!' .

1/

I

I

© *The Pakistan Development Review*

51:4 Part I (Winter 2012) pp. 51:4, 7-22

*The Quaid-i-Azam Lecture*

Economic Reforms in Pakistan: One Step Forwar·d, Two Steps Backwards

ISHRAT HUSAIN

. '

. I

'I,

In 1998 I was invited by Dr Sarfraz Qureshi, the then Director of PIDE to deliver a lecture on "The Political Economy of Reforms: A Case Study of Pakistan". 1 This lecture was subsequently published by PIDE as a monograph. A year later, in ·December 1999, I had the honour of becoming the Governor of the State. Bank of Pakistan and actually participated actively in the formulation and implementation of economic reforms. During· the six year period of public policy making I realised that my knowledge about the political economy as manifested in my PI,DE lecture was incomplete. The narrative was more complex than 1 had developed as an outsider.

Now, six years later after my retirement from the State Bank of Pakistan I again reflected upon this topic as an observer and analyst rather than a participant. I realised .

I

!

' .

. *i¥*

that my learnings have become much richer by applying these different prisms-those of

an international development economist>. a public policy-maker and now an independent analyst. I am .grateful to Dr Rashid Amjad and Dr Musleh ud Din and their colleagues at PIDE for providing me this opportunity to share these learning with my colleagues, peers and other scholars present here today.

:' The political economy of economic reforms and structural adjustment has become

focus of growing attention in the literature drawing at the inter-disciplinary tools of analysis· and cross-country comparative perspectives. Detailed case studies of country situations do throw useful insights which are not captured through cross-country studies.

-The key question that is explored by this group of researchers is: if policy and institutional reforms are associated· with high economic pay offs, then why are these reform programmes not sustained and imp1einented consistently? Why are they derailed?

I would like to focus the discussion on Pakistan only and address the following q estions:

Why is Pakistan slipping relative to other developing and emerging countries?' Why is the record of reforms so poor and uneven?

Why are policy and institutional changes not sustained ovei- time? .

Before I address these questions I should establish the case as to why economic reform should take·place in the first instance. If a country is· an equilibrium. state with

: ··;.-:



Isharat Husain <ihusain@iba.edu.pk> is Dean and DireCto, Institute of Business Administratin (IBA)

and Fo·rmer .oo·vernor, State Bank of Pakistan, Karachi.

1Jiusain, Ishrat (1999). *The Political Economy of Reforms.* Islamabad: Pakistan InStitute of

DeVelopment Econoniics.

l.

i,:,

!i



.,

'I

51:4, 8 *lshrat Husain*

markets func ionirig well, macroeconomic balances in placeinstitutional framework strong, microeconomic distortions not affecting efficiency of resoUrce allocation then

.there is hardly any need for economic reforms or in titutional restructuring. But if

·changes ithese pre-conditions hae displaced the equilibrium then the reforms become necessary to bring the. economy back to a new state of equilibrium. The changes in the pre-conditions can be triggered by Unfavourable external (terins of trade, interest rate, abrupt withdrawal of capital flows, worldwide recession) or domestic shocks (large scale foreign borrowing, cumulative effect of unsustainable policies). The shocks can be sudden, abrupt, discrete and large 0r they can cumulate through slow, gradual, small and continuous changes. These can be anticipated or unanticipated. As I would show the contents of economic policy reform do vary with the passage of time as the intellectual and academic thinking and research findings change in the light of new evidence and

cross couiltry· experienCes oveJ1:ime. For example, the recent lMF rnantra2 is that fiscal

multipliers are quite large and therefore expansionary fiscal policies are to be encouraged to stimulate economic: growth. Until. recently, the conventional wisdom advocated by the Fund was that fiscal con·solidation i.e. contractionary fiscal policies were the cornerstone ofsound economic inanage·ment.

There. is a widely shared consensus about the .. nature of reforms that Pakistan

should embark upon. This consists of two cornponents stabilisation and . long term structural reforms. Under the first component the economy has to be stabilised with the help of fiscal consolidation, widening of tax net and mobilisation of domestic resources,

.cutting down the losses of state owned corporations, curtailing wasteful development

el\penditure and assigriing priority to removing supply-side bottlenecks such as energy and infrastructure, keeping inflation under control and maintaining exchange rate stability. The·.second componerit requires governance refonns in the structure, processes and human resource ·policies of the Federal, Provincial and Local governments, taxation and ·tariff ·reforms, removing· microeconomi- distortions. such as issuing· selective Statutory Regulatory Orders (SROs) for specific firms, liberalising and deregulating

·. goods and factor inarkets, strengthening regulatory architecture, promoting market

· cofupetitive forces and building human capital particularly in science and technology.

.We should now exatnine the record of last sixty five years in respect to these refornis.

THE RECORD 1947-2012

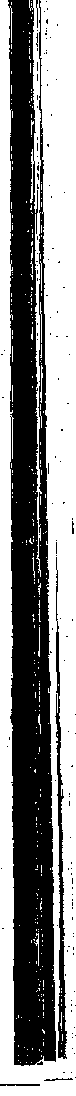
Last five dec.ades have witnessed a remarkable change in the econ\_omic fortunes of variOus· countries and continents. The poor. underdeveloped, developing and ·emerging

· \_countries that..account for two"fifth of the world population have, by and large, undergone

structural transformation of the magnitude that is unprecedented and was not anticipated. The economic po-wer equilibrium is graduaJly shifting from the advanced countries to developing countries. The distinction . between advanced and developing, North and South, First World and Third World is becoming redundant and irrelevant. For. the first time since cross-country data on poverty is being compiled all the six continents have recorded a decline in the incidence of poverty. The ·Millennium Development Goal of

2lnt mational Monetary Fund (2012) *World Economic Outlook.* Washington, DC: lMF.

*Economic Reforms in Pakistan: One Step Forward, Two Steps Bac/..ovards* 51:4, 9



reducing poverty by one half has been achieved five years ahead of 2015. The two lagging regions of the World-South Asia and Sub-Saharan Africa-are growing rapidly and lifting millions out of poverty.

In tlJe 1960s Pakistan was considered as a model developing country and its manufactured exports were higher than those of Thailand, Malaysia, Philippines and Indonesia.' While our larger next door neighbour was stuck with 3 percent growth rale Pakistan was averaging six percent annual growth rate. The Eastern wing of the country felt left behind in this rapid progress and decided to become independent in 1971. At that time Ba gladesh' *s* economic prospects were dubbed by the inten1atio \1 community in most uncharitable terms. In the 1970s Viet Nam was completely devastated by a prolonged war fought against a super power.

t

!

Advance the clock forward. Forty years later not only all the four East Asian Countries mentioned above have become economic power house but India, Viet \_Nci.m . and Bangladesh-way behind us in almost all 'the indicators-have not only caught up but are surging ahead. India,. despite its large population and uninterrupted period under· deniocra y, has become one of the drivers of global economic growth momentum. A slowdown in Indian economy is considered with serious trepidation by .the rest of the world.

