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Industrial Policy under Clientelist Political Settlements in Pakistan

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A STRACT

Developed and developing countries are diverging rather than converging in their growth trajectories in contradiction to theory. Many explanations have been put forward to explain this fact but they fall short of providing an adequate account of the growth experiences of all countries. The key to explaining this divergence lies in the source of growth in developed countries on the one hand—industrial sector development, and the channel employed by developing countries attempting to emulate their experience on the other hand—industrial policy. The implementation of industrial policy in developing countries has been influenced by political economy factors such as political settlements. Against this backdrop, the interplay between political settlements and formulation and implementation of industrial policy will shed light on the experience of developing countries with industrialisation, and lessons for the future. The aim of this paper is to identify specific political economy factors that could explain the economic growth performance of Pakistan s industrial sector, by comparing two distinct periods of industrial development, and in so doing contribute to the policy debate on industrial policy in the country. his paper finds that Pakistan s political settlements have fractured over time and in doing so compromised the ability of the state to effectively monitor and enforce policies designed to influence and direct economic activity.

EL Classification: D72, P48, L52

eywords: Political Settlements, Industrial Policy, Political Economy

1. INTROD□CTION

Contrary to the expectations of convergence theory,[1] the gap between developed countries and late developers has been widening over time, rather than shrinking as expected. The former are continuing to expand production frontiers and the latter are struggling to catch up with, let alone overtake the former. Many explanations have been put forward to explain this fact but they fall short of providing an adequate account of the growth experiences of all countries. The key to explaining this divergence lies in the source of growth in developed countries on the one hand—industrial sector development, and the channel employed by developing countries attempting to emulate their experience on the other hand—industrial policy. The interplay between political settlements and formulation and implementation of industrial policy sheds light on the experience of developing countries with industrialisation, as this case study of Pakistan s experience shows.

Developed countries set the precedent of successfully boosting their economic and social development through industrial sector development and developing countries have attempted to emulate this model (by prioritising development of their industrial sector using specifically designed policy instruments). The focus of these countries is not on starting from scratch but on acquiring capabilities (technological as well as organisational) and the physical technology required to start manufacturing products. Such technology acquisition efforts have been the preferred conduit to enable productive efficiency and ability to compete globally. However, the experience of these countries in this regard has been inconsistent.

Pakistan is one such developing country; having experienced a number of very promising periods of growth, followed by periods of great instability and faltering growth trends. Frequent changes in political leadership and reversals in policies by the state are linked to these shifts in growth trends. For example the period of the 1960s was characterised by high incidence of income inequality within the country and corruption within the state, while there were massive investments in setting up productive capacity in numerous industries. As a result there was a shift towards market enhancing policies that were actually reaping

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[1]Theorised by, among others Kerrl, *et al*. (1990); Dunning and Hopper (1966); and Kerr, *et al.* (1971).

the benefits of the capabilities built up during the previous period and did not yield the benefits one had come to expect based on the experience of other developing countries. The reason why Pakistan had such a lacklustre experience lies in the changes in political settlements in the country that impacted the institutional choices and performance of the domestic economy.

The aim of this paper is to identify specific political economy factors that could explain the economic growth performance of Pakistan s industrial sector, by comparing two distinct periods of industrial development, and in so doing contribute to the policy debate on industrial policy in the country. Section 2 recaps key concepts of political settlements relevant to the discussion. Section 3 presents an overview of the state of the economy and the political economy of industrial policy in Pakistan s early formative years, which stands in contrast with the state of the economy and the evolution of the political economy in the post-Zia democracy period discussed in Section 4. A comparative analysis of developments in Pakistan s experience wraps up the discussion in the conclusion in Section 6.

2. POLITICAL SETTLEMENTS

For a country that has embarked on a chosen path to development of the economy and transformation of society, the question remains as to how do we ensure that economic agents behave in a manner that is consistent with the ultimate goal of development and growth, especially when there are market failures present in the system? Left to themselves, firms and entrepreneurs will seek out opportunities that offer the highest return for their investment, and those do not necessarily include (among other initiatives) long term and high risk technology acquisition efforts that lead to building up of dynamic technological capabilities. On the other hand, with the proper guidance and motivation from a state with a holistic view of the development process, arrangements can be made to ensure such initiatives are undertaken and the goals achieved. The relationship that the state and its allied institutions forge with economic agents; and in particular with entrepreneurs and firms, will determine the success or lack thereof of its developmental efforts. The state manages to maintain social order while organising a political compromise between itself and groups within society. This social order has been termed as a political settlement in the literature and the concept can be used as a lens through which we can assess the performance of institutions in a developing country such as Pakistan, which in turn will assist in an analysis of growth challenges in such countries. Towards this end, a closer look at the political economy background of institutions, and of the concept of political settlements is required to allow us to link the two together (an overview of the different thematic areas, key definitions and focus of the literature is provided in Table 1).

Table 1

Political Settlements Literature: Thematic Areas and Focus

Thematic Area	Key Definitions	Focus On
Role in defining state and society relations	Fritz and Menocal (2007): negotiated agreement binding state and society in an on-going process, and not a one-off event. John and Putzel (2009): the outcome of bargaining and negotiation between elites.	Explaining vertical relationships
As an outcome of elite negotiations	Menocal (2009): a common understanding between elites about how power should be organised and exercised; including formal institutions and informal agreements. DfID (2010b): ongoing formal and informal bargains between elites. DfID (2010a): a common understanding between elites about how power should be organised and exercised; including formal institutions and informal agreements. Parks and Cole (2010): arrangements elites agree to in order to end violent competition over power and resources. Settlements characterised by elite actors, pursuing their interests, thereby influencing the shape of institutions. Gleason, *et al.* (2011): dynamic, on-going negotiations between elites. AusAID (2011): the formal and informal institutions, agreements, and understandings, between elites and between elites and the wider society, that underpin a political system.	Explaining horizontal relationships
Representing power structure (balance and distribution) in society	Khan (1995): the overall balance of power in society. Khan (2010) and Khan (2009): social order a compatible, viable, sustainable combination of power and institutions. DfID (2009): starts with a common understanding between elites then expands into a contract between state and society. An adaptable political process that is formalised through, or grounded upon one-off events like peace agreements.	Explaining institutional performance
Conduit for overcoming violence and political instability	Whaites (2008): informal, unarticulated understandings between elites. OECD/DAC (2008): The outcome of peace processes. Barnes (2009): a common understanding between elites about how power should be organised and exercised. The outcome of peace processes in war-to-peace transitions. Sharan (2011): a framework for ending hostilities amongst competing elites.	Explaining radical change

Source: Based on Laws (2012).

