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Political Economy and the Rule of Law in Pakistan 1999-2004: Resistance to Implementation of Law and Caste Capitalism

By

Foqia Sadiq Khan

Thesis submitted for the degree for PhD in Development Studies

January 2014

Department of Development Studies,

School of Oriental and African Studies, University of London

Declaration for SOAS PhD thesis

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Signed:

A handwritten signature in blue ink, appearing to read 'Fadiq', written over a horizontal line.

Date: 24-01-2014

To

My Mother - Kishwar Begum Sultana

My Father – Sardar Ghulam Sadiq Khan

My Husband - Q. Isa Daudpota

Abstract

Political Economy and the Rule of Law in Pakistan 1999-2004: Resistance to Implementation of the Law and Caste Capitalism

By

Foqia Sadiq Khan

The thesis examines the relationship between the political economy and the rule of law in contemporary Pakistan. The premise is that the rule of law can be meaningfully studied if the undercurrents of the political economy are explored. It investigates the rule-of-law-based reforms pushed by the International Financial Institutions (IFIs) that are meant to promote a level playing field for intra-capital relations, and to regulate relations between capital and the state.

The institutional governance reforms of the IFIs are analysed from 1999-2004 within the historical context. The thesis presents two case studies of the IFIs reforms: a tax law (General Sales Tax in the Value-Added Tax mode), and a corporate governance regulatory body (the Securities and Exchange Commission of Pakistan).

The third case study is about the textiles sector. In the productive textiles sector, the interplay of the rule of law and political economy is explored. This case study discovers caste capitalism even in the formal textiles sector. Here the lack of impersonalisation and the weak rule of law encourages reliance on the social structures that lead to perpetuation of business networks along the caste lines. Personalisation in the textiles sector in Pakistan comes from the society being in the transition phase. The textiles case study concludes that the textiles manufacturers do not want more mature capitalism.

There is a political economy explanation to the resistance to the rule of law. We present an analysis of how IFIs institutional governance reforms are resisted by the capitalist and intermediate classes. This leads to these reforms having only limited success.

The rule-violating behaviour of the capitalist class and the intermediate classes has led to varying impact on accumulation - ranging widely from theft of resources, investment in

value-enhancing activities, to no significant impact. The rule-violating behaviour presented in the case study chapters is viewed in terms of the transition of a traditional society to a modern “Weberian” state.

The background literature review discusses the notions of the Weberian rational-bureaucratic state, the rule of law and impersonalisation. The literature review also discusses the underlying structural basis of power in society, patron-client relationships, the politics of patronage and the need for rents creation for maintaining political stability.

The thesis presents a nuanced analysis illustrating a spectrum of contestations between the forces which wish to promote the pro-market rule of law against those who resist it. Studying such a contestation enables the thesis to make a contribution in the overall understanding of the political economy and the rule-violating behaviour in the middle income countries such as Pakistan.

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List of Acronyms

ADB: Asian Development Bank

ADBP: Agricultural Development Bank of Pakistan

AGM: Annual General Meeting

AMPTMA: All Pakistan Textiles Manufacturers Association

ATC: Agreement of Textiles and Clothing

CAS: Country Assistance Strategy

CBR: Central Board of Revenue

CIRC: Corporate Industrial Restructuring Corporation

COT: Carry-Over Trade

DFI: Development Financial Institution

EPB: Export Promotion Bureau

FBR: Federal Board of Revenue

GST: General Sales Tax

HLB: Habib Bank Limited

ICP: Investment Corporation of Pakistan

IDBP: Industrial Development Bank of Pakistan

IFC: International Finance Corporation

IFIs: International Financial Institutions

IMF: International Monetary Fund

ISI: Import-substitution-industrialisation

KSE: Karachi Stock Exchange

LAO: Limited Access Order

MNCs: Multi-national Corporations

NBP: National Bank of Pakistan

NDFC: National Development Finance Corporation

NGO: Non-governmental Organisation

NIT: National Investment Trust

OAO: Open Access Order

NPA: Non-Performing Assets

PAC: Public Accounts Committee

PICIC: Pakistan Industrial Credit and Investment Corporation

PR: Property rights

PTEA: Pakistan Textiles Exporters Association

SA: Structural Adjustment

SAP: Structural Adjustment Programme

SBP: State Bank of Pakistan

SECP: Securities and Exchange Commission of Pakistan

SRO: Statutory Regulatory Ordinance

UBL: United Bank Limited

UNIDO: United Nations Industrial Development Organisation

VAT: Value Added Tax

WB: World Bank

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Chapter 1. Introduction: Political Economy and the Rule of Law in Pakistan 1999-2004: Resistance to Implementation of the Law and Caste Capitalism

The impetus to this thesis comes from a wish to understand the kind of capitalism and the rule of law that is shaping Pakistan. My particular interest is to focus on the relationship between political economy and the rule of law. In part, this has to do with my background; I had worked on the justice system and law and order issues in Pakistan before starting the PhD. Academically, there are also good reasons to choose this analytical angle. The Weberian arguments in the development of a modern state are very much alive. They have inspired much mainstream thinking about the role of the state today, including, in some ways, the whole “good governance” discourse and the set of policies flowing from this. Hence, the thesis looks at Pakistan’s transition from traditional society to a modern “Weberian” state from the perspective of the rule of law.

In Pakistan’s contemporary political economy, the International Financial Institutions (IFIs) have largely set the terms for Pakistan’s economy from 1988 onwards. This makes an engagement with the good governance discourse of the IFIs important. According to this approach, rent-seeking by public office holders is a core obstacle to development. The “good governance” perspective emphasizes the view that if the “rule of law” works and right incentives are provided through a level playing field, then the developing countries can move towards a modern state. However, to set up a binary construction of corrupt versus non-corrupt practices is inadequate. It is not uncommon for a state to provide targeted subsidies to bolster an emergent capitalist class. Such targeting is not ‘corrupt’ per se – it does not violate the rules and laws. Such interaction amongst the state institutions and the emergent capitalist class led to industrialisation in Pakistan in the 1950s and 1960s. The state institutions used various instruments to intervene in the economy and not all of them fell under the rubric of corruption, despite them being transfers meant to change the property rights in favour of the emergent capitalist class. Hence, the corruption and rent-seeking approach is limited.

What do IFIs wish to achieve in a developing country like Pakistan through their institutional governance reforms? The broader contours go back to the relationship of neo-liberal agenda with institutional economics. In institutional economics, Coase has made seminal contribution to the literature on institutional economics. In his insightful

articles on *The Nature of Firm* (1937) and *The Problem of Social Cost* (1960), Coase has cogently challenged the mainstream assumptions of economists' reliance on price mechanism to direct economic resources. Coase's view is that if the market were to function organically on its own, then there would be no *raison d'être* for a firm to exist in such an economic system. Firm comes into being because organizing production through price mechanism is *not* free of cost. Firm, in some sense, represents long term contract and preference of coordination over short-term contracts. Emergence of firms is quintessentially related to the prevalent uncertainty in economic transactions and process of production. Firms work through reducing some of that uncertainty (Coase, 1937). Coase's contribution has led to development of literature around transaction costs concepts whereby firms exist to reduce transaction costs of market exchange (Williamson, 1985; Joffe, 2011). The transaction costs literature spearheaded by North (1990) states that there are clear information, searching, bargaining, transacting and exchange costs in any market. Hence, market does not work through 'hidden-hand' principles only. It works by minimising the transaction costs to the exchange process. North (1990) has defined rules as institutions. IFIs in their institutional governance framework borrow from the foundations of institutional economics to stipulate that if only the rules and regulations are implemented, sanctity of contract is honoured and transaction costs minimized, it will unleash the hidden potential of dynamic forces in developing countries and they will be able to gallop along the path of capitalism. Other than the institutional economics, the rule of law focus of the IFIs governance reforms in also inspired by the neo-Weberian notions, as we discuss later.

The IFIs, however, fail to take account of the political economy considerations of the reforms process. Working through incentives and similar tools does make sense. However, any process of incentivisation cannot work unless there is an understanding of the power dynamics of the society. Not only are there winners and losers of a reforms process, as the literature on reforms often points out; those winners and losers work in the framework of political, social, economic, legal and ideological structures. Often the interaction of the winners and losers of the reforms with socio-political and economic structures is mediated through power structures in the developing countries. This is the theme explored in depth in the literature review of the thesis.

Structural and political economy explanations are needed to discuss the institutional governance reforms with due context. The thesis will learn from political economy

analysis and seek to apply it specifically to the rule of law challenges of transition to a modern “Weberian” state.

The empirical focus of the dissertation arose from an initial survey of relevant theoretical literature. This covered the role of “good governance” in the reforms literature on Pakistan, and professed moves towards a “Weberian” state in Pakistan.

Given the fact that the thesis is about the relationship between political economy and the rule of law in Pakistan, there is a need for a theoretical focus that takes into account the complexity of an inter-disciplinary study. The thesis reviews key IFIs reforms in contemporary Pakistan which are largely inspired by the “good governance” discourse. There is a need to trace the theoretical roots of the “good governance” discourse and present its informed critique as well.

The good governance reforms model is inspired by the “Weberian” conceptions of the rule of law, sanctity of contract and provision of a level playing field. IFIs documents reviewed for the thesis mention these concepts time and again. There is a need, therefore, to review the Weberian conception of legal-rational state. Another issue identified in the literature review is whether the Weberian analysis was meant for the developing countries or has it been erroneously applied to them? It may be desirable to establish a modern “Weberian” state in the developing countries like Pakistan. It may not, however, be possible to do so without going through a long, difficult, negotiated and complex transition process.

The literature review discusses the challenges of transition to a modern “Weberian” state. It states that merely replicating the institutions of advanced countries in developing countries does not work. The structural analysis of Mushtaq Khan (2004, 2005, 2013), Lieven (2011) and North et al. (2013) discusses in detail the challenges of transition in the context of politics of patronage, patron-client relationships, and the role of rents. Rents are created outside the ambit of formal rules and do not conform to the “Weberian” notions of the rule of law. Yet, the market consensus is mistaken in considering all forms of rents to be bad for the society. Some forms of rents can be growth-enhancing. Some forms of rents can also help to maintain political stability and allow economic growth. Rents are the costs that have to be paid to ensure political stability in developing societies but the mainstream literature fails to take into account these necessary costs.

The literature review also states that the way redistribution of resources takes place in the advanced countries is fundamentally different from the developing countries. There are structural differences between the relationship of the capitalist sector and the rest of society that set apart the redistributive agenda in the advanced countries from the developing countries. These structural differences need to be taken into account in any debate on reforms. The literature also states that protection of property rights is costly and the developing countries do not have large surpluses or revenues to be able to afford it unlike the advanced countries. The literature also takes into account the state is weak and social groups are strong in Pakistan. Kinship-based networks help the majority of population to negotiate with the state institutions. While the state apparatus exists in Pakistan, most of the matters are settled outside the ambit of law.

After discussing the theoretical direction of the thesis, we focus on the IFIs reforms and their impact on empirical case studies. The logical question is why study the IFIs reforms? There is a long history of foreign aid having played a crucial role in the economic development of Pakistan. The focus on the IFIs needs to be seen in the context of Pakistan's history.

Generous US aid started in the 1950s due to Pakistan's geostrategic role in the Cold War. It played a major role in the country's economic development. Some of the aid filtered into the national credit institutions. The state institutions supported the traders who became the industrialist class in the 1950s and 1960s. The Harvard Advisory Board also played an important role in steering the economy in those decades and Pakistan was showcased as a successful case-study for a 'take-off' economy with high GDP growth. Pakistan's GDP growth averaged 5.2 per cent from 1958-1964 and rose to 9.4 in 1964-65 (Zaidi, 2005, p. 98). The average growth rate in manufacturing reached the climax of 11.7 per cent in 1960-65. During the 1980s, it again went up to 8.2 per cent (Zaidi, 2005, p. 130). The US aid closely coincided with high growth rates in Pakistan's manufacturing.

The US aid to Pakistan was often stopped. It first dried up when Pakistan went to war with India in 1965. It dwindled through late 1960s and the 1970s. In the 1980s the US reinvigorated its relations with Pakistan to gain its support to oust the Soviets from Afghanistan. This led to Pakistan's over 6 per cent GDP growth. However, US aid

started to dry up with the pullout of Soviet troops from Afghanistan in the late 1980s and the dividend of being the front-line state in America's proxy war largely vanished.

Pakistan needed funds for its macroeconomic stability. The outgoing authoritarian government signed the Structural Adjustment Programme (SAP) with the IMF in 1988. The democratically elected government of Benazir Bhutto which came into power after eleven years of dictatorial rule inherited the SAP. Since then Pakistan has been in the group of developing countries whose economies are closely regulated by the IFIs.

IFIs remain the most important players in Pakistan's economy. In the 1990s, Pakistan went to the IMF for a macroeconomic stability loan. IMF agreed to provide the loan tied to a set of conditionalities which required Pakistan to conform to the neo-liberal agenda. Pakistan carried out some "reforms" but fell short of meeting conditionalities. The structural adjustment loan was, therefore, stopped pre-maturely. Pakistan again fell into a dire macroeconomic situation and rushed to the IMF for support. Another structural adjustment loan was negotiated. The initial tranches were released along with the handing over of a list of conditionalities. Pakistan again failed to meet them fully. Another programme was aborted mid-way. This has been the classic pattern throughout the 1990s.

At the same time, Pakistan's domestic economy and industry suffered due to the conditions of the IFIs. The tariffs were brought down and imports liberalised. The domestic political instability coupled with the doing away of the protection for the industry had an adverse impact on the economy. The 1990s was considered the "lost decade" for Pakistan's economy. Pakistan's overall manufacturing growth was 4.8 per cent in 1990s; the first quarter of the 1990s registering a growth of 5.75 per cent and the last half registering a growth of only 3.22 per cent (Zaidi, 2005, p. 130). Pakistan's manufacturing growth again went up to 6.9 per cent during 2000-2003 as Pakistan became a front-line state in the 'war on terror' post September 11, 2001 (Zaidi, 2005, p. 130). Again, the US aid and softening of the IMF's terms for loans helped.

Some of the first generation IFIs reforms in Pakistan in the early 1990s were tariff liberalisation, freeing of exchange controls, devaluation, interest rate liberalisation, privatisation, financial sector liberalisation and imposition of a value-added tax called the general sales tax. By mid 1990s, the IFIs began to focus on institutional governance reforms. They are often called the "second generation reforms" in the literature on IFIs.

These reforms focused on accounting methods, regulation of the corporate sector, justice system reforms, accountability and transparency and civil service reforms. They also continued with the taxation and financial sector liberalisation from the earlier reform efforts. Later, the requirement for the automation of property records was added to the second generation reforms.

The IFIs good governance reforms are meant to create a regime for the rule of law in Pakistan. The pro-market reforms are designed to provide a level playing field both for intra-capital relations and also capital's relationship with the state. The real challenge is to find out how the inherent distribution of power in societies like Pakistan confronts the IFIs efforts for the implementation of the rule of law. However, IFIs are promoting a particular type of the "rule of law". It is not applicable across the board to labour for example. The larger point is, however, to study the contesting efforts promoting the rule of law and how they are being contested by the societal power structures. The thesis aims to study the challenges to the rule of law in contemporary Pakistan from 1999 to 2004, with due historical context.

The period of 1999-2004 was chosen to enable the study to capture two on-going developments of relevance. First, IFIs institutional governance reforms started from mid-1990s after IFIs had seen the limitations of their structural adjustment programmes in Latin America and Asia. Hence, 1999-2004 was appropriate to see the implementation of the "rule of law" related reforms. Secondly, an authoritarian regime of General Musharraf was in government in Pakistan, which would have been more likely to push the otherwise difficult reforms. The fieldwork for the thesis was conducted in 2004; hence, it was the cut off year for the thesis. However, the time period 1999-2004 has been chosen with a clear understanding that this work will be seeped in due historical context.

The thesis conducts case studies of a law (General Sales Tax in a VAT mode), an organisation (Securities and Exchange Commission of Pakistan), and a productive sector (textiles).

The VAT was imposed through a General Sales Tax Law in 1990 as a direct conditionality of the IMF, as part of the structural adjustment programme. Later, the IMF and World Bank attempted to strengthen the VAT/GST through further loans and conditionalities. The World Bank funded a multi-million dollar project to automate the

process of refunds in the VAT/GST. The purpose of investigating IFIs reforms in the thesis was to see how the rule of law reforms were actually implemented. They provide an interesting interaction of the political economy with the rule of law. GST in a VAT mode is embedded both in the political economy as well as in the rule of law.

The Securities and Exchange Commission of Pakistan (SECP) was formed as a result of a direct loan from the Asian Development Bank (ADB) in 1999. The idea was to have an independent regulatory body for the public listed companies in particular and the corporate sector in general. Earlier, the Capital Law Authority, SECP's predecessor was within the Ministry of Finance in the federal government. The SECP was to be an autonomous organisation where technocrats could regulate the financial sector and public listed companies in particular and supervise the corporate sector's compliance with the relevant laws in general. Again, law was used to direct the economy in a certain way. Hence, again there is a clear linkage with both the law and the political economy.

The third case study in the thesis is of the textiles sector and caste capitalism. There is more than one reason to look at the textiles sector. It is the largest industrial sector in Pakistan. It provides a useful perspective on the productive capitalist sector while reviewing the reforms aimed at the rule of law. Extensive interviews with the textiles manufacturers provided useful and interesting insights on VAT/GST and SECP. The thesis is therefore able to show linkages of the IFIs pushed reforms in the largest manufacturing sector of Pakistan.

While analysing the textiles sector from the point of view of capital, the thesis discusses the role of two traditional trading castes, Memons and Chinioties, dominating the formal textiles sector in Pakistan. This phenomenon is rooted in its historical specificity. Harriss-White (2003) has discussed the phenomenon of caste, religion, gender and locality being used to "regulate" the informal market in India. The thesis terms the dominance of Memons and Chiniotis even in the formal textiles sector as "caste capitalism" and links it to the larger rule of law debate.

The thesis also questions the ability of a weak state to deliver on the implementation of 'good governance' reforms. The literature says that neo-liberal agenda has weakened the state in developing countries (Byres, 2005). Given the fact that IFIs have actively pushed for essentially the roll-back of the state in Pakistan, how do they expect the "rule of law" reforms to succeed in an atmosphere of a weak state? A contrast between the rule-

violating behaviour and the rule of law reforms becomes even starker in the context of a weak state.

The thesis uses qualitative research methodology throughout. It helps to throw light on the complicated issues analysed in the thesis. In contrast, the causality methods used in quantitative research often struggle to capture such complex issues. Also, in terms of time and resource constraints, it was not feasible to use the quantitative methods. The methodology is discussed further in Chapter 4.

The division of the chapters of the thesis is as below:

Chapter 1: Introduction.

Chapter 2: The Literature Review. This chapter begins with the Weberian notions of the rational-bureaucratic law-abiding state. This is followed by themes around the state's monopoly over the instruments of violence (or lack of it); the role of institutions; the compatibility of institutional capabilities with the distribution of power in the society; the structural basis of the power in developing countries; the patron-client relationships and the politics of patronage; the critical role of rents creation for maintaining political stability and also allowing economic development. This discussion is in the context of the transition to a modern "Weberian" state.

Chapter 3: Background on the Political Economy. It reviews the literature on the political economy in Pakistan from the 1950s onwards. It looks into the role of the state provided subsidies, credit, import licenses in the realm of governance. It also looks at Bhutto's nationalization and instruments of industrial policy in the 1980s. It also briefly discusses the role of the Structural Adjustment Programme (SAP) in the 1990s. It overall discusses the background to the political economy of Pakistan. It also has a brief discussion on the role of landowning class and its link with the politics of patronage.

Chapter 4: Methodology. It discusses the qualitative methodology used in the thesis, qualifies the choice of case studies, sampling procedures and discusses the entire fieldwork process in detail. The chapter also operationalises certain terms used in the thesis such as the "rule of law" and "caste capitalism".

Chapter 5: Structural Adjustment Programme and IFIs Role in Contemporary Pakistan. This brief chapter just sets the stage for the two case studies of the IFIs pushed institutional governance reforms. It briefly discusses the IFIs relationship with Pakistan, since the onset of the Structural Adjustment Programme (SAP) in 1988. It also gives details of the IFIs first and second generation reforms in Pakistan.

Chapter 6: A Case Study of the Value added Tax (VAT) as the General Sales Tax (GST). It discusses the history of GST, its success and failures. The chapter discusses a key IFIs reform in the fiscal arena to raise revenues and increase documentation. An attempt is made to chronicle the kind of resistance GST (in a VAT mode) has received from the Pakistani capitalist and the intermediate classes.

Chapter 7: A Case Study of the Securities and Exchange Commission of Pakistan (SECP). This case study discusses the challenges of Badla trading, unlawful intra-corporate financing between firms and implementation of corporate governance amongst other reforms. It also discusses the family oriented nature of private businesses and resistance to the SECP reforms in regulating the listed companies in particular and supervising the corporate sector in general.

Chapter 8: An Overview of the Textiles Sector through Manufacturers' Perceptions. This chapter works as a background to the last case study on caste capitalism in the textiles sector. It presents key statistics by contextualizing the textiles sector historically, lays down the stages of production in the textiles sector, and discusses the main findings of the fieldwork through the manufacturers' perceptions. Linkages to the overall rule of law debate have been made wherever applicable.

Chapter 9: Inter-Generational Hereditary Entrepreneurship: Family, Caste Capitalism and Social Networks in the Textiles Sector. The chapter analyses caste capitalism in the context of literature on "social structure of accumulation". Caste capitalism is prevalent even in the formal textiles sector in Pakistan both due to the reasons of historical specificity and also due to the dysfunctionality of Pakistan's system of honouring contracts. The chapter discusses four case studies that show inter-generational hereditary entrepreneurship and various strategies to deal with the family control and ownership.

Chapter 10: Conclusion. It sums up the main findings of the thesis.

Chapter 2. The Literature Review

This chapter discusses the relevant literature regarding the transition from traditional society to a modern “Weberian” state in the context of the rule of law. It begins with Weber’s conception of legal-bureaucratic state, followed by its implication for the developing countries by discussing Mushtaq Khan’s work. To contrast the different viewpoints, an analysis along the lines of neo-patrimonial thinking is presented by giving the main ideas of Acemoglu and Robinson’s book. It is followed by a discussion on the patron-client relationship and the structural analysis of Mushtaq Khan and Lieven. Discussion on the limited access order by North, Wallis, Webb and Weingast and its link with rent creation, political stability, the rule of law and growth is presented thereafter. At the end, an analysis of the literature is given by briefly discussing the main strengths and weaknesses in the context of “Weberian” characteristics of the rule of law, impersonalisation and monopoly over the instruments of violence.

We chose the “Weberian” focus for the literature review since the thesis discusses some key IFIs reforms in Pakistan. IFIs push the “good governance” reforms model which is inspired by neo-Weberian thinking. They focus on the implementation of the rule of law, sanctity of contract, a level playing field and rule-based governance. The theoretical roots of such rule-based governance go back to the “Weberian” analysis. We want to ascertain, on the basis of the literature, Weber’s view of legal-rational state. We also want to discuss the literature that explains how Weber’s writings have been appropriated (even wrongly) to justify the reforms package that is not compatible with the structural features of the developing countries like Pakistan. The focus of the literature review is, therefore, to link to the “Weberian” characteristics of modern state and present a more nuanced political economy structural analysis.

2.1. The Weberian framework

In the Weberian framework, the state has monopoly over the instruments of legitimate violence. Yet, business of the state is carried out with a “minimum of voluntary compliance”. A higher level of compliance would be desirable without coercion (Weber, 1978, p. 212). According to Weber, there are three pure kinds of legitimate rule whose legitimacy is established on the following grounds (Weber, 1978, pp. 215-216):

- 1) Legal-rational authority: Enacted rules have sanctity under law. Those who occupy positions of legal authority do so on the basis of rules and they govern on the basis of the rules as well;
- 2) Traditional authority: Loyalty to traditional authority is derived from honouring time-tested traditions and those occupying power under the traditional authority derive their legitimacy from those traditions;
- 3) Charismatic authority: Dedication to some outstanding hero or sacredness is the basis of legitimacy for the charismatic authority. Rules or orders sanctified by the exceptional individual define the ways of charismatic domination.

We mainly discuss the legal-rational authority in detail because it is most relevant for the thesis. Out of above three “pure” or ideal types, these categories can often overlap. For example, “hereditary monarchy” can gain its legitimacy both from traditions and charisma. A president under the legal-rational order can be chosen through a plebiscite due to his charisma (Weber, 1978). The Weberian ideal types have their inner contradictions. There can be conflict between the rationale of charisma and of a rational-bureaucratic order. Such sporadic tensions are sometimes necessary as they can challenge the bureaucratic rule by preventing its stagnation. Therefore, Weber’s conceptualisation is “deliberately ‘antinomical’” (Mushtaq Khan, 2005, p.714).

2.1.1. Legal-Rational Authority

Impersonalisation is the hallmark of the legal-rational order. Compliance to it is sought by those in authority (Weber, 1978).

Legal rules are established on the basis of an agreement of members of the organisation or through an imposed obligation. These rules are decided on the basis of rationality or pragmatism or a combination of the two. Members of an organisation pledge to adhere by certain rules. Their jurisdiction is extended to a specific territory through an administrative process. For the legal-rational authority to succeed, both the leader and members of the organisation must follow the “law” in an impersonal manner (Weber, 1978).

An administrative agency in the legal-rational order works by “continuous rule-bound conduct of official business” (Weber, 1978, p. 218). It works according to the principles

of a division of labour and sets up clear “means of compulsion” with a specified jurisdiction. Functions of the administrative agency are regulated by established conditions. These principles apply in the case of government, large-scale business companies, in the army, political parties, church or trade unions (Weber, 1978, pp. 218-222).

Legal-rational authority is hierarchical. Higher officials supervise the lower officials, with arrangements for appeals and grievances procedures and norms/technical rules are stipulated to run an office. Given the technical nature of the rules, specialist training and qualifications are necessary for the officials (Weber, 1978).

Weber emphasizes the impersonal nature of legal-rational authority repeatedly:

“In the rational type it is a matter of principle that the members of the administrative staff should be completely separated from ownership of the means of production or administration... There exists, furthermore, in principle complete separation of the organization’s property (respectively, capital), and the personal property (household) of the official... The dominance of a spirit of formalistic impersonality...The dominant norms are concepts of straightforward duty without regard to personal considerations. Everyone is subject to formal equality of treatment; that is, everyone is in the same empirical situation. This is the spirit in which the ideal official conducts his office” (Weber, 1978, pp. 218-219, 225).

The character of the office is objective and independent in order to best serve the rules. Administrative decisions are preserved in writing. Regular functioning of the office and written documents that record all necessary stages of decision-making are the essential core of an office. Security of tenure is assured. There is also a career in the bureaucracy where officials are promoted and their remuneration increased with grade. Arbitrariness is not acceptable – formalism is required. Due to the impersonal nature of bureaucracy, an official works “without appropriation of his office”. It runs under the control and discipline of the rules. The bureaucracy is “monocratic” rather than consisting of collegial bodies. It functions under one head and is needed to make quick decisions rather than reliance on collegial bodies. These work on the basis of compromise and decision-making process can be affected by “shifting majorities”. Monocratic bureaucracy is efficient and the most rational form of administration (Weber, 1978, pp. 220-226).

Though capitalism and bureaucracy have evolved out of different historical processes, the development of capitalism has played a significant part in the evolution of modern bureaucracy. The coming together of a well-functioning, “calculable” and “stable” administration that runs according to the rules has happened “largely under the capitalist auspices”. The bureaucracy is a required for capitalism to grow in its modern form. Moreover, “...capitalism is the most rational economic basis for bureaucratic administration and enables it (the bureaucracy) to develop in the most rational form, especially because, from a fiscal point of view, it supplies the necessary money resources” (Weber, 1978, p. 224). In Weber’s framework social order is most rationally organised through a modern bureaucratic state just as economy is most rationally organised through capitalism (Khan, Mushtaq, 2005).

Weber was of the view that the legal-rational bureaucracy is needed not only in the realm of government but also in other sectors including the “large-scale private enterprises” as stated earlier. The complete separation of powers is also needed in the private sector:

“With respect to the separation of the official from ownership of the means of administration, the situation is exactly the same in the field of public administration and in private bureaucratic organizations, such as the large-scale capitalist enterprise” (Weber, 1978, p. 222)

The case studies presented in the thesis show that such impersonalization has not taken roots in the textiles sector in Pakistan. This sector is family-owned. The line between the private and the public is often blurry. It is discussed more in detail in the case study chapters.

2.2. Framework for the Literature Review:

Having established that the modern “Weberian” state has impersonalisation, division of labour, impartiality, hierarchy and a legitimate monopoly over the instruments of violence, we provide a framework for the literature reviewed.

All the literature discussed in this chapter is directly or indirectly related to the notions of “Weberian” state. There is a near consensus that the advanced countries of the developed

North closely resemble the key characteristics of “Weberian” state. There is, however, a divergence of opinion about its application to developing countries.

There is a “good governance” set of analyses that states that stable property rights, the rule of law, broad political participation and open competition are prerequisite for development. There is another structuralist (political economy) set of analysis that also contends that the modern “Weberian” state and socio-politically sustainable growth are desirable for the developing countries. The key difference among the two sets of analyses is that while the former aims to replicate the “Weberian” institutions of the advanced countries in the developing countries, the latter states that the rule of law and stable property rights are only possible *after* the developing countries have achieved dynamic growth. High growth, in turn, is only possible if the underlying distribution of power in the society is compatible with the institutional capabilities needed for transformation (see Khan, Mushtaq, 2004).

Another key difference amongst the two schools of thoughts is about the role of rents. The “good governance” school of thought considers rents to be inherently unproductive, damaging and a drain on society. While, the structuralist school of thought considers growth-enhancing rents as well as growth-damaging rents. The advanced countries historically changed property rights in favour of the capitalists during the process of their development. Rents are needed to constrain violence, maintain political stability and allow economic growth in the developing countries. The real dilemma is not that rents are bad *per se*, it is whether the rents are captured by the productive groups or unproductive groups. The issue is whether the process of rents creation leads to “elite bargains” that allow political stability and economic growth or whether it leads to further chaos and violence (Khan, Mushtaq, 2005; North et al., 2013). Within the structuralist school of thought, there is literature on the weak capacity of the state, kinship-based networks and the wider politics of patronage (Lieven, 2011).

The literature reviewed in this chapter falls into the above-mentioned two categories. Most of the literature discusses the political economy inspired structuralist school of thought. It includes writings of Mushtaq Khan, Lieven and North et al. The “good governance” school of thought is either discussed in the critical manner within the structuralist framework or elaborated through the work of Acemoglu and Robinson

(2012) which is based on a limited interpretation of history (as the structuralist school of thought would contend).

The “Weberian” modern state and dynamic growth is, generally, desired end for everyone. The real point of divergence is the path taken to make it possible. The “good governance” school of thought advocates characteristics of the modern “Weberian” state *first* in order to develop. The structuralist school of thought contends that you need to balance between political stability and economic growth. It also states that “Weberian” state characteristics are only possible once a certain level of economic growth has taken place. The point of divergence is how to make a transition to a modern “Weberian” state and achieve dynamic growth.

The literature only discusses the relevant parts of the literature that directly or indirectly relate to the notions of modern “Weberian” state and/or weak state capacity.

2.3. Implications of the Weberian Analysis for Developing Countries:

Mushtaq Khan (2005) points out that the debate on clientelism in developing countries’ politics is often contrasted with the Weberian conception of the rational-bureaucratic state. Neo-Weberians check the health of developing countries against the “ideal-typical” characteristics.

The developing countries fail to meet the criteria of Weberian rational-bureaucratic state. Indeed, Weber’s analysis was not meant for the modern developing countries. His analysis contrasts the traditional societies with the rational-bureaucratic state. For Weber, loyalty to a traditional leader is the hallmark of pre-capitalist patrimonial rule. Hence it is erroneous to compare the Weberian patrimonial rule with the personalized politics in modern developing countries (Khan, Mushtaq, 2005).

In contrast, the idea of neo-patrimonialism is used to analyse the prevalence of pre-modern features of governance in developing countries. Personalised power is the distinguishing feature of neo-patrimonialism. The leader’s personalised rule of the state is run with the support of clients who in turn are rewarded for their support. Formal regulations are not adhered to. Neo-patrimonialism is different from the standard Weberian analysis which only analysed patrimonialism. In the neo-patrimonial analysis,

democracy by establishing a rational- bureaucratic state is necessary for capitalism to function as a social organisation. The way neo-patrimonial analysis links democracy to capitalism was not part of original Weberian analysis. The “good governance” policy discourse in the post-Cold War period is largely based on the neo-patrimonial analysis (Khan, Mushtaq, 2005).

Patron-client relationships are the hallmark of politics of developing countries and they are structured around payoffs rather than just traditional legitimacy or loyalty. Such relationships are structured along the “modern forms of exchange”. Patron accesses the resources of the state by using the political and organisational power of the clients and clients are rewarded for having played their part in the form of payoffs from the acquired public resources (Khan, Mushtaq, 2005).

This sub-section clearly points out that neo-Weberian conceptualisation to measure the developments in developing countries against the yardstick of Weberian “ideal-types” (discussed in Section 2.1) is erroneous. Patron-client relationships are not just based on traditional loyalty but on modern forms of payoffs and are linked to the wider patterns of patronage which are part of the developmental process.

2.4. ‘Limited Interpretation of History’ Analysis:

We present an example of the ‘limited interpretation of history’ analysis done by Acemoglu and Robinson (2012) in this literature review. Its detailed presentation helps to contrast it with the more structural analysis later. The point to present such a limited analysis is to highlight the necessity of having a structural analysis of the developing countries to refute rather simplistic “good governance”-oriented theories.

Acemoglu and Robinson’s book differentiates between inclusive and extractive political and economic institutions. It attempts to explain why inclusive institutions emerged in some parts of the world and not others. Inclusive pluralistic political institutions are critical in engendering inclusive economic institutions based on competition, innovation and “creative destruction”. They encourage investment due to the property rights being well-defined and enforced. Inclusive economic and political institutions are critical in getting nations out of poverty and for putting them on the trajectory of long-term growth. They provide broad political participation, the rule of law, secure property rights, no

entry barriers, sanctity of contract and a level playing field for their societies (Acemoglu and Robinson, 2012). The features of the inclusive political institutions described by Acemoglu and Robinson have some “Weberian” characteristics such as the rule of law, sanctity of contract and a level playing field.

In contrast, extractive political institutions are absolutist. They concentrate power in the hands of a tiny elite. They do not have checks and balances and have much fewer constraints. Drawing from large body of historical data going back as far as the Neolithic Revolution, Acemoglu and Robinson explain the history of hundreds of years through a rather simple theory¹ (Acemoglu and Robinson, 2012).

Innovation and “creative destruction”² led the developed world to adopt new technologies which created the “technological gap” between them and the developing countries. It is not geography or culture that determine the path of development of a particular country rather the institutions make the main difference. Inclusive economic institutions help to harness the talents and skills of the majority of people. Sanctity of contract and exchange is preserved through the rule of law. The state provides the

¹ Acemoglu and Robinson begin their book by considering an area on the US-Mexican border called the Nogaleses. They contrast the examples of two Nogaleses which are divided between the United States and Mexico. In the earlier form of democracy after the establishment of Jamestown colony in the seventeenth century in the United States, the population had a voice in the running of the government. Inclusive political institutions made the Nogaleses, Arizona in the US to be more developed compared to its underdeveloped half in Sonora, Mexico. The colonists initially tried to replicate extractive economic institutions by trying to force settlers to work as exploitative labour, but did not succeed. They had to provide incentives to settlers to make them work hard. The democracy-leaning political institutions had an impact on the growth of the economic institutions. Giving details of the divergent colonial past of the US and Mexico, Acemoglu and Robinson state that political instability in Mexico resulted in weak property rights. The Mexican state was inherently weak and could not raise enough taxes to provide effective public services. Its economic institutions were based on exploitation and monopolies due to its historical past. Exploitation and monopolies in Mexico did not provide enough economic incentives or competition to its people to flourish. Historically, the South America as a part of Aztec state was rich. It became poor due to colonialism and persistence of extractive institutions whereas the North America which was poor historically became rich due to setting up of the inclusive political and economic institutions. Due to the severe competition, banks provided finance at low interest rates in the US while competition was largely missing in Mexico. While the political and economic rights were consolidated in the US over a long period, most Latin American countries only became fragile democracies in the recent past. The political institutions in the US provided continuity and stability and also secured property rights according to the rule of law (Acemoglu and Robinson, 2012).

² Acemoglu and Robinson use the Schumpeterian concept of “creative destruction”. The old sectors are replaced by the new sectors, old firms give way to the new firms and old technologies become obsolete and new technologies hold forth. This process of change creates its winners and losers. The fear of change accompanying the process of “creative destruction” is at the heart of blocking inclusive economic institutions. Whereas, “creative destruction” is necessary for innovation, technological advance and enhanced productivity (Acemoglu and Robinson, 2012).

necessary infrastructure and public services through a central authority. Without centralisation³, it is difficult to push for economic growth (Acemoglu and Robinson, 2012). In terms of the rule of law preserving the sanctity of contract, we again see the linkage to the Weberian legal-rational authority. The desire for centralisation that could ensure monopoly over the instruments of violence also draws from the Weberian tradition.

Absolute political systems create political institutions that only enrich the ruling elite, and create monopolies that benefit a tiny political elite. In the inclusive political institutions, power is distributed widely. Checks and balances are needed that constrain the ability of the ruling elite (Acemoglu and Robinson, 2012).

The authors contrast the inclusive political and economic institutions with extractive political and economic institutions. They are of the view that there is “synergistic relationship” between extractive political and economic institutions. Extractive political and economic institutions are in “negative feedback loop” which makes these institutions “vicious”. The ruling elite with little checks and balances establish economic institutions that are exploitative, monopolistic and narrowly based. Such monopolistic economic institutions serve the interests of the ruling elite only rather than engendering broad-based growth. Whereas the inclusive political institutions have a “positive feedback loop” with inclusive economic institutions and such a cycle is “virtuous” as inclusive institutions complement each other. The authors contrast the “positive feedback loop” that creates the “virtuous cycle” with the “negative feedback loop” that creates the “vicious cycle”⁴ (Acemoglu and Robinson, 2012).

³ The process of centralisation requires one group within the society to be powerful enough to impose order over the rest of society. If this were to happen, it would dilute the power of other groups or clans in the society. The groups or clans who tend to lose political power as a result of centralisation block the process. It happened in Somalia. There is diffused political power in there but no group or clan is powerful enough to impose its power on others. Diffused power in the absence of a centralised authority does not lead to inclusive institutions (Acemoglu and Robinson, 2012).

⁴ They give the example of Sierra Leone where the pricing policies did not create incentives for the farmers. The rural interests did not hold power, hence, they could not get the marketing boards to make prices favourable to them. Property rights over land and tenure were also not secure. Chieftains did not allow cultivation of perennial crops for fear of letting others establish some sorts of property rights over the land controlled by them. Sierra Leone also suffered from the “indirect rule” during its colonial period where powers were vested with the chieftains. Sierra Leone is an example of “vicious cycle”. The British colonialists built the extractive institutions and the post-colonial rulers continued with them. Extractive

The authors are of the view that there is still the possibility of growth under extractive political institutions, at least, by two possible means. One is when the ruling elite in the extractive political institutions can allocate resources to highly-productive sectors and control it politically. The second way is when the political elite feel secure in their hold of power and they allow some degree of growth of inclusive economic institutions as this does not threaten their hold directly. Also, inclusive economic institutions persist due to the historical reasons where the elite decide not to block such institutions. In these circumstances, some degree of inclusive economic institutions is possible even under the extractive political institutions (Acemoglu and Robinson, 2012).

Extractive political institutions can generate growth as happened in the case of Soviet Union from 1928 till 1970. However, such growth is not accompanied by technological change and “creative destruction”. Such growth hits a limit and the economy begins to stagnate afterwards. Also, the economic growth under the extractive political institutions is fragile since this often leads to infighting and civil strife. Such infighting and civil strife prevents centralisation of power as in sub-Saharan Africa and in some other parts of the world (Acemoglu and Robinson, 2012).

The way out of the “vicious cycle” of extractive political and economic institutions is to transform them into inclusive institutions. This can happen due to a variety of reasons: a) due to some certain elements of inclusiveness within these institutions; b) people rising up and challenging the extractive institutions and changing them toward inclusive institutions; c) it can happen due to the “contingent nature of history” as well (Acemoglu and Robinson, 2012).

Although Acemoglu and Robinson present a largely path-dependent historical analysis⁵, yet they state that they do not favour historical determinism. They present a number of

political and economic institutions complemented each other and there was no check against the use of arbitrary power to amass resources. There was abuse of power which also ignited infighting, civil war, state collapse and lawlessness. New groups wanted to wrench power away from the old groups to accumulate wealth. This took states further away from centralisation and economic growth (Acemoglu and Robinson, 2012).

⁵ They show that Britain became the first country to experience the Industrial Revolution due to the Glorious Revolution of the seventeenth century and the socio-economic changes resulting from the Black Death, and by the opening of the Atlantic trade route. The Industrial Revolution that started in Britain spread to Western Europe, the US and Australia. It is the brush with “critical junctures” that makes countries change. The Glorious Revolution heralded the onset of inclusive political and economic

caveats in their otherwise simple theory. Patterns of economic prosperity and partial inclusive institutions could be reversed as happened historically. They also state that there is no “cumulative process” of institutional change towards sustained growth. They call institutional differences as “institutional drift” and say that changes occur due to the “institutional drift interacting with critical junctures”. The “institutional drift” explains how small differences in their interaction with “critical junctures” lead societies to divergent paths (Acemoglu and Robinson, 2012).

As the structuralist political economy analysis discussed later in the chapter states that stable property rights and the rule of law emerged after the advanced countries reached a certain level of economic development. The structuralist analysis indicates that theories like the one by Acemoglu and Robinson that advocate inclusive political and economic institutions as a prerequisite of the growth have got the direction of causality wrong. Dynamic process of growth took place first and only later the property rights were stabilised and the rule of law was made applicable across the board. The advanced countries changed property rights in favour of their propertied classes as famously analysed by Marx in the case of the ‘Enclosures Movement’ in Britain, a process that started in the 16th century and was only completed in the 19th century. Resources were distributed outside the ambit of the formal law to the propertied classes and emergent capitalists historically. Once a certain level of dynamic growth was achieved, the property rights were made secure because the large surpluses enabled the state to earn fiscal revenues that could be spent on the protection of property rights, as per the structuralist analysis discussed later in the chapter.

institutions in Britain. It undermined the power of feudal aristocrats and monarchs and consolidated power of peasants and led to spread of “independent cities”. Commercial farming started and cities grew due to the dynamism of industrialists and merchants. These new ascendant groups voiced their demands for more political rights from their monarch. Opening of the trade route in the Atlantic created opportunities for trade in the Western Europe. The authors discuss other paths to inclusive institutions as well. They take the French Revolution as one such critical path that led to the downfall of absolutism and led to a whole volley of “interstate conflicts” and these conflicts in turn led to institutional reforms. Such institutional reforms led to economic growth, the Industrial Revolution and the inclusive economic institutions in the Western Europe. The rule of law and the inclusive political institutions in turn led to the industrialisation (The US and Australia followed the path similar to the Britain). Once the rule of law was established and pluralistic institutions were in place, there was demand for more political rights and inclusiveness. Inclusive economic institutions in turn distributed wealth more equitably paving the way for an even playing field for all. Once inclusive political and economic institutions have been established, they generally tend to persist. However, one cannot exclude them from “irreversible” changes. They do face challenges and have to surmount these challenges to persist. Britain is an example of a “gradual virtuous cycle”. Each little step helped to take another step toward more inclusive institutions. The process by which the inclusive economic and political institutions emerge is, however, conflictual. The old elite had to give up their powers and the new groups sought broad-base political participation (Acemoglu and Robinson, 2012).

Going back to the notions of “Weberian” state, it is not possible for the developing countries to have the rule of law and legal-rational authority to begin with. Similarly, it is not possible to start off with inclusive political and economic institutions. Acemoglu and Robinson have reduced the history between countries and nations that have inclusive political and economic institutions and those that do not. This chapter calls it a ‘limited interpretation of history’ analysis because one cannot reduce history in terms of the prevalence of inclusive and extractive institutions only. There are other complex processes that enable the evolution of inclusive institutions and dynamic growth. Unless those complex processes have been analysed, such a simple theory of world history remains limited and reductive. Acemoglu and Robinson explain the way those inclusive political and economic institutions were established in the developed world through vague terms like “institutional drift” that took place in the history and such an “institutional drift” interacted with “critical junctures”. For them, such vague terms explain how small differences in their interaction with “critical junctures” led societies on different paths. Such *ex-post facto* analysis fails to analyse the material and structural basis of historical developments. As the structural analysis states that the advanced countries followed the process of dynamic growth by altering property rights and once dynamic capitalism emerged in those countries, they were able to have secure property rights, sanctity of contract, the rule of law and open competition. It is, therefore, not desirable to recommend the developing countries to have inclusive institutions and “Weberian” state characteristics as a prerequisite of development without analysing the underlying structural features of those countries and societies. We turn to the structural analysis in the next sub-section.

2.5. Structural Political Economy Analysis:

In contrast to the limited analysis of Acemoglu and Robinson, Mushtaq Khan’s view is that the preponderance of the structural features determine the developments in the developing countries. The way socio-political and economic factors interact in the advanced countries are different from the developing countries. Political players in the democracies of advanced countries adopt different strategies from that of developing countries. There are underlying structural differences that need to be explained (Khan, Mushtaq, 2005).

In the advanced countries, the capitalist sector is dominant. The whole system depends on the capitalist sector for its healthy functioning⁶. Since the overall system depends on a viable capitalist sector, political differences are expressed in a manner which does not put the capitalist sector in jeopardy. The overall politics is constrained from being excessively testing to a viable capitalist sector. The overall dominance of the capitalist sector in the advanced countries' democracies is preserved through "powerful feedback mechanism" (Khan, Mushtaq, 2005, p. 716).

Given the nature of broad-based political activity⁷, the redistributive agendas whether in the form of regulations or subsidies are settled in a transparent and impersonal "Weberian" way. It means that political competition is open in the advanced countries and violations of rules are dealt by the state's capacity to impose the law across the board through transparent bureaucratic procedures (Khan, Mushtaq, 2005).

Due to economic development in the advanced countries, large surpluses are earned from viable economic activities and these large surpluses ensure that state earns enough revenue through taxation to offer effective protection for assets and economic activities. In turn, redistribution agendas are allowed through an open competition to determine the regulatory frameworks. Assets cannot be expropriated given the effective protection of property rights by the state. Advanced countries are often described to have "stable property rights and a rule of law, with relatively low expropriation risk" (Khan, Mushtaq, 2005, p. 717). The statistical link between the rule of law/secure property rights and economic development is strong. However, the statistical link does not easily determine the "direction of causality". Stable property rights are likely to be ensured both because the redistributive coalitions do not "cross the line between redistribution and expropriation" and also due to the state's ability to enforce property rights (Khan, Mushtaq, 2005, p. 717).

⁶ Private sector workers and professionals depend on it for their wages/salaries and the public sector depends on taxation revenue which is generated due to a well-functioning capitalist sector. The overall dependence of the whole system on a viable capitalist sector is obvious to all. There are of course competing interests between groups and classes and they are expressed in the democratic process through various ways (Khan, Mushtaq, 2005, p. 716).

⁷ Given the large national incomes and fiscal budgets, the redistributive coalition of politically active groups in the advanced countries is set by broad-based large organisations which are representative of large number of people of similar sectors, regions or classes. Such broad-based political organisational activity represents large groups of population sharing "common economic interests" (Khan, Mushtaq, 2005).

In contrast to the advanced developed countries, the dominance of the capitalist sector is not established in the developing countries. Most of the population directly depends for its income either on the petty informal sector or non-capitalist agriculture. Decline in the capitalist sector will however have an impact on the people's incomes if growth shrinks in the long-term. Here, dependence of the majority of population on the capitalist sector is at best indirect. The kind of constraining effect on redistributive coalitions that has been discussed in the case of advanced countries is therefore much weaker in the developing countries. The feedback mechanisms are also weak. Organising political activity for redistributive demands through mass movements may damage the economy of developing countries but it does not directly affect the income (in the short or medium term) of those engaged in these processes. Constraints on the organisation of vocal political activities such as mass movements are much weaker in developing countries (Khan, Mushtaq, 2005).

Revenue generated through taxing the economy and incomes is much smaller compared to the advanced countries. Much smaller revenue⁸ earned through taxation also means that the state does not have resources to offer effective protection to assets and economic activities in developing countries in contrast with the advanced countries. Property rights protection is expensive and the governments in the developing countries cannot afford to provide protection unlike the advanced countries (Khan, Mushtaq, 2005). Property rights are not stable and the rule of law is weak in developing countries. The developing countries cannot afford to pay for across-the-board rule of law and characteristics of modern "Weberian" state unless they have dynamic growth.

Unlike the advanced countries where broad-based economic interests of large groups are expressed through redistributive politics aimed at regulatory or fiscal measures, in the developing countries, the "political entrepreneurs" use different strategies to seek redistribution "through a combination of fiscal, off-budget and even illegal means" (Khan, Mushtaq, 2005, p. 719). In the developing countries, "political entrepreneurs" often belong to the middle classes. Unlike the advanced countries where there is congruence of interests between the middle classes and the capitalist sector, the

⁸ Overall national income is small given the underdevelopment in developing countries. Similarly, the capitalist sector is small in the arena of formal economy. Taxes are generated from a "smaller share of a much smaller national income". In contrast to the advanced countries, coalitions seeking redistribution do not focus on the budgets of their governments given the fiscal constraints discussed above. Neither do the redistributive activities focus on the regulatory measures given the large percentage of economic activities being unregulated (Khan, Mushtaq, 2005).

“intermediate classes”⁹ in the developing countries are not directly dependent or constrained by the viable capitalist sector. Hence, they can organise political activities and mass movements even if such activities damage the formal capitalist sector. The “intermediate classes” seek redistribution of resources by using their organisational abilities that allow them to capture state’s resources by seeking economic payoffs from their patrons (Khan, Mushtaq, 2005).

There is prevalence of patron-client relationships¹⁰ in developing countries. In contrast, neo-Weberian analysis assumes that patron-client networks exist due to the intentions or the will of leaders and can be done away with through more transparency, accountability and competition. The neo-patrimonial analysis says that patron-client networks are ‘modern’ in the sense that they are not based on just traditional loyalty and legitimacy. They are based on the payoffs that clients, as rational members of the informal networks receive from their patrons. Informalisation of governance and patron-client networks cannot however be dispensed with through democracy. They are prevalent in both

⁹ “The intermediate classes include the educated classes with college or university education, the petty bourgeoisie, particularly those in the informal sector, and middling to rich peasants. This middle strata may be numerically small (possibly 10 to 30 per cent of the population) and economically weak (compared to emerging capitalists), but in terms of legitimacy and organizational power, they are collectively the most powerful political groups in most developing countries” (Khan, Mushtaq, 2005, p. 719)

¹⁰ The pyramidal patron-client networks are the most rational way of political organisation in developing countries as economic gains from the patrons are more than what could be expected from the open budgetary processes. Faction leaders mobilise those below them in social and economic status and this pyramid goes down to “foot soldiers” who are only mobilised during the strikes, elections and riots for a small economic gain. Faction leaders also include the most aggressive sub-factions and clients to build the organisational muscle. Democracy operates through patron-client networks. Authoritarian regimes also need to include the “most powerful and vociferous groups” for political stability. Political entrepreneurs from the “intermediate classes” often lead the factions and reproduce the politics of patron-client networks through their organisational abilities by building up political power. Faction-based patron-client networks do not work to aspire for the changes in the subsidies and taxes through open electoral politics. Their strategy to access the state’s assets or the revenue entails amassing enough resources to make payoffs to their clients. These payoffs are often redistributed in an uneven way according to the organisational abilities of the clients whose muscle is used to gain resources. If patrons fail to make the payoffs to their clients, they risk losing their sub-factions to other faction leaders. Changes in factional configuration and re-configuration mark the volatility and political instability in developing countries. While the policies of various governments do not often change, yet actors who are running the governments change quickly due to the political instability of factional patron-client network. It allows the new faction leaders to earn money by controlling the state resources while pursuing the policies similar to the government they replaced. Since property rights are not effectively protected in the developing countries, it can enable the powerful factional patron-client networks to potentially encroach on weakly protected economic resources. Even when the weakly protected resources are not taken away, their protection is bought for a price to allow for the functioning of economic activities (Khan, Mushtaq, 2005).

democratic and authoritarian rule and the reason for their prevalence are structural rather than the mere personal intentions of rulers in the developing countries (Mushtaq Khan, 2005).

The redistributive politics through patron-client factions can range from “growth-enhancing strategies in some cases to growth-destroying strategies in others” (Mushtaq Khan, 2005, p. 721). If neo-patrimonialism in developing countries closely resembles warlordism, then it leads to near anarchy and “growth-destroying strategies”. Whereas, if patron-client relationships are managed in a way that lead to political stability with protection of property rights bought through payoffs, then such a situation can allow the functioning of economic activities and lead to “growth-enhancing strategies” (Khan, Mushtaq, 2005).

Patron-client networks are part of the very economic and political structures of the developing countries. The neo-Weberian notion that personalised politics through clientelism needs to be tackled first for development to take place is flawed. Whether it is democracy or authoritarian rule, faction-based patron-client networks exist due to the structural features of the developing countries (Khan, Mushtaq, 2005).

2.6. Weak State, Kinship-based Patronage, Power Structures and the State Failure:

In this sub-section, we present Anatol Lieven’s analysis along with Mushtaq Khan. Lieven’s analysis is focused on Pakistan, however it has wider implications. According to Lieven, the state is weak and the society is strong in Pakistan. Social groups use their power to capture the state’s resources through patronage. They also use the bureaucracy and the law to their advantage for this purpose. There is not much difference between the civilian and military governments in Pakistan given the fundamental weakness of the state. There have been many changes in the governments, both civilian and the military, yet the deeper structures of the society have remained entrenched. The presence of bureaucracy, police and judiciary in Pakistan may give the impression as if there is a state apparatus. However, the social groups largely settle their scores outside the ambit of the state. Since the state does not function according to its formal laws, kinship groups

help negotiate power both with the state institutions and also at the societal level (Lieven, 2011).

Kinship groups mark the inherent strength of the society in Pakistan. People get favours and protection through their kinship relations. They on the one hand contribute to the weakness of the state and on the other offer stability in societal terms as the political elite (particularly in the rural areas) rely on them for their power. Kinship groups explain the dynastic political parties in Pakistan. Another consequences of the strong kinship-based patronage is that “even the best-designed” reforms cannot take place in Pakistan.

Western discourse on corruption suggests that Pakistan’s political system should not be corrupt. Actually, corruption is part and parcel of the interlocking of patronage with kinship networks and the political system runs on the basis of these dynamics. Kinship groups and local power structures are strong in Pakistan (Lieven, 2011).

Patronage continues as part of “favours” that government bestows to social groups. Some forms of patronage that keeps the state weak is distribution of ministerial posts as part of “favours” (that in turn allows the concerned ministers to make money using their offices in the government), bank loans (often not repaid), tax evasion, dishonest allocation of government contracts, fraud and undue tax advantages. Patronage keeps the state “poor” and weak but benefit the powerful social groups (Lieven, 2011).

Kinship networks and patronage politics are deeply embedded into each other. Though Lieven acknowledges that there are not enough resources to be redistributed to everyone, “there just isn’t enough patronage to go around” (Lieven, 2011, p. 206). Yet, he says that patronage is distributed quite widely in the society. Just as Mushtaq Khan (2005) says that patron-client networks penetrate to the level of “foot soldiers” who are mobilised in elections or riots or strikes, so Lieven (2011) states that patronage networks go deep into the society where a wider part of the society seeks protection, negotiates with the state and seeks other favours through these networks. Even the very poor benefit from the food distributed in the villages by the political patrons on special occasions. It explains why social inequality is low in Pakistan and how the kinship-based patronage networks are a bulwark against Islamist or socialist revolution. Development works done in the constituencies of politicians in the form of water, electricity or constructing roads also form an important part of patronage politics.