· Why has Pakistan ended up *in* its current economic conditio\_n? ConsPiracy theodes

galore that the Americans, Jews and indians have ganged up on us to destabilise the country. They have got us embroiled in unnecessary wars in Afghanistan, promoted all

1.

I· kinds of'.ethnic, sectarian, civil-military, religious divisions in. the society, made us

dependent on foreign aid (IMF and the US particularly) and deprived. the .country of its

sovereignty in decision making. According to them, the last ·decade has. seen

f intensification of these nefarious activities and the recent economic regr'eSsion faced by

us can be directly attributed to the intensity of these efforts.

The problem with this explanation is that it assumes that we a proud nation of 180

t million people are so naive, gullible, easily amenable to manipulation by others and I

external influences. that we arunable to distinguish what is right' from the wrong for· I

ourselVes and our children.

Se leaving this popular myth aside, let us try to explore other plausible

explanations for this rel.ative economic decline of Pakistan. For this We-have to examine

the cumulative experience of economic growth and development in various periods of Pakistan's history keeping the changes in academic thinking in 'different eras in the background.

Economic policies ai·e underpinned by certain intellectual precepts, axioms; theory and evidence. This body of knowledge does not remain static and keeps on changing with the passage of time and emergence of new evidence. The post-colonial independence period of most developing countries was marked by a group of charismatic political leaders who·were suspiciuus of the policies and advice· of their erstwhile rulers and wanted to keep themselves at a distance from what the colonial masters were. preaching. This period also coincided with the appearance of a new field in economics called Development Economics that focused on ·the proqlems of ne)l'ly independent countries.. The academic tnidition at that time highly embedded in Post-Keynesian Economics came

3 World Bank(2002) *Development Policy Review.* Washington, DC: World Bank.

I

l

51:4, io ***Ishrat Husain***

I'· .

ti'

up· with the notion of 'Balanced Growth', 'Big Push', 'Controlling Com!11anding **Heig ts\ 'Critical minimum effort', 'Export elasticity pessimism' and 'low level** equilibrium trap'. The end result of this strand of literature was advocacy of a dominant role of the State in planning, directing and m naging the economy. Under five year plans, State-owned enterprises setting-up 0ew industries became the main instruments of **resource allocation. It was argued that agriculture exports were inherently unstable and** · col!ld keep the countries in "low level equilibrium" and hence Import Substituting Industrialisation led by the State owned enterprises would maximise economic growth "with emphasis on production of capital goods and pr.imacy to heavy industry' For these embryonic industries to achieve industrial traction they had to be protected from import competitioh, provided subsidised capital and foreign exchange at preferential exchange **rate. The impressive success of Non-Colonial Soviet Union in achieving high rates of**

**economic growtacted· as :a vcilidatiofi for this inward looking strategy.**

Pakistan in the 1960s did not follow this strategy but had a mixed economy model

';n which the state set up the industries but then divested them to the private businesses. Profit motive then inspired these private businessmen to invest and expand in other

**.sectors of the econoffiy. Economic -reforms were initiated in Agriculture, Education, L gal, Land. and other Trade and Taxation. at the same time. The initial results were quite** spectacular and the model ahracted the attention of outsiders-both the academics as well as policy-makers from ol\ler countries. One of the distinguishing features of the Mixed economy model was that Pakistan had a strong bureaucracy that guided and directed the private sector. Planning. Commission of th.e 1960s was a powerful, technocratic

.. institution assisted by foreign economic experts.5 Corruption and parochial interests had

not permeated the higher level decision making to the degree that subverted the economic progress or institution building,

The academic influence of the state-led industrialisation and control on the commanding heights of the economy by the state spilled over in Pakistan in the late



1960s and in the early 1970s and gave ammunition to the political opponents of the regime. The slogan of ''22 families"6 controlling the wealth of the country and the hue and cry. ofreg)onal economic. disparities from the professional eco omists of the Eastern wing' strengthened the movement against Ayub Khan. The 1965 War with India also **gave a sense of vuhlerabHity to the people of East Pakistan and economic momentum** also suffered a setback. This combination of events therefore led to a nationwide agitation and subsequent o:verthrew of the Ayub regime. Along with him the incipient economic and sectoral reforms that Were beginning to make positive difference were also

**overturned. These ieforms would have taken at least another five years to take. film roots.**

**The separation of East Pakistan and the ascendancy of the socialist leaning Pakistan**

Peoples' Party in power in the new Pakistan gave an abrupt death knell to the refonns of the

1960s. The PPP, interpreting the economic reforms policies of 1960s as responsible for

**4 For a review of the\_ post World War II academic thinking please see Shahid Yusuf (ed.) (2009)**

***Development Economic.s though the Decades.* Washington, DC: The World Bank.**

**5For an insider's review depiction of the planning process In Pakistan see Parvez Hasan, "the Heydays**

**of Planning in PakistaJl {965-70" in *My Life My Country* (Fero1Son Pvt. Ltd.)**

**6This slogan gained respectability as it was coined and popularised by non other than the then Chief**

**Ec nomiSt of the Planning Commission, Dr Mahbub-ul-Haq.**

***7 The Pakis.tan Development Review (PDR)* issues of the l 60s contain most of these a"rticles.**

*Economic Reforms in Pakistan: OnStep Forward, Two Steps Backwards* 51:4, II

concentration of weal1 and regional income 'inequality, and seeing the paradigm shift in academic thinking about development economics tw·ned the tables. All major industries, banks, insurance cOmpanies, educational institutions were natibnalised ov'efnight ·without adequate thinking or preparation. Private investment in these industries and sectors- was prohibited and the intrusive hands of the bureaucrats in granting licenses, permits, financial resources became too entrenched. Risk taking and enterpdse took a ·back. seat and bureaucratic controls, inertia and malfeasance \_dominated the economic la dscape. , GovennTien\_t officials with no training or. exper-i$:mCe· in running· businesS were entrUsted with the n)anagement of multimillion rupees large enterprises so critical for the rest of the econ'omy. Bereft of market competitive pressures and preoccupied mainly wiih appeasing their political bosses they committed resources to ve.ntures and activities that were neither economically feasible nor commercially viable. In the name of redistribution lo the poor, economic growth was sacrificed making the poor worse off. The nationalisation of banks and the proliferation of government-owned and managed development financial institUtions

(DFis) opened another major avenue of patronage. Debt capital was provided by these - ·

govemment-colitrolled institutions to the poiiticaliy influential bonowers who. never repaid the loru1s. Through over-invoicing, collusion with bank officials and manipulations of accounts these state-spawned industrialists financed their own equity share of the industry (other than those reserved for the state owned enterprises) from these loans. Once the sponsorS had recovered their capital several times over, the enterprises were\_ abandoned aS

'sick industries' and left in the tender care of the creditors. By the end of the 1990s, more

than half of the non-performing loans advanced by the Nationalised Commercial Banks

· (NCBs) and DF!s were blocked in these sick industries. The losses incurred by the banks and DF!s were, in turn, borne by the tax payers.

