

**TO BE EMBAROGED UNTIL DELIVERY.**  
**CHECK AGAINST DELIVERY.**

**PAKISTAN: POLITICAL ECONOMY AND POST-2000 DEVELOPMENTS**

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After a downturn during the 1990s, the economy of Pakistan experienced a dramatic revival in the post-9/11 period after 2001. In 2007, this economic surge was still in evidence, with an average growth rate in excess of 6% over the period. The economy had observed cyclical patterns in earlier decades, and therefore by 2007 the question remained to what extent and for how much longer this upturn could be maintained. Tied to these questions was the issue of how long the military dictatorship of President Pervez Musharraf would last. Beginning with the coup that ousted the civilian government of Prime Minister Nawaz Sharif in October 1999, and initially unable to reverse the economic malaise it had inherited, the Musharraf regime had overseen the return to economic buoyancy since 2002. These developments can be better understood in the context of broader impacts on political economy that have shaped Pakistan's economic structures and processes before and after decolonization in 1947. A brief survey of these emerging patterns in political economy will provide a useful perspective to an analysis of the economic scenario since 2000.

To a large extent, Pakistan's political economy was shaped by developments in the colonial period of British rule. The nature and extent of economic change in the Indus basin had decisive ramifications for the post-colonial period. These developments hinged principally on the emergence of an extensive network of perennial canals, taking off from the Indus and its western tributaries, in the provinces of Punjab and Sindh. Constructed from the mid-1880s, these canals transformed hitherto arid and barren land into an agricultural zone that is of critical value to, and indeed underwrites, the contemporary Pakistani economy. The low population density of essentially semi-nomadic pastoral tribes, and settled communities along riverain tracts, was transformed through colonization and land settlement by allotting land to grantees from more populous areas. The basis for the selection of grantees, and the patterns of utilization of canal irrigated lands, established the mainsprings of the Indus basin's political economy in the twentieth century.

Land distribution was a process controlled by the state, since colonization occurred predominantly on land categorized as 'State Waste', though the extension of canal irrigation to proprietary land also consolidated the position of incumbent landlords. Since the bulk of colonization occurred under imperialist rule, the British were able to gain major political leverage from the transfer of a valuable economic resource to selected segments of native society. Most

land was allotted in smallholdings of up to 50 acres, and grantees were chosen not from the landless rural poor, or the lowly 'service castes' in indigenous hierarchy, but from hereditary landholding castes. Their proprietary rights had been acknowledged by the British in return for land revenue payments, which were the chief source of state revenue. These were also the same elements that were being heavily recruited into the British Indian military after 1857, with the Punjab alone accounting for over half the total army. Sizeable areas were also allocated for larger landholdings, thereby shoring up the landlord stratum, which served as an essential intermediary for imperialist rule.

In institutional terms, the authority of both the military and the state bureaucracy were significantly strengthened in the emergent hydraulic society. Significant landed resources were reserved for grants to army pensioners and then veterans of the two world wars, as well as for the breeding of cavalry horses. The native bureaucracy also gained stature from control over irrigation water, land allotments, and land transfers and mutations; and was heavily embroiled in rent seeking. The post-1947 dominance of the military and bureaucracy, and the continued authority of the landlord element leveraging on rich peasant support, were underlined by their consolidation during colonial rule. By contrast, business groups had also emerged with the major increase in trade, processing and distribution of agricultural commodities; but their access to canal irrigated land was limited to auction purchases. Since they were predominantly non-Muslim in composition, their exit to India in 1947 further emasculated the prospects of the business segment posing any major challenge to the traditional order. The exclusion of the rural poor before 1947, from both electoral enfranchisement and occupancy access to landed resources, also reflected their continued neglect in the structure of state expenditures after decolonization.

The Pakistani state then continued for the next half century to abide by the political economy modes established under imperialist tutelage. Arguably, as later developments were to show, within supposed sovereignty imperialist control remained pivotal in the exercise of authority, albeit with a shift away from Britain to a new hegemon. For one, a vital consequence of the British success at maneuvering agricultural colonization to their own political advantage had been an extremely weak nationalist stimulus in the region that became Pakistan. Only in the frontier province did a political grouping, led by Ghaffar Khan and allied to the Indian National Congress, displayed nationalist sentiments and achieved electoral success. Significantly, in Pakistan Ghaffar Khan was humiliated, imprisoned and exiled. In Punjab and Sindh, the British

aligned landlord nominees of the upper peasantry continued to dominate the provincial legislatures right up till decolonization, leading thereby to a continuity of dependent authoritarianism into Pakistan. By contrast, the Congress had severed this nexus with the 1936 elections in the area that became India, and it thence assumed rulership for the next half century in a democratic Indian state that could espouse neutrality. The notion of 'delayed nationalism' should therefore be noted, as it has continued to play an integral role in Pakistan's political economy.