There are a number of definitions of political settlement as the term has been used on the literature on political economy of development till now, and the variation observed depends on the focus of the research. The term was first introduced by Melling (1991) to describe political processes and their impact on welfare policies during the time of 19th century British industrial capitalism and the welfare state. The development studies context was provided as a means of looking at institutional performance and was later refined to represent distribution of organisational and political power between competing groups

and classes in society by Khan (1995, p. 71) and Khan (2004, p. 168). On the other hand, Fritz and Menocal (2007) considered political settlements in the context of a binding agreement between the state and society; however they focused on the vertical context of such agreements while glossing over class conflict that arises within various groups in society. Indeed, a typical society is comprised of diverse elements and will not be homogeneous in nature, and the stratification is more pronounced for the marginalised groups. Consider the gender stratification; till the emancipation of women, men tended to receive preferential treatment, and this trend continued till women challenged the status quo and won the right to vote. Overlooking the diversity present in society, especially in the case of developing countries where large swathes of society can be marginalised, seriously undermines the validity of any model based on this treatment of the concept. Khan (1995) and Khan (2004) recognised the importance of exclusion of groups and the conflict which arises from divisions in society, thus making this interpretation more relevant for developing countries.

Examples from developing countries around the world [in particular the case of South Africa as discussed in Laws (2012)] suggest that though sustainability of political settlements is important and requires that the settlements be responsive to the interests of society in general, the interactions between states and elites and their followers is also crucial. In other words the vertical as well as the horizontal context is relevant to the definition of political settlements. Whaites (2008) has looked at the horizontal interactions between elites in society and in addition has also considered that elites have the ability to organise, persuade, command or inspire their social constituents; terming political settlements as a two-level game.

(DfID 2009) associated the spatial distinction (vertical and horizontal relationships between the state and society and within society itself) with the notion of state responsiveness; characterising states as belonging to one of two categories; (i) unresponsive, and (ii) responsive.

Political settlements in the former are characterised by informal rules, patronage, and friction between predatory elites. The latter on the other hand have progressed to the stage where there is little discord between groups and the state is responsible for providing basic needs that allow contract enforcement, such as security, rule of law and accountability. In this scenario, political settlements are taken to be adaptable in the responsive states, since these states are able to accommodate demands for political or even social change. However, it needs to be kept in mind that the adaptability and flexibility is not unrestricted in these states. Unresponsive states lack the flexibility and adaptability of responsive states and fundamental changes in political or social needs tend to shatter the existing political settlement and lead to the genesis of a new settlement, as seen in the recent Arab Spring.

Keeping in mind the fact that states in some developing countries tend not to have the power to organise compromises with society and within society due to conflicting demands on limited resources and capture by strong groups within society, we offer a characterisation of states in developing countries that mirrors a distinction also found in the developmental state literature (i) weak, and (ii) strong. Strong states in developing countries such as the East Asian tigers will lean more towards DfID (2009) s responsive state category, while the weak states of South Asia and Latin America will exhibit more traits of the unresponsive category.

John and Putzel (2009) propose the notion that there is bargaining between elites and between the state and society with conflicting interests; an argument that is in opposition to the understandings between elites that have been highlighted in earlier definitions. Though certainly valid, the extent of the misunderstanding being suggested by the authors is deemed to have been overstated, as the definitions do suggest that the understanding have to be reached a process of bargaining [Laws (2012)].

The sustainable and viable compatibility of the distribution of economic benefits that are supported by institutions, both formal as well as informal, and are coupled with the distribution of power in society will lead to the emergence of political settlements according to Khan (2010). This definition of political settlements is well suited for an analysis of the performance (or lack thereof) of institutions in developing countries as they pursue their developmental agenda. The focus here is on the compatibility of institutions with the distribution of power and economic benefits among groups and elites in society. The spatial components (horizontal as well as vertical relationships) of earlier definitions are accounted for in this definition, as is the fact that a number of institutions in developing countries are informal, and not just formal institutions and agreements as typical in developed countries.

There are five key components of this particular definition of political settlements that bear mentioning. First, power refers to the holding power of elites in society, or the capability of an individual or group to engage and survive in conflicts [Khan (2010), p. 6]. The distribution of this power is contingent on the presence of informal institutions, mainly patron-client networks that are employed for allocation of economic benefits, rather than formal institutions that exemplify developed countries. Formal institutions that mirror the characteristics of those present in developed countries are unlikely to have much success at achieving their goals of accountability (for example) since the power of the elites is contingent not on formal institutions, as in developed countries, but on informal institutions, namely patron-client networks that characterise the majority of developing countries.

Second, sustainable political settlement is one that leads to the creation of minimum levels of economic performance and political stability [as stated by

Khan (2010)] that ensure that the settlement endures over time and does not collapse in on itself. As long as sufficient economic benefits are accruing to the elites, there will be no incentive to challenge the status quo and existing political settlement in hopes of receiving a better payoff and hence the settlement will be sustainable over time.

Third, compatibility of the settlement is in the context of sufficient number of powerful groups and elites in society receiving an adequate share of the economic benefits that accrue to comply with the existing order and forego any contestation and conflict with other groups, elites and even the state.

Fourth, viability of the political settlement is in the context of being economically productive enough to forestall economic crisis, and politically stable enough that conflict and violence do not threaten to overthrow core institutional and political arrangements.

Finally, institutions and the distribution of power in developing countries share a symbiotic relationship: institutions create economic benefits for groups and elites in society, while powerful groups and elites will attempt to influence the working of institutions to deliver more favourable economic benefits. Political settlements must be flexible and sufficiently dynamic to accommodate changes in power relations.

Typically, holding power of a group in society is affected by two factors; the ability to impose costs on other groups, and the ability to absorb costs that have been imposed by the state and other groups in society. The greater or stronger these abilities, the more likely it is that the group will prevail in any conflict it engages in. A group with sufficient holding power will be able to contest the enforcement of benefits by an institution and thereby affect its (the institution s effectiveness in influencing activity. he ability to absorb and inflict costs is in turn determined by economic power, on the extent of resources (wealth) that groups can draw on, for their survival. However, there is a trade-off in terms of greater expectations being associated with the higher level of resources being utilised, meaning that it is not certain that richer groups will prevail in every conflict. If poorer groups have a greater political ability to organise, mobilise a greater number of people for support, or a greater claim to legitimacy (for example) than more powerful groups it is conceivable for these groups to survive in conflict with richer groups. These latter abilities, in contrast to economic power, are harder to quantify and assess, and this uncertainty and lack of predictability is what creates conditions for conflicts to arise between groups in society.

When a social order emerges, the distribution of power is embedded in an institutional arrangement, formal as well as informal, that sustains it. Khan (2010) has argued that political settlements in developing countries can be characterised as *clientelist political settlements"* where the informal productive sector rather than the formal productive sector dominates the economy.

3. A K AN'S GRO T TAKEOFF

The economic growth of Pakistan presents a very interesting case of the growth experience of a developing country and will undoubtedly yield lessons for future growth prospects. Pakistan s growth experience has been far from consistent over the years since independence; a number of promising periods of growth have been followed by periods of great instability and faltering growth trends that jeopardize the growth process. There were frequent changes in political leadership and sharp reversals in policies implemented by the state that were linked to these shifts in growth trends. The decade of the 1960s was characterised by a high incidence of income inequality within the country and high perceived levels of corruption within the state that were the result of growth enhancing policies that were favoured in industrialisation efforts. This led to a shift towards market enhancing policies that were considered more successful but were in actuality reaping the benefits of capabilities that had been built up during the earlier period but not yielded the expected benefits by the time of the policy shift. he reason for Pakistan s lackluster growth experience lies in the changes in political settlements in the country that impacted the institutional choices and performance of the domestic economy, and in particular the industrial sector. The following sections will shed light on Pakistan s growth experience in the 1960s and contrast that with growth trends in the 1990s.

