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Structural Adjustment and Health in Pakistan[1]

Shahrukh Rafi Khan and Sajid Kazmi

Abstract

Government health expenditures as a percentage of GDP have declined in Pakistan, though not in absolute real terms, over the structural adjustment period. Progress over this period is evident on a number of health indicators. However, Pakistan still lags far behind the means of low income countries and South Asian countries in all child survival statistics. In view of this, and since the evidence shows a significant and sizeable association of public sector health expenditures and the decline in infant mortality rates, there seems little justification in cutting public sector expenditures.

Introduction

A clear statement is contained in the World Development Report 1993 (Report) on the World Bank's view with regard to health sector reform in less developing countries. As is the case in reading many other Bank documents, this one seems to have drawn on numerous critiques of conventional health practices. Government inefficiency and corruption is criticised. Also, the practice of heavy expenditures on curative medicine and related specialised health training, which subsidises the rich or the off spring of the rich, is criticised and restructuring expenditures from tertiary medicine to primary health care (PHC) is endorsed. Indeed, in some respects, the Report makes the Bank sound quite radical. Adopting such a view, however, would be erroneous. While the Bank suggests many sensible reforms, such as the ones mentioned above, there remain important differences in the Bank's approach and that of its radical critics.

The most fundamental difference however is one of perspective. Simply put, the Bank wants to restrict the role of government to the bare classical essentials and enhance the role of private provision and markets. This is consistent with the Bank's ideological underpinnings that comes through in most Bank documents. The Bank acknowledges the following role for the government. First, since positive externalities exist in public health, such as in the realm of disease control, a role for the government is required for immunisation and diet supplement programmes, probably school based, since private providers would provide too little of this public good. Second, the related role of disseminating information for disease control is also viewed as essential.

[1] Many thanks are due to Mozaffar Qizilbash and Haris Gazdar for helpful comments.

Third, regulation is considered important for market based insurance since a market failure is acknowledged as resulting from moral hazard (incentives for over supply in the case of third party insurers) i.e. hospitals have an incentive to raise medical expenditures which are to be reimbursed by medical insurance companies. Fourth, regulation is called for in drug supply and the concept of an `essential drug list' is endorsed. Fifth, since exclusion of the most needy and high risk is likely when insurance is left to the private sector, the Bank does not rule out efficiently provided cost containing social insurance. Pre-paid private sector insurance provided in a health maintenance "managed competition" framework is endorsed as an alternative. Finally, the role of the government is acknowledged in providing essential clinical services for the poor.

The Bank views much existing government expenditure as inefficient and suggests that it could be pared down by one half (p. 7). This could be done not only cutting back on subsidies and inessential services, but also by improving efficiency via decentralisation, performance based incentives and management systems development. Costs could be further reduced by engendering competition in supply by enhancing the role of the private sector in delivering health services and in delivering inputs such as drugs, other medical supplies and equipment. Indeed, the Bank recommends a subsidy to private providers delivering services to the poor! Other ways recommended for cutting costs are vouchers for the poor to enhance choice, competition and efficient delivery and user fees are recommended for recovering costs. While the Bank calls for cuts of fifty per cent in public sector expenditures as expalined above, it does call for doubling or tripling spending on public health programmes (p. 7).

Two points on these expenditure cuts are in order. First, since health data are not reported for public health separately, it is not possible to ascertain what the impact would be of the World Bank proposal on total health expenditures. Since the Bank suggests that traditionally very little was allocated to primary health, in that case there would be a substantial overall decline. Second, it is important to note that most government sector urban and semi-urban hospitals and other facilities now serve the poor and lower middle class and not the rich. Thus health expenditure cuts would inevitably affect the poor.

The reforms mentioned above fit into what the bank calls a three-pronged approach. Macro-stabilisation is called for to improve growth. This is necessary for enhancing incomes of the poor which would in turn increase their ability to invest in household health[2]. At the same time, government

[2] The Report does point out that this association would be much stronger if economic policies are pursued which would increase the income of those in poverty. However, the

expenditures are viewed as being wasteful due to inefficiency and corruption, and hence should be cut. Thus the other main reforms suggested fit into the categories of improving (re-structuring and reducing) government spending on health and promoting diversity and competition (enhancing the role of the private sector).

As earlier indicated, while the Bank has absorbed much of the critique of health systems in less developing countries, its approach to reform is fundamentally one of paring down the size of the government and in enhancing the role of the market, even to the extent of subsidising private sector provision. The Bank's critics, of whom Qadeer (1997) is a very articulate one in the South Asian context, remain unmoved by the Bank's incorporation of many elements of their critique into its own agenda[3].

Thus, Qadeer views the Bank's approach as technocentric and narrowly interventionist in the areas of population control, reproductive and child health and communicable diseases. She also views the Bank's notion of primary health care to be a very narrow one. Further, the dismantling of the public sector is resented and the cuts in food and basic service subsidies are viewed as part of the cut in the public sector's role in health care[4]. Juxtaposed to the Bank's approach, Qadeer endorses a much broader concept of comprehensive public sector primary health care which includes the provision of basic minimum services such as nutrition, housing, water supply and sanitation, education and livelihoods along with preventive care which is in touch with the political, cultural, and economic realities of the poor. This perspective is fundamentally different from the Bank, since it views alternative solutions such as private or NGO provision as an abdication by the state of its central role as a tax collector and provider of basic human needs.