Thus, the weakness of nationalist organization allowed those forces aligned against democracy to remain dominant in the new country. This position could not, however, have been secured without continued acquiescence to western power, a relationship that was to articulate sequentially in the coming decades. The denial of democracy to the people was evidenced through the failure to hold elections in the first decade, characterized by deinstitutionalized and factionalized landlord politics. This 'instability' was followed by a decade of military rule, during which the nexus between internal authoritarianism and the dependence of the civilian and military elites on the west was further reinforced. While social sector spending remained minimal and the real incomes of the vast majority stagnated, both power and resources tended to remain highly concentrated. Untrammelled by popular sanction, the bureaucracy could also indulge in decision making with little accountability but increasingly blatant rent seeking. The military for its part continued to absorb a high proportion of public expenditures.

The reason given for maintaining an army of over half a million was the threat from India, and a controlled media plied the people with anti-Indian themes. It could be argued that Indian depredations on the Kashmiri people, and its denial of their right of self-determination, provided the moral basis for this rationalization. Yet, despite the huge and continued resource diversion, the military cannot sustain a conventional war for more than a few days. Such armies in the Third World have also been a pushover when attacked: people's militias are a more effective defence against foreign aggressors, as witnessed in West Asia. In whose interests then this large military apparatus was maintained? Was it perhaps that it was the Pakistani people, inordinately poor and deprived, that paid entirely for a resource draining military capacity against possible Soviet-Russian expansionism? The commonly evoked theme of the United States military 'assistance' to Pakistan would need to be reversed, since the resource drain has been heavily in the other direction. Moreover, to maintain this relationship, continued deinstitutionalization and the satiation of rent hungry intermediaries has led over time to a

breakdown in orderliness, public management delivery, and state legitimacy. Pakistan wallows at the nether end of societal and institutional indicators worldwide. Hence, the notion of 'delayed nationalism' needs to be associated with that of 'anarcho-vassalage', as significant determinants of the nation's political economy.

In the economic sphere, public policy in the first two decades focused on overcoming the almost complete non-existence of an industrial sector. While the Indus region was a substantial exporter of agricultural commodities and raw materials, there had been virtually no large scale industrial investment there during colonialism. Beginning with savings accumulated during the Korean War trade upturn, and heavily induced through state subsidies, incentives and tariff protections, an incipient industrial sector began to emerge in the 1950s, and gained further momentum in the 1960s with increasing wealth concentration. The emergence of a few business groups, dominating the large scale industrial sector and diversifying into the financial sector, began to appear iniquitous, since political rights and labour unions were suppressed, and real wages of workers remained stagnant. Small and medium enterprise failed to receive the subsidies and public sector divestments accruing to some selective business beneficiaries. Regional misgivings also arose, with East Pakistan (later Bangladesh) increasingly resenting apparent resource transfers from jute exports to industrial investment in the western wing. In agriculture too, the Green Revolution benefits accrued mostly to middle and large farmers, who could afford the new inputs needed for optimal profits, such as agricultural machinery, pesticides, fertilizers and high yielding seeds. The upper peasantry was further squeezed, with tenant expropriations induced by farm mechanization, and undertaken through authoritarian fiat. More rapid economic growth had heightened rather than reduced income inequity and wealth concentration.

The consequence of these growing inequalities and tensions was evident in the 1970 general elections, the first in Pakistan's history. These followed on the overthrow of the Ayub Khan military regime after a popular agitation, and in the context of an assertion of popular will they can be seen as equally an expression of a nationalist struggle as the events leading to 1947. Not only did half the country break away to form Bangladesh, but in the remaining part a reversal of economic strategy under the Peoples Party government of Zulfikar Ali Bhutto saw extensive nationalization of large scale industry, banks and insurance, and even the education and health sectors. Bhutto's 'progressive' policies, however, were heavily over-determined, and in the end betrayed, by an underlying hostility to business and market forces, inherent in his

alliance with the upper peasantry of Punjab, the large landlords of Sindh, and urban workers and intelligentsia. His anti-capitalist 'counter-revolution', initially directed at large scale business, was reinforced through follow-up nationalization of the intermediate agro-processing sector, and of trade, distribution and export in the major agricultural commodities. This effort to remove the private sector from the agricultural value chain, and the moves against big business, led to private sector investment constraints in the medium term.

However, it was Bhutto's resistance to renewed superpower pressure that more probably led to his downfall, and eventual execution. With a new military partner, General Zia-ul-Haq, in place by 1977, the efforts to destabilize Afghan neutrality led to the Soviet military invasion in 1979. The subsequent 'jihad' in Afghanistan through American sponsored armed resistance, and its related induction of an Islamic 'ideology' for Pakistan through military fiat and newly arisen religious 'fundamentalism', has made it more problematical for an impoverished people to normalize their economic and political environment. The price of a freedom with no bloodletting for eastern Europe and the ex-Soviet republics was paid with over a million dead in Afghanistan, and with Pakistan awash with drugs, arms and religious militancy, apart from the burden of sustaining over three million refugees. While Pakistan's growth rate of around 6% in the 1980s was the highest in a painfully slow growing south Asian region, much of this was induced by workers remittances and foreign loans, rather than enhancements in industrial productivity or any significant diversification away from the focus on cotton textiles.

