SHAHID AHMED

RENTIER CAPITALISM

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RENTIER CAPITALISM: DISORGANISED DEVELOPMENT AND SOCIAL INJUSTICE IN PAKISTAN

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To my family

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Preface

Since the end of the Second World War, and more particularly since the 1980s, two regions of Asia – East Asia (China, Taiwan and South Korea) and South-East Asia (Indonesia, Malaysia, Thailand and Vietnam) – have experienced rapid economic growth with impressive advances in health and education. Today, South Korea and Taiwan have standards of living equal to those of the developed economies, while Malaysia and Thailand have reached middle-income status, and Indonesia and Vietnam are well on the way to achieving that status in a decade or so. In popular parlance, these economies are described as 'tiger economies' and development experts including international agencies, such as the World Bank, have produced extensive literature to understand the reasons for their success. The economies of South Asia (India, Pakistan, Sri Lanka and Bangladesh), on the other hand, have lagged behind, and India – even after a period of rapid growth in the 1990s and since – remains behind Indonesia and even Vietnam in terms of per capita income. It is an intellectual puzzle why the three regions of Asia, starting with fairly similar initial conditions in the 1950s and 1960s, have diverged so widely in their development experience over the last three decades.

It can be argued that in both East and South-East Asia success has not been accidental. They began their development journey by tackling the problem of rural poverty. These regions carried out land reforms, invested in public goods and then pursued industrial development via a combination of State support and market incentives strongly linked to a growing export economy. In doing all this, the State was very much in the driving seat not only in articulating a long-term vision and a supporting policy framework but in generating and deploying public and private resources according to this vision. Problems did arise in the late 1990s (in Indonesia, South Korea, Malaysia and Thailand), but the institutional resilience of the two regions and a certain amount of good fortune that allowed exports to bounce back enabled them to overcome their difficulties quickly. In contrast, the economies of South Asia generally and

Pakistan specifically have never seriously confronted the problem of rural poverty and their subsequent efforts at development, notwithstanding periodic bursts, have tended to flounder especially in the areas of education, health and infrastructure.

It will also be argued that, in part reflecting the failure to undertake rural reforms, the political economy of Pakistan has meant domination by the feudal class and its urban allies. This has now transmogrified into patronage and rent-seeking on an industrial scale as Pakistan finds it increasingly difficult to compete in international markets. This process has been facilitated in Pakistan by the financial sector and manifests itself in the country's love affair with bankers who have exercised damaging influence on the country's development partly by facilitating rent-seeking and partly through their penchant for short-term gimmickry. Today, Pakistan's economy has become locked in a vicious cycle of slow growth, low generation of public resources, weak or misdirected private sector investment, poor provision of public goods and infrastructure and low productivity in agriculture and industry, with growing informalization in both sectors. Since the early 1990s, the country's ruling elite have eagerly embraced neoliberal ideas embodied in the Washington Consensus as these have provided intellectual justification for their behaviour. However, in Pakistan the neoliberal ideal of a 'small' State has turned out to be the reality of a weak or soft State, and much policy space in the economy has been ceded to the private sector, in stark contrast to East and South-East Asia.

The overall conclusion is that despite occasional straws in the wind, such as the elections of 2013, no lasting change in Pakistan's fortunes is likely without a fundamental change in the attitudes of the governing elite and the implementation of a radical reform programme, in both urban and rural areas, based on equity and social justice that concentrates substantial new resources on the poor. For the time being, the post-2013 scenario remains one of rhetoric. There is little new thinking about how to break out of the current skewed pattern of development, how to improve decision-making so that resources can be deployed to better effect and, above all, how to increase the quantum of resources. It can be justifiably argued that Pakistan's development problems are problems primarily of its political economy and not those of wayward policymaking per se or of institutional failure or of outside interference as is often alleged.

The book argues that after three decades of neoliberal ideology, development practice has come full circle back to being a State–private sector partnership with the State again in a leadership role and not one that has been captured by a rent-seeking private sector. Contrary to what neoliberal ideas have claimed, the experience of East and South-East Asia indicates that the private sector alone cannot deliver inclusive development. It might be able to deliver jobs but mainly in the informal economy and jobs alone cannot produce public goods. Without the latter, development will be neither inclusive nor sustainable. South Asia in general and Pakistan in particular remain seduced by the illusion of trickle down, but Pakistan's experience should be a salutary corrective to that belief. In several universities in Britain and the United States today, Economics courses are being modified to align theory and policymaking more closely with the real world; hopefully this book should be a contribution to the process in the area of development economics. There is hope, too, that the ideas expressed in this book will go beyond the teaching of Economics and evoke in Pakistan's elite genuine soul-searching and self-examination about the country's failure to match its neighbours in East and South-East Asia and to initiate a genuine programme of reform for the years ahead.

Acknowledgements

The idea of this book – trying to understand why Pakistan's economy compares so unfavourably with those of East and South-East Asia in both economic and social development – grew from the many lively informal discussions that used to take place in the cafeteria at the United Nations in Bangkok during the time that I spent at the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP). I owe a deep debt of gratitude to my many colleagues at ESCAP, who greatly enhanced my understanding of what was happening in that remarkable part of the world, home to almost half its population that includes people and cultures unmatched in their diversity, energy, sense of purpose and resilience in the face of daunting challenges. Some colleagues, however, should be mentioned by name, and foremost among them were my immediate compatriots in the then Development Research and Policy Analysis Division (now renamed as the Macroeconomic Policy and Development Division) – Drs Azizul Islam, Janet Farooq, Aynul Hasan, Hussain Malik, Hiren Sarkar, Syed Nuruzzaman and Amitava Mukerjee, all outstanding experts in their fields who showed me that analytical rigour must be combined with compassion and a heavy dose of empathy if the work of social scientists is to have relevance for the wider world. I am also thankful to Dr Richard Kozul-Wright of UNCTAD, who graciously found time to comment on the outline of the book and its proposed chapters and made a number of constructive suggestions, and to Bruce Lloyd, Professor Emeritus at the South Bank University, London, for his encouragement and support when I embarked on this venture and as I reached the finishing line.

Before I decided that I might be the person who would attempt to explain the nature of the disorganized development in Pakistan, I had extensive discussions with a number of people in Pakistan about the overall project. Two whose insights were particularly valuable are my long-standing friends Prof. Ijazul Hassan, a person with an unmatched understanding of the social and political cross-currents in Pakistan, and Prof. Khalid Mirza, formerly of the World Bank and thereafter Chairman of the Securities and Exchange Commission of Pakistan and of the Competition Commission of Pakistan, now teaching at the Lahore University of Management Science, who possesses a similarly acute perception of the cultural and institutional constraints that affect policymaking in the country. With both of them, I also shared some of my initial chapter drafts and received many suggestions that improved both the organization of the book and its contents. Against that general background, I should also express my profound thanks to two other friends, Shaharyar Ahmad and Saeed Iqbal Chaudhry, who were heads of two private sector banks that came into being in Pakistan in the early 1990s. Their grasp of the underlying reality of operating in Pakistan and their insights into the economic and business environment in the country were invaluable and, indeed, alerted me to the problem of rent-seeking in the country. Finally, very special thanks are due to another ESCAP colleague, Amornrut Supornsinchai, who responded to my request for help with preparation of the tables with extraordinary promptness. Needless to add, any errors or omissions in the book remain my sole responsibility.

Introduction

The book seeks to shed light on the journey of Pakistan's development over the last six decades. It is a journey that began with promise and hope but has become mired in disappointment and despondency when compared with the dynamic economies of East Asia (China, South Korea and Taiwan) and South-East Asia (Indonesia, Malaysia, Thailand and Vietnam), all of which were at roughly the same level in terms of per capita income in the early 1950s. Indeed, India, of which Pakistan was a part until 1947, was considered to have the best prospects of any major economy in Asia at the time (see tables in Appendix). Pakistan began the journey reasonably well, and although the country had its share of twists and turns, a mood of mild optimism remained intact up to the 1970s. Thereafter, Pakistan's ruling elite[1] – politicians, senior civil servants, military leadership and businessmen – seem to have steadily lost their bearings and, instead of concentrating on development as the core objective, began an obsessive preoccupation with security and national identity issues based upon an exclusively religious narrative about Pakistan's separation from India.

Almost no one would argue today that improved security or a deeper and more widely shared national identity is the need of the time. On the contrary, Pakistan is racked by internal conflict and division far greater than any rationally conceivable outside threat to its territorial integrity, and there are multifarious competing sectarian and ethnic identities involved in an orgy of bloodletting. The Pakistan State looks on at the daily killings either helplessly or with a cavalier lack of concern. Meanwhile, the economy is wholly unable to meet the expectations of the population in jobs, housing, education and access to basic health services, not to forget the energy quagmire that has brought ordinary life close to breakdown over much of the country. The consequence has been discord, frustration and widespread social alienation in the country. Not so far away, the economies of East and South-East Asia have raced ahead with South Korea and Taiwan having already reached a standard of living of developed societies, all within the space of a single generation.

Being outshone in an increasingly globalized world is bad enough. But, in Pakistan, as economic performance has deteriorated, widespread rent-seeking behaviour (defined in Chapter 2)[2] by the elite has emerged to compound already serious issues of low productivity, low growth and a lack of international competitiveness of the economy. Badly thought out reforms, inspired by the neoliberal Washington Consensus beginning in the mid-1980s, to make the economy more productive have, on the contrary, merely entrenched rent-seeking further, so the country continues to perform poorly, and social problems fester. Pakistan's social sectors, the recipients of continuing and systemic neglect for many years, both in terms of resources and as a policy priority, have relegated Pakistan to semi-permanent membership of countries with low human development (UNDP Human Development Reports), a source that should be no longer one of mere embarrassment but of shame given the pompous self-regard and pretensions of the country's leaders and media pundits. Very few of Pakistan's elite are aware, and fewer still probably care, that schoolchildren in East Asia now regularly outperform their cohorts in Europe and North America at the age of 15. Pakistani schoolchildren, in contrast, are still functionally illiterate by this age while a large minority does not even have schools to go to.

Thus, after more than six decades of independence Pakistan can be described as a country in a state of arrested development with abysmally poor governance, ramshackle infrastructure, minimal social cohesion and low aspirations. Unless a radical reform effort to counter the palpable sense of drift can be launched, the future is bleak. Against this rather dismal background, the book hopes to be a modest contribution to improve understanding of how and why societies lose a sense of themselves and are captured by narrow coteries who, upon finding competition with the outside world increasingly difficult, take the easy route of merely sharing out the spoils between themselves. For the majority and, for that matter, all those whose relationship with the wider governing elite is tenuous, Pakistan can sadly offer little, if any, hope on any realistic time scale.[3]

This is therefore a journey that needs to be described as much for the people in Pakistan as for those outside who are still puzzled by what has happened in that country. The story of the journey is not aimed at development economists per se, although much of what is said is derived from a development economics context. It is aimed, first of all, at Pakistanis in the age group 16–39 for it is only they who can be the harbingers of change that Pakistan so desperately needs. It is also aimed at mid-level public servants in Pakistan without whose unqualified support no attempt at reform has any chance of success, and, finally, it is aimed at students and practitioners of social science everywhere and all those interested in development, who can understand and accept the need for injecting a clear moral purpose in their disciplines and enquiries.[4]

The first half of the book is devoted to understanding the trade-off between economic growth and social justice and the limits of public policy in a country like Pakistan. These important themes are considered against the backdrop of Pakistan's 'way of doing things', that is, its political economy, of its poor TFP (total factor productivity) and of its blundering incompetence even at matching its tactics – the exchange rate, tariff structure, domestic taxes and so on – with a long-term strategy of promoting economic growth and social development. Contrasts are drawn with the very different approach adopted by East and South-East Asia to tackle the same problems. The second half of the book seeks to understand the relationship between the State, private enterprise and development; how market failures occur and are addressed in developing countries; and the false trade-off between growth and equity created by the Washington Consensus with its supposed emphasis on efficiency that Pakistan must now address. The second half of the book also looks at what East and South-East Asia can teach Pakistan about the value of effective governance embodied within a robust, egalitarian social contract. The concluding chapter examines what is needed and is realistically possible, say, over the next 10 years and beyond in the country given Pakistan's recent history and its socio-cultural dynamics. An epilogue assesses what impact, if any, the elections of 2013 might have on Pakistan's politics and economics in the years ahead.

Following the end of the Second World War, the colonial empires in Asia became independent nations in the 1950s, and their governments had to grapple with the problems of what was then known as 'underdevelopment' or even plain 'backwardness' in predominantly rural-driven economies. By underdevelopment was meant low per capita incomes, high levels of poverty – both absolute and relative – low levels of literacy and high levels of population growth. With the paucity of resources available to most governments, the objective of development bordered on the impossible. Would faster economic growth alone do the trick or was the job more complex than had been initially imagined by glib or naïve national leaders? It was certainly possible that economic growth could deliver jobs and prosperity for some, but how would this reduce the all-pervasive poverty in the country and how would governments find resources to invest in the roads, dams, power stations, ports, factories, hospitals and schools that an escape from backwardness required.

In dealing with these very difficult issues, Pakistan's record up to 1975 was satisfactory but not spectacular. Indeed, it had to contend with the aftermath of partition, the economic tension between its two geographic wings – East and West Pakistan – the break-up of the country into present-day Pakistan and Bangladesh, a high rate of population growth and the major oil shock of 1973/74. But roughly from the early 1980s, under a succession of military and political governments development lost its momentum, particularly in the social sectors, and a sense of drift took over. Overlaid on the second oil shock of 1979/80 an exploding population made the problem daunting in the extreme. In fact, in comparison to East and South-East Asia, both regions began with the same initial conditions after the Second World War, Pakistan's record is lamentable. The book postulates that this has been the result of Pakistan's own poor decisions, the decisions made by its own ruling elite and is not due to the malign intervention of any external powers, agencies or events.

Understanding why societies react to challenges in particular ways makes it necessary to trace, albeit in passing, the evolution of the problem of development since the Second World War. We know now that economic growth alone is a necessary but not a sufficient condition for development. The wider notion of development includes not just a reduction in absolute poverty which will happen when a growing economy generates new and better-paying jobs but will require demonstrable improvements in access to decent housing, public transport, schools, health facilities, sanitation and clean water for the poorest. The latter should not only address the problems of non-income poverty but, as we know, make an economy more productive. Without such publicly funded investments, a country risked being trapped in endemic inequality for a long time. Thus was born the relatively modern idea of inclusive development, that is, that governments would have to ensure that the fruits of growth were equitably shared between, say, the top decile and bottom quintile of the population. It is implicitly based on the precept that societies as a whole, not particular segments or groups within them, create sustainable value and wealth, and the growth of economy and social justice are two sides of the same coin.

How would the goal of inclusive development be achieved by countries suffering from a resource-constraint and weak administrative capacity? In the 1950s and 1960s, development was seen very much as a partnership between the State and the private sector, the former providing the physical and institutional infrastructure and often the finance needed for productive investment, the coordination between its various responsibilities and the public goods, while the latter would provide the actual goods and services. In the late 1970s, as growth faltered across the world, global macroeconomic instability created new challenges for the developing countries. With poverty remaining high, particularly in South Asia, the role of the State and the rationale of a mixed economy began to be questioned. By the early 1980s, an alternative view that the private sector and a privatized public sector, driven by signals from the market, would deliver both growth and development in a globalized world of free trade and unrestricted movements of capital rapidly acquired the status of received wisdom. The role of the State would henceforth be limited to that of an enabler.

This approach came to be known as the Washington Consensus. But, some 30 years later the Washington Consensus, too, has had its day. Growth has not accelerated; income, wealth and social inequalities have reached grotesque levels nearly everywhere; a grossly inflated financial sector has become the hand-maiden of rent-seeking; and vast movements of international capital have delivered few benefits but many costs to developing countries in the form of macroeconomic and financial sector instability.[5] Moreover, the neoliberal ideal of a small State has become the reality of a weak State unable to play the role of an effective umpire between competing interests in society. The countries that have managed to avoid the pitfalls of the Washington Consensus are those that have persisted with the State–private sector partnership and have nurtured strong State and private sector institutions within an equitable framework which is able to exploit the opportunities of free trade and of access to international capital. Critically all have been willing and able to discipline the recipients of State support. These countries are primarily the economies of East and South-East Asia (and some now in Latin America). Indeed, such is the resilience of the East and South-East Asian economies that the Asian financial crisis of 1997 is now remembered primarily for its brevity and for its minimal long-term impact on these economies.

Looking at Asian development experience through the prism of the last 30 years, we get a mixed picture. East and South-East Asia, for instance, are the clear success stories, while South Asia's progress has been slower and more fitful. In social development that embodies the quality of life, South Asia languishes in the bottom quintile of countries on a global basis. Why has this happened? By and large, the South Asian State (with one or two important exceptions) has wilfully neglected the social sectors over the last three decades. The provision of essential public goods like primary education, primary health care, sanitation and clean water has been hopelessly inadequate, and Pakistan is a prime example of this extraordinary neglect. The neglect shows up most strikingly, over the last 20 years, in the lack of progress in dealing with urgent social problems like high female illiteracy, excessive child mortality, child malnutrition and poor sanitation. For most governing elites, it is uncomfortable to accept that these phenomena are not blind forces of nature; they are the result of deliberate choices made by them and their wilful neglect has produced dire consequences. Pakistan is left today with a complete lack of social cohesion and without any meaningful notion of responsible citizenship in the country.

There is no doubt, of course, that from the very beginning Pakistan faced the unrelenting pressure of inadequate resources, both natural and financial. It was, and still remains, a low-saving and generally tax-avoiding country and possesses few natural resources.[6] In the beginning, Pakistan's answer to this problem led to a significant dependence on external assistance for funding its development; that dependence lasts to this day, especially if IMF (International Monetary Fund) stabilization programmes are included. The expectation was that through external assistance, primarily official, the richer countries would assist Pakistan with capital and technical help and thus a virtuous circle of economic growth and development would begin. But, at some point, Pakistan would need to graduate to a more self-sustaining path led by buoyant domestic and external markets, more indigenous investment and the ability to absorb and develop higher technological inputs. In other words, it would make a transition under its own steam to generate higher savings and more tax revenues to invest in infrastructure and modern industry and achieve progressively greater international competitiveness to pay its way in the world, replicating the broad pattern of development in East and South-East Asia since the early 1960s. However, Pakistan seems to be moving, if anything, in the opposite direction even 50 years later. Investment levels – both public and private – remain paltry, and public resources can barely cover current spending on administration, defence and debt servicing. Why has this happened?

It needs to be stressed that the political and cultural values of society and of the elite do not appear out of the thin air. They are the outcome of decades of evolution and change, reaction to challenges such as real or imagined foreign interference, interaction with other cultures, the influence of the prevailing system of beliefs and attempts, if any, to develop a more productive society. In Pakistan's case, this would have meant giving priority to the rural economy, having an equitable land tenure system and a commitment to equity and social justice. Needless to say, the elites of some countries, while obviously motivated primarily by self-interest, sometimes voluntarily share their power and resources with the rest of society, partly out of altruism but often out of enlightened self-interest. The latter set of motivations can come about for many reasons: moral pressure, an urge to create an image in the international community, the success achieved by exploiting opportunities in expanding export markets and even, perhaps, a sense of guilt on their part.[7] Many societies, however, are not governed by enlightened elites. They are governed by elites motivated primarily by a desire to preserve the status quo and their own entitlements and privileges, and Pakistan appears to be governed by such an elite. They thus end up with systems akin to old-fashioned feudalism which, as much of Indian history during the colonial period shows, have rarely resisted bullying and interference by major foreign powers; have not made any serious attempt to make the economy more productive; and have usually obstructed the development of a more sustainable political economy and society in the country built on social justice. The truth of the matter is, as Pakistan's history shows, that preserving the current status quo cannot be made compatible with social justice; it cannot be made compatible with any notion neither of a representative government nor of a merit-based society. That is the political and economic cul-de-sac in which Pakistan has become trapped today in terms of its social and political evolution. In Pakistan, the notion of equity exists – if it does – most volubly in the realm of feigned political rhetoric. Real social dynamics, in reality, are apartheid in all but name and neither military nor political governments have been able to alter the social dynamics of a feudal culture in a meaningful way.

From a sociological perspective, however, the truly remarkable aspect of South Asian development is the ease with which the political power of the feudal class, especially in Pakistan, under both military and political governments, has remained intact with little or no resistance in the country. Indeed, it has successfully thwarted even the few half-hearted attempts at land reform. Since 1970, there have been outward trappings of government by consent in the form of periodic elections, but power continues to rest unabashedly with the elite and feudalism continues, though not formally but certainly in the values, habits and aspirations of the governing elite. In fact, the absence of genuine reform of the rural economy can explain many of Pakistan's economic failings today. Pakistan's cultural setting explains not only why rent-seeking and patronage thrive in the economy but also the chronic nature of rural poverty, the continuing lack of investment in public goods and the easy acceptance of a tax-avoiding and tax-evading culture in society. Even military governments have been helpless against the entrenched power of the feudal class. Against this, the history of East and South-East Asia can be summed up in land reform and an equitable land tenure system. Not only was land reform instrumental in overcoming rural poverty and in breaking the political hold of the feudal class, it also helped creating a far more egalitarian social and economic culture than in South Asia. Indeed, without this underlying egalitarianism their spectacular development since the 1980s would not have been possible. Significantly, the one laggard in South-East Asia is the Philippines whose land tenure system resembles that of South Asia (Studwell 2013).

A peculiar feature of Pakistan's development experience is that despite the poor performance of the economy during the last two decades, most development experts and much of the intelligentsia in the country remain fully wedded to neoliberal nostrums. They are unconvinced and probably unaware that a viable model of development still implies a strong partnership between the State and the private sector. Such is the allure of the Washington Consensus in Pakistan that even in 2014 there is widespread and uncritical acceptance in the country – in the media, the universities and bureaucracy – that market signals will allocate resources in a socially optimal manner and that continuing privatization and deregulation hold the key to greater competitive efficiency in the economy. The truth is that, whether in Pakistan or elsewhere, the reliance on markets has produced neither any sustained acceleration in the pace of economic growth nor any improvement in resource allocation. If anything, growth has slowed and critical goods remain under-provided across a wide swath of developing countries including Pakistan. Moreover, many key sectors of the economy are examples of rigged markets and cartelization.[8] The fiasco in the energy sector in Pakistan is a case in point, as are other cases of market failure, such as the chronic inadequacy of low-cost housing in the economy and the mushrooming growth of pricey higher education. In Pakistan, privatization has literally failed to deliver the goods. Research by the Asian Development Bank and others indicates that only a fifth of privatizations up to the year 2000 had done better under their private owners (Asian Development Bank 1998), while a largely privatized financial sector operates as a cartel camouflaging its internal failings by charging massive spreads on its cost of funds to remain profitable.

In a world where social and financial stability is a critical prerequisite of development, the primary lesson of success stories is that the relationship between the State and the private sector must satisfy two conditions: legitimacy and long-term sustainability. The first condition indicates that for any system to enjoy long-term prosperity and stability it must manifestly satisfy the needs and expectations of the majority and not just of the elite and their allies. The second condition indicates that the system must not become preoccupied with short-term gimmickry, such as daily pronouncements of vast new projects initiated (usually no more than memorandums of understanding), buoyant stock markets and other stray bits of manufactured 'good' news. Any partnership between the State and the private sector should instead seek to build a stream of steady long-term economic and social benefits, say, over a time span of 15–20 years, far longer than the 'get rich quick' schemes that the private sector is strongly partial to, most notably in property and stock market speculation. It is worth noting here that China's huge investment in infrastructure or in social health insurance over the last decade would never have been made by the private sector or even by a public–private partnership. But this State spending will ultimately deliver a steady stream of benefits, in the form of higher TFP, for China decades ahead (the Communist Party of China calls its economic model *socialist market economy*). Lack of public resources makes such a course of action difficult for Pakistan, but relying on the private sector to make the economy more productive means living just in hope.

Just as Pakistan in particular and South Asia generally are examples of poor governance and economic priorities that are highly skewed in favour of the ruling elite, East and South-East Asia are examples of far more effective governance, especially in the delivery of public services, and of more egalitarian political cultures at the grass-root level with significant State resources expended on public goods as a result. This has happened under both military and political governments in East and South-East Asia. The questions that arise then are what should be the nature of the relationship between democracy, or representative government, and development, and what do the contrasting histories of South Asia, East Asia and South-East Asia teach us. Conventional wisdom suggests that democracy, in the sense of entrusting the affairs of society to a State or government that is broadly representative of society, is a necessary pre-requisite for bringing about change in that society. The evidence of history, however, does not bear this out and South Asia figures prominently in this.

It has to be accepted that democracy and development are not cause and effect and are, in fact, very weakly correlated. Nineteenth-century Europe and America experienced economic growth and some social progress, such as the provision of free schooling, without democratic governance in its latter-day sense. The establishment of modern social institutions in the early to mid-twentieth century, like old-age pensions, public health systems and unemployment insurance can be attributed more to the impact of climacteric events like the two world wars than to democracy as such. In fact, the examples of East and South-East Asia tend to suggest that democracy, or representative government even in its autocratic East Asian variant, have had very little to do with their success in development. As their respective histories indicate, their success has been due, first, to the ending of feudalism, second, to the carrying out of land reforms and, third, to the provision of effective governance in the implementation of robust industrial policies and in the delivery of public services. All three agents of change are products essentially of the cultural evolution of East and South-East Asia, not of democracy per se. According to the eminent economist-philosopher Amartya Sen, the question of whether democracy encourages or retards development is based on a false dichotomy. Looked at from a long-term perspective, say, of around a generation, the experience of East and South-East Asia suggests that, like human development, democracy is more a by-product of development than its driver. This was true of Japan in the early part of the twentieth century, of Taiwan and South Korea in the 1980s and of South-East Asia more recently.[9]

The spectacular rise of China is unique in that representative government in the Western sense, especially elections between parties with markedly different ideologies and approaches, does not figure in the country. However, its rapid development has been driven by a remarkable grass-root-level participation over many years, through regular debate and consultation, in the country's decision-making process of bodies such as the National People's Congress. The ruling Communist Party itself, which has an extraordinary 75 million members, provides channels of communication extending from the smallest street and village committees in the remotest corner of the country to its own Central Committee, Political Bureau and ultimately to the State Council. It needs to be stressed that the uncomfortable fact for outside observers lies in the high degree of confidence that the Chinese people continue to have in these arrangements compared, say, to the notionally more democratic forms of government that exist in South Asia. Only an obdurate cynic would decry this achievement.[10]

In South Asia, in contrast, although feudalism does not now exist in a blatantly obvious form, especially, for example, in India, it continues to dominate social intercourse and politics in the subcontinent, especially in Pakistan. Visible serfdom has ended but the land tenure system of South Asia is one in which the rural population, even if it owns and farms its own (usually small) parcels of land, is only a step away from serfdom, or its modern variant of bonded labour, given its poverty, its low productivity, low earnings and high levels of indebtedness. Both the official bureaucracy and judiciary are powerless to tackle this vulnerability of the rural poor to abuse by the powerful. Moreover, high population growth has simply skewed the land–labour ratio in favour of the former so that rural workers, including those tilling their own land, can rarely rise above subsistence level. In fact, as the rural poor migrate to the cities, they make the problem of poverty effectively unsolvable. No pro-poor implicit social contract exists, and the idea of providing decent public services to the poor as a cultural norm or moral duty is completely foreign within the value system in Pakistan. In truth, public services exist only in name for the vast majority of the population, avenues of formal employment are as scarce as gold dust and the rural poor who drift into urban areas, usually squatter colonies, end up as 'vote banks' for politicians on the basis of whatever narrow, atomized social identity they can muster. And, it is that narrow social identity which provides them with the occasional job and a sense of physical security in the cities.

There remains the question of the rule of law in the concrete. The conventional belief is that the rule of law embodied in property rights and the enforceability of contracts is critical to development, especially development within a mixed economy framework. The governing elites of developing countries have become enthusiastic proponents of this belief, as is the case in Pakistan. Yet, across Asia the rule of law remains a very nebulous concept, as indeed are property rights and contractual obligations. On paper, all the institutions of the rule of law exist in all countries irrespective of their level of development, and the legal profession flourishes in most countries; in practice, judicial redress or judicial protection remains a far cry from its equivalent, say, in twentieth-century Europe. As in other matters, Asia operates its judicial systems also within the bounds of its implicit social contract. The legal framework is ultimately a product of the prevailing political and social culture, and decisions within it are the outcomes of a complex web of ethnic, class, caste and sectarian considerations.

The objective of a purely merit-based judicial system remains an ideal even in most developed societies; in Asia it exists only in the realm of fantasy. In this respect, South Asia, East Asia and South-East Asia are not dissimilar. Where the latter two are different is perhaps in the level of general trust that exists in society that can be relied upon by its members in their daily life without recourse to third-party intervention. South Asian societies have generally very weak levels of trust which is why they have become progressively atomized over the last two decades. This trait undoubtedly adds to the difficulties that individuals and groups face in their daily lives, as well as to the cost of doing business and makes South Asian societies very risk-averse, at least with their own resources. Like representative democracy, the rule of law is clearly a product of development – in the sense that it reduces transaction costs in the economy and could be described as a public good – it is not a precondition for successful development. To this end, the anchor of a functioning social contract has far more significance as far as development and equity are concerned.

Finally, given the enormous difficulties that Pakistan has accumulated through its own choices and neglect over the last 20–25 years, what might be a realistic agenda for the future? First and foremost is the need to put the economy on a higher growth path that is sustainable for the next 10 years. For this, investment levels have to be raised dramatically from their current paltry levels of 12–13 per cent so that GDP (gross domestic product) growth can be raised to above 7 per cent a year. This will take the edge off poverty not only by generating jobs but through the resulting tax buoyancy, and without the need to raise the tax–GDP ratio immediately or significantly, and provide the State with additional resources to fill the massive gaps in infrastructure, for instance, in the energy sector. Reform of the financial sector will be essential for achieving this. Second, improved governance, especially where public service delivery is concerned, is a critical need. Some of it can be achieved by increasing mid-level civil service salaries so that better qualified and better motivated public servants can be involved both in the design and implementation of policies, especially in the rural areas and smaller towns. But, there is need also for a gradual devolution of responsibilities, including budgets and spending, to the lowest levels of administration in the country. In the past, it has to be admitted, experiments with decentralization have not been resounding successes in Pakistan. However, across the developing world decentralization combined with more grass-root empowerment and the deliberate nurturing of a more public service ethos are seen by most as the best way forward, and it is happening in South-East Asia. Pakistan, too, needs to find a practical way of delivering better governance to the people and thereby loosening the stranglehold of the local bigwig and the *arthi* and *patwari* on the lives of the rural poor. Building a civil society that is independent from the ruling elite and has the means to discipline it will be a fundamental component of this process. The urban poor are marginally more enfranchised, but ethnic, tribal and *beradari* loyalties make it difficult for them to hold their elected representatives to account. In any case, grossly underfunded public services run by underpaid functionaries have little relevance in their lives.

It is over the long term that sustaining development is likely to prove far more challenging for Pakistan. If 'development' means a reduction and eventual elimination of poverty and some notion of social justice then the problem has to be tackled at its roots, that is, in the rural areas. Poverty has two elements: income and non-income poverty. A growing economy should, over time, be able to generate more secure jobs and provide a means of escape for (some of) the poor from the income side of poverty. But non-income poverty, such as lack of sanitation, lack of access to safe drinking water, lack of schools, lack of access to primary health care, has to be tackled by the State. No private sector agency can do it on the scale required. The Pakistan State has significantly failed to address the non-income side of poverty in six decades or more. Indeed, the elite have been quite happy to see more and more public services privatized and outsourced to non-governmental organizations (NGOs) and philanthropists.[11] Such practices might assuage the guilt feelings of the elite; in reality, they are mere drops in the ocean when considered against the magnitude of the problems confronting the country. Unsurprisingly, expensive and generally poor-quality higher education serves no useful long-term development purpose. And the prevailing temptation of elites, especially political elites, is to make grand gestures devoid of substance and use an acquiescent media to enhance their public standing simply on that basis. A genuine change of mindset is, hence, needed on the part of the elite. In fact, the elite should do exactly the opposite: use the media to explain to the people the gravity of the problems they face and set about creating a more explicit pro-poor and pro-public service ethos in the country. Take polio, for example. Five years ago, India accounted for nearly half the world's infections. Now it has been declared polio-free. Surely, Pakistan can and must do the same. Likewise malnutrition, especially amongst the under-fives, is virtually unknown in East and South-East Asia as a result of a more productive rural economy and decent public services across the country. It will not be easy, but Pakistan should be able to match this, given the requisite political commitment.

The ultimate long-term challenge, however, is to build, or create anew, a strong implicit social contract in the country based on a genuine sense of inclusion and fairness in society as a whole. Without this, sustainable development will remain a forlorn hope. Building such a social contract cannot be achieved in a few years, but neither does it require decades of effort. If the examples of East and South-East Asia can be adduced, a decade should be enough to make visible the sustainable improvements. Clearly, this huge challenge has to be met within the limits of a poor society governed by a State whose authority and capacity has diminished dramatically over the last two decades. That narrows the options, but it should not make the task impossible. For instance, agricultural experts in East Asia say that the world is at the doorstep of a second green revolution that is expected to significantly boost rice yields and thus have a major impact on the lives of the rural poor. However, the interesting aspect of the new varieties of rice is that they are the result not of the creation of a miraculous new seed but of a series of small improvements in different varieties of rice grown in different soils over a number of years. Pakistan's approach to its problems should be the same: strive for and achieve incremental change by scaling up its own successful programmes, say, in education and health.

In trying to obtain release from its current arrested, if not comatose, state of development, the elite of Pakistan should concede that they have neglected the poor, especially during the last 20–25 years, but are now ready to make amends. The change of heart must, however, be authentic and not get drowned in meaningless posturing and slogan-mongering. A genuine reform of the rural economy which boosts the productivity of small and medium-sized farmers is a necessary first step. This would have to be followed by and combined with the implementation of a realistic industrial policy and the reigning in of rampant rent-seeking in the financial sector. Once that process starts, Pakistan's economic future could begin to change for the better and, hopefully, be transformed over the next two decades.

1
Development, Social Justice and the Limits of Public Policy

Historical background

Pakistan's development experience of recent years can be best understood by briefly retracing events that followed in the immediate aftermath of the Second World War. In 1945, as the war ended, large parts of Europe lay in ruins, the task ahead was primarily one of reconstruction. However, the idea of development was already in the minds of the political leaders, civil servants and academics who began sketching out the post-war settlement at Bretton Woods in 1944. Hence the name International Bank for Reconstruction and Development (IBRD or the World Bank) was chosen for the institution that would seek to embody the collective will of the then global community. Its aim would be to benefit not only those areas of the world that had been devastated by the conflict but also those that had been characterized by their chronic backwardness. The idea of a global compact in which rich countries helped the poor in their quest for development was thus born, formalized with the creation of a series of regional economic commissions and extended through the 1960s with the United Nations Decade of Development that also made it morally incumbent on the rich countries to provide the equivalent of 0.7 per cent of their GDPs to the poor countries as Official Development Assistance (ODA).

It should be remembered that taking the world as a whole, the impact of the war had varied substantially. Africa (except Libya and Egypt), Australia and Latin America had seen little by way of military action. Even in Asia only Japan, during the war itself; China, from the time it had been invaded by Japan in 1937; and the Philippines had witnessed the kind of destruction that Europe had suffered during the war, whereas Burma, Thailand, Malaya, Indonesia and French Indo-China had been occupied by the Japanese. The South Asian subcontinent (India, Pakistan, Bangladesh and Sri Lanka) escaped the physical detritus that war brings, but it suffered from the war-related disruption in trade and investment between 1939 and 1945 and from the mobilization and subsequent demobilization of several million soldiers who had fought on the side of the allied powers. Indeed, all significant economic activity involving international trade and payments had been effectively suspended during these years, and virtually all public and private resources and agencies, even in non-combatant countries, had been adversely affected by the conflict not just in Asia but across the world.

It was consequently self-evident that, whether in Asia or elsewhere, restarting meaningful economic activity after 1945 was going to be a tall order. Moreover, this would have to take place against the gathering momentum of political development and independence from colonial rule. The South Asian subcontinent and the whole of South-East Asia, consisting of Thailand, Malaya, French Indo-China, the Philippines and Indonesia, had yet to emerge from colonial control in 1945 as, indeed, much of Africa. Latin America, nominally independent at that time, did not figure prominently in the popular imagination. The struggle for real political independence from colonial control was thus considered to be the foremost expression of a desire in these countries to be able to take decisions that would lead to an improvement in the living conditions of their people. It took precedence over everything else.

Second, as the struggle for political independence took primacy, the idea of economic development as an overarching strategic objective had yet to acquire a measure of concreteness or urgency. Economics itself was still grappling with pre-war issues related to the balance of payments and the trade cycle, and the theory of economic growth was in its infancy. Development economics, as we know it today, was also in its infancy. In India, for instance, most nationalist leaders in the 1920s and 1930s had spoken of improving literacy as the route to remove impoverishment; others had spoken of the need for self-sufficient villages; some saw industrialization as an essential prerequisite of progress; freedom from hunger was another post-colonial objective while nationalist movements generally alluded to a nebulous desire for their people to take their 'rightful place' in the community of nations. An overriding compulsion to attack poverty in society was largely absent from the political discourse in the colonies although the Colonial Act passed in the late 1930s had marked a shift in that direction. In fact, for a number of years after independence most nations took only somewhat inchoate steps towards economic development in its more modern sense. Nevertheless, there was fairly wide agreement that the State and central planning would be the harbingers of progress in the newly independent countries and a blind faith in market forces had been profoundly shaken by the events of the 1930s.

Against this background, rather strikingly, the South Asian subcontinent, though poor, was ahead by some distance in a number of vital areas even in the late 1940s compared to its counterparts in East and South-East Asia. With a population of around 350 million it amounted to a huge, essentially integrated, single entity connected up through one of the largest railway networks in the world. Some modern manufacturing, including steel industries, had been established and the Second World War had given a major boost. Agriculture, though not particularly efficient, that is, either in terms of per capita or per acre productivity, nonetheless could feed the majority of the population, provide important raw materials for industry, contribute to exports but, above all, provide a livelihood for roughly two-thirds of the population. There was, too, a competent administrative bureaucracy recruited through competitive examinations by the State, an embryonic merchant class and a nascent corporate sector. Underpinning all this or, more accurately, performing in tandem, a fledgling group of intellectuals produced by the country's universities was participating in and, indeed, setting the terms of a vigorous debate on the core issues of economic progress, albeit mostly in a foreign language, English. Such auspicious conditions for initiating the process of development were not available everywhere in Asia.

In both India and Pakistan, the real big questions were those of the resource constraint and of priorities. Given the level of domestic savings, how was the development effort going to be financed?[1] In this a degree of wishful thinking could be discerned in both the Indian and Pakistani nationalist movements – as in many former colonies – as if the mere transition to independence would by itself release the required resources. Other pertinent questions were either not asked or, more generally, ignored: for instance, what should be the share of education and health in public spending vis-à-vis other sectors of the economy? When India and Pakistan separated in 1947, many of the advantages listed above for South Asia accrued disproportionately to India. What is now Pakistan began with a population of 33 million, inherited a useful part of the Indian railway system and an extensive irrigation network in the Punjab but little by way of industry or a modern corporate sector. The economy was overwhelmingly agricultural and backward. In fact, three out of the four provinces that currently constitute Pakistan were especially undeveloped even by the standards of undivided India.

Development and poverty alleviation

More than half a century later, the questions of the resource constraint and priorities, along with others, have become the core elements of a radical debate on development not only at the academic level in research institutes and universities but at the global level in the United Nations, the World Bank and in other forums. After a somewhat slow and hesitant start, the wider question of human development and of poverty has taken centre stage over the last two or three decades through the Human Development Index (UN HDI), the Millennium Development Goals (MDGs) and at a more anodyne level in the World Bank's Poverty Reduction Strategy Papers (PRSPs). How the required resources are going to be raised fall under the rubric of another UN-led initiative called Financing for Development. But both these initiatives reflect an uneasy feeling that after relatively steady progress in the 1950s and 1960s in terms of GDP growth per capita (Gunnar Myrdal had incidentally alluded in 1968 to the intractable nature of South Asian poverty in his seminal work: *Asian Drama: An Inquiry into the Poverty of Nations*), the pace of improvement has visibly slackened from the 1990s onwards. Expectations that the private sector would deliver proved optimistic. For most reasonable observers, it has become self-evident that development and poverty alleviation are intertwined, and judging by the experience of the more successful developing countries no country can claim to have succeeded in the former without visible progress in the latter.

Over the last three decades or so, much of the visible success with respect to development has occurred in East and South-East Asia (and to a lesser extent in Latin America). South Asia, too, has made some progress but at a markedly slower pace and primarily in GDP growth per capita. Progress in the social sectors has been very poor. And as the pace of economic growth has decelerated since the beginning of the millennium in Pakistan, most social indicators have stopped improving in both Pakistan and India. In addition, everywhere in the world, including South Asia, there has been a marked increase in inequality over the last 15 years. Moreover, while the absolute numbers living in absolute poverty (i.e. on less than $1.20 a day) have declined, indicators relevant to the quality of life such as literacy, access to health care, maternal and child health and sanitation suggest that the record is one of acute disappointment if not of outright failure for the majority of the population in South Asia. The majority of the population remains acutely vulnerable to the vagaries of both the global economy and natural disasters.

In other words, the development effort of 1950–1980 appears to have run out of steam in South Asia. As such, it is now creating new social issues and is in urgent need of reappraisal and renewal. Even where it has had a temporary, positive impact in boosting jobs and incomes, as, for instance, in India in the first few years of the millennium, the poorest quintile of the population appears to have been bypassed.[2] In the 1960s, the 'green revolution' had boosted food production and rural incomes over the whole of South Asia and, more recently, India has had considerable success in its IT sector. Bangladesh has become the second biggest exporter of clothing in the world after China. But, impressive as these achievements are, a decisive breakthrough in reducing poverty and improving the quality of life for the poorest, that is, raising incomes *and* improving social outcomes has proved elusive. As a result, governments have either stopped talking about social issues or are content to leave it to GDP growth as the way of tackling poverty and its many consequences for society. As a result, social justice as an integral component of development and requiring concerted State intervention has been quietly pushed into the background or forgotten altogether. In Pakistan, everything ostensibly rests on boosting the GDP growth rate and hoping that 'trickle down' economics will take care of the poor.[3] The power of the elite in setting such an agenda for development is reflected in the fact that this has happened without serious debate in the media or, indeed, elsewhere.

Given that much of the developing world started with broadly the same initial conditions in the early 1950s (most developing countries had per capita incomes within a range of \$150–\$200 per capita) the question why some parts of the world have done significantly better than others in terms of outcomes is thus a fundamental part of the debate on development now, some 60 years or two generations later. Two major oil shocks in 1973/74 and 1979/80 were obviously major setbacks but some countries were able to absorb them far better than others and South Asia escaped the debt crises that afflicted Latin America. The questions that arise are: Is poorer performance of the last two decades merely down to poor policies and weak administrative ability or is it because the idea of development as a shared national endeavour has lost its appeal partly because progress has become so difficult on the poverty front? More particularly, why has social justice been abandoned in the development effort in Pakistan in all but name. This can be seen not just in the increase in inequality in the country so that there is now something resembling a system of quasi-apartheid in the country but in most social indicators, like maternal and child health, primary school enrolment and subsequent drop-out rates, access to clean drinking water and sanitation where Pakistan appears to be either making no progress or moving in the wrong direction. Such phenomena cannot be wished away with facile explanations or simply ignored by commentators on development but that is the case in Pakistan.

As mentioned earlier in the chapter, one part of the explanation lies in the revival of neoliberalism in the 1980s and 1990s. As a result, a degree of revisionism has crept into the debate on development and the revisionism comes from the way Economics is taught in universities across the world and the type of empirical research that is funded by think tanks. In the developed countries the 'small state' is now widely assumed to be more conducive to growth and even international organizations like the World Bank, IMF etc. have promoted such views in advice to the developing countries. Likewise, in countries like Pakistan the official rationale questions why development with its emphasis on social indicators should be given extra importance and why it should take precedence over a simple measure like GDP growth per capita in terms of policy attention? After all, it is GDP growth that generates the jobs and incomes that improve the lives of people. In this largely one-sided process the public sector, as a countervailing force, has been wound down and many public services outsourced, privatized or simply abandoned. There appears to be near-unanimity that it is GDP growth that will deliver the needed social sector improvements. If such a contention is justified where does it leave the State?

The examples of East and South-East Asia tell us that improvement in the social indicators is not an automatic outcome of getting prices right; it is a necessary element of inclusive development as GDP growth alone will not prove sustainable in the long run if its rewards are not widely and fairly shared. The private sector on its own cannot tackle rural and urban poverty and provide essential health services such as vaccinations and low-cost or free education for the poor. Moreover, the incidence of large-scale poverty in any society is not just unacceptable itself but from a pragmatic point of view is likely to undermine social cohesion and morale and make such a society far less stable and less productive over the long run. Hence, some form of State-directed deployment of public expenditure towards the poor is an essential policy goal and not an act of generosity on the part of the well-off. In Pakistan, the presumption is that this redistribution cannot be done via taxing the well-off but by out-sourcing as much of it as possible to NGOs and philanthropists. It is abundantly clear that such solutions would not only be mere drops in the ocean but beg a series of questions about how priorities are to be set. What will be the drivers of success and how would success itself be measured? Such questions are only parenthetically posed. In Pakistan, too, a combination of ideology and narrow self-interest have conspired to present neoliberal ideas as being value free social science. Countries are in pursuit of growth and efficiency; equity is therefore regarded as a luxury. At a fundamental level, such a belief system excuses the rich from any responsibility for what happens to the poor in the country. More specifically, to take one important example, tax avoidance can be justified on the grounds that the rich are not users of public services and governments often waste taxes although it still does not address the free rider issue.

