Pakistan: The Impact of Economic Liberalisation on Poverty

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I. Introduction and background

Economic liberalization is viewed as having played a major role in the success of developing countries, especially in the East Asian region. It has been asserted that exports and foreign direct investment, which now account for a significant proportion of ASEAN's GDP and investment, explain the high economic growth rate and the macroeconomic stability achieved by these countries in the last four decades or so. These factors are also believed to have led to the infusion of new technologies and management skill, and to the consequent gains in productivity.

Almost all the developing countries have switched to a market based system—partly on their own, but mostly because of exogenous pressure by the IMF, World Bank and the World Trade Organization (WTO). The latter added to the pressure for reforming of trade regimes. Following the trends of the world economy, Pakistan has also liberalized its economy since the 1980s to integrate it more fully with the global economy. Import-substitution industrialization (ISI) is no longer in fashion, and at any rate, it is difficult to practice as a WTO member.

The reform program that Pakistan gradually implemented during the 1980s and the early 1990s dismantled many of the components of the ISI strategy.[1] The extent of dependence on quantitative import controls was sharply curtailed. The exchange rate became increasingly determined by market forces and tariff rates were reduced. The discrimination against exports, relative to import substitutes, was reduced. There was also a sharp reduction in restrictions to which foreign direct investment had been subjected to in the past. The reform of trade and foreign investment was of course accompanied by many other reforms. Notably, there was a general reduction of direct regulation of prices; a greater dependence on the market for resource allocation; and a reduction in the public ownership of the means of production in favour of the private sector, via denationalization and privatization of manufacturing units and banks.

A primary focus of the reform of the trade and investment regime, and the reform programme in general, was to promote a greater integration of the economy with the global economy. The reduction of impediments to free trade was intended to enhance the competitive strength of domestically produced goods. It was expected that the reform programme would encourage the expansion of production and export of goods and services. These could be produced at relatively low cost in terms of domestic resources. At the same time, there was a replacement of domestic production by the import of those goods and services that were costly to produce domestically. As a result, the rate of growth was expected to be higher due to the improved efficiency of resource use. The reform strategy anticipated a further impetus to higher growth from an increased flow of foreign direct investment. Thus access to capital, technology, management and marketing skills were expected to induce economic growth.

1. These components include overvalued exchange rates, quantitative import controls, high and non-uniform rates of effective protection, discrimination against export and strong impediments to foreign direct investment particularly in export-oriented industries.

Reforms were also expected to improve the distribution of income and reduce poverty. This would come about from the higher growth and from an increased reliance on comparative advantage that would promote specialization in labor intensive goods and services. The growth of productive employment is viewed as the most effective and efficient instrument for poverty reduction.[2] Of course, poverty reduction is possible only when liberalization of trade and investment accompany other complementary investments in the human development of the poorest. In this regard, though with some delay, Pakistan has pursued a comprehensive Social Action Program since 1992.

Theory notwithstanding, the Structural Adjustment Program (SAP) and the implementation of the WTO commitments have resulted in heightening of structural problems. The inappropriate timing, phasing and sequencing of SAP have had significant adverse implications for growth, employment, poverty and income distribution. Also, social sector expenditure as a proportion of total public expenditure fell after the adoption of the reform programme in 1988. Finally, attempts to protect public expenditures that benefit the poor were not successful.[3]

During the ISI period, the price of food grains was repressed so that low wages could be sustained for industry. The principal instrument used for this manipulation was a tax and/or quota on agricultural exports. Reforms have now dismantled much of these controls and have resulted in increased prices of agricultural products including food. The available evidence suggests that the effect of this on the poor has been substantial.[4]

While foreign direct investment has helped augment gross production it has mostly been directed to capital intensive large infrastructure and energy projects. The rest of the foreign investment went into import substituting capital-intensive industries, which also did not create direct benefits for the poor.

Whereas SAP and WTO liberalization did not bring the required impetus for growth in the economy, the WTO-led new trading environment also did not provide Pakistan the agreed market access. This was mainly because of back loading of liberalization by developed countries in textile and clothing imports. The East Asian financial crisis and the global economic recession has further aggravated economic conditions. Pakistan's exports in the last eight months have declined by about 24 percent.

With the above background the main objectives of this study are:

I. To assess the conditions under which liberalization will contribute to development targets in Pakistan.
II. To provide arguments and evidence to enable the Department for International Development (DFID) to push for the best possible deal for developing countries in the new trade round.
III. To build capacity in countries of South Asia to participate in an informed way in multilateral trade negotiations, and to help inform their decisions on the consistency, timing, phasing and sequencing of proposed liberalization commitments.

In particular, this study will focus on how consistency, timing, phasing and sequencing of proposed liberalization commitments can be undertaken in a way most likely to lead to effective poverty reduction. A central assumption through out the study is that policies cannot be undertaken in isolation. A secondary focus will therefore be on the other complementary policies which need to be in place (e.g. public

2. That is employment generation with increases in real wages.
3 Amjad and Kemal (1997).
4 Amjad and Kemal (1997).

investment in health and education especially for girls and women and the redistribution of assets including land reform) to ensure that the benefits of trade and investment reach the poor.
The section outline of the study is as follows: Section II examines the linkage between economic targets and trade and investment liberalization. The process of economic liberalization in Pakistan is discussed in Section III. The impact of liberalization on growth and equity in Pakistan is reported in Section IV. Finally, Section V contains a set of recommendations for the domestic economy and for future trade negotiations.

II. Linkage between economic targets and trade and Investment liberalization

Pakistan's economic targets are primarily commitments it has made with the IMF, the World Bank and the WTO. Broadly speaking, these commitments involve liberalization of trade in goods and services by lowering tariffs, removing subsidies, taxes on exports, dismantling non-tariff barriers, deregulating foreign investment and enforcing intellectual property laws. The implications of these commitments are that of opening the economy for trade and investment, making a shift in industrial strategy from import substitution to export promotion, reforming domestic regulations and developing enforcement mechanisms of international trade laws according to agreed international treaties.

The import substitution (IS) strategy basically relied upon industry achieving an above-average growth rate if, in addition to increasing output to satisfy the growth of domestic demand associated with rising incomes, increases in domestic output substitute for imports. The export promoting (EP) strategy depends upon the international market to absorb higher rates of growth of output. The IS strategy inevitably entails trade interventions to protect the domestic market while the EP strategy involves an open trade policy.

Policymakers have generally regarded import substitution and export promotion as alternatives. However, these two strategies can be self-reinforcing. Normally, an IS strategy discourage exports and results in balance of payments deficits. This in turn results in policies that further encourage import substitution and discourage exports. First, the higher price that domestic firms must pay for inputs produced domestically reduces their international competitiveness. Second, the allocation of resources toward the lucrative and protected domestic market automatically reduces export growth. Finally, the built-in requirements for capital goods, raw materials, and intermediate goods associated with many import substituting industries lead to a rapid growth of demand for imports and result in quantitative restrictions upon imports, hence raising their price and production incentive in the domestic market. These phenomena usually result in a an overvaluation of the exchange rate that in turn intensifies the emphasis on import substitution as exports are further discouraged.[5]

An EP strategy is also self-reinforcing. First, the rapid growth of exports leads to the availability of foreign exchange thereby mitigating the need for barriers to imports. Second, exporters' needs for imported inputs checks the containment of imports. Finally, an export promotion strategy requires a realistic exchange rate that encourages export performance and contains the demand for imports.

