

"Economic Policy and Industrial Growth in Pakistan"—A Review

A. H. M. NURUDDIN CHOWDHURY*

Stephen R. Lewis (Jr.) is one of the few foreign economists most competent to write on Pakistan economy judged on the basis of his past publications, length of association with this country and sincerity of commitment to understand it. Therefore, the volume under review [10], coming from the pen of such a knowledgeable person, cannot but be seriously taken by all students of the Pakistan economy.

The general purpose of the work has been to explore the causes of rapid industrialization in Pakistan, to analyse the process of industrial growth and to assess the relative importance of policy variables and nonpolicy determinants in explaining the pattern and speed of industrialization. Lewis extensively draws upon the previous studies on Pakistan economy relating to the structure of tariffs and commodity taxes, the growth and structural changes in manufacturing industries, the intersectoral terms of trade between agriculture and manufacture and the effective rates of protection to industries (many of which were done either by him or with his inspiration or collaboration), so much so that the book looks like a lengthy digest of these studies carried out in the past. However, he marshals the empirical findings of these works to deduce some new conclusions.

The 169 pages of the book are subdivided into seven short chapters. Chapter I describes the structural changes that occurred in the Pakistan economy, the broad outlines of policy formulations and a brief statement of the author's interpretation of the industrialization that took place. Chapter II is devoted to explaining a few expository models and concepts used in the book. Next four chapters, III, IV, V and VI, seek to answer three basic questions: *i*) what were the reasons for the spectacular industrial growth; *ii*) was there too much growth of consumer-goods industries and not enough growth of industries producing intermediate and capital goods; and *iii*) what was the relative role of policy variables like tariffs, exchange rates, quota restrictions and nonpolicy determinants like Partition of the country, domestic availability of raw materials.

*The author is a Deputy Director, Research, State Bank of Pakistan. The views expressed are in his personal capacity and do not reflect the opinion of the State Bank in any way.

The final chapter summarizes the main conclusions of the previous chapters and evaluates some of the arguments for and against the industrial policy and the pattern of growth in Pakistan.

The main conclusions of the book, though not the rigour it tries to depict, can be easily summarized: Pakistan witnessed a very spectacular rate of industrialization and significant degree of structural transformation over a short span of time. The motive force for this industrial growth came primarily from nonpolicy determinants. At Partition, Pakistan possessed an abnormally low manufacturing capacity. The industrialization that ensued simply worked off this disequilibrium. The policy variables only made the process speedier. The pattern of industrialization would be the same under any plausible set of alternative policies. Domestic market and domestic availability of raw materials determined the composition of output, not any discriminatory policy incentives. He carefully analyzed the high costs of industrialization, but emphasized that these costs had started falling quickly. Initial disequilibrium in the cost-and-price structure was removed and the adverse terms of trade for the traditional sector were largely offset as industrial output increased. Some of the important industries even started to export, albeit with the help of some subsidy, and Pakistan's export performance has been remarkable among the developing countries.

Lewis notes that the policy of differential system of protection followed in Pakistan was leading the country into structural problems during late 1950's which was cushioned off by the fortuitous massive increase in foreign aid. The reforms in 1960's by differentially limiting the effects of the licensing system, accentuated the economic distortions. As a result, structural bottlenecks are likely to appear in the future. But he does not recommend any reforms to obliterate them.

One weakness of the book is that, though published in 1969, most of its analyses are based on data up to 1964, perhaps because the time span covered by the empirical researches it surveyed did not go beyond that year. Consequently, it not only fails to give a sense of up-to-dateness but also fails to benefit from the lessons of recent socio-politico-economic movements in Pakistan which forced attention to many neglected aspects and cooled off the enthusiasm of some belonging to Lewis' camp.

