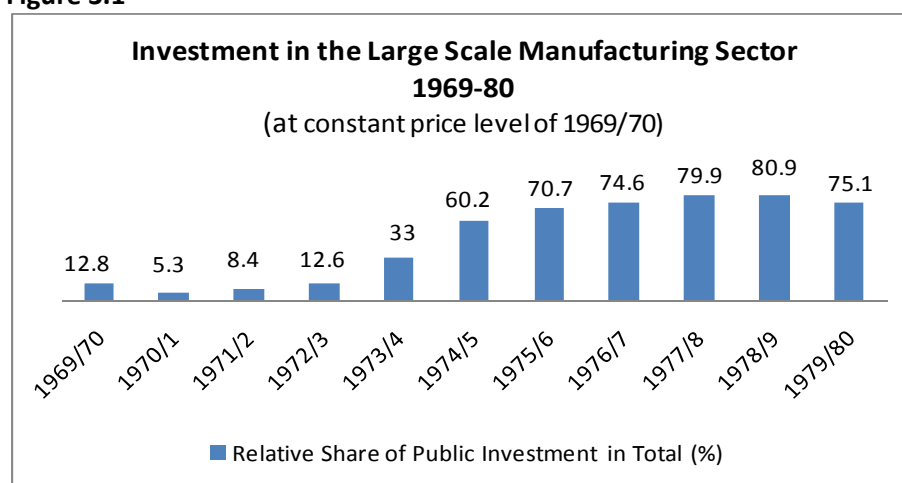
3.2.3 Investing in Public Sector

⁹ It was argued that nationalization damaged private sector investors' confidence in the economy.

¹⁰ The expenditure on oil imports increased from 1% of GDP to 6% in 1973. However, concessionary loans from Saudi Arabia and Iran eased economic difficulties of Pakistan (Hasan 1998, p. 208).

Economic policy orientation towards concentration of private industrial capital was change and many subsidies and concession were withdrawn from industrial sector during 1971-77. Export Bonus Schemes were also discontinued. However, massive investments were made in the public sector during the mid 1970s. These investments had long gestation periods and results were visible during the 1980s (Ahmed and Amjad, 1984). The below given figure 3.1 shows the trend in public sector investment. In addition, to give boost to agricultural support, price for wheat, rice, and sugar were increased. In addition, nationalization of financial institutions made it possible to divert credit towards export sector as well as towards small farmers.

Figure 3.1



Source: Zaidi (2005), Table 6.16 in the source.

It appears that though investment in public sector was significantly increased but these investments did not proactively generate employment in the manufacturing sector as compared to other countries. For example, the contribution of manufacturing to employment increased in South Korea from 7% to 14% between 1970 to 1980 whereas Pakistan remained at the level of 2% for the same period (WB, 1990, p. 3). Structural issues such as weak human capital formation and a general lack of labour-intensive industrialization strategies in the economic growth prioritization were the main reasons.

3.4 Industrial Growth amid Inefficiencies - The Fourth Decade:

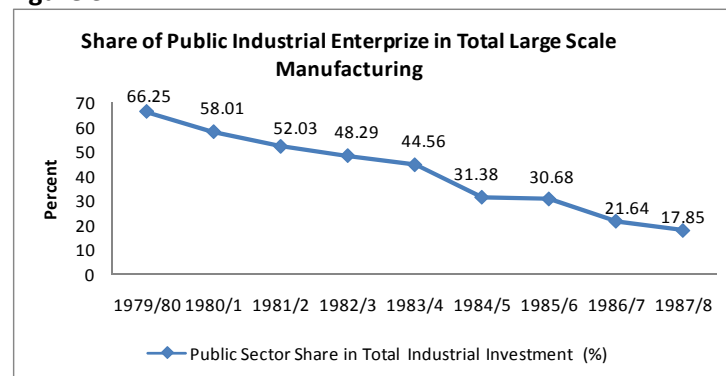
After the end of Bhutto regime in 1977 in the wake of military coup, 1980s were for most part under the military dictatorship. It has been argued that this period benefited from the public sector investments in manufacturing and infrastructure and revival of the private sector investment as well as foreign aid flows (Zaidi, 2005). The following table 3.5 gives a picture of public and private sector investments in the manufacturing sector.

Table 3.5

Invetsment in Manufacturing Industries			
Year	invetsment in manufacturing as percentage of GDP		
	Private	Public	Total
1964-65	2.9	0.5	5
1969-70	2.9	0.4	3.3
1974-75	1.3	1	2.3
1979-80	1.5	2.8	4.3
1984-85	2.1	0.8	2.9
1980-90	3.3	0.4	3.7

Source: Kemal (1999), Table 2 in the source.

During the fourth decade, Pakistan achieved 6.5% GDP growth rate during 1980-88 (WB, 1990). Manufacturing sector, during this decade, grew by 9% as compared 3.7% between 1972-77 and large scale public investments such as in Pakistan Steel Mill in Karachi also started production in 1981 achieving full capacity in 1984 (Hasan, 1998). After 1977, Pakistan did not resort to nationalization during the subsequent decades. With little denationalization, the public sector share in total industrial investment also declined from 65.25 % in 1979-80 to 17.85% in 1987-88. Reversal of public sector investment was a major policy shift from the previous decade. The figure 3.2 illustrates dwindling public sector share in large scale manufacturing (Sayyed, 1995, p. 117).

Figure 3.2

Source: Sayyed, (1995), Table 6.8 in the source.

3.4.1 Industrial Policy, Coordination and Structural Issues

Notwithstanding, economists also take 1980s as an era in which resources were wasted without gaining the required levels of efficiency. It is also argued that though the value added industrial sector expanded but it also did not generate employment¹¹ (UNIDO, 1990). Interestingly, Pakistan's economic performance showed significant implementation gaps, though it was the only era when industrial policy as formulated and executed. Most significant was increase in the share of capital stock (82.33%) in overall manufacturing growth without much increase in total factor productivity (3.17%) and productivity of labour (14.5%). The share of capital stock was high and Total Factor Productivity (TFP) lower than developing country averages (Sayyed, 1995, p. 111).

¹¹ This phenomena has also been called 'jobless growth' in UNDP (2006). Job creation is assumed as a one important indicator of the success of industrial policy.

In this line of reasoning, Pakistan possibly learnt little from the East Asian experience. In fact, the country kept industrial policy unworkable and coordination between the state and private sector remained an elusive dream (Hasan, 1998). According to Chang (1996), coordination between the government and the private sector for industrial development has been a key feature of East Asian strategy.

3.4.2 Export of Manufacture: The Question of Value-added

Pakistan's sixth five year plan (1983-88) emphasised deregulation, liberalization, and incentives for exports and showed initiation of a gradual move from specific to general industrial policy (Zaidi, 2005, p. 117). Therefore, in pursuit of export led growth, there was increase in the level and spread of a wide range of export subsidies. However, a few initiatives such as Export Processing Zone (EPZs) did not take off. Reasons of failure included 'internal coordination failure, between the ministries of industries, commerce, and finance' (Hasan, 1998, p. 244).

During 1980s, textile and clothing sector received priority due to low gestation and immediate profit generating potential. However, the system of incentives did not build demand for value addition and cotton yarn remained a major export which also received considerable subsidies (Nadvi and Sayyed, 2004; Hasan, 1998). While exports remained concentrated into gray cloth and cotton yarn, small scale industry appeared to be the main employer. This important sector was, however, remained trapped in low wage, low productivity, extreme competition equilibrium (Nadvi and Sayyed, 2004).