A liberalized trade and investment regime can encourage employment since higher rate of growth of the economy, owing to superior resource allocation, would presumably entail more employment growth. Also under an EP strategy, labor intensive export industries generally grow faster.

5 Krueger et. al. (1981).

III. Liberalization in Pakistan

A. Trade and investment policy

Pakistan, like most other developing countries, initially relied heavily on ISI. The policy resulted in high growth rates of manufacturing output starting from a small base. With the passage of time, this drove a wedge between private profitability and social profitability and resulted in gross allocative inefficiencies. It entailed a net social cost to the economy if the cost of the resources transferred to these industries is valued at distortion free prices. In this sense, the implicit incentive structure retarded the long run growth of the manufacturing sector.

Since the mid-1980s, Pakistan has considerably liberalized its trade regime and the structure of tariffs has been rationalized. As a result, the average effective protection rate (EPR) in 1990-91 was 77 percent. While the EPR is still quite high, yet it is significantly lower than the protective rates of the1960s.

The maximum tariff rate has been reduced from 125 percent in 1989-90 to 45 percent in 1997 and further reduction to 35 percent in 1999 as part of the Structural Adjustment Programme of the IMF and commitments made with the ADB. All the para tariffs like *Iqra* (education) surcharge, flood relief surcharge, regulatory duties and the import license fee were merged in the statutory tariff regime. Import licensing has been eliminated except for a relatively small number of items on the negative and restricted lists that are being reduced further. Non-tariff barriers are being dismantled, except for reasons of security, health, religion and reciprocity. Restrictions on the payment of royalty and technical fee have also been eliminated.

The measures to promote exports include: (i) streamlining of schemes of duty drawback, bonded duty free imports for export processing and export finance credit; (ii) the garment units in the Export Processing Zones have been allowed to buy textile export quotas from the market; (iii) foreign companies have been allowed to undertake export trade; and (iv) improvements are being made in the institutional arrangements for quality control, marketing and training of skilled manpower for a number of important exports. At the same time, incentives were given for the growth of higher value added and diversified exports-led domestic production. The policy also laid emphasis on the creation of efficient and competitive import substitution industry through easy access to raw material, intermediate goods and machinery.

The exchange rate has been liberalized to complement the liberalization of the trade regime. The managed float exchange rate system has achieved full convertibility of Pak. rupee for all investment and debt related transactions. There is no exchange controls on trade, debt, investment, and production related transactions. Recently, some controls were temporarily introduced to counter the effects of economic sanctions imposed by the G7 countries after Pakistan’s nuclear tests. However, these controls are being gradually removed with the signing of agreements with the IMF and with the Paris and London Clubs.

Pakistan has implemented a more liberal foreign investment policy as part of its economic reform program. Virtually all of Pakistan’s industrial sectors are now open to foreign investment with foreign equity holdings allowed up to 100 percent. The issuance of shares, remission of dividends, and repatriation of capital by foreign investors is permitted. Prior to the initiation of reform in 1988, foreign investment was generally subject to prior approval, with restriction on equity participation and capital and dividend remissions. The basic rules on foreign investment are laid down in the Foreign Private Investment (Promotion and Protection) Act 1976. The Protection of Rights in Industrial Property Order 1979 and the Protection of Economic Reforms Act 1992 provide legal guarantees against compulsory acquisition or takeover of foreign investments by the government. Foreign investors may, at any time, repatriate their capital, including profits and appreciation, in the currency of the country in which the investment originated. Work permit restrictions on expatriate managers have been withdrawn and salary and wage remittance restrictions have been eased. Equal treatment is accorded to foreign investors in the application of laws, rules, and regulations relating to import and export of goods. Borrowings from the private financial sector has been allowed

As a result, Pakistan was able to attract about US$ 6.5 billion between 1990 and 1998 in foreign investment. While there has been no analysis on the impact of foreign investment on Pakistan's economy, the current debate on the issue of Independent Power Projects (IPPs) clearly reflects the concern of economic managers regarding its implications on internal obligations and the balance of payments.[6]

B. External liberalization commitments

The Uruguay Round (UR) Agreement of the GATT is expected to open up opportunities for Pakistan. The proportion of exports affected by the existing non-tariff barriers (NTBs) should fall from about 60 percent in 1992 to 8 percent by 2004.[7] A significant expansion in market access in three major importing countries/region – the EU, US, and Canada – for textile and clothing are expected due to the increase in export quotas over a 10 year period.[8]

Pakistan's textile and clothing exports are largely directed towards quota countries, particularly the high value added products whose quota utilization rates are very high. This suggests that the Multi Fibre Arrangement (MFA) is a binding constraint on Pakistan's high value added textiles. Thus, Pakistan may benefit greatly from the eventual removal of the MFA in 2005. Ingco and Winters (1995) estimate that Pakistan may gain from US$ 500 million to US$ 1.3 billion (on a 1992 base and in 1992 prices) from the abolition of the MFA.

So far, restrictions on textiles and clothing remain high in the developed countries (DCs). In fact, the agreement-phasing rules have allowed the quota countries to delay the bulk of liberalization towards the end of the phasing-out period. Contrary to Pakistan's expectations, the experience of the past four years has been disappointing. Virtually, no items previously under quota had been included in the first integration phase, and the integration programme of the more quota sensitive products in each category has been postponed.[9] Such postponement has violated the spirit of a gradual phasing-in of the products covered by the Agreement on Textiles and clothing (ATC).

Interest groups opposed to liberalization in DCs claim that trade with poor countries will produce more poor at home. Such fears have inhibited the adjustment process in DC markets. In fact, the change in the Rules of Origin applied to textiles and clothing has now started disrupting trade in textiles and clothing. These Rules of Origin are not used in accordance with the provisions of the ATC.

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6 Foreign Independent Power Producers (IPP), with World Bank guarantees, initiated thermal power production in Pakistan in response to very attractive terms offered by the Government of Pakistan. The government soon realised that the unit purchase price promised them could not be sustained by the utility subsidising local electricity consumption. The new governments allegations of kickbacks to the prior government for the initial contract and the attempt to renegotiate the unit price have created major waves and discouraged foreign investment.

7 Low and Yeats (1994).

8 Khan and Mahmood (1996).

9 The latest projections suggest that most of the liberalisation is concentrated at the end of the 10-year period [Bender (1997)].

