

Surviving Economic Melt-down and Promoting Sustainable Economic Development in Pakistan

Published by the Nonproliferation Policy Education Center
By S Akbar Zaidi

This paper was originally meant as a comment on Shahid Javed Burki's paper – entitled: 'Pakistan's Economy: It's performance, present situation and prospects' – as part of this Panel in this Conference, where I was invited to serve as a discussant. However, given the very detailed and comprehensive nature of Mr Burki's arguments, I find myself with few disagreements, if any at all. Mr Burki has laid down a substantive manifesto and policy document with which few economists would disagree. My paper, hence, refers to Mr Burki's paper where I need to, but does not repeat any of the arguments or even the large amount of data and facts, that he provides and with which I agree. My paper builds on Mr Burki's paper and I try to raise other issues which he has not covered in this paper, although he has written on many of them quite extensively in the past as well. Both papers should be seen as complimenting each other rather than as responses or critiques and should be read in tandem. Where Mr Burki's paper provides ample economic data and analysis, my paper builds on that economic base and uses a political-economy perspective to take the debate further. While many of Mr Burki's economic interventions are logical, appropriate and most timely, many of them will come up against vested and institutional interests which hamper any attempt at the urgently needed reform he talks about. Moreover, one of my key arguments is, that unless some key political issues, no matter how symbolic they may appear to be, are resolved, much of the substantive part of the economic policy will remain unimplemented, and the economic melt-down will become far worse, perhaps even threatening the democratic transition underway in Pakistan today.

The Structural Transformations of Pakistan's Economy and Social Structure

Mr Burki in his paper presents a number of key structural factors that have affected Pakistan's economy in the last sixty years, and shows how these shifts are affecting economic and social structures. In this section, I add a number of other factors that have changed over time and are going to affect how Pakistan's economy, its social sector and politics responds to such dynamic influences.

Perhaps the most important factor that has undergone substantial change and transformation as Mr Burki has also pointed out in his paper, a factor that sadly, many other Pakistani social scientists still do not comprehend, is that Pakistan is neither a so-called 'feudal', agricultural, rural or even 'traditional' society or economy. Only those social scientists who write their papers on anecdotal evidence, still talk of Pakistan being 'feudal'. Even a cursory examination of any kind of economic data, suggests that this is not so. With the share of agriculture as part of the GDP falling drastically, from 26 percent in 2000 to 20 percent in 2007, agriculture has lost its predominance in the economy. The share of agricultural labour has also fallen, from more than half of the total

in 1990, to 43 percent today, and land tenure relations and landholdings, have also changed markedly. In terms of social 'values' and behaviour, while many analysts still call them 'feudal', perhaps 'authoritarian, discriminatory and undemocratic', may better describe the nature of social relations between people, values and behaviour which are found in many highly developed countries as well. In order to understand social change and transformation, it is critical that we move beyond clichés which limit our ability to observe and understand.

This is particularly so with regard to clichés such as 'Pakistan is an agrarian economy', and the view, that 'Pakistan is largely rural'. Raza Ali's extraordinary research on the 1998 Census,¹ showed clearly, that Pakistan was an urban country with perhaps 50-55 percent of the population living in settlements which by no stretch of the imagination, could be called 'rural'. A decade later in the forthcoming Census, most certainly, the characteristics which help us define the sensibility and the social and economic relations of exchange and production, will reveal an even greater share of the urban. Moreover, with the increase in communications of all sorts, and with so-called 'urban' amenities, such as phones, electricity, roads and other social services, easily accessible, if not available, to so-called rural dwellers, the arbitrary binaries between urban and rural begin to fade. While a huge host of data can be shown to emphasise this point, the simple fact is, that of the one million mobile phones added to the 81 million in service in Pakistan *every month*, the large majority are 'rural', or outside the spaces which are administratively defined as 'urban'. This development of Pakistan being increasingly, if not now predominantly, urban, allows it far more possibilities and opportunities to build on its economic and social structures. However, one must also emphasise, that there is also the possibility, that unless this urban transition is not adequately managed, it could also implode.

A particularly interesting consequence of this demographic and spatial change, is in how it affects Islamic political parties. Results from the most recent election – probably the fairest in Pakistan's history – show that for the most part, electoral Islam has been reduced to being primarily a rural phenomenon, and 'Islamic' parties won largely in rural areas – from Balochistan and the NWFP – and from the least developed districts in these provinces.