This was also a period in which some desirable reforms were also initiated.

External trade regime was liberalised and the 'multiple exchange rate system was replaced· by a more unified exchange rate with an effective devaluation Of 25 percent for exports and 40 percent for imports. The depreciation of the exchange rate produced a large supply response and helped to divert goods previously exported to East Pakistan to international markets. However, by th.e 1975, the competitive effect of devaluation was eroded by inflation.' ·

The military regime that took over in July 1977 and lasted until December 1988 did nOt denationalise the industries or banks or institutions taken over by the preyious regime. They carried on with the business as usual with the exception that new investment and industrial expansion· was ppened up to the private sector. But the continued reliance on state-owned enterprises and nationalised banks created distortions and inefficiencies in the economy. Although growth rates did pick up to the level of the

1960s the structure of the economy was no different. from that inherited from the previous

regime. The Middle East Oil boom that started in 1970 also favoured Pakistan as the workers employed in those countrie-s remitted :foreign exphange which eased the balance of payments situation. The war in Afghanistan to throw out the Soviets also proved to be a boon for Pakistan as international aid flows relaxed the foreign exchange and budgetary constraints. The compulsions for domestic policy reforms therefore became weak.

8Naqvi, S. N. H. and Khawaja Sarmad (1997) *External Shocks and Domeslic Adjustm\_ents* (Oxford

University Pr'ess).



5.1:4, 12 *lshrat Husain*

By the 1980s there was a shift in economic thinking arising from disenchantment with the state-led mod!of inward lookig import industrialisation strategy. *''The* 1970s were a decade of creeping disillusionment not. development".' The blame for the crisis of the 1970s was laid primarily on domestic policy errors due to distorted prices. The message ..distilled .from the East Asian economies was that market-"-guided industrialisation within the milieu of a relatively open economy could res\_tilt in rapid

·growth if industries were able.to comPete in export rnarkets.10 Empirical crQSs country

·

studies on foreign trade regirnes 11 in developing ·countries provided the intellectual arguments for abandoning the strategy of Import Substituting Industrialisation. Elements of a new consensus began to appear that emphasised mone.tary restraint, keeping real interest rates pbsitive,. fiscal deficit at a sustainable level, real exchange rate that improved international competitiveness and promote exports, reducing the stock of external debt to manageable levels and structural reforms such as financial sector refOrms, remuriei-atiVe ·producer pricing; trade liberalisation and tax reforms \_to make the economy flexible and efficient. .

This package of outward-oriented private sector-led development strategy known

·as Structural Adjustment Programme was widely promoted by the World Bank and International Monetary Fund(IMF). The Washington consensus12 that weaved the above mentioned elements ofpolicy reforms became the dominant paradigm in developing and emerging in economies for the next two decades. Pakistan entered into a programme of this type with the IMF in 1988. This was followed by several other programmes in the decade of 1990s-none of which was completed. Nawaz Sharif Government in 1991 introduced a major' reform programme through Economic Reform order consisting of liberalisation, privatisation and deregulation. Foreign exchange regime was liberalised, investm nt controls-were relaxed, st8:te owned-enterprises were privatised, an.d incentives were provided for do\nestic and foreign private investment. 13 But it is argued that political instability and poor governance acted against these reform efforts. Instead, the

14

,, greater openfless of the economy contributed to the financial crisis. .

1',:.

At the same time, the Congress Government with Dr Manmohan Singh as Finance

Minister introduced similar reforms in India. These reforms did not make much impact until they were adopted and continued by the BJP Govermnent that came to power after defeating the Congress party. Indian and global investors realised that the Licence Raj was over and the r forms undertaken in'1991 were irreversible." Nothing of this sort happened in Pakistan although Benazir Government did not reverse these reforms they were unenthuSiastic in owning and implemeriting them because the credit, wo.uld have gone to their opponents.

gShahid Yusuf- *ibid.*

1 orld Bank (1993) *East Asian Miracle* (Washington, D.C.).

. 1A multivolume student of Foreign trade regimes in several developing countries including Pakistan

was commissioned \_and produced by OECD, Little l.M.D, Scitovosky and Scott.

11Williamson, J hn ( l990) Latin American Adjustment: How much has Happened? (Washington, - C.

lnstitute of International Economics).

nHusain, Ishrat (1999) *Pakistan: The Economy of an etwst\_State* (OxfOrd University Press).

14Hasan, Pervez (1998) *Pakistan's Economy at Cross Road* (Oxford University Press).

1 or a comparative analysis of Structural Reforms in India and Pakistan, see lshrat Husain and Rajir

Kumar, "ComparingStruch.J.ral Reforms in India arid Pakistan". In Philippa, *Policy Refornis in South Asia*

. (Routledge De) (ed)(2012).

***Economic Reforms in Pakistan: One Step Forward, Two Steps Baclovards*** 51:4, 13

The period 1988-99 saw frequent changes in government because of four general elections with four interim governments. None of the elected government lasted more than two years on average. The quest for outmanoeuvring the other political party was the **main preoccupation of the sucCessive governments in the 1990s...Ecohomic rnanagem.ent**



. took a back seat. Benazir Government introduced a policy to bring private investment

into power generation sector. But this policy was put in the cold storage d inquires against the Independent Power Producers (IPPs) were initiated soon after the Government was dismissed. Had that policy been continued uninterrupted over time along with governance reforms in the··energy sector we wouid not have' faced the supply shortages which we are facing today.

l

The Musharraf Government that assumed power in October.!999 did undertake major economic reforms in the six year period between 2000 and 2006 which slowed down in 2007 due to the impending e!ecti9ns and confrontation with the judiciary. The intensity and frequency of the reforms were high in the initial three year period before the transition to the elected government in end 2002.16 Pakistan successfully met all the performance criteria under the Stand-by programme and the Poverty Reduction and Growth Facility (PROF) negotiated with the IMF. The major areas of successful reforms **wefe T de and Tariff, Financial Sec\_tor including the privatisatiOn of-·nation\_alised** commercial banks, breaking up the monopoly of Pakistan Telecommunication **Corporation .and opening up the sector to the private sector and Prom-otion of Higher** Education. Devolution to Local Governments and Police Reforms were highly significant but got embroiled in controversy, back tracking and power struggle between. the Provincial· Governments and Local Governments. Accountability-transparent and effective-c-acted as a powerful deterrent against corruption and misuse of public offices in the first three years. But it fell victim to selective use of National Accountability Bureau \_(NAB) for winning political allies and coercing others to fall in line. Actions

·were limited only to tliose who stayed in the opposition. The action against 'judiciary and the compromises made under the National Reconciliation Order (NRO) precipitatd ·the downfall of the PML-Q led regime at the 2008 general elections. President Musharraf had to resign in August 2008.