The MFA also permits exports from countries and firms that are not internationally competitive. With its phasing-out, a very competitive export market will emerge. However, market access will not be automatic. Unless Pakistan competes in cost, quality and other standards, it might not be able to maintain, let alone increase, its share in the global market. The MFA quota currently protects some of the inefficient firms in Pakistan that will be wiped out once the MFA is no longer there. Thus, with trade liberalization in textiles and clothing in Pakistan, which is reciprocally demanded by the DCs, the import bill may rise because of the demise of local firms, since importing may becomes more profitable than producing in the country.

The agreement on agricultural commodities will restrain further growth in agricultural protectionism. Consequently, it is expected that Pakistan's agricultural exports would increase, provided that domestic policies do not discriminate against the agricultural sector. As a result of the implementation of the Uruguay Round agreements on agriculture, Ingco and Winters (1995) predict that for Pakistan's major agricultural imports, real prices (relative to prices of manufacturing exports from OECD) are expected to rise by 3.8% for wheat, 2.3% for coarse grains and 1.8% for sugar. It is expected that price of rice will decline by 0.9% and cotton by 1.2% by 2002. There will be welfare losses for Pakistan due to agricultural trade liberalization. However, these losses may be offset by potential efficiency gains from improved resource allocation due to the removal of policy distortions.

In net terms, the implementation of reforms in the agriculture sector is predicted to result in a net gain for Pakistan of about US$ 27.2 million (in 1992 prices). The estimated gains increase by and additional US$ 43 million if the potential induced investment and increasing returns in the sector are also taken into account.

So far the agreement on agricultural commodities has done little to actually liberalize trade. This is because of the way the tariffication exercise was undertaken. Developed countries inflated tariff equivalent calculations in such a way that they are more than compensated for the non-tariff measures they were replacing, and ensured that the agreement had little effect on the actual level of protection.[10]

The general agreement on trade in services (GATS) provides Pakistan with an opportunity to increase the economic efficiency of its services sector, get greater access to lower cost/higher quality service inputs, and increased market access for its own competitive service exports. With a vast pool of low wage skilled labour, service is an area that provides great potential for growth to Pakistan. Pakistan can gain by specializing and exploiting the newly granted market access and by attracting foreign investment in the services sector. A competitive and efficient services sector would create income directly and would stimulate competitiveness elsewhere in the economy. However, Pakistan's financial sector and telecommunication services will face tough competition from foreign companies as it has committed to opening up these sectors for foreign competition.

The liberalization of trade in services can also bring gains for the Pakistani economy if the issues most important to Pakistan (e.g. temporary movement of unskilled and semi-skilled workers) are ultimately included in the GATS. While analyzing the commitments made by the members, Hoekman (1995) notes that market access commitments by the DCs in labour-intensive services (which require temporary movement of workers) are more restrictive. Most of these commitments are still subject to the "economic needs" clause that inhibits the movement of natural persons from the less developed countries (LDCs). Pakistan's primary challenge in this regard is to actively participate in future WTO negotiations to ensure

10 Low (1995).

that its own agenda is ultimately incorporated into the Agreement. Also, Pakistan needs to frame rules and regulations, for its own service sector, that conform to WTO rules.

The implementation of the trade-related investment measures (TRIMs) is expected to attract foreign investment. However, Pakistan maintains a link between certain tariff exemptions and local content requirements (the deletion programme in the engineering sector) in a number of industries, which have to be eliminated by the year 2000. Because of the elimination of the deletion programme, the manufacturing industry developed since 1987 will face tremendous competitive pressure.

It is expected that the agreement on trade-related aspects of intellectual property (TRIPs) will increase the prices of patented pharmaceutical products (medicine) between 25 to 67 percent in Pakistan, with the associated welfare loss ranging from US$46 million to US$186 million respectively. The agreement is likely to restrict Pakistan's access to scientific and technological knowledge, which will have adverse implications for productivity and real wage growth. Uncontrolled diffusion of intellectual property will not be possible under the new regime. A sweeping application of the WTO regime, even on small or simple processes, products, and technologies, which can be easily copied with indigenous resources, will act as deterrent to technology transfer. Since the TRIPs agreement relies heavily on the Paris and Berne Conventions to which Pakistan is not a signatory, it will therefore have to make significant changes to its legislation on intellectual property rights. In this regard, Pakistan has sought technical assistance from the World Intellectual Property Organization (WIPO).

The positive side is that Pakistan's commitment to fulfil its TRIPs requirements would send a clear and powerful signal to foreign investors that the country is committed to attracting and protecting intellectual property. Also, the increased supply of foreign knowledge and technology under the TRIPs environment could stimulate domestic R&D activities and ultimately promote technology-led development in the country. Over the long run, Pakistan's strategic challenge is to promote indigenous technology by making greater investment in R&D and restructuring its ailing technology apparatus so as to minimize its dependence on foreign technology.

The most threat to Pakistan's exports is the linking of market access to performance in non-trade related areas such as environment and labor standards. Access to DC markets, particularly in labor-intensive manufacturing in which Pakistan has a comparative advantage, is threatened by the DC who are now insisting on setting and enforcing levels of labor or environment standards beyond Pakistan's stage of development. Pakistan has already expressed its concern on the application of trade legislation whose compatibility with the WTO Agreements is doubtful.[11]

The regional blocs such as the European Union, North American Free Trade Area, and Asia Pacific Economic Co-operation are likely to have a far-reaching impact on developing countries, including Pakistan, which are not members of any of these trading blocs. Pakistan's policy response should be to strengthen regional associations, namely the South Asian Association of Regional Co-operation (SAARC) and the Economic Co-operation Organization (ECO) with Iran and Turkey. Pakistan is a signatory to preferential trade treaties with both the regional blocs. It has also committed to sign a free trade arrangement in year 2000 with SAARC. Such regional groupings should help the bloc to enhance collective bargaining power in future multilateral trade negotiations. Harmonization of trade and

11 The WTO Ministerial Conference at Singapore in 1996 addressed the question of core labour standards and rejected the use of labour standards for protectionist purposes, recognising that the comparative advantage of low-wage LDCs must not be put in jeopardy. Nevertheless, LDCs fear that, to restrict their exports, DCs will use other tactics including anti-dumping measures.

investment policies on a regional basis by following international standards should enable the regional group to join a bigger and relatively more developed bloc. Also, this should help promote complementary specialization with in the regions that these can also attract more foreign direct investment.

C. Consistency, phasing and sequencing of internal liberalization commitments

Consistency among various components should be a major concern when designing adjustment / liberalization programs. Almost every component of an adjustment program has fiscal implications. In particular, the exchange rate and trade policies, financial liberalization, and price liberalization in selected sectors have large effects on the budget. Unless these effects are anticipated and their influence incorporated into fiscal programming, they can be destabilizing and disruptive and lead to a collapse of the program and to policy reversals. Similarly, sequencing is essential because not containing the budget deficit first makes the other goals impossible to achieve. The essential point is that if reforms are to be successful, they must be internally consistent and sequenced properly.

