# A brief history of Pakistan's economic development

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## Introduction

This paper briefly describes the development of Pakistan's economy during seven distinct decades, from the late 1940s to the end of the 2000s. Pakistan has progressed from a low-income to a lower middle-income developing economy — GDP per capita increased from US$294 in 1980 to US$1,017 in 2010 according to the World Bank (2012).

## The late 1940s: era of emergence of a new national economy

At its inception in 1947, Pakistan had a predominantly agrarian economy – agriculture contributed 53% of GDP in 1947, and 53.2% of GDP in 1949-50.[1] Then, Pakistan had a population of 30 million with 6 million people living in urban areas, 65% of the labour force working in the agricultural sector, and agricultural output contributing 99.2% of exports and about 90% of Pakistan's foreign exchange earnings.[2] Pakistan's resources, in East Pakistan and West Pakistan, were an immense reservoir of land and mineral resources – natural gas, crude oil, coal, limestone, and marble.[3] Pakistan had a per capita income of almost $360 (1985 international dollars) in 1950[4] and a literacy rate of 10%,[5] amidst economic crises – absence of economic infrastructure, financial resources, and industrial base.[6] Then, poverty incidence ranged from at least 55% to 60% in the West Pakistan.[7] Keeping in view the scarcity of capital in Pakistan's small private sector, the Government relied on the public sector for building the economic-cum-industrial base.[8] In 1949-50, Pakistan registered a national savings rate of 2%, foreign savings rate of 2%, and an investment rate of 4%.[9] Then, manufacturing contributed 7.8% of GDP and the services/trade/other sectors contributed 39% of GDP – a result of policy of imports-substituting industrialization.[10] Pakistan's trade balance of payments was in deficit by 66 million Rupees (Rs) during 1949/50-1950/51.[11]

[1] State Bank of Pakistan (2010), Husain (1999) and Zaidi (2005).
[2] Husain (1999), Khan (2002), Fasih-Uddin and Swati (2009), and Zaidi (2005).
[3] Fasih-Uddin and Swati (2009).
[4] Khan (2002).
[5] Fasih-Uddin and Swati (2009), and Zaidi (2005).
[6] There were small industries and few services, and there were almost no large-scale industrial units at all in 1947 [Husain (1999), Fasih-Uddin and Swati (2009), Zaidi (2005) and The World Bank (Undated)].
[7] Hasan (1997) and Hasan (2004, p. 63).
[8] Fasih-Uddin and Swati (2009), and Zaidi (2005).
[9] Hasan (1997).
[10] Hussain (2003), Husain (1999), and Hasan (1997).
[11] Zaidi (2005).

### The 1950s: era of a traditional economy in transition

The 1950s was the first decade of planning.[12] After launching the Colombo Plan in 1951, Pakistan instituted a series of Five-Year Plans during the period 1955-1998 and a Ten-Year Perspective Plan alongside a rolling Three-Year Development Plan.[13] Pakistan continued its policy of imports-substituting industrialization during the 1950s.[14] During the Korean War (1950-1953), Pakistan's public and nascent private sector thrived on spectacular merchant profits, which were transformed into industrial capital that accelerated industrialization.[15] Pakistan banned the imports of cotton textiles and luxury goods in 1952 and regulated virtually all imports in 1953.[16] Consequently, Pakistan joined the group of the most rapidly growing countries in the 1950s.[17] But, anti-agriculture policy biases and anti-agriculture terms of trade between industry and agriculture caused the annual growth rate of agriculture to decline from 2.6% in 1949/50-1950/51 to 1.9% in 1957/58-1958/59.[18] After achieving self-sufficiency in cotton textiles in the late 1950s, export development assumed vital significance,[19] amidst inflow of the US military and economic aid of US$500 million during 1955-58.[20] Consequently, Pakistan entered a phase of foreign aid-dependent growth in the 1950s.[21] In 1959 − after military *coup d'état* in 1958, the martial law regime introduced export bonus vouchers, which were treated as import licenses, and free list of the goods, which could be imported without having any import license.[22] Balance of trade deteriorated from -831 million Rupees in 1950/51 to -1043 million Rupees in 1959/60 due to sharp decrease in exports from 1,038 million Rupees in 1950/51 to 763 million Rupees in 1959/60.[23] Agriculture grew at a rate of 1.6% per annum and manufacturing grew at a rate of 7.7% per annum in the 1950s.[24] In 1959-60, Per Capita GNP was Rs.355 in West Pakistan and Rs.269 in East Pakistan.[25]

