

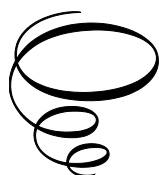
Revisiting the Rise and Fall of Industrial Productivity in Pakistan

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By

Shahida Wizarat

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This book is dedicated to six people who have had a profound impact on my personal and professional life. Three of these are my family members, while the other three are professional family members.

My father Dr Wizarat Ullah Khan who was a very exceptional father, whose deep love and affection for me and the family was extra ordinary. Unfortunately I lost him when I was only six years old.

My mother Mrs. Ayesha Wizarat was also a very exceptional mother. It was due to her personal sacrifices that we were able to get good education and pursue our ambitions in life.

My grand uncle Mr. Mohsin Ali Khan who was a civil servant, whose love and affections I will always remember.

Professor Dr. Sir Hans W. Singer (then Professor Emeritus at the Institute of Development Studies, University of Sussex) was external examiner on my PhD thesis. His knowledge, uprightness and honesty made him a truly great academic and person.

My PhD supervisor Professor Dr. Stephen W. Davies' (then Head of the Economics Department, University of East Anglia, Norwich, England) unassuming disposition camouflaged his stature and knowledge.

And Professor Dr. James S. Worley's (then Director of the Graduate Programme in Economic Development at Vanderbilt University, Nashville, Tennessee, U.S.A) guidance and hospitality during field trips to Southern US states are memories to remember and cherish.

TABLE OF CONTENTS

Profile	ix
Foreword	x
Preface I	xi
Preface II	xiii
Acknowledgements	xv
Abbreviations and Acronyms	xvii
Chapter 1	1
Introduction	
Chapter 2	3
Economy at a Glance	
Chapter 3	39
Growth and Productivity: Literature Survey	
Chapter 4	63
Industrial Productivity Growth in Pakistan	
Chapter 5	71
Sources of Growth/Decline in the Industrial Sector: Single Equation Estimation	
Chapter 6	78
Inter-Industry Productivity Differentials	
Chapter 7	92
Intra-Sectoral Productivity Differentials	

Chapter 8	100
Sources of Growth/Decline in the Industrial Sector: Simultaneous Equation Estimation..	
Chapter 9	124
Distribution of Income Between Capital and Labour.	
Chapter 10	163
Origin of Market Concentration.	
Chapter 11	177
Summary and Conclusion.	
Appendix I.....	182
Appendix II	183
References	184
Index.....	213

PROFILE

Professor Dr. Shahida Wizarat did her Masters from Vanderbilt University, Nashville, Tennessee, USA on a Graduate Fellowship by the Rotary Foundation of the Rotary International. She did her PhD in Economics from the University of East Anglia on a British Council scholarship. Dr. Wizarat's areas of interest are industrial productivity; profitability; concentration; economic policies; international financial institutions; debt management; privatization and liberalization; food security; political economy; natural resources, conflict and growth. She has authored five books: Two editions of *The Rise and Fall of Industrial Productivity in Pakistan*; *Fighting Dependence: Proclaiming Sovereignty for an Enslaved Pakistan*; *Fighting Imperialism: Liberating Pakistan and Alternative to the IMF and Other Out of the Box Solutions*. She has published more than 49 research papers in international and national journals. She has served as chief editor of the *Pakistan Journal of Applied Economics* and *Pakistan Business Review*; Director, Applied Economics Research Centre (AERC); Director Research and Dean CESD, IOBM; Director Karachi Stock Exchange; member editorial board, *Journal of the Institute of Far East - Russian Academy of Sciences* and member editorial board, *Asian Economic and Financial Review*, *Asian Economic and Social Society*. Dr. Wizarat has been visiting faculty at the Naval Staff College, Air War College Karachi, Command and Staff College and Southern Command Quetta and National Defense University, Islamabad. Currently she is Professor at CESD, IOBM.

FOREWORD

There is now an emerging ('post-Washington') consensus that the process of liberalization within the context of globalization creates losers as well as winners. The losers can be whole countries, whole sectors or regions or classes within a country or more narrowly defined firms or groups of people. In global governance, this calls for special concern, compensatory or preventive action and safety nets on behalf of such threatened losers. The research by Dr Shahida Wizarat shows that, for the period up to the early 1990s at least, the crucial manufacturing sector in Pakistan has been in a low-productivity trap. This has prevented the hoped-for convergence successfully achieved within the group of industrial countries as well as by East Asia (and a few selected countries elsewhere). On the contrary, the overall prevailing picture is more one of divergence and growing inequalities, between and within countries. The Rise and Fall of Industrial Productivity in Pakistan sends a clear warning signal that, due to a failure to reach the required threshold of productivity and technological capacity, the industrial sector—crucial for countries at Pakistan's stage of development—has failed to develop the virtuous circles leading to catching up and convergence within the industrial countries. It confirms that part of the new consensus which stresses that liberalization must be carefully sequenced and accompanied—or preceded—by the creation of technological capacity and human capital. At the very least—as Dr Wizarat herself points out—it calls for examination of more recent years on the basis of new data and closer examination of specific industries, as well as the reasons for the lack of a more targeted and selective industrial policy on the Korean model looking for dynamic and not only static comparative advantages. But her findings should be of interest well beyond Pakistan. Many other countries are at the stage of development where industry (rather than agriculture or services) should be a leading sector. In any case, industrial productivity is still important to countries at all stages of development from pre-industrial to post-industrial. In a globalizing world, competitiveness is all; an essential—albeit not the only—element of competitiveness is the total factor productivity analyzed by Dr Wizarat. It is, therefore, to be hoped that her book will be widely read and help to change her 'dismal picture' into a more hopeful one of a converging world where the poor have a chance of inclusion and catching-up.