The newly elected government that carne to power in March 2008 started out as a coalition of all major political parties of the country. This sparked some optimism that the country would be able to steer itself in the right direction. But this coalition lasted for a few months only.· Once their common objective of removing President Musharraf from the office was achieved, the coalition fell apart and the survival of the Government became the major policy goal of the majority party. The lingering crisis became quite unmanageabl,e in 2009 forcing Pakistan to approach the IMF in November 2o'09. A

'homegrown' reform package consisting mainly of mobilising additional-taxes to bring

fiscal deficit under control was agreed upon. Lack of politiCal consensus on General Sales Tax (GST) and Agriculture Income Tax (AIT) among the coalition partners led to the breakdown of the agreement with the Fund but after incurring a. he·avy financial oblig tion of $8 billion to be repaid in 2012 and 2013. Economic growth has been anaemic in the 2008-12 period, public finances have been heavily distressed, and huge

**16Fot' detailed catalogue and 'analysis of these reforms, see Ishrat Husain (200) *Economic Management in-Pakistan 1999 to 2002* (Oxford University Press).** ·



51:4, 14 *Jshrat Husain*

borrowing from the banking system to finance widening fiscal deficit resulted in double. digit inflation. Exchange rate depreciated steeply and private domestic and foreign investment dried up. Narrow political considerations of patronage and pelf have not allowed economic reforms make any headway except the devolution of powers from the Federal to the Provincial Governments under the' 18th Constitutional amendment and an

"· enlarged share to the provinces out of Divisible Tax pool under the NFC award. The unintended . consequ.ences of these well-meaning· reforms have generated some

dislocatiotis in the short term. The devolution remains incomplete aS the local

government reforms have been put on hold.

The above historical survey of the economic refonns and structural policy changes since 1960s to date shows a highly emilie and volatile path. Some analysts have hypothesised that although over the last four decades Pakistan has experienced over 5 percent average GOP growth rate, industry has not been the main engine of Pakistan's

grOwth which. has led to, on average, a low and variable growth rate 17 Meaningful

actions with high. potential of success were initiated and carrid forward some distance. But as soon as·a new government-democratic or military--came to power these policies were either reversed, backtracked or not implemented fully. The expected benefits were either postponed or accrued only in dribs and drabs. We, therefore, have to tum to understand the factors that can shed some light in explaining this uneven-one step forward, two step backward recor-d of economic reform implementation.

FACTORS IMPEDING SUSTAINABILITY OF REFORMS

One of the critical success factors for reforms is its ownership by the country, In Pakistan with the exception of few occasions, there has never been a broad based ownership of the reforms nor has the reform package been designed and formulated by the economic managers of the country. In almost all cases (except two programmes entered with the IMF that were succesSfully completed) the main-motivation· has- been to

.secure· infusion of short :term liquidity to avert the impending foreign currency crisis. The

International Financial Institutions (IF!s), on the other hand, wanted the. country to

dertake both stabilisation measures and structural reforms that could set the country on

the right direction. Pakistan, as a prolonged user of the IMF resources 1



'

got addicted to

I,I,

.,

''

:i'

this infusion at' regular interVals of time. As soon as the liquidity situation improved Pakistan got off the track after receiving a few initial !ranches because the Go.vernments found the tough corrective measures agreed with the IF!s politically difficult to implement. Pakistan acquired the reputation among the International Financial Community as a one-tranche country. In a few instances where some painful adjustments had to be made, the· policy-makers, in order . to avoid the blame, deflected the responsibility towards the IMF. Structural reforms came to be associated in the public mind with the conditionalities of the IMF and IF!s. The political resistance to

17Pakistan (2012) *Industrial Policy: Its Spatial Aspects and Cluster Development.* (Islamabad, Ministry

of Industry).

111

\_ A historiCal review of Pakistan's relations with the IMF can be found in lndcpcndent Evaluation Office

(2002) Evaluation of PrOlonged Users ofJMF Resources (Washington, D.C. International Monetary Fund). A more recent analysis appeared in Ishrat Husain (2010) Pakistan's Experience with the International Monetary Fund (IMF) 2000-2 04 *Business Review* Vol. 5, No. 1 (Karachi, Institute of Business Administration).



***Economic Reforms in Pakistan: One Step Fonvard, Two Steps Backwards*** 51:4, 15

implementing quite sensible measures that, otherwise would have helped the country, became fierce as they were considered an externally dictated imposition. This · entanglement of what should have been done by the policy-makers in the first place to set the economy on the right path with a popularly held perception that these difficulties and pain were being caused under external influences did not allow Pakistan to build a **consistent and credible track record. The tack Qf- domestic ownership translated into** highly fragile implementation of reforms. There was hardly a genuine. and consistent



·desire to bring about long-term improvement in domestic economic performance.

There is no evidence from the country studies that external aCtors have tipped the political scales in favour of reform. When the domestic institutional and coalitional environment was unfavourable, lending in such settings postponed adjustment. Studies clearly show that providing support to committed government did, however, increase the **domestic political credibility ofihe refomters.** 19 ·

Another factor impeding th·e progress· on ref9rm process. alluded earlier has been the reversal, discontinuity, uneven and Jack lustre implementation record. A flip flop in design and implementation .is the only feature that has appeared consistently irrespective of the nature of the political regime. Military, deinocratically elected, quasi-democratic,' authoritarian and mixed technocratic-elected have all been found guilty of this behaviour. The time period for the ref01ms to produce the desirable results goes b yond the normal five year electoral cycle. Assume that the· Government that comes to power in 2013 earnestly embarks upon a set of economic reforms and makes some progress in the right direction. l3ut the chances that a successor government that comes in its place in 2018 and had been opposed to the. outgoing political party will reverse, by pass or show indifference towards these reforms and associated investments arc 'quite high. With the los> of momentum the country would be worse off as all the costs have been incurred but when the time comes for reaping the dividend the pot has been broken. The new **government will ·start its own journey ab...dnitio without building on the momentum, nurturing and bringing to fruition the reforms that they had inherited. It is hard to fathom as to why the successors do ndt capture political credit for themselves by conlpleting the** process: Let me illustrate this point with the example of Higher Education Reforms. Had the Government in 2008 decided to continue and support the-ongoing reforms initiated in .

· **2001 by the previous regime the access, quality and output of all universities by 2013** I •

through the cumulative gains of the prcviou'L 12 years would simply. have been astounding. The ruling party would have taken credit for this performance at the time of elections. Similarly, if instead of al;>olishing the entire Local Government system the present regime had brought about changes to improve the system they would have earned

votes of grateful beneficiaries of the devolved system of delivery of basic public services

r ·in 2013: But these examples demonstrate that there has .been a setback to both tertiary .