### The 1960s: era of economic growth

Amidst massive inflow of American aid, political stability enabled Pakistan to sustain high rates of growth in the 1960s.[26] Poverty incidence (poverty headcount ratio expressed as a percentage of population) ranged from almost 50% in the early 1960s to 54% in 1963-64.[27] In the 1960s, Pakistan achieved an agricultural growth rate of 5% per annum by achieving

[12] Zaidi (2005), Khan (2002), and Hasan (1997).
[13] Fasih-Uddin and Swati (2009).
[14] Hasan (1997), Husain (1999), and Zaidi (2005).
[15] Merchant profits referred to the profits realized from the Korean War-induced dramatic growth in exports of raw materials to the war-panicked countries, which were then piling up raw materials during the war [Zaidi (2005), Papanek (1996), and Hussain (2003)].
[16] Hasan (1997), Khan (2002), and Zaidi (2005).
[17] Zaidi (2005) and Husain (1999).
[18] Even negative growth rates in the agricultural sector were observed – that is, -9.1% in 1950/51-1951/52 and -0.8% in 1953/54-1954/55. With the then 75% of the population of Pakistan living in the rural area, the prolonged stagnation of the agricultural sector in the 1950s restricted further growth in the manufacturing sector (Zaidi, 2005).
[19] Hasan (1997).
[20] This US aid − a result of Pakistan-United States Mutual Defense Pact signed in 1954 − reduced the heavy burden of public expenditure on the budget of the public sector (Hasan, 1997).
[21] Nafziger (2012) and Hussain (2003).
[22] [Hasan (1997) and Zaidi (2005).
[23] Hasan (1997), Zaidi (2005) and Fasih-Uddin and Swati (2009).
[24] Fasih-Uddin and Swati (2009).
[25] Thus, the West-East Disparity Ratio was 1.32 (Zaidi, 2005).
[26] Chenery and Strout (1966), Papanek (1996). Zaidi (2005) and Khan (2002).
[27] Hasan (1997) and Hasan (2004, p. 63).

significant investments in water resources, increased incentives for farmers, mechanization of agricultural production processes, increased usage of fertilizers and pesticides, and the increased cultivation of high yielding varieties of rice and wheat.[28] The large-scale manufacturing grew at a rate of 16% per annum during 1960/61-1964/65 due to protection of domestic industry from imports and subsidies for exporters.[29] In the wake of the Pakistan-India War of 1965, the reduced foreign economic assistance caused the large-scale manufacturing to grow at a lower rate of 10% per annum during 1965-70.[30] Pakistan achieved an average annual growth rate of 6.7% in GDP during 1960-1970.[31] In 1969-70, poverty incidence declined to 46%[32] and Per Capita GNP was Rs.504 in West Pakistan and Rs.314 in East Pakistan – indicating a widening of the regional economic disparity noted earlier.