Professor Sir Hans W. Singer, Professor Emeritus,
Institute of Development Studies (IDS) University of Sussex, England, U.K.

PREFACE I

The divergence between the industrial sectors of Pakistan and the developed countries paints a rather dismal picture for the future. As a result of the technological, administrative and financial discontinuities, the spillover effects propounded by the New Growth theory are nowhere in sight. And gauging by the ground realities, it seems realistic to assume that there is also divergence between the agricultural and service sectors of Pakistan and the developed countries. It, therefore, appears that while Pakistan is disbanding its 'industrial economy' status, it does not seem to be acquiring the 'new economy' status either. In view of this, the wedge between Pakistan and the developed countries will widen further in the future. Pakistan and other countries similarly placed, will become poorer and more under-developed compared with the developed countries. The analysis indicates what a misnomer the term 'developing countries' is. For it is the developed countries that are actually developing, while Pakistan, euphemistically referred to as a developing country, is actually an under-developing country.

How to escape from the dismal scenario? This necessitates that we realize the gravity of the situation. It also entails that we make a serious resolve of where we want to go and how to get there. An evaluation of the present economic structure of the country necessitates the recognition that an economic structure based on the growth of the agricultural and service sectors will be unsustainable. Growth in the agriculture and service sectors will be sustainable only with a growing and vibrant industrial sector. But at the same, we cannot have a growing and prosperous economy when most industries are faced with a decline. The causes of industrial decline in Pakistan need to be addressed on an urgent basis, if we are to get out of the quagmire in which we find ourselves today. The whole gamut of policies towards industry need to be evaluated and changed radically if we still want to salvage industry in this country. Moreover, even during the 1960s when we used industrial policy very effectively, the tendency to produce a wide range of commodities and the grant of across the board fiscal incentives created imbalances. Formulating an industrial policy for the future necessitates that we evaluate our strengths and weaknesses objectively and dispassionately. Both the principles of static and dynamic comparative advantage should figure in such a policy formulation. The industrialization

of the under-developed areas should initially be based on the static comparative advantage of these areas. Such industrialization can be reinforced with industry-cum-area specific fiscal incentives. This will ensure a viable industrial structure in the rural and hitherto under-developed areas. At the same time, a dynamic comparative advantage should be nurtured in selected industries at the national level. Extreme care needs to be exercised in the choice of these industries. First, these should be a select group of industries and not a multifarious lot. Second, the country must possess some strengths in these industries. Third, the income elasticity of demand for the products of these industries must be high. This is how we can construct a viable industrial structure in Pakistan.

As a result of lack of competition there is transfer of income from wage earners and consumers to capitalists. This is increasing the skewness in the distribution of income in the country with all the ugly manifestations that we are witnessing today. And in spite of a very strong emphasis on distributive social justice in Islam, the importance accorded to it by the governments and the society in this country reflects not only callousness, but mere lip service to principles we claim to accord the highest priority! A very effective way to improve the distribution of income in this country would be through fostering competition in the economy. This entails an evaluation of the existing anti-trust policy, removal of any lacunae and the effective implementation of the same. This, of course, presupposes not only good governance on the part of the government, but a commitment towards promoting socially desirable objectives. If this is an unrealistic supposition, then the consequences from this lapse are likely to be far more catastrophic than anything hitherto experienced.

A new partnership between workers and employers based on mutual interest and consideration is being recommended. This partnership should take into cognizance the fact that the interest of labour and employers are mutually intertwined. For example, the capitalists need to realize that wage increases, by increasing productivity of workers will swell profits and thus be in their own long term interest. Similarly, if some of the increase in profits are spent on providing better amenities to the workers, they would certainly be better motivated. This new partnership between the workers and the industrialists has to be based on the premise that consideration for the welfare of others has a way of bouncing back to us. But this might be a tall order for a society that accords very low priority to social gains. So ultimately, what is called for is a lesson in character building and moral values in this country. This only enhances my belief that the problems in this country are of a politico-social character rather than economic!

PREFACE II

Pakistan has come a long way since the first edition of 'The Rise and Fall of Industrial Productivity in Pakistan' was published in 2002. Since then four more programmes were signed with the IMF. These have taken their toll, as reflected by the decline and fall of industrial productivity in Pakistan's large-scale manufacturing sector, and the persistent decline in the wage share of income during the last sixty years. IMF programs' tough conditionalities and the transfer of massive amounts for debt servicing is resulting in decline in GDP growth, stifling development, deindustrialization, increasing imbalances in income and wealth distribution, increasing poverty, etc. The impact of these economic variables on the socio-political fabric of the society in the form of murders, kidnappings, snatchings and other heinous crimes present the picture of an economy and society in total disarray. Add to this the political circus being enacted by those in the corridors of power and the opposition, the constitutional crisis and the political stand-off and you have the complete picture.

