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Solving Pakistan's Poverty Puzzle: Whom Should We Believe? What Should We Do?

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INTRODUCTION

Understanding Pakistan's economic performance has never been easy. Its capacity to generate impressive rates of economic growth in the 1960s and 1980s with low levels of savings, investment and very poor human development indicators confounded its critics. Indeed during the overall period 1960–1990 Pakistan's growth performance would place it in the top ten countries in the world. This made an eminent economist Professor Richard Eckaus remark, "Pakistan is a puzzle, a miracle of levitation. With one of the lowest domestic savings rate in Asia, its economy has performed quite creditably. Since we do not believe in miracles, we have to wonder whether the capital inflows that have sustained this growth will last".[1] Unfortunately they did not. Pakistan's growth rate in the 1990s came tumbling down, the result of a number of factors of which a decline in capital inflows also played a significant part.

If Pakistan's growth performance has been in part difficult to justify then understanding or explaining changes and wide fluctuations in its poverty levels has posed even a more challenging task. Pakistan has witnessed over the last three decades periods of high economic growth, as in the 1960s, accompanied with increasing poverty levels, periods of low economic growth, as in the 1970s, accompanied by reductions in poverty levels, periods of high economic growth leading to a decline in poverty as in the 1980s and periods of low economic growth as in the 1990s accompanied by as we shall see by increasing poverty levels.

Can we satisfactorily explain these movements and wide fluctuations in poverty levels in Pakistan? And more importantly what can we or should be doing to reduce existing high levels on a more sustained basis? My friend Dr A. R. Kemal commenting on a paper I presented some years ago said that the author presents

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Author's Note: The views expressed in this article are his own and do not necessarily represent those of the ILO.

[1]Cited in Amjad (1991).

many puzzles but "does not satisfactorily resolve them". Let me try to improve on my record though I may add that if we economists made it a habit of satisfactorily solving economic puzzles we would soon find ourselves without a job!

I. ESTABLISHING POVERTY TRENDS IN PAKISTAN, 1960–2001

In recent years, sparked partly by the millennium development goals (MDGs) of halving world poverty by 2015 and the advent of the recent PRSP (Poverty Reduction Strategy Paper) process undertaken by many developing countries including Pakistan, there have been an impressive number of studies and assessments of poverty in Pakistan. Indeed it was recently observed that estimating the poverty line and poverty trends has become the fastest growing cottage industry in Pakistan!

Besides official publications of the Government of Pakistan, these have included studies undertaken by research institutions, prominently amongst them the Centre for Research on Poverty Reduction and Income Distribution in Pakistan (CRPRID), the Pakistan Institute of Development Economics (PIDE), the Social Policy and Development Centre (SPDC), economists both within and outside Pakistan, and international agencies including the Asian Development Bank (ADB), the International Labour Organisation (ILO), the United Nations Development Programme (UNDP), and the World Bank. Pakistan has also a rich literature on poverty and income distributions starting with the eminent economist Professor Naseem's pioneering work in the late 1970s, followed by a number of studies to which many of you in this room have significantly contributed. I do not intend to review this rich body of literature in my presentation today, and there are some excellent studies which do so. I will of course draw on some of these studies in the course of my presentation.

Let me at the outset say that in my analysis of poverty levels and trends in Pakistan I will in most part use an indicator based on minimum caloric intake or basic needs basket (food and non-food items) to establish the percentage of population living below the poverty line. I am fully cognizant of the limitations and controversy surrounding this approach but am somewhat confident that it can serve as a robust indicator on tracing poverty levels and movements in Pakistan. The fact that most studies on poverty in Pakistan have used this indicator also perforce makes it difficult to use any other indicator in a consistent way when analysing time series data.

I am also aware that poverty levels can be significantly affected by changes in the distribution of income and that increasing or decreasing income inequality can negatively or positively impact on poverty. There is again a rich set of studies analysing trends in income distribution but I in my analysis will not review these trends but refer to them as and when I believe that they had a significant impact on changing poverty levels in the country.

My first task then is to establish from the evidence available a consistent time series on poverty trends taking it back in time to the extent that the data allows us to do so. Drawing on some of my earlier studies, review of the recent literature and help from friends in PIDE I have presented in Table 1 and Table 2 what in my view is the best set of alternative estimates of poverty trends in Pakistan.

We can draw two main conclusions from these Tables. The results reported in Table 1 from the early 1960s till 1986-87 reflect the general consensus first that poverty levels increased in the 1960s and fell in the 1970s and 1980s although the extent of the decline in the 1970s is somewhat disputed. The second as shown in Table 2 that for the post-1987-88 period there is a significant difference between the results of studies which would argue that poverty levels increased after 1987-88 and those including that of the World Bank which argued that poverty levels had declined till 1996-97 and then increased leading the World Bank (2002) to conclude that poverty levels remained stagnant in the 1990s.