It is interesting to note that the EPZs did not give boost to manufactured exports in Pakistan but in Mauritius it contributed substantially. It seems that unlike Pakistan, the Mauritian state tried to maintain meta-institution of participatory democracy which established Mauritius as a 'supercivil society'. Under this institutional environment, EPZs as institutional innovations contributed in balancing protection-based ISI interests and free-trade regimes (Rodrik, 2007, p. 28 and 166). Pakistan's manufactured exports though increased from US \$ 1.3 billion to US\$ 3 billion but the growth rate was much lower than most of East Asia and Turkey. The table 3.6 illustrates the performance in terms of export earnings.

Table 3.6

Performance of Manufactured Exports (US \$ Billion)		
Country	1980	1988
Bangladesh	0.55	0.85
Brazil	7.84	6.17
China	8.69	34.7
India	5.07	10.66
Indonesia	0.44	5.71
Korea	15.75	56.44
Malaysia	2.47	9.38
Mexico	1.87	11.36
Pakistan	1.28	3.01
Thailand	1.82	8.22
Turkey	0.78	7.46

Source: Hasan (1998), Table 5.4 in the source.

3.5 Adjusting Structurally - The Fifth Decade

3.5.1 Implementing Structural Adjustments

Starting from 1988, there is a beginning of long season of Structural Adjustment Programmes (SAP) in Pakistan. In fact, since the 1988, running throughout the 1990s, there has been a slowdown in growth, rising inflation, worsening income distribution, and rise of poverty in Pakistan (Hasan, 1998). Under the circumstances, International Monetary Fund (IMF) and the World Bank conditionalities were accepted by the government. The new growth strategy changed the policy orientation towards the manufacturing sector in a fundamental way. Therefore, the Seventh Five Year Plan (1988-93), developed under the influence of structural adjustment programmes, projected to reform the industrial sector while re-inforcing the agenda of deregulation, privatization, and liberalization. In addition, understanding with IMF and World Bank has been to reduce subsidies on gas, electricity, telephone, and fertilizer, and limiting the list of specified industries as well as phasing out of industrial location policies (Zaidi, 2005).

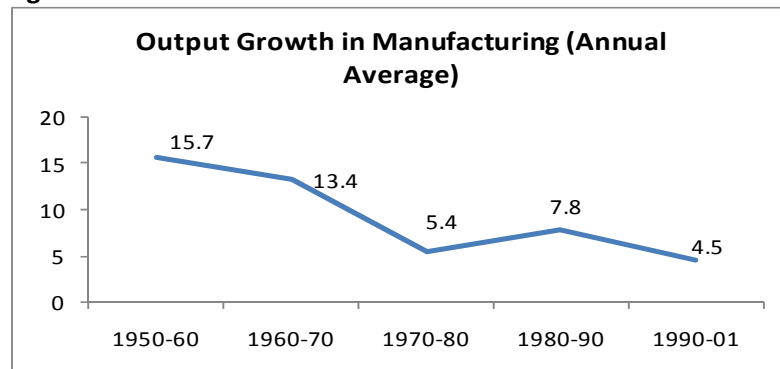
In fact, the Economic Reforms Act of 1991 liberalized the economy with policy prescription of 'getting prices right' and shifted the resource allocation from the state towards the market (Nadvi and Sayyed, 2004, p. 7). Embarking on the new policy environment, private sector participation was encouraged in the field such as power generation, highway construction, airlines, shipping, and banking while controls on private investment were relaxed. Foreign equity investment was encouraged -100 per cent equity was allowed for foreign investors on repatriable basis. Access to foreign borrowing was also allowed (Hasan, 1998).

3.5.2 Industrial Performance in the Era of Structural Adjustment

However, suspicion about the success of neoliberal policy shifts during 1990s remained high amongst researchers. In fact, the manufacturing sector annual growth rate declined from 8.21% in 1980s' to only 4.8% in 1990s. In 1996-7 the growth rate contracted to minus 0.1 per cent and was only 1.5% in 1999-2000 (Zaidi, 2005, p. 122). Manufacturing sector in 1977-88 grew by 9.2%. However, it started declining and between 1988-90 it grew by 4.8% while 1990-93 witnessed 6.5% growth rate, which again declined to 5.1% in the years 1993-96 (Hasan, 1998). The figure 3.3 provides a recap of the previous years and provides the manufacturing output of this decade.

3.5.3 Exploring Growth Rates

It appears that despite reforms the percentage share of manufacturing in total investment has remained almost stagnant (17.0% in 1979-80 and 17.7% in 2000-1) while the share of manufacturing employment has actually reduced to 11.5% in 2000-01 from 15.5% in 1969-70 (Nadvi and Sayyed, 2004). In addition, it appears that the increase in interest rates on working capital along with prices of utilities, and quick dismantling of tariffs have possibly negatively impacted on the industrial growth (Khan, 1999; Zaidi, 2005).

Figure 3.3

Source: Nadvi and Sayyed 2004, Figure 2 in the source.

Explaining the low economic performance, there are many economic policy and non-economic variables which can help understand the meltdown of Pakistan's manufacturing sector. It has been argued that in the absence of macro-economic stability, the exchange rate liberalization, privatization of public assets, and incentives for foreign and domestic investment did not produce growth spurts. High growth trajectory remained an illusion despite neoliberal reforms in the 1990s. In fact, it is argued that poor governance coupled with economic liberalization contributed to the financial crises during 1990s (Hasan, 1998, p. 269).

Interestingly, to help cope with the worsening economic situation, the international finance institutions emphasize, amongst other prescriptions, the importance of attracting Foreign Direct Investment (FDI) for industrial development and growth and create right policy and investment environment. Such environment includes reducing cost of doing business and removing barrier to competition (WB, 2005). It appears that Pakistan has got the issues which require an entrepreneurial state which can provide vision, institutional arrangements, and execute coordination between the public and private sector.

3.6 Liberalizing Further - The Sixth Decade:

3.6.1 Industrial Performance in 2000s

Interestingly, since the start of liberalization under structural adjustment programmes in 1988, no government in Pakistan has been able to develop a viable and independent industrial policy framework. The policy emphasis has been on developing the World Bank and International Monetary Fund (IMF) compliant policy framework papers (Zaidi, 2005). As mentioned in the previous section, 1990s witnessed unambiguous decline in the manufacturing sector which possibly had linkages with the sequencing and structure of reforms. The table 3.7 shows the overall trend in manufacturing sector which shows some recovery in 2000-03.

Table 3.7

Growth Rates in Manufacturing, 1950-2003 (% increase at constant factor cost)								
Average Annual								
Total	1950-55	1955-60	1960-65	1965-70	1970s	1980s	1990s	2000-03
Manufacturing	10.3	5.16	11.73	8.1	5.5	8.21	4.8	6.97

Source: Zaidi (2005), Table 8.1 in the source

Under the World Bank and IMF inspired growth strategy, the sixth decade is the period which witnessed more reforms and commitment of the Government of Pakistan in the direction of liberalization, deregulation, and privatization (MOF, 2008). However, paradoxically, the manufacturing sector did not pick up as it was thought to take off as a result of neoliberal reforms. In fact, as the table 3.8 shows, the growth rate increased but then contracted from 2005-06 onwards. As Zaidi (2005, p. 122) pointed out, the growth in manufacturing appeared to be short lived. However, the small scale industry shows some recovery after growth reversal which dipped to negative (-20%) in 2003-04.