Pakistan's recently announced new health policy in 1997 reveals the influence of the Bank thinking in several respects[5]. First, the private sector is expected to take up more responsibilities in areas of preventive services, family planning and drugs. Second, selected Basic Health Units and Rural Health Centres are to be contracted out to private physicians, NGOs or

---

Report does not acknowledge that there could be conflict between the macro-stabilisation policies it endorses and pro-poor policies [see Khan and Aftab, (1997)].

[3] Many progressive writers resent the Bank's proclivity towards absorbing their concepts, due to its vast research and dissemination capacity, but in not fundamentally altering its orientation. A case in point is the concept of "participation" which the Bank is viewed as having appropriated. While some researchers in the Bank are aware of the origin of this concept as originally being about empowerment of the poor, for others in the Bank who have been exposed to this concept, it is about a more efficient way of engendering service delivery.

[4] See Khan and Aftab (1997).

[5] "Salient Features of New Health Policy," The News International, December 18, 1997, p. 8.

existing staff to deliver a standard package of services at fixed user charges under the supervision of community based organisations. Third, autonomy will be given to selected hospitals to be run by Hospital Management Boards under the supervision of District Health Authorities. These hospitals will be authorised to levy user charges.

It is inevitable that the debate on health policy in Pakistan between the Bank and its critics will sharpen. Our perspective is a pragmatic one. In principle we agree that providing comprehensive primary health care is the role of the state. However, we feel that public pressure for the reform of the government to one that is accountable and focuses on efficiently delivering services should continue but that, in the meantime, alternatives, such as grassroots NGO service delivery as well as private initiatives, should be welcomed if they work well[6],[7]. While the above debate is important, the ultimate objective is to improve the well being of the poor. Thus it seems foolish to hold the ultimate objective hostage to the resolution of the debate. It would be equally foolish to wait until the reform of the government is realised such that it is capable of engaging in the kind of service delivery that many expect it to provide.

In section 2, we briefly discuss the method we employ for assessing impacts. One would have to wait for the implementation of the new health policy to assess its impact on general health. However, it is possible to assess the changing state of general health over the structural adjustment period, particularly over the period that the Social Action Plan (SAP) has been in place. We present this evidence in section 3 in terms of health expenditures, outputs and impacts and also present evidence on hypothesis testing with regard to testing the effectiveness of government health expenditures. We end with conclusions.

Method

In assessing impacts, the approach used is a variation of a "results based assessment" that some donors are moving towards[8]. First we

[6] We deliberately avoid mentioning "good governance." While we endorse much that that is mentioned in the package of good governance reforms, we feel that the choice of the word governance is a very unfortunate one. Insofar as language is important, the emphasis should be on providing "good service" rather than on governing well. Civil society elects political representatives and pays for civil and military bureaucracies via taxes to serve it rather than to rule or govern it.

[7] A legitimate rejoinder in this regard is that instead of engaging in service delivery, NGO efforts should be expended in mobilising communities to demand service delivery from the government.

[8] For example, the Canadian International Development Agency (CIDA) has instituted a "results based matrix" to assess the work of Institutions whose funding it contributes to.

investigate expenditures as a level of effort or input indicator. Following that, we document outputs which include changing access to various facilities such as doctors, nurses and hospital beds. Finally, we examine how these access or outcome variables translate into impact variables which reflect the health status of the population. These impact variables include the usual indicators such as the infant, child and maternal mortality rates as well as life expectancy at birth and nutritional changes.

In considering access and impact, we review Pakistan's progress using both secondary data and also published data which were specifically generated by the Government of Pakistan and the World Bank to assess the progress of the Social Action Plan. Finally, we contrast Pakistan's achievements to date with that of other developing and South Asian countries.

The results based method described above for assessing impact assumes that government expenditure is of consequence in improving health indicators. However, as pointed out in section I, in laying out a three-pronged approach to government policies for improving health, the World Development Report 1993 views government expenditures as being wasteful due to inefficiency and corruption, and it is asserted that governments should spend about 50 per cent less than they are actually doing on the less efficient kinds of government expenditures and two to three times more on public health programmes (p. 7). Also, it mentions pursuing economic growth policies as being an effective mechanism for the improvement of public health. Evidence is cited to indicate that in countries in which average income rose by more than 1 per cent, child mortality fell by more than twice that of countries for which average income fell (p. 7). The causation is viewed as going from faster growth to increased household income to more household health expenditures to better health. Thus, per capita GDP is used as a proxy by the Bank for personal household expenditures on health. Zaidi (1997, p.7) suggests that improvements in health indicators in Pakistan over the 1980s could have been due to the inflow of remittances of Pakistani workers abroad. This makes sense since personal household incomes and hence health expenditures can also be influenced by remittance inflows. Finally, it is possible that government expenditures on health actually do improve health.

These statements suggest testing the following associations:

$$HI = HI\,(\,PCGDP,\ REM,\ GEH), \qquad (1)$$

Where,

HI = Health indicators;

PCGDP = Per capita GDP;

REM = Remittances;

GEH = Total government expenditures on health.