Anwar and Qureshi (2002) in a detailed study presented at the PSDE Conference last year have in an attempt to "to evolve a consensus on the use of a consistent poverty line, sources of data and data adjustments for measuring poverty" have come up with a series for the period 1990-91 to 2001. They conclude that the use of consistent time series estimates of the poverty line shows that the headcount measure of poverty has increased from 17.2 in 1990-91 to 30.4 percent in 1998-99 and to 35.6 percent in 2001. They have also raised serious doubts on the methodology adopted by the World Bank for its estimates of poverty in the 1990s and concluded that "the stagnation and/or a slight decline in poverty estimates seems to be a statistical artefact due to overestimation of poverty in earlier years relative to the late 1980s by the World Bank". I have seen no evidence of the World Bank retracting its views on poverty trends in the 1990s or a rejoinder to the assertions made by Anwar and Qureshi (2002) except I believe preparations are under way for conducting a follow-up poverty assessment to its earlier study.

Much of the controversy on poverty levels and trends flowed from the fact that there was no established 'official poverty line'. The Planning Commission has recently in 2002 defined an official poverty line for 1998-99 based on 2350 calorie per adult per day (2150 calories per adult for urban areas and 2450 for rural areas) as an average requirement for all individuals and based on this benchmark estimates are now available from 1986-87 onwards. Let me just mention that this poverty line is higher than that of India (2250 calories) and Bangladesh (2150 calories). These estimates suggest that overall poverty levels based on the official poverty line declined from 29.1 percent in 1986-87 to 26.1 percent in 1990-1991 and then increased to 32.1 percent in 2000-2001. The major increase is in the rural areas where poverty levels after declining between 1986-87 and 1992-1993 from 28.2 percent to 24.6 percent then increased considerably to 38.99 percent in 2000-2001. Urban poverty on the other hand as per the Planning Commission estimates declined from 29.8 percent in 1986-1987 marginally to 28.3 percent in 1992-93 and then to 22.67 percent in 2000-01.

Anwar and Qureshi (2002) have suggested that there is an “uneasy feeling in comments from some quarters on the official poverty line that the lowering of the threshold from 2550 calorie intake to 2350 calories was motivated by a desire on the part of the government to show the poverty levels lower than those coming out of a higher threshold”. However, they find that the official poverty in 1998-99 to be quite close to the one estimated by them for that year. However, they do not comment on the differences in levels and trends between their study and that of the Planning Commission.

Whom Should We Believe?

The answer to this question at least during the second half of the 1990s was that it depended on whom you asked!

But before dwelling on this a bit further let me state here that two facts have always been known by those who have worked on poverty in Pakistan. The first that both the level and trends in poverty are very sensitive to the choice of the poverty line. The second and this follows from the first that a significant portion of the population is clustered around the poverty line a fact very well illustrated by the recently published Pakistan Human Conditions Report 2003 [CRPRID (2003)]. By dividing the population into poverty bands they show that almost 40 percent of the population lives around 25 percent of the poverty line. These transitory vulnerable (above the poverty line) and the transitory poor (below the poverty line) can as a result of even marginal changes in their economic conditions move above and below the poverty line.

I find it somewhat of a simplified notion however that this shows that a small increase of or transfer of income from the better off to the transitory poor would lead to a significant fall in poverty. This may be statistically true but as the Human Conditions Report 2003 shows that there are winners and losers in the growth process and that while between years a significant portion may come across the poverty line an equally significant number can also fall through it in the same period. It is in analysing this dynamics of change that a real understanding of factors which improve or worsen the poverty situation in a country lies.

The more important point which I will build up further upon is that this lack of agreement on poverty trends in the 1990s including the view taken by the World Bank may well have been an important factor in not giving significant attention to poverty and unemployment issues in the country by governments and economic managers in successive regimes during the 1990s. Parvez Tahir, now Chief Economist in the Planning Commission, in his contribution to the Pakistan Human Conditions Report [CRPRID (2003)] has stated that the Economic Coordination Committee (ECC) of the Cabinet had in 1994 directed the Statistics Division the controlling Division of the Federal Government for the Federal Bureau of Statistics to submit a report on income distribution and poverty. This he points out was the first higher level policy level recognition of poverty as an issue meriting official attention. However, the report whose main conclusion was that basic needs poverty in Pakistan had increased between 1987-88 and 1990-91 was never submitted to the ECC. Thus ended the first effort to officially recognise the problem of increasing poverty in Pakistan.

I also recollect that after Kemal and I published our study [Amjad and Kemal (1997)] which presented evidence that after a decline in poverty in the 1970s till near the end of the 1980s, in the next subsequent few years there was evidence that the decline in poverty had been arrested and indeed indications were that poverty levels were beginning to show an increase, this view was strongly contested.