By the end of the 1950s, the foundations of the industrial sector had been laid and large scale manufacturing was rapidly expanding, the state bureaucracy was established, and while the agricultural sector continued to dominate the economy, its growth was starting to stagnate. A high growth rate of population exceeding that of the agricultural sector meant that there was a decline in per capita availability of food. Per capita income levels in the economy remained stagnant during this time, and the economy was highly regulated. Import substitution increased the disparity between different groups and segments in the economy which resulted in political discontent, and culminated in a military coup in October 1958 to restore political stability and revive the country s growth trajectory.

Economic Trends

The military regime led by Ayub Khan was committed to the development of capitalism and a willingness to intervene in the economy at a fairly micro level to achieve this goal.[2] Moreover there was allocation of massive amounts of resources to a limited group of industrialists that was reminiscent of the earlier import substitution era, and the South Korean *chaebols*. This resulted in a rapid accumulation of assets that provided the

[2]Khan (1999).

stimulus for a highly accelerated rate of investment in the manufacturing industry (16.9 percent on average in the early 1960s, and dropping to a slightly over 10 percent on average in later years) that was the most promising among developing countries at the time. It is logical to attribute growth in the early 1960s to the rapid accumulation process and investment spurt according to Khan (1999), and not to the liberalisation policies of the time as suggested by Gardezi and Rashid (1983).

Political Settlements

Import controls were relaxed to facilitate the import of raw material and an Export Bonus Voucher Scheme for manufactured goods was introduced that gave exporters an additional claim on foreign exchange to import goods that they required. While the rapid accumulation process stimulated growth, it also resulted in massive concentration of wealth in the hands of a few industrialists. The exact degree of concentration at the time is not clear; however, according to Mahbub-ul-Haq, 22 families controlled 66 percent of Pakistan s wealth in 1968. On the other hand, researchers such as Amjad (1982) found that 18 industrial groups controlled 35 percent and 44 groups controlled approximately 50 percent of all industrial assets of the country.

The state favoured large scale manufacturing industries for investment purposes; industries such as cotton and jute textiles, cement, chemicals etc., which also tended to be more capital intensive. This is evident from that the fact that, according to Khan (1970), the capital labour ratios in most manufacturing industries were higher in 1962 than those in Japan, and Islam (1976) found similar results for the year 1969. This suggests that the small and medium scale sector, which was relatively more labour intensive, was neglected in favour of large scale manufacturing which was more capital intensive.

To complicate the situation further, the state was unable to deliver conditional subsidies based on output performance to the industrialists, as a result of which there was poor industrial performance in terms of output. In comparison, the South Korean state also allowed concentration, but this did not impede growth since the subsidies were made conditional on export growth. Most crucially, the conditionality was credibly enforced to ensure *chaebols* conformed to the state s ob ectives. nlike South Korea, the Pakistani state was unable to intervene selectively and push development of priority/strategic sectors that would allow sustainable growth of the economy. Moreover, at a time when other countries had begun to push industrialisation efforts towards new, riskier ventures, Pakistan was unable to follow suit due to internal political instability. Resources had to be diverted away from more productive areas to deal with political contestation and unrest. To ensure its political survivability in the face of political agitation and to forestall the loss of power, the state opted to divert resources towards meeting the demands of political agents of unrest. There is evidence that subsidy withdrawal and other centrally

allocated rights were being allocated on a political basis rather than on the basis of productivity, and this led to loss of credibility and the start of rent-seeking activity in the country [Khan (1999)].

To gain access to more resources and ensure continued access to such resources, industrialists formed connections with the bureaucracy and the political leadership in a mutually beneficial way. Small and medium scale enterprises lacked the economic power to influence the state but were able to dominate trade associations and used their political power to contest for allocation of the scarce resources.

In the wake of the chaotic beginnings of the nation and once the dust had settled, the foundations of the industrial sector were laid and evident in the rapid growth of large scale manufacturing. The administrative machinery of the state, including various institutions such as the central bank, was put in place. The agriculture sector dominated economic activity in the economy, but growth in the sector stagnated during this period. Population growth on the other hand exceeded agricultural output growth, and as a consequence, domestic per capita food availability was reduced. With the establishment of the administrative branches of the state, the regulations governing investment, trade, pricing and a number of other economic areas increased.

The military take-over in October 1958 followed a great deal of political instability during the most part of the Fifties. To introduce some form of democracy in the country despite the promulgation of Martial aw, a basic democracy programme was launched in an attempt to legitimise military rule with the masses. This set up allowed the military government to settle on a presidential rule, and to ignore the important constitutional issues of representation in the federal legislature and provincial autonomy.

On the economic front, the government set out to improve economic management and to deal effectively with corruption and unfair practices by the private sector especially in industry and retail trade. The windfall gains and profits arising after industries were set up and the situation was compounded with the earlier lack of regulations governing economic activity, which had allowed private sector profiteering and the concentration of wealth in the hands of a few families controlling key companies. While it was a necessary evil at the time to encourage economic activity in the desired areas, subsequent steps were not taken by the state to follow through and exert control over companies to invest the accumulated wealth in productive activities that would yield the maximum benefit to the economy. Besides introducing strict price and profit controls in the form of administered prices and profit margins, it also dealt with the menaces of hoarding, black-marketing, and smuggling with an iron hand. The initial impact of these measures was favourable and the general price index registered a fall in the early months after the Martial Law. But the government soon realised that the direct controls had introduced rigidities in the system and

thus hampered the growth of the manufacturing sector.[3] Within just one year of taking over, the government began to dismantle the price control system and moved towards a general policy of economic deregulation through a greater reliance on the market mechanism.

Development strategy during much of the Sixties continued to be heavily biased towards promoting industrial growth in Pakistan. The government maintained an over-valued exchange rate to ensure the cheap availability of capital goods and other imported inputs to the industrial sector. Also, by keeping prices of agricultural inputs at below world market prices, it made domestic raw materials available to the industrial sector at very cheap prices. This, together with the policy of import controls and tariffs, tax concessions such as tax holidays, accelerated depreciation allowances, and loans at very low interest rates, markedly accentuated the pro-industrial bias in the growth strategy. To further help its industrialisation drive, the government adopted a series of measures to promote exports of manufactured goods. The most significant measure was the introduction of Export Bonus Scheme (EBS), which subsidised manufactured goods exports through a system of bonus vouchers.[4] Furthermore, preferential access to credit and a host of fiscal incentives were part of a policy package meant to enhance export competitiveness. These policies not only led to robust growth in the exports of manufactured goods, but also helped diversify the product composition of Pakistan s exports.