Clearly the issues that have arisen over the last few years are the bread and butter of professional development economists, but, it must be admitted, development economics does not have all the answers. The answers can only be found by reference to a value system. The purpose of this chapter is to explain why inclusive development should be accepted as a critical goal for developing countries, why it must be firmly anchored by social justice and to understand why it has succeeded in some countries and failed in others. The issues that arise need to be tackled from two different perspectives and not from an exclusively development economist's point of view. One, from a generic, common sense point of view in which some elementary political philosophy issues come in and, second, from the narrower standpoint of Pakistan's experience in South Asia. The overall perspective is important as some voices have begun to ask why should not other indicators, such as general well-being, override conventional development indicators. Additionally, why should notions of social justice be the responsibility of the State at all? It should be conceded here that the more novel elements of the debate, for example, measures of happiness and well-being, are still in a nebulous state; hence, not much can be said about them for the time being.[4] But other doubts need to be tackled and for this we need to turn to a mix of sociology, anthropology and history to help us understand the nature of the beast that is called economic and social 'progress' and to understand how GDP growth and social justice are ultimately two sides of the same coin.

As far as Pakistan is concerned, answers to the questions are of interest because of all the countries in South Asia its early experience with development was propitious. Although it was a country that was not very richly endowed with resources it became the recipient of significant external help for at least the first three decades after independence (in part an unintended consequence of the cold war and its security aberrations). Its subsequent failure to reach the ranks of middle-income countries, such as those of East and South-East Asia, needs to be candidly analysed and understood. Has it simply been crass political failure at the highest level or a case of massive corruption in government and society, poor and wayward decision-making and a failure of domestic governance, as many are plausibly prone to allege? Or, have other, more intractable and more sinister causes been responsible?

The State and the origins of social justice: A digression

Sociologists and historians tell us that of the countries that have sought to modernize and develop many have been held back not so much by a lack of resources but by the absence of an implicit social contract, the latter defined as the multitude of informal arrangements and unwritten rules on whose basis any society functions on a day-to-day basis. It is the extant implicit social contract which ultimately determines a society's priorities and the manner in which the resources required for development may be raised and deployed. The concept of the social contract was the brainchild of the French philosopher Rousseau. His ideas of liberty, equality and fraternity not only inspired the French revolution but constituted the core of the challenge to the prevailing feudal system of political and social organization in the second half of the nineteenth century.

The social contract has its own system of incentives and penalties and society responds to them better than, say, to the grand-standing of individual political leaders or the changing priorities of the State which reflect the preferences of the ruling elite. With a working social contract resources can be deployed in a broadly agreed dispensation to further the aims of society. Sometimes State policies can upset or overturn the social contract, for instance, when a particular ethnic, social group or institution captures the lion's share of resources in the country. At other times, countries have been able to progress rapidly as the social contract has been more in tune with the preferences of the elite and of society and the latter have responded positively to the incentives and penalties that the State has put in place. East and South-East Asia fall in the latter category. Pakistan probably falls in the former category. Just as analysts and observers seek to understand the drivers of success there is an equal, if not greater need, to understand how and why failure results (Landes 1998; Easterly 2001a).

Before getting to grips with the full gamut of issues in which development and social justice become conjoined as national objectives it may be worthwhile to ask what are their philosophical and conceptual underpinnings vis-à-vis the functions of State in a developing country? The State has been traditionally seen as an amalgam of institutions where bargaining between different groups and policy trade-offs are negotiated. In carrying out this role does the State also have to foster economic growth and development directly or can it restrict itself to being a passive, coordinating enabler? At one level, an argument propounded by the more extreme neoliberals in recent years is that other than providing a rule of law, ensuring the sanctity of private property rights and the enforceability of contracts the State, strictly speaking, should have no further responsibilities (Friedman 1980).

At the next level, this minimalist argument is extended by pragmatists to include the provision of public goods, protecting the environment and protecting the health and safety of the population from the negligence, wilful or otherwise, of third parties (Williamson 1985). Within the matrix of both these arguments the concept of social justice, as currently understood, is considered by many to be a luxury. It is widely deemed not only to be unaffordable in most developing countries but likely to deflect the attention of the State from investing in growth, like promoting investment in production and jobs – far better routes to development, as many neoliberals tend to argue. In fact, according to this view, opportunity costs alone would be enough to relegate social justice to the background. In other words, the fashionable view is that if the State attempts to promote growth *and* ensure social justice it will succeed in neither; hence, it must choose one or the other to focus its efforts and resources. However, choices of this nature are far from being clear cut. As we live in a moral universe giving primacy to the criterion of economic gain has to be counter-balanced against notions of fairness and equity.

From the earliest musings of primitive man we can safely postulate today that mere survival was never considered enough as *Homo sapiens* organized themselves in primitive societies. During the transition from the hunter-gatherer stage to that of a more settled existence in which agriculture became the predominant activity, the production of a surplus over and above immediate needs motivated many of the earliest societies to divide the time available to them between satisfying immediate needs *and* investing for the future. Several millennia later, the idea of steady physical improvement in our lives has evolved into a datum and falls under the all-embracing idea of 'progress'. In fact, the idea of progress forms the backbone of virtually every society and culture across the world today. Indeed, post-enlightenment Europe has added a variety of non-physical measures of progress: freedom from oppression, equality before the law; equality of opportunity, universal literacy and since the end of the Second World War, perhaps controversially, access to publicly funded, social protection systems.

But while these goals or ideals are straightforward enough the means to their attainment raise complex questions. The means often require centralized decision-making with regard to priorities and for raising the substantial resources required for making progress. Doing so adds a series of new and difficult questions about the role of freedom and democracy in meeting the goals. But, whatever the means or the organization adopted for travelling on the road to progress there is no doubt that the notion of 'fairness' is both a justification and a compass for that journey. If the underlying culture gives fairness a high weighting the State with its monopoly of coercive power will be needed in a variety of ways to ensure that progress comes with fairness.

A generation ago the philosopher John Rawls in his work *A Theory of Justice* asked his students to visualize a society unaware of its own past, that is, that its members had erased any notion of their own familial or social origins. He called this the 'veil of ignorance' and he asked what kind of society would they then create. More recently, Amartya Sen, the eminent Indian economist/philosopher, has revisited Rawls in his book *The Idea of Justice*. Sen states that there is almost certainly never going to be universal agreement on what constitutes absolute fairness or a perfectly just society but what societies can realistically aim for is to journey in the direction of greater fairness. In other words, all members of society should be entitled to the same rights and opportunities as other members of society ab initio and not as the result of favours or concessions made by their leaders or by other social groups. They should not be subject to extraneous and arbitrary considerations such as the colour of their skin, their gender or their adherence to a creed; they should be judged solely by their abilities and the effort that they put into achieving not just their own goals but the goals of society as well. Sen goes on to create the idea of the 'impartial spectator' for making these judgments. The impartial spectator would judge how much liberty that society enjoys, are its members free from want, that is, do they have adequate access to food and shelter, and what opportunities does this society provide to its members to enhance their capabilities in order to lead full and satisfying lives. Based on these criteria, the impartial spectator would be able to tell us whether a society is moving closer, or drawing further away, from the goal of fairness.

There is little doubt that progress in the advancement of fairness, in Sen's terms, presupposes a great deal of give and take in the deployment of society's resources, not only between individuals but also between groups. For this purpose, democracy, defined, say, as regular tests at the ballot box of people's preferences, thus becomes one vehicle, *amongst others*, to fructify the process. Society continuously defines and redefines its objectives – its social preference function – through an iterative process, for instance, through periodic elections or through a more gradual evolution of its attitudes along a collective indifference curve, as it were. But underlying the social preference function is the implicit social contract that gives social preferences their flesh and bones.

Within the framework of Sen's ideas all societies, and consequently States, can claim some degree of uniqueness and hence a measure of autonomy in what their individual practical approach is going to be. But the touchstone of fairness ultimately has universal application, rather like members of the United Nations signing up to its charter that includes the Universal Declaration of Human Rights. Irritating as it might be, the universality enshrined in the concept of fairness does permit others to pronounce if particular societies or States are falling short of what they have signed up to. The impartial spectator can legitimately ask if they are seriously addressing glaring shortcomings such as chronic malnourishment, premature child and maternal mortality, uneven access to education and health and preventing evils like bonded and child labour and the oppression of women? Fairness, like so much else, is not an absolute measure; it is at heart based on comparative judgments and one country, or one society, will inevitably be judged against another. Indeed, one can safely deduce from the foregoing that the concept of fairness can be encapsulated in the term 'social justice' and individual countries will almost certainly be judged against international benchmarks or peer group achievements. Thus, viewed from any reasonable standpoint, progress and the idea of social justice become integral components of development. Indeed, without one it is difficult to imagine the other.

The State and development: Limits of public policy

Given all this, what then is the role of the State in development? In all societies the State has the responsibility to raise resources in order to promote development in its widest meaning. For this, it has to tax the people that come under its jurisdiction and levy other fees and charges. In the pursuit of development, it has to provide internal and external security; invest in physical and social infrastructure; coordinate the activities of the public and private realms; establish a rule-based environment for savers, investors and workers; create effective institutions to carry out its responsibilities; devise a strategic framework of policies to realize its aims; and ensure that the notions of value addition and its ensuing rewards are in balance, in particular that the benefits of development are equitably shared in society.

The weaker the State the less can it carry out its responsibilities. States can be weak or strong depending upon their historical evolution. The ruling elite of a State might deliberately wish to keep the latter weak as it then gives it a freer hand to advance its own interests more or less unchecked. At other times, it might seek to strengthen the State to suppress competing interests, for instance, in a fascist State. The only uncertainty arises when rival groups within the ruling elite vie for power and, when in power, pursue their own narrow interests, including vendettas against their rivals. In such cases, States get irredeemably weakened in the process and can no longer discharge any of their functions in a meaningful way. Pakistan probably falls in that category.

Historically, especially following the demise of colonialism and despite lurches into despotism from time to time, the typical postcolonial State has remained a weak or 'soft' State (Myrdal 1970). A soft State is one that is characterized by a fixation with form rather than substance. Form is portrayed in the over-elaborate way that institutions are fixated on status, and the trappings of power and softness is manifested in deficiencies in law observance, officials using public service for personal gain, the toleration of widespread social indiscipline and influence peddling by powerful individuals and groups to bend circumstances for their personal gain in contestable situations. In its latter-day manifestation – although such phenomena are hardly new – soft States are prisoners to a combination of rent-seeking by narrow elites on the one side and the distribution of patronage by the State on the other. While most developing countries could be described as being 'soft' to some extent, South Asia displays these traits with particular vigour, and Pakistan is no exception. Indeed, it is a soft State par excellence.

A central feature of softness in a developing country is a chronic resource constraint. Few people feel obliged to pay taxes and tax–GDP ratios are low and stagnant, often no more than 10–12 per cent of GDP compared to 20 per cent in the more successful developing countries and 40–45 per cent in the developed countries. Budgetary and balance of payments deficits are unsustainably high, typically ranging from 6 to 8 per cent and 4 to 5 per cent of GDP respectively, as such countries also tend to live well beyond their fiscal means. The resource constraint sharply circumscribes their capacity to undertake any meaningful development activities, such as investment in infrastructure and public goods, or even to carry out its minimal functions in providing security to its citizens. In addition, high levels of domestic and foreign indebtedness built up over the years leave such States dangerously vulnerable to inflation and external shocks, whether from rising energy and commodity prices or from the vagaries of international finance that can cause severe difficulties in raising external resources. Often, the States fall into a debt trap in which debt-servicing eats up the lion's share of their own resources. Debts are periodically written down and/or rescheduled, but these are never more than temporary respites. Over time, genuine reforms become too difficult and powerful interests not only 'capture' the State for their ends but create subsidiary power centres, such as tribes, castes and a plethora of interest and pressure groups. In most soft States, the rich elite also hedge their bets by keeping a substantial portion of their assets abroad. As for the majority of the citizens, they are always only a step or two from destitution, such is the level of dysfunction in these States. Both development and social justice are obvious casualties of the soft State.

Against this background it would be difficult to imagine what useful value-adding role the soft State could play in development. It is worthy of note that some half a century after the ending of colonialism its legacy remains mixed. On the one side, colonialism continues to haunt the post-colonial world and the soft State is part of that legacy. This happened as the imposition of an outwardly benign colonial administration aimed almost exclusively at extracting economic rent in the colonies, maximizing revenue collection and maintaining law and order came up against the realities of traditional cultures dominated by tribal and feudal mores. This contact resulted in a breakdown of the extant system of rights, obligations and rules, conventions and procedures. Pakistan (as part of pre-colonial India) was no exception. While the traditional culture was by no means development-friendly, it did have the merits of familiarity and predictability for the people. It is true that people already accustomed to being ordered about in the pre-colonial tribal/feudal system often found their new colonial masters more, rather than less, amenable in their dealings. But most people also kept a residue of loyalty for and identity with their pre-colonial masters. The upshot of this divided system was that for both individuals and groups self-preservation took precedence over all else. Indeed, there is wide agreement amongst social experts and behavioural psychologists that in Pakistan today self-preservation is the motive force that drives people, not grand notions of national goals. Most people across the social spectrum have learnt how to get away with doing as little as they can, especially where collective goals are concerned. There is a sense of resignation not only to official diktat but also to a pattern of subtle disobedience, and these sentiments have continued broadly unchanged more than half a century after independence. As a result, Pakistan functions today without a discernible work ethic and, whether in the tribal areas, the quasi-feudal rural areas or in towns and cities, society functions as best as it can on the basis of a kaleidoscope of constantly shifting alliances, loyalties and identities. Instead of making themselves more productive, much energy is wasted by members of the elite in strengthening their position and bargaining power in these shifting alliances in Pakistan.[5]

This is not to say that the Pakistani State has never sought to confront its dysfunctional nature. Both military dictatorships and elected governments have made attempts to remove at least some of the impediments that stand in the way of development. But the critical need to make governance more effective has been lost in a plethora of largely symbolic initiatives, often clothed in rhetorical language. In order to acquire a veneer of success, the State has resorted to inducements of various sorts: whether exhortations to ethnicity, tribe, caste and religious identity; or subsidies, like cheap electricity for some, loans that are more like grants-in-aid; or a general freedom to flout laws to some groups, the latter opening up substantial new vistas for maladministration, corruption and straining what are already weak administrations to begin with. It is hardly surprising that given the type of social stratification with diffused power and authority that exists in Pakistan subsidies invariably end up with the better off. It is striking to note here, for instance, that despite frequent attempts to introduce and empower local self-government in Pakistan stretching back to the 1960s, actual power, that is the ability to deploy significant resources to meet particular needs, remains in the hands of narrow elites whether at the centre, in provincial capitals or in districts. It is for this reason that most attempts at reforms to improve the functioning of the economy that have been carried out in Pakistan, including land reforms, have been adornments without any practical significance. Other than breeding cynicism, they have resulted in no change in the condition of ordinary men and women, whether intended nominally in the reform attempts or simply pretended to have been accomplished as, in the last few years, Pakistan has sought to improve its international standing.

Over the years, ordinary people, the supposed beneficiaries of these reforms, have lapsed into a resigned indifference. This phenomenon has created a sharp contrast between the interests of the ruling elite and the continuing inequities in society. As Gunnar Myrdal once commented about South Asia, the officials who operate the administration have a vested interest in its preservation, family and social connections mean so much, collusion between business and officialdom becomes a natural tendency and the corrupt get a vested interest in the system (Myrdal 1970) In Pakistan, the State has thus paradoxically become a major part of the problem of how to push the objectives of development forward. Far from being a vigorous leader of the development effort as in East and South-East Asia, the weak or soft Pakistani State can only provide feeble public services, poorly designed policies and, increasingly, an idiosyncratic implementation of its own policy agenda. Indeed, an abiding characteristic of societies with weak States is that they do not create environments in which predictable, arm's length rules can incentivize people to undertake economic activity beyond that of subsistence or low-level survival. It is for this reason that Pakistan's development momentum petered out some time ago. Rent-seeking has become the only way that the richer sections of society can protect their interests, and patronage has become the modus operandi of the State.[6]

So, what can the State realistically hope to accomplish in a country like Pakistan? Fundamentally, very little can be hoped under current arrangements as the Pakistani State has to become an unequivocal 'developmental' State like those in East Asia; it is the ruling elite that have to make that choice. Once the choice is made, the answer lies in curbing rent-seeking and returning to the old 'development from below' approach whereby the informal institutions of extended family, *beradri* (network of families) and tribal networks that underpin the implicit social contract in Pakistan are brought into play and nurtured to pursue a collective developmental end. The State has also to consciously divide its obligations between those that can be centrally delivered, like raising the required resources and making investments in large infrastructure projects, and those that can be decentralized and delivered closer to their recipients, such as education and health. The real test would have to be the standard of delivery and not budgetary allocations. If some leakage of funds through corruption has to be tolerated in the process then so be it. The process is, incidentally, both time-intensive and effort-intensive.

In this overall scenario, the critical need and perhaps the only way is to build on the existing social capital of the country. Social capital is merely the package of norms, associations and networks that are based on mutual trust and workability achieved over periods of time. The poor often rely on their networks to share tasks and minimize risks. It is these networks that will ultimately improve governance in a country like Pakistan and introduce a measure of accountability, not the formal system of civil administration which merely dispenses patronage. Grandiose schemes of reforms will never succeed until the people operating them develop a degree of self-interest in their success. Moreover, given the long residue of disappointments such success will not come instantly; it will at best be a gradual process, extending probably over decades, providing incremental improvements until a critical mass of efficacy can be achieved. Learning from ones mistakes and patience would be at a premium in following the *development from below* approach. The real question is whether Pakistani society and the Pakistani State are willing to undertake such a task and see it to its end, to discipline the penchant of the elite for rent-extraction and, instead, increase investment in public goods.

Pakistan's recent approach to development

As we have seen from the foregoing, the objective of sustainable development raises many contentious issues that involve trade-offs between economic growth and social justice (not to ignore more modern problems concerning the environment) and to what extent public policy can, or cannot, realistically attempt to resolve them. Within the latter, the exact demarcation between the roles of the public and private sectors becomes another source of contention especially with the neoliberal preference for a 'small' State. These trade-offs are far from easy, and much rests on how society tends to view the choices involved. In addition, the process of development is not linear in nature, and possessing ample natural and financial resources alone, for example, by being an oil or gas producer, cannot automatically 'buy' development. Experience from outside Asia, for example, some countries in parts of West Asia, Africa and Latin America, suggests that possessing an abundance of financial or natural resources can mitigate the pain of failure in critical areas of development, for example, failing to invest in human capital through education; they cannot ensure success. Nigeria is a case in point.

Success in development in recent years, as achieved by the so-called tiger economies of East and South-East Asia, has been the outcome of strong policy interventions by the State that have combined the pursuit of economic growth with social justice, the latter driven by a wide, non-discriminatory provision of public goods by State authorities, directly through investment in good-quality education and infrastructure and indirectly through primary health care, sanitation and improved maternal and child nutrition. In the eyes of most students of development, East and South-East Asia are now portrayed as models for others to follow in combining sustained development and social justice (whereas countries in Latin America even when they have achieved high rates of economic growth remain prey to endemic social instability). Financial resources can make society more productive through sensible policies. However, poor policies and their wayward implementation can result in things going drastically wrong and instead of making progress societies are faced with stagnation, demoralization, discontent, violence and even regression. The recent developments in the Middle East are testimony to this.

Till the early 1980s, Pakistan approach to development, too, had followed the mixed economy model very similar to the approach adopted in East and South-East Asia, although the overall work ethic was almost certainly weaker in Pakistan (as in the rest of South Asia). Its record of development was satisfactory with successes on the economic growth front but remained inadequate elsewhere. From the 1980s, Pakistan, under IMF, ADB and World Bank tutelage, accepted neoliberal nostrums and prescriptions rather uncritically, and not only the social sectors but urgent investments in infrastructure were pushed into the background, leaving the latter to the allegedly magical capabilities of liberalized, efficient markets driven by private investors.

One major reason why this happened was that Pakistan's own implicit social contract exerted little pressure on the State as a countervailing force to the private sector in the economy. In East and South-East Asia in contrast, the implicit social contract enabled the State to pursue economic growth *and* provide public goods to the population. In Pakistan, on the other hand, the lack of a functioning, implicit social contract effectively paralysed the State and society from pursuing a more broad-based model of development especially over the last two decades or more. In fact, it has enabled a narrow section of the population to engage in virtually unchecked rent-seeking, defined as capturing, in whole or in part, the value addition of others. Influence peddling, deal-making, acquiring access to scarce assets on the basis of connections are classic examples of rent-seeking, as are rigged markets, and in the financial sector, exploiting moral hazard in the economy whereby gains are privatized and losses socialized or, indeed, in the running of what are effectively quasi-Ponzi schemes in banking. It needs to be said that Pakistan is hardly alone in this, but the growing hold of rent-seeking has created a powerful self-perpetuating comprador class with a stranglehold on the country's meagre resources that is perhaps unique in the developing world. Moreover, it has created a strong culture of systemic tax evasion and avoidance leaving the State bereft of the resources needed even for the minimal provision of public goods.[7]

In writings on development, Pakistan presents an intriguing if not baffling case study. Most authors, including foreigners, still tend to stress the positives by looking, say, at stock market performance or the successes of individual companies. From that narrow perspective, even the United Nations and international aid-giving bodies have been muted in their criticisms of the country's development record. However, such views tend to ignore the parlous nature of its international competitiveness and deteriorating social indicators. A more balanced view should therefore compel us to look at its manifest weaknesses and shortcomings. And these have become so serious now that there remain few grounds for optimism unless a radical transformation occurs in the behaviour of the elite. In any case, optimism must be subjected to the harsh light of realism, if not to become a millstone of perennially dashed hopes and expectations.

There is ample evidence that since the mid-1970s Pakistani society has become more atomized, identities narrower, governance has deteriorated, and violence has become endemic across the country. During this time, the State has become steadily more disorganized and very few of its institutions or policy programmes to do with development can be said to be performing adequately. Instead of going up, the investment–GDP ratio has remained low by any contemporary development standard, and public expenditure on the social sectors has been despairingly inadequate. In fact, such is the waywardness of both societal preferences and State policies that hardly anybody would suggest that Pakistan can be said to be operating on the basis of a forward-looking, robust socio-political culture that values and promotes the collective well-being of the people. Indeed, the country can be described as sitting today on a knife's edge with rising levels of violence and a growing inability to tackle long-term issues such as population growth, rural poverty, enlarging the tax base, energy shortages, low agricultural yields, soil degradation and water conservation.

Today, in critical areas of the economy, decision-making has been captured by tiny coteries of self-interested groups within the elite. In the process, scarce resources have become prisoners of ever more extravagant consumption patterns and of massive capital flight by a tiny minority of the population instead of being used for productive investment in the economy.[8] Any idea of the long-term national interest in the national psyche appears to be either bogus or of purely rhetorical significance. From the State, financial and administrative resources are being wilfully wasted on grandiose vanity schemes, such as six-lane motorways, that make little economic sense for a poor country like Pakistan. Indeed, it can be argued that Pakistan's failure over the last decade or more cannot be attributed to poor governance or corruption as is customarily alleged by Pakistanis and foreigners alike. It is almost certainly the case that as the implicit social contract with which it managed its affairs in the first two decades after independence has withered, the governing elite of Pakistan have become self-seeking and the economy has become mired in chronic underachievement.

The Millennium Development Goals and development policy options

As stated earlier, during the 1990s it came to be the conventional wisdom that the mixed economy model of the 1950s and 1960s in most developing countries was not working well. While most States were groping in the dark for a new modus operandi, neoliberal maxims and the globalization mantra of the Washington Consensus created further challenges for the State and for its development effort. Indeed, for the poorest, conditions became worse as the market produced little, if any, trickle-down effect. There were virtually no new jobs in the private sector or in the privatized public sector. For those in work, real incomes for the majority were squeezed as the cost of privatized services went up much faster than incomes, and job insecurity became widespread. The rich elite meanwhile were able to convert their privileged access to resources into marketable assets through the less regulated financial sector, especially the stock markets. The incidence of inequality increased enormously and polarization between social groups led to a virtual breakdown of law and order with kidnappings for ransom an everyday phenomenon in the larger cities.

When the new millennium dawned, there was a somewhat surprising consensus in the global community that the world needed to wake up to the urgent challenges of poverty and deprivation. The neglect and growing immiserization of the poor could not last ad infinitum. For this, countries had to be brought within a framework of measurable goals and objectives to make development more visible and capable of being measured beyond the annual comparisons of GDP growth rates done by various global and regional bodies (the UNDP Human Development Report being the exception). The United Nations General Assembly unanimously agreed in 2000 that all countries, developed and developing, would henceforth work towards the MDGs (see Table A8 in Appendix). Alongside this commitment, the United Nations also provided a set of mechanisms that would enable the global community to find the means to achieve the MDGs. This was the Conference on Financing for Development in Monterrey, Mexico, in early 2002 whose aims were reiterated at the World Summit on Sustainable Development in Johannesburg, South Africa, in the later part of 2002.

Today, MDGs and Financing for Development are still works in progress. The 2015 objectives are likely to have been missed by many countries, and formalizing the complex development process into a series of goals and measures is obviously fraught with risks. At one level, it reduces development to an oversimplified quantitative exercise whereas Sen's test of enabling people to enhance their capabilities is a richer, more qualitative notion. However, without some form of quantitative assessment the MDGs get reduced to a largely pointless exercise in hope, capable of manipulation by those who might not wish to commit themselves to achieving them in a serious way. Quantitative benchmarks, however flawed in conception, also enable progress to be measured at different points in time, allow corrective actions to be put in train, if needed, for laggard countries to be named and shamed. For once, the Millennium Declaration setting up the MDGs, put countries like Pakistan on notice. Individual countries will not only be judged on their own achievements but against their peers too, in how they have fared in meeting the twin goals of development and social justice.

It is self-evident that achieving the MDGs needs both financial resources and higher level of administrative competence, which are in short supply in the developing countries. Already, the evidence suggests that Pakistan will fall well short of achieving the initial set of MDGs by 2015. The reasons are many: shortage of finance is a crucial part of the equation, and deploying it to best effect is another. However, countries are realizing that the second part of the equation should be seen both as a running cost and as a capital investment. For an initial period of years, say 10–15, the resources that will be needed for reducing poverty and hunger in a substantial way and delivering significant improvements in the social indicators will cost. Raising the finance will depend largely, though not exclusively, on MDG 8 which envisages the development of a global partnership for development in the form of increased ODA for poverty alleviation, technology transfer and debt relief. But over the medium term the initial costs incurred will become an investment, not only lifting millions out of poverty but by so doing making the whole of society more productive. More market-driven capital flows might then sustain the development effort thereafter as has happened in East and South-East Asia.

Notwithstanding the need for a global partnership in the context of MDG 8, the primary responsibility in this area – and, indeed, in other areas – nevertheless rests with individual developing countries. Ideally, they should develop their own strategies tailored to their own conditions and capabilities and formulate their own policies for the MDGs. But countries like Pakistan can also learn from others that have attained middle-income status. As already indicated, many countries, especially the poorest, simply do not have the resources to ensure that MDG-related expenditures can be adequately funded. Such countries will remain dependent on the global community for generating the required resources for many years. With the global community passing through fiscally straitened circumstances and financial resources being fungible how can the world ensure that external resources are responsibly used and do not end up substituting for the country's own efforts. Pakistan does not quite fall in this category. It needs external help only because its own efforts at taxing the better off are so abysmal.

The UN Financing for Development offers a useful framework for countries like Pakistan to follow. As far as domestic resources are concerned, the ability of most governments to significantly raise taxes and/or borrowing is severely restricted in the short term. However, countries like Pakistan need to make a commitment to reform their taxation systems to (a) prevent outright tax evasion; (b) minimize tax avoidance by closing loopholes; and (c) alter the balance between direct and indirect taxes in favour of the former. Indirect taxes are regressive in nature, and an overdependence on them could effectively negate poverty reduction efforts in the country. Using bank finance as an anti-poverty device is now de rigueur in the form of microfinance and that, too, should be brought into play. However, such efforts are likely to have only a marginal impact on either development or social justice. Indeed, beyond the provision of employment opportunities which can be done by the private sector, MDGs are essentially public goods with large positive externalities, and they should therefore remain the prime responsibility of the State. Against this broad background, in succeeding chapters we embark on a quest to understand Pakistan's historical and cultural legacy and where it stands on the journey that one day could bring development with social justice for its people.

2
Why Has Pakistan's Economy Underperformed?

Performance and issues in the early years

Notwithstanding poor outcomes in the social sectors, what else does Pakistan's economic history tell us and what does it tell us in terms of the reasons for its underperformance? First, let's go through some numbers. Taking a long-term view of Pakistan's economic history from 1950 to 2010, a period of 60 years, long enough for any bumps in the road to have been evened out, GDP growth has been around 4 per cent a year and population growth around 2 per cent a year (between 1990 and 2010 the average growth rate is closer to 3 per cent). In other words, per capita GDP has roughly trebled from about \$450 in 1950 (at 2010 prices) to about \$1350 (\$3000 at purchasing power parity (PPP)) in 2010, while India's per capita has reached \$1700 (\$4200 at PPP) over the same period (Pakistan and India were one country until 1947) and Sri Lanka's per capita has reached \$3000 (\$6500 at PPP). Given Pakistan's initial difficulties, this could be described as a respectable performance and, indeed, many developing countries have done worse than this. However, compared to East and South-East Asia Pakistan's performance is distinctly unimpressive. Starting at approximately the same level in 1950, Indonesia's per capita income had reached \$3700 (\$5200 at PPP) and Thailand's had reached \$5800 (\$10,000 at PPP), while South Korea's per capita income had grown to an extraordinary \$24,000 (\$33,000 at PPP) over the same period, the level of a developed economy (see Appendix for more information on Pakistan's comparative performance in key areas).

The immediate and straightforward conclusion one can draw from these figures is that Pakistan's economy has merely sputtered along, especially since the 1990s, without really confronting the underlying challenges of making a durable improvement in the lives of the people, especially the poorest. Pakistan's ruling elite appear to have spent much of their time wasting opportunities in squabbles and grandstanding, an almost pathological preoccupation with security and identity issues and never really making development their highest priority except during brief interludes in the 1960s and the early years of the millennium. Within the elite, the country's decision-making class, that is, senior bureaucrats and politicians, has never been able to project an inclusive vision for the country 20 or 25 years ahead to which the nation as a whole might subscribe. There have been five-year plans galore, numerous ambitious statements of intent and brief periods of economic growth in the 1960s, 1980s and in the early years of the millennium, but neither the plans nor the statements nor, indeed, the periods of growth have been able to provide a secure platform for long-term development, let alone the wider social improvements that include human development and a discernible improvement in the quality of life of the poorest people. Thus, in addition to the persistent neglect of the social sectors there is little evidence of a concerted or serious effort to make the economy more productive and more internationally competitive on the part of successive governments, both political and military. In fact, with the advent of globalization in the 1990s, the country's economic weaknesses have been shown up particularly starkly. It is in such an atmosphere that rent-seeking and patronage have become virtually the exclusive modus operandi of the elite.[1]

Standard growth theory tells us that economies become richer on a per capita basis when the three factors of production (land, labour and capital) combine to produce a bigger output than was previously the case. In everyday parlance, this phenomenon is called TFP or total factor productivity and the key to enhancing TFP is investment, that is, current consumption foregone. Investment in physical infrastructure, such as roads, bridges, energy and ports, including their regular maintenance, is required to make land more productive. Likewise, investment in machinery, technology, management skills, training and social infrastructure, such as education and health, is required to make management and labour more productive.

Investment in institutional development, such as a rules-based economic and social environment and a credible decision-making framework that combines a realistic long-term vision with stable short-term macroeconomic policies, is needed to make capital more productive. In short, it is improving TFP that drives growth in economies and generates the resources to make societies more prosperous.

It is true that not every developing country can address all these areas simultaneously *and* be successful, but the more genuine and serious the effort a country can make towards enhancing TFP the greater are its chances of success, notwithstanding any cultural constraints. At a minimum, depending upon the capital–output ratio for a developing country, an average country needs to invest about 25–30 per cent of its GDP to achieve a growth rate of about 7–8 per cent a year or per capita growth of 5–6 per cent a year. Some growth will occur simply by adding units of investment that a growing population needs – for example, more food and housing – but sustained, long-term growth will ultimately come only through improvements in TFP. It is in this critical area that Pakistan has visibly lagged behind the economies of East and South-East Asia especially since 1990. By and large, the investment rate in Pakistan has been barely half the levels routinely reached in East and South-East Asia over long periods of time, and this has been reflected in low and now declining TFP.

In 1950, the complexity of development issues and the difficulties involved in fashioning a quasi-optimal framework of policies was only dimly perceived. It is true that low levels of literacy were recognized as being an impediment to development, but beyond this patently self-evident realization, discussion on development issues was effectively overwhelmed by such everyday matters as budget and balance of payments deficits. Indeed, in the 1950s and 1960s most developing countries – and Pakistan was no exception – were almost wholly preoccupied with the balance of payments, that is, the foreign exchange constraint on development.[2] Not many might remember today the elaborate restrictions that were in place for the simplest transactions requiring foreign exchange, the vast gap that existed between the official and the 'market' exchange rates of the rupee against the US dollar and the ingenuity of Pakistan's businessmen in getting round such restrictions through over-invoicing exports and under-invoicing imports (and thus finding a remarkably efficacious mechanism for the far more serious phenomenon of capital flight that continues to this day). Indeed, with the benefit of hindsight it is almost certainly the case that patronage, on the part of the government, and rent-seeking, on the part of the business community, was effectively begun and thereafter facilitated by the severity of the foreign exchange controls in operation at the time.[3]

For the first three decades, that is, from 1950 to 1980, by following the mixed economy model Pakistan conformed to the pattern of development that was in vogue over much of East and South-East Asia (with the exception of China which until the 1978 reforms followed a centrally planned, entirely State-directed model) at the time. Except briefly during the 1950s, the overall approach was mainly import-substituting. Many analysts believe today that the nationalizations undertaken by the Bhutto government of 1971–1977 set Pakistan's development back by many years. There is a superficial allure in this view but like everything else its impact on the economy has been greatly exaggerated. In the first place, the private sector in Pakistan had shown little inclination to go beyond the simplest forms of value addition other than in the textile industry. Indeed, the textile industry was left alone by the Bhutto government. It is often forgotten that there was no private sector engineering industry in the country to speak of and even in sectors like fertilizers, oil refining and chemicals, apart from FDI (foreign direct investment), the private sector lacked both capital and technical capacity to invest in higher value-added manufacturing to make it a more vibrant sector of the economy. The presence of a strong public sector in manufacturing in Pakistan, as was the case in East and South-East Asia, was hardly going to be the stuff of revolution in Pakistan.

It could be argued that the Bhutto nationalizations were in many ways a pragmatic necessity. Indeed, had the private sector been even half aware of the development pattern in the rest of Asia, it might have been a useful partner for the public sector in the longer-term growth of manufacturing in the country by creating backward and forward linkages in more technologically demanding value chains than spinning and weaving grey cloth. In the second place, more relevant to long-term growth, overall levels of investment in the economy (as a ratio of savings or GDP) did not decline; they remained much the same or were higher in the Bhutto years. GDP growth rates suffered marginally but tax buoyancy remained intact.

What can be more plausibly argued, however, is that the Bhutto government did not support the public sector with a properly thought-out industrial policy as was being done elsewhere, most prominently in South Korea and Taiwan (Malaysia, Indonesia and Thailand followed later) but also in Turkey. Pakistan's comparative advantage obviously lay initially in the textile industry, being a cotton grower. But beyond the spinning into yarn of raw cotton and low-end manufactures like grey cloth, hosiery and simple items of clothing, what else was the country going to do in the manufacturing sector over the long term? In East and South-East Asia, not only was there an industrial policy in place but it was being supported with the needed subsidies, loans and protection, and the economies were steadily moving into higher value-added sectors like electronics, household durables, steel, ship-building and engineering largely under State guidance. In addition, these countries were *simultaneously* looking to exploit economies of scale, overcoming their inability to produce capital goods and upgrade domestic manufacturing quality by moving from low-quality import substitution to high-technology export promotion. Pakistan has not made that transition to this day. Indeed, even the textile industry has lost ground internationally especially in clothing.[4] The reasons for this failure are simple: rent-seeking is much easier than value addition, especially when you have to compete globally in the latter activity. The globalization of the world economy of the last two decades has exposed Pakistan's weaknesses. What has been revealed is mediocrity and a lack of ambition on the part of the country's business leaders.

Most of all, successive governments and many half-hearted attempts at reform have simply not been able to address the fundamental weakness of the Pakistan's economy: its resource constraint. At the very beginning of the development process, the dearth of resources has to be made up through foreign loans and FDI. Thereafter the country must itself generate the bulk of the resources, and it is the job of the government to create the conditions in which this becomes possible. On the institutional side, banks and stock markets are obvious vehicles to this end, but they need to be supported by a stable macroeconomic and rule-based environment. In Pakistan, the resource constraint starts with a low propensity to save which is primarily a cultural trait but also has economic determinants. Regardless of how it originates, its effects have been demonstrably harmful.

A high propensity to consume deprives the private sector of resources for investment at an economically reasonable price. It also effectively deprives the State of resources with which to build infrastructure and provide public goods to make the economy more productive. Both the State and the private sector are then either compelled or induced to over-leverage, with dire consequences for the economy.

Over-leveraging by the State invariably creates a debt trap at some stage in which debt-servicing begins to grow faster than revenues, budget deficits are monetized and high inflation results. Over-leveraging by the private sector leads to frequent defaults on debts and loans, undermines the sanctity of contractual obligations and results in a steady decline in business ethics as loan defaults become the norm and the vehicle of choice for making rent-seeking both possible and acceptable.[5] Moreover, high inflation either creates the delusion of high value addition in the economy or diverts resources into inflation hedges like property, capital flight and jewellery. We now look at different sectors of the economy in greater detail to understand how fundamental development issues in these sectors have been left unaddressed.

Problems of the rural economy

Even by 2010 agriculture remained the backbone of Pakistan's economy. It produced more than a fifth of the country's GDP and provided employment, both seasonal and non-seasonal, to between 40 and 45 per cent of the population. Approximately two-thirds of export earnings have their origin in agriculture. Within agriculture, cotton, sugar cane, wheat and rice account for 75 per cent of the output. Pakistan is an internationally significant producer of these commodities being the fourth largest of cotton, fifth largest of sugar cane, seventh largest of wheat and 14th largest of rice in the world. But in yields per hectare Pakistan's position is much less noteworthy: it is in the bottom quarter of countries. In yields per man it is even worse lying in the bottom decile of countries producing the same commodities. Climate and soil conditions notwithstanding, Pakistan's low productivity indicates a persistent lack of investment by both the public and private sectors in the rural economy and the absence of modern methods of farming over much of the country. At the level of the provincial government, as agriculture is a provincial matter, outdated irrigation practices and lack of maintenance of the canal network mean that as much as 25 per cent of the water is wasted, while the incidence of unlevelled fields adds to the problem of water run-offs and topsoil erosion. Farmers lack the means to deal with soil degradation which adversely impacts yields, and they have few, if any, proper storage facilities for their crops after harvests. Perhaps a fifth of the output of the main crops is rendered unusable for these reasons. Research and Development is rudimentary, and there is massive rent-seeking in agricultural value chains.[6] Estimates of the costs of rent-seeking in agriculture are difficult to find in Pakistan, but the Indian equivalents of the *arthi* could be skimming off anything between 6 and 14 per cent in commissions on sales (*The Economist*, 27 June 2015).

In addition, the government intervenes in the rural economy through a variety of support or administered prices. On the average they have been around 30 per cent below international prices over the years and their main purpose has been to keep the price of food low in the country presumably to minimize the likelihood of urban unrest but also to keep labour costs down in manufacturing. What this adds up to is a far higher level of rural poverty, of more than 40 per cent of the rural population, than urban poverty, of less than 20 per cent of the urban population. As already mentioned in an earlier chapter, the agricultural sector is also characterized by significant inequality. Over the country as a whole just 2 per cent of the rural population owns 45 per cent of the land.[7] The 2 per cent not only capture the best extension services but can successfully divert government subsidies, say, for fertilizers and insecticides, to themselves and can perpetuate their hold on access to credit markets and marketing outlets.

The lack of policy attention to boost agricultural performance over the years has two distinct causes: one, it indicates the conventional urban bias that is present in decision-making in most developing countries; two, it manifests the power over general economic management exerted by the land-owning rural elite of Pakistan. It is also in the rural areas of the country that the neglect of the social sectors shows up most vividly, whether it is school enrolment, access to basic health facilities, coverage of vaccination programmes or essential sanitation services. The rural poor in Pakistan suffer from both income and non-income poverty. One reason for this is that the political power of the feudal class in the rural areas has remained essentially intact over more than 60 years even if the average size of its land-holdings has declined on account of the process of intergenerational inheritance transfers during this period. Attempts at the critical issue of land reform by different governments have been perfunctory and half-hearted and have been easily thwarted. It is important to understand why.

Why is land reform important and why is it so difficult to carry out? Again, it is the development experience of East and South-East Asia to which one must turn. Most East and South-East Asian economies have attempted to follow the example of Japan in their approach to development after the Second World War. Japan's development began in the 1870s with the Meiji Restoration of 1868 which essentially broke up the feudal estates into much smaller farms and gave the urban middle class a say in decision-making. Although the then government dispossessed the feudal and quasi-feudal landowners it showered them with honours, such as membership of the upper house of parliament, and thus neutralized their opposition to land reform. But more significantly it gave genuine ownership titles to small farmers to the holdings that they were allocated. Over 100 million transfers of ownership were issued in a period of three years, an incredible bureaucratic feat, and redistributed land could now be freely sold and mortgaged. Agricultural taxes were fixed at levels lower than the rents hitherto charged by the feudal landowners so that farmers were incentivized to improve their holdings and make them more productive. The taxes, in turn, were used by the government to improve education and the rural infrastructure like irrigation ditches and rural roads. Even though much of Japan's soil is volcanic, and only 14 per cent is cultivable, these essential changes nevertheless improved yields steadily and by 1910 Japan had become comfortably self-sufficient in rice. Self-sufficiency in rice released land for the production of other crops, such as mulberry leaves, which enabled Japan to export silk in substantial quantities. Moreover, a great deal of previously unused land was also brought into cultivation by clearing and terracing. In just 30 years Japan's economy was transformed from a relatively poor agricultural one into a dynamic, broad-based agro-industrial economy (Studwell 2013).

Similar land reforms were undertaken by China in the 1930s under the auspices of the Communist Party and by Korea and Taiwan after

1945. South-East Asia, too, has followed but perhaps more hesitantly and possibly without the same enthusiasm and efficiency in breaking up large landholdings. Indeed, the worst-performing economy in this region is the Philippines which has not had a land reform at all. Thailand, on the other hand, gave transferable ownership rights to small holders of land soon after 1945.[8] The purpose of the reforms in China, Korea and Taiwan was essentially to take land from large landowners and divide it up amongst the rural population into small, family-run holdings of 2.5 hectares. In Thailand and Malaysia (in the latter the largest holdings were mostly foreign-owned plantations) the purpose of the reforms was more to provide security of tenure to the actual tillers of the land than to break up the power of any feudal estates that existed.

Backed by government investment in rural credit and extension services, training and more efficient input and output markets the results have been a dramatic increase in yields – China, the most efficient agricultural economy in Asia, has per hectare yields that are twice those of Pakistan and India in all the main crops (except sugar cane). The success of the land reforms in these countries has been nothing short of remarkable. Plots of 2 or 2.5 hectares are tended by families of 6–7 adults, essentially in a form of labour-intensive market gardening. What it also reveals is that, contrary to received wisdom which emphasizes economies of scale, a labour-intensive approach can be far more effective in improving per acre output yields and, at one remove, per man yields as well. But without the active support of the relevant governments in ensuring a level playing field in terms of access to credit, inputs and markets, these improvements cannot materialize.

The conclusion is that an egalitarian pattern of agriculture with the State acting as a neutral arbiter and enabler can deliver remarkable increases in productivity and higher rural incomes in quite short periods of time. Simply announcing land reforms and then standing back and doing nothing is worse than useless.

Countries like Pakistan inherited a pattern of landholding bequeathed by the British. Some large holdings were simply gifts from the Mughals to so-called tribal chieftains, a practice that the British also continued to buy and reward loyalty from their Indian subjects. Others were long-term tenancies also given by the British at minimal rents when the system of canal irrigation was developed by them in the Punjab around 1910. With no urban middle class to speak of, political power in provinces like the Punjab was almost entirely in the hands of the land-owning class both old and new. It is hardly surprising therefore that no government has been able to carry out any meaningful land reforms in the country. Governments of all hues have willy-nilly tended to put their faith in large landholdings. This has served a political purpose; its economic rationale has been an afterthought. But the results have been stagnant or even declining productivity over the years, especially over the last decade, and it is not difficult to understand why.

When the land–labour ratio deteriorates (the quantity of land being fixed) large landowners can lease out land at higher rents and make yet more money by becoming moneylenders at usurious rates of interest. Farmers, facing rising rents and expensive loans are then unable to invest in the land that they farm and yields and incomes stagnate. The landholders who can invest are not incentivized to do so as they can make more than enough money by extracting high rents and moneylending. Indeed, the political economy of the latter function is that any farmer who defaults on his loans can then expect to lose some of his land which he has offered as security to the bigger landowner, thus strengthening the vicious circle of poverty, indebtedness and deprivation. The situation that has arisen, not just in Pakistan but in large parts of India as well, is that rent-seeking has thrived at the expense of output maximization and, worse, effectively kept the rural population locked in debt and poverty.[9] None of the conditions of East or South-East Asian style economic transformation have therefore been met.