These structural shifts in economic and consumption patterns have given rise, finally, to the recognition of the emergence, substantial growth, and consolidation of a Pakistani middle class. The consumer boom that has taken place in Pakistan over the last decade or so, would not have been possible without the existence of a large entity called the 'middle class'. Just how large such a class is, is difficult to capture or measure, and one hopes that some estimates of its size will emerge through research. On account of easy credit, one can present data which support the claim that a consumerist middle class defines the workings of the economy. For instance, the numbers of cars and of motor cycles, doubled in Pakistan between the period 2001-07; mobile phones, which had a density of just 5 percent of the population in 2004, within four years, have reached the equivalent of 51

¹ Raza Ali, 'Underestimating Urbanisation?', in S Akbar Zaidi, (ed.), *Continuity and Change: Socio-Political and Institutional Dynamics in Pakistan*, City Press, Karachi, 2003

percent of the Pakistani population. Moreover, despite growing regional and income disparities, per capita income has almost doubled since 2000.

While an economic middle class exists, one can perhaps surmise that along with the huge growth in the media providing constant news and information, this class has also become more aware of its rights and perhaps, even responsibilities. Perhaps it was these new, emergent and assertive groups who participated in, and gave direction to, the political and civil society movements of 2007, and Pakistan's media revolution played a key role in this. In 2002 when the last elections were held, there was only one private TV channel in the country; today there are perhaps more than thirty private news and information channels, in all major languages. With constant information, analysis, and chatter about even miniscule political tremors and developments, much of Pakistan's society has become involved and informed, about what goes on in the country. While numerous rumours and spins are given to political stories, no one can any longer claim to be uninformed.

However, one must add a word of caution here. If the economic transformations from the agrarian, rural and 'feudal' structures have given rise to these new groups or middle classes, it is important to state, that the political role of such classes need not be 'progressive', as is often incorrectly assumed and romanticised. The category of the middle class has no particular moral or ideological mooring. This group or class, can be as democratic and revolutionary as it can be fascistic.

Another factor that is affecting society and its relations, is the increasing visibility of women in public spaces, and not merely in Parliament. While the largest number of women have been elected from the General seats in the last elections, evidence from most urban centres suggests that women are more visible at higher tiers of education, in the media, and in the growing services sector. It is not just that girls predominate in liberal arts and humanity colleges, but rough estimates suggest that in the case of Karachi University and Government College University, for example, girls dominate the campuses by a huge margin, perhaps four-to-one. While many observers point out that while on university and college campuses more girls are certainly more visible, they immediately add that most wear some version of the hijab, suggesting a form of growing conservatism. These visual descriptions perhaps confirm the view of some, that Pakistani society has become far more socially conservative, yet obscure the liberating element in the lives of many of these girls who escape from their oppressive, traditional, patriarchal and familial bonds, if even for a few hours in the day. Clearly, just the fact that girls are being educated in growing numbers, and that women are coming out to work, is a revolutionary transformation, which has multiple and diverse social, demographic and economic repercussions, which many would consider highly progressive.

A dramatic shift that has taken place in the last six years or so, and I believe, this might be the only benefit from the consequences of 9/11, is the substantial change that has taken place in India-Pakistan relations. On the one hand, little seems to have changed, with an inhospitable visa regime still in place, with bureaucrats trained in many an old school, still determining relations between the two countries. On the other hand, one of the most

astonishing sets of figures which paint a completely different picture show something very different. For example, *India is today Pakistan's seventh largest trading partner for source of imports*, and the first three in this list supply primarily oil to Pakistan. Pakistan imports more from India than it does from France, Germany, Canada, Switzerland, Iran, Turkey or even Thailand! Overall, *India is Pakistan's ninth largest trading partner*. From official trade from around \$ 235 mn in 2000, trade between the two countries now is over \$ 1.4 bn. And this, despite insurmountable travel and visa restrictions for traders and businessmen. One of the few positive policy actions taken by the new democratic government, were the extended measures announced in its Trade Policy for 2008-09 announced on 18 July 2008, in which trade with India was encouraged and a number of new concessions given. Early estimates suggest, that if these opportunities are taken, trade with India will cross the \$ 3 billion mark, an astonishing turn-around from just eight years ago. If this does happen, India can become Pakistan's third major non-oil trading partner. The consequences of that happening could change Pakistan's political economy very substantially.²