### The 1970s: era of socialism and its aftermath

Because of growing interregional economic disparity, East Pakistan revolted against West Pakistan and became independent (Bangladesh) in 1971. Then, the martial law authorities empowered the socialist Pakistan People's Party amidst very difficult macroeconomic circumstances[33] − poverty incidence rose to 55% in 1971-72,[34] there was an increase in Pakistan's import bill due to the October 1973 world oil price shock, a serious post-1973 global recession during 1974-77, failures of cotton crops in 1974-75, pest attacks on crops, and massive floods in 1973, 1974, and 1976-77.[35] Pakistan experienced the worst inflation during 1972-77, when prices increased by 15% per annum.[36] During 1973-77, annual average fiscal deficit/GDP ratio was 8.1%.[37] Trade balance deficits were US$337 million in 1970-71 and US$1,184 million in 1976-77.[38] A military coup d'état occurred on 5 July 1977, and the martial law regime accomplished denationalization, deregulation, and privatization.[39] Agriculture grew at a rate of 2.4% per annum and the large-scale manufacturing grew at a rate of 5.5% per annum in the 1970s.[40] While the large and medium-scale private manufacturing contributed 75% of the value-added and 70-80% of the total investment in manufacturing in the 1970s, the remainder of the 25% of the value-added was contributed by the small-scale manufacturing.[41]

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[28] Husain (1999) and Hasan (1997).
[29] Hasan (1997).
[30] Hasan (1997).
[31] Hasan (1997), Zaidi (2005), and Fasih-Uddin and Swati (2009).
[32] Hasan (1997).
[33] Socialism was instituted by nationalizing private industries/banks/schools/colleges and enforcing socialist reforms in the land tenure system [Husain (1999), Zaidi (2005) and Hasan (1997)].
[34] Hasan (1997).
[35] Hasan (1997) and Zaidi (2005).
[36] Hasan (1997).
[37] High fiscal deficits were financed primarily by means of inflationary money creation in the 1970s.
[38] Zaidi (2005).
[39] Due to a significant decline in the popularity of the ruling socialist party caused by both the high inflation and the nationalization policy, the ruling socialist party won the general elections of 1977 with simple majority, amidst the opposition's accusations that the general elections were rigged. Then, the opposition launched an anti-socialist regime political movement, which culminated in Pakistan's second military coup d'état. The martial law regime launched a program of accelerating economic growth via a massive inflow of the foreign remittances and the foreign aid from the Western countries in the wake of Soviet invasion of Afghanistan in 1979 [(Zaidi, 2005), (Lansford, 2012)].
[40] Fasih-Uddin and Swati (2009).
[41] World Bank (Undated).

### The 1980s: era of revival of economic growth

Hallmarks of the 1980s were the reversal of the nationalization regime of the 1970s[42] and the revival of private sector's industrial investment, which led to high rates of growth.[43] Poverty incidence declined to 29.1% in 1986-87.[44] Unemployment rate declined from 3.7% in 1980 to 2.6% in 1990.[45] During 1985-88, the Government tried to implement the Islamic interest-free banking system, which introduced Islamic business partnerships between entrepreneur and the owner of capital based on the principle of sharing profits and losses.[46]

Pakistan achieved a national savings/GDP ratio of 16% in 1986-87 amidst massive inflows of worker remittances from the Middle East.[47] However, Pakistan experienced the problems of negative public savings and declining public investment/GDP ratio throughout the 1980s and used a large portion of the additional national savings to finance the enlarged fiscal deficits – a result of both the steep growth in the public sector's non-development expenditures and the tendency of the tax revenue/GDP ratio to decline – since the 1980s.[48] The increasingly enlarged budget deficits in the early 1980s were financed mainly via non-bank domestic borrowing.[49] Domestic debt grew from Rs.58 billion in mid-1981 to Rs.521 billion in 1988.[50] Consequently, the public debt/GDP ratio was 77.1% in 1988, 81.9% in 1989, and 82.6% in 1990.[51] This explosion of the domestic debt resulted in large interest payments, public expenditure, and fiscal deficits.[52] Democracy was restored in 1985.[53] During 1980-1990, Pakistan's average annual growth rate of GDP was 6.3%.[54] A manufacturing exports' boom occurred in the 1980s, with an annual large scale manufacturing growth rate of 8.8% and an annual agricultural growth rate of 5.4%.[55]