Pakistan has now incidentally lifted all limits on the size of landholding in the belief that big commercial farms will deliver the productivity improvements that the rural economy so urgently needs. Fortunately not much has happened so far. For in a country with so much rural poverty this supposedly long-term solution is likely to be worse than the problem itself: a further increase in rural poverty and a further drift of the poor to the cities in search of low paying jobs or simply casual employment. What has not been sufficiently realized by Pakistan's decision makers is that a developing country with surplus labour has to maximize production not just within its given factor endowments but within an acceptable framework of equity, one in which *the use of labour is maximized* especially in the rural areas. It is as important to stress per capita productivity as it is to stress per acre productivity. Farm mechanization is important but its benefits must be weighed against the potential displacement of labour. Greater efficiency measured as per acre yields cannot be the sole criterion in such situations. It might therefore be preferable to promote a greater utilization of labour to achieve higher production and productivity in Pakistan. This approach has been tried in East and South-East Asia and has delivered a combination of both efficiency and equity to an impressive degree. For countries still stuck in quasi-feudalism the East Asian approach is thus *the* model to be emulated not some far-fetched notion of commercial agriculture. But, needless to add, it will require a radical change in the existing social contract and a new mindset in society for it to happen.

The industrial sector: Weak and uncompetitive

For the vast majority of developing countries, manufacturing offers the best route to modernization and an ability to become part of the global economy. Even if they do not possess any significant natural resources the processing of food is a natural first step to this end. Developing new technology, global marketing chains, the development of new products and enhanced access to international capital have been the main elements of the development strategy followed in East and South-East Asia. Thus far, Pakistan's record in industrial development is profoundly unedifying. Pakistan's industrial sector accounts for about a quarter (or a third including mining and quarrying which is largely natural gas and some coal) of GDP. This consists of large and small-scale manufacturing and utilities such as electricity, gas distribution and water. Manufacturing, in which the textile sector dominates, accounts for about a fifth of GDP. Within manufacturing, roughly two-thirds of value added originates in the textile sector. This sector also predominates in terms of employment (40 per cent of the manufacturing labour force) and merchandise exports (33 per cent). Other significant manufacturing sectors are cement, fertilizers, edible oil, sugar, tobacco, food processing, oil refining and steel. But in virtually all sectors, value addition is minimal and international competiveness close to non-existent. Small-scale manufacturing, on the other hand, is more dynamic in fields such as sports goods and has done well internationally with little or no help from the government.

On the utilities side Pakistan has an installed capacity of around 20,000 megawatts in electricity but a combination of mismanagement (specifically a hotchpotch of public and private sector responsibilities in the production and delivery of energy), persistent underinvestment and the absence of a coherent energy policy have meant chronic shortages of both electricity and gas over the past few years. These have had an adverse effect on the performance of virtually all sectors of the economy and compelled enterprises and the more well-off households to invest in expensive, alternative systems of power such as small capacity generators that in other countries are used primarily as back-up facilities. No end to the energy quagmire is in sight as of 2015.[10]

Initially, the public sector played a useful, though not decisive, role in the development of industry in the country through the PIDC (Pakistan Industrial Development Corporation). While utilities were mostly in the public sector the overwhelming bulk of manufacturing was in the private sector but the public sector was involved in more demanding activities like steel, heavy engineering and machine tools. Today, both manufacturing and utilities suffer from deep-seated structural problems. Compared to East and South-East Asia the sector has made only a marginal contribution to the economy in terms of modernization, innovation, the development of more complex and higher value-added chains and export competitiveness. Over the years, high rates of tariff protection without the discipline of an industrial policy have meant that net value added when compared to border, that is, world, prices has been miniscule if not negative in many sectors. Added to that, the low quality of products, lack of standardization and an absence of brand development has caused Pakistan's market share in global output and trade to stagnate or decline. More perversely, it has created incentives for the inward smuggling, and now the import, of a wide variety of goods that has further undermined the viability of domestic manufacturing especially in shoes, clothing, household durables and house wares.

Following the end of the Bhutto government in 1977 a process of deregulation, liberalization and privatization was begun in industry. Most of the administrative interventions were done away with, the import regime rationalized and the rupee made largely convertible other than on the capital account. Over the two decades from 1980 to 2000 a total of 166 units were privatized yielding the government around Rs 500 billion or roughly about $10 billion, equal to about a year's worth of tax revenues. In hindsight, neither the liberalization of the industrial regime nor the privatization of public sector enterprises has produced much of an impact on the performance of the sector in terms of growth in value addition, additional exports or investment in infrastructure. According to a study by the ADB, only about a fifth of the privatized enterprises have performed better in their privatized incarnation than before (ADB 1998). Many reasons have been adduced for this – political instability following the death of Zia-ul-Haque, a worsening of the law and order situation and, on the technical side, an overhasty reduction in the protection given to domestic industry and the absence of competitive forces in the economy. A weak, if not crumbling, infrastructure has merely added to the woes of the sector.

Plausible as these reasons are two other, perhaps more fundamental, factors probably played a more important role. One, there has been the absence of an industrial policy in the wake of the privatization programme and two, the steady growth of a rent-seeking culture in society. Pakistan, after 1980 in particular, shied away from following an industrial policy, that is, designating particular industrial sectors for priority long-term support in the form of tariff protection, access to credit and subsidized inputs. This has been presumably based on the neoliberal notion that the State cannot 'pick winners' and that the allocation of capital and other resources in industry should be left to the autonomous decisions of private investors. Far from picking winners, it is remarkable that neither the government nor the private owners of the textile industry had even made tentative preparations for the impact that the entry of China into the WTO and the subsequent ending of the quota regime for the export of textiles and apparel would have on Pakistan. Since the beginning of the millennium Pakistan's industry has lost ground more rapidly than the developing countries as a whole with its global share of exports down from 1 per cent in 2000 to 0.5 per cent in 2010 and in textiles from 8 per cent to 3 per cent.

The insidious phenomenon of rent-seeking that began in the 1950s had remained broadly in check until the Bhutto government. From the late 1970s onwards as the public sector began to withdraw from the economy the Zia-ul-Haque government saw patronage as a means for securing its own political survival. Many new investments in textiles, sugar and cement were made in the 1980s by prominent business groups who were supportive of Zia-ul-Haque but who had little or no relevant knowledge or background in the running of such industries and enterprises in a professional way. Combined with the easy availability of credit from a politically pliant publicly-owned banking sector these investments were initially deemed to be successful and raised the GDP growth rate. However, within only a few years as capacity built up and the domestic market became saturated, mill closures and idle capacity made their inevitable appearance. Rent-seeking in the form of loan write-offs provided an easy way out. Exports were never pursued seriously as competing internationally was implicitly accepted as being beyond the capacity of Pakistan's industrial class and deemed to be far more difficult than selling in the domestic market.

Again, the example of East and South-East Asia provides a salutary perspective in how to develop an efficient industrial sector. At the beginning of industrial development the use of subsidies and tariffs to protect domestic industry is an entirely justified policy approach. But, if domestic consumers are not going to be merely exploited in the form of high-priced shoddy goods then the subsidies and tariffs must also deliver measurable technological progress and international competitiveness in the form of quality, reliability, prices and export penetration. Joe Studwell (2013) aptly states that in order to thrive in the global economy governments must find mechanisms that force manufacturing entrepreneurs to become globally competitive and make profits for themselves. Studwell calls this mechanism 'export discipline'. Exports, apart from overcoming the foreign exchange constraint, provide a real test of whether domestic manufacturers are internationally competitive, possess managerial competence, are utilizing the right technology, producing the right quality at the right price, are using capital efficiently and are not being feather-bedded by hapless domestic consumers. Without this test industrial development degenerates into blatant rent-seeking with domestic enterprises thriving in rigged markets without having to prove their worth in the international marketplace. Where export competitiveness has been absent, domestic investors have also succeeded in misdirecting capital into property, the surest route to the creation of asset bubbles with all their negative consequences for the stability of the financial sector and of the wider economy in Pakistan as elsewhere.

This pattern of industrial development with export discipline at its core had its origins in Japan from where it spread to Korea and Taiwan, Japan's colonies and then to China. In all these economies there was also a significant bias in favour of companies and enterprises owned wholly or partially by the State. However, in Japan most of the State-owned firms were eventually transferred to private owners but within strict performance parameters. Japan then refined its industrial policy over the three decades starting from the mid-1920s up to the mid-1950s in which the State accepted the need to promote mergers and the winding up of smaller, weaker firms and MITI (Ministry of International Trade and Industry) came into being. MITI operated a strong pro-manufacturing bias with rigorous export discipline. Export promotion was based upon an exemption of 80 per cent of export revenues from taxation and the aggressive acquisition of foreign technology. What Japan did in the 1950s and 1960s was aped with gusto by Korea and Taiwan in the 1970s and 1980s and by China in the 1990s.[11]

China's experience with industrial development, while broadly similar to that of Japan has, however, also been different in important respects. In 1949, after the revolution, the Communist Party nationalized virtually all agriculture, services and industry. But even before 1949 the Kuomintang nationalists had preferred to give a strategic role to the public sector in the economy. Under them, industrial policy was run by the National Resources Commission (NRC) and even in 1945 almost three quarters of registered firms belonged to the State, all of which were run by the NRC. After 1949, the NRC was converted into the State Planning Commission which continued to implement the plans of the former body. After 1978 and the beginning of the Deng reforms, the Planning Commission became the National Development and Reform Commission and effectively managed the transformation of China into the economic and exporting powerhouse that it has subsequently become.

A point worthy of note is that in the whole of East and South-East Asia the accent on industrial development has not dogmatically followed a particular theoretical approach determined by economists, domestic or foreign. Instead, it has been based upon strong governance, effective implementation, constant and critical monitoring, high-quality decision-making expertise on the part of administrators and a preference for problem-solving skills by teams of multidisciplinary experts. In Taiwan this role has been played by engineers and even in China, to this day, there is an unusually strong role assigned to bureaucrats with an engineering or science background in the economic management of the country. In South-East Asia, in contrast, a bigger role was given to the likes of the World Bank, ADB and IMF and their pro-free market economic prescriptions but a spirit of pragmatism strongly embedded in their cultures has nevertheless also prevailed and free market nostrums have never been accepted as uncritically as in South Asia, especially as in Pakistan in the 1990s. The crucial variable has been the nature of the relationship between the State and private enterprise. In South-East Asia the State has used its authority primarily to ensure that the private sector does what is needed to implement an effective industrial policy while the State carries out its side of the bargain by investing in infrastructure, providing protection, access to credit, subsidized inputs where appropriate and support for capturing foreign markets.

It must be remembered that any industrial development policy is ultimately a political undertaking. If the State becomes the handmaiden of private business interests and allows rent-seeking to run amok, as it has in Pakistan, it amounts to a failure of the State to carry out its responsibilities as an umpire and coordinator. The private sector, especially in developing countries, is primarily incentivized to make money – the more the better – in the easiest and quickest ways possible. In Pakistan, esoteric notions like corporate social responsibility are still in their infancy and, where they exist, must be weighed against widespread tax avoidance and market manipulation.

In order to carry out an industrial policy the State devised a grand bargain in East and South-East Asia whereby the private sector has been made to deliver export competitiveness, superb products and sufficient taxes for the State to carry out its side of the implicit social contract. The State has consequently been enabled to invest in public goods and infrastructure to take the process of industrial development further and beyond anything that might have been deemed possible, say, in 1980 or 1990. In the process, rent-seeking has been reduced to a point where the State can develop, and keep in play, realistic notions of the national interest without having to pander to the demands of this or that social group or sector of the economy.

Resources can be directed to increase the size of the cake rather than their individual shares. Pakistan developed no such grand bargain.

The growth of financial services

Financial services are the third leg of the development tripod. Financial services provide the means to pool savings and to use them to best effect, that is, where the returns are the highest. However, the latter can often mean investments that do not have long-term sustainability. For such investments, the firm guiding hand of the State is required. The capital-allocation role of financial services is often regarded as being of critical importance in promoting the efficient use of resources in any economy, developing or developed. Traditional uses of financial services in the context of development have been the provision of working capital and trade finance, providing efficient payment mechanisms, both national and international and facilitating the growth and expansion of well-run enterprises by providing them with access to public savings in the form of loans/bonds or equity. In countries that run budget deficits public savings provide the means to finance the deficits through the issuance and sale of government securities. Where deficits are monetized – as they have been in Pakistan – the financial sector recycles the additional liquidity into the economy. While the size of the official debt market is quite large the private debt (*mudaraba*) market remains limited. Other than in leasing, private debt has not become a major source of private sector investment financing in Pakistan. Project financing was not a part of the traditional provision of financial services and governments set up specialized institutions for this purpose, DFIs (development finance institutions) such as PICIC (Pakistan Industrial Credit and Investment Corporation), IDBP (Industrial Development Bank of Pakistan), ADBP (Agricultural Development Bank of Pakistan), NDFC (National Development Finance Corporation), ICP (Investment Corporation of Pakistan) and NIT (National Investment Trust) that provided access to a wide array of financial services to investors related to project financing, including foreign currency loans. In Pakistan, other than ZTBL (Zarai Taraqiatty Bank Limited), the successor to the ADBP, none now survive. Project financing is the responsibility of the stock markets where both equity and debt finance is raised. The greatest weakness of Pakistan's banking sector has been its preference for relationship banking, that is, extending support to known business groups and individuals often without adequate security and certainly without a critical understanding of the risks involved. This weakness has not only magnified the problems of moral hazard but made banks willing partners in rent-seeking in the economy.

But, a modern financial services sector comes with a significant price tag. As financial sectors right across the world function with an implicit State guarantee, this has greatly added to the problem of moral hazard in the sector. Indeed, in the developed countries the temptation to merely pursue balance sheet growth, often at the expense of the needs of the real economy, has incentivized bank managements to create giant financial institutions that tend to speculate more in the trading of esoteric securities and instruments and less on the nitty-gritty of corporate finance, such as short-term working capital or project finance. In the process they have become less risk averse. In fact, the implicit guarantee from the State operates in such a way that financial institutions have been able to privatize gains and socialize losses, an arrangement that applies to no other sector of the economy. Against this quite bizarre reality, strong regulation and oversight is therefore needed for this sector. However, on current evidence the new internationally agreed regulatory regime, embodied in BIS III, is likely to be significantly diluted by the time it comes into operation in 2019. Such is the power and influence of financial capital in today's world. As far as stock markets are concerned, given their inherent volatility and proneness to manipulation, their role in furthering the aims of development is clearly subject to doubt. Pakistan's experience bears this out. Despite a booming stock market over the last 2–3 years, the number of IPOs has been tiny.

In Pakistan, a fairly conservatively managed financial sector was nationalized in 1974 by the Bhutto government. At the time this had little, if any, economic rationale and was almost certainly driven by political considerations (India had incidentally nationalized its banks in 1969). Initially, the nationalized banks did provide much needed, and useful, support to both the public and private sectors at the longer end of the maturity spectrum. After 1979, the Zia-ul-Haque government announced its intention to privatize not just the commercial banks but also the DFIs. But banks provided an extraordinarily effective vehicle for dispensing patronage by the government;

the process therefore did not really get under way until ten years later, under Nawaz Sharif. In fact, the Nawaz Sharif government also gave licenses to new banks in the private sector so that, over time, financial services would become an essentially private sector activity.

As of today, Pakistan's financial services (i.e. the total of financial assets, not value added) are equivalent to about 50 per cent of GDP but account for a healthy chunk of corporate profits. This compares with India at 60 per cent, where they remain largely publicly owned, but with East and South-East Asia at over 100 per cent where they are a mix of public and private institutions. Pakistan's financial services/GDP ratio is broadly in line with the intermediation needs of an economy of Pakistan's size and development. But, even so financial services remain suppressed and shallow to a large degree. Suppression means that interest rates on deposits do not provide a real return (they are below the rate of inflation) so that savers are in effect subsidizing borrowers; also that a mere 3 per cent of the population is classified as borrowers. In other words, the financial system caters to a very limited section of the population with a small range of services. Furthermore, the cost of services is quite high. This is reflected in the high spreads between deposit and lending rates, often in excess of 5 per cent, and as the return on total assets is only around 2 per cent, the high spreads mean that the overall quality of banking assets must be poor.[12] It is the more creditworthy borrowers who subsidize the more risky borrowers, the former paying more for credit than they otherwise would have needed to in a more developed financial sector where they would have been able to issue their own debt.

Cross-subsidization is not inherently wrong, but the manner in which it is done in Pakistan encourages moral hazard as higher-risk loans can be advanced with minimal scrutiny. Worse, it also encourages a lax banking culture in which borrowers can over-leverage on a massive scale with virtually no downside risks (loans are generally regularly rescheduled[13] before being eventually written off for the well-connected). Above all, it puts into question the effectiveness of monetary policy if the standard instruments of policy implementation ultimately have such a small impact on the behaviour of borrowers. The structure of the financial system is, moreover, highly skewed. More than 50 per cent of banking assets are in the hands of the five largest banks with the remainder spread over some 36 banks.

Too many small banks means that economies of scale are difficult to achieve, such as in the use of IT, and achieving financial deepening in which banks can provide a wider, more sophisticated range of services – for example, catering to the full states of nature in terms of maturity – also becomes problematic. In fact, most small banks can, and have, become the financial arms of major business groups thus aggravating the problem of moral hazard.

What then has been the role of financial services in Pakistan's development? As a low-savings society and economy the first job of financial services is to encourage and enable people to save. How successful the Pakistan banking sector has been in this regard is difficult to say. In a low-savings, high-inflation economy most people are likely to put a high premium on inflation hedges; if these have some measure of capital gains built into them so much the better. Banks will argue that they are not wholly independent in the matter of offering inducements to savers as these are set by the State Bank, the central bank. Hence, they can only play a marginal role in boosting savings. But, banks can reduce moral hazard by improving their internal risk assessment and risk management capabilities on the asset side of their balance sheets. This might even give them greater freedom to offer higher interest rates to savers and thus attract funds that would otherwise be invested in inflation hedges. The trade-off might well be lower profitability in the short term but greater stability and sustainability over the long term.

On the asset side of the balance sheet banks need to do a much better job of identifying key sectors of Pakistan's economy that are likely to grow in the future. As Pakistan does not have an industrial policy, such a responsibility has not been easy to carry out. A large part of the banking system's balance sheet is still locked up in the textile industry. But, investment in back office functions like foreign market intelligence and economic and industrial research might give banks an ability to go beyond the relationship banking that has been their forte in Pakistan historically and has indirectly encouraged rent-seeking in the economy. Such an ability should also enable the banking sector to play a more socially sensitive role – through cross-subsidization if need be – in dealing with glaring instances of market failure, such as the lack of financial support for SMEs and in critically important areas like low-cost housing where there has been a signal failure in Pakistan as elsewhere.

Financial intermediation in a developing country like Pakistan remains beset with a host of regulatory issues. Whatever the merits of the BIS models of prudential regulation and of minimum capital adequacy ratios, strong and effective regulation is ultimately a political phenomenon. In a country that has become so inured to rent-seeking and patronage, bank balance sheets can only reflect this underlying reality. The lack of a strategic perspective on the part of most banks in Pakistan and somewhat hazy notions of risk management means that the ability of the banking system to play a meaningful role in Pakistan's development is likely to be increasingly constrained in the years ahead. At around the equivalent of $150 million in capital resources, most of Pakistan's smaller banks are hopelessly outgunned, compared to their East and South-East Asian counterparts. Indeed, they are outgunned even within Pakistan compared to their larger counterparts. How these constraints are going to be overcome, where the additional capital resources are going to be raised, how relationship banking is going to be subsumed within an overall 'decision-on-merit' culture are unanswered questions for the time being. The broad direction and contours of the journey ahead can be discerned but a more detailed picture needs a properly funded, ongoing research effort on the part of the State Bank to determine how financial services can deliver a competitive and relevant package of services for Pakistan's long-term development.

Some concluding observations

Pakistan's underperforming economy has many causes, external and internal, and understanding them necessitates a degree of candour. As far as external causes are concerned, there have been adverse events in the form of oil shocks and the fighting in, and stream of refugees from, Afghanistan that has gone on from 1979 virtually without a break. There have also been issues of market access into the United States and European Union in the past and the fact that Pakistan's immediate neighbourhood, that is, SAARC (South Asian Association for Regional Cooperation), has failed to develop into a dynamic trading area similar, say, to ASEAN (Association of South-east Asian Nations). Suffice it here to say that the oil price issue has affected all oil importing countries and cannot be invoked as having had a severe impact specifically on Pakistan. With regard to market access issues, it would be only fair to say that these have applied to the textile industry and not to Pakistan's exports in general, and many other countries have been similarly affected when the quota system was in vogue. Indeed, the performance of Pakistan's textile exports since the ending of the quota regime has been very poor so that earlier complaints about market access were almost certainly misplaced. Other countries diversified their way out of the quota system; Pakistan did not, or could, not.

In the matter of SAARC, the establishment of free trade zones requires political will and a willingness to compromise on the part of all concerned as trade concessions create winners and losers initially at any rate. However, regional free trade agreements are not a zero sum game, and Pakistan's exporters have clearly missed out on the dynamic benefits of freer trade within the region as SAARC has made little, if any, progress in that direction. Pakistan cannot really claim that SAARCs slow development is the exclusive fault of others (these matters are more fully discussed in a later chapter). It, too, has shown little interest in this area preferring to continue its political rivalry with India in the economic arena.

Internally, as has been discussed in Chapter 1, development is the result of a partnership between the State and the private sector, with the State providing the institutional framework, incentives and policy direction and the private sector responding to incentives within the given institutional framework of rules and policies. Clearly, the partnership has been less than satisfactory, especially after Pakistan fell under the spell of neoliberal nostrums in the 1980s and 1990s, and it is important to understand why. First, take the failures on the part of the State. The lack of a strategic long-term vision has already been mentioned. To this might be added weaknesses at the tactical level as well. For instance, policy instruments like exchange rate policy, monetary policy and tariffs, to name only three, need to be consistent vis-à-vis the overriding goal of growth. Instead, Pakistan has been governed by a succession of IMF programmes designed always to avert an imminent default on its foreign obligations.[14] And this has usually meant reduced public spending with hardly any countervailing policy emphasis on improving the long-term performance of the economy. In fact, IMF programmes have delivered no structural improvements for the Pakistan's economy; instead, they have progressively weakened the State vis-à-vis the private sector through privatizations. Another consequence of the IMF programmes has been that as Pakistan has lurched from crisis to crisis, exchange rate policy has never explicitly had an export-promotion objective while the whole structure of import tariffs has been essentially ad hoc in nature, producing a mishmash of incentives and penalties for domestic industry with no clear development or growth rationale. Even lower inflation, the avowed aim of exchange rate policy in the IMF programmes, has not been achieved except for brief periods of time.

With regard to a lack of State direction in development, the absence of an industrial policy in Pakistan has already been alluded to. In the current political climate in which markets have been made the ultimate arbiters of resource-allocation decisions, industrial policy has become unpopular, at least at the theoretical level. But, both East and South-East Asia have used industrial policies in their development, and over much of the developed world in the past industrial development was protected with high tariff walls. In East and South-East Asia (following Japan's example) governments created a framework of incentives (tax breaks, subsidies and preferential access to credit) for particular industries to thrive. This was based on the notion that a country's long-term comparative advantage was a matter of dynamics and could be manipulated over time by the State, for instance, by mastering modern technology (through leapfrogging) and building up a skilled workforce through high-quality education (Korea and Taiwan are examples). The rationale is that just as manufacturers make a judgement about the future when making new investments, governments can do so for entire economies. Indeed, governments can use more than one type of industrial policy and address *both* emerging and declining sectors in the economy by encouraging the former and discouraging the latter through incentives and penalties. In East and South-East Asia, the power of the so-called invisible hand of prices and demand has been significantly modified by the visible hand of the government.

The lack of resources has been a major handicap for Pakistan in development, and this has only been made worse by wasting limited resources on vanity projects like motorways and expensive urban public transport systems leaving very little for investment in far more important public goods like education, health and sanitation and rural roads. The argument is made that too much spending by the government 'crowds out' the private sector, and since the former is inherently inefficient, it drags down the growth rate. However, an equally legitimate case can be made that high government spending, especially on public goods and infrastructure, could have the opposite effect, that is, 'crowd in' private investment by providing it with the benefits of a more educated, more skilled workforce and more efficient logistics for production and marketing.

In fact, the absence of a skilled, better rewarded workforce has created a double jeopardy for Pakistan: (a) the country has found it impossible to graduate to more complex, higher value-added manufacturing systems that use higher technology and (b) limited the size of the effective market for many products. Generally speaking, wage rates in manufacturing are low, being just above the unskilled, subsistence level, say, in the construction industry, and much of the workforce, for example in textiles, is on daily wages.

Industry owners claim that investing in higher-level skills is pointless on account of the low productivity and high levels of labour turnover in the country. There is of course some truth in this. Equally, it is the case, that foreign investors operating in Pakistan are able to pay their workers decent wages, are able to invest in their training, improve their productivity and reduce turnover. The critical difference is probably the level of professionalism in the management of the two sectors of the economy with Pakistani enterprises being mostly family-run concerns.

Finally, development requires not just a partnership between the State and the private sector but a symbiotic relationship between the commodity producing sectors of the economy, that is, agriculture, industry and financial services. In China, this was called 'walking on two legs' after the 1978 reforms. In Pakistan, the lack of an industrial policy makes such a relationship difficult as financial services have no clear perception of what lies ahead in terms of Pakistan's longer-term development. The opportunities and challenges emanating from globalization are too complex for a typical bank to grasp and utilize in building scenarios for its operations in the future. The State Bank of Pakistan has prepared a medium-term strategic framework, but this is almost exclusively a financial services-centred view; it does not take into account how Pakistan's economy is likely to grow and evolve, say, over the next decade. What is needed is strong leadership on the part of the government – through, say, the Planning Commission – in articulating a vision for the long term; more regular 'conversations' between research institutes, the media, representatives of the private sector and civil society organizations as to the kind of society and country that lies ahead with unchanged policies; and what needs to be done to change course. This critically important task cannot be left to the wildly unrealistic rhetoric of politicians alone.

3
The Social Sectors in Pakistan: A Story of Neglect

The social reality in Pakistan

Chapters 1 and 2 have argued that economic growth alone is unlikely to prove an adequate driver of wider economic development and that direct investment in the social sectors is needed to make development more sustainable and more inclusive in the long term. In this chapter, we look at the social sectors in depth and focus on their neglect. To be fair to Pakistan, social sector development only really became mainstream in development in the late 1980s; prior to the 1990s, it was assumed that growth alone would at least alleviate, if not solve, the problems of the social sectors and of poverty through its trickle-down effects. In the late 1970s and early1980s, as poverty issues came to the forefront in development, the recommended policy actions were still somewhat ad hoc, and this was true in most developing countries. Indeed, many countries were characterized by rather excessive zeal for catchy initiatives like the 'basic needs approach'. These initiatives, while well-meaning, were conceptually oversimplified and impractical in their application, merely suggesting that the responsibility of the State lay in topping up the meagre consumption of the poor. The more systematic approach to poverty signified by the MDGs lay some years ahead. Nonetheless enough was now known about the important role of education and health in improving the quality of life of the poor and as public goods for the wider population to indicate that developing countries needed to *both* increase public spending in these sectors *and* improve their delivery, especially in the smaller towns and in the rural areas. It was already the case that the generation of jobs alone would be sufficient neither to improve the quality of life of the people nor to drive the process of development forward and make it self-sustaining, if the experience of the more successful developing countries was anything to go by. Hence, from the late 1980s in Pakistan, too, somewhat greater policy attention began to be directed towards the social sectors if only in a rather fitful and perfunctory manner.

Notwithstanding the caveat above, even a casual glance reveals that the performance of the social sectors in Pakistan under a succession of governments over the last three decades or more has been consistently poor and is likely to remain so into the foreseeable future for reasons which will be discussed and elucidated later in this chapter. For example, Pakistan ranked 146th in the UN Human Development Index in 2013 compared to India at 136, Indonesia at 121 and Sri Lanka at 92 out of 187 countries. It would be well to remember that as far as Pakistan is concerned even a broad overview will suffer from serious data problems. Budgetary allocations for the social sectors at the federal and provincial levels are known. What is not known if these allocations are fully utilized or whether any portion of the funds has been diverted to other uses. Also, what is not known is what happens in terms of outcomes. The lack of reliable data, especially about outcomes, is indicative of the low priority that the social sectors have had in Pakistan's approach to development, but the lack of data has almost certainly reduced public awareness of the dire situation prevailing in the country – especially vis-à-vis comparator countries in South Asia and elsewhere. Finally, it has severely limited the development of a coherent strategy for these sectors and constrained the ability of successive governments to intervene with effective policies. What we have had is an excess of rhetoric and grandstanding to which the public has become resigned. It is a story essentially of systemic neglect.

As highlighted above, historically, Pakistan has been one of the low spenders on the social sectors. More than four decades after independence, total social sector spending was around 2.5 per cent of GDP compared to an average of 4.5 per cent in the developing countries (e.g. Indonesia 9 per cent) and 15 per cent in the developed countries. Some ground was sought to be made up during the period of the Eighth Five-Year Plan (1993–1998) in which an ambitious Social Action Programme (SAP) was launched by the first Nawaz Sharif government (1990–1993) that involved total spending of some $8 billion spread over five years of which 50 per cent was to be provided by foreign donors. However, according to most outside observers the programme was effectively abandoned with barely 25 per cent of its constituent programmes begun.[1] Its lack of success, as well as of any subsequent spending on the social sectors, can be seen in the fact that as of the beginning of the current decade Pakistan had one of the lowest literacy rates in South Asia with marked differences in terms of both gender and urban and rural areas. Female literacy rates continued to lag behind male literacy rates by a wide margin, and wide gender disparities exist in Khyber Pakhtunkhwa and Baluchistan with women lagging behind in every indicator. Urban areas, especially in the provinces of the Punjab and Sind, were significantly ahead of the rest of the country in both male and female literacy rates. Unfortunately, the same is true for measures like the primary school enrolment rate. Data for the proportion of pupils starting in grade 1 who go on to reach and complete grade 5 do not exist. However, it can be safely presumed that dropout rates are very high in primary schools, especially in the smaller towns and in the rural areas of the country. Clearly, the situation varies widely across the country and within the provinces, but even in the best cases what has been achieved is hardly inspiring.

According to the National Education Census of 2005, there were roughly 300,000 educational institutions in the country across all three levels: primary, secondary and tertiary. There were 34 million students (64 per cent in the public sector) with 1.4 million teaching staff of whom just over 50 per cent were in the public sector. Public sector educational institutions thus had a much worse teacher–student ratio than those in the private sector. Even more tellingly, perhaps, there was a massive urban bias in the distribution of these institutions between the rural and urban areas with the latter accounting for almost three quarters of the total. Moreover, close to 80 per cent of educational institutions in the rural areas were and remain in the public sector, while the opposite is true of the urban areas (little is known of the exact number of madrassas in the country or of madrassa-like institutions in the rural areas).[2]

These rather harsh facts are indicative not only of the gross imbalance between urban and rural incomes (more people living in towns and cities can afford to send their children to private sector institutions, regardless of their quality, than in the rural areas) and between rural and urban literacy rates but also of the systemic urban bias in the disposition of public resources on education. Anyone who has ever seen the state of physical infrastructure, not just schools, in the rural areas will hardly be surprised at these findings. Furthermore, schools and other public facilities in the rural areas are often far away from the nearest cluster of villages (they tend to be located near main roads) making school attendance a real challenge for the families living in the rural areas. Other than the distance issue, they also lack basic facilities like drinking water, toilets and furniture as well as an adequate number of qualified teachers. Indeed, even in the Punjab, there are school buildings that have been expropriated by local landowners for their private use.

Many reasons are given for the crumbling state of education in the country. First and foremost are inadequate resources. Under the constitution, education is (mainly) a provincial responsibility. While provincial governments are given block grants by the federal government on a per capita basis, provinces like Khyber Pakhtunkhwa and Baluchistan – and indeed, all rural areas – start with a huge handicap in terms of their level of development. Older urban areas in the Punjab and Sind start with a natural advantage and are also less poor anyway. But even within the limited resources that are committed to education in the public sector, little attention is paid to outcomes. For instance, monitoring systems are close to non-existent, so no government or, indeed, any outside observer can tell if any given school has enough textbooks and adequate monitoring and assessment systems in place. In this critical component of education, standards of governance vary enormously within the country. Given that public sector schools are rightly perceived to be of poor quality, there is now a huge and understandable demand for private schools, especially in the urban areas where incomes are somewhat higher and teachers are easier to recruit. However, at the lower end of the spectrum, it is unlikely that the private sector is better than the public sector in delivering reasonable quality at an affordable price anywhere in the country.

The health sector is no better as the depressing observations from the United Nations Children's Fund (UNICEF) about Pakistan bear out: high numbers of avoidable deaths during pregnancy and childbirth, widespread prevalence of anaemia in pregnant women resulting in low birth weights of newly born children and the high levels of malnourishment and premature deaths amongst the under-fives (Evaluation for the Social Sectors in Pakistan, ADB 2005). The sad reality is that in the wider South Asia only Afghanistan has a worse record than Pakistan with respect to under-five mortality rates.[3] The same embarrassing, if not shameful, underachievement can be seen in levels of immunization and maternal mortality.

For the majority of people, public health facilities are close to non-existent with 58 per cent consulting a private sector service provider when faced with the need to do so. More incredibly this holds true even in the rural areas. Over the country as a whole, some 18 per cent never seek treatment at all when ill. World Health Organization (WHO) data on health expenditure indicate that annual per capita public expenditure is around $5 (roughly comparable to the rest of South Asia) but equivalent to only about a fifth or sixth of the level in South-East Asia. In fact, Pakistan suffers not only from the problems emanating from a lack of development (prevalence of infectious diseases and nutritional deficiencies) but will now have to face the added burden of more middle class chronic health problems like obesity, diabetes and heart disease, a massive burden on its already stretched public health system.

Two of the principal determinants of health in any developing country are water quality and sanitation. Here Pakistan claims that over 90 per cent of the population has access to safe drinking water. But if a narrower measure is used, that is, access to safe piped water, the proportion falls to 53 per cent. Access to sanitation was around 54 per cent according to initial UNICEF/WHO estimates (over 90 per cent in urban areas and 35 per cent in rural areas) but more recent government figures suggest that coverage is much lower, perhaps around 40 per cent of the population. Pakistan's own data show that there was little or no improvement in the decade prior to the year 2000 with regard to either water quality or sanitation in the country. A more alarming finding was the growing share of the far more expensive private provision of water in urban areas. For instance, although local governments were responsible for 94 per cent of piped water in the country this was equivalent to only 26 per cent of total water provision. From these figures it is clear that private water provision, in slums and other squatter settlements in the larger cities, has been and remains a huge burden on the urban poor. With respect to sanitation, the share of households with no sanitation actually increased from 37 per cent to 49 per cent between 1993 and 2005, hardly surprising in view of the lack of investment by the government in these services and the unchecked, mushroom-like growth of informal housing virtually across the length and breadth of the country.[4]

The neglect of the social sectors in Pakistan: An explanation

All countries and all societies possess unique characteristics and traits, a kind of collective DNA, that predisposes them to do certain things in certain ways or, for that matter, not to do certain things at all. Thus, for instance, more homogeneous societies with some degree of agreement on what constitutes the common good will be aware of the handicaps they need to overcome to make progress towards that goal by making development more inclusive but will also find the resources to do so. As stated in Chapter 1, such societies have a functioning implicit social contract that provides the framework and incentives for the ruling elite to act in this fashion. Other societies riven by ethnic, religious, sectarian and caste rivalries – functioning without an implicit social contract – will find it much more difficult to do so.

In Pakistan's case, failure to address fundamental development issues appears to be down to a combination of a severe and continuing resource constraint, the almost complete lack of a common purpose on which there is general agreement in the country, the overwhelming presence and constant intrusion of security issues into national priorities and the increasing ability of the tiny ruling elite, who have commandeered the country's decision-making, to advance and protect their own interests. In the process they have successfully pre-empted the country's limited resources for themselves. According to William Easterly the political economy of countries like Pakistan explains the systemic underinvestment in the human capital of the majority (Easterly 2001). This statement explains a great deal of what has happened in Pakistan and it would be worthwhile to examine in greater detail how this general thesis explains the ongoing neglect that the social sectors have suffered in the country over the last two or three decades.

As stated in Chapter 2, during the first four decades after independence Pakistan's decision-making was dominated by an alliance of landowners, serving and former civil servants and an amalgam of businessmen and armed forces officers. They not only captured the lion's share of the resources but, as part of the bargain, also tolerated widespread rent-seeking in the economy. Making the country more productive by investing in infrastructure and public goods was very low in the elite's priorities. A peculiar feature of Pakistan's social evolution since independence has been that while society overall has become increasingly polarized the country actually remains less unequal than many other comparator countries as measured by the Gini coefficient (UN ESCAP's *Economic and Social Survey of Asia and the Pacific,* annual, various issues). What is true, however, is that social divisions between the rich and the poor have, if anything, become more entrenched. Even many of the not-so-rich seem to have unmistakable feudal aspirations, and these attitudes have percolated down into the lower segments of the middle class. Meanwhile the poor are resigned to their inferior social status principally on account of their low educational achievements. Easterly has hypothesized that it is the skewed distribution of education that is a more important dimension of inequality than income in Pakistan (Easterly 2001, Ibid.).

In addition to inequality, Pakistan has suffered from chronic provincial rivalries that defy any rational explanation. Domination by the most populous province, the Punjab, in the affairs of the country has been a running theme of the country's political discourse more or less since independence. Sind, Khyber Pakhtunkhwa and Baluchistan have all had a plethora of complaints against 'Punjabi domination' that have never been properly addressed despite a succession of constitutional arrangements interspersed by military coups (three of each). The truth of the matter is that the elite in every one of the provinces have been happy to perpetuate the neglect of the social sectors within their sphere of decision-making and have used the Punjabi domination allegation as a substitute for doing nothing. It has been argued in political economy writings on development that elites in developing countries are likely to resist widespread education because literate citizens, even if they are poor, can sometimes defy their superiors. The 1970 elections in Pakistan are a case in point.[5] At the time, it was not education per se that allowed this defiance to take place but the extent of the effort made by the educated middle class to engage with the poor in the political process.

It has to be conceded also that at the earliest stage of development – primitive accumulation – education does not generate high returns and the rich have little or no incentive to tax themselves to provide public goods for the poor. However, as development proceeds, the need for a more skilled and healthier workforce becomes critical to success. But, deeply ingrained attitudes that have allowed the rich to neglect the poor with some initial justification become progressively difficult to throw off. Rent-seeking provides the solution whereby it becomes more important to obtain a bigger share of the existing pie rather than to seek to increase the size of the pie. A great deal of research on development has shown that ethnically diverse countries underinvest in public goods – indeed, this is true even of the more ethnically diverse cities in a developed country like the United States. The same research reveals that ethnic diversity is also the cause of poorly functioning public institutions and low quality government services.

A massive handicap in highly polarized societies like Pakistan is that the ruling elite find it difficult to agree on what constitutes a 'public good' and what value to put on it. In Pakistan, ethnic, linguistic and sectarian rivalries within the ruling elite have effectively prevented a consensus from emerging on education, health (bizarrely even in children's vaccination programmes) and population planning. Pakistan's experience shows that polarized societies cannot put up an effective fight against rent-seeking and in the process allow public institutions to become dysfunctional. The increasingly dysfunctional nature of public institutions reinforces the poor quality of public service delivery and creates a vicious circle of low achievements in the social sectors like education and health which further entrenches the ruling elite's power in society. The upshot is that Pakistan's elite from the vantage point of 2015 have squandered the benefits of a moderately respectable GDP performance in the country's first four decades by wilfully neglecting the social sectors. As Easterly states 'Pakistan is an interesting example that growth alone is not enough for broader development . . . (and) helps us understand that economic growth is not always reliably associated with social and institutional progress' (Easterly 2001, Ibid.).

Pakistan and the Millennium Development Goals

As stated in Chapter 1 the global community agreed the Millennium Development Goals at the United Nations in the year 2000 to make a major dent in the problem of poverty and social deprivation in the developing countries. A number of targets were agreed to be reached by the year 2015 and these were broken up into eight goals based on 48 indicators (see Table A.8). Pakistan adopted 37 of these indicators. After some early progress Pakistan is regrettably on track only with respect to four indicators. There are many reasons for this extraordinary failure on the part of Pakistan to make headway on the social sector front and it is necessary that the situation be seen in its variegated dimensions.

First, there has undoubtedly been some improvement in the poverty head count since the mid-1990s, from 30 per cent in 2000 to 22 per cent of the population up to 2009. But leaving aside actual numbers – as these are nearly always subject to dispute – Pakistan's own estimates suggest that within the category of the poor, divided between the transitory poor, the chronically poor and the extremely poor, only the chronically poor appear to have declined in number.[6] The other two groups of the poor have actually increased. In fact, in terms of overall magnitudes some 40–45 per cent of the population is still clustered round the poverty line. In other words, close to half the population remains dangerously vulnerable to sudden shocks. These can come in the form of a major illness in the family, the loss of a job or higher food and transport costs. Moreover, while the proportion of the population categorized as poor has declined, this phenomenon has been accompanied by rising inequality in the country. In a country where a tiny elite have established a stranglehold on its scarce resources this trend betokens further regression on the social front through the conventional means of a redistribution of public resources. Thus an already dire situation could easily worsen in the years ahead.

Second, over the last few years the global financial crisis combined with large increases in food and energy prices – partially reversed of late – have exacted a massive toll in Pakistan, as in other developing countries. In 2007, inflation surged to over 25 per cent and has remained above or near 10 per cent in subsequent years. At the same time GDP growth has shrunk and these together have adversely affected between 7.5 and 10 per cent of the labour force either through job losses or lower real incomes. Anecdotal evidence suggests that private sector investment activity has remained flat or has declined and there is little optimism that the situation will change for the better in a sustained manner in the near future. As a result, more children have left school to add to household incomes and the poorest households are spending a third or more of their meagre incomes on food. The increasingly poor security situation in the last six or seven years has been a tremendous strain for Pakistan, affecting the economy through lost output, low investment levels, weak revenue collection and diversion of substantial resources from urgently needed infrastructure and social sector spending to security. It has also strengthened a growing sense of alienation within society from a larger collective identity. A rough official estimate puts the adverse impact on the economy alone as being of the order of $70 billion over the ten years since the beginning of the millennium, a staggering figure for Pakistan. The costs of alienation in society could be far more and are likely to be incurred for many years to come in the future in the form of a fractured polity and society.

To make matters worse, Pakistan has experienced three major natural disasters over the last ten years. A devastating earthquake in 2005 caused over 70,000 deaths, 200,000 injured and 2 million homeless with billions of dollars worth of physical damage. More recently, in 2010 and 2011 Pakistan has been hit by huge floods in two successive years with a colossal impact on already vulnerable communities in the poorer areas of rural Sind. All three disasters have eaten into scarce government resources and, despite the generosity of Pakistan's own population and the international community, have increased Pakistan's domestic debt burden severely. Moreover, the disasters have stretched Pakistan's limited administrative capacity to breaking point thus further adding to the marginalization and alienation of the poor in the country, especially in the flood-affected areas of Sind.

While these external events have clearly had an adverse impact on Pakistan's ability to pursue a more coherent MDG strategy the country's own institutional failings have also contributed to the worsening state of affairs. The overall attitude to the MDGs borders on indifference. Thus, for instance, the MDG secretariat in the Planning Commission has not been sufficiently empowered to lead a national campaign on behalf of the government for the advocacy and achievement of the MDGs. The provincial governments are worse still. The lack of political will in this important area of policy can also be seen in the fact that progress in achieving the Goals has not been made either a cabinet or parliamentary subject for regular monitoring and reporting. In addition, as discussed earlier, despite growing evidence to the contrary, the approach of the government to social issues continues to be based on the facile assumption that growth will take care of them.

A further setback came with the 18th amendment to the Constitution in 2010. This amendment transferred responsibility for education, health and other public services to the provinces from the Federal government. There is little doubt that of the four provinces the administrative resources of neither Baluchistan nor Khyber Pakhtunkhwa are even remotely capable of taking on these challenges. In view of this change the likelihood of achieving the MDGs and the Sustainable Development Goals starting in 2015 in Pakistan will almost certainly recede into the distant future. In the eyes of outside experts, doubts have also surfaced about the quality of the data and the seriousness of the monitoring being done with regard to the MDGs. Other significant handicaps that have become apparent are the lack of ownership and advocacy in the country, whether on the part of the Federal and provincial governments or the media, of the MDGs and of outright and perverse hostility within certain sections of society to some of the Goals. How and when these handicaps will be overcome must remain an open question for Pakistan and contrasts with the commitment shown and progress made in Bangladesh.

Taking a broad sweep of Pakistan's history it can be seen that in the 60 years from 1950 to 2010, military and political governments have shared power for approximately equal lengths of time, around 30 years each. Neither set emerges with much credit as far as social development is concerned. Political governments are probably more prone to encourage rent-seeking than military ones, the latter feigning to rely more on a display of efficiency in decision-making to legitimize themselves. However, in practice, military governments, too, have not been averse to participating in rent-seeking. Their saving grace is that for brief periods of time politicians can be excluded from the rents being extracted and some extra resources thereby find their way into the social sectors. It is also the case that while each component of the social sectors has its own unique set of issues leading to persistent underachievement, it is essentially the lack of decentralization and poor governance that make it unlikely that social sector delivery can be improved in the near future. Devolving delivery to provincial governments is only a first step but this might prove insufficient if not accompanied by serious and sustained efforts to bolster governance significantly in the social sectors. These matters are more fully discussed in the last chapters of the book.

The Millennium Development Goals and beyond: What can be done?