The incentives provided to manufactured goods exports were partly meant to offset the anti-export bias inherent in the policy of import substituting industrialisation followed during most of the decade, barring a few years when import regime was liberalised somewhat.[5] While protectionist policies did contribute to industrial diversification and growth, these had several shortcomings. In particular, protection of domestic industry through high rates of effective protection led to inefficiencies in domestic production, prevented the country from realising its full export potential, and contributed to a worsening of balance of payments (the increase in capital goods and raw material imports outweighed the growth in exports).

The neglect of agriculture in the Fifties not only resulted in food shortages but also constrained the domestic supply of agricultural raw materials to the industrial sector. These complications led to an agricultural policy that was aimed at achieving self-sufficiency in food, increasing agricultural production, and reducing unemployment. The shift in emphasis in policy also

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[3]Direct controls on prices and profits weaken the incentive to expand production.

[4]The bonus vouchers often carried a high premium in the market as import licenses were automatically issued against the vouchers. More than 80 percent of the total export subsidies were accounted for by this scheme [see Kemal (1978)].

[5]To a large extent, import liberalisation was made possible by the increase in foreign loans and grants. The process of import liberalisation, however, had to be cut short owing to drastically reduced foreign aid inflows in the wake of the 1965 war with India.

coincided with the advent of green revolution technology in the economy. he revolution started with introduction of high-yielding varieties of seeds (HYV), chemical fertilisers, pesticides etc., and coupled with greater use of agricultural machinery, mainly in terms of number of tube-wells in operation as well as tractors. The state facilitated the adoption of new technology by heavily subsidising high-tech varieties of agricultural inputs. These factors contributed to a marked improvement in the growth performance of the agricultural sector: the average annual growth rate jumped to 6 percent in the second half of the Sixties, up from 1.8 percent in the corresponding period of the Fifties.

With a view to restructuring land relationships, the state introduced land reforms which prescribed ceilings of landholdings at 500 acres of irrigated land and 1,000 acres of non-irrigated land. However, the reforms were not implemented properly, and landlords were able to use a variety of loopholes and exemptions to sidestep a bureaucracy hamstrung by political and administrative constraints. As a result only modest amounts of land being transferred to small farmers and landless labour, and the land reforms did not result in a meaningful redistribution of land holdings.

The long-term development strategy pursued during the first five years of the Sixties was outlined in the Second Five-Year Plan (1960-65). The plan sought to accelerate the pace of development and overcome the inadequacies of achievement during the First Plan period, and to ensure that the stage of self-generating growth was reached within a reasonable period. In addition, the plan attempted to restore the balance between agricultural and industrial development. Consequently, the pattern of public sector expenditure was heavily concentrated in the agricultural sector mainly because of the large expenditures on the development of water resources. The Second Plan was quite successful in fulfilling its major objectives: the increase in national income during this period was over 30 percent as against the target of 24 percent.

The Third Five-Year Plan (1965-1970) was formulated in the light of the achievements and shortfalls of the two previous plans. Its principal objectives were to attain rapid growth in national output, reduce the degree of intra and inter-regional income inequality, increase employment opportunities, strengthen the balance of payments, and improve the availability of social services like health and education. However, the plan targets were overly ambitious, and soon after the launching of the Third Plan, it had to be revised in respect of its resources and priorities in the light of various adverse circumstances. These included increased defense expenditures following the outbreak of war with India in September 1965, drastic cuts in foreign aid along with the hardening of the terms of loans and mounting repayment obligations, and successive droughts and floods leading to a fall in agricultural productivity and rise in food imports. Not surprisingly, then, achievements in most sectors fell short of expectations.

Despite rapid growth in both the industrial and the agricultural sectors, the Sixties witnessed rising economic and political tensions, not least because of a lack of interest in issues of equity and social justice which contributed to concentration of wealth in the hands of a few individuals. In addition, the suppression of provincial autonomy sowed the seeds of discontent between East and West Pakistan and there was a growing perception that the East wing was not receiving its fair share of resources. Besides regional disparities, there was a widespread feeling that income inequalities had increased in both the provinces during the Sixties. A statement by Mahbub-ul-Haq, then Chief Economist of the Planning Commission, to the effect that twenty-two families controlled 66 percent of the industrial wealth and 87 percent of the banking and insurance in the country, stirred up widespread disturbances in the winter of 1968 which eventually led to the downfall of the military government.

The fact that strong growth performance was not accompanied by an improvement in the living standards of the majority of population led many to uestion the government s economic policies in the ixties. It must, however, be pointed out that regardless of the controversy on the overall economic policies pursued during this period, there is a broad agreement on the fact that the Sixties was a period of sound macroeconomic management which contributed to greater monetary discipline, price stability, and low budget deficits. Furthermore, in the backdrop of political instability that had characterised much of the Fifties to the detriment of economic planning and management, a major achievement of the military government was the strengthening of the administrative capacity, which greatly facilitated the formulation and implementation of policies and programs.

Measured by GDP growth, economic performance in Pakistan in the Sixties clearly surpassed initial expectations (as evident from the broad macroeconomic aggregates presented in Table 2): the growth rate of the economy more than doubled from 3.11 percent per annum in the Fifties to 6.60 percent in the Sixties (see Figure 1 for decade-wise averages). After exhibiting stagnant and even negative growth in the initial years, the agricultural sector recorded a healthy growth rate of 6.04 percent in 1961-62. Growth in the agricultural sector peaked at 11.66 percent in 1967-68, before decelerating sharply to 4.15 percent in 1968-69, and then rebounding to 9.12 percent in 1969-70. It is noteworthy that agricultural sector performed relatively well in the second half of the Sixties as compared to the first half: the average annual rate of growth in the agriculture sector climbed from 3.88 percent in the first half to 6.36 percent in the second half.

Large scale manufacturing sector posted strong growth in both halves of the Sixties, though there was a marked slowdown in the second half when industrial output grew at an average annual rate of 8.11 percent, down from 11.72 percent in the first half. Several factors contributed to the impressive performance of the

industrial sector in the Sixties. First, a large and lucrative market for domestic production was created by a restrictive import regime, especially for consumer goods, resulting in high profits in the industrial sector. Second, relaxation in direct controls on investment coupled with improved profitability in the industrial sector led to a substantial increase in real gross fixed investment. Third, there was cheap availability of agricultural raw materials to the industrial sector, thanks largely to export controls on these products which depressed domestic prices of these commodities relative to their world prices.

