Reforming Pakistan's Economy
Performance, Progress, Prospects and Problems

ISHRAT HUSAIN

Pakistan was one of the few developing countries that had achieved an average growth rate of over 5 percent over a four decade period ending 1980. Consequently, the incidence of poverty had declined from 40 percent to 18 percent by the end of 1980s. But the 1990s proved to be a lost decade for Pakistan, Growth in per capita income dropped to slightly over 1 percent. Poverty resurfaced and about one third of the population now lives below the poverty live of $1 per day. Social indicators are worse than other countries with comparable income. The country was turned into one of the heavily indebted countries and was declared as one of the most corrupt country in 1996. The challenge facing the government which assumed power in October 1999 was to put the economy back to its pre 1990 track.

Macroeconomic performance and progress on structural reforms

The economic revival strategy laid out in December 1999 envisaged 4 key goals:

- Macroeconomic stability and the restoration of a working relationship with international financial institutions (IFIs),
- structural reforms to remove distortions in the economy,
- improving governance, especially economic, and reviving key national institutions. And,
- poverty alleviation measures.

The implementation of this strategy has been broadly successfully, with some set backs because of an extremely difficult environment over the last two years. While the progress since December 1999 is highlighted in the following pages, the failures are largely attributable to a host of factors, that include: (1) continuing economic sanctions after Pakistan's nuclear tests in May 1998 and the imposition of new sanctions after the suspension of 'democracy', (2) an unprecedented drought severely affecting the backbone of Pakistan's economy, the agriculture sector, (3) September 11th and associated hostilities in Afghanistan, (4) the more recent tension on Pakistan borders following the December 13th attack on the Indian parliament. (5) a synchronized global recession. Additionally, over time rampant corruption, poor governance, institutional decay and weak human resources in the public sector have severely restricted the government's ability to quickly implement policy initiatives. Moreover, certain structural measures implemented since December 1999 have themselves contributed to creating confidence issues in the economy; these include: activities of the National Accountability Bureau (NAB) against tax evaders and loan defaulters, the documentation drive by the Central Bureau of Revenue (CBR), and additional efforts to create a level playing field for all economic agents. All this has been exacerbated by the global economic downturn and a sharp decline in unit prices of exports.

However, some progress has been made on the four fronts highlighted above:

<u>Macroeconomic stability/relations with IFIs</u>

The restoration of macroeconomic stability and interaction with the IFIs has been achieved though a number of milestones:

- The last two years have seen a sharp reduction in the fiscal deficit from historical levels of 7 percent of GDP to 5.2 percent in FY01.
- Prudent fiscal measures and a tight monetary policy have resulted in inflation being brought down to 5 percent from an average of 10 percent in the 1990 – 98 period.
- Tax revenues have increased by about Rs 86 billion (26 percent) over the last two years, from Rs 308 billion to Rs 394 billion. As a consequence, the tax-GDP ratio is up from 10.6 to 11.3 percent.

- By limiting government borrowing to manageable level, SBP's discount rate and government Treasury bill rates have been significantly reduced, lowering the average cost of government bank borrowing and the export finance scheme. However, a weak monetary transmission mechanism, a large portfolio of defaulted and non-performing loans (NPLs), and the consequent high intermediation costs, are preventing a substantial lowering of lending rates.
- From levels of around US$ 1.0 billion (translating to 3 to 4 weeks of imports) in 1999, Pakistan liquid FX reserves currently stand at more than US$ 5.0 billion (5 months import cover). This has been made possible by purchases of excess foreign exchange from the Interbank and Kerb markets, the lifting of sanction since September 11th, grants from the US and Japan, PRGF disbursements, a rise in workers remittances, and an increase in capital inflows as confidence began to recover.
- Pakistan has shifted to a free floating exchange rate regime. After an 18.5 percent market correction of an overvalued Rupee, post July 2001 the exchange rate has remained relatively stable. However, following September 11th, the Rupee has been appreciating resulting in a significant lowering of the kerb premium from traditional levels of 4 to 5 percent to less than 1 percent. This, coupled with strict monitoring of the Hundi/Hawala business in the Middle East and North America, has led to a resurge in home remittances through banking channels.
- Pakistan's exports had been stagnant at around US$ 8.0 billion over the late 1990s. However, FY01 has witnessed a 15 percent increase with exports totaling about US$ 9.2 billion. Europe Union has triberalized market access to Pakistan. The same is expected from the United States.
- The breathing space that has been provided by the rescheduling of bilateral credits has been the direct outcome of Pakistan's resumption of relations with the IFIs. For the first time in recent history, Pakistan has successfully completed a Standby Arrangement with the IMF and has now graduated to a medium-term facility (PRGF).
- These developments have led to a ratings upgrade by Moody's Investors Services.