At the United Nations the MDGs were adopted at the beginning of the millennium as post-second World War development experience had showed that there was a positive correlation between life expectancy at birth and levels of child and female nutrition and economic growth.[7] In addition, the relationship between years of schooling and labour productivity was especially clear cut. The importance of the social sectors had thus become an essential prerequisite as far as economic development was concerned both at a theoretical and at an empirical level. Furthermore, as an internationally agreed development agenda the MDGs brought greater clarity to its objectives and underlined the shared responsibilities between governments and domestic agents in the development process. The MDGs provided an integrated conceptual and operational framework both for the United Nations at the multilateral level and for governments at the national level to monitor and gauge their progress in development. Nonetheless, progress since the MDGs were adopted has been uneven not just in the world as a whole but within Asia as well. As of 2010, the poorest performing region in Asia with respect to the MDGs was South and South-West Asia which includes Pakistan. In contrast, South-East and East Asia were broadly on track to achieve, and perhaps even to exceed, the MDGs by 2015. In fact, they were the best-performing regions in Asia by a wide margin. Indeed, Vietnam's progress in South-East Asia with respect to the MDGs has been nothing short of spectacular.

One of the principal concerns in monitoring the MDGs has been that they are often presented in the form of national averages. It is important to remember that national averages for individual countries often mask wide disparities in a number of areas. For example, differences between males and females. This is particularly true of Pakistan. In addition, it is worth pointing out that women have a biological advantage that should enable them to live four or five years longer than men. If the data show otherwise then there is a major issue either in the design or the delivery of health services in the country. That, too, is true for Pakistan. Another disparity that is often masked within a national average is that between urban and rural areas of the country and Pakistan again scores poorly with poverty rates ranging from a low of around 10 per cent in urban Sind to a high of over 40 per cent in rural Baluchistan.

Goal 8 as an international compact in the MDGs means that progress in the achievement of the MDGs becomes a shared responsibility between the individual country and the international community. Nonetheless, the primary responsibility rests with individual countries to have their own strategies for the MDGs suited to their own conditions, and to formulate effective policies to that end. In an ideal world, global targets, however valid, should not be imposed on countries independent of their specific situation and recent history. The purpose of the MDGs remains primarily to galvanize individual countries to focus on a set of development indicators as a way to address the more fundamental issue of poverty, particularly non-income poverty. In the case of Pakistan and most developing countries in Asia, the policy format that guided their approach to development before the MDGs was the PRSPs or Poverty Reduction Strategy Papers.[8]

In Pakistan, PRSPs did include some, but not all, the subsidiary goals that became part of the MDGs. Thus, for instance, while they covered education and health their coverage of gender issues was quite weak. In South Asia as a whole, SAARC (South Asian Association for Regional Cooperation) nevertheless committed itself in 2007 to setting out 'a comprehensive and realistic blueprint for the next five years in the areas of poverty alleviation, education, health and the environment...' to achieve the MDGs by 2015. However, a preliminary review of progress against this commitment suggests that in Pakistan practical emphasis has remained on macroeconomic policies, such as budget deficits and inflation. Although PRSPs were meant to assess the impact of macroeconomic and other policies on poverty and on social indicators this has not happened. In fact, there has been little or no discussion on viable policy choices and trade-offs with regard to the impact of macroeconomic policies on the poor and on the social indicators. Other than stray voices emanating from NGOs officialdom in Pakistan has resolutely avoided getting involved in the nitty-gritty of the MDGs.

As has been pointed out in this and earlier chapters, the resource constraint has been a critical handicap for a succession of governments in Pakistan in the pursuit of development, especially in improving the quality of growth. No developing country government has the resources to satisfy all the needs of the people and hard choices in deciding public spending priorities have been, and remain, fundamentally unavoidable. In addition to their low per capita incomes most developing countries have tax–GDP ratios of 15–20 per cent as against 35–40 per cent in the developed countries. Pakistan currently raises a mere 10 per cent or less of its GDP in tax. The resource constraint thus cannot be wished away; it restricts sensible decision-making in a fundamental way. Furthermore, what remains of the resources raised usually gets captured by the urban middle class that is much more effective than the poor in furthering its claims and interests. Yet, the ruling elite in Pakistan have been successful in pretending that the resource constraint does not exist. In fact, most people in Pakistan think that the country is rich enough to afford almost anything.

But resources have not been the only constraint in Pakistan. What Pakistan has consistently failed to project is a pro-poor public policy ethos. Public awareness of the problems of poverty, and more particularly of non-income poverty, remains abysmally low. This has left the space open for a whole range of eccentric ideas, some of them bordering on the bizarre, to become commonplace in the country's development policies. Ludicrous as it may seem, not just six-lane motorways but high speed trains can make it into the pages of serious media outlets in the country. As part of an irrational mindset, NGOs and philanthropy have been given excessive importance, especially in education, thus giving the government an excuse to withdraw from this area leaving the space open to patronage, corruption, rent-seeking and an almost complete absence of accountability of what happens to the funds and other resources that the NGOs raise. But the lack of government interest in the social sectors has simultaneously provided justification for conspiracy theories in the minds of many people to thrive. While NGOs are welcomed they are also treated with suspicion especially when they are foreign funded. Many people firmly believe that foreign donors who support the NGOs are pursuing hidden agendas and that foreigners are to blame for the country's lamentable state of affairs.

Few would deny that Pakistan and in many other developing countries the state of public services is profoundly unsatisfactory. Compared to what is needed, most countries spend only a fraction and without substantially more resources, enhancing delivery is impossible. Some extra resources can be found by reducing expenditure on general administration and by reducing waste but an increase in taxation would be inevitable to fund more and better services. Even if this involves more regressive taxation, or higher government borrowing, the resultant benefits of improved health and education outcomes would justify them. In addition, user charges set at affordable levels could reduce the financial burden on the government and perhaps also lessen over-use of the services. But no government in Pakistan has ever tried to understand, far less emulate, the health reforms of Thailand or the health and educational reforms of Indonesia and how these reforms have contributed to the well-being of these countries. Both countries have during the last decade rolled out universal health care schemes.

Just as important as finding additional resources Pakistan needs to change in how things are done and find out more about the successes achieved in East and South-East Asia in social policy. The country must develop new skills and capabilities to ensure that both national and provincial authorities and local bodies fit the requirements and aspirations of the twenty-first century. What this means is not just new rules and procedures but elements of a more robust implicit social contract that can lead, in time, to improved patterns of behaviour – cultural, economic and social. If Pakistan is serious, the SDGs from 2015 will oblige its government to measure progress in the social sectors and Pakistan will need to create an environment conducive to development that is based on the eradication of poverty.

In this context, the first task is to ensure that the infrastructure is in place necessary to deliver public services to those most in need. This is particularly true for the long-neglected rural areas of the country and for urban slums. Experience from elsewhere suggests that there is advantage in linking public services to a rights-based approach whereby all citizens are covered. In practice, however, there would be trade-offs involved as governments weigh up their obligations in this area. For instance, the physical location of schools and health facilities will mean much more for the women of Pakistan and in the rural areas. Women tend to need health services on a more continuous basis than men and they are also more affected by unreliable water supplies. Inadequate sanitation is a serious problem for everyone but more so for women and girls, who need more privacy than men. The location of clinics and communal taps thus acquires great importance.

It is also the case that even when facilities are in place, their effectiveness is questionable – typically chronically absent staff and insufficient supplies (i.e. school textbooks and medicines in clinics). What East and South-East Asia teaches us is that providing good quality services is, indeed, a massive challenge but that one that can be met if the providers and the recipients can be incentivized to behave responsibly. In meeting this challenge, Pakistan can bear in mind that insisting rigidly on high national standards that can only be provided for a small number of users will penalize those who are left out. Stressing incremental improvements is the key. East and South-East Asia also show that a flexible, relatively gradualist approach that aims to bring certain basic services to the majority of the population while planning for and financing upgrades over time has proved to be far more effective than spending huge amounts of money on showcase pieces or examples that merely placate the egos or political ambitions of the few. The examples of China's health insurance and old age pension show that nation-wide services can be delivered on a cost-effective basis, given a modicum of realism in their implementation. But a gradual approach does not mean several decades; China has managed to introduce both an old age pension and a socialized system of health insurance for the majority of its population in less than ten years.

Rethinking social services in Pakistan

The effective provision of social services on a national basis poses a major challenge even for developed countries. For the developing countries, the World Bank discussed some of the challenges in its Development Report 2004. If anything, given the rapid pace of population growth, the constraint on resources, the increase in violence across the country, and the slowdown of economic growth, the challenges have become even more severe in Pakistan over the last decade. There are two sets of issues that need to be confronted: one, on the supply side the services can be and usually are badly organized (understaffed clinics are a common problem), schools may be sited in the wrong place, too far from the relevant catchment areas and there may be a lack of appropriate expertise available, say, in remote rural areas (teaching very young children requires some level of training). Two, on the demand side, cultural norms may adversely affect the population, principally women but also minority groups, from utilizing the available services. For example, delivering health in conservative, largely illiterate societies, extensive public education programmes are a critical pre-requisite before proceeding, say, with the actual vaccination or family planning campaigns. Failure to do so will only allow suspicions and fanciful theories to take root as, for instance, with the delivery of polio shots in parts of Pakistan.

The fundamental problem in Pakistan, as was the case initially in South-East Asia, is that those who are entrusted with the delivery of social services are poorly incentivized to do so and the recipients of these services suffer from low expectations. Very little can be achieved given these two massive handicaps. Absenteeism of teachers and medical staff is widespread and the recipients barely protest, preferring instead to use private providers of dubious quality whether it is schools or doctors when in need. In combination, because of both supply and demand side issues the quality of public schools and clinics is close to zero except where such facilities are used as showcases for political purposes. Experts who contributed to the 2004 Development Report and others are of the view that genuine decentralization is the way ahead by involving the local community in managing both the financial resources, raised by the Federal or provincial governments, and in the hiring of staff needed for implementation. It has to be stressed that this approach is not a magic bullet and will not automatically lead to huge improvements and instil accountability where none exists. Moreover, in the end, it is by no means an ideal solution as it may only result in local rather than provincial leaders capturing federal resources. But, compared to the inherent corruption and waste that provincial governments have become notorious for, it should be an improvement providing more visible accountability than teams of auditors from provincial capitals inspecting accounts. The key to success in the long term is good-quality monitoring of the management of the financial resources, perhaps entrusted to an outside, independent body, the nurturing of a stronger public service ethos and, where appropriate, rewarding success generously, overtly and without reservation.

It has to be remembered, too, that the whole of Pakistan cannot be run on a uniform model. There is now ample theoretical and practical knowledge available to understand the dynamics of both urban and rural societies in the country and the impact of economic trends, such as inequality, on the expectations and needs of the poor. Much can be learnt from the experience of NGOs, who often have a better record than domestic public service deliverers, about what works and what does not, especially in the rural areas in the social services arena. They are also more likely to be aware of best practice in other parts of the world. In addition, on the ground evaluations that ask basic questions about what kind of incentives are needed to improve service delivery, what should be the structure of institutions tasked with delivery, can public-private partnerships work in this important area of development and how can the poor be included in the decisions that affect them, should, over time, provide the raw material for much more effective programmes of education and health services to be designed and implemented. What is needed is patience and a local leadership incentivized to take up the challenges involved.

Looking to the examples of East and South-East Asia (and in Latin America recently in Brazil, Peru and Uruguay) two major lessons in the delivery of social services stand out: first, whatever change is sought must be part of a long-term continuum. Anchoring change to the past gives it greater legitimacy. Vested interests can be best overcome through a combination of encouragement and rewards, and by involving them in decision-making, than by excluding them completely. Second, governments must learn to make haste slowly. Decentralization in a highly centralized State like Pakistan needs to start with a commitment on the part of the decision-makers that it will be sustained; and that it will not be abandoned at the first sign of trouble. When political parties can be persuaded to share a consensus – however reluctantly – as, they did around the Benazir

Income Support Programme in Pakistan, or the Baht 30 medical scheme in Thailand, or the cooked midday meal programme in India, agreement on other, more tactical matters, becomes much easier.

As of 2015, there is little evidence that the poor can exert pressure from below to get the social services that they deserve; nor is there much evidence that the ruling elite itself have realized that it might be to their own long-term advantage – in the sense of making Pakistan a more productive and more humane society – to undertake investment in decent education and health services.

4
The Cultural Setting: Patronage and Rent-Seeking

The background

Nothing happens in society without a prior chain of causation. The overwhelming influence in the chain is that of culture which itself is the product of decades of change and evolution in the face of myriad physical and non-physical challenges. Within the parameters set by culture, understanding why individuals behave in certain ways tells us much about the collective attitudes and predilections of society at any given time. In Economics textbooks, this has been explained by the utility maximization theorem. According to this theorem, similar to investors seeking to maximize profits, individuals seek to maximize utility in their daily lives *as they conceive it*. Utility need not necessarily mean maximizing income and the acquisition of material goods alone. It can include altruistic activities like voluntary work or community service, as well as preferring leisure or free time to pursue hobbies to extra income. It is hardly worth stressing that maximizing utility for those in the upper decile of the population would have an entirely different meaning than for those in the bottom quintile. For the latter, physical survival would take precedence over everything else, certainly in a developing country. However, what the theorem suggests more generally is that individuals can be incentivized in different ways, that is, with monetary and non-monetary rewards, to maximize their utility.

In societies with a variety of economic, religious and social distinctions, as India had both before and after the advent of British rule, individuals sought to protect their economic and social standing by identifying closely with the religion, sect or caste to which they belonged. This identification was meant to bolster a sense of security engendered by membership of that group, and it was further cemented by the giving and taking of favours. In some cases, these could take the form of extravagant gifts from the leaders or chieftains, like pieces of land as reward for exceptional acts of loyalty, a practice adopted with enthusiasm by the British in their dealings with the native population. Thus was born the system of patronage which all governments exercise to this day to buy or win support from both supporters and opponents in Pakistan.

Rent-seeking, too, has its origins in the tribal/feudal social system so deeply rooted in the history of the country. The early part of British rule of India, that is, from 1770 to 1830 coincided with the industrial revolution in Britain. This was marked by a transformation of Britain's economy and by a massive shift in her foreign trade, such as the growth of textile (and other) exports to her colonies. While many artisan skills gradually died out in India as a result the tribal or feudal nature of society was strengthened. In 1793, through the Permanent Settlement, the British converted share-cropping farmers and revenue officials in Bengal and adjacent areas into private landlords, granting them the rights of private property over large tracts of land. This was done on the condition that the new landlords would collect greatly enhanced revenues from those actually tilling the land, the peasants, and pass them on to the State (the East India Company). In other areas, notably Bombay and Madras, the British opted to deal with the tillers directly. Under both systems, however, the old conventions of India's rural economy were submerged under a formidable apparatus of law courts, lawyers, procedures and rules and a class of people emerged from within Indian society who became experts in how to navigate the rules and procedures that now held sway in the country. Before long the tillers were supporting an impressive array of middlemen, speculators, moneylenders and absentee landlords. In due course land itself became available for sale, lease or transfer, a phenomenon hitherto unknown in India. The new system, which was in time also extended to other areas that came under British rule, like the Punjab and Sind, remained broadly in place until 1947. Directly, it created a large rentier class standing between the tillers and the State; indirectly, it opened up the rural economy to the power of the moneylender, the absentee landlord, the lawyer and the petty official who administered the system; rent-seeking in its classic form was born.[1] The rights, interests and well-being of the tillers of the land who actually grew the crops were all but forgotten, a situation very similar to the one that has prevailed in Pakistan for more than 60 years.

Societies, like individuals, also seek to maximize their collective utility. But the components of utility in particular societies, like income, material comfort and altruism and the weights assigned to them are the products of history, the belief system, the physical environment and contact with other societies. These influences may, or may not, include a desire to make society more egalitarian or more productive and some components of utility might be contested between different groups. For instance, feudalism existed in societies in East and South-East Asia just as much as in South Asia. But in East Asia in the late nineteenth century, feudalism came to be recognized by large sections of society as being an impediment to progress – as they saw it – was therefore subject to reform. In Pakistan it has continued because the utility-maximizing objective of the governing elite has not given reform of the feudal system high priority. It has therefore remained in place, more or less unchanged; not so much now in the form of great landholdings but as a system for dispensing political and social patronage and as a vehicle for facilitating rent-seeking. Today, patronage is the way the State establishes and exercises its authority over both its supporters and opponents and rent-seeking is the way the governing elite of Pakistan preserves its status and hold over the distribution of incomes and resources in the country.

It is this long-standing, culturally sanctified, predisposition in favour of the status quo that bedevils not just day-to-day governance in Pakistan but explains why successive attempts at reform have ultimately run into the sand. Thus, for instance, the land reforms and desire to enhance literacy mentioned in the 1946 election manifesto of the Muslim League were quietly forgotten soon after Pakistan came into being. Two further attempts at land reforms and improving literacy, by the Ayub and Bhutto governments, also came to nothing. At a more mundane level, there have been a host of administrative and taxation reforms over the years, including explicit commitments to the IMF and World Bank with regard to taxation. Some reforms have, indeed, been attempted, notably the Bhutto and Musharraf reforms for the civil bureaucracy, while others have been attempted only in a half-hearted manner, such as the reform of the taxation system. The Pakistan State has never felt the need, or, indeed, felt itself to be strong enough to attempt a serious reform of the economy. Today, patronage and rent-seeking have become firmly entrenched in the Pakistan economy with huge, often unrecognized, consequences for development.

In classical economics rent-seeking was defined as attempts to earn incomes that one is not entitled to, such as a landholder capturing the output produced by his tenants merely on account of the title of ownership or control over the holding. Bribery is an extreme form of rent-seeking but is categorized as criminal everywhere in the world. However, there are other forms of rent-seeking that are regarded as legal and culturally acceptable but have the same function in practice. For instance, super profits earned in times of shortages or padding on unnecessary charges on invoices or earning commissions on the sale of goods or services by exploiting political or social connections. Incidentally, such forms of rent-seeking are common across the world and developed economies are by no means immune to the phenomenon.

Other forms of rent-seeking are the excess profits earned in non-competitive markets, for example by forming cartels, or by rigging the bidding process whilst tendering for public sector projects. What is clear is that most of the examples given here clearly have an adverse effect on the functioning of the economy, usually in the form of higher prices but also by preventing economic and commercial decisions being taken on merit. As a result, mediocrity becomes embedded and efficiency is lost. Moreover, the political system becomes warped in favour of the rent-seekers with their resources and networks of influence.[2]

However, not all rent-seeking behaviour is egregious. Extra profits earned through patents, for instance, in pharmaceuticals, are considered legitimate as are innovations that enhance the efficiency of products. The only question that has to be answered is the number of years for which society should give legal protection to the patent-holder to exploit his or her monopoly position. Innovations will give super profits only until an imitator comes along. But it is obvious that rent-seeking which is simply eating into the value-adding activities of others, sits very comfortably with political patronage, especially in developing countries and Pakistan has raised it to a fine art with favours dispensed in the form of access to bank loans, land and gas and electricity connections to friends. Patronage not only facilitates rent-seeking but creates incentives for the continuation of both as the two are usually subsumed within the parameters of acceptable behaviour in the country. A change in government hardly ever leads to change; it merely replaces one set of rent-seekers with another.

In Pakistan, rent-seeking and patronage have been standard features of the economy for many years. However, as mentioned above, it would be fair to add that rent-seeking is neither limited to Pakistan nor does it occur exclusively in State-private sector interactions. A relatively new form of rent-seeking is one that is associated with the problem of moral hazard in the delivery of financial services in the economy. As financial intermediation now operates with an implicit State guarantee even privately-owned financial institutions can earn super-normal profits by taking greater risks in their operations than they would otherwise do, thus internalizing the State guarantee for their own benefit.[3] In Pakistan, an additional form of rent-seeking in the financial sector is the high spread or mark-up that banks charge on their advances compared to their cost of funds. By doing so, the banks are able to internalize the extra profits in their own balance sheets or, if provisions have to be made for advances that have turned sour and profits are thereby reduced, the general depositors in these banks have to make do with lower returns on deposits. Indeed, there is a growing view in economics that the entire purpose and rationale of innovation in the financial sector is to create self-contained, non-competing markets within the sector that generate high rents in financial intermediation. Furthermore, the more esoteric the financial service the higher the risk of creating a temporary distortion in the market and, hence, the greater the likelihood of earning higher rents from customers.

What then might be the costs to the economy of patronage and rent-seeking? This is a rather difficult question to answer even in the developed countries with generally competitive markets and good information about the economy; in Pakistan it would be next to impossible to make even a rough estimate, so widespread is the incidence of both patronage and rent-seeking in the economy and so poor the data. But, heroic attempts to quantify the costs of patronage and rent-seeking in other settings suggest that the cost of poor lending decisions, for instance, the magnitude of bad loans, in the financial sector could be equal to 0.16 per cent of GDP per year. The cost of undeserved access to credit, like loans to non-creditworthy customers, might be equal to another 0.8 per cent of GDP in terms of efficiency foregone in the economy. In round terms this would amount to 1 percentage point of GDP per year, or a reduction of 20 per cent in GDP since 1994 (Khwaja, Ijaz and Mian 2011). If true for Pakistan, such an estimate would amount to a colossal loss for an economy in the early stages of development.

The State normally has two objectives in the management of the economy: one, to address short-term issues like high inflation and exchange rate instability; two, to alter the behaviour and decisions of savers, investors, producers and consumers in ways that promote the goal of economic growth and jobs over the medium term. To this, one might add social stability and environmental sustainability over the long term as ancillary State responsibilities. In an economy in which there is a massive resource constraint, on the one side, and patronage and rife rent-seeking, on the other, normal channels of policy transmission are unlikely to produce the desired impact. Moreover, the State can become prey to narrow sectional interests and pressure groups so that its policy decisions lack a clear rationale vis-à-vis any of the goals stated above, including the short-term ones. The full range of policy instruments that the State possesses like tax rates, custom tariffs, interest rates and exchange rates are then reduced to mere adornments lacking any ability to achieve any desired end. They are there simply to put a gloss over the largely futile attempts of the State to put a quasi-rational development agenda into effect. In the meantime economic and social problems continue to fester.

It must be remembered that economic policies are introduced based on the presumption that people will react in broadly predictable ways as economic theory suggests. But, in Pakistan the upper income groups have made themselves immune to policy changes by a process of implicit 'dollarization' in their day to day calculus. Neither short-term inflation nor exchange rate depreciation therefore carry the same horrors for the governing elite as they might do elsewhere. Likewise, the bottom quintile is also immune – up to a point – as their earnings and wages are informally indexed to the price of food. There is a small middle section of the population, perhaps no more than 7–8 per cent of the whole population, who are on fixed incomes and who are consequently adversely affected by inflation and exchange rate depreciation. These are mainly public sector officials and their families and the State will usually attempt to protect their incomes and standards of living. But, since there is always a time lag in the actions taken by the government and the rather overt and visible demonstration effects of the behaviour of the upper income groups, petty corruption gets added to the problems of patronage and rent-seeking in the economy. Frustration and alienation are the natural results of these sociological compulsions. Instead of making an effort to address the underlying issues, governments in Pakistan waste their time in thinking up ever more bizarre explanations for the problems facing the country, foreign conspiracies being a particular favourite.

A constrained policymaking process

This is the cultural and social background against which any attempts at reform in Pakistan have been made. Leaving aside the first four Five-Year Plans, from 1950 to 1970, that theoretically provided the overall economic rationale for policymaking in the country Pakistan has made three major attempts at reform. The most radical were the Bhutto reforms (about which something has been said already). These were followed by the Islamization of the banking system under Zia-ul-Haque and a partial reversal of the nationalizations carried out by the Bhutto government. The second major reforms were initiated by the Nawaz Sharif government in the early 1990s that involved a fuller commitment to privatize all State assets and to tilt the balance of the economy decisively in favour of the private sector and away from government controls. The third major reforms were undertaken by the Musharaff government which took the Nawaz Sharif reforms further – under the somewhat grand and pretentious title of 'second generation reforms'. These reforms were meant to propel the Pakistan economy into middle income status under the aegis of neoliberal precepts with the private sector leading the way, including investing in and managing a deregulated energy sector.

It has to be said that for brief periods of time all three reform efforts had an aura of success about them. For short periods a mood of optimism would be generated. Indeed, GDP growth would go up;

the investment/GDP rate would also go up and grandiose projections for the long term would come thick and fast from both official and unofficial sources, including sometimes from sober international agencies. Such moods would then gradually dissipate and reality would make its unwelcome presence felt. A telling and chastening statistic is that between 1973 and 2000 Pakistan resorted to nearly 20 bailout packages from the IMF, perhaps the highest in the world. Each bailout package would be initiated as being necessary to deliver structural change in the form of fiscal space to make growth more sustainable and to make the country more internationally competitive. In fact, each bailout package ended prematurely with very few of the underlying weaknesses of the economy having been dealt with. GDP growth merely sputtered along without any meaningful acceleration. Moreover, investment rates have remained stuck at around 15 per cent of GDP. Hardly surprisingly therefore, that on the competitiveness front, the World Economic Forum currently ranks Pakistan at 133 (just below Zimbabwe) and far below comparator countries such as India 60th, Sri Lanka 65th and Bangladesh 110th. In South-East Asia, Thailand is ranked 37th, Indonesia 38th and Vietnam 70th. In East Asia, China is ranked 29th, Taiwan 12th and South Korea 25th (World Economic Forum website). It is true that the methodology used in these rankings may not be above criticism, but the rankings nevertheless tell a tale, that is, that Pakistan's governing elite has chosen not to accept the challenges and discipline of being a successful exporting economy and has consciously preferred rent-seeking to thrive in the domestic economy.

More fundamentally, the real failure of all reform attempts has been that none of them have sought seriously to tackle the problems of the resource constraint under which the Pakistan economy operates. The resource constraint is generic and cultural, in that the country does not save enough as those who can afford to save have a high propensity to consume, mostly on demonstration goods. The government also cannot save enough as its spending commitments far exceed its revenues. The corporate sector does not save as much as it can, preferring to keep a significant proportion of its assets abroad.[4] Hence, investors do not have access to the quantum of investible funds that other countries normally have, especially in the high saving economies of East and South-East Asia. Likewise, the State, too, has remained bereft of resources and has not been able to address the inadequacies of the country's infrastructure and its poor provision of public or merit goods. As a result, total factor productivity has never risen to match the levels attained in East and South-East Asia. Overall, the tax take has barely risen above 12–13 per cent of GDP and has, in fact, come down to below 9 per cent in the most recent tax period. Here, too, comparator countries have done consistently better with virtually all of them achieving more than 15 per cent of GDP in raising tax resources.

In Pakistan, all efforts at reform have steadfastly ignored both the low domestic savings and the low taxes raised by the State. Instead, following globalization in the 1990s, an unrealistic degree of reliance has been placed on FDI and public-private partnerships also involving foreign capital as a solution to the resource constraint problem. Neither channel has been able to remotely overcome the constraint of resources. In fact, much of the FDI that has come has been invested in existing assets with the possible exception of the communications, that is, mobile telephone, sector. The bulk of the economy remains characterized by low FDI inflows, low technology uptake and inefficient value chains. All the evidence suggests that international competitiveness has deteriorated and not improved regardless of the depreciation of the exchange rate. If efforts at reform are not going to tackle fundamental impediments to improving the performance of the economy then their rationale and overall purpose cannot rise above the rhetorical and the meaningless. More damagingly perhaps, it conveys the short-sightedness of the country's governing elite and their cavalier attitude to the country's problems that seems to consist of making wildly unrealistic claims for the future. Two areas of policy that can serve as examples to illustrate the harm done by badly conceived reform processes are: one, policies to promote market efficiency in Pakistan and two, the privatization solution for natural monopolies like the energy sector that has been put into effect in the country.

One of the chronic problems of development is that markets, instead of tending towards competitive efficiency, are prone to failure. A market failure is a situation where producers fail to produce at their highest level of efficiency and prefer to limit production. As there are often a small number of producers in most sectors of the economy, market rigging and rent-seeking are much easier. Cartels and oligopolies are easier to establish and inefficiencies easier to hide. The misallocation of resources follows naturally. Such behaviour has a huge impact on the investment decisions of other would-be investors. There is a strong bias to invest in small production facilities to make goods that cater to demand primarily from the higher income groups. Here, profits can be maximized by concentrating on earning monopoly rents, not through the pursuit of efficiency aimed at economies of scale and winning export markets. Indeed, sometimes entry barriers are erected, with or without the connivance of the government, to keep new producers from entering the particular sector where rent-seeking gains are high.

In order to deal with such behaviour, the government has three solutions available to it: one, make such behaviour expensive for the perpetrators by penalizing them, say, through a robust competition agency. Two, use the taxation system to alter the after-tax price to reduce demand for such goods so that profits can be reduced to a more normal level. Three, threaten to allow the entry of competing imports, say, from low cost countries in East Asia particularly China. Indeed, in this way the behaviour of both producers and consumers can be altered through the use of price signals that mimic the way markets would allocate resources.

In Pakistan, there are umpteen instances of market failure in a wide range of economic sectors as the reports of the Competition Commission testify. But, few, if any, actions, such as fines, taken by the Commission have been implemented. The country's legal system has simply not grasped the wider significance of the legislation promoting competition and to try to reduce cartelization and market rigging in the economy. East and South-East Asia solved this problem by creating both incentives and penalties through *export discipline*, a solution that Pakistan's business elite has consistently shied away from.[5] There have been export targets galore, but few have been achieved on a sustained basis. Producers and investors continue to thrive in domestic markets by producing at a limited scale and earning quasi-monopoly rents. The sports goods industry is a notable exception in the country to this practice.

Public–private resource allocation in a developing economy

In a mixed economy resources are allocated both by the private sector and by the State. For the private sector the market will determine what goods are produced, in what quantities and to whom they are sold. In the public sector such decisions are taken either by the government directly or indirectly by the relevant State enterprise or organization. If the private sector gets its sums wrong it will be faced with bankruptcy (although not in the financial sector); with the public sector the censure is likely to come from an alert media followed by a change of management or even closure if it is deemed to be the least bad political option. As the principal problem of development is the resource constraint, it is important that the size of the two sectors and interaction between them in vying for access to the country's scarce resources minimizes waste and the two sectors complement one another. For example, one of the arguments against large public deficits is that they 'crowd out' the private sector. But much depends on what the government does with the resources it raises. If they are used primarily for consumption, such as subsidies and/or higher civil service salaries, then they are clearly wasteful and by denying them to the private sector they damage economic performance. If, however, they are used for investment in infrastructure they are not wasteful, as they will 'crowd in' private investment by making it more productive and efficient. From that standpoint they should actually improve economic performance.

By the same token, spending on public goods like education, health and sanitation has often been regarded as consumption as it delivers no benefits to the economy in the form of extra output that a conventional private investment would deliver. However, such expenditure should also be seen as improving the skills and health of the population with a time lag and thereby making it more productive. Seen in that light it becomes indistinguishable from any investment expenditure with a long gestation period; moreover, such long-term investment expenditures are rarely undertaken by the private sector. The question that arises is: where should the line between the public and private sectors be drawn?

In many countries the principle of the mixed economy was accepted without much opposition up to the 1980s. However, the actual demarcation between the public and private sectors was determined partly by political and partly by pragmatic considerations. At the time political parties of the left were unconvinced of the ability of the private sector to act in the public interest; hence they instinctively favoured the public sector. But there was also a more pragmatic realization that there were some activities, notably retail trade, that were best left with the private sector. After the early 1980s the pragmatic side of political preferences has, however, been effectively cast to the winds. Indeed, as mentioned elsewhere there is now a firm conviction, bordering on religious belief, that the public sector should be shrunk to the smallest size possible including through privatization. This is neoliberalism in action. Regrettably, as we will see, it has led to a number of bad outcomes not just in Pakistan but across the world.

It has long been accepted that certain products and services will not be provided by the private sector, or provided only at a limited scale, well below the needs of society. This market failure, the under-provision of public goods that exists in virtually every society regardless of development, requires intervention by the government on a regular basis. But the pro-private sector sentiment of the last 20 years nonetheless prevails and now finds expression in the outsourcing the delivery of public goods to private suppliers with the State purchasing the products or services on behalf of the people. Another variant of this is privatization of the provision of the good or service in its entirety, for example utilities, but with safeguards in the form of rules, regulations and performance indicators. While it sounds convincing in theory, entrusting delivery to the private sector has not worked in practice.

The central tenet of this chapter is that patronage and rent-seeking have been the principal drivers of economic activity in Pakistan, and it is important to concede that privatization does not quite fall within that explanatory schema as far as Pakistan is concerned. On the face of it, privatization in fact goes against both patronage and rent-seeking as the government is seen to be willingly *giving up* a useful vehicle for dispensing patronage and facilitating rent-seeking. However, the reason why privatization became accepted policy in Pakistan – as, indeed, elsewhere – was that it was deemed to be a vital source of extra fiscal resources and would thus provide the government breathing space to carry on for another few years without having to make the more difficult effort at tax reform and raising new tax revenues. In other words, the overall preferences of the governing elite in favour of the status quo were catered for. And, so it has proved. Any improvement in government finances has been limited and, at best, temporary. Apart from a modest improvement in the tax–GDP ratio, which has now been reversed in Pakistan, in the last decade there is precious little to show for the divestment of public sector enterprises in the country.

Proponents of privatization still contend that irrespective of the motivation behind privatization it is likely to result in some improvement in efficiency and can therefore be justified. In Pakistan only a minority of the privatizations undertaken can be so justified. But the real criticism of this justification is that efficiency gains can only happen if the wider economy provides the right environment for the new management to capture those gains. For example, improved allocation of capital resources is only likely to happen if relative prices in the economy reflect their scarcity values. In Pakistan, some prices are fixed by the government while others are not. In such an environment, it is difficult to discern what signals relative prices are sending. Private operators may thus be in a strong position to negotiate a generous package of concessions from the government for the privatization to be shown as successful as in the generation of electricity by the Independent Power Producers (IPPs). Another set of efficiency improvements may be possible simply on the basis of a more business-like running of the privatized enterprise by its new owners. Here, too, it will depend upon the actual business group that has acquired the State enterprise. In Pakistan, in the majority of privatizations the previous owners bought back the enterprise, usually at a substantial discount; in others, through patronage political favourites got the enterprise also at a considerable discount. Hence, the privatization process itself became mired in rent-seeking and, far from being an attempt to eliminate or reduce one or the other, greatly strengthened both patronage and rent-seeking.

That is not all. One of the most widely observed post-privatization phenomena is that prices of the goods or services sold to the public usually go up much faster than in the past. This is true of both developing and developed countries and suggests that in the case of natural monopolies privatization is not such an attractive option as it might seem. One reason why this tends to happen is that a private owner will not wish to cross-subsidize the delivery of his output *unless legally compelled to do so.* Even in a developed economy like the United Kingdom – where privatization began in the 1980s – the record of privatized utilities has attracted a storm of criticism in recent years. Privatized water companies have raised prices far more than the water companies still in public ownership. Nor is there strong evidence that privatized water companies are being more efficiently run, although the salaries of top executives have ballooned out of control and have created a new class of rent-seekers in the UK economy.

The privatization process in a developing country like Pakistan was never going to be easy. But to make it politically palatable its benefits had to be greatly exaggerated. In the first place, the task of valuing any public enterprise offered for privatization was almost certainly beyond the capacity of the civil bureaucracy and any technical advisors helping it. Moreover, in a country like Pakistan where the governing elite are a relatively tightly knit group, the process itself cannot be performed on an arm's length basis. This is further complicated by the undeveloped and poorly regulated nature of capital markets so that raising the financing for the enterprise can introduce additional controversies and be subject to extensive manipulation.

The general conclusion is that when it comes to assigning roles to the public and private sectors in a developing country it is best to proceed with caution and to take a broadly pragmatic view rather than decide ab initio that 'private' is good and 'public' is bad. Indeed, the best course of action for the future is to keep a significant public sector stake in different sectors of the economy as a comparator at the very least as has been the practice in East and South-East Asia. The experience of the deregulation and privatization attempted in Pakistan's electricity sector sheds light on how fraught the process of privatization has been, one that has produced neither enough nor cheaper electricity for the country, and landed the country in a quagmire of its own making.

Pakistan's electricity sector fiasco: Bad policy and rent-seeking

Electricity is undoubtedly a key element in any country's economy and no organized activity on a sustained basis is possible in any economy, without access to reliable supplies of electricity. However, with rising capital costs of new investments in electricity, governments across the world, particularly cash-strapped developing country governments like Pakistan, have been trying to find a new model of electricity provision based on the partial or complete privatization of the sector. Developments in IT have theoretically made the 'unbundling' of the sector possible so that the old model of a single monolithic generator and retail supplier of electricity is no longer de rigueur. Subsidies will have to continue for a time to make electricity affordable for the poorest sections of society – these have been estimated at Rs 1.7 trillion ($1.7 billion) over the last 12 years in Pakistan. It is possible now to break up the production and sale of electricity into two or three sub-sectors: generation, distribution and retail sales, and give it over entirely to the private sector. But Pakistan's experience of reforming the electricity sector underlines the serious risks that arise when the job is done without a clear rationale based on objective reasoning and falls prey to patronage and rent-seeking (Jamasb et al. 2005).

Pakistan adopted a strategic plan based upon such a division of functions in 1992 and divided up the existing State-controlled monopoly Water and Power Development Authority (WAPDA) into separate generation and distribution companies, although full-scale privatization then and, indeed, now is still a distant objective. Private sector involvement is in the role of so-called IPPs (independent power producers) or private sector investors in the generation part of the sector. To regulate activity in the sector the government set up NEPRA (National Electric Power Regulatory Authority) in 1995. The Karachi Electric Supply Company was separately privatized in 1998. On the face of it NEPRA, rather than the government, is the decision-making body for the sector including in the critical function of concluding long-term supply contracts with the IPPs.

It should be borne in mind that Pakistan remains a very limited user of electricity. Per capita consumption is only around 450 kilowatt-hours, about one fifth that of Thailand and two-thirds that of India and a very long way short of the East Asian economies. This is indicative both of low industrial and domestic demand for electricity. At present, total generating capacity in the country is around 22,000 megawatts but because of age and maintenance issues only about 16,500 megawatts is actually available at any given time for distribution. Because of a problem called 'circular debt' in which IPPs are not paid in full and they, in turn, are unable to pay their suppliers of fuel oil, the main fuel used for making electricity, the IPPs cannot generate up to their full capacity. Thus a persistent gap between supply and demand has emerged since 2007 varying between 4000 and 6000 megawatts annually.

Despite the circular debt, new capacity is gradually coming on stream, both in the public and private sectors, but as demand is rising faster than supply and the circular debt issue has not been decisively resolved by the government the problem of 'load-shedding' or rolling power cuts has become a chronic feature of life in the country for the best part of a decade with no real end in sight. The gap is further aggravated by seasonal factors that do not allow the full generation of hydro power in the winter months when water is required to be stored for the next planting cycle. A critical structural issue is the absence of a long-term strategy for an environmentally sustainable mix of generating options not only in electricity but in the entire energy sector. Long-term planning for both is largely on hold and is almost certainly responsible for the chaotic state of affairs and ad hoc decision-making in the sector such as the use of rental power stations to meet urgent shortages of power that happened in 2008–2010.

Pakistan's policy for electricity works on the standard assumption that electricity networks are huge assets that cannot be replicated and its operational rationale is built around the notion of 'open access' whereby different generating companies compete to provide electricity over the existing network. Here the regulator NEPRA comes in with its legal role to charge an access fee to the generating company. In such a system the most important consideration is to design contracts that ensure the correct incentives for long-term security of supply into the overall system and for the generator to be able to earn extra profits by becoming more efficient. In fact, because of constant meddling by the government, no such security exists and the system has been mired by patronage and rent-seeking and of accusations of corruption on a massive scale.

Across the world, electricity markets are characterized either as supply-driven or demand-driven. In the former there is usually an excess of supply vis-à-vis demand whilst in the latter there is an excess of demand vis-à-vis supply. Pakistan clearly falls in the latter category. When there is an excess of demand it becomes a sellers' market and suppliers can increase prices during periods of high demand as happens in the deregulated markets of the developed countries. Without strong oversight on the determination of prices on the part of NEPRA there is no pressure on the generating companies to optimize production and to cut costs and prices over the lifetime of the contract, although the problem of not being paid in full does complicate the situation for the IPPs and, indeed, for the public sector generators as well.

The problem of insufficient revenues is not just of an ageing system which suffers from high transmission losses but also of large-scale theft of electricity across the country as a whole; actual billing revenues barely covering 50 per cent of the electricity generated with government departments and agencies the worst offenders by not paying their bills.[6] In Pakistan, the sole emphasis of the unbundling exercise of WAPDA has been on power generation, rather than the development of a wider policy for the sector with or without private sector participation. It has, for instance, largely sidelined the fundamental issue of consumer affordability of electricity from the equation. Electricity is being generated by low priced gas as well as expensive imported furnace oil and now imported coal. Hydro power is the cheapest but it is not available throughout the year when river flows decline. On the thermal front, gas is the cheapest feedstock but around 20 per cent of it is also needed for making urea and is the primary if not exclusive household fuel. As a result, not only is the average cost of generation of a unit of electricity high and variable but with line losses and theft the gap between the revenue per unit of power delivered, based on a unified system of tariffs, and revenue actually received, becomes higher still. Moreover, a great deal of juggling has to be done with gas supplies between different uses, all with a credible case for preferential treatment. When the losses between the cost of generation and actual revenues received have to be made good some customers end up paying much more for electricity than they might otherwise have had to do. For industrial consumers it means that power becomes an unpredictable and expensive element in their costs of production.

The question of tariffs would be an extraordinarily complex one for NEPRA alone to resolve; constant political interference and meddling make it even more complex. What Pakistan has achieved in practice therefore is the worst of all worlds in which the government has made interventions in both prices and contracts with IPPs that have lacked any long-term rationale while also undermining NEPRAs authority and technical role in the process. The only beneficiaries have been the IPPs who have managed to treat their contractual obligations to provide electricity in a cavalier fashion in the face of the government's interference and its lack of policy nous in asking for a renegotiation of contracts. IPPs have either reneged on their contracts or have managed to operate on a cost-plus basis – hardly a recipe for greater efficiency.

In the broad context of patronage and rent-seeking, a remarkable detail often missing in the media in Pakistan is that in the economies of East and South-East Asia State-owned firms make up around 40 per cent of the corporate sector and nearly 50 per cent of stock market capitalization in Asia (*The Economist*, 31 May 2014). In a world where the nostrums of the Washington Consensus are considered to be akin to religious verities the fact that the most successful economies in the world continue to rely on a strong State role in the economy speaks volumes for their pragmatic approach to economic development. Indeed, even where World Bank or ADB-inspired privatizations have occurred, the Eastern or South-East Asian model has been a hybrid with the government continuing to remain a dominant shareholder in the privatized enterprise.

It might not be too late for Pakistan to reverse some of the unbundling that has happened in the electricity sector, with very little to show for it. But to make electricity available to the bulk of the population in a reliable way and at an affordable price the government needs to fashion a realistic policy for the energy sector as a whole and within that develop a long-term integrated framework for the electricity sector. A model that is worthy of emulation is the successful provision of low cost mobile telephone services in the country. But even within that model the initiative to set up modern generating plants should not be left to the whims of private investors in which rent-seeking might be their principal motivation.

Finally, it is worth remembering that electricity is highly capital-intensive and adding to capacity involves countries like Pakistan in difficult choices. However, its wider benefits to the economy and to society can only be realized once it is made available to the bulk of the population. This, the private sector cannot, or will not, do. Hence, the government will have to become involved in *delivering electricity at an affordable price* to the country. In Pakistan, as well as in a number of other developing countries, private sector involvement has not been a great success and the debate should now focus on what the government must do to meet its responsibilities to the people of Pakistan in providing a fundamental input like electricity.

For any outside observer, two sets of issues come to attention immediately: one, the question of subsidies. Subsidies are unavoidable but they should not have a negative impact on overall electricity generation. Cross-subsidization should be used more extensively so that bigger consumers bear a bigger share of the subsidies but also to develop a system of long-term average prices that would provide more stable price signals for future investment in the sector. Two, develop a coherent long-term strategy for the sector. This is absolutely essential for the future of both the sector itself and the wider economy. A long-term strategy will identify the resource requirements for the future and how they might be raised. It will also show the extent of private sector contribution to building up capacity and a candid appraisal of the country's financial system to support the private sector in this critical area of the economy. Such a strategy should also examine what role renewable sources of electricity, such as solar power, will play in the country.[7]

5
The Political Economy of Pakistan's Development

Why is political economy important?

Feudal culture, patronage and rent-seeking underpin the political economy of Pakistan. The term 'political economy' has been traditionally defined, first, as the interrelationship between political power, society and the economy and, second, as the macroeconomic situation and public policies, that is, how public finances are raised and how the State spends them. To these two components could be added the competitive standing of a country vis-à-vis others in the global trading system in terms, say, of its exchange rate and trade agreements. The organization and structure of its agriculture, industry and services would also become relevant in terms of the pattern of ownership. Finally, the framework of law and practices that govern the economy also have a bearing on political economy issues. Legitimate questions thus arise with regard to the existing distribution of power and of rewards in society *and* the impact policy and institutional change are likely to have on them in the future. The neoliberal faith in the role of markets in allocating resources efficiently has to be seen against the background of these different components of political economy. Here, we need to understand how Pakistan's political economy is likely to impinge on the country's development in the years ahead.

What does political economy teach us? When the formal study and teaching of Economics began in universities in Britain more than a hundred years ago, it was considered to be a branch of moral philosophy, and the subject itself was initially known as political economy.

When we study modern political economy, that is, beginning with the Keynesian revolution in the 1930s which greatly enlarged the role of the State in economic affairs, it is part of a longer term continuum going back to Adam Smith, David Hume and John Locke. For them, and for others subsequently, ethical judgements were never far from the close scrutiny of the central tenets of economic, social and political analysis. Indeed, they should not be. We all wish to live in a better world, and social science should not shy away from making normative judgements. Thus, whatever the current claims of neoliberals in presenting Economics as a value-free discipline – or even more implausibly as a science having the precision of applied mathematics, in any reasonable context involving social justice, the test of fairness must be considered the single most important criterion in judging how an economy is structured.