This lack of official attention on poverty changes throughout most of the 1990s must be seen against the backdrop that Pakistan had embarked on a structural adjustment reform programme in the end 1980s under the auspices of the World Bank and the IMF with strong donor support. The programme was implemented in fits and starts in the 1990s although a number of important reforms were initiated under the programme. The Musharaf government signed an agreement in 2000 which by and large is still being strictly implemented till December 2003 although the government has said that it would not renew this agreement after the end of 2004. Was there a feeling in some quarters that highlighting poverty issues in the 1990s might lessen the resolve for economic reforms given that their initial impact was in most cases going to adversely impact on poverty in the country?

An important argument being developed in this paper is not to say that reforms were not needed or that Pakistan could have sustained the macro imbalances that had been built up in the 1980s, but that by not bringing the issue of what was happening to poverty levels to the centre stage of policy-making in the 1990s the people of Pakistan indeed paid a very heavy price.

To conclude this section on balance we can state that the dominant view that has now emerged from the analysis and review of the data is that poverty levels increased in the 1990s and that there was significant and large increase in poverty in rural areas during this period. This view is now openly acknowledged by the Jamali government which set up in December 2003 a Task Force to come up with policy measures to reverse this trend of rising poverty and unemployment levels in the country. This view is also supported by the latest Human Development Outlook 2003 published by the CRPRID (2003), studies by PIDE , the SPDC in its annual survey last year [SPDC (2002)] and the Asian Development Bank, the ILO, and the UNDP. But clearly valuable time has been lost and the cost of suffering of the people who have borne the brunt of the reform programme has been high.

Cross-country Comparisons[2]

How does Pakistan's experience in poverty reduction especially over the 1990s compares with other countries? While fully cognisant of the limitations of such comparisons we examine the experience of India, Bangladesh, Indonesia, Philippines, Thailand and Egypt and draw some broad lessons which may be relevant to understanding Pakistan's experience in poverty reduction. The choice of countries is partly explained by data availability but more importantly that these countries have economic and structural features which are broadly similar to Pakistan.

India, starting with very high levels of poverty in the early 1970s of around 55 percent has had a steady decline in poverty levels in the 1980s and 1990s though problems of data comparability have sparked debate on the extent and rate of decline in poverty during these two time periods. A more careful analysis of the data carried out in recent studies [Deaton (2003)] concludes that poverty levels have indeed declined in the 1990s although the rate of decline may not be as high as official estimates claim. According to Deaton's estimates rural poverty in India declined from 37.3 percent in 1993-94 to 30.2 percent in 1998-99 and in urban areas from 32.4 to 24.7 percent in the same period. Overall therefore poverty levels have fallen from around 51 percent in 1977-78 to 38.9 percent in 1987-88 and to around 30 percent in 1998-99. For those who may argue that given India's size and economic diversity overall trends in poverty may mask regional differences for our study it is important to note that the Indian States bordering Pakistan also witnessed a decline in poverty in the 1990s in line with the overall national trend.

Higher economic growth especially in the agricultural sector contributed to this decline as India moved from its historical growth rate of around 3 percent in the period till the 1970s (popularly known as the "Hindu growth rate" in contrast to the then "Pakistani growth rate" of 6 percent) to around 5.8 percent in the 1980s and after declining to 4.8 percent in the first half of the 1990s to 6.4 percent in the second half of the 1990s. Agricultural growth rate in the 1980s and in the second half of the 1990s averaged around 3.4 percent. Real wages increased by 4.6 percent in the 1980s and by 2.4 percent in the 1990s. Despite this creditable performance it is important to remind oneself that at the end of the 1990s the absolute number of poor in India were around 300 million -just slightly lower than there were in 1973.

Let me at this stage flag a few important features of India's experience to which I shall refer later when discussing Pakistan's poverty experience in the 1990s. First is the higher rate of economic growth in India as compared to Pakistan in the 1990s but keeping the important proviso in mind that while agricultural growth in India at 3.4 percent was high in this period it was still lower than that of Pakistan which despite wide fluctuations averaged around 4 percent in this period. Second is the continuing rise in real wages in the 1990s even if its rate of growth

[2]These comparisons rely heavily on ILO (1997); Khan (1997), and Islam (2003).

may have slowed down as compared to the 1980s. According to Sunduram and Tendulkar real wage rate of agricultural labourers increased at 2.8 percent and casual rural labour in non-agriculture at 3.6 percent during 1993-94 to 1998-99 pointing to a tightening of the labour market. Third is the rate of decline in subsidies in India under the reform programme. According to World Development Indicators (2003) subsidies and other current transfers in India declined as a percentage of total federal government expenditure from 43 to 41 percent between 1990 and 2000 for Pakistan they almost halved from 20 to 11 percent over the same period. On this last comparison I would be cautious but it is indicative of the magnitude of changes involved.