Structural Reforms

The economic stability highlighted above has been accompanied by wide-ranging structural reforms; measures taken in key areas are listed below:

Tax Administration/Tax Law

- A Task Force was formed to look into tax issues relating to the expansion of the tax base, strengthening tax administration, promoting self assessment, eliminating corruption, using IT in tax assessment and reorganizing the CBR. The Task Force has now submitted its report and its recommendation (which have been approved by President Musharraf) will be implemented over the next three years.
- A new income tax ordinance was introduced in 2001 which allows for universal self assessment, uniform tax rates, the removal of non-adjustable withholding taxes and detailed audit. Exemptions are also being phased out.
- The tax survey and documentation drive has resulted in 134,000 new income tax payers, 30,000 new sales tax payers, and the profiling of 600,000 tax payers that will help make tax assessment more effective.
- Multiplicity of taxes is being eliminated by reducing the number of taxes levied and collected.

Trade and Tariff Reform

- The maximum tariff rate has been brought down to about 30 percent in FY01 from about 225 percent in FY91. This will be followed by another 5 percent cut from 1st July 2002 and a reduction in number of slabs to 4. Quantitative import restrictions have also been largely removed.

- In order to bring then in conformity with WTO regulations, several laws pertaining to anti-dumping, countervailing measures and intellectual property rights have been promulgated.
- A comprehensive range of export finance facilities along with guarantee schemes are being provided to facilitate pre-shipment and trade financing to local exporters. Moreover, the implicit subsidy in the export finance rate has been removed by linking them to T-bill rates.

Privatization and Deregulation

- Key public sector units which will be offered to investors include nationalized commercial banks (NCBs), Pakistan Telecommunications Company Ltd., power distribution companies, oil and gas fields and companies.
- The public enterprises which are not currently on the privatization agenda (Pakistan Steel Mills, PIA and Pakistan Railways) are undergoing substantial downsizing and financial restructuring to make them operationally viable to reduce quasi-fiscal pressures on the government and prepare them for eventual privatization.
- Given the uncertain investment conditions, over all progress has been slow on this front. However, the recent 10 percent sale of National Bank of Pakistan (NBP) stocks has provided a boost to the efforts of the Privatization Commission.
- In terms of creating competitive markets and eliminating direct or implicit consumer and producer subsidies, the imports and pricing of petroleum products has been deregulated, reforms in primary freight pool have been introduced, and price distortions in natural gas have been eliminated. Additionally, all restrictions on the import and export of agricultural commodities have been abolished.
- The government has constituted a Deregulation Commission to look into the complaints of heavy government intervention in day to day operations of businesses.