What are these other aspects, referred to in the writings of Griffin [4], Khan [7], Bose [1], and Chowdhury [3] and brought into limelight by the political processes, that Steve Lewis either ignored or left underemphasized in this summing up of a long series of studies on Pakistan's economy? To mention a few, these are the great magnitude of income transfer forced by the industrial policies from the vast majority of farmers, workers and artisans in the traditional

sector to relatively a few privileged groups of businessmen, industrialists, salary earners, professionals, urban rentiers and anti-social elements like smugglers and corrupt officials; the great waste of these income transfers in conspicuous consumption of the rich and in supporting the high cost of inefficient industrialization; the high cost of protectionism that is being borne by the impoverished masses even at this stage of the so-called "successful industrialization"; and the fact that development planning cannot be judged merely in terms of short-term or short-sighted economic calculus abstracting from the possible feedbacks of the socio-political repercussions that economic policies inevitably generate.

Steve Lewis seems to side with those growthmen who would tolerate any loss of static efficiency for economic growth without bothering about the real content of that growth in terms of human welfare (perhaps on the excuse that it is not so neatly measurable) and the costs of such growth (perhaps because these are borne by others). Let us turn to the more important specific issues where we find ourselves in basic disagreement with Lewis.

First, Lewis very unconvincingly asserts that the pattern of industrialization in Pakistan would be fundamentally the same under any other alternative set of policies (including a floating exchange rate, specifically mentioned by him). But a floating exchange rate would give uniform protection to all industries and not permit the growth of industries contributing negative value added at international prices of output and input. It would not promote exports to 'lose foreign exchange' (bearing optimum tariff possibility). It would not give unbridled opportunity of oligopolistic exploitation of domestic market. The pattern of resource allocation would be much more rational and its use free from the various failings of administrative controls. Alternatively, a policy of socialistic planning could mean a host of significant departures from the pattern of industrialization that actually emerged in Pakistan, as has been pointed out by Griffin [4, Pp. 604-605]. Lewis fails to understand these because he limits himself to a poor standard of internationally average degree of industrialization and some arbitrary classifications of the industrial output to the neglect of the more vital aspects of industrialization like allocative and productive efficiency emphasized by orthodox economists, and income distributive and welfare aspects emphasized by the socialistic ones. Thus, different sets of policies would give economic structure materially different in nature, though the macroeconomic aggregates used by Lewis would fail to decipher the differences.

Second, Lewis seems to underplay the effects of the economic policies both ways. He fails to realize the crucial role played by the policy-created condition of *high and sure* profit in initiating industrial growth in a backward region. A floating exchange rate with marginal profit incentives could keep the economy persistently wedded to a low-level equilibrium. Therefore, it is incorrect to

say that the policies only helped make the process of industrial growth speedier. Even without the Partition of the country, if the policies of import licensing, capital issues, providing social overheads and economic infrastructure, and disbursement of public and foreign-aid funds could be biased significantly in favour of the region constituting West Pakistan, this region could thrive in a controlled economy. The established industries of the rest of India could not compete with them due to lack of licences to import inputs or lack of permission to expand capacity. The moot question is whether in an undivided India such biases in favour of this region would obtain; the answer to which will be most probably in the negative. On the other hand, Lewis' nonpolicy determinants were equally applicable in the case of East Pakistan but failed to evoke the same spectacular transformation of the economy of this region. In fact, the Eastern province is stagnating by any standard due to the fact that the dominant policy variables were unfavourable for this region. Thus, it is a gross failure to understand the Pakistani experience to minimize the decisive role of the policy variables in fostering the industrialization of West Pakistan. The more interesting questions to ask are whether they were necessary to initiate the growth, whether they were the most efficient set available to policy-makers, and whether they deserve to be continued at this stage. Lewis does not prove of any help on these issues. This reviewer has considered these questions elsewhere and suggested that the policies pursued in Pakistan were important in initiating economic growth due to fiscal weaknesses, market imperfections and lack of industrial entrepreneurship. But the policies are retained long after their initial rationale has disappeared and should be replaced by an optimal set of indirect control [2].