Bangladesh, somewhat similar to Pakistan, has seen fluctuations in its level of poverty. Poverty declined in the first half of the 1980s but then increased during the second half from 51.7 percent in 1985-86 to 58.8 percent in 1991-92 and then again fell during the 1990s to 49.8 percent in 2000. The rate of decline in the second half of the 1990s was however lower as compared to the first half although growth rates were marginally higher in the second half at 5.3 percent as compared to 4.5 percent in the first half. Economic growth in the second half of the 1980s was low at 2.5 percent.

While a lower economic and agricultural growth (around 2 percent compared to 3.1 percent in the 1990s) was mainly responsible for the increase in poverty in the second half of the 1980s a number of factors accentuated the situation. Aggregate investment rates were lower in this and public development expenditure in agriculture fell steeply after the mid-1980s. Subsidies on agricultural inputs were either withdrawn or drastically reduced and this was not replaced by alternative incentives for agriculture. Real rate of interests increased sharply as a result of financial sector reforms and this was not matched by measures to provide credit to small producers.

Before we leave the South Asian experience let me say something on comparing the levels of poverty in these three countries. While official figures are not comparable as they are based on different poverty lines estimates from the World Development Indicators by the World Bank based on a \$1 a day poverty line suggest that 13.4 per cent of Pakistan's population lived below the poverty line in 1998 compared to 34.7 percent in India in 1999-2000 and 36 per cent in Bangladesh in 2000.

Indonesia after seeing rural poverty increase between 1970 and 1976 has witnessed a study decline in poverty from 40.1 percent in 1976 to 11.3 percent in 1996 when poverty levels sharply increased as a result of the East Asian financial crisis but have subsequently declined. High rates of labour-intensive manufactured exports growth based on high levels of foreign direct investment and sustained increase in agricultural production contributed significantly to this increase.

In Indonesia it is important to note that the relationship between growth and poverty alleviation has varied over time. Between 1981 and 1987 growth slowed down as a result of stabilisation measures but this did not result in a slow down in the rate of poverty reduction because a rise in inequality was avoided. Employment did not decline because the reduction in public expenditure was concentrated in capital-intensive sectors and grants to public enterprises were reduced. An important lesson that the Indonesian government learnt from the rise in rural poverty during 1970-76 was that it was the result of a rapid increase in food (principally rice prices) and it subsequently followed a policy of stable rice prices. Self-sufficiency in rice was pursued as a key policy objective and this was achieved in the mid-1980s.

A comparison between Philippines and Pakistan is always instructive as both countries have significant proportion of their labour force abroad as contract workers mainly in the Middle-East and a large migrant diaspora abroad including in the USA. Also those of us who may be too old or too young to remember both Pakistan and the Philippines were showcased as the two potential Asian tigers based on their growth performance in the 1960s and whose subsequent economic performance did not live up to the earlier expectations.

Philippines like Pakistan has also had large inflows of remittances from workers abroad but in contrast to Pakistan seem not to have had as significant an impact on poverty as happened in Pakistan in the late 1970s and 1980s. In the Philippines period 1985 and 1988 there was some decline in poverty in both rural and urban areas. In the post-1988 period till 1997 poverty declined in the urban areas from 28 percent in 1994 to 21.5 percent in 1997 but in the rural areas increased between 1988 and 1994 and then declined marginally to around 50 percent in 1997.

Philippines major problem has been its inability to sustain growth in contrast to its South-East Asian neighbours. Overall growth was 1 percent in the 1980s, and despite some growth momentum gained in the mid-1990s its overall growth was badly affected by the East Asian crisis and was a meagre 3.3 percent in the 1990s.

In Thailand poverty levels declined steadily since the early 1970s till the East Asian economic crisis the result of sustained agricultural growth as well as very impressive growth of labour intensive manufactured exports. Poverty levels had fallen to 13 percent in the early 1990s.

In Thailand the main engine of poverty reduction has been economic growth and there has been little in the way of targeted poverty reduction measures. While growth overtime has been accompanied by increasing income inequality high growth has offset the rise in income inequality although this affect has become weaker overtime.

Egypt[3] saw a reversal in poverty trends since the 1980s with poverty declining during the second half of the 1990s from 19.7 to 16.4 percent between 1995-96 and 1999-2000 although recent economic set backs may have again reversed these trends. Three major factors are attributed to reversing this trend. The first is a rapid economic growth which averaged over 5 percent between 1996 and 2000 a marked

[3]This section is based on World Bank (2002a).

increase from the growth performance in the 1980s and the early 1990s. The second was significant improvement in its human development indicators especially for females, and the third a rapid growth in jobs, incomes and productivity in the late 1990s.

It is important to draw attention to the substantive safety net which Egypt has in place to protect its vulnerable groups from falling into poverty. The first is the food subsidy programme which has been in place since 1945 with a subsidy on indigenous bread (baladi) which is provided at about one-third the cost of production. There are also subsidies on sugar and cooking oil but they are more restricted and given through ration cards and based on incomes and needs. This food subsidy accounts for 1.5 percent of GDP. The second is a Social Fund for Development targeted towards new graduates, unemployed youth, displaced public enterprise workers and female-headed households. It supports programmes for small enterprise development public works programmes and human resources development especially through skills development and training.