Financial Sector and Capital markets

- Regulatory and supervision functions of the State Bank have been significantly strengthened and strict enforcement of prudential regulations have led to widespread recapitalization and a consequent improvement in the health of the banking system.
- The NCBs have undertaken a major restructuring by downsizing their staff and closing down their branches. These NCBs are expected to be privatized by the end of 2002.
- The restructuring of Development Financial Institutions (DFIs) through mergers and acquisition, closure, liquidation and reorganization is also been carried out.
- In efforts to create a long-term yield curve of government securities that will provide a pricing benchmark for private sector securities, the SBP launched the Pakistan Investment Bond (PIB) available in maturities of 5 to 10 years. A burgeoning corporate bond market has begun to emerge brining together long term institutional investors and borrowers interested in long term sources of financing.
- The Corporate and Industrial Restructuring Corporation (CIRC) has been set up which will deal exclusively with the problem of non-performing loans of NCBs and DFIs, and will also help revive sick industrial units.
- A network of institutions at the district, provincial and national level for microcredit financing is also envisaged under the financial sector reforms. The first institution – Khushali Bank formed by certain foreign and domestic banks, in collaboration with the Asian Development Bank, has already started operations in 30 districts of the country. Another microfinance bank has been established in the private sector by the Aga Khan Network and the International Finance Corporation.

Improving governance and key institutions

The agenda for improving governance is based on the devolution of power, improved public financial management/accountability, fighting corruption, and civil service, judicial and police reforms. Towards this end, the following points list some of the achievements so far:

Devolution

This Devolution Plan is aimed at increasing public sector efficiency through enhanced competition, greater accountability and creating ownership for work done. The purpose of the devolution plan is to provide a network of broad-based grass roots institutions that would undertake developmental activities. Additionally, to support the effective functioning of local government structures, district budgets have been prepared in a framework of fiscal devolution, which would operate through the mechanism of a provincial finance award.

Financial Management and Transparency

Regulatory structures, previously with Ministries, have now been made independent and enjoy quasi-judicial powers. The Chairman and Board members cannot be arbitrarily removed and are answerable through public hearings and consultations with stakeholders. Additionally, since access to information is critical for eliminating corruption and improving economic governance, a Freedom of Information Act is under discussion and will be enacted soon.

Anti-Corruption measures

The National Accountability Bureau (NAB) is serving as the main anti-corruption agency. A large number of high government officials, politicians and businessmen have been sentenced to prison terms, heavy fines and disqualified from holding public office for 21 years. Major loan and tax defaulters were prosecuted and have been forced to repay overdue loans and taxes of about Rs 30 billion.

Civil Service, Judicial and Police reforms

- The independence and responsibilities of the Federal Public Service Commission (FPSC) have been enhanced and its scope of work extended to all posts from Grades 11 to 21 in an effort to depoliticize recruitment, promotions and career development. The FPSC is now fully in-charge of merit based recruitment and promotions. The Civil Service Act has also been amended to reflect performance based career progression and enable the government to retire civil servants who are inefficient and/or corrupt. Additionally, the public sector educational training infrastructure is being restructured to strengthen skill-based training at all levels.
- The recommendations of the Committee on Rightsizing and Restructuring are being implemented; surplus staff is being readjusted, performance benchmarks revamped and structures of federal, provincial and local governments reconstructed. The implementation of these reforms has already led to the elimination of 40,000 positions and 23,000 ghost pensioners.
- In an effort to expedite the provision of justice, reforms aimed at case management, automation and court formation systems, human resource development, implementation of management information systems and upgrading the infrastructure supporting the judicial system are being carried out.
- Similarly, extensive police reforms will separate the law and order, investigation, and prosecution functions of the Police and promote functional specialization. Measures being taken include: Public Safety Commissions at federal, provincial and district levels, an independent complaint authority, and an emphasis on logistics, communication, mobility and training.

Poverty Reduction

The poverty reduction strategy, developed after extensive consultations with stakeholders and donors, is based on macroeconomic stabilization, improved governance, revival of economic growth, targeted interventions, social sector development and social safety nets. While a summary review of the first two elements has already been presented in earlier sections, the paragraphs below will focus on the latter four areas.

Revival of economic growth

Pakistan's growth rate in the last five years has been inadequate to reduce poverty. Towards reviving private sector led economic growth, the government has identified four major areas: agriculture, small and medium enterprises (SMEs), oil and gas sector, and information technology.