We start here with addressing the sequencing issue first. Not only does the debt crisis manifest itself as a budget crisis; it is also the root cause of the balance of payments crisis since the budgetary crisis has inflationary repercussions which make exports less competitive. The excess demand implicit in the budgetary crisis also results in a depletion of foreign exchange reserves with its accompanying problems.

Exchange rate adjustments alleviate the symptom. Because action on the budget is more difficult, so far economic reform packages have provided symptomatic relief by depreciating the rupee, increasing prices of government services, and making ad hoc expenditure cuts. By shifting the burden of adjustment on to the balance of payments, successive reform efforts made meaningful budget reform more and more difficult. Moreover, by excluding debt restructuring from the reform agenda, Pakistan has failed to address the budget crisis. Without genuine budget reforms, the reform programmes have only bought time.

Thus, stabilization and adjustment programs implemented over the last 15 years or so in Pakistan, have generally failed. Some maintain that this has been due to the government's failure (or inability) to implement the reforms to the full extent and within the recommended time frame. This may or may not be true. What is true, however, is that the sequencing of reforms in Pakistan was clearly contrary to the established notions of sequencing, as reflected not only in academic research but also in WB/IMF research as well.[12]

Pakistan has recently revived its structural adjustment program (SAP) after a hiatus brought about by the nuclear test induced sanctions. The policy framework paper (1999) underlying this, as in the case of past SAPs, has the usual design flaws and mutual inconsistencies.[13] The performance criteria include the usual growth, inflation, and current account and budget deficit targets. The specific conditionalities include cuts in tariffs, effective devaluation, increase in utility prices and cuts in public expenditures. The policy framework paper outlining the program says many sensible things but the policy inconsistencies damn the program.

For example, Pakistan is currently facing a slow down. In the face of such a slowdown, the country is expected to cut its already trimmed down development expenditure. If, partly as a result, the slowdown continues, revenue targets and growth targets will be difficult to meet.

12 World Bank, (1992).
13 This can be accessed from the IMF web-site.

Pakistan is also facing a massive problem of de-industrialisation with a high number of sick units (over 4000 units). In the face of this, it has recently cut down tariffs, as agreed to in the structural adjustment program, providing a further risk of de-industrialisation and unemployment.[14] The tariff cuts also mean a loss in revenue, making the budget deficit target hard to meet. Also, if the tariff cuts raise imports, it would make it more difficult to meet the balance of trade deficit target.

Before proceeding, it is important to point out to the reader the logic of requiring tariff cuts. One reason for lowering the tariffs, in theory, is that it will encourage competition. But if the lack of competition is the problem, the first best policy to attain this is via deregulation and strengthening the monopoly control board. The research in the 1970s that supposedly established a case against protection actually established a case for competition.[15] Furthermore, the East Asian development experience has shown that successful export promotion is premised on having established a solid and competitive industrial base.[16]

Another conditionality is raising gas and power rates. It is of utmost importance to research the unit costs in Pakistan before deciding that a subsidy exists. Utility subsidies in Pakistan cannot be deemed to exist by comparing rates in Pakistan to rates that exist in countries with much higher labour and other costs. Otherwise, higher utility rates represent another blow for local industrialists.

An effective devaluation is also on the books. Devaluation raises the price of imports and gives exporters a better rate for the foreign exchange they earn. In principle, incentives are very important and economic agents do respond to them—provided demand is there for exports and local industry has the capacity to respond to export incentives. Devaluation risks at least a one time increase in prices via higher priced imports in rupee terms, which could make the inflation target harder to meet. If the price jump fuels inflationary expectations, the problem could be longer lasting. Research has also shown that devaluation in Pakistan has not been an effective tool for removing the balance of trade deficit.[17]

In view of all these program inconsistencies, failing to meet targets seems almost inevitable. At this stage, the reader wonders what the critic is suggesting. Our view is that improved tax administration and tax efforts to generate higher revenue as suggested by the structural adjustment program are very sensible. Beyond this, the government should concentrate in reviving domestic industry, while ensuring adequate environmental safeguards, and having a sound investment policy, with a particular focus on maintenance, to ensure that the proper infrastructure is there for agricultural and industrial production. Also, a "competition policy" is critical so that there is a level playing field and success is premised on effort rather than special privileges. This will go part of the way in offsetting the regressive social impacts of structural adjustment policies by creating jobs. However, much more effort in this direction is essential.

A competition policy is particularly important for the textile and clothing sector because, as earlier indicated, by the year 2005, quotas will be abolished under the World Trade Organization (WTO) Uruguay Round provisions. If Pakistani firms are not competing internally by then, there is no chance that they will be able to compete externally. The abolition of the quotas will thus be an opportunity but, if our firms are not ready, it could prove to be a nightmare.

14 The maximum tariff rate has been reduced from 45 percent to 35 percent.
15 Little Scitovsky and Scott (1970) and Krueger (1978) are cases in point.
16 Wade (1990)
17 Khan and Aftab (1996)

D. The role of social policy to contain poverty

The first *Human Development Report* in 1990 shocked Pakistan out of its high-growth complacency by giving the country a human index ranking of 120. This and the fiscal austerity imposed by SAP persuaded the Government of Pakistan (GOP) to redress the decline in human development. In 1992, the Social Action Programme (SACP) evolved as a response to the serious imbalance between economic growth and human development.

SACP was designed to enhance essential public services including education, health, water supply and sanitation and population control. The initial focus was on closing the income, regional and gender gap in access to such services. Although, SACP does not represent a direct poverty alleviation strategy, building human capital and containing population growth could in principle bring more prosperity for future generations, assuming that income earning opportunities are created by then. Also, while SAP fiscal adjustment emphasized resource mobilization, low-income groups were protected under the new income tax system and food items were initially exempted from sales tax.

In its original formulation, the inspiration for the implementation arrangements of SACP was the community participation evolved by the Agha Khan Rural Support Program (AKRSP) in the Northern Areas starting in 1982. Subsequently, government and donor funded rural support programs started operating in the North West Frontier Province (NWFP) called the Sarhad Rural Support Program (SRSC) in Balochistan called the BRSP and more recently (1998) in the Punjab called the PRSP. An attempt is also being made to replicate this effort via the National Rural Support Program (NRSP) created in 1992. Thus SACP was to be, at least in part, implemented through the agency of such government-donor created rural support programs and other development support programs. In any case, community participation was to be central to implementation since such development programs had limited capacity.

With the involvement of donors since 1993-94, the implementation design emphasized enhanced allocations for maintenance and quality inputs to departments and institutional arrangements and procedural improvements to ensure their timely release and for monitoring of utilization. Despite the initial emphasis on participation, in reality community-based approaches were supported through a small separate component called the Participatory Development Programme. Ever since its implementation began, there have been attempts on the part of the legislators to convert the SACP into a programme of political allocation. District Development Committee and the District Social Action Boards distorted merit-based site selection and recruitment. Thus, for the most part, SACP operated as the usual supply driven government program with a host of leakages and inefficiencies.