GOPs initiate privatization programs using the narrative that State Owned Enterprises (SOEs) are running in losses, but start off with the privatization of the most lucrative and strategic assets. It appears that the only option available to the Government to mobilize resources are those causing deindustrialization, depriving people of their livelihoods, food, education and health facilities. And depriving people of their dignity by making them stand in long queues to get food and living in community housing. The people of Pakistan are being given the very minimum required for survival, while the surplus is extracted and transferred to wealthy Pakistanis and overseas. This surplus is splashed on extravagant expenditures related with salaries and allowances to the parliamentarians, cabinet ministers, CEOs, heads of banks and financial cos, cricket coaches from abroad are all going to be paid hefty remunerations by the hungry people standing in queues to get food and staying in community housing. Money is not available for their basic needs, but is being splashed around on fat cats in Pakistan and their partners in crimes abroad. Civilian and non-civilian bureaucrats, parliamentarians, judges, etc., living like royalty, enjoying free petrol, electricity, gas, joy rides in helicopters and bullet proof cars. And bureaucrats who decided to enjoy lives overseas getting their pensions in

foreign currencies, and those who have served several institutions getting several pensions. All this elite capture is being transferred abroad resulting in Pakistan's decline. If the same amounts had been spent on meeting the basic needs of the Pakistani population, they would have resulted in virtuous cycles and backward and forward linkages, pre-empting the economic decline now staring us in the face.

The sad part is that far better alternatives are available that can get us out of the quagmire. My book "Alternative to the IMF and Other Out of the Box Solutions" was launched in December 2022. The book gives alternatives that can get Pakistan out of the present quagmire, revive the economy and increase the growth rate. But the Government is not interested in solutions which are in the long term interest of the country. It wants only those solutions which are pushing Pakistan deeper into poverty and underdevelopment. Government of Pakistan's decision to sell 25% of its shares in Riko Diq to Saudi Arabia is meant to turn Pakistan into a minority shareholder in Riko Diq. In the present global scenario when tiny states are preparing their populations with state of the art education and technological know-how, the present policies being pursued by successive Pakistani Governments is really appalling!

ACKNOWLEDGEMENTS

I am extremely grateful to Allah for giving me the strength to work on this book after a gap of twenty three years, remember all the minute details and draw attention towards the plight of industry in Pakistan. In 2002 the first edition of 'The Rise and Fall of Industrial Productivity in Pakistan' was published. And now after a gap of almost 24 years, the second edition is on its way. I would like to acknowledge the benefits I derived from discussions with my PhD supervisor Professor Dr. Stephen W. Davies. In 1983 when I started my PhD at the University of East Anglia he was Professor and Head of the Economics Department. I gained a lot from discussions with him during the period 1983-85. These culminated in the publication of several papers and the first edition of this book. Since I am using some of those models with more recent data, I would like to acknowledge the benefits I gained from my discussions with Steve.

Professor Dr. Sir Hans W. Singer was external examiner on my PhD viva held in April 1989. The keen interest he had in problems of development in Third World countries echoed my own concerns and worries about development of the Third World. In 2002 I requested Sir Hans to write the Foreword for the book. The eagerness with which he wrote the Foreword was highly encouraging. I am really missing these two economic giants, whom I was fortunate to know and benefit from. Professor Dr. Sir Hans W. Singer passed away on 26 February 2006 and Professor Dr. Stephen W. Davies on 04 August 2022. Their passing away is great personal and professional loss to me.

I would also like to acknowledge Professor Dr. William F. Steel's ideas and thoughts in the estimation of the capital-stock variable, which was used in the computation of total factor productivity and production function estimates. Dr. Steel taught me Theory and Problems of Development at Vanderbilt University, but had since moved to work for the World Bank. He was greatly admired by the post graduate students at Vanderbilt University. His class on the Theory and Problems of Development inspired a lot of enthusiasm and discussions on the problems faced by Third World countries, which unfortunately have only gotten worse.

Thanks are due to my research assistant Kamran Mahfooz who helped with data manipulations and computations with great zeal and enthusiasm. His hard work, eagerness to learn and commitment to study and research convince me that he will be a very good addition to the economics profession. Fatima Junejo is also a very bright and committed student and with her law background will be another very good addition to the profession. Fatima helped to extend the capital stock series to more recent years. I would also like to thank my Development Economics batch of Summer 2023, especially Zainab Zia, Alysaad Hassan, Abdul Rafay and Mahnoor Kamal for help with computations.

I owe a debt to Areeba Nafees, my former P.A. who formatted the book. And as always Areeba formatted the book with great dedication and commitment. Dr. Kashif Imran, Associate Professor, Department of Economics, IoBM's valuable formatting expertise was also helpful, for which I am very grateful to him.

And a word of thanks to the Institute of Business Management (IOBM) where I work. Thanks are also due to my family and colleagues. And a final thank you to my parents Mrs. Ayesha Wizarat and Dr. Wizarat Ullah Khan for lighting the candle of knowledge and personal sacrifice in me.