Let me now try to draw some broad conclusions on factors influencing poverty based on the experience of the countries cited.

First, given that a significant proportion of the population in each of these countries works and lives on the agricultural economy the fortunes of this sector have a very important bearing on poverty in these economies. In India sustained agricultural growth in the 1980s and 1990s which translated itself into real wage increases for farm and non-farm labour in the rural areas was an important factor in leading to a decline in rural poverty. As mentioned earlier Pakistan witnessed on average an over 4 percent growth in agricultural production, albeit with a significantly higher growth rate of population, yet saw poverty levels significantly increasing. What were the structural features and changes in the 1990s in the rural economy which can explain rising rural poverty with a respectably high rate of agricultural growth?

The second that the impact of economic growth on poverty is most strongly transmitted through the labour market i.e. if it is employment generating and enhancing labour productivity. What therefore one finds in the same country or across countries is that the impact of economic growth on poverty can vary with higher growth resulting in a lower rate of poverty reduction as compared to a relatively lower rate of growth. This happened in Bangladesh in the 1990s and also in Pakistan when you compare the 1960s with the 1970s. In Bangladesh this was because growth was more employment intensive in the first half of the 1990s as compared to the second half so that despite higher economic growth in the latter period the rate of decline in poverty alleviation was lower [Islam (2003)]. In Pakistan in the 1970s large outflows of labour and resulting remittances both eased labour market pressures as well as encouraged growth of small and medium labour intensive enterprises resulting in poverty reduction despite much lower growth in this period as compared too the 1960s when poverty increased despite higher economic growth. Indonesia and Thailand are classical cases of generating high rates of labour-intensive exports which resulted in rapid poverty reduction.

The third that incomes of the poor are as much a function of economic growth, better employment opportunities as it is of what happens to prices of basic food items and other necessities of life. Here government subsidies can have an important impact on poverty movements in the economy at least in the short term.

The fourth may be bracketed as micro interventions in the form of public works programmes and wage guarantee schemes and other such interventions to help reduce unemployment and poverty in both urban and rural areas. In India there has been a massive public works support programme which clearly played an important role in reducing poverty in the 1980s and 1990s. The same is true in Egypt where a very large donor supported Social Development Fund has been effectively used to create employment both directly and indirectly through public works programmes, training and encouraging small enterprise development.

Why did Poverty Increase in Pakistan in the 1990s?

Let me again acknowledge that the recent studies on analysing poverty in Pakistan have made a valuable contribution to our understanding of the underlying structural constraints and poor governance which contribute significantly to the persistence of poverty in the country. Yet, to my mind a number of these studies have either not sufficiently analysed or at times completely ignored the impact of the economic reform programme on rising poverty in the 1990s and indeed in the subsequent three years. There are clearly exceptions to this but here too much more careful and exhaustive analysis could have been done. I cannot pretend to be able to carry out such an analysis in this paper but I will try to highlight areas where economic management could have been decisively better and point to areas where much more can be done to tackle the problems of poverty and rising unemployment in Pakistan. In this I will try to draw some lessons from the experience or should I term them snippets of selected countries which I have earlier discussed.

Economic Management in the 1990s

Let me very clearly state at the outset that Pakistan economic managers faced a very difficult situation in the 1990s. Indeed I am reluctant to call it the lost decade when seen in relation to the real challenges the economy faced in this period. In fact I would argue that the 1980s was a period of missed opportunities and that the legacy the economic managers of this period left for those who followed was not an enviable one. First was the rising fiscal deficit the result of a very large increase in government expenditure (including defence) which left a crushing debt burden on the economy. Second, if the needed economic reforms to achieve macro balance and competitiveness had been initiated then when the economy was in a relatively strong position it would have lessened the burden on the economy and the people of undertaking these reforms when the economy was in relatively much weaker position.

Let me spell out what I believe were the major reasons which contributed to increasing poverty pressures in the 1990s. The first and perhaps most important was the slowing down of economic growth. Major factors responsible for this included large fluctuations and decline in cotton production which was persistently hit by pest attacks, continuing slowing down of remittance inflows, bad weather conditions which directly affected agricultural production and economic sanctions after Pakistan's nuclear explosion in May 1998 all contributed to the economic slow down. Frequent changes in governments in this period added to economic uncertainty and lack of continuity in economic decision making. Political considerations also may have dictated unsound economic decisions such as the building of the Lahore-Pindi motorway. Last, but not least interim governments entered into agreements with the multilateral financial institutions with the burden and constraints it imposed to be borne by the political government that followed. That these agreements were in many cases subsequently not fully implemented may have reflected that the costs these imposed were too high or as some have argued reflected lack of political will to undertake and sustain much needed reforms. The truth perhaps reflected a mixture of the two.