Some researchers claim that after tariff reductions in 2002, manufacturing is growing at 12 percent per annum (Ahmad, 2008). Whereas, the table 3.8 shows the evidence of declining trends in manufacturing after 2004-05.

Table 3.8

Growth Performance of Components of Gross National Product						
(% Growth at Constant Factor Costs)						
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Manufacturing	6.9	14	15.5	8.7	8.2	5.4
Large Scale	7.2	18.1	19.9	8.3	8.6	4.8
Small Scale	6.3	-20	7.5	8.7	8.1	7.5

Source: MOF (2008), Table 1.2, p. 5

3.6.2 Liquidity and Private Investment Situation

A key feature of the 2000s is the availability of liquidity in the market. However, Pakistan has not been able to benefit from this opportunity in terms of robust gains of private investment in manufacturing (Bengali, 2008). It has been argued by researchers that the state intervention has been dismal as compared to regional competitors in overall strategy of Pakistan's industrial development. In addition, macro-economic liberalization since 1988 has persistently removed many rents for the manufacturing sector, and did not usher any significant efficiency or accumulation gains (Nadvi and Sayyed, 2004).

Empirical evidence shows that during the fiscal year 2007-08, gross fixed investment by the private sector grew by 0.9% in real terms while manufacturing received only 8.1% of the private sector investment. Foreign Direct Investment showed decline of 16.7% during the first ten months in comparison with the last year, it is, on the other hand, concentrated (67%) in financial, communication, and oil and gas sector. More than half (57%) of the total FDI comes from three strategically important countries i.e., UAE, USA, and the UK (MOF, 2008). The table 3.9 illustrates the trends in the structure of public and private investment.

Table 3.9

Structure of Investment (as Percentage of GDP)								
	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Gross Fixed Investment	15.8	15.5	15.3	15	17.5	20.5	21.3	20
Public Investment	5.7	4.2	4	4	4.3	4.8	5.7	5.7
Private Investment	10.2	11.3	11.3	10.9	13.1	15.7	15.6	14.2

Source: MOF (2008), Table 1.6, p. 12

3.6.3 In Search of Industrial Development Environment

Asian Development Bank has advised the Government of Pakistan to develop new industrial policy which should focus on structural transformation of manufactured exports while moving towards high-technology products¹² and invite investment to fill the technological gap (Haque, 2008). It can be argued that one of the basic underpinning for the role of the state in industrial development emerges from the technological capability argument as asserted by Lall (2000). The Box 4.1 sheds lights on some aspects of a technology policy and investment.

To create industrial development environment, question may be asked about the factors that have caused industrial decline? The factors associated with the decline in industrial performance can possibly be found in economic as well as political and social domains. These factors may include law and order, energy crisis, political instability, price increases in fuel and energy all put together. In line with this line of argument, researchers have also hinted that the structural adjustment programmes have association and clear link in the decline of manufacturing sector in Pakistan (Khan, 1999). Put differently, the reasons for industrial decline also have been associated with structural, institutional, policy, and procedural constraints in Pakistan (Bari et al., 2003; Nadvi and Sayyed, 2004). Therefore, as a key learning from South Korea, the new industrial policy has to be embedded in overall development strategy of the state.

Box 4.1

Investment and Technology Policies: Justification and First Steps

The aim is to achieve internationally competitive sectors enjoying high productivity and the potential of rapid productivity growth within relatively short time periods using industrial and technology policies of some or all of the following types :

- . Coordinating technology acquisition decisions across firms and sectors
- . Sharing risk and enabling the financing of investment in new technologies and sectors
- . Sharing risks in labour training and learning processes
- . Providing targeted infrastructure to critical sectors
- . Developing regulatory capacity to maintain and enhance competitiveness

The mix of policies will depend on the technologies being adopted and the pre-existing strengths and weaknesses of entrepreneurs, financial institutions, infrastructure and skills in the sector. The critical determinant of success is likely to be governance and regulatory capacities to maintain and enhance competitiveness through monitoring and taking tough action when required, including the early withdrawal of support if progress is unsatisfactory.

Source: Khan (2007), Box 1 in the source

Conclusion

Pakistan decided to industrialize and transform the economy soon after coming into existence. The main strategy of industrialization in Pakistan has historically been ISI¹³ with some interest in EOI. During the first decade the state deployed policy instruments to

¹² According to the World Development Report (2008, p. 343), in 2005, the share of high-technology exports from Pakistan of the total exports was 2%.

¹³ By 2001, there were around 86 programmes of ISI (Ahmad 2008, p. 50)

generate push for industrialization. The second decade encouraged and supported the private sector to accumulate and invest for industrial development. However, responding to the political pressure on the issue of economic inequality, the state brought public sector to prominence through nationalization during 1970s. In 1980s, the state could not rectify the inherited structural issues of the economy and the resource waste resulted in a near-failure of the second round of industrialization. The 1980s ended with the start of neoliberal ascendancy under various forms of Structural Adjustment Programmes in Pakistan. So far, no unambiguous breakthrough has been made in the manufacturing sector growth under the export-led growth strategy. In fact, the controversial growth spurt which started between 2004 and 2006 is fast declining.

Pakistan seems to have reached a point where the state must try to understand industrial decline without losing the sense of history, institutions, and social and political processes. It must capacitate itself to provide vision, institutional arrangements, and coordinate structural transformation for industrial growth. The next chapter explores the role of the state as entrepreneur and conflict manager.

Chapter 4: The Role of the State as Entrepreneur and Conflict Manager

Introduction

The role of the state for rapid industrialization is central since it is a process of structural transformation and needs effective institutional arrangements to coordinate and encourage certain economic activities (Chang, 2004). Therefore, in industrialization the role of the state must be of entrepreneur who can conceptualize and also create institutional arrangements to coordinate resource allocations and growth strategies. The other role must be of conflict manager who can provide governance structures to execute public policy agenda while harmonizing the social and economic disequilibrium (Chang and Rowthorn, 1995b; Stein, 2003).

In the context of above mentioned dual role of the state in industrial development, this chapter is divided into two parts which cover the two life spans of the state of Pakistan. The first one starts with 1947 when Pakistan was created comprising of two wings i.e., the East and West Pakistan and ends with the break-up of the state in December 1971. As the year 1971 is a watershed event, the second part covers the later period till 2008.

Part I: From 1947 to 1971

4.1 Industrial Development and the Role of the State

As mentioned in the previous chapters, Pakistan started from a small industrial base and development-oriented administrative capacity was limited. It inherited a meagre 10% of total all India industrial and 7% of employment facilities with nearly 18% of the population (Jalal, 1990, p. 64). Structural transformation from primitive agriculture to industrialization was the task. ISI strategies using commercial and foreign exchange policies were implemented and merchant capital was converted into industrial capital (Zaidi, 2005; Ahmed and Amjad, 1984). The state played a central role in industrialization process specially where private investment was not forthcoming (Ford and Harvard, 1965).