With the anti-Soviet agenda achieved, the intensity of geo-strategic attention on Pakistan waned. After Zia's timely demise in an air crash in 1988, Pakistan returned for the next decade to civilian governments. None of the four governments in this period, two each of Benazir Bhutto and Nawaz Sharif, were allowed to complete their tenures, till military rule was again reestablished in 1999. Coincidentally, the return to a compliant military regime was followed by another war in Afghanistan two years later. Significantly, from being one of the largest programmes in the 1980s, United States foreign assistance was virtually eliminated in the period of civilian democracy in the 1990s. Pakistan even suffered sanctions after it conducted a nuclear test in response to India's in 1998.

This period witnessed an economic downturn, in which the growth rate for once went below that of India, and both fiscal deficits and foreign debt rose to unsustainable levels. Political uncertainty discouraged investment, while rapid population expansion virtually negated real

growth rates. Ongoing civil conflict in Afghanistan led to takeover by the Taliban, presumably a further version of the 'Islamist terrorists' originally generated under American sponsorship. The freedom struggle in Kashmir also incurred Indian outrage, thus commencing an intense process of vilification of Pakistan. Such efforts at 'demonization' began to shape perceptions of Pakistan overseas; and they have found their latest expression in those seeking scapegoats for the continuing failure to quell resistance in Afghanistan, following the invasion and occupation of that country by the western axis.

In the first couple of years of his rule, Musharraf was unable to turn around the economy, which continued to suffer from the structural weaknesses that had emerged in the 1990s. Especially crippling was a foreign debt burden exceeding US\$30 billion, which had risen precipitously since the 1980s through the willingness to lend of multilateral agencies like the World Bank, Asian Development Bank and International Monetary Fund, aided by the resource hunger of native intermediaries into whose coffers these funds appeared to have mostly disappeared. The foreign currency deposits held by Pakistanis in overseas banks were said to be roughly equivalent to the country's foreign debt. Loan repayments became difficult to meet, necessitating rescheduling of debts. The problem was compounded by repayment pressure of debt that had been raised at commercial rates, to meet interest payments on soft loans. This action had apparently been taken by the interim 'caretaker' regimes established after the dismissal of elected governments in the 1990s, when some multilateral agency hirelings, like Moeen Qureshi and Shahid Javed Burki, took over temporary control of the administration and public finance. By mid-2001 the foreign exchange reserves had sunk to a mere \$200 million, and inability to maintain repayment schedules was even moving the country towards sovereign default.

These fiscal adversities had significant roll on effects in the economy. In the face of fiscal deficits of 6% or more, which reflected an excess of even current expenditures over revenues, public finances began to suffer a continuing resource gap. With military expenditures continuing at high levels, the development budget had to be severely curtailed. This left little room for any decisive improvements, or even increments, in infrastructure, communications, energy resources, social sector amenities and health and education, and human resource development. The financial stringency, as well as perceptions of heightened country risk, kept interest rates above 20% with financial institutions, and at even higher levels in the highly pervasive informal money market. These prohibitive rates affected investment levels as well as

the overall growth rate, which stagnated at around 4%. A drought also affected agricultural performance at this time, accompanied by emerging scarcities in irrigation resources and the failure to develop any major hydro-electrical projects.

Efforts at widening the income tax base proved unsuccessful, in the face of corruption in the revenue bureaucracy, lack of documentation in the widely diffused informal sector, and resistance by the rural elite to taxation of agricultural incomes. Under pressure from the international money lending agencies for meeting interest payments on external debt, the government started a process of reducing subsidies and moving towards user charges in utilities. It then resorted to indirect taxation by introducing a high general sales tax, at the rate of 15%, thereby transferring the revenue and fiscal burden on to the poor, since further state income could not be derived from the better-off through direct taxes. The higher input costs that both agriculture and industry began to experience made them uncompetitive with economies like China and India, where producers continued to enjoy substantially subsidized energy rates. Also, other low income countries, like Bangladesh and Vietnam, threatened to erode Pakistan's competitiveness in the staple industry, cotton textiles, especially in the value added segments of apparel and made-ups. Margins there tended to be higher than in the commoditized yarn and grey cloth segment, where the bulk of Pakistan's investment in textiles remained concentrated.

Despite these deep-seated problems, Pakistan's economy experienced a considerable turnaround after the September 2001 attacks on the World Trade Centre in New York City. With the American invasion of Afghanistan and the ensuing campaign against 'Al Qaeda', Pakistan again became a front line state in geopolitical conflict, and an essential ally for meeting western military objectives. Once again, the economic benefits that it obtained were a pittance of the strategic contributions that it was called upon to make. It has never been the destination of any sizeable investment flows from the West, in comparison with the substantial amounts directed towards first East Asia, then South-east Asia, and more recently India. From 2002, some foreign assistance was resumed, and the more onerous sanctions were lifted; but the real dynamic behind the turnaround were the inflows of money from expatriate Pakistanis, in the face of greater accountability and vigilance over money laundering and the funding of 'terrorism' networks. Another source of inflows was the bounty money paid to the Pakistani military for handing over 'terrorist' suspects to be sent to concentration camps and torture facilities, run by or for the United States. Investment funds have also reached Pakistan from Arab oil economies,

largely to purchase industrial and infrastructure assets and financial institutions under the privatization programme.