ABBREVIATIONS AND ACRONYMS

2SLS	Two Stage Least Squares
3SLS	Three Stage Least Squares
ADB	Asian Development Bank
ALS	Adjusted Least Squares
BOT	Balance of Trade
CES	Constant Elasticity of Substitution
CMI	Census of Manufacturing Industries
CPI	Consumer Price Index
CSO	Central Statistical Office
DC	Developed Countries
DW	Durbin Watson
ECM	Error Correction Model
EU	European Union
FBR	Federal Board of Revenue
GDP	Gross Domestic Product
GLS	Generalized Least Squares
GNP	Gross National Product
GOP	Government of Pakistan
GMOs	Genetically Modified Organisms
ICP	Investment Corporation of Pakistan
ICT	Information and Communication Technology.
IDBP	Industrial Development Bank of Pakistan
IMF	International Monetary Fund
IPPs	International Power Producers
ISI	Import Substitution Industrialization
LDC	Less Developed Countries
LP	Labour Productivity
MCA	Monopoly Control Authority
MES	Minimum Efficient Scale
NICs	Newly Industrialized Countries
NIT	National Investment Trust
NOC	No Objection Certificate
OECD	Organization for Economic Cooperation and Development
OGI	Open General License
OLS	Ordinary Least Squares
PER	Public Expenditure Review

PICIC	Pakistan Industrial Credit and Investment Corporation
PMLN	Pakistan Muslim League Nawaz
PPP	Pakistan Peoples Party
QRs	Quantitative Restrictions
R&D	Research & Development
SBP	State Bank of Pakistan
SBPAA	State Bank of Pakistan Amendment Act
SHMI	Small-Scale and Housing Manufacturing Industries
SMAC	Solow, Minhas, Arrow and Chenery
SOEs	State Owned Enterprises
TFP	Total Factor Productivity
VES	Variable Elasticity of Substitution
WB	World Bank
WTO	World Trade Organization

CHAPTER 1

INTRODUCTION

The story of the Rise and Fall of Industrial Productivity in Pakistan is now turning out to be a story explaining its decline and fall, rather than rise and fall. Except for a short stint from the late 1950s to the mid-1960s, total factor productivity has declined continuously as successive Governments of Pakistan have been totally oblivious of the fact that economics is too serious a business to be left to bankers, chartered accounts, dual nationals, US Generals and “international civil servants.” Since the first edition of the ‘Rise and Fall of Industrial Productivity in Pakistan’ was published in 2002, Pakistan has signed four more programs with the IMF, i.e. 2008, 2013, 2019 and 2024. These have taken their toll with the Governments unable to achieve rates of growth of mere 2 to 3 percent, the rate of inflation rising to unprecedented levels, along with food inflation rising to levels never witnessed in Pakistan before. As a result, increase in poverty surpassing Asian Development Bank estimates of 50 percent for Pakistan and 85 percent for interior Sindh for the 1990s. Due to continued borrowing from the IMF and other lending institutions, the country's indebtedness has increased to unprecedented levels, as the data in Chapter 2 reveals. Other performance indicators have also performed poorly as can be seen from the same Chapter. Only two performance indicators have done well, i.e. Tax/GDP ratio and Debt Servicing/GDP ratio, reflecting that Government's only preoccupation seems to be to levy more taxes and use them for servicing debts.

While the early estimates on market/seller concentration and aggregate concentration were high, they have increased to unprecedented levels as revealed by more recent estimates in Wizarat (2003), Ashfaq Khan (2010) and Baig (2014). This has ominous consequences on the functional distribution of income and consumer welfare through increasing market rigidity revealed by the productivity price relationship. In Wizarat (1988b and 1989a) one percent increase in productivity led to -.62 percent decline in prices during the period 1955 to 1980-81. But in the present study the response of price to productivity is positive at .49 percent, reflecting that

prices are now more rigid than during the 1955-56 to 1980-81 period. This hardening of the market environment is due to increase in the level of both market/seller concentration and aggregate concentration.

Moreover, the wage share of income has continued to decline continuously in Pakistan's large-scale manufacturing sector. In the earlier period Monopolistic Pricing Theory captured through high concentration ratios played the dominant role directly, as well as indirectly through the productivity variable. The rigid market environment did not allow increase in productivity to be passed on in the form of higher wages, but were passed on as higher profits, swelling the profit share of income and declining the wage share of income. The profit share of income also increased due to price rigidity, due to which increase in productivity did not result in decline in prices. But in the present study profitability of the industrial sector has been eroded considerably as a result of IMF conditionalities related with increase in electricity and gas charges and unprecedented hike in the interest rate during the period 1955-56 to 2015-16. Therefore, the impact of concentration in increasing the profit share of income has been diluted, although market structure continues to reduce the wage share of income through the productivity variable.