On the political and administrative side, unlike the Congress leadership in India, All India Muslim League had to build its constituency in diverse regional political realities of an emerging nation-state¹⁴ (Khan, 2000a). As a result, tangent to the pre-partition political rhetoric of the Muslim League about decentralization and provincial autonomy, Pakistan covertly pursued a centrist state orientation with authoritarian and repressive tendencies in the systems of governance. Civil-military bureaucracy as relatively 'over-developed' institutions (in Alavi's words) superimposed their political, administrative¹⁵ and economic

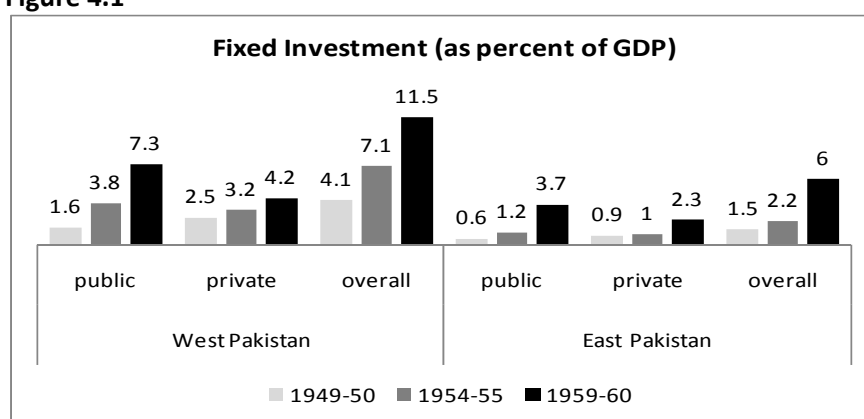
¹⁴ The areas which became Pakistan were not an established political constituency of All India Muslim League. These areas had regional political parties whom Mohammad Ali Jinnah the founder of Pakistan represented at All India centre in Delhi as the 'Sole Spokesman' (Jalal, 1985).

¹⁵ An expression of civil-military power between 1947 to 1958 is that Pakistan had several Prime Ministers and one commander-in-chief of the armed forces while the reverse was true for India (Sayeed, 1980).

acumen (Jalal, 1995; Jalal, 1990; Alavi, 1972). However, the discipline, efficiency, and clarity of objectives of the civil and military bureaucracy fell victim to the 'wrong choice of objectives' during the first two decades (Noman, 1988, p. 35). Therefore, administrative and planning capacity and orientation of the state together with a fragmented political society possibly developed a number of economic problems of regional and income equality, skewed investment priorities, and social unrest.

The figure 4.1 illustrates the fixed investment patterns during the first decade of the creation of Pakistan. The table 4.1 shows disparity of per capita income between the East and West Pakistan. It appears that inequality increased towards the end of united Pakistan in 1971.

Figure 4.1



Source: Hasan (1998), Data from Table 2.7 in the source

Table 4.1

Per Capita GDP in East and West Pakistan (at 1959/60 constant prices)			
Year	Per Capita GDP East	Per Capita GDP West	West-East disparity ratio
1959-60	269	355	1.32
1969-70	314	504	1.61

Source: Ahmed and Amjad (1984), Table 6.6 in the source

The authoritarian civil-military bureaucracy on political commanding heights had numerous implications for the state and society relationships. The role of state as a trust worthy political and economic conflict manager was seriously compromised. Therefore, imposition of Governor Rule in East Pakistan against lower-middle class struggles in 1954 as well as military operation in East Pakistan in 1970 exposed the inherent weaknesses of the dominant bureaucratic polity (Khan, 2000a; Waseem, 1989; Sayeed, 1980). The table 4.2 presents the magnitude of unrest in the East and West Pakistan which reflects negatively on the ability of the authoritarian state to manage political conflicts.

Table 4.2

Riots in East and West Pakistan		
Year	West	East
1958	1356	4550
1959	913	3232
1960	1114	4499
1961	1681	4777
1962	609	4792
1963	758	5182
1964	1086	5723
1965	995	5626
1966	967	6135

Source: Noman (1988, p. 32), table 1 in the source

4.1.2 Industrial Capital for Industries and Political Alignments

To cope with the issues of regionalism and national integration, the civil and military regimes predominantly used financial capital to manage political alignments. With these interventions, the military regimes also sought legitimacy to rule. Therefore, access to resources for industrialization became more like political deals than a coherent policy for economic change (Khan, 2000a; Sayyed, 1995). This particular political context defined the system of rent-creation for industrial enterprises in Pakistan. Therefore, the relationship between the dominant civil-military bureaucracy and the business houses was less a coordinated drive for industrialization than a political patron-client relationship (Nadvi and Sayyed, 2004).

In theory, it is argued that ‘political, institutional and technological contexts in which rents are located’ make the difference (Khan and Jomo, 2000, p. 67). Research on Pakistan and India shows that rents created by the state and their distribution were politically more explosive and the ability of the state to withdraw rents on inefficiencies was extremely limited (Khan, 2000a).

In South Korea, on the other hand, chaebols were a small group of rent-seekers and most of them were equally competent as conglomerates. Perhaps strategically managed rent-creation and distribution kept the transaction costs low and hence efficiency increased (Chang, 1993). In addition, owing to autonomous institutional arrangements and coordination mechanisms in place, the state was more able to withdraw support on the basis of export performance and impose discipline to execute industrial upgrading and technological gear shifting (Amsden, 1989). Yilmaz Akyüz argues that the process of ‘export-investment nexus’ has been a key feature of South Korean success (Akyüz et al., 1999)

In Pakistan, it can be argued that a general lack of institutional arrangements which could effectively monitor performance of firms on some objective criteria, such as export in the case of South Korea, were important factors behind failure of industrial policy.

4.1.3 Investment Coordination and Authoritarian State

Building human capital and technological capability in line with industrial development vision requires entrepreneurial qualities from the state. That quality lies in building capacity and structures for investment coordination to manage allocation of resources in priority

sectors (Chang, 1996). The state in Pakistan did not show any credible evidence of the ability of the state to execute an entrepreneurial type of control over sectoral allocations (Khan, 2000a). The state, nevertheless, issued Industrial Investment Schedules to facilitate investment in specific industries in which official sanction was not required (Ahmed and Amjad, 1984, p. 83). However, such systems of economic decontrols did not have any semblance of the effectiveness of the state in South Korea.

While the dominant feature of Pakistan's economy during 1960s, under the influence of Harvard Study Group was towards market friendly economy, the South Koreans followed the path of imperative planning without being admirers of free market economy (Chang, 2006). South Korea shows a systematic drive for coordinated and sequenced industrial upgrading while picking up a range of industrial sector as 'priority sectors' and creating discriminatory environment with policy instruments. Such instruments included entry barriers, protection, public sector investment funds allocations, tax holidays, and subsidized credit like 'policy loans' (Chang, 2006).

From this discussion, it appears that having an authoritarian state is not a sufficient condition for industrial development. An authoritarian state not able to coordinate sectoral allocations, beyond politically motivated interventions, lacks the traits of entrepreneurship. Such a state possibly needs a drastic change of orientation to execute industrial policy for longer terms industrial success. Pakistan provides an example in this line of reasoning.

4.1.4 Foreign Aid in Industrial Development

In Pakistan, foreign aid has played an important role in development. Industrial credit expansion through over-valued exchange rate during 1960s was also possible due to foreign aid. Some researchers even argue that without foreign aid, development in 1960s cannot be explained. The inflow of money helped Pakistan build economic and social infrastructure (Papanek, 1967, p. 225; Zaidi, 2005, p. 100-101). Some researchers have called Pakistan a 'foreign aid dependent regime' in which industrial development was critically dependent on foreign aid. Industrial performance suffered when the foreign aid dried up after 1965. In fact, the country was left without any alternative to external finance. There was no innovative domestic resource mobilization mechanisms as such (Amjad, 1982, p. 166).