Lieven (2011) describes the processes of patron-client networks which are similar to Mushtaq Khan's description. One of the reasons why patronage is distributed widely in the society is linked to the political structures. Control over the state institutions helps to make money. In order to gain control of the state, political power is required. Political power is amassed through supporters who not only vote but also perform other useful functions. In order to keep the support of people as a source of political power, patronage has to be distributed widely amongst the supporters.

The state is unable to provide adequate public services to its population in Pakistan. It can neither raise enough revenue nor stop the corruption of its own officials. There is almost a dialectical relationship of patronage politics with the "predatory state". On the one hand, people need protection through patronage because the state is predatory. On the other hand, since the state is used by the kinship groups to accumulate economic resources, power and ascendance over competing kinship groups; the very process that makes the state predatory in the first place. Shahrukh Khan et. al. (2007) describe similar processes of people indulging in patron-client relationships in rural areas to access the state institutions and to deal with the police and courts. Lieven sums it up as follows:

"So the ancient Pakistani kinship groups and the modern Pakistani state dance together down the years, trapped in a marriage that ought to be antagonistic, but has in fact become natural to each" (Lieven, 2011, p. 215).

We have discussed how the state is weak in developing countries like Pakistan. Moving on to the state failure in developing countries, Mushtaq Khan (2004) distinguishes between the "service delivery model" and the "social transformation model". The service delivery model advocated by the reformers focuses on the state's ability to provide services, competitive markets, property rights protection, and low risk of expropriation. Such service-delivery model is also linked with the anti-corruption and pro-democracy discourse. While, the social transformation model focuses on the state institutions' ability to intervene and create a capitalist class that can be incentivised to become productive so that viable capitalist transformation could take place. The state failure is linked with the inability of a viable capitalist transformation to take place (Khan, Mushtaq, 2004).

In contrast, the service delivery model's roots can be traced in neo-Weberian thinking. Its application in the developing countries is out of sync with the structural features. Mushtaq Khan criticizes the main tenets of the "service delivery model". According to

him, the market consensus model regards corruption as bribing public officials for illegal rent-seeking. It also states that the lack of democracy leads small groups to capture political power (and access privileges). It says that low salaries of the bureaucrats and weak judiciary gives incentives to the officials to accept bribes and indulge in rent-seeking. To deal with the illegal rent-seeking, market reforms package focuses on strengthening democracy, decentralisation and civil society participation to keep check on the power of government. It also advocates a lean state and civil service/judicial reforms. However, the “service delivery model” misses the main point. The state failure does not take place in the developing countries because they cannot provide services, competitive markets, property rights protection, and low risk of expropriation. The state failure takes place because developing countries do not have political and institutional capability to go through a dynamic capitalist transition. History shows that the states have been able to deliver effective services and protect property rights *only* after they first succeeded in achieving high-growth and not before it. The reform efforts to make the developing countries adopt institutions of the advanced countries without going through a viable transformation is not workable. The main issue for developing countries is not that they do not function on the lines of service-delivery model. Instead the main issue is whether the processes of rent creation would lead to a viable dynamic economy or whether unproductive groups would capture resources leading to chaos. The chances of the success or failure of a viable capitalist transformation depend on how political and organisational power is distributed amongst various classes and groups and in turn how such a “political settlement” interacts with the institutional capabilities in order to push for transformation (Khan, Mushtaq, 2004). As stated earlier, reforms based on the implementation of the characteristics of “Weberian” state are not likely to succeed unless the developing countries go through the process of a viable transformation.

The process of rents creation is costly and rents could be growth-enhancing or growth-retarding depending on the socio-political structures of the specific countries. In the market economy consensus, rents are reduced to subsidies or monopoly rents¹¹. While there are other rents as well such as learning rents, Schumpeterian rents, natural resource rents and information rents. The process of rent creation and enforcement has costs. The enforcement costs result not only from the process of creating institutions but also

¹¹ Acemoglu and Robinson (2012) in their book also exclusively focus on the monopoly rents as stated earlier.

making them functional and enforcing their mandate. The market economy consensus regards the costs of enforcement as loss while ignoring that in the case of growth-enhancing rents, “enforcement costs” are necessary to help economies take-off. High-growth countries initially allowed significant changes in the distribution/reallocation of property rights in the favour of productive groups. The stability of property rights took place once the dynamic capitalism emerged and the new property rights were allowed to stabilize (Khan, Mushtaq, 2004).

“Indeed, the state’s ability to carry out relatively massive interventions in property rights systems and to create and manage growth-generating rents has been critical in high-growth economies. States have also carried out significant transfers that have contributed to political stability and thereby made the emerging institutional structure politically viable... In all successful countries, states manipulated changes in property rights to accelerate the emergence of proto-capitalists and managed rents to accelerate the acquisition of technology by these proto-capitalists while ensuring that inefficiency was not sustained or increased” (Mushtaq Khan, 2004, p. 176, 180).

The underlying distribution of power in a country determines its compatibility with dynamic institutional capacities. Restructuring of organisational and political power is linked to institutional capacities. Any feasible reforms package needs to take into account the inherent distribution of power in the society in the form of its “political settlement”, its previous capitalistic growth and the technological capabilities of its industrialists. Reform in institutional capacities is a “deeply political” issue and reforms can only be meaningful when their intense political nature is recognised (Mushtaq Khan, 2004).

The rule of law cannot be enforced through apolitical, management-oriented reforms that emphasize establishing characteristics similar to a modern “Weberian” state without understanding the interaction and balance between socio-political and economic structures. The state institutions have historically made transfers to the social groups outside the ambit of law. The real question is not whether such transfers/rents should be created or not. The real question is whether the changes in property rights lead to value-enhancement or theft of resources. Violation of the formal rule of law is not an issue. The issue is whether such violation leads to viable growth or retards growth. We expand

this debate in the next sub-section by introducing an explicit discussion on the role of rents for maintaining political stability.

2.7. Limited Access Order, Rents Creation, Political Stability, the Rule of Law and Growth:

North, Wallis, Webb and Weingast (2013)'s edited book presents the idea of "limited access order" whereby rents are generated to minimize violence, allow political stability and let some level of economic development to take place. Such rent generation amongst the ruling elite creates limited access order. There is a spectrum of limited access order ranging from fragile, basic to mature. Limited access order is contrasted with open access order where there is the rule of law, impersonalisation, open competition and monopoly over the instruments of violence.

North et al. (2013)'s open access order is also "Weberian" in its nature. As stated above, in the open access order, there is the rule of law, impersonalisation, and monopoly over the instruments of violence and these are features of a modern "Weberian" state. North et al. also consider open access order to be desirable as an end of the complex process. They, however, are much more realistic that transition to such an open access order is likely not possible for most of the developing countries till they reach the stage where they meet the "doorstep conditions". For them, transition within the limited access order moving along the spectrum from fragile to basic and from basic to mature can also bring considerable improvements in the lives of people living in the developing countries.

There is a consensus that institutions matter. However, it is erroneous to assume that transplanting the institutions of the OECD countries in the developing countries will solve the problem. The institutions of the OECD countries function quite differently when they are replicated in the developing countries. The neoclassical thinking is that social and political hurdles prevent markets from functioning to their full potential. However, an alternative nonlinear framework asserts that violence is pivotal in determining the parameters of development in the developing countries. Here, actual or threat of violence is used to accumulate economic resources and power. Hence, rents are generated by the political elite through social arrangements to constraint the violence and this is called the limited access order (LAO). Political, economic and social

arrangements that limit the use of violence and control the latent violence in a way that it allows development to take place are LAOs. Organisations are critical in facilitating rent generation, coordinating incentives to limit actual or latent violence. Negotiation to limit violence as a part of rent generation is part of the “elite bargains” framework. The critical issue is which types of the “elite bargains” have led to positive socio-economic development and which did not (North et. al., 2013).

In LAOs, the possibility to start rival organisations is limited. Leaders of the each group control the behaviour of their members. Given the fact that central governments do not have monopoly over violence in the Weberian sense, the ability of the group leaders to control the behaviour of their members becomes important. These groups are organisations. LAO calls patron-client networks, political parties, ethnic groups or even crime families as organisations. The agreement amongst leaders is critical in making their organisations productive. Since they can depend on each other for support, it helps them to earn rents not only through their “privileged access” to the economic resources but also by making their own organisations more productive. Such agreement amongst leaders makes them a part of coalition. LAO framework calls it the “dominant coalition”. In a well-working LAO, dominant coalition members can be political, economic, educational or religious leaders. The dominant coalition plays the role of third-party enforcement in the absence of the enforcement capacity of a centralised state (North et al., 2013). In the LAO framework, the state’s monopoly over the instruments of violence is weak in the Weberian sense. There is a need, therefore, for the dominant coalition to act as third-party enforcement.

Rent creation through privileged access is pivotal to the functioning of LAO. Like Mushtaq Khan, LAO does not consider all rent-creation as wasteful. Following the Ricardian classical political economy tradition, LAO discusses rents that contribute to social stability by limiting violence and thereby allowing development to take place. It is based on the assumptions that rational individuals and organisations work to maximize their rent generation. LAO framework differentiates its concept of rent generation from the directly unproductive (DUP) rent-seeking. It states that Krueger and Bhagwati expanded on the work of public-choice economists like Tollison, Buchanan and Tullock to come up with the concept of rent-seeking. Public-choice links rent-seeking with wastefulness and deadweight welfare loss for the society (North et al., 2013).

In DUP rent-seeking, resources are spent to capture rents and such use of resources has no useful function for the society. It only contributes to DUP behaviour. In the good governance and anti-corruption development discourse (inspired by the neo-Weberian analysis), all forms of rent-seeking has been reduced to DUP rents. While, the governance discourse has dropped the qualifier DUP and just equated the whole concept of rents to be bad for the society. Mushtaq Khan in his writings has distinguished between growth-enhancing rents and growth-retarding rents amongst many other types of rents. Similarly, the LAO framework criticizes reduction of various forms of rents to only DUP rents. It resuscitates the classical concept of rents whereby they can also be useful for the society (North et al., 2013).

In the LAO framework, rents limit violence only because rents of the dominant coalition are reduced with the outbreak of violence. The dominant coalition can earn more rents from cooperation and limiting violence than indulging in violence. It leads to the process of rent creation as part of the effort to limit violence. The DUP framework does not take into account the violence in societies and how it impacts the very structures of society in which rents are created. It assumes that doing away with rents will create market economy based on competition. Actually, in violence-afflicted societies, doing away with rents will lead to violence and disorder (North et al., 2013):

“The LAO focus on violence and instability highlights the trade-off between stability and efficient growth... rent creation in LAO is the means of creating stability, rents are a symptom of the development problem, not the cause of it” (North et. al., 2013, pp. 7-8).

It does not however mean that LAO societies always grow rapidly. Rents creation is not predictable in LAOs and it can have mixed results. This phenomenon explains why LAOs have periods of rapid growth alternating with collapse or stagnation. LAOs do not always lead to steady productivity or stability due to the complicated nature of arrangements through which rents are negotiated. Due to the privileged access to the process of the rent creation, there are limitations and constraints on open competitive economy. Such restrictions and monopolies do not lead to competitive markets. Such limitations effect the long-term growth. LAO solves the problem of violence, however, this very solution is a problem for development in itself. It can allow a number of outcomes. In some cases, LAOs can grow steadily over the long period by having access

to the markets, technology and institutions of the advanced countries. While, in other cases, there have been reversals that lead to retarding growth and bringing living conditions down, at least temporarily. While, in the case of most LAOs, there has been the possibility of attaining some growth within the LAO framework by limiting violence. It means while the majority of LAOs have not been able to make the transition to “open access order” (OAO), yet they have shown potential to grow within the LAO framework (North et al., 2013). In other words, immediate transition to a modern “Weberian” state may not be possible for most of the developing countries. Yet, they can mature along the limited access order spectrum to move toward “Weberian” impersonalisation and the rule of law while balancing the need for political stability and economic growth.

There are stark differences amongst the low and middle-income countries despite all of them being part of LAOs. Their per capita income differs widely. The authors present a spectrum within the LAO framework to differentiate amongst them. They present the continuum of spectrum rather than separate stages. This spectrum ranges from fragile, basic, to mature LAO (North et al., 2013).

The dominant coalition barely survives the external and internal violence in the fragile LAOs. Organisations that can continue trading off between political stability and economic growth do not carry on for a long time in the fragile LAO societies. These organisations are generally closely associated with the leader and there is a great deal of personalisation. The government does not have monopoly over the instruments of violence. In fact, the government itself may or may not function. Violence is the main instrument to gain resources and rents. There is the possibility of the outbreak of violence if the equilibrium between rent creation and balance of power stumbles. There can be more instability and uncertainty given the inability to sustain the dominant coalition over long periods (North et al., 2013).

The range of government organisations are well-established in the basic LAOs. Organisations do exist even outside the ambit of the government consisting of the dominant coalition members, yet the process of rent generation and “elite privileges” are closely associated with the government. Organisational set-ups are fairly stable in the basic LAOs in contrast with the fragile LAOs. Organisations including political parties are within the domain of the dominant coalition and often personally associated with it.

Basic LAOs do not generally allow the organisations to develop outside the ambit of the dominant coalition (North et al., 2013).

In contrast with the basic LAO, the mature LAO allows organisation even outside the ambit of the dominant coalition. However, access of the private organisations is still limited. This limited order works by controlling competition, averting violence and creating rents. Institutional structures within the mature LAOs are more robust. Public law delineates the functions of the government. In mature LAOs, on the one hand the government functions are more developed and on the other hand the role of private organisations is also better developed. These private organisations work outside the ambit of the state. They are a kind of pressure group to make government adhere to its commitments¹². They help governments to mature in their functions. Due to the mature nature of LAOs, they can better absorb shock compared to the fragile and basic LAOs. The government structures and the dominant coalitions are more durable. Nonetheless, breakdowns could occur in mature LAOs if the shocks are strong and they lead to sporadic crises in mature LAOs. However, overall the government structures are more durable and the role of private organisations more prominent in the mature LAOs (North et al., 2013).

There is movement, progression and even regression along the spectrum of LAOs. If “elite bargains” are more profitable and they can earn more rents, LAOs can move from fragile to basic and from basic to mature. However, they can also regress if they are unable to absorb shocks or if the new power configuration leads to violence when groups within the dominant coalition want to out-compete others to capture more rents. If the elite peacefully negotiate the new terms of rents, then progress happens and it does not lead to violence. However, if arrangements are settled through show of force, then it leads to violence. It reflects issues of progression or regression along the spectrum of LAOs (North et al., 2013).

It is obvious as LAOs progress from fragile to basic or from basic to mature, they get closer to “Weberian” notions of impersonalisation, the rule of law and relatively stronger monopoly over the instruments of violence. They do so through the process of rents creation which but helps to achieve political stability and allow economic development.

¹² This point is somewhat similar to Acemoglu and Robinson’s focus on having checks and balances.

Spreading out of the rule of law helps LAOs to mature. However, instituting some form of the rule of law is only possible when it is compatible with violence-restraining rent generation patterns. Even a limited form of the rule of law promotes economic development and restrains violence. During the process of maturity of LAOs, the rule of law covers elite's "public relationships" only. Later in the maturation process the rule of law could be made applicable to the population at large or some aspects of it to be made valid across the board. Similarly, LAOs mature when the private organisations and opposition parties outside the ambit of the government can hold government accountable to its commitments. They play the role of third-party enforcement in the progression of the maturation process (North et al., 2013). We again see the process of gradual transition to the "Weberian" notion of the rule of law as LAOs mature along the spectrum.

The authors contrast LAOs with open access order (OAO). In OAOs, there is an open competition both between political and economic institutions. Open political competition allows open access in the economy. OAOs conform to the "Weberian" conceptualisation of the state. The state has monopoly over the instruments of violence through police and military while other organisations are barred from the use of violence. The commitments of the governments in OAO are durable and well-implemented. OAO allows the social groups to organise themselves to promote their interests and also check the government's monopoly over the instruments of violence. Entry is free in the OAOs and political, economic, educational and religious activities are allowed given that they meet impersonalisation requirements. The rule of law is applicable across-the-board for all citizens in an impartial manner (North et al., 2013). As stated earlier, OAO represents the model of a modern "Weberian" state.

The authors claim that historically the rule of law was made applicable to the elite first. Once the elite interactions were guided by the rule of law, only then it spread to the wider public. It happened because making credible commitments to the property rights of elite in the initial phase was more enforceable than making such commitments to the property rights of the wider public to begin with. The whole process of the enforcement of the rule of law was linked to the growth of the developed public and private organisations that in turn made the commitments of the governments credible (North et al., 2013). It shows why reforms advocating establishing the "Weberian" rule of law as a

prerequisite of development are flawed. As stated earlier, the rule of law develops as the result of a gradual process where it has covered the elite interactions first.

Discussing the transition from LAO to OAO, the authors identify three “doorstep” conditions to move towards impersonalisation of relationships amongst the elites. Rule of law that covers the elite interactions is the first condition. Continuity of the public and private organisations beyond the life time of its leader/s and support for such perpetual organisations is the second condition. Having a “consolidated political control” over the instruments of violence including the state organisations (police and military) is the third condition (North et al., 2013):

“All three doorstep conditions are consistent with the logic of the LAO and arose historically within some limited access orders. The establishment of laws and courts is the means by which the dominant coalition regularizes relations among elites. Perpetually lived organisations are a vehicle for limiting entry and generating rents in a more systematic manner. Consolidating military power and other violence capacity under control of the political system creates a monopoly on violence that dramatically reduces the frequency of violence. Combines, the three doorstep conditions create the possibility of impersonal relationships within the elite” (North et. al., 2013, p. 19).

As stated earlier, the three “doorsteps conditions” are rooted in the Weberian notions of impersonalisation, the rule of law and monopoly over the instruments of violence. They, however, cover the elite interactions. The rule of law is not applicable across-the-board manner. It advocates impersonalisation at the level of elite. The above-mentioned “doorstep conditions” are “Weberian” in nature and are applicable in the transition phase. Such is the nature of the LAOs’ transition to a modern “Weberian” state. In this transition phase, characteristics of “Weberian” state cannot be implemented to the entire population, they aim to cover the elite interactions to start off with.

The Western donors attempt to impose characteristics of OAOs such as the rule of law, good governance, open competitive economy, democracy¹³ and property rights in the LAO countries by ignoring the logic of violence. Such an approach considers violence as a country-specific condition to be dealt with by the police and courts of LAOs rather than

¹³ Though, the authors also note that elections, even if they are not free and fair by the standards of open access order, help to act as agents of political stability in LAOs.

thinking of violence being embedded in the development framework itself. LAOs function to create rents as part of their efforts to limit violence. Due to lack of understanding of the relationship between violence and development, the Western donors fail in attempts to impose OAO characteristics, and sometimes make violence worse in LAO countries. If rents that give stability and prevent violence are taken away, it leads to more violence and disorder and not a competitive economy as proclaimed by the reforms discourse. Other than preventing violence, rents creation can also encourage productivity, efficiency and learning (North et al., 2013).

Rent creation is more personalised in the fragile LAO. However, as LAOs transition towards a more mature spectrum in LAOs, rents distribution has more impersonal characteristics. Towards the fragile end of LAOs spectrum, organisation (be they political parties or others) are closely associated with personalities of the leaders of dominant coalition. These personality based organisations function in an uncertain environment and the conditions keep on changing. If the creation of rents provide incentives to entrepreneurs and increase the size of economic assets, then they are likely going to have a positive feedback into the transition from a privileged access society to more open impersonalised rights-based society (North et al., 2013). Contours of transition to “Weberian” impersonalisation are again evident here.

The authors recommend improving the conditions of societies who are within the LAO framework and facilitating a transition from fragile LAOs to basic and from basic to mature rather than focusing on a transition from LAOs to OAOs. Maturity along the spectrum of LAOs leads to reduction in violence and increases income for people, even without the transition to OAO. Having established that rents provide incentives to limit violence, the authors, similar to Mushtaq Khan's framework, also distinguish between the rents that increase development and those that do not (North et al., 2013).

Mushtaq Khan states that the dominant discourse is to implement the “good governance” agenda to achieve growth. While governance needs to be improved to maintain growth, however the priorities needed to institute governance capacity may not be the one advocated by the “good governance” framework. It does not address the costs required to maintain political stability and it does not give the elites in LAOs a workable solution. Some ways of accomplishing political stability may be better and more in sync with offering sustainability of growth than others. The policy agenda for LAOs needs to limit

violence at the political level and sustain growth at the economic level (Khan, Mushtaq, 2013).

Rents have to be created outside the ambit of the formal rule of law for the elites to achieve political stability. “Good governance” agenda fails to understand it. While, rent creation is necessary yet some types of rents have not been able to effectively achieve stability. Some types of rents also retard growth in the economy. While, other types of rents have been able to make some measure of stability possible. Yet, other types of rents have also at least allowed maintenance of economic growth or even contributed to improving growth. The political and economic impact of rents distribution needs to be analysed along the lines of above-mentioned nuances to understand the functioning of LAOs. Productive rents have to be created and managed to respond to market failures. Any efforts to reform LAO need to be based on the proper understanding of the challenges that the functioning of LAO faces in any particular country. The reform efforts should focus on “incremental institutional and organizational changes” that would allow mutual co-existence for the competing elites and also maintain economic growth (Khan, Mushtaq, 2013). The author calls mutual co-existence needed for the elite in LAO as “live and let live agreement” (Khan, Mushtaq, 2013, p. 61).

The Weberian notions of the rule of law is again worthwhile to consider in the discussion of rents. As discussed above, the rents are created outside the ambit of formal laws. Therefore, a universal implementation of “Weberian” notions of the rule of law is not possible. Some forms of rents create political stability. If the ability to create such rents is taken away, it would lead to more violence and chaos. Rents creation is needed to maintain political stability and allow economic development. It means that “Weberian” notions of the rule of law cannot be applied in an across-the-board manner in the transition phase as rents are generated in contravention of formal rules. At the same time, during the transition phase, some level of maturity that can deepen impersonalisation and the rule of law at the level of elite interactions is desirable. In other words, a full-fledged replication of the institutions of the advanced country with the universally applicable rule of law, impersonalisation and a complete monopoly over the instruments of violence may not be possible in LAOs during the transition phase as rents have to be created to maintain political stability and constrain violence. At the same time, as LAOs mature across the spectrum from fragile to basic and from basic to mature; the rule of law,

impersonalisation and a relatively stronger monopoly over the instruments of violence moves towards achieving “Weberian” characteristics to cover the elite interactions.

2.8. Analysis of the Literature Review¹⁴:

The literature review begins with Weber’s conception of legal-rational state. It has impersonalisation, hierarchy, impartiality, division of labour and above all legitimate monopoly over the instruments of violence. The principles of legal-rational bureaucracy are equally applicable to the government, large-scale private enterprises, army, political parties, church or trade unions.

All analyses on the transition from pre-capitalist societies to high-growth states are directly or indirectly based on the Weberian conceptualisation of rational-bureaucratic state. Whether it is North et al.’s “open access order” or Mushtaq Khan’s description of high-growth advanced countries, all of them conceptualise the state as having monopoly over violence. The literature reviewed discusses other above-board characteristics such as the rule of law, stable property rights, open competition and well-functioning bureaucracies. Weber’s conception of the rational-bureaucratic state has acquired a universal acceptance as a benchmark of advanced societies.

In the Weberian analysis, the relationship between capitalism and bureaucracy is mutually reinforcing. Capitalism provides the necessary resources for bureaucracy to function in its most rational form. Mushtaq Khan extends Weber’s ideas by stating that the advanced countries earn large surpluses from the viable economic activities that in turn enables them to earn enough revenue through taxation. High fiscal revenue makes it possible to protect the property rights across-the-board. Similarly, North et al. state that the process of rent creation can mature as a transition from limited access society to a more impersonalised society based on citizens’ rights. We once again see the contours of Weberian thinking here.

¹⁴ All authors discussed below are the one whose literature has been reviewed in the chapter. To avoid duplication, we do not generally provide the years of publications below as we are only referring to the authors discussed above.

We discuss below some of the strengths and weaknesses of the literature review as it relates to transition to a modern “Weberian” state:

The main fault line between neo-Weberian and the structuralist political economy approach is that the former recommends replicating the institutions of advanced countries in the developing countries to ensure stable property rights, the rule of law, open competition, broader political participation and monopoly over the instruments of violence. While the latter explain in great detail why replicating institutional characteristics of Weberian state in the developing countries is not going to work and painstakingly charts out a roadmap of a transition that is aligned with the more structural features of the developing countries.

An important contribution of Mushtaq Khan in the literature discussed above is to clarify that Weber’s analysis (as described by neo-Weberians) was not meant for the modern developing countries. Weber contrasted traditional societies with the rational-bureaucratic state. In a traditional society, loyalty to the leader is the distinguishing feature of patrimonialism. The pyramidal patron-client relationships in the developing countries are based on modern forms of exchange and payoffs. They are not based on just traditional loyalty. It is, therefore, erroneous to compare the Weberian patrimonialism with the politics of patronage in the developing countries. The neo-patrimonial analysis links functioning of democracy necessary for capitalism. The way democracy is linked with capitalism was not part of original Weberian analysis. The “good governance” reforms agenda is based on (flawed) neo-patrimonial analysis. Mushtaq Khan clarifies the underlying theoretical confusion caused by appropriating Weberian analysis.

Another contribution of Mushtaq Khan is to acknowledge the strong statistical link between the rule of law, stable property rights, low expropriation risk and economic growth but at the same time question the “direction of causality”. The conventional market consensus is that economic growth took place because there were stable property rights and the rule of law. Mushtaq Khan states that historically, the states have been able to protect property rights and ensure the rule of law only *after* having achieved high growth and not before it. By extending Khan’s analysis one could say that it is misleading to advocate stable property rights and the rule of law as a prerequisite for the economic growth.

The “direction of causality” issue is linked with the “Weberian” notions of the rule of law, even if in an indirect manner. The market consensus’s insistence on stable property right and the rule of law translates into categorizing rents as a loss to society per se. Since rents are created in contravention of formal rules, they do not meet the standards of the rule of law in the “Weberian” sense. As the literature reviewed shows, rents can be growth-enhancing as well as growth-destroying. It is wrong to reduce all forms of rents to directly-unproductive-rent-seeking (DUP) or monopoly rents. There are also learning rents, Schumpeterian rents, natural resource rents and information rents that can be growth-enhancing.

Mushtaq Khan and North et al. reject the narrow view of rents. They not only view rent creation intrinsic to maintaining political stability in the developing countries, they also view the outcome of the development processes is dependent on how well rents are managed. Mushtaq Khan is of the view that the underlying structures in the society need to be compatible with the institutional capabilities for dynamic capitalism to develop. The underlying structures depend on the distribution of power in a society and he calls it the “political settlement”. If the “political settlement” is compatible with the dynamic institutional capabilities, then the developing countries can transition toward high-growth countries. North et al. emphasize the central role of some forms of rents in maintaining political stability, constraining violence and allowing economic development. North et al. also state that if useful forms of rent creation is stopped due to imposition of the institutions of the OECD countries in the developing countries, it can lead to chaos and violence rather than a competitive economy. One can extrapolate from the detailed discussion on rents in the literature review that neo-Weberian ideas of rents being violation of the rules and equating all forms of rents to be a loss for society are misplaced. A full-fledged transition to the “Weberian” rule of law (that can put an end to the process of rents creation) is not possible in the developing countries for the reasons discussed above.

Another strength of Mushtaq Khan’s analysis is his discussion of the strong feedback mechanism between the capitalist sector and the rest of society in the advanced countries and a weak feedback mechanism between the capitalist sector and the non-capitalist intermediate classes in the developing countries. The whole system depends on the dominant capitalist sector for its functioning in the advanced countries. Given the large surpluses and fiscal budgets earned from a viable capitalist sector, the redistributive

coalition of politically active groups is set by broad-based organisations in the advanced countries. These broad-based organisations represent large number of people of similar classes, sectors and regions. Given that political activity is broad-based, the redistribution of resources in the form of subsidies or regulations takes place in a transparent and impersonal “Weberian” way. The redistributive agendas are settled in a different way in the developing countries. There are structural differences. The capitalist sector is not dominant in the developing countries. The majority of population depends on the non-capitalist or petty informal sector for its income. The non-capitalist intermediate classes can organise political activities and mass movements even if it may damage the capitalist sector since the feedback mechanism are weak. The redistributive agendas are, therefore, not settled in a transparent and impersonal “Weberian” way. They are settled through a combination of budgetary, off-budgetary and illegal ways of transferring resources. It again explains why the implementation of the “Weberian” rule of law is not possible in the developing countries.

The main strength of Lieven’s work lies in his explanation how the state is weak and the society is strong in Pakistan. The state apparatus exists in the form of police, judiciary and bureaucracy. Yet, the kinships based social groups largely settle their matters outside the ambit of the state apparatus. They also negotiate with the state institutions on the basis of kinship networks. The state does not function according to its formal laws. The governments bestow “favours” to social groups through the politics of patronage. The Western donors want an end to the corruption. Corruption and politics of patronage is, however, part and parcel of the way the way the state and society functions. It again shows why the “Weberian” legal-rational bureaucracy and rules cannot be implemented in Pakistan as they are not congruent with the underlying structures of the society. Lieven states that there have been many changes in the government in Pakistan. The politics of patronage has remained entrenched both through the civilian and military governments (Similar point has been made by Mushtaq Khan as discussed in the literature).

The main strength of North et al. is the conceptualisation of the limited access order as opposed to the “Weberian” open access order. They not only conceptualise the limited access order, they also differentiate across the LAO spectrum between fragile, basic and mature features. While the “Weberian” open access order where there is monopoly over the instruments of violence, impersonalisation, the rule of law and open competition is

desirable. North et al. thoroughly explain why it may not be possible for most LAOs to transition to the “Weberian” open access order. The gradual transition within the LAO framework is possible as a more robust balance takes place between the need of political stability and economic growth while moving from fragile to basic and from basic to mature LAO. However, LAOs can also regress, within the spectrum, when the old arrangements of rent creation breakdown and new mechanism have not evolved fully.

North et al. state that privileged access to rents and the need to generate rents to maintain political stability and constraint violence is part of the development problem. It is, however, not acknowledged in the market consensus reforms. The conventional analysis fails to take into account the dynamics of the threat of actual or latent violence. In other words, there are costs to be paid for maintaining political stability and allowing economic development. The mainstream reform efforts emphasize replicating the institutions of the OECD countries in the developing countries without acknowledging the different structures in LAOs. The rule of law, impersonalisation and monopoly over the instrument of violence in the “Weberian” sense cannot be replicated in LAOs. There are “elite bargains” and the level of gradual maturity of LAOs depends on which sort of “elite bargains” lead to development and which do not. The rule of law has historically evolved to cover the elite interactions first. Only when it has been made applicable to the elite, will it gradually spread to the rest of society. The “doorstep conditions” to transition towards the “Weberian” open access order cover impersonalisation and the applicability of the rule of law at the level of elite first. To sum up, North et al. show in their thorough analysis why the neo-Weberian inspired “good governance” reforms have got it wrong by promoting open access order characteristics as a prerequisite of growth. The “Weberian” open access order can evolve gradually as LAOs mature by balancing the need for political stability and economic growth.

Acemoglu and Robinson’s framework of dividing the world into countries who have inclusive political and economic institutions and those who do not is problematic. They, however, raise some relevant issues regarding the need for centralisation and having checks and balances. They also discuss the role of political elite when they feel secure in their hold of power and allow some degree of growth of inclusive economic institution that does not threaten their hold directly¹⁵. Yet, their overall emphasis that nations fail

¹⁵ This point is somewhat similar to the “elite bargains” discussed by North et al.

because they do not have inclusive political and economic institutions is limited.

Inclusive political and economic institutions are the symptoms of much larger structural processes. Acemoglu and Robinson only focus on the outcome rather than the processes themselves. The world cannot be divided into the binary categories of inclusive and extractive institutions or “virtuous” and “vicious” cycles. They explain the long historical processes through vague terms like “institutional drift” interacting with “critical junctures”.

Acemoglu and Robinson declare that broad political participation and democracy is largely a prerequisite of open competition and end of monopolies by the tiny extractive elite. They make the same mistake as neo-Weberians that we have discussed earlier. The structuralist approach states that the way neo-Weberians link democracy to capitalism is not part of the original Weberian analysis. The authors make the same mistake of linking democracy to capitalism.

Evolution of capitalism is the long historical process which is marked by the ugly and often violent processes of the appropriation of resources by the proto capitalists. We have already discussed the Marxian “Enclosures Movement”. Marx famously said “...capital comes dripping from head to toe, from every pore, with blood and dirt” (Marx, 1976, p. 926). Historically, the states have transferred property rights to their emergent capitalists in violation of formal laws. It led to dynamic capitalism in the instances when the transferred property rights were used productively. Growth of inclusive economic institutions and open competition is not a neat and clean process that can be necessarily induced through broad political participation and democracy. To link the ugly process of the evolution of capitalism with democracy or with the “Weberian” notions of the rule of law, sanctity of contract and a level playing field points to a theoretical confusion. This is a major weakness of Acemoglu and Robinson’s analysis.

As discussed in the literature review, the structural features of the developing countries remain intact whether it is democracy or authoritarian rule. To assume that broad political participation and democracy will lead to more accountability, transparency and checks and balances is generally not true. We have discussed in detail in the literature review that the underlying structural features of the advanced countries are different from the developing countries. The redistributive agendas are open and transparent in the “Weberian” sense because they are set by broad-based organisations who are

representative of large number of people of similar regions or classes or sector. Acemoglu and Robinson's analysis fits the description of political economy of the advanced countries. In contrast, the way rents are generated in the developing countries by mobilising patron-client relationships (who mobilise political activities and earn economic payoffs largely through illegal means) and through the politics of patronage point to a weakness in Acemoglu and Robinson's analysis. Democracy or broad political participation does not necessarily lead to accountability, transparency, end of monopolies, open competition and the rule of law. Democracy in developing countries often works through the politics of patronage. To mix the rule of law with democracy and broad political participation is misleading.

Coming back to the overall literature review, there is some difference in the emphasis about whether it is the elite or the middle classes that make all the difference in developing countries. Acemoglu and Robinson are entirely focused on the role of tiny elite blocking reforms and development of inclusive political/economic institutions because they have fewer constraints and do not have effective checks and balances. North et al. also conceptualise their limited access order as part of "elite bargains" whereby rent creation takes place and limits violence and allow economic activities. Mushtaq Khan in his earlier writings (2004, 2005) gives prominence to the role of the intermediate classes. Lieven also discusses the kinship-based patronage politics in Pakistan trickling down to the wider sections of the society. For Mushtaq Khan, "political entrepreneurs" from the non-capitalist intermediate classes form the patron-client relationships to build up organisational and political power and earn economic payoffs as a reward. However, Mushtaq Khan in his later writing (2013) has also focused on the role of elite. In his earlier writings, Mushtaq Khan emphasized a viable capitalist transformation as opposed to the "good governance" inspired service delivery model. In his later writing (2013), he has also discussed "live and let live agreement" for the elite in LAOs rather than emphasizing a full-fledged capitalist transformation.

It may be worth considering how some of the issues identified in the literature can be extended further. The literature discusses in detail how the feedback mechanisms are weak between the capitalist class and the non-capitalist intermediate classes. It is applicable in most of the cases. It may, however, be worth pondering how in certain instances the interests of the capitalist sector and the middle classes can be aligned with each other. The suppliers, vendors, traders, wholesalers, and retailers as part of the

middle classes and they can be partners of the capitalists as they indulge in redistributive politics to claim the state's resources through legal as well as illegal ways. The capitalist sector and certain sections of the middle classes can also be partners in rule-violating behaviour. As Harriss-White (2003) points out that the interests of small businesses and traders can also be aligned with the industrial classes. Industrialists have vertical networks with whole-sale suppliers, subcontractors, merchants. They are based on both "modern" and traditional relations of family, *beradari* (partilineal lineage), clan, and caste. The interactions between the industrialists and their suppliers are also "socially embedded" (Nadvi, 2002). Giving an example from empirical data, in Chapter 3 we discuss the case of Bhutto regime in the 1970s in Pakistan. Certain sections of the middle classes were antagonised by nationalising the small-scale industries as part of the wider nationalisation policy. The antagonised middle classes (largely associated with the capitalist sector) whose patronage was taken away were instrumental in participating in the mass agitation against the Bhutto regime. It may, therefore, be worth exploring the nature of feedback mechanisms between the capitalist class and the middle classes, directly or indirectly linked with the capitalist sector.

The literature also links the concept of political stability to either the threat of violence or actual violence. It makes ample sense doing so given the missing link of violence in the development debate. It is, therefore, understandable to link political stability to violence. Given the reality in most of the developing countries where the threat of violence is looming large, the emphasis on the role of violence is a major contribution. It is, however, worth pointing out that political stability cannot be, however, reduced to the threat of violence or actual violence. In case of the government functions being better developed in the developing countries, political instability can also be induced through constitutional and legal crises. The governments can be prematurely dismissed or brought down and it can lead to political instability even without use of violence. It may be worthwhile to broaden the concept of political (in)stability to the constitutional and legal crises in the developing countries where government functions are better developed. Again to give an example from Pakistan, the political governments were dismissed repeatedly from 1988 till 1996 through the operationalisation of constitutional clauses and it led to immense political instability even without the direct threat of violence.

Kinship is indeed a strong theoretical concept. Harriss-White (2003) has discussed the role of caste along with other categories of the “social structures of accumulation”. We have found the role of two prominent castes dominant even in the formal textiles sector in Pakistan. We, therefore, wholly agree that kinship-based networks are strong in Pakistan. Yet, kinship is not a monolith category. There are factions even within the same kinship groups. While doing the fieldwork for Shahrukh Khan et al. (2007), we found that there were faction-based subdivisions (even within the same kinship groups) based on how clan members voted or how they took sides in important court cases. There are, therefore, divisions and fissures within kinship groups. The fact that kinship is not a monolith category needs to be taken into account while discussing the dominant role of the kinship networks. However, we fully agree with the overall structural analysis that the state is weak and social groups are strong in Pakistan. We also agree that the social groups largely settle their matters outside the ambit of law.

To conclude, transition to a “Weberian” modern state with the rule of law and impersonalisation is desirable for everyone. Neo-Weberians promote replicating the characteristics of the institutions of the advanced countries in the developing countries as part of the transition. The structural analysis largely inspired by the Marxist political economy focuses on the underlying distribution of power in the developing countries by emphasizing its compatibility with the institutional capabilities in the developing countries. The structural analysis explains why rents are created outside the ambit of formal laws. It also explains why some forms of rents are essential to maintain political stability. Rents are the necessary costs that have to be paid to balance the needs of political stability and economic development, which the mainstream pro-market analysis fails to take into account of.

The transition to a “Weberian” state is a worthwhile end of the long, difficult and negotiated process. The structural analysis forewarns against over-simplification of such a complex process. Most of the literature reviewed above discusses the challenges of transition to the “Weberian” rule of law and impersonalisation. These challenges are linked to the empirical focus of the thesis where various forms of rule-violating behaviour are discussed. The resistance to taxation measures and corporate governance elucidates various facets of the rule-violating behaviour. Such resistance needs to be contextualised in terms of challenges of transition to a modern “Weberian” state. The structural analysis helps to explain why rents were created in the form of bank loans as

part of the politics of patronage. The weak capacity of the state discussed in the literature review sheds light on the weakness of the state institutions to recover the defaulted loans or collect taxes. Rents distributed through default of bank loans might have been necessary to earn legitimacy and maintain political stability for various governments in contemporary Pakistan. Moreover, the specific phenomenon of caste capitalism in the textiles sector reflects the challenge of achieving the “Weberian” impersonalisation. The literature reviewed in this chapter is appropriate to focus on the various forms of rule-violating behaviour and the lack of impersonalisation discussed in the case study chapters of the thesis. The challenges of the transition to a modern “Weberian” state in theory are illustrated by the empirical case studies in the thesis.

The literature makes distinction the between growth-enhancing rents and growth-retarding rents. Similar to the approach taken in the literature, we also describe the rule-violating behaviour of the case study chapters that had a differential impact on accumulation. In some cases, the rule-violating behaviour and rents earned led to theft of resources. In other instances, the rents created as a result of the rule-violating behaviour led to value-enhancing activities. Also, in other instances, the rule-violating behaviour had no significant impact on accumulation. The point to emphasize is that the rule-violating had varied impact on accumulation ranging from aiding capitalist accumulation to leading to assets destruction. In the Conclusion of the thesis these different forms of the rule-violating behaviour are analysed with reference to the examples from the case study chapters.

Chapter 3. Background to the Political Economy of Pakistan

The chapter discusses Pakistan's history by looking at the state policies and their interaction with economy, industry and social groups. This chapter, overall, looks at the state's policies and social groups in Pakistan in the context of the relationship between development and patronage. The chapter uses secondary sources along with the Government of Pakistan's primary documents (*Economic Survey of Pakistan* series). The chapter provides a background for the empirical analysis of the thesis done in the case study chapters. Although, the thesis does not focus on the role of the landowning class, this chapter discusses it briefly towards the end as part of the background to political economy.

Growth rates from the 1960s to 2003-04 are given below in Table 3.1:

Table 3.1: Growth Rates for Pakistan¹⁶

	1960s	1970s	1980s	1990s	2000-01	2001-02	2002-03	2003/4
Growth Rate (%) (Constant factor cost)								
GDP	6.8	4.8	6.5	4.6	1.8	3.1	5.1	6.4
Agriculture	5.1	2.4	5.4	4.4	-2.2	0.1	4.1	2.6
Manufacturing	9.9	5.5	8.2	4.8	9.3	4.5	6.9	13.4
Commodity Producing Sector ¹⁷	6.8	3.9	6.5	4.6	0.5	1.3	4.9	7.7
Services Sector	6.7	6.3	6.7	4.6	3.1	4.8	5.3	5.2
As % of GDP								
Public Investment	--	10.3	9.2	7.5	5.7	4.2	3.6	4.6
Private	--	5.6	7.8	9.1	10.2	11.3	11.2	11.7

¹⁶ Annual average for decades from 1960s to 1990s given in *the Economic Survey of Pakistan 2003-04*.

¹⁷ It includes agriculture, forestry and fishing.

Investment								
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Source: Government of Pakistan. *Pakistan Economic Survey 2003-04*. Statistical Appendix, pp. 2-3

Table 3.1 shows that GDP growth during 1960s grew close to 7 per cent and overall manufacturing close to 10 per cent. All growth indicators fell in the 1970s with GDP growth being close to 5 per cent and manufacturing growth being just above 5 per cent. There was turnaround in the 1980s, largely due to the exogenous factors as discussed later in the chapter. The GDP growth was over 6 percent and manufacturing growth over 8 per cent. The growth indicators again fell in the 1990s with both GDP growth and manufacturing going below 5 per cent. In the 2000-2004 period, the first two years witnessed abysmal GDP growth and the economy picked up in post-September 2001 period, as discussed later in the chapter.

3.1. Political Economy of Pakistan: Politics of Patronage and the Industrial Sector

Going back to the earlier period of industrialisation in Pakistan, it is worthwhile to link it with the politics of patronage (as discussed in the Literature Review). The role of patronage and rents has been important in the industrial development in Pakistan from the 1950s onwards. The role of the state institutions in distributing patronage started with the distribution of the evacuee trust property after the partition. It spread to the patronage of the emergent capitalist class through various policy instruments in the 1950s and 1960s. Industrialization was considered imperative for the survival of the country given that Pakistan started with virtually no industrial base. Industrialists were given subsidies as part of the industrial policy and they received rents. Politics of patronage has been fairly entrenched in the industrial development of Pakistan since its initial decades.

Pakistan quickly moved towards an import-substitution-industrialization (ISI) strategy. The government had fixed prices of agricultural produce below world prices, the merchant class made a profit selling them abroad. After the boom in the prices of raw materials burst due to the Korean War, the government imposed controls to discourage the imports of consumer goods in order to create incentives for domestic industrialization. Since high profits were no longer possible in trading, the merchant class turned to (mostly agro-based) industrialization. Due to the government's policy,

they were able to buy raw material on fixed prices, import machinery on lower rates and sell their manufactured commodities at high prices in the domestic market. Import-substitution policy was pursued due to the differential tariffs for consumer, intermediate and capital goods. The import licensing rationed the foreign exchange and government pursued the policy of allocation of credit (Ahmed and Amjad, 1984; Amjad, 1974; Sayeed, 1995; Zaidi, 2005; Khan, Mushtaq, 2000a; Papanek, 1991).

The interaction amongst the state institutions and the emergent capitalist class led to overt and covert resource transfers and created rents. Overtly the state institutions used various instruments such as the Bonus Voucher Scheme, granting of import licenses, making foreign exchange available and providing credit to transfer resources. Covertly, the industrialists were inducted on the boards of credit disbursing institutions, so there was an inter-locking of interests. Details of the state institutions' transfers during 1950s and 1960s are discussed below.

In the 1950s, the government used a policy called the Bonus Voucher Scheme or Export Bonus Scheme. It was a subsidy given by the government allowing import liberalization by using some of market mechanisms. This subsidy was provided by using a combination of direct transfers from the government and indirectly helping to procure transfers by selling Bonus Vouchers in the import market at a premium (Zaidi, 2005). It shows a policy instrument being used to provide subsidy to the privileged emergent industrial elite.

The Pakistan Industrial Development Corporation (PIDC) was set up as an autonomous organization in 1950. From 1950 to 1962, PIDC established fifty five projects on its own and in collaboration with the private sector. Five of these projects were in cotton textile mills and woollen mills. Along with these formal projects in the textiles, PIDC also provided the finance to fund six "model" ginning factories in partnership with the private sector. This was active state interventionist planning and PIDC kept a "balance between consumer goods industries and durable goods industries" (Government of Pakistan, *Economic Survey of Pakistan 1961-62*, p. 40). PIDC established projects and then disinvested them to the risk-averse industrialists at attractive prices. The infant industries received the "learning rents" and it led to rapid industrialisation. These rents were distributed as subsidies to the small number of industrial houses (Khan, Mushtaq, 2013).

Both the Pakistan Industrial Credit and Investment Corporation (PICIC) and the PIDC were largely funded by US Aid. There was also close interaction between the emergent capitalist class and the bureaucracy. The PIDC was used to promote the interests of large-scale manufacturers. It was able to achieve the objective of industrialization without the government setting up a big public sector owned industrial enterprises. The initial high-tide of industrialization, however, slowed down in mid-1950s. Exhaustion of domestic market, rising population with the absorption of over eight million refugees, lack of an efficient agricultural sector to provide food for the rising population and a substantial expenditure on food imports led to stagnation of the first phase of industrialization. Food shortage also led to black marketing and hoarding. Industrialization led by migrant merchants slowed down. Also, further industrialization required greater risks in terms of sectoral allocations and this required strong government intervention (Ahmed and Amjad, 1984; Amjad, 1974; Khan, Mushtaq, 2000; Rizvi, 2000).

The most significant feature of the government's strategy in the 1960s was the full-throttled promotion of the interests of urban industrial capitalists. In this second phase of industrialization, the government relatively widened the net of industrial houses from migrants-only industrial houses (with the exception of one landed family of the NWFP) to allow new large landowner-turned-industrialist entrants from Punjab primarily; a few Sindhi large landowners also joined in. However, the industrial capitalists were still dominated by the migrants¹⁸ (Amjad, 1974; Papanek, 1991). The access to rents was (still) limited to only small number of industrialists¹⁹ (Khan, Mushtaq, 2013).

During the 1960s, the planned industrial development was promoted through instruments such as the "Industrial Investment Schedule" which set the targets for each industry and micro-managed "individual projects" by providing finance for it. As part of the policy, 31 industries that met the criteria of export performance were provided licenses. Bonus vouchers as part of the Export Bonus Scheme were used to buy raw material and spare parts by the industrialists (Government of Pakistan, *Economic Survey of Pakistan 1961-*

¹⁸ The huge number of population that migrated from India to Pakistan (about 7 million in the West Pakistan) were naturalized and are citizens of Pakistan (living mainly in urban Sindh, i.e. Karachi and Hyderabad), yet they were commonly called "*mohajir*" (literally meaning "migrants"). These "migrants" adopted this term to define their identity.

¹⁹ The web of the emergent capitalists largely consisted of small number industrialists from the West Pakistan. The East Pakistani capitalist class was not developed on the lines of the West Pakistan.

62). It shows the rents creation as an instrument of industrial policy for the privileged industrial elite.

Other measures of the state-directed transfers included setting up of a National Investment Trust to guide private investment towards industrial projects, establishing technical institutes to train skilled labour, tariff protection for chosen industries, provision of infrastructure and facilities like electricity, land and water by setting up industrial estates (Government of Pakistan, *Pakistan Economic Survey 1965-66*). The Investment Promotion Bureau set up in 1959 provided investment for private and public sector industrial development (Government of Pakistan, *Pakistan, Economic Survey 1967-68*). The Economic Survey clearly states that private sector in Pakistan was provided “liberal facilities by the Government” (Government of Pakistan, *Pakistan Economic Survey 1965-66*, p. xix). These “liberal facilities” provided by the government are the various forms of subsidies provided to push industrialisation through a small number of industrial houses.

Import controls were relaxed in the first half of 1960s. Imports of consumer goods were substituted by intermediate and capital goods. Also, “domestic demand and absorption” were key factors in the 1960s, which saw a high increase in imports, production, and investment. The industry responded well to the liberalisation of imports and manufacturing sector grew. Large-scale manufacturing grew from 8 per cent per year from 1955 - 1960 to 17 per cent from 1960 - 1965. However, foreign aid was curtailed in 1965 due to the Indo-Pak war and import controls were put up again to bolster foreign currency reserves. While growth rate fell after 1965, it was still high. Subsidy given to exporters in the form of Export Bonus Scheme and loans and disinvestments from development financial institutions worked (Zaidi, 2005, pp. 98-100). It again shows the creation of rents in terms of Export Bonus Scheme and disinvestments from the financial institutions.

Government started to loosen control on private sector investment during the 1965-70 period. Industrial projects using local machinery no longer needed the permission of the government according to the new Investment Schedule. For projects needing imported machinery, the power to sanction projects was transferred to financial institutions such as PICIC and Industrial Development Bank of Pakistan (IDBP). The policy shift was to move away from “direct to indirect control of private sector investment” (Government of

Pakistan, *Pakistan Economic Survey 1967-68*, p. 36). It also liberalized a restrictive import policy by taking off over 90 percent imports from the restrictive government list (Government of Pakistan, *Pakistan Economic Survey 1967-68*).

The Economic Survey 1968-69 notes the achievements of the government's industrial policy:

“...within a short period of two decades, the country is now undergoing an economic transformation—from an agricultural economy to an industrial one—and though the features peculiar to the pre-industrial society still preponderate, the characteristics typical of modern industrialism are also asserting themselves (Government of Pakistan, *Pakistan Economic Survey 1968-69*, p. 34).

The industrial policy from 1965-70 aimed to extend ISI, diversify into exports based industries and branch out into the intermediate industries. The overall model was basically private-public partnership. The Third Plan allocated twice as much for the private sector compared to the public sector (Government of Pakistan, *Pakistan Economic Survey 1969-70*). Since the foreign exchange became scarce after the 1965 Indo-Pakistan war, only a few of the loans sanctioned were disbursed after 1965.

Pursuing the “Doctrine of Functional Inequality” under the tutelage of the so-called Harvard Advisory Group meant that capital was diverted towards the industrial sector as it was presumed to have a high proclivity to grow at the cost of agriculture, labour and urban consumers. This policy, however, had more specific consequences within the industrial sector. It promoted crony capitalism. The families who had established a firm control over the industry also had a firm grip over banking and insurance. There were no formal rules to forbid interlocking directorates within the industries. Family banks were giving loans to the companies owned by their own families (Zaidi, 2005).

Zaidi quoting Rashid Ajmad's pioneering work on industrial concentration says:

“a dominant small group of monopoly houses had begun to emerge in the 1950s in the industrial sector, a trend which was accentuated in the 1960s. In 1970, there were 44 monopoly houses, which controlled about 77 per cent of gross fixed assets of all manufacturing companies listed on the Karachi Stock Exchange. These firms controlled about 35 per cent of all assets of the entire large-scale manufacturing sector and at the same time had close links with the

financial sector. Seven of the seventeen Pakistani banks were under the direct control of the monopoly houses, accounting for 60 per cent of total deposits and 50 per cent of loans and advances. They had an extended network of interlocking directorates, where the board of directors of one company sat on the board of directors of others. Moreover, there were strong links between private industry and government financial institutions: between 1958 and 1970, 65 per cent of total loans disbursed by PICIC went to thirty-seven monopoly houses, with the largest thirteen of these accounting for about 70 per cent of these loans” (Zaidi, 2005, p. 102).

The massive concentration of wealth shows how the small number of industrial houses were able to receive rents in the form of various policy instruments. The erstwhile traders received subsidies, which enabled them to build industrial houses through inter-locking their interests with the financial sector, along with other benefits such as an overvalued exchange rate, availability of foreign exchange and imposition of import controls (some of these subsidies are also discussed by Mushtaq Khan, 2013).

Foreign loans and credits for the industrial sector have been mentioned in various Government of Pakistan documents. These documents also mention the role of foreign capital in bolstering economic and industrial development in the 1960s. The largest investment in the industrial sector during 1965-70 came from the USA (Rs. 681.60 million) and it was followed by Britain (Rs 115.30 million) and Japan (Rs 405.30 million) (Government of Pakistan, *Economic Survey of Pakistan 1969-70*).

We have discussed in detail how rents were created as part of instruments of the industrial policy which benefited the privileged industrial elite. Mushtaq Khan considers that these rents were not managed effectively as political organisers had become powerful and they were able to protect the inefficient industrialists. The state’s capacity to manage these subsidies was quite limited. Due to the limited capacity of the state, the investments could not lead to speedy productive growth to ensure the viability of these investments (Khan, Mushtaq, 2013).

The 1965-70 period industrial policy could not achieve its target of 13 percent growth in the large scale manufacturing sector; it only managed 8 percent. This was attributed to the war with India in 1965, cut in foreign aid and harsher terms of loans and political unrest. The civil agitation during the end years of the Plan had a bad impact on

economic, industrial and exports growth and led to “widespread dislocation of economic activity” (Government of Pakistan, *Pakistan Economic Survey, 1969-70*).

Agitation against the Ayub regime in late 1960s was led by the middle classes, which play an important role in the politics of the Indian Subcontinent. The resistance of “emerging middle classes” started in West Pakistan and spread to the East Pakistan. Even Ayub regime’s suppression measures failed against the strength and organizational power of the middle classes. The imbalance of development between the West and East Pakistan turned into a political slogan. Ironically, mobilization started in the East Pakistan when for the first time the resources and particularly foreign inflows, were being transferred to the East Pakistan. The distribution started in 1967 and it was substantial to the point that it slowed down industrialization in West Pakistan. Yet, it was perhaps “too little too late”. This once again underlies the need to devise an economic strategy that is compatible with the social structures, otherwise the social structures hamper the implementation of economic policies (Khan, Mushtaq, 2000a).

As stated earlier, people at the forefronts of the anti-government agitation in the late 1960s were from the middle classes in small towns. Developments in agriculture led to differentiated dispossession of small and medium peasants in 1960s. They joined in the protests. Later on lawyers, government servants, and other professional classes also joined in. The legitimacy of the government policies was lost because the industrial class did not enjoy a base in the rural areas. Also it did not have an indigenous political base. Whatever economic prosperity was achieved slowed down due to the 1965 war and the consequent thinning of foreign aid. The avowed purpose of the government planning was “creation of ‘surplus value’” had backfired. The doctrine of “functional inequality” turned into the slogan of “22 families” looting the country (Sayeed, 1995; Burki, 1991; Khan, Mushtaq, 2000a).