That said, however, economic management in the 1990s suffered from some serious shortcomings to which I would like to draw attention. Let me call these the "seven shortcomings of economic decision making in the 1990s" (rather than the "sins of economic planners" à la Haq and Baqai in their classical post-mortem of the 1960s), which I believe made matters worse in an already difficult and trying economic environment and directly and indirectly contributed significantly to rising poverty and rising unemployment in this period.

First and foremost was the sequencing and pace of implementation of the economic reform programme. A striking example of this is the financial sector reform programme adopted in the late 1980s as part of the Banking Sector Adjustment Loan from the World Bank which some have termed as the single biggest disaster in terms of economic decision making in this period. By drastically raising interest rates to market prices on government borrowing it increased many fold the interest payment burden of the government which increased from Rs 33.2 billion or 4.9 percent of GDP in 1987-88 to Rs 243.3 billion or 7.7 percent of GDP in 1999-2000. Clearly the sequencing of the financial sector reform was wrong. The fiscal deficit should have been reduced prior to the financial reforms so that the government did not have to borrow at such high rates of interest. This seriously constrained public sector development expenditures in the 1990s. The same could be said of the sequencing of the tariff reforms and changes in the taxation structure which led to the closing of a very large number of industrial units (around 3000) increasing unemployment and a regressive taxation structure which increased the burden of taxes on the poor and was an important contributory factor in increasing income inequality in the 1990s [Kemal (2003)].

The second was the failure to effectively protect real incomes of the poor and the vulnerable segments of the population against rise in prices of essential items. Of this a pertinent example is the removal or the phasing out of poverty related subsidies in the 1990s particularly on food and essential items. Existing studies have not sufficiently analysed the impact on poverty of the removal of food subsidies but what evidence is available points to it being an important contributory factor in increasing poverty in the 1990s. According to the ILO (2003) report in the 1980s the poor on average consumed 2503 Kcals per day but this average caloric consumption decreased to 2196 Kcals in the 1990s. Also during the 1990s the poor increased the food share in their consumption bundle significantly from 53 percent in the 1980s to 62 percent in the 1990s but were not able to prevent a slide in their calorie consumption. Niazi (2002) in a background study for the ADP Poverty Assessment report has shown the very large decline in the end-1990s in poverty related federal subsidies as a percentage of total subsidies from around 90 percent in the mid-1990s to around 4 percent and in absolute terms from around Rs 5.3 billion in 1990-91 (0.52 percent of GDP) to around Rs 0.6 billion in 2001-02 (0.03 percent of GDP).

Increases in energy prices including in recent years were also an important contributory factor in rising poverty. The rationale of opening the energy sector to Independent Power Producers (IPP) on the terms and conditions agreed with them imposed a heavy burden on the economy which it may have been able to bear if was in an upturn but not in the prevailing conditions in the 1990s. Also recent decisions to increase fuel prices have raised profit margins of oil producers and distributors without sufficiently taking into account their impact on consumers. This process needs to be made more transparent.

The third was the targeted lowering or the capping of the fiscal deficit as part of the IMF stand by loan agreements at a level during the 1990s which seriously constrained the Public Sector Development Programme (PSDP) which declined sharply from around 6.4 percent of GDP in 1992-93 to only 2.8 percent in 2000-01. Part of this decline was the result of the government's decision not to participate in commercial activities but this dramatic decline at a time when private investment was also falling further slowed down the growth of the economy with an adverse impact on poverty and employment in the economy. The income and employment multiplier of this sharp decline was seriously underestimated as was the role of public spending in "drawing in" private sector investment. In the second half of the 1990s with inflationary pressures declining and private investment falling there is considerable merit in the argument that there was sufficient fiscal space in the economy to accommodate a higher level of PSDP and carry a higher fiscal deficit without generating macro imbalances in the economy. The capping of the fiscal deficit agreed upon by the interim Farooq Leghari government in 1996 and then the economic managers in 2000 with the IMF must in this context be seriously questioned.[4]

Fourthly, an insufficient effort was made to increase the employment intensity of public sector expenditure depleted as it was to counteract the rising unemployment levels which more than doubled in the 1990s as compared to around 3 percent in the 1980s. The special public works programmes started were clearly neither sufficient nor well targeted to halt the rate of rising unemployment and underemployment in the economy. To make matters worse little protection was afforded to workers against falling real wages and deteriorating employment conditions as more and more employment was made precarious in the form of part-time, daily or on contract basis. The weakening bargaining position of workers was dealt a very serious blow with the passage of the Industrial Relations Ordinance 2002 which both curbed workers' rights for collective bargaining and provided enormous leeway to convert permanent workers into contract workers a practise which has become very common in many of the large scale units in the country.