Under the changed circumstances, Pakistan's macroeconomic outlook also improved. There was a rise in export earnings, though these are still inadequate for a country of 160 million people. By 2007 they had exceeded US\$15 billion, from a level around US\$10 billion in 2000. Pakistan's exports were still higher than India on a per capita basis, but it had nowhere near the latter's performance in the information technology business. Pakistan's foreign exchange reserves rose from the desperate level of US\$200 million in 2000 to a purported US\$13 billion by 2006. The government also claimed that the country had paid off the more harmful high interest component of the foreign debt, which still nevertheless stood above US\$35 billion. The external debt to GDP ratio also improved, leading to greater fiscal space that allowed for more resource allocation to the development sector. The more 'positive' attitude towards Pakistan among foreign donors had arguably the deleterious effect of renewed multilateral and bilateral loan flows into the country, a process induced with the avid support of a bureaucracy that should actually have been questioning the relevance and efficacy of adding on further debt.

The rapid rise in liquidity had a visible impact on Pakistan's economy. Interest rates came down sharply, and at one point hovered around historic lows of 5-6%. This led to a consumption upturn, and also spurred investment to meet the increasing demand for goods and services. A speculative boom in property also ensued, with major price rises taking property values to unprecedented levels. These peaks were followed by downward swings; and overall they represented a diversion from more productive employment of resources in infrastructural development and in industrial deepening. The property value escalations indeed allegedly diverted industrialists towards raising bank credit for quick returns on property speculation to the neglect of their core businesses. The involvement of senior military personnel in land scams also began to erode the Musharraf regime's reputation. The cancellation of the allotment of 240,000 acres to 'institutions', in the area around the new seaport development of Gwadar, was one of the grievances the regime had against the Chief Justice of Pakistan's Supreme Court, whose dismissal by Musharraf in March 2007 raised a popular political outburst.

The stock market, which had languished around the 1,200 index level in 2000, rose by 2006 to over 12,000. Pakistan had the best performing stock market in the world for long periods since 2000 than any other country. Again, the index was highly skewed towards pockets of robustly

performing firms in the energy, communications and financial sectors, and among consumer products based multinational corporations. By contrast, the predominant number of scrips in the textile sector, representing Pakistan's largest industry, remained well below par value, and in many cases 70-80% below. This desuetude reflected the failure of Pakistani industrial entrepreneurs to meet their obligations to the capital markets. They were able to make a once off resource gain, through a double take on bank loans and public share subscriptions, but failed to reciprocate with dividend payments, bonus or rights share issues. They could, of course, repeat the process through new share floats, if the diminishing returns on reputations are allowed. Hence business 'groups' ended up with several independent companies, rather than as corporatized entities. Also, uncontrolled insider trading, apparently with the connivance of politically well placed elements, was allegedly responsible for the wild fluctuations in the share index that periodically convulsed the stock market. During this time some of the major brokers established their own investment banks, and indeed emerged as the new super rich of the country.

The economic turnaround, however, might not be entirely a function of financial inflows induced by overseas insecurities over monetary accountability. As I have discussed elsewhere:

*“Conversely, it could be argued that the money flows into Pakistan had a more positive dimension. They could only partly be explained through insecurities in overseas quarters over money accountability. They also reflected the undervalued levels of the Pakistani share and real estate markets, and were a response to a favorable investment environment. Moreover, the liberalisation since the 1990s of financial and currency markets, and the major concessions given to foreign investors, such as 100 percent equity and full remittance of profits, were bound to produce results. More business friendly public policy approaches were also designed to stimulate both domestic and foreign investment, through a series of conducive measures, such as export rebates, concessionary import duties on capital goods and industrial raw materials, removal of wealth and capital gains taxes, and control over progressive rates of corporate and individual income taxes. The investment spurt only awaited a more politically stable environment, and this was not forthcoming in the 1990s, owing to internal political factors and Pakistan's external image. After 2001 the greater acceptance of the Musharraf regime by the international community*

*and, to some extent, relief from the prevarications and greed of opportunistic civilian politicians, created a salubrious environment for investment. This would be the more positive interpretation of capital flows into Pakistan, except that these flows came largely in individual remittances, rather than as substantive doses of corporate or business investment.” (Ali, 2007)*

According to the Pakistan government statistics, the growth rate of the economy reached above 5% in 2003, and stayed above 6% in the mid-2000s. The agricultural growth rate, which is important enough to affect overall GDP, also remained positive, with no major reverses since the end of the drought around 2002. Increasing domestic demand for food crops, from wheat to vegetables and fruits, as well as smuggling of food items to Afghanistan, India and Iran, helped to maintain the buoyancy of the agricultural sector. At times seasonal shortages of certain commodities, such as onions, tomatoes and even potatoes, sent their price spiraling, in some cases necessitating imports from India. These price hikes affected inflation rates and cut into the already meager disposable incomes of the great majority, thereby even threatening political stability. Nevertheless, with a cultivated area of over twenty million hectares and other impressive indicators, such as a livestock herd roughly equivalent in size to that of the US and the EU, Pakistan’s agribusiness potential remained one of its key resources.