The real failure of the praetorian policies of the government was to excessively limit the access to rents creation to small number of emergent industrial houses. The authoritarian government relied on suppression measures to exclude the political organisers from accessing rents. The suppression measures worked initially but they failed as the excluded groups launched powerful opposition. The authoritarian regime failed to ensure the long-term political stability by excluding the wider elite from accessing rents. It led to the collapse of social order and eruption of massive violence (Khan, Mushtaq, 2013).

As the Chapter 2 states that the underlying distribution of power needs to be compatible with institutional capabilities for social transformation. In this case the underlying power structures were not compatible with the limited capabilities of the government to maintain political stability, constrain the political organisers or discipline the industrialists in the long run.

The Pakistan People's Party (PPP) in West Pakistan and the Awami League in East Pakistan provided the political platform for the disgruntled middle and lower-middle classes. Awami League led by East Pakistani leaders won the majority in the first elections held in 1970 on the basis of adult franchise. The West Pakistani elite were not willing to transfer power to Awami League led by Mujeeb-ur-Rahman without them accepting laid out conditions. The mobilization got violent, particularly in the East Pakistan where it turned into a civil war (Khan, Mushtaq, 2000a). Army action in the East Pakistan led to massive loss of citizens' lives and liberties. It prompted India to militarily intervene in 1971 and defeat the Pakistan army in a full-fledged war, and as a result the East Pakistan became a new country - Bangladesh.

The 1970s was an era of populism and the rise of middle classes in the new Pakistan after its separation from the East Pakistan in 1971. Since concentration of wealth in the hands of a tiny industrial class was one of key criticisms against the Ayub government during the agitation, the opposition led by Bhutto declared the policy of nationalization of industries and financial services after coming to power. Nationalisation did not prove to be an overall economic success for Bhutto's government. There were other "bad luck" factors for the Bhutto government due to floods and other natural disasters. This era also strengthened the state's role in rent-seeking practices as the state institutions and nationalized industries were used to dole out jobs to the regime's loyalists as reward for their struggle against the Ayub regime (Zaidi, 2005). This changed the entire nature of the politics of patronage in Pakistan as discussed in Chapter 7.

Bhutto first nationalised the capital and intermediate goods. In 1972, insurance companies were nationalised and the State Bank tightened control over scheduled banks to redirect credit. Rice and cotton trading was nationalised in 1973 and so were vegetable oil, petroleum marketing and shipping. The banking sector was nationalised in 1974. This broke the back of the industrial sector. In 1976, Bhutto government nationalized the small scale cotton ginning, rice husking and flour milling. Pakistani rupee was

devalued by 131 per cent in 1972 and prices of agricultural products increased by 100 per cent between 1972-77. A prime source of subsidy in the form of Export Bonus Scheme of 1960s was done away with. Measures were taken to end of overvalued exchange rate through devaluation, make “a deliberate attempt to alter the pro-industry anti-agriculture bias of the previous growth strategy” and cut down direct and indirect subsidies to the manufacturing sector (Zaidi, 2005, p. 105). It shows how the subsidies and rents of the emergent industrial class were taken away by the Bhutto regime.

In Bhutto’s regime of the 1970s, the middle classes were given space in the state apparatus with the induction of left-leaning people. Getting jobs and being part of the government was valuable for the members of rural middle classes. It of course remained a necessity for urban workers and middle classes. This was because of the gradual reduction of opportunities in the agrarian sector. The populist regime was overwhelmed by demand for jobs. A major damper on the economy was the nationalization of industries, made worse by the emergent industrial class shifting its profits abroad. This led to loss of confidence, economic activity and employment creation in the country. The economic and social problems started to unravel. Although Bhutto regime started to send people abroad for employment, it took some time before remittance began to influence the economy. The government had strained beyond its capacity (Sayeed, 1995).

The measure that turned out to be the most harmful for the Bhutto government was the nationalization of small industry. It antagonized traders, merchants and brokers (Sayeed, 1995). Whereas nationalization appeased some sections of the middle classes through expansion in the public sector industries and employment creation, it antagonized others. Some sections of the middle classes were appeased by Bhutto regime at the cost of others. Those who lost out mobilized against the government. The policies pursued to absorb the interests of some sections of middle classes through public sector employment contributed to the alienation and antagonism of the *other* sections of the middle classes. The Bhutto regime’s populist policies failed and led to its downfall.

There was not enough patronage to be distributed too widely to all the potential political organizers. Rents were taken away from the industrial elite and also from the middle classes associated with the capitalist class. This antagonized the industrial elite and the certain sections of the middle classes. The middle classes are not a monolith category as Chapter 2 discusses. Bhutto’s nationalization of small industries had a negative impact

on small traders and merchants and they provided the cannon fodder for anti-Bhutto mobilisation by late 1970s.

Through nationalization of industries and particularly small industries, the Bhutto's government antagonized the vast majority of trading classes across the country. The economic concerns were expressed in the ideological idiom of a re-asserted Islamic identity. Such an Islamic identity was projected to be under threat due to the liberal and progressive cultural image of the Bhutto government. The trading classes along with other disgruntled groups got mobilized and launched the Pakistan National Alliance (PNA) movement to overthrow the Bhutto government in 1977. The army decided to overthrow the Bhutto government.

Thereafter the military government decided to let the private sector play the main role in 1980s. It started with the denationalisation of small units such as cotton ginning, rice husking and flour milling in late 1977. The government also denationalised some small engineering units. Cement and chemical units were made available to the private sector. In 1978, the private sector was also given tax holidays to promote industry in less developed areas. The industrial sector also got export rebates and interest rates were brought down. Regulations and the process of getting private sector investment were made less stringent. Target for growth of large-scale manufacturing at 12 per cent per annum was achieved in the period from 1978-82. Even though there was no major reversal to denationalisation, public sector investment fell from 72 per cent in 1978-79 to below 18 per cent in 1987-88 (Zaidi, 2005).

The military government took a number of measures in the 1980s to boost industrial production. The government provided duty free access for the import of machinery, facilitated credit through the export finance scheme, and applied "compensatory rebate" on exportable items. It also liberalized the imports and exports. Liberalisation of imports was done to increase industrial output. To give boost to exports, the provision of raw materials and intermediate goods was facilitated. The government also set up two export processing zones in Lahore and Karachi respectively (Government of Pakistan, *Economic Survey of Pakistan 1982-83*, p. 44). The government also provided incentives such as the Exports Rebate Scheme, Exports Finance Scheme, Export Credit Guarantee Scheme and Export Processing Zones. Other incentives also included relaxing some of the rules of the Securities and Exchange Commission 1971. Industries were also

exempted from getting “prior sanction”, excluding a few cases (Government of Pakistan, *Economic Survey of Pakistan 1982-83*). It shows that the military government provided subsidies as instruments of its industrial policy and distributed rents through liberal bank loans. Unlike the 1960s, the recipients were not only the small number of industrial houses. Patronage was distributed more widely in the 1980s and its nature was more diffused (Cheema, 2003).

A detailed industrial policy was designed and implemented from 1978-88 period. The government put an end to further nationalization and encouraged the private sector. Manufacturing continued both in public and private sectors in a “mixed” economy. The government moved slowly to denationalize state-owned industries and financial institutions. The over-riding objective of the regime was to *survive* and prolong its rule. The government, therefore, did not control the smuggling, gun-running and other black economy-oriented activities. The government pursued the policy of “purposeful neglect” (Burki, 1991; Sayeed, 2002; Belokrenitsky, 1991).

There was a burst of growth in the 1980s and the rate of industrial growth reached 9.6 per cent, but this was largely due to exogenous factors. The disparity between high growth and low productivity arose due to lack of productive allocative capacities. Over 80 percent of contribution to growth came from “large capital input.” These capital inputs were from “exogenous sources”: foreign-remittances, economic and military aid, and loans from multilateral financial institutions. A certain portion of exogenous capital input was given by the state owned banks as loans to industrialists and private sector. A considerable percentage of these loans ended up being declared bad loans and were written off. This was because they were given without adequate precautions. The real purpose was not to promote industrial development *per se* but to pursue patronage politics by doling out the state’s resources. The loan recipients kept rescheduling their loans. They were, in the meanwhile, able to receive new loans. Without having the capacity to impose discipline to pay back loans, it became easier to earn quick money through getting loans sanctioned from the public financial sector and then defaulting. It led to “sickening” of the industrial sector. The rot in the manufacturing sector in 1990s sprang from dire credit distribution policies of public banks in the 1980s (Sayeed, 2002; Belokrenitsky, 1991). It shows how rents were created and transfers were made in the form of bank loans by pursuing the politics of patronage. As discussed in Chapter 8, political motivation was one of the key reasons behind bank loans default.

The new intermediate classes' best way forward was to become part of the state apparatus and redirect rents to themselves. The state capture through local body elections (and later on through the provincial and national politics) was an effective way to redistribute property rights. In the 1980s, the entrepreneurial class realized that the best way to safeguard its business interests was to get directly involved in politics. They realized that direct involvement in politics was necessary to earn rents (Zaidi, 1999; Sayeed, 1995).

Industrial-politician Nawaz Sharif became active in the national politics in the 1980s and ended up leading a political party- Pakistan Muslim League (Nawaz). He twice became the Prime Minister of Pakistan in the 1990s. Another industrialist Chaudhry Shujaat also became quite prominent in the 1980s and later founded his own faction of the centre-right party – Pakistan Muslim League (Quaid). The rise of Sharif and Chaudhry families in the 1980s and 1990s is an archetypical example of businessmen getting involved in politics. The industrial/financial strength of the industrial-politicians increased manifold after joining politics. The state machinery, credit provisions, under-taxation measures and other instruments were used to accumulate rents.

In the 1990s, Pakistan's economy grew at only 4 per cent compared with 6 per cent in the previous four decades. The economic conditions worsened at the end of the Afghan war and the consequent drying up of foreign aid. The country's budget was partly financed by borrowing from international monetary institutions. The Structural Adjustment Programme (SAP) worsened the human development as poverty increased. Clientelist policies of governments continued. The era of liberalization led to a downturn in the economy. New policies of interest and exchange rate liberalization, tariff reduction, narrowing the budgetary deficit and privatization had adverse effects on industrial development to the extent that over 4000 industries were declared sick by 1998. The process of default and "sickening" of industries whose foundations were laid in the 1980s easy credit policy had almost become a reality given manufacturing projects were not sustainable with the high interest rates. There were more incentives to spend the money on short-term high return activities. Even if loans were spent on manufacturing, the chances of collapse of such projects were quite high. Excessive devaluation did not boost exports and led to inflation. Privatization was carried out on a large scale in the first half of 1990s; about 80 percent of public sector industries were privatized. The industrial class did not resist liberalization because this enabled it to transfer industrial

capital into finance capital (stock exchange, real estate, foreign currency deposits in the country or abroad) without taking the risks of industrial capital. This also made it possible for the industrial class and other accumulators from the “shadow” economy to whiten their money. The fact that the power of industrial class has not necessarily declined is reflected in the fact that the government has not been able to force them to return “bad debts” to public financial institutions. In spite of poor growth figures in the large scale manufacturing, government continued to pursue a policy of liberalization. The liberalization policies were accepted under the pressure of the international financial institutions (Sayeed, 2002; Zaidi, 1999; Khan, Mushtaq, 2000a).

Pakistan’s export performance declined over the decades. For example, in 1972, Pakistan’s export of manufactured goods matched that of the four Southeast Asian countries put together. But both Thailand and Indonesia exported “more than three times” compared to Pakistan in 1990 (Papanek, 1991, p. 2). Exports performance improved somewhat in the period of structural adjustment, yet it still lagged behind the average of “low income countries”. Intermediate goods sector had been hit the worst. The overall scenario pointed towards a trend of “de-industrialization” as a consequence of structural adjustment and the regime of liberalization (Khan, Shahrukh, 1999). External debts proved to be a drain on the economy in 1990s. During the structural adjustment period, the debt to GDP ratio increased compared to the previous decades. Since aid and concessional grants stopped and the terms of debt got worst, the debt-trap coupled with Pakistan’s nuclear tests pushed the country to the brink of default (Khan, Shahrukh, 1999; Naseem, 2002; Burki, 1991).

Growth rate for the overall manufacturing sector was only 4.8 per cent in the 1990s compared to 8.2 per cent of the 1980s. Compared with the 1960s figures, the performance of the manufacturing sector was abysmal under the SAP in the 1990s. The industrial sector witnessed negative growth rate in 1996-97 as it fell to minus 0.1 per cent and it was barely 1.5 per cent in 1999-2000. The rise in post 2001 figures was due to exogenous factors. Fixed investment as percentage of GDP fell from 19 per cent in 1990-91 to 13.1 per cent in 2002-03, public investment almost halved from 8.5 per cent in 1990-91 to 4.5 per cent in 2002-03, while private investment fell from 10 per cent of GDP in 1992-93 to 8 per cent in the post 1998-99 era (Zaidi, 2005, pp. 122-124).

The interest rates rose due to financial liberalization under SAP badly affecting the industrial sector. Whereas in the 1990, the interest rate was on the average 12 percent, it increased to 20-23 percent on average for “long term industrial investment” and 25-30 percent for the working capital in 1997. The utility prices similarly went up on the principle of market principles. From 1991 to 2001, electricity cost went up by 14.7 percent and the price of gas increased by 10 percent. Increase in utilities and upping of interest rates had an adverse impact on the industrial sector. Tariff rates fell tremendously from the maximum of 225 per cent in 1986-87 to 25 per cent in late 1990s. Reduction in the tariff rates made imported supplies cheaper. It is therefore, “...not surprising that more than 4,000 industrial units have been declared ‘sick’” (Zaidi, 2005, pp. 123-24). The cost of doing business was much higher in Pakistan compared to its neighbours in South Asia (Bari, 2006).

The military, led by General Musharraf, again took over power in 1999. Musharraf era can be clearly divided into two phases: 1) 1999 to pre-September 11, 2001 era; 2) post September 2001 to 2008 era. Musharraf government was internationally isolated before the September 2001 attacks and the low economic growth figures of 1990s continued well into 2001. With the turnaround in Pakistan’s stated policy on the Taliban under US pressure, the international community welcomed the government with enthusiasm. Pakistan got generous aid by the US, easy loans from the IFIs, and large foreign inflows as remittances from overseas Pakistanis.

Pakistan’s macroeconomic performance improved from 2000 to 2004. As the Table 3.1 points out, in the financial year 2003-04, the economy grew at 6.4 per cent against the projected growth of 5.3 per cent. Overall manufacturing grew by 13.4 per cent against the target of 7.8 per cent with the automobile group growing at 52.7 per cent as a trail-blazer. Electricals and pharmaceuticals grew at 45.8 per cent and 21.1 per cent respectively. Inflation remained under 4 per cent and external debts payment decreased substantially as a percentage of the annual budget. Foreign reserves reached \$12 billion (Government of Pakistan, *Pakistan Economic Survey 2003-04*). This was largely due to the exogenous factors as discussed above.

Consumer financing and consumerism sums up the economic performance of the Musharraf era. Due to the financial sector liberalization, private banks and leasing companies opened in large numbers and they instituted consumer financing. This led to

the sale of consumer items, ranging from automobiles to cellular phones. The financial sector liberalization which started in the early 1990s, got consolidated in the Musharraf era. Interest rates also came down from 18-20 percent to 6-8 percent as part of policy to expand financing. The government privatised the United Bank in 2002 and Habib Bank in 2004. Overall, the issue of privatization of state owned banks and allowing more private and foreign banks to be set up was intricately linked with the high portfolio of non-performing loans in the state owned banks. The changes in the financial sector liberalisation fuelled the consumer financing to the expanding middle classes (Bari, 2006).

3.2. The Landowning Class and the Politics of Patronage:

The politics of patronage and clientelism discussed in Section 3.1 is not limited to the capitalist sector. It is spread over the wider sections of society. The landowning class, the capitalist class and the intermediate classes are all part of it. The thesis does not focus on the role of the landowning class. We briefly discuss it below as part of the background to the political economy of Pakistan.

Chapter 2 discusses in detail the linkage between the distribution of power in the society and the institutional capabilities needed for transformation in developing countries. Patron-client relationships are “modern” in the sense that they are not only based on traditional concepts of loyalty only but on the economic payoffs that patrons bestow on their clients through redistributing the state’s resources in exchange for the organisational power of the intermediate classes (Khan, Mushtaq, 2004; 2005). Kinship-based patronage is widespread in the Pakistani society and is structured around the concept of “collective defence” where the power of the state institutions is negotiated through the clan networks (Lieven, 2011).

The literature reviewed in Chapter 2 shows that contrary to the prescriptions of the ‘good governance’ model, there may not be much difference in democracy or authoritarianism rule in developing countries. The prevalent power structures remain the same. Democracy also works through patron-client relationships and the politics of patronage. Accessing the power of the state institutions is one of the effective strategies in rents generation and its redistribution to clients. We state that the landowning class, the capitalist class and the intermediate classes have all benefited from the politics of

patronage. We discuss the role of the capitalist class and the middle classes in the case study chapters (6, 7, 8, 9) in detail. We briefly discuss below the role of the landed class in the historical context.

Lieven is of the view that Pakistan does not have “feudals” along the lines of medieval Europe. “Feudals” in the Pakistani discourse are landowners. As much as 500 acres is considered a “big estate” in the country. The “feudal” families, particularly in northern Punjab, have risen due to their (state-centred) corruption or through ownership of urban property and not due to income from land-owning sources. The power of the so-called “feudals” in Pakistan is not due to their land-holdings but due to them being heads of big clans/tribes and kinship networks which augment their hold. Even in the case of migration to the urban areas, the kinship patterns remain entrenched going back to the rural backgrounds. Kinship networks help the members of a clan to negotiate with the state institutions even after their migration to the urban areas (Lieven, 2011).

Going back in Pakistan’s history, the Green Revolution of the 1960s initiated a process of change in the rural areas. It changed the economic, social and technological relations in the country. Green Revolution introduced new seeds, fertilizers, mechanization through tube-wells and tractors. It provided incentives to the large landowners to mechanize and to small landowners to economize. It led to the displacement of landless labour and small farmers. The economically displaced sections of the population migrated to nearby towns and provided the essential services for the agricultural change. In this way, the process of urbanization was strengthened. This urbanization process led to the growth of urban middle classes in Pakistan. These small towns provided the services required for the agricultural change (Zaidi, 1999; Khan, Mahmood, 1981; Raj, 2002). In the urban areas, the state institutions successfully created incentives to turn the merchant/trading class into proto-capitalists as discussed in Section 3.1. The agricultural sector paid the “tribute” to the urban industrial sector due to fixed pricing of agricultural products and displacement of small peasants, tenants and the landless due to the Green Revolution (Raj, 2002).

There are reasons behind the state institutions’ focus on industrialisation and perpetuation of the “urban bias” in their policies in the earlier decades of Pakistan. The vision to industrialise was part of policy of modernization. The overall trend in the

developing countries at that time was an economic policy focused on import-substitution-industrialization (Amjad, 1974). Mushtaq Khan (2013) referring to Ayesha Jalal's work points out that the military government that took power in 1958 needed a viable economy. The country's survival was perceived to be dependent on its military strength. To finance the military's power, there was a need for a viable economy. This argument provides another strong explanation for focus on industrialisation that translated into the "urban bias".

Despite, the so-called "urban bias", the landed class was largely able to maintain its status-quo (Khan, Mahmood, 1981). Another view looks at the phenomenon of "urban bias" differently. According to this view, the landed elite was in "money illusion" as it did not see its income decreasing and failed to understand a change in real income with the rise of industrial capitalists (Amjad, 1974). The Land Reforms of 1959 were effective in weakening the landed interests in the country and the Ayub regime was able to push these reforms due to its authoritarian character.

The other salient feature of the Ayub era was the introduction of the system of Basic Democracy (BD) in 1959. This BD system elected 80,000 basic democrats²⁰ from the West and the East Pakistan. They were elected to be members of union councils in rural areas and union committees in urban areas. It was an effort to build a political constituency for the Ayub government. Though the BD members did not enjoy much power, they got money from the state for the developmental work in their respective areas under the banner of the "Rural Works Programme." This was clearly a way for the authoritarian regime to create support for itself in the rural areas²¹. It also undermined the power of national political leadership and big landowners (Sayeed, 1995; Rizvi, 2000).

The distributive politics of the BD system was the continuation of patron-client relationship that the state institutions had established with social groups. Earlier, it was exercised through the state institutions' monopoly over the distribution of evacuee trust property. The BD system was a sophisticated way of doling out state resources through

²⁰ Commonly known as BD members.

²¹ According to Mushtaq Khan, the policy of distributing patronage through the 'basic democrats' proved to be "self-defeating". It might have worked in the short-while to bypass the national political leadership through decentralization. However, ultimately, the rural basic democrats became more ambitious and they threw their weight behind the political organizers in the urban areas against the Ayub government. The coalition of the economically excluded became powerful enough to topple the Ayub government (Khan, Mushtaq, 2013).

elected representatives. This became an institutionalized practice that Bhutto continued in the 1970s by pursuing the policy of nationalization, job creation and politically motivated inductions. Zia-ul-Haq practiced it more blatantly in 1980s through the distribution of bank loans and development funds (Sayeed, 1995; Zaidi, 2005). Politics of patronage got further strengthened in the 1990s when the two main political parties kept alternating in power before the military took over power in 1999.

Getting access to the power and resources of state institutions plays an important part in the web of patronage. Adnan Adil (2000) has done an interesting study on the key players in the Punjab's politics from 1970-1997 on the basis of tabulating the National Assembly seats won by the different social groups. The landed class²² got almost half of the seats from the Punjab in the National Assembly from over this period. The other key finding of Adil's study (which corroborates the fieldwork findings discussed in Chapter 8) is the rise of businessmen in politics in the 1980s and 1990s. Businessmen won only 6% of seats for the National Assembly in the Punjab in the 1970 elections. Their share started going up since the non-party-based elections in 1985 and went upto 20 percent in the 1997 elections. Businessmen displaced the professionals and other middle classes who had won in the 1970 elections. Another interesting finding is that the landed class, which has been winning almost half the National Assembly seats from the largest province, Punjab, had fairly established links with the business sector. Members of the landed class had business interests in manufacturing, transport, trade and urban real estate. One explanation for the convergence of land-owning interests with business interests could be the low income from the agricultural sector only. Hence, the landowners-politicians needed to venture into the business to supplement their incomes and contest electoral battles. The industrialists had also been buying up land (Adil, 2000).

The landed class - including the big land-owners and "rich/middle" farmers - winning almost half the National Assembly seats from the largest²³ province, Punjab, points to the landowning class having been as much part of the patronage politics as other powerful groups. The landowning class has been venturing into business and the capitalists are investing in the lands. Continuing with the BD tradition of the Ayub era, various governments allocated considerable development funds through the elected

²² Adil (2000) includes both the big landowners and "rich/middle farmers" amongst the landed class.

²³ In terms of population.

representatives from 1980s onwards. It formalised the role of politicians (with a considerable representation of the landowning class) in the politics of patronage in their respective constituencies. The landowning class is also powerful enough not to let the income tax be applied to the agricultural income.

To sum up, the power of the landed class was negatively affected due the urban industrial bias of the state institutions' policies in the 1950s and 1960s. The landed class re-asserted itself since the 1970s. As stated above, the landed class has won half the National Assembly seats from the Punjab from 1970 till end of the 1990s. It has been an essential part of the politics of patronage distributed through the developmental funds and other ways of earning rents through its capture of the state institutions. The landowning class, the capitalist class and the intermediate classes have all been part of the patronage politics and clientelism depending on their relative configuration of power in the structures of society.

Chapter 4. Methodology Chapter

The dissertation has used the qualitative research methodology to investigate the relationship between political economy and the rule of law in contemporary Pakistan. Qualitative research methodology is better at capturing the complexity of the phenomenon than other methods. Hence, the dissertation offers a rather unique view of the nexus of the political economy and the rule of law issues using only qualitative research methodology.

It was decided to use the qualitative research methods on the basis of the past experience as well. For pre-PhD research work on the people's perceptions regarding justice system and law and order at the local level, my co-author - an economist - and I came to the conclusion that semi-structured interviews and other semi-anthropological qualitative methods work better than sophisticated questionnaire-based quantitative methods.

Of course, qualitative research methodology has its limitations too, but it does have the ability to point to the certain patterns very clearly which makes the analysis rich. Hence, purely qualitative research methods have been used. The thesis uses a number of different qualitative methods ranging from a critical reading of primary documents and making inferences on the basis of the documents to conducting key informant interviews. It has used the quasi-anthropological methodology of conducting in-depth key informant interviews and using case studies and quotes from those interviews in the thesis. Of course, the secondary literature has been used wherever possible. Primary documents and interviews have been used interactively. Documents have been read in the context of interviews and interviews have been conducted keeping the primary documents in the background. A check-list for the interviews was used and is in the appendix of the thesis. Participant observation was also used while waiting for logistics to be sorted out in the government offices and textile manufacturers' offices and it has offered some interesting insights as well.

Having chosen a qualitative approach, the next step was to decide what the specific focus of the research should be. As outlined in Chapter 1, the Introduction; I chose a dual focus on institutional reforms and a productive sector.

4.1.Choice of IFIs Reforms in Pakistan:

Case studies of the General Sales Tax (GST) and the Securities and Exchange Commission of Pakistan (SECP) were chosen for studying the IFIs institutional governance reforms. The question is why these were chosen for case studies and why not other reforms such as privatisation of the banking sector, default of bank loans, privatisation, accountability, augmenting of accounting methods and accountability / transparency.

Initially an attempt was made to work on default of bank loans. Through concerted effort, confidential lists of top loan takers in the textiles sector from 1999 till 2004 was received from the State Bank of Pakistan's well-guarded internal database. The idea was to compare them with the lists of top exporters and the top companies trading on the Karachi Stock Exchange to gauge if the bank loans were going to productive entrepreneurs in the textiles sector or not. From the point of value-enhancement, bank loans case study would have been illuminating and very relevant. It would have been able to show whether the value-enhancement was still taking place in the banking sector and also throw light on whether resources were going to productive versus unproductive capitalists. Other than receiving the confidential lists of top borrowers in the textiles sector, a lot of effort was also made to collect the company reports of the top loan takers from the Karachi, Lahore and Islamabad stock exchanges to assess company performance. However, after having invested quite a bit of time and effort, it was concluded that the kind of time and material resources needed to do this kind of analysis were not available and hence this case study was aborted. Hence, default of bank loans data proved to be a cold trail.

Reforms in the accounting methods were not chosen due to lack of expertise. Relevant data was not available for a case study of the privatisation. Hence, I conducted the two case studies of the GST and the SECP.

4.2. Choice of the Textiles Sector:

As discussed in the Introduction (Chapter 1), it was considered necessary to study a productive sector along with the chosen IFIs institutional governance reforms to look at interplay of the taxation, regulation and the rule of law issues in a productive sector. The textiles sector was therefore chosen by eliminating other sectoral choices such as the sugar, iron & steel and cement. Textiles sector's contribution to the economy in Pakistan was phenomenal. At the time of the fieldwork, it contributed 60% to total exports, 46% to total manufacturing and 27% of industrial value addition. It also contributed 8.5% of total GDP and 38% of total employment and consumed 31% of total investment (Government of Pakistan, "Textiles Vision 2005"). Here is how the key government economic document mentions textiles:

"Its share in the economy, in terms of GDP, exports, employment, foreign exchange earnings, investment and contribution to the value added in industry; makes it the single largest determinant of the growth in overall manufacturing activity... Pakistan has emerged as one of the major cotton textile product suppliers in the world market and its share in world yarn trade is about 30 percent while its share in cotton cloth trade is about 8 percent...The value addition in the sector account for 9 percent of GDP and it employs 38 percent of industrial workers" (Government of Pakistan, *Economic Survey of Pakistan 2002-03*).

In a study on the rule-based governance, if there is one single sector that *cannot* be ignored, it is *the* textiles. Moreover, the primary reason for choosing the largest manufacturing sector in Pakistan was that if the rule-based governance and mature capitalism is not prevalent in the largest manufacturing sector, then there would be even less chances of it taking place in less critical sectors.

4.3. The fieldwork

The main fieldwork for the thesis was conducted from May 2004 to April 2005. The overall focus of the thesis at the time of the fieldwork was the role of IFIs, the rule of law, the textiles sector and the rule-based governance. The review of the literature of the theoretical background and the political economy of Pakistan was done in the Upgrade document before the commencement of the fieldwork. Its finalised versions are in Chapter 2 and Chapter 3. The first few weeks of the fieldwork were spent on getting the

background documents from the World Bank, IMF and government of Pakistan offices. A large amount of time was, however, spent on collecting primary documents from the Ministry of Finance and Pakistan Law Commission in Islamabad.

In the pre-PhD programme period, I was associated with a local NGO-cum-research think tank in Islamabad. This was since 1997, and I worked in various capacities including research positions. When I returned to Pakistan, this research think-tank offered me a position of Visiting Research Associate during the time of fieldwork. It used to work on development, environment and gender issues amongst others. It enjoyed a good reputation in the country's policy circles and was well-known at that time. It played the role of a gate-opener for my fieldwork. The research think-tank provided office space, facilities and an intellectual environment which facilitated the design of the fieldwork.

4.3.1. Stakeholders Interviews

After the first phase of collecting basic documents on the role of IFIs, institutional governance reforms, and the textiles sector; various stakeholder interviews were conducted starting from June 2004.

Interviews of 27 stakeholders were conducted. The initial interviewed were conducted to get 'sense of the scene'. These interviews were mostly conducted in Islamabad with representatives of the IFIs, government officials and academics in Islamabad. Interviews with the IFIs representatives were focused on the institutional governance reforms, those with government officials on the IFIs role and government policies. These stakeholders were also asked their perceptions about the textiles sector. The next leg of the fieldwork was the conducting of the interviews of the textiles manufacturers. An academic in a stakeholder interview was not hopeful of getting much out of textiles manufacturers' interviews. His experience of working on political economy issues with textiles manufacturers showed them unwilling to be available for researchers and their queries.

Before discussing the textiles manufacturers' interviews, the tactic used to gain appointments with the members of IFIs, government officials and with other stakeholders is described. A brief statement of the research objectives of the thesis were written as part of individualised letters on the NGO's letterpad indicating my associations both with the local research think-tank and SOAS. These letters were sent to the heads of respective organisations followed by the phone calls. This strategy proved

to be extremely useful in general (excluding the textiles sector). This strategy also worked really well with the Central Board of Revenue in Islamabad later. The head of the organisations generally designated one or more officials to make time available for meetings and interviews.

4.3.2. The Textiles Sector Fieldwork

A textiles sector study doing an overview from the perspective of political economy and rule of law has essentially to focus on capital. Mezzadri (2009) has used a similar approach to study labour through the perceptions of capital. This thesis focuses on capital and its interaction with the state. Hence, it is very relevant to interview the owners of the textiles companies.

Another reason for doing so relates to the need for analysing the backgrounds and dynamics of the families which started the textiles business. For this leading manufacturers had to be interviewed. A few employees of the textiles companies were also interviewed. Representatives of various textiles associations were also interviewed.

The interview process begun by meeting the All Pakistan Textiles Mills Association (APTMA) representatives. This is the largest association representing this sector. Their views were very important in designing the sampling process - they were considered in detail along with other criterion. An effort was made to interview the companies which were not large per se but were important for other considerations. For example, during the sampling process it became important to investigate textiles companies which were loan defaulters. This was to provide a valuable perspective on the relationship of textiles with the rule of law. Three known defaulter companies were identified. Further, a balance was needed between companies listed on stock exchange and those which are private and unlisted.

Overall, a complicated sampling strategy was evolved so that the entire range of complexities within the large and small manufacturers could be covered while keeping the focus on large manufacturers. For the same reason the representative of a multi-national company which makes polyester fibre was interviewed just to get their perspective of the sector. Representatives of the garments association and also garments manufacturers were also interviewed but only to get an idea about how chain of value

addition leads from the textiles to garments. A visit to a power loom in Faisalabad gave a good sense of how the process of subcontracting for making grieg cloth works.

The three cities where textile manufacturing takes places are: Faisalabad and Lahore (in Punjab province) and Karachi (in Sindh province). That is where interviews were conducted.

Key informant interview was conducted on the phone with the Textiles Commissioner in Karachi (which was later followed by an interview in person in February 2005). There was insignificant help from APTMA in obtaining appointments with manufacturers. APTMA representatives themselves were however willing to meet. It seemed that the warning of the Islamabad-based academic mentioned earlier was coming true. The textiles sector was proving to be virtually inaccessible. Discussion with a fellow researcher, Dr Karin Siegmann however helped to open doors. Her friend, Mr Azam Muhammad, Joint Secretary, Ministry of Commerce, Government of Pakistan proved an invaluable contact.

The regional Export Promotion offices in the Punjab and Sindh were under the control of Ministry of Commerce, Islamabad. Azam Muhammad was the high ranking officer there and agreed to help out. The Agreement on Textiles and Clothing (ATC) was nearing phasing out in October 2004.²⁴ In the ATC regime, the Export Promotion Bureaus (EPBs), which are under the Ministry of Commerce, regulated the export quota. It meant that the textiles manufacturers had to work closely with the EPBs. Hence, on Azam Muhammad's request, the regional EPBs arranged my interviews with the textiles manufacturers. The plan finally worked out.

I was aware that this plan has its limitations. As a researcher recommended by a Ministry meant that the textiles manufacturers may not be frank with me or may not appear critical of the government etc. But this was the only way for a researcher to access these very busy people in the textiles sector.

Effort was made to overcome the limitation by building trust. This was done by generally starting the interviews with asking them about their family history and how they got

²⁴ The ATC expired on 31st December 2004.

initiated into the textiles sector. It helped to break the ice. Of course no government representative accompanied me to the interviews. So it was clear that while a government office was used to gain access, the government was not part of the research process in any way. To my pleasant surprise, quite a few textiles manufacturers were not hesitant about being critical of the government or the policies of its various institutions. What they voiced was often criticisms of the government which they had earlier expressed in various official meetings as well. Some of them shared their presentations during the interview process.

Of special interest was to learn the process of how the textiles companies of how they develop and how they interact with the government. What were their views on General Sales Tax/Value Added Tax? How did they perceive the Securities and Exchange Commission of Pakistan as a regulatory body? Given that I was interested in their perceptions of how things worked, they opened up generally.

An able research assistant, Ms Rabia Malik, assisted me during the interviews by taking notes. A backup tape-recorder was used. Textiles manufacturers interviews lasted from November 2004 to February 2005 and we covered Lahore, Faisalabad and Karachi²⁵ in that period (with breaks). After the interviews Rabia and I typed out our handwritten hurried notes. Clarifications were later added.

The textiles chapter is based on 64 key informant interviews conducted of the leading textile manufacturers, employees, textile and garments associations and textiles related government officials. Forty four (44) textiles manufacturers, 10 senior employees of the companies, 6 representatives of textiles and garments associations and 4 textiles-related government officials have been interviewed. Textiles manufacturers were interviewed from 40 textiles companies/groups.

Companies have been chosen on the basis of purposive snowball sampling keeping in mind the feedback of APTMA and other textiles ‘knowledgeable’ in the government and textiles sector. Their views have been matched with the lists of Karachi Stock Exchange, APTMA membership and ranking of “major exporters” of the Export Promotion Bureau

²⁵ Rabia did not go to Karachi due to air ticket being expensive.

(EPB). Prominent manufacturers were also consulted about other companies/groups. Amongst the textile spinning, textile weaving and textile composite categories of Karachi Stock Exchange (excluding silk, rayon and woven garments), roughly 10% of listed textiles companies were selected through purposive sampling, while being aware of the preferences of APTMA members and other stakeholders.

The 19 companies selected from Karachi Stock Exchange were further triangulated by choosing 5% of APTMA members. APTMA, the most prominent textiles association of spinners, weavers and composite units, has 394 members. Twenty- one of APTMA members were selected keeping in mind the choice made earlier of the Karachi Stock Exchange Members. The aim to triangulate was to also include private limited companies in the sample. This selection was further strengthened by reviewing list of “major exporters” of bed linen, cotton fabric and cotton yarn composed by the EPB (Government of Pakistan, Export Promotion Bureau, 2004).

Total of 49 companies were listed by EPB as major exporters of bed linen, cotton fabric and cotton yarn. Out of those 49 companies, 33% of companies (16) were selected keeping in mind the membership of the Karachi Stock Exchange and APTMA. In selecting major exporters, there was a bias towards the selection of more value addition and composite units compared to less value addition and only spinning units. The purpose to choose 33% of major exporters in bed linen, cotton fabric and cotton yarn was to select the key players in the textiles sector. Also, other than the APTMA representatives and other stakeholders feedback and the lists to measure the yardsticks of performance, another practical criteria was of course to choose the “leading lights” who agree to meet and been recommended by the Export Promotion Bureau.

As stated earlier, some garments manufacturers were also interviewed. Two big garments manufacturers were interviewed. Others were small garments manufacturers. Similarly, Pakistan Readymade Garments Association representatives were also interviewed. Power loom workers in one power loom in Faisalabad were also interviewed to get an idea of the process. Some medium²⁶ and small textiles companies were also interviewed to get an idea of the picture across the spectrum. As stated earlier, three defaulter companies,

²⁶ All companies less than 100 million USD of assets were considered medium.

one defunct textiles group of the 1960s, and a polyester fiber making multinational group were also interviewed.

Roughly, half the companies interviewed were public companies and others were private companies. Owners of private companies were generally not forthcoming regarding their company's assets etc.

As a Pakistani woman working on political economy and the rule of law issues related to the textile sector, my experience resulted in problems free fieldwork. The fact that there were no barriers in conversing in Urdu, Punjabi and English helped.

One leading garments manufacturer that I interviewed in Faisalabad gave a very enthusiastic interview and at the end offered me to teach in the College of Fashion Design that they were setting up in Faisalabad. The interview revealed the massive shortage of skilled human resources in the garments sector and it sometimes needed to get female garments makers from Sri Lanka and Philippines. Some other textiles manufacturers advised me to get into international trade law once I finish my PhD, so that I can help Pakistan's case in the European Union when they had to deal with anti-dumping duties etc.

Preference was for quasi-anthropological in-depth key informant interviews as opposed to focus group discussions. However, sometimes in the textiles association meetings with half a dozen textiles representatives being around, the discussions turned out to be something akin to focus group discussions. An attempt was made to have 'informal' discussions once the formal interview process was over and the tape recorder was off. Some interesting insights came out of these 'informal' discussions. Often one was interested in one textiles manufacturer views about another and about digging out the reasons for companies' loan default etc. Some textiles manufacturers were of the view that one of the companies that defaulted in Lahore did so because its owner kept a very tight control over the company and did not delegate anything to his employees. The owner-manufacturer micro-managed the company and it led him to default. Others talked openly about another defunct textiles company's owner committing fraud and making a fool of all the lenders.

The following few paragraphs are meant to give a feeling of the range of respondents' reactions and attitudes.

There were some leading textiles manufacturers who spoke at length and indulged in the process of the interview to a great extent. Others thought they needed to get over with it as soon as possible and get back to their work. The obvious corollary would be that the busier the person was or the most important the person was, the less time he²⁷ would have had for the interview. For example, an owner of the leading textile company in Karachi had very little time for the interview. He gave very brief answers and went for his coat as I was asking the last question. However, his cousin who is an owner of another successful textile company took great pride in describing his achievements of getting a new textiles mill running. One owner of a large public textiles mill in Faisalabad also gave a very brief interview. However, the owners of two large sister companies in Lahore which belong to the Shaikh family took lots of time not only to narrate their own stories but to also connect it with the wider issues of political economy. So, the link between a 'big group' and 'less interview time' is not that straightforward.

Two owners of defaulter companies in Lahore spoke candidly about why their companies had to default. However, there were other defaulters in the list as well who did not mention that their companies have defaulted since I did not know about it. I found out their default information from the State bank of Pakistan's confidential database afterwards using the local research think-tank's high-powered professional connections.

The owners of the large textile mills were often part of large business groups. Such groups generally had businesses other than textiles such as the cement or banking or chemicals. They often spoke on the behalf of the group rather than just being the textiles manufacturers and they had to be brought back to focus on the textiles sector.

The owner of a large textiles company in Karachi spoke very eloquently about the threats he had to face because he refused to pay the extortion money to the ethnic parties in the mid-1990s. These ethnic parties control the city. Hence, his company had to default for two years.

The son of the owner of the largest textile mill in Pakistan spoke very openly about the hostility of the Pakistan People's Party government towards his business group. While, an informed seasoned journalist in Islamabad told me how the owner of the largest

²⁷ Textiles manufacturers are all men. There was one woman who had taken up the family business after her father passed away suddenly but she was not available for the interview.

textiles mill was given a bank as part of the privatisation process by Pakistan Muslim League (Nawaz)'s government in 1991 despite the fact that he was not the highest bidder. Pakistan People's Party and Pakistan Muslim League (Nawaz) were bitter political rivals in the 1990s.

4.3.3. General Sales Tax (in VAT mode) Fieldwork:

The General Sales Tax (GST)/Value Added Tax (VAT) fieldwork was the most fruitful fieldwork in terms of the thesis despite its brevity. It was done in March-April 2005. To facilitate the meetings a letter was written to the Chairman of the Central Board of Revenue (CBR), which is a very powerful position in the government bureaucracy. Due to General Musharraf's overall policy of hiring technocrats to head various departments, Abdullah Yusuf, the Chairman, was a professional. He forwarded my fax to three wings within the CBR: Research Wing, Tax Reform Wing and Sales Tax Wing (VAT). These wings replied saying that they would be happy to help out with the research, and then interviews with representatives of the three wings followed. Two senior members of the Sales Tax Wing gave very candid interviews highlighting the high level of resistance put up by the capitalists and the intermediate classes to the taxation efforts via GST/VAT. These interviews provided significant insights for the research.

Various CBR Wings gave me their taxation reports etc which were meant for public sharing. The Sales Tax (VAT) Wing was requested to provide their internal documents from 1999 to 2004 that could throw light on how various measures were being taken and what justifications were being given within the department. I knew I was pushing my luck. The Pakistani bureaucracy is very protective of its internal reports which are never officially shared with the public. I wanted to study some primary documents and must have been persuasive. Luckily they agreed to share their internal memos and files on how decision were internally made and justified!

Chapter 6 on GST/VAT is relatively short, yet it is very informative. Studying the rule-violating behaviour is not at all easy anywhere or in Pakistan. Those indulging in under the table transfers and rents resist making them public. There was no easy way to document the rule-violating behaviour. During the textiles manufacturers' interviews in Faisalabad before the GST/VAT fieldwork, candid discussions with some textiles manufacturers revealed information about the 'fake and flying' invoices that were used to claim fraudulent refunds from the GST/VAT authorities. This information was given

by the manufacturers who themselves claimed not to be involved in receiving fake refunds but were upset that their competitors got them. Hence, they candidly talked to me about it. I was briefed about them before I went to the CBR office. I had understood that the Pakistani capitalists were resisting attempts to tax them or regulate them and were sabotaging them through various measures.

I wanted to get internal CBR files to see how the manufacturers' attempts at evasion made the tax authorities change its course of action. This was made clear by the Sales Tax officials. I also got the internal files which I read in the light of CBR and textiles manufacturers interviews. This was the big breakthrough for the thesis.

4.3.3. Securities and Exchange Commission of Pakistan's Fieldwork:

Securities and Exchange Commission of Pakistan came into being to regulate the capital sector and non-banking institutions in 1999 through a large ADB fund. The 'success' in getting the CBR documents could not be repeated with the SECP. I repeated my request for access to internal SECP documents that could throw light on the level of success of the SECP's attempts to regulate the capital market. The SECP refused. They only gave their annual reports which have been used in Chapter 7.

Hence, the level of evidence is less in comparison to the GST/VAT Chapter 6. To supplement the SECP case study the thesis considers the listings and delisting of the public companies in the Stock Exchange reports. Since the SECP came into power, the public listed companies started to delist themselves as they were not happy being regulated. This is a crucial empirical finding. I have also conducted in-depth key informant interview with someone who was formerly in a very high-up position in the SECP. This interview threw light on the SECP's 'failures' which no report could have revealed. He was very knowledgeable and very open source of information, so I have used finding from this interview extensively. I also used my interviews with the textiles manufacturers regarding corporate governance in Chapter 7.

From within the IFIs, the ADB was most unwilling to share information. The ADB funded both the SECP and the Access to Justice Programme (AJP). Repeated requests to the ADB, even through informal channels did not yield much. One ADB official was however interviewed; however, he did not deal either with the SECP or the AJP. Even

after the formal fieldwork, I made repeated requests to the ADB for access to documents but never got a response.

Of the IFIs, the World Bank was most cooperative. Access to their public documents was easy and various officials working for the World Bank made themselves available for interviews. The IMF has a very small presence within Pakistan despite their funding the government. Yet, the IMF was accessible and their public documents were available on the internet. Due to lack of cooperation on the behalf of the ADB and the SECP, the SECP case study is not as strong as it could have been. Similarly, I could not do a case study on the ADB's judicial reforms due to data not being made available despite many attempts. This despite the fact that I had written up the background on judicial reforms efforts before the ADB intervention.

5. General Note about Anonymous Sources:

Total 91 key informant interviews were conducted for the thesis: 64 from the textiles sector and 27 of other stakeholders and government officials. I have kept the names of textiles manufacturers, government officials, the IFIs representatives and other stakeholders anonymous to follow the research protocols.

The list of interviews is given at the end of bibliography.

6. Operationalisation of terms: the “rule of law” and “caste capitalism”

It is important to state how terms such as the “rule of law” and “caste capitalism” are being used in the thesis and how they need to be contextualised and the methodological difficulties regarding the use of such terms.

The thesis is looking at the interrelationship between political economy and the rule of law in the context of IFIs institutional governance reforms and the textiles sector. It is trying to assess how IFIs institutional governance reforms meant to push for the “rule of law” in Pakistan are being resisted by the Pakistani capitalists and intermediate classes. The thesis labels this resistance as rule-violating behaviour. Such behaviour is part of the process of transition of a traditional society to a modern “Weberian” state.

An obvious criticism of such an approach to contextualise the rule-violating behaviour could be to box such an approach in binary constructions of ‘South’ versus ‘North’. In other words, a criticism of such an approach could be levelled as follows: the thesis

implies that the rule of law is weak in Pakistan and efforts to supplement the rule of law by IFIs and to rule-based governance is being resisted by Pakistan capital as if it *only* happens in Pakistan or in the ‘South’ and not in the developed ‘North’? In other words, the obvious criticism is that the “rule of law” is resisted and subverted everywhere be it ‘South’ or ‘North’. Rule-violating behaviour is taking place in the ‘North’ in terms of criminality etc; rule-based governance is resisted everywhere and “caste capitalism” or accumulation through “social structures of accumulation” (Harriss-White, 2003) takes place everywhere be it Pakistan or ‘North’. So what is the specific case that the thesis is trying to build for Pakistan? Is it to say that Pakistani capitalists and intermediate classes are “bad” and the IFIs are trying to do “good” for Pakistan in a paternalistic manner? It is a very serious criticism and needs to be addressed.

The thesis deals with it by not juxtaposing it as a ‘South’ versus ‘North’ or ‘East’ versus ‘West’ phenomenon. While, the impersonalised Weberian state being pushed by the IFIs possibly does not exist anywhere in the “ideal” form. Yet, it is a historical fact that the rule-based governance is established in the ‘North’ as close to the “ideal” type as possible. However, it does not mean that rule-violating behaviour, rents generation, patronage does not exist in the ‘North’ in some limited form. It also does not mean that ‘caste capitalism’ is not present in the transnational corporations in the ‘North’. It may well be. It is, however, not a concern for the thesis for the reasons listed below:

- 1) The thesis is not posed as the ‘North’ versus ‘South’ comparison. It is not making an ethical or moral judgement that illegal transfer of property rights and rents generation is bad in the ‘South’ while the ‘Northern’ countries work according to the rule of law. The thesis makes a clear statement about Pakistan as it is a case study of Pakistan. Such a concern will be an issue of methodology for any comparative study;
- 2) The degree of intensity is also quite relevant here. Even if the rule-violating behaviour exists in the ‘North’; even if ‘caste capitalism’ exists in the corporate sector of the ‘North’; even if the rule-based governance is being resisted in the pockets of the ‘North’; the real issue is the prevalence and degree of intensity. Pakistan is amongst the worst tax earners amongst the middle income countries of the world. Pakistan’s largest formal manufacturing sector i.e. the textiles is dominated by the two castes of Memons and Chiniotis. It is a fact. Not analysing

it and not contextualising it in its proper historical specificity is not an option either. The thesis looks at Pakistan in the category of group of countries who are in the phase of transition towards a modern “Weberian” state. The thesis focuses on Pakistan and grapples with the question how is it transitioning towards a modern state. It is a valid question to ask. The attempts of Pakistani capitalists and intermediate classes to resist and subvert the IFIs ‘reforms’ pushing for the rule-based governance is actually an effort to de-intensify legal relations rather than intensify legal relations. The level of comparability and congruity with similar level or different levels of intensification of legal relations is really a work of comparative analysis; something that this thesis does not claim to be carrying out.

Having said that it is still important to qualify how thesis is using the terms like the “rule of law” or the “rule-based governance”. The thesis infers these terms on the basis of interpretation of the IFIs documents on contemporary Pakistan. IFI documents call for ‘government effectiveness’, accountability, transparency, increased revenues, justice system reforms, automation of procedures be they property records or refunds procedures in General Sales Tax (GST)/Value Added Tax (VAT), better accounting methods, well-regulated capital sector and civil service reforms. These reforms are meant to establish the “rule of law” essentially for intra-capital relations, for capital’s relation with the state and better accounting methods within the government. They are the institutional governance extension of IFI’s larger pro-market neo-liberal agenda. Hence, when the thesis uses the “rule of law”; it essentially means the “rule of law” for intra-capital relations and for capital’s relationship with the state where there is level playing field for the capital. IFIs’ vision of the “rule of law” does not include labour or other dispossessed. There is no mention of the enforcement of labour laws or supervision of programmes meant for the welfare of labour or extending the formalisation of labour. Though, the justice system reforms are meant for everyone particularly when reforms are targeting the subordinate judiciary in Pakistan. There is the lip service to poverty reduction and growth strategy and the poor being able to get justice or the poor being able to have secure property rights. However, the essence of the need for a well-functioning justice system lies in where contracts are honoured, so that capitalist relations can

prosper and the rule-based governance can take place. It is a specific notion of the rule of law.

The “rule-based governance” is, again, derived from the IFIs documents. It means conformity to the “Weberian” notions of a modern state as discussed in Chapter 2. It also means that the state and society work according to the rules and regulations by providing a level playing field. The rules work in the realm of formality and as a phenomenon contribute to the intensification of legal relations and Weberian impersonalisation.

Chapter 5. Impact of the Structural Adjustment Policies of the International Financial Institutions (IFIs) on the Economic and Institutional Governance Structures in Pakistan

This chapter focuses on the role of IFIs and the structural adjustment policies in economic management and evolution of institutional and legal structures in Pakistan. Its first section reviews key IFIs-driven structural adjustment policies in the realm of economy from 1988 onwards. Section two discusses the legal and institutional issues. The chapter gives an overview of the economic and institutional governance reforms IFIs advocated in Pakistan from 1988 to 2004 in the context of the relationship between the political economy and the rule of law. The chapter draws on secondary material and primary IFIs documents. The detailed case studies start from the next Chapter 6.

5.1. Introduction

The structural adjustment programme is essentially a sequence of reforms inspired by the neo-liberal school of thinking. Structural adjustment is based on an economic philosophy whose main elements are “liberalization, deregulation and privatization” of the economy. Structural adjustment policies were first implemented in the industrialized countries in the post-1973 oil crisis period to check inflation, tighten monetary and fiscal balance and liberalise trade. After their implementation in parts of the developed world, similar prescriptions were made for the developing countries. In the 1980s, they were “exported” to the developing countries as a panacea for economic problems. These policies had huge impact on the economy and politics of developing countries, including Pakistan. They aimed to replace the state led economic management with market driven forces (Ghai, 1992). Therefore, the basic tenet of the structural adjustment programme is a shift of focus from government controlled to private sector run economy to reduce fiscal deficit. Economic structures in trade, financial, fiscal, monetary sectors underwent a liberalization transformation during the structural adjustment (SA) reforms.²⁸

Foreign aid, particularly from the US, has always played a crucial role in the economic development of Pakistan. As mentioned in the Introduction, the liberal industrial credits in the 1950s and 1960s and also in the 1980s were bankrolled by US aid. Pakistan’s

²⁸ These general points are mentioned in most of the literature on SA reforms.

impressive growth since the late 1950s would not have been possible without foreign aid. This greatly boosted the private sector and import substitution industrialisation: “Pakistan’s growth in the 1960s, and the policies pursued were contingent upon the country receiving a substantial amount of foreign aid. Once the aid stopped, so did growth in the economy” (Zaidi, 2005, pp. 100-101).

Foreign aid and strategic factors were also important in the political economy of the Zia regime (1977-88). During this period, Pakistan earned remittances, particularly from the Gulf States, through employment policy started by Bhutto’s government (1972-77). Substantial military and economic aid was given by the US due to Pakistan’s role as the front-line state in the war in Afghanistan. The aid helped to keep inflation low in the 1980s and largely kept the middle classes away from joining anti-government political alliance (Zaidi, 2005; Sayeed, 1995; Sayeed, 2002; Rizvi, 2000). Foreign aid again played an important role in the consumerism-driven economy of the Musharraf regime (1999-2008). It was US aid, soft terms of the IFIs lending, and increased foreign remittances in the Musharraf era that led to economic growth discussed in Chapter 3.

The influence of the International Financial Institutions (IFIs) needs to be seen in the above mentioned context. IFIs, particularly the IMF and the World Bank, dominated Pakistan’s economic policy since 1988 under the guise of the Structural Adjustment Programmes. The core of the structural adjustment regime has been that the IMF provides the necessary balance of payments support to Pakistan while imposing strict conditionalities on its loans. The IMF’s influence on Pakistan’s economy began in 1980 through its Extended Fund Facility programme, closely propped by sectoral and structural adjustment loans by the World Bank. A more intense Structural Adjustment Programme started in 1988. This programme had various requirements for the industrial sector: de-regulate decision-making in business, divest public sector corporations’ share to the private sector, increase efficiency in the public sector through corporate rationalisation, improve incentives to exports, decrease protection to the industrial sector, and reduce import barriers and tariffs (Zaidi, 2005).

The reliance of Pakistan on the World Bank has been quite strong since the 1960s. The Bank mediated the negotiations of the Indus Water Treaty between India and Pakistan. Similarly, the ADB has long been working with Pakistan on various projects concerning infrastructure development.

In the 1980s, the economic relationship was broadened between Pakistan and the IFIs in the form of structural adjustment reforms due to the fiscal deficit and initiation of denationalisation. The stated objectives were to achieve macroeconomic stabilisation, privatization, revenue-generation, and tariff reduction. Structural adjustment policies advocated measures such as revenue generation through the General Sales Tax (GST), exports competitiveness, removal of pricing distortion, and institutional reforms for agricultural production (World Bank, *Pakistan and the World Bank*²⁹).

The extensive phase of Structural Adjustment Programme (SAP) can be roughly divided into four phases. The first phase (1989-91) steamrolled reforms such as the imposition of General Sales Tax (GST), liberalization of exchange rate, imports and share prices, cut in government subsidies, regulation of financial institutions, improvement in financial reporting, trade liberalization through a cut down in non-tariff barriers and privatisation. Most of these policies were implemented in 1991. The second phase (1994-97) emphasized revenue generation measures, tightening of government expenditure, elimination of tax exemptions, levying income tax on agricultural income, further reductions in tariffs, increase in the scope of GST in the Value Added Tax (VAT) mode, surge in utility prices and strengthening the regulatory role of the State Bank of Pakistan (SBP), devaluation and privatisation. The third phase (1997-1999) included the “second generation” reforms such as the autonomy of the SBP, enactment of the Banking Companies Act for recovery of loans, further reduction in tariffs and devaluation. Pakistan tested its nuclear device in 1998, froze foreign currency accounts and lost out on the economic front. The fourth phase (1999-2004) further strengthened the SBP’s autonomy by making it a part of the constitution. It also focused on the Central Board of Revenue (CBR) reforms. Anti-corruption measures through the National Accountability Bureau (NAB) were also part of it. There was also collaboration with the Asian Development Bank on *Access to Justice Programme* (AJP). The government also participated in a World Bank’s project to improve the government’s audit and accounts functions (Zaidi, 1999; World Bank, 2002).