Table 2

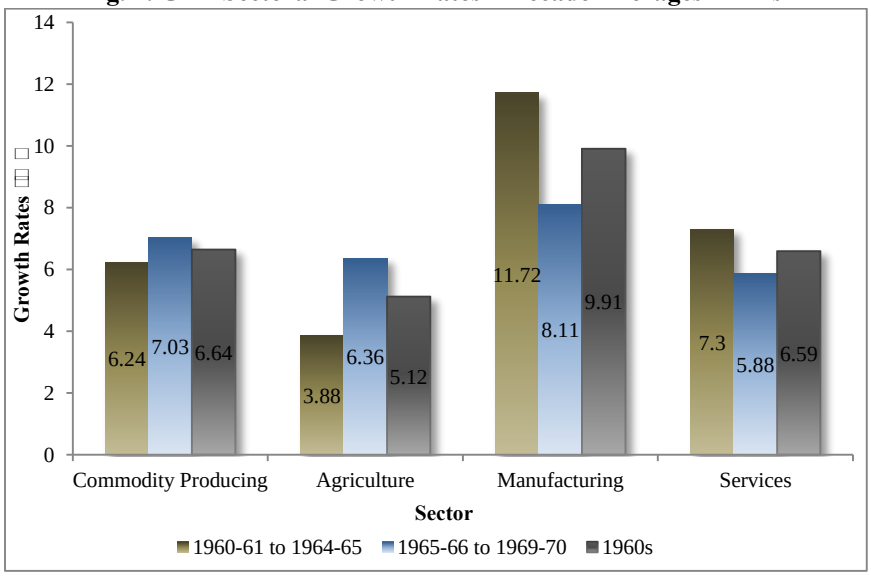
GDP and Sectoral Annual Growth Rates (1960–1969)

(%)

	Sector					
	Commodity Producing			Services		
Years	Total	Agriculture	Manufacturing		GDP (FC)	Per Capita Income (Rs)
1960-61	3.75	-0.39	12.85	5.98	4.67	2.01
1961-62	6.86	6.04	13.28	3.89	5.61	2.65
1962-63	6.91	4.91	11.18	7.05	6.97	3.85
1963-64	6.86	3.83	11.34	6.34	6.65	3.76
1964-65	6.83	4.99	9.93	13.22	9.46	6.22
1965-66	3.01	0.86	8.58	11.67	6.70	3.84
1966-67	5.17	6.00	5.65	1.95	3.74	0.83
1967-68	9.57	11.66	6.37	3.48	6.90	4.08
1968-69	6.58	4.15	8.62	5.56	6.15	3.13
1969-70	10.83	9.12	11.32	6.72	9.10	6.20

Source: Government of Pakistan (1999a).

Fig. 1. GDP Sectoral Growth Rates Decade A erages 1 s



Source: Government of Pakistan (1999).

With an average share in GDP of around 41 percent, the agricultural sector continued to play a dominant role in the economy (as evident from the trends in Table 3). On the other hand, while vigorous industrialisation efforts helped to raise the share of manufacturing sector in GDP from 10.68 percent in 1960-61 to 13.44 percent in 1969-70, the average share of manufacturing sector remained low during the decade at about 12.41 percent. The share of services in GDP did not show much variation during the period, and its average share stood close to 42 percent (see Figure 2).

Table 3

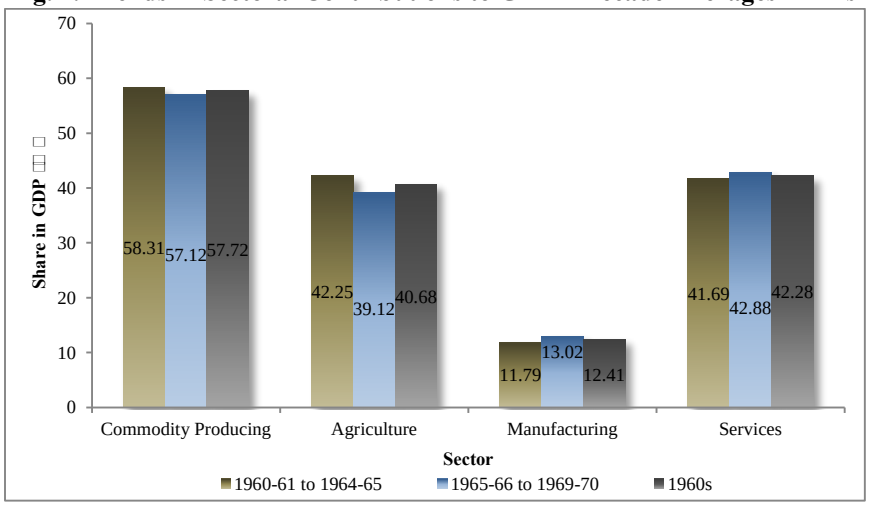
Trends in Sectoral Contribution to GDP (1960–1969)

(%)

	Sector			
	Commodity Producing			Services
Years	Total	Agriculture	Manufacturing	
1960-61	58.02	43.41	10.68	41.98
1961-62	58.70	43.58	11.45	41.30
1962-63	58.67	42.74	11.90	41.33
1963-64	58.79	41.61	12.43	41.21
1964-65	57.37	39.91	12.48	42.63
1965-66	55.39	37.73	12.70	44.61
1966-67	56.16	38.55	12.94	43.84
1967-68	57.56	40.27	12.87	42.44
1968-69	57.80	39.51	13.17	42.21
1969-70	58.71	39.52	13.44	41.29

Source: Government of Pakistan (1999a).

Fig. 2. Trends in Sectoral Contributions to GDP Decade A□erages □1□□□s□



Source: Government of Pakistan (1999).

Total investment increased from Rs 11.51 billion in 1960-61 to Rs 23.68 billion in 1969-70 (see Table 4 for trends), registering an average annual growth rate of 9.20 percent. Growth in investment considerably slowed down in the second half of the decade to 0.29 percent, from 18.69 percent in the first half (Figure 3). On average, the share of total investment in GDP stood at 17.36 percent during the period.

Table 4

Total Investment Trends (1960–1969)

(%)

Years	Value (PKR Millions)	Growth Rate	Share in GDP
1960-61	11,508	9.59	13.81
1961-62	13,401	16.45	15.22
1962-63	17,040	27.15	18.08
1963-64	20,801	22.07	20.67
1964-65	24,587	18.21	22.34
1965-66	21,829	11.22	18.58
1966-67	22,773	4.33	18.64
1967-68	20,534	9.84	15.77
1968-69	20,588	0.27	14.86
1969-70	23,683	15.03	15.61

Source: Government of Pakistan (1999a).

Note:

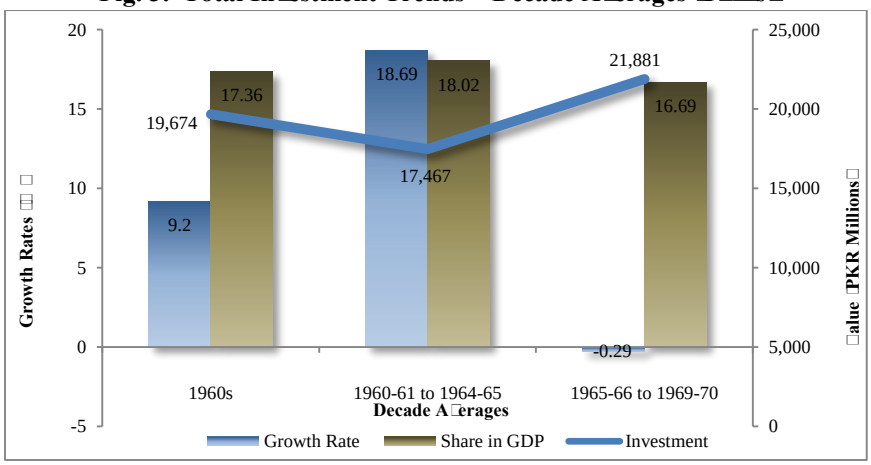
GDP MP used for analysis based on expenditure side.