Even so, SACP succeeded in increasing expenditures on basic social services from 1.7 percent of GDP in 1991-92 to 2 percent in 1995-96. Out of a total of around $4 billion, about 85 percent constituted local effort and the World Bank, Asian Development Bank, Canadian International Development Authority and others funded the rest. While this level of expenditure was a significant achievement in a country known for its neglect of basic social services, some key output indicators indicate poor social sector progress. According to the results of the Pakistan Integrated Household Survey (PIHS) conducted by the Federal Bureau of Statistics, over the SACP I period, the net enrolment rate in primary schools declined from 46 percent to 44 percent, the share of government primary schools in total enrolment fell from 86 to 79 percent, the drop-out rate remained unchanged, the infant mortality rate was higher than the targeted rate and only 5 percent of the households reported the existence of a community water supply committee.

Phase II of SACP has commenced from 1996-97 for a four year period (1996-2000) at an expected cost of $10 billion (four-fifths to be borne by the GOP). SAP II is expected to encourage the provision of services through NGOs and the private sector and try again to encourage meaningful community participation. Other goals include consolidation and improvement in capacity, decentralization; adequate allocation of funds and their efficient use and training of teachers at all levels. In addition, monitoring and third party validation by the auditor general's office is being done.

E. Fiscal policy and its impact

The government has decreased the income and corporate tax rate and marginally enhanced the tax base (increased the number of taxpayers). However, agricultural income tax is still largely out of the tax net. The federal government insists that the responsibility of levying this tax is that of the provincial governments. In turn, the feudal lobbies in the provincial assemblies mean an agricultural income tax, that treats agricultural income like all other income, is unlikely to be imposed soon.

The structural and stabilization program aims at reducing the fiscal deficit by mobilizing additional resources and by reducing public expenditures. The main tax instrument recommended to mobilize resources has been an increase in direct tax revenue and the extension of the sales tax net. Over the 1984-85 to 1987-88 period, the share of indirect taxes in total tax revenue increased from 84.1 percent to 86.8 percent but fell to 84.0 percent by 1990-91 and was 71.4 percent in 1997-98. The tax/GDP ratio increased from 13.0 in 1984-85 to 13.8 percent in the 1987-88 but declined to 12.7 percent in 1990-91 and was 13.2 percent in 1997-98. The public revenue/GDP ratio increased from 16.4 in 1984-85 to 17.3 percent in 1987-88 but declined to 16.7 percent in 1997-98.

In order to access the extent to which changes in the tax structure were responsible for the increase in poverty over the 1987-88 to 1990-91 period, Kemal (1994) estimated the tax incidence by income group for 1987-88 and 1990-91. These findings, reported below in Table 1, show that for the highest income group, the tax incidence declined over the 1987-88 to 1990-91 period by 4.3 percent while for the poorest group it increased by 10.3 percent. This finding results from reliance on indirect tax, mobilization, particularly the sales tax, for resource mobilization.

Table 1: Incidence of Both Direct and Indirect Taxes

Income Groups (Rs. Per month)	Tax Paid/Income		Percentage Increase in Tax Burden as a % of Income
	1987-88	1990-91	
Upto 60	7.08	7.81	10.3
601-700	7.53	8.04	6.8
701-900	7.87	8.24	4.7
901-1000	7.67	8.01	4.4
1001-1500	7.78	8.01	3.0
1501-2000	7.93	8.11	2.3
2001-2500	7.65	7.79	1.8
2501-3000	7.85	7.92	0.9
3001-3500	7.58	7.69	1.5
3501-4000	8.63	8.65	0.2
4001-4500	7.56	7.74	2.4
4501-above	11.54	11.04	-4.3

Source: Kemal (1994).
Note: Includes income tax, tariffs, excise duties and sales tax.

F. *Industrial policy*

During the structural adjustment period the Government expended the role of the private sector. Not only was sanctioning of private investment and import licensing abolished, but also a number of other regulatory restrictions (including registration of technical and foreign loan agreements, procedure for employment of foreign workers, etc.) were removed. Areas of investment previously reserved for the public sectors were opened to the private sector, including power generation, commercial and development banking and air and sea transport. Privatization of some 105 manufacturing units was initiated and steps taken to expand the privatization program to the energy and telecommunications subsectors. By 1997-98, 96 public sector units had been sold and important preparatory steps to privatize the telecom utility (PTC) and gas utilities were underway.

Traditionally, Pakistan's industrial policy environment relied almost exclusively on preferential access (popularly known as "the license-permit regime") rather than on prices and incentives. Under the adjustment programs adopted by government, the ability of government efforts to favourably influence markets came under severe criticism and this practice was abandoned. As a result, "industrial policy" has been all but abandoned by government. The main thrust of the present industrial policy – if it may be so called – is to provide a "level playing field" to domestic investors and to actively woo foreign investors (and by association their local partners). This is being done by providing wide-ranging government guarantees (typically covering rates of profit, foreign exchange and even political risk, and exemptions from laws applicable to local investors).

The other salient features of the current industrial policy include the elimination of sanctioning requirements for industrial investment, custom duty concession on imported machinery, equal treatment of domestic and foreign investment, fiscal incentives to export-oriented industries and easing of credit restrictions and debt-equity ratio requirements. Further details are provided below:

1. *Licensing and regulation:* With economic deregulation and liberalization during the 1980s and the 1990s, the entire system of licensing, permits and controls have been eliminated. As a result, only five industries require sanction of the Federal government: (i) arms and ammunition, (ii) high explosives, (iii) radioactive substances, (iv) security printing, currency and mint, and (v) manufacture of alcohol (except industrial alcohol). The government sanction is also required if the project cost exceeds Rs. one trillion or where a major policy decision is required prior to the establishment of an industrial unit, irrespective of the proportion of imported inputs and foreign equity.
2. *Location policy:* The uneven distribution of natural resources and factors of production, economies-of-scale, agglomeration economies and proximity to markets are some of the major factors responsible for the concentration of industries around a few urban centers in Pakistan. As an instrument of economic development policy, the government pursues the goal of dispersal of industry and the development of backward regions through a variety of incentives including a negative location list, Special Industrial Zones, Industrial Estates and Export Processing Zones. Studies, that have examined the effectiveness of fiscal incentives towards regional development conclude that these incentives are not successful because the under-developed areas lack the necessary infrastructure facilities. The tax and tariff concessions prove costly to government, and also distort the allocation of resources. Only those industrial estates achieve some degree of success that are in close proximity to the industrial centers.
3. *Tax policy:* With a high share of indirect taxes (71%) relative to direct taxes (29%), Pakistan's tax structure appears to give favorable treatment to savings and investment (since spending and not income is taxed). Direct taxes comprise of income tax, wealth tax, capital tax

and workers welfare tax, while indirect taxes comprise mainly of customs and excise duties and sales tax. For the development of the industrial sector, tax incentives are reviewed every year and new measures are introduced in the announcement of the government's annual budget. As an instrument of fiscal policy, differing tariff rates are applied to signal investment flows for industrial promotion overall and that for key industries.