The SA credit was initially earmarked for short periods i.e. from one to three years and the extensions would follow suit. Usually, Pakistan was unable to meet the credit conditions and was given only half or less of the sanctioned money by the IMF. In some

²⁹ The year of publication is not mentioned in this booklet. However, a look inside the book reveals that it was published around the mid-1980s.

cases, it got close to two-thirds of the sanctioned amount and in others much less than even half of it. However, in no instances before 2000, it was able to draw all the sanctioned money. So the SA phase that was initially supposed to last for a short period to undertake drastic and surgical changes in Pakistan's economy lasted for fifteen years till 2004. The Musharraf government announced non-renewal of the Poverty Reduction and Growth Facility (PRGF) with the IMF after its expiry in December 2004 (International Monetary Fund, 2002a).

5.2. Analysis of Structural Adjustment Policies

Analyses of SA policies are highly loaded. Pro-SA reforms viewpoint that reforms should have been carried out a decade earlier in 1980s while the critical SA positions also vary from questioning "sequencing of reforms" to substantial criticism.

The SA reforms' underlying theory is that high fiscal deficit is the cause of most ills of the economy. High fiscal deficits were experienced as a result of expansion in the public sector since 1970s and it continued till 1990s. Fiscal deficit was financed by bank borrowings and it led to high levels of inflation that in turn discouraged "private investment" and economic growth suffered. Had governments managed the macroeconomic balances better by controlling fiscal deficits, it would have led to higher growth levels (Haque and Montiel, 1997). A rather strong pro-SA reforms view is that had the financial sector reforms taken place a decade earlier in 1980s rather than in 1990s, it would have led to financial deepening. Pakistan missed about 5 per cent added real output every year by delaying structural adjustment reforms (Hasan and Khan, 1996).

Another analysis testing the relationship between SA lending and Pakistan's macroeconomic variables suggests that increase in inflation and lessening of productivity had virtually no impact on exports. On the other hand, capital formation and government's "current consumption" increased due to the SA lending (Iqbal, 1994). The last point is interesting because the SA lending is directed at decreasing government expenditure. However, substantial resources are needed to undertake "structural" reforms, so that government consumption increases invariably.

The critical view is that SA policies led Pakistan to an era of “poverty, low growth, low savings, and low investment”. One of the prescriptions of SA policies was to liberalise interest rates in order to boost savings and narrow the savings-investment gap. Another recommendation was to devalue the currency to boost exports. Both these hypotheses did not produce the expected results. Shahrukh Khan found no evidence of a link between interest rate liberalization and increase in savings, investment and growth. On the other hand, apprehensions are that high interest rates might have crippled the small industry by increasing the price of capital and making industrial investment unsustainable, particularly for the small industries. Moreover, there was no significant increase in exports either (Khan, Shahrukh, 1999; Khan, Shahrukh, 1999a; Ahmad, 1999).

Another strong criticism of SA policies is that the conditions laid out by IFIs contradicted each other. High debt servicing ratio and decrease in the revenue was compounded by the liberalization measures taken by the government. Doing away of the trade and exchange controls cut on the government’s prospects of raising the tax revenues. Though, fiscal deficit philosophy focused on reduction of the government’s current expenditure and raising revenues (Haque and Montiel, 1997; Ghayur, 2001). It seems to have the opposite effect.

Contradictions in structural adjustment reforms are borne at by the fact that the primary IMF condition of cutting down the fiscal deficit conflicts with another IMF condition of generating more revenues. Fiscal deficit is cut by tightening government expenditure, including government’s expenditure on infrastructure development. Whereas, infrastructure investment is critical to push productivity. Tightening government expenditure generally results in decreased spending on infrastructural and social development. Therefore, cut in the government expenditure brings down the level of economic productivity. A decrease in the productivity means that there is less income available to tax. Decrease in government expenditure and revenue generation are contradictory conditions, at least in the short run (Khan, Shahrukh, 1999; Khan, Shahrukh, 1999a; Ahmad, 1999).

Another SA condition suggested cutting down tariff rates and abolishing non-tariff barriers. Again, this condition clashed with the objective of increasing revenue collection. Decrease in revenue due to tariff liberalization and cut in import duties had to be financed through some other means. It led to generating revenue through indirect

taxation. One better way of sequencing SA policies could have been to first reform the tax administration and expand its capacity to raise more direct taxes and then cut down tariffs and import duties. Similarly, interest rate liberalization had adverse impact on the manufacturing sector (Khan, Shahrukh, 1999; Khan, Shahrukh, 1999a; Ahmad, 1999). It is interesting to read the admission of mess-up of SA policies in an IMF report:

“The repeated attempts to stabilize the economy without following through with structural reforms pushed the economy in a mire of vicious circles. In particular, increased taxation on a shrinking tax base has led to further shrinkage in the tax base due to tax evasion and the expansion of the underground economy, calling for further hikes in taxation. Sluggish budgetary revenues have led to cuts in public investment and production and reinforcing the weakness in revenues. Low employment generation by the private sector has been partly compensated for by overstaffing in the public sector, which has further depressed its efficiency. Double-digit inflation has created the need for nominal depreciation, which has fed back into inflation. Declining profitability in the banking system has depressed the rate of return on bank deposits, leading to intermediation which in turn has led to a further decline in bank profitability. More broadly, the Pakistani economy has continued to be trapped in the vicious circle of *poverty, low growth, low savings, and low investment, which further hampers growth and poverty alleviation* (emphasis added). Moreover, these structural problems have eroded the institutional fabric of the society and contributed to a deterioration in governance and in security conditions” (International Monetary Fund, 1997, p. 5).

This is by far the most critical comment in the IFI report. The general feedback in IFI reports is that the fault lies in the implementation. For example, it is noted that tax collection has been spoiled by various concessions and exemptions given by the government through Statutory Regulatory Orders (SROs). The underlying message is that had it not been for these concessions given by the government against the spirit of SA policies, the government would have been close to meeting its revenue targets. A political economy analysis explaining the rationale for granting SROs-led special concessions is missing from the IFIs analysis.

It is yet to be determined if these mutually contradictory reforms could have been sequenced better. According to a key informant interview, “IFIs were too well aware of the contradictions of SA policies... They had come to the conclusion that the only way the government is going to reform and put its house in order is if it does not have any financing alternatives left” (Interview with an ADB official on June 25, 2004). It partly explains why IMF kept on negotiating new Structural Adjustment Facility, Extended Structural Adjustment Facility, and Stand-by Arrangement loans. IFIs might have known too well that these strict SA conditions cannot be fully implemented. They might have wanted to keep the pressure on the government to restructure towards market-oriented reforms while not opening the purse strings too generously and making the government to make hard choices to fit the bill.

SA prescribed macroeconomic stabilization and reduction in the fiscal deficit translated into cut in the development expenditure, unemployment, movement of labour from the formal to the informal and home-based sectors, a substantial reduction in (food, agricultural and utilities) subsidies, imposition of recessionary taxes and hike in petroleum prices. These measures had a huge impact on the prevalence of poverty. The structural adjustment policies hit the poor and labour the most. Removal of subsidies on grains and utilities directly affected the poor and curtailed increase in wages. Therefore, it is not surprising that poverty increased considerably in the decade of 1990s. It increased from 25 per cent of people living below the poverty line in mid-1980s to 39 per cent people living below the poverty line by end 1990s. The gini-coefficient that measures the level of inequality in a country³⁰ went up from 0.34 to 0.41. The poor and lower middle classes bore the brunt of hard choices due to the government’s decision to drastically cut down the development expenditure. The defence expenditure, though, was merely frozen in real terms during the difficult years in the SA phase (Khan, Shahrukh, 1999; Khan, Shahrukh, 1999a, Kemal, 1994).

5.3. IFIs and the Institutional Legal Structures

The SAP has a complex relationship with the legal structures and development of capitalism. The IFIs do not favour an import-substitution-industrialization (ISI) policy in developing countries. Their main focus is on belt-tightening fiscal and monetary reforms.

³⁰ The values of gini co-efficient vary from 0.0 to 1.0. The higher the gini coefficient i.e. the more it is close to 1.0, the higher the level of inequality in the country.

Conditions imposed by SA loans and technical assistance nudge countries towards macroeconomic stabilization rather than spending resources on protection of capital and intermediate goods industries. Therefore, it is the promotion of well-accounted, well-managed and fiscally-stable structures that IFIs would like to see established in Pakistan. It is a fundamental point to note when looking at the relationship between IFIs and the legal structures in Pakistan. The concept of “government effectiveness” in essence translates into minimization of government’s role as an effective regulator of macroeconomic stabilization and market economy growth policies.

The World Bank’s 2003-05³¹ *Pakistan Country Assistance Strategy (CAS)*³² gives extensive details of the economic-legal structures in Pakistan. The focus is on governance issues and strengthening of legal structures. CAS’s section on “Restoring the Integrity and Accountability of State Institutions” gives details of the governance related reforms undertaken by Pakistan for improving its effectiveness. The primary economic governance institutions listed in CAS are the Central Board of Revenue (CBR), the Central Bank of Pakistan (SBP), the Auditor General and Comptroller of Accounts, the judicial system, police and the civil service. The performance of these institutes is judged by their ability in “public financial management, accountability, and increased transparency and information” (World Bank, 2002, p. 9). Privatization is also linked to governance issues in terms of its ability to check rent-seeking and corruption. Similarly, the ADB’s *Country Strategy and Program* focuses on the governance issues, tax reforms, civil service reforms and support for the devolution programme (World Bank, 2002; Asian Development Bank, 2003a).

The IFIs documents set the parameters for the “second generation reforms”. These reforms essentially focus on the state’s ability to earn its revenues through reforms in the tax structures, enable the Central Bank to monitor government’s borrowing independently, and improve its accounting capabilities. They also call for the devolution of power at the local level, and passage of *Freedom of Information Act* to improve transparency. The ADB attempted to implement an extensive *Access to Justice Program*³³. The overall focus shifted to soft and sophisticated issues of economic

³¹ Though, it was published in 2002.

³² IFIs documents do not give details of their conditionalities attached in IMF and World Bank agreements. They only discuss the developments that take place in the member country in the context of their interests.

³³ It largely failed to reach its objectives.

governance from financial tight-belted centred first generation SA reforms. However, the focus on tax collection is common in the first and second generation reforms.

The relationship between legal structures³⁴ and economic institutions is quite complex in the context of structural adjustment policies of the IFIs. Although, the overarching ideology is the minimisation of state's role and maximization of the market regulated economy, yet two dialectical trends are discernible regarding the IFI's relationship with the emergence of the legal structures:

- 1) The IFIs advocate legal structures that enhance an authentic recording, documentation, compilation, and dissemination of data on economic interactions. They also promote autonomy and independence of institutes that can play the role of a watch-dog. They support enactment of legislation and the "rule of law" to ensure "government effectiveness" regarding revenue generation and improved taxation, modernized audit and accounts institution, regulation of government borrowing, supervision of prudential regulations of banks through an autonomous central bank, oversight of the public and private companies by a securities regulatory body, accountability through a permanent national bureau and access to information through enactment of the *Freedom of Information Ordinance*;
- 2) On the other hand, IFIs prescribe reduction, minimization and possible elimination of legal structures that were introduced by the state in its central planning phase of economic management. They wanted to end the government's role in levying import and custom duties, granting import licenses, issuing tax and other exemptions, concessions, and holidays through Statutory Regulatory

³⁴ The World Bank's priorities for "Government Effectiveness" are also listed in the formulation of its Millennium Development Goals in which the "effectiveness" is linked with "macro stability, fiscal reform, governance reform and devolution" and Business Climate is linked to "political/macro stability, incentive/regulatory regime for power, oil, gas and ICT (Information and Communication Technology), financial services, infrastructure services, manufacturing and services, agriculture and water" and pro-poor growth is linked with "education reform, health reform, rural development, gender equity and social protection." In terms of strategizing itself in various categories, the Bank identifies its various priorities along the contours of its level of "engagement". Taking the lead from the government's commitment and policies, the "Areas of Deep Engagement" are "economic management and financial governance, including technical and financial assistance to the State Bank of Pakistan (SBP), the Comptroller General of Accounts (CGA), the Auditor General's Office (AG), support for the reforms of the Central Board of Revenue, the civil service, investment climate (including support to reform the governance and regulatory environment for power, gas, oil, financial sector, pricing and tariff reforms, and privatization), provincial and district governments reforms, education, health, water management and rural development, district services, and community infrastructure. Among "Reformed" and "High" on the list are "financial public goods" (World Bank, 2002, pp. 13-19).

Ordinances (SROs), recording foreign exchange movement etc. IFIs advocated dismantling of those rules and laws that augment the powers of government whether discretionary or otherwise. They justified it on the grounds of reducing rent-seeking, checking abuse of government's discretionary powers, promoting effective governance and transparency.

It is important to understand these dialectical trends in the IFIs policies regarding the role of law in economy. These trends are not mutually exclusive. They often co-exist. The thesis contends, as stated earlier, that IFIs want the “rule of law” for intra-capital relations on the one hand and for capital's relation with the state on the other. Their conception of the “rule of law” and “government effectiveness” is based on the conceptions of the rule-based governance where capital operates on the principle of playing level playing field based on rules and where there is sanctity of contract.

It is worthwhile to look at the government's viewpoint on the relationship between law and economic structures. The significance of the legal structures for economic growth was strongly emphasized in an article on “Legal Framework for Economic Development in Pakistan” posted on the government's website:,

“Economic development does not take place in a vacuum. It requires an enabling environment, which includes *a proper legal and regulatory framework* (emphasis added). The Government plans to lay down such an orderly framework for carrying out its economic reforms... the Government has... formulated an extensive legislative agenda cutting across various sectors of the economy, including the banking and financial sectors, commerce and industry sectors, energy sector, information technology sector, social sector, and last but not the least the administrative and judicial system” (Hassan, 2000, p. 1).

The government's vision of the legal structure needed for economic reforms is similar to the need of “government effectiveness” drummed by IFIs in their reports. It reflects a clear alignment of the government's position with the IFIs or the latter's influence on the former, at least in terms of the stated policies.

Just like the above quote from the government's source, the emphasis in the World Bank's report is on “government effectiveness” through transparency and fair play. It

recommends improvement in the CBR functional operations, introduction of fiscal framework, reactivation of the Public Accounts Committee (PAC), institutionalization of the accountability process through a permanent accountability bureau, a comprehensive financial accountability of the processes of budget making, reforms in financial reporting, accounting, auditing, corporate governance and civil service (World Bank, 2002).

As stated earlier, the issues identified in the World Bank document are the same as by the government. The difference is in the emphasis. For example, the government has followed the re-activation of PAC. The IFIs good governance recommendations had to negotiate through the ground realities during the process of implementation. For example, the PAC banned entry of journalists in its meeting in July 2004. The political governments since 1988 did not take PAC seriously and according to one estimate around “550 audit reports containing 28000 audit paras against those governments are still pending with the PAC since 1988” (Klasra, 2004). These pending reports concern politicians from both the treasury and opposition benches (Klasra, 2004). The IFIs much-trumpeted transparency cannot be ensured through memorandums of understanding signed by the government only. The IFIs prescriptions do not take into account the prevalent power structures, the distribution and configuration of power, hence, they do not properly analyse the active and passive resistance to their reforms.

In the Bank’s vision, the role of government is to act as a regulator only and not intervene or plan the economy. This vision is not in consonance with the state-led planning and industrialization model that was pursued in Pakistan in the 1960s. While, there was little mention of growth in large-scale manufacturing in the World Bank documents, the emphasis was on regulations. The structural adjustment rationale of the IFIs advocates monetary and fiscal balance as the panacea. They also advocate the legal and regulatory framework for economic management. They do not focus on the industrial productivity and transition to dynamic capitalism. Instead, their emphasis is on fiscal management, government effectiveness, and financial accountability.

The IFIs’ vision in the realm of law is on documentation, recoding, accounting of economic activities. This is to change the nature of the informal economy to a formal one by bringing it on record. Recommended measures such as financial regulation and accountability, documentation of economy, limiting state’s discretionary powers point to

a framework where the government is deprived of its discretionary powers to distribute patronage. IFIs advocate an economic management and “good governance” paradigm. IFIs formulated rule-based reforms do not focus on the need to balance between the political and economic structures that can allow growth to take place.

Conclusion

The IFIs promoted structural adjustment policies that focused on fiscal, monetary, exchange, and trade sectors, particularly from 1988 onwards. The main thrust of the reforms has been stabilization, i.e. cut the fiscal deficit, generate revenues and tighten government’s expenditure. These policies called for reducing the government’s role in running the economy and promoting the market-led alternative. The salient features of the reforms were tariffs, foreign exchange, and interest rate liberalization, cut in subsidies, increase revenue generation and reduction in the fiscal deficit.

The IFIs focus shifted from macroeconomic stabilization (the hallmark of the initial structural adjustment period) to issues of economic and financial governance by the mid-1990s. The legal structures advocated by IFIs went hand in glove with the first generation of economic reforms, some of which were still in the process of implementation. Deregulation and privatization were mentioned time and again in governance reforms. The rationale was that it would decrease the potential for rent-seeking and boost market-oriented private investment.

Other measures of second generation reforms were the autonomy of the State Bank of Pakistan; establishment of regulatory bodies in the vital sectors of economy; setting up of Securities and Exchange Commission of Pakistan; enactment of laws and ordinances related to accountability; improvement in the audits and accounts. This regulatory paraphernalia was needed to steer the stabilization and economic reforms.

The SA policies have been criticized for bad “sequencing” of reforms which caused an adverse impact on the poor and lower middle class groups. The SA reforms were often contradictory. Devaluations and low interest rates did not lead to growth of exports. Cut in government expenditure did not decrease the budget deficit or avert foreign exchange crises. Cut in tariffs did not increase the government’s revenues. Implementation of the SA policies is as much an ideological issue as an economic or political one.

The main problem with economic management and governance model is that it is being superimposed on the socio-economic and political structures that are not in harmony with it. It explains the resistance being put up to almost the IFIs prescribed reforms ranging from audit and accounting, taxation, civil service to eliminating exemptions. The IFIs reports interpret such resistance as an expression of political clout of certain interest groups who benefit from the status-quo. Resistance is equated with bad politics as opposed to the clean implementation of the rule-based management. Such resistance is certainly political and it does favour certain groups and factions at the cost of others. It is, however, rooted in the socio-economic and political structures of developing countries like Pakistan. Therefore, it is important to understand those underlying power structures, the distribution of power in the society, politics of patronage and the processes of rent creation as discussed in Chapter 2.

The contestation between the forces who indulge in the rule-violating behaviour and the regime of rule-based governance is explored in the case study chapters to follow.

Chapter 6. General Sales Tax in Pakistan: Resistance to Implementation

The chapter begins with a brief global overview of the Value-Added Tax. It is followed by a discussion on the General Sales Tax (GST) in a Value-Added Mode (VAT) in Pakistan. Refunds system and resistance to it is discussed thereafter. It is followed by an analysis of the tax administration's internal documents. The scale and extent of the tax evasion is discussed towards the end.

The General Sales Tax (GST) was enforced in a Value-Added Tax (VAT) mode in Pakistan in 1990 to fulfil an important conditionality of the IMF's Structural Adjustment Loan. To study the relationship between the political economy and the rule of law, a case study of the General Sales Tax (in a Value-Added Tax mode) is an apt pointer to understand the contemporary taxation measures in Pakistan. Harriss-White (2003) calls tax evasion a form of subsidy. We analyse IMF's proposed General Sales Tax (GST)/Value-Added Tax (VAT) in terms of contestation over fiscal space between the forces who promote the rule-based governance and those who resist it. This chapter is based on primary documents, tax officials' and textile manufacturers' interviews, and secondary material. The chapter reviews the GST/VAT since 1990 with a particular focus on the 1999 to 2004 period.

How does VAT work? Output tax minus Input tax. Only value addition is taxed. Section 7 of the Sales Tax Act in Pakistan discusses in detail how VAT is supposed to work. Sales tax "be levied and collected on the difference between the value of supply for which the goods are acquired and the value of supply for which the goods are supplied". It is levied on "taxable supplies" by deducting input tax from output tax (Central Board of Revenue, 2005, *Sales Tax Act 1990*).

Table 6.1: Function of VAT

Here is an example of Comprehensive VAT:

Stage of Production and Distribution	(A) Value of Sales (Rs/Unit)	(B) Cost of Intermediate Goods (Rs/unit)	(C) Value Added (A-B)	(D) VAT (10% of C) (Rs/unit)	(E) Sales Tax (10% of A) (Rs/unit)	(F) Tax Credit for VAT paid on Intermediate Good (Rs/unit)	(G) Total VAT payable (E-F) (Rs/unit)
Cotton	24	0	24	2.4	2.4	0	2.4
Ginning	33	24	9	0.9	3.3	2.4	0.9
Spinning	60	33	27	2.7	6.0	3.3	2.7
Cloth	90	60	30	3.0	9.0	6.0	3.0
Retail	100	90	10	1.0	10.0	9.0	1.0
Total			100	10.0	30.7	20.7	10.0

Source: Lahore University of Management Sciences, 1990.

6.1. Brief Global Overview

It is worthwhile to briefly review the global picture on VAT before focusing on Pakistan. VAT has been in place for over 50 years in the world. It was first implemented in France in 1954 and it is being levied in more than 66 countries particularly since 1990 (Bird and Gendron, 2007; Fathi and Esmaeilian, 2012).

VAT was first introduced in the European Union (EU). The “real” operational VAT is closer to the EU model. The role of the IMF has been crucial in the in the adoption of VAT by many developing and transition economies (Bird and Gendron, 2007).

For developing and transitional economies, it is better to have a high threshold of VAT. For small firms, the compliance cost is high. Other problems with VAT are refunds fraud, fragile registration procedure and inadequate audit. It is considered better to start with a fresh VAT rather than overhauling an existing one. New VAT machinery can be established, from the scratch, in three years (Bird and Gendron, 2007).

The “self-controlling” feature of VAT is distinguishing where “payers of each successive way of VAT are claimants of paying other levels of tax” (Fathi and Esmaeliani, 2012, p. 2). However, when the trade is happening between registered and non-registered suppliers, such “self-controlling” mechanisms do not work too well. Data of 17 OECD countries from 1987 suggests that more expenditure on tax administration, low rate of VAT, extended period for VAT implementation and less “non-zero rates” improve collection of VAT overall. Data from 44 countries from 1970 to 1999 suggests that political factors such as stability and political participation have an influence on the efficiency of VAT (Fathi and Esmaeliani, 2012).

In Egypt, VAT was introduced in 1991. Initially, it only applied to importers and manufacturers. Egypt later tried to expand VAT to the retail trade and wholesale. This led to too many small firms getting registered without a corresponding increase in the revenues thereby putting burden on the VAT administration (Bird and Gendron, 2007).

Fraud and tax evasion of VAT has increased in the recent years. It is not easy to find a direct relationship between the rate of VAT and tax evasion as Spain, Italy and Greece have more than 20 percent tax evasion, one of the highest in the European Union while Denmark, Netherlands and Britain have only 5 percent tax evasion which is the lowest in the European Union. However, Denmark has the highest rate of VAT. Hence, the relationship between tax rate and tax evasion is not “decisive and definite” (Fathi and Esmaeliani, 2012, pp.3-4).

VAT was introduced in Greece in 1987 to regulate its indirect taxation after it joined the European Economic Council in early 1980s. Agapitos is of the view that the VAT evasion is more than 45 per cent in Greece. He also states that “less organized economies” have more tax evasion. By “less organized” Agapitos probably means less documented economies or economies where the rule of law is weak. He also explores the relationship between the direct and indirect taxation. According to him, the chances of tax evasion are higher in direct taxation rather than indirect taxation such as the VAT where authorities can detect tax evasion (Agapitos, 1999).

Agapitos mentions quite a few reasons for VAT tax evasion. However, other than the significant number of self-employed tax-payers and the nature of small businesses, none

of the other is really specific to VAT. Reasons such as lack of good public services, incompetence of tax authorities, high tax rates, excessive regulations, lack of automation, obscure rules etc are generally applicable to taxation in general and need not be specific to VAT (Agapitos, 1999).

Another critical issue for the implementation of VAT is to minimize the exemptions and “zero-rating”. Zero-rating means where you get refunds on your input tax and the output tax is zero. While imports are taxed and exports are generally zero-rated. Again, there are great variations. In Ireland, zero-rating is applicable to 12 percent of goods and services while in the UK, zero-rating applies to one-fifth of all transactions. Jamaican VAT, introduced in 1991, initially functioned with quite a few exemptions. Later on, Jamaica minimized them in the comprehensive reforms in 2003 (Bird and Gendron, 2007).

A major advantage of the VAT is the “self-enforcing” mechanism where each level of production and distribution gets documented by adjusting for output tax against the input tax. Since the transaction is between a seller and buyer, there is, therefore, more in-built check in the system as fraud requires both parties to be involved. In the case of VAT evasion, a “shell” company can be created that sells to itself and creates fraudulent invoices. Moreover, in fraudulent invoices, the value of exports could be increased through fraud. Exports that might not have taken place are falsely accounted for. Fake invoices is not only a refunds issue, it points to a deeper problem with the tax administration itself (Bird and Gendron, 2007).

6.2. The General Sales Tax in Pakistan

Sales tax has been operating in the country in non-VAT mode since 1948. The roots of the GST go back to the Government of India Act 1935 where the states/provinces had the right to levy sales tax on goods and the federal government on services. The Constituent Assembly of Pakistan reversed this order in 1948 and made the federal government responsible for a turnover style sales tax. In 1948, minimum turnover tax was set greater than Rs 5,000 and there were protests against this tax. A correction was made in 1951 and the Sales Tax Act was made applicable to consumption only. Taxation of Goods Order 1960 applied the sales tax to goods trading and manufacturing as well (Ahmad, Ehtisham, 2010; Ahmad, Shahid, 2004; Pasha, 1995; Lahore University of Management Sciences, 1990).

The federal government was made responsible for the sales tax on goods and the provinces were given the power to implement sales tax on services in the 1973 Constitution. Earlier, the income tax department was also responsible for administering the sales tax. However, General Zia's government made amendments in the sales tax in 1981 and 1982 and made the central excise department responsible for the sales tax. There were, however, massive exemptions granted till the Sales tax was changed into VAT mode in 1990. The extent of exemptions in pre-VAT mode were such the National Tax Reform Commission in its report in 1986 reported that had it not been for exemptions, tax receipts of Rs 4.6 billion would have been Rs 40 billion. Government of Pakistan signed the structural adjustment programme with the IMF in November 1988 and agreed to replace the prevalent sales tax with General Sales Tax in a VAT mode. IMF sense of "compulsion" was used for the implementation of VAT. In 1990, for the first time, a VAT style General Sales Tax was enacted. In 1993, Pakistan agreed with the IMF to broaden the base of sales tax and income tax and cutting down tariffs. It led to confrontation with traders of the country and business community. It was levied at goods at the manufacturing stage and on imports. Manufacturing goods had many exemptions given. GST was changed into a proper VAT in 1995-96. It was levied on imports in 1997 and on wholesale and retail in 1998 and on services in 2000 (Ahmad, Ehtisham, 2010; Ahmad, Shahid, 2004; Pasha, 1995; Lahore University of Management Sciences, 1990).

GST was levied at the rate of 12.5 percent in 1990 but was later increased to 15 percent. Tax was defined as follows "...there shall be charged, levied and paid a tax known as sales tax at the rate of fifteen per cent... Taxable supplies made by a registered person in the course or furtherance of any taxable activity carried on by him; and goods imported into Pakistan" (Central Board of Revenue, 2005, Section 1, *Sales Tax Act 1990*).

Registration is a requirement according to the Section 14 of the Sales Tax Act. Any manufacturer whose annual turnover is more than Rs two and half million and any retailer whose supplies are more than Rs one million is required to register with the Sales Tax authorities. Other than importers, wholesale dealers and distributors are also required to register. Registered persons are required to file monthly returns according to Section 26. There is also a provision for retail tax return. Book keeping and invoicing requirements are mentioned in Sections 22 and 23. Keeping records of goods purchased

and supplied is needed at registered offices, including records of zero-rated and exempted supplies. Similarly, details of tax invoices are also required to be maintained. Tax invoice has details of the person to whom the invoice is issued (Central Board of Revenue, 2005, *Sales Tax Act 1990*).

The tax is zero-rated on exports as per Section 4 of the Act. To discourage fake invoices of exports it clearly states that “nothing in this section shall apply in respect of a supply of goods which have been entered for export under Section 131 of the Customs Act, 1969 (IV of 1969), but are not exported” (Central Board of Revenue, 2005, *Sales Tax Act 1990*). This emphasis in the law could not deter fake or flying invoices, discussed in detail later in this chapter.

Certain rules were used to increase the documentation and registration compliance for the Sales Tax. According to Section 7, a distinction was made between taxable and non-taxable activities: “If a registered person deals in taxable and non-taxable supplies, he can reclaim only such proportion of the input tax as is attributable to taxable supplies”. Other than that a condition was laid out that only a registered person shall be able to claim input tax: “No person other than a registered person shall make any deduction or reclaim input tax in respect of taxable supplies made or to be made by him” (Central Board of Revenue, 2005, *Sales Tax Act 1990*).

Section 21 (2) of the Sales Tax Act blacklists a registered person or suspends his registration if he is found to be indulgent in fake invoices or tax evasion and/or fraud. However, it seems as if drafters of Sales Tax Act were aware of problems they were likely going to face in its compliance. Section 26AA states: “Notwithstanding the penalties prescribed in section 33, if a registered retailer wishes to file a revised return voluntarily along with deposit of the amount of tax short paid or amount of tax evaded along with additional tax, whenever it comes to his notice, before receipt of notice of audit, no penalty shall be recovered from him” (Central Board of Revenue, 2005, *Sales Tax Act 1990*). It seems as if the drafters of the Act were desperately trying to encourage a compliance with the Sales Tax Act by taking into the account the challenges they were likely to face.

The secondary literature on VAT is categorical about it being imposed to replace the revenue lost due to trade liberalisation in developing countries (Bird and Gendron, 2007; Ahmad, Ehtisham, 2010). The same scenario fits the Pakistan since 1990. Tariffs were brought down from 125 per cent in 1990-91³⁵ to 25 per cent in the late 1990s under the Structural Adjustment Programme that Pakistan signed with the IMF. International trade taxes were a major source of revenue in the form of customs duty. Tariffs came down to 80 per cent in 1993-94, 65 per cent in 1995-96. By end 1990s, there were four slabs of 5 per cent, 10 per cent, 20 per cent and 25 per cent applicable with maximum rate being 25 per cent. With decrease in tariffs, there was a need for another revenue source to compensate the revenue lost. VAT styled Sales Tax was designed to fill that gap (Central Board of Revenue, 2004; Pasha, 1995; Central Board of Revenue, 2003a; Central Board of Revenue, 2001).

Table 6.2: Tax/GDP Ratio Direct Taxes

Year	Income Tax	Other Direct Taxes	Total Direct Taxes
1998-99	3.5%	0.24%	3.75%
1999-00	3.35%	0.24%	3.59%
2000-01	3.43%	0.21%	3.64%
2001-02	3.76%	0.16%	3.93%
2002-03	3.62%	0.16%	3.78%

Source: Central Board of Revenue, 2004, *CBR Yearbook 2002-03*

Table 6.3: Tax/GDP Ratio Indirect Taxes

Year	Customs	Central Excise	Sales Tax	Total Indirect Taxes
1998-99	2.22%	2.07%	2.45%	6.75%
1999-00	1.96%	1.77%	3.71%	7.44%
2000-01	1.90%	1.43%	4.49%	7.82%
2001-02	1.32%	1.30%	4.59%	7.21%
2002-03	1.71%	1.11%	4.86%	7.68%

³⁵ In mid-1980s, tariffs were as high as 225 per cent. They were brought down to 125 per cent in 1990-91 and then reduced further.

Source: Central Board of Revenue, 2004, *CBR Yearbook 2002-03*

GST replaced import tariffs. High tariffs protected the domestic manufacturer. The share of import duties decreased from being 40.8 per cent of total taxes in 1991 to 15.9 per cent in 2001. It was replaced with the GST whose share in total taxes rose from 16.6 per cent to 38.3 per cent during the same period. Import duties to GDP ratio decreased from 4.82 per cent to 1.86 per cent from 1991 to 2001 while sales tax to GDP ratio increased from 1.96 per cent to 4.49 per cent during the same period. The tax drive effort made during the 1990s can be seen as offsetting the impact of cutting down of import duties rather than raising the overall tax to GDP ratio significantly (Fatima and Ahmed, 2001).

Pasha illustrates the role of IMF in imposing the GST in Pakistan:

“... it appears that the pace of implementation of the reform has been artificially increased by the presence of IMF conditionalities. Consequently, the broad-basing is taking place without adequate strengthening of the tax department, proper survey, registration and education of tax payers and printing and circulation of forms” (Pasha, 1995, p. 20).

The World Bank followed the taxation cue from the IMF by launching \$120 million large loan by late 1990s to reform the taxation system and establish an integrated revenue collection mechanism. The World Bank programme on tax reforms was for eight years and it was meant to institute an automated refunds system (Ahmad, Ehtisham, 2010; World Bank, 2008). It had, however, only limited success.

With decrease in the high tariffs, domestic manufacturers were double exposed to challenges: 1) through facing international competition with low duties, 2) by maintaining registration requirements due to imposition of the GST. It had adverse effects on domestic industrial production as domestic producers had to face the competition from imported goods and they also had to pay sales tax and withholding tax (Fatima and Ahmed, 2001). Although GST was passed on to consumers, it still required registration, monthly returns, book-keeping and tax invoicing details which could enable tax authorities to assess income level of manufacturer and/or retailer and thereby help them to impose a more accurate income tax on them. Hence, there was resistance from manufacturers, traders and retailers to the GST.

Pasha (1995) and Ehtisham Ahmad (2010) make an interesting point. According to them, GST is a tax on consumption where all the input tax paid is adjusted against the output tax. Hence, it actually favours manufacturers in the formal sector as their inputs are paid back. This is based on the assumption that their final products are sold in the formal sector where GST is levied. Both Pasha and Ahmad are of the opinion that GST is resisted by the manufacturers, traders and retailers as it documents the economy by mapping the audit trail which in turn could show their true income and make them liable to a proper income tax. Despite the fact that GST taxes the consumption, manufacturers and wholesalers/retailers opposed it. Another reason for opposition to the GST is the compliance cost. Due to self-policing mechanism of the sales tax, compliance cost for the manufacturers and wholesalers/retailers is high because they have to maintain proper records (Pasha, 1995; Ahmad, Ehtisham, 2010). This is a powerful argument not fully explored in the literature on VAT. For this reason, Pakistani manufacturers prefer exemptions (where there is no paper trail) over zero-rating (where there is paper trail) despite the fact that the latter is more beneficial to them.

Resistance by manufacturers, traders and retailers to the documentation of economy by GST is actually a resistance to the regime of rule-based governance. Despite the fact that they do not need to pay out of their own pockets, they still resisted VAT tooth and nail. They did not want documentation that comes with the VAT package. A proper documentation would show true scale of their businesses and they might be asked to pay income tax as per their real income level. That would in turn take away the hidden subsidy of under-taxation. It could cut into the massive income tax evasion. Resistance to GST is actually a resistance to IFI's rule-based governance reforms.

Pasha (1995) states that the resistance to GST could be seen in terms of the contestation between the winners and losers of the reforms. The losers had organisational power to form a coalition to resist the imposition of the GST:

“The experience with reforms of the GST demonstrates how an effective coalition of potential losers can be organized in the presence of weak support for the reform from potential gainers due primarily to the dispersed, uncertain nature and uneven distribution of gains and of agents of state who have demonstrated

some lack of vision, commitment and preparedness of the reform” (Pasha, 1995, p. 20).

Ehtisham Ahmad (2010) also mentions the role of “interest groups” who resist the GST. In Ahmad’s view, the tax administration resists reforms because it cuts their rents while the “interest groups” resist it because they want to avoid documentation. The thesis is of the view that “interest groups” is somewhat of a misnomer in the case of the GST. It is better to call a spade a spade. Pakistani manufacturers, exporters, retailers, wholesalers and traders resist the GST. In other words, both the capitalist class and intermediate classes resist rule-based governance and revenue generation. In the case of the GST, they not only dodge the GST but also resist documentation of economy that could in turn make them liable for a proper income tax evaluation.

6.3. Resistance to GST through Subverting the Refunds

Preceding the discussion on how the process of refunds actually worked in Pakistan and resisted, we briefly review the textile manufacturers’ views about the refunds process. These tie in with the broader picture of the resistance to the GST implementation.

Textiles manufacturers’ interviews show that a majority of them were opposed to their funds getting stuck in the refunds process. They were of the view that since textiles sector exports and imports are zero-rated. There is little rationale in paying an input tax and getting their funds stuck in the refunds process. They stated that it led to them facing the liquidity crunch. Hence, there is no reason to pay input tax in the first place³⁶.

G, an owner of the medium textiles mill in Faisalabad complained about the time and energy of the staff spent in dealing with formalities of laws such as the GST (G, Textiles Mill, Interview). Another point made by an owner of a small textiles mill in Faisalabad was that GST implementation is difficult since the retail sector is largely unregistered for the tax. According to him, there is a need to get the entire retail sector registered. Governments have tried this but with little success. The manufacturers do not need to hide their account books, if the end user is registered (S, Textiles Mill, Interview). Non-

³⁶ This refunds reimbursement and its impact on business finances and refunds fraud is also mentioned by Bird and Gendron (2007) in the literature that came after the fieldwork.

registration of local suppliers needed to pay the tax echoed in the interview with the chief financial officer of a large company in Lahore (N, Weaving Mill, Interview).

As the Methodology Chapter states, it was possible to get access to some internal CBR documents entitled “Explanatory Circulars 1998-2004” (Central Board of Revenue, 1998-2004). An internal summary of the Sales Tax Wing in the Central Board of Revenue (CBR) showed that government earned only Rs 4.4 billion as the net sales tax from the textile sector in 2003-04. Total collection was 44.5 billion while refund paid to the textile sector was Rs 40.182 billion. Key informant interviews with Sales Tax officials revealed that the government was actually losing out in sales tax refunds. The officials’ statements were more serious than what the documents³⁷ showed. As a result, the CBR decided to declare ginned cotton as zero-rated in 2004 and was actively considering to declare yarn to be zero-rated. It was done on the basis that the government was actually losing out money through its payment for refunds. Many fake and “flying” invoices were submitted to the CBR. They were invoices of exports which either never took place or their value was inflated³⁸. Though, Ehtisham Ahmad (2010) and the World Bank report on taxation (2008) link it to the “dummy” companies being set up just to claim the fraudulent refunds. On the basis of the fieldwork, we are of the view that fake and “flying” invoices were not only submitted by the “dummy” companies but that the genuine companies were also inflating the value of their exporters.

Here is an illustration of how fake invoices work. Business A claims having exported printed cloth worth Rs 5 million and claiming input tax of Rs 450,000 at the rate of 15 per cent on 3 million of grieg cloth that he purchased from B. In reality, A did not purchase the stated grieg cloth from B. Neither was there an export of the stated printed cloth. It is possible that A actually purchased grieg cloth of only Rs 1 million and exported printed cloth of worth Rs 2.5 million. In both instances, A created fake invoices to prove the claim for the input adjustment. Unless the Sales Tax Directorate was able to actually trace having received the claimed input tax, it lost revenue by refunding more money than it received:

³⁷ Though later in the Chapter, another internal written document also states that the government is losing out more money in refunds than earning in tax receipts.

³⁸ It is also mentioned by Bird and Gendron (2007).

“These people are quite evil genius. So they started thinking about how to exploit the loophole to make money for themselves. They registered themselves for the sales tax and showed that they were registered and made a fake sales receipt. Some exporters set up fake company names and make their yarn purchase invoices out of these fake companies to claim refund” (G, Textiles Mill, Interview).

Linked to the phenomenon of the fake and “flying” invoices is the issue of manufacturer-exporter versus the commercial exporter as it was discovered during the fieldwork of the textiles sector. Manufacturers export their own products while the commercial exporters process orders for others. In the textiles sector, commercial exporters often do not have their own set up. Customers place orders for the processing of grieg cloth against the payment (O, Silk Company, Interview).

“Commercial exporter is like a trader; he gets an order, picks up yarn from somewhere, gets cloth made at a third place, gets it printed or dyed at the fourth place and then exports it. The phenomenon of fake or flying invoices of the Sales Tax is linked with commercial exporters. Since commercial exporters do not have a regular premises, they can get fake invoices against the number of containers to be exported and reclaim sales tax without having actually exported the goods claimed” (G, Textiles Mill, Interview).

In vertically integrated textiles units, it is not easy to hide purchases and sales, whereas commercial exporters can hide their sales figures (S, Textiles Mill, Interview).

“The trading companies can fold up their business and go somewhere else. The commercial exporters often do not have a permanent address; they can also easily manipulate the sales tax law. They can send empty containers abroad and fill out fake invoices and claim sales tax refunds” (G, Textiles Mill, Interview).

It again shows, as pointed out in the literature (Bird and Gendron, 2007), that VAT works better with the formal sector. The more formal and established the sector is, the more manageable is to apply VAT. As stated earlier, a well functioning VAT with minimal exemptions discourages the informal sector.

Refunds fraud is a classic VAT problem (Bird and Gendron, 2007). A few textile manufacturers openly admitted that refunds fraud takes place in collusion with the Sales Tax authorities. A textile manufacturer B belonging to a textile mills association was of the opinion that the Sales Tax Directorate in collusion with businesses allow the setting up of dummy companies and entertain fake refunds (B, All Pakistan Textile Mills Association, Interview). The fieldwork was conducted in 2004 but this view of the CBR being part of the tax evasion was later also confirmed by Ehtisham Ahmad (2010). He argues that FBR³⁹ (new name for CBR) does not want taxation reforms to succeed as it would cut down their rents.

Those textiles manufacturers who were not part of the fake refunds racket suffered. Their competitors were able to under-price their products due to the extra income received through the fake refunds. C, an owner of a large textiles mill in Karachi was of the view that the factories take more refunds and then sell their goods at lower than market prices. It leads to the importing of anti-dumping duty on the whole industry; “for 5 per cent of black sheep, the whole country suffers” (C, Textiles Mill, Interview).

Efforts were made to plug the hole in the GST refunds and to stop the phenomenon of fake/flying invoices. This meant making refunds only after an input tax has been verified. Electronic data bases such as STARR (Sales Tax Automated Refund Repository) and STREAMS (Sales Tax Risk Evaluation and Management System) were set up funded by large World Bank’s loan. It had, however, no discernible impact on the extent and prevalence of the fake and flying invoices (*Business Recorder*, October 8, 2007).

A CBR official in his document explained the refunds issue and its link to fake and “flying” invoices as follows:

“... problematic area in the implementation of VAT has been refund payments. Since VAT is primarily a tax based on value addition at source and exports are zero-rated on the destination principle, there is an in-built need for the documentation of transactions involved in the entire supply chain in the export

³⁹ Federal Board of Revenue.

business. However, the system is marred by the element of fake invoices creating difficulties for its smooth functioning. While textiles cater for the major exportable commodities of Pakistan, various intermediary manufacturing and processing activities are largely carried out in the unorganized and undocumented sector. This gap is filled by invoicing malpractices to inflate refund and suppress local supplies. Thus the refund issue in the textile sector has assumed staggering dimensions posing challenges for the VAT administration in Pakistan” (Ahmad, Shahid, 2004).

The refunds fraud became so serious that the government declared the entire top five export sectors zero-rated. In 2005, the government declared textile products, carpets, leather goods, surgical goods and sports goods as zero-rated (World Bank et al., 2008). The signs of the government’s defeat in imposing a VAT styled GST were obvious at the time of the fieldwork in 2004.

Another internal CBR document lists the relief measures taken in the budget 2004-05. One of the “relief measures” taken by the CBR was to declare ginned cotton as zero-rated. Earlier, the ginned cotton supply was charged at the rate of 15 per cent. This measure meant that no output tax would be levied on the purchase of ginned cotton. The internal CBR document justified this measure as follows: “as the sales tax collected on ginned cotton was adjusted or refunded at subsequent stages of production by the spinning sector, the supply of ginned cotton has been zero-rated. This measure will not only remove cash-flow problems for the spinning sector, but also expedite payment to the ginner and growers of cotton and considerably reduce export-related refunds” (Central Board of Revenue, 2004e, CBR Internal Document: “Relief Measures for the budget 2004-05”).

Similar logic was extended to “zero-rate” (actually exempt) manufacturers of all the five major exporting sectors in 2005. GST with a prime emphasis on the documentation of economy and a detailed VAT that adjusts output tax against input tax by paying refunds was defeated due to the high costs imposed by manufacturers and the intermediate classes who resisted the tax. According to the tax officials interviewed during the fieldwork, “Government wants to get rid of documentation”. “It (sales tax in the context of refunds) defeats the purpose” (Tax Officials Interviews).

The GST being defeated by the manufacturers and the intermediate classes came through vividly during the fieldwork. One forthright and socially aware owner of the large textiles mill in Karachi further threw light on the government's defeat in its failure to implement GST:

“I have no problems with the sales tax as a tax. It takes 3-4 months to get refunds. I have problems with its procedure, with its refund mechanism. On the whole there is corruption, there are these floating invoices providing tremendous incentive for the corrupt to under-price. Government needs to take action against its own officers. *The point is that the government is accepting defeat when it says we would exempt this sector and that sector. The government is accepting defeat that it cannot manage. I want to know what the hell can government manage in this country?*” (GT, Textiles Mill, Interview)

This is a clear representation of the rule-violating behaviour having succeeded in defeating the regime of rule-based governance. GST is resisted by the manufacturers, retailers and traders to the point that they imposed a heavy cost on the government by making it pay back more money in refunds than it actually received in tax receipts. The government's capacity is so weak that it could not match refund payments to their actual receipts. This is despite the World Bank's large loan for taxation reforms. One of the large components of the Bank's loan was automation of the refunds procedure. To minimize the losses, the CBR thought it expedient to do away with the refunds altogether rather than receiving them first and then remitting them in the case of the export sector. As Ehtisham Ahmad (2010) mentions that the CBR has the power to alter tax rules without referring it to the Parliament and it fully utilizes this rule to benefit certain “interest groups”. In this case, the government did away with the refunds which translated into the sales of the major five exporting sectors in the local market also getting exempted.

In the post fieldwork literature, Ehtisham Ahmad (2010) states that not only government zero-rated the five major exporting sectors but it actually exempted them. This does not make sense if one looks at it at a cursory level. As discussed in the literature (Bird and Gendron, 2007), zero-rating is better for the manufacturers than exemption. If certain sectors are zero-rated, it means that those sectors can still get the value of their inputs refunded while their final produce is exported. It is financially beneficial for the

manufacturers to be zero-rated than exempted. Why then did the CBR-manufacturers collusion opted for exemption option rather than zero-rating? Officially, they say exports are zero-rated. However, actually they are exempted as no tax papers are filed.

Exemption is better for the industrialists than zero-rating since it leaves no “paper trail” – there is no documentation. The whole emphasis of the rule-based governance reforms promoting the documentation of the economy is defeated. If there is a proper documentation, it could mean that the tax authorities would be able to assess the true level of income the manufacturers and the intermediate classes are making and it could make them liable to proper income tax. As discussed above referring to Pasha (1995) and Ehtisham Ahmad (2010), doing away with documentation mean no proper income tax liabilities. The manufacturers and the intermediate classes actually bear some financial loss and do not even claim the value of inputs through zero-rating. No refunds are claimed and documentation is done away with. It is obvious that the income tax they would become liable to with proper documentation is more than the refunds they would receive for the value added to the inputs. The exemption of the five sectors is a commentary on the colossal level of overall tax evasion and rule-violating behaviour.

6.4. Reading of CBR Internal Documents and the Extent of Tax Evasion:

CBR internal documents show the pressure exerted by the manufacturers and the intermediate classes that resulted in changing of the CBR decisions. CBR officials were also interviewed. These internal CBR documents provide evidence in addition to the interviews and the secondary literature.

A relief measure taken by the 2004-05 budget zero-rated import and supply of all plant, machinery and equipment. In VAT, exports are zero-rated and not the imports. Actually, imports are a significant source for GST revenue (World Bank et al., 2008). It is counter-intuitive for CBR to zero-rate imports for 2004-05. This CBR measure meant no output tax was levied on the import of machinery via SRO 500(I)/2004 dated 12th June 2004. The key difference being that earlier, this zero-rating was only applicable on “import of plant and machinery used or intended to be used for manufacturing of taxable goods, under SRO 987(1)/99 dated 30.08.1999”. This exemption was given to the import and supply of all machinery “to give a major impetus to capital investment and increase in GDP growth, import & supply of all plant, machinery and equipment, on which either the statutory rate of customs duty is 5 per cent or attracts concessionary rate of customs

duty under any customs notification has been zero-rated”. Earlier, the emphasis was on manufacturing and taxable goods, later that clause was done away with. The earlier SRO 987(1)/99 was clearly in favour of manufacturing and taxable goods, hence it was for industrial development. It was done away with. Revenue impact of this measure was estimated to be a loss of Rs 1.6 billion (Central Board of Revenue, 2004e, CBR Internal Document: “Relief Measures Taken in the Budget FY 2004-05”).

There is a similar clause under Section 3 (1A) of the Sales Tax Act, 1990 which was done away with by the CBR. The clause was to charge a further tax at the rate of 3 per cent to supplies made to unregistered persons. This was levied to “increase compliance cost of informal sector and to provide partial protection to the registered/organized sector” (Central Board of Revenue, 2004e, CBR Internal Document: “Relief Measures Taken in the Budget FY 2004-05”). This measure was drafted to discourage supplies made to unregistered dealers, and to discourage the informal sector. Doing away with the clause took away that encouragement of registered dealers and documented business. Revenue impact of this measure was a loss of Rs 7.5 billion. The rationale given by the CBR document for doing away of the further tax is as follows:

“Businesses have generally claimed that further tax was a regressive levy, encourages the phenomenon of flying invoices with the result that *the government ends-up paying more refunds, against such flying invoice*, than the actual collection from this levy. Therefore, to remove all trade distorting practices with a view to reduce menace of fake/flying invoices and to prevent inadmissible refund payments, the levy of ‘further tax’ has been completely abolished” (emphasis added) (Central Board of Revenue, 2004e, CBR Internal Document: “Relief Measures Taken in the Budget FY 2004-05”).

This indicates the cost imposed by the manufacturing and traders on tax revenue. The cost of collecting the sales tax is so high in terms of refunds being higher than actual collection that the sales tax authorities decided to do away with the further tax.

Fake/flying invoices have also been cited as one of the key reasons for doing away with the further tax clause. The rationale is that since registered dealers are preferred over unregistered ones, businesses have an incentive in producing fake/flying invoices to show that transaction has taken place with a registered dealer even if it was actually done with an unregistered one. Doing away with the further tax of 3 per cent abolished the

possibility of such a distortion. It is not clear how the tax authorities would deal with fake/flying invoices issued by unregistered dealers. The fact that fake and flying invoices are produced by non-registered dealers was not discussed.

Another measure dealt with the retail sector. A simplified tax regime was suggested for the retail sector. The retail sector continued to be difficult as far as implementation of sales tax is concerned. There was massive resistance to retailers' registration. The registered retailers were only liable to pay sales tax if their turnover was Rs 5 million or above. Relief Measures document says that over 77 per cent of registered retailers declared their income to be below Rs 5 million. They paid no tax. The CBR allowed retailers having turnover of more than Rs 5 million to pay sales tax at the rate of 10 per cent addition to value. It was estimated that this measure would earn CBR Rs 600 million (Central Board of Revenue, 2004e, CBR Internal Document: "Relief Measures Taken in the Budget FY 2004-05"). Close to 80 percent retailers not filing for GST returns due to them being below the threshold level of Rs 5 million is another example of tax evasion.

Another internal CBR document states that for 2002-03, a bigger chunk of GST i.e. 54 per cent was collected in lieu of imported goods and rest on domestic goods. CBR Yearbook 2002-03 also notes an increase in Sales Tax domestic. GST increased from Rs 29 million in 1998-99 to Rs 89 million in 2002-03. It increased the share of the sales tax (domestic) in total tax receipts from 9.4 per cent to 19.4 per cent during this period (Central Board of Revenue, 2004, *CBR Yearbook 2002-03*). The increase in the GST figures from late 1990s to early 2000s is explained by the increase in the coverage of the GST as it was imposed on the whole/retail and service sectors. However, post 2002-03 figures point to a trend in the opposite direction. According to the World Bank:

"As percent of GDP, the GST revenue increased from 3.1 percent of GDP in 1999/2000 to 4.1 percent of GDP in 2002/03, but then declined to 3.5 percent of GDP in 2007/08⁴⁰. Since 2006/07, the GST share in FBR taxes has dropped below 40 percent and fallen behind the share of direct taxes. International comparisons confirm that GST collections in Pakistan are weak. For example, India and Sri Lanka collect around 1.5 to 2.5 percent of GDP more through GST

⁴⁰ A period that roughly corresponds to the five major export sectors being declared zero-rated or virtually exempted.

than Pakistan. The lower collection is not because of lower rates. Until 2007/08, Pakistan charged a standard GST rate of 15 percent on sales price inclusive of any federal excise duty and/or customs duty, the same rate as in Sri Lanka and higher than the 12.5 percent rate in India” (World Bank et al., 2008, p. 69).

An international comparison of Pakistan’s GST productivity shows that it is not only lower than Sri Lanka and India but also to other middle-income countries such as Egypt, Turkey, South Africa and Thailand (World Bank et al., 2008, p. 75). Pakistan’s Tax to GDP ratio that was already low at 10.6 percent in 1999/2000 went up to 10.7 percent in 2001/02 but since then has been declining. It went down to 9.8 percent in 2003/04 and further declined to 9.7 in 2004/05 (World Bank, 2008, p. 11).

Giving details of tax evasion, the CBR Task Force on taxation reforms points toward political lobbying and certain influential groups being exempted from income tax. Agricultural income is not taxed and falls in this category. There is the other category of “vendors, small workshops, small shops, self-employed and similar inconspicuous categories of taxable individuals and trades” who fall within the tax bracket but they have been able to remain outside the tax net. Traders, small companies, and self-proprietors are in the tax bracket but under-report their income (Central Board of Revenue, 2001, Report of the Task Force on Reform of Tax Administration, pp.7-8).

One indication of evasion can be gauged from the fact that assets of Rs 120 billion were declared by the tax evaders when government announced a tax amnesty scheme in 2000. These assets were not declared earlier: “a tax at the rate of 10 percent on these assets raised Rs 12 billion in revenues. Assuming that 10 percent was a low tax rate and that under normal course of events a marginal tax rate of 20 percent would have applied, the extent of tax evasion could be taken as Rs 24 billion. If these assets had been created within the last 10 years, the annual tax evasion would amount to Rs 2.4 billion. This is about 2.27 percent of the income tax revenue raised in 1999-2000” (Central Board of Revenue, 2001, Report of the Task Force on Reform of Tax Administration, p. 8). It reflects the extent of tax evasion within the system.

Giving details of tax evasion, the Task Force’s report says:

“Within the tax administration, corruption takes the form of policy manipulation, whereby import duty structures are changed overnight by issuing SROs to favour

a single industry or firm at the cost of others, collusion between the tax officials and interest groups, and extortion, which is made possible by the immense discretionary powers of the tax officials. The most common form of corruption in the tax administration, however, is speed money” (Central Board of Revenue, 2001, Report of the Task Force on Reform of Tax Administration, p. Xv).