Third, in his desire to maintain a pseudo-scientific aloofness from politically sensitive economic issues, Lewis does not venture much analyses or opinions on the problem of regional disparity in economic growth. While the problem has been recognized by the planners and policy-makers at the topmost level in the country¹, analyzed by foreign economists² and economists belonging to West Pakistan³, Lewis could only report: "*East Pakistanis complained that not only were they less well off at the time of Partition, but they also had been exploited by the West Wing to provide resources for development in that province*". Further he could only cite the study by Khan and Bergan [9] as the best available estimate of disparity in regional income, in spite of other writings that would indicate greater extent of this disparity than a simple comparison of provincial

¹The existence of serious disparity in regional income has been recognized and its removal was incorporated as a constitutional obligation in the country.

²John Power, a visiting research adviser at the Pakistan Institute of Development Economics, attempted a rough estimate of the magnitude of resource transfer from East Pakistan to West Pakistan [12].

³Mahbubul Haq gives one of the early analysis of the regional problem and some estimates of regional disparity and resource transfer [5].

income figures would suggest⁴. His failure to understand the regional problem in Pakistan led to an incorrect assessment of the mechanics of industrial strategy that obtained in Pakistan. The policies which helped a concentrated use of country's own resources and foreign aid in one region were crucial and may not be available in other countries. In fact, it will be illuminating to analyze the external transfer of resources to West Pakistan and the industrial growth of this wing separately. The magnitude of resource inflow per capita would be quite unparalleled in recent years for a country having comparable population size.

Fourth, the industrial policy is highly successful, according to Lewis, because it has worked off the disequilibrium at a rapid pace. But this judgement sharply conflicts with the empirical analyses he quotes that show at what a high relative cost the equilibrium has been found. The implicit exchange rates provided to certain industries are skyhigh and some industries are unlikely to become competitive, according to his own analysis, at any exchange rate. Even though the cost of some industries have declined, most of them continue to subsist on domestic income transfer and the level of subvention needed is too high for the traditional sector to bear, as its surplus has been depleted. While he notes the export performance of some of these industries as evidence of 'success', the evidence on the inefficiency of export-incentive schemes would give lie to this claim [6; 11; 13]. Maximizing export earning, regardless of the cost or exchange rate involved, is not desirable, but for the purpose of keeping an inefficient system from running into structural problems. Export performance of the industrial sector could be acclaimed if it could recompense domestic resources adequately at international prices. The evidence is that 'real value added' in many of the export industries were very low or even negative.

To describe the Pakistani industrial process as the successful case of working off a disequilibrium is basically erroneous. Any country possibly can create such an artificial disequilibrium and get some industries even at a spectacular rate if sufficient external aid is made available, if the inefficiencies of the resultant industrial structure is of no concern and if the problems of regional and interpersonal distribution of income could be ignored; but perhaps these countries are better off for not attempting to do so.

Lewis' thesis of initial creation of a disequilibrium and its working off due to growth in domestic capacity overlooks the possibility of wrong direction of specialization, *i.e.*, growth of domestic production where the country possesses no comparative advantage, the lack of competitive pressure to force the domestic

⁴It has been recognized by many that a simple comparison of regional income figures seriously understates that extent of differences in real income and standard of living. Samiullah Khan [8] listed the differences in per capita availability of a number of items. Haq [5] noted that a big change in the extent of regional disparity is introduced by a correction for the relative price of wheat and rice in the two region of Pakistan.

costs as low as possible and the policy-created obstacles to cost minimization embedded in the conception as well as implementation of the differential system of protection.

We feel that the Pakistani economy is suffering from various structural disequilibria, that a number of domestic activities are burdened with the high costs of others which have no future of being competitive and that a conversion of the welter of differential protection into a system of uniform protection to domestic value added through drastic adjustment of the exchange rate and the tariff structure is necessary to bring about an equilibrium. It will not be automatically achieved under the present system, as suggested by Lewis. Many of the industries will survive with the help of the protection implicit in the exchange-rate adjustments, though, in many cases, they have to introduce major rationalization in costs. Many industries will go under in the face of foreign and domestic competition. However, the weeding-out process must be left largely to the forces of market mechanism, since in a situation of pervasive distortions introduced by all sorts of interventions the ability of economists to rank industries in order of efficiency is very inadequate.