In terms of investment interests, a new phenomenon is the emergence of business interests from the United Arab Emirates and other Gulf States. Awash with excessive amounts of money on account of the rise in oil prices, Arab Sheikhs have been buying up key sectors in Pakistan. They have invested in real estate, banking, telecoms, information technology, and in other service sector tie-ups. While in its very early days, there are indications that the UAE is 'getting involved' in Pakistan's economy and politics to the extent that it can influence decisions. Both Nawaz Sharif and Asif Zardari have had very close ties – business and personal – with many of the rulers in the Emirates, and both have lived in Dubai for long periods of time. Moreover, the 3 November 2007 closure of the private channel Geo News (following General Musharraf's Martial Law), which was based in Dubai, suggests that numerous arms of the Pakistani state also have close connections with the Emirates' Sheikhs. If UAE business interests grow, and given the overlapping business, personal and political relationships, one can be sure that financial capital from the Gulf will influence, or keenly follow, developments in Pakistan.

These are just a few of the many changes that are transforming Pakistani society, its economy, its politics, and its social relations of exchange and production. There are many reasons for these changes, from excess capital liquidity, to globalisation, to the media boom, to women's education, and similar trends. Some of these, such as trade with India, are reversible, but many suggest a more permanent trend. There is a need for scholars to interpret and further explore such trends to examine and understand what, if anything, they mean for political transitions and transformations, and for economic development. One must add, however, that while there have been substantial and noticeable transformations, some institutions and some forms of politics, have still not changed.

² For domestic linkages and political-economy consequences of trade with India, see Chapter 20 of my *Issues in Pakistan's Economy*, Second Edition, Oxford University Press, 2005; my *Pakistan's Economic and Social Development: The Domestic, Regional and Global Context*, Rupa and Co., New Delhi, 2004, and; USAID, *South Asian Free Trade Area: Opportunities and Challenges*, USAID, Washington DC, 2006. I must also acknowledge the fact that Mr Burki was one of the first Pakistani economists to talk and write publicly about improving Pakistan's economic relations with India.

The Politics of Economics: The 2008-09 Budget

In his paper, Mr Burki gives a comprehensive assessment and critique of the 2008-09 Federal Budget announced on 11 June 2008, the first of the new government of Prime Minister Yousuf Raza Gilani, and ends his paper by saying that the while new government had an opportunity, and perhaps the responsibility, to undertake a number of reforms, some of them urgently needed, the opportunity to do so, 'was lost'. One cannot agree more with Mr Burki's assessment, and many economists have come down hard on the new government for not dealing with many of the critical issues which Mr Burki has highlighted, ranging from exorbitant food prices, the rising price of oil, the cost of doing business, stabilising the Rupee, and so on. In this section I examine how the politics of the new government affected its ability to act, and argue, that it first had to address some important political issues before economic management became its central plank.

If the economy is in as bad a shape as the two Finance Ministers since March this year have maintained, then the Budget presented in Parliament in June 2008, failed to address issues to turn the economy around. In fact, by not addressing pressing problems at this juncture, the government has made things for itself far worse within a very short space of time. This lost opportunity to move forward on the economy is symptomatic of the way this government has functioned, a fact displayed in the two other critical arenas, with regard to the President and the judiciary, where it was unable to act and to forge ahead at full speed. Its failure to act clearly and forcefully on the economic front, in a timely manner will, in all probability, only add to causes which will result in its own undoing.

Of course, the present government is in no way responsible for the numerous problems that afflict Pakistan's economy, yet the fact that it is in power, assumes that it must take responsibility if it fails to address these problems. While we celebrate the return of the democratisation process, albeit one which continues to be partial and interrupted, we also have expectations from the government that they must fulfil their responsibilities.

As Mr Burki's paper shows, the main economic indicators show that a deteriorating trend has been in process for some months now. The GDP growth rate expected to be 5 percent, is still considerably higher than the average for the 1988-2003 period, but is lower than the trend seen over the last five years. While perhaps this slowing down in the growth rate was to be expected given adverse international commodity prices and on account of the fact that the previous growth was built on weak foundations, expectations suggest that growth is going to be lower for some years to come. With a growing fiscal deficit at present around 7.8 percent of GDP, the highest in over a decade, and a current account deficit which worsened as oil prices rose, all estimates for GDP growth seem to be overly optimistic. While these three key indicators need to be addressed soon by the government, what is particularly important from the point of view of a democratic and popular government, is to be able to address the single most important issue which affects all citizens, that of inflation.