Fifthly, efforts to improve the country's very low human development indicators were on the whole disappointing in terms of results achieved and resources allocated for this critically needed improvement. This is a well documented and well researched area especially the factors which contributed to the lack of success of the donor supported Social Action Programme (SAP) to improve the country's human development indicators in the 1990s.

Sixthly, the safety nets for the vulnerable and the poor proved grossly inadequate to deal with the deteriorating economic, employment and poverty situation in the 1990s. This is not to underestimate the dedicated work done by NGOs and other welfare bodies in this period the absence of which would have matters worse but a stark recognition of the fact that productive employment is the only real safety net for the majority of the working population in a developing country like Pakistan. Yet results could have been better if the economic managers had more effectively strengthened the existing safety nets by pooling in resources where possible and devising innovative and affordable protection to at least lessen the enormity of the problem faced.

The seventh was the freezing of the foreign exchange accounts in the aftermath of the nuclear explosion in May 1999. It not only adversely affected the

[4]To quote Ishrat Husain on the recent reform programme, post-1999: "If public sector expenditures and development projects were initiated at the same time, to give a kick-start to the economy, then these conditions (conditionalities that raised prices of essential items) would have been seen in a different light. But the government was unable to do so because it had to meet the fiscal targets". [Husain (2003), page 59. parenthesis added].

deposit holders but shattered business confidence from which the country has not yet fully recovered. It can be disputed whether there was any alternative in the wake of economic sanctions (although it may have been worth playing it out for some more time before freezing the accounts) the simple fact was that this situation should never have been allowed to develop. I must add here, however, that this was not only the folly of the financial managers and economic decision makers and that we in the economic profession too cannot be completely absolved of blame as I do not recall any article in any of our leading economic journal pointing out to the vulnerability of these accounts especially since most of us were aware that there were no real reserves to back up these deposits which had been already spent.

While poor economic management as outlined above made matters worse for an economy which was facing difficult and challenging times there is one other important poverty puzzle we need to address before we leave the issue of rising poverty in the 1990s. This is the question of why rural poverty increased significantly when overall agricultural production increase by over 4 percent during this decade.

Let me attempt an answer relying to a large extent on the insights and dynamics on rural poverty provided to us by a number of the recent studies cited earlier. First the growth rate of agriculture impressive as it was at over 4 percent per annum over the 1990s must be prefaced by the fact that Pakistan's population was still growing at around 2.6 percent per annum during this period, significantly higher than that of the Asian countries mentioned earlier and a labour force which was also growing at around the same rate. More than half of the rural labour force of Pakistan is landless and it relies both on agriculture and non-agricultural activities for its livelihood. Agricultural growth in the 1990s was highly uneven. Some of the more labour-intensive sectors such as cotton, fruits and vegetables and livestock production grew at a slower rate and were subject to fluctuations due to weather conditions and in the case of cotton pest attacks. The elasticity of productive employment therefore declined and this is reflected in the elasticity estimates for this period [ILO (2003)]. As the overall economy slowed down and the government public sector development expenditure declined its impact on the rural non-farm economy must also have been sharply negative. Available evidence suggests that wages of rural workers declined in this period reflecting the slackening of the labour market. There is evidence to support the fact that in the 1990s large and medium sized farms benefited more from agricultural growth as compared to the small sized farmers somewhat akin to what had happened in the 1960s after the advent of the "green revolution". One factor may have been the removal of subsidies on fertiliser, seed and other inputs mentioned earlier and difficulties in access to credit for small farmers. Did increasing mechanisation in agriculture lead to an eviction of tenant farmers and increase in owner-occupied by farmers thus increasing the number of landless who faced a constricting labour market in the 1990s? There is some evidence to suggest this but one would have to await the results of the last agricultural census to confirm this view. On the whole however there were many factors especially within the labour market which can provide an explanation for why rural poverty increased in this period.

What Should We Do?

I have fundamentally argued that a difficult economic situation that Pakistan faced in the 1990s was made worse by serious lapses in economic management and that needed measures to cushion the impact of the slowing down on employment and poverty were not taken into account especially in the economic reform programmes agreed upon with the IMF and the World Bank.

A major problem with our economic decision making has been that we have been piecemeal in our approach to economic problems and challenges faced. Frequent changes in governments made matters worse in the 1990s. Post-1999 there has been more consistency in the policy framework and some creditable achievements [Husain (2003)] although by entering into an IMF stand by programme the governments room for manoeuvre was extremely restricted. I have argued that there was perhaps fiscal space to follow a more anti-cyclical fiscal and monetary policy especially in terms of higher public sector development expenditure programme and initially a lower rate of interest to stimulate the economy in this period.

Be as this may the government has now announced its intention not to extend the stand by agreement beyond the end of 2004. This should now provide the opportunity to take important strategic decisions to steer the economy and make a decisive impact on reviving growth and making a major dent in reducing poverty and high levels of unemployment in the economy. Indeed the government has in the past few years come up with a Ten Year Development Plan 2001-2111 and just finalised its Poverty Reduction Strategy Paper (PRSP) in December 2003 which should provide the much needed strategic vision on critical development issues over the foreseeable future.