I

**education and delivery of basic public at the g[ass root level and the country is worse off in both·these ai-eas. The ruling parties lost an enormous ·opportunity of translating this** national loss into a political gain tor themselves and wide spread benefits to the people of Pakistanc There is also a more deep rooted damage that is done by reversals, and discontinuities of reforms, policies and investments. Credibility and .indifference by those · committed to reforms sets in and the public-at-large also does not believe the -political

I

t **19 Hagg'ard S. and Steven Webb (eds) (1994) *Votingjor Reform* {Oxford University Press).**

l

51:4, 16 ***lshrat Husain***



**leaders when they annoUnce their ·own pet policies or reforms or projects·. They have** heard it all before but have never seen, with some, exceptions, any tangible and perceptillle results. The media, in its usual negative mode, further adds fuel to the fire and·· **the pace of implementation, is retarded or slowed down. Of course, in some instan es** there is a time inconsistency problem also. The pains caused ]ly initiating most of the

·reforms or policy changes are incurred upfront while the benefits accrue over time. The

political regime which has to undertake these niforms and thus bears the costs is reluctant becaUse they risk losing popularity by enforcin& harsh and painful measures. According to their calculation they have everything at risk while nothing to gain politically within ihe span of the ele.ctoral cycle. They apprehend that they would look bad in the eyes of the public as the beneficiaries of these reforms will attribute the benefits, when they occur, to their opponents who may be in power at that time. This asymmetry in the timing

·of the incurrence of costs and· the app opriation of gains from reforms, in so far as the

opponents reap the political dividends and take credit for them politically while. the party initiating these reforms bears all the backlash and criticism, therefore, becomes a stumbling block.

Third, each set of reforms has winners and losers.. The losers from reforms are **identifiable, immediate ·and cohesive. If subsidies re eliminated or i\_mp?rted goods beconle expensive or wages deCline and public sector employment is either frozen or cut** doWn as a resuli of reforms, those presently. benefitting from these policies would raise hue and cr)' immediately. They will coalesce, organi'se public demonstrations, approach · **their elected representatives, coerce the media intgiving them wide coverage and create**

.difficult conditions for the ruling party. At times they could become unruly and resort to violence or disruption of public services. Let us take two examples to illustrate this point. The retail and wholesale traders (18,2 percent of GDP) in Pakistan account for as much as agriculture sector {20 percent) in national income. Out of almost 9 million persons employed iri this sector only a miniscule proportion pays any tax to the exchequer. Per

I

' capita earnings in this sector are about Rs 400,000 annually-much above the income tax

'

'

**thfeshold of Rs 350,000. It can b.e safely estimated that at least one million of those**

employed· in this sector have taxable incomes above this threshold with the potential to

. add atleast Rs 60 billion to tax revenues. But every time any attempt is made to bring them into· the tax net either by the military government or the democratic government they go on a shutter down.. strike disrupting economic activity in the country. The opposition parties and the media come out openly in their sympathy a:nd support. The **Government has to back down and let them remain out of the net. The losers from the tax** reforms are therefore alive and kicking but the winners are unknown, diffused and likely

. to emerge in tl)e future. They will never group together and come in the forefront in

support of reforms. Nowhere in the world where reforms have been successfully implemented there was an identifiable, homogeno\)s group that publically agitated or **demonstrated in favour of reforms such as widening the tax net. It is always· a visionary** and committed leadership that weighs the benefits and costs and takes the initiative. To him or her the winner from the tax reform will be the country's fiscal situation as deficit wilt be brought down, external and domestic borrowings will be reduced and inflation **will be controlled. But have we ever heard of public demonstrations in fav :mr of fiscal** discipline.



***Economic Reforms in Pakistan: One Step FQrward, Two Steps Backwards*** 51:4, 17



•

1.:

'·

The·other example is that of privatisation of State-owned enterprises (SOEs). A country that is allocating only 1.7 percent of GDP on education is spending about 2 percent on the losses of SOEs. It is not only the budgetary impact but misallocation of **resources, high priced products to consumers, poor service standards etc. But** privatisation has become a dirty word in Pakistan because the political leaders find them a convenient vehicle for providing employment to their supporters and enjoying many perks conferred upon by them by these enterprises. The very mer1tion of privatisation brings together the alliance between the employees of these SOEs and the politicians. The losers fear loss of employment and loss of privilege respectively and coalesce together to **subvert any attempt to restructure or privatise these enterprises. The winners from this** reform will be mijliops of out-of-school children in the backward districts and regions of Pakistan who will be able to get education and a decent livelihood in the future. Are these **children·, or their parents·going.to come out on the streets in favour of]Jrivatisation?**

The fourth factor is the capacity issue of implementing the reforms. Civil services .

· inherited from the British era perf0qned extremely well in the early period of Pakistan's history. They were competent, diligent, dedicated and honest. Millions of refugees from

India were settled, new businesses and industries were established as the Hindu owners left the country, basic public services were restored throughout the nook and comer of the **country· law and order and security of life\_ and property were assured and institutions of governance and economic development were setup and nurtured.**

The Planning Commission in the 1960s enjoyed the stature and autonomy and had

**the competence to initiate, and monitor the imPlementation of various reforms. In China,** this task has been performed by .the National Development Reform Commission (NRDC) aided by a think tank the China Society, of Economic Reforms (CSER) Malaysia had its Economic Planning Unit (EPU), Indonesia BAPPENAS, Thailand Naiional Economic and Social Development Board (NESDB), the Philippines National Economic Development Authority (NEDA), Korea Economic Planning Board (EPB) and. Korea Develop;nent Institute (KDI). Pakistan does not have similar institutions in place for a **long timalthough the ·Planning Commission does exist on pa·per but has become** primarily a project clearing agency. The East Asian countries had highly meritocratic and insulated bureaucracies with. a core of technocratic managers. The high-quality **bureaucracies and rules and procedures were institutionalised and insulated from political**

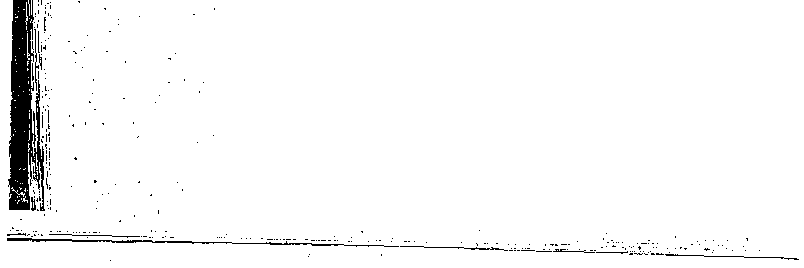
. **interventions. In particular, recruitment and prOmotiOn were merit.' based?0 But in**

Pakistan since the 1970s the civil services have become politicised, got overstretched and. entered areas in which they had little expertise or training. Constitutional guarantee for the security of service was taken away and the compensation and benefits got'diluted. Bright al1d talented young men and women stayed away from civil service and those

opting for them were motivated by considerations other than public service. Aligning i

**themselves with the interests of the political party in pOwer became the norm for survival and car er "progression. This alignment also helped the civil servants in accumulating enormollmonetary beflefits. Despite many commissions, commii:tees, expert groups etc.** which have made recommendations for the reform of civil services nothing much has happened. As a matter offact the reforms of2001 abolishing the posts of Commissioners, Deputy Commissioners and placing the police under the control of District Nazims gave

l ***20 The East Asian Miracle, ibid.***

51;4, 18 ***Ishrat Husain***

a big blow to the Civil Sewices. The Intake has deteriorated both in terms of numbers as we11 as quality:Positions remain unfilled as the Public Service Commission is unable to identify suitable candidates for filing in the vacancies. Only mediocre and those with · ulterior motives appear at the competitive examinations. Those who are in the service fuce many dilemmas. Uncertainty abounds as Secretaries to the Government. are pushed **around various ministries . every thfee tO six months. There is hardly any institutional** memory to guide them in their work or any passion as they are not sure as to how long

**they Will stay on their job. If we can have six Secretaries in key ministry such'.as Finance**

or. six ch.airmen of FBR over a four year. period what should we expect from them in terms of performance or output?