The emphasis in agricultural sector development is on improvements in the productivity of small farmers and creating employment opportunities for landless peasants. The enhanced productivity of the agricultural sector could also stem the tide of rural-urban migration, which can help in alleviating urban poverty. To increase agricultural output, several measures including better utilization of existing water resources through improved canal irrigation and maintenance; conservation and augmentation of water; promoting water efficient cultivation methods through enhanced availability of equipment and better extension work; corporatization of agriculture; deregulating agricultural commodities prices; on farm water management; and several initiatives on livestock development and agro-based industries are at various stages of design and implementation.

Recognizing the role of SMEs in employment generation, government policy is aimed at providing support institutions to resolve the financing, technical know-how and marketing problems being faced by these businesses.

Other than SMEs, information technology has been given due emphasis with telecommunication, connectivity and large scale training being used as the primary expansions vehicles. Additionally, favorable government policies have resulted in attracting considerable foreign investment and interest in the oil and gas sectors in areas of exploration, transmission and distribution.

Poverty targeted interventions

Where poverty is endemic in the country, the following targeted intervention programs have been introduced.

Khushal Pakistan Program (KPP): The Rs 20 billion KPP covering a 2 year period has been completed with the creation of some 0.5 million jobs and providing essential infrastructure in rural and low income urban areas. The program has resulted in construction of farm to market roads, rehabilitating water supply schemes, repairing existing schools, small rural roads, streets, drains, and storm channels in villages. Moreover, the scheme will be directed towards lining watercourses, de-silting canals, and providing civic amenities in towns, municipal committees, and metropolitan corporations.

Micro Finance: The government has established the *Khushali* Bank, which is the first micro-credit institution in the country aiming to provide credit access to poor households.

Social Sector development

This element of the poverty reduction strategy focuses on education, health, population welfare and enhancing the role of women.

Education Sector Reforms (ESR): The thrust of these reforms is achieving universal primary education and higher adult literacy, improving the quality of education, and a focus on technical and vocational education. The ESR also recognizes the role of the private sector in implementing the envisaged strategy. The proposed package of incentives for private sector includes the provision of land either free or at substantial concessional rates, non-commercial utility rates, liberal grant of charters, and several tax exemptions. Additionally, primary education is being made compulsory and measures are being taken to meet the needs of poor students such as free text books, uniforms, etc.

Moreover, all new teachers in the public sector will be appointed through a selection process involving a competency test. The program of pre-service and in-service training has been revitalized for both new and existing teachers, education budgets have been increased and non-salary expenditures are being expanded and protected.

Health Sector reforms: The new health policy is rooted in a 'health for all' approach based on accessibility, affordability and acceptability of health services by the general population.

The shift of public expenditure from tertiary to primary and secondary health care and devolving and decentralizing financial and administrative powers to local tiers form the crux of reforms in this sector. This new approach provides a clear signal that preventive rather than curative health care will be given priority in the allocation of expenditures along with the disadvantaged, weaker sections of society particularly those in rural areas.

Water Supply and Sanitation: Water supply facilities are to be increased from 63 percent to 68 percent by 2003-04 and sanitation facilities to 44 percent. Construction of drinking water supply and sanitation is already receiving the utmost importance under the Khushal Pakistan program. At local levels, efforts are being taken to enhance the design, management, maintenance and operation capacity of these schemes to ensure sustained benefits.

Social Safety Nets

- The Government has launched direct cash-transfer programs for poor families through medical assistance along with educational stipends through the *Bait ul Mal.* The Food Support Program (FSP) covers about 1.2 million poorest households with monthly income of up to Rs 2000. Rs 2.5 billion has already been spent in FY01 on this program.
- The Zakat program targeting widows, orphans and the disabled has been strengthened; about 2 million beneficiaries receive such assistance. It is envisaged that an additional 1.5 million will be added to the list of recipients through rehabilitation schemes which will provide loans of Rs 10,000 to Rs 50,000 starting small businesses. An allocation of Rs 5 billion has been made for these schemes in addition to normal stipends to *Mustahqeen*.
- The school feeding program for female students (Tawana Pakistan program), successfully piloted in a few districts, will be replicated throughout the country. This program will help address malnutrition of female students, which was resulting in low enrolment, high absenteeism / dropout and low cognitive achievement.
- Employees old-age benefits Institutions (EOBI) and provincial social security institutions provide pension and medical care benefits to private sector employees. About 183,000 beneficiaries receive pension benefits of approximately Rs 0.9 billion annually. Sindh and Punjab provide medical care benefits to about 700,000 beneficiaries and their dependents at