Total Investment = Gross Fixed Capital Formation + Change in Stocks (taken from table Expenditure on GNP at Current Prices in Economic Survey).

Investment Series derived by dividing the respective investment series (in current prices) by the GDP Deflator.

All figures are at constant 1980-81 base.

Fig. 3. Total In□estment Trends Decade A□erages □1 □□□s□



Source: Government of Pakistan (1999).

Contrary to the popular belief, official figures on income distribution indicate a slight improvement in the distribution of income in the Sixties. The Gini coefficient, which is a convenient summary measure of the degree of income inequality, declined from 0.39 in 1963-64 to 0.34 1969-70 (Table 5), indicating an improvement in the distribution of income. Another indicator of income inequality is the share of the lowest 20 percent and highest 20 percent of households in income. During the period from 1963-64 to 1969-70, the share of the lowest 20 percent of households increased from 6.4 percent to 8.0 percent, whereas the share of the highest 20 percent of households declined from 45.3 percent to 41.8 percent (Figure 4). Notwithstanding this, the pattern of income distribution remained skewed towards high income households, as indicated by the substantially high proportion of income accruing to households in upper income bracket. The incidence of poverty, as measured by the headcount ratio, increased during the Sixties: the percentage of total population falling below the poverty line was 46.53 percent in 1969-70, up from 40.24 percent in 1963-64.

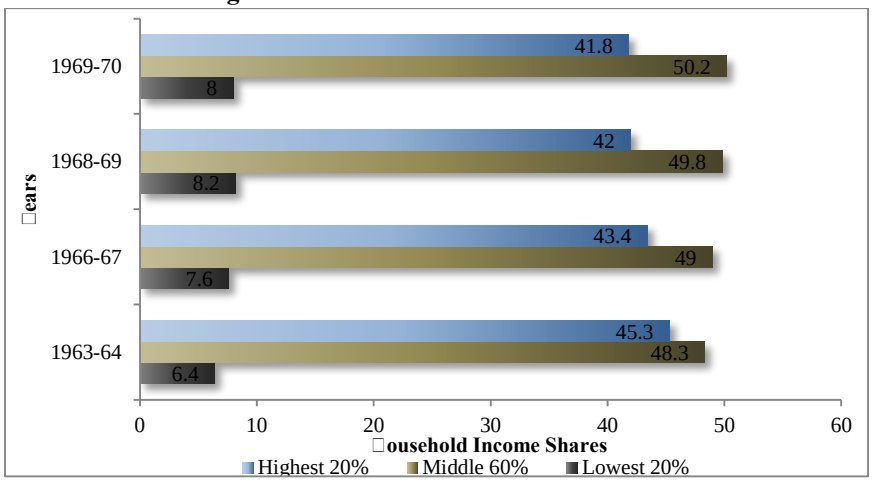
Table 5

Household Income Distribution (1960 – 1969)

Year	Household Gini Coefficient	Ratio of Highest 20% to Lowest 20%	Poverty Head Count Ratio: Total
1963-64	0.39	7.08	40.24
1966-67	0.36	5.71	44.5
1968-69	0.34	5.12	-
1969-70	0.34	5.22	46.53

Source: Government of Pakistan (1999a).
Author s own calculations.

Fig. 4. □ousehold Income Shares □1□□□s□



Source: Government of Pakistan (1999).

Pakistan s exports recorded a nearly three-fold increase during the period, increasing from USD 114 million in 1960-61 to USD 338 million in 1969-70 (Table 6) with an average annual growth rate of 10.72 percent. The strong growth in exports was accompanied by rising imports, which grew at an average rate of . percent. he country s trade balance remained in deficit throughout the decade.

Table 6

Exports, Imports, and Trade Balance (1960–1969)

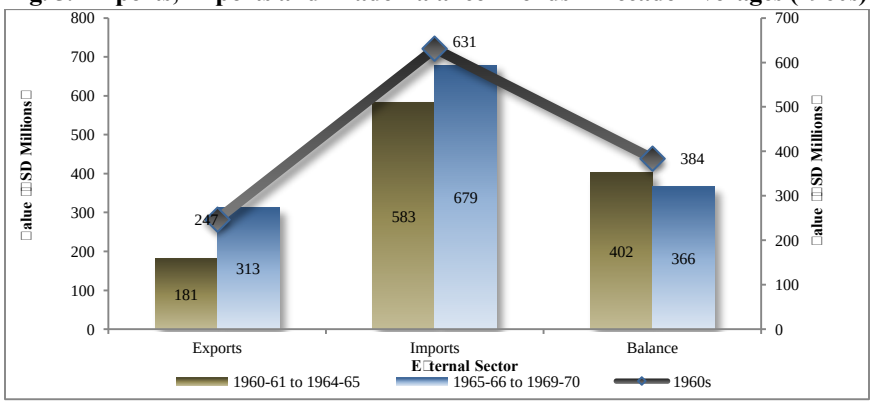
(USD million)

Year	Value		
	Exports	Imports	Balance
1960-61	114	457	343
1961-62	114	470	356
1962-63	210	588	378
1963-64	226	626	400
1964-65	239	772	533
1965-66	253	605	352
1966-67	273	762	489
1967-68	346	699	353
1968-69	357	640	283
1969-70	338	690	352

Source: Government of Pakistan (1999b).

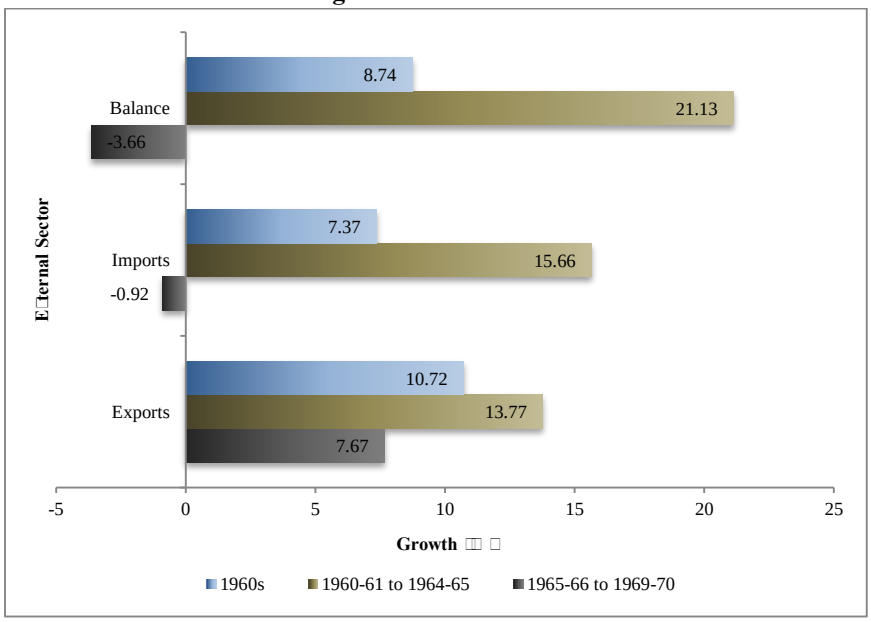
Exports averaged USD 181 million during the first half of the decade, almost doubling in the latter of the decade to USD 313 million, while imports also increased between the first and second half of the decade, from USD 583 million to USD 679 million (Figure 5). Corresponding figures for the trade balance on the hand showed a decline between the two sub periods, falling from USD 402 million to 366 million, indicating that there was a rapid rise in exports stemming from the Korean War driven jute exports.