It is interesting to learn that contrary to the situation prevailing in the OECD countries during the early 1950s to 1973, the wage share is now declining in these countries as well. This decline in the wage share in the OECD countries has been attributed to globalization, financialization and openness. The decline in the impact of concentration on functional distribution of income in Pakistan needs further investigation. With decline in industrial profitability as a result of structural adjustment and stabilization policies in Pakistan, can the decline in the wage share be attributed to greater opening up of the economy and globalization? Further research is required to determine whether the decline in wage shares in the rich and the emerging economies are now attributable to similar phenomenon.

CHAPTER 2

THE ECONOMY AT A GLANCE

At the time of independence in 1947, Pakistan had a predominantly agrarian economy, exporting primary commodities (mainly raw jute and cotton) and importing manufactured goods (mainly consumer goods). There was hardly any manufacturing capacity, with the exception of an oil refinery, a few cotton textile and sugar mills and some tea processing and cement manufacturing capacity. Lewis (1969) explained industrialization in Pakistan in terms of working off the disequilibrium created due to partition and the break-up of the customs union between Pakistan and India, which made agricultural raw materials available for domestic production on the one hand, while on the other, it made available a large domestic market for consumer goods.

Rapid industrialization has been pursued in Pakistan ever since it gained independence. The reasons for promoting industrialization were three: First, in view of the labour surplus conditions prevailing in the country, it was argued that sustained growth of per capita income was possible only if there was a massive shift of labour from agriculture to industry and services. Second, on account of slow growth of demand for primary commodities in world markets, it was opined that a strategy based on export of primary commodities would result in slow growth of income and employment. And third, it was thought that long run improvement in the balance of payments could be achieved through export of manufactured goods on a massive scale.

The major focus of this chapter is on the changing policy environment during the last seventy-five years, and its impact on the growth of the economy, composition of output, labour force, savings, investment, debt, imports, exports, etc. The major emphasis is, however, on the performance of the economy during the last three decades.

2.1 The Evolving Policy Framework

2.1.1 Pre-liberal Era

There were restrictions and economic controls in Pakistan during 1947-55. The government decided to provide protection to manufacturing through the use of overvalued exchange rates, import licenses¹ and quantitative restrictions. By giving unfavourable exchange rates to agricultural exports and curtailing import of manufactures, the domestic prices of manufactured goods were maintained at a high level, while those of agricultural goods kept low. This increased the profitability of manufactured goods in the country, causing rapid increase in investment in the manufacturing sector. The import substitution encouraged by these policies was most rapid in consumer goods industries.

Two more measures gave an impetus to manufacturing. The first was the distinction made following the 1955 devaluation between primary and manufactured goods in terms of import entitlement.² The second was the provision made in the export subsidy introduced in 1956 for the reimbursement of custom duty on the import of raw materials used in the manufacture of exports.³ For a little more than two years between July 1950 and December 1952 there was substantial liberalization of imports as a result of the Open General License (OGL). The devaluation of the Rupee in 1955 was inadequate as is apparent from the fact that import controls and export incentives were used even in the post devaluation period. During 1959-65 (the period of the Second Five Year Plan) there was liberalization of controls and a tendency towards indirect controls. A major step towards liberalization was the Export Bonus Scheme⁴ introduced in 1959, which entitled the exporters of manufactured goods to import goods equal to a fixed proportion of the value of exports. However, the Export Bonus Scheme had no more than a marginal effect on liberalization, since it affected only about 10 per cent of the total licensed imports. In 1961, a new Open General License system was introduced and in 1964, the Free List entitled a number of goods to be imported without a license. Both these liberalization measures proved very effective in increasing the volume of imports, which trebled between 1958 and 1964.

Although the tariff structure still favoured the domestic production of consumer goods, the role played by tariffs in allocating resources between different groups of industries was limited. Import licensing was more effective as a protective device since the licensing authority had the power to ban imports. For example, Lewis (1969) found that quantitative

restrictions (QRs) rather than tariffs determined import prices. During the period 1954-55 the average nominal tariff⁵ for consumer, intermediate and investment goods industries were 80, 50 and 30 per cent respectively, but due to import licensing their domestic prices were 194, 185 and 167 per cent above c.i.f. prices. Similarly, Pal (1964) showed that prior to the introduction of the free list QRs rather than tariffs determined domestic prices. His results imply that the incentives to domestic production contained in the tariff structure not only understated the general level of protection, but also mis-specified the relative degree of protection to different industries. Power (1963) also found that the licensing system influenced the direction of industrialization in Pakistan. By giving greater protection to consumer goods rather than intermediate or investment goods industries, it encouraged the development of consumer goods industries in the country.

The Third Five Year Plan (1965-70) emphasized liberalization and indirect controls, but there were setbacks to liberalization on account of the Indo-Pak war, bad harvests during 1965-67, and a decline in foreign aid. During this period agriculture was given top priority and quantitative restrictions (QRs) were imposed on consumer and non-development imports. In May 1972 the rupee was devalued, import licensing and Export Bonus Schemes were scrapped and tariff rates were reduced. These steps were taken to open the economy to competition.