### The 1990s: era of debt crisis

In the 1990s, Pakistan confronted the problems of declining worker remittances and rising external deficits.[56] In the wake of declining growth rates of GDP, there occurred the second worst inflation in the 1990s.[57] Unemployment rate sharply increased to 5.9% in 1991 and

[42] Husain (1999) and Fasih-Uddin (2008).
[43] Fasih-Uddin (2008).
[44] Fasih-Uddin and Swati (2009).
[45] World Bank (2012), *World development indicators 2012.*
[46] Nafziger (2012).
[47] Hasan (1997), Husain (1999) and Zaidi (2005).
[48] Hasan (1997).
[49] Hasan (1997).
[50] Hasan (1997).
[51] Fasihuddin (2008).
[52] Hasan (1997).
[53] After both the dismissal of this democratic government by the President of Pakistan in 1988 and general elections of 1988, the newly formed government was dismissed in 1990. General elections of 1990 resulted in a new government. This scenario depicts higher political uncertainties, fast changing economic policies, and higher economic risks for investors (Lansford, 2012).
[54] Pakistan's average GDP growth rates remained higher than the average GDP growth rates of India, Bangladesh, and Sri Lanka for the periods 1960-1970, 1970-1980, and 1980-1990 [(Hasan,1997) and (Lansford, 2012)].
[55] Hasan (1997) and Fasih-Uddin and Swati (2009).
[56] Hasan (1997).
[57] Prices grew at a rate of 12% per annum from mid-1993 against a backdrop of explosive growth in money creation for supplying credit to the public sector, especially during the period 1990-96 (Hasan, 1997).

7.2% in 2000.[58] Pakistan financed the enlarged current account deficits via the sustained increases in her residents' Foreign Currency Deposits.[59]

In 1995, external debt amounted to US$30 billion – external debt tripled during 1980-1995.[60] During 1980-1995, the external debt/GDP ratio increased from 42% to 50%, the external debt/exports ratio increased from 209% to 258%, and the debt service ratio sharply increased from 18% to 27%.[61] Due to a seriously deteriorating profile of Pakistan's external liabilities – the prime cause of her foreign exchange difficulties after the first half of 1996 – domestic debt rose to Rs.909 billion, and the domestic debt/GDP ratio rose to 42%.[62]

A serious debt crisis occurred in the late 1990s, when the public debt/GDP ratio rose from 57.5% in 1975-77 to 102% in 1998-99.[63] Similarly, the public debt/revenues ratio rose to 624% in 1998-99, interest payments/revenues ratio rose to 42.6%, and the public debt became unsustainable.[64] Likelihood of external debt default emerged in 1996, and 1998, due to the Western economic sanctions imposed in reaction to Pakistan's nuclear tests on 28 May 1998.[65] Sanctions triggered massive capital flight.[66] This debt crisis occurred despite an agricultural growth rate of 4.4% per annum and a large-scale manufacturing growth rate of 4.8% per annum in the 1990s.[67] Poverty incidence sharply increased to 30.6% in 1998-99.[68]

### The 2000s: era of economic crisis

In 2001, the official Debt Reduction and Management Committee judged the high public debt as a major cause of decline in the growth rate to less than 4 per cent per annum.[69] Debt crisis of the 1990s was followed in the 2000s by an era of macroeconomic crises[70] − in spite of improvement in the growth rate until 2004-05 when the growth rate was 8.6%, the subsequent