Pakistan's dependence on foreign aid can be contrasted with South Korean government's vision for 'independent economy' which actively sought to reduce dependence on foreign sources of financing. One essential feature of this strategy was emphasis on technological and industrial upgrading and control over consumption but simultaneously ensuring social-well being of the population. While no consistent parallel exists in Pakistan, the state in Korea had banned foreign holidays and imports of luxury goods till late 1980s. Some of these features were criticized as unfair but the state in Korea wanted faster long term growth and efficient structural change and they got that (Chang, 1996; Chang, 1993). The table 4.3 shows the comparative performance of growth rates in manufacturing.

Table 4.3

Manufacturing Growth Rates in East Asia and South Asia						
Years	East Asia		South Asia			
	South Korea	Taiwan	Pakistan		India	
			(West)	(East)		
1950-55	NA	NA	NA	9.1	NA	6.1
1955-60	NA	NA	NA	5.7	NA	
1960-65	11.8	12.7	11.1	10	5.7	6.8
1965-70	20	19.1	7.5	6.8	6.9	4.2

Source: Khan (2000a), Table 1 in the source

It can possibly be assumed that the role of the state and economic bureaucracy in establishing viable systems of resource allocation and establishing a vision for 'independent economy' than foreign aid dependant development bears fruits of industrial development. From an entrepreneurial perspective of state, the point is not only visualizing economic change but make it happen (Yu, 1997). Empirical evidence, on this account, in table 4.4 shows the receding nature of dependence of South Korea on the US aid towards the end of 1960s.

Table 4.4

US Aid to South Korea 1956-67		
	in US\$ million	% of GDP
1956-58	270	15
1959-61	222	8
1962-64	199	6
1965-67	111	2

Source: Edwards (1992), Table4.1 in the source.

A question then arises that why the state dominated by bureaucracy and military in South Korea¹⁶ had been more entrepreneurial in comparison with Pakistan? It is argued that the British rule, in the areas which became Pakistan, was politically accommodative and contented itself with extracting economic rents and ensuring peace. The regional local political loyalties, thus remained strong (Jalal, 1995; Noman, 1988). The centrist tendencies of the administration in Pakistan were a clear break from the past as well as from the political agenda of the All India Muslim League. The civil and military bureaucracy was busy more in managing patron-client relationships in line with political alignments than using industrial policy as means of coordination.

South Korea, on the other hand, remained under Japanese imperial rule. The Japanese political legacy does not respond to political pressures from lower and lower middle classes (Khan, 2000a). Therefore, the Korean bureaucracy was predominantly focusing on instructions provided by the state and actively seeking to bridge coordination and information gaps in industrial growth processes. The bureaucracy in South Korea, after 1950s, thus built a viable system of managed rent-creation for innovation and reduced social waste (Chang, 1996; Edwards, 1992).

¹⁶ South Korea also had a military coup in 1961.

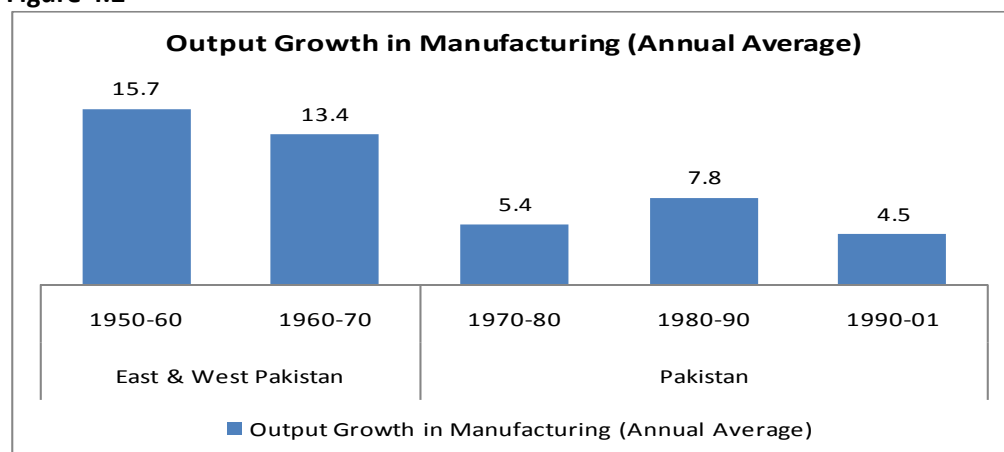
Part II: 1971-2008

4.2 Industrial Development and the Role of the State

An important lesson of the dismemberment of Pakistan in 1971 is that when state fails to coordinate and execute industrialization for equitable economic change, social unrests become difficult to manage even with authoritarian military regime. It appears that without consciously building 'meta-institutions of participatory politics', the effectiveness of the state in managing conflicts is sufficiently weakened (Rodrik, 2007, p. 166). Therefore, imposition of military and civil oligarchy in multiethnic societies seldom creates national integration and developmental dynamism. In fact, repeated military coups d'etat challenge the legitimacy of the state's existence itself and the country suffers (Noman, 1988).

In the context of Pakistan's dismemberment in 1971, the following figure 4.2 is redesigned (see figure 3.3 in the previous chapter). It shows that the output growth of 1950s and 60s never returned to Pakistan by the end of the century.

Figure 4.2



Source: Data from (Nadvi and Sayyed, 2004)

4.2.1 The State for Industrial Development – Bhutto Regime

The civilian government in Pakistan had promised 'food, shelter, and clothing' during the election campaign and the agenda became a determining feature of ensuing reforms. Most of the reforms, however, met partial success, if any, in changing the primary orientation and structures of the state. The ability to manage conflicts and political polarization with institutional innovations possibly did not emerge, though there was a strong sense of 'populism' and personalization of administrative and political structures (Jalal, 1995, p. 77).

The regime showed contradictions in managing the polity. Though progressive legislation for workers was made in 1972 and the real wages increased but the regime was intolerant and penalized criticism (Khan, 2000b). Nationalization and administrative reforms in civil bureaucracy were undertaken but institutional capacity and orientation to manage 'state capitalism' remained questionable (Hasan, 1998; Khan, 2000b). It has been argued that nationalization, paradoxically, further entrenched the regressive and 'unaccountable' controls of civil bureaucracy. In this line of the argument, it is also claimed that the direct interventions by the state in industrial management were used as tools for political patronage. In a sense, the policy of the state placed landowning elites over industries which

precipitated a systematic diversion of resources from public sector to private political gains (Noman, 1988; Nadvi and Sayyed, 2004; Burki, 1980).

The role of the state in Pakistan during 1970s had ensured that 'relatively autonomous' state acted on behalf of the political and landowning elites rather than providing a coherent administrative structure with long term institutionally embedded vision and coordinating structures. Therefore, the private capital had either to be nationalized or moved to another country. In sharp contrast, the East Asian economies show enormous possibilities of well-coordinated collaboration between the state and the private sector. Entry of firms such as Samsung, Goldstar, Hyundai in semi-conductor business are a few examples (Amsden, 1989). In addition, the political regime massively intervened in the administrative apparatus which resulted in over-politicization of administrative bodies (Jalal, 1995; Sayeed, 1980). In the wake of such interventions, it possibly turned difficult for the permanent executive to autonomously execute public policy agendas. Under the circumstances, 'embedded autonomy' of the state was hardly possible which once established coordination between the public and the private sector in East Asia (Wade, 1990; Evans, 1998).