The industrial policy required approval for industrial investment at many different levels depending on the project's characteristics. An investment sanction was required: if the cost of the project exceeded Rs. 500 million; was on the specified list; required import of machinery and raw material above a certain limit; private foreign investment was involved and entailed import of second hand machinery. An import license was also required if the project entailed import of capital goods exceeding Rs. 50 million (\$ 3.1 million) per year for new projects and Rs. 30 million (\$ 1.9 million) per year for expanding existing projects. For import of raw material which exceeded 60 per cent of total raw material cost and 20 per cent of fixed assets annually, cabinet level approval was also required. Moreover, a location clearance was required from the provincial government in areas specified by the provincial location policy. Further, the terms of a foreign loan, royalty and technical fees had to be approved if these exceeded a certain specified limit. Most of the required sanctions had to be obtained sequentially. For example, location clearance by the provincial government was required before the investment sanction, and an investment sanction was required before applying for an import license.⁶

The impact of the exchange control regime on the efficiency of the large-scale manufacturing sector has been of interest to academics and policy makers. Comparing ex-factory prices with the prices of competing imports in 115 industries, Islam (1967) found that 30 per cent of the industries had ex-factory prices 50-100 per cent higher than the corresponding c.i.f. prices, while 15 per cent had prices 100-200 per cent higher. But the evidence provided by Islam is not conclusive, since in the context of the infant industry argument, it is the behavior of cost ratios (the ratio of ex-factory prices with the prices of competing imports) over time that is important. In another study Islam (1968) found that the cost ratios of the following industries declined: bakery products, paints, varnishes and polishes, pharmaceuticals, rubber and rubber products, non-metallic mineral products, electric machinery, transport equipment and textiles. But this study suffers from the limitation that comparative cost ratios do not isolate the effect of taxes on inputs.

According to Little et al. (1970) estimates of value added in manufacturing industries at domestic and world prices, the share of manufacturing GDP at world prices is almost insignificant for Pakistan. Comparing the value added in Pakistani prices with the value added in world prices in different industries as measured by the effective rate of protection, Islam (1981) also found many Pakistani industries to be inefficient.⁷ But the problem with the value added approach is that it does not distinguish between inefficiency and high profitability. Ahmed, (1980) on the other hand, did not find empirical evidence to support the X-inefficiency hypothesis for Pakistan's large-scale manufacturing industries.

The exchange rate policy militated against agriculture vis-à-vis manufacturing, within manufacturing against small-scale vis-à-vis large-scale manufacturing and within large-scale manufacturing against labour vis-à-vis capital. This resulted in a redistribution of income among sectors and income groups, accentuating the already skewed distribution of income. The price of imported capital goods were lower for the large-scale industrial units than small-scale units which bought their capital goods from commercial importers. Moreover, the CMI data indicate that the ratio of raw material costs to total output was higher for small firms than for larger firms, which corroborates the hypothesis that small⁸ firms paid a higher price for raw materials than larger firms (Islam 1981). In spite of this, the small-scale sector was a more efficient user of capital as is borne out by lower capital intensity observed for this sector.

During the 1960s, concentration ratios both across the entire manufacturing sector as well as in individual markets were high in Pakistan. Barriers to entry gave rise to high concentration ratios, which in turn fostered a regulatory environment that maintained and strengthened these barriers. As White (1974) remarked: 'Barriers created pockets of concentration and economic power. This economic power in turn, generated political power that maintained these barriers or erected new ones'. As already observed, in order to enter an industry, investment and import licenses were required for the import of capital goods and industrial raw material. It was these investments and import licenses which constituted barriers to entry. Firms that did not have access to these licenses experienced great hardship in acquiring imported capital goods and raw materials often at much higher rates. Lewis (1969) reported that access to import licenses resulted in 39 per cent extra value added for firms as compared with firms without such licenses.

According to Papanek (1967) out of 3000 firms in Pakistan in 1959, only twenty-four controlled almost 50 per cent of all private industrial assets. Furthermore, seven industrial families⁹ controlled 25 per cent of assets, while fifteen families owned about 75 per cent of shares in banks and insurance companies. White (1974) found that among the 197 industrial companies listed on the Karachi Stock Exchange in 1968, with total assets worth Rs. 9,726 million, forty-three families controlled ninety-eight industrial companies with total assets equal to 53.1 per cent of the total. In terms of Pakistani firms only, four families controlled 25 per cent, ten families controlled a little less than 50 per cent and forty-three families controlled 75 per cent of the assets of industrial companies. Amjad (1982) found that in 1970, forty-four monopoly houses controlled about 77 per cent of gross fixed assets of all the companies listed on the Karachi Stock Exchange. The percentage rises to 80 if foreign owned firms are excluded.

Another important characteristic of the corporate environment during the 1960s was the inter-locking directorates between industry, banking, insurance and trade.¹⁰ Amjad (1982) found that the seven banks controlled by the industrial families accounted for 60 per cent of total deposits and 50 per cent of loans and advances of all the banks. Most of the loans advanced by these banks went to industrial families. Moreover, of the forty-seven Pakistani insurance companies, fourteen were controlled by the industrial families and their share of assets came to 76 per cent of the total assets of insurance companies in 1970. The portfolios of these insurance companies favoured companies owned by these families. The insurance companies also favoured banks owned by these families by keeping their time deposits with these banks.