· **This serious displacem(!nt of erit and conlpetency based appointment system has** eroded the capacity to formulate policies, implement reforms and execute projects. Even ifthere is a weli-intentioned government that is willing to take the plunge it gets stuck because of these capacity constraints. This problem has become more acute since the 18th **amendment and NFC award as most of the administrative powerS and financial resources** have been devolved to the provincial governments but they do not have the adequate **cap city to carry them out. This disconnect between the- powers and resource availability** on one hand and the limited capacity to implement is going to get worse unless serious **efforts are made to reform the structure, processes and human resource management** policies at the provincial and local government.

"The informal asymmetric power relations within the bureaucracy also create an

incentive for poor governance. Accountability of the Civil Servants and public sector employees h.as been limited mostly to the officer class or top and senior managers, In formal terms and accordit)g to the distribution of duties within the organisat)on on paper the responsibility lies on the shoulders of these officers. But in actual practice the informal but effective power resides in 'tower echelons of bureaucracy. The clerks, **Patwari, SHOs, InspectOrs, and C urt ·Readers enjoy enorm us. discretionary power alld** indulge in institutionalised corruption. However, they remain unsc thed from ac ountability measures because they do not have any formal authority and cannot be

.

. held responsible in strict legal sen&e. All the purges, screenings and dismissal under the

military regimes were targeted at the senior officers and so did the NAB inquiries and .j

l

prosecutions in the recent years. As their superior officers keep rotating while these lower ranking officials remain entrenched almost semi-permanently in their positions they

. create deep seated. fears-among those who wish to complain against their high handedness

and extortionary practices. If they lodge a formal complaint against these lower I

**functionaries to their superiors two possible outcomes are likely to ensure. First, if the** superiors !'fe in cahoots with the subordinates the complainant may risk harassment and persecution. In the event tl1ere is an honest officer at the helm of the affairs the

. complainant may incur the wrath after the transfer of that officer-a postponed punishment. A resident of the area who depends upon the whims and discretions of the bureaucracy for day to day survival can hardly afford that. .

Thnel(t factor pertains to the structure of political institutions, patterns of leadership including type of regime and the dynamics within the political parties including their support bases. Economic reforms imply important shifts in the balance of political powers among contending interests: for example, between the export and import-competing

***Economic Reforms in Pakistan: One Step Fonvard, Two Steps Backlvards*** 51:4, 19



sectors and between capital and labour. The sharp squeeze on Government resources also spark fundamental debates about the role ofthe state in the development process. 21 Some analysts have argued that "economic liberalism and political democracy may be in conflict for countries at certain stages of growth. Market-oriented reforms may exacerbate social

· dislocation as highly unequal distribution of assets and incomes pose threat to political

**stabiliiy".22 Pakistan's long experience with the authoritarian rule haS proved that the**

popular and widely held notion that reforms can be carried out only under authoritarian or military regimes has also lost Its lustre. Unlike other countries where military governments undertook economic reforms prior to initiating the transition to democracy and those **refonns having yielded tangible benefits, policy gains were not reversed by the transition/ 3** the opposite has been the·case for Pakistan. ·

The Ayub and Musharraf Governments did undertake some serious economic reforms· which, if allowed to continue and sustain over a long time hori;;:on, would have brought about fundamental structural changes. However, these reforms were reversed or disfigured or made inconsequential by the subsequent governments. This observation **suggests that economic accomplishments devoid of political legitimacy, howeve·r imprel,)sive they maybe, prove to be short-Jived in our cultufai context. Without the** involvement and participation of the people, elegant and technically sound economic

**solutions developed .by authoritarian regimes have a short shelf life as they are quickly\_** '

**replaCed once the regimes changes, causing irreparable loss to the economy. 24**

The inner dynamics of political parties also betrays some insights as to why . economic reforms are not undertaken by democratically elected regimes and if they are, **do not survive for long. Persoriality-cult, authoritarian style of leadership,. centralised** decision making, demand by the leader. for absolute loyalty, intolerance of dissent,· reliance on a small coterie of sycophants and. cronies and nominations rather than elections of the party posts at all level have germinated some unhealthy tendencies within the politiCal parties. Ministers of Finance could be the· natural champions for economic· reforms. But they fear upsetting their colleagues and leaders and losing their jobs if they vigorously pursue unpopular policies, the constituency for these reforms within the ruling **party, therefore, remains weak or non-existent, In absence of a champion, there is hardly** any scope for these tough reforms to·make any headway.

. The prevalent social and cultural norms in Pakistani society also pose a powerful **deterring force to reforms particularly in the area of economic gov\_emance. The Pakistani** society is characterised by strong bonds of kinship, biradari, class, friendship and familial relations. The operating social behaviour is governed by consideratiDns of 'Lihaz, Sharam and Murawat', ingrained and nurtured right from the childhood. Formal **organisations are, on the oilier hand, driven by edicts, evidence, due processes, neutrality** and objectivity. This in-built tension between the appropriate social behaviour required as **a member of the society and organisational rules imposed as\_ part of professiOnal** responsibilities inhibits practice of good governance. Nepotism and favouritism are the

**11Haggard, S. and Robert Kaufman (eds.) (1992) *The Politics of EconOmiC Adjusiment* (Princeton**

**University Press).**

**22Haggard and Kaufman - *ibid.***

**23Haggard S. and Steven Webb (eds.) (1994) *Votin$for Reform* ( xford Universit)r Press).**

**2 tHusain, Ishrat (2009) "The Role of Politics in Pakistan's EconOmy". *Journal of International Affairs***

**(New York, Columbia University).**

I.