Policy manipulation is the most common form of legalised corruption where import duty structures are changed to favour one industry or firm over others. This is one form of under- the-table transfers. Duty structures were changed on the import of BMW luxury cars, steel items, and scrap metal through SRO. If the duty was something like Rs 5000 per ton for scrap metal, it was changed to Rs 500 per ton. It would favour a particular firm or industry for the required period (Central Board of Revenue, 2001, Report of the Task Force on Reform of Tax Administration).

The following table gives a rough idea of the extent of tax evasion by the three key departments:

Table 6.4: Perceived Revenue Lost by Departments

Organisation	Revenue Earned	Revenue Lost
Income Tax	36%	64%
Customs	52%	48%
Sales Tax	55%	45%

Source: (Central Board of Revenue, 2001, Report of the Task Force on Reform of Tax Administration, 2001).

A detailed tax survey was undertaken by the military government in 2000. The purpose was to find out the expenditure of people and compare it with income declared. The exercise again faced swift resistance by business groups and the intermediate classes. According to the State Bank, only limited tax resources were generated through the Tax Survey drive (Fatima and Ahmed, 2001). The extent of tax evasion can be gauged from the fact that “less than 60 percent of imports actually pay duty” (Pasha, 1995, p.129).

In terms of costs enforced by the tax payers, the issue of thresholds is important. A system of multiple thresholds was introduced to take into account the requirements of various categories that were required to pay the GST. At the lower threshold, manufacturers with turnover of Rs 0.5 million and retailers with turnover of Rs 1 million were needed to pay a turnover tax at the rate of 2 per cent. A higher threshold of Rs 5 million was fixed for both manufacturers and retailers to pay sales tax at the rate of 15 per cent. There were so many complications in the function of multiple threshold system that government had to do away with it and stick with the single threshold for manufacturers and retailers at Rs 5 million and above. Problems included businesses registering in the wrong lower threshold categories, to avoid the due tax. Suppliers would appear in the sales tax records and then disappear prompting the use of term “short-life” taxpayers. Given the fact that multiple thresholds overloaded the Sales Tax Directorate with a wide but relatively unreliable taxpayer clientele. The CBR shrunk the GST base by 26 per cent but stuck with more “complaint” taxpayers’ base and reduced the cost of tax administration (Ahmad, Shahid, Central Board of Revenue, 2004). Abolition of lower threshold of Rs 0.5 million for manufacturers and Rs 1 million for retailers reflects the cost imposed in terms of non-compliance by the middle and lower-middle classes who fall in the category of lower threshold or small businesses.

An unpublished paper by a CBR official collected at the time of the fieldwork pointed out that VAT in Pakistan is being levied as an excise duty rather than a multi-stage tax on production and distribution with a proper “paper trail”. Pakistan quickly enacted Sales Tax Act 1990 under the IMF pressure. The necessary organizational inputs were not in place. GST was administered on the lines of excise duty with physical controls and many exemptions. Only half of the registered persons and businesses filed their monthly tax returns. Low compliance was due to at least two reasons: a) individuals and businesses did not register in the first place; b) when they registered, they did not file monthly tax returns (Ahmad, Shahid, Central Board of Revenue, 2004). Same point made later by Ehtisham Ahmad (2010) and World Bank et al. (2008) is that VAT in Pakistan is functioning as an excise duty rather than a properly functioning VAT.

The World Bank et al. (2008) state that the industry pays more GST in terms of its contribution to GDP compared to agriculture and services. Agriculture’s contribution to the GDP is 20 percent whereas its share in the GST is just over 1 percent; and the

services' contribution to the GDP is 58 percent while its share in the GST is only 22 percent. The rest of the GST i.e. 77 per cent is paid by the industry. However, a close analysis shows that in industry, it is not the textiles sector whose share is below its GDP contribution. The industry's share comes from petroleum products (over 21 times its share of GDP) and other consumer goods such as cigarettes, edible oil, automobiles etc. Even with these sectors, GST is often applied as an excise duty rather than as a multi-stage tax on production and distribution with refunds working. This indirect excise duty on consumption such as petroleum and import duties fill the GST coffers largely as presumptive tax. Low VAT collection in the services sector is linked to the informal or "shadow" economy (World Bank, 2008). Hence, GST is working as a presumptive excise duty on final turnover rather than functioning as a fully operationalised VAT.

Post fieldwork literature points out the extent of income tax evasion. It is significant in the formal manufacturing sector. The Securities and Exchange Commission of Pakistan (SECP) has 47,500 registered companies while the FBR has only 23,100 companies registered. It means that roughly more than half "active companies do not have a national taxpayer number". Even out of those 23,100 companies, "less than half filed a tax return". It means less than 11,000 companies filed tax return and out of these; "two-third declared either a negative or zero taxable income, and one-third positive taxable income". It essentially means out of 47,500 companies registered with the SECP, about 4,000 reported a taxable income. Even among these less, "only one-in-eight companies declared a taxable income in excess of Rs. 1 million". It means only about 500 companies pay tax worth more than Rs 1 million taxable income. Foreign companies did far worse in comparison with the local companies. Of 494 foreign companies, only 17 filed a return (World Bank et al., 2008, p. 65). This massive tax evasion of income tax is directly linked to the GST. Since companies do not pay their income tax, they subvert the GST, preventing the economy from being documented. Their true incomes remain hidden.

The extent of GST evasion is also pervasive. Post fieldwork World Bank et al. (2008) publication indicates that direct GST is earned of less than 2,000 large companies out of

130,710⁴¹ registered. Less than 2,000 businesses paying GST means less than 3 percent of the registered businesses pay the tax. In essence, the large companies with a turnover of Rs 300 million rupees or more paid nearly 90 percent of all GST collected. These large companies who paid the GST are the manufacturers, exporters and importers with high “visibility” due to the nature of their businesses (World Bank et al., 2008, p. 80).

According to the 1973 constitution, the federal government is responsible for levying GST on goods and the provincial governments on services. During the Musharraf era, in 2004, the federal government levied VAT on services on the behalf of the provinces and transferred proceeds to them. The provinces do not have the organizational capacity to impose GST on services and there are complicated issues relating to inter-provincial transfers. One of the provinces, Sindh, tried to impose GST on services later but did not succeed. The centralised FBR is considered not motivated to tax the difficult services sector considering that the proceeds to be transferred to the provinces (Ahmed, Ehtisham, 2010; World Bank et al., 2008). It further complicates the VAT compliance of the services sector. The consistent non-compliance by traders, wholesalers, retailers and the services sector shows that the intermediate classes are resisting the imposition of a proper GST. Even professionals such as lawyers, doctors and other self-employed categories do not pay the GST. The intermediate classes have played a significant role in resisting the GST along with the capitalist class.

Conclusion:

The chapter discusses the limited implementation of the GST in a VAT mode. The tax was imposed to meet the IMF conditionality in 1990. There have been many amendments in the Sales Tax Law to do away with the exemptions and make it work closer to spirit of VAT. The World Bank gave a large loan for comprehensive taxation reforms in 1999 with a particular focus on the automation of the refunds system. GST has been able to replace the import tariffs in the revenue records. Yet, its overall implementation is far from what the VAT requires. It functions more like a presumptive excise duty imposed on turnovers.

⁴¹ The difference in the figure of the SECP companies being the total of 47,500 and businesses registered for the GST purposes being 130,710 is that the latter also includes small businesses, wholesale and retail. While, the SECP figures are for companies.

One of the key reasons GST has been opposed by the manufacturers, retailers, traders and wholesalers is that it helps to document the economic activities and level of their incomes. This if done properly could make them liable to an increased income tax. Hence, GST has been opposed tooth and nail. The refunds system which is part and parcel of a well-functioning VAT has been subverted. The government's tax department lacks the capacity to match refund requests with the actual tax receipts. A volley of fake invoices were produced to claim fraudulent refunds. The situation got so bad that the CBR admitted they were giving more money in refunds than the revenue they were earning. The CBR, therefore, practically exempted the five exporting sectors by declaring them as zero-rated. This meant that domestic produce of the five exporting sector is also exempted from GST.

This chapter outlines way of interpreting and analyzing the rule-violating behaviour and the weak capacity of the state in Pakistan to enforce rule-based governance and revenue generation. If the capitalists and the intermediate classes were to pay their due share in taxes, it would transfer resources from them to the state. By resisting taxation reforms such as the GST, the capitalists and the intermediate classes indulged in the rule-violating behaviour through their non-payment and subverted efforts towards documentation of economy. This chapter also shows how the IFIs institutional governance reforms were resisted in contemporary Pakistan. GST was imposed to meet a direct conditionality of the IMF in 1990 and has been amended and "reformed" as part of the IMF-World Bank loans but resisted on the ground by the capitalist and the intermediate classes in Pakistan.

Chapter 7. Securities and Exchange Commission of Pakistan: ‘One Step Forward, Two Steps Backward’ of Corporate Governance

The Securities and Exchange Commission of Pakistan (SECP) was established in 1999 as an independent body replacing the Corporate Law Authority (CLA) that had worked as a subsidiary organisation within the Ministry of Finance. The SECP was established as a result of the Asian Development Bank (ADB)’s programme loan. This chapter chooses to study one of the critical ADB’s reforms in the development of corporate governance through the setting up of the SECP as an autonomous institution.

The SECP regulates the public listed companies and the financial sector in particular and supervises the corporate sector’s adherence to the Companies Ordinance in general. It regulates companies in the financial sector due to the public money being involved. It also regulates public listed companies. All other companies whether private, unlisted public, and not-for-profit are registered with the SECP under the Companies Ordinance, 1984. The SECP’s mandate includes supervising the compliance of the private and other companies with the relevant provisions of the Companies Ordinance⁴² (I, ex-SECP top-echelon official, Interview).

Using the SECP’s annual reports from 1999-2004, Karachi Stock Exchange annual reports, and key-informant qualitative interviews, this chapter maps the relationship between regulation and the rule of law. The main purpose of the SECP was to regulate the securities market and promote a level playing field by introducing corporate governance reforms for intra-capital relations as well as the capital’s relationship with the state.

7.1. Background

The chapter discusses the ADB’s programmatic focus after having contextualised the political economy of the SECP in Pakistan since the import-substitution-industrialization (ISI) phase of 1950s and 1960s.

⁴² “For instance, details of directors, submission of accounts and clearance of the articles and memorandum of association. Any affected shareholder can lodge a complaint for dispute resolution even in private companies. Mostly the questions of beneficial ownership are raised after the death of a director or principal shareholder” (I, ex-SECP top-echelon official, Interview).

Chapter 3 discussed in detail how the ISI worked in the 1950s and 1960s. The interaction among the state institutions and the emergent capitalist class led to rents creation. It was crony capitalism, with a high level of concentration. Control over the industry was established by maintaining control over banking and insurance. The policies of the ISI resulted in the consolidation of 44 monopoly houses which accounted for “77 percent of gross fixed assets of all manufacturing companies listed on the Karachi Stock Exchange” (Zaidi, 2005, p. 102). These monopoly houses also controlled majority of the banks. Other than providing subsidies through schemes such as the Export Bonus Vouchers etc, the state also provided liberal credit facilities and made the scarce foreign exchange available for the capitalist class to buy machinery. Formal rules to stop interlocking directorates did not exist and family banks were used to give loans to their own family enterprises. Moreover, the industrialists were on the board of the government’s industrial development institutions such as Pakistan Industrial Credit and Investment Corporation (PICIC) that in turn helped them to get access to the scarce permits and licenses (Zaidi, 2005). Cheema et al. (2003) also discuss the concentration in the industrial sector and access to liberal credit.

When the bubble of state-led industrialization burst due to the failure of Ayub government to earn legitimacy (in the Weberian sense) and maintain political stability, it led to the anti-cartelization movement in the country. Yahya Khan’s Martial Law was promulgated in March 1969 and the corresponding *Economic Survey* shows changes that led to the civil strife since 1968. The civil agitation against Ayub Khan was led against the industrial and banking monopolies and concentration of wealth. Two ordinances by the Yahya government in the form of *Monopolies and Restrictive Trade Practices Ordinance, 1970* and *Securities Exchange Ordinance 1969* tried to assuage public opinion against monopolies and cartelization. The former prohibited “undue concentration of economic power, unreasonable monopoly power and unreasonably restrictive trade practices” while the latter aimed to give “protection to investors and regulating markets and dealings in securities”. Securities Exchange Ordinance pushed the Stock Exchange towards registration. Issuers of securities were directed to submit their annual reports and statements to the government (Government of Pakistan, *Economic Survey of Pakistan 1969-70*, pp. 88-89). Hence, the roots of the SECP go as far back as 1969 to the Securities Exchange Ordinance.

The Monopoly Control Authority was established in 1971. Corporate governance went through a transformation in early 1980s when the Corporate Law Authority (CLA) was set up in 1981 and the Companies Ordinance, 1984 was introduced to replace the Companies Act, 1913. CLA consisted of two wings namely the Corporate Regulation Wing and the Monopoly Control Wing. The latter essentially replaced the Monopoly Control Authority of 1971. Monopoly Control Wing of the CLA made regulations and rules aimed to stop the monopolization of commercial and financial sector, whereas the Corporate Regulation Wing focused on the regulation of stock markets and implementation of the Company Law. CLA worked under the Ministry of Finance as said earlier. There was an affiliated office of the Controller of Capital Issues (CCI), also under the Ministry of Finance, that dealt with the regulation and approval of all equities and debt (Lahore University of Management Sciences, 1995). The Companies Ordinance 1984⁴³ was amended in 1999 to replace CLA with the SECP. The Companies Ordinance, 1984 is one of the main laws through which the SECP regulates the corporate governance.

CLA was considered ineffective because it worked in a bureaucratic manner under the Ministry of Finance. It lacked professional staff. Rather than working on its own to impose fines etc, it relied on the slow courts system which did not work largely. Even the powers that CLA enjoyed under the Securities and Exchange Ordinance 1969 and the Companies Ordinance 1984, were not often exercised so as not to upset the market functions. Management restructuring of the under-performing companies did not take place. Also, the various Stock Exchanges did not support CLA's efforts to push companies to hold their annual general meetings and pay dividend. The CLA, however, took a stance on the holding of annual meetings and the payment of dividends. But the CLA did not focus on restructuring the management issues to bring the companies' internal structures up to the standards of corporate governance (Lahore University of

⁴³ The Companies Ordinance, 1984 defined jurisdiction of courts, defined the powers and function of corporate governance authority; set the procedures for the incorporation of companies and their memorandum of associations; discussed matters relating to the transfer of public companies into private companies and vice versa; set out details of "allotment, issue and transfer of shares"; provided details of functions of share capital; registered procedures to take into account mortgages; established parameters on members' registration, meetings and proceedings, directors' designation and role, chief executive designation and role, setting up of non-banking financial institutions, account keeping, payment of dividend, audit, mismanagement, arbitration, liquidation and winding up. It also contained various "miscellaneous provisions regarding investments, contracts, officers and shareholdings, trading and interests" (Securities and Exchange Commission of Pakistan, *The Companies Ordinance, 1984*).

Management Sciences, 1995). Hence, the idea of the SECP was conceived that could function as an autonomous organisation.

The literature on corporate governance deals with another element in the formation of SECP. This has to do with liberal credit facilities provided to the corporate sector by the state (Asian Development Bank, 2003; Cheema et al., 2003). The liberal credit was provided since the ISI days. However, state direct credit reached a high level in the 1980s and 1990s. As discussed in Chapter 3, the Zia regime did not privatize the state owned banks but used bank loans to distribute patronage. Also, the new political-cum-industrial class that emerged in 1980s due to the local bodies' elections used the loans to further their industrial interests (Sayeed, 1995).

The liberalisation of entry into the industry and easy access to liberal bank credit led to a massive bank loans default in 1990s (Cheema et al., 2003). Non-performing loans were 20 percent of gross advances (Bari, 2006). The State Bank of Pakistan has covered the loan default as part of its financial sector assessment. Non-performing loans were Rs 66.1 billion in December 1990 and they increased to Rs 271.4 billion in December 2000. It is indicative of the politics of patronage and clientelism in 1990s despite the liberalization reforms. "However, their annual average rate of increase has come down from 17.4 percent during the first seven years of the decade to 10.1 percent during January 1998 to December 2000" (State Bank of Pakistan, *Pakistan: Financial Sector Assessment 1990-2000*, p. 123).

The Musharraf government passed the Financial Institutions (Recovery of Finances) Ordinance in 2001 (State Bank of Pakistan). This Ordinance not only established banking courts in Pakistan, it also made rules for recovery of written-off loans and procedures for the sale of mortgaged property. Some of the banking issues are discussed in length by Cheema et al. (2003). As result of this Ordinance, a special autonomous organisation called Corporate and Industrial Restructuring Corporation (CIRC) was set up to acquire the "bad" assets of state-owned banks, re-package them and sell them to the private sector to earn some proceeds against the hefty non-performing loans (O, CIRC, Interview). During the time of the fieldwork, CIRC had acquired assets of the six leading public sector banks and development financial institutions and re-sold them after "cleansing" them and transferred the proceeds to the government (O, CIRC, Interview). The details are given in Appendix 2 of the thesis.

The larger point in the literature is centred around bank loans (discussed above) for industrialization and the corporate sector being financed by credit. Due to this liberal credit, the corporate sector did not feel compelled to raise equity in the market. As discussed in Chapter 3, the financial sector started to get privatized from the early 1990s. The privatisation process intensified during the latter half of the decade (Cheema et al., 2003).

A crucial aspect of corporate governance regarding the family-oriented nature of the textiles sector came through very strongly during the fieldwork. The literature on corporate governance also discusses it. Details are in the tables below:

Table 7.1: Investor Composition in Listed Local Private Companies in Pakistan
(percentage shares owned by an investor type)

Investor Type	Textile	Non-Textile
Direct Holding by Family	29.3	9.1
Members		
NIT/ICP ⁴⁴	8.4	11.1
Financial Institutions	5.1	8.2
Foreign Investors	1.9	14.3
Joint Stock Companies	23.2	16.9
Associated Companies of the controlling family	17.4	21.4

Source: Cheema et al., 2003

⁴⁴ NIT: National Investment Trust; ICP: Investment Corporation of Pakistan.

Table 7.2: Family Control in Asian Corporates**(Percentage of the sample companies)**

% of family control	Pakistan (Textiles)	Pakistan (Non-Textiles)	Indonesia	Korea	Malaysia	Taiwan	Thailand
10% cut off	92.9% ⁴⁵	88.9%	67.1%	67.9%	57.7%	65.6%	50.8%
30%cut off	85.8% ⁴⁶	55.5%	58.7%	20.1%	45.6%	18.4%	54.8%
More than 40%	50.0% ⁴⁷	38.9%	35.4%	3.5%	14.7%	5.0%	38.9%

Source: Cheema et al., 2003

Table 7.3: Ownership Concentration in Asian Corporates

	Concentration Ratio (%)
Country	Top Five Shareholders
Pakistan	37.0% ⁴⁸
Indonesia	67.5%
Korea	38.5%
Malaysia	58.8%

⁴⁵ “The figure implies that in 92.9% of our sample companies the family *controls* equal to or more than 10% of the total share capital” (Cheema et al., 2003).

⁴⁶ “The figure implies that in 85.8% of our sample companies the family *controls* equal to or more than 30% of the total share capital” (Cheema et al., 2003).

⁴⁷ “The figure implies that in 50% of our sample companies the family *controls* more than 40% of the total share capital” (Cheema et al., 2003).

⁴⁸ “Implies that the top five shareholders of an average company in Pakistan own 37% of the share capital” (Cheema et al., 2003).

Philippines	60.2%
Thailand	56.6%

Source: Cheema et al., 2003

Table 7.1 shows that hold of family-oriented equity in the corporate sector. There is greater concentration in the textiles sector than other sectors. Yet, even in the non-textiles sector, family equity contributes one-third of investment if one takes family held associated companies as well. In the case of the textiles sector, family controls half of the equity including its investment in the associated companies. The family control over the textiles sector is pretty obvious.

Tables 7.2 and 7.3 compare the family control of equity in Pakistan with other Asian countries. The control over share capital in Pakistan is much greater than ownership⁴⁹. This means that there is a separation of control from ownership. It also means that the family-based management can use external investors' and minority shareholders' capital according to their own discretion. Given the poor auditing standards and weak disclosures, this contrast between control and ownership is compounded because it allows the family based management to use others' money for its own private benefits; benefits such as expenditure on items of luxury personal consumption or political lobbying etc. Hence, the companies do not announce dividends and retain the profits. The SECP has been concerned with the low levels of payment of dividends. In 2002, over 59 per cent of companies did not declare dividends. It makes the argument for the company's profits being used for "personal benefits" (Cheema et al., 2003).

⁴⁹ There is a need to be cautious in making estimates about the intensity of ownership on the basis of just the top five shareholders. A key informant interview with a top officer in the SECP revealed that top shareholders not only hold shares against their own names but also against their family members and other trusted associates' names (I, Ex-SECP top echelon official, Interview). Hence, it may not be right to infer too much on the less degree of concentration in the ownership of top five shareholders only.

Table 7.4: Annual Share Turnover in a Sample of Pakistan’s Listed Companies, 2000

Ownership Type	Turnover in an Average Company (as a percentage of total annual turnover of the entire sample)
Family-based	0.91%
Government	4.6%
MNCs	9.3%

Source: Cheema et al., 2003

Table 7.4 shows the nature of illiquid stock market in Pakistan. The share turnover is very low in family based companies, it is a little high in the government companies and gets higher in the case of multi-national companies. It shows that family controllers do not trade shares of their companies often, which in turn, contributes to stock market being illiquid. Family controllers do not risk the likelihood of loss of their control over the company by trading shares of the company. Illiquid stocks decrease the possibilities of holding companies accountable for inefficiency. The cost of takeover of a company also increases due to an illiquid market. The family based controllers oppose reforms that could weaken their control and make them comply with shareholding patterns disclosures. It also explains why equity is not raised through capital markets because doing so will weaken the family controlled nature of the companies. Although discouragement of external investors and prevalence of “underdeveloped capital markets” is not in the larger interest of the corporate sector or the country’s economy, such larger interests are opposed in favour of family control (Cheema et al, 2003).

7.2. The Asian Development Bank (ADB) and Corporate Governance

The ADB funding for the setting up and operating of the SECP is part of the IFI’s pro market reforms. The ADB evaluation report of six countries’ “domestic capital market development” discusses Pakistan where pro-market reforms were promoted (Asian Development Bank, 2008). The ADB has provided programme loans for capital market

development since 1980s. Its efforts became quite vigorous after the Asian financial crisis of the mid-1990s. In 14 developing countries, the ADB provided 36 programme loans worth \$9.2 billion aimed at financial sector projects. It also funded 109 Technical Assistance (TA) worth \$59.9 million in twenty developing countries and these TAs were focused on capital market development either fully or partially. A substantial part, 68 per cent, of the ADB's lending went to Pakistan, Indonesia, Philippines, Viet Nam, Sri Lanka and Mongolia. More than one-third, 37 per cent of total programme lending went to capital market related loans (Asian Development Bank, 2008).

The ADB has been involved in Pakistan's financial sector since 1968. However, substantial involvement started in the mid-1980s. This started with a shift of focus by the ADB to the development of "long-term financial markets" rather than just providing credit. Development finance loan of \$110 million was approved in 1983 and the government made a binding commitment to promote domestic mobilization. Following this, the ADB concentrated on the liberalization of the government's monetary policies, credit allocation and interest rates. Yet another \$200 million Industrial Sector Program was approved in 1988 to "develop the government bond market". In 1989, a TA was approved to study Pakistan's securities market (Asian Development Bank, 2003).

The ADB has focused on capital market development in Pakistan particularly since 1995. It started off with technical assistance from the 1995-1997 period. The ADB evaluation report of 2003 focuses on six TAs in particular. First TA set the overall capital market development agenda. A programme loan of \$250 million called capital market development programme funded the implementation of agenda identified by the first TA. Three TAs focused on reforming the insurance, mutual funds and pensions sectors respectively. The remaining two TA aimed for reform in capital market law and insurance law, and regulation of interest rates for the domestic national saving schemes (Asian Development Bank, 2003).

The capital market development programme of the ADB was initiated in January 1998 on the basis of the agenda identified by TAs, with the disbursement of a first tranche of \$125 million. Disbursement of the second tranche of \$125 million took place in June 2000. The Loan ended with 10 months delay in October 2001 and the TA specifically focused on the SECP ended in July 2002 with 19 months of delay and four extensions (Asian Development Bank, 2005). Programme loans by the IFIs are given to the

government of Pakistan as part of its budget support and the government is expected to deliver on conditionalities set in the loan (I, Ex-SECP top-echelon official, Interview). Pursuit of the neo-liberal agenda to roll-back the ISI policies is obvious from the ADB documents:

“...ADB strategy for the financial sector in Pakistan included a focus on assisting its structural transformation from *directed* to market-led operation (emphasis added). This transformation would address critical capital resource deficiencies, and place greater reliance on a dynamic private sector capable of generating foreign and domestic capital resources to finance industrial growth. This purpose was consistent with ADB’s country operational strategy, which called for greater private sector participation in the pursuit of economic growth” (Asian Development Bank, 2003, p. 18).

Overall, the ADB seemed satisfied with the results of its capital market development programme. It provided “new regulatory framework for the capital market” against its objectives of “providing level playing field to the private sector” (Asian Development Bank, 2003, pp. vi, 16). CLA was transformed into the SECP with the introduction of Securities and Exchange Commission Act of 1997. The ADB introduced settlement of exchange on the stock market within three days along with margin financing; minimum equity requirements for brokers were increased and redefined; Central Depository Company was established in the stock exchanges; the Code of Corporate Governance was agreed upon; stock brokers registration guidelines and rules were introduced; and a national clearing and settlement system was set up in the stock exchanges. The ADB also pushed for the privatisation of public sector mutual funds and reform in the mutual funds regulations. The mutual funds management was not running on the professional lines, hence there was poor performance on that front. With a lag of two years, new insurance rules were partially issued and also a new insurance law was put in place to replace the old one. National savings schemes’ interest rates were rationalized. Leasing industry was revamped and provided a new impetus. Management of the stock exchanges was given to more professionals and stock exchanges were modernized. “However, the market is still narrow and remains highly speculative, and the stock exchanges are still perceived to be manipulated by a few powerful brokers” (Asian Development Bank, 2003, p. vii). Moreover, “daily turnover remains concentrated in very few stocks that have large market capitalization” (Asian Development Bank, 2003, p. 7).

There is a question mark regarding the ADB's "satisfaction" over its capital market development programme. There were achievements of the programme as discussed above (and also in the rest of the chapter). However, given the fact that ADB itself admits that a few powerful brokers manipulate the stock exchanges in Pakistan and there is very limited trading of shares leading to an illiquid market, there is a huge question mark over the overall success of the ADB's objectives.

7.3. Securities and Exchange Commission of Pakistan

The process to set up the Securities and Exchange Commission of Pakistan (SECP) started as a result of *Securities and Exchange Commission Act 1997* that in itself was an offshoot of the ADB's capital market development programme (discussed above). Securities and Exchange Commission Act 1997 sets the terms of establishment of the Commission, the board of governors, powers and functions of the Commission. In terms of powers, it sets out powers of enforcement and investigation by the Commission, powers of cognizance and prosecution of offences, and power to make rules and regulations (Securities and Exchange Commission of Pakistan, *Securities and Exchange Commission Act 1997*).

When Commission came into being in 1999, it was given the task of regulating the capital market and corporate sector. Later, non-banking finance, insurance and private pensions were also assigned to the Commission (Securities and Exchange Commission of Pakistan, 2004).

SECP administers a number of laws under its purview. Companies Ordinance 1984 is the main architect of the structure by which the SECP governs as stated above. Other relevant laws are The Securities and Exchange Ordinance, 1969 and the Securities and Exchange Commission of Pakistan Act, 1997 amongst others (Asian Development Bank, 2005).

The organisational structure of SECP is as follows: there is a Securities and Exchange Policy Board that guides the Commission on key policy decisions, and five Commissioners including the Chairman who oversee relevant areas of the Commission. There are six divisions under the Chairman each headed by an Executive Director. Chairman is the Chief Executive Officer of the Commission while Commissioners assist him in overall supervision. Each Executive Director heads a Division. Wings are headed by Directors while Sections are headed by Joint Directors. The main idea behind the

setting up of the Commission was to integrate coverage of securities market with the regulation of the Companies Ordinance and look after non-banking financial companies, given the linkage amongst these areas (Securities and Exchange Commission of Pakistan, 2000). The details of functions of divisions are as follows:

Securities Division deals with securities market functions that include regulation of secondary market, market surveillance, licensing and coordination. Enforcement and Monitoring Division investigates compliance of laws, reviews listed companies' accounts, oversees regulations' compliance by the management and carries out prosecution. Specialized Companies Division deals with the leasing, *modraba* funds, mutual funds and other specialised companies. It also deals with compliance, licensing and enforcement of the relevant laws. The main responsibility of the Company Law Administration Division is application of statutes of the Companies Ordinance 1984 to all listed, private and unlisted companies. It also supervises various field offices known as Company Registration Offices in various cities of Pakistan. Regulation of the insurance sector is dealt by the Insurance Division. It deals with the supervision and licensing of the insurers as well (Securities and Exchange Commission of Pakistan, 2000).

From 1999-2004, the Commission has been involved in a number of initiatives to promote the rule-based governance. These ranged from ensuring transparency, carrying out monitoring and evaluation to taking punitive actions. Some of them are discussed below:

7.3.1. Code of Corporate Governance

One of the major activities the SECP has been involved with is the making of the Code of Corporate Governance⁵⁰. During 1999-2000, the SECP initiated the process of deliberations over the Code. It was implemented in March 2002. The Code was finalised after extensive consultations and it was modelled on the principles of corporate governance of the Organization for Economic Cooperation and Development's (OECD) (Securities and Exchange Commission of Pakistan, 2000; Securities and Exchange Commission of Pakistan, 2002).

⁵⁰ There is a detailed description of the Code of Corporate Governance in Cheema et al. (2003). However, the chapter uses the original text of the Code of 2002 collected during the time of the fieldwork. This chapter does not use Cheema et al. (2005) discussion on the Code which is overly detailed and laborious.

There are certain voluntary and mandatory provisions of the Code of Corporate Governance. The most important shortcoming of the Code is making a voluntary requirement for having non-executive directors to represent the minority interests on the Board of Directors (BoD). The feedback from the fieldwork discussed later in the chapter shows that this condition has not been complied with in most cases. The other voluntary clause relates to nomination or election of a broker on BoD. The rest of the clauses of the Code are mandatory. The SECP is empowered to discipline compliance of the Code. The mandatory clauses relate to selection of directors of the company; eligibility and qualification of a director; directors' office tenure; powers, responsibilities and functions of the BoD; procedures to appoint and remove the chief financial officer (CFO) and company secretary; setting up the frequency of financial reporting; and establishing the parameters for the directors' report to shareholders (Securities and Exchange Commission of Pakistan, 2002, *Code of Corporate Governance*).

Other mandatory clauses deal with forbidding any conflict of interest of the company's directors holding shares in the company, disallowing auditors not to hold shares in the company, recommending disinvestment of shares by sponsors etc and setting out details of corporate ownership patterns. The rest of the mandatory clauses deal with audit mainly. The audit functions have been strengthened by the Code. It gives details of the formation of the audit committee; functions of internal audit; procedures for external auditors' appointment and their rotation schedule; issuance of management letter by external auditors and requirement for the external auditors to attend the company's annual general meeting (Securities and Exchange Commission of Pakistan, 2002, *Code of Corporate Governance*).

A deeper look into the Code of Corporate Governance shows that the idea behind having non-executive directors is to introduce an element of accountability in the system. Non-executive director can better look after the interests of minority shareholders and also keep check on the health of the company. However, as a voluntary stipulation it did not yield the expected results. The Code also stipulates having an "independent" director representing a banking or non-banking financial institution. An independent director is not supposed to be related to the management of company to eliminate conflict of interest. An independent director is a representative of "institutional investor". It is again meant to keep a check on the financial health of the company from the point of view of

the banking or non-banking financial institution (Securities and Exchange Commission of Pakistan, 2002, *Code of Corporate Governance*).

According to the Code, a financial report needs to be submitted as the “directors’ report to shareholders”. It includes a financial statement on behalf of the management, changes in equity and cash flows etc. The financial report must also have details of shares held by associated companies; by chief executive officer and directors and their families; by banking and non-banking financial institutions; and by shareholders who hold voting rights in the company due to their shares being ten percent or more. This financial reporting is to be carried out on quarterly, six-monthly and yearly basis respectively. Quarterly reports are un-audited and are circulated with the director’s review. Six-monthly financial reports need to have some review by the auditors while the annual financial statements are authorized by the auditors. There is a disclosure clause that requires the management to declare the shares they hold in the company (Securities and Exchange Commission of Pakistan, 2002, *Code of Corporate Governance*). These stipulations are meant for better financial reporting and transparency. Annual company reports were being shared even before SECP; frequency of financial reporting increased with SECP.

Another area the Code focuses on is the audit function within the companies. The Code emphasizes the establishment of an audit committee with a preference of a non-executive director of the company heading it and two other members being part of it including the chairman. The audit committee needs to meet every quarter to review the audit related matters. The audit committee’s terms of reference are to be decided by the BoD. They include matters like appointing external auditors, reviewing audit reports before their announcement, interacting with the external auditors, reviewing management letter etc. In other words, the audit committee plays the role of a bridge between the company and the external auditors. In addition to the audit committee, there is an internal audit for the company recommended as well. The internal audit coordinates with the audit committee and produces the internal audit report which is made available to external auditors (Securities and Exchange Commission of Pakistan, 2002, *Code of Corporate Governance*).

The Code also stipulates detailed requirements for external auditors. External auditors need to carry a “satisfactory rating” from the Institute of Chartered Accountants of

Pakistan. All companies are required to change their auditors at least every five years. The management of the company cannot be partner with the audit company to avoid a conflict of interest. Moreover, the companies need to issue a statement of their compliance with the Code of Corporate Governance and their statement needs to be reviewed by statutory auditors (Securities and Exchange Commission of Pakistan, 2002, *Code of Corporate Governance*).

The 2002 Report of SECP notes that despite extensive consultation prior to the evolution of the Code of Corporate Governance was evolved, “implementation of the Code was resisted by some elements in the private sector and the Commission had to stand firm to ensure that the initiative was not derailed” (Securities and Exchange Commission of Pakistan, 2002). This suggests the thesis’s hypothesis of the contested space on governance issues. The implementation of Code of Corporate Governance was opposed to the point that SECP had to acknowledge it in its annual report. While the evolution of the Code has been a definite “step forward”, it has not been without the issues of implementation.

Take the requirement of having a non-executive director representing other interests including the interests of minority shareholders. This is needed for accountability, transparency and ensuring diffused control of the companies. As discussed earlier, this is a voluntary clause in the Code. During the fieldwork it was seen not to be implemented by the majority of companies in letter and spirit. Many companies did not appoint non-executive directors. Even for companies where non-executive directors were appointed, their powers were often not at par with the executive directors. Giving credence to minority shareholders would have led to more accountability and reduced the possibility of manipulation by the majority shares executive directors.

Changes in the disclosure requirements, appointment of important company officials and reconfiguring the role of directors have far-reaching consequences in the way companies function. Audits, frequent financial reporting, minimization of the conflict of interest are required for the professional handling of company matters in the family-held corporate sector. The SECP faced considerable resistance in the implementation of the Code of Corporate Governance. Listed companies began delisting from the stock exchanges since they did not wish to change. The chapter later discusses the delisting in detail. Key

informant interviews for the textiles sector referred to the Code of Corporate Governance not being implemented in letter and spirit.

7.3.2. Carry-Over-Trade or ‘Badla’ versus Margin Trading

Introducing the margin trading to replace the Carry-Over-Trade (COT) or ‘Badla’⁵¹ has been another ‘step forward’ in the SECP’s way of progressing towards efficient corporate governance. Badla is speculative in nature. The SECP’s effort has been to replace the speculative trading that carries risk, disputes and fewer settlements with banks financed margin trading that works like a stable overdraft.

Various types of trading takes place in the stock exchanges in Pakistan. The most direct one is called delivery-based trading. Here, whatever a buyer pays is translated into his equity. The buyer gets paid soon afterwards. Opposed to this, Badla works on borrowed money. Financiers or investors lend the money and the trade takes place against the lent money. However, the trade is not settled and is carried over to other transactions where the same borrowed money is used for further trading. It is speculative in nature, leading to volatility in the market. Also the trade settlement is delayed and thereby reduces transparency (I, Ex-SECP top-echelon official, Interview). Hayat throws further light on this “post-trade financing”:

“Those who wish to speculate on borrowed money in the T+3⁵² market obtain funds from those who are willing to lend. Through a reverse repurchase, lenders pay the clearinghouse on behalf of speculators and take delivery of securities while speculators carry over their positions from one settlement to another. The speculators and lenders represent a mix of brokers, individual clients, and institutional investors. The motive for the speculators is capital gains and for the lenders, interest income” (Hayat, official SECP, Dawn, 05-01-2004)

⁵¹ ‘Badla’s is the Urdu name for COT and it is also accepted in the international publications on finance.

⁵² “Investors must complete or ‘settle’ their security transactions within three business days. This settlement cycle is known as ‘T+3’, shorthand for ‘trade date plus three days’. T+3 means that when you buy a security, your payment must be received by your brokerage firm no later than three business days after the trade is executed. When you sell a security, you must deliver to your brokerage firm your securities certificate no later than three business days after the sale. The three-day settlement date applies to most security transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnerships that trade on an exchange. Government securities and stock options settle on the next business day following the trade” (<http://www.sec.gov/answers/tplus3.htm>).

Badla netted Rs 13 billion on average in daily financing in 2003 – with great variation ranging from Rs 6 billion to Rs 25 billion. Badla influences the overall trading to a great extent. Forty to sixty percent of trading is Badla on average. It represents almost half of the trading on average in the KSE (Hayat, official SECP, *Dawn*, 05/01/2004). So in Badla for example, a buyer pays one million rupees of cash and buys securities worth five million; four million being covered by the financier. On sale of securities, the buyer pays interest to the financier and hops on to another transaction. Hence the buyer is speculating on borrowed money.

Badla provides the required liquidity for transactions. However, it is intrinsically linked with the “systemic risk” of the market. There is a possibility that buyers would “accumulate large unsettled positions” without having the actual ability to pay at the clearinghouse if push comes to shove. With the fall in prices, speculators masquerading as buyers tend to exit out by selling en-mass which puts further pressure on selling. Similarly, financiers try to hold back on funds as they fear speculators’ default induced by losses. In cases of default, clearinghouses often end up with more losses than they can accommodate. Due to Badla, any volatile condition leads to a crisis in the stock market. Liquidity in the market is highly skewed. There are 700 listed companies on the KSE. The degree of skewedness is so severe that 70 percent of trading is represented by 10 stocks and 95 percent of trading accounts for only 30 stocks. The rest of stocks do not trade at all. A similar kind of imbalance is evident in Badla trading. Four⁵³ shares took up half of the Badla financing (Hayat, official SECP, *Dawn*, 05-01-2004).

The SECP introduced margin trading to replace Badla. The key difference between the two is that while Badla is post-trade financing, margin trading is pre-trade financing. Financing for Badla is provided by the individual investors or brokers while margin financing is funded by the banks or Development Finance Institutions (DFIs). A certain margin (for example 20 percent or 30 percent) of stocks is pledged with the help of bank financing. Margin trading works on the basis of collateral. A small percentage of current assets of cash is held as a collateral and purchase of shares is allowed against that collateral by providing financing for it. During 2003-04, Margin Trading Rules 2004 were introduced to reduce risks linked with Badla. These reforms were introduced in

⁵³ Pakistan State Oil (PSO), Pakistan Telecommunication (PTC), Pakistan Oil Field (PAKO) and Hub Power Company (HUBCO).

collaboration with the stock exchanges and the Central Depository Company. The SECP also limited clearing house of the stock exchanges to limit guarantee of Badla to 29 companies only. There was still the risk of default (Securities and Exchange Commission of Pakistan, 2004).

In the margin trading, the risk of default shifts to banks or DFIs who are providing financing. In margin trading, the risk are monitored at three levels: banks or DFIs monitor risks being the financiers and investors; the respective stock exchange monitors risk regarding the brokers, and brokers in turn look into the risk regarding the customers. Margin trading is a much safer than Badla. Margin trading can only be performed by brokers registered with the SECP, it further helps with risks mitigation. The registered brokers are required to have “minimum net capital balance” requirements; that helps further. The SECP also bars brokers from giving margin financing facilities to their own partners or directors and to any firm where there is a joint interest. This is to deal with the conflict of interest (Securities and Exchange Commission of Pakistan, 2004).

Despite the introduction of margin trading rules and plans to phase out Badla by 2005, Badla still carried out majority of the trading in the market at the time of the fieldwork. According to a key informant interview done with a functionary of Islamabad Stock Exchange even after the fieldwork, close of 70 per cent of trading was done through Badla (X, Islamabad Stock Exchange, Interview). This figure is higher than stated by the SECP official above. Margin financing had not really taken off. It illustrates efforts to reform corporate governance have been ‘one step forward, two steps backward’.

There was huge resistance by the stock brokers to phase out Badla and replace it with quick settlement of shares. In Badla, the shares keep on exchanging hands but a quick settlement is not carried out. Shares keep on changing hands just as in the property market, files of potential plots keep on changing without the change in the formal ownership. It is speculation and leads to conflict amongst brokers and shareholders. To discourage this speculation, the SECP called for settlement of shares within a short time of turnover. Stock brokers hugely resisted it because with every turnover without the settlement, they got their commission. Whereas, finalization of settlement within a short time of turnover decreased their profits (I, Ex-SECP top-echelon official, Interview).

The ADB is cognizant of the short-term carry-over trade or Badla⁵⁴. Intra-day short-term trades are partly financed by Badla. More than 60 per cent trades are Badla or carried over. The ADB evaluation report had to concede: “though SECP is generally perceived to be an effective regulator, it has not yet been successful in eliminating market manipulation and maintaining a healthy balance between speculative and non-speculative investment” (Asian Development Bank, 2003, pp. 7-8). It shows serious challenges to the ADB’s efforts to implement the corporate governance reforms in Pakistan.

7.3.3. Payment of Dividend

The SECP took measures to ensure payment of dividend to shareholders as per regulation of Section 236 of the Companies Ordinance, 1984. Companies who failed to pay dividend to shareholders were put on defaulters counter by the relevant stock exchange. During 1999-2000, the Enforcement Division of the SECP picked 177 companies from Karachi Stock Exchange’s defaulters’ counter. These companies were asked to explain their poor performance regarding the payment of dividend. 76 companies responded by paying their due dividend to the shareholders after a gap of five years (Securities and Exchange Commission of Pakistan, 2000). There has been improvement in the percentage of companies paying dividend. The number of companies paying dividend increased from 268 in 1998 to 354 companies in 2000. This improvement has been due to the monitoring by the Enforcement and Monitoring Division (Securities and Exchange Commission of Pakistan, 2001). During 2001-2002, shareholders of 255 companies received their dividends. Moreover, the rate of companies declaring dividend also improved. During 1998-99, 33 per cent of companies declared their dividend, in 1999-2000, 41 per cent of companies declared their dividend, whereas in 2000-2001, 48 per cent of companies declared dividend, and in 2001-2002, 41 per cent of companies declared their dividend (Securities and Exchange Commission of Pakistan, 2002). Improvement in the payment of dividend has been a “step forward”. However, SECP report also shows that if 41 per cent of companies declared their dividend in 2002, it means that 59 per cent of the companies did not declare dividend. It raises question marks about the SECP’s ability to enforce corporate governance reforms as they have not been able to make the majority of the companies to declare the dividend. As discussed by Cheema et al. (2003), if dividend is not paid, it weakens the control of

⁵⁴ It is explained in detail later in the chapter.

external and minority shareholders and strengthens the family controlled nature of companies where the management can use the profits for “private benefits”.

There is an issue regarding the non-payment of dividends that is worth discussing. Companies do not pay dividends when they run a loss or they reinvest back in the companies. Hence, it is not necessary that every case of non-payment of dividend is related to the management using it for personal benefits. Having granted that, there are general trends that point otherwise. Close to 60 per cent companies did not pay dividend in 2001-02. It is unlikely that such a large percentage of companies to have suffered losses or have reinvested. Moreover, non-payment of dividend was serious issue as it is mentioned as a violation of law in the SECP annual reports. If dividend was not being paid only due to some genuine reasons such as the loss or reinvestment, the SECP would have taken it into account and would not highlighted lack of payment of dividend as a violation.

7.3.4. Holding of Annual General Meeting

The holding of the Annual General Meeting (AGM) for listed companies is mandatory according to the Companies Ordinance, 1984. It is mandatory for companies to hold their AGMs within six months of the close of the financial year. It gives an opportunity to shareholders to be informed of the state of affairs of the company and to participate in the decision-making process. Annual general meetings of the company also provide a window to shareholders to comment on the performance of the management. AGMs also discuss matters related to dividends’ declaration, annual accounts approval, directors’ election and external auditors’ appointment. Failure to hold AGMs is a violation of the law (Securities and Exchange Commission of Pakistan, 2000; Securities and Exchange Commission of Pakistan 2002; Securities and Exchange Commission of Pakistan 2003; Securities and Exchange Commission of Pakistan 2004).

Fines of over Rs 2 million were imposed by the SECP on 26 companies during 1999-2000 for not holding the AGMs. The total number of companies monitored during 2001-2002 was 617, out of which 548 companies held their AGMs while 69 companies did not hold their meetings within the stipulated time. Fine was imposed on 17 companies while proceedings were started against other companies. Thirty one show-cause notices were sent to companies due to non-holding of AGMs within the allowed time framework (Securities and Exchange Commission of Pakistan, 2000; Securities and Exchange

Commission of Pakistan, 2002). Out of total of 536 companies during 2003-04, 472 complied while 64 companies did not. Show cause notices were sent to defaulter companies and fines worth Rs 1.06 million were imposed (Securities and Exchange Commission of Pakistan, 2004).

The breakdown of level of compliance over the years is as follows:

Table 7.5: Compliance of Holding of Annual General Meeting

Year	No of Companies	No of Compliant Companies	Compliance %
2004	536	472	88.1
2003	582	498	85.6
2002	617	548	88.8
2001	635	534	84.1

Source: Securities and Exchange Commission of Pakistan, 2004

Holding of AGMs is another step towards the rule-based governance. AGMs provide shareholders with a mechanism to keep check on the affairs of the company. It provides them with a window to keep tab on how the company is being run. Since, annual accounts are presented in the AGMs. With the timely holding of the AGMs, they make it possible for annual accounts and other related matters to be discussed by shareholders. AGMs could also provide with an illusion of accountability. There is not much that shareholders can do by meeting once in a year. It is by no means an effective mechanism of accountability by minority shareholders. Nonetheless it is a window of opportunity. It may not ensure the rule-based governance but it is certainly a step towards it.

Companies are largely family held businesses as stated earlier. Key informant interview with an Ex-SECP top-echelon official showed that quite a few company owners were not happy with holding AGMs and attempted to resist it as much as they could. They were of the view that in the AGMS, “every Tom, Dick, Harry (amongst the shareholders) can ask a question and potentially embarrass the management of the company”. They tried to convince SECP to swap AGMs with sending a small gift to shareholders annually by the company (I, ex-SECP, Interview).

7.3.5. Accountability of Auditors

Presentation of annual accounts is the linchpin of regime of the rule-based governance. If the quality of auditing is not up to mark, it does not present a true or fair picture of the accounts. Unless accounts are fairly presented, there is no mechanism to find out the health of company. Proper documentation is essential as a prerequisite of proper accounting. During 1999-2000, the Enforcement Division of the SECP reviewed the performance of auditors and two cases of auditors were sent to Institute for Chartered Accountants of Pakistan (ICAP) requesting action against the auditors due to poor quality of auditing (Securities and Exchange Commission of Pakistan, 2000).

During 2000-2001, several auditors were identified who were not working according to the statutory requirements while auditing the concerned companies. Action was taken against the negligent auditors and their cases were also referred to the Institute of Chartered Accountants of Pakistan (ICAP) for disciplinary measures (Securities and Exchange Commission of Pakistan, 2001). During 2001-02, the SECP tried to mitigate the conflict of interest between the auditor firms and the companies they were auditing, emphasized auditors' rotation, and also imposed fines on the auditor firms that were found guilty of misconduct (Securities and Exchange Commission of Pakistan, 2002).

During 2001-02, two audit firms were prosecuted for performing bad audit on accounts of the two listed companies. Court of Session was approached to prosecute the case of Adil Polypropylene Products Limited, and another case was also referred for adjudication (Securities and Exchange Commission of Pakistan, 2002). Several cases were brought to the SECP's notice where either the auditors did not fulfil the "statutory requirements" or issued false reports. The Enforcement and Monitoring Division of the SECP started proceedings against 20 firms in 25 cases and penalties were enforced on most of the firms. The Commission started handling cases on its own rather than referring them to the ICAP. Previous cases that were referred to ICAP took a long time to get decided (Securities and Exchange Commission of Pakistan, 2002).

During 2002-03, several violations of the Companies Ordinance and International Accounting Standards were noticed by the SECP. Due to the false nature of accounts, the SECP initiated proceedings against 14 chartered accounts firms in 19 cases. Penalties were imposed on 14 cases while the 5 were pending. ICAP was approached to take action against the negligence of accounting firms (Securities and Exchange Commission

of Pakistan, 2003). It is interesting to note that action against auditors continued even during 2003-04. It seems that despite tightening the screw, quality of statutory auditing still left much to be desired. During 2003-04, proceedings were again started due to false or bad accounting. One chartered accountant firm was fined while prosecution initiated against another one (Securities and Exchange Commission of Pakistan, 2004).

Overall, the SECP took action against auditors year after year as discussed above, yet there were still irregularities in the performance of some auditors over the years. Despite the SECP's adherence to professional accounting practices and its penalization and taking strict actions, there were still chartered accountant firms and listed companies which kept on violating the rules quite consistently. Key informant interview with Ex-SECP top-echelon official revealed that chartered accountants resisted the SECP's interventions not only in the auditing realm. They were also opposed to the SECP automating the company names and making them publicly available. Earlier, the accountants used to earn a certain income when a new company name was approved. Automation cut into their income. However, the real resistance was to the SECP's attempts to penalize false or bad auditing as it cut into the deals the auditors would make informally with the companies they were auditing and which were tantamount to the violation of relevant laws (I, ex-SECP, interview). Resistance of accountants and brokers falls within the thesis's assertion that the intermediate classes resist the rule of law as well as the capitalist class.

7.3.6. Unlawful Inter-Corporate Financing

Inter-corporate financing can lead to productive capital formation. However it is often mis-used to transfer funds to associated companies for the management's benefit. To discourage misuse, Companies Ordinance has imposed some restriction on associated companies getting investments from sister concerns (Securities and Exchange Commission of Pakistan, 2003). Inter-corporate financing is not encouraged to avoid unauthorized use of the company's resources to fund associated undertakings. During 2000-2001, proceedings were initiated against ten companies for violating Section 208 of the Companies Ordinance, 1984 and penalties worth Rs 7.3 million were levied. The companies were instructed to annex a list of their investments in their associated undertakings. The aim of this measure was to increase transparency with regards to inter-corporate financing (Securities and Exchange Commission of Pakistan, 2001).

During 2000-2001, the Enforcement and Monitoring Division of SECP sent directives to nine companies to check irregularities with the possibility of fraud. Ghani Textile Mills sold to “themselves” investment worth Rs 9.6 million made in the associated company of Ghani Glass Mills Limited. They were instructed by the SECP to deposit that money in the company’s account as it was considered an “undue gain”. Similarly, Pioneer Cement Limited “erroneously” paid Rs 11 million as reimbursement of medical expenses to its Chairman. The directors of the company were told to return that money to the company. Husein Sugar Mills sold shares of its subsidiary company to the directors of the said company at a low and “inadequate” price. The directors of Husein Sugar Mills were told to give Rs 15 million in the subsidiary company’s account to cater for the exceedingly low price. Similarly, six companies⁵⁵ (which were a mix of textiles and non-textiles companies) were told by the SECP not to pass “special resolutions” regarding sale of their companies’ assets or to further inter-corporate financing in contravention of the law (Securities and Exchange Commission of Pakistan, 2001).

Abuse of inter-corporate financing was checked by the SECP in 2001-02 by pointing towards incorrect facts in the notices sent for annual general meetings. The companies approved the unlawful inter-corporate transfers through “proposed resolutions” that were to in effect hoodwink the SECP. The Enforcement and Monitoring Division stopped the transfer of Rs 120 million to associated companies by asking the parent companies to withdraw the “proposed resolutions” for such investments in 2001-02. Similarly, one company wanted to sell its investment in an associated company at a “throw-away price”; it was stopped from doing so. Companies were identified where they had made investments to their subsidiary companies, which were either over the allowed limit or such an investment was done without the permission of shareholders. In addition to this, 15 companies were prosecuted for violating the “mandatory provisions of the Companies Ordinance”. Ten such cases were in the process of adjudication whereas five were disposed of. As a result of this action, the SECP made more than Rs 1.1 million to be returned to the companies (Securities and Exchange Commission of Pakistan, 2002). Table 7.6 below describes in detail the actions taken against the cases of unlawful inter-corporate financing during 2001-02:

⁵⁵ Dewan Sugar Mills Limited, Dewan Mushtaq Textile Mills Limited, Dewan Khalid Mills Limited, Dewan Textile Mills Limited, Haji Muhammad Ismail Mills Limited and National Tannery of Pakistan Limited.

Table 7.6: Cases of Unlawful Inter-corporate Financing Disposed of During the Year 2001-02

S. No	Company	Amount Invested (Rs in Million)	Action Taken
1	Spencer and Company (Pakistan) Limited	504.697	Penalty of Rs 1 million imposed on the CEO and direction given to recover the investment along with return
2	Gharibwal Cement Limited	501.841	Penalty of Rs 1.5 million imposed on the CEO and directors and direction given to recover the investments
3	Mandviwalla Mauser Limited	18.000	Penalty of Rs 200,000 imposed on the CEO and direction given to recover the investment and return thereon
4	Yousaf Textile Mills Limited	5.626	Penalty of Rs 10,000 imposed on the CEO
5	Ghani Glass Limited	49.935	Penalty of Rs 135,000 imposed on the CEO and directors and direction given to recover the return on investments
	Total	1,089.099	

Source: Securities and Exchange Commission of Pakistan, 2002

Like the previous years, and even during 2002-03, cases of the unlawful inter-corporate financing surfaced. The SECP intervened to stop four companies from making Rs 27 million worth of investment in their associated companies. More cases were investigated where investments were made in associated companies without the prior “approval of shareholders or free of return”. There were nine more cases of unauthorized inter-corporate financing. Four of those were dealt by the SECP in 2002-03 while five were sent for adjudication. The SECP led to overall Rs 776.109 million being returned to

parent companies rather than being unlawfully used by associated companies (Securities and Exchange Commission of Pakistan, 2003).

During 2003-04, similar patterns of the unlawful inter-corporate financing continued. Two companies were stopped from making investments worth Rs 111.06 million in their associated companies due to intervention of the SECP. Moreover, evidence was gathered for cases where investment in associated companies was made without the proper approval of shareholders. Even during 2003-04, two companies were prosecuted for violating the Companies Ordinance in terms of the inter-corporate financing. One such company was told to take its investment back from its associated company and was also fined Rs 100,000 of penalty. The SECP's actions to check unlawful inter-corporate financing during 2003-04 were estimated to return an investment of exceeding Rs 97 million to the parent companies (Securities and Exchange Commission of Pakistan, 2004).

Unlawful transfer of funds to associated companies is a clear example of violation of rule-based norms pushed by the IFIs in the realm of corporate governance. In the instances quoted above, unlawful inter-corporate transfer was either stopped or where the transfer had already taken place, it was reversed and in more serious cases even proceedings were initiated against the concerned companies. It is again a pattern similar to malpractices related to audit functions discussed above. The SECP kept on taking action year after year to stop unlawful inter-corporate financing, yet more such cases kept on surfacing as the years passed by. From the SECP annual reports, this chapter only discusses the cases where the unlawful inter-corporate financing was prevented or actions were taken to prevent it from taking place. We do not know of cases where the inter-corporate financing did take place as an unlawful transfer and either it was not brought to the notice of the SECP or the SECP could not take action against it. Nonetheless, the SECP's action to prevent unlawful inter-corporate financing is a "step forward" in terms of transition to the rule-based governance.