The industrial families had great leverage over the Pakistan Industrial Credit and Investment Corporation (PICIC) and the Industrial Development Bank of Pakistan (IDBP) by having their representatives on the Board of Directors of these organizations. During 1958-70, 65 per cent of the total loans disbursed by PICIC went to thirty-seven families, while more than 30 per cent of the loans disbursed by IDBP went to the industrial families during the 1960s. They had a similar influence on the National Investment Trust (NIT) and the Investment Corporation of Pakistan (ICP).

In addition to high aggregate concentration in the economy, there were oligopolies in individual manufacturing markets. White (1974) estimated the average four firm concentration ratio at 70 per cent for eighty-two Pakistani industries. Using a concentration ratio of 33 per cent as the starting point of oligopoly formation, he found that three-fifths of the manufacturing value added originated in oligopolistic industries. Moreover, most of the leading firms in an industry belonged to the industrial families. Oligopolists acted like monopolists, since Pakistani law did not forbid open collusion, price fixing, etc. Import licensing¹¹ and the interlocking trading and industrial interests also helped to cartelize industries.¹² Barriers to entry and high industrial concentration resulted in windfall profits for the industrialists in Pakistan, as is borne out by empirical evidence in White (1974), Sharwani (1976), Amjad (1977) and Wizarat (1992 & 2002).

The First and the Second Five Year Plans were silent on the problem of concentration. In 1959, the Credit Inquiry Commission found that 60 per cent of all bank credit went to 222 accounts only. In order to widen the base of ownership of industrial assets, the government declared that companies that went public would pay taxes at a lower rate as compared with privately held companies. The PICIC and the IDBP were also set up to encourage small-scale businesses. In 1963, the National Investment Trust (NIT) and the Investment Corporation of Pakistan (ICP) were formed. Their purpose was to float mutual funds and act as stock brokers for small investors. There was a passing reference to the problem of concentration in the Third Five Year Plan (1965-70). In February 1970, the Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance 1970 was promulgated. The ordinance established a Monopoly Control Authority (MCA). Another ordinance in 1970 forbade insurance companies from investing in companies in which the directors of the insurance companies had an interest.

The industrial policy was used very effectively to bring about rapid industrialization during the 1960s, but the socio-political fallout led to the abandonment of an otherwise successful growth strategy. In 1972, with the

induction of a new government these policies were reversed. Initially, thirty-one firms belonging to ten industries were nationalized, these were: iron and steel, basic metals, heavy engineering, heavy electrical equipment, motor vehicles, tractors, petro-chemicals, gas and refineries, cement and electricity. This was followed by the nationalization of the vegetable ghee (shortening) industry. A little later, banks and insurance companies were also nationalized.

Nationalization of industries did not prove effective in lessening the concentration of income and wealth in the country, for it converted large private sector monopolies into public monopolies. If the former were making windfall profits, the latter were extremely inefficient. These inefficient public sector corporations soon became a burden on the national exchequer, as they consumed a substantial portion of the resources.

2.1.2 The Onset of Liberalism

Liberalization of the regulatory environment started since 1987 accelerated in 1990. The measures were aimed at removing the barriers to entry and exit of firms and included: an increase in the investment sanction limit, reduction in the list of specified industries that require government sanction, removal of non-tariff barriers and reduction in tariff levels.

The sanction threshold limit was raised from Rs. 300.00 million in April 1987 to Rs. 1 billion in April 1989 and was abolished altogether in December 1990. Investors are now allowed to set up a project, irrespective of its cost by applying directly for loans to commercial banks and domestic financial institutions (DFIs). Moreover, the number of industries on the specified list was reduced from fourteen in 1984 to seven in 1989, which was further reduced to four. The industries on the specified list which require government sanction are arms and ammunition; security printing; currency and mint; high explosives and radioactive substance.

With a view towards improving the efficiency of public manufacturing enterprises the government embarked upon a dis-investment programme. This actually started in September 1977 when agro-based industries were denationalized. The period of the Fifth Five Year Plan (1978-83) was a period of slow denationalization. This policy was later replaced by a more comprehensive privatization programme.

Pakistan's privatization experience for the last three decades shows that privatization has not improved performance of SOEs, whether it is the

Karachi Electric Supply Corporation, or others. In fact, the performance of SOEs seems to have deteriorated considerably after privatization. Previously, their poor performance was on account of inefficiency, but after privatization it is due to abuse of market power, switching from the use of quality inputs to cheaper substitutes, board room corruption resulting in fantastic salaries to higher management and laying off labour and linemen as a cost saving measure. Moreover, there is overwhelming evidence that when privatizing strategic state industries, governments retain control over key distribution network.¹³ Moreover, privatization of strategic sectors all over the world has been “partial” because national governments either manage to keep a major stake in privatized companies or often retain control of a strategic distribution network, even for fully privatized companies.¹⁴

In the light of the above discussion, the following recommendations have been made¹⁵ First, the privatization policy of the GOP will have to distinguish between strategic and non-strategic sectors. For the non-strategic sectors GOP may resort to full privatization or partial privatization. Second, in line with government policies in many countries, strategic sectors should not be privatized. Starting privatization of profitable units will increase the budget deficit further. Third, GOP should use its power to benefit the poorer segments of the Pakistani population, rather than teaming up with big foreign companies.