51:4, 20 ***lshf.at Husain*** ·

· **expected outcomes of demand placed by social and cultural norms while, merit and**

impartiality are expected to reign supreme .under the fonnal organisational rules of

· business. Constituency politics and coalitions reinforcthese social norms. It is only with **the spread of urbanisation, nuclear families, xpanding middle class, professiQnal\_ism and** weakening of feudal and tribal hold on the society that the balance will shift in favour of theformal organisational rules. No quick fixes are available as even some of the highly educated persons coming from tribal and feudal families do not deviate significantly from **these· norms.**

**·coNCLUSION**

I now come back to revisit the question. Why is Pakistan slipping relative to other developing countries? In light of the record of last sixty five years and the factors

·impeding the sustainability of reform I would identify four broad underlying t;ends. First, sustainei;l economic development does not take place in absence of political stability. In thel950s we had s ven changes of government and in the 1988-99 period eight different governments ·came and went ouof office. In between there were decade-long military rulers in power who disrupted the path oflong term stability and evolution of the political system. Second, the popular mind-set in Pakistan has become highly suspicious of private enterprise and marke(s.. Executive branch, Judiciary, Parliamentary committees, Accountability Bureaus and the media have all created an atmosphere in which it has **become difficult to make large investments and earn decent returns. We are driving out** and discouraging even honest and hardworking businesses by our collective witch­

. hunting "mode. Prices are ordered to be fixed arbitrarily, profits are looked upon with

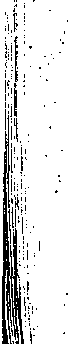
. · contempt, enforcement is capricious and corruption is rampant. Other countries throw **wel\_come mats to investors for attract-ing therU but not us. Our overzealousnes.s and media** frenzy is costing us too much. Third, the battle lines between those who wish Pakistan to become a part of'global system and those who want the country to withdraw, isolate and disengage itself from the international arena are being drawn sharply. The isolationists have a very different economic model i.e. an inward looking self-reliance that does not fit in with the prevailing world view of those who think Pakistan can gain immensely from globalisation, Finally, Pakistan hasn't faced a major abrupt and sharp downfall in its economic fortunes. Only twice in its history it has recorded a negative growth rate. Pakistan has never faced an economic collapse despite predictions on many occasions. The private informal sector has always been buoyant providing over ll resilience to the **economy.**

**Recent histo.ry has shown that most countries have undertaken reforms and**

. **adjustment in response to' some crisis--domestically induced. or extemally precipitated.**

The Latin American debt crisis of the 1980s, the Indian balance of payments crisis of

1991, the Mexican crisis of 1994, the Asian crisis of 1995-96, the Russian crisis of 1998 and more recent Global financial crisis of 2008-09 have all invoked reforms and



· adjustments ·of various degrees. and duration. In most cases, the financial assistance of

*:* International Monetary Fund was sought to tide over the crisis. Pakistan hasn't faced a deep crisis of the magnitude or intensity faced by these other countries. There has been a **"creeping but conti!luous" crisis' that has forced the country to seek to IMFs assistance**

. on many occasions. Thus, Pakistail's need for reforms has been distinct from those of the

-. - -- - -

----"-"---'--'--='---

***Economic Reforms in Pakistan: One Step Fonvard, Two Steps Backlvards*** 51:4,21

,-,

cns1s co'untries. The volatility and fluctuations in Pakistani economy have been too **prono·unced but the root cause was not external shocks but domestic mismanagement)** poor governance and reluctance to take tough economic decisions.

Crises that are not large or abrupt do not get much attention and the policy-makers

do not feel the need for any action. Small doses of good news are exaggerated and bad

**news-are ignofed- or suppre:ssed in the poliCy-making circles. It has been argued25 that a**

. society that faces no major crisis experiences a buildup in the power of pressure groups

·and a· consequent decline in flexibility. Policy-m.akers become the prisoners of special interest g oups. This characterisation fits in well with the case of.Pakist;m. . ·

What are the prospects of economic reforms in Pakistan in the future? This is a tough question to answer as I do not have a crystal ball. But let me sketch out the broad landscape of development that is being reshaped in the 21st century. Glo'balisation (trade, investment, ·people, and ideas) Localisation (fiscal and administrative decentralisation), climate change, rapid urbanisation, demographic tninsition and shift in economic power equilibrium from advanced to developing **countries such as China will be the drivers of change. Chlnas leaders are supposed** to have decided to undertake their reform programme when they realised that their neighbours were growing more rapidly (han they were. The adjustment initiated by Malaysia in the second half of the 1980s also fits this description." Would our leaders wake up to meet this challenge? Inclusive and pro-poor growth that spreads the benefit to the majority of the population will be tl)e acceptable outcome. of a **development tratCgy. The Incoming Government in Pakistan and the visionary** leadership if it emerges as a result of the electi'ons have to ·capitalise on the honeymoon period to shift the direction of economic policies and govemimce and establish credibility by taking some tough but inevitable decisions during thatperiod. Unless this directional shift takes place the prospects for inclusive rapid economic growth do not look very promising. Oh the other hand, if this shift is engineered Pakis(an can get back to the growth trajectory it had attained in the early and mid-

**2000s and will be able to catch up with so\_me of the countries· which. are leading the race at presei?-t.**

**REFERENCES**

Fischer, S. and Vittorio Corbo (!995) Structural Adjustment, Stabilisation and Policy

Reform. In J. Behrman and T. N. Srinivasan (eds.) *Handbook of Development*

· *Economies.* Vol 3B. North.Holland El Sevier.

Haggard, S. and Steven Webb (eds.) (1994) *Voting for Reform.* Oxford University Press. Haggard, S. and Robert Kaufman (eds.) (1992) *The Politics of Economic Adjustment.*

**PrinCeton University Press.**

Hasan, Pervez (I998) *Pakistan's Economy at the Cross Road.* Oxford University Press. Hasan, Pervez (201 I) *My Life My Country.* Ferozsons Pvt. Ltd.

Husain, Ishrat and Rajiv Kumar (2012.) Comparing Structural Reforms in India and

Pakistan. ·In Philippa De (ed.) *Policy Reforms in South Asia.* Routledge.

**250!son, M. (1982) *The Rise and Decline of Nations* (New Haven CT, Yale Univers\_ity Press).\_**

**26 Fischer, S. and Vittorio Corbo (1995) Structural Adjustment, Stabilisation and Policy Reform. ln**

***Handbook of Develop"ment Economies* Vol. 3B (North Holland El Sevier).**

51:4,22 ***lshrat Husain***

I

i..

. i.

i

I

f

':.

I ,

Husain, lshrat (1999) *Pakistan: The Economy of an Elitist State.* Oxford University Press. Husain, Ishrat (1999.) *The Political Economy of Reforms: A Case Study of Pakistan.*

·Islamabad: Pakistan Institute of Development Economic;.

Husain, Ishtat (2003) *Economic Management in Pakistan 1999-2002.* Oxford University

**Press.**

. Husain, Ishrat (2009) The Role of Politics in Pakistan's Economy. *Journal of*

· *International Affairs.* New York, SIPA, Columbia .University.

Husain, lshrat (2010) Pakistan's Experience with the International Monetary Fun4 (IMF)

2000-2004. *Business Review* 5:I.