In recent years, as the study of Economics has evolved, a number of sub-themes have emerged such as neoclassicism, Keynesianism and neoliberalism to shape political economy. It also goes without saying that the circumstances against which public policy choices have to be made are in a constant state of flux. There are the effects of wars, global instability and internal conflict, of major technological change and of periodic economic upheavals, for instance, the mass unemployment of the 1930s, the stagflation in the late 1960s, the two oil shocks, several financial crises in the 1980s, 1990s and early years of the millennium culminating in the banking meltdown of 2008/09. Likewise, the policy responses to them will inevitably differ. But ultimately the most important yardstick for judging their efficacy would inevitably have to be the Rawlsian test of moral legitimacy and of fairness, not one of economic efficiency alone.

The nature of political economy in Pakistan

It has to be recognized that societies nearly everywhere are highly unequal and are growing more so these days. It is also accepted that this is the result of policy choices. For three decades after the Second World War, societies were becoming *more* equal. What has changed today is the distribution of political power and the ability to set the political agenda by different groups in society. Societies are unequal not just in economic terms, but more so in political terms, which is making the pursuit of social justice increasingly problematic. With regard to the former it is obvious that in terms of consumption patterns and market power the richest quintile of the population bears no resemblance in behaviour and needs to the poorest quintile. If left to the markets, the poorest quintile is unlikely to have many of its needs adequately catered for based on the assumption of profit-maximizing behaviour by producers. When markets consistently under-provide goods and services to specific segments of the population, as already explained elsewhere, the phenomenon is known as market failure. One glaring example of market failure is the lack of low-cost housing across the developing world and the egregious growth of slums in the larger cities. Other cases of market failure relate to education and health care in which across the world only a small minority has its needs met by private providers. In all such cases, the State has to intervene directly to correct market failures, and how it intervenes is very much determined by the prevailing political economy.

The same inequality holds true politically. While the poorest certainly have the vote in developing countries, their inability to articulate their needs has meant that political parties with populist manifestoes can usually obtain their support at the ballot box with extravagant promises and then proceed to do nothing. Moreover, in most developing countries, turnouts at elections are very low, rarely exceeding 55–60 per cent of those who are eligible to vote. Nearly everywhere in developing countries the poorest hardly ever bother to vote, such is their lack of faith, or interest, in the ballot box. Worse, middlemen like urban gangsters or powerful rural officials and personalities can dragoon the poor into voting and they can then deliver their vote en masse to the highest bidder. This is true not only in India and Pakistan but also in large parts of South-East Asia as well. Those who sincerely profess to have faith in the electoral process as an agent of social change need only look at the examples of India, Pakistan and the Philippines to see the tenuous nature of the link between the electoral process and development with equity.

The macroeconomic situation, in particular the size of the fiscal deficit, is an area of public policy with a huge impact on the lives of the poor. By and large, other than a tiny handful of the elite, ordinary citizens have no say in fiscal and monetary matters. But it needs to be emphasized that ongoing high fiscal deficits, especially those that are needed to finance current consumption, are nearly always a recipe for inflation and inflation has varied impacts. Inflation penalizes savers because low real returns on savings mean that savers are in effect either subsidizing banks or their customers. In addition, people in the poorest quintile can usually have their subsistence-level earnings indexed, and upper-income groups can effectively 'dollarise' their incomes, a large chunk of society belonging to the middle three quintiles, primarily those on fixed incomes, for instance, lack the means to be able to defend their earnings and consumption. This group will find its standard of living under constant pressure when inflation is high.

Pakistan has experienced high inflation for long periods of time, especially since the early 1970s. Inflation has averaged around 7–8 per cent per annum over the last two decades or more, a much worse performance than the economies of East and South-East Asia. This has caused people to lock their savings in inflation hedges, such as jewellery and real estate, or in foreign currency accounts, and it is natural that productive investment has clearly suffered in the process. High inflation has also led to a depreciating exchange rate. This has, in turn, massively exacerbated the burden of debt servicing on loans taken out in dollars or other foreign currencies for the country. With a foreign debt of around 40 per cent of GDP the consequences of exchange rate depreciation on debt servicing are severe. One obvious, though largely unstated, consequence has been that budgets for public services have been relentlessly squeezed. Inflation has had another deleterious consequence. It has shortened the horizon for decision-making and put a premium on get-rich-quick schemes where patronage and rent-seeking can and have played a decisive role.

The experience of East and South-East Asia suggests that rent-seeking and patronage can be effectively kept in check when a country opts to follow an export promotion strategy. As explained earlier, exports impose an external discipline on rent-seeking by curbing anti-competitive behaviour. Paradoxically, a depreciating exchange rate should help in that objective, but in Pakistan that has patently not been the case. The proviso here is that the country must have industries and enterprises that are globally competitive, not dependent for their survival on rigged markets, the manipulation of prices and unending access to bank credit. On the global competitiveness front, Pakistan's record in increasing exports has been exceptionally poor (and appears to have deteriorated further between 2010 and 2015). Not only has its share of international trade stagnated over the years but even its own export/GDP ratio has worsened significantly and now stands at under 12 per cent compared to a global average for developing countries of over 30 per cent and over 25 per cent now in the case of India. Pakistan runs a trade deficit of 6–7 per cent of GDP that is partially made up by home remittances equivalent to 3 per cent of GDP, but in terms of macroeconomics there is an annual funding gap of approximately 2 per cent of GDP that has to be met from foreign sources mainly in the form of loans. A steadily depreciating exchange rate should, on the face of it, have boosted export growth, but Pakistan has signally failed to exploit the opportunities offered by the global trading system. Indeed, the ending of the quota regime in apparel has been a huge challenge for the textile industry which it has not been able to meet. In the export of clothing, newcomers like Bangladesh and Vietnam have overtaken Pakistan in recent years. New exports, involving higher levels of technology have simply not emerged.

All the evidence from East and South-East Asia indicates that exports are a vital component of economic growth; their ability to curb rent-seeking is a bonus. Exports serve many useful purposes: they enlarge the size of markets for producers and facilitate economies of scale, they allow domestic savings to be converted into capital investments and they force domestic producers to 'up' their game in terms of technology, productivity and innovation. Domestic producers can become links in global value chains and thus avoid the need for substantial marketing efforts and expenditure. Indeed, the failure on the export front has produced wider repercussions. Pakistan has never been able to understand the value, or even the usefulness, of international competition as a spur to improving its economic performance and business people have taken refuge in rent-seeking in domestic markets. Regrettably, such behaviour has become the norm in the economy with price rigging, entry barriers and manipulation of markets common in huge swaths of the economy. It is remarkable that even the most inefficient units of production continue to survive in the economy whether in textiles, cement or sugar.[1]

Although, on the face of it, the structure of Pakistan's economy is comparable to that of middle-income countries, serious weaknesses exist in it. Large-scale manufacturing is still dominated by textiles which accounts for close to 60 per cent of value added in this sector. But the textile industry, Pakistan's oldest, is weak and uncompetitive. It is wracked by a range of difficult issues: unreliable power supplies, small size of individual units which leads to high per unit costs especially in spinning, persistent underinvestment in new technology and processes, poor management skills and lack of integration, save for a handful of companies, in global value chains. While the shortage of electricity is a serious problem, none of the other equally serious problems have been overcome by the textile industry. Overall, the industry has steadily lost its international focus; it increasingly caters to the domestic market for which it imports high-quality, long staple cotton from the United States and Egypt. But in the domestic market for low-end products, it cannot compete with China, for instance, in the production of cotton cloth blended with artificial fibres. Thus, far from being the leader in an export-promoting strategy, the industry is a net importer of raw materials, intermediate inputs and machinery. For 50 years or more, the textile industry has received a range of incentives and subsidies but has barely succeeded in maintaining its global share of output or trade. It has failed to contribute to the growth of new industries, say, the manufacture of higher-value-added products or of textile machinery.

Agriculture is similarly a case of low yields, both per hectare and per man. As a result, the cycle of low rural incomes and, hence, low domestic demand has never been broken as it has in East and South-East Asia. In fact, Pakistan is now faced with declining soil quality and water shortages at a time when individual holdings in the sector have probably fallen below their economically viable size. Some 86 per cent of 6.6 million rural households farm less than 50 per cent of the land, and about a third of the rural labour force consists of landless labour who together with very small farmers (owners of less than 2 hectares) account for the overwhelming incidence of rural poverty. But the chief cause of Pakistan's poor performance in agriculture is that there has never been a meaningful attempt at land reform in the country's history. The pattern of land tenure and the culture of the rural economy have precluded productivity-enhancing investments. Land reforms in East Asia were not only meant to limit the size of individual holdings; they were meant equally to incentivize farmers to increase their incomes by becoming more productive. Higher rural incomes made manufacturing viable by boosting demand for simple products like bicycles, sewing machines, household utensils, TVs and radios and cheap furniture. This virtuous cycle has never materialized in Pakistan.

Other than hard-to-measure retail services consisting of very small shops, services in Pakistan which account for 50 per cent of the economy are dominated by the financial sector and telecommunications. The latter are entirely foreign owned, while the former have substantial foreign ownership, perhaps more than 60 per cent. Only a quarter of the population is estimated to have bank accounts and access to credit is enjoyed by no more than 8 per cent of the population. On the face of it, this would suggest that the Pakistan economy does not require much credit. It is more likely, however, that the informal financial system dominates the small business sector in the urban areas and the rural economy where it is able to charge high rates of interest. No one really knows the true size of the informal financial system, nor its modus operandi. Within the informal banking system, given the size of the mark-ups or spread between the rates earned on deposits and the rates charged on loans, it is this sector where the incidence of rent-seeking would be at its prime. Relatively cheap funds, whatever their source (Islamic banks are one), are on-lent with massive mark-ups to borrowers. Such borrowers lack the ability to approach banks directly or do not have any proper collateral. More generally, even in the formal system there exists only a weak banking culture in the country. The management of debt by corporations is not taken seriously, and risk is poorly appreciated with very little by way of insurance or hedging services available. Banks are constantly rescheduling or writing down loans, non-performing loans (NPLs) are a recurrent nightmare and the spread between deposit and lending rates, hovering between 4 and 5 per cent, is one of the highest in the world. The system remains viable primarily on account of the low tax/GDP ratio and the ensuing monetization of the budget deficit which provides banks with ample liquidity on a day-to-day basis. In communications, mobile telephone services are one of the rare success stories of development in Pakistan providing good quality coverage at low prices, and there are close to 100 million subscribers. However, as every handset is imported and the entire sector is foreign-owned, the burden on the balance of payments must be enormous.

Pakistan has a modern system of laws that govern its economic life and regulate its corporate bodies through supervisory institutions such as the Securities Exchange Commission (SEC), Competition Commission of Pakistan (CCP), Oil and Gas Regulatory Authority (OGRA), National Electric Power Regulatory Authority (NEPRA) and Pakistan Electronic Media Regulatory Authority (PEMRA). These bodies have been empowered to counter malpractices in the economy by corporate bodies. However, the impact of laws is wayward at best and corporate bodies either drag out legal proceedings in the higher courts or take their responsibilities to the wider public very lightly. For their part, the higher courts not only allow cases to carry on for years without a proper hearing but have acquired little, or no, expertise in matters concerning the laws and practices that regulate the economy and commerce in the country. It is remarkable that in its entire history no corporate officer or, indeed, the owner of an enterprise in Pakistan has ever been convicted and punished for any corporate offence. Regulatory capture not only is rife but also has encouraged a culture of ignoring or manipulating the laws and functioning of markets to become the norm in the corporate life of the country. There are over 600 companies listed on the Karachi Stock Exchange with a market capitalization equivalent to $50 billion is deemed to be moderately overvalued. The ten largest companies account for about a third of market capitalization which indicates that the average size of a listed company remains modest by the standards of East and South-East Asia (the market capitalization of the Thai Stock Exchange, for example, is roughly ten times that of Karachi and the largest Thai companies would dwarf their Pakistani equivalents). Small companies are family-run concerns, are poorly managed and spend little on innovation. Moreover, the free float of shares available for trading in the stock exchanges on a daily basis is worth a mere 1 per cent of its market capitalization. The stock market is thus not an effective agency for raising capital by new companies nor have investors shown much interest in the few innovative companies that have listed over the years. As a result, stock markets in Pakistan enable existing enterprises to access public savings but provide little protection to minority shareholders.

The political economy of Pakistan in an historical perspective

How has Pakistan reached this cul-de-sac in its economic history? At the time of independence in August 1947, Pakistan was governed by a quasi-secular political party, the Muslim League. Having separated from India, the party was driven by the need to justify the country's separate existence through economic progress, although a massive influx of some 6–8 million refugees from India after separation must have overwhelmed its fragile economy and administration in the first few years. Decisions about spending more on, say, education and health would therefore have been kept in abeyance, survival being uppermost in the minds of both decision-makers and the general public. What then might have been the general approach to economic management at the time? It is worth noting that, other than some minor exceptions, the senior membership of the party was almost exclusively drawn from the rural landowning class in what is now Pakistan. The party did have a fairly populist economic programme (drawn up before independence in 1946), but this was based on little more than pious statements of intent with no serious discussion of the underlying issues, especially the critical lack of resources in the country.

As very few of Pakistan's political leaders had held public office in undivided India much of the day-to-day governance, including policymaking, was left in the hands of senior civil servants – in fact, even the first two finance ministers of the country were both ex-civil servants. It is hardly surprising that there was a conservative, somewhat authoritarian, business-as-usual slant in the way the economy was managed in the initial, financially straitened years, almost as if the British had never left. There was a brief respite during 1951–1953 when the Korean War caused an international boom in commodity prices and Pakistan enjoyed strong export growth in these years. This allowed some of the more draconian restrictions on imports and investment to be lifted and a partial return of business confidence in the country followed. However, significant failures of the wheat crop in 1952/53 and in 1953/54 and a fall in cotton prices soon put paid to Pakistan expecting a more sustained, investment-driven period of GDP growth. On the contrary, growing tensions with India on account of the unresolved Kashmir dispute increased defence expenditure and effectively pushed a more development and socially oriented agenda into the background. It is also the case that throughout these years, nor in subsequent years, Pakistan's fiscal position never really stabilized with the country running substantial budget deficits that were, in turn, monetized. While runaway inflation was avoided, the precarious nature of the country's finances and economy were partially instrumental in Pakistan beginning its long and tortured relationship with the United States with the signing of the Mutual Defence Agreement of 1954 and joining the US-led South-East Asia Treaty Organisation (SEATO) and Baghdad Pact, later renamed Central Treaty Organisation (CENTO).

The relationship with the United States did allow the resource crunch to ease to some degree and Pakistan formally issued its First Five-Year Plan in 1955 (a continuation of the 1948 Plan which was never implemented on account of the severe resource constraint and trade problems with India after the latter's exchange rate devaluation). The Plan was to have an outlay of Rs 9 billion (or $2 billion)[2], but crucial issues of resource generation, public spending priorities, policies for industry and the public and private sectors were cast in terms of homilies than in the form of well-thought-out programmes of action. There was, however, initially a strong recognition that as the shortage of foreign exchange in the post–Korean War phase was the main constraint on investment, the country would need to follow an import-substituting strategy of economic growth. Foreign exchange was strictly rationed, import licenses were needed for all imports and, by corollary, investments would also need prior government approval for which finance would then have to be obtained through public sector bodies like Pakistan Industrial Credit and Investment Corporation (PICIC), the Industrial Development Bank of Pakistan (IDBP) and the Agricultural Development Bank of Pakistan (ADBP).

Though nominally the economy was primarily in the hands of the private sector, this was against the background of heavy intervention by the State needed for the issue of licences, permits and approvals without which no private sector investment could be realized. In fact, the Pakistan government established the PIDC (Pakistan Industrial Development Corporation) to set up industries, such as cement, where the private sector was reluctant, or unwilling, to invest. With the benefit of hindsight, it might be said that both rent-seeking and patronage were born in the 1950s as success in dealings with the relevant government agencies depended almost entirely on the investor's ability to influence the civil servants involved rather than on the merits of the investment proposal per se. Research by the Pakistan Institute of Development Economics in the 1960s into the long-term economic viability of much of the manufacturing industries set up actually showed that when shorn of all the explicit and implicit subsidies provided by the State, the industries actually resulted in *negative* value addition for the economy. It seems now as if the State itself had concluded that patronage was an easier way of economic management than reliance on arm's length decision-making based on merit. Pakistan thus acquired very early in its history a ruling elite consisting of a coalition of business interests, civil servants and politicians dividing up national resources for their own benefit. From 1958 onwards, following a military coup, officers from the armed forces also joined this group. Very soon the group had become, through intermarriage and other forms of formal and informal bonding, a broader social identity capable of self-perpetuation and of tenaciously protecting and promoting its own interests.

The Second Five-Year Plan was launched in 1960 under more auspicious circumstances. It had a planned outlay of Rs 19 billion or $4 billion and delivered on all its main objectives. The 1958 coup had changed Pakistan for the better outwardly but only for a brief period of time. A more business-like approach to economic management had emerged with a more confident private sector leading the way, especially in the development of the textile industry and in attracting some FDI in a number of hitherto undeveloped sectors of the economy, such as pharmaceuticals, though never on the scale of the economies of East and South-East Asia. The 1958 government also initiated reforms in agriculture, education and export promotion ostensibly to drive long-term economic growth. During the Second Five-Year Plan, the parliamentary system of government was done away with and a restricted franchise was introduced for elections. The rationale for this was that a centralized presidential system based on an indirect franchise was likely to be more stable and more conducive to efficient decision-making in the country. The general reaction in the country, however, was one of indifference, and the results of the Second Five-Year Plan were unspectacular for the country as far as the reforms were concerned.

This was particularly true in the rural economy and in education. In agriculture, a nominal programme of land reform was begun with very generous upper limits on the size of individual landholdings. In other words, there was no real attempt at reforming the land tenure system that was the principal weakness in the sector if not in the economy itself. Even in education, where no strong vested interests were involved, virtually the entire emphasis of reforms was on the tertiary stage, that is, universities, to produce better managers and leaders, not to have a literate and not on a more productive population. There was a general discussion of primary and secondary education which mainly dealt with the need to improve the quality of instruction and syllabi in these stages, but with little or no discussion as to how low literacy rates, especially female literacy, were going to be improved in the country and what would be needed from the State in terms of extra expenditure on building new schools, training teachers and providing incentives for poor families to send their children to school – a failure that persists even today.

In foreign trade, a rather convoluted attempt was made with advice from a German academic to shift the overall focus of policy attention from import substitution to export promotion, but it only achieved mixed results. With the emphasis on export promotion, the Bonus Voucher Scheme introduced multiple exchange rates in the economy. This had the effect of complicating economic management further and significantly muddying the investment climate. The Scheme introduced a plethora of exchange rates, all centrally administered in the Ministry of Finance, but essentially how the system worked was that it devalued Pakistan's currency for some exports and for some imports at different rates; the whole of foreign trade thus became subject to whimsical administrative control. The Bonus Voucher Scheme certainly helped in boosting some exports over the short term. However, the multiplicity of exchange rates – all at the mercy of bureaucratic fiat – introduced a gratuitous new element of uncertainty in the economy. The uncertainty clearly dampened investment activity; indeed, most people expected the scheme to be abolished sooner rather than later. In the process, many investors adopted a 'wait and see' attitude and postponed their investment decisions.

Looking back at the post-1958 years up to the 1965 war with India, the popular view is that these were the best years for Pakistan's economy. The economy grew at over 6 per cent a year and a middle class began to emerge. However, it can also be said that unlike, say, in East Asia not one of the reforms can be said to have left a mark on the wider society in the form of greater participation in the economic and social dynamics of the country. Nor did the elite understand or accept the discipline of modernization. It clung to its privileges with increasing determination. In fact, wealth became more concentrated in Karachi, although a new class of Punjabi industrialists also emerged, and the growing disparity between West and East Pakistan in investment, both public and private, and in incomes eventually led to the acrimonious break-up of the country.

Prior to the break-up, buoyed by the apparent success of the Second Five-Year Plan, Pakistan had embarked on an ambitious Third Five-Year Plan to run from 1965 to 1970. Notwithstanding the 1965 war with India, the first three years ran roughly according to the Plan, driven mainly by high levels of investment, including foreign investment, and industrial growth. In the public sector, decisions to build large hydroelectric and irrigation projects were taken and implemented while the green revolution visibly improved the rural economy. But this progress was accompanied by growing urban social unrest that can only be understood in sociological terms. Expanding numbers of the middle class with high aspirations had to confront the reality of stagnant real incomes and virtually non-existent public services, notably good-quality education. A growing disconnect between their aspirations and the ability of the economy to satisfy them emerged. Moreover, the safety valve of jobs in the Gulf had yet to open as an option for the people. Persistent and growing unrest led to another change of regime in which one military dictator handed over power to another. This led to a chain of events that saw the break-up of the country into Pakistan and Bangladesh in December 1971.

Following break-up, the Pakistan economy underwent a radical change under the left-leaning and more populist regime of Zulfikar Ali Bhutto. Significant chunks of the economy were nationalized, and new industries were set up by the public sector in highly capital-intensive sectors like fertilizers, oil refining and steel. More strikingly, perhaps much of education was also nationalized, and the goal of free schooling for all finally registered on the national political consciousness, not to mention the radical slogan of *roti, kapra aur makan* (food, clothing and shelter) which incidentally predated the *garibi hatao* (remove poverty) aspiration of India's Congress Party in the 1971 elections in India. On the general policymaking side, given the inherent uncertainty in making worthwhile economic projections, five-year plans were effectively abandoned and were replaced by the ADP, the Annual Development Programme, and the Budget as the main policy implementation instruments on the part of the government. While superficially these changes heralded a better balance between resource availability and resource use (domestic and foreign), the public and private sectors of the economy and greater recognition of the needs of the poor in society, in actual fact very little was achieved on the ground.

There were several reasons for this. First, while the elite liked to pretend otherwise, the country lacked the needed financial resources and administrative ability to manage a nationwide programme of free schools, especially in the backward rural areas with their completely different social dynamics. Moreover, free schooling is not simply a matter of building schools. It is predicated upon a huge and sustained programme of inducting dedicated and quality teachers, having the requisite teaching materials, such as textbooks and laboratories, and having curricula that lead to the acquisition of useful knowledge and skills by poor children to facilitate their entry into jobs – a tall order by any standard. Second, neither the rural nor the urban population had been trained, or even made aware, that most social programmes would need to be implemented on a largely self-help basis with minimal support from the State. Third, Bhutto's own personality became a major impediment in the successful implementation of the programmes of his government. He often appeared to take decisions based upon a quirky calculus of personal likes and dislikes. He thus often succeeded in doing more harm than good, sometimes gratuitously adding to the growing list of his opponents and enemies. The nationalization of rice-husking mills and cotton ginning factories, for example, was devoid of any economic or political rationale. Fourth, there was no attempt at redressing the imbalances in the rural economy between the large and small landholders with the former exerting disproportionate control over the latter. A land reform was initiated in name; its results on the ground were next to nothing. The big landowners continued to hold sway in large parts of the country, but more particularly in the province of Sind as they monopolized access to social infrastructure-like extension services and credit.

The ouster of the Bhutto government in 1977 by Zia-ul-Haque, and the subsequent execution of Bhutto in 1979 saw a radical reversal of the reforms that had been begun during his tenure. All nationalized industrial units were gradually returned to their previous owners, and a programme of public sector divestment began. Other parts of the policy agenda, such as free schools, were quietly pushed aside by allowing a plethora of private investment to take place in all stages of education, enabling the well-off to opt out of the official system altogether. More fortuitously perhaps, from 1979/80 onwards, following a second large increase in oil prices, there was a massive outflow of workforce to the Middle East and the Gulf to take part in the construction boom. This not only eased Pakistan's economic situation but also acted as a safety valve for the domestic jobs market. By the mid-1990s, a remarkable 2.5 million Pakistanis had made their way to jobs in Saudi Arabia, the UAE, Qatar, Oman and Bahrain from where they sent back $700–$800 million a year and boosted Pakistan's foreign earnings substantially. These developments also coincided with Pakistan playing a critical role on behalf of the Western powers in Afghanistan and becoming the recipient of significant economic and military assistance in return. These extra resources led to a new bout of private sector-led investment activity in the country, in textiles, cement and sugar. GDP growth rates improved, and for a brief period there was a welcome increase in exports.

The Zia-ul-Haque government ended abruptly in 1988 when he and a number of senior army officers were killed in a mysterious air crash. His government was followed, to use a cricketing term, by two 'truncated innings' each by Benazir Bhutto and Nawaz Sharif that took the country to 1999 when General Musharraf ousted Nawaz Sharif in yet another military coup. Prior to the coup, Pakistan had passed through another crisis when, after its nuclear test, the country was put under a variety of economic sanctions by the Western powers. But though the sanctions made a bad situation worse, there was no doubt that the Pakistan economy had lost its vim and was significantly underperforming in the 1990s. The experience with both democratic governments was highly unsatisfactory. Even a cursory overview of the performance during the 11 years by the two governments with supposedly popular mandates suggests that these were essentially holding operations designed only to manage the decline in economic performance, and not begin a programme of economic renewal. Neither government appeared to have a proper grasp of what was required to implement a serious development agenda in terms of resources and priorities.

Both the Benazir Bhutto and Sharif governments were weak in both formulating a realistic development strategy and in implementing it with the right policies. This had inevitable effects on the economy. This was the time when the contrast between Pakistan and East and South-East Asia was becoming glaringly obvious as East and South-East Asia started to grow rapidly and move towards middle-income status. There was no push to reinvigorate the economy, say, through an export drive and no major public sector initiatives, whether in infrastructure or in the social sectors to boost productivity. A Lahore–Islamabad highway built at a cost of nearly $1 billion exemplifies the priorities of the Nawaz Sharif government. The road has certainly eased travel between the two cities for the car-owning population, but its wider economic benefits for the country remain unknown. Overall, not only did GDP growth decline but, with the continuing implementation of the neoliberal economic agenda, social indicators suffered significant slowdowns and the incidence of poverty increased. It seemed as if the idea of development combined with social justice had been either mislaid or, more accurately, forgotten and abandoned. Education and health were the main casualties, but experiments in the privatization of public sector enterprises left the country with a vastly expanded array of rent-seeking and patronage options. The drive to be externally competitive became weaker every year, and during this period massaging official statistics also began to occur.

The 20 years between 1979 and 1999 must be remembered as the period when Pakistan lost its focus on, and any serious interest in, economic issues as it became increasingly trapped in a range of identity and security uncertainties. The governing elite became increasingly preoccupied with the nature of an Islamic polity in the country. But questions about how it might be reconciled with the needs of economic modernization and development were largely ignored. The country also became fixated with a variety of foreign and domestic threats, real or imaginary. The Afghanistan problem and the ongoing ups and downs of relations with India provided ample justification for this shift, but these were not just the fears of the elite; the country as a whole (the media, universities, even minor opinion formers in civil society) bought wholeheartedly into its fears. The country became visibly more inward-looking and less inquisitive about the outside world. In view of Pakistan's poorly performing economy, the ruling elite had perhaps concluded that engaging with the outside world, economically, politically and culturally, was likely to prove too difficult and not a little discomfiting, especially in view of the rapid strategic shifts in economic activity and global influence that the rise of China and other East Asian economies had set in train. Pakistan's own understanding of the world has always been one that has been based on the datum of the continued domination of the West under the leadership of the United States. In this scheme of things, an aggressive projection of identity and security issues took precedence over the pursuit of a clear-cut and more overt, inclusive development agenda. The Pakistani diaspora in America and Europe became part of these identity issues. Development and social justice were thus willy-nilly downgraded not just because of the resource constraint but also because other matters had become, emotionally at any rate, far more important and pressing for the country and for its diaspora. By 2010, interest in the success achieved by East and South-East Asia was close to zero amongst Pakistanis, whether in the ruling elite or in the wider body of opinion formers.

The elite's fears were, if anything, enthusiastically shared by the rest of the country as revealed in opinion polls. Judging by the tone and content of the Urdu press, the mood in nearly the entire country was one of sullen indifference towards the rest of the world. Both officially and privately within the country, a huge increase on defence and security spending was accepted as being unavoidable. The idea of national identity and citizenship lost whatever little meaning it might have had in the past, and narrow ethnic and religious narratives became pre-eminent. In the process, society became more atomized and the quality of governance declined by the day. Ethnic tensions, especially in Baluchistan and Sind, multiplied, and with the ushering in of a more austere, religiously bounded conservative atmosphere, the intellectual space for a more rational discussion of policy choices for the economic and social progress of the country became confined to the opinion pages of English newspapers. From the outside, it almost seemed that as Pakistan now possessed nuclear weapons, nothing mattered on the economic front. Ironically, these trends actually encouraged a sense of victimhood in the country as for most people job opportunities failed to keep up with a rapidly growing population.

Against this background, the Musharraf coup of 1999 was almost universally welcomed in the country. But the euphoria was short lived. As any new government in Pakistan quickly finds out, the hiatus between high-flown rhetoric and reality is simply too big to be wished away, irrespective of official proclamations. The first problem is of course the perennial problem of inadequate resources. The second is administrative capacity. The third is the lack of a functioning social contract which adds to conflict and chronic social instability and skews decision-making. The hopelessly inadequate efforts of civil society cannot overcome these difficulties nor, for that matter, fill the intellectual vacuum. These impediments mean that even a well-meaning government, seriously interested in making development its priority will come up against issues that can only be addressed realistically over a long period of time, whereas the temptation to make unrealistic promises about time tables is irresistible. Indeed, had the problems of administrative capacity and the social contract been not so severe, the Musharraf government might have been able to deal with the resource constraint: post-9/11 Pakistan not only acquired international acceptability that it had lost following its nuclear test in 1998 but also won substantial reductions in its international debt. Additional resources were there to be deployed had the country's social contract permitted.

But in the 2000s, and throughout its history, Pakistan's collective social preferences have never given education or, indeed, other social issues, particularly high priority. Every now and then the country endures a chorus of fine statements of intent, and some tentative forward movement but with little happening that is of any durable value. Without a compelling social contract, Pakistani society is wracked by apathy, suspicion and indifference.

The second problem of the Musharraf government was its uncritical acceptance of neoliberal ideas as the way ahead for the Pakistan economy. There are many reasons why the ideas of free markets and privatisation fell on such willing ears in Pakistan. First, much external assistance has been, and remains, conditional regarding the neoliberal ideas being accepted and pursued by Pakistan. Second, over the years the quality of debate on crucial aspects of economic policy and more specifically long-term development policy has declined visibly in the country. Whether it is in the universities, in the country's few research institutes or in the media, contrarian views that challenge those held by the World Bank, IMF and ADB barely figure in the debate on national issues. The Washington Consensus has been accepted with hardly a murmur of protest in the country. Third, neoliberal nostrums seem to chime well with the dynamics of a rent-seeking society as everything that happens can be attributed to the workings of impersonal global market forces. Fourth, it must also be conceded that Pakistan's experience with the public sector, whether as a producer of goods or in the delivery of services, has been deeply unedifying. Other than during the first two decades, when bodies like the PIDC and WAPDA were established and did a respectable job, the public sector has been simply unequal to its responsibilities as a counter to the depredations of the private sector. On the contrary, the contribution of the nationalized banking system to a corrupt political culture has been substantial and in all likelihood essential. It is important therefore to understand how social preferences in a country like Pakistan come about in the first place and how they are then converted into policy action by the State.

The political economy of choice

Since the 1980s, Pakistan's long struggle to achieve economic growth and social progress with inadequate resources, its preoccupation with security issues, its apparent indifference towards the problems of poverty and its uncritical acceptance of neoliberal ideas (even in the wake of the global financial crisis of 2008) have posed huge challenges for the promotion of an agenda based on collective sense well-being. For instance, the idea of a redistributive tax regime seems to be politically, and administratively, out of the question. How development spending and, more specifically, social spending will be financed thus remains an awkward and unanswered question about which no honest discussion has ever taken place.[3] In the post-2000 world, every developing country is both morally and politically committed to raise living standards, especially of the poorest in society, and to make its people more productive to that end. It is also incumbent on developing countries to enable the poor to participate in the process of development by taking advantage of the opportunities that it brings, such as jobs and higher incomes, as the first step out of poverty. The poor also need to be enabled to access decent education and health services if they are to participate in, and contribute to, the development process in a meaningful way. Such views may sound paternalistic; but, in fact, as already argued, they constitute the bedrock of sustained development as the experience of East and South-East Asia amply demonstrates. What choices have Pakistan's decision-makers made as regards the trade-offs involved and what might lie ahead now?

We have already seen that development as defined in Chapter 1 ceased to be the core objective of the State from the early 1990s. Without corrective action, the social sectors were neglected and inequality increased in society. Once inequality has become embedded in society, the poor, according to the Indian anthropologist Appadurai (2004), are encouraged to subscribe to norms to further diminish their dignity. Thus, these norms result in 'constraining preferences' in a self-fulfilling system where the poor demand little and are given or offered even less. Pakistan's constrained preferences since the 1990s have their origin in the rural economy, as a result of which there has been a systematic neglect of education and basic health facilities in the rural areas. Thus, the rural poor have not only remained poor but have contributed to, and perversely confirmed, the prevailing attitudes about their fecklessness.

By far the most noteworthy example of this attitude has been the failure in Pakistan to reform the system of landownership and tenure. Historically, the need for land reform, as for instance in East Asia, has been driven not so much by a need for economic and social justice but by the need for higher productivity in the rural economy. In Pakistan, every attempt at land reform has been a sham. Indeed, the few attempts at reform have actually tended to benefit the well-off, thus exacerbating the incidence of inequality in the rural areas. Now even the sham of land reform has been abandoned. In the absence of land reform, there is little reason for hoping that other institutional improvements, such as community development, wider agricultural extension services and a more equitable distribution of credit, will not be successfully thwarted by the well-off too. What this means is that the exodus of the rural poor to city slums will continue where there are few opportunities for gainful employment adding to the 'dead weight' problem posed by poverty. With the public sector now more or less in full retreat in Pakistan, the urban poor face a lifetime of uncertainty in the form of sporadic and casual employment and few opportunities to educate their children and to bring up their families in a stable environment. Whatever its previous failings, without the strong intervention of the State and the public sector to address these issues, the future is bleak indeed.

The fundamental problem of both rural and urban poverty in Pakistan is that the poor have not really been given the education and skills to make them more productive. They thus cannot find the means to escape the limits imposed on them by the constrained preferences of the social system. Even if the economy were to grow strongly in the years ahead, this would only defer the underlying problem, not resolve it. A strongly growing economy may well generate jobs (mostly informal) and higher incomes; but it will not automatically provide the public goods – the schools and health facilities – without which development will not be sustainable in the years ahead. That must remain the job of the State.

In this context, it is worth recalling Gunnar Myrdal, who said that 'history is not destiny but is man-made' (1970). Where Pakistan stands today is the result of what has happened over many years, and its future rests on the decisions it will take now and over the next few years. How will Pakistani society realize what is required of it in terms of meaningful change? And how will it respond to the needs of development and the modernization that it entails? The answer has several parts, and they are more fully discussed in the concluding part of the book. For now, the following need to be stressed: first, Pakistan's capacity to undertake radical reforms is indeed limited. This is because of both the resource constraint and the country's weak administrative capacity. Announcing measures that have little chance of being implemented therefore only breed cynicism and despair. Second, from a political economy perspective, the ruling elite are primarily interested in preserving the status quo in which rent-seeking has become institutionalized. In the status quo, the needs of the poor are not the primary concern of the elite; their own standard of living is. Within the elite, there is a partial, mainly academic, acceptance of the need for change. But, at the same time, any change that happens must take place with the utmost caution so as not to disturb the existing pattern of social relations and rewards. These rather contradictory views are on display in the commissions of enquiry that successive governments in Pakistan have appointed (for instance, on taxation alone there have been several, one every decade or so) and then proceeded to ignore their findings. Third, both the urban and rural poor understand the nature of their life chances; they do not expect miracles in their lives, but they do expect some degree of hope. But because of past failures they are now sadly prone to drift into religious fanaticism, ethnic jealousies or plain criminality. Indeed, such is their lack of faith in the future and acceptance that nothing will change that even at relatively low incomes the poor somehow feel happy in their lives, a remarkable finding, given the poverty and low social development of the country (Happiness Report 2015).

Given these issues, how will Pakistan's political economy be able to tackle poverty seriously and make development its overriding concern? In other words, how can the exercise of choice, whether by the State or by enterprises and individuals, be made more rational, less self-centred and more forward-looking? As far as the State is concerned, it has been established that development is multi-faceted and goes beyond jobs and higher earnings. If conceived only as growth in per capita incomes, it will not be sustainable over the long term, as Pakistan's brief spurts of GDP growth can testify. The urgent question is to find the resources to ensure the provision of public goods in education and health. In poor societies, such choices also pose huge challenges for administrative capacity. As the existing administrative arrangements have failed lamentably in their ability to manage programmes efficiently, the answer might lie in using the existing networks of extended family and community and delivering the public goods through them (as was alluded to in Chapter 1).

In this regard, Pakistan has to make a conscious effort to unlearn its own past and learn from the experience of others. There is no magic bullet available.[4] Progress will be slow and uneven, but there is no viable alternative. On an optimistic note, the fight has already been won at one level. No one in the country doubts the value of education. All that is needed is for it to be provided widely and with serious intent. Health services, on the other hand, are more expensive and pose more complex problems of delivery. Here, too, it is sustained provision that is lacking. Since the State cannot realistically provide comprehensive health coverage to the population for a long time to come, a good starting point would be to concentrate resources initially on maternal and child health and nutrition. It has also been argued that under some circumstances development itself may incentivize the elite to invest in public goods. If this happens, so much the better. Indeed, such an approach should allow the elite to reap the benefits of higher economic growth triggered by the accumulation of human capital and the availability of a larger market. In such circumstances, investment in public goods could become the forerunner of a virtuous circle of self-sustaining development.

As far as rent-seeking is concerned, the State now has little choice but to use its fiscal muscle to reorient the private sector towards greater international competition and an export drive. Ignoring the problem will not only accelerate damaging polarization in the country but also send the economy into a downward spiral from which it may not recover. Competing with the outside world should take care of rent-seeking, at least in manufacturing industry. This has been the route taken by East and South-East Asia. The idea that in the long term building an international reputation of high quality in production is a far better strategy than rent-seeking will take time to sink, but is viable. Other societies have managed it. Pakistan's Chambers of Commerce, especially those of the smaller towns, could be the vehicles for changing mindsets. Altering the perceptions of the rich elite in this manner is the only way that relatively honest enterprises can free themselves from the unwelcome attention of rent-seekers in the country, who wish to have an easy life, form cartels and manipulate markets. In the outside world, new opportunities in terms of goods, technologies and markets are constantly arising. Since the 1970s, it is the economies of East and South-East Asia that have grasped these opportunities while rent-seeking economies like Pakistan have been bypassed. Their role in the global economy will inevitably shrink further as without producing added value in goods and services and becoming internationally competitive will be progressively more difficult to extract economic rent from the economy.

A progressive agenda in politics will also be needed so that participation in decision-making can be extended to those whose views are currently barely audible. The question is the direction of causation. From the experience of East and South-East Asia, it is patently obvious that more inclusive economic development can, and has, driven political change towards greater participation. In Pakistan, there is a strongly held view that democracy (defined simply as periodic elections) is an essential prerequisite for development. The relationship between democracy and development is discussed more fully in Chapter 8. Suffice it to say here that the two are weakly correlated, as causality can flow in both directions depending upon the level of development. It is self-evident that a period of strong economic growth will modify not just the institutions that drive growth but also the underlying social relations, behaviours and culture. As Nicholas Stern et al. have stated that under some circumstances growth and development may give elites an incentive to facilitate the emergence of a middle class (Stern et al. 2005). It could also be the case that growth will gradually reduce the power of the elite. This happens when growth starts to benefit larger sections of society beyond the narrow confines of the elite and its friends and supporters. As a result, the political elite themselves come to be drawn from a wider social spectrum in the country, and this dilutes their rent-seeking power. Investing in public goods, such as education, remains one of the few instruments that promote both economic growth and radical social change in developing countries.

In the exercise of political choice, it is necessary, however, that we should not overstate the case for education. In a country like Pakistan, a large number of cultural factors almost certainly inhibit the ability of the poorest sections of society to take advantage of the few opportunities that do come their way. Remote and marginalized communities, especially those living away from the larger urban centres, find themselves excluded from education, housing, credit and even voting in elections. Exclusion can take place on the basis of gender, class, religion and language. Moreover, entry into education may require the payment of fees (formally or informally) that the very poorest cannot afford. It is obvious that simply being poor is a massive disadvantage even when the State is able to make investments in the relevant public goods. Indeed, such disadvantages can become endemic and permanently exclude the poor from exercising any choice in their future.

Looking at the situation in both the rural and urban areas of Pakistan, two basic observations follow. First, most of the poor consider the impediments they face in their daily lives to be inevitable and are effectively resigned to their fate. Second, this certainly does not mean that they regard the situation as being fair. Far from it. A chronic sense of injustice in highly unequal societies usually manifests itself in low-level, non-confrontational forms of resistance that undermine the authority of those who are in charge without completely destroying the system. In Pakistan, we can see the evidence of this attitude in the indifference towards the general public that virtually all institutions display in the country. In such an atmosphere, when efforts are put in train to improve governance, after an initial period such efforts run into the sand. The price that has been paid for this quasi-apartheid is endemic inefficiency in the lives of the people, lower productivity across all sectors of economic life and a pace of development that has produced very little change for the majority of the people of the country. No society should be expected to be satisfied with such a deplorable state of affairs.

6
Regional Economic Cooperation in South Asia and South-East Asia

Why regional economic cooperation?

Since the 1980s, globalization has been a major driving force in international economic relations. More open markets and fewer restrictions on capital flows have made for a huge increase in global trade and capital flows, especially FDI. Globalization has enabled export-driven economies to exploit the opportunities of freer trade to capture new markets and to exploit scale economies. East and South-East Asia have been major beneficiaries of globalization; South Asia much less so. In this regard, it would be appropriate to reiterate that, based on one of the least contested axioms of classical economics, international trade promotes economic growth. Countries and, indeed, regions within countries can specialize in doing what they are best at and continue to improve at what they are doing. The rationale for cross-border trade can be summed up in three ways: one, different goods (outputs) require different resources (inputs) in different proportions; two, such resources are unevenly distributed in the world; and three, while some resources can be internationally exchanged, the costs of transporting them can make their exchange commercially unviable. It is therefore more rational economically to transport the finished goods than the resources or inputs that go into their production. It is well to remember that, unlike individuals, countries do not specialize in making only one output; even the largest importers of, say, textiles and clothing will still be making some textiles and clothing within their own borders. The gains from international trade are ultimately based not on *absolute* but on *comparative* advantage so that even the largest textile importers could still be producing high-end products in the textile industry. Italy is a good example of this. South Asia is a late convert to boosting exports, but unlike East and South-East Asia the conversion is incomplete.

It needs to be remembered that comparative advantage is a dynamic concept and global trade is not a zero-sum game; all countries can benefit from it. New production methods, new production inputs, such as a more educated workforce, and improvements in transport and logistics can change, and have changed, the relative production efficiencies obtaining in different countries, thus changing comparative advantage radically.[1] As a result, countries that were major producers and exporters of certain goods have lost their comparative advantage and have become major importers of the same goods, but they have simultaneously gone on to specialize in other goods. The textile industry is a notable example of this phenomenon after the Second World War, as is the production of household electronics such as TVs and, more recently, virtually the entire information technology industry with its software and hardware components developing simultaneously in different parts of the world.

Following the First World War, as countries struggled to recover from the disruption that the war had caused in the global economy, many placed restrictions on the free movement of goods. A variety of restrictions of different levels of severity came into being: quotas, tariffs and exchange controls and subsidies for domestic producers. The justification for these restrictions was that countries needed to protect jobs and employment at home. Another justification was that for some countries the gap between their exports and imports was too large and some way of limiting imports had to be found. But international trade is a two-way process: one country's imports are another country's exports. Thus, there was the possibility, if not the probability, that the exporting country or countries would retaliate in some way to counter the restrictions placed on their exports. And, if a sufficiently large number of exporting countries did so, the whole of international trade would be affected and the gains from specialization effectively lost. Not only that, consumers across the world would be made to pay higher prices for protected industry goods and such industries would be shielded from foreign competition, giving rise to the near certainty of rent-seeking behaviour being encouraged in these industries and in these countries.

Following the end of the Second World War, an agreement between 23 major trading countries known as GATT, the General Agreement on Tariffs and Trade, came into being with the objective of reducing tariffs and dismantling other barriers to trade. A series of negotiating rounds culminated in the conversion in 1994 of GATT into the WTO, the World Trade Organisation. Membership of the WTO means that all economies are entitled to the same set of privileges and obligations in their trading relations vis-à-vis other members on a reciprocal basis. Furthermore, the WTO is now tasked with the responsibility of policing the global trading system to ensure that all members are carrying out their obligations. This is based on the presumption that a globalized trading system can formalize national rivalries, and by containing conflict make international trade a positive-sum game.

GATT was a global attempt at regaining the benefits of free trade after the Second World War and was therefore slow moving in achieving agreements on the many complex components of trade, such as FDI and intellectual property. As a result, several smaller groups of countries felt the need to increase economic cooperation at a regional or subregional level and form economic cooperation agreements as a ‘second best’ alternative to global trade free of restrictions. Such agreements had many variants – a free trade area, a customs union, a common market, a full-fledged economic union – but all were expected to lead eventually to the benefits of international trade without barriers and quotas. The European Economic Community, the forerunner of the European Union (EU), was the first to be established by six developed countries of Western Europe in 1957. Thereafter, a number of other economic cooperation agreements have been set up across the world between sets of both developing and developed countries. The one common feature of these agreements is that members are either neighbours or physically proximate to one another. In other words, the countries agreeing to participate in economic cooperation tend to be natural trading partners.[2]

From the perspective of this chapter, the two agreements that are of interest to us are SAARC, the South Asian Agreement on Regional Cooperation, and ASEAN, the Association of South-East Asian Nations. The differing performances and impacts of SAARC and ASEAN explain why some attempts at economic cooperation have been more successful than others. A comparison of SAARC and ASEAN also highlights the importance of how a shared vision of development through economic cooperation between disparate nations can help to overcome long-standing national rivalries. Unfortunately, a common culture and other affinities have been of little or no significance in the case of SAARC, and the dysfunctional nature of development in South Asia has even thwarted attempts at regional economic cooperation, so intense have been the political rivalries and suspicions between the member states.