A constraining feature on the maintenance of higher growth rates could be impending shortages in energy and irrigation water. Under the Musharraf regime there have been no major increments in energy production, since contracts were reached with independent power producers in the 1990s for higher cost thermal power generation based on gas and furnace oil. The inability to construct further hydro-electric projects, and especially the ongoing postponement of the Kalabagh Dam on the Indus, has threatened to lead to future energy shortfalls. Robust economic growth has increased energy demand levels, without commensurate supply enhancements, and with the government caught without an energy strategy. With local gas reserves due to run out in the next decade, Pakistan has yet to take decisive measures to develop renewable or alternative energy sources. Pakistan has the world’s sixth largest coal reserves, but it is of high phosphoric content, and its mining will have environmental repercussions. The nuclear power generates not more than 1% of Pakistan’s energy needs. The energy shortfall will not only incur popular wrath, and a chaotic situation have already took place in some cities, but it will also constrain industrial growth and agricultural operations in future.

Irrigation resources are also considerably stretched, and Pakistan is now seen as a water scarce zone. Some global warming projections projected a decline in water availability in the Indus river system of the magnitude of startling 40% by mid-century. This threatens the very survival of a population already swollen beyond sustainability. Pakistan has the largest contiguous irrigation system in the world, and this provides the backbone of the Pakistani economy. Efforts at decentralizing irrigation management to a more participatory mode, through the creation in 1997 of statutory irrigation development authorities in Punjab and Sindh provinces, experienced a failure of implementation under Musharraf. Specifically, there was an inability, or unwillingness, in the face of vested interests, to push through the creation of farmers' organizations of local irrigators, and apex area water boards at canal command levels, that were to take over operational management from the endemically corrupt and inefficient irrigation departments surviving from the colonial period. Lately, the World Bank and the Asian Development Bank are providing credit for water sector projects. There has been a pressure to initiate the irrigation reform. New technologies also enable more accurate measurement of water flows, and identification of water diversions and misappropriations. However, follow-up legal action is resisted by the miscreant alliance of corrupt officials, on the one hand. On the other, the larger water users that also permeate the power structure.

The discrepancy between stated policy goals and actual performance pervades other aspects of public administration. Significant shortfalls in policy implementation are not confined to Pakistan among developing countries, yet they seriously challenge the equity of high relative resource absorption by ineffective public functionaries and their private sector associates. One glaring example lies in the continuing failure in population planning and control. This is a vital variable in Pakistan's economic sustainability. From a base of 35 million in 1947, the country's population now exceeds 160 million; and the current projections will take it to well over 250 million by 2025. The administration's response has been to simply descend to untruths over the population growth rate. This was reduced in official claims from 3.1% in the mid-1990s, first to 2.6% by 2000, to another neat downward adjustment of 0.5% to 2.1% by 2004, and to a more comforting sub-2% estimate of 1.9% currently! There is no real explanation of how a 30% reversal in demographic behaviour has come about. Meanwhile, with the census process in disarray, the government remains oblivious of how many people there really are in the country. One equation is very obvious, and officially acknowledged: over half of the population is under twenty years of age. The demographic implications of such huge numbers reaching school age and

employment age, and then entering the reproductive cycle with attitude, as well as their demands on physical and institutional resources, defies the capacity of the state to even conceptualize these problems, let alone devise strategies for their amelioration.

To some extent, the descent to Malthusian mayhem is a product of extreme economic inequalities, combined with major inequities in political economy. Again, these symptoms are shared with other developing countries, but they remain part of the crisis of social economy that Pakistan has been encountering. The historic low level of expenditures on human development and on the social sector, combined with political exclusion and the absence of redistributive mechanisms as well as old age and unemployment benefits, has induced the poor to seek security in number of children. With declines in the death rate and generally improved food security, combined with the weak controls over the creation of child labour, deciding the generational resource transfers from child to parent. There is a rationale that poor people want to have large families. The state has proclaimed on paper a prioritization for 'poverty alleviation' strategies, but these appear more for the facilitation of funding by the international donor community; and the bulk of resources get absorbed by political intermediaries and the middle class salariat rather than reaching the poor. Also, patterns experienced in the past, especially in the 1960s, the high growth actually increased income inequalities, appear to have reemerged. The shift to indirect taxes, and relief from wealth tax, has helped upper income groups. Inflationary trends in basic commodities have also affected the poor. The relative numbers under the 'poverty level' remains contentious, with the administration claiming a poverty reduction towards 25%, and analysts putting this figure closer to 35%. But such a level is itself arbitrary: clearly the great majority of Pakistan's population suffers from serious to severe economic deprivation.