In this strategy to my mind the role of developing an efficient, well functioning and equitable labour market must be seen as critical both for increasing international competitiveness of the economy as the basis for sustained economic growth and for the generation of productive and remunerative employment opportunities which is the key to poverty eradication.

It is now recognised that a well educated and skilled labour force provides an economy the cutting edge in global markets [ILO (1998)]. Low wages and unskilled labour may provide temporary footholds in the global market for low value added products but these are more often than not unsustainable as one is overtaken by those who can sell at even lower wage rates. A certain level of flexibility in the labour market is also required to allow enterprises to adjust to changing demand in fast changing global markets. But here too the answer must not be found in developing a labour market which is based almost entirely on short term wage or contract labour which is both poorly motivated and there is little incentive for employers to invest in developing their skills.

I strongly believe that to be internationally competitive and to constantly move to higher value added products one needs to develop a well functioning labour market in which the need for flexibility for enterprises is balanced with the need for stability for workers at a wage which meets their basic needs and provides a modicum of social security. Such a labour market also provides the environment for both employers and workers to invest in skills development.

I therefore am extremely concerned at the way the labour market is developing in Pakistan especially in recent years and especially after the passage of the IRO 2002. It is important that this labour legislation be debated and discussed through tripartite dialogue and in Parliament to redress this swing of the pendulum to the extreme detriment of a well functioning and equitable labour market.

Let me also say at this stage to establish a well functioning and equitable labour market we need to invest in and develop robust and well functioning labour market institutions by strengthening workers' and employers' organisations so that they can play a constructive and positive role in helping develop consensus on key economic, social and labour market issues. The role of the government in both developing a well functioning and equitable labour market and creating conditions for a healthy bipartite or tripartite dialogue will be critical.

To help improve the functioning of the labour market the ILO is also working with the government to develop labour market services within an active labour market policy framework for the setting up of integrated labour services which combine registration of job seekers with placement, training and retraining and providing opportunities for self employment through provision of loans from micro credit institutions. The idea is to first set up around six such labour market service centres in six districts in the different provinces and then based on the lessons learnt to further expand these services.

The other major area to which I wish to draw attention is how to increase the employment generating capacity of the economy with some concrete suggestions in the existing development policy framework.

First, I would shift what I believe is an overemphasis on motorways and highways to increase provision of water for irrigation whether this is in the form of investing in lining for existing water courses, building of small dams or large irrigation projects. Water as my old Professor Reddaway once said to me is employment friendly and one of the key inputs which increases both land and labour productivity a fact borne out of the experience of East Asian economies. We need to actively encourage growth of employment intensive sectors with strong backward and forward linkages with the rest of the economy. Measures recently initiated to encourage growth of the housing sector and small and micro enterprises (SMEs) could play a leading role in increasing the employment intensity of future economic growth.

Second is making a very concerted effort in educating our girls and then making an even greater effort in finding them jobs. A disturbing development in the labour market has been the very high levels of female unemployment especially of the educated. This acts as a disincentive for parents and boys and girls to invest time and resources in formal education. Indeed I believe this has been a major factor in not being able to increase enrolment in primary and secondary educational levels despite considerable efforts in this direction. Both the private and social returns to education and skills development are high in a growing and employment generating economic environment.

Third is developing the access and capability to the world wide web. This new technology can provide the means to leapfrog stages of economic development as some countries have managed to do. It is also absolutely essential for marketing and increasing competitiveness in the global market place. Pakistan has taken important strides in developing access and skills to this technology but given the global downturn in the ICT sector returns including export earnings from this sector may be low. But the global economy is picking up and it should be a major source for both jobs and export earnings in the not too distant future.

Fourthly, I believe that the key to increasing the employment intensity of economic growth is through increasing spending of development expenditure at the local level. I am a very strong supporter of the government devolution plan and although I am sure it still suffers from may weaknesses it could be the key to improving lives and incomes of ordinary people especially the majority of our population which lives in rural areas. The employment multiplier of local level expenditure is high.

So let me end as I have done with many of my policy prescriptions for alleviating poverty and generating employment and sustainable development in Pakistan. First is to considerably strengthen the macroeconomic management of the economy both to avoid mistakes which I have illustrated we made in the past and to be able to better bargain with multilateral financial institutions and donors, which are an integral part of the global financial architecture within which we have to operate. Second is to take the "high road" to economic development by investing in education and skills of our work force and creating conditions for the development of an efficient, well functioning and equitable labour market. Finally our development strategy must rest on what I term the three Ws—Water, Women, and the World Wide Web—to which I have added a fourth—Workers' Rights—along with strengthening the devolution process and local level institutions which will be the key to bringing the gains of economic development to ordinary people living in this country.

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