One of the objectives of trade liberalization and tariff reforms is to lower the cost of imported inputs used in the intermediate and capital goods industries. The maximum nominal rates of import duty have been reduced. Duty rebate is given to export industries in order to zero-rate the trade regime. Exporters are allowed to claim refund to the extent of custom duty paid on imported raw materials used in the value-addition process. In the past five years, a number of industry specific incentive packages (especially in the textile sector) have been announced by the government to promote high value added exports.

4. *Deletion policy:* The deletion policy was initiated in 1987 to promote the transfer of technology and to increase value-addition in assembly-cum-manufacture of some capital goods and durable consumer goods. Enterprises, which opt for the deletion programme, are entitled to import prescribed components and parts for the assembly and manufacture of specific items at concessionary rates of import tariff. Other importers or manufacturers who do not participate in this programme have to pay the normal rates of tariff. The policy is open to both foreign and domestic enterprises. The programme has been availed mainly by enterprises in electrical, electronic, machinery and automotive vehicles industries. During the last eleven years, deletion programs have been formulated for more than 800 industrial enterprises. This policy assisted in expanding industrial production, transfer of technology, employment opportunities and foreign exchange savings. It has also led to the establishment of over 500 vendor units for the manufacture of automobile and electrical/electronic components.
5. *Industrial "sickness" and financial restructuring:* By the end of 1998, there were over 4,000 sick industrial units in both the public and private sectors. Most financial institutions define a sick industrial unit as one in which the following three conditions are met simultaneously: (i) the firm defaults in meeting consecutive half yearly installments of interest or principal for a period of two years; (ii) the firm incurs cash losses for a period of two years or continuous erosion in net worth; and (iii) the firm has mounting arrears in servicing of loan liabilities. The State Bank's prudential regulations (XVIII, October 1994) provide a policy framework and guidelines to banks to deal with cases of financial re-structuring of sick industrial units. The prudential regulations limit the scope of banks to re-structure loans; subsequently, both banks and industry lobbied to obtain exemptions from the application of regulations to cases of loan default. Industry (in particular, the textile association, APTMA) sought to convert short-term loans into long-term loans, to waive repayment of penal interest, to allow re-valuation of defaulting firm's asset in order to improve the debt/equity ratio and to waive the condition that banks cannot provide new finance to firms with adverse financial ratios.

In the current policy environment in Pakistan, the act of being declared a 'sick' industry has become a profitable rent-seeking activity. Traditionally, government policy and efforts have focused on lowering of entry barriers in order to promote industrialization. With the initiation of major economic reforms, the expected industry adjustment process has been stunted by government policy – the so-called 'revival of sick units'. This then may be considered as policy-sanctioned erection of exit barriers in the industry. But more fundamentally, by removing the threat of financial bankruptcy of the owners' of sick units, the risks associated with undertaking investment activity in a market economy have been eliminated. In fact, the owners of sick units receive a financial shot in the arm, which then perpetuates a "non-competitive" market environment.

G. Access to technology/technology policy

The importance of technology for the promotion of manufactured exports is widely recognized. The government, with the assistance of the World Bank, has put together a National Technology Policy (NTP) in 1991, along with a Technology Development Action Plan (TDAP). The TDAP has identified five areas in which the World Bank is funding some 156 projects: (i) technical manpower development, (ii) establishment of industrial extension centers, (iii) provision of venture capital, (iv) metrology, standards, testing and quality (MSTQ) center, and (v) macroeconomic policy reform, especially in the area of labor, taxation, and tariffs.

Quite separately from initiatives in furtherance of NTP/TDAP, the government has established a high-powered Engineering Development Board (EDB) in October 1995. The EDB has also undertaken a number of initiatives. Two notable initiatives are: (i) a US$ 50 million Technology Development Fund (TDF), under an autonomous Board reporting to the EDB, has been proposed to enhance technological capacity of individual firms, and industry and trade associations, on a matching grant basis; and (ii) a US$ 10 million Engineering Training Fund (ETF) has been proposed, under similar administrative arrangements, for providing training in key skills like engineering design, process analysis and quality concepts.

Pakistan depends heavily on imported technology because of its ailing science and technology apparatus. Even dyeing technology and scrapped and second-hand machinery is imported. The transfer of obsolete technology often results in higher production costs. The major constraints for Pakistan involved in the transfer of technology are the cost of technology imports, suitability of imported technology to domestic resource endowment and the availability of infrastructure to absorb the imported technology. In addition, the transfer of technology is restricted because of: (i) a weak intellectual property rights regime in Pakistan and (ii) the presence of trade-related investment measures which are contrary to WTO requirements.

IV. Impact of liberalization on economic growth and poverty

A comparison of economic indicators sets the stage for an analysis of the implications of liberalization on growth and poverty. Compared to an expansion of money supply of 46.5 percent in 1984-85 to 1987-88 period, the money supply expanded by 40.6 percent in the 1987-88 to 1990-91 period. Despite a fall in monetary expansion, the inflation rate remained high mainly due to supply-side constraints. As a result of this inflation, the real wage fell sharply. At the same time, job opportunities declined due to slack in the economy, privatization of public enterprises, on going downsizing in the banking sector, fall in public sector investment especially in labour-intensive mega projects, and a fall in emigration.

Gross domestic product registered a growth rate of 6.2 percent over the 1984-85 to 1987-88 (the pre-SAP) period and 4.8 percent over the 1987-88 to 1997-98 (the post-SAP) period. [See Table2]. While the growth rate of the manufacturing sector also declined from 8.3 percent to just 5.6 percent, the growth rate of agriculture sector increased from 4.1 percent to 4.9 percent over the two time periods. Because of the backward and forward linkages of the manufacturing sector, the slow down of manufacturing sector resulted in a lower level of output in most of the other sectors of the economy. The slow down of manufacturing sector may be attributed to a host of other factors as well. However, the structural adjustment program seems to have played a major role.

The higher growth of GDP in 1984-85 to 1987-88 period was accompanied by a decline in income inequalities; the Gini coefficient fell from 0.369 in 1984-85 to 0.348 in 1987-88. The slower growth of GDP from 1987-88 to 1997-98 was accompanied by rising income inequality; the Gini coefficient increased to 0.400 (1993-94).[18]

Table 2: Growth rates of GDP, agriculture and manufacturing

(Percent)

Period	Growth Rate of Output			Growth Rate of Employment		
	GDP	Agriculture	Manufacturing	Total	Agriculture	Manufacturing
1984-85 to 1987-88	6.2	4.0	8.3	2.5	2.9	-
1987-88 to 1997-98	4.8	4.1	5.6	2.2	1.3	0.2

Source: Economic Survey-1997-98.

Despite the impressive growth in output realised in the past, poverty remains widespread in the country. About 29 percent of the population live below the poverty line, which accounts for a total of over 30 million people, as indicated in Table 3. A heuristic correlation between poverty and the GDP growth rate suggests that, in general, during the period when Pakistan witnessed relatively high growth (1980s) poverty was declining, while poverty started rising as soon as the economic growth slowed down in the 1990s. Table 3 below shows poverty rising after 1990-91, which is when economic growth slowed down.