SAARC and ASEAN

SAARC was formally established in 1985 and now has eight members. Total GDP is around $2.0 trillion but total intra-trade amounts to only $20 billion. The seed of greater economic cooperation in South Asia had been germinating for many years before, perhaps from the 1950s onwards. The first oil shock of 1973/74 followed by the North-South dialogue gave the idea of regional economic cooperation a major boost. The point worthy of note in this regard is that the bulk of SAARC was an integrated economic area up to the 1940s so that the physical infrastructure for greater economic cooperation already existed and notionally could be brought back to life with minimal expense if political rivalries could be somehow softened. SAARC does now have a secretariat and is supported by a number of regional centres that deal with cooperation in important-sounding sectors such as agriculture, human resources, energy, development and culture; and trade itself is on the agenda in the form of South Asian Free Trade Area (SAFTA). Indeed, some tentative steps towards trade liberalization began in 2006 under the tutelage of the SAFTA Ministerial Council comprising the Commerce Ministers of member states, and a programme of duty reductions was initiated in 2009 for intra-SAARC trade. In the realm of theory at least, a full-fledged SAFTA is supposed to be implemented at some point in the future. Indeed, ministerial and heads of government meetings are a regular feature of SAARC suggesting that it could happen one day. The truth of the matter, however, is that despite its age and the wide range of activities that SAARC has become involved in, there is a complete absence of political will to take the difficult decisions and make the required compromises that will lead to the establishment of a genuine free trade area. Evidence for this scepticism can be found in the fact that agreement on a relatively anodyne matter such as visa-free travel within SAARC seems to be beyond reach of the powers that be, so great are the suspicions between member states (essentially India and Pakistan). It is the politics that would clearly need to be tackled first in SAARC, if the idea of economic cooperation is to acquire any tangible significance.

In contrast, ASEAN, consisting of a far more disparate set of ten economies, with a combined GDP in excess of $2.5 trillion and intra-trade of more than $250 billion has shown a much greater sense of purpose in its pursuit of economic integration over roughly the same time span. Building initially upon an alliance between the Philippines, Malaysia and Thailand that was formed in 1961, Indonesia and Singapore joined the three founding countries in 1967 and ASEAN was formally established. At first, the development aims of ASEAN were enunciated in the most general terms without reference to any mechanisms involving trade or timetables. It is generally accepted that a common fear of communism provided the principal impetus and motivation for ASEAN, but, interestingly, all member states accepted that *a strategy of economic development* would have to be used to counter its dangers, not military pacts. The Sino-American détente and ending of the Vietnam War in 1975 changed perceptions fundamentally, and a further fillip was provided by Japanese FDI flows to South-East Asia in the 1980s.[3] Now, development would need to be buttressed with greatly enhanced trade and liberalized investment flows in the region. The 1997/98 financial crisis gave an additional boost to the idea of regional cooperation, leading to the Chiang Mai Initiative whereby members of ASEAN would now pool a part of their substantial and growing foreign exchange reserves when faced with another financial crisis.

ASEAN has expanded over the years and now consists of ten member states with widely differing economic and political systems – from the more open, market-oriented economies of Thailand, the Philippines and Singapore to the largely government-run economies of Vietnam, Cambodia and Laos. But such is the momentum in terms of opening up markets and trade that ASEAN could easily rival the EU in terms of dynamism once the Asian Free Trade Area (AFTA) comes into being in 2015 and the ASEAN Economic Community is simultaneously created, that will cover investment and trade in services.

Michael Yahuda has postulated that the ASEAN way of not laying down political preconditions for agreements in economic matters has, thus far, at any rate, worked well (Yahuda 1996). The member states of ASEAN are countries at varying stages of economic, political and cultural development, yet they have found ways to cooperate on a wide range of issues. Initially, they did not aspire to any form of political cooperation or economic union but merely wished to be part of an association of broadly likeminded countries. The progress that they have made has been built upon the actual experience and benefits of step-by-step trade liberalization and keeping political disagreements in the background. In this, the member states have been helped by the informal, consensus-building, non-confrontational style of 'doing things' in South-East Asia. Indeed, the logic of concentrating on economic cooperation has encouraged ASEAN to forge ties, first, with China, Japan and South Korea and, more recently, with Australia, New Zealand, the United States, Russia and India. Given time, these ties could provide the rudiments of evolving into an immense trading and investment bloc. That is not to say that no political considerations figure in these agreements. However, the overwhelming evidence is that they are not allowed to scramble the primacy of the trade and development agenda, and the best examples of the latter in East and South-East Asia are the reconciliation that Japan achieved with the United States after 1945, the ready acceptance of a unified Vietnam after 1975 by its erstwhile foes and the continued deepening of economic cooperation between the People's Republic of China and Taiwan. Occasionally, differences do boil over, but the evolution of ASEAN and the focus on economic and social development throughout Asia, barring the membership of SAARC, suggests that economic cooperation remains the major priority in these countries' quest for economic development, which is what drives policy outcomes else in this region.

Regional economic cooperation: Some questions

Regional economic cooperation involving developing countries at widely varying levels of development is a recent area of research in economics. One of the practical problems of cooperation that needs to be discussed is whether liberalizing trade within a group of countries, as a component of economic cooperation, is likely to lead to benefits for all or would one or some countries stand to benefit more than others. A related and oft-discussed question is whether any increase in trade itself is likely to be a 'diversion', that is, a diversion from trade already taking place with the outside world to within the newly formed group or would it be a 'creation' of new trade spurred by the removal of trade restrictions between the group.

As regards the distribution of benefits, according to the model known as the 'gravity equation', the value of trade tends to increase with the size of the GDP of the trading partners and decrease with their geographic distance apart. The model includes other variables, such as a common language and culture or a common land border, but excludes determinants such as comparative advantage and trade policy regimes. In other words, a large and therefore diversified economy by itself will attract trade flows (both imports and exports) from its physical neighbours, regardless of other considerations, and will make trade liberalization a worthwhile supporting policy for that economy and for the countries lying in its immediate vicinity. This would be the 'China effect' for the economies of East and South-East Asia. UN estimates suggest that according to this model, roughly half of all trade in Asia should be intraregional and a similar relationship should hold for subregional trade such as trade within ASEAN and SAARC. Indeed, the trade intensity of ASEAN is comparable to that of the North Atlantic Free Trade Area (NAFTA) and the EU but unsurprisingly for SAARC it is much less.[4]

Would a large economy such as China or India capture the lion's share of benefits accruing from trade? Not necessarily and certainly not permanently. A large economy will be automatically more diversified and would thus be able to *both* produce a wider range of goods and services *and* provide bigger markets to its trading partners. At the start of a cooperation agreement, it is likely that the first impact might be stronger than the second, but this should not hold true forever. Indeed, its smaller neighbours might be nimbler in exploiting the opportunities that arise and thus grow their exports at a faster rate than their imports. In the end, however, who benefits by how much will be determined not by the nature of the trade agreement but by their respective competitiveness: large economies have scale economies on their side to help their competitiveness, whereas smaller economies should have innovation and shorter response and lead times on their side. This should lead to beneficial specialization, but the benefits of specialization can be captured, or will last, only so long as specialization leads to competitive efficiency.

It is well to remember that competitiveness does not mean costs per unit of output produced alone. It also means costs per unit of trade conducted, and in this, SAARC, unlike ASEAN, has made virtually no headway. Trade costs, or transaction costs related to trade, are to do with the fulfilment of regulatory requirements and domestic and international shipping and logistics costs. In particular, the costs of completing documents and complying with a plethora of procedures prior to shipping can add up to 15 per cent of the value of the traded goods. For instance, the average cost of importing a 20-foot container for Malaysia, Thailand and Vietnam is estimated to be around $650; it is twice as high for Pakistan and four times as high for landlocked Afghanistan. On the export side, moving goods from the factory to a ship at the nearest seaport is only 19 days in ASEAN; in SAARC, it is more than a month. Moreover, although time is money, it is not the only relevant variable. The actual costs incurred in cross-border trade are an equally important component of the trade metrics; and in the SAARC members, these are going up, while elsewhere they are going down. Physical proximity is of course very important, but if countries do not make any serious effort to improve trade logistics, including transnational payment systems, there is little likelihood that the former alone would lead to enhanced trade and its associated benefits following a trade cooperation agreement. SAARC is a clear example of that. Such is the impact of trade logistics that for SAARC member states it is often cheaper to import from Singapore – and now from China – than from any of the other member states.

The question whether a trade agreement would, over the long run, create new rather than divert existing trade, has been long discussed in economics. In its simplest formulation, a regional trade agreement should increase incentives for trade between its members and create disincentives for trade between members and non-members. While, in principle, this should not have deleterious effects on its own, it would be the case that some trade will be distorted and inefficient producers protected at the expense of more efficient or even marginal producers. However, it may also be the case that once a trade agreement has come into being and *created* new trade between its members, the ensuing higher incomes, in their second-round effects, should also stimulate new trade from outside the agreement.

It would seem therefore that the economic benefits of free trade agreements are real, but they tend to occur gradually. Furthermore, once trade has stimulated growth it is not easy to disentangle the effects of trade alone from the higher trade that higher growth will have brought in its wake. So, is the case for regional economic cooperation clear-cut and valid?

From the experience of East, South-East and South Asia, the conclusion has to be that subregional cooperation in trade should be promoted but primarily as a building block towards freer trade in the whole region, that is, the whole of Asia. Despite the example of the European Common Market, countries in Asia have been late starters in exploiting the potential of preferential trade. Before the beginning of the millennium, preferential agreements were limited to a few countries, the most notable being the Bangkok Agreement, a framework agreement for the ASEAN Free Trade Area. However, the 1997/98 financial crisis gave a huge boost to the idea of cooperation, and this led to the formation of the ASEAN +3 (China, Japan and Korea) grouping, and this, in turn, brought the leaders of Australia, India and New Zealand to attendance at the ASEAN summits and the creation of a new annual forum, the East Asia Summit. These interactions have driven the creation of several free trade agreements between ASEAN countries, both individually and as a bloc, and to what are described as an eventual Asia-wide regional trade agreement or an Asian 'noodle bowl'. They should be seen therefore as stepping stones on the way to a much wider, liberalized trading area covering nearly two billion people with a GDP and trade approaching that of the EU. If previous experience is anything to go by, countries who participate in the trade that will be generated in the region will see wider benefits in much higher levels of activity and employment than might otherwise have taken place.

Against this background, the process of ASEAN economic integration is by far the most advanced in the region while SAARC is the least. ASEAN's AFTA is being complemented by the ASEAN Framework Agreement on Trade in Services, the ASEAN Industrial Cooperation Scheme and the ASEAN Investment Area, with the goal to form an ASEAN economic community, comprising a single market in 2015 or very soon thereafter. SAARC, too, has adopted the SAARC Agreement on Trade in Services to complement its free trade agreement, but SAARC's record in adhering to time-tables is not encouraging.

These agreements should stimulate trade in the short term, but the eventual goal of a seamless, Asian cooperation agreement should not be overlooked, and SAARC should work towards this without getting bogged down in political rivalries and petty suspicions. Such an agreement will allow economic activities to be located and structured on the most efficient basis in the region. But freer trade will stimulate economic growth only up to a point. For the benefits of such trade to be fully captured will still require major investments in infrastructure and public goods, a fact that has been alluded to elsewhere in the book.[5]

SAARC and ASEAN in the context of globalization

It needs to be stressed that both SAARC and ASEAN operate in a world where the logic of globalization is largely accepted as a self-evident truth. Here again, as with the theorems that supposedly validate the postulates of neoliberalism, theory is one thing, actual reality another. In principle, globalization should benefit all countries by facilitating a more balanced distribution of economic activities across the world on the basis of comparative advantage and factor endowments. Jeffrey Sachs has stated: 'globalization means that all parts of the world are linked through trade, investment and production networks. In the latter, a final product such as a computer, mobile phone, or automobile is the result of production processes located in many countries, often a dozen or more' (Sachs 2011). Where a particular stage of the production process is located determines whether an individual country is benefiting from globalization or not. In other words, some countries will gain, and have gained, from globalization; others have been not only left out but increasingly marginalized over time. Benefiting from globalization will ultimately depend on how competitive they are to begin with and how successfully they can maintain their competitiveness. A brief recap of post-Second World War international economics sheds light on how globalization has evolved in the recent past and how it might evolve in the future.

Up to about 1950, manufacturing was based upon the shipment of raw materials from the developing countries to production sites in North America, Europe or Japan with final products traded between the developed and developing countries or between the developed countries alone. Roughly from 1980 onwards, production has been steadily broken down into several parts along the value chain, from raw materials to final packaging, spread over many countries with many, if not most, of them located in East and South-East Asia. This process has been driven by the multinational corporation, initially those domiciled in the United States but now from an increasingly diverse range of economies including South Korea, China, India and Taiwan. For the United States, data suggest that compared to a mere 5 per cent of corporate profits in the 1960s more than 25 per cent now originate from foreign operations. With many corporations also listed in a variety of stock markets and senior management drawn from a multitude of nationalities, globalization has reached a stage where the modern business enterprise spread over several jurisdictions no longer has a singular national identity, can no longer realistically be expected to participate in any one country's long-term aspirations, has little or no incentive to pay corporate taxes even where it earns the bulk of its profits and is motivated by the maximization of profits alone, leaving aside a major chunk of those eaten up by senior management in the form of salaries, bonuses and stock options (Stiglitz 2002).

Although globalization has been the dominant force in the international economy for no more than 25 years and was initially welcomed enthusiastically by most countries, it has already generated major long-term repercussions. The first of these is that the technological lead of the developed countries vis-à-vis the developing ones is narrowing by the day. Thus, for instance, East Asian economies have mastered new technology not only in basic manufacturing activities such as textiles and household durables but even in cutting edge areas of the economy such as information technology, microchips and high-speed trains. But this has not happened by accident; it has been through deliberate action by the State in these countries, through investments in state-of-the-art infrastructure, in high-quality education and massive expenditures on R&D. The same processes are being followed, albeit at a somewhat slower speed, in South-East Asia. In Pakistan and over much of South Asia, in contrast, the lack of a serious long-term national development goal has meant little or no investment in new manufacturing and a steady loss of international competitiveness and participation in global trade. Thus globalization, far from providing an opportunity to Pakistan to diversify its manufacturing base, has succeeded only in marginalizing it even in the areas where it had a comparative advantage, textiles, and where it had a lead of at least two decades over South-East Asia.

The second major effect of globalization has been through its downward pressure on wages and earnings across the world. Indeed, with its unrelenting pressure on cutting costs and maximizing profits, many mid-level jobs in manufacturing have disappeared altogether. With so much of manufacturing having migrated to East Asia from the developed countries, wages in low-skill industries have effectively stagnated during the last 20 years. Many countries, including those in South Asia, have reacted to this development by offering yet more tax and regulatory concessions in a race to the bottom. In this downward spiral, all countries will eventually lose as multinational corporations merely move from one low-tax, low-regulatory regime to another. Governments and labour are the main losers in this process; owners of capital and senior management are the principal winners. It is true that globalization has generated tens of millions of jobs in manufacturing in East and South-East Asia and has brought a variety of goods within reach of the less well-off, but these jobs have devastated family life, for example in China.

The third major effect is the inexorable increase in inequality across the world. This has happened not just in the economies where wages have stagnated at or near subsistence level, such as in South Asia, but also in those economies where they have grown in tandem with productivity, such as those in East and South-East Asia. This is because with higher profits, low labour costs and low taxation, capital has benefited disproportionately from globalization. In fact, a key outcome of the globalization phenomenon thus far has been a huge change in income distribution in favour of the rich in large parts of the world. Worse, with the exception of a tiny handful of countries, it has been met with inaction or indifference in most countries. Sadly, there is no evidence that any country has taken an initiative to counter the sophisticated tax avoidance schemes that are now in operation or to counter the pressure of capital flight from the developing countries. This has meant that governments have been hamstrung on the resources front to take any mitigating action. With the exception of a few countries, little new spending has been directed at retraining workers or in providing decent-quality public goods especially to the lowest income quintile of the population. Indeed, the race to the bottom is evident not only in making more and more tax concessions to multinationals but also in the weakening of labour standards, health and safety regulations and, worse of all, in a lack of enforcement of environmental standards. In other words, the idea of equitable and sustainable development has been all but forgotten in the onward march of globalization.

Globalization has clearly had a very mixed impact on developing countries. East and South-East Asia – despite the 1997/98 financial crisis – have been its most prominent beneficiaries while South Asia in general, and Pakistan in particular, has lost out. But losing out cannot be exclusively blamed on globalization. For its part, Pakistan has failed to invest significantly in maintaining its competitiveness and its elite have succumbed to the easier lure of patronage and rent-seeking. Against that background, membership of even a reinvigorated SAARC will not help in promoting Pakistan's development agenda. Regional trade arrangements can be of benefit if there are demonstrable trade complementarities between their members, and a joint market will offset the higher transport and transaction costs of trading with non-members. However, this is by no means self-evident as far as SAARC is concerned. SAARC would have benefited had it become a free trade area soon after it came into being in the 1980s and then proceeded to exploit the opportunities of globalization, such as those that went to East Asia, when greatly enhanced FDI flows to the developing countries began in earnest. The challenge now would be to use freer trade more to resolve the long-standing political problems of its member states and less to obtain any direct benefits from trade itself.

The future is unclear as far as globalization and SAARC are concerned. It is true that closer interaction between economies, even between those at widely varying levels of development, is desirable. But exactly how such interaction takes place and how fruitful it is in practice depends a great deal upon each country's long-term development goals, such as equity and inclusion, and how much it is willing to invest in enhancing its ability to meet those goals, essentially questions of political economy. Thus, for many countries with balance of payments problems, unrestricted FDI without stringent requirements to boost export earnings might not be an unalloyed benefit. Similarly, cross-border flows of capital that cause asset bubbles, for instance in the property and stock markets, can cause more new problems to arise than resolve older ones, although some would undoubtedly benefit from these flows. It is essential therefore that Pakistan, always tempted to take more measures towards more openness even at a regional level, will make a much more careful assessment of the costs and benefits involved. As far as SAARC is concerned, its purpose, after 25 years of globalization, should now be only to enable its member states to develop greater harmony between each other, socially and politically. Should it succeed in that objective, it will not only release new public resources for development but, hopefully, promote substantial new investment from non-members as East and South-East Asian labour cost rise and their economies move up the value chain.

The future of regional economic cooperation

In an ideal world, the need for regional economic cooperation in the form of free trade agreements would not arise. There would exist a global economy largely free from the distorting effects of customs duties, non-tariff barriers and domestic subsidies. Individual countries would then be able to specialize on the basis of their comparative advantage, and global trade flows would be determined by how efficient these countries were at what they were producing. Regional trade deals are not as effective as global ones, but they are still beneficial as 'second best' alternatives. The real world is a world of national rivalries, strong cultural affinities and preferences and the physical constraints imposed by borders and geography. In other words, the flow of trade approximates only to second best optimality with the possible exception of very large free trade areas like the EU. Moreover, contrary to what post-Second World War experience teaches, most countries still tend to regard international trade as a negative-sum game, whereas, in reality, over any reasonable time span, it should be a positive-sum game that significantly adds to welfare by lowering the costs of providing a much bigger range of goods and services. There has thus been a level of reluctance in pursuing trade liberalization as an aim in international economic diplomacy and protecting domestic industries regardless of their international viability has been the modus operandi of regional trade negotiations. But with the liberalized global trade agenda of the WTO receding far into the future, a veritable noodle bowl of bilateral and multilateral trade agreements has sprung up across the world, some 379 at the latest count with about ten coming up every year. Many have asked whether they should be considered stepping stones, or stumbling blocks, on the road to a liberalized global trading regime. In a world of strong national rivalries, the answer could not be more obvious, and few countries have actually implemented the tariff reductions to which they have committed themselves. The question therefore arises whether these trade agreements are likely to deliver any real benefits at all?

In most developing countries, their effect has not been positive, thus far at any rate. Complex rules of origin have made it exceptionally difficult, if not impossible, for an importer to find the best quality at the lowest price, and the crisscrossing nature of bilateral trade preferences have, in effect, added another layer of complexity, and of distortion, to the overall flows of trade based on comparative advantage. Above all else, if an active industrial policy is accepted as the key to industrial progress, as has been argued elsewhere in this book, this would go against the basic logic of free trade agreements. Moreover, international trade trends since the early 1980s suggest that while the content of manufactures in international trade has increased substantially over the last two or three decades, some would argue that the phenomenon has been almost exclusively due to the 'China effect' on global trade, that is, the direct exports of manufactures from China itself plus the many different value chains that China and the other East and South-East Asian economies have created. From a mere 0.2 per cent of world manufacturing exports in the 1960s, China now accounts for as much as 17 per cent; other trading economies have also grown but nowhere near the rates that China has achieved. If there is a new global division of labour that is centred on East and South-East Asia, then it is the result more of the absolute advantage of these subregions than of the effects of more liberalized trade. The key therefore for any country is to concentrate on and boost its international competitiveness and leave regional trade and economic cooperation to follow.

There does remain, however, one justification for regional economic cooperation in the future and that lies in the arena of long-term finance. Whether in South-East Asia or South Asia, the overriding constraint on development remains the shortage of resources especially for infrastructure finance. Resources are needed not only for raising the level of overall investment in these economies but increasing the footprint of the State in the social sectors so as to 'crowd in' investments from other sources both domestic and foreign. The UN and Asian Development Bank (ADB) have estimated that for investment in infrastructure alone (electricity, roads and telecommunications) there is a funding gap of around \$8 trillion, or \$700–\$800 billion a year in Asia between 2010 and 2020. At present, financial institutions such as the World Bank and the ADB simply cannot fill this gap. There is thus a strong prima facie need to create an investment bank on the lines of the European Investment Bank or the Nordic Investment Bank to provide much bigger volumes of long-term funding for the economies of South and South-East Asia.[6] It is here that regional economic cooperation might perhaps have its greatest need and relevance, and the idea of pooling a part of each country's foreign reserves for this purpose suggests a viable way of doing so. The question arises whether SAARC or even ASEAN would have the necessary political will to take this critically important step. On the evidence of the last three decades, the answer is self-evident as far as SAARC is concerned. But, there is also the evidence of SAARC countries participating in Asia-wide ventures such as the ADB. A SAARC investment bank would only be a smaller version of the ADB. Seen from a purely pragmatic perspective, the future of regional economic cooperation lies not in achieving a quasi-utopian free trade agreement that then delivers few benefits, but in a somewhat less utopian investment agreement covering finance. With more investment in infrastructure and in trade logistics, SAARC transformed into SAFTA might yet become the driver of a long-term political settlement in South Asia and rescue the citizens of this region from the disorganized pattern of development foisted on them by their ruling elites.[7]

7
The State, Private Enterprise and Development

An historical perspective

Rent-seeking is a phenomenon that is in evidence in many countries across the world regardless of their level of development. It tends to thrive in non-traded activities or in those sectors of the economy where competition is weak. Either way it is facilitated in environments where the State is weak and is unable to exercise its authority in an even-handed manner or project a long-term vision of development. The issues surrounding the role of the State and private enterprise in the economy became the bread and butter of discourse on political economy as far back as the 1930s, with the beginning of the Keynesian revolution. Simultaneously, how private enterprise might fit into the scheme of things where the State was umpire, rule-maker and player rolled into one raised new and contentious issues. In 1962, the Cambridge economist Joan Robinson, uncannily anticipating the controversies that would hit Economics in the 1970s asked, 'what were the rules of the game?' (Robinson 1963). In other words, as strongly held views on the State and society ebbed and flowed and political ideologies rose and fell with changing circumstances, how should the complex interactions between society and the institutions that it had set up for the purpose of its own governance, that is, the State, be viewed and assessed? Joan Robinson was simply following in the tradition of eminent nineteenth-century thinkers like John Locke, David Hume and Adam Smith, who had concluded even in the early years of the industrial revolution that markets and private enterprise could not exist, let alone flourish, without a central coordinating and rule-making body, the State, and the latter would have to be funded by society through taxes. What has never been properly settled though is how much of the 'State' is needed to ensure that private enterprise can operate to maximum effect before some of its more malign consequences emerge.

It is at this point that pragmatic realization has tended to come up against hard ideology, the latter often dressed up in highly emotive terms as 'freedom' and 'liberty' as, for instance, in the United States in the stance taken by the University of Chicago. But, some 200 years later, the moderate liberal, Professor James Meade – also of Cambridge and a Noble laureate – whilst defending private enterprise and the free market, had the honesty to admit that for the pricing system to work with equity it was necessary to achieve a fair distribution of income and for the State to take measures to ensure an equitable distribution of income and property. Following the debacle in large parts of the financial system in 2007/08, society has come full circle and is, once again, having to face up to the appropriate role of the State in the management of the economy. As no market-based economy has been found to be self-regulating and has no inherent tendency towards equilibrium, questions of social stability built on social justice, ignored during the last three decades, can no longer be brushed aside. This chapter attempts to outline the nature of the relationship between the State, enterprise and development in Pakistan and contrast it with East and South-East Asia.

After the end of the Second World War, driven by the Keynesian revolution and possibly as a direct consequence of the War itself, the State became involved in a huge range of activities that have an impact on the wider economy. Apart from defence, infrastructure and domestic law and order, the State began to provide health and education services, myriad subsidies to producers and consumers and investments in R&D, pensions, unemployment benefits, access to shelter, libraries and museums. It also became the owner in many countries, although by no means all, of oil and gas companies, banks, airlines and utilities. In order to do all this, the State had to generate resources, to invest in enterprises and to create a supporting narrative to justify its actions. Today, the size of the State is measured by the ratio of the taxes it raises vis-à-vis the size of the GDP or the amount of its spending vis-à-vis the GDP. In the OECD countries, the average of the latter measure is 40–45 per cent (including transfer payments such as pensions and unemployment benefits) compared to 15–25 per cent for the developing countries.

But, crude figures alone cannot capture the full impact of the State on the economy. For instance, developing countries do not, by and large, have significant levels of transfer payments and many observers of a neoliberal bent looking at the East and South-East Asian economies of recent years jumped to the conclusion that their dynamism had been driven by the smallness of the State. On the contrary, as mentioned elsewhere, these economies were always subject to strong State control and direction, through planning, policies, regulation and executive orders. Yet, across the world, such is the power of the media – much of it controlled by interests with a strong anti-State agenda – that the role of the State in the economic life of the people stood almost entirely discredited until the financial crisis hit the global economy in 2007.

Are markets always efficient?

Clearly, there is a need to redress this imbalance, and the best place to start is with the market economy itself. Paraphrasing the ideas of Adam Smith, the notion of market equilibrium exists when the demand and supply for every good and service produced in the economy is in balance. In such a situation, there is no need for any action by the government to intervene in this equilibrium, as the price of each good and service will automatically adjust to any change in demand or supply. Improbable as it may sound, many people appear to think that such an equilibrium can be reached in real life – leading to the greatest possible well-being of all those participating in the various markets in an economy – but for the interference of outside agencies, particularly the government. Thus, it is the business of all concerned to minimize the impact of the government on the functioning of the economy. In fact, other than in text books, few economies have been, or are, characterized by market equilibria on an economy-wide scale and many individual markets often over- or under-provide goods and services. These phenomena are called instances of market failure, which have been described earlier in the book, and even a cursory examination of the real life functioning of an economy will show that market failure is far more common than perfectly functioning, or efficient, markets.

It used to be accepted that efficient markets could not exist where there were clear monopolies or oligopolies or where a public good was to be provided, such as roads, ports, affordable health facilities and/or basic needs like electricity and gas. In the latter, it would be extravagantly wasteful to have a multiplicity of suppliers; indeed, no economy exists where this is the case. If private suppliers were involved in such markets they would need to be subject to fairly strict regulation by the government. Another area where government intervention was needed was where there were wide differences between private and social costs. For example, industries that pollute thereby create what are called 'negative externalities' and have to be appropriately taxed and regulated so that the costs of pollution can be recovered. Also, markets where there is asymmetric information between buyers and sellers can create opportunities for rigging and fraud by the latter, such as in the recent financial crisis, require very close supervision and regulation by the government. The idea therefore that an economy can function on its own and deliver the best outcomes on the basis of market signals is fanciful. The State is central to the functioning of any economy developing or developed.

Indeed, even if markets were unambiguously better than the State in producing the greatest output at the lowest cost, there is wide agreement that the pursuit of efficiency should not be considered the only, or even the most important, objective of economic policy. Fairness, embodied in the notion of social justice, is a critical test of how equitable and sustainable relationships can be achieved within a given implicit social contract. As a result, extremes of wealth and poverty are regarded as being unacceptable nearly everywhere, although in recent years a small minority of people has begun to argue in many countries that 'freedom' and 'liberty' should take precedence over fairness. According to Jeffrey Sachs, modern societies have three basic goals: efficiency, fairness and sustainability, and the task of a responsible State should be to facilitate the simultaneous achievement of all three goals (Sachs 2011).

In some societies where the underlying social contract, or the State itself, is weak, the elite pay lip service to these goals, especially fairness and sustainability; in others, the goals are taken more seriously and the government makes every effort to raise the needed resources and create an appropriate institutional ethos to achieve these goals.

Hence, in a nutshell, once there is agreement on the goals, the argument will tend to boil down to means. In this context, looking at the experience of the last three decades or more, a free, predominantly private sector-driven economy is not enough; the State has to intervene on behalf of those members of society that the markets nearly always neglect or ignore. The poor are overwhelmingly those who have suffered from the inadequate availability of public goods and for whom the markets have 'failed' in that their needs – education, basic health facilities and housing – have not been met. Therefore, the real question today is finding the right balance between the private sector and markets, on the one hand, and the State on the other. The early stages of development almost certainly require that the State play a strong role.

Development as a partnership between the State and private enterprise

Up to about the mid-1970s, the post-Second World War consensus on development conceived as a partnership between the State and private enterprise was part of the conventional wisdom. Indeed, in many cases, the State had to take a leading role in the development process not only in terms of building institutions and policy support but also in directly providing those goods and services that the private sector was unable, or appeared unwilling, to do. Thereafter, as growth faltered in the second half of the 1970s, the ideology of neoliberalism, built around the concept of a small State and private sector–driven economic development, gradually supplanted this conventional wisdom. This happened first in the United States and United Kingdom, second in global and regional institutions like the World Bank, the IMF and the ADB, and third, as globalization gathered momentum, in countries wishing to attract higher levels of foreign investment and thus hoping to achieve an acceptable rate of economic growth. The latter was especially true of South Asia and, indeed, briefly of South-East Asia as well following the 1997/98 Asian financial crisis. In East Asia, including both pre and post-war Japan, development was always led by the State and the public sector was entrusted with critical responsibilities in the process. In fact, this approach has remained broadly intact so far in East and South-East Asia where 40 per cent of firms engaged in manufacturing and banking are partially or wholly owned by the State, much higher, of course, in China and Vietnam (*The Economist*, 31 May 2014). Indeed, even where privatizations have occurred, these have been partial and designed primarily to leapfrog into modern technology. It is striking that as of 2010, State-owned firms continue to dominate the stock markets in both East and South-East Asia, with the exception of Japan.

It should also be conceded that the change of approach embodied in neoliberalism was not driven by the impact of domestic circumstances alone. The upheavals in the global economy caused by the two major oil shocks (1973/74 and 1979/80), the ensuing chronic macroeconomic instability, high inflation and output losses had indirectly dissipated faith in the mixed economy model. But throughout the 1950s and 1960s, right-wing ideologues had not missed any opportunity to berate the involvement of the State in the economy and the 'wasteful' nature of its activities. When the mixed economy model was replaced in the early 1980s by neoliberal ideas, it was not just a benign, pragmatic response to circumstances but a gleeful triumph for the elites in many countries who had now found much-needed intellectual support and justification for their long-held political views on the economy and society. In these views, the role of the State was to be sharply curtailed, budget deficits were to be squeezed or eliminated altogether with the provision of public goods taking the first hit, direct taxes to be lowered and publicly owned assets to be privatized, including natural monopolies like utilities. In addition, the allocation and pricing of inputs and outputs was to be determined by market forces and the State was to be restricted to the role of a mere enabler, providing institutional oversight, policy support and so-called light-touch regulation, with the private sector providing the goods and services – a remarkable policy prescription in countries with only rudimentary legal systems and non-existing accountability. Pakistan, in company with several other developing countries, bought the neoliberal approach with enthusiasm, which is not surprising, given its penchant for patronage and rent-seeking. Its love affair with Wall Street bankers and entrusting them with major responsibilities since the 1990s under both military and political governments becomes easier to understand against this background.

The neoliberal approach did not come without other appendages. Side by side, the forces of globalization, such as free trade, FDI and cross-border capital flows, were not to be resisted and, over time, import tariffs were to be reduced to very low levels for countries to find their respective niches in the global division of labour, thus giving an unconditional opportunity to foreign capital to enter economies and play havoc with any attempt at developing local industry or of any domestic value chains. All commitment to social justice and equity was effectively cast to the winds, and the poor would have to rely largely, if not exclusively, upon the phenomenon of trickle down for their well-being or even on NGO-provided charity. With no countervailing forces to promote social justice, the already soft State of Pakistan would be used unabashedly now by the elite to facilitate patronage and rent-seeking on an industrial scale. Similar change also happened in East and South-East Asia, but in these economies investment in public goods was maintained and the few privatizations that did take place were through a hybrid model with the State usually keeping a strategic stake. Moreover, where private FDI came in, it was nearly always in the form of joint ventures with domestic partners and with strict obligations to bring in modern technology and boost exports.

Implications of the 2007/08 financial crisis

As mentioned earlier, the events of 2008–2009 have shown that faith in a primarily private sector-led, market-driven model of the economy has proved to be a chimera. Indeed, taking a global view, neither developed nor developing countries have been immune to its shortcomings. Markets in most economies have failed to allocate resources in an optimal manner, critical goods and services have been consistently under-provided, so-called light-touch regulation has produced asset bubbles and bouts of instability, while the idea of unchecked profit-maximization has not only put a squeeze on the share of income going to labour but has turned out to be a poisoned chalice especially in the financial sector (Minsky 1992). Meanwhile, globalization has created opportunities through regulatory arbitrage for crises to migrate across borders exploiting weaknesses in national economies and often magnifying them.

Looking at the last three decades, four developments stand out: First, other than in a few countries, the increased reliance on markets has produced no sustained acceleration in the pace of either growth or productivity, nor any significant improvement in stability on the macroeconomic front with the freeing up of exchange and interest rates. This is true of both developed and developing economies. For example, amongst the former, the United States and the United Kingdom are plagued by lacklustre productivity growth and chronic current account and budget deficits. Within the latter, in the bulk of developing countries, overall progress is no faster than it was before, except in the last few years, as China's impact on the global economy has become more visible. Pakistan is an exception on the downside in that its growth rate has declined substantially since the 1990s, except for a brief spurt in the first few years after 2000. There are a small number of exceptions on the upside, notably countries in East and South-East Asia, some in Latin America and, more recently, in India (economies in Africa have benefitted primarily from higher commodity prices in the last few years and not through any domestic reforms). Interestingly, within the developing countries, progress has been faster and more evenly distributed in those pursuing State-driven development. Those following neoliberal maxims have done less well. Amongst the developed countries, notwithstanding recent difficulties, only German, Holland, Austrian and the Scandinavian economies are the exceptions as are Australian and Canadian, the latter two being essentially natural resource producers.

Second, the gains from growth and development have been primarily captured by the upper-income groups with a huge increase in inequality as measured by the Gini coefficient virtually across the world. There has been little or no trickle down. In fact, the bottom fifth of the population has seen its real income stagnate for the last 30 years in the developed economies, while in the developing economies any signs of a real breakthrough in reducing endemic poverty continue to recede into the long-term future. Whether in the developed or in the developing economies, it is hardly credible that a system that traps large numbers of people in low-paying, low-skilled jobs will make development sustainable in the long term. The exceptions are the State-led economies of East and South-East Asia.

Third, few, if any, developing country governments have been able to offset the inexorable increase in inequality by channeling higher public resources into health, education, public transport and social housing. Even in India, for instance, despite acceleration in the GDP growth rate in recent years, there has been very little impact on the social indicators since the late 1990s. This relative failure may well be down to poor policy implementation and ineffective governance; it is more likely to be the result of an over-reliance on the private sector to deliver socially desirable outcomes.

Fourth, globalization has brought internationally transmitted shocks, such as financial crises, to the very heart of developing countries via the integrated nature of financial markets and cross-border banking, a consequence of globalization. Countries have not only suffered substantial output losses as in the 1997–1998 Asian crisis, in the deflation of the IT-driven stock market bubble in 2002 and after the financial crisis of 2008 but continue to remain in thrall to the fickleness and vagaries of international finance.[1]

Mitigation of these adverse effects has not even been attempted because tax buoyancy has hardly improved in most developing countries; most face a fiscal crisis. In developed countries, the richest have invented sophisticated tax avoidance schemes and tax havens are flourishing. Moreover, since the philosophical underpinnings of neoliberalism have precluded higher public spending on goods that are consumed by the lower-income groups, the State, too, has willy-nilly accepted the notion that higher taxes on the rich are a non-starter and acquiesces in the ongoing neglect of public services consumed by the poor. Pakistan falls in the latter category.

The response of the market has been to cater almost exclusively to the needs of the middle- and higher-income groups – the growth of high-priced private schools, universities and hospitals are good examples of this phenomenon. Indeed, other examples of market failure of a more structural nature can be found in the chronic lack of investment in low-cost housing, in paltry expenditures by pharmaceutical firms in the development of anti-malaria treatments and other affordable drugs that are primarily needed by the poor. In some countries, notably Brazil, the recent large-scale conversion of sugar cane and maize into ethanol as an additive for motor car fuel, is a phenomenon that has sharply raised the price of a wide variety of foodstuffs, a major expense for the poor, but has kept the price of petrol low.

In Pakistan, notwithstanding the recent improvements in the poverty statistics, the long-term trends are less sanguine. In fact, the immiserization of the poorest in the developing countries generally, that is, those having to survive on less than $1.20 a day in the developing countries has been a particularly shameful feature of the last

20–30 years with hardly any contrition on the part of the ruling elites of these countries. A further lesson of the last 20 years is that, given the size and urgent need for higher social spending, especially on public goods, it cannot be realistically left or outsourced to philanthropists and NGOs, as is often urged; such spending must remain an unequivocal State commitment and responsibility if the poor are to be given a decent start in life. In fact, the underlying neoliberal assumption that State spending *crowds out* the private sector is almost certainly false. On the contrary, evidence suggests that the public sector, through investment in infrastructure, technical education and public goods, tends to *crowd in* private investment, as has been demonstrated in East Asia and, more recently, in parts of Latin America.

Perhaps the most egregious failure of public policy in the last 20–30 years has, however, been to give the financial sector unchecked freedom to grow and create an ocean of indebtedness in many economies. This has made finance prey to even minor errors of judgement in how risks are assessed. These errors then balloon into a collective loss of confidence in the sector stretching across borders through contagion, involves the State in huge bail-out obligations and encourages moral hazard and rent-seeking. Moreover, despite international efforts at the Bank for International Settlements going back to 1988, the sector's own inability to pre-empt bouts of illiquidity and insolvency betokens a fundamental problem in post-1980 capitalism, that is, the unregulated pursuit of profit, excessive risk-taking by the financial industry driven by moral hazard, a lack of balance between the public and private sectors in most economies and the withdrawal of the State from playing the role of a fair arbiter in the equitable distribution of rewards and public resources. This withdrawal is most visible in the financial sector in which financial institutions have been allowed to grow to such a size even in developing countries like Pakistan that they now dwarf corporate bodies in other sectors of the economy. In addition, through excessive risk-taking, fiduciary obligations to depositors are all but ignored. As a result, the sector has created massive systemic risks for regulators, savers and governments, that is, for the whole of society, in the event of the failure of even a single modestly sized institution.

In Pakistan, as in many developing countries, the bulk of banking either has been in the hands of the State or was nationalized at some stage in the past. This had led to a plethora of bad debts, and governments had been forced to make good the periodic losses made by banks. In Pakistan, both governments and businessmen saw easy access to bank credit a convenient means of rent-seeking. Proponents of market-based reforms confidently touted the privatization of banks as the solution to the principal agency problem and of moral hazard. But the solution of a largely privately owned banking system has proved to be a mirage. Such is the reality of political power and the demonstration effects of wealth that with the State available as a back-stop, risk-taking in banks has multiplied and corporate and household debts have mushroomed.

The neoliberal experiment in the United States and the United Kingdom

The United States and the United Kingdom provide very apt case studies of what a market-driven model of capitalism can ultimately lead to and has lessons for the long-term development of Pakistan and other developing countries. The first oil shock of 1973/74 was followed by the rise of the East and South East Asian economies, a second oil shock in 1979/80 and the rapid closure of many low-skill industries in the developed economies but more particularly in the United States and the United Kingdom. Pressure on corporate profits caused by inflation and high interest rates meant that R&D expenditures were cut, wages were squeezed and labour unrest was widespread. In consequence, productivity growth declined and structural external deficits emerged in the 1980s. Both the United States and the United Kingdom lost their competitive edge in a range of manufacturing activities, notably cars, consumer electronics, machine tools, steel and computers that had hitherto been their preserve. However, neither politicians nor mainstream economists in the two countries viewed these developments as anything other than temporary blips.

As we know now, the effects of this 'hands off' approach by the State have been catastrophic in both countries. Banks have ceased to be providers of working capital, their primary function, and have become much more involved in complicated financial engineering via the sale of esoteric products and services whose purpose is simply to boost balance sheet growth. In the freewheeling atmosphere of the 1990s and early 2000s, the effects of light-touch regulation have been compounded by the development of information technology and by the use of new, technology-driven financial products, such as trading in securitized loans and derivatives. Up to the early 1980s, only the very largest private companies used to issue bonds, and derivatives were unknown. With the invention of high-yielding junk bonds and constant search for higher profits, this restraint ceased to function. As a consequence, activity in the financial sector, such as hostile takeovers, junk bonds, leveraged buy-outs and trading in complex financial instruments, has multiplied, with bankers giving themselves mammoth rewards in the process.

This expansion of activity in the financial markets has almost certainly been instrumental in the creation and inflation of asset bubbles not just in the United States and the United Kingdom, but in several other countries as well (Minsky 1992). Nth degree, that is, unchecked speculation in the trading of financial instruments has emerged as a central activity in the financial markets, giving the illusion of real value addition for the wider economy. In fact, because of a collective lack of risk aversion, the financial sector (deemed as being too big to fail) has become an enormous systemic risk through these very activities.[2] At the same time, there is no evidence that the real economy has benefited from any of these innovations. It is true that many States, developed and developing, have made substantial gains from the taxes that the financial sector has generated in the last ten years. But, those gains have proved to be ephemeral and, in any event, have been more than cancelled out by the huge amounts that States affected by the financial crisis have had to commit to save their financial sectors from ruin.

Side by side with its appetite for risk-taking, the sector has inevitably generated opportunities and incentives for fraud and malfeasance. The Libor and other scandals in the United Kingdom are typical examples. But, in order to counter public disquiet, the sector has bought itself both political protection and intellectual respectability with its vast financial resources (see last paragraph of this chapter). Looking back, the 2007–2008 collapse of the financial sector revealed not only the staggering complexity of the risks hidden away on bank balance sheets but also the nexus of nods and winks between regulators and banks that have left taxpayers across the world with immense liabilities in their efforts to restore the sector to solvency. Furthermore, the risk of moral hazard and opportunities for rent-seeking have been greatly magnified. While the financial sector might be particularly prone to rent-seeking and malfeasance, the rest of the corporate sector in most economies is hardly a model of responsible behaviour. Apart from a general lack of transparency, the corporate sector has felt no embarrassment in squeezing its lower-paid employees and resorting to complex tax avoidance schemes as a way of maximizing profits and earnings for senior executives.

Lessons for inclusive development

Needless to say, some attempts at reform are under way, and many observers still cling to the hope that this crisis of rentier capitalism, for it is that, will ultimately pass. On the other hand, the depth of the problems that have arisen and the structural nature of the 2008–2011 global recession have led to a degree of soul searching amongst policymakers and academics and have raised many questions. What is the nature of the public–private social contract that is likely to provide a durable, long-term solution to today's problems: the Anglo-American market-driven model, the welfare-based social democratic approach of Western Europe or the State-dominated model that has transformed China and East Asia in the last three decades?

Clearly, there are major problems in each of the three models. The private sector market-driven model has clearly failed to deliver higher, more stable growth *with equity* but appears to have entrenched a tiny financial clique in virtually unchallenged political control. As we have seen in the aftermath of the financial crisis the Western European approach has saddled several States with unsustainable levels of debt, but the corrective measures have involved them in programmes of austerity in which the brunt of the burden has been borne by the ordinary people in the form of higher indirect taxes and reductions in social protection. The Chinese model of a strong developmental State driving the process forward relentlessly through investment and exports owes more to its own recent history; it is sui generis and certainly not capable of replication in South Asia. Indeed, it cannot be replicated by any country with low savings rates, ineffective governance and a plethora of non-tradable services in its GDP. The last decade indicates that for any viable model of growth and development that emerges over the next few years in the developing countries should be able to pass three stringent tests: *legitimacy*, *sustainability* and *stability*.