Fig. 5. Exports, Imports and Trade Balance Trends—Decade Averages (1960s)



Source: Government of Pakistan (1999b).

Fig. □. E□□orts□Im□orts and Trade □alance Growth Rates Decade A□erages □1□□□s□



Source: Government of Pakistan (1999b).

4. POST ZIA DEMOCRAC□ PERIOD

The end of the 1980s decade saw a renewed focus on efforts to establish democratic rule and transition of power from military to civilian hands in the months following General Zia-ul-Ha s death in a plane crash on August 1 , 1988. These efforts culminated in party-based general elections being held for the first time since the constitution was suspended in 1977, and Pakistan People s Party headed by Ms. Bena ir Bhutto emerged victorious. However, this early attempt at democratic rule was short-lived and marked the beginning of a frequently changing political landscape, as approximately twenty months after assuming power the National Assembly was dissolved and Prime Minister Bhutto removed from office in August 1990.

Economic Trends

GDP growth trends reveal that overall economic performance of Pakistan during the Nineties slowed down in comparison with the decade of the Sixties. Whereas GDP growth had exceeded 6 percent in the earlier period, growth during the Nineties was much lower and averaged 4.4 percent over the decade, reflecting an overall weak performance of the manufacturing sector, even though in the first half of the decade the sector grew by 5.6 percent, but slowing down to 2 percent in the latter half of the decade.

Table 7

GDP and Sectoral Annual Growth Rates (1990–1999)

(Percent)

Years	Sector: Commodity Producing: Total	Commodity Producing: Agriculture	Commodity Producing: Manufacturing	Services	GDP (FC)	Per Capita Income
1990-91	5.91	4.96	6.25	5.21	5.57	4.49
1991-92	8.61	9.50	8.05	6.76	7.71	3.92
1992-93	0.09	-5.29	5.35	4.63	2.27	0.53
1993-94	4.87	5.23	5.48	4.20	4.54	1.49
1994-95	5.66	6.57	3.60	4.80	5.24	3.16
1995-96	8.45	11.72	4.80	4.99	6.76	3.09
1996-97	0.37	0.12	1.29	3.61	1.93	0.93
1997-98	2.39	4.52	-1.61	1.64	2.03	0.57
1998-99	3.42	1.95	4.07	4.99	4.18	1.90
1999-2000	3.67	6.09	1.53	4.15	3.91	1.22

Source: Government of Pakistan (2000).

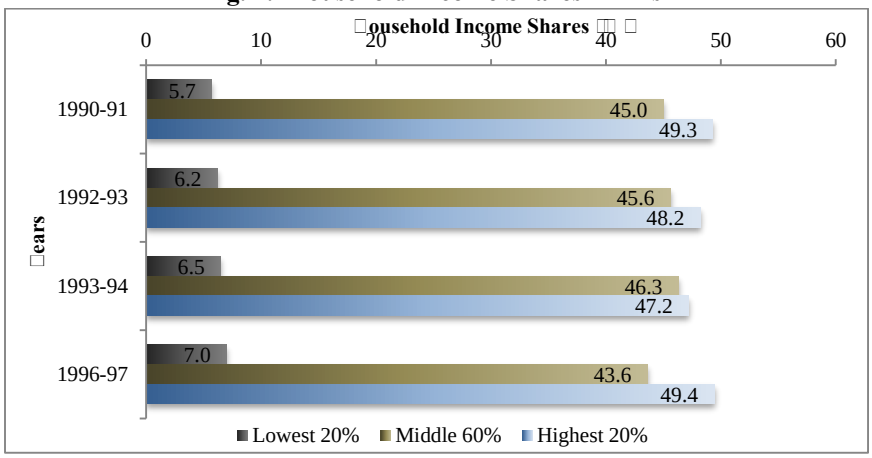
Table 8

Investment Trends (1990 – 1999)

(%)

Year	Growth Rates of Investment: Public	Private: Total	Private: Manufacturing	Private: Agriculture	Share in Total Investment: Public	Share in Total Investment: Private
1990-91	2.98	5.51	8.06	0.79	47.16	25.60
1991-92	16.67	18.38	36.52	7.11	48.67	26.04
1992-93	6.51	4.43	0.23	4.72	48.48	26.45
1993-94	3.73	1.07	2.43	5.47	49.17	26.10
1994-95	6.61	4.59	35.83	6.27	47.03	27.90
1995-96	7.66	9.66	12.73	1.91	47.95	27.93
1996-97	11.05	5.63	5.43	34.46	53.05	26.02
1997-98	33.67	3.97	12.45	1.50	55.13	17.25
1998-99	33.52	16.35	26.66	23.07	50.63	25.28
1999-2000	3.49	11.27	5.96	1.44	52.52	24.39

Fig. □. □ousehold Income Shares □1□□□s□



Source: Government of Pakistan (n.d.).

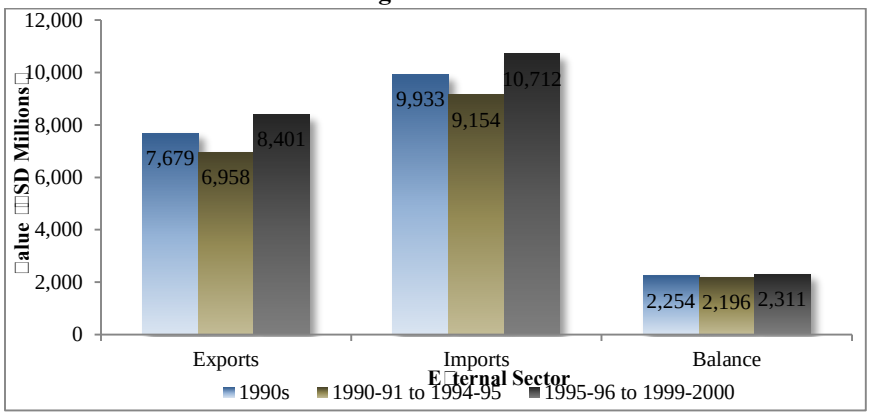
Table 9

Household Income Distribution (1990 – 1999)