Table 3: Percentage of population below the poverty line (basic needs approach, head count)

Year	Total Pakistan	Rural	Urban
1986-87	29.1	28.2	28.9
1987-88	29.2	30.3	28.2
1990-91	26.1	25.2	26.6
1992-93	26.8	24.6	28.3
1993-94	28.7	25.4	26.9

Source: MHCHD (Mahbub Ul Haq Centre for Human Development) / UNDP (1999, p.10).[19]

Absolute poverty brings many ills with it. It exacerbates environmental damage, results in under-nourishment and hence infant and child mortality and low productivity of rural and urban workers. Thus poverty alleviation is important not only as an indicator of human development and general well being of the populace, but is also a critical input to the growth process.

The impact of the growth of output and changes in income inequalities on poverty can be examined by decomposing the reduction in poverty due to changes in the growth of output, income inequalities and other factors. World Bank (1995) presents such estimates for consumption poverty over two time periods as indicated in Table 4 below. These estimates show that unless growth is sufficiently high, it does not compensate for the poverty inducing effect of increasing income inequalities. Consumption poverty declined by 18.6 percent over the 1984-85 to 1987-88 period because both growth and income distribution reinforced poverty alleviation. In the latter period, the effect of growth on poverty reduction has been largely diluted by forces generating income inequalities.

A pertinent question is whether this trend is still continuing. Most informed observers seem to believe that the increase in inequality observed in the earlier years of 1990s has probably continued. Given the weak growth performance of the economy, this could well mean that poverty has increased further since 1993/94.

18 Household Income Expenditure Data, which are the basis of Gini computation, are available only up to 1993-94.

19 While HDC/UNDP (1999) have produced the first consistent set of poverty estimates over time, controversy continues over method and estimates.

Table 4: Consumption poverty change due to changes in growth and inequality

(percentage change in the head-count)

	1984-85 to 1987-88	1987-88 to 1990-91
Total change in consumption poverty	-18.6	-9.1
Change due to:		
Growth	-15.7	-16.4
Inequality	-2.5	5.6
Residual	-0.4	1.8

Source: World Bank (1995).

There are inevitable costs of structural adjustment in the short to medium term, especially when structural problems are too strong and supportive measures are not taken in the interim period. As noted earlier, SAP in Pakistan has coincided with low economic growth. Consequently, it has created new poor in the urban area amongst the low income working classes and in the rural area amongst small farmers and non-agricultural workers. Also, the self-employed, especially in the informal sector, are facing the brunt of adjustment as their business activities have shrunk due to a slowdown in the economy.[20]

Up to 1987, partly due to a large inflow of foreign remittances and foreign aid, Pakistan experienced a high rate of economic growth. As a result, real wages in all sectors rose sharply and poverty declined. However, as soon as reverse migration started and foreign capital inflow went down, poverty started surfacing. There is thus a need to find suitable alternatives to compensate for these adverse effects.

It is argued that economic hardship and low government spending on the social sector leads to increasing drug abuse/trafficking, a rising crime rate, environmental degradation, social inequities, breakdown in positive social values and new afflictions such as AIDS. Unfortunately, Pakistan is suffering from all these problems. According to the latest estimates available, the number of drug abusers in Pakistan is around 3 million, rising at the rate of nearly 7 percent annually. The National Survey on Drug Abuse in 1993 reports that 72 percent of the drug abusers are under 35 years of age.

Subsidies, transfer payments, provision of education and basic health facilities by the state all can be expected to reduce poverty in the short or long run. For instance, in the agriculture sector, an increase in prices did not provide much benefit to subsistence farmers. However, this price reform badly affected small and land-less farmers and the urban poor were also hit by rising food prices. Given that subsidies are ruled out by the WTO, the state will have to create employment opportunities for disadvantaged groups via the agency of the market or via infrastructure maintenance projects.

At the state level, the system of Zakat and Ushr, Bait-ul-Mal, and food stamps have been instituted to transfer the income to the poorer section of the society. The impact of these measures has been relatively small because the number of beneficiaries compared to the number of the poor is small and because of complaints regarding the distribution of Zakat.[21]

Keeping in view the specific conditions prevalent in Pakistan, the United Nations Development Programme (UNDP), in cooperation with the Government, NGOs and communities prepared comprehensive poverty eradication programs to substantially reduce overall poverty and inequalities in the shortest possible time. The goal is to assist the Government in formulating national policies that are oriented to meeting basic needs and reducing inequalities and to developing partnership among the

20 Anwar, (1996).

21 The size of Zakat collection is small, i.e. 0.2 percent of the GDP.

Government, private sector and communities with the active support of donors, to address the structural causes of poverty and inequality in Pakistan.

V. Conclusions and policy recommendations

A. Conclusions

This study has analyzed the impact of Pakistan's economic liberalization on poverty. The conclusions are summarized below:

1. *Inconsistency in reform policies* Pakistan's experience of the reform programme suggests that consistency among various components of the programme is not ensured before the execution of the programme. Consequently, various components of the programme generate a budget deficit. As a result, many required policies can not be implemented and reform can not pick up pace. Such policy inconsistency also adversely affects economic growth and public spending on the social sectors.
2. *Lack of debt management in budgetary efforts* Debt is the main cause of budgetary and balance of payments imbalances and thus this needs to be dealt with head on.
3. *Lack of support policies* In the initial period of reforms, the social sectors were completely neglected. Later, the country initiated a Social Action Programme. The first phase of the programme could not significantly improve human development indicators in the country. The main reasons for lack of success were political interference, poor institutional capacity, centralized decision making processes, inadequate allocation of funds, non-availability of trained staff and the non-involvement of NGOs and civil society.
4. *Incidence of tax burden* The tax burden has increased for the lowest income groups. For example, the direct taxes introduced over the period, such as the turnover tax and the withholding tax on exports and imports, were passed on to the consumers. Consequently, they have adverse implications for poverty.
5. *Emergence of internal industrial protection* The policy of revival of sick units has in effect erected exit barriers for inefficient units. This has removed the threat of financial bankruptcy for the owners of sick units and the risk associated with undertaking investment. Consequently, this policy has perpetuated a form of internal protection that negates a premium on competitiveness and efficiency.
6. *Loss in productivity* The total factor productivity has been declining since the middle of 1980s. This is mainly due to problems associated the ailing domestic science and technology apparatus, the lack of a competitive domestic market and limited transfer of technology from abroad.
7. *Persistence of anti-export bias in policies* Despite the trade liberalization that has been achieved, the anti-export bias remains in trade policies. This is mainly due to the slow pace of rationalizing the tariff structure. Export development measures were inadequate and procedures to draw benefit from these measures were cumbersome.
8. *Import-substituting foreign investment* Foreign investment was directed towards import substituting industries instead of export-oriented industries. This is mainly due to the way textile and clothing export quotas are managed in the country. At the same time, prospects of market access in importing countries are not very bright in the medium term despite the Uruguay round relaxation of quotas.
9. *Elimination of subsidies* Subsidies, transfer payments, and the provision of social services can help in poverty reduction. Due to the reform program and the WTO commitments, subsidies are now ruled out. This has aggravated the material conditions for the poor. Although social sector

expenditures have increased in recent years, it is yet unclear whether the poor will benefit from these services and, even if they do, this is in any case a long run strategy for poverty alleviation.