Therefore, controversial outcomes of nationalization made researchers argue against the capacity of the state in Pakistan to play a central role in investment coordination for industrial and technological development (Altaf, 1983). However, in contrast to the role of the state in Pakistan, in 1973, South Korea adopted the Heavy and Chemical Industry Promotion Plan in 1973 and, in execution of the programme, the state directly guided the private sector. Another example of the state intervention in investment decision is from ship-building industry in 1970s (Chang, 1993). Interestingly, like Pakistan, the state in South Korea was forthcoming to invest public funds and setup public enterprises where the private sector was reluctant. However, the critical difference between South Korea and Pakistan was institutionally embedded coordination mechanism between the private and the public sector in South Korea¹⁷.

4.2.2 The Zia Regime

The military take over changed the regime in Pakistan. The new regime, instead of state capitalism or state socialism, sought legitimacy under a controversial drive for islamization and resorted to political alignments for distribution of economic rents (Sayyed, 1995). The period between 1979-88 was a difficult period for the progressives, women, and the poor alike. Lingering of basic issues of a federal state, ethnic and religious conflicts, and inter-provincial disharmony became more manifest. The regime was 'a long and trying night of military rule' (Jalal, 1995, p. 100).

The state, ultimately, failed to provide a viable entrepreneurial vision and institutional arrangements for conflict resolution. The so-called Islamization of economy was perhaps not a solution of Pakistan's problems. For example, to take care of the poor, Zakat system (religious tax) was established and according to some estimates it could add only 2% in the household income of the poorest 20% households (Hasan, 1998). Militarism and Islamization was, primarily, designed to gain legitimacy, break populist appeal of the previous regime, and also create an ideological support for participation in the cold war. The rhetoric of regime was, however, coached in stability, efficiency, and morality which neither delivered

¹⁷ For details see Amsden (1989) and Chang (1996)

economic efficiency nor political stability at the end of the regime (Noman, 1988; Jalal, 1995; Sayyed, 1995).

The industrial policy during the regime did not create employment growth effects. The growth in manufacturing sector had been more favourable for capital rather than labour absorption. The state, on the other hand, like the previous regime, encouraged temporary migration of workers (Jalal, 1995, p. 102). The table 4.5 shows that the remittances from migrant workers were more than the total exports of Pakistan in the year 1982-83. However, remittances were suboptimally used and around 63.09% of the expenditure went chasing consumer goods while 22% settled in the real estate (Khan, 2000b, p. 186). In South Korea, in sharp contrast to Pakistan, consumption and investment management by the state played a key role in establishing rapid industrialization and growth in export of goods (Chang, 1993).

Table 4.5

Trade and Remittances (in US\$ million)				
	1970-71	1977-78	1980-81	1982-83
Exports	422	1287	2798	2430
Imports	757	2751	4857	5782
Workers' remittances	60	1156	2097	2850

Source: Khan (2000b), Table 1 in the source

The regime could not control systemic inefficiencies. The share of wages and salaries in manufacturing value-added fell from 26.9% in 1976 to 20.3% in 1986 (UNIDO, 1990, p. 20-23). On the other hand, expenditure on government increased from 23.5% of GDP in 1976-77 to 27% in 1987-88 and the inflation adjusted figure of government expenditure for the period between 1977-88 showed an increase of 150% (Hasan, 1998). Similarly, to increase the influence of the military, lateral entry system introduced by Bhutto to induct technically competent personnel in civil bureaucracy was extensively used to place army officers on key positions (Khan, 2000b; Noman, 1988). Inefficiencies in public sector did not lead to a rigorous search for systemic solutions, and East Asian experience despite being relevant was possibly thought idiosyncratic and not for any use in Pakistan.

The South Korean state coordinated investment decisions by establishing 'obligatory reporting system' in the bureaucratic apparatus. To increase exports, the diplomats abroad and agencies like Korean Trade Promotion Corporation KOTRA played a key role. It has been claimed that their performance was sometimes more enterprising than the private sector (Chang, 1993, p. 146). It is interesting to note that in Pakistan despite having control over the commanding heights of the economy, the martial law regime was not able to resolve the structural bottlenecks such as investment in human capital formation, investment in infrastructure specially in power, roads, and water supply. In the aftermath of inefficient governance, poor coordination amongst institutional arrangements, the sixth five year plan could not achieve the targets and as a result people suffered. This indicates a loss of national competitiveness¹⁸ in the comity of nations (Noman, 1988; Hasan, 1998).

¹⁸ National competitiveness refers to the ability of an economy to produce, service, and distribute goods better than the competitors with aim to improve standard of living of the people. This view goes beyond other measures such as current account position, trade balance and foreign exchange reserves (Memiş and Montes, 2008, p. 23)

4.2.3. Towards Neoliberal Economic Management: Civilian Regimes

In 1988, with general elections¹⁹, Pakistan again returned to democracy with frequent changes in governments²⁰. However, the economy remained under fiscal imbalances, stagnant investment, neglected human resource development, and structural weaknesses in manufacturing sector. As a result, manufacturing growth declined to half from 9.2% in 1977-88 to 5.1% in 1993-96. Economic liberalization under structural adjustment programmes, poor governance, and coordination failure weeded out industry resulting in low output growth (Hasan, 1998). In the absence of strong institutions of social protection within the state structure, the privatization proceeds were mainly utilized to meet government expenditure rather than managing the adjustment period through social policy framework. Excessive politicization of economic bureaucracy continued and short-term projects, bypassing the planning commission's review procedures, were executed. As a result, a strong sense emerged that the bureaucracy in Pakistan, as central agent of coordination and implementation was ill-equipped and over-politicised to meet the challenges of twenty-first century. Such critiques appeared to be a reiteration of the words which the first five year plan of Pakistan (1954) espoused about Pakistan's civil administration (Hasan, 1998; Ford and Harvard, 1965).

To correct macro-economic instability, the international donor agencies advised for increasing exports. The policy orientation had to be export-led growth and opening up for global integration with shrinking the role of the state in industrial policy²¹. The results of such prescription during 1990s were mixed. In theory, it is argued that macro-economic stability is necessary for openness to deliver (Winter, 2004; Ulku, 2008). Empirical evidence also shows that when economic fundamentals were in bad shape, trade liberalization and other policy reforms in the areas of deregulation and privatization did not lead to high quality growth in Pakistan. During the period of structural adjustment and liberalization, 'growth declined substantially, poverty increased considerably, and income distribution worsened' (Zaidi, 2005, p. 439).

For Pakistan, the challenges possibly go beyond macro-economic stability and are rooted in the orientation of development strategy. Easterly (2003) shows that between 1950 to 1990 Pakistan have had the average per capita growth rate of a respectable 2.2 percent. However, the social development indicators remained worst in the world showing gaps in welfare, social development and institutional progress. The growth dynamics are expressions of elites' performance excluding a wide range of people of Pakistan.