To endorse the Bank's assertion that many government health expenditure are generally inefficient and that economic growth is fundamental to improved health, the estimation of equation 1 above should show a positive association of HI and PCGDP and REM, and at best an insignificant association between HI and GEH. Unfortunately, we are not able to disaggregate the expenditure data to see the specific impact of public health programmes relative to other government sector health expenditures.

Findings

(a) Input or level of effort.

We are inferring the government's commitment to the health sector or its level of effort from its development and recurring expenditures. Table 1 below presents evidence on how this commitment has changed over time.

Appendix Table I: Data matrix used in regression reported in Table 4.

Years	IMR	GDP	WREM	HEXP
1982	120.0	3551.09	353.83	23.06
1983	123.5	3618.88	321.95	26.96
1984	127.0	3776.49	296.76	27.00
1985	116.0	3864.33	311.70	31.82
1986	106.0	3989.89	272.80	41.01
1987	104.0	4165.08	225.26	45.64
1988	108.0	4240.25	203.64	40.90
1989	107.0	4295.96	212.81	36.88
1990	105.0	4394.09	182.30	34.04
1991	102.0	4595.78	140.73	32.92
1992	101.0	4547.34	138.31	32.76
1993	99.5	4585.87	129.78	31.41
1994	98.1	4673.56	147.39	30.95
1995	78.0	4753.62	110.22	36.75

Sources: World Development Report 1984 (1984, p. 262) for the 1982 IMR, Social Indicators of Development 1995 for the IMRs from 1984-1992 and 1995. We have extrapolated the IMRs for 1983, 1993 and 1994 as an average of the prior and preceding year IMR. GDP, remittances, expenditures and population were drawn from the Economic Survey 1996-97, Statistical appendix (1997, pp. 30-31, pp. 150-51, p. 209 and p. 21) respectively.

Notes:
GDP : Real gross domestic product per capita
WREM : Real remittances per capita
HEXP : Real health expenditure per capita
IMR : Infant mortality rate. Measured as the number of deaths per 1000.
SE : Standard error

Table 1: Time series development and recurring health expenditure

Years	Health expnditure as a pecentagee of GDP		
	Dev.	Rec.	Total
1970-71	0.12	0.29	0.40
1971-72	0.14	0.29	0.43
1972-73	0.20	0.28	0.48
1973-74	0.31	0.28	0.59
1974-75	0.45	0.29	0.74
1975-76	0.45	0.31	0.76
1976-77	0.35	0.33	0.68
1977-78	0.31	0.34	0.65
Average 1970-77	0.29	0.30	0.59
1978-79	0.33	0.33	0.66
1979-80	0.35	0.31	0.66
1980-81	0.36	0.32	0.68
1981-82	0.34	0.34	0.68
1982-83	0.37	0.38	0.75
1983-84	0.37	0.40	0.77
1984-85	0.37	0.44	0.81
1985-86	0.44	0.55	0.99
1986-87	0.50	0.64	1.14
1987-88	0.44	0.64	1.08
Average 1978-87	0.39	0.44	0.83
1988-89	0.36	0.59	0.95
1989-90	0.32	0.56	0.88
1990-91	0.25	0.55	0.80
1991-92	0.19	0.56	0.75
1992-93	0.19	0.56	0.75
1993-94	0.21	0.51	0.72
1994-95	0.25	0.52	0.77
Average 1988-94	0.25	0.52	0.77

Sources: Pakistan Economic Survey 1995-96 (pp. 239).

Notes: GDP = Gross Domestic Product.

Rec. = Recurring expenditure. It includes salaries, maintenance and other recurring items.

Dev. = Development expenditure consists of expenditure on infrastructure in the form of buildings and durables.

Information in Table 1 is reported for three time periods that coincide with the following political regimes: the 1971-78 period with the first populist PPP government; the 1978-1988 period with military rule and with the gradual liberalisation of the economy; the post 1988 period with the intensive phase of structural adjustment currently underway. Both time series and period averages are presented.

Development expenditure on health as a percentage of GDP rose from 0.14 to 0.45 from 1971-72 to 1974-75 and then declined to 0.31 per cent in 1977-78. Recurring expenditures on health as a percentage of GDP rose steadily from 0.29 in 1971-72 to 0.34 in 1977-78. Both these expenditures continued to rise steadily in the 1978-88 period. The 1978-88 period average for development and recurring expenditure as a percentage of GDP was 0.39 and 0.44 respectively compared to 0.29 and 0.30 in the 1971-78 period. Subsequently, post 1988, both recurring and development expenditures steadily declined.

That development and recurring expenditures declined in the structural adjustment period would not generally be considered surprising. The austerity imposed by conditionalities accompanying structural adjustment programmes to meet the budget deficit targets have traditionally had an adverse impact on social sector expenditures[9]. Also, public sector health expenditure cuts are consistent with the Bank's view on this issue presented in the introduction. However, in Pakistan, so much has been said about protecting the social sectors via allocations to the Social Action Plan (SAP), that the post 1988 reduction does come as a surprise.

Health has high social value because it contributes directly to individual wellbeing and also indirectly by enabling individuals to be more productive. Furthermore, negative externalities can be offset if individuals are healthier and therefore more resistant to disease. Thus, it is important to explore if health expenditures are effective (sub-section c.(ii))[10] This is

[9] Cornia, Jolly and Stewart (1987).