Unlawful inter-corporate funding is related to the earlier discussion of control versus ownership (Cheema et al., 2003). Given the family-based management and their discretion to use the company's funds makes unlawful inter-corporate financing possible in the first place. Knowing the nature of family controlled businesses in Pakistan and the

SECP limitations, the percentage of unlawful inter-corporate financing checked by the SECP is likely to be small. Most such cases may have slipped through the system.

7.4. Resistance to the SECP

As the literature discussed above makes it abundantly clear that corporate sector in Pakistan is family business (Cheema et al., 2003). The same finding reverberated throughout the fieldwork. Textiles mills are owned by families including the public listed companies. This family owned corporate sector put up resistance to the SECP measures to enforce the rule-based governance. Perception amongst the majority of the textile manufacturers was that since textiles is mainly family held business, there is little need of its monitoring and the protection of the interests of minority shareholders. As discussed earlier, only a small number of companies actually trade their shares on the stock exchange and the rest of the companies' shares are illiquid. Therefore, the textiles manufacturers interviewed were unhappy about what they termed "excessive monitoring" by the SECP (discussed in detail above) which led to de-listing of companies from the stock exchange. Views of the some textiles manufacturers on corporate governance by the SECP are stated below:

"All textiles is mainly held by families. They may be public, may be private. *It makes no difference* (emphasis added). There you bring law like Securities and Exchange Commission of Pakistan, what's the point? For most of the textile companies, their shares are neither being sold, nor purchased. They are stocks that are closely held by families... We have some conceptual difference with the Securities and Exchange Commission of Pakistan. We have adopted whatever is happening in America and Europe. We have adopted those rules and systems by forgetting that their management is controlled by shareholders through equity, shareholding, and mutual funds. This is not the case in Pakistan. Other than few companies, which have transferred from government companies to publicly listed companies, companies are held by families... Securities and Exchange Commission laws are not encouraging public companies. Since 2001, insignificant number of companies are listing. Manufacturers are delisting. There are just too many laws while listed companies are closely held by families... What is the point of having so many formalities? The law requires me to have internal auditors. Such laws would have been appropriate had companies been in

the format of European and American companies where there is no one owner sitting” (O, Silk Company, Interview).

The above quote is self-explanatory and it is by no means a minority view. Such views were echoed throughout the fieldwork. A socially aware large textiles manufacturer in Karachi spoke in similar terms:

“It is fine to make rules and regulation to protect the shareholders. They are being effective but we should not compare them with the Securities and Exchange Commission in New York... *The rules are there but somehow the spirit vanishes.* The form, the letter has been emphasized today without creating the spirit. You cannot bring change by creating rules, you bring change by creating conditions” (GT, Textile Mills, Interview).

From this more subtle criticism of the SECP, a denim manufacturer in Karachi put his criticism of SECP more squarely:

“A lot of companies are de-listing... There are a lot of the SECP’s requirements of Code of Corporate Governance and other prudential regulations. Due to the SECP, most of the companies feel suffocated. Too much of monitoring and too much control” (JC, Denim Company, Interview).

This resistance is not limited to the criticism of the SECP. It translated into actions. It led to de-listing of public companies.

In terms of background to listing, tax breaks provided the incentives to the corporate sector to list companies on the stock exchange. Tax breaks were given for publically listed companies by mid-1990s. Whereas corporate tax was 43 percent for private companies, the public companies paid only 35 percent. Hence, quite a few erstwhile private companies listed themselves on the stock exchange to take advantage of the tax differential⁵⁶ (OJ, Federal Board of Revenue, Interview). However, the other side of going public for the companies was to declare the annual income, profits and liabilities to the public, to adhere to the Code of Corporate Governance, and the SECP monitoring. Public listed companies started to delist soon after the SECP initiated monitoring of

⁵⁶ It has changed now and the government has imposed a flat rate of 35% across the board.

corporate governance. The details are as below for the Karachi Stock Exchange, the biggest in Pakistan:

Table 7.7: De-listing of Companies from the Karachi Stock Exchange

Listed Companies in 1994	724
Listed Companies in 1995	764
Listed Companies in 1996	782
Listed Companies in 1997	781
Listed Companies in 1998	773
Listed companies in 1999	767
Listed companies in 2000	762
Listed companies in 2001	747
Listed companies in 2002	711
Listed companies in 2003	700

Source: Karachi Stock Exchange, Annual Reports from 1994 to 2003.

The figures in Table 7.7 show the effect of corporate tax breaks with an increase in the listing of public companies starting from 1995 and continuing more or less till 1997 when the *Securities and Exchange Commission Act* was promulgated. It starts to decline from there to the period between 2000 and 2001 where there is a major drop. This period corresponds to the SECP taking various measures to promote rule-based governance as discussed above. It continues to decline from there onwards.

De-listing of public companies is a strong example of resistance of the Pakistani capitalist class to the regime of corporate governance of the SECP funded by the ADB. Karachi Stock Exchange in 2003-04 ended up with fewer companies than it had a decade ago in 1994.

Other than de-listing, not many new companies listed on the stock exchange. Only a small percentage of registered companies were on the stock exchange. An owner of a large private textiles mill provided an interesting rationale for it:

“My parents are conservative (in terms of financing). My father told me never to borrow money from others for business and not to lose control over the business” (JJ, Textiles Mill, Interview).

Therefore, JJ’s company was never registered on the stock exchange or entered into a venture capital with a foreign firm due to fear of losing grip over his business. This short quote sums up well the larger sentiment in the corporate sector in Pakistan. Not listing and not raising equity as a process of capital formation is due to the fear of losing control. It shows the resistance to the SECP’s corporate governance reforms.

Related to the family-owned nature of Pakistani corporate sector and the shares not being actively traded is the debate regarding the success of corporate governance reforms in Pakistan by the ADB. Ex-SECP top-echelon official in the key informant interview raised a critical issue. The cornerstone of any capital market development programme is to promote the equities market. A successful implementation should have translated into liquidity of trading in shares, so that the companies could raise finance through public equity rather than relying on family fortunes or bank loans. As discussed earlier, it did not happen in the case of Pakistan. Ex-SECP top-echelon official was of the view that in the broad sense, the ADB’s capital market development programme failed because it did not lead to an effective equities-driven capital formation, despite making gains in some other sectors such as revamping of interest rates for the national savings schemes etc. The SECP checked petty corruption through automation, it also initiated the leasing companies, *modrabas* and mutual funds and brought the non-profit sector under control through the Companies Ordinance. However, it did not lead to capital formation through equities market (I, Ex-SECP top-echelon official, Interview).

This is a fairly strong indictment of the ADB’s intervention in corporate governance in Pakistan. The literature shows that the ADB was aware of it and acknowledged it (Asian Development Bank, 2003). This criticism is also applicable to the SECP. While, the SECP made progress on the Code of Corporate Governance, holding of Annual General Meetings, paying of dividends to shareholders, checking unlawful inter-corporate

financing and automating the company names etc; it failed to raise an effective capital formation through equities market.

This chapter on SECP mainly covers the period from 1999 to 2004. However, just to gain some perspective on the developments immediately after the fieldwork, it is worthwhile to note that the Karachi Stock Exchange crashed in March-April 2005. It reached a peak as the Asia's best performing stock exchange due to the combination of large inflows coming into Pakistan post September 11, 2001 and investment being made with short-time horizons in the property market and the stock exchange. KSE-100 share index ballooned from over 6,000 points on 31st December 2004 to over 10,000 points on 15th March 2005. Market surged a great deal in these few months. The index started dropping from March 16th 2005 onwards. On 12th April 2005, it crashed by dropping back to a little less than 7,000. This crash led to a loss of Rs 780 billion, mostly to small and middle investors. Big brokers⁵⁷ were thought to have made billions of rupees of windfall profits. The stock market crash happened due to "market manipulation, insider trading and market abuse". Big brokers were later protected by the government by not letting the SECP Chairman Dr Tariq Hassan to implement the findings of the task force on KSE crash in March 2005 (New Pakistan, May 2005).

If the SECP reforms to phase out Badla trading with margin trading had been implemented in letter and spirit, such high volatility in the market would not have occurred. The SECP made attempts to introduce margin trading. However, it clearly was not very successful and led to the market being manipulated by powerful brokers which led to its crash in March-April 2005.

The ADB literature mentions a few powerful brokers running the capital market in Pakistan (Asian Development Bank, 2003). During the key informant interview, Ex-SECP top-echelon official was very candid in terms of the powerful brokers and chartered accountants resisting the SECP management of corporate governance. According to I, the highest resistance to SECP was put up by the powerful stock brokers. Some of these brokers were so powerful that they had direct access to the then President Musharraf and then Prime Minister Shaukat Aziz. In the key informant's experience of

⁵⁷ Names of 13 big brokers out of the list of 88 who have been named to have grossly profited from the crash of March 2005: Atlas Investments, AKD Securities, BMA Securities, Arif Habib, Orix Investment Bank, KASB, Taurus Securities, Abdul Jabbar Khanani, Escort Investments, Jehangir Siddiqui, Akbar Ali Cassim and Sons, Motiwala Securities, and Elixir Investments (New Pakistan, May 2005).

getting rules to be passed by the then President and Cabinet, he met one powerful stock exchange broker coming out of the President's room as he went for the Cabinet meeting and the stock broker told then SECP top-echelon official that those rules would not be passed by the Cabinet. The SECP official did not believe the broker as those rules were item number two on the Cabinet meeting agenda and all the necessary groundwork had been done needed for the legislation. During the Cabinet meeting chaired by the President where the SECP top-echelon official was also present, proceedings took place exactly as predicted by the broker. Despite the SECP rules being agenda no 2 on the meeting, the concerned minister and bureaucrats backed out of their earlier written summaries and those rules were not passed (I, Ex-SECP top-echelon official, Interview). This incident is an anecdote; however, it is supported by a firm perception that the stock brokers were very powerful in Pakistan and they had access and influence in the highest policy making circles. Cheema et al. (2003) refer to Khwaja and Mian study on "insiders" and brokers of the stock exchange resisting change in the functions of the stock exchange. This was because even though the number of beneficiaries of the old system were small, the rents associated with it were large. Therefore, even a small number of powerful players could oppose the reforms.

There is little domestic ownership of IFIs pushed reforms. Key informant I was of the opinion that "The decision makers do not believe in them (the reforms). They just do it to get money from the IFIs". Hence, as soon as the programme term expires, the back-tracking and policy reversals start taking place (I, ex-SECP top-echelon official, Interview). One of the key reasons behind the setting up the SECP was to have an autonomous institution run by professionals who manage corporate governance. The purpose was to take corporate governance away from the control of the Ministry of Finance. After the lapse of the programme loan period, however, the influence of the Ministry of Finance in the SECP and its Board of Directors was again palpable (I, ex-SECP top-echelon official, Interview). Presently, the Secretary of Finance Division⁵⁸, the Secretary of Ministry of Commerce⁵⁹, and Deputy Governor of the State Bank are on the policy board of the SECP, with the Finance Division Secretary being the Chairman of the Board. The ADB's massive effort to make the SECP autonomous has been largely reversed.

⁵⁸ Government of Pakistan.

⁵⁹ Government of Pakistan.

7.5. Hidden Subsidy: Capital Gains Taxation and Vehicle Leasing

Share trading on the stock exchanges was exempted from capital gains tax. In a severely under-taxed economy, such an exemption is an anomaly. As Chapters 4 and 6 state, it was possible to get access to some internal CBR documents entitled “Explanatory Circulars 1998-2004” (Central Board of Revenue, 1998-2004). These circulars show changes in taxation related legislation from 1998-2004. They offer an interesting insight into the implementation of the rule of law in the corporate sector.

Capital gains tax is defined as “any profit or gain arising from the transfer of capital assets, other than immovable property or assets which are entitled to depreciation allowance, is chargeable under this head” (Central Board of Revenue, 2004, p. 29). In 2004, government extended the period of tax exemption on capital gains. Capital gains is charged on redeemable capital of registered companies and sale of *modaraba* certificates. This period was extended until 2007 (Central Board of Revenue, 1998-2004, “Explanatory Circulars 1998-2004”). However, capital value tax was levied on purchase of shares in Stock Exchanges at the rate of 0.01 per cent. It was applicable on purchase of redeemable capital or *modaraba* certificate. It was imposed from July 2004. Apparently it seemed to push rather contradictory measures. On the one hand, the tax authorities were continuing to grant exemption to the capital market on capital gains tax. On the other hand, they imposed a nominal capital value tax on purchase of redeemable capital (Central Board of Revenue, 1998-2004, “Explanatory Circulars 1998-2004”). However, capital value tax is minimal. Overall, the tax authorities gave advantage to the capital market by persisting to exempt it of capital gains tax. The capital market really prospered during this period. In some sense, by extending exemption on capital gains, government gave a hidden subsidy to capital market sector. An elated performance of the stock exchange in early 2000s when Karachi Stock Exchange was considered one of best performing markets in Asia could not be delinked from this hidden subsidy. Similarly there was an exemption given to venture capital companies from withholding tax. That exemption was also extended till 2007 (Central Board of Revenue, 1998-2004, “Explanatory Circulars 1998-2004”).

Chapter 3 discussed the thriving of consumer financing during the Musharraf era. The SECP had a certain role to play in it. Due to the capital market development plan of the ADB, leasing sector was reinvigorated. The SECP annual reports show that the

government encouraged vehicles' purchase financing through concessions in *the Finance Ordinance, 2001*. It led to an increase of 9 percent of investment in the leasing sector. Tax concessions were again to the leasing sector in the Finance Ordinances of 2001 and 2002 (Securities and Exchange Commission of Pakistan, 2002). Tax incentives were provided to the vehicle leasing sector which further contributed to a boom in vehicle leasing. Similar practices were repeated in the Finance Act 2003 (Securities and Exchange Commission of Pakistan, 2003). Giving boost to the vehicle leasing through tax concessions is another case of hidden subsidy being given through tax related concessions.

7.6. Post-fieldwork Studies

Pakistan's stock market's capitalization was close to Rs 600⁶⁰ billion in 2003 and only a miniscule number of companies are listed on the stock exchanges (Bari, 2006). A World Bank report says that there are 47,500 registered companies in Pakistan (World Bank, 2008). Out of 47,500 registered companies, only 700 plus are publicly listed, or just over 2 per cent. Public listed companies are a miniscule part of the overall corporate sector in Pakistan, which shows the shallowness of the capital market development programme of the ADB.

The ADB in its 2005 report states that the objective of the capital market development programme (CMDP) was "creating an enabling policy environment to enhance competition and a level playing field" (Asian Development Bank, 2005, p. iii). The ADB's evaluation considered CMDP "highly relevant". The ADB was satisfied with the "level playing field" provision, the SECP's management of securities market and the leasing sector. It considered pension and insurance reforms only partly successful. It also underlined risks from new types of manipulation of the market in the securities and the need to strengthen the market surveillance system of the SECP. It repeated the findings of the ADB 2003 evaluation regarding the CMDP achievements and notes that the SECP-directed TA Loan 1577-PAK(SF) was only partly successful since it contributed

⁶⁰ Pakistan's GDP (factor cost) for 2003-04 was Rs. 5206.56 billion or 5.2 trillion (Government of Pakistan, Economic Survey of Pakistan, 2003-04).

only “marginally” to the strengthening of the SECP’s corporate governance structures (Asian Development Bank, 2005).

The ADB 2008 evaluation of its capital market development programme in six countries -Pakistan, Indonesia, Philippines, Viet Nam, Sri Lanka and Mongolia -is more realistic compared to earlier evaluations. It terms the ADB’s intervention as “borderline successful”. In terms of impact, while capital markets were more developed as the result of the ADB’s reforms, the evaluation acknowledges that liquidity in the stock markets of the developing countries has only been “modest”. It also admitted that on politically sensitive issues, either the ADB pushed reforms were “not implemented or reversed later on” (Asian Development Bank, 2008, pp. iii-v).

The 2008 evaluation report also underscored the need of ownership and commitment from all relevant stakeholders over the long-term for the difficult reforms to succeed. In terms of achievement, the ADB evaluation report is of the view that though market capitalization hovered around 20 per cent of GDP in the programme countries and was at par with some other Latin American and Eastern European countries, it was less than other developed markets in Asia such as Singapore, China, Hong Kong and Malaysia. The evaluation report notes that the turnover of shares trading in Pakistan was high⁶¹ matching more developed market, it was due to Badla trading that also introduced high volatility and unpredictability in the market. In terms of value addition, the ADB’s programmes achieved “substantial” value addition in the Philippines and Pakistan and it was not realized in Sri Lanka while the rest of the three countries fared in between. The evaluation also acknowledges the preponderant role of Ministry of Finance of the borrowing countries in the corporate governance organisations despite the fact that ADB’s intervention emphasized autonomy and independence (Asian Development Bank, 2008).

Conclusion

There is a ‘one step forward, two steps backwards’ relationship between the law and governance in terms of the SECP’s performance. It captures the struggle between forces

⁶¹ Since turnover of shares is very low in the family owned and controlled corporate sector; such a high-turnover of shares would have taken place in the government owned or foreign companies.

which want to impose a regime of rule-based governance and those which resist it. The SECP has taken action against bad auditors, unlawful inter-corporate financing, non-holding of Annual General Meetings of the companies amongst other measures. It also introduced the Code of Corporate Governance and introduced margin financing to phase out Badla trading. The SECP is also perceived to be successful in the leasing sector. It also made interventions in the reform of mutual funds and insurance sector. All these measures are a step forward.

Market volatility due to Badla trading, market manipulation by the powerful stock brokers, illiquidity in trading and a general failure in achieving a substantial capital formation through an equities market are failures for capital market development reforms.

The ADB evaluation reports keep mentioning market manipulation by powerful brokers as the main opposition being faced to capital market development in Pakistan. As discussed in the chapter, it is the capitalist sector in Pakistan which also resisted corporate governance reforms. Since the corporate sector in Pakistan is family based and owned, it is wary of losing control if external investors and minority shareholders are protected. It is also wary of active trading of shares of the public listed companies. It is the capitalist class which resisted the SECP reforms of corporate governance and started to de-list from the stock exchange rather than adhering to the reforms. In other words, the capitalists do not want more mature capitalism. They want to continue with their family controlled and owned corporate sector that helps them maximize their gains using all strategies including the rule-violating behavior.

However, it does not mean that stock brokers and chartered accountants did not resist the SECP backed reforms for transparency and rule-based governance. Powerful stock brokers and other professional classes also resisted the reforms. The intermediate classes and the capitalist class indulged in the rule-violating behaviour either in collusion with each other or on their own. Such rule-violating behavior documented in this chapter points towards the challenges of transition to a modern “Weberian” state.

Chapter 8. An Overview of the Textiles Sector in Pakistan through Manufacturers' Perceptions

This chapter gives an overview of the textiles sector in Pakistan largely through the manufacturers' perceptions and views. It also gives background, statistics, discusses various stages of production in the textiles and presents the key findings of the fieldwork. This chapter is based on sixty-four key informant interviews of the textiles manufacturers, representative of the textiles' association, employees and stakeholders, in addition to statistics from the government publications and some secondary sources. This chapter is to serve as a background overview to the next Chapter Nine, which presents quasi-anthropological case studies on the phenomenon of inter-generational hereditary entrepreneurship.

8.1. Background

There is not much specific literature available on the textile groups in the 1950s and 1960s. There is, however, literature on the monopoly houses of that era, and textiles was a significant part of those monopoly houses.

As Chapter 3 states, erstwhile traders became the new industrial class in Pakistan in the 1950s and 1960s due to an active role of the government institutions to redistribute resources to the emergent capitalist class. These erstwhile traders mostly traded in cotton and yarn. The industrial tycoons of Pakistan, i.e. the so-called 22 or 43 families,⁶² largely emerged from these traders. Half of the total production in the textile sector came from nine big industrial houses in 1959 with over 37 per cent textiles being produced by the top five industrial houses. Over 70 per cent of total production of these big industrial houses in the then West Pakistan consisted of textiles. This pattern got consolidated over the next decade. The largest four industrial houses produced 28 per cent of textiles in 1970 where only twenty-three industrial houses produced the textiles in total (Amjad, 1974; Zaman, 1984; Zaidi, 2005).

As discussed in Chapter 3, the government's liberal finance played a crucial role. Thirty-seven monopoly houses got 65 per cent of the total funds given from 1958 to 1970 by the Pakistan Industrial Credit and Investment Corporation (PICIC). One leading business

⁶² Depending on whether one takes Mahbub-ul-Haq's definition who popularized the concept of 22 families ruling Pakistan or Lawrence White's definition who calculated monopoly houses to be 43.

house owner Adamjee was the Chairman of the investment corporation while other 7 were on its board of directors. A similar pattern was observed in the National Investment Trust. Pakistan Industrial Development Corporation (PIDC) started business enterprises and then disinvested them at throwaway prices to the leading monopoly houses such as Amin, Adamjee, Bawany, Dawood, Fancy, Isphani, Nishat, Saigol, Karim and Hoti. Quickly, a capitalist class in Pakistan was born. Many of the business houses started off in the textiles and jute businesses but then branched into others such as chemicals, sugar, cement, shipping, and later into insurance and banks. Half of the total assets in textiles were owned by the 17 largest houses (Amjad, 1974; Zaman, 1984).

Papanek (1967) is of the view that profits were so high in a captive domestic market in the 1950s and 1960s that textiles manufacturers were able to earn 50 to 100 per cent profit on their investment and “robber barons” emerged in two to three years time having fully earned back their initial investments.

Significant patronage was distributed through bank loans in the 1980s and 1990s as discussed in the thesis earlier. Using 1996-2002 election results and bank loans data, Khwaja and Asim state that politically connected firms borrowed “45 per cent more and have 50 per cent higher default rates” than others. They also say that incidence of politically motivated loans is higher in the textiles sector compared to other sectors (Khwaja and Mian, 2005).

The spinning sector expanded at an exponential rate (Cheema, 2000). Default of bank loans in the textiles in the 1980s and 1990s led to its decline. The government banks bailed out inefficient, sick, failing firms through political corruption that defaulted on loans. It led to negative spiral of productivity in the spinning sector (Cheema, 2003).

8.2. Textile Sector in Contemporary Pakistan

Textiles is the leading manufacturing sector in Pakistan. As discussed in Chapter 4, all statistics on Pakistan emphasize the primacy of the textiles sector:

Textiles “... share in the economy, in terms of GDP, exports, employment, foreign exchange earnings, investment and contribution to the value added in industry; makes it the single largest determinant of the growth in overall manufacturing activity... Pakistan has emerged as one of the major cotton textile product supplier in the world market and its share in world yarn trade is about 30

percent while its share in cotton cloth trade is about 8 percent” (Government of Pakistan, 2003, *Economic Survey of Pakistan 2002-03*).

The above quote illustrates that value addition has not taken deep roots in Pakistan’s textiles sector. While Pakistan had 30 percent share of yarn in world trade, it has only 8 percent of world share in cloth. Moreover, Pakistan’s overall share in the world textiles was only 2.9 percent in 2000 (United Nations Industrial Development Organisation, 2009). We will return to this later in the chapter.

Major economic contribution by the textile sector during 2002-03 is given below:

Table 8.1: Primacy of the Textiles Sector in Pakistan in 2004

Exports	68 % of total exports (US \$ 7.4 billion)
Manufacturing	46 % of total manufacturing
Employment	38 % of total industrial workers
GDP	10.5 % of total GDP
Investment	31 % of total investment
Taxes	Rs. 101 billion per annum
Salaries & Wages	Rs. 4.5 billions per annum
Contribution To R&D	Rs. 148 billion per annum
Banks financing	US\$ 1 billion during 2002 & 2003
Investment in last 4 years	US\$ 4 billion

Source: *Pakistan Investment Guide*, Ministry of Industries, Government of Pakistan, 2004

These statistics speak volumes about the significance of the textiles sector.

The structure of Pakistan’s textile industry in 2004 was as follows:

Table 8.2: Composition and Structure of the Textiles Sector in 2004

Sub-sector	No. of Units	Size (installed capacity)	Production
1. Ginning (unorganized/cottage, small sector)	1221	5,488 Saws	More than 10 million cotton bales ⁶³
2. Spinning			
Spinning (organised sector)	392	9.2 million spindles, 147,853 rotors	1,550 million kilogram yarn
Composite Units (organized sector)	50	(un-stated)	(un-stated)
Total (Spinning and Composite)	442	(un-stated)	(un-stated)
3. Weaving			
Composite Units (organized sector)	50	9,876 looms	384 million square meter of fabric
Independent Weaving Units (organized sector)	140	23,600 shuttleless looms	(un-stated)
Independent Weaving Units (unorganized/cottage, small-scale sector)	453	50,000 looms	3600 million square meter of fabric
Power looms (unorganized/cottage, small scale sector)	20600	175,200 looms	(un-stated)
4. Finishing			
Organized Sector	10 (plus composite units)	(un-stated)	(un-stated)
Unorganized/cottage, Small Sector	625	Cotton	2,700 million square meter
		Synthetic	760 million square meter
		Total	3460 million square meter
5. Garments			
Organized Sector	50	5,000 sewing machines	(un-stated)
Small-scale Cottage Sector	2500	30,000 sewing machines	650 million pieces
6. Terry towels (small-scale cottage sector)	400	7,600 looms	55 million kilograms
7. Canvas (small-scale cottage sector)	100	2,000 looms	35 million kilograms
8. Knitwear (small-scale cottage sector)	600	12,000 knitting machines	400 million pieces

Source: Government of Pakistan, 2004, *Pakistan Investment Guide*; All Pakistan Textile Mills Association, October 2004.

The Table 8.2 above gives an overview of the textiles sector in Pakistan. It shows that the only organised sub-sector within textiles is spinning. The bulk of weaving is done in the small-scale weaving sector or on the power looms. For finishing, the statistics of the formal sector are not available but indications are that the bulk of finishing is also done in the small-scale and unorganised sector rather than the formal sector. The formal textiles sector was largely limited to close to 400 spinning mills and 50 composite units in 2004.

⁶³ One bale of cotton is approximately 170 kilogram of cotton.

Appendix 3 is a comprehensive representation of the basic textiles sector from 1948 to 2004-05. The table shows capacity not being used in the formal sector weaving. Less than half of the installed capacity was not being used. Looms hours worked started to go down in 1970-71 and in 2004-05, they were roughly 1/6th of 1970-71 average. It is the same period when the informal sector started taking roots in Pakistan. Hence, it would be fair to assume that weaving capacity started to shift from the formal to informal sector from 1970-71 onwards. With the change of government in late 1970s, spinning picked up from 1980-81 as the increase in yarn production shows.

Appendix 3 also shows rapid increase in the spinning started from mid-1980s. It almost doubled by 1990-91 and had increased four-fold by 2004-05. Production of cloth really started to pick up around 1954 when Pakistan's emergent industrial class set up the textiles mills and there was the Korean War boom as discussed in Chapter 3. From 29.5 million meter in 1948, cloth production peaked to 658.3 million meter in 1970-71. It started going down from then onwards in 1970s and 1980s. It somewhat started to pick up from 1991-92 reaching barely above its 1970-71 figure of 658.3 million meter in 2003-04.

Table 8.3: Pakistan Share of Cotton Yarn and Cloth in World Trade (1971-2002/03)

(000 Metric Tons)

Period	Cotton Yarn	Cotton Cloth
1971	24.5	5.4
1972	28.8	5.9
1973	25.4	7.1
1974	14.1	8.0
1975	25.6	5.8
1976	14.6	5.8
1977	7.1	4.5
1978	11.0	5.9
1979	11.8	4.5
1980	11.7	5.9
1981	10.6	6.6
1982	13.5	6.5
1983	14.8	7.3
1984	9.2	6.0
1985	14.5	6.5
1986	17.1	5.7
1987	16.7	5.8
1988	18.3	6.2
1989	22.6	6.1
1990	29.4	7.1
1991	30.4	7.6
1992	35.1	7.4
1993	34.9	6.4
1994	27.5	6.4
1995	28.0	5.9
1996	29.1	8.3
1997	23.8	7.0
1998	23.8	10.4
1999	26.1	13.0
2000	27.3	9.7

2001	28.0	9.9
2002-03	30.0	8.0

Source: All Pakistan Textiles Mills Association, 2004; Government of Pakistan, 2003, *Economic Survey of Pakistan 2002-03*.

The decline from 1970s is evident in Table 8.3. Pakistan had over 28 percent share of world yarn trade in 1972, and in 2001 it still had roughly the same percentage as of 1972. Pakistan's share in cotton cloth almost doubled since the 1970s which is a step towards value addition. Cloth export's share started to increase since the early 1980s and kept on hovering around 6 percent for 1980s. It remained around 7 percent in the first half of the 1990s and increased to over 10 percent for the first time in 1998 before coming down to 8 percent in 2002-03.

Pakistan's share of yarn exports dropped in 1974 and then kept on steadily declining from 1976 onwards, touching a low of 7.1 percent in 1977. It started to pick up from 1985 and reached above 30 percent in the years of spinning glut of the early 1990s. Again started to come down in 1994 around the time of spinning crisis and reached 30 percent in 2002-03 again.

Table 8.3 should be read along with the point 8.4.2 in the findings of the fieldwork concerning post-nationalisation textiles sector later in the chapter.

Appendix 4 shows the value addition in bedwear, garments, hosiery and cotton manufacture. All of these sectors started to take off by the mid-1980s. This finding is verified by the qualitative fieldwork. Appendix 4 should also be read along with point 8.4.2 regarding the post-nationalisation textiles sector discussed in chapter later.

There were special regimes governing the trade in the textiles sector for over thirty years. The Short Term Cotton Arrangement was enacted in 1961, the Long Term Cotton Arrangement was prevalent from 1962-1973, and finally there was the Multi Fibre Arrangement (MFA) from 1974-1994. The General Agreement on Tariffs and Trade (GATT)'s general preferences were changed to set up the MFA. The purpose of MFA was to protect the imports into the US and Europe from certain countries such as China and allocate quotas to other less developed countries in the world. Multilateral trade negotiations of the Uruguay Round included the textiles sector in 1986. At that time it was not possible to bring the quota driven trade into normal GATT rules right away. However, in 1995, it was decided to make quota based trade of the textiles and garments

under the World Trade Organisation (WTO)'s Agreement on Textiles and Clothing (ATC). ATC gave a ten years phase-out transition period for quotas. The rationale behind agreeing on a ten year transition period was to provide time for adjustment for the exporters and importers to adapt to the WTO regulations. With the start date of 1st January 1995, the transition took place in stages and ended on 31st December 2004 (Pakistan Textile Vision, 2000; United Nations Industrial Development Organisation, 2009; Siegmann, 2005).

MFA quota regime had a great impact on Pakistan's textile and garments exports. Forty-eight percent of exports of Pakistan's textiles and eighty-seven percent of exports of its apparel were done through the quota regime to markets such as the United States and European Union in 2001 (Siegmann, 2005).

8.3. Different Stages of Textiles Production in Pakistan

- 1) Cotton ginning⁶⁴ is the first stage of value addition in textiles. Pakistan has an inherent advantage in textiles since its main raw material, cotton, is grown in Pakistan in southern Punjab and upper rural Sindh in Pakistan.⁶⁵ Ginning factories are located around the cotton belt.⁶⁶ They are owned by farmers.
- 2) Ginned cotton is made into yarn through spinning. Spinning is the main textiles sector. Spinning is done in the organized sector due to the nature of production. Over the years, due to advancement in the value-addition capacity, 73 per cent of yarn is consumed within the country to make grieg cloth or finished products and

⁶⁴ Pakistan is cotton growing country. There is lots of contamination in Pakistani cotton which affects the ability to produce good quality yarn, fabric and garments. It is difficult to produce higher value added products due to this contamination. Pakistani cotton is contaminated by "bad" ginning. Ginning is leased out by absentee landlords in upper Sindh and southern Punjab. Lower Sindh cotton is early but is not of good quality. Pakistan does not have modern ginning facilities. Since cotton production is localised, textiles manufacturers do not invest in ginning. Contaminated and non-contaminated cotton gets a rough treatment during ginning which deteriorates its quality further. The quality of raw material for spinning is not of good quality (RB, All Pakistan Textile Manufacturers Association, Interview; JJ, Textiles Mill, Interview). With Pakistani cotton, the manufacturers generally get up to 30-40 counts. For better results, you need yarn of 80 to 120 counts. Poly-cotton gives you up to 300 counts (S, Textiles Mill, Interview). Pakistani manufacturers are also using polyester fibre along with cotton for spinning. A multinational company set up the first polyester fibre making plant by mid-1990s. Hence, other than importing polyester fibre, it is also being produced locally.

⁶⁵ To give a recent estimate, close to 10 million bales of cotton per year have been produced in Pakistan from 1999 till 2004.

⁶⁶ The quality of ginning is generally not considered to be good. It is an enigma why the government or the textile capitalist class does not invest resources to improve the ginning quality.

only 27 per cent of it is exported (Textiles Commissioner's Office, 2004). Distribution of yarn makes an interesting read. According to the Textiles Commissioner's Office documents the largest portion of yarn i.e. 39 per cent goes to the un-organised sector that includes power looms and small scale weaving units. 27 per cent of yarn is exported. 22 per cent goes to the organized sector to be consumed in shuttleless looms. 7 per cent yarn goes to organized knitting and 5 per cent to towel sub-sector (Textiles Commissioner's Office, 2004). It shows that in terms of yarn consumption, the informal cottage sector is the biggest consumer. It conforms to the statistics shown in Table 8.2 regarding weaving.

- 3) Yarn is made into grieg cloth through weaving. Weaving is done both in the formal and the informal sectors. In terms of the number of units, informal sector is bigger than the formal sector as Table 8.2 shows. According to the key informant interviews, there is the lack of proper estimates about the informal sector. No one exactly knew how big the informal weaving sector was. The available statistics on weaving are in Table 8.2.
- 4) The grieg cloth produced through weaving is processed through printing and dyeing. Printing and dyeing is again done both in the formal and informal sectors. Though, figures for the formal sector production were not available. The figures for small-scale and unorganised sector production show that a large part of printing and dyeing is done by small, independent units. In terms of economies of scale, bulk of the printing and dyeing is done in big composite units.
- 5) The processed fabric is turned either into garments or home textiles. Garments are again produced both in composite units and in the small scale sector. There are 2500 small garments units in the cottage sector compared to 50 garments factories in the organized sector (*Pakistan Investment Guide*, 2004). Towels and canvas is a growing sub-sector. Knitwear is a highly under-utilized sector in Pakistani textiles. In knitting, the yarn is knitted directly. Despite being the most profitable,⁶⁷ it has not been fully capitalized.

⁶⁷ One Bale of 170 Kgs of Cotton is worth (in USD) 119 in raw cotton, 253 in cotton yarn, 434 in towels, 579 in cotton grieg fabric, 603 in finished fabric, 618 in bed-wear, 1,401 in knitwear and 1,561 in woven garments. (*Pakistan Investment Guide*, Government of Pakistan, 2004).

Pakistan's organized sector is still dominated by spinning, though other sub-sectors are catching up and value addition has increased. The spinning sector's preponderance also came through key informant interviews:

“The strongest sub-sector in the textile industry in Pakistan is spinning. Weaving and knitting complements it. A lot of finishing units have recently been established highlighting the trend that shows that industrialists are investing in downward integration. More value addition-oriented sectors are being invested in. In weaving, manufacturers are using shuttleless looms. Now the trend is towards having composite units” (B, All Pakistan Textile Mills Association, Key Informant Interview).

There is a heavy reliance on cotton crop due to dominance of spinning. Even though Pakistani manufacturers have been importing cotton since the 1990s and using polyester fibre in their spinning, the cotton crop still plays a pivotal role. Raw materials constitute about 70 per cent of the total cost of production. Textile manufacturers need to store cotton upfront for three months, November to January, for their whole year of production. If the textiles manufacturers succeed in buying cotton at a cheap price, they make huge profits (G, Textiles Mill, Interview).

Spinning and weaving in the organised sector is capital intensive, energy intensive and highly automated (BS, Defunct Textiles Mill, Interview). Thirty-eight per cent of total employment is generated by the textiles sector, yet, textiles sector has relatively limited capacity to generate jobs on its own. Jobs are really generated by the garments sector as the formal textiles sector is largely automated and does not create mass employment.

The garments⁶⁸ and apparel⁶⁹ sector is mainly in Karachi, Lahore, Faisalabad and Sialkot but has some presence in Multan and Hyderabad as well. There are 50 large and 2500⁷⁰ small garments units in the cottage sector: 60 per cent in Karachi, 30 per cent in Lahore, 5 per cent in Sialkot, and 5 per cent in Faisalabad, Multan, Hyderabad combined.

⁶⁸ This chapter mainly discusses the textiles sector in Pakistan. Garments, apparel and hosiery etc are discussed only to give an idea of the downward integration in the textiles sector. Garments sector on its own is not the focus of this chapter.

⁶⁹ Apparel includes garments, any kind of garments including knitted and woven fabric and other type of garments including jeans, knitted sports goods, woven and knit pyjamas (night-ware), and industrial clothing. (NN, Former Chairman Pakistan Readymade Garments Association, Interview).

⁷⁰ *Pakistan Investment Guide*, 2004 figures (see previous page).

Organised sector mostly exports. The informal estimate is that 90 per cent of garments production in the formal sector is exported. There are a few well-known companies, like Cambridge and Bonanza which manufacture garments for the domestic market. The companies that export use a number of different strategies. Some of them directly sell to stores abroad, e.g., to Walmart. Others sell to other American and European chains and others still to overseas importers. Importers have their sourcing offices with buying agents in Karachi, Lahore, and Faisalabad. Garments in the unorganised sector is a small-sized operation. It ranges from 10 stitching machines to 150 machines employing 30 to 200 workers respectively. It is generally a “one person show”. Labour laws and social compliance standards are not followed in the unorganised sector. Unorganised sector sells to the domestic market and to flea markets abroad (NN, Former Chairman Pakistan Readymade Garments Association, Interview). Garments is the most labour intensive sector.

Hosiery is still a cottage industry in Pakistan, despite 5 per cent of composite units. In the unorganised hosiery sector, the whole family often runs the show together: “father is cutting the cloth and children are stitching it” (TA, Pakistan Hosiery Manufacturers Association, Interview). Just like garments, hosiery is a labour-intensive sector process in the informal sector as sewing is involved. The size of hosiery set up varies. For example, a vertically integrated hosiery-based textiles mill, Masood Textiles Mill, in Faisalabad, has 10,000 employees where as a small unit has 20 employees (TA, Pakistan Hosiery Manufacturers Association, Interview).

Towels sector deals in bibs, aprons, small towels, and mopping towel. Majority of towel factories (90 per cent) are in Karachi, whereas the rest are in Lahore. In the unorganised towel sector, there are ten thousand small factories. Big towel companies also buy from small units (NS, President Towel Manufacturers’ Association, Interview). One-fifth of the towel production is done by commercial exporters in the un-organised sector. However, 80 per cent of total towel production is done by 20 companies that includes recognised names like Naqshbandi, Afroze, Universal, Hala, and United (SU, Towel Mill, Interview).

The fieldwork was done near the end of the phase-out of the Multi-Fibre Agreement on Textiles and Clothing by the end of 2004. There was a strong perception that garments

were going to suffer in the post quota phase due to the high competition from China. A small garments factory owner said:

“Garments units are working on very small margins. It has become very competitive now. If it gets more competitive, I will not be able to sustain.” (R, Garments Company, Interview).

R’s words indeed proved to be correct. A few years after the fieldwork of 2004, an effort was made to contact over half a dozen garments factories interviewed at the time of the fieldwork. It was not possible to contact even one of them as they had all gone under in the post-MFA phase in Pakistan.

8.4. Main Findings of the Fieldwork on the Textiles Sector in Pakistan through Manufacturers’ Perceptions

We present the main findings of the fieldwork through the textiles manufacturers’ perceptions below:

8.4.1. Bhutto’s Nationalisation Undermined the Textiles Sector in the 1970s

From late 1960s, the years of “disjuncture” started in Pakistan’s political economy (Sayeed, 2002). As discussed in Chapter 3, massive concentration of wealth led to unrest in towns and urban areas. Populist parties won the elections. After the dismemberment of Pakistan, the People’s Party (PPP) government in the erstwhile West Pakistan formed the government and implemented the policy of nationalization. It did not nationalise textiles, though there were rumours that it might happen. Still, it had a massive impact on the textiles sector. Pakistani nascent business class had no idea what had hit them.

There was public anger against Ayub government and its “cronies”. Resentments against the business class were part of the PPP’s election manifesto. Still, the capitalist class was shocked at the initial wave of nationalization. When Bhutto nationalised banks and insurance companies in 1974 that broke the back of the capitalist class. The government cut the hand off that was feeding the big business. The business community was in a state of disarray. Those who had invested in East Pakistan lost their assets. Others assets were nationalized. Quite a few of them left the country as they feared persecution. The strong reactions of the capitalist class on the impact of Bhutto’s nationalisation come

across in the case studies on inter-generational hereditary entrepreneurship are discussed in Chapter 9. The negative impact of Bhutto's nationalisation comes across sharply in the textiles statistics given above in the tables and in the appendices. We provide a few quotes from the manufacturers to illustrate their resentment against Bhutto's nationalisation:

“Bhutto destroyed the industrial class, though left some big fish. We lost the discipline. Middle management and skilled work force, they both lost the discipline. Bhutto pushed Pakistan back” (JJ, Textiles Mill, Interview).

“Bhutto's nationalisation of banks was really a disaster. *You can use any word that you want.* It brought down the country to a very bad financial condition” (R, Garments Manufacturer, Interview).

8.4.2. Post-Nationalisation Textiles Sector

The contemporary textiles industry in Pakistan mainly consolidated in the 1980s, having emerged in some form in the 1970s. It expanded from the mid-1980s onwards and modernised in the 2000s. There are some old groups such as Crescent Textiles Mill, Colony Mill, Kohinoor Textiles Mill, Gul Ahmed Textile Mills and Nishat Textiles Mill who started in the 1950s and 1960s. However, the majority of the textiles sector consists of the post 1970s groups. Just to quote an example: Lawrence White accounted for the forty-three monopoly houses in 1960s. Out of those forty-three⁷¹ groups, very few are in business in contemporary Pakistan. Moreover those few old groups who still existed at the time of the fieldwork went through a process of metamorphosis. They split up or went dormant or faced labour problems in the 1970s. They regrouped in 1980s. In a sense, their present reincarnation also belongs to the 1980s. Tables earlier in the chapter further illustrate this point.

Bhutto encouraged the small-scale industry in the 1970s. As a result of this, lots of units came into existence that were either in printing or dyeing or in towel making. Both printing and dyeing were low-budget forward chain integration in the textiles sector. Commercial exporters and outsourced vendors got into it. In the 1970s, the towel

⁷¹ Lawrence White's list in terms of financial strength of the industrial groups includes Dawood, Saigol, Adamjee, Jalil (Amin), Shaikh, Fancy, Valika, Bawany, Bashir (Crescent), Wazir Ali, Ghandara, Isphani, Habib, Khyber Textile Group, Nishat Group, BECO, Gul Ahmed, Arag (Haji Habib), Hafiz, H.A. Karim, Millwala, Hyesons, Dada, Premier Group, Hussein Ebrahim, Monoo, Maulabaksh, Adam, A.K. Khan, A.A. Ghani, Rangoonwala, Haroon, Hirjina, Shaffi, Fakir Chand, Haji Hashan, Dadabhoy, Shah Nawaz, Fateh Textile Group, Noon, Hoti, Ghulam Faruque, and Haji Dost Mohammad (Zaidi, 2005).

industry boomed in Pakistan. The Soviet Union agreed to buy towels from Pakistan through a barter agreement. It enabled firms like Hala Enterprises in Lahore and Naqshbandi in Karachi to get initiated in towel production. Later, these towel companies started to produce for American clients as well. They were mainly supplying cheap “white” towels for the motel industry (Manufacturers interviews).

In Bhutto’s period, small units with a few looms were given income-tax exemption. Small units mushroomed, particularly in Faisalabad. Small scale industry was encouraged and economies of scale was neglected. Although the tax exemption was removed after the Bhutto era, most of the small industrialists avoided paying tax. Due to their origin in the tax-exempted days of Bhutto era, they considered that it was their right not to pay tax (B, All Pakistan Textile Mills Association, Interview).

Commercial exporters started out in the 1970s. Quite a few industrial houses like Afroze Textile Industries, Karachi; Al-Abid Silk, Karachi; J.K. Spinning, Faisalabad; Milli Textile Mills, Faisalabad; S.M. Denim, Karachi and King’s Apparel, Karachi, started out as commercial exporters in the 1970s and they gradually developed a base for themselves and started manufacturing in the 1980s and 1990s. Manufacturers started to move into value addition and “higher end of production” (Manufacturers Interviews). Again, tables earlier in the chapter and in the appendices show how the textiles, garments production and exports started to pick up from the mid-1980s onwards.

Cheema (2000) has discussed in detail how the “new entrants” dominated the spinning industry in the 1980s, particularly from the mid-1980s onwards. The government was essentially giving a subsidy on cotton in the 1980s. Cotton was bought on fixed rates from growers and sold to buyers. This fixed rate was apparently in place to offer support price to farmers. Also, a ban on export of cotton was a hidden subsidy in price offered to spinning factories. Cotton, the main raw material for spinning, was made available to factories at lower than world price. It enabled spinners to earn windfall profits. However, in the 1990s this situation changed. Cheema is of the opinion that this happened mainly due to the collective action of the farmers’ lobby and their electoral strength in the 1990s (Cheema, 2000). Key informant interviews indicate that the hidden subsidy on cotton was done away with both due to the pressure of International Financial Institutions and pressure by the farmers’ lobby (Manufacturers Interviews).

“During the 1980s, license regime disappeared and new breed of entrepreneurs came in. They had political clout. They got government patronage. Banks provided them money without scrutiny” (CB, Industrialist, Interview).

Earlier, the industry had high entry barriers and there were restrictions on setting up the business. Nawaz Sharif removed those restrictions and licensing regime was done away with (B, All Pakistan Textile Mills Association, Interview). International Financial Institutions again played a role in doing away of the licensing regime and liberalising the entry into business.

Small entrepreneurs invested successfully in weaving, printing, and dyeing in the 1980s. This part of the story came across quite clearly in Faisalabad during the fieldwork. Since the city of Faisalabad had over a hundred thousand power looms to weave cloth, new emerging small commercial exporters or cloth merchants-turned- entrepreneurs set up printing machines. The sociological background of the new class of textile manufacturers of the 1980s and 1990s in Faisalabad is interesting. Their fathers and forefathers were traders in cotton, yarn and cloth. There is a ‘yarn market’⁷² in Faisalabad near the Big Clock (*Ghanta Ghar*). Fathers and forefathers of the new manufacturers used to sit in the yarn market to trade yarn and fabric. From trading yarn and cloth, they got into textiles manufacturing. From traders, some of them or their children moved into becoming commercial exporters and then continued to get high dividends due to value addition through printing and dyeing. Later on, they moved back into weaving and spinning.

Karachi had a somewhat similar story as far as garments are concerned. Garments manufacturers set up small units in the 1980s and 1990s. The story of birth and growth of T Garments explains how the garments sector worked in Karachi. T Garments was a small garments factory in Karachi. Its owner, UB, a Punjabi described it as follows:

“I used to work with my cousin in another garments factory in 1980s. We have been in the leather business. My parental grand-father was from Amritsar (Indian Punjab) and maternal grand-father from Kanpur (India). I started this business from the scratch in 1993. I just had one buyer. I started as commercial exporter. I got an order, bought raw material and rented a place and started off with riding trousers. I had the know-how. It was a special knit. I got it dyed. That’s how I

⁷² Known as *Sutarmandi*.

started. In the first five years, the business doubled every year. I moved to a bigger place in 1996. I had 400 stitching machines and established in-house washing” (UB, Garments Company, Interview).

In the 1990s, the removal of cotton subsidy and liberalization of the economy had adverse impacts on large scale manufacturing. The textiles sector experienced negative growth like most of the other medium and large-scale manufacturing industries in the mid-1990s. Its growth rate went down by 1.21 per cent over this period. There were 1135 “reporting establishments” in 1990-91 which decreased to 1068 in 1995-96 (Government of Pakistan, 2001, *Census of Manufacturing Industries, 1995-96*).

After the crisis in the spinning sector in the early to mid 1990s, Pakistan’s textile sector had another turn-around from 1999 onwards. From 1999 to 2004, the textiles exports increased 63 per cent and value-added textile exports increased by 71 per cent.

Approximately \$4 billion of investment was made in balancing, modernizing and replacement (BMR) in the textiles sector. This investment was made due to the phase out of quota regime at the end of Multi-Fibre Agreement. The textiles sector re-invested heavily in modernization to make it competitive with China and India. Most of the BMR investment was made in spinning and finishing sub-sectors. Despite the fact that cotton production was consistently close to 10 billion bales since 1999, Pakistan still imported over two billion bales of pima cotton. Due to liberalization in the 1990s, export and import of cotton was permitted. It allowed “product diversification” in the textiles sector. Pakistani cotton is short to medium staple in the range of 7-30 counts. Imported cotton with enhanced spinning capacity could go up to 80 counts. It helped to produce wider-width fabric needed for bed-sheets and home furnishing. Higher counts of spun cotton is also needed to produce fine women clothing (All Pakistan Textile Manufacturers Association, 2004).

In 2004 and 2005, textile manufacturers were quite buoyant about the state of textiles sector. A manufacturer of a large textiles mill commented:

“Textile industry has come a long way from the 1970s and 1980s. The spinning industry from the late 1980s has had tremendous improvement in technology and productivity. There was a recession after six years of growth from 1986 to 1992. There was a downturn. The big spinners realized that they need to have weaving capacity in order to balance their own growth and go logically forward to the next

step of integration. In the early 1990s, we saw development of shuttleless looms. Money went into weaving by the manufacturers who were spinners before. Others started expanding in finishing, printing and dyeing” (GT, Textiles Mill, Interview).

Despite USD 4 billion of investment in modernizing Pakistan’s textiles and clothing sector, a study by the Asian Development Bank concluded that Pakistan continued to produce “the least sophisticated products” and that it lost exports share in the dynamic sub-sectors of the global market. The ADB report was of the view that technology, skills and quality would be the yardsticks in setting the pace of the future growth of Pakistani textiles (Asian Development Bank Institute, 2004).

8.4.3. Big companies were predicted to dominate in the post MFA-phase

Multi-fibre Agreement on textile and clothing expired on 31st December 2004. With the expiry of the quota regime, the overwhelming feeling amongst the textile manufacturers was that it was going to lead to concentration of power in the big groups. The informal textiles sector in weaving and finishing would continue to exist as before as it caters to a different market. However, amongst the formal sector, the big players would dominate.

Nishat Mills Ltd (Faisalabad/Lahore), Nishat Chunian (Lahore), Kohinoor Textiles Mills (Lahore), Kohinoor Weaving Mills (Lahore), Gul Ahmed Textiles Mills (Karachi), Al-Karam (Pvt) Mills (Karachi), Sapphire Textile Mills (Lahore), Mohammad Farooq Textiles Mill (Karachi), Chenab Textiles Mills (Faisalabad), and Masood Textiles Mill (Faisalabad)⁷³ were some of the big companies listed amongst the big textiles mills. All companies with an annual turnover of more than \$100 million were considered big textiles companies.

The big groups exported 80 per cent of their output. Big groups sold to the US and European chains like Walmart, JC Penny, and Sears etc. They mostly produced bed sheets and home textiles. Towels, men’s shorts, socks are auxiliary products sold by intermediary companies in the export market. A few composite units such as Masood Textile Mills Faisalabad catered to such knitted garments export.

⁷³ In Karachi Stock Exchange list of top one hundred companies called KSE 100, there are only 7 textile companies i.e. Nishat Mills, Kohinoor Textile, Nishat (Chunian), Gul Ahmed Tex., Bannu Woollen, Dawood Lawrencepur, Gadoon TextileXD (<http://www.kse.com.pk>).

The top textiles groups were all composite units and vertically integrated. It meant that they processed ginned cotton all the way to the end product. They had spinning units that produced yarn from ginned cotton, weaving machines that produced cloth from yarn. Grieg cloth went through certain treatments like mercerizing and then the cloth was either printed in automatic rotaries or dyed in large dyeing machines. It was cut and stitched in the garments section. Finally the end product went through packaging, marketing and sales departments.

Textile manufacturers thought that big companies were going to dominate in the post-quota phase:

“The future lies with 40 major companies. The rest are going to be irrelevant. The reason is that the nature of business is such that it plays on scales and how organised you are. There is not much room for the cottage industry. It has to be on big scale; otherwise you cannot survive for long. One *shalwar kurta* (dress) of tailor versus thirty thousand garments in a factory. This is a phenomenon. *That is the way*. Pakistani textiles is up against something humungous like socks cities and necktie cities in China. *Only the big fish can survive that kind of competition*” (TT, Textiles Mill, Interview).

Another owner of a large textiles mill was of the view:

“In the textiles, big players would survive and do well now. Social compliance is needed to sell it to retail groups abroad. Only big groups can provide social compliance. With the phase out of quota, buyers like Walmart do not need to deal with ‘a guy with 50 machines’. They would like to deal with big players so that they can deliver on time. Big players are organised, they have got the financing, and they have got the factory conditions and quality control. One cannot have economies of scale unless you are big. Earlier, manufacturers used to set up factories with 12 thousand spindles, then 25 thousand spindles. No one talks about 25 thousand spindles now. People talk about 100 thousands spindles. The same is in weaving. It’s getting bigger and bigger and more competitive” (JB, Defunct Textiles Mill, Interview).

The Textiles Commissioner office in Karachi was very clear that the government would support the big groups. Only the big groups would be able to compete with China. It was the war of quality and processing (H, Textile Commissioner Office, Interview).

The trend was shifting towards vertically integrated units at the time of the fieldwork. The textiles manufacturers were of the view that customers had started to prefer a finished product from under one roof, i.e. spinning, weaving, printing all under one management. According to their view, the trend was shifting towards customer specific items by moving away from the standard products. Industry had to deliver better products at lower costs and with better, efficient service. The order lead times had also gone down (BL, Textiles Mill, Interview).

In the middle-level textiles companies, the trend was to have one major company listed as a public limited company, while three or four small and export based sister concerns would be private companies. Some companies had textiles mills set up separately from their export houses. It helped to act as commercial exporter on the side along with being a manufacturer. In terms of tax advantages, export houses did not declare annual tax returns. One per cent of income tax was deducted at source at the time of export by the bank. Earlier there used to be four different rates: .75 per cent, 1 per cent, 1.25 per cent and 1.5 per cent on the principle of the value addition. However, by 2004, a flat rate of 1 per cent was imposed across the board. It was a presumptive income tax. There was pressure on Pakistan by the international organisations to revise the tax upwards. Pakistan, however, kept the low-tax rate to “facilitate” its exporters. Export houses did not file income tax returns, they only filed their annual statements (OJ, Federal Board of Revenue, Interview).

The big companies, on the other hand, were moving towards merger with their sister concerns to attain economies of scale. Kohinoor Maple Leaf Group, Nishat Textiles Mill and Sapphire Textiles Mill had merged their spinning, weaving, printing and garments sections. This was meant to attain the economies of scale (B, All Pakistan Textile Mills Association, Interview).

Nishat Mills was the biggest textiles mill in the country after the merger with 180 thousand spindles, 600 looms, 2 rotaries and 2 dyeing machines. They produced 7 million meter of grieg cloth in a month, 6 million meter a month meter of dyed cloth and 3 million meter of narrow width fabric. Various units in the Nishat Mills worked as

autonomous units. For example, if the spinning unit could sell specialized yarn to an outside buyer at a higher price compared to selling it in-house to its weaving unit, it was allowed to sell outside. This was the strategy to make units competitive. With big groups, the trend was to bring all operations under one roof rather than compartmentalizing them into other sister concerns (Manufacturers' Interviews).