an annual cost of Rs 1.4 billion. Similarly, the Workers Welfare Fund provides social security support to workers and their families.

Prospects

Public skepticism surrounding the debate on the successful completion of the present reform process is understandable. The track record of previous governments is littered with many promises, but little delivery. While it is acknowledged that there exists no foolproof guarantee that these reforms will fully realize themselves and will not be unraveled, there are certain compelling reasons which tilt the balance in favor of a cautiously optimistic outcome.

Firstly, the record of the present government in taking much-needed tough and unpopular decisions during the last two and a half years, speaks for itself. After completing the first Stand-by Agreement (SBA) with the IMF in recent history, along with a structural adjustment program with the World Bank (WB) and various sectoral reform programs with the Asian Development Bank (ADB), Pakistan has graduated to a medium term Poverty Reduction and Growth Facility (PRGF) and associated programs of other multilateral institutions. The recent (February 2002) credit ratings upgrade by Moody's is testimony to the credibility the government has established by implementing difficult fiscal, external, social sector and governance reforms.

Secondly, policy changes implemented thus far and the reforms being envisaged for the future have been evolved by extensive deliberations with stakeholders. The proposed reforms have been made publicly available and are open to criticism and debate. This level of transparency and stakeholder-involvement is unprecedented. In the past, these policy decisions were the exclusive domain a select group of 'technocrats' in the Ministry of Finance and the central bank. This is the first time that a broad spectrum of private sector businessmen, academics, researchers and public sector managers have been involved in the formulation of different measures. Thus, the ownership of the reform process is broad-based at a local level, and has not been passed as a fiat accomplished by international financial institutions. This domestic ownership has been accompanied by a strong commitment by the top leadership of the country; President Musharraf has not only been instrumental in developing various strategies and building a consensus, but is also actively involved in monitoring reform progress and making needed mid-course corrections.

Third, previous army takeovers resulted in the setting up of a parallel hierarchy of military leadership operating under their own laws leaving civilian institutions dormant and inactive. This contributed to the decay of institutional capacity in the country, and when democracy returned, the underlying rot began to resurface. However, in a change from the past, the present regime has made an attempt to bring about fundamental restructuring of key institutions without the direct involvement of the military. The present strategy consists of strengthening institutions which are likely to be retained in the public sector, the transfer of some (WAPDA, KESC, OGDC, PSO etc) to the private sector, separation of policy and regulatory functions, the formation of independent regulatory agencies, and the liquidation of defunct institutions that are no-longer viable or required (NDFC, FBC and BEL). This strategy should provide hope that the process of institutional decay will be arrested on a sustainable basis.

Fourth, a major constraint to successful reform in the last decade has been has been the fierce resistance of vested interests groups, such as rent seeking businessmen, corrupt bureaucrats, finance-seeking politicians, made powerful by a weak judicial system and a non-existent accountability mechanism. The present government has put in place a strong and well functioning accountability mechanism, under which many politicians, bureaucrats and businessmen have already been convicted. Additionally, discretionary powers on public sector recruitment, awarding of contracts, licenses and permits are being eliminated or heavily curtailed and transparency and disclosure of information being made mandatory. Corruption at higher levels of the government has disappeared, but extortion and harassment by low level functionaries is still rampant. However, the moot point is that the unholy alliance of vested interests and the sources of poor governance have been eroded to a large extent.