[10] This view is influenced by Chambers (1995) and Dreze and Sen (1995).

particularly the case when Pakistan's progress in health is judged in a cross-country perspective (sub-section c.(iii)).

(b) Outputs

The level of effort reflected in the expenditures in Table 1 translates into trained medical personnel and facilities. In Table 2, we present the aggregate level of access of the population to medical personnel and facilities. The time series data reported in Table 2 shows a steady and continuous improvement is access to both health personnel, as measured by population per doctors, dentists and nurses, and facilities, as measured by population per hospital bed. Indeed, it appears to be a puzzle why the decline in health expenditures as a percentage of GDP did not translate into a decline in access to medical personnel and facilities per capita. The answer is actually quite straight forward. While development and recurring health expenditures have declined as a percentage of GDP, because of a growing GDP, in absolute real terms they have increased by 11 per cent and 38 per cent respectively between 1988-89 and 1994-95[11]. Thus the real issue is not that access to medical personnel and facilities has declined, but that it has not increased by as much as it should have.

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[11] Real development and recurring health expenditures increased from Rs. 1.46 and Rs. 2.41 billion to Rs. 1.63 and Rs. 3.34 billion respectively. The development expenditures were deflated by the building materials price index and the recurring expenditures by the general price index, both drawn from the Economic Survey 1995-96, p. 146. In each case, the base was 1980-81.

Table 2: Access to health facilities and personnel.

	Population per			
Years	**Hospital Bed**	**Doctor**	**Dentist**	**Nurse**
1970	2,061	15,256	155,466	-
1971	1,804	14,343	137,870	-
1972	1,792	13,190	123,953	-
1973	1,848	12,824	120,018	-
1974	1,893	12,164	111,311	73,065
1975	1,852	11,628	107,661	36,332
1976	1,843	11,133	102,153	29,426
1977	1,834	10,278	101,405	23,908
Average	1,866	12,602	119,980	40,682
1978	1,804	9,526	98,079	20,283
1979	1,779	8,695	93,309	17,873
1980	1,716	7,549	87,672	15,712
1981	1,731	6,027	82,357	14,147
1982	1,717	5,033	77,110	13,045
1983	1,708	4,271	72,930	12,504
1984	1,714	3,584	68,110	11,441
1985	1,695	3,153	66,900	9,276
1986	1,692	2,870	62,689	8,382
1987	1,678	2,610	62,552	7,985
Average	1,723	5,331	77,171	13,065
1988	1,610	2,422	58,589	7,638
1989	1,613	2,263	55,808	6,958
1990	1,512	2,127	53,134	6,713
1991	1,501	20,47	51,883	6,463
1992	1,525	1,954	51,496	6,232
1993	1,555	1,919	50,341	6,147
1994	1,510	1,880	48,046	5,976
1995	1,503	1,837	46,498	5,842
Average	1,541	2,056	51,974	6,496

Sources: Pakistan Economic Survey 1995-96, (pp. 238-9).

Published data in the 1995-96 Pakistan Integrated Household Survey (1997, pp. 44-58) makes possible an assessment of the population's health during the structural adjustment period in which the SAP was underway. Once again, the evidence suggests an across-the-board improvement in access to services and preventive coverage.

Consultation of a medical practitioner for the treatment of diarrhoea in children 5 years or under declined from 90 to 87 per cent in urban areas but rose from 82 to 85 per cent in rural areas. Since ORS is generally recommended, these numbers show an increasing confidence in self-treatment in urban areas. The gender gap in consultation closed from 6 per cent to 4 per cent in urban areas and from 6 per cent to a 1 per cent higher consultation for girls in rural areas. There has been an increase (from 22 per cent to 27 per cent) in rural areas in the percentage of cases in which a government health practitioner was consulted first for diarrhoea treatment.

The percentage of children five years and less that have received at least one immunisation increased from 81 to 87 in the urban areas and 66 to 74 in the rural areas. The percentage of children five years and less that have received full immunisation increased from 40 to 61 in the urban areas and 20 to 51 in the rural areas. These results again show a closing of the regional (urban/rural) gap. The gender gap also once again closed from a 6 and 7 per cent gap in urban and rural areas to a 2 and 1 per cent gap respectively[12].

Access is one area in which progress seems limited. Of those who did not visit a government facility for treatment of diarrhoea, 51 per cent in urban areas and 47 per cent in rural areas cited distance as the reason for not doing so. For other illnesses and injuries, about a third in urban and rural areas cited distance as the reason for not visiting a government facility and a fifth cited the lack of medicines as the reason. Thus access continues to be perceived as a problem in both urban and rural areas.

This perception can be juxtaposed with actual distances from government facilities in rural areas. By 1995-96, 15 per cent of the households in the sample had a government hospital within 5 kilometres of their home, a third a government dispensary or rural health centre and about two-fifths a basic health unit. Thus it appears that the perception of a lack of access is grounded in reality.

(c) Impact

We have sub-divided this section into three parts. First, we review Pakistan's progress in health by reporting and discussing its conventional health indicators utilising the period analysis reflected in the earlier Tables based on secondary data and by reporting on findings of the Pakistan Integrated Household Survey. Second, we identify variables that may be

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[12] These improvements are probably the result of the acclaimed UNICEF expanded program of immunisation. See Cornia (1997).

responsible for improved health indicators. Finally, we contrast Pakistan's achievement to date with that of other developing and South Asian countries.