The perception amongst the textiles manufacturers was that medium and small companies would be disadvantaged against the big companies in the aftermath of MFA phase-out. There was the sense that small companies would die. There was also the sense that the powerful textiles association, All Pakistan Textile Mills Association, was controlled by the big groups (O, Silk Company, Interview). One owner of a small company aired his strong views and resentment against the big groups as follows:

“Small and medium entrepreneurs do not get loans from the banks easily. They have to mostly reinvest their own profits. *There is a cartel of large manufacturers, exporters and distributors. They are one domain. It is getting stronger and stronger every day. It is a cartel. It is not a free market*” (R, Garments Company, Interview).

Perceptions amongst the textiles manufacturers indicated that the top forty groups had concentration of power and it was set to increase in the post quota phase. With social and environmental standards requirements and the need to deliver on time set by the international buyers, only those companies who had economies of scale were going to survive at the end of MFA.

Table 8.4 and Table 8.5 below illustrate the state of Pakistan's textiles and manufacturing sector in the immediate post-MFA phase out period:

Table 8.4: Leading Asian Exporters of Textiles, 2007

	Share of World Exports 2007 (%)	Share of World Exports 2000 (%)	Rank in Top 15 in 2007	Growth from 2000-2007 (%)	Share in Economy's Total Merchandise Exports 2007 (%)
China	23.50	10.30	2	19	4.6
Hong Kong – re-exports	5.4	7.8	3	1	3.9
Hong Kong – domestic exports	0.2	0.8	-	-12	2.6
Korea	4.40	8.10	5	-3	2.8
Taiwan	4.10	7.60	6	-3	4.1
India	4.00	3.60	7	8	6.5
Pakistan	3.10	2.90	9	7	41.3
Japan	3.00	4.50	10	0	1
Indonesia	1.60	2.20	12	1	3.2
Thailand	1.30	1.20	13	7	2
All Asia Textile Exports	47.8	44.8	-	7	-
World Textile Exports	100	100	-	6	1.7

Source: United Nations Industrial Development Organisation (UNIDO), 2009.

Pakistan did not lose market share in textiles in the aftermath of MFA. As stated earlier, MFA phased out by end of 2004. Pakistan's share in the world textiles was 2.9 per cent in 2000 and it grew by 7 per cent in the 2000-2007 period and its share was 3.10 per cent in 2007. So, the USD 4 billion investment in BMR paid off. Overall, China gained massively in the post-MFA phase. Gains for India and Thailand were not significant and other Asian countries lost out vis-a-vis China which made most of the gains (UNIDO, 2009).

Table 8.5: Leading Asian Exporters of Garments, 2007

	Share of World Exports 2007 (%)	Share of World Exports 2000 (%)	Rank in Top 15 in 2007	Growth from 2000-2007 (%)	Share in Economy's Total Merchandise Exports 2007 (%)
China	33.4	18.2	1	18	9.5
Hong Kong –Re-exports	6.90	7.20	3	8	7.2
Hong Kong – domestic exports	1.40	5.00	-	-9	27.5 (sic)
Bangladesh	2.9	2.6	5	10	80.8
India	2.8	3	6	7	6.6
Vietnam	2.1	0.9	7	22	14.9
Indonesia	1.7	2.4	8	3	5
Thailand	1.2	1.9	11	1	2.7
Pakistan	1.1	1.1	12	9	21.3
Sri Lanka	1	1.4	15	2	42.4
All Asia Garments Exports	52.4	46.0	-	10	-
World Garments Exports	100	100	-	8	2.5

Source: United Nations Industrial Development Organisation (UNIDO), 2009.

Pakistan did not lose out its share in the garments either in the post-MFA phase. Its share of the world exports was 1.1 percent in 2000 and it remained the same in 2007. It did not gain or lose. China again gained massively in the phase-out of MFA. Both Bangladesh and Vietnam also gained due to the duty free access to their exports in the West as they fall in the least developed countries category (UNIDO, 2009).

Overall, Pakistan's textiles did well in the post-MFA phase with a slightly increased market share. In garments, its market share of world exports remained the same largely due to the output of the vertical composite units. The small garments factories went under.

8.4.4. Textiles is a family run business

As outlined in Chapter 7, most of the corporate sector is run by business families. The same finding came through in the textiles sector fieldwork. There were 442 textiles companies in the organised sector at the time of fieldwork (*Pakistan Investment Guide*, 2004, Ministry of Industries, Government of Pakistan). 190 textile companies were listed on the Karachi Stock Exchange. Over 200 non-listed companies were private limited. Again, as discussed in Chapter 7, shares trading on the Stock Exchanges was illiquid and trading took place against shares of only few companies. Thirty companies accounted for 90 per cent of trading in the Karachi Stock Exchange (Malik and Hayat, *The News*, June 14, 2008).

Families held most of the shares for most of the companies. Shares were not held by public at large and there was hardly any venture capital. Manufacturers' interviews indicated that they either themselves were owners or sons and nephews of the owners. The large companies had hired professional management. However, owners still decided and effectively ran the business. Sons of manufacturers inherited the right to be next in line on the company throne. The fieldwork bore unanimous testimony to it all over Pakistan. Views of some of textiles manufacturers are stated below:

“Faithfulness only comes with *blood* is the entrenched belief amongst the manufacturers. They do not keep professional management. Lack of joint ventures is a problem. You cannot advance unless there are joint ventures. There are family restrictions to such ventures” (H, Textiles' Commissioner's Office, Interview).

The interviews showed that the textiles sector was family run business - and that it often lacked professional management. The largest manufacturing sector in Pakistan did not want mature capitalism. Inter-generational hereditary entrepreneurship is discussed in detail in the next Chapter 9 in the context of family and caste acting as social institutions of accumulation.

8.4.5. Patterns of Bank Loan Default

The patterns of banks loan default varied: default of loans taken through political connections, circumstantial default, and default due to plain fraud. During the fieldwork, three textiles companies publically known to be defaulters were taken as case studies. All three companies got into trouble when they took loans from international credit

institutions such as the IMF's subsidiary International Financial Corporation (IFC) or foreign banks and defaulted on them. The international credit institutions took the textiles companies into litigation and the local banks followed suit for their defaults. In other words, had these textiles companies not borrowed from the international credit institutions, they might have continued to go on without much trouble as the local banks were not geared up for prosecution of defaulters. The justice system is almost dysfunctional in Pakistan. It perpetuates conditions where bank loans default and the politics of patronage continues with impunity. Details from three case studies are given below:

N Textiles Mills in Lahore whose owner BT committed fraud and faced criminal proceedings. BT comes from a branch of a well-known family which own textiles' business in the Punjab. The rest of the distant family's textiles concerns were running quite well. In the early 1990s, BT had most ambitious and innovative ideas to expand his textiles business. He dazzled banks with his ingenuity. Other manufacturers described him moving around with two slick laptops displaying the latest business models. It was a period when banks were providing liberal credit for expansion in spinning. Banks got really taken in by BT's glib marketing. A National Accountability Bureau (NAB)'s officer was of the opinion that BT did not spare any bank on the famous financial street, I.I. Chundrigarh Road, in Karachi. BT got huge loans both from the public banks and foreign lending institutions such as the IFC and the American Express. BT did not invest much of the loan in his textiles mill, defaulted on payments and closed down the mill. The American Express as a foreign bank was the first one to declare BT a defaulter. National banks followed suit. NAB arrested BT in 1999 when the Musharraf government started its high-handed accountability campaign. BT served prison and was out on bail at the time of the fieldwork. BT in his own interview did not admit fraud. He was of the view that he expanded too quickly and was too ambitious and that's what led to default. However, there was consensus amongst the manufacturers and the NAB officials that BT never borrowed with the intention of investment in the textiles mill. He committed fraud (BT, Defunct Textiles Mill, Interview; NT, the National Accountability Bureau, Interview; Manufacturers Interviews).

Another defaulter was UJ of I Enterprises. UJ set up his towel factory in the 1970s and was running a successful business. Push for expansion came in the mid-1980s. He planned to set up a huge spinning plant in the late 1980s. The financing, however, only

came through in the early 1990s. The slump in the spinning sector had already started. He could not deal with higher cotton prices and recession. According to him, “I did not have enough financial depth to take on the adverse circumstances”. UJ had also borrowed from the IFC. UJ’s case was one of the circumstantial default. Other manufacturers were of the view that UJ kept a tight control over his towel making operations and did not delegate powers which led a default in the business. UJ is Chinioti and was still running part of business after having settled terms with the State Bank’s new rules on default under the then Musharraf government (UJ, Textiles Mill, Interview; Manufacturers’ Interviews).

NB of B Cotton Mills was another fallen star who defaulted in Lahore. NB and BB, two brothers set up B Cotton Mills in the mid-1980s. Earlier they were builder-contractors and used to construct buildings for textile manufacturers. They branched into the textiles from construction and set up their own weaving plant in 1987. It was a state of the art plant with the latest Sulzer weaving machines. They also won an international award for high quality weaving. They made plans for expansion. The elder brother BB wanted to get into backward expansion by setting up a spinning unit. Younger brother NB wanted to go into forward integration by concentrating on printing. Elder brother prevailed. They got huge bank loans but their expansion coincided with a slump in spinning. They lost their investment and were declared defaulters. Other manufacturers were of the view that B brothers were close to Nawaz Sharif, the twice elected Prime Minister of Pakistan in the 1990s. Manufacturers were of the view that the B brothers got huge banks loans due to their political connections. Due to their close political connections, they were singled out by the next political government of Pakistan People’s Party in 1993. Banks hounded them and they lost their edge. B brothers were still running their spinning business at the time of the fieldwork and wanted to make a comeback in the textiles, while their default cases were continuing on the side (NB, Textiles Mill, Interview; Manufacturers’ Interviews). NB’s default was a combination of a flawed business strategy and having partisan political connections with one leading political party that ruled Pakistan in the 1990s.

These case studies document the various patterns of rule-violating behaviour and rent transfers from the public banks to the textiles manufacturers. As discussed in Chapter 7, non-performing loans were Rs 66.1 billion in December 1990 and they increased to Rs 271.4 billion in December 2000 (*Pakistan: Financial Sector Assessment 1990-2000*,

State Bank of Pakistan). It shows rent transfers on a gigantic scale despite the liberalisation process in the financial sector having started since the early 1990s.

8.4.6. Capitalist Class in Pakistan was Powerful and Protected its Interests Well

Business association and bodies were in place in the textiles industry; however, most of lobbying took place on personal level. All Pakistan Textiles manufacturers Association (APTMA⁷⁴) was a powerful textiles body representing large scale spinning, weaving and composite units. There were other over three dozen⁷⁵ textiles and garments related bodies in the field.

According to Kochanek, Ayub's government was close to the top influential monopoly houses on a personal basis in 1960s. He lamented the lack of associations' culture. Lobbying was done through negotiations. The organized power of the capitalist class was diluted due to the petty politics and factional fights in the Chambers of Commerce. Most of the lobbying was done through personalized contacts (Kochanek, 1983). The fieldwork found that the patterns described by Kochanek fitted well with the nature of lobbying that took place in 2004. The top textiles manufacturers had direct access to the then President Pervez Musharraf and the then Prime Minister Shaukat Aziz (I, Ex-top echelon SECP official, Interview). Business associations represented the "formal" interests of the businesses before the government, while most of the deals were sealed under the table. Textiles manufacturers had easy access to top executives of the country

⁷⁴ "All Pakistan Textile Mills Association (APTMA) is the premier national trade association of the textile spinning, weaving and composite mills representing the organised sector in Pakistan. APTMA emerges as the largest association of the country as it represents 346 textile mills out of which 274 are spinning, 43 weaving and 29 composite units. These spinning mills have production facilities of texturing, mercerizing and dyeing of yarns; weaving mills have sizeable number of air-jet looms, and the composite mills have manufacturing facilities from spinning to finished textile products under one roof. The total installed capacity of APTMA member mills accounts for 8,000,000 spindles, 63,216 rotors and about 10,000 looms. The Association's members produce spun and open-end yarn, grey, printed dyed fabrics and bed linen" (All Pakistan Textiles Mills Association, 2004).

⁷⁵ Some of them were: Pakistan Bedwear Exporters Association, Karachi; Pakistan Cotton Fashion Apparel Manufacturers and Exporters Association, Karachi; Pakistan Readymade Garments Manufacturers & Exporters Association, Karachi; All Pakistan Cloth Exporters Association, Faisalabad; Pakistan Yarn Merchants Association, Karachi; Pakistan Canvas & Tents Manufacturers and Exporters Association, Lahore; Towel Manufacturers Association of Pakistan, Karachi; Pakistan Carpet Manufacturers & Exporters Association, Karachi and Karachi Cotton Association, Karachi. APTMA, the powerful association and lobby group of organized sector spinning; weaving and composite units had offices in Karachi, Lahore and Islamabad and covered most of the Pakistan through its regional zones.

and influenced policy decision in the textiles sector in particular (I, Ex-top echelon SECP official, Interview).

The participant observation also showed that the textiles sector had “cultivated” deep contacts in the relevant bureaucracy in Pakistan and there were discussions over the phone about the “favourable” outcomes of the policy meetings that impact the textiles sector in Pakistan in exchange of “gifts”. Before the expiry of MFA, Pakistani bureaucracy and its Export Promotion Bureaus interacted very closely with the textiles sector to allocate, re-allocate and manage the quota. There were widespread perceptions of mismanagement of the quota regime and Pakistani’s bureaucracy having allowed “quota mafia” to exist.

The legalised corruption was also pointed out by key informants during the fieldwork. Powerful bureaucrats served on the boards of dozens of corporate companies at the same time. The board meetings took place in exotic locations around the world with lucrative perks and benefits. It was also pointed out that capitalists offered their flats in London and New York to bureaucrats’ offsprings who go there for studies (I, Ex-top echelon SECP official, Interview). Hence, legalised corruption and “favours” took place along with other monetary “gifts”.

Pakistan’s capitalist class is powerful and well-connected, in general, with not only the top decision-makers but also with the bureaucracy in general. On the other hand, the capitalist class is not powerful enough to push for improvements in infrastructure or cheap availability of utilities or availability of much needed skilled human resource in the country overall. Yet, the capitalist class is well-connected and powerful enough to protect its immediate interests and earn rents as a result of its interaction with the state institutions.

8.4.7. Different Nature of Patronage

Cheema states that accumulation was efficient in the 1960s because a small group of elite bureaucrats could interact with emerging capitalist class through “repeated interaction”. It is a game theoretical application of prisoners’ dilemma in political economy. Whereas there was “decentralised corruption” in late 1980s, due to the fragmented state structure, less concentrated power of bureaucracy, urban intermediate class of the Punjab entered spinning and bringing the overall efficiency and productivity of the spinning sector down (Cheema, 2003). As discussed earlier, there was still close

interaction of bureaucracy in Pakistan with the capitalist class at the time of the fieldwork despite the fact that ISI policies had phased out and liberalisation of economy took place.

One of the reasons that the 1960s patronage and rents creation was different from the 1980s onwards has to do with political stability of the regimes. Cheema (2000) discusses political stability being highlighted by the spinners (Cheema, 2000). Lack of political stability in the 1990s came across very strongly during the fieldwork. In the 1990s, the two main political parties kept on taking turns without ever completing their terms in office and reversing the economic and industrial policy decisions of their rivals when in power. Hence, there was huge political instability and uncertainty and it had quite adverse impact on the corporate sector.

However, on the basis of fieldwork, this chapter states that the larger explanation of the difference nature of patronage of the 1960s and the 1980s onwards had to do with the varied ways of rent creation. There was crony capitalism in the 1950s and 1960s and the state institutions actively intervened, planned and facilitated the process of the emergence of capitalist class in Pakistan. Chapter 1 and 3 discuss in the patronage in the earlier decades of Pakistan. The role of the state institutions was critical in creating rents while redistributing the evacuee property after the partition. The state institutions used various instruments of its industrial policy to bolster the emergent capitalist class in the 1950s and 1960s. The Ayub government distributed patronage through its rural works programme by allocating funds for the local bodies' representatives known as the members of Basic Democracies. Politics of patronage was in practice since the formative years of Pakistan.

In the 1980s onwards, the role of "political entrepreneur" became important as pointed out earlier in the literature. The nature of the 1980s patronage got fundamentally altered due to Bhutto's nationalisation of 1970s. As the literature in Chapter 3 points out that Bhutto used the nationalised units and other public sector departments to allocate jobs in the public sector. It set precedent of a new way of interacting with the state. The new way was to take-over the state institutions and use them to earn rents not only for the development of the capitalist class but also to indulge in the theft of resources. The interaction of the state institutions with the capitalist class led both to growth-retarding rents and in other instances to also value enhancement.

Discussion on the role of the “political entrepreneur” of the 1980s is contextualised in the nationalisation of Bhutto years. From 1980s onwards, the most lucrative way to earn rents for the political elite and the intermediate classes had been to take-over the state institution. Phenomenal rise in non-performing loans in the 1990s has been discussed. There was theft of resources and rents were used unproductively. However, some of the defaulted bank loans and other rents were also used for value-enhancement as this chapter discusses in the next section.

8.4.8. Value-Enhancement

As discussed above, significant parts of the textiles sector defaulted on bank loans, which amounted to a theft of resources. Alongside this there were some value-enhancing activities. In the background of a rather tenuous relationship of the textiles sector with the rule of law, some rents that the capitalists earned through their interaction with the state institutions led to value-enhancement. The fieldwork points both to theft as well as to value enhancement of the industry.

The fieldwork showed that almost one third of the large textile mills in our sample availed the loan write-off facility from the State Bank of Pakistan. The State Bank refused to divulge the names of such companies but confirmed this finding. This group of large textiles companies is also amongst the top exporters in 2004. We could therefore not match the individual defaulter companies against the list of top exporters on a case by case basis. The link between the defaulter companies having enhanced value and defaulters is established indirectly in our sample.

One egregious example is that of a textiles group found during fieldwork had received economic “favours” through the privatization process in contravention of the rules in 1991. One of the mills owned by this politically-connected group became the largest in the country in 2004. This is a micro example of rents being used productively.

At the macro level there are indications of the textiles sector having become competitive internationally. As per Table 8.4, the UNIDO (2009) statistics reveal that Pakistan’s share of the world exports in the textiles was 2.9 per cent in 2000. After the phase-out of the MFA, Pakistan rather than lose market share in fact gained slightly to achieve 3.1 per cent in 2007. Amongst the Asian exporters, China gained massively as generally predicted. India and Thailand also did not lose its market share and gained slightly. Other Asian exporters lost their market share. Even in garments as per Table 8.5, Pakistan did

not lose its market share. Contrasting this with Pakistan's manufacturing performance in the 1990s this is progress, albeit limited. This is considering the fact that large-scale manufacturing suffered in the 1990s.

Due to the SAP and its policy of liberalization and massive tariff reductions, Pakistan's industry in particular and the economy in general had suffered in 1990s, considered the "lost decade" for economic development in the literature. More than four thousand companies were declared "sick" and the large-scale manufacturing growth was negative in 1996-97. In such adverse circumstances, Pakistan's textiles industry spent USD 4 billion on balancing, modernization and replacement in the early 2000s to deal with the challenges of post-MFA phase. It paid the dividends. Pakistan's textiles sector showed signs of being internationally competitive in 2007 as per the UNIDO (2009) estimates.

Value-enhancement did take place in the textiles sector in Pakistan. Apart from the one example of a highly productive politically-connected textiles mill in our sample general trends also show this. These trends were indirectly established through the fieldwork and supplemented by the macro picture. We have also established earlier that rents creation took place in the textiles sector. We assert that while some of these rents ended up as plain theft of resources, others added value.

Conclusion

Pakistan's textiles sector mostly exports yarn, though value addition in the exports of bedwear, garments and other manufactured items has increased since the mid-1980s. The contemporary textiles sector consolidated itself in the 1980s after being uprooted by Bhutto's nationalisation. The nature of patronage and rents creation has changed over the decades. Patronage in the 1950s and 1960s was transferred largely by the state institutions actively planning and intervening in favour of the emergent capitalist class. Its nature changed after Bhutto's nationalisation. Patronage from the 1980s onwards was a system where the state institutions had been 'taken over' and the political influence used to get liberal bank loans leading to both the theft of resources as well as some value-enhancement.

The future of the Pakistan's textile sector was considered to lie with the top forty companies, which had vertical units and could achieve economies of scale. The capitalist sector was strong and powerful enough to be connected with the decision-makers and

bureaucracy to protect its immediate interests. However, it was not powerful enough to make the state institutions implement much needed improvements in the physical infrastructure as well as the human resources in the country.

The way family held capitalist sector works in Pakistan, it shows that the industrialist in Pakistan do not want more mature capitalism. The family-held nature of the Pakistan's textiles sector is explored more in the next chapter 9.

Chapter 9. Inter-Generational Hereditary Entrepreneurship: Family and Caste Capitalism in the Textiles Sector in Pakistan

This chapter applies the concept of caste capitalism to Pakistan's textiles sector and makes an attempt to link it to the rule of law debate. It is mainly based on textile manufacturers' narration of their family stories and their perceptions. Though, this chapter provides four case studies. These four case studies have been chosen from a pool of forty case studies. These forty case studies have been conducted through sixty-four key informant interviews of the textiles manufacturers, representative of the textiles' association, employees and stakeholders. The four case studies given in this chapter are, therefore, representative of the overall trends of the fieldwork on the textiles sector. The chapter builds a narrative around family and caste as social institutions through which accumulation takes place. It also links family and caste capitalism to the state's policies.

9.1. "Business is in their Blood": Caste Capitalism in the Textiles Sector in Pakistan

"Chinioti are business-minded and hard working. *Business is in the blood* (emphasis added). It is not just a job, it is their whole life" (BN, Garments Mill, Interview).

One of the surprising findings of the study of the textiles sector is that it turns out to be dominated by family and caste capitalism. We found that social institutions play a preponderant role in accumulation. Two trading castes Memons and Chiniotis have dominated the textiles manufacturing since the founding of Pakistan. Just like Marwaris in India, Memons and Chiniotis have dominated the textile industry in Pakistan. Memons were ascendant in the 1950s and 1960s while Chiniotis have risen since the 1980s.

9.1.2. Literature on Caste and Accumulation

Basile and Harriss-White have studied the "social structures of accumulation" of a small town in India and the role of caste therein. They criticize the "double reductionism" in the orthodox economics, whereby capitalism is reduced to the market and in turn market is reduced to the economic realm. Opposed to this, the "social structures of accumulation" school of thought contextualizes accumulation through the interplay of social institutions. They argue that in countries such as India, accumulation is embedded in the social structures or institutions located in the sphere of civil society, independent of the state. Social institutions including 'caste' mediate production factors; they play a

part in the process of money being converted to means of production; they organise the production process; they usher the transformation of product into money through the sale process. In other words, accumulation is embedded in the social institutions at every process of production, exchange and distribution. Basile and Harriss-White note that other variables such as locality, occupation, gender, religion, and party politics also play a role in organising the process of accumulation. However, the most prominent category of importance for the social structures of accumulation is that of caste. The capitalist class interacts with caste and occupational associations and transforms the institution of caste in the process (Basile and Harriss-White, 2000).

Basile and Harriss-White take a Gramscian interpretation of civil society whereby social institutions regulate conflicts in capitalist production to ensure accumulation and stability. They say “caste is a specifically Indian form of civil society” (Basile and Harriss-White, 1999, p.5). In the organisation of contemporary occupation “caste clustering” is prevalent. Hence, “caste clustering” plays a role in the resources and skills’ distribution; labour markets’ regulation; information asymmetries and support of material and human functions of production (Basile and Harriss-White, 2000).

“Caste clustering” lowers transaction costs. Harriss-White explains the growth of networks⁷⁶ through transaction costs lowering matrix. Exchange through networks is not tantamount to market exchange as intermediaries play an important part in the regulation and functioning of the networks. Networks are built around the concept of trust. They reduce the market exchange costs by lowering transaction costs. Transaction costs such as insurance, information, suitable pricing, security against default and uncertainty are lowered. It is done through “repeated contracts” amongst the members of the networks regulated by social institution. These repeated contracts are based on relations and they take time to evolve and “reproduce the networks” (Harriss-White, 2003).

Harriss-White quotes Khalid Nadvi to explain “collective efficiency” through social networks tied together through geography and work in the similar sectors or clusters. Some of the facilitating factors behind “collective efficiency” that lower transaction costs through exchange of information. An exchange is based on personalised contacts. The process specialisation in the cluster based exchange takes place through subcontracting arrangements (Harriss-White, 2003, p. 206).

⁷⁶ In our case, “the network” is caste capitalism.

Chari (2004) developed the concept of “fraternal capital” to describe how the agrarian past of the Gounder caste in Tiruppur, South India, has turned the small town into a garments production powerhouse. Chari attributes Gounder caste success on their “propensity to toil”. Tiruppur became a global production centre of cotton knitted garments. Tiruppur’s exports revenue ballooned from \$25 million to \$636 between 1986 and 1997 due to the success of “fraternal capital”. From making basic T-shirts; Tiruppur graduated into exporting fashion garments with a nine times increase in its exports during the period mentioned above. Small firms ushered this boom by being woven into the detailed arrangements of subcontracting. Gounder caste coming from the working class and agrarian origins organised these subcontracting arrangements and capital around them (Chari, 2004).

Chari’s academic interest lay in analysing how the agrarian past of the Gounder men and their “propensity to toil” led to their industrial present in Tiruppur. The revolution started in the stitching sections in 1970s which led to harnessing of capitalist development and this “provincializing capital” used the subaltern power and knowledge as its means. Chari states that state did not play a role in promoting garments production through Gounders, rather they succeeded “*despite* the state”. However, this claim is contradicted a bit later by pointing out state’s role in shielding the small-scale sector’s specific commodities and also in the disbursement of credit by the State Bank of India led industrial development in a decentralized manner in Tiruppur. Moreover, kinship relationships served the purpose of providing the “background” that worked well to keep the caste hegemony intact in the garments work. It also had an impact in terms of devising labour arrangements that were differentiated by caste and gender (Chari, 2004).

There was upward class mobility as Gounders who worked as wage earners or contractors became owner-operators of the stitching sections. Fraternity and ownership relations guided this process of subcontracting and industrial decentralisation by working through ‘sister concerns’ networks. Collective bargaining processes and piece-rates produced better and finer quality of garments (Chari, 2004).

It is interesting how Chari has used the concept of “toil”. He does not refer to toil to denote “physical effort”, rather toil is a “specific, shared history of work that confers advantages in work discipline”. Chari looks at “toil” as a well-spring of skilled resource for Gounder men to “draw from their past” (Chari, 2004, p.782). It is exactly his

interpretation of toil as a “*specific, shared history of work*” that is similar to the “business in their blood” description in the case of Memons and Chiniotis in Pakistan.

We see the “propensity to toil” and “business is in their blood” capital through kinship and fraternal ties in other contexts as well. In China, it is “*guanxi*” (connections).

Batjargal and Liu define *guanxi* as the “Chinese version of social networks and networking... a web of extended family relationships, a cluster of patron-client exchange relationships for instrumental purposes... and special relationship due to the existence of particularistic ties” (Batjargal and Liu, 2004, p. 160). They further emphasize that there is empirical proof of *guanxi* capital working in China as it ushers in a trust relationship, speeds up mobility in the job market and contributes to performance of the firm. In their view, *guanxi* is not limited to the private realm only, it extends into *guanxi* relationships with government officials as well. Entrepreneurs in China use network members to gather credible information and use *guanxi* contacts to get loans from banks. Investment decisions are made through their working out the indirect or direct relations of social capital. *Guanxi* relationships mitigate against risks and decrease monitoring costs (Batjargal and Liu, 2004).

New businesses are set up by those who have had previous experience and knowledge of the industry and selection of investment decisions are made through “*prior relations*” (Batjargal and Liu, 2004). It is worth asserting this point. In the case of Memons and Chiniotis, prior industry experience and knowledge came up during the qualitative interviews quite strongly. Memons and Chiniotis harnessed their business skills in trade and hides and skin before the partitions. Hence, after the partition, when there was a need to make an industrial class for Pakistan, they quickly assumed the mantle given their past knowledge of business and trade.

Batjargal and Liu further explain that relationship between the rule of law and *guanxi*:

“Chinese are more likely to rely on *guanxi* mechanisms and channels to protect their interests than on contractual covenants, which may be difficult to enforce given the legal and institutional deficiencies” (Batjargal and Liu, 2004, p. 169).

“...general partners of state-owned venture capital firms are more reliant on informal social mechanisms than formal legal means” (Batjargal and Liu, 2004, p. 169).

In these observations, the authors hit the nail at its head. Similarly, Memons and Chinioti-dominated caste capitalism flourished in Pakistan after the partition. This was through social networks, prior business and trade knowledge and path dependent business skills formation. Lack of Weberian impersonalisation and the weak rule of law also contribute to the dependence on caste capitalism. Since the formal legal system does not guarantee honouring of contracts, litigation is often inconclusive and the implementation of the rule of law is costly in terms of time, effort and money. There is reliance on caste networks to secure timely supply of input factors of production and manage the process flow of production. It is the weak legal system that contributes to relations of production being reliant on the larger family and caste relationships. The weak legal system and rule of law indeed explains the caste capitalism of Memons and Chiniotis.

Even though Memons and Chiniotis are neither strictly restricted to one geographical area nor to one town we find that the conclusions drawn by Harriss-White aptly describe caste capitalism in the textiles sector in Pakistan. Textiles entrepreneurs themselves were shy of admitting the significant preponderance of Memons and Chiniotis in the textiles sector. One manufacturer was alarmed at being identified as belonging to a leading caste in the textiles sector in contemporary Pakistan. Another common response was, “Everybody is doing well”, not only the Memons and Chiniotis. However, our fieldwork findings (see below) show that Chiniotis and Memons constituted 69 per cent of the major exporters in key textiles categories in 2004. It may well be explained through the proposition that caste lowers transaction costs such as information, search, reputation, reliability. There is little doubt that caste-specific feedback loop was working in the textiles sector and subcontracting was getting organised through personalised contacts. Repeated interaction of trust facilitated by caste relationships could explain the hold of caste capitalism in the textiles sector.

9.1.3. Background

Several Muslim trading communities moved to Pakistan from what became India after the partition. Memons⁷⁷ moved to Karachi and Chiniotis moved to Lahore and Faisalabad. Before that, there were only a couple of “local” business houses in Pakistan,

⁷⁷ A generic word used for Gujaratis, Kathiawars, Bohras and others.

like Colony⁷⁸ in the Punjab and Gandhara and Hoti in the NWFP. Even Saigols who were Punjabi had their earlier business experience in Calcutta.

Memons and Chiniotis are trading communities who have their roots in pre-partition India. Memons belong to Gujarat in India and they went to trade in Asian and African countries and other parts of the India since the 18th century. They have a long history of being in business. Chiniotis are from a place in the central Punjab⁷⁹, North-West India called Chiniot. They went to Calcutta and other parts of the united India, but mainly to Calcutta, to deal in hides and skins in the 19th century since Hindus who dominated trade in India did not want to deal with leather due to religious taboos (B, All Pakistan Textile Mills Association; UJ, TT, SU, Textile Mills, Interviews).

From geographical point of view, during colonial times, people tended to migrate from North-West India to the Madras-Calcutta belt. People went to 'mainland' India from the 'frontier' regions. There was hardly any business in the frontier regions. Most of the land was controlled by Muslims while most of the business was controlled by the Hindus. Muslims were landlords and peasants and not in business. Thus, pre-partition textiles were controlled by Hindus (B, All Pakistan Textile Mills Association; UJ, TT, SU, Textile Mills, Interviews).

When Pakistan came into being in 1947 and mass scale migration took place between the new India and Pakistan, both Memons and Chiniotis went to Pakistan and started off with trading and quickly ventured into manufacturing. Post-partition textile mills were largely set up by Memon and Chinioti families such as Valikas, Dawoods, and Crescent. Memons were basically traders. After they came to Pakistan, they were supported by the government to set up plants. Memons like Valikas, Adamjees, Dawoods, Gul Ahmed rose to prominence in Karachi while Chiniotis like Nishat and Colony in the Punjab. They were all traders to begin with. Our key informants claimed that 80 per cent of the textiles sector in Pakistan was controlled by Memons and Chiniotis at the time of the fieldwork in 2004. This chapter takes it as an indicative statement (B, All Pakistan Textile Mills Association; UJ, TT, SU, Textile Mills, Interviews). Memons are called "Seths" and Chiniotis are "Mians". Hence, the common perception during the fieldwork was that the "Seths" and "Mians" were controlling the textile sector.

⁷⁸ Colony group is also Ismaili Chiniotis.

⁷⁹ It is part of Pakistani Punjab now.

9.2. Inter-generational Hereditary Entrepreneurship: Evidence from Fieldwork

We matched this qualitative finding regarding caste dominance of textiles with the empirical data. We identified “major exporters” of bed linen, cotton fabric and cotton yarn for 2004⁸⁰ (Government of Pakistan, 2004) and sought to find out⁸¹ whether they belonged to Chiniotis or Memons or neither of them. Out of 49⁸², 22 were Chiniotis, 12 were Memons and 15 were neither Chinioti nor Memon. In other words, 69 per cent of “major exporters” in our sample were Chiniotis and Memons and 31 per cent were neither of the two. Memons alone were 24 per cent of “major exporters” and Chiniotis alone were 45 per cent of “major exporters”. This confirms the qualitative finding regarding caste dominance of the sector.

Most of the key informant interviewees had a single phrase to describe hold of Chiniotis and Memons over the textiles sector: “business is in their blood”. This chapter interprets “business is in their blood” to denote inter-generational role of hereditary entrepreneurship in the textiles sector in Pakistan. We contextualize inter-generational hereditary entrepreneurship through looking at the role of social networks in the development of the textiles sector in Pakistan. The inter-generational hereditary chain is vertical but tied to the horizontal linkages in terms of clan membership of closely knit community. As one Chinioti entrepreneur put it: in a family business, every male family member is given a role and the family acts collectively by taking everyone together.

⁸⁰ The year of fieldwork.

⁸¹ Information about the ethnic background was gathered from Tariq Mahmood, the Chairman All Pakistan Textiles Mills Association (APTMA) Lahore; Mohammad Azam, Zonal Incharge Secretary APTMA Karachi; Aftab Ahmed, Secretary Pakistan Textile Exporters Association, Faisalabad and Mushtaq Chhapra, a Memon businessman in Karachi.

⁸² Adamjee Enterprises (Memon), Afroze Textile Industries (Pvt.) Ltd. (Neither), Al-Abid Silk Mills Ltd. (Neither), Ali Akbar Spinning Mills (Chinioti), Al-Karam Textile Mills (Pvt.) Ltd. (Memon), Al-Rehmat Traders (Pvt.) Ltd. (Neither), Amer Cotton Mills (Pvt.) Ltd. (Chinioti), Amsons Textile Mills (Pvt.) Ltd. (Memon), Arzoo Textile Mills (Chinioti), Chenab Ltd (Neither), Diamond Fabrics Ltd. (Chinioti), Din Textile Mills (Chinioti), D.L. Nash (Pvt.) Ltd. (Neither), Fairdeal Textiles (Pvt.) Ltd. (Memon), Fawad Textile Mills (Chinioti), Gadoon Textile Mills (Memon), Gul Ahmed Textile Mills (Memon), Gulistan Textile Mills (Chinioti), Home Furnishings Ltd. (Memon), Husein Industries Ltd. (Memon), Indus Dyeing Manufacturer Co Ltd. (Chinioti), KAM International (Neither), Kohinoor Textile Mills Ltd. (Neither), Kohinoor Weaving Mills (Neither), Lahore Textile and General Mills (Chinioti), Legler Nafees Denim Mills (Chinioti), Lucky Textile Mills (Memon), Masood Spinning Mills (Neither), Mohammad Farooq Textile Mills (Memon), Monoowal Textile Mills (Chinioti), Mustaqim Dyeing Printing Industries (Pvt.) Ltd. (Memon), Nafeesa Textile Ltd. (Chinioti), Naveena Industries (Pvt.) Ltd. (Chinioti), Niagara Mills (Pvt.) Ltd. (Neither), Nina Industries Ltd. (Neither), Nishat (Chunian) Ltd. (Chinioti), Nishat Mills Ltd. (Chinioti), Quetta Textile Mills (Chinioti), Rahimbaksh Textile Mills (Chinioti), Reliance Cotton Spinning Mills (Chinioti), Riaz Textile Mills (Pvt.) Ltd. (Neither), Sadaqat Textile Mills (Pvt.) Ltd. (Chinioti), Saif Textile Mills (Neither), Samin Textiles Ltd. (Neither), Sapphire Textile Mills (Chinioti), Shams Textile Mills (Chinioti), Siddiqsons Denim Mills (Pvt.) Ltd. (Neither), The Crescent Textile Mills (Chinioti) and Yunus Textile Mills (Memon).

They do so by assigning tasks to every family member. Families exist and prosper together (BT, Textiles Mill, Interview). The inter-generational hereditary vertical integration becomes horizontal as extended family ties transform into social networks.

Genealogies of inter-generational hereditary entrepreneurship and migration came through strongly through in the qualitative fieldwork interviews. These inter-generational cross-migratory case studies reflect on how social institutions such as caste and family played a leading role in the continuation of business cycles. We discuss below four case studies, two each from Chinioti and Memon families:

“Memons and Chiniotis do well since business is an art. *Memons and Chiniotis have it in their blood*” (emphasis added) (R, Textiles Mill, Interview).

9.2.1. D Textiles Mill

D Textiles Mill is one of the oldest mills in Pakistan. It was set up in the 1940s. At the time of the fieldwork, it was a public limited company. It was a spinning mill with a weaving component. It had 185,000 spindles and 120 looms. D Textiles Mill also had another spinning mill at the time of the fieldwork. This other spinning mill was set up in 1992, with 12,000 spindles, and had expanded to 35,000 spindles in 2004.

The story of the inter-generational hereditary entrepreneurship of the D Textile Mills owners is as follows, in the words of the present generation:

“We are the fourth generation of the family. We are an Ismaili Chinioti family. The group was started in 1860s. My great grandfather started the business in Chiniot. He started with rice and flour milling. My great grandfather, with his sons, also went into the cotton ginning business. They had fifteen ginning factories in the cotton belt, which stretches from the Jhang to Faisalabad and Multan. They would travel quite a bit. In 1946, my grandfather, bought land in Muzaffarabad, near Multan and set up D Mills. My grandfather died shortly after the construction of the mill started. My father and his brothers took up the business after his death. At that time, there were very few names in the industry” (OT, Textile Mill, Interview).

OT’s grandfather’s brothers split from him in 1920s. That was the first split in the family. The second split happened in 1962 during the time of OT’s father and his

brothers. His father had three brothers. The second split happened in 1962. OT's father and one of his uncles stayed together. The other two brothers split up. Other brothers got two subsidiary textile mills. OT's father got D Textiles Mill, Multan. The third split in the family happened when OT's father and his brother also split up. OT's family kept the group name while the other brother opened up his business with a new name (OT, Textiles Mill, Interview).

OT has been in the business since 1985 while his younger brother joined in 1992. His younger brother ran the Textiles in Multan along with their father. The younger brother was considered the brains behind the whole operation. OT looked after the business in Lahore. Their business philosophy was to do volume business on low margins. They relied on the economies of scale (OT, Textiles Mill, Interview).

The above case study of a Chinioti family illustrates that there is not only welding of family ties, but also the splits along the line. The broken lines of the family set up their individual businesses and the new generation joins up with their own immediate family members. It reflects how vertical inter-generation hereditary entrepreneurship is spreading horizontally.

9.2.2. C Textiles Group

C Textile Mill Group, also set up by Chiniotis, did not experience family splits as witnessed by the D Textile Mills. C Textiles Group owned ten textile mills at the time of the fieldwork. Their flagship C Textile Mills was set up in 1951. They had 150,000 spindles and 300 looms at the time of fieldwork. The overall capacity of all their textiles units was half a million spindles. They had one thousands looms for weaving and processing capacity of half a million meters per day. They also have integrated fabric production: dyeing, bleaching to finishing. They produced home textiles. Their flagship C Textile Mills is not public limited, while two other textiles mill are. They believed in value addition as their business strategy. Their story in the words of the present generation management is as follows:

“The business started with my father and his brothers. My father had four brothers. They also had their cousin with them. So five of them started the business together. They set it up in the tanning business in India in pre-partition times. They were originally in the tanning of leather in 1910. They went from the

Punjab and worked all over India. This is more like a classical model for all Chiniotis. We are Chinioti family” (TT, Textiles Group, Interview).

The description below by another member of the C Textiles Mill illustrate the role of migration and the specificity of Chinioti caste in consolidating business as discussed earlier in the chapter.

Each of brothers of the C Textiles Group had two or three sons. BT’s father had three sons. Their forefathers moved from undivided India where they had had their business in a few locations: Madras, Calcutta, Jalandhar and Delhi. Their primary business was exports of leather. BT’s grandfather and his brothers were involved with the leather business at the time. BT’s grandfather was the eldest brother. They came to Pakistan in 1949. That is when they started the cotton ginning business. They set up a number of ginning factories in the interior Sindh and Multan (BT, C Textiles Group, Interview).

C group was in cotton ginning before Pakistan came into being. Other than tanneries, they had their offices in Karachi. They were in cotton ginning and cotton export. When Pakistan came into being, they set up ginning mills in Pakistan. Finally, they set up their first flagship textile factory – C Textile Mills - in 1951. Their flagship unit was one of the first composite textile units established. It was the pioneering mill in Faisalabad. It was managed by TT’s father. During the time of the fieldwork, TT’s brother managed it. Slowly and gradually, C Group went into export of fabric in the late 1950s. The group’s major business was trading cotton as it was a natural progression from cotton ginning. They were trading up to 40 per cent of total cotton produced in Pakistan in the 1960s. Then they started trade in other commodities as well. The Group expanded by acquiring industrial units off Pakistan Industrial Development Corporation (PIDC) and went into sugar, jute and insurance business as well. It was a time when businesses were controlled by government licenses and C Group had no problems with it. They bought another textiles mill in the early 1960s, and set up yet another textile mill in their home town of Chiniot. It was sanctioned to someone else but C Group bought it. They also expanded in sugar and got two more units in 1960s (TT and BT, C Textiles Group, Interviews).

In 1970s, a “triple calamity” hit business groups: the loss of the then East Pakistan, the massive devaluation and “hostility to anything that was industrial or business” and it led to nationalisation. The C Group was embarking on expansion in the then East Pakistan but “luckily” had not established any major stakes there and henceforth did not suffer

losses on account of the secession of the East Pakistan (TT, C Textiles Group, Interview).

C Group did lose cotton ginning and cotton export trading due to nationalisation. Cotton export was their major business. They had a company which was exporting cotton from Pakistan. The company was set up during pre-partition days. The company was not nationalised, but the government took over cotton trading and export, hence the company went out of business:

“It was a huge loss. Along with business, we lost the heart and faith due to the terror of the (Bhutto) regime. Businessmen and industrialists were not called nice names. It was said that people who were in the industry are leaches. Even until today, people have not been able to shake that mind set off completely. That ‘phenomenon’ (Bhutto’s nationalisation) put us further in the dark ages” (TT, C Textiles Group, Interview).

C Group was “more or less” dormant throughout 1970s. Textiles and sugar were not nationalised. Factories kept on running “in whatever manner they could”. C Group restarted their active interest in business in 1979. They expanded and set up new textile units: “None of them were named C because of fear of nationalisation. We used lot of generic names, *anything but C* (emphasis added)”. Later on, they went into steel pipes and engineering pipes in 1985. They also put up the first investment bank in 1989. They set up some leasing companies in late 1980s. In the 1990s, they mainly grew in the financial services sector and set up several *modarabas*, leasing companies and investment banks. There was also consolidation and expansion of the textiles. C Group set up other textiles mills, making it a total of ten at the time of the fieldwork (TT, C Group, Interview).

The structure of the business was such that the entire family had joint ownership of all the companies. For public companies, the family owned about 50 per cent of the shares of the companies and the rest were owned by the public (BT, C Textiles Group, Interview).

C Group’s family members represented their companies on the board of directors but the day to day management of the company was handed over to professionals. The structure of family ownership was such that no one person owned a single company. Everyone

owned shares in every company. There had been no split in the family. Everyone owned an equal number of shares. Ownership was mutual. Depending on the particular field of expertise, each member of the family got allotted a certain company to manage for a while. In this way, different members of the family got allocated management responsibilities in different companies. So at any given point in time, one family member was working for one family business and then he could be shifted to another business depending on his interest and expertise (BT, C Textiles Group, Interview).

“Ours is a Chinioti family. Chiniotis are successful because they have been in the business for a long time and the business of trade is *in the blood*. The family used to be known as the ‘cotton kings’ because at the time they were exporting cotton out of Pakistan whereas no one else was doing as much export” (BT, C Textiles Group, Interview).

C Textiles Group’s story is quite different from D Textiles Mill, though they were both amongst the Chinioti pioneers in textiles in Pakistan. In the C Group, there had been no family splits and the family remained a cohesive group. It is a strong commentary on family and caste ties working as a social institution. C Group’s ancestors migrated from Chiniot to India to trade in leather and then moved back to Pakistan to start off with the textiles. Hence, migration is linked up with caste and family’s emergence as a social institution mediating accumulation.

9.2.3. HB and BL Textiles Mills

HB and BL Textiles Mills in Karachi belong to a Memon family. They are both large textile mills with HB being a public limited and BL a private limited. They have similar stories of migration and inter-generational hereditary entrepreneurship. However, the owner of the HB Textiles Mill did not want to speak much. This case study draws on his cousin JJ’s narrative about the family history.

HB was set up as a private company in 1953. It was later listed on the Karachi Stock Exchange in 1972, as a public limited company. The installed capacity of the mill is over 100,000 spindles, over 500 looms and a finishing and processing plant.

HB and BL Textiles Mills’ owners’ Memon forefathers were in business since 1900s. JJ, owner of BL narrated the family story as follows:

“We are a Memon family. We have been in the business in Pakistan since 1947. We chartered the flight and came in with the whole family from Rajkot, Gujarat, India. There we were in trading, so here we also started trading. Then we got into import of textile business with Japan in 1948. We decided to put up a textiles mill. My uncle put it up. He passed away before the mill started operating in 1950. He did the construction for the mill. There was a proposal to get into a joint venture with the Japanese. My father suggested our share would be 51 per cent and Japanese would own 49 per cent. Japanese wanted it the other way round. He did not agree. He came back from Japan, liquidated all the trading companies and started the textile mill with 100 per cent of our capital in 1954. He got the same machines as were due in the joint venture. We did not know how to set up the textile mill. He hired middle managers and spinning managers from Japan. We got them on a five year contract. That’s the story of birth of HB Textiles Mill which is run by my cousin now” (JJ, Textile Mills, Interview).

JJ started working in the textiles business in 1971. By 1985, all of his cousins were grown up and were running the business. He narrated the story of his personal endeavour in the textiles sector:

“I told them (his cousins) that they either work my way or I walk out. It was instead decided that I leave. I started running BL Textiles Mill in 1985. It used to be B Textile Mill before. It was lying idle. It had been foreclosed. We bid for it. Four manufacturers bid for it. I was most desperate. We bid the highest and got the mill. It was a ghost house. There was no electricity, no water. Somebody had taken the machines out. We went to get it registered. We needed L4 license⁸³. L4 was the license to operate. Later, the IMF and World Bank forced Pakistan to reform and do away with L4, which is good. We went to the concerned department and said we want to pay excise duty and start production. They refused to give us the license on that day. It was summer *Ramzan*⁸⁴, and they made us sit outside in the sun. At *iftar*⁸⁵ time, they said ‘come tomorrow’. They made us sit like this for three days and then gave us the license. Our ‘crime’ was that we had bought a mill through the high court by paying full amount and we

⁸³ Licensing has been abolished now.

⁸⁴ Muslim holy month of fasting.

⁸⁵ Break of fasting after sunset in the holy month of fasting.

had bought cotton that was waiting to be spun. We wanted to pay the taxes. We were standing in the queue but they refused to take our taxes because we did not have L4 number. We managed to make it work out with great difficulty” (JJ, Textile Mills, Interview).

JJ restarted the old mill in 1985 with European machinery. By 1990, they were into exports with an edge in home textiles. Anti-dumping duty was imposed by Europe on Pakistan in 1992. Anti-dumping duty made it difficult for them to compete in Europe. BL Textile Mills found a niche in the US market. They expanded and made sister concerns. They set up another textile mill in 2001 (JJ, Textile Mills, Interview).

Other than HB and BL Textiles Mills owned by two Memon cousins, another of their cousin owns a towel making factory. The family also has two other private textiles mills.

HB and BL Textiles Mills stories show how the inter-generational hereditary entrepreneurship works out in real life. This is a story of typical Memon family who have been in business in Gujarat (India) since the 1900s. They were in trading. They migrated to Pakistan and started off with trading and then branched into the textiles sector. The family splits later on egged on by extended members of the family to set up their own ventures which turned out to be successful due to the “*business in their blood*” rationale.

9.2.4. B Defunct Textiles Mill

Memons were in ascendance in the 1950s and 1960s. By 2004, many Memon groups were still in business, but their hegemony was broken as a lot of them went under in the 1970s due to Bhutto’s nationalisations. This resonates with the story of B Textiles Mill in Karachi which went under in the 1970s. This mill was part of a big B group of the 1960s. They were a Memon family. One of the family members, JB, narrated the story of migration and hardships:

“We are a Memon family. We belong to Gujarat, India. There was nothing much to do in Gujarat. Agriculture was bad. We were Muslims in that part of the world. People started going out in the business. Depending on where you were situated, if you were in coastal areas, people went to Sri Lanka, South Africa and then to East Africa. We were in the interior. We are from a place called Jetpur. We had

inner roots, so we went to Calcutta. My grand-father built the B Group in Pakistan. He was close to Jinnah (JB, defunct B Textiles Mill, Interview).

JB related the story of the demise of the B Group in the 1970s:

“We sold our textiles factory in 1971. It was a huge place, into acres. We made a big mistake by selling it. It was later sold to BL Textiles Mill. Bhutto destroyed a lot of institutions. We thought he would also take over the textile industry, so we decided to sell it to get rid of it. B Group lost everything in the then East Pakistan overnight. We lost a jute mill in the East Pakistan, 25 thousand people were working there. We lost the largest tea gardens spread over acres. We had three textile mills there that we lost. They were all medium sized textile mills. We lost chipboard plant and we lost 5 units of jute. One of our biggest businesses was jute trading. We lost it overnight. We do not even know the real value of our assets. Stock exchange was not active in those days and we do not know the real value of our assets lost. We came to the then West Pakistan and after a while, Bhutto nationalised our life insurance company called B Life Insurance. He nationalised our ND Bank. My grandfather, my father and my uncle had started the bank. When nationalisation started, we sold off our sugar mill and our textile mill. We decided that we had enough. *Enough of this non-sense*. We lost everything in East Pakistan. We got no compensation for it. This phrase of ‘22 families’ got popular and it made things bad for us. They took our passports away. Having lost everything there, we came here. We lost things here too. Bhutto took Pakistan 30 years back. People are still frightened to do things because of nationalisation. He took over things like flour mills and cotton export. We were also into the export of cotton. He started government organisations like Cotton Export Corporation of Pakistan. Though, he did not take away everything but our business stopped. We were not allowed to function anymore. Pakistan has suffered enormously. We lost a generation. The work ethics in this country totally deteriorated. The will to do business was lost after the fall of the East Pakistan and Bhutto’s nationalisation. We started to break-up as a family as well. When you have this kind of situation, what do you do?’ One person said he was going to London, like my brother who left for London. Others in the family said we did not want to get involved with nationalised business. Everybody had their own

views at that time of crisis. The big family got broken up” (JB, defunct B Textiles Mill, Interview).

The story of B defunct Textiles Mill group shows how the social institution of family and caste could not save the business and how the government’s nationalisation and break up of Pakistan made the family lose their business. It is a commentary of the state’s policies and political influences and their interaction with the social institutions of family and caste. It shows how the latter could not save the business due to the powerfulness of the former.

9.3. Caste Capitalism and the State’s Policies

Memons and Chiniotis represent caste capitalism in the textiles sector in Pakistan. However, they are two different castes. They have their distinct sense of caste identity and loyalty. Exaggerated and differentiated claims to fame accompany all success stories. The same is the case with Memons and Chiniotis. Some Memon manufacturers were of the opinion that unlike Chiniotis, Memons came to Pakistan by transferring their capital from India to Pakistan and were pioneers in setting up the textiles industry in Pakistan. Some Chinioti manufacturers were of the opinion that they were initially suppliers and vendors and later became involved in the small scale spinning plants that mushroomed in Lyallpur (now Faisalabad)⁸⁶ after the partition. Chiniotis set up the flagship textiles mills soon after the partition in then Lyallpur. Chiniotis also scored point against Memons for fleeing the country after Bhutto’s nationalisation and only returning later, while the Chiniotis dug in during the difficult times, staying put, and prospering later (Manufacturers Interviews).

Caste capitalism is intricately linked to state’s policies. “Social structures of accumulation” prosper or decay in the context of the state’s industrial policy and patronage as the above discussed case studies show. In the 1950s and 1960s, Memons were in ascendance and enjoyed close association to policy makers. Since the 1980s, Chiniotis are in ascendance. The close nexus of the Punjabi industrialists with the state became prominent in the non-party elections of 1985. As Chapter 3 discusses, the rise of the Sharif and Chaudhry families goes back to the 1980s. Though, both these families are

⁸⁶ Now Faisalabad.

non-Chiniotis and not in the textiles sector, there was a spinoff amongst the Punjabi Chinioti groups in the textiles sector.

Close association of the largest textiles mill group and defaulter textile mill owners with the Sharifs became clear during the fieldwork. It was also pointed out that some Chinioti manufacturers have been able to earn rents due to the state institutions' patronage from the mid-1980s onwards.

The larger point is caste capitalism explains reduction in transaction costs, path dependency, repeated contracts, trust and proves to be a lubricant in easing the production processes. Yet, the caste capitalism functions in the context of the overall state policies as the ascendance of Chiniotis over Memons in the post 1980s period indicates. Of course, the other contributing factor is that Memons were in ascendance in the 1950s and 1960s and were hit hard both by Bhutto's nationalisation of 1970s and dismemberment of Pakistan and suffered the most. Most of the leading Memon families left the country in disarray as the case study discussed earlier shows. Yet, rise and fall of business groups cannot be explained without taking into account the state institutions' patronage.

The balance of power between Memons and Chiniotis changed since the 1980s and it has roots in the politics of the state patronage. During the fieldwork, there were strong perceptions that the patronage took place and benefitted the Chiniotis. They were able to earn rents. Textiles Mill A in our sample expanded quickly in late 1980s due to the close connections of the owners with Nawaz Sharif while he was Chief Minister of the Punjab. There was also a perception that the owner of the largest textiles mill in Pakistan, a Chinioti, got spoils of the privatisation process set in place by Nawaz Sharif in 1990. The owner of the group got a bank privatised by the government in 1991 despite the fact that he was not the highest bidder. He got it due to patronage by Sharifs. It is quoted as a concrete example in the banking circles. This also extended to other investments by the group including textiles. The owner's son described the influence of government on their group's performance as below:

“My father, NN, has always been close to various governments. The government changes a lot over here, when you take a group like ours. The governments are mostly against the industry. We have had lots of difficulties with the Benazir

government⁸⁷. With the present government⁸⁸ things have been fine. We had hard times with the Benazir government in the 1990s. We did not get along well with them. They wanted to take back ND Bank from us. We got the Bank during Nawaz Sharif's privatization campaign in early 1990s. Benazir government thought that the privatisation was wrong. They were after us. We resisted and did not let the blackmail take place" (IN, Textiles Mill, Interview).

It shows the rent generation and the politics of patronage is intricately linked to social institutions such as caste and family. The overall interaction between the state institutions and the capitalists leads to overt and covert transfers, often mediated through the caste capitalism.