Finally, the income redistribution effected in the economy to finance the industrialization has resulted in an absolute fall in the real income of industrial workers, agricultural labourers and the rural sector in general over most of the period, despite the fact that there has been some gain in per capita income in the economy as a whole. Available evidence suggests that the income redistribution against the rural sectors and the industrial workers was partly wasted in conspicuous consumption of the recipients in the privileged sectors. Net saving by this class has actually been negative [3, Pp. 97-100]. This has been instrumental in generating the social tensions that are currently threatening the growth prospects of Pakistan's economy and the very foundation of this nation. The emphasis of industrial growth to the neglect of social sectors and distributive justice may not make the development performance of Pakistan an envy of anybody in the long haul. Lewis' evaluation of the industrial growth in Pakistan seems very narrow and short-sighted in not taking these aspects into account.

In a poor economy like Pakistan, spectacular industrialization or even high rates of growth in national income for a few years still leaves the average income embarrassingly low. But major gains in social welfare can be quickly achieved through policies aimed at improving public health (fighting diseases like cholera, small pox, malaria and tuberculosis), eradicating illiteracy, removing extremes of poverty and deprivation and narrowing the traditional inequality of economic opportunities prevalent in such societies. Such policies also help maintain social harmony while modest but continued growth in income and structural transformation become impressive in the long run. Therefore, at least in retrospect, one wonders if economic policy in Pakistan did not set

wrong goals for itself and adopted inappropriate instruments to achieve them. If industrialization of any kind at any cost was to be the dominant objective of economic policy simply because the ratio of manufacturing to national income in Pakistan was below the average for countries of the same income bracket, then Lewis' judgement that Pakistan's industrialization was a success may be valid. But one can hardly support such a queer objective. More acceptable objectives of economic policy are efficient utilization of resources, increasing general welfare of the people, maintaining social stability and creating conditions for harmonious growth. One can read even between the lines of Lewis' analysis that Pakistan's economic policies failed to further such objectives. That Lewis did not spotlight these aspects seems to be the chief weakness of his book. Therefore, whatever is not secondhand in the book is largely uninteresting to people who, like the present reviewer, feel that economic analysis should seek social relevance by taking into account the socio-political dynamics along which economic policies have to operate, particularly in the developing countries.

REFERENCES

1. Bose, S. R., "Trend of Real Income of the Rural Poor in East Pakistan, 1949-66", *Pakistan Development Review*, Vol. VIII, No. 3, Autumn 1968.
2. Chowdhury, A.H.M.N., *Financing Economic Development in Pakistan*. Paper presented to the Seminar on South East Asia, organized by the International Economic Association, held at Kandy, Ceylon, June 1-11, 1969.
3. ————— "Some Reflections on Income Redistributive Intermediation in Pakistan", *Pakistan Development Review*, Vol. IX, No. 2, Summer 1969.
4. Griffin, K. B., "Financing Development Plans in Pakistan", *Pakistan Development Review*, Vol. V, No. 4, Winter 1965.
5. Haq, M., *The Strategy of Economic Planning in Pakistan: A Case Study of Pakistan*. (Karachi: Oxford University Press, 1962).
6. Hufbauer, G. C., Nayyara Aziz and Asghar Ali, "Cotton Textile and Leather Exports: What Cost Foreign Exchange?", *Pakistan Development Review*, Vol. IX, No. 3, Autumn 1969.
7. Khan, A. R., "What Has Been Happening to Real Wages in Pakistan?", *Pakistan Development Review*, Vol. VII, No. 3, Autumn 1967.