(i) Pakistan's health progress over time

Table 3 below shows that the increase in output of medical personnel and facilities has been effective in that conventional health indices show an improvement corresponding to the output increase.

Table 3: Pakistan's child survival and other health indicators

Years	IMR	MMR	<5 MR	LEAB	CMN <5
1970	142	--	--	48	--
1972	140	--	--	49	--
1977	130	--	--	52	55
1980	--	600	151	--	--
1982	120	--	--	54	--
1985	116	--	--	--	57
1987	104	--	--	57	49
1990	105	--	--	--	40
1993	100	340	137	--	--
1994	98	--	137	62	40
DC*	68	384	101	62	30
SA*	82	583	120	61	52

Sources: *World Development Report, Human Development Report*, various issues, and *Human Development in South Asia 1997.*

Notes:

IMR = Infant Mortality Rate (Per 1,000 Live Births)

MMR = Maternal Mortality Rate (Per 100,000 Live Births)

<5 MR = Under Five Mortality Rate (Per 1,000 Live Births)

LEAB = Life Expectancy at Birth (Years)

CMN <5 = Child Malnutrition Under age 5 (% Under Weight)

DC = Low Income Countries

SA = South Asia

* = Data are for 1993 or 1994.

Table 3 above shows a steady improvement, including in the structural adjustment period, in all health indices for which data were available. Thus the infant mortality rate has declined by 33 per cent from 1972 to 1994, the maternal mortality rate has more than halved from 1980 to 1988, the child mortality rate has declined by 10 per cent from 1980 to 1994, the life expectancy at birth has increased by 12 years to 61 from 1972 to 1994 and child malnutrition declined by 38 per cent (from 55 per cent underweight in 1977 to 40 per cent underweight in 1990).

The findings reported in the 1996 Pakistan Integrated Household Survey show that the percentage of children under 5 suffering from diarrhoea (30 days prior to the time of survey) decreased from 22 to 15 in urban areas and 27 to 19 in rural areas. There was virtually no gender gap in either year, and for 1995-96, no evidence that the incidence of diarrhoea was inversely associated with household income.

The infant mortality rate (IMR -- deaths per 1,000 live births) encapsulates summary information about the general state of children's health and is therefore a useful indicator. Between 1987-1989, the IMR for boys in urban areas declined from 123 to 77 and for girls from 100 to 85. The corresponding decline in rural areas was from 152 and 125 to 115 and 101 respectively. While the regional gap for boys is larger, the gender gap in both urban and rural areas narrowed considerably.

(ii) Explaining improvements in the infant mortality rate

We estimated equation (1) (see section II) to identify the determinants of improvements in health indicators. We managed to cobble together a time series for the infant mortality rate[13]. This should be expected to respond to government expenditures on health and public health and also to private household expenditures. We regressed this variable on GDP per capita, public health expenditure per capita and remittances per capita. The results are reported in Table 4 below.

[13] A note of caution is in order. There may be some consistency problems with the series that we have put together, since different sources have been relied on and IMRs are sensitive to method.

Table 4: Determinants of the infant mortality rate (IMR)

	Coefficients	SE
INP	289.77*	(87.75)
T	-5.08*	(0.97)
GDP(-1)	-0.02	(0.02)
WREM(-1)	-0.21**	0.07
HEXP	-0.54*	0.14
R bar squared	0.97	
F-Stat.	44.16*	

Sources: World Development Report 1984 (1984, p. 262) for the 1982 IMR, Social Indicators of Development 1995 for the IMRs from 1984-1992 and 1995. We have extrapolated the IMRs for 1983, 1993 and 1994 as an average of the prior and preceding year IMR. GDP, remittances, expenditures and population were drawn from the Economic Survey 1996-97, Statistical Appendix (1997, pp. 30-31, pp. 150-51, p. 209 and p. 21) respectively.

Notes:

GDP : Real gross domestic product per capita

WREM : Real remittances per capita

HEXP : Real health expenditure per capita

IMR : Infant mortality rate. Measured as the number of deaths per 1000.

SE : Standard error

The data matrix is reported as Appendix Table I.

The results are corrected for serial correlation by using the Cochran-Orcutt Method. Since not all variables were stationary, we tested for equation co-integration using the Augmented Engle-Granger (AEG) test which is a Dicky Fuller (DF) test of the stationarity of the residuals. The absolute value of the estimated (statistic of 4.6362 is greater than the critical value, with trend, of 3.9272 in absolute terms at the 95 per cent level of significance. Thus the residuals (t are stationary, and we conclude that the estimated equation is cointegrated and that the associations identified are not spurious.

SE	=	Standard error
*	=	Significant at the 1% level
**	=	Significant at the 5% level
(-1)	=	One period lag

HEXP lagged one period was not statistically significant

Contrary to the World Bank view, public sector health expenditures proved to be very effective in reducing the infant mortality rate. The coefficient for the public sector health expenditures are significant at the 1 per cent level and magnitude of the coefficient suggests a Rs, 10 increase in public health expenditures per capita per annum is associated with a decline in the infant mortality rate of five per thousand.