Legitimacy indicates that for any system to enjoy long-term acceptance it must manifestly satisfy the needs and expectations of the majority and not just those of the narrow elite, its allies, friends and cronies through widespread rent-seeking. This is regrettably the case in many countries now, in which the ruling elite exercises almost total control through its ownership of the media. As a result, social justice and more inclusive growth have been made to sound like platitudes and have been derided in the media. But, without some kind of redistributive fairness – the kind that has underpinned the social democracy of Western Europe – sustained growth in the years ahead is unlikely to occur. Above all, a perceived sense of equity is particularly important in the form of less income inequality. The financial sector which currently operates with a massive implicit subsidy from the State is a case in point. However, the question is: what is to be done about moral hazard? Here, it should be stressed that a supposedly democratic polity alone cannot bestow real legitimacy, especially in developing countries like Pakistan; nor, for that matter, can the rule of law in the abstract, as both can be, and have been, rigged by minority sectional interests in many countries to their benefit. In other words, in order to be acceptable, legitimacy would have to be intrinsic, demonstrable and embedded within the system.

The second test of sustainability is that the new model must not be preoccupied with the short term, such as quarterly GDP and trade figures and share price movements. It should, instead, seek to build socially productive assets that will provide a steady stream of long-term benefits on the collective effort invested by society as a whole (by the State, private capital, management and labour) over a time horizon, say, of 20–25 years, far longer than the private sector is currently accustomed to take into account. China provides a good example of this long-term approach amongst the major economies as do others in Western Europe. China's huge public investment in infrastructure will boost economy-wide productivity decades ahead (incidentally, Germany's *landsbanken* and *mittelstand* combine to provide world-beating product quality through innovation and attention to detail without the fear of stock market volatility and 'shareholder value' constantly interrupting both processes).

In fact, given the accumulating dangers arising from climate change, within the sustainability matrix, the serious risks of global warming in the years add another layer to the problem, risks that few countries in South Asia generally are currently taking seriously.

Finally, the test of stability is not merely one in which unnecessary volatility and speculation in the financial markets must be ironed out. It is a test in which participants in the process of value addition are guided both by self-interest and by notions of fairness and the equitable sharing of rewards. There is little doubt that such a model would be completely at odds with the neoliberal construct; it would not be possible without a long programme of public education across much of the world that squarely confronts the biases and propaganda of the media that decry any role of the State in the economy and society except when taxpayer-funded bailouts are required. The few real-life examples of this model are the social democracies of Western Europe and the developing economies of East and South-East Asia. Among developing countries, Brazil and China have created social safety nets and are implementing credible anti-poverty programmes without experiencing a fiscal crisis or a significant slowdown in growth. It is true, however, that inequality, too, has increased significantly in both countries and social unrest has become more visible. Most other developing countries, especially in South Asia, regrettably, have shown neither serious political will nor the administrative capacity to deliver even a modicum of social protection to their most vulnerable citizens.

For such tests to be faced at the political level, society will need to resolve a number of awkward dilemmas. The private sector-driven model of development is patently a double-edged sword. On the one side, it has made possible vast improvements in material conditions for millions. It has incentivized and amply rewarded creators, makers and innovators, who, in turn, have provided new technologies and improved products for the public. But, at the same time, it has opened up enormous opportunities for rent-seeking, corruption and greed that have effectively nullified the fundamental principles of merit, fairness and morality without which societies cannot function. It has done so, first, by a grossly lopsided system of rewards in society in which a small handful of people, primarily owners of capital and members of some professions have benefited and, two, by making negative human traits like avarice and envy respectable. In the process, it has created a class of the super-rich and sharply polarized societies everywhere. Professor Michael Sandel has commented that 'we have drifted from being a market economy to being a market society' with a price being put even on ordinary norms of decent behaviour (Sandel 2012).

Looking ahead what then would constitute a viable strategy led by the State in Pakistan? An active government is needed to fashion, first, a genuinely favourable investment climate in which commitments made are honoured and, second, to promote the participation of the poor in economic life. By the first is meant creating an environment of reasonable macroeconomic stability, providing good infrastructure, physical and institutional, and a predictable, rule-based administrative system. By the second is meant providing access to sanitation, health and education to the poor on an equitable basis. In other words, spending on these services should be free of biases that commonly bedevil their provision in Pakistan and in South Asia as a whole, such as skewed spending in favour of the urban middle class. Equally important would be fostering a social environment that enables the poor to influence in some way the many decisions that are taken on their behalf either by bureaucrats or by politicians. The latter suggests decentralization and 'development from below'. Admittedly such experiments have not succeeded in Pakistan in the past, but it may be the case that they have been abandoned either prematurely or were not properly designed in the first place. This means that they have to be tried again and again, if need be.

What about the dilemmas posed by a weak State governing a poor society with limited resources? There are many examples of countries where governments took on too many responsibilities and thus failed to deliver on most, and Pakistan, unlike South-East Asia belongs in that category. The World Bank measures the capacity of developing country governments through the Country Policy and Institutional Assessment (CPIA) index, which is composed of 20 equally weighted criteria grouped around four headings: economic management, structural policies, policies for social inclusion and equity and public sector management and institutions, but does not share it with the outside world. There are arguments both for and against keeping such an index confidential. On balance, however, there is a need to make the information more widely available so that the elites, politicians and bureaucracies of particular countries can be held to account.

That process of accountability requires much unlearning of the maxims of the recent neoliberal consensus and presenting the role of the State in development in a much more balanced way. In general, in Pakistan, as elsewhere, the US economy is considered to be the epitome of economic success, and for most students of development the experience of East and South-East Asia barely registers with them. However, it is rarely realized that even in the United States, from the Internet to nanotechnology, fundamental advances have been funded by the State and 75 per cent of the most innovative medicines owe their existence to State funding via the National Institutes of Health (Mazzucato 2013). By ignoring, or deliberately downplaying, this phenomenon, we are contributing to the increasingly dysfunctional version of capitalism that will blight the lives of countless millions before change will eventually come one way or the other.

The task ahead is daunting. The economists Norbert Häring and Niall Douglas (2012) have traced how a supposedly neutral social science like Economics can become the handmaiden of right-wing ideologues. Respected organizations such as the Rand Corporation (32 Nobel laureates are connected with it) have been at the forefront of this process that the authors call 'corruptonomics' in which neoliberal ideas have been dressed up in mathematics and presented as value-free science. It has become a truism that in the general mass of notions and sentiments that make up society's *weltenschauung* the ideas concerned with economic life and a sense of social justice play a central role in how deeply held views in society come about. In this respect, it is well to remember that Economics has been a vehicle for the ruling ethos of each era, as well as a means for the systematic investigation of economic and social phenomena. No other discipline comes close. Today's world appears to have accepted the glib assertions of the neoliberals as permanent truths.

In both developed and developing countries, we see that individual well-being or the well-being of small, powerful groups within society has been elevated virtually to the level of a non-negotiable religious creed, while the collective aspirations of society and the needs of the weakest have been relegated almost to the point of irrelevance. Indeed, judging by the reporting on economic issues in the

Western-dominated media, we are to accept now that higher taxes can never be levied on the rich, nor can spending on the most vulnerable in society be increased. If social justice still has any significance, it is patently obvious that a new and more durable social contract has to be refashioned so that the world can tackle the twin menaces of stagnation and inequality. Finding the right role for the State is the first step on that long road.

8
Democracy and Development: Diagnosing Poor Governance

Some general ideas

South Asia, in sharp contrast to East and South-East Asia, suffers from abysmal governance. Many have speculated about this state of affairs and reasoned that this is primarily an outcrop of its history. It has to be remembered that the quality of governance is ultimately a manifestation of social and cultural norms. As South Asia has not been able to throw off its long feudal past, its governance shows all the signs of being a quasi-feudal society and culture in which notions of public service have been conspicuous by their absence. This is particularly visible in the delivery of public services in health and education, which remain hopelessly inadequate across the region.

As has been stressed in previous chapters, the central function of the State is to enable decisions to be taken on behalf of society and to then provide the machinery for such decisions to be implemented. In other words, the State authorizes a group of people to exercise power through its administrative and judicial machinery over the rest of the population. In democracies, such power is theoretically exercised with the consent of the population with appropriate checks and balances; in dictatorships and monarchies, power derives its legitimacy through claims either of more effective governance, realizing some grand national objective or by the invocation of more esoteric justifications, such as divine dispensation. Ultimately, the nub of all arrangements is whether the State can meet and/or satisfy the reasonable expectations of the population in matters such as the protection of life, liberty and property.

More recent additions include access to decent public services within an overall milieu of fairness between different population groups, enshrined in a body of laws and conventions. However, there is nothing to suggest a priori that any particular arrangement will automatically deliver good governance, although democracy through its periodic electoral tests indicates that it might at least be more accountable, and therefore more efficient in this regard, than the others. But, even a cursory glance at history provides evidence that culture plays a major role.[1] Thus, democracy by its very nature is a prisoner of the electoral cycle and cannot therefore be expected to support a long-term view of the problems facing society unless there is a large degree of consensus on the underlying issues and on the difficult trade-offs involved in tackling them. Taking real-life examples, for instance comparing South Asia with East and South-East Asia, conventional notions of democracy and good governance, as practised in South Asia, appear to be fairly weakly correlated, and democracy and rapid development even less so. It is the underlying culture that has delivered good governance in East and South-East Asia both before and after the revolutionary upheavals experienced by countries in the two regions.

It might be well to recognize here that the wider objective of inclusive development, as opposed to merely maintaining the status quo, clearly involves an interplay of complex political and economic forces involving trade-offs and choices that are ultimately determined by a society's values and collective aspirations. Jeffrey Sachs has stated that lasting change can be achieved (only) when these components are brought into proper balance (Sachs 2005). In societies dominated by powerful elites, entrenched social, political and cultural disadvantages can prevent marginalized groups from participating in the economic, political and social life of the country, so that terms like 'equality of opportunity' or 'equality before the law' are rendered all but meaningless in practice. Democracy in the form of electoral support for governments exists in many societies, but the difficulty of aligning multifarious political ideologies with the interests of the population creates massive opportunities for political rent-seeking, that is, grandstanding and investment in symbolic vanity projects. The media, too, become party to portraying the latter as progress by equating them with development. It is the underlying culture based on inequality that allows such political rent-seeking.

Remarkably, in Pakistan's political and social evolution, no progressive and credible counter-narrative has emerged, except briefly in the 1960s and early years of the 1970s, to challenge the dominance of a largely self-perpetuating elite in the affairs of the country. The tendency over the last two or three decades has been to equate, rather simplistically, democracy with development or to give it some kind of causal role in it. In both official circles and academia, the implicit assumption has been that democracy will deliver development more or less automatically. Effective governance has barely figured in the typical political arguments over development in the country's media. Unlike the economies of East and South-East Asia, however, that have successfully combined rapid economic growth with high levels of social welfare, Pakistan's experience has been singularly inadequate on both fronts, economic growth and social progress, and neither military nor political governments have shown more than a superficial commitment to the pursuit of more inclusive development, such as that of East and South-East Asia. What should therefore be explained is how poor governance and economic mismanagement have bedevilled Pakistan, and why the underlying social and political causes of this dysfunction have persisted for six decades or more.

In an earlier chapter, it was averred that even a weak State can exert a powerful influence on the lives of the people. For instance, marginalized groups often fall prey to the more powerful in an unaccountable environment. The powerful are motivated primarily by the need to maintain the status quo, or worse, to grab an even larger share of national resources. Democratic procedures, such as elections or even laws, do not ensure that the interests of the more powerful are aligned with those of the rest as the former are often able to rig the elections or 'capture' the relevant institutions of the State. Furthermore, the poor tend to be less educated, are less articulate, are badly organized and suffer from systemic social exclusion. A further problem in religiously factious and ethnically diverse societies such as Pakistan is that, irrespective of the laws, minority groups can expect to bear the brunt of both explicit and implicit discrimination against them from the majority. The problem arises both at the initial conceptual stage, that is, policy formulation, and at the next stage, that is, policy implementation and we can adduce public choice theory to understand what has been going on in Pakistan.

Public choice theory

Modern public choice theory owes its origins to the work of the Swedish economist Knut Wicksell, and goes back to 1896, and was subsequently developed by Nobel laureates Kenneth Arrow and John Nash. It explains that democratic polities, developed and developing, contrary to the ideas of the utilitarians, expressed in the maxim the greatest good for the greatest number, are heavily biased in favour of 'expressive interests' (Winch 1971). They are, hence, prone to deliver suboptimal outcomes when it comes to the formulation of economic and social policies and the deployment of public resources. By expressive interests is meant hard lobbying, bestowing jobs, lavish awards and praise on official functionaries, huge expenditure on public relations and by special pleading. By doing so, expressive interests can succeed in radically influencing the decision-making process at both the conceptual and implementation stages in their favour, leading to outcomes with significant negative externalities. Examples of such bias can be found in a whole range of developing and developed countries in which State resources have remained heavily concentrated towards the urban and middle classes despite much rhetoric to the contrary and in the protection and promotion of their own interests such as housing schemes for the rich and subsidized higher education.

In any society, good governance based on equity and fairness can be construed as a public good at the abstract level. But few developing countries have been able to achieve it in practice. Except in textbooks, policymaking and policy implementation never takes place in the abstract; States have to function in the real world full of competing interests and what they do affects the entire population consisting of actual men and women including those who are not the supporters of the government in power. In this regard, one illustration is telling. Subsidies by the State for a whole host of activities – electricity, fuel and fertilizer, for instance, are prime vehicles for dispensing patronage in many developing countries including Pakistan. The costs of subsidies are spread over the entire population and are usually so small as to be barely noticeable at the individual level. But, the benefits of the subsidies are concentrated within a much smaller group, and the group tends to become expert in protecting and furthering its interests. Indeed, special interest groups are powerful enough to effectively negate the interests of far bigger numbers who tend to be either ignorant of what is happening around them or are too diffused to act in concert. A multiplicity of interest groups, all succeeding in their efforts to influence policymaking and policy implementation, can ultimately lead to a failure of the State, a situation very similar to that of market failure, in which it eventually runs out of resources.

Success in obtaining State subsidies is a fairly standard form of rent-seeking. Rent-seeking thrives when State authority becomes weak and cannot resist the pressures exerted by expressive interests. Outright bribery apart, regulatory capture is a normal symptom of rent-seeking behaviour, and the latter has taken place under both military and political governments in Pakistan. Rent-seekers are able to subvert State authority by applying relentless pressure on politicians, bureaucrats and the judiciary and even an apparently independent media falls in line to present the interests of special groups as the national interest to the wider public. Decision-making becomes progressively distorted so that the general public interest exists only in the realm of slogans. Pakistan's recent history is almost a controlled experiment of the stark reality of public choice theory in which the interests of the general public have been captured by at least three different groups: the bureaucracy, politicians – including military governments – and the private business sector. Although they may have their own spheres of activity and responsibility, in the matter of preserving the status quo and sharing out the spoils, the three groups not only overlap through close friendships and kinship ties but have been, and remain, closely allied in attitudes to the world around them.

It may seem old-fashioned but linking democracy with development, given the constraints of public choice theory, can be best understood within an analytical framework that John Stuart Mill, the father of utilitarianism, called 'government by discussion' (Roll 1962). If public policy is to achieve its objective of the greatest good for the greatest number, it should be based on institutions where people can interact and find some common ground for action. In order to participate effectively, marginalized groups will need not just opportunity but a degree of acceptance and encouragement from others, specifically the more powerful, to aspire. That encouragement is not just a matter of providing decent education and good teachers but the sustained fashioning of a strong socio-cultural milieu that gives pre-eminence to social justice and non-discrimination. Such a milieu can only emerge through the efforts of society as a whole.

Egalitarian cultures: Their origin and significance

Although in evolutionary terms the whole of humanity has travelled on the same journey since pre-history, outcomes in terms of widely differing cultures, driven mostly but not exclusively by the physical environment in which these cultures have evolved, are a notable feature of the global human family (Childe 1964). What we are able to see today in East and South-East Asia, and in South Asia, is the culmination of many generations of social, economic and political evolution – including warfare and foreign intervention, especially during the colonial interlude of 1750–1950. Not only are the two regions different ethnically, but in meeting the physical challenges of their land and agronomy have created economic, social and cultural organizations that reflect the nature and level of their economic development and the structure of their social relationships, whether based on European-style feudalism, caste or East Asian-style extended family networks and ties. A culture or society can exist as a group over the course of many decades, if not centuries, only if its members have acquired common feelings about what is an acceptable way of conducting its affairs. These common feelings are expressed in that group's collective attitudes towards the rest of the group, to each other and to the outside world, or what amounts to the implicit social contract.

As early hunter–gatherer societies evolved into settled agricultural societies and developed hierarchies, the first divisions within the group implying status emerged. The evolving social structures had to be justified by the development of a supporting narrative or narratives; these in turn led to the emergence of governing ideologies. Professor Gordon Childe states that the power of ideas to influence action depends on their acceptance by society. In this context, even absurd beliefs can win credence provided every member of the group accepts them (Childe 1964). Thus was born the notion of conformity to the prevailing mores and norms in many, if not most, societies. Not only does ideology hold society together but it underpins the underlying economic structure and social relationships. Today, the developed economies of the world function efficiently only as a result of the cooperation of their citizens in a vast and highly complex set of productive arrangements. Without this cooperation no modern economy would be able to function, but it is well to remember that the principle of cooperation, far from being modern, has been present in all societies throughout history. Cooperation was necessary not only for the sake of maximizing output but also for survival itself against predators and hard times. All these cooperative arrangements then had to be sanctified by a supporting ideology partly for the sake of stability but also to help entrench a ruling class in power.[2]

Adjustments to the physical environment have played a large role in the differences that have emerged between cultures over the course of many years. Different societies have been impelled to find their own individual ways of growing food, building shelters and inventing tools. Likewise, societies have come up with widely varying arrangements for their social organization. However, over the course of hundreds of years, cultures and ideologies have interacted and better, or more productive, cultures have been mimicked by the others. In Europe, for example, feudalism emerged to tie semi-nomadic tribes into farming under the aegis of a feudal lord. This may seem backward today, but it was a huge improvement over the slavery of the Roman Empire in which the vast majority of ordinary people had to live. Simultaneously, the guild system secured for some in these societies not only freedom from the feudal lord but also a higher economic status in society. The discovery of North and South America in the fifteenth century and of Australia in the seventeenth century increased the supply of food, opened up a much greater range of economic opportunity for the people of Europe and gradually led to the ending of feudalism.

In East and South-East Asia, the cooperative division of labour that underpinned rice cultivation, however, continued into the Middle Ages. Anthropologists have seen the pattern even in places far removed from China, like Java and Borneo. What it amounted to in practical terms was an implicit obligation for all members living in a particular settlement to work alternately on their own paddy field and on that of their neighbours within a collective endeavour. Indeed, all tasks associated with life in and around a particular settlement, such as collecting firewood and organizing the water supply, were cooperative endeavours. These societies were thus able to function and even prosper without a 'ruling class' as it were. According to custom, the chief of the settlement of an extended family was usually one with the best knowledge of their particular natural environment. Later, the extended family living within a particular settlement became a 'confederation' of families within a much larger area. The idea of capturing territory from neighbours seems not to have become a major preoccupation in East and South-East Asia as appears to have been the case in both Europe and South Asia.

Why did these distinctive forms of social organizations not evolve into European-style feudalism in East Asia? The answer can only be speculated upon. But one plausible explanation is that while the breakup of the Roman Empire in Europe led to internecine warfare between different tribal communities and eventually to the birth of the nation state with its own language, boundaries and territorial limits after the Peace of Westphalia, in East Asia it led to the emergence of China which is aptly described as a 'civilisational' State by modern observers like Martin Jacques (2012), notwithstanding a period of intense struggle in the twelfth and thirteenth centuries between the Mongols and the Han Chinese. An empire and an emperor emerged in China, with a so-called mandate from heaven, combining both temporal and spiritual authorities as in the Holy Roman Empire. But, lower down the social scale, the cooperative form of social organization in agriculture remained intact and artisans flourished in the production of silk, ceramics and tools. Instead of feudal lords, China and East Asia, however, acquired warlords who were quasi-kings within their domains, but succession was never an exclusively dynastic process. The phenomenon of warlords was the harbinger of much chaos and suffering in both Japan and China in the nineteenth and twentieth centuries. On the other hand, the seed of an egalitarian social contract that had been planted in the Middle Ages proved to be a hardy survivor and gave these cultures the foundation of a strong rural economy in the nineteenth and twentieth centuries.

It is consequently the strong instinct of cooperation dating from the earliest settled societies that underlies the societies and cultures of East and South-East Asia. And this instinct has made it easier for these regions to evolve into the egalitarian cultures of the twentieth and twenty-first centuries where the common weal is given precedence over individual rights and privileges, a quite different set of attitudes to social preferences and a pattern of production in which rent-seeking dominated the European economies right up to the twentieth century. South Asia, too, followed a European pattern of social and economic evolution. Throughout the Middle Ages, the Indian subcontinent was divided into fiefdoms in which loyalty lower down the social scale, that is, outside the ruler's *durbar* and courtiers, depended upon patronage buttressed where appropriate by ties of marriage. Because agriculture was primarily rain fed, rather than intensively cultivated like paddy, and every seven years or so the rains failed, the modus operandi of these fiefdoms was rivalry rather than cooperation and that attitude continued to dominate the economy and society both under the Moghuls and under colonialism; indeed, it dominates the economies of both India and Pakistan with their remarkable array of ethnic, religious, linguistic and caste rivalries. What about the ordinary people? By and large, they were ignored while the physically able-bodied ones might forge careers as soldiers. Such administration as there was, was for delivering public services and was only set up during the colonial period. Today, because of the sheer weight of numbers and inadequate resources, on the one side, and dearth of merit in the selection of public officials, on the other, public service delivery has all but collapsed in South Asia.

From pre-history to the modern world, society has been motivated by the idea of progress (as discussed in Chapter 1), and sustainable progress can ultimately only be built on a notion of fairness. Today, it is known that development requires that the benefits of economic growth be widely shared both for itself and as a moral imperative. In this regard, government by consent is undoubtedly something to be admired and valued for its own sake and for its ability, in theory at least, to deliver equitable outcomes. But, real-life governments cannot override the constraints imposed upon their freedom of action by the surrounding social and cultural ethos. The modern State has been in existence in South Asia for no more than 150 years; the mores of South Asian society go back many hundreds of years into the past. An equitable polity has never been part of the political economy of South Asia and that characteristic dominates the political economy of the region more than six decades after independence, despite numerous elections and the rise of an embryonic middle class.

In attempting to identify a causal link between democracy and development, it is necessary to examine the nature of the political economy of society because it is the political economy that will determine how effective governance is in that society. Improving governance will require that the driving force of rivalry be replaced, or at least attenuated by cooperation, a tall undertaking at the best of times. But with resources in short supply and governance deteriorating by the day, the task becomes doubly challenging. Is there an alternative way ahead?

It is accepted almost without demur today that in most developing countries elites can exert disproportionate power even within a democratic system of government with its full panoply of elections and a judiciary. The reasons for this are not hard to find. It is the job of all ruling elites to capture the means of political influence: education, especially higher education, the media and access to finance, which help to dress up their special pleading in the garb of 'science', such as the maxims of neoliberal ideology over the last three decades. In addition, they can often co-opt non-elite groups – blue-collar workers, middle-level farmers and shopkeepers – to further their aims. Indeed, such groups are adept at exerting political pressure and in giving in to such pressure the elite can plausibly claim that they are pursuing a wider agenda than their own narrow self-interest. But pandering to the interests of the near poor means that by building schools and clinics in cities and towns there are even fewer resources available to be spent on the really poor, especially in the rural areas. Thus, the extension of democracy might be perversely instrumental in reducing the attention that the rural poor receive from the State.

Above all else, the urban bias means that overall governance also suffers. Conditions of life being what they are in the rural areas of South Asia only an incorrigible optimist would believe that the State can provide a decent level of governance in these areas. The upshot is that the rural poor get schools with no teachers, clinics with no staff or medicines and law courts without officials. The comparison suggests that the cooperative cultures of East Asia found it easier to deliver equitable development to the people on the basis of effective governance, not democracy as practised in South Asia. South Asian democracy has delivered quasi-legitimacy; it has not delivered equity or good governance. Rapid cultural development delivered by a modern educational curriculum, and supported by a collective desire to understand how East and South-East Asia have grappled with the same problems, will be needed to make progress.

Is China a special case?

Following China's spectacular economic rise after the 1978 reforms, a much-discussed question amongst development specialists is whether its approach to development can be replicated, in whole or in part, by other developing countries. There is little doubt that China's economic transformation between 1980 and 2010 is a phenomenon without parallel in human history, but what lessons does it have for the rest of the developing world? An interesting cultural context of China's economic growth is that it has occurred in a part of the world, namely East Asia, that has also seen the remarkable rise of Japan after the Second World War and the equally phenomenal growth of Hong Kong, Taiwan and South Korea in the 1970s and 1980s. There have been impressive bursts of growth in parts of Latin America as well, but none have had the sustained or enduring power of the East Asian economies. Indeed, perhaps more than geographic proximity, East Asia and the tiger economies of South-East Asia, Malaysia, Thailand and Singapore and now Indonesia and Vietnam do have one important thing in common: they fall in a broad cultural category that might be described as 'Confucian'. Confucius lived in China some 500 years before the Christian era, and his Analects have gradually come to have the same intellectual influence in the development of Chinese civilization as Greek philosophy has had in the evolution of European society. From the standpoint of development, what is especially noteworthy is that Confucius stressed the importance of the *community* rather than the rights of *individuals* but neither overrode the other. For the latter, he always emphasized that rights were to be balanced against obligations for the collective good. In this respect, his ideas were more in harmony with the needs of development than, say, modern Western democracy with its championing of the individual to the point of self-indulgence.

But, is a common culture based on a collective value system enough to deliver the remarkable results that East and South-East Asia have achieved? As we have seen in this chapter, the cultural foundation of any society can tell us a great deal in terms of whether cooperation, rather than an emphasis on individual endeavour, is the primary driving force for change, and how egalitarian the overall outcome might be. In essence, East Asian economic success, including that of China, has been down to successful State interventions *on behalf of the community* in three critical areas: making the rural economy more productive, focusing on manufacturing and international competitiveness and making the financial system subservient to the needs of both the rural economy and modern manufacturing. Broadly speaking, this is the pattern of development that Japan followed after 1868 Meiji Restoration and what China also embarked upon in the 1920s. Indeed, it might be hazarded that the whole of East and South-East Asia has followed the pioneering example of Japan in their quest for modernization and development. If there is something special in China's development, it is its unique history and history can bestow advantages that, too, are unique. History cannot be replicated in South Asia, but its lessons can be.

Most historians of East Asia tend to focus on things that are unique to China. For example, China produced a centralized but highly competent State apparatus far back in history, long before it happened in Europe. This was almost certainly the consequence of its own culture and unified language that promoted and sustained the idea of common purpose and common weal into which China's social fabric was subsumed. Indeed, it happened without significant resistance from either the forces of conservatism or the wealthy classes. It appears that the whole of Chinese society had bought into the notion of China as a way of life rather than as a mere country. Francis Fukuyama has observed that China was able to produce able civil servants through competitive examinations, the Mandarins, several hundred years before the modern State came into existence in Europe. Indeed, what the Communist Party of China has done since 1949 is to revive that very State administration after a gap of a hundred years, proving that an efficient State delivering decent public services does not need the checks and balances – and conflicts – of Western-style democracy. It is society's values enshrined in its social contract that accomplish these things.

It must be remembered that China has always been more than just a nation state; it embodies within it elements that transcend the nation state. It is as if the whole of Europe, North and South

America were one country speaking the same language and without the national rivalries that tipped Europe regularly into orgies of killings and destruction right up to 1939. When the Chinese talk of 'China', they mean not just the international legal entity but Chinese culture and civilization, which have existed continuously for more than 4000 years. In this respect, India, too, has a long and chequered history as a nation going back several millennia, but, barring the colonial interlude, one that appears to have involved far more conflict, division and rivalry than in China. Martin Jacques has declared that China enjoys a double identity: as a nation state and as civilization state (Jacques 2012). What this has meant in practice is that China's implicit social contract underlies the supreme importance and responsibility of the State in managing human affairs and the absolute primacy of the need for stability and unity for those taking decisions about the future. The Chinese State and the Communist Party of China are thus regarded as trustees of a grand vision of the past and not merely temporarily in charge of a territory and the people living in it. Within this long historical continuum, extraordinary stress has been laid on the medium of education by the Communist Party whereby the values necessary for the collective weal would be transmitted to the people. The stress on education is very much a part of the belief system in China that has traditionally venerated learning and wisdom, with teachers being regarded as the repositories of both.

Chinese society's view of itself thus includes giving primacy to the State not just in day to day matters but, perhaps more importantly, as a source of values and moral authority. In this regard, neither the State nor the people of China would have much time for competing areas or sources of authority such as a feudal class, business interests and the hierarchies of religious organizations. It is therefore in the nature of things that China's cultural development has not been influenced by competing versions of history and different world views that might emerge from the work of universities and think tanks, as, for instance, in the West. Throughout the last six decades, China's pursuit of modernization has been enthusiastically promoted by its leadership. It has been sold to the people of China as something inherently Chinese, to be organized and realized by the Chinese State. Few would quarrel with the assertion that at both the tactical and strategic levels the quality of decision-making by the Chinese State since the 1978 reforms has been outstanding. It has combined the resource allocation function of the market with the primacy of the State in which competing centres of power or influence, such as the military and civilian pressure groups, have been absorbed.

It is true, of course, that by the norms and values of the modern world China is certainly not a democratic society. Yet, countless observers have accepted that the Chinese State enjoys far greater legitimacy than any superficially democratic country, developing or developed. This is because it is the State in China that has always restored order after every period of chaos and the people of China, with their acute sense of the past, recognize and accept this. Moreover, democracy has to be the means to an end, which is social justice and effective governance. Democracy may be construed to be an end in itself only insofar as it legitimizes a government in power through popular consent *and* one that delivers social justice and effective governance. But countless democratic developing countries, and some developed ones as well, have failed signally to provide either social justice or decent governance to their citizens and have merely legitimized rent-seeking. So, democracy in China will eventually be a product of its own cultural evolution, a product of its own past, reflecting its sense of itself and the peculiar nature of its social contract in which the State is central to both the everyday concerns of its citizens and how Chinese society perceives the long-term future in the pursuit of its aspirations.

The lesson for outsiders is that China has successfully administered a vast country of more than 1.3 billion people over the past six decades. There have been blunders and great successes; *the objective of the State has always been to improve the lives of the ordinary people of China*, and this is the overarching lesson for Pakistan. Indeed, over the last three decades, the job has been done with extraordinary élan absorbing the upheavals of modernization with little fuss, lifting 500 million out of poverty and turning China into a relatively wealthy nation that dominates the global economy as no other. Problems of inequality, corruption and environmental harm have emerged over the last decade, but the Chinese State has accepted the challenges that they pose and has set up the machinery of institutions and policies to tackle them. Instead of being viewed with dread and suspicion, China is an example for other countries to follow in terms of the determination and single-mindedness that it has brought to improving the lives of its people. There have been and will be setbacks, even failures, but China, more than any other country, has demonstrated the strength, capacity and determination to deal with them. The question is, can the same determination be transplanted and nurtured in Pakistan with its very different culture and history? The answer is that politics alone will not do it, nor will pressure from any external agency. However, as the problems of poor governance intensify, the fear of chaos arising out of endemic social problems might finally force the elite of Pakistan to accept the need for equity and social justice in the country.

9
An Agenda for Pakistan's Future

The main challenges ahead

As an anxious nation looks to the future, all those who hold Pakistan's well-being dear know exactly what its problems are and what needs to be done. Lack of action by successive governments since the 1990s in making critical investments in infrastructure and in the social sectors has made those problems much more difficult, but not impossible to resolve. Similarly, a culture of patronage and rent-seeking in the country has all but cancelled out the principle of merit on which decisions should be based. However, there are chinks of light which suggest that hope need not be completely lost. What the country has to focus on is how to plan its journey to greater prosperity and to make progress on the long road ahead without needless delays and detours. It has taken the best part of three decades for things to have come to this sorry pass; dramatic change is not going to happen overnight. Indeed, for the next few years it might be best to seek to build consensus on how the journey should be undertaken, based on the principle of *no one left behind* without which any future development will not be sustainable. The global community through the United Nations itself has defined such an approach, in succession to the MDGs, and called it the Sustainable Development Goals (SDGs). In practical policy terms, the journey to prosperity in Pakistan should include a new deal for the poorest and, indeed, for all hitherto marginalized groups in the country: women, minorities, the rural population and all those whose concerns are rarely discussed in a meaningful fashion either by the decision-makers or the media. In any event, nothing will be possible if the country cannot tackle the endemic violence that has gripped the country for the last decade.

As the previous chapters have argued, starting on the long road to prosperity the country will have to confront the problems created by its version of rentier capitalism that has led both to grotesque levels of inequality and to oppressive mediocrity in the management of the economy over the last three decades. Few can argue that these phenomena have not had a major retrograde impact on the country's ability to compete in the global economy and instead have made a complete mockery of notions of efficiency, merit and social justice in the country and have reduced Pakistan's international economic status and influence to that of a bystander. The Pakistan elite thus need to put in train a serious and credible development and modernizing agenda[1] which enables the country to face the challenges of the twenty-first century, of competing in a rapidly changing global economy, of combining growth with equity and of preparing itself to absorb the changes taking place in technology and organizational and logistical skills. Above all, the country must grasp that Pakistan, like the rest of the world, is also subject to the great impersonal forces of history, many of which are beyond the control of the country. It is best to harness those forces as best as the country can manage and not to waste resources and effort in resisting them. The forces of globalization with their winners and losers are one example.

There is, however, an uncomfortable sense that the country's chronic failure to make any meaningful progress on this journey thus far must also call into question whether prosperity can be delivered within a meaningful time frame in the future. On the basis of the model of development followed by the country's elite, the last three decades of fitful progress do not inspire huge confidence for the future. The country must, however, embark on the journey not least on the assumption that since East and South-East Asia have managed to achieve and sustain broad-based development with enviable success, it should be possible for Pakistan, too, to follow in their footsteps. Prosperity for a developing country like Pakistan means getting to, or near, middle-income status over the next 10–15 years in terms of per capita GDP, that is, around \$5000 on a PPP basis. But on this journey, equity should not be neglected. The country has to improve the quality of life for the roughly two-thirds of the population who currently have to eke out a living on less than $2 a day, to give meaning to the idea of a common citizenship beyond the ethnic, sectarian and provincial ties that define the people of Pakistan and to strive to create a society where any future prosperity will be shared fairly and equitably.

At present, decisions about the economy and about investing in the social sectors effectively boil down to the distribution of the country's limited resources, with a heavy bias towards security issues, the needs of the middle class and of the country's urban areas. The poor have seldom been the recipients of meaningful policy attention; even less in terms of resource allocation. To make progress now, the future leadership of the country will have to make a conscious effort to admit and seek to rectify their many mistakes of the past. The leadership also have to make a viable plan for the future which puts the development and modernization agenda centre stage. The plan should take into account the country's weaknesses, in particular the weakness of the State, its lack of resources and expertise in critical areas of the economy and the limited administrative capacity in both the public and private sectors to tackle the myriad problems confronting society. No one should pretend that either the public or the private sectors of Pakistan can drive the economy forward in their current state. Their serious weaknesses cannot and should not be wished away; these weaknesses can, however, be overcome gradually if the necessary effort is forthcoming, vested interests can be kept in check, and a much higher level of honesty and candour enters the public debate. To this end, Pakistan's leadership needs to fashion, and put in place, a new and more egalitarian social ethos for the country's governance. Without such a commitment, it is difficult to envisage how the journey to prosperity can be contemplated far less undertaken.

Any moderately discerning observer accepts that Pakistan today is faced with three huge sets of challenges as it seeks to develop and implement a plan for the future. Two of these are obvious and have been discussed in earlier chapters, that is, the poor performance of the economy over the last two decades or more and the neglect of the social sectors. The third is less obvious but will almost certainly affect the country in the long term: the environment, in which the shortage of water as global warming advances is going to stretch the country's physical and administrative resources to their limits. As far as the economy is concerned, by far the most urgent need is to resolve the energy problem in a sustainable way based on realism. Without reliable access to electricity and/or gas the economy cannot function, and the country will not be able to grow and generate neither the jobs for the growing population nor the public resources to invest in energy and in infrastructure.

There is a rule of thumb that needs to be made a minimum benchmark for Pakistan's economy: a GDP growth rate of 7 per cent per annum. At this rate, the economy doubles every ten years and judging by the experience of East and South-East Asia the doubling should make a visible change in the lives of even the poorest citizens. But, for this rate to be achieved the country needs to follow a hard system of priorities. For the first five years or so, it might need to focus exclusively on the energy sector and eschew other investments if need be, and the first step in this direction is to develop an energy policy that recognizes both the country's needs and the evolving international consensus on climate change and CO_2 emissions. At the end of the fifth year, Pakistan then needs to embark on a concerted export-driven growth strategy, as without the discipline of such a strategy the country is unlikely ever to get to grips with the problems of rent-seeking in the economy. Furthermore, it has to produce a large more skilled workforce over the next ten years. In other words, children about to start school in 2015 should come out in 2025 with the ability to compete with the workers of South-East Asia in literacy, technical skills and awareness of the wider world.

Overcoming the energy crisis

To have enough affordable electricity in the country that simultaneously does the least environmental damage, Pakistan has to develop a mixture of hydroelectric and gas-burning power systems. Hydroelectric resources at the scale required are very capital intensive and will take many years – ten years at the very least – to build, but once the dams are in place the hydroelectricity is the cheapest that can be generated with the added bonus of providing water storage capacity for irrigation purposes. Pakistan is currently said to be actively pursuing two major hydroelectric projects that should add over 6000 megawatts to the national grid, but little information is forthcoming as to their financing arrangements nor, indeed, the time span over which the projects are expected to be completed.[2]

Natural gas is the next best alternative after hydro power, but Pakistan's domestic gas resources are close to exhaustion. Imported gas raises difficult issues of major investments in liquefied gas terminals and of vulnerability to international price fluctuations and trends. An optimal approach for gas, in order to maximize its impact on the economy in the next decade, would imply that the existing reserves be used only for generating electricity or for conversion into urea. However, this would not be politically possible. Moreover, having made a substantial investment in providing piped gas to virtually every end-user, including households, to then render it redundant would be extravagant and foolish. In East and South-East Asia, the mix of fuels used to generate electricity reflects their domestic availability. China, for instance, generates nearly 65 per cent of its electricity with coal, a resource that it possesses in abundance, but it is rapidly investing in gas, nuclear and domestically developed renewable sources like solar power and wind turbines. By 2020, China will be generating over 40 per cent of its electricity from these three sources, thus substantially reducing its carbon footprint in the years ahead. Similarly, South Korea has already made a huge investment in nuclear energy so that by 2020 it should be on the way to generating more than 40 per cent of its electricity from this source, leaving domestic coal as the fuel for under 40 per cent of the electricity generated, with gas and renewable sources accounting for the rest. Thailand and Malaysia are already using gas in preference to furnace oil.

In Pakistan, no long-term energy plan has been developed, so decision-making continues to be of an ad hoc nature in this sector. It is clear, however, that hydroelectricity is the best option in that it combines electricity with water storage in a part of the world where water-related stress driven by global warming is likely to become the single most important policy issue over the next two or three decades. The highest policy attention and the greatest resources should be directed at building as much generating capacity based on hydroelectric power as is technically and financially feasible. The same is true of gas. Gas exploration has been hampered by the subsidies that both fertilizer production and electricity generation receive. How much more gas can be found in Pakistan can only be guessed at, but without a substantial increase in drilling test wells no one can tell what Pakistan's true realizable reserves of natural gas are.

Against this background of missed opportunities and policy blunders, the first step is to make NEPRA truly independent, run by experts with strong professional and technical qualifications who are capable of taking decisions in an unbiased manner. In this context, taking the cue from the mobile telephone sector in Pakistan and elsewhere, a standardized contract between *all generating companies*, public and private, needs to be drawn up so that conditions of entry and exit and operational obligations are known to all and can be properly evaluated by investors and independent third parties. Suppliers and distributors of electricity will then be able to operate on a more or less predictable legal basis.

The second precondition is the need for consolidation on the generating side of the sector. Relying on the private sector for close to one third of generating capacity has meant that only small capacity plants have been set up thus far. This is because the private sector in Pakistan does not have the financial wherewithal or, indeed, the technical expertise to invest in high capacity generating plants. The plants set up by private investors do not use the latest technology and are high cost as they are based on imported furnace oil adding to the problem of affordability for poorer consumers and to the costs of subsidization for the government. Specifying a minimum scale of production suggests the most viable solution. This might eliminate the private sector from the equation but a reinvigorated WAPDA supported by public funds can and, indeed, should fill the breach.

The third precondition is to encourage the use of alternative sources, renewables plus nuclear, for generating electricity and to develop a more environmentally sensitive electricity policy. This is already happening in other developing countries and Pakistan should not simply shrug its shoulders on the grounds of the expense involved. Over the long term, Pakistan, like other developing countries, will also have to make a contribution to the reduction of greenhouse gases in the fight against global warming. The right approach is to start with pilot schemes now in solar power and wind farms. The private sector has shown neither interest nor capacity to make a meaningful contribution in this regard. The government therefore has to take a more robust view of its long-term responsibilities in this area and invite FDI for this purpose.

As far as NEPRA is concerned, its contribution to the future course of electricity generation and distribution in the country should be the benchmark of its role as a regulator. Throughout the world the contribution of electricity is recognized as being critical to the functioning of the economy and, in fact, goes much beyond its percentage share of GDP. Here is a sector whose wider social benefits far exceed its output measured in megawatts of electricity generated. The analytical framework for understanding this has to take into account economic, social and environmental considerations leading to many different results and outcomes. For instance, the electricity sector consists of both competitive and monopolistic elements and there is usually a substantial list of 'legacy' issues that have to do with Pakistan's long-term and recent history of investments in this sector. Dealing with all of them requires not just technical expertise but professional integrity of a very high order. The Pakistan State will need to meet this requirement one way or another.

In any case, with both electricity and gas, the financial constraints are by far the most serious as neither WAPDA nor OGDC have the internal cash flows to take on these massive tasks. At a tax take of 10 per cent of GDP the Pakistan Government simply does not have the resources to invest in hydroelectricity and in gas exploration on the required scale. To imagine that the private sector, domestic or foreign, will step into the breach is pure fantasy. Hence, without tackling the underlying political economy issues of raising additional taxes the electricity problem and, indeed, raising the overall public investment–GDP ratio in the economy as a whole will remain unresolved.

Increasing public resources

Nothing will be possible without a substantial increase in resource generation by the Pakistan government. Over the years, Pakistan has constituted a number of taxation commissions and reforms but the blocking power of the elite is such that, far from going up, the tax–GDP ratio is now sliding downwards and at 10 per cent it lies a good 5 to 8 percentage points below the tax take of countries in East and South-East Asia, all of which are societies with much higher per capita incomes which enable their governments to expend their own resources on education and health.

Therefore, the first test for the elite of Pakistan would be to stop 'taxing what they can' and have a credible programme of 'taxing what they should'. Cutting down on corruption, or even eliminating it altogether – an impossible objective, will not automatically raise the tax–GDP ratio. Regrettably, within the elite, there is little evidence of any social or moral compulsion to promote economic growth with equity, to invest in public goods, to improve literacy (especially female literacy), reduce malnutrition or provide a safe water supply for the poor. To pay taxes carries no moral or practical compulsion for the rich, their own lives remaining unaffected either way. Such attitudes will have to change however painful the process might be.

Furthermore, the media are complicit in this remarkable neglect, being preoccupied with the daily rough and tumble of petty political rivalries and the scandals that they inevitably generate. This may make for 'good' television; it does not advance the development agenda one bit. In fact, the neglect of the social sectors exists even in the research arena. Few people know the true extent of Pakistan's social problems, fewer still know what kinds of policy interventions are needed to address them. Indeed, the case for higher social spending by the State or for redistribution via the tax system has never been seriously argued. NGOs and philanthropists have been cast in the unlikely role of saviours.[3] Yet, without a major break in the hold of the elite the Pakistan State will never have the resources to carry out its responsibilities to the country's citizens. This is a point that the so-called intelligentsia, including the media, is reluctant to emphasize in their daily debates and discussions. For an outside observer, there exists an air of unreality in the way the subject of public good provision is discussed in the media, as if all it requires at any given time is a change in government.[4]

The second test will be to have a target for raising both absolutely *and* as a share of the total, direct taxes in the economy. All tax systems across the world are theoretically built on the entirely reasonable assumption of ability to pay. There is a trade-off between the ability to pay and ease of collection which is acceptable but a minimal commitment towards fairness has to be present. In Pakistan, the trend over the last two decades has been towards indirect taxes so that the system has become much more regressive over the years. It has to be conceded that individuals and companies will not start paying their share of direct taxes simply on the basis of moral exhortation. But a start has to be made and one step in that direction would be to learn from the experience of economies in East and South-East Asia.

The countries of East and South-East Asia have the advantage of a much more egalitarian social contract and while hardly anybody in the world actually *likes* paying taxes these countries have succeeded in building support for the role of the State in society and thereby for their tax systems, by minimizing waste and blatant rent-seeking and by delivering decent public services efficiently to the public.[5] Even in Pakistan support for a fairer tax system could increase if a serious and genuine effort was made and people could actually see and experience the benefits flowing from an improved provision of public services. Even in the rest of South Asia tax–GDP ratios are higher than they are in Pakistan and their underlying political and social cultures are similar to those of Pakistan. Why can Pakistan not emulate its neighbours?

Tackling the menace of growing social polarization

Against the background of the two tests stated above it is self-evident that a massive effort needs to be made to create a more pro-equity climate of opinion in the country. The return of inequality to levels not seen since the 1920s across much of the world reflects not only a significant failure in how neoliberal ideas have actually played out in real life but a larger political and intellectual failure that stubbornly seeks to justify their re-emergence as being either an unavoidable consequence of market-led economic growth but also one that the State should leave well alone. Such views are completely at odds with any notion of fairness in society. Indeed, left unchecked, current levels of inequality will almost certainly bring growth to a shuddering halt across the world. In Pakistan, while the principal responsibility in dealing with the menace of growing inequality lies with the State, the State alone cannot fashion a new and more egalitarian social contract. That is the responsibility of the decision-making elite, supported by the intelligentsia, looking at its own failures with a critical eye and seeking at long last to follow the example of the successful economies of East and South-East Asia by way of redress.