Perhaps the most major reform under the Musharraf regime has been the setting up of a local government system. This is clearly the most ambitious and innovative in South Asia. And to a large extent its success is challenged by the scale of the transition that is entailed. A three tier system has been introduced, at the level of the district, sub-district *tahsil* and municipal authority, and local union councils. Elections to non-executive positions are on a non-party basis, while the elections of the district mayor, or *nazim*, are indirect. This has led to allegations that the system was devised to reduce the hold of political organizations on local politics, and counter the influence of politicians elected to the provincial and national legislatures. Another critique has been that the power of the bureaucracy has been hobbled, by removing the judicial

powers of the pivotal Deputy Commissioner position and placing it under the control of the district government. A number of other roles and functions have been devolved to the local level, though in practice the bureaucracy in the provincial governments continues to exercise significant authority, if only because local governments lack the expertise and capacity to handle the administrative complexities. In the 2002 local government elections, the military intelligence apparatus did apparently intervene to ensure that their supportive groups assumed the office; while the fact that the district *nazim* is not directly elected also leaves room for manipulation. Nevertheless, if this new structure continues to articulate, then local development, social sector delivery, and the application of economic resources at the ground level will have experienced a major transition.

A major reform that the Musharraf regime could have attempted, but failed even to consider seriously owing to the risks attached, was the restructuring of provincial entities. Pakistan has the same four provinces it inherited in 1947, though the population has more than quadrupled, socio-economic realities are far more complex, and administrative and governance challenges have increased manifold. India has almost doubled the number of states in sixty years, reflecting greater responsiveness to changing conditions and ethnic or linguistic distinctions. In Pakistan, having four large provinces, each carrying major weight, has created seemingly insurmountable problems over such decisions as the construction of the Kalabagh Dam, till recently the sharing of waters of the Indus river system, and even the annual national finance award for the provincial sharing of fiscal resources. The Punjab alone has over eighty million people, larger than any country in Europe except united Germany. Karachi, with approximately fifteen million people, could easily be a separate province. Around twelve provinces could be created with thin administrations to provide better services to the growing population.

The level of cooperation and integration in the regional economy can make a significant contribution to a country's economic well-being in the contemporary world. Pakistan is uniquely placed in an excellent geographical location where all three circles of Central, South and West Asia intersect. Its geographical position has given intense economic and geo-strategic importance over millennia matched by few other regions (and it's 'civilization' is now, for better or worse, in its seventh millennium). However, South Asia is the region where its natural alignment lies. Nevertheless, efforts at regional cooperation in South Asian have been perhaps the most retarded internationally. Not only is the total external trade of the SAARC (South Asian Association for Regional Cooperation) countries a mere fraction of total world trade, but only a

miniscule fraction of this trade is within the SAARC region. Moreover, the two largest economies of South Asia, India and Pakistan, are also the least focused on intra-regional trade. While India has granted Pakistan a Most Favoured Nation status, which is now quite common under the GATT/WTO protocols, Pakistan has not reciprocated; and this has been a bone of contention between these two countries. While Pakistan has linked this with a resolution of the core issue of Kashmir, India has retaliated by trying to keep Pakistan out of other regional and international networks, such as the Indian Ocean consultative process. In lieu of granting MFN, Pakistan has maintained a 'positive list' of items on which it would allow trade with India and in 2006 this list extended to over 750 items.

Meanwhile, within the SAARC framework, there is a process of moving towards a South Asian free trade area. The signing of a South Asia Preferential Trade Agreement (SAPTA) in 1996 was followed by further negotiations on trade liberalization. These culminated in the signing of the South Asian Free Trade Association (SAFTA) that came into effect on July 1, 2006. Under this, all items would be open to free trade, except for a restricted 'negative list' that members could retain. In July 2006, Pakistan announced that in the case of India it would retain its 'positive list', coupling the move to free trade with a resolution of the Kashmir dispute. India has reacted negatively to this proviso, and the matter still remains unresolved. In the meantime, trade with India has increased to over one billion dollar, whereas actual trade either through smuggling or via the Gulf States is already considerably higher. In the next few years India-Pakistan trade flows should gain further momentum. Pakistan has also moved in line with World Trade Organization (WTO) thresholds towards import liberalization; and indeed the subsequent hike in imports created a worrying trade imbalance in 2006. There is a fear that a recurring trade gap would lead to a return to current account deficits could only be forestalled by either reducing imports or raising exports, both of which appeared problematical. Without these rectification measures, the Pakistani Rupee could begin to come under pressure, as it had been devalued vis-à-vis the US dollar almost 10% per year in the 1990s.

One of the problems Pakistan continued to face was the lack of diversification in exports. These remained heavily concentrated in a few commodities: three quarters were in the light manufactured goods, comprising cotton, synthetic textiles, leather goods, garments, knitwear and rice. The export destination was about 40% to the United States, around 25% to the European Community, and 25% to Asia (of which 8% was to China, including Hong Kong) but only 1% to India. With concentration in commodities and with weak bargaining power,

Pakistan's export resilience was by no means assured. Indeed, the negative effects of the trade imbalance would be much greater, without the inflow of remittances in Pakistan of approximately four billion dollars annually in the mid-2000s. As opposed to exports, a quarter of total imports were in petroleum products, one of the highest ratios in Asia. Edible oils also feature high in quantity on the import list, reflecting expanding domestic demand and the inability to generate domestic supply of this commodity. Pakistan is also the world's third or fourth largest importer of tea.