Conclusion

Caste capitalism has been at work in Pakistan's textiles sector for over sixty years and it has strong similarity with the way fraternal or *guanxi* (connections) capitalism has worked in other parts of the developing world. The politics of state patronage has cast its long shadow over the contestation by two particular castes – Memons and Chiniotis - in the textiles sector. Together, these two castes dominate the largest export sector in Pakistan and caste capitalism works in the context of overall state's politics. Other than their historical specificity, one of the key reasons that these two castes dominate the textiles sector in Pakistan is because of the lack of Weberian impersonalisation and the weak rule of law in the country. When the rule of law is weak, there is greater likelihood of the relations of accumulation being even more firmly getting entrenched and embedded in social institutions such as caste and family.

⁸⁷ First Benazir government was from 1988 to 1990, while the second Benazir government was from 1993 to 1996.

⁸⁸ The Musharraf regime was from 1999-2008. This interview took place in 2005.

Chapter 10 - Conclusion

The first part of the Chapter summarizes the key findings of the thesis. In the second part, the rule-violating behavior is discussed in terms of its differential impact on accumulation. The second part also discusses the case studies in the light of the literature review. There is also a brief discussion on the appropriateness of the methodology used in the thesis and possible future extension of this work.

The thesis investigates the relationship between the political economy and the rule of law in Pakistan from 1999-2004. This is in terms of transition from a traditional society to a modern “Weberian” state. It chronicles the challenges of such a transition.

Empirically, the thesis looks at the International Financial Institutions’ (IFIs) ‘good governance’ reforms (couched in the neo-Weberian language) and the reaction to these by the capitalist and intermediate classes in contemporary Pakistan. It has three case studies: (a) a tax law (General Sales Tax imposed as VAT), (b) a corporate sector regulatory body (Securities and Exchange Commission of Pakistan) and (c) a productive sector (textiles sector). These case studies are contextualized through a political economy framework, providing due historical context since the 1950s. It also provides a background analysis of the IFIs Structural Adjustment Programme that started in Pakistan from 1988 onwards, and links the governance debate to the neo-liberal agenda of pro-market institutional governance reforms. The textiles sector case study provides a linkage to the taxation and regulation issues in the corporate sector. It also discusses caste capitalism as a social institution, both due to its historical specificity and also with an eye to links to the wider rule of law issues.

The IFI’s Structural Adjustment Programme (SAP) aimed to roll back the interventionist role of the Pakistani state. The IFI’s first generation reforms dealt with macroeconomic stability, tightening of fiscal belt, freeing of trade, bringing down tariff, free flow of currency exchange, liberalizing imports and exports and cutting down subsidies. However, IFIs, after having failed in their structural adjustment programmes in Latin America and having faced the financial crisis in Asia, tried to reinvent themselves and focused on “soft” second generation reforms after the mid-1990s. These second generation institutional governance reforms dealt with the rule of law, government effectiveness and the state's ability to be a regulator. The IFIs called for improved

taxation, modernized audit and accounts institution, regulation of government borrowing, supervision of regulations through a securities regulatory body, accountability through a permanent national accountability bureau, access to information, and reforms in the judicial system.

The whole premise for the IFIs institutional governance reforms was to take power away from the government and bestow it to pro-market independent and autonomous institutions. For example, control of the central bank was taken away from the Ministry of Finance and the State Bank of Pakistan was made an autonomous institution in 1997. Company Law Authority within the Ministry of Finance made into an autonomous Securities and Exchange Commission of Pakistan (SECP) in 1999. IFIs wanted to reduce corruption, rent-seeking and check abuse of government's powers through institutional governance reforms. However, the IFIs over-simplified the entrenched structural problems in the political economy of developing countries like Pakistan by seeking to substitute rent-seeking with the institutions of law. As the case studies show, the IFIs reforms met huge resistance in Pakistan.

As the literature in Chapter 2 argues that the structural factors in the developing countries do not allow across the board implementation of the rule of law. The politics of patronage is prevalent in the countries like Pakistan with patron-client relationships structured around the payoffs in exchange for political/organizational capabilities. Institutions matter, but just replicating the institutions of the advanced countries in the developing countries does not lead to desired results. Developing countries have their own political, economic and social dynamics that need to be taken into account.

For the period under scrutiny (1999-2004) the thesis argues that, in Pakistan, contestation took place between the IFIs promoted pro-market rule-of-law reforms and the forces on the ground opposing it. The thesis is essentially a story of aspects of this contestation. It is shown that IFIs reforms met concerted resistance from both the capitalist and the intermediate classes. The governments tacitly supported these domestic social groups while paying lip service to the IFIs governance agenda.

This contestation (between the rule of law reforms and resistance to them) forms the core of the first two case studies. The IMF pushed VAT-styled General Sales Tax (GST) to substitute for the revenue lost through doing away with customs duties. In the GST case, the resistance was put up by the capitalist and intermediate classes of traders, retailers

and wholesalers. Chapter 6 of the dissertation focuses on how the refunds system was subverted by these groups by claiming fake returns on fake invoices. This led the tax authorities to giving more refunds than the actual tax receipts. Tax official admitted to providing more money in refunds than the actual receipts. During key informant interviews, manufacturers admitted that the textiles sector indulged in the phenomenon of ‘fake and flying’ invoices. A few manufacturers explained in detail how the fake system worked in practice. VAT works properly when only few exceptions are allowed, and it needs to be applied to the entire chain of economy. Initially, GST had provisions that gave incentives to purchases from registered suppliers, in order to enable documentation of the economy and increased registration. However, as internal Central Board of Revenue (CBR) documents show, this provision was done away with due to the heavy cost being imposed on CBR by the tax dodgers. Instead, CBR over the years has given so many exemptions that GST resembled an excise duty rather than a properly functioning VAT.

At the same time, capitalists in the textile sector were keen to avoid proper documentation of their economic activities. When all major export sectors including the textiles were zero-rated in 2005, the manufacturers preferred being exempted rather than allowing proper registration of their economic activities. Resistance to the proper implementation of the GST/VAT shows rule-violating behavior and challenges to the transition towards a modern “Weberian” state. Documentation of economy can lead to proper income tax being levied. Resistance to the documentation part of the GST is actually a resistance to the assessment. Proper income tax is paid by only a fraction of population, i.e. the salaried employees. Pakistan’s tax to GDP ratio was just over 10 per cent in the early 2000s but has continued to plummet since then and is amongst the lowest in the middle income countries. Traders, retailers and wholesalers have publically protested the imposition of GST. On the other hand, the IMF’s loan was suspended in 2010 because Pakistan refused to implement a reformed GST that called for doing away with exemptions. Overall, the imposition of the GST in a VAT mode ended up with limited success.

In the second case study in Chapter 7, the struggle over imposing a proper regulatory framework for corporate governance in Pakistan is summarised as a case of ‘one step forward, two steps backward’. The ADB funded the formulation of the new regulatory law and also the setting up of the autonomous regulatory body, the Securities and

Exchange Commission (SECP) of Pakistan in 1999. The purpose was to take control away from the Ministry of Finance and give it to an autonomous institution to provide a level playing field for intra-capital relations. The SECP came up with the Code of Corporate Governance by introducing the concept of voluntary non-executive directors and audit committees amongst other measures. The SECP also pushed for holding of Annual General Meetings of the companies, to get dividend paid to shareholders, to prevent unlawful inter-corporate financing, to improve the auditing standards and to introduce margin financing in order to phase out the volatile carry-over-trade or 'Badla' financing. All such measures were steps towards the pro-market rule-of-law and meant to ensure a level playing field. Due to the family-oriented nature of its corporate sector, stock markets in Pakistan are largely illiquid. Very few shares of companies are bought and sold and 30 companies' share constituted 90 per cent of trading as the literature referred to in chapters 7 and 8 shows. However, the ADB induced reform of corporate governance largely failed to create an equities market that could, potentially, bolster capital formation. The SECP was also not able to fully phase out post-financing carry-over-trade or 'Badla' either. Stock brokers resisted the reform as they preferred high turn-over without the transactions leading to quick final settlement. The more the turn-over of the shares, the more their commission, whereas settlement-oriented secured transactions acted against their interests. However, the high volatility in the market led to the crash of the Karachi Stock Exchange in early 2005.

The ADB evaluation reports discuss the market manipulation by a few powerful stock brokers. They, however, fail to mention the resistance to the corporate governance by the capitalist class itself. It is not only the intermediate class of professionals such as chartered accountants and stock brokers which resisted the SECP reforms. The capitalist class itself resisted it, as evident from the qualitative key informant interviews. The textiles manufacturers were of the opinion that inappropriate rules of the Northern regulatory bodies were being imposed in Pakistan.

It is obvious from the SECP case study that Pakistan's capitalist and intermediate classes do not want mature capitalism. Capitalists want to keep the family controlled and owned corporate sector, which is either not registered on the stock exchange or, if it is, then barely traded there. Capitalists resist the pro rule-of-law reforms. The SECP reforms led to capitalists de-listing their companies and taking them away from public view rather than letting them be regulated. The SECP case study further throws light on the rule-

violating behaviour of the capitalist and the intermediate classes. It shows why transition to a modern “Weberian” state is difficult in Pakistan.

The third case study of the textiles sector in Chapters 8 and 9 shows that the textiles sector in Pakistan has a tormented relationship to the rule of law. Not only did the textiles sector get more bank loans than other sectors, it defaulted more than others, as Chapter 8 points out. It is also one of the worst sectors amongst the large-scale industry for non-payment of GST, as per Chapter 6. In terms of loan default, three different case studies in Chapter 8 present three different scenarios ranging from default of loans secured through political connections, default due to fraud, to circumstantial default. In these case studies of default, the IFC and foreign banks initiated the default proceedings and the national banks followed suit. The national banks did not take the initiative to go after the defaulters, highlighting their tolerance to default. The textiles case study explains dimensions of the rule-violating behavior and shows how the “Weberian” impartiality and rule-based governance is challenged.

Other than the formal/informal sector dichotomy prevalent in the textiles sector, there was also the issue of commercial exporter versus manufacturer exporter from the rule of law viewpoint. The phenomenon of fake invoices for GST refunds was linked with the commercial exporters being without permanent premises.

In the textiles sector, it is worth pointing out that the default of bank loans, one the one hand, led to the theft of resources. On the other hand, it led to some value-enhancing activities. Despite the tormented relationship of the textiles sector with the rule of law, some of the rents that the capitalists earned through their interaction with the state institutions led to value-enhancement. The fieldwork points both to theft of resources as well as to the value-enhancement.

At the level of the fieldwork, almost one out of every three large textile mills in our sample availed the loan write-off from the State Bank of Pakistan. The State Bank refused to divulge the names of individual companies that got their loans written-off. They, however, confirmed that one amongst every three large textiles mill in our sample availed the loan write-off. This pool of large textiles companies is also amongst the top exporters in 2004. Due to the confidentiality clause of the State Bank of Pakistan, we could not match the individual defaulter companies against the list of top exporters on a

case by case basis. The link between the defaulter companies having enhanced value is established in an indirect way in our sample.

At the micro level, a textiles group in our fieldwork sample got economic favours in 1991 through the privatization process in contravention of the rules in 1991. This textiles company owned by a politically-connected group became the largest textiles mill in the country in 2004. This is a micro example of the rents being used productively.

Indications of the textiles sector having established itself competitive internationally are also there at the macro level. As discussed in Chapter 8, the UNIDO (2009) statistics reveal that Pakistan's share of the world exports in the textiles was 2.9 per cent in 2000. After the phase-out of the MFA, Pakistan did not lose its market share in textiles, nor in the garment subsector. It in fact gained slightly to 3.1 per cent in textiles in 2007. Other than China (first and foremost), India and Thailand; most other Asian exporters lost their market share in textiles. In garments, China gained massively, Vietnam and Bangladesh also gained somewhat and Pakistan did not lose its market share. Contrasting these statistics with the Pakistan's manufacturing performance in 1990s (where the large-scale manufacturing even went into the negative growth in 1996-97), this is a welcome sign. Due to the Structural Adjustment Programme and its policy of liberalization and massive tariff reductions, the 1990s is considered in the literature the "lost decade" in terms of economic development. In these adverse circumstances, Pakistan's textiles industry spent USD 4 billion on balancing, modernization and replacement in early 2000s to deal with the challenges of post-MFA phase. It paid dividends. Pakistan's textiles sector showed signs of being internationally competitive in 2007 as per the UNIDO (2009) estimates.

All our three levels of investigations (micro case study example, general trends established through the fieldwork, and the macro picture) indicate that value-enhancement did take place in the textiles sector in Pakistan. We have also established earlier the overt and covert transfers were made to the textiles sector. We assert that some of these rents ended up as theft of resources. Other rents added some value.

It seems what distinguished the industrialists who used the rents productively from those who wasted them is the "decentralized competitiveness" and the path-dependant business histories. In other words, it was not the result of disciplining mechanisms used by the state institutions that forced some industrialists to be productive rather than wasting resources. The state is weak in Pakistan and lacks effective enforcement capacities.

Some rule-violating behavior led to value-enhancing activities due to the peculiar business histories of the industrial groups which entrenched them in path-dependant ways of utilizing the rents for value-enhancement compared to others who were largely the new entrants and used the acquired rents to get rich quickly. The industrialists who used the rents for value-enhancement may have been in the business for generations. Business is the way of life for them as illustrated by a phrase very frequently used during the fieldwork: “business is in their blood”. We are only pointing to a very general trend and there are exceptions to this pattern. Established houses went under particularly in the aftermath of Bhutto’s nationalization and also afterwards. Similarly, some new entrants have done very well. They often started with dyeing/printing and earned profits, reinvested profits in the backward expansion and went into spinning. There are sizeable exceptions to the general pattern we describe above. Despite this, we point to a general pattern of path-dependence where some family business groups with peculiar histories used the rents for value-enhancing activities. We describe the peculiar nature of caste capitalism in the textiles sector below.

The family-controlled and owned business was the other major finding of the fieldwork. The family ownership interacts with the rule of law by not letting the equity market develop and not transforming the business into joint ventures as discussed in the thesis. This poses challenges to the notions of impersonalisation that is the hallmark of Weberian thinking.

All accumulation is socially embedded. The literature (Harriss-White, 2003) points specifically to the accumulation being organized by the “social structures” of caste, gender, locality and religion in the informal sector in India as per Chapter 9. Lieven (2011) discusses in detail the role of kinship-based networks in the politics of patronage in Pakistan. The fieldwork of the thesis shows that two trading castes - Memons and Chiniotis –were the dominant players in the textiles sector.

Both the Memons and Chiniotis have peculiar migratory histories, taking them from colonial India to East Africa and Pakistan. Memons and Chiniotis’ inter-generational hereditary entrepreneurship has been chronicled through four caste studies in Chapter 9. It is a commentary on the rise and fall of leading textiles groups and their stories of accumulation mediated through migration, family and caste. Different groups used different strategies for family cohesion, control and horizontal spread. Memons who

were ascendant in the 1960s were badly hit by Bhutto's nationalisation and dismemberment of Pakistan in 1971. With a different phase of patronage starting in the 1980s, Chiniotis overtook Memons in the textiles due to their close connections with the ruling Punjabi politicians. Chiniotis dominance continued in the 1990s and beyond. This illustrates quite well that while all accumulation is socially embedded, accumulation also takes place in the overall context of the state policies and its overt and covert patronage. Memons got the state patronage in the 1950s and 1960s, while Chiniotis were favoured more from the 1980s onwards.

Finally, the weak rule of law is also an underlying reason for the caste capitalism of Chiniotis and Memons. Had there been an honouring of contracts and a well-functioning justice system, there would have been less reliance on family and caste networks for the growth of business. The weak rule of law regime perpetuates dependence on family, kinship and caste relations even in the formal textiles. Lack of Weberian impersonalisation is exemplified well through caste capitalism.

In Chapter 2, North et al. (2013) state that the institutions of the OECD countries behave quite differently when they are replicated in the developing countries. Chapter 2 also discusses Mushtaq Khan's (2004, 2005) criticism of the "good governance" reforms and the "service delivery model". In line with these arguments, the case study chapters also show that the IFIs governance reforms only had limited success in Pakistan. The textiles manufacturers interviewed used similar language to that of the literature reviewed. The textiles manufacturers were of the opinion that Western rules are being imposed in the case of the SECP and such rules do not go with the ground realities of the family-owned and controlled capitalist sector in Pakistan. The rule-violating behavior of the Pakistan's capitalist class and its intermediate classes did not lead to the law being made applicable across the board in an impartial manner in the Weberian sense.

Rule-violating behavior may have several different consequences for accumulation. On the basis of the case studies, we can divide the rule-violating behavior in terms of its linkage with accumulation into the following five categories:

- 1) Rule-violating behavior that led to *theft of resources*: As Chapter 7 states, the non-performing loans were Rs 66.1 billion in December 1990 and they increased to Rs 271.4 billion in December 2000. Interviews with the textile manufacturers show that many of the new, politically connected, companies rose while making

use of the easy flow of bank loans and folded up soon afterwards either due to unfavourable business climate or due to them having started the business for embezzlement purposes. Chapter 8 discusses in detail a case of fraud of bank loans in the textiles sector. There is no doubt that one outcome of rule-violating behavior was theft of resources.

- 2) Rule-violating behavior that led to *value-enhancing activities*: As discussed in detail above that some overt and covert transfers from the state institutions to textiles manufacturers were used productively and led to value-addition as well.
- 3) Rule-violating behavior that *may or may not* have had much impact on accumulation: Not paying taxes is a rule-violating behavior discussed in detail in Chapter 6. Resistance to the GST was such that its entire refunds systems was subverted by making fake claims for more money than was actually paid in tax. Under-taxation is a rule-violating behavior and its impact on accumulation is indirect, if at all. Earning tax revenues gives fiscal space to the governments to spend on infrastructure and human resource development. Such development expenditures may in turn help with the productivity of the capitalist sector and aid in accumulation. However, such a link is only indirect and there is rule-violating behavior that may or may not have a direct influence on accumulation.
- 4) Rule-violating behavior that *may not* have had much impact on accumulation: The case study chapters show that some rule-violating behavior may not impact accumulation in any significant way. Unlawful inter-corporate financing in one such examples. The SECP had disallowed transferring money in excess of an allowed limit to its sister concerns. The companies nevertheless indulged in the unlawful inter-corporate financing. Some were caught and penalized for it. However, such transfers to sister concerns may not have had much influence on accumulation. Similarly, not holding the Annual General Meetings (AGMs) is unlawful and the SECP pushed the companies hard to hold their AGMs. Holding AGMs increases transparency and accountability and is desirable for the implementation of the rule of law, but it may not directly influence accumulation.
- 5) Rule-violating behavior that led to *assets destruction*: There is some rule-violating behavior that destroys assets rather than contributing to accumulation. Speculative COT/Badla financing is one such measure. Badla financing is speculative and works on borrowed money. The trade is not settled and carried over to other transactions where the same borrowed money is used for further

trading. Badla introduces an element of uncertainty and speculation in the stock exchanges. It leads to high volume of trading and fewer settlements. Such high speculation can potentially lead to a crash of the stock market as happened in the case of Karachi Stock Exchange in April 2005. Therefore, measures such as the speculative Badla trading leads to assets destruction rather than accumulation. Similarly, when some textiles manufacturers under-priced their products in Western markets, it led to the imposition of anti-dumping duties for the whole industry. It was possible for some “black sheep” manufacturers to under-price their products below their standard costs either because they defaulted on bank loans, not paid their utility charges, not paid the due tax or were recipients of some form of unlawful covert transfers. They used such rents to subsidize their products and under-priced their products to increase their profit margin. When caught, such rule-violating behavior led to the imposition of an anti-dumping duty on the entire industry. Anti-dumping duty made Pakistani products more costly compared to their competitors and led to cut in the profit margins. Unlawful under-pricing is another such behavior that negatively impacts accumulation.

Overall, various categories of the rule-violating behavior described above and in the case study chapters of the thesis chronicle the resistance of the traditional society to the development of a modern “Weberian” state. They document the challenges to the framework of the “Weberian” state that IFIs want to enforce in countries like Pakistan. Due to the weakness of the state and underlying structural distribution of power, the rule of law based framework is resisted.

We have looked at the relationship between political economy and the rule of law by contextualising this in terms of transition from a traditional society to a modern “Weberian” state. The thesis was able to pursue this issue empirically. As Chapter 8 argues, there is capitalism in Pakistan and the textiles sector is a capitalist sector. The formal textiles sector is dominated by the top forty companies. They are averse to mature capitalism and resist rule based governance. The case studies on GST and SECP not only document the resistance to the rule-based governance generally, they also situate the resistance in the biggest large scale manufacturing sector of the textiles.

The qualitative methodology for an inter-disciplinary Development Studies thesis proved useful, utilising a combination of qualitative research methodologies. Quasi-anthropological qualitative key informant interviews and case studies of textiles manufacturers also worked well, along with a critical reading of primary and secondary documents. Reading of documents showed another side of the picture and was triangulated with manufacturers, and other stakeholders' perceptions, views and stories. This combination stitched together a good representation of ground realities.

Overall, the thesis achieved what it set out to do. It has presented new ways of analysing political economy and the rule of law and, in turn, it has contributed to the understanding of the political economy of the development in middle income countries like Pakistan. The overall finding of the thesis is that the rule-based governance was resisted in the contemporary Pakistan of 1999-2004. The capitalist and the intermediate classes did not want mature capitalism. They wanted family-controlled and owned corporate sector and indulged in rule-violating behaviour by resisting the rule-based governance in the aftermath of ISI era. This is the robust and firm main finding.

The thesis also shows that the nature of patronage has changed since Bhutto's nationalization of 1970s. The trend to allocate development funds to the rural elected representatives started with the Ayub regime's Basic Democracies (1959). The new forms of patronage focused on taking over the state institutions since 1970s. The literature discusses the role of "political entrepreneurs" seeking the state patronage. The new trend in Pakistan is to takeover the state in order to redistribute rents to the elite and the intermediate classes. Those who manage to take over the state institutions redistribute the patronage to their connected clients. It is the easiest way to accumulate wealth for consumption as well as for reinvestment in the business. Short term investment in property or stocks is preferred over investment in industrialization. Stashing money away in foreign banks and buying foreign property is preferred over investment in the country. The qualitative fieldwork threw light on these aspects.

Other than dealing with clientelism, the state has also been under pressure from the neo-liberal reforms of the IFIs. The IFIs focused on cutting down the role of the state. They pushed for the roll-back of the interventionist state and at the same time wanted "government effectiveness" to deliver a level playing field for intra-capital relations and also for the capital's relationship with the state. Also they wanted to achieve these

seemingly contradictory objectives (where the state is weak and strong at the same time via-a-vis different functions) by largely ignoring labour. Their plans for “government effectiveness” with a lean state were resisted as the thesis shows.

As Chapter 2 discusses, there may not be much difference between the civilian and authoritarian governments in developing countries as the underlying structural patterns of patron-client relationships remain intact. This finding is re-confirmed by the thesis. Military governments have not fared much better than civilian political governments. The military governments, including the Musharraf government since 1999 in Pakistan, had to grant patronage to maintain political stability and earn legitimacy by appeasing the powerful social groups. Military as an organization has protected its own immediate interests very well. However, military governments have failed in enforcing the rule of law, as they also had to make concessions similar to the democratic governments to survive due to the structural constraints of the society.

The literature review of Chapter 2 discusses the Weberian rational-bureaucratic state, where there is impersonalisation, impartiality, division of labour and hierarchy. The principles of the legal-rational bureaucracy are equally applicable to other large-scale organizations other than the government, e.g. big private enterprises, political parties, army, church or trade unions. Moreover, the state has monopoly over the instruments of violence. North et al. (2013)’s “open access order” (OAO) as a contrast to the “limited access order” (LAO) builds on this to develop its own approach. In OAO, there is an open competition in the political and economic institutions. The government’s commitments are well-implemented and durable in the OAO. It also allows organizations outside the government (opposition parties, citizens groups) to organize and keep a check on the government’s powers. Political, economic, educational and religious activities are allowed openly as long as they fulfill the impersonalisation criteria. The rule of law is applicable across the board. The concept of OAO broadly meets the criterion of a modern “Weberian” state.

A close reading of the IFIs documents and the objectives of their reforms shows that they want to establish a modern “Weberian” state. Concepts such as the “rule of law”, “sanctity of contract” and providing a “level playing field for all” are discussed time and again in the IFIs documents. They want to replicate the institutions of the advanced

countries in the developing countries and consider “politics” as hindrance to achieving their objectives.

Opposed to this, Mushtaq Khan and Lieven (Chapter 2) both argue that it is precisely all about politics. Pyramidal patron-client networks are essential political and economic structures of the developing countries. The underlying distribution of power in a country determines its compatibility with dynamic institutional capabilities. The neo-Weberian notion that personalized politics through clientelism needs to be checked first for development to take place is flawed. This is because faction-based patron-client networks exist due to the structural features of the developing countries. Systems of governance work through the politics of patronage. Lieven (2011) also states that the state is weak in Pakistan and kinship-based social groups are strong in Pakistan.

The easy provision of the bank loans provided opportunities for the capitalists to accumulate rents often through rule-violating transfers. Rents were also earned through pursuing the policy of privatisation. The state-owned enterprises and financial institutions were privatised often and through this bestowed favours and allowed the politically connected elite to earn rents. The rest of the rule-violating behaviour of the capitalist elite and the middle classes (discussed in the case study chapters) might or might not have had an impact on accumulation, yet it forms part of a pattern of traditional societies like Pakistan in their transition towards a modern “Weberian” state.

The weakness of the state was apparent not only its lack of ability to collect taxes or enforce corporate regulations but also its inability of the state institutions to recover the defaulted bank loans. The judicial system is clogged to the point of being dysfunctional. There is no effective deterrent against the rule-violating behavior. In the loan default case studies discussed in Chapter 8, the international lender - the IFC and foreign banks—initiated criminal proceedings against three defaulters and only then did the national banks follow suit. The national financial institutions lacked the capacity to keep adequate collateral, assess the viability of projects or recover the defaulted loans. In the Musharraf era, a new institution Corporate Industrial Restructuring Corporation (CIRC) was set up to “sell” the bad loans by seizing the available collaterals, restructuring and auctioning them to make some recovery for the government. CIRC only managed to recover a fraction of the original due loans and the interest. Some details of the CIRC activities are given in Appendix 2.

The literature discussed in Chapter 2 has different focus ranging from the “elite” to the “intermediate classes”. North et al. (2013) focus on the “elite bargains” in rent creation for the relative political stability. Mushtaq Khan (2005) in his earlier writings has focused on the role of the “intermediate classes”. Political entrepreneurs from the “intermediate classes” are part of faction-based patron-client relationships where they earn economic payoffs due to their political/organizational strength. In the case study chapters of the thesis, we found that there need not be conflict amongst the “elite” and members of the “intermediate classes” while they indulge in rule-violating behavior. In the context of the GST, the traders, retailers and wholesalers vehemently opposed the taxation and documentation of the economy. The capitalist elite used its own strategies to subvert the GST refunds mechanism. Similarly, in the case of SECP, it was not only the capitalist class that resisted regulation and started to delist their companies from the stock exchange; accountants and stock brokers equally detested the rule-based governance measures. There need not be conflict amongst the “elite” and the “intermediate classes” regarding rule-violating behavior. They may resist rule based governance due to their own vested interests either on their own or in alliance with each other.

In terms of the application of the North et al. (2013)’s framework (as discussed in Chapter 2), Pakistan had basic “limited access order” – LAO - during the case study period of 1999-2004, with features of maturity as well as vulnerability. Pakistan’s economy grew rapidly from 2002-2004 period (Table 3.1), largely as the result of exogenous factors as discussed earlier. This growth proved to be fragile in the post case study period. In terms of the mature feature during the case study period, the government organizations were well-established. From 1999-2002, there was direct military rule, yet the local government elections were held in 2001. The National and Provincial Assemblies’ elections were also held in 2002. The elections allowed political organizations to exist outside the government. The leaders of both the main political parties – Pakistan People’s Party (PPP) and Pakistan Muslim League-Nawaz (PML-N) – were in exile. The party (PML-N) which was ousted through the military coup in 1999 split and the newly created faction, the Pakistan Muslim League (Quaid), sided with the military government. As stated earlier, organisations existed outside the ambit of the government and this feature points towards the relative maturity. There was opposition within the Parliament (without its top leadership), independent TV and radio stations

were allowed and the civil society functioned freely. These private organizations were, however, not powerful enough to hold the government fully accountable, yet they were functional. There were elements of vulnerability as well in the basic LAO during the 1999-2004 period (which became accentuated from 2007 onwards).

In terms of vulnerability, the old rent creation mechanism in the form of “competitive clientelism” (to use Mushtaq Khan’s term, 2013) of 1990s had broken down which led to uncertainty. From 1988-1999, the two main political parties – PPP and PML-N took turns to rule. The political governments did not complete their tenure as the political parties in the opposition often allied themselves with forces outside the Parliament to bring down the government. Both the main political parties and their political clients remained keen to get to power and earn rents. It was a period of “competitive clientelism” in Pakistan. The old rent creation mechanism was unstable. It broke down and the army took over in 1999. But the army had to share power with the new civilian leadership from 2002 onwards. There was an effort to cobble a new “dominant coalition” with its own rents sharing mechanism. The new civilian leadership was in alliance with the military government. The period from 1999-2004 had a basic LAO with features of both maturity and vulnerability. From 2007 onwards, the vulnerable features became more prominent and the government’s monopoly over the instruments of violence was seriously challenged due to the deepening Taliban insurgency. Other armed groups also actively started to indulge in violence.

The influence of the capitalist elite has increased both directly and indirectly in the “dominant coalition” in the contemporary Pakistan. As Chapter 3 points out, the share of businessmen went up from 6 per cent in 1970 to 20 percent in 1997 in the National Assembly seats in the Punjab province. It points to a trend of the new leadership that emerged out of the local government elections of the 1980s, assuming the mantle of new political leadership. As discussed earlier, the industrialists having learnt the lessons of the losing power and rents during Bhutto’s nationalization, many joined politics with a few of them taking over the national leadership also.

A few representatives of the textile groups got ministerial posts in the Musharraf government, but the textiles manufacturers were themselves not an active partners of the “dominant coalition” during 1999-2004. Their interests were served through their indirect connections with the “dominant coalition”. The leading textile groups have been

close to the decision-makers. It was the continuation of the policy of 1980s and 1990s that the Chinioti industrialists associated themselves closely to the industrialist-politician Nawaz Sharif and got state patronage.

As stated earlier, the rents creation that took place as the result of the interaction of the state institutions with the capitalist both led to theft of resources as well as value-enhancing activities. By extending the North et al. (2013) framework, we speculate that even seemingly waste of resources might have been necessary for political stability. North et al. (2013) call the rents needed for ensuring relative political stability as a development problem. Mushtaq Khan (2013) states that the policy agenda for LAOs needs to limit violence at the political level and sustain growth at the economic level.

The textile manufacturers interviewed were cognizant of the need of political stability for their business growth. There had been lots of political instability in the 1990s when both the main political parties kept destabilizing each other's governments. The textile manufacturers time and again emphasized the need of political stability and long time horizons for the government's policies that can help them make their long-term business plans.

North et al. (2013) point out that for the maturity of a LAO, the rule of law needs to be made applicable to the elite first. In other words, "elite bargains" are important in achieving relative political stability through rent-sharing mechanism. Applicability of the rule of law to the elite is one of the "doorstep conditions" identified for transition from LAO to OAO. In the case of Pakistan, the rule of law is not yet applicable to the elite as it has not reached the stage of meeting the "doorsteps conditions".

To conclude, the transition to a modern "Weberian" state is desirable. It is, however, a worthwhile end of a difficult, negotiated and long process. The structural analysis, largely inspired by the Marxist political economy, is critical of over-simplification of such a complex process. These challenges to the "Weberian" rule of law and impersonalisation are analysed in the case study chapters. We have seen with the GST and the SECP case studies that the IFIs had only limited success in their governance reforms of pushing a framework for pro-market rule of law reforms. The case study chapters chronicle a wide range of the rule-violating behavior. The resistance to taxation measures and corporate governance explains various forms of the rule-violating behaviour. The structural analysis helps to understand the rents creation in the form of

bank loans as an intrinsic part of the politics of patronage. One can speculate that rents provided through massive bank loans default may have been necessary to maintain political stability and earn legitimacy for various governments in contemporary Pakistan. Different forms of rule-violating behavior had varying (or even no) impact on accumulation.

The challenge of achieving the “Weberian” impersonalisation is elucidated through the specific phenomenon of caste capitalism where personalisation is prevalent. Caste capitalism is also linked with the weak rule of law and less likelihood of contracts being honoured, hence reliance on the family and caste networks. The main finding from the case study of the textiles sector is that capitalists in Pakistan do not want more mature form of capitalism. Overall, various forms of rule-violating behaviour and lack of impersonalisation shed light on the challenges of transition to a modern “Weberian” state.

In terms of further implications of themes explored in the thesis, it should be pointed out that Pakistan is considered the least effective tax collector amongst the middle income countries. The structural factors may not be too different across the Indian Subcontinent or South Asia. India and Sri Lanka are able to gather 1.5 to 2.5 percent more revenue through the GST than Pakistan (World Bank et al., 2008). Having taken into account the similar structural factors in South Asia, there has to be an explanation why Pakistan cannot collect even as much tax as its surrounding countries. This can be explored in terms of the further investigation into the weak state capacities and the rule-violating behavior *specific* to Pakistan.

Under-taxation traps Pakistan in a vicious cycle. Due to the lack of fiscal resources, Pakistan cannot adequately provide power generation, infrastructure or human resource development required for viable economic development. On the other hand, lack of domestic revenue generation makes Pakistan more and more dependent on the IFIs. Pakistan is stuck in the whirlpool of debt burden where a substantial part of its resources is allocated just to service the debt, leaving little space for its developmental agenda. The debt burden is so alarming that more loans are needed to pay off old ones. With every new negotiation of the loan programme with the IFIs, Pakistan accepts more “good governance” reforms that have been shown here to have had only limited success. It is thus clear that there is a dire need to raise taxation levels in Pakistan at least to the South

Asian level. We take into account the prevalent politics of patronage discussed in detail in Chapter 2 that is part and parcel of any the developmental agenda. We also take into account the structural factors that explain why across-the-board rule of law is not possible to begin with and why the rule of law is resisted. However, there has to be a good explanation why Pakistan cannot achieve the same tax to GDP ratio as India or Sri Lanka having similar structural features. Such an explanation needs to be developed academically and its implications on the political economy of taxation policy need to be studied further.

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C, the World Bank, Islamabad, June 1, 2004.

F, Human Development Centre, Islamabad, September 22, 2004.

FB, UNDP, Islamabad, June 3, 2004.

H, Asian Development Bank, Islamabad, June 25, 2004.

H, World Bank, Islamabad, June 28, 2004.

I, Ex-SECP top-echelon official, Islamabad, June 8, 2004.

I, State Bank of Pakistan, Islamabad, September 21, 2004.

IA, World Bank, Islamabad, June 28, 2004.

K, Pakistan Institute for Development Economics, Islamabad, June 30, 2004.

M, the WB, Islamabad on June 28, 2004.

MA, Privatisation Commission, March 18, 2005.

N, Corporate and Industrial Restructuring Corporation, Lahore, September 28, 2004.

NT, National Accountability Bureau, Government of Pakistan, March 7, 2005.

O, National Accountability Bureau, March 7, 2005.

OJ, Federal Board of Revenue, July 27, 2009.

S, Economist, Islamabad, March 20, 2005.

T, Central Board of Revenue, Islamabad, April 23rd, 2005.

T, Finance Division, Islamabad, September 22, 2004.

U, National Accountability Bureau, March 8, 2005.

V, National Accountability Bureau, March 8, 2005.

W, Economic Affairs Division, September 21, 2004.

X, Islamabad Stock Exchange, Islamabad, May 6, 2008.

X, Private University, Lahore, September 30, 2004.

Z, IMF Resident Mission, Islamabad, June 29, 2004.

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B, All Pakistan Textile Mills Association, Lahore, November 10, 2004.

BA, Pakistan Textile Exporters Association, Faisalabad, December 2, 2004.

BB, Textiles Mill, Karachi, February 10, 2005.

BG, Textiles Mill, Lahore, November 11, 2004.

BI, Garments Company, Faisalabad, December 2, 2004.

BJ, Textiles Mill, Faisalabad, December 1, 2004.

BK, Polyester Fibres Company, March 29, 2005.

BL, Textiles Mill, Karachi, February 9, 2005.

BM, Ministry of Commerce, Government of Pakistan, March 14, 2005.

BN, Garments Company, Karachi, February 12, 2005.

BS, Defunct Textiles Mill, Lahore, March 28, 2005.

BT, Textiles Mill, Lahore, December 14, 2004.

BU, All Pakistan Textile Mills Association, Lahore, November 12, 2004.

C, Textiles Mill, Karachi, February 10, 2005.

CB, Industrialist, Lahore, November 12, 2004.

EL, Textiles Mill, Textiles Mill, Karachi, February 9, 2005.

G, Pakistan Textile Exporters Association, Faisalabad, December 2, 2004.

GL, Textiles Mill, Karachi, February 9, 2005.

GN, Garments Company, Karachi, February 12, 2005.

GT, Textiles Mill, Karachi, February 11, 2005.

H, Textiles Commissioner's office, Ministry of Industries and Production, Government of Pakistan, Karachi, February 10, 2005.

HR, Textiles Mill, Karachi, February 8, 2005.

IE, Textiles Mill, Islamabad, February 21, 2005.

IN, Textiles Mill, Lahore, March 28, 2005.

JB, Defunct Textiles Group, Karachi, February 15, 2005.

JC, Denim Company, Karachi, February 15, 2005.

JJ, Textiles Mill, Karachi, February 8, 2005.

KT, Textiles Mill, Lahore, November 11, 2004.

LN, Textiles Mill, Rawalpindi, October 27, 2004.

MA, Clothing Company, Faisalabad, December 4, 2004.

ME, Caretaker at a Power Loom, December 5, 2004.

MJ, Export Promotion Bureau, Ministry of Commerce, Government of Pakistan, Karachi, February 7, 2005.

MZ, Textiles Mill, Faisalabad, December 01, 2004.

N, Textiles Mill, Lahore, December 14th, 2004.

NB, Textiles Mill, Lahore, November 10, 2004.

NM, Textiles Mill, Faisalabad, December 2, 2004.

NN, Pakistan Readymade Garments Association, Karachi, February 13, 2005.

NS, Towel Manufacturers' Association of Pakistan, Karachi, February 12, 2005.

NU, Textiles Mill, Karachi, February 10, 2005.

NX, Textiles Mill, Faisalabad, December 3, 2004.

NZ, Textiles Mill, Faisalabad, December 1, 2004.

O, Silk Company, Karachi, February 15, 2005.

OA, Textiles Mill, Karachi, February 12, 2005.

OH, Textiles Mill, Faisalabad, December 3, 2004.

OL, Textiles Mill, Karachi, February 5, 2005.

OR, Textiles Mill, Lahore, December 3, 2004.

OT, Textiles Mill, Lahore, November 30, 2004.

R, Textiles Mill, Karachi, February 9, 2004.

RB, All Pakistan Textiles Mills Association, Karachi, February 11, 2005.

S, Textiles Mill, Faisalabad, December 3, 2004.

SM, Textiles Mill, Faisalabad, December 4, 2004.

SR, Textiles Mill, Lahore, December 14, 2004.

SS, Textiles Group, Lahore, November 30, 2004.

SU, Textiles Mill, Karachi, February 10, 2005.

TA, Pakistan Hosiery Manufacturers Association, Faisalabad, December 5, 2004.

TD, Textiles Mill, Faisalabad, December 01, 2004.

TM, Denim Company, Karachi, February 5, 2005.

TN, Textiles Mill, Faisalabad, December 3, 2004.

TS, Export Promotion Bureau, Ministry of Commerce, Government of Pakistan, Faisalabad, December 4, 2004.

TT, Textiles Group, Karachi, February 13, 2005.

TZ, Textiles Mill, Lahore, Dec 15, 2004.

UB, Garments Company, Karachi, February 5, 2005.

UJ, Textiles Mill, Lahore, Dec 15, 2004.

Appendix 1: Key-Informants Interview Checklist for the Textiles Sector

1. When was the company established?
2. Who established the company? What is the story of company since its establishment?
3. Where did the money come from?
4. Where did the machinery come from?
5. Was this the principle business? Why did you get into this particular business?
6. Was it established as a spinning unit/weaving unit?
7. What was the capacity at inception?
8. What is the capacity today?
9. How has the company grown? Is it mostly reinvesting retained profits? Has most of the money for expansion come from loans?
10. Has the business branched into other industries?
11. How has the business scenario changed in Pakistan? How is the business scenario today different from what it was in the 1960s, 1970s, 1980s, 1990s?
12. Who were the big groups in the textile industry in the 1960s, 1970s, 1980s, 1990s and who are big groups now?
13. How did these groups emerge? Who were they? How did they become the big names in the industry?
14. Who succeeded and who failed and why?
15. What has the government's role been in encouraging/impeding the growth of the textile sector?
16. What would you like to see the government do?
17. Important policies that have affected the textile sector in particular and the industrial sector as a whole since independence?

18. Your experiences of the General Sales Tax?
19. Your experiences of the Securities and Exchange Commission of Pakistan?
20. Which major government sectors does the industry/company come in contact with?
21. Are there any problems faced? If so can they say what problems?
22. What have been your most successful business strategies? What would you have done differently in retrospect?
23. What role has the financial/banking sector played in encouraging/impeding growth of the industrial/textile sector?
24. What bank do you deal with the most? Where do most of the loans come from?
25. Have they ever defaulted on a bank loan? If so, did you have trouble getting a loan the next time?

Appendix 2: Corporate and Industrial Restructuring Corporation's Performance in Managing the Non-Performing Assets (NPAs) of Various Banks of Pakistan in 2004

(Rupees in million)

Referred Non-Performing Assets (NPAs)

	ADBP (Agricultural Development Bank of Pakistan)	HBL (Habib Bank Limited)	IDBP (Industrial Development Bank of Pakistan)	NBP (National Bank of Pakistan)	NDFC (National Development Finance Corporation)	UBL (United Bank Limited)	Total
Accounts Referred	9	300	138	69	154	109	779
Outstanding Amount involved	1,094	36,190	22,632	11,160	37,212	32,853	141,141

CIRC Acquired Status of NPAs

	ADBP	HBL	IDBP	NBP	NDFC	UBL	Total
Accounts Acquired	9	89	23	7	44	62	234
Outstanding amount involved	1,094	8,236	2,299	1,199	7,746	26,132	46,706
Purchase Price	22	1,160	229	87	278	4,120	5,897
Accounts Acquired – With No Assets		33			9	26	68
Outstanding Amount involved		4,160			710	17,336	22,206
Net Accounts Acquired with asset	9	56	23	7	35	36	166

Outstanding amount involved	1,094	4,077	2,299	1,199	7,036	8,795	24,500
Accounts in process of acquisition			30				30
Outstanding amount involved			5,510				5,510

CIRC Auction and Settlement Status of the Acquired Portfolio

	ADBP	HBL	IDBP	NBP	NDFC	UBL	Total
Accounts Exclusively Auctioned by CIRC	7	19	15	6	29	18	94
Outstanding Amount involved	812	1,239	1,440	1,157	6,035	1,894	12,576
Purchase price	20	181	142	87	278	173	881
CIRC share	81	267	126	89	765	231	1,559
Gross Sale Price	94	259	173	121	1,518	811	2,976
CIRC-running surplus / (deficit)	61	86	(16)	2	486	57	678
	ADBP	HBL	IDBP	NBP	NDFC	UBL	Total
Auctioned accounts settled by CIRC	2	1			1	1	5
Outstanding amount involved	282	49			60	749	1,140
Purchase price	2	5			0	60	67
CIRC Share	68	7			9	78	161
Total Proceeds received by CIRC	75	7			9	164	254
CIRC running surplus /	65	1			9	19	94

(deficit)							
Accounts exclusively settled by CIRC		5	1	1	1	4	12
Outstanding amount involved		282	228	43	55	5,258	5,866
Settlement amount		46	17	22	5	895	986
Purchase price		41	17	0	0	750	808
CIRC-running surplus / (deficit)		5	0	22	5	146	178
Total NPAs auctioned/settled							111
Total gross proceeds							4,216
Total surplus achieved by CIRC							950

Source: Corporate Industrial Restructuring Document dated 28/09/2004.

Appendix 3: Basic Textile Statistics (1948 to 2004-05)

Year	No. of report- ing mills	Installed capacity		Working at the end of the periods		Spindle hours worked (Million)	Looms hours worked (Mill- ion)	Consump- tion of cotton (Million kg)	Total yarn produced (Million kg)	Surplus yarn (Million kg)	Total product- ion of cloth (Million Square Meter)
		No. of spind- les (000)	No. of looms (000)	No. of spindles (000)	No. of looms (000)						
1948	..	78	3	78	3	330	6.8	6.8	6.2	1.9	29.5
1949	..	137	3	137	3	495	7.3	8.7	8.3	2.9	37.4
1950	..	182	3	182	3	725	10.1	13.6	12.1	5.5	46.3
1951	..	225	3	225	3	1,008	12.5	21.8	16.5	8.0	58.5
1952	..	499	6	302	4	1,386	18.8	27.1	22.4	2.9	87.9
1953	..	649	9	603	7	2,930	34.4	49.4	46.1	22.8	160.9
1954	..	1,113	15	940	13	4,191	57.4	99.0	77.9	43.7	236.0
1955	..	1,449	23	1,355	19	6,513	92.0	146.2	114.2	67.1	325.6
1956	..	1,518	24	1,422	22	7,091	109.6	158.4	123.6	70.6	366.5
1957	..	1,568	25	1,447	22	8,079	119.3	164.5	128.1	70.2	393.3
1958	..	1,569	26	1,459	24	9,332	128.8	169.7	138.3	72.9	427.2
1958-59	70	1,581	26	1,448	24	9,599	136.9	181.4	148.8	81.2	451.0
1959-60	72	1,582	27	1,491	26	201.2	160.4	90.4	455.0
1960-61	..	1,586	27	1,531	26	205.0	163.4	85.7	513.1
1961-62	71	1,644	28	1,524	26	11,969	161.5	205.3	166.7	83.9	534.4
1962-63	76	1,850	29	1,810	26	12,419	160.3	213.2	174.4	90.2	516.6
1963-64	81	1,913	30	1,792	28	13,171	175.3	233.5	198.6	112.1	579.6
1964-65	83	1,967	31	1,852	28	13,534	175.0	237.4	206.0	111.4	597.6
1965-66	89	2,056	31	1,871	27	13,318	152.2	230.7	194.0	105.0	544.6
1966-67	94	2,043	30	1,888	28	13,298	172.7	243.6	207.0	114.6	571.6
1967-68	95	2,048	30	1,916	28	14,208	173.5	271.9	224.6	126.4	597.7
1968-69	100	2,175	30	2,090	27	15,247	188.0	296.1	238.8	146.7	593.8
1969-70	107	2,397	31	2,327	27	16,964	197.1	334.7	273.2	175.4	606.5
1970-71	113	2,605	30	2,491	27	18,505	202.8	360.0	303.8	205.4	658.3
1971-72	131	2,848	30	2,650	26	19,629	188.5	407.1	335.7	236.9	628.2
1972-73	150	3,226	29	3,057	27	22,606	190.6	463.1	376.1	286.2	588.6
1973-74	155	3,308	29	3,034	26	23,617	192.7	475.3	379.5	283.4	592.2
1974-75	143	3,410	29	2,823	25	20,438	179.2	420.6	351.2	263.1	555.9
1975-76	127	3,478	29	2,579	23	20,095	167.4	419.7	349.7	265.7	520.3
1976-77	135	3,544	29	2,650	19	18,118	138.6	343.2	282.6	217.2	408.3

Year	No. of report- ing mills	Installed capacity		Working at the end of the periods		Spindle hours worked (Million)	Looms hours worked (Million)	Consumption of cotton (Million kg)	Total yarn produced (Million kg)	Surplus yarn (Million kg)	Total production of cloth (Million Square Meter)
		No. of spindles (000)	No. of looms (000)	No. of spindles (000)	No. of looms (000)						
1977-78	140	3,560	26	2,680	15	19,776	110.5	356.0	297.9	242.7	391.3
1978-79	152	3,704	27	2,772	14	20,456	95.0	387.6	327.8	276.6	339.4
1979-80	149	3,731	26	2,841	16	21,468	99.1	428.6	362.9	325.0	342.3
1980-81	158	3,983	25	3,176	13	22,217	90.5	446.6	374.9	331.7	307.9
1981-82	155	4,180	25	2,944	13	22,924	85.1	501.0	430.2	387.5	325.0
1982-83	158	4,265	24	3,062	14	23,011	78.6	516.7	448.4	397.9	335.5
1983-84	162	4,224	24	3,020	12	23,683	91.6	506.5	431.6	396.6	296.6
1984-85	158	4,396	23	3,022	10	33,274	69.8	558.7	431.7	375.2	271.8
1985-86	160	4,422	19	3,158	9	24,620	64.7	553.6	482.2	436.3	253.5
1986-87	187	4,293	17	3,499	9	26,836	57.8	697.7	586.4	550.0	237.9
1987-88	197	4,330	16	3,690	9	29,823	66.2	779.7	685.0	643.5	281.6
1988-89	219	4,790	17	3,966	9	32,089	67.9	872.0	757.9	720.3	269.9
1990-91	247	5,493	15	4,754	8	39,542	60.2	1,197.5	1,041.2	1,001.0	292.9
1991-92	271	6,141	15	5,260	8	43,606	58.8	1,342.8	1,170.7	1,134.7	307.9
1992-93	284	6,768	14	5,433	6	46,364	55.5	1,427.0	1,219.0	1,148.6	325.4
1993-94	320	8,182	14	5,886	6	47,221	44	1,483.4	1,309.6	1,272.8	314.9
1994-95	334	8,307	14	5,991	5	49,734	418	1,558.9	1,369.7	1,340.6	321.8
1995-96	349	8,493	13	6,356	5	52,239	37.1	1,661.9	1,495.1	1,434.9	327.0
1996-97	357	8,137	10	6,465	5	53,625	36.4	1,670.1	1,520.8	1,473.9	333.5
1997-98	353	8,274	10	6,556	4	55,005	37.7	1,751.0	1,523.3	1,478.9	340.3
1998-99	348	8,298	10	6,594	5	55,802	35.2	1,839.6	1,540.3	1,482.4	384.6
1999-00	351	8,383	10	6,750	4	57,205	34.3	1,961.6	1,669.9	1,604.4	437.2
2000-01	353	8,594	10	7,105	4	59,219	34.1	2,070.1	1,721.0	1,652.7	490.2
2001-02	354	8,967	10	7,078	5	61,267	36.3	2,155.2	1,808.6	1,731.2	568.4
2002-03	363	9,216	10	7,623	5	64,274	38.7	2,371.3	1,934.9	1,855.4	576.6
2003-04	363	9,592	11	8,009	4	70,214	32.6	2,407.6	1,938.9	1,845.8	683.4
2004-05	423	10,906	9	8,817	5	72,255	30.3	2,622.8	2,280.6	2,175.2	920.7

Source: Government of Pakistan, 1989; Government of Pakistan, 1997; Government of Pakistan, 2006, (*Economic Survey of Pakistan* 1988-89; 1996-97; 2005-06).

Appendix 4: Details of Export of Textiles and Garments (1971-2002/03)

(Million US\$)

Per- iod	Yarn	Cloth	Tent and Can- vas	Cot- ton Bags	Tow- els	Bed- wear	Other Made- ups	Gar- ments	Hos- iery	Thr- ead	Cotton Manufac- ture	Total Exports
1971- 72	127.5	81.5	1.9	1.2	6.1	0.9	1.2	3.2	3.2	2.3	229.0	590.7
1972- 73	200.5	126.8	2.3	4.5	7.0	1.3	0.9	3.3	6.2	3.2	356.0	817.3
1973- 74	189.5	143.9	7.5	8.1	16.3	4.9	4.5	8.6	8.3	5.3	396.9	1026.4
1974- 75	92.3	132.6	22.4	7.2	15.6	5.6	3.7	14.4	10.3	5.8	309.9	1039.0
1975- 76	145.0	137.5	25.1	7.9	18.3	3.7	5.0	21.5	10.2	4.0	378.2	1136.7
1976- 77	118.4	162.0	25.0	8.3	14.2	3.3	3.8	30.4	11.8	4.4	381.6	1100.8
1977- 78	107.0	175.9	26.0	9.0	12.9	4.8	2.9	30.4	9.8	7.1	385.8	1311.1
1978- 79	197.6	215.7	27.7	11.2	21.2	7.9	5.4	38.1	12.3	5.8	542.9	1709.6
1979- 80	205.9	244.1	31.7	21.2	26.5	12.0	3.9	53.9	20.0	7.1	626.3	2364.7
1980- 81	207.0	241.4	65.3	35.7	47.9	20.6	11.1	75.2	23.2	10.1	737.5	2957.5
1981- 82	196.7	279.5	64.3	31.4	42.9	35.8	9.7	94.2	28.5	7.7	790.7	2490.0
1982- 83	247.3	281.4	93.8	17.9	39.1	67.5	19.5	122.7	36.5	12.8	938.5	2707.7
1983- 84	217.6	360.2	64.1	15.5	46.6	53.3	22.9	162.4	56.0	8.6	1007.2	2768.1
1984- 85	260.4	305.9	49.6	12.1	49.7	51.0	29.2	132.0	42.6	4.8	937.3	2491.2
1985- 86	279.2	314.8	31.1	9.5	67.5	90.1	52.2	206.1	54.6	3.8	1108.9	3069.8
1986- 87	506.1	345.3	23.4	8.1	83.9	123.9	51.1	355.2	96.6	3.3	1596.9	3686.4
1987- 88	541.0	485.4	30.3	12.3	117.4	136.9	64.1	349.9	134.3	3.8	1875.5	4454.6
1988- 89	600.8	464.8	41.1	13.5	140.4	147.9	58.8	335.5	166.9	3.0	1972.8	4661.5
1989- 90	833.7	559.0	28.8	13.4	129.8	190.8	78.2	393.7	273.7	3.0	2504.2	4954.3
1990- 91	1183.0	675.8	79.6	20.5	129.4	246.2	108.9	497.1	333.6	3.4	3277.4	6133.1

Period	Yarn	Cloth	Tent and Canvas	Cotton Bags	Towels	Bedwear	Other Made-ups	Garments	Hosiery	Thread	Cotton Manufacture	Total Exports
1991-92	1172.5	819.4	51.2	32.4	136.7	284.0	113.5	613.5	425.1	3.7	3652.1	6904.0
1992-93	1121.5	863.1	39.9	23.7	139.0	351.6	125.5	617.7	464.1	4.8	3750.9	6813.5
1993-94	1259.3	820.6	29.1	17.3	129.2	285.6	129.4	612.2	509.1	4.0	3795.8	6802.5
1994-95	1528.1	1081.4	38.2	19.1	144.8	340.2	163.5	641.7	688.5	1.9	4647.5	8137.2
1995-96	1540.3	1275.9	39.5	24.6	174.1	422.2	179.1	648.5	703.4	1.5	5009.1	8707.1
1996-97	1411.5	1262.4	36.2	27.6	194.1	456.3	208.7	736.4	688.9	1.7	5023.8	8320.3
1997-98	1159.5	1250.3	58.1	23.1	200.1	508.8	245.8	746.5	696.7	1.8	4890.7	8627.7
1998-99	945.2	1115.2	40.8	20.8	177.7	611.0	255.3	651.2	742.1	1.5	4560.8	7779.3
1999-2000	1071.6	1096.2	52.9	19.2	195.6	709.9	307.6	771.7	886.7	1.3	5112.7	8568.6
2000-01	1076.6	1035.0	50.0	19.0	243.0	734.9	328.2	827.5	910.3	1.0	5225.5	9224.7
2001-02	942.3	1132.7	47.4	18.2	269.8	918.5	351.3	882	841.5	-	5404	9123.6
2002-03	930.1	1330.9	69.5	18.2	373.5	1320.8	356.8	1094.4	1136.2	-	6630.4	11030.5

Source: All Pakistan Textiles Mills Association, 2004.