With inflation at around 28 percent, the highest in the last three decades, any government would have had a major task dealing with causes which are not in its control. The rise in food and oil prices globally are the main reasons why inflation is so high, although a number of poor decisions and an equal number of indecisions by the Shaukat Aziz government and the caretaker government, have made things far worse. Moreover, the economic policies of the previous government were responsible for creating an artificial bubble which resulted in a substantial deterioration in income distribution.

The finance ministry must realise the scale of the issues it has to confront and has to quickly deal with if it is to make its mark on the economic front and stop the economy deteriorating further. However, the budget did not show any substantial sign of an attempt to turnaround the economy, and although a couple of measures have been taken, they are insignificant to deal with the nature and scale of the problems. The imposition of import duty on luxury imports was long overdue, and the attempt to provide an income support programme for the poor, is welcome. Development expenditure has also been raised, as is standard practice, and one can only hope that better and effective targeted provision of all government expenditures take place. What is troubling, however, are a number of measures that were announced in the budget, and many that are conspicuous by their absence.

The cut in subsidies might help marginally lower the fiscal deficit, but will probably result in higher prices for oil, power, fertilisers and food items for consumers, especially the poor. Similarly, an increase in the proportion of indirect taxes will also have a disproportionately higher incidence on lower income earners. Neither of these two measures will help the poor and will further challenge their ability to survive under worsening economic conditions mostly related to rising inflation.

With a tax-to-GDP ratio of a mere 10 percent and with a fiscal deficit of 7.8 percent of GDP, one would have expected the government to be considerably more imaginative on the revenue generation front. It is unforgivable that the government has allowed the exorbitant profits from the stock market to go untaxed for another two years, a concern also raised by Mr Burki. There is no reason why profits from speculation should be untaxed under stable and normal circumstances, and under conditions where the economy is facing serious crises, such generosity is criminal.

The government should have gone out of its way to give inflation and food shortages its highest priority. It should have had a short-term, immediate, focus which would have meant compromising on other issues at the moment, and a medium and longer term economic agenda. One would have expected that the Peoples Party election manifesto, launched with much fanfare, would have had more substantive issues addressed with regard to the economy, some of which would have found expression in its first budget.

The democratically elected government in power today, is struggling with an economic melt-down and economic crisis affecting its own constituency, but also a crisis of legitimacy, effectiveness and political control. The disappointment one has with regard to the budget, is just another indication of the democratically elected government's failure

to act on a number of critical issues, both economic and many political. Although a new president has been elected, it is quite clear that the new government in Pakistan seems vulnerable and weak. The war on Pakistan's borders, for one, seems to be getting out of hand, and differences with Pakistan's main ally, the United States, bodes ill for any economic aid or rescue package that was envisioned. Economic and financial issues – such as the continuing deterioration in the rupee, the lack of foreign direct investment, the stock market unable to reflect any bullishness – are all linked to political stability in Pakistan.

*Political Stability and Development*³

The arguments made above need to be reemphasised: without political stability in Pakistan, economic development will not take place. Political stability is a prerequisite for economic development. There are three arenas where political stability needs to be managed and resolved. Firstly, there is the need for the newly elected democratic government to deal with the regime, institutions, individuals and power structures in place since 1999, and to establish its writ. Secondly, there is a need to resolve provincial, domestic and local political issues, such as the NFC Award mentioned by Mr Burki in his paper, inter- and intra-provincial disputes and inequalities, and issues about devolution and local government. In this category, there is also a need to develop degrees and forms of a consensus amongst and between the different political parties vying for power, in a more accommodative political framework. And finally, and equally importantly, there is a need to address and resolve issues related to Pakistan's neighbours, the war on terrorism, and in particular, the relationship between Pakistan's newly elected leaders and the US Administration. This last point is probably the most important and affects the other two, and hence, it is to this I now turn.