If the ruling elite of Pakistan are serious, all public and private institutions have to participate in laying down the basic contours of such a social contract. A starting point could be made by making it obligatory for the media, both print and TV, to devote a fixed amount of space and time each day to show how the poor cope with everyday life. In China some of the best documentaries on pressing social issues like the plight of the rural migrant workers, the registration system or *hokou,* the one child policy, the impact of rapid industrialization on the environment, have been produced and aired by the State TV channel CCTV. These documentaries have not only provided crucial information to the viewers but have, over time, strengthened the ethos whereby the State can justifiably claim to be addressing the country's problems fairly and consistently. Pakistan's media have never shown a similar inclination or, indeed, an ability to discuss social issues like education and health, devoting much time and effort instead on exposing and discussing political scandals in a highly personalized way. The signs for the future are certainly not encouraging; nor are they all wholly discouraging. But, much hard work has to be done if a pro-poor ethos is to be created.

Preparing for climate change

All the signs are that climate change in the form of global warming is happening and virtually no region of the world will be immune. Remarkably, however, wide swaths of influential public opinion in both developed and developing countries continue to either deny that it is happening or greatly underestimate its likely impact on the global economy and oppose any action, including any based upon the principle of insurance from being taken.[6] In Pakistan, where 60 per cent of the population is dependent on water for its survival both the government and the media have opted for the easy course of looking the other way in the hope that the problems of climate change will either resolve themselves or will go away. As Pakistan is one of those countries most likely to face water-related issues of climate change such indifference is incredible.

The consensus of global expert opinion on the subject is that Pakistan is likely to suffer from both less and more unreliable rainfall patterns over the medium to long term. Allied to the melting of glaciers and diminished river flows the impact on the population that is dependent on agriculture would be dire. The World Bank is predicting a future in which conflicts over water and food security could become commonplace in South Asia. Massive investment in water management capacity will be needed over the next decade to give Pakistan a fighting chance to face up to the challenge of climate change and global warming.

Improving the country's technological metrics and investing in human resources

At the technical level any strategic vision has to be supported by investment in the needed human resources. For example, raising literacy is not simply a matter of investing in school buildings: it needs a steady supply of teachers in all subjects that the economy will need in the years and decades ahead. Other countries, especially those in East and South-East Asia, have traversed well-known routes towards achieving their long-term visions by investing in primary, secondary and tertiary education in the right proportions. Such a long-term vision needs active State involvement. Leaving it all to the whims of the private sector would be a monumental blunder as can be seen in the remarkable expansion of high-priced tertiary, and hence largely unaffordable, education in the country over the last two or three decades. Enhancing functional literacy is required also to improve the quality of human resources if devolution of responsibility to the grassroots in the social sectors is to succeed.

Over the last 60 years or so Pakistan's private sector has barely inched beyond textiles while the economies of East and South-East Asia are the main producers of all manner of new, high technology goods ranging from computers, household electronics, digital communications and, in the case of China, even to the production of renewable sources of electricity like solar panels and wind turbines. Moreover, instead of wasting time and resources on marketing, these economies have concentrated their energies in becoming parts of international value chains – Vietnam is a clear case in point. One reason often adduced by the private sector for their failure to upgrade has been the shortage, if not the absence of qualified manpower. There is undoubtedly some truth in this and the primary responsibility for the failure must be laid at the door of the State which has sedulously neglected the country's human resources. But the unfortunate reality is that the private sector in Pakistan spends next to nothing on upgrading the skills of its workers.

Today, Pakistan must realize that there is a huge world beyond textiles and strive to find a niche in it somewhere. As the private sector has failed to grasp any of the opportunities coming its way in the remarkable expansion of global trade over the last 20 years it may well be for Pakistan to reinvigorate its public sector to this end. Few people remember how organizations like the PIDC, PMTF, HMC blazed a trail in the 1950s and 1960s in importing new technology into the economy. There were failures as well, notably in the PSM, but even Japan, South Korea and Taiwan in East Asia and Indonesia in South-East Asia had their share of failures. And, as of 2015, these economies are far ahead of Pakistan on virtually any measure, especially in the value-addition generated in non-traditional industries. Given the penchant for rent-seeking in Pakistan's private sector, it is hardly likely that they are going to bring investment into the country to enhance its international competitiveness. Public sector bodies need to be set up to drive investment in new industries.

There are those who profess to have faith in the ability of technology to solve the problems of development. Indeed, in view of the stasis that appears to have overtaken politics over much of the world, with the rapid development of technology standing in glaring contrast to the virtual paralysis in politics there are many who believe that technology, if allowed to evolve on its own, can find a way out from many, if not most, of the problems facing society. Is their faith appropriate or is it misplaced?

There is no doubt that during the last 20 years or so the birth of the internet and the web have completely transformed the way ordinary people can access information and share it with one another. This transformation has not been restricted to the developed countries as was often the case in the past but is true over much of East and South-East Asia with South Asian countries laggards to some degree. China alone has over a billion telephones and nearly 600 million users of the internet, the highest anywhere in the world. There is a view that with so many well-informed people sitting in judgment over the actions of governments, internet technology has the power to make conventional politics irrelevant or to bypass it altogether. In other words, technology will enable people to create and use their own networks of friends and associates, build and sustain consensus on a wider variety of issues, deliver collective action without friction and even perhaps raise the required resources for whatever collective end deemed to be desirable, as has been seen in many countries already.

But a note of scepticism is in order: it would be a mistake to overstate what technology can do. For example, technology cannot provide the physical infrastructure of roads, school buildings and clinics without which development simply cannot occur. These would still have to be provided by the State. Moreover, the development and supply of technology itself depends upon stable and well-functioning political institutions and on State-provided largesse for the really big developments. For instance, no one can seriously believe that the problems of climate change, of polluted rivers and water supplies, of endemic diseases like malaria, of urban life for the poor living in slums will be solved by the private sector acting on signals from the market. There have been signals galore without the private sector lifting so much as a finger. Indeed, private investors simply do not have the resources to effect genuinely transformative change in people's lives; only the State has that capacity. Champions of the private sector have an almost religious belief in its ability to solve any problem. In real life, success is more often the result of a partnership between the State and the private sector than of either acting alone and this is as true of technology as it is of the provision of public goods and services. Furthermore, only the State has the ability to marshal the resources on the scale needed for new technology to make a measurable difference to the lives of the ordinary people of any country.

Investing in human resources is the key for sustained long-term development, for developing the right priorities, for the development of technology and for harnessing the collective energy of society. The first stage of this investment is to create a critical mass of people who can not only read and write but also understand and evaluate what they have read. The second stage of the investment is to enable everyone to become a well-informed 'thinker', i.e. one who can participate in the decision-making processes that affect him or her and is not merely one who is the passive recipient of information and decisions that affect the way he or she lives. Indeed, decentralization will not be possible without the creation of aware and active citizens as part of a modernizing agenda. As things stand, the poor in Pakistan are incapable of playing a meaningful part in society. It is hardly surprising that turnouts in elections in Pakistan are amongst the lowest not only in South Asia but in Asia as a whole. The poor need not only to be enfranchised but enabled to become effective citizens of the country and active members of society. That is the challenge of development that Pakistan has to face over the next 10–15 years.

Overcoming the constraints of being a soft State

Soft States, essentially poor countries where the State is soft either because of its own limited capabilities or because it has been captured by self-perpetuating coteries and cliques, are unable to meet their citizen's needs or expectations; from the protection of their lives and property, to access to decent public services. One of the principal reasons behind the failure of South Asian countries, including Pakistan, to reach the UN Millennium Development Goals is that, by and large, they are soft States as far as development objectives are concerned, and are preoccupied with security issues. The consequence is that there is both limited capability and inadequate resources for States in South Asia to carry out their responsibilities, especially in the delivery of public services. As a result, many developing countries have allowed this space to be occupied by NGOs, several of them foreign funded. At a basic level, the abdication creates the illusion that delivering public services is simply a matter of philanthropy and, philanthropists, in turn, are happy to point to their apparent generosity as a way of deflecting attention from their greater responsibility of paying their due share of taxes to the State as corporate and well-to-do members of society. At a more mundane level, even well-meaning not-for-profit organizations, such as charities, are more than likely to follow agendas and practices that are at variance with national objectives and priorities. How then to ensure that the State carries out its responsibilities?

This is one area of development experience where there is no single model of 'best practice'. Even the more successful developing countries have been proceeding on the basis of trial and error, without finding a solution that can be replicated in other settings, beyond the rather general invocation of the principle of decentralization. Indeed, experience suggests that even if countries choose the 'right' policies and systems of implementation, the bureaucrats who will eventually manage the systems are likely to be driven by their own self-interest. The key in development parlance is to find the most effective way of 'incentivising' them to act in the best interests of society. Once their own interests and the interests of the wider public are aligned, standards of service delivery usually improve. This is the trick that East and South-East Asian countries have pulled off. Public services are of course better funded in both regions but that alone does not fully explain why schools, clinics, hospitals and public transport facilities are so much better than in South Asia. It would appear that than an ethos of public service has also been fashioned as part of the extant social contract in East and South-East Asia. As in so many other things South Asian countries are the laggards when it comes to engendering a pro-poor ethos.

Despite serious difficulties, the number and coverage of schemes that provide public funds to the poor continue to grow across the developing world. A recent study by the World Bank estimates that, in addition to education and health, there are only nine countries in Asia without an anti-poverty scheme consisting of income-contingent cash payments, subsidies for food or public work programmes. While waste and corruption continue, better record-keeping with the aid of technology has improved outcomes, for instance in Bangladesh and Indonesia. Better record-keeping offers the hope of reducing administrative costs and makes it less likely that bogus applicants will succeed. But having said that, even the best technology will not be able to decide who is eligible to benefit from the schemes. That remains a political decision and the most appropriate level for that is at the local level. Again, research in Indonesia suggests that local scrutiny has begun to work well although in Pakistan an audit of the Benazir Income Support Programme has shown that nearly half of those chosen to benefit from it were ineligible in terms of the Programme's own criteria for eligibility (*The Economist*, 10 January 2015). What this indicates is that the road ahead to fashioning a pro-poor social contract in the country is going to be long and difficult; persistence is the key. The way to proceed might be to concentrate effort on small-scale pilot projects, to then make frank assessments of their real success rate but to scale them up with adequate resources if and when they can be judged to be providing value for money.

Concluding thoughts

Some readers will be surprised that in enunciating an agenda for the future not enough emphasis has been put on the role of economic growth, nor, indeed, on the explicit need for improved governance in delivering the benefits of development. In fact, the experiment with neoliberal ideas beginning in the mid-1980s in Pakistan in which boosting growth alone and letting trickle down take care of the rest was based upon this very notion and it failed to deliver. Neither did the growth rate accelerate nor did the social indicators improve; and Pakistan began to slip further behind East and South-East Asia on both fronts. There is little likelihood that improved governance can be obtained through administrative or political reforms alone. What is really needed is the creation of a pro-poor social ethos within a more egalitarian social contract. If the elite can follow the path of their peers in East and South-East Asia and genuinely desire to usher in a new deal for the poor then it can happen, perhaps over the next 10–15 years. If not, Pakistan's economy will continue to slide towards greater dysfunction, more social instability and crises such as gas and electricity shortages will become endemic.

Why is an anti-poverty strategy so important? The principal reason is that the existence of poverty, and at one remove rising inequality and allied social ills of various sorts, are by far the most important long-term problems facing the country. Chronic poverty not only blights the lives of the poor but, by strengthening social exclusion, destroys any sense of community or of nationhood. It also sharply accentuates ethnic and religious divisions. In fact, left unaddressed it will, and probably already has, affected the rate of economic growth as well. Yet, it is difficult to detect a great groundswell of public opinion in favour of tackling these long-standing problems in the country. On the contrary, the uncritical acceptance of neoliberal ideas has fostered the strongly held belief, shared not only by the elite but by much of the intelligentsia too, that there is not much that can be done directly to alleviate the conditions in which the poor live. The underlying theory is that since the State has limited resources, spending on the social sectors is a luxury that Pakistan cannot afford. Given that Pakistan has one of the lowest tax burdens in the world and the paltry taxes raised are themselves largely regressive it is hardly surprising that leaving it all to the private sector has become conventional wisdom in Pakistani society.

What about the question of not being able to afford greater spending on the social sectors, such as decent health care, in Pakistan? Research, however, shows that basic health care at a reasonable level can be provided at very low cost to the bulk of the population. A number of countries have been able to do so. The most significant example is that of the Indian state of Kerala where universal coverage has been achieved at a per capita dollar cost that is not much more than what is currently being spent in Pakistan. This goes against the typical argument that a poor country should not even attempt to provide health care for all as the inevitable outcome will be uneven coverage, waste and corruption. More appositely perhaps, as far as Pakistan is concerned, it is the case that after many years of relatively high social spending, Kerala is now the richest state in India in terms of per capita GDP.[7] The economic rationale behind the question of affordability is that basic health care is generally labour-intensive. Poor countries where labour costs are low can therefore provide reasonable coverage at reasonable cost. Moreover, health care bears the hallmark of a collective good which markets generally are not good at providing. The missing ingredient in countries where basic health care is patchy is poor organization and the low morale of the providers. It is clear that these are the areas that a country like Pakistan needs to tackle with vigour in the years ahead.

One of the more intriguing features of Pakistan's political and social evolution especially over the last three decades is the smugness with which the successful development of East and South-East Asia has been viewed in the country. This lack of interest, bordering on indifference, in the two regions of the world that are considered models of development by the entire world is, however, understandable. East and South-East Asia owe their success to the mixed economy model in which the State has played a central role. Furthermore, by opting for and pursuing a strong open and outward strategy based on export discipline the two regions of Asia have prevented their resident elites from indulging in unchecked rent-seeking. Both East and South-East Asia are prime examples of the importance of fashioning an implicit social contract based on equity and then carrying out pro-poor land reforms and investing in public goods. Pakistan will find it difficult to pursue this agenda but it can and should learn from these countries.

Finally, a lesson for Pakistan from East and South-East Asia is that while all policymaking is contextual, its success ultimately depends upon a realistic long-term vision germane to that society. Pakistan's recent history gives exactly the opposite impression. Policymaking and the priorities that underline the process appear to be almost entirely ad hoc in nature, the country often lurching from one crisis to another, with no clear vision of where the economy and society are headed. Without a frank debate on what Pakistan's long-term vision should be the failed ideas of the elite and rent-seeking and patronage will continue to thrive. For this debate to take place, it is critically important that the successful transformations of East and South-East Asia be more widely known in the country and brought to the attention of Pakistan's decision-makers and the wider elite. Universities and research institutes are where this process should begin.

Epilogue

Pakistan held a general election in mid-2013, and while the result was largely predictable in the form of victory for the conservative Pakistan Muslim League (Nawaz group), there was also an element of unexpectedness in the relatively young political party the Pakistan Tehreek-e-Insaf (PTI), led by the former Test cricketer Imran Khan, which made major inroads into the support base of the existing political parties. Many people in the country, not least PTI's own supporters, interpreted the election outcome as a harbinger of radical change not only in the politics of the country but in setting the scene for a visible improvement in the way the economy is managed and social problems are tackled in Pakistan. Indeed, PTI supporters and others with an optimistic bent looked upon the elections as a watershed in ushering in an era of greater electoral accountability, breaking the hold of a small number of political families and, at long last, creating the conditions to confront the chronic problems of poor governance and corruption in the country.

There is no doubt that a substantial section of Pakistan's middle class has been energized over the last two or three years by Imran Khan's PTI. Although essentially an offshoot of Pakistan's governing elite in terms of social background and the family links of its leadership, if not (yet) in the matter of dispensing patronage and favours, PTI appears, on the face of it, to be different from the existing political parties, in that it seems to have fewer and weaker feudal connections. Moreover, it appears to have a primarily urban, middle class rather than a primarily rural, or urban poor, or lower middle class following. Imran Khan himself exudes genuine charisma after having built a modern cancer hospital in Lahore. However, the question nevertheless arises: Does the PTI really constitute a clear break from the traditional politics of Pakistan in which the feudal class has thus far ruled the roost one way or another? Obviously, until the PTI actually exercises power for an extended period, an objective answer to this question is not really possible. However, to any detached observer the signs are not propitious. For instance, its early record in Khyber Pakhtunkhwa is mixed. There is admittedly less overt corruption, especially at the higher levels, but public services seem to be as stretched as before in the province and no big programme of expanding primary school enrolment or improving basic health services either is being implemented or is on the horizon. Substantial volumes of funds for capital investment remain unutilized. For the average person, there is not much evidence of an improvement in the quality of life in the near future, for that matter.

In addition, as mentioned elsewhere, Pakistan's elections are normally marked by low turnouts. At just over 55 per cent (of which the PTI got 17 per cent or under 10 per cent of the total electorate), although an improvement on previous elections, the 2013 elections could hardly be described as a decisive breakthrough as far as popular enthusiasm for the electoral process is concerned. Indeed, they remain a long way short of the 80 per cent recorded in Sri Lanka in January 2015. In other words, while the PTI has certainly enthused a section of the population, the non-voters in Pakistan, who are predominantly the poor and especially poor women, remain unimpressed. It is also the case that PTIs election manifesto, like that of the other parties, consisted of a long list of homilies interwoven with a longer wish list of goals that would *need* to be attained; however, there was little information or discussion on *how* any of the latter would in fact happen in terms of policies and resources were the PTI to come to power.

It goes without saying that not even the richest country on earth has the resources to do everything and poor countries like Pakistan much less so. If poor countries are to pursue a broad-based development agenda with some expectation of success, they must (a) securely anchor their goals within the constraint of their resources, (b) develop a transparent system of priorities for the deployment of whatever resources, domestic and external, they can marshal and (c) divide their goals into what *must* be done over the next 3–5 years in Pakistan. The priority should be to overcome the electricity imbroglio as well as what *ought* to be done over the next 10–15 years, for example, to overcome low rates of female literacy. Regrettably, however, the PTI appears to be given to populist grandstanding on critical issues as much as the other parties, and prior to the elections it made all manner of wild promises to the voters. To the writer, this is in marked contrast to the far more circumspect stance and sober pronouncements, say, of the newly elected President Joko Widodo in Indonesia both before and after his election.

In the first three chapters of the book, the difficulties of following an agenda for development in Pakistan based on fairness and equity were highlighted. It is sufficient to say here that an essential part of any reform process starting in Pakistan now would be to squarely confront this challenge. What are the principal weaknesses of the State in carrying out its responsibilities, in other words, by being a soft State how is Pakistan's ability to implement a reform agenda compromised? Incompetence and demoralization of the administrative machinery would probably come at the top of the list, followed by poor policy formulation, followed, in turn, by the absence of a concept of 'merit', taken in its wider significance of fairness and rationality, in day-to-day decision-making. The lack of a public service ethos also characterizes the behaviour of both politicians and bureaucrats in a soft State. The former are primarily, if not exclusively, interested in re-election while the latter, instead of implementing State policies, increasingly tend to constitute themselves into one more interest group in society competing with the elite for a share of the spoils. The sum total of these negative traits adds up to an appalling level of governance for the public at large with no means of redress for the vast majority of them. The question for a serious reformer therefore would be where to start the reform process. More importantly perhaps, the question is how to develop consensus for a rational and realizable set of policy goals, how to raise the required resources and how to align the incentives of the administrators with those of the general public so that the chosen goals – for instance, the 2015 MDGs – are eventually achieved. Not an easy task, but learning from countries like Indonesia and Vietnam might help. A combination of better training and better mid-level salaries for public functionaries has played a big role in both countries in this regard.

At 10 per cent of GDP, Pakistan raises less tax revenue than any of its peers and is a good 4–5 percentage points less than the economies of East and South-East Asia. At this level, the Pakistan State simply does not generate enough resources to carry out even its minimal developmental responsibilities. Pakistan has constituted many taxation commissions over the years to deal with the phenomena of widespread tax evasion and avoidance but to no avail. The situation today is one of chronic budget deficits, high levels of monetization of the deficits, explosive growth in the money supply and chronic inflation, eased temporarily by falling energy prices. Unsurprisingly, the tax system has also become steadily more regressive over the years. It is true that very few countries in the world have tax systems with which taxpayers are wholly at ease and an elaborate tax-avoidance industry exists in virtually all countries (including those in Europe where huge welfare expenditures have to be funded through the tax system that is, by and large, part of a broad-based political consensus). In Pakistan, on the other hand, the underlying culture is not just one of systemic tax avoidance, it is one of outright indifference, if not of utter contempt, towards any personal or corporate tax obligations. Neither political nor military governments have been able to make the slightest difference in this regard.

Looking at Pakistan's recent history it does appear that most of the wealthy individuals and corporate bodies are far more prepared to make periodic donations to charity as a way of assuaging their consciences than to meet their obligations to society and pay their share of taxes. The inevitable outcome is that the State has remained shamefully bereft of resources, virtually all public goods have been, and continue to be, grossly under-provided and a brazen culture of free-ridership has come about generating feelings of entitlement on the part of the elite, on the one side, so that they can milk the State without hindrance, and of resentment and non-cooperation by the general public, on the other side. As mentioned elsewhere in the book, such attitudes have led to an atomized society, sharpened ethnic and sectarian divisions and prevented any collective identity or sense of community from emerging in the country.

Looking ahead, it is the elite of Pakistan that will ultimately have to decide what kind of Pakistan they wish to bequeath to their children. For now, they are happy to live in a society where intellectual argument and debate about such matters is conducted mostly in TV studios, whose real forte is scandal-mongering. Those who might question how long-term issues are to be tackled are so few that they can be described as oddities in Pakistani society. Yet, in Pakistan, as in other countries, the elite also fund NGOs, think tanks and universities, with the State now largely unseen in vast swaths of the public realm. It is remarkable in this context that there is barely a voice raised against yet more privatization of State assets, when previous experience with it has been so uninspiring. The sad reality is that however dysfunctional the State, the elite continue to thrive via patronage and rent-seeking, and the more doggedly they protect their own interests by institutional capture and by monopolizing public discourse. In Pakistan, instead of dealing with the causes of dysfunction, which ultimately affects rich and poor alike, the elite continue to seek to set the terms of the public discourse, and one of the ways they have done so is by controlling the media.

From a practical point of view, far-fetched though it may seem in 2015, Pakistan needs a political movement and party that genuinely connects with and represents the poor. Bodies like the United Nations, the World Bank, the ADB and even the IMF talk of the need for a 'pro-poor' bias in policymaking in developing countries. As this book has argued, East and South-East Asia were able to combine growth with equity in the 1980s and 1990s, and several countries in Latin America have managed to do so in the first decade of this century despite the intense pressure of globalization in the other direction. Hence, advancing such a thesis is not as far-fetched as it might appear at first sight. Simply by interposing on the political scene and by shifting the parameters of political debate even marginally away from neoliberal ideas such a party could make a significant contribution towards undoing a part of the banal sterility of current public discourse on the country's problems. The old Pakistan People's Party lost its pro-poor bearings many years ago and is now not up to the job either in terms of political orientation or in terms of its organization. In this respect, the PTI for all its newness on the political scene, appears to be no more than a pale imitation of the Pakistan Muslim League (N). While it fulminates against corruption and the 'system', it is unable to grasp that this is what capitalism in its neoliberal version combined with a system of patronage and rent-seeking inevitably delivers. On the national political stage, the Muttahida Qaumi Movement remains too narrow in its membership, ideas and appeal to play such a role. Without a more overt pro-poor bias in policymaking, most people will merely shrug their shoulders and either point once more to the failed ideas of trickle down or make some other, equally implausible, claim that the State in Pakistan is already doing all it can to reduce economic and social deprivation.

There is thus a clear gap in Pakistan's political spectrum; it needs to be filled by a political party that espouses a much more radical, egalitarian view of society and of development that is driven by the State and is combined with high levels of spending on public goods. Following the global financial crisis of 2008, anyone who looks at the preponderant cross-currents in the world economy cannot fail to see great cause for concern: inequality rising inexorably in all societies, vast private wealth lying in tax havens or in lightly taxed property assets at home and abroad, vanishing job security even in low-paying jobs and the State's readiness to privatize public assets for yet more private sector reward. Also visible to all, this neoliberal world includes many millions of people who are deeply worried about the future and the future of their families, who are terrified of losing their jobs or of falling ill and who are desperately looking for an alternative way of making their way in the world.

Across the world, including Pakistan, there is a unique opportunity for the elite by exercising their self-interest in an enlightened way, to offer the people of Pakistan a new deal for the future that breaks the vicious cycle of despair that grips the country. In this new political reality, a progressive party untrammelled by the agendas of the various interest groups that comprise the elite can forcefully explain and reiterate certain self-evident truths of the political economy of development: that in Pakistan elections alone rarely provide leaders and legislators capable of looking after the needs of the many, who tend overwhelmingly to be the poor. As has been seen in Pakistan, elections tend merely to legitimize the rich and powerful as self-appointed guardians of society or, more implausibly, as disinterested decision-makers – for only they have the means to fight elections – and thus allow them to pursue their own private agendas without hindrance.

A massive change has therefore to come about in the attitudes of the elite, like the decision by the ruling white minority and the African National Congress leadership to end apartheid in South Africa, and a more honest debate on the issues confronting Pakistan can drive this change. Even in a conservative society like Pakistan, a party akin to the social democratic parties of western Europe can make a powerful intellectual and moral case for social justice through redistribution, articulate more sharply the just aspirations of the poor and empower them intellectually and perhaps organizationally to challenge the status quo. The alternative will be more of the same, that is, economic and social stasis, arcane disputes within the elite as they fight over a diminishing quantity of the spoils, a dispiriting national narrative, public services declining further into irrelevance and the country as a whole sliding into ungovernability. It is genuine social justice that will make development sustainable in the long run in Pakistan. However, to undo the damage of the past, Pakistan's elite must honestly re-examine their own role in making Pakistan what it is today.

Appendix

Table A.1 GDP per capita PPP (in US dollars)

		1990	1995	2000	2005	2006	2007	2008	2009	2010
East Asia	China	1007	1786	2853	4948	5717	6665	7412	8118	9031
	Republic of Korea	8619	13,513	18,123	24,220	25,820	27,910	28,718	28,481	30,423
	Taiwan	–	–	21,231	27,844	30,119	32,650	33,417	32,946	36,866
South Asia	Bangladesh	691	866	1124	1535	1929	2085	2201	2304	2445
	India	1174	1542	2043	3037	3369	3743	3908	4214	4639
	Pakistan	1918	2379	2745	3577	3844	3981	4041	4101	4130
	Sri Lanka	2163	2977	3964	5208	5710	6212	6651	6860	7426
South-East Asia	Indonesia	2782	4217	4463	5925	6360	6853	7314	7617	7973
	Malaysia	6578	10,251	12,412	15,851	16,923	18,120	19,008	18,519	19,778
	Thailand	4125	6751	7318	10,826	11,660	12,470	13,039	12,767	13,905
	Vietnam	972	1492	1961	3125	3406	3685	3928	4128	4400

Source: Asian Development Bank website www.adb.org.

Table A.2 Tax revenue as % of GDP (refers to central government only)

		1990	1995	2000	2005	2010
East Asia	China	15.1	9.9	12.7	15.6	18.2
	Republic of Korea	14.8	15.2	17.0	13.9	14.0
	Taiwan	12.7	10.3	13.3	9.1	8.0
South Asia	Bangladesh	5.8	7.9	6.8	8.6	7.8
	India	7.5	6.9	6.5	7.3	7.3
	Pakistan	14.0	13.8	10.6	10.1	10.1
	Sri Lanka	19.3	17.9	14.2	13.7	12.9
South-East Asia	Indonesia	17.8	16.0	8.3	12.5	11.2
	Malaysia	17.8	18.7	13.2	14.8	13.7
	Thailand	16.0	16.4	12.8	15.3	14.6
	Vietnam	11.5	19.1	18.0	21.0	22.4

Source: Asian Development Bank website www.adb.org.

Table A.3 Gross domestic capital formation as % of GDP

		1990	1995	2000	2005	2010
East Asia	China	36.1	41.9	35.1	42.1	48.2
	Republic of Korea	38.1	36.9	32.9	32.2	32.0
	Taiwan	24.4	26.7	25.7	22.7	22.4
South Asia	Bangladesh	17.1	19.1	23.0	24.5	26.2
	India	26.0	26.2	24.3	34.7	36.5
	Pakistan	18.9	18.5	17.2	19.1	15.8
	Sri Lanka	20.7	25.6	25.4	26.1	27.2
South-East Asia	Indonesia	30.7	31.9	22.2	25.1	32.3
	Malaysia	32.4	43.6	26.9	22.4	23.3
	Thailand	41.6	42.9	22.3	30.5	25.5
	Vietnam	14.4	27.1	29.6	33.8	35.7

Source: Asian Development Bank website www.adb.org.

Table A.4 Public spending on education, total (% of GDP)

		1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
East Asia	China	–	1.9	–	–	–	–	–	–	–	–	–	–	–
	Republic of Korea	3.3	3.2	–	4.1	4.0	4.4	4.4	4.1	4.2	4.2	4.8	5.0	–
	Taiwan	–	–	–	–	–	–	–	–	–	–	–	–	–
South Asia	Bangladesh	1.6	–	2.4	2.5	2.3	2.4	2.2	–	2.5	2.6	2.4	2.2	–
	India	–	–	4.3	–	–	3.6	3.3	3.1	3.1	–	–	3.2	3.3
	Pakistan	2.5	2.8	1.8	–	–	–	1.9	2.3	2.6	2.6	2.7	2.6	2.3
	Sri Lanka	2.4	3.0	–	–	–	–	–	–	–	–	–	2.1	2.0
South-East Asia	Indonesia	–	1.0	–	2.5	2.6	3.2	2.7	2.9	–	3.0	2.9	3.5	3.0
	Malaysia	–	4.3	6.0	7.5	7.7	7.5	5.9	–	4.5	4.4	4.0	6.0	5.1
	Thailand	–	3.2	5.4	5.0	4.1	4.0	4.2	4.2	4.3	3.8	3.8	4.1	3.8
	Vietnam	–	–	–	–	–	–	–	–	–	–	4.9	–	6.3

Source: World Bank website www.worldbank.org.

Table A.5 Public spending on health (% of GDP)

		1995	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
East Asia	China	3.5	4.6	4.6	4.8	4.8	4.7	4.7	4.6	4.4	4.6	5.1	5.0
	Republic of Korea	3.7	4.3	5.0	4.8	5.2	5.2	5.6	6.1	6.4	6.6	7.1	7.3
	Taiwan	–	–	–	–	–	–	–	–	–	–	–	–
South Asia	Bangladesh	3.5	2.8	3.0	3.1	3.0	3.1	3.2	3.4	3.5	3.5	3.7	3.7
	India	4.0	4.3	4.5	4.4	4.3	4.5	4.2	4.0	3.9	3.9	3.9	3.7
	Pakistan	3.3	3.0	2.8	3.0	2.9	2.8	3.2	3.7	3.5	3.3	3.0	3.0
	Sri Lanka	3.3	3.7	3.7	3.9	3.9	4.2	4.0	4.0	3.7	3.4	3.3	3.4
South-East Asia	Indonesia	2.0	2.0	2.2	2.2	2.5	2.4	2.8	2.9	3.1	2.8	2.8	2.9
	Malaysia	2.9	3.0	3.3	3.3	3.9	3.7	3.2	3.6	3.5	3.4	3.9	4.0
	Thailand	3.5	3.4	3.3	3.7	3.6	3.5	3.5	3.5	3.6	3.9	4.1	3.8
	Vietnam	5.2	5.3	5.6	5.1	5.2	5.5	5.9	6.5	7.1	6.0	6.5	6.9

Source: World Bank website www.worldbank.org.

Table A.6 Exports as % of GDP

		1960	2005	2006	2007	2008	2009	2010
East Asia	China	4.34	33.76	35.72	34.93	31.64	24.08	26.60
	Republic of Korea	0.82	31.67	32.17	33.09	42.11	40.31	42.61
	Taiwan	–	–	–	–	–	–	–
South Asia	Bangladesh	–	15.42	19.07	18.20	19.32	16.88	19.13
	India	3.53	11.94	12.83	12.12	15.92	12.08	13.25
	Pakistan	10.79	14.66	12.33	11.71	11.95	10.44	12.08
	Sri Lanka	27.09	26.01	24.36	23.93	20.76	17.46	17.35
South-East Asia	Indonesia	–	30.43	28.40	27.30	27.36	22.17	22.29
	Malaysia	48.62	98.22	98.76	91.04	86.38	77.84	80.24
	Thailand	14.89	62.91	62.64	62.30	65.22	57.80	60.61
	Vietnam	–	56.29	60.00	62.73	63.23	53.86	62.31

Source: Calculated from data available at World Bank website www.worldbank.org.

Table A.7 Pakistan share of global merchandise and textile exports

	1990	1995	2000	2005	2010
Pakistan exports as % of global exports	0.16	0.15	0.14	0.15	0.14
Pakistan textile exports as % of global textile exports	2.55	2.79	2.93	3.49	3.11

Source: WTO website www.wto.org.

Table A.8 The Millennium Development Goals

Goals/targets	Indicator
Reduce extreme poverty by half by 2015	1. Numbers living on less than $1.25 a day 2. Poverty gap ratio 3. Poorest fifth's share of GDP
Reduce extreme hunger by half by 2015	4. Prevalence of underweight children 5. Prevalence of malnutrition
Achieve universal primary school enrolment by 2015	6. Net enrolment in primary schools 7. Proportion that completes five years 8. Literacy rate of 15–24 age group
Promote gender equality	9. Ratio of boys to girls in education 10. Ratio of literate males to females 11. Ratio of males to females in jobs 12. Women in elected bodies
Reduce infant and child mortality by two-thirds by 2015	13. Under-five mortality rate 14. Infant mortality rate 15. Rate of immunization of below 1 year
Combat HIV/AIDS, malaria, etc.	16. Halt and reverse their spread by 2015
Ensure environmental sustainability	17. Integrate sustainable development in national policies 18. Access of people to safe drinking water 19. Achieve significant reduction of urban slums

Table A.8 (Continued)

Goals/targets	Indicator
Develop a global partnership for development	20. Open, rule-based non-discriminatory trading system 21. Address the needs of least developed countries, cancelation of their Official Development Assistance (ODA) debt and more generous ODA for poverty reduction 22. Address special needs of landlocked countries 23. Make debt of developing countries more sustainable 24. Develop strategies for youth employment 25. Improve access to essential drugs and make drugs more affordable 26. Improve access to new technologies such as information and communication technology.

Source: United Nations Economic and Social Survey of Asia and the Pacific 2001.

Table A.9 Human Development Index ranking

		1980 rank out of 124	**1990 rank out of 141**	**2000 rank out of 157**	**2005 rank out of 174**	**2008 rank out of 175**	**2010 rank out of 187**
East Asia	China	92	103	100	101	96	98
	Republic of Korea	45	32	25	21	20	18
	Taiwan	–	–	–	–	–	–
South Asia	Bangladesh	106	122	126	133	134	143
	India	100	112	117	124	126	136
	Pakistan	101	117	124	131	131	147
	Sri Lanka	59	71	69	73	74	79
South East Asia	Indonesia	83	98	94	103	104	110
	Malaysia	58	64	55	58	60	62
	Thailand	75	88	83	89	87	92
	Vietnam	85	108	105	114	115	121

Source: UNDP website www.undp.org.

Notes

Introduction

1. The idea of governing or ruling elites was first discussed by the fathers of political sociology, Pareto and Mosca, more than a hundred years ago. Its modern application is the brainchild of the doyen of American sociologists, C. Wright Mills.
2. See *The Economist*, 15 March 2014, on 'The New Age of Crony Capitalism' for an extensive discussion on the subject.
3. William Easterly's *The Elusive Quest for Growth* contains a wide-ranging discussion of the subject of arrested development.
4. A substantial body of opinion now considers that Economics is not a science in the strict sense of the word. It is primarily a combination of logic and common sense. Given this, what is good or bad in terms of policy outcomes cannot be derived from Economics but has to be judged separately in terms of ethics.
5. Even those who believe that markets are always efficient concede that they tend to fail in the provision of collective goods. Three critical areas where this has happened in both developed and developing economies are health care, education and housing.
6. Much is made of Pakistan's possession of vast coal reserves. What is always missing in such claims is any mention of the staggering investment that would be required to exploit the coal reserves that neither the government nor any private investor can realistically finance.
7. It has been suggested that the more homogeneous the population the greater the likelihood of the elite acting in a collective, as opposed to narrow provincial, sectarian or other interests.
8. See various annual and sector reports of the Competition Commission of Pakistan including, in particular, the first two reports on the *State of Competition in Pakistan*.
9. Even after the upheavals of the first decade of this century Japan remains a remarkably egalitarian society. The share of wealth held by the richest decile is lower than in Norway and Sweden and executive salaries and perks a long way short of their peers in Europe and the United States.
10. For a detailed discussion of the system of decision-making, see Martin Jacques' *When China Rules the World*.
11. Virtually, the whole of higher education has been privatized.

1 Development, Social Justice and the Limits of Public Policy

1. For an excellent discussion on the limited range of choices available to Pakistan, see Mahbub-ul-Haq's *The Strategy of Economic Planning* (1966) and S M Naseem's *Dilemmas of Destiny* (1993).

2. Despite the fact that most jobs created have been in the informal economy.
3. One direct attempt at helping the poor, the Benazir Income Support Programme, became mired in free-riding with the inclusion of relatively well-off persons amongst its beneficiaries.
4. The Happiness Report issued in 2015 grapples with the complexities of measuring happiness in different countries.
5. Much interesting and useful background material on the political culture of Pakistan is available in Mujib's *Indian Muslims*, Mason's *Men Who Ruled India*, Wolpert's *Jinnah of Pakistan* and Cohen's *Idea of Pakistan.*
6. See also Romila Thapar's excellent *History of India* (vol. 1) for a description of the origin of patronage in India.
7. Globally, almost 8 per cent of firms (in terms of market capitalization) are run by relatives of their countries' leaders. See *The Economist*, 18 April 2015.
8. Pakistanis are major investors in Dubai real estate.

2 Why Has the Pakistan's Economy Underperformed?

1. The most visible outcome has been the loss of international competitiveness as evident in Pakistan's weak export performance especially over the last decade or so.
2. The annual Economic Surveys from the Ministry of Finance and publications of the State Bank of Pakistan provide an excellent flavour of the times.
3. Prof. Mushtaq Khan of the School of Oriental and African Studies, University of London has delved deeply into the relationship between development and rent-seeking.
4. Pakistan's share of global textile exports including clothing has declined from 8 to 3 per cent between 2000 and 2015 (World Trade Organization).
5. How the financial sector facilitates rent-seeking has been explained succinctly by Asim Khwaja and Atif Mian in 'Rent-seeking and corruption in financial markets' in the *Annual Review of Economics* 2011.
6. Many World Bank reports on Pakistan allude both to the intractable nature of these problems, and the fact is that they have been left unaddressed by successive governments.
7. Around two-thirds of the rural population owns no land.
8. For a discussion of this and related issues, see Larsson, Tomas (2012): *Land and Loyalty: Security and the Development of Property Rights in Thailand*, Cambridge University Press, Cambridge.
9. See Jennifer Bussell's 'Variety of corruption: the organization of rent-seeking in India', Paper presented at a conference at Harvard University on Westminster Model of Development in Crisis, May 2013, for an analysis of the origin and persistence of rent-seeking in India.
10. Kugelman, Michael (2015): *Pakistan's Interminable Energy Crisis: Is There any Way Out?* Wilson Centre, Washington, DC.

11. A wide-ranging survey of the pattern of development in East and South-East Asia is contained in *Asia and the Pacific: A Story of Transformation and Resurgence* (2014): United Nations ESCAP, Bangkok.
12. Spreads and returns on assets are notoriously difficult to compute in South Asia.
13. There are moves afoot to stop such practices in India where the largest banks remain in public ownership.
14. Pakistan has been under IMF tutelage more frequently than any other economy in Asia and, with one exception, in the world.

3 The Social Sectors in Pakistan: A Story of Neglect

1. See the report on the *Evaluation for the Social Sectors in Pakistan*, ADB Operations Evaluation Department, July 2005, for what went wrong with the SAP.
2. All these matters are discussed in *State of Education in Pakistan* (annual, various issues)
3. Pakistan's under-five mortality rate is worse than that of Nepal and Myanmar, both of which are poorer than Pakistan in per capita income.
4. There has been a plethora of reports on the Millennium Development Goals emanating from the United Nations, the World Bank, the Asian Development Bank and national sources, all telling the same story.
5. As were the 2015 elections to the Delhi State Assembly in India.
6. Income is often an inadequate measure of poverty. The poor also lack intangible assets like social networks which make them even more vulnerable to adverse events. A Gallup survey conducted in 2014 found that a third of the poorest quintile of developing countries had nobody to rely on in times of need. The poor lack access to such networks precisely because they are poor.
7. Problems and issues are discussed in *Roadmap for the Millennium Development Goals in the Asia Pacific region*, report presented to UN ESCAP, commission session, Almaty, May 2007.
8. These papers were started by the World Bank to concentrate the minds of developing countries on the importance of tackling the problem of poverty.

4 The Cultural Setting: Patronage and Rent-Seeking

1. For a discussion, see Daniel Thorner's 'The transformation of the rural economy' in *The Economic Development of India before 1947* in The *Encyclopedia Americana*, 1960.
2. See *The Economist*, 15 March 2014 for a discussion on crony capitalism and rent-seeking in the global economy.
3. For a pithy description of this phenomenon, see 'Rent-seeking and corruption in financial markets' by Asim Khwaja and Atif Mian, *Annual Review of Economics 2011*.

4. Capital flight has been a chronic problem for Pakistan but few know its true extent.
5. The current Pakistan government has announced that textile sector exports will be increased from $8 to $25 billion and total exports from $25 to $100 billion in five years. Given its past performance and Pakistan's poor competitiveness these targets appear to be barely credible and betoken another exercise in futility.
6. Extensively discussed in *The State of Competition in Pakistan 2009*, Competition Commission of Pakistan, Islamabad.
7. Renewable sources have already reached 15 per cent of gross generating capacity, much higher still in countries like Germany.

5 The Political Economy of Pakistan's Development

1. The Competition Commission of Pakistan has an impressive track record of identifying anti-competitive behaviour in the economy. However, its efforts have yet to lead to any demonstrable results for the wider economy of the country.
2. For both East and West Pakistan. Plan outlays converted at the official rate of exchange prevailing at the time.
3. A degree of success achieved by the Benazir Income Support Programme is an encouraging sign despite its many problems.
4. The complex nature of effective public service delivery is discussed at length in a collection of essays in *Reinventing Public Service Delivery in India,* (2006): ed. Vikram Chand, Sage Publications, New Delhi.

6 Regional Economic Cooperation in South Asia and South-East Asia

1. In terms of growth and employment, productive efficiency can offset a deterioration in the terms of trade as in 2009 and 2010
2. The establishment of Asia Pacific Economic Cooperation (APEC) may not lie comfortably with this hypothesis. However, the Pacific now, and the Atlantic previously, while being physical barriers also benefited from the development of fast, low-cost shipping services that overcame the disadvantages that physical distance posed to the countries around the two oceans.
3. These followed the sharp appreciation of the yen and led to the 'hollowing out' of Japan in the form of outward FDI by Japanese manufacturing enterprises.
4. See the *Economic and Social Survey of Asia and the Pacific 2011* for its discussion of the issues pertaining to connectivity in Asia and the Chinese initiative to set up the Silk Road Development Fund to boost connectivity with its Central Asian neighbours.

5. See the annual *Trade and Development Report* prepared by UNCTAD for a sense of the evolving views on trade, development and regional economic cooperation.
6. The UN recommended the establishment of such a bank in 2007.
7. Two new infrastructure and long-term development financing institutions on the horizon are the Chinese-led Asian Infrastructure Investment Bank and the BRICS New Development Bank consisting of Brazil, Russia, China, India and South Africa

7 The State, Private Enterprise and Development

1. One of the consequences of neoliberal ideas and globalization has been to increase the size of the financial sector vis-à-vis the rest of the economy. This has left developing country governments dangerously vulnerable (a) to the instability inherent in the financial sector and (b) an inexorable rise in inequality in society, as Minsky predicted in 1992.
2. The astronomical OTC derivatives market is almost ten times the size of the global economy.

8 Democracy and Development: Diagnosing Poor Governance

1. This should not be taken to mean that all countries must remain prisoners of their cultures forever. It merely suggests that in more egalitarian cultures notions of equity are not resisted tooth and nail by the rich when it comes to the funding of public services.
2. Diamond, Jared (2013): *The World Until Yesterday: What Can We Learn from Traditional Societies*, Viking Press, London has a fascinating account of these issues from the perspective of life in Papua New Guinea.

9 An Agenda for Pakistan's Future

1. Modernization has many different meanings. Here, it primarily signifies a post-enlightenment merit and reason-based approach to solving problems.
2. All infrastructure projects across the world are bedevilled by major cost overruns and delays.
3. Such preferences have been described as 'moral licensing', *Harvard Business School* working paper, December 2014.
4. In April 2015, during a visit to Pakistan by the president of China, assistance amounting to $45 billion to be given to Pakistan for investment in infrastructure and energy was announced. While obviously welcome, in order to evaluate its impact on Pakistan's economy more details are needed.

5. Singapore's Lee Kwan Yew was a firm believer in the responsibility of the State not only in developing the economy but in delivering the kind of society that Singapore should strive to become.
6. Pakistan has its share of deniers although the prevailing mood, such as there is, is one of indifference to the problem.
7. Information extracted from an article by Amartya Sen and Jean Drèze: *An Uncertain Glory: The Contradictions of Modern India*, Princeton University Press, Princeton.

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Note: The letter 'n' following locators refers to notes.

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