GDP per capita is not significantly associated with a decline in the infant mortality rate. If income distribution is very uneven and the growth process is neutral to or accentuates inequalities, higher PCGDP will not be associated with a generalised improvement in health indicators. Evidence reported in Khan and Aftab (1997, p. 11) suggests growing inequalities from the mid-1980s on, and so this result is not surprising.

Ideally, we should use private household expenditures on health, but no such time series was available. Since remittances are an important source of household income, particularly for the lower income groups, we have used remittances per capita. This variable proved to be significant at the 5 per cent level and a Rs. 10 increase in remittances per capita per annum is associated with a decline in the infant mortality rate of two per thousand. Thus public sector health expenditures which are targeted, are much more effective as should be expected.

However, the significance of remittances is premised on some of the money flowing into households finding its way into better nutrition and increased household expenditure on health. Data [Government of Pakistan, (1995, p. 165)] show that the percentage of private household expenditure on health, as a percentage of total household expenditure, did increase from 1.9 per cent in 1970-71 to 2.9 per cent in 1990-91. This increase in private health expenditures could reflect a greater household priority to health or an increase in private health expenditures induced by increased user charges and a greater availability and aggressive pushing of prescriptive medicines.

One way to get a handle on increased user charges is by reviewing how government receipts in the health sector have changed over time. The data available are reported below in Table 5.

Table 5: Provincial government receipts from health services (Rs., million, real)

Province	1970-71	1994-95
Balochistan	1.19	5.25
NWFP	2.19	19.75
Punjab	11.10	39.94*
Sindh	15.45#	24.78*

Source: Govt. of Balochistan, Finance Department, *Statements of Receipts 1971-92*, (1971-72, pp.40-42, 1995-96, pp.35-37); Govt. of NWFP, (1971-72, pp.53-55, 1995-96, pp. 66-70); Govt. of Punjab, (1971-72, pp. 49-52, 1992-3, 48-51); Govt. of Sind, (1989-90, pp. 35-41, 1992-93, pp. 37-43)

Note: Receipts included those collected from general and public health services provided. 1980 has been used as the base year and the price index.was drawn from *Economic Survey 1996-97*, Statistical Appendix (1997, p. 21).

* Data used are for 1991-92

Data used are for 1988-89

It is quite clear from the table above that, over time, there has been a substantial increase in the government receipts for health and public health services across all provinces. Thus, user charges have not merely appeared in policy documents but are actually being implemented. It appears then that the increased private household expenditures are at least partly induced by public sector fee for service delivery. One would, however, expect better and more effective services being demanded when user fees are paid.

(iii) Pakistan's health progress in a cross-country perspective

Table 3 also reports the mean outcome variables for South Asia and Less Developed Countries. While the outcomes for Pakistan are encouraging when viewed over time, they are much less so when viewed in a cross country perspective at least with regard to child survival statistics. Pakistan's infant mortality rate and less than five mortality and malnutrition rates are higher than the averages for developing countries and South Asia. Pakistan's life expectancy at birth matches the average of South Asia and developing countries, but its maternal mortality rate is lower than these cross country averages.

Conclusions

A review of the background statistics for Pakistan's health sector shows that while some progress has been made, much more is needed. Data on government expenditure on health show that, true to form, the structural adjustment period is associated with declines in development and recurring expenditures as a percentage of GDP. In absolute real terms, expenditures did increase, and these have translated into better access over time to medical personnel and facilities. Also, health impacts, as gauged by conventional health indicators, including maternal mortality, infant and child survival statistics, nutrition and life expectancy, were positive.

Survey data also show improvements in basic health with regards to access to services, preventive coverage and incidence of ailments. Also, gender and rural gaps in this regard and in immunisation and infant mortality rates closed between 1991 and 1996. Closing such gaps is a stated objective of the Social Action Plan.

However, access continues to be perceived as a problem in both rural and urban areas and data on actual distances from government facilities suggest that these perceptions are grounded in reality. Also, compared to the average of developing countries and South Asia, Pakistan lags in all the child survival statistics. Thus there is little justification in allowing health expenditures as a percentage of GDP to slide.

This is particularly the case since evidence shows that government expenditure on health has a significant and sizeable association with the decline in the infant mortality rate in Pakistan. Also, contrary to the Bank's view, the growth in GDP per capita was not significantly associated with a decline in the infant mortality rate.

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Discourse of Development

Zahid Shariff

> The assumption that people were to be given theatre was of course in keeping with the government fiction that people were to be given development particularly if they behaved themselves. (Wa Thiong'o, 1986:41)

Despite our short history, the norms of scholarship in Pakistan have already become well entrenched: the grooves already seem so deep that digging ourselves out of them may present some difficulties. (One example of that in the social sciences generally, and political science and history in particular, is the retelling of the major historical events and noting major trends without offering any remarkably new interpretations). The need, in other words, of newer and different understanding of where we are and how we got there is considerable. One purpose of introducing Escobar's (1997) *Encountering Development* and related materials is to offer an opportunity to get out of these academic ruts. Specifically, two exits are simultaneously provided by Escobar; one lets us interrogate the dominant narrative of development, and the other enables us to consider the possibilities that postmodernism opens up. He applies the latter to the former, which is an uncomplicated way to make what is valuable in postmodernism clear and accessible. (In what follows, the numbers in parenthesis refer to pages in Escobar's work).