Inequitable development and low labour skills limits the capacity of the people to benefit from growth (WB, 1990, p. 51). In this line of argument, UNDP (2005) claims that the successful globalizers invest in human development and sequentially integrate into global

¹⁹ General Zia-ul-Haq also died in a mysterious plane crash near Bahawalpur district on August 17, 1988 at around 4:30 p.m.

²⁰ Most of the elected governments were removed on the charges of corruption and inefficiencies.

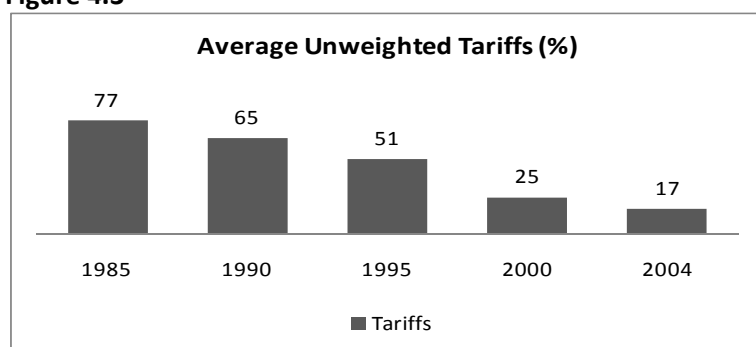
²¹ Under the three-year agreement (1988-91) between the Government of Pakistan and IMF, Pakistan committed to limit the list of specified industries, reduce level of protection for different industries, reducing the tariff range, phase-out industrial location policies, and privatization of state managed enterprises (Zaidi, 2005, p. 120)

economy. Appendix A in this working paper provides evidence from Vietnam and Mexico on differential gains from globalization.

4.2.4 Industrialization under Liberalization - Musharraf Regime

Military took over the reins of power in October 1999 in Pakistan and held elections during 2003 and 2008. The main public agenda of the military regime was to reform the functioning of the institutions of the state, devolution, and achieving a high growth path²² (Tahir, 2008). The regime²³ has continued the economic growth strategy primarily based on free market. One key aspect of this strategy is to liberalize the trade regime for export led growth with slashing both tariffs and tariff bands. Figure 4.3 shows the reduction of tariffs on foreign trade.

Figure 4.3



Source: SDPC (2006), Chart 1.3 in the source

The rapid economic growth strategy aims to increase the share of Pakistan's trade so that the export led growth delivers welfare benefits for the people. The table 4.6 illustrates the share of Pakistan's exports at the global level which shows that during the last 14 years the share of Pakistan's exports has not changed much.

Table 4.6

Pakistan's Share in World Exports	
Year	Share (%)
1990	0.16
1995	0.16
2000	0.14
2004	0.15

Source: SPDC (2006), Chart 1.10 in the source.

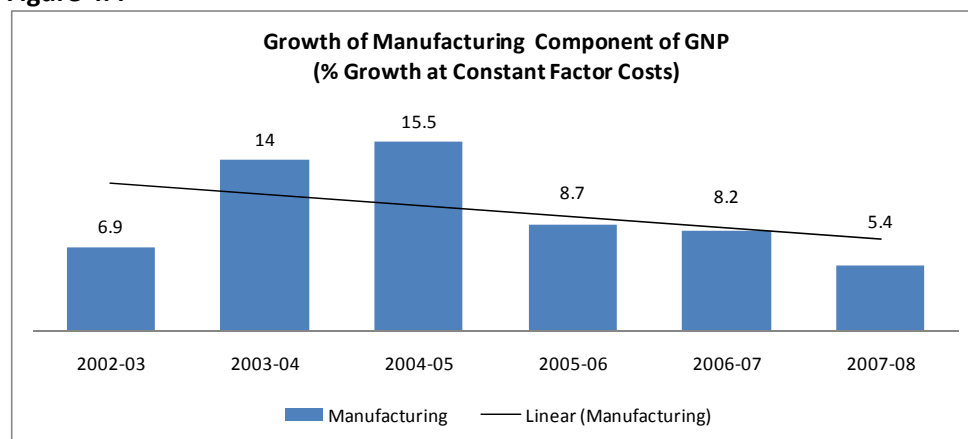
Some researchers argue that for Pakistan's industrial development further reduction of tariffs is required. The main argument is that the ASEAN countries are Pakistan's competitors and their tariffs are much less than Pakistan i.e., within the range of 4-5%. Therefore, Pakistan should also make a downward revision making the ASEAN tariffs as bench mark.

²² The devolution plan and high growth have been a serious concerns of the government. However, in the year 2008, many researches have disputed the claims of the regime. For details Bengali (2008) and Tahir 2008.

²³ President General (ret'd.) Musharraf resigned on August 18, 2008 and Presidential elections will be held on September 6, 2008.

They also argue that with tariff reforms Pakistan's industrial performance has actually improved (Ahmad, 2008, p. 50-52). The following figure 4.4, however, necessitates a cautious and more comprehensive review of the determinants of industrial growth strategy which should go well beyond the trade reforms. In figure 4.4 the linear trend line shows decline in manufacturing growth component in GNP. This evidence testifies the assertion of UNDP (2005, Ch. 4) that tariff liberalization must be sequential, selective and subservient to a long-term industrial policy (Shafaeddin, 2005, p. 53).

Figure 4.4



Source: Data from (MOF, 2008)

A question in the context of industrial decline arises that what impact liberalization might have had on poverty and inequality in Pakistan? Commenting on the current liberalization, researchers have argued that it has actually contributed further to social fissures and regional disparities in Pakistan. Tariq Khan (2000b) argues that though the current trend of economic liberalization gives hope to the private sector but under the military, bureaucracy, and landlords ridden state structures society remains polarized. Empirical evidence also suggests that the rural areas which accommodate around 65% of the population have lagged behind and inequality has been further entrenched during the liberalization period. The reasons behind this phenomena of falling fortunes of rural economy includes less gainful employment opportunities for the rural population and a general neglect of agriculture sector in Pakistan (SPDC, 2006).

4.2.4.1 The International Context for Industrial Policy

Chang (1993) and UNDP (2005) argue that industrial growth can happen better under comprehensive development strategy managed by the state. Empirical evidence from late industrializers and now developed countries suggests the fact that at the comparable level of development, they used the ladder of subsidies, tariffs, domestic support as well as investment coordination and reverse engineering. These ladders are denied to the developing countries under WTO regimes specially under the Trade Related Intellectual Property Rights (TRIPS) and Trade Related Investment Measures (TRIMS) (Chang, 2003b). The Non-Agriculture Market Access (NAMA) negotiations in the current phase of Doha Development Round at WTO are also being commented as a threat to industrialization potential in developing countries specially because of irreversible tariff reductions (Chang, 2005).

It is therefore, argued that the social and political effects of liberalization are possibly negative. The state must come back in executing purposeful and targeted development agenda. One of the main targets should be industrial revival for growth and job creation.

4.2.4.2 From Political Economy of Defence to Military Capital

As mentioned in this chapter, the military has played a central role in defining the contours of economic transformation and resource allocation because of repeated interventions in political domains. The main reallocation of resources has been for defence related purposes and it shows interesting comparison with development allocations. For example, between 1977-88, the defence related expenditures grew at the rate of 9% per annum while development expenditures increased by 3% per annum. Therefore, in 1987-88 defence expenditures had surpassed the development budget (Hasan, 1998). Based on the assumption of discipline and efficiency, armed forces were thought as an agent of modernized economic change. Such assumptions about the military rule, have nevertheless been qualified with the a number of other institutional, political, and economic variables which results in economic efficiency and equity (Jalal, 1990; Jalal, 1995).