10. *Slow inflow of foreign capital* When Pakistan received large flow of foreign capital, in the form of worker's remittances and foreign aid, it experienced high growth, increasing real wages and a decline in poverty. With a reversal in these flows, which incidentally coincided with the reform programme, poverty resurfaced. Alternative livelihood opportunities were not created.
11. *Slow economic growth and employment* Pakistan's industrial sector has remained economically inefficient. As soon as the country withdrew some protection, exporters collapsed and generated unemployment. Public sector enterprises laid off a large number of their workers to prepare themselves for privatization. In sum, as a result of industrial sickness and privatization of public enterprises, high unemployment resulted.
12. *Impact of global environment* Where as local industry has started restructuring to meet the challenges posed by the WTO-led changes in the trading environment, Pakistani exporters are not getting the expected access in developed country markets. The East Asian financial crisis and the global recession has also adversely affected Pakistan's export volume and export prices. All these developments have not only affected the reform process in the country, but have had adverse impacts on growth, employment, income distribution and poverty.

B. Initial conditions and sequencing

Outcome of strategies and policy actions depend on the initial conditions. At the start of the late 1980s liberalization program, Pakistan's initial conditions can be described as unstable from a macroeconomic and political perspective, poor in human and technology resources, weak in soft and hard infrastructure, weak in resources, weak and non-competitive in the private sector and poor in governance.

Given this baggage, a proper sequencing of reforms becomes more essential. The basic aim of any reform program is to remove distortions by re-aligning relative prices that are consistent with market-determined outcomes. For this to happen, structural rigidities in factor markets needs to be identified and reformed to bring about flexibility in the price mechanism. At the same time, government must give overriding importance to the distributional impact of reform initiatives, if it is not to repeat the mistakes of the past.

Based on international experience, the suggested sequencing of liberalization for Pakistan could proceed as follows: First, one must begin with proper debt management, a reduction of the fiscal deficit, removal of domestic capital market distortions while retaining support measures in the social sectors; Second, elimination of exchange controls and free floating of the exchange rate, accompanied by an announcement of a phased program for removing commodity market distortions.

C. Policy Recommendations

Once a consistent and properly sequenced and phased programme of liberalization is in place, poverty needs to be the focus of attention. For the desired changes in the structure and direction of the economy, it is important that poverty is reduced or else social disharmony will constrain reforms. In particular, serious attention needs to be devoted to employment creation.

1. Domestic policy initiatives

At the most general level, the best recipie for reducing poverty is fast, equitable growth, i.e. growth whose benefits are shared at least proportionately by the lower income groups. Some policies are more likely to contribute to growth and others to an improved income distribution. A number of suggestions are given below:

a. Carefully manage the transition by implementing compensatory action in order to protect those among the poor who are hurt by the process of globalization during the transition period. Examples of such policies are as follows: (a) public works programs pertaining to maintenance and infrastructure building, (b) protection of public expenditure that provide the poor with access to human capital and public services; and (c) targeted income transfers to the poor unable to benefit from public works programs.
b. The government should ensure that foreign investment is consistent with the social objective of limiting the inequality effects of growth in the era of globalization. A well conceived policy of decentralized development of infrastructure, based significantly on public works programmes, should be synchronized with the effort to spread the location of foreign investment.
c. Integration with the global economy within the framework of macroeconomic stabilization of the extreme kind – leading to a collapse of economic growth or of the capacity to protect public expenditure that preserves the access of the poor to human capital and services – is inconsistent with the protection of the poor. It is however clear – as amply demonstrated by the Indonesian experience – that reasonably effective stabilization can be consistent with the protection of the poor. This was possible because the donors made it possible for Indonesia to avoid a more extreme programme of stabilization by permitting a reasonably high rate of capital inflow during the period of stabilization.
d. A faster growth rate of the GDP tends to reduce unemployment. However, to reduce the unemployment rate below a certain threshold requires direct employment policies suggested above. Also, unemployment can be reduced further, in the long run, by reducing the population growth rate. Policies to limit the family size raise the welfare of the mothers and other family members and lower labor force growth rate can raise wages.
e. Even though the share of the agricultural sector in the GDP has constantly gone down as part of the process of structural transformation, this sector still provides the most jobs in the country. In the event of a negative impact of globalization on urban employment, the agricultural sector could provide more jobs if this potential is sensibly realized. This would also ensure stable food prices.
f. Micro-enterprises and small and medium-sized enterprises provide employment opportunities to much of the workforce. The Government has founded the Small and Medium Enterprise Development Authority (SMEDA) which is acting as a facilitator between the banks and the private sector. This is a well thought out program, but it is yet to soon for any evaluation.
g. Continued strong efforts to raise the coverage and quality of primary education are needed, for girls in particular, as a long-term instrument for social mobility and gender equality.
h. Preventive and primary health care and nutrition policies are needed to avert health related loss in productivity, working days and jobs.
i. Development NGO programmes, especially in the poorer regions of the country, offer considerable hope for poverty alleviation. Some have performed very well in recent years.
j. Special anti-poverty programs will have to be initiated to reach out to the poorest. In this connection, direct steps will have to be taken to create a more egalitarian distribution of rural and urban wealth by a combination of certain key legislative measures—e.g. by instituting effective land reforms and by more adequate (direct) taxation of urban and rural income and wealth.
k. Direct transfer of income to the poorest, in the form of welfare payments, will also be required to treat cases of extreme distress.

2. Agenda for Multilateral Trade Negotiations

For Pakistan, the most important agenda for the WTO should be the effective implementation of the earlier agreement. We suggest the following agenda in future trade negotiations.

a. Pakistan's multilateral trade negotiation agenda on textiles and clothing should resist linkage of future integration programmes of Northern importing countries with any further market access on the part of the exporting countries. This is because the South has already delivered while the North has not.

b. Pakistan should also link additional meaningful foreign market access with its trade and investment liberalisation.

c. Pakistan should participate in future WTO negotiations so that its own agenda is ultimately incorporated into various agreements. In this regard, Pakistan can benefit by forging alliances with other regional countries having common interests.

d. Pakistan should resist linkage of non-trade issues, such as labour standards and environmental standards, to future multilateral trade agreements. However, it needs to realise that meeting such standards is in its own best interests.

e. Pakistan should lobby for the transfer of technology, particularly clean technology.

f. Pakistan should lobby for the movement of skilled and unskilled workers becoming part of the General Agreement on Trade in Services.

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