Perhaps an appropriate way to introduce postmodernist analysis is to acknowledge that observation is not possible without observers; when taken seriously, its implications are profound. An equally relevant insight is that the criteria for evaluation are not separate from the phenomena to which they are applied; the two are related. Postmodernists "respond to normative claims of others by displaying the processes of thought, writing, and power on which those very normative claims are based" (Cahoone, 1996: 15-16). Furthermore, there is no independent reality out there that can be discovered by neutral observers; instead, "discourse is the process through which social reality comes into being" (39)[1].

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[1] Application of postmodernist analysis, it has often been noted, leads to ambiguous, even contradictory, results. That is reflected in the work of two prominent Pakistani scholars in the United Kingdom. Akbar Ahmed believes, according to Gerholm (1994:209), that since "postmodernism hinges on the loss of faith in metanarratives, i.e., orthodoxies, ideologies, complete answers and total explanations," Islam "stands a better chance in the West, and perhaps world-wide." Ziauddin Sardar, on the other hand,

The considerable power of some concepts, and the practices associated with them, lies in our diminished ability to notice their presence. Our taking them for granted makes it much harder to notice that there was a time when they were not around. That appears to be true in case of what is now the well-entrenched division of the world into modern or developed, on the one hand, and underdeveloped or developing, on the other. A considerable part of life in the South[2] appears to be focused on development: are the public policies promoting it, do certain proposals detract from it, do the appropriate attitudes and cultural values support or hinder it, how close is the country getting to those that are believed to be already developed? Few issues, in other words, are as central to our intellectual commitments, governmental policies, and political rhetoric as development. But it was not always so; development's history is remarkably short.

In the period between the two World Wars, a certain way of understanding was created and put in place that established "a connection between the decline of the colonial order and the rise of development" (26). When the former colonies began to be collectively called the Third World,[3] the power of the discourse of development to locate, explain, and evaluate peoples and countries grew until it became virtually the only, or at least the dominant, way in which the Third World was seen by the First World, and the way it began to see itself. The globe which had previously been divided into the imperial powers and their colonial possessions was now sorted into the First, Second, and Third Worlds; and such sorting ranked these countries accordingly, with advancement, civilization, and progress associated primarily with the First World. Escobar reminds us that "these concepts did not exist before 1945" (31). He tells the story of how such a discourse and the associated practices emerged, and what were their consequences.

From the works of Michel Foucault and Edward Said, Escobar distills some significant postmodernist insights. Development, in his analysis, emerged not from material conditions (or the "reality" of poverty, hunger,

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suggests that "postmodernism is an oblique attack on all fundamentalisms, i.e., on all convictions that there is an absolute truth… The obliqueness lies in its readiness to tolerate foreign fundamentalists. By doing that, relativism *de facto* states that there is no absolute truth. And if postmodernists and other relativists do tolerate such extravagant claims when they come for others, it is because they themselves know better" (Gerholm, 1994:210).

[2] As opposed to North, that is. This terminology is widely believed to be preferable to such categories as developed and developing, or First, Second, and Third worlds.

[3] I am aware that several events make Third World as a category highly questionable. I will, however, continue to use it because Escobar has chosen to do so.

poor health, etc.) but from regimes of representation and recursive practices that constructed images and identities from which emerged national plans and policy interventions. That it occurred in specific ways, at a particular time, and with the backing of a variety of resources, is made explicitly the focus of considerable attention. Indeed, our unquestioning acceptance of development as a yardstick for our progress, construction of knowledge, distribution of resources and prestige, and historical change reveals its considerable and pervasive power.

Escobar does not provide a one-sentence definition of development, but the broad elements that it is based on are hard to miss. It seems to me that it is the gaze that sees human societies in a comparative and relational context. One set of countries and peoples are (a) viewed as less (advanced, developed, civilised) in some cumulative or expansive sense than others (developed, Second or First Worlds), (b) in need of help, which is available from developed countries, and (c) in transition from their present condition to one that exists in developed areas. Development became after World War II the dominant aspect of the relationship between the United States and the major former colonial powers, on the one hand, and the Third World, on the other.

Being Less

After the war, the United States as the only superpower provided very generous support to Europe but relatively insignificant amounts to the other continents. Europe was to be reconstructed while the Third World was to be developed. Until then the potential of the "natives" was thought to be severely limited; colonial rule could not survive without this and related assumptions that collectively are referred to by Aijaz Ahmed (1996) as "inferiorisation." But almost as soon as colonial rule ended, the people who had been living under it were found to be in need of development. Escobar quotes President Harry Truman's "fair deal" speech of January, 1949: "More than half the people of the world are living in conditions approaching misery… Greater production is the key to prosperity and peace. And the key to greater production is a wider and more vigorous application of modern scientific and technical knowledge" (3). Such an orientation gathered momentum as first the World Bank and then the United States Agency for International Development (US AID) as well as the International Monetary Fu8nd (IMF) got off the ground with considerable enthusiasm.