Lastly, President Musharraf has publicly committed to the continuation and sustainability of these reforms. Towards this end, he has proposed a multi-pronged action plan to achieve this difficult objective. In the first instance, he will remain President for the next five years and is exploring various constitutional avenues to ensure this happens. He has also vowed to introduce constitutional checks and balances to ensure that there reforms will be protected. Another way of ensuring continuity in the reform process is to make it irreversible. That is, by privatizing public institutions, banks etc, changing the structure, size, processes of civil service, police and judiciary; by establishing independent quasi-judicial regulatory bodies outside the control of the executive branch; and by strengthening the Public Accounts Committee and external audit functions. Yet another method is to enter into agreements with IFIs, which will bind successor governments to meet some of these commitments in good faith. Finally, a strong, free and vibrant media will make it difficult for unscrupulous elements in successive governments to try to derail the reform process.

Problems and dilemmas

Despite positive developments in the last two years or so, Pakistan still faces a number of social, financial, political, structural and external problems. These will hamper the full realization of economic benefits from the reform process, or will lag these benefits into the future. Towards the stated goals of reviving economic growth and improving living standards of the poor, there are several constraints facing the government. These are highlighted below:

In a recessionary environment, where there is a serious backlog of private sector investment, public expenditures are able to provide a boost to economic activity. This stimulus not only creates a multiplier effect for the economy, but also provides infrastructure and social services for the private sector. However, in Pakistan, heavy public indebtedness and requirements of strict fiscal management under a stabilization program, do not allow the country for a large government stimulus package that will widen the fiscal deficit beyond current levels (and add to the already high public indebtedness). A constrained public sector and a recession-hit private sector have led to a declining investment to GDP ratio for the last six years. The conflict between stimulating economic activity through enhanced public expenditures and caps on the level of government borrowing and the fiscal deficit is taking its toll on the economy. This has no obvious solution other than trying to create an enabling environment for private sector led recovery. However, given the adverse developments over the last decade, confidence building will take time.

The second dilemma facing policy makers is that while there is an urgent need for expeditious implementation of policy reforms, programs and projects, the institutions responsible for implementation have become dysfunctional over time. The on-going restructuring of existing institutions, the creation of new efficient public institutions, harnessing new models of development such as private – public partnership and the privatization of some institutions will take time to show the desired results. Notwithstanding, the public expects these changes to take place quickly, new policies to become effective immediately, and government functionaries to behave in a responsive manner. This disconnect between popular expectations and ground realities has become a major problem.

Thirdly, there is serious tension between the goals of reviving private investment and that of retrenching interest groups of the small ruling elite which has traditionally doninated the

Pakistani economy. The present government is making serious attempts to create a level playing field, introduce transparency, strengthen accountability, and widen the tax net to capture informal economic transactions and agents within an overall framework that ensures enhanced governance in all aspects of economic, social and political life. On the other hand, most private sector investment in the past has been generated through tax evasion, misappropriation of government funds, selective privileges, concessions and exemptions, loan defaults and the non-payment of public utility dues. The investors that had rooted themselves in the economy are finding it difficult to carry on business as usual under the present changed set of rules. A new class of investors, used to competition and enterprise, has yet to emerge. However, this will take time since new economic agents want to be sure that these new rules are here to stay.

Fourth, the country suffers from serious deficiency of human, technical and managerial manpower. The quality of higher education in the country has deteriorated; graduates produced by our universities do not measure up to acceptable international standards. Those who excel in their fields have been migrating abroad for the past two decades or so. This migration has created a large reservoir of trained and experienced Pakistani expatriate community overseas. Some of these expatriate Pakistanis are willing to return to Pakistan and provide the missing expertise. However, those working in institutions where expertise is urgently required (particularly in the public sector) oppose their induction as they feel that this will sideline them. The popular media also unwittingly protects the interests of these less qualified insiders by highlighting differences in the salaries and perks offered to incoming experts without realizing their professional worth. As a consequence, these overseas Pakistani experts either refuse to join or if they have joined, pack up and leave. It is paradoxical that the country, which is short on highly skilled professional, cannot attract those who are willing to supply these skills.