Along with the political foothold of the armed forces, there is emergence of military capital as a distinct form of industrial development resource²⁴. The distinctive points include that despite being both in the public and private sector, the military industrial capital remains under the formal and informal control of armed forces. The capital is invested in non-tradable sectors which make it protected against the direct shocks of global competition and privatization. In some instances, the state has supported the budgets, investments, and foreign exchange loans of the firms running with military capital (Siddiqua, 2003; Nadvi and Sayyed, 2004).

Apparently, the military capital seems to have an 'enclave mentality' but the preferential treatment by the state reflects on the autonomy of the state structures in economic management. It may be argued that the role of the state in support of the military capital does not build on the East Asian model of firm level intervention to create entrepreneurial dynamism for export expansion. How the military capital grows in future and how it affects the mainstream private capital is still a question. It, however, appears that for researchers, along with political economy of defence a new theme of military capital has emerged.

Conclusion

In this chapter, it has been argued that at the core of Pakistan's industrial, political, and social development issues lies in the role of the state. Before and after 1971, this is the civil military oligarchy which makes decisions about the capital accumulation and distribution of resources. The basic criterion has been political alignment instead of economic performance in line with an industrial development strategy. However, economic liberalization and shrinking the role of the state policies have not been able to make unambiguous upward swing in the manufacturing sector. Instead, it appears that neoliberal reforms have coincided with decline in the large scale manufacturing sector output.

²⁴ This part of the working paper is based on learning from Nadvi and Sayyed (2004) and Siddiqua (2003). Since, this is a new area of research and paucity of literature put constrain on a detailed analysis.

Though, in Pakistan, the state has not been able to play the role of an entrepreneur and conflict manager, it is argued that the state has to be the central actor because ultimately this is the state which has to rectify the problems of the state and make itself autonomous yet embedded in the social and cultural settings. In this sense, Pakistan, for industrial development, needs to look for innovative solutions and interventions beyond the neoliberal prescriptions of becoming a night watchman. The state must focus on the human development aspects of industrialization and actively engage itself in strengthening institutional arrangements for coordination especially in the areas of social and labour policy. The ultimate test of the success of any development strategy, definitely, lies in the well-being and improvement in the standards of living of its people.

Having said that it must also be recognized that in the post-nine eleven situation, terrorism has added another dimension into the complexity of governance and economic development. Inability of the state to settle disputes and implement coordination mechanism may be the biggest hindrance in making Pakistan a viable set of institutional arrangements.

Chapter 5: Conclusion

The present study tried to analyse the political economy of industrial policy of Pakistan. The analysis used the Institutionalist Political Economy framework which was developed to explain major economic changes involving institutional arrangements. Therefore, the role of the state as entrepreneur and conflict manager in Pakistan's industrial development was scrutinized. Historical analytical perspective which is embedded in the framework provided the design of the study. The state has historically been an important player in economic change and structural transformation. For rapid industrial development both the late industrializers and now developed countries have used the institutional arrangements of the state. Most important role of the state has been in providing support systems for structural transformation of the economy from agricultural to manufacturing which has ultimately resulted in industrialization of almost every sector.

The state of Pakistan has also played an important role in industrialization efforts since it made the decision to structurally transform the economy through the ISI strategy. In pursuit of the goal, the state created organizations and financial institutions to fuel the 'engine of growth' and provided protection to domestic manufacturers against the foreign competition. It also provided subsidies and cheap foreign exchange for input imports. Despite these efforts, the early industrialization strategy exacerbated the development differentials between the East and West Pakistan. The state which was dominated by the civil and military bureaucracy could not establish participatory democracy credentials in a multiethnic and fragmented body politic of Pakistan.

The ramifications of inequitable industrial and economic growth were enormous. Before 1971, despite visible industrial growth, authoritarian state dominated by the military and civil bureaucracy failed to act as entrepreneur who could visualize and create choice sets for higher levels of equilibrium in the allocation of economic resources. The state failed to act as a trust worthy conflict manager who could address social, political, and economic grievances of the people. The state, however, partially succeeded in addressing the needs of a small group of people who could politically align themselves with the military regime. The small group of people included big business houses, top brass of the military and civil bureaucracy, landlords, and to a certain extent opportunistic politicians who were either industrialists or landlords. However, the small group could not ensure the continuous growth in the manufacturing sector as the state might have wished earlier.

Immediately after 1971, there was change in the balance of power in favour of the middle class but it remained for a very short period of time. The nationalization, land reforms, and administrative reforms programmes could not establish the credentials of Pakistan as entrepreneurial state which some countries of East Asia did manage to get. The post-1971 Pakistan is structurally the same Pakistan which was created in 1947. It still has a very low level of human development, it is still dominated by the civil military bureaucracy, and it is still trying to achieve industrial growth which could drive its society towards a sustained level of high growth path. Most importantly, the meta-institution of participatory democracy is still weak and therefore the institutions of dispute settlement and management are fighting for survival. The neoliberal reforms have added little to the growth of manufacturing sector and technological capability. Big push in the private and public investment in the

manufacturing sector is still awaited though foreign direct investment has increased in oil and gas as well as telecom and financial sector.

The state must understand that the ultimate saviour of the state is the state itself but weapon of the first and last resort are its people. They are human capital when skilled and an expression of population explosion when unskilled. They serve as engineers and doctors when trained and cause social unrest when deprived and illiterate. They are entrepreneurs when respected and fodder for anti-social canons when excluded from mainstream economic activities. The post-1971 state of Pakistan needs to understand that 'industrialization is a necessary but not a sufficient condition for development' (Nixon, 2002). Perhaps, more than that Pakistan needs to learn from the experiences of its own past.

However, for rapid industrialization the first important step is to develop a coherent development vision and industrial policy. The other policies such as labour, competition, and FDI policy should follow the logic of industrial policy. A key component of the industrial policy may be the re-distribution side of the economy to address rapidly increasing spatial and income inequality which has produced socially and politically inefficient results. In this sense, the state should not only be a facilitative agent for change, it should move ahead and become an entrepreneurial and institution builder which can provide viable governance structure for an equitable structural change.

To conclude, it may be said that the theoretical and empirical evidence presented in this study possibly built a case to argue that:

'A major economic transformation in (or towards) modern economy requires a state which can effectively perform the roles of the ultimate entrepreneur and the conflict manager.' (Chang and Rowthorn, 1995b, p. 46).

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Appendix A

Human Development Report 2005 by UNDP argues that Vietnam by balancing growth and human development considerations with trade: income poverty fell from 58% to 28% during 1990s; life expectancy at birth increased six years; child mortality cut in half (from 40 to 20/1000 live births). The table A illustrates experience of Vietnam, a cautious globalizer in comparison with Mexico, a fast globalizer.

Table A

Two Globalizers: Vietnam and Mexico		
Indicators	Vietnam	Mexico
Average annual growth rate of exports, 1990-2003 (%)	20.2	11.4
Average annual growth rate of income, 1990-2003 (%)	5.9	1.4
<i>Extreme Poverty Rate (%) (national poverty line)</i>		
1990	30	22.5
2002	15	20.3
Income share of the poorest 20% (2002)	7.5	3.1

Source: Data from UNDP (2005)



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