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[58] World Bank (2012), *World development indicators 2012.*
[59] Hasan (1997).
[60] Amidst this external debt fiasco, Pakistan met almost one-third of her foreign exchange gap via the use of volatile short-term liabilities in the form of the resident and non-resident foreign currency accounts (Hasan, 1997).
[61] That is, principal and interest payments/foreign exchange earnings ratio (Hasan, 1997).
[62] Hasan (1997).
[63] Debt overhang caused a decrease in the rate of investment to 15% of GDP in 1998-99/1999-2000. In the wake of this debt crisis, the third *coup d'état* empowered the third military regime on 12 October 1999 for the period 1999-2008. In spite of realization of some debt relief by Pakistan via her agreement with IMF regarding the rescheduling of her debt payments obligations, the possibility of her external debt default was not ruled out [(Hasan, 1999) and (Lansford, 2012)].
[64] Hasan (1999).
[65] Lansford (2012), Fasih-Uddin (2008) and Hasan (1999).
[66] Irfan-ul-Haque (2010).
[67] Fasih-Uddin and Swati (2009).
[68] Fasih-Uddin and Swati (2009).
[69] Pakistan's debt entrapped her in a vicious circle of high debt servicing, which caused stagnation in investment and growth as well as limited her capacity of debt servicing (Debt Reduction and Management Committee, 2001).
[70] Namely, a rise in the fiscal deficit/GDP ratio to 4.3% in the fiscal year 2000, a dire deterioration in the balance-of payments position in 2001, a reduced average annual economic growth rate of 2%, a negative trade balance alongside the signing of IMF's standby agreement with an exceptionally tough conditionality amidst the looming prospect of default on external debt during 1998-2001, the failure of public and private sectors to effectively use the inflows of US$62.2 billion realized during the period 2002-2007 as a result of the increased strategic significance of Pakistan in the post-9/11 scenario for establishing a robust basis for sustainable growth, the sharp deterioration in Pakistan's international investment position after the fiscal year 2005, the increasing conspicuous consumption, and a steep hike in the import bill in the fiscal year 2008, which caused unsustainable trade deficits [(Irfan-ul-Haque, 2010) and (Zakaria, 2012)].

years were characterized by growth slowdown and low growth along with high inflation, energy crisis, and deterioration in fiscal and balance of payments positions.[71] Poverty incidence increased to 34.5% in 2000-01 and then decreased to 22.3% in 2005-06.[72] Unemployment rate increased to 7.8% in 2002 and then declined to 5% in 2008.[73] Adult literacy was 55% in 2007-08. Pakistan experienced economic crisis in 2008[74] and the prime effect of global financial crisis in 2009-10.[75] In 2009-2010, the inflation-adjusted growth rate was a respectable 4.1%, the agricultural growth rate was 2%, industrial output growth rate was 4.9%, large-scale manufacturing growth rate was 4.4%, and the services growth rate was 4.6%.[76] In March 2010, the total public debt amounted to Rs.8,160 billion with a total public debt/GDP ratio of 56%, while the foreign-currency denominated debt/GDP ratio was 25%.[77]

Pakistan experienced remarkable development-oriented structural transition — GDP share of agriculture declined from 53% in 1947 to 21.2% in 2010, GDP share of industry rose from 9.6% in 1949-50 to 25.4% in 2010, and GDP share of the services rose from 37.2% in 1950 to 53.4 % in 2010.[78]

## Conclusions

The history of Pakistan's economic development highlighted the key role played by the manufacturing sector. Pakistan progressed from its status as a low-income to a lower middle-income country and achieved her objective of poverty reduction.[79]

For sustainable growth, Pakistan needs to significantly increase national saving and investment rates, achieve budget surpluses for minimizing her domestic and external debt burden, and have political stability to promote a healthy investment climate for domestic and foreign investors, high levels of investment in human capital, and greater openness to international trade and private foreign investment.[80]

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[71] Fasih-Uddin and Swati (2009).
[72] Fasih-Uddin and Swati (2009).
[73] World Bank (2012), *World development indicators 2012.*
[74] 2008 was the year of transition from the military regime into a democratically elected Government of Pakistan.
[75] Irfan-ul-Haque (2010).
[76] Ministry of Finance, Government of Pakistan (2010).
[77] Ministry of Finance, Government of Pakistan (2010).
[78] State Bank of Pakistan (2010) and Fasih-Uddin and Swati (2009).
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