Market/Seller and Aggregate Concentration

The onset of liberalism has resulted in increasing both market/seller concentration as well as aggregate concentration or concentration of economic power as revealed by the estimates on CR3, HI and aggregate concentration by Wizarat (2003), Ashfaq Khan (2010) and Baig (2014). These are discussed in detail in Chapter 10, along with estimates for 2022, their origin, impact on the economy, especially profits and distribution of income between labour and capital in Chapter 9.

International Power Producers (IPPs)

The role played by the World Bank in pushing for a hefty rate of return to the IPPs and making it mandatory for the GOP to purchase electricity produced by them, even if it is in excess of our requirements have converted the IPP into an albatross around our neck. Since the WB believes in the free market it should have allowed forces of demand and supply to determine the return to the IPPs.

Abbasi (2024) points out that the percentage of hydro power has declined from 60% in 1991 to a mere 29%, while the share of thermal power in the total has increased to about 50%, violating the Paris Declaration to which Pakistan is a signatory. Moreover, the problem of circular debt has risen substantially over the years and stood at Rs 3000 bn in March 2024. Abbasi strongly advocates that all the thermal power plants should be shut down immediately to reduce circular debt and lower consumer electricity bills. This will ensure Pakistan's compliance with international agreements, especially with respect to the Paris Declaration, which has committed Pakistan to lower its carbon footprint.

IMF Programmes

Pakistan has signed four programmes with the IMF since 2002. These were signed in 2008, 2013, 2018 and 2024. For the last three decades IMF conditional-ties have failed to deliver.¹⁶ And as I pointed out in an earlier article: First, IMF standard prescription of devaluation of the Pak Rupee has had a severe adverse impact on the economy, but it has not increased our exports and reduced the balance of trade (BOT) deficit. Second, increase in the interest rate by the IMF/State Bank of Pakistan has had an adverse impact on the economy, but there has been no reduction in prices (CPI). Both devaluation and increase in the interest rate have increased prices and the debt burden. Foreign borrowing of \$6 billion from the IMF has resulted in increasing interest payments on foreign debt to the tune of \$150 billion during 2018 to 2023.

Another serious drawback of borrowing from the IMF is that whatever alternatives are available to us will not be available once we sign a new program with the IMF, as the IMF will decide the policies. Markets left to their own can lead to collapse, that is why US and Europe intervened heavily in the market during the financial crisis of 2008-9 through injecting liquidity and nationalization of cos., banks and financial institutions. This option of intervening in the market is lost to a country on the IMF program. Neoliberal policies are pitting us deeper into debt, poverty, unemployment and poverty. And according to Einstein "insanity is doing the same thing over and over and expecting different results."

State Bank of Pakistan (SBP)

As a result of the 2018 Programme the PTI Government signed with the IMF, the SBP was made "autonomous". The argument that the SBP Amendment Act is making the SBP autonomous would hold ground if the

SBP was moving out of the control of the Government of Pakistan (GOP) and conducting itself independently. But Section 46-B(8) states that the Government has to consult the SBP for any legislation related with the SBP, who will convey its decision after consulting the IMF. Since 16.75 % voting shares of the IMF are owned by the US, the SBP has got subordinated not only to the IMF, but to the US Government as well.

The new SBP Act envisages no roll over of public debt by the GOP. This means that if the Federal Board of Revenue is unable to meet its revenue targets, GOP will have to borrow money to pay its debts, which will increase the markup and the debt/GDP ratio further. Section 9C stops the Government of Pakistan from borrowing from the SBP (stating that direct borrowing from the SBP hinders savings, while government borrowing from commercial banks promotes savings) has resulted in increasing the size of the domestic debt tremendously, with 90% of tax revenues collected by the Federal Board of Revenue (FBR) being paid to commercial banks on account of interest only. And commercial banks enjoying investment in Government securities at exorbitant interest rates of 22 and 23%, while no credit is made available to the private sector.

Chohan (2022) evaluated the performance of the SBP on the basis of functional independence, statutory independence, inflation targeting and lending to the government. The author concludes that the State Bank of Pakistan Amendment Act (SBPAA) has failed on all four accounts. First, the SBPAA aimed to make the SBP free of political interventions through greater statutory independence. He observes that the SBP has become more subservient to the government, “towing the same line even when it shouldn’t, and leaving things to “Daronomics.” Daronomics has not worked well, as the last economic survey shows, and the value of the Rupee, inflation, government debt, credit ratings and money supply are all indicative of the failure.”

Second, Chohan says the SBPAA does not allow the SBP to enjoy greater functional independence, allowing more freedom in choosing monetary tools to achieve the goals that are deemed most appropriate. He says the SBP has achieved only two things: raised interest rates and dabbled in letters of credit (LCs). This has resulted in raising rates to 21% which is the highest in the world and stifling economic activity, as the investor is better off with idle funds instead of investing them. The author says the LCs fiasco has turned the SBP into an “investment broker or export-merchant dealer, arbitrarily picking (or having picked for it) the winners and losers (and most are losers) in terms of who will be able to do business and who will not.