In the wider context, the state of business development in Pakistan is remained sub-optimal. While after the period of 1990, the emphasis on market forces had given more incentive to the private sector, the post-nationalization disincentives came through from the 1970s that took time to overcome. The 'big business' groups of the 1960s never really reemerged, and those that had survived through a focus on cotton textiles did no longer take diversification business strategy by establishing more sophisticated and value added industries. The post-1985 return of private sector investment remained concentrated in lower value added segments of cotton spinning and weaving, and increasingly turned to the even more commoditized investment in sugar production. A heavy incursion of rent capitalism in the 1990s, leveraging off civilian politics, left much of the credit portfolios of financial institutions in non-performing loans. Since then, privatization of the extensive network of state owned enterprises, and especially privatization of nationalized banks, has restored confidence in the private sector, and raised levels of foreign direct investment (FDI). The volume of FDI is claimed to be nearing five billion dollars in 2006-07, from levels only one-tenth of this a few years earlier. However, growth in the infrastructure sector, especially the telecommunications parastatal, are responsible for this hike rather than any decent investment rise in the export sector and globally competitive manufacturing production. The development of the latter capabilities is the greatest challenge to both Pakistani state and entrepreneur.

In addition, Pakistan as a zone of FDI flows did not receive the enough attention from international investors compared to the South-east Asian miracle economies. This lack of attention is also contrasted vividly with Pakistan's own prominence in internationally critical geo-strategic conflicts; and this must rank as one of the great blind spots in the structure of international investment. Perhaps in the 'world system' Pakistan "was indeed called, and then chosen, by globalization, but for the latter's strategic and geo-political imperatives, rather than for its economic and wealth generating virtues." (Ali, 2005)

**Table 1: Economic Indicators: 2000-2006**

Indicators	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	Jul-Sep 2005	Jul-Sep 2006	+ (-) %
Exports (Billion \$US)	9.20	9.13	11.16	12.31	14.39	16.47	4.15	4.27	3
Imports (Billion \$US)	10.72	10.34	12.22	15.59	20.60	28.58	6.55	7.43	13
Trade Balance (Billion \$US)	(1.52)	(1.20)	(1.06)	(3.28)	(6.21)	(12.11)	(2.40)	(3.16)	32
Net Revenue (Billion Rs.)	393.9	404.1	460.6	518.8	590.39	712.61	149.2	NA	
FDI (Million \$US)	322.40	484.70	798.00	949.40	1524	3521	328.7	1029	213
Workers Remittances (Billion \$US)	1.09	2.39	4.24	3.872	4.17	4.60	1.00	1.23	23
Forex Reserves (Billion \$US)	3.22	6.43	10.72	12.33	12.61	13.14	12.0	12.53	4
Exchange Rate (Rs./ US\$)	58.4	61.0	57.7	57.92	59.66	60.16	59.5	60.5	2
Stock Exchange Index	1300	1520	3402	5279	7450	9989	8226	10512	28
GDP Growth	2.6%	3.6%	5.1%	6.4%	8.4%	6.6%			
Inflation	4.4%	3.4%	3.3%	3.9%	9.3%	8%			

Source: State Bank of Pakistan (SBP), Federal Bureau of Statistics (FBS), Central Board of Revenue (CBR), Business Recorder

**Table 2: Key Investment Indicators**

<b>Fiscal Year (July - June)</b>	<b>1997-98</b>	<b>1998-99</b>	<b>1999-00</b>	<b>2000-01</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>
Growth of Gross Total Investment	9.00%	-3.60%	10.20%	8.60%	3.20%	10.70%	14.40%	27.50%	29.50%
Growth of Gross Fixed Investment	1.50%	1.60%	10.50%	8.50%	3.20%	8.20%	14.70%	28.60%	30.70%
Growth of Gross Private Fixed Investment	13.30%	-11.40%	14.30%	7.20%	17.30%	9.80%	13.10%	29.10%	31.60%
Total Foreign Investment (million US\$)	822.6	403.3	543.4	182	474.6	820.1	921.7	1,676.60	3,872.50
Portfolio Investment	221.3	27.3	73.5	-140.4	-10.1	22.1	-27.7	152.6	351.5
Foreign Direct Investment	601.3	376	469.9	322.4	484.7	798	949.4	1,524	3,521
<b>FDI Shares by sector:</b>									
Power	39.80%	27.80%	14.30%	12.50%	7.50%	4.10%	-1.49%	4.80%	9.11%
Chemical, Pharm. & Fertilizer	12.00%	11.50%	25.50%	8.20%	3.70%	11.60%	3.00%	6.10%	-0.29%
Construction	3.60%	2.90%	4.50%	3.90%	2.60%	2.20%	3.37%	2.80%	2.54%
Mining & Quarrying and Oil exp.	16.50%	23.90%	17.00%	26.30%	56.70%	23.60%	21.43%	12.80%	9.08%
Food, Beverages & Tobacco	3.20%	1.60%	10.60%	14.00%	-1.10%	0.90%	0.47%	1.50%	1.70%
Textile	4.50%	0.40%	0.90%	1.40%	3.80%	3.30%	3.73%	2.60%	1.33%
Transport, Storage & Comm.	1.70%	7.10%	6.60%	25.30%	7.30%	14.30%	24.29%	34.90%	55.56%
Machinery other than electrical	0.00%	0.20%	0.70%	0.10%	0.00%	0.10%	0.07%	0.20%	0.03%
Electronics	0.40%	0.30%	0.50%	0.90%	3.30%	0.80%	0.79%	0.70%	0.51%
Electrical Machinery	1.40%	0.40%	0.30%	0.70%	2.20%	1.30%	0.92%	0.20%	0.05%
Financial Business	3.40%	5.20%	6.30%	-10.80%	0.70%	26.00%	25.50%	17.70%	9.35%
Trade	2.10%	1.20%	1.60%	4.10%	7.10%	4.90%	3.75%	3.40%	3.35%
Petrochemicals & Refining	0.30%	8.20%	2.60%	2.70%	1.00%	0.40%	7.62%	1.60%	1.16%