Fifth, a major difficulty faced in making relative price adjustments whether they are exchange or interest rate, agriculture or utility prices, or the retrenchment of surplus manpower in the public sector, is the timing of these adjustments. In an environment where real incomes of fixed income groups have eroded by almost 75 percent since 1994, unemployment rates have almost doubled, incidence of poverty has been on the rise, new private sector investment has been declining, the social costs imposed by measures such as a large depreciation of exchange rate, a hike in real interest rates, upward movement of public utility prices and withdrawal of subsidies have created severe financial hardships. The government wants to ensure that these groups be insulated from such financial pains, but these adjustments are inevitable to bring about a reduction in the chronic fiscal imbalances and persistent current account deficits that are pushing the country towards chaos.

Sixth, the recent initiatives taken by President Musharraf to cleanse the body politic of the country from the clutches of religious extremists have given rise to retaliatory measures such as targeted killings, kidnappings and violence. This has created an element of uncertainty and fear. Under these circumstances, foreign businessmen avoid visiting Pakistan, shift their orders to other places and prospective investors (both domestic and foreign) postpone taking decisions. The Western media is also to blame for a creating a negative image of the country. Many that visit Pakistan see an entirely different image, and return to their home countries with a positive impression, its people and business environment. However, these individuals are very few in number, and are not always successful in convincing their superiors at company headquarters that ground realities in Pakistan varies markedly from the picture painted. Being risk-averse, company executives avoid investing in Pakistan. The cumulative effect of these decisions is that despite an improving business climate the country is ignored as a haven for investment. Notwithstanding, the purging of extremist and terrorist elements is a necessity in establishing a moderate, progressive and harmonious society, but has serious consequences for the level of economic activity in the short run.

Finally, growth in the agriculture sector, which accounts for the livelihood of 60 percent of the country's population, has a strong correlation with poverty alleviation. However, the sector has been heavily regulated by the government. The present regime's attempts to liberalize output and input prices, withdraw subsidies and support prices, get the public sector out of procurement and marketing of major crops, have unfortunately coincided with a severe drought, shortages of irrigation water for the last three years, and a softening of international cotton, wheat and rice prices. Although the production response by farmers to new incentives has been substantially positive, accruing returns and profits have severely fallen. There is an apprehension that the surpluses created in the recent years may be at risk.

These problems and dilemmas, while real and grave, have not diluted the resolve and willingness of the political leadership or economic managers to pursue the course of reforms. While there will be some other unanticipated exogenous shocks which might temporarily steer away from this course it is our singular belief that the country needs to restore its trend economic growth rate and reduce the incidence of poverty, improve its economic governance and build up strong institutions and upgrade its poor social indicators.

The case study of Pakistan, however should elicit an in depth examination of the recent consensus which has emerged at Monterry. Development economists have convinced the policy makers on the basis of empirical research that countries pursuing sound economic policies, good governance and increased spending on human development should be rewarded through foreign economic assistance. This amalgam of good policies and foreign capital flow will accelerate economic growth and reduce poverty. For last two and a half years Pakistan has followed this recipe diligently and earnestly. But economic growth has eluded us so far. Why is this happening? We can offer some alternate hypotheses.

?? Is it that the excess baggage of the past bad policies and poor governance has not yet been shed off?

?? Are the intensity and impact of external shocks outweighing the benign influence of domestic adjustment?

?? Is deterioration in institutional capacity the main stumbling block?

?? Are the non-economic factors and the negative perceptions about the country relatively more powerful?

?? What is the appropriate time lag between good policies and resumption of growth?

What is clear is that the usual and more common explanation i.e. the adjustment itself has been partial, incomplete, half hearted or devoid of domestic ownership will not apply in this case. There is a need to go beyond this simple explanation and explore the real factors that are hindering rapid growth impulses in case of Pakistan.