Year	Household Gini Co-efficient	Ratio of Highest 20% to Lowest 20%	Poverty Head Count Ratio: Total
1990-91	0.41	8.6	18.64
1992-93	0.41	7.8	15.5
1993-94	0.4	7.3	
1996-97	0.4	7.1	27
1998-99			25.9

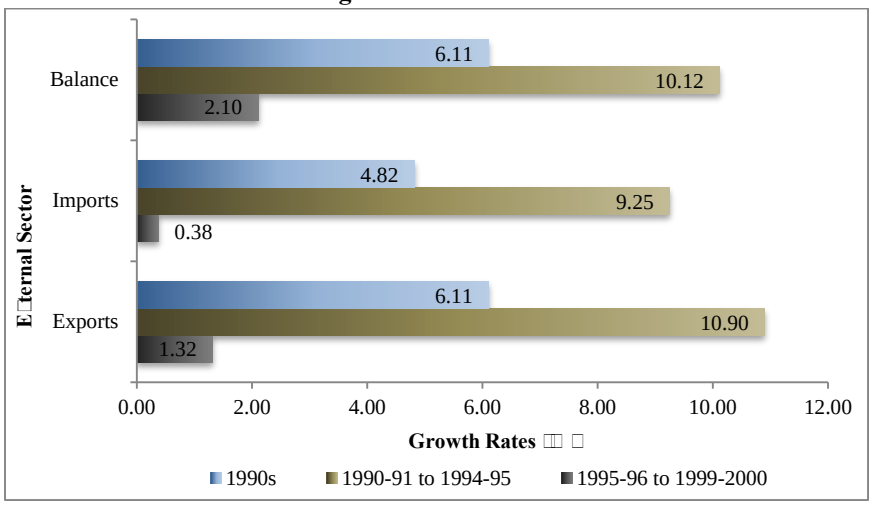
Source: Government of Pakistan (2000).
Author's own calculations.

Fig. □. E□□orts□Im□orts and Trade □alance Trends
Decade A□erages □1□□□s□



Source: Government of Pakistan (n.d.).

Fig. □. E□□orts□Im□orts and Trade □alance Growth Rates
Decade A□erages □1 □□□s□



Source: Government of Pakistan (n.d.).

Table 10

External Sector Performance (1990–1999)

(USD million)

	Value			Growth Rate (%)		
Year	Exports	Imports	Balance	Exports	Imports	Balance
1990-91	6,131	7,619	1488	23.76	9.86	24.89
1991-92	6,904	9,252	2348	12.61	21.43	57.80
1992-93	6,813	9,941	3128	1.32	7.45	33.22
1993-94	6,803	8,564	1761	0.15	13.85	43.70
1994-95	8,137	10,394	2257	19.61	21.37	28.17
1995-96	8,707	11,805	3098	7.01	13.58	37.26
1996-97	8,320	11,894	3574	4.44	0.75	15.36
1997-98	8,628	10,118	1490	3.70	14.93	58.31
1998-99	7,779	9,432	1653	9.84	6.78	10.94
1999-2000	8,569	10,309	1740	10.16	9.30	5.26

Source: Government of Pakistan (1999b).

5. CONCL□SION

Industrial policy has been used by developing countries; with varying degrees of success, as a tool to boost productivity and growth in the domestic economies, for the ultimate goal of achieving sustainable growth and closing the gap between developed countries and themselves.

Political settlements represent the distribution of power across economic, political and bureaucratic organisations in society [see Khan (19950; Khan (2010) and Khan (2013)], power which evolves over time. Such distributions are important in the context of policies aimed at learning because they determine the capability of organisations to affect allocation of various rents. Thus the actual outcome of a policy may be significantly different from the intended outcome due to rent allocation and its subsequent evaluation and enforcement that could not be enforced given the political settlement prevailing at the time. This paper has provided an overview of developments in political settlements in Pakistan at two key periods in the country s history that are linked to changes in the policy framework and economic performance of the country. The evolution of political settlements provides a framework for analysing the experience of manufacturing firms in Pakistan in technology acquisition and efforts to gain competitiveness in a global market.

It is clear that the political framework in the early formative years of the country under Ayub han s rule different from the post-Zia democracy period; a Basic Democracy Programme was launched to help legitimise the regime, but provisions were introduced into the constitution which allowed for Presidential rule. Following Zia there was a revival of democracy efforts but four elected governments were dismissed on various grounds over a period of eight and a half years; a trend that was reminiscent of the time before Ayub Khan came to power, when a total of 6 PMs held power over a period of eight years. On the economic front, the state wielded significant power and intervened in the economy where and when it was deemed necessary. In the democracy period following ia s rule, on the other hand, there were major efforts to deregulate the economy and the private sector, in particular small and medium enterprises were encouraged to take the initiative in an investment climate that was designed to promote investment and economic activity. The economy was able to benefit and grow as a result of the benefits from the productive capacity built up during Ayub han s time.

he early period of Pakistan s history was marked by an absence of a viable entrepreneurial class that meant the state had to step in and start the industrialisation process before handing over newly created industries in key sectors to potential industrialists. Later, these industrialisation efforts were given more structure and the state offered a number of rents, including subsidies, preferential access to markets, easy access to credit, and tariffs designed to encourage domestic production of products Pakistan s deletion program).[6] On the political front there was considerable upheaval and unrest with frequent changes in leadership, and attempts to solidify and sustain

[6]The deletion programme refers to a programme of phased indigenisation of production; components or products that manufactured locally are removed (deleted) from the list of components that enjoy concessionary duty rates.

themselves by assuring continued access to rents in exchange for support. For instance Ayub Khan started the system of basic democracies to gain support for his martial rule, while Zia-ul-Haq promoted religion and religious parties to rally support for his regime from the marginalised religious parties. In each case, the incumbent leadership gave rise to new or supported previously marginalised groups in order to guarantee support and sustainability. However, once established, these new groups established links within the existing political settlements and emerged with their own agenda and direction. This development further fractured the existing political settlements in the country and compromised the ability of the state to effectively monitor and enforce policies designed to influence and direct economic activity. This is in contrast to the case of other countries, such as South Korea, where the state supported the local *chaebols* but also managed to exert sufficient control over their operations to effectively direct development of industrial activity. Firms in South Korea were faced with the credible threat of closure if performance was below expectation and provided the incentive to develop capabilities for achieving competitiveness. In South Asia, India was able to compel a foreign manufacturer, Suzuki, to upgrade the capabilities of domestic component manufacturers by threatening to open access to the protected domestic market to other firms if targets were not met. This threat was credible and worked as Suzuki did not have any deep connections within the political settlement prevailing at the time. In the case of Pakistan, automotive manufacturers have sufficient holding power to withstand changes in state policy that would impact their profits, as evidenced by the failure of the state to impose penalties on automobile manufacturers for failing to meet indigenisation targets.

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