Tourism/Paper & Pulp	0.90%	0.00%	0.10%	0.40%	0.20%	0.20%	0.19%	0.00%	0.10%
Cement / Sugar	0.50%	0.40%	1.30%	4.70%	0.10%	0.20%	0.24%	1.10%	1.25%
Other	9.60%	9.10%	7.20%	5.80%	4.90%	6.20%	6.09%	9.70%	5.15%
<b>FDI Shares by Country:</b>									
USA	42.70%	45.40%	35.50%	28.80%	67.30%	26.50%	25.11%	21.40%	14.70%
United Kingdom	22.50%	18.90%	36.00%	28.10%	6.30%	27.50%	6.84%	11.90%	6.90%
UAE	3.20%	1.50%	1.20%	1.60%	4.40%	15.00%	14.18%	24.10%	40.50%
Germany	4.00%	4.20%	2.20%	4.80%	2.30%	0.50%	0.74%	0.90%	0.80%
France	0.80%	2.10%	0.30%	0.20%	-1.40%	0.30%	-0.59%	-0.20%	0.10%
Hong Kong	0.30%	0.60%	0.20%	1%	0.60%	0.70%	0.66%	2.10%	0.70%
Italy	0.10%	0.00%	0.10%	0.40%	0.00%	0.00%	0.20%	0.00%	0.00%
Japan	3.00%	12.50%	3.80%	3%	1.30%	1.80%	1.59%	3.00%	1.60%
Saudi Arabia	0.20%	4.80%	6.10%	17.60%	0.30%	5.50%	0.76%	1.20%	7.90%
Canada	0.10%	0.10%	0.00%	0.00%	0.70%	0.10%	0.05%	0.10%	0.10%
Netherlands	4.50%	1.20%	2.30%	1.50%	-1.10%	0.40%	1.48%	2.40%	3.40%
Korea	1.00%	1.00%	2.00%	1.10%	0.10%	0.00%	0.10%	0.10%	0.05%
Others	17.60%	7.60%	10.30%	12.00%	19.10%	21.80%	48.88%	33.00%	23.20%
<b>Selected Industrial Output:</b>									
Fertilizer ('000 tonnes)	3,894	4,242	5,059	5,129	5,187	5,269	5,673	5,989	6,236
Sugar (000 tonnes)	3,555	3,541	2,429	3,015	3,249	3,676	4,021	3,115	2,960
Cement ('000 tonnes)	9,364	9,634	9,314	9,674	9,935	11,020	12,862	16,088	18,483
Pig Iron ('000 tonnes)	1,016	989	1,107	1,071	1,043	1,140	1,176	1,137	788
Tractors (Units)	40,144	26,644	34,559	31,635	23,801	26,240	35,770	43,746	49,439
Cars (Units)	33,684	38,619	32,461	39,819	41,233	63,095	98,461	126,817	160,642
Paper & Paper Board ('000 tonnes)	345	356	435.4	531.1	547.8	374.4	406.5	400.1	454

<b>Stock Market Indicators:</b>									
KSE-100 index (Nov.1991=100)	879.62	1,054.67	1,520.73	1,366.43	1,770.11	3,402.47	5,279	7,450	9,989
SBP General index (2000-01=100)	98.72	106.38	128.8	118.72	106.7	204.9	312.7	359.99	427.01
Market Capitalization (Billion Rupees)	259.3	289.2	391.86	339.3	407.6	746	1357.48	2013.20	2766.41
Turnover of Shares (Billion Rupees)	15	25.5	48.1	29.2	29.1	52.7	96.96	88.3	79.45

Source: Board of Investment, Government of Pakistan, *Key Investment Indicators*, <http://www.pakboi.gov.pk>

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