International Evaluation Office (2002) *Evaluation of Prolonged Users of IMF Resources.*

Washing,ton, DC: IMF..

International Monetary Fund (2012) *World Economic Outlook.* Washington, DC: IMF. Khan,' Mohsin, Peter Montiel, and Nadeem Ul Haque (eds.) (1991) *M:rcrModels for·*

*A4iustment in .Developing Countries.* Washington, DC: IMF. ,

Naqvi, S. N.H. and Khawaja Sarmad (1997) *External Shocks and Domestic Adjustments.*

Oxford University Press.

**Nelson, Joan (1990) *Economic Crisis and Policy Choices.* Princeton University Press.**

Olson, M. (1982) *Th.e Rise and Decline of Nations.* New Haven *CT:* Yale University

Press.

Pakistan,. Government of (2012) *Industrial Policy:' Its Spatial Aspects and Cluster*

*Development.* Islamabad: Ministry oflndustries.

Williamson, J. (1990) *Latin American A4iustment: How Much Has Happenecl?*

Washington, DC: Institute oflnternational Economics.

World Bank (1993) *East Asian MiraCle,* Washingtbn, DC: The World Bank.

Yusuf, S. (ed.) (2009) *Development Economics through the Decades.* Washington, DC: The World Bank.

Za.idi, A. (2006) *Issues in Pakistan's Economy.* Oxford University Press.







***Comments***

Dr Ishrat Hussian has just reviewed the sixty year record of reforms implemented but not sustained in Pakistan. He has identified; among others, two main factors for the failure of these reforms-political economy-considerations and limitations to implementation capacity. I fully agree with this conclusion and, I would like to substantiate this by focusing on tax reforins. The reason for focusing on tax reforms is I

. feel it is perhaps the biggest failure of reform today. Currently the tax-to-GDP *ratio* in

Pakistan is low around 9.1 percent, the\_ ! west compared to other developing countries at the same level of development. Also, not only is the level low, it has fallen from \3.8 percent in 1995-96. Even if we adjust for the GDP debasing, the fall is over two percentages points over the period.

**Let me start by listing some areas of retreat in tax reforms.**

Customs Duties

(I) Maximum Rate decreased and then increased.

(2) More SROs, currently less than half of total imports pay imports duties... (3) Withdrawal of Minimum Import Prices (to tackle Under invoicing).

(4) Concession in Duties on Regulatory Duties an Adhoc Basis.

**Income .Tax**

i

(I) Change in Legislation.

(2) Reduction in Rates. (3) Tax amnesty Scheme. (4) New tax Expenditures.

(5) Retreat on Agriculture Income Tax.

(6) Retreat from the Survey of Tax Payers.

' .

GST

(I) Taxation of Export Oriented Sector. (2) .Failure to Implement RGST.

(3) Rise in Rate and then fall.



Administration Reform

, (I) Failure ofTARP Project.

The list of unsucces ful reforms is long. Why? Clearly tax reform is an area where there are well defined gainers and losers and therefore there is need to build a coalition of support for refonn and. find champions of reform. Also, orie feels that tax policy in

51:4,24 ***Aisha Ghaus Pasha***

Pakistan has been complicated because we have tried to use this instrument to achieve too many objectives. Taxation policy is used:

.) (I) to rise adequate revenues,

(2) to influence- pattern of industrialisation through the instrument of effective protection viacustom duty, and

· **(3) Income tax has been used as a means .to incentivise and support particular**

•. target groups, export growth, regional disparities, and to promote savings.

i'. . These objectives, at time conflict with each other and inevitably political economy

·comes into play and at the end of the day revenues are sacrificed. With all due respects,

i.·

I

·

I'

'

'.

I

i

the tendency to pander io special interests to build a support base is more pronounced in military/autocratic governments to build legitimacy. For example, during the decade of the 80s, the tax-to-GDP declined. so did the share of direct taxes in total taxes. Similarly, despite the fast growth, the tax-to-GDP ratio did not rise· significantly during the peak days of the Mushaiaff regime. This substantiates the point that "taxation without **iepres ntation"- is difficult. Also during the. tenure of the Military gove111ments, when the** flow of external financing was high the domestic fiscal effort tended to slacken. The only period when. the tax-to-GDP ratio increased significantly was the first half of the decade of the 90s when it increased by almost 2 percent points of the GDP but the increase was not.sustained subsequently.· The primary reform which brought about this increase was the regime of presumptive/withholding taxes which spread the tax net more widely, reduced evasion and contributed to a quantum jump in income tax revenues, the.share of which in total revenues increased from 14 percent to over 30 percent.

The tax breaks in the Musharff ·government, both in the form of big reduction in tax rates arid special concessions and exemptions eroded the tax base. The best example of this is the exemption· give!) to capital gains on securities at a time when the stock market was booming.. At its peak, the exemption rep1·csented a tax break to the rich of

.. over Rs 150 billion per annum. 1addition there are other examples of tax breaks including abolition of wealth tax, zero-rating of domestic sales of export oriented sectors

**·and a rash r'SROS\_ in custom duties for particular sectors like automobiles. The end**

result is that during the period of fast growth while India was able to increase its tax-to­ GDP ratio bypercentage points, our tax-to-GDP ratio languished.

During thi: last four years while we had a democratically elected government, which did take some steps initially like raising the rate of GST, extending the tax to **financial services, .introducing .minimum income tax and special excise duty, its success has ·been limited -by the political·economy of a ·coalition government and the c·ansequent**

. inability to take strong political decisions. This is manifest in the colossalf ilnre to

introduce a broad based VAT on goods and services and a failure to catch tax evaders. In addition one feels that the sequencing of some important reforms in Pakistan went wrong. First, at the time when Pakistan started the trade liberalisation process the income tax and

. GST "should already have been developed to substitute for the loss of custom duty·

. revenues but this did not happen. Also, ideally the reforms of tax administration should have preceded major recent tax policy initiatives but at the time the new government assumed power, FBR was in a state of turmoil implementing the Tax Administration Reform Project (TARP) of the World Bank. There was little ownership of this reform

***Comments*** 51:4, 25

within the hierarchy of FBR ·and there was strong resistance to change, particularly the restructuring of FBR into the· Inland Revenue Services (IRS), and customs separately. Consequently the tax· policy reform process was frustrated by problems of implementation capacity.

**Having studied he evolution of Pakistan tax systems· for over the last two decades,**

·I have come to the conclusion, like Dr Ishrat Hussain that an understanding of the **political economy ·and is·sues of implementation capacity along with sequencing of** reforms are important determinants of successful reform process. I am also convinced **that "t.axation with representation,' is important but for this we require .a democratic government which has a majority", is able to take difficult decisions, is accountable to the** people and maintains high standards of governance. This is my pray for the future government of Pakistan.

Institute of Public Policy, **Beaconhouse National Univ rsity;** Lahore.

A isba Ghaus Pasha