It took the previous US Administration under President Bush, some months to come to accept the new reality in Pakistan, that its old and trusted ally since 2001, was not acceptable to the new government in Pakistan. For six months, it seems, the US put pressure on Pakistan's new elected leaders to accept General retired Pervez Musharraf as President of Pakistan even after he and his political allies were resoundly defeated in the 18 February elections. The US Administration under President George Bush, because of its own agenda and need in the region, to fight and win the war on terrorism, had not been able to move beyond its political arrangements in Pakistan since 2001. By supporting General Musharraf after 9/11, almost unconditionally, the Bush Administration was seen as the most powerful force propping up a military dictator in Pakistan. While political parties were equally to blame for not working for democracy and for being the General's collaborators and ensuring his longevity, it would be fair to say that General Musharraf continued to stay in power largely on account of US support for him. While the US' stand has been understandable, perhaps till the 18 February elections, the victory of democratic forces since then, and importantly, the rejection of Musharraf's policies by the Pakistani

³ See my unpublished Background paper presented at the International IDEA/CSDS Conference on *Democracy and Development*, held in New Delhi, 17-18 June 2008, entitled: 'Democracy, Development, Dictatorship and Globalization: The Complicated Histories of Pakistan'.

electorate, not only delayed the democratic transition in Pakistan, but was also the main reason for political instability in Pakistan.

In the period between early February to end of June, US State Department officials had more meetings with the two most important unelected Pakistani civilians – Asif Zardari and Nawaz Sharif – than they probably had with Pakistan’s quasi-civilian leadership between 2002-07. These meetings were held not just in Pakistan, but apparently, in London and the Gulf States as well, whenever the two Pakistani leaders were abroad. Moreover, more substantive quantitative research would also support the impression, that the number of meetings the two leaders had with the US Ambassador to Pakistan, and her excessive public presence in the media, as seldom been as high as it was in the last five months before, during, and after the 18 February elections. Public announcements by senior State Department officials seemed to suggest that these meetings and the pressure put on the Pakistani leadership, was to garner continued support for the US’ war on terrorism in the region, and to ensure that President Musharraf was not removed.

The US, rather than support the process of further democratisation and support Pakistan’s emerging democracy to a more sustainable level, continued to support the one man who was unpopular and probably, illegally in power. The needs and requirements of the previous Bush Administration and the desires of the Pakistani people, were seen to be at odds. Eventually, however, President Musharraf was replaced by the leader of the Pakistan Peoples Party, Asif Ali Zardari who was sworn as Pakistan’s democratically elected President. Only time will tell if President Zardari is able to gain the same trust and confidence of the new US Administration under President Obama, as did the man he replaced. With the US playing such a crucial role in the region and in Pakistan, and with democracy still emerging and establishing itself in the country, the relationship between Pakistan’s elected leaders and the new US Administration under President Obama, will be crucial. Moreover, it is also important for President Zardari and his new government, to diversify and expand their diplomatic relationships with other regional powers, such as China and India, and build alliances which look beyond too much reliance and dependence on the US.

It is important to point out, that US intrusion in the region and on Pakistan’s borders in military terms, does not bode well for Pakistan’s government and its democracy. Already, military attacks by US drones on the border region with Afghanistan have caused a great deal of resentment in Pakistan and help the anti-US sentiment grow further. Moreover, statements by Pakistani leaders, both civilian and military, seem to be at odds with those of US military leaders, and clearly, differences of opinion, priority and tactics, have emerged. This relationship between the present US Administration and the new democratically elected leadership, and its relationship through the war on terror, may determine far more than just the future of democracy in Pakistan. Much more is at stake, and a misreading or mishandling of the situation will have multiple consequences, most of them ugly, on numerous actors and relationships in the region.

Conclusions

In agreement with Mr Burki's suggestions of how Pakistan should exploit its many positive economic trends, my paper has only added to the debate, suggesting that some key political and diplomatic issues need to be addressed quickly, alongside issues related to the economic melt-down affecting the economy and the Pakistani people. Political instability and factors related to the war on terror, will hinder economic development. It is in the interest of the new US Administration under President Obama to support and strengthen the civilian democratic set-up in Pakistan and to show a longer-term commitment to stability in the country. The longer any uncertainty lasts, the greater the economic melt-down. The 'blow-back' of an economic crisis along with a political one, will benefit neither the people of Pakistan and nor the US Administration in its war on terrorism in the region. Continuing instability and the unravelling of the Pakistani economy and the state, are likely to have consequences far beyond Pakistan itself.