Escobar notes that in 1950 the World Bank's mission to Columbia, the first of its kind, interpreted its "terms of reference as calling for comprehensive and internally consistent program… Only through a generalized attack throughout the whole economy on education, health, housing, food and productivity can the vicious circle of poverty, ignorance, ill health and low productivity be decisively broken" (25). In undertaking this effort, "Columbia would not only accomplish its own salvation, but would at the same time furnish an inspiring example..." How could such astonishing confidence and the sweeping set of interventions that it called for acquire legitimacy and spread quickly? By investing heavily in it. Besides the funding for international aid (which, while small in relation to the Marshall Plan for Europe, was significant in the context of countries with low incomes), the discourse of development was very well funded and launched from many sites: universities, research centres, and such powerful international organisations as the United Nations, World Bank, and IMF. Incentives were put in place for supportive research and publications, as well as grants for education. The prospects for attractive careers, especially for economists, also helped in disseminating it. The media and Hollywood contributed significantly to the construction of those images. In addition to these, interactions and transactions among unequal parties produced, as unequal exchanges virtually always do, predictable results.

A major, perhaps more accurately, the only characteristic of the former colonies that entered the discourse of development was their deficiencies, of which poverty was preeminent but others (having to do with education, health, housing, etc.) were also included. Within a short period of time poverty "brought into existence new discourses that shaped the reality to which they referred" (24). It is not entirely surprising that the gaze of observers from affluent countries should focus on what is one of the most visible differences between their own surroundings and the Third World. But these differences here, as in so many other spheres, were not mere curiosities to be noted or admired; they were of a particular kind; and they drew attention exclusively to what the Third World lacked. To observe the absence of some useful trait or resource in an area or among a people is one thing, to define an area or people by reference to some deficiency is quite another. It was on this totalising definition that the regimes of representation were built. "Reality" was thus "colonised by the development discourse" (5).

How does one understand the propensity of these observers to see in such an extraordinarily selective fashion? What were their motivations? They were many and complex to be sure, but they are not beyond comprehension. It is easy, in these times, to get too comfortable with cynicism. It is worth nothing then that the desire to bring the good life one enjoys to others one believes are less fortunate is not in itself an exploitative or evil emotion, even if it is condescending. In addition to that, other forces were also at work. Shoring up the extended and far-flung borders of the Cold War involved making communism less attractive by trying to reduce poverty. Circling the

Soviet Union with the U.S. – inspired military alliances was yet another consideration. Access to resources and markets played an important role as well. These motives took root and flourished in what Said (1978) has called an Orientalised world: white man's burden being borne in an infantalised Third World.

Getting Help

The help that was offered soon acquired a pattern, i.e., repetitive and formulaic ways of "solving" the problems of deficient societies. It had mostly to do with scientific techniques, capital, and cultural values. It may now appear to be a strange coincidence that what the Third World was thought to be in need of turned out to be exactly what the First World could supply! But the discourse of development then was too overwhelming to allow space for such ironies to be frequently noticed. In any case, even here some problems, not fully explored by Escobar, were encountered. When scientific knowledge was viewed as technology, its transfer was limited either by patent rights or future threats of competition. Khor (1996:18) reports that "a proposed United Nations code of conduct on technology transfer to help the Third World countries build up their own technological capabilities was scuttled, and in its place the trade-related intellectual property rights of global companies were given protection under GATT." The supply of capital was reduced by the inability in many instances to provide reasonable collateral and/or assurances of repatriation. Nevertheless, it was to the early foreign aid projects, which included soft money loans, that can be traced the current debt trap of the Third World countries. Cultural traits also were often fond to be impediments to development, and since they proved to be even more formidable a problem, help consisted of technical assistance, institution building, and exposure of many (current and future) professionals to American higher education.

It was help that hurt. A basic assumption was made that what preceded development or what it would replace was either a void or some unpleasant phenomena. The past and present were not to be understood or appreciated; they were to be overcome. In Latin America, the United States took upon itself the right to intervene in "weaker, darker, poorer countries" (28). Upon arrival in a Third World country, Lauchlin Currie, who was on another World Bank mission, could only see "problems, darkness, chaos" (56). As development proceeded, the farmers in a Colombian village began "to interpret their lives before the programs as filled with ignorance and apathy" (51). A development economist found the Third World caught in a "vicious circle of poverty": lack of food, ill health led to low work capacity, which generated low incomes, and that in turn brought one back to lack of food. A prominent West India development economist, W. Arthur Lewis, recommended that the traditional elements be replaced by "modern" ones. He seemed neither perturbed by his discounting of Third World cultures nor by his unabashed acknowledgment that development would increase income inequalities. These lop-sided perceptions ignored such positive cultural and economic norms in the third World as community ties, frugality, and sufficiency.

Also ignored was the colonial context of development and its contemporary resurgence.

> Colonialism is making a comeback. For centuries, the governments and corporations of the industrial nations, backed by military power, exploited the resources and markets of the poorer countries. The determination of these countries to recapture control of their resources and impose policies that favored domestic over foreign interests spurred the anti-colonial struggles that culminated in independence for much of Latin America, Africa and Asia. Now the former colonial powers are in the process of regaining the right of transnational companies to dominate the economies of the former colonies, this time through trade agreements. (Khor, 1996:17)

Such agreements, together with privatisation, NGOs, and the growing influence of international organisations reduce the ability of the Third World governments, and provide the neo-liberal context of contemporary development.

Being Developed

Facts are not discovered as much as they are created, and what enables their creation are labels and categories of analysis that serve as receptacle for them. The choice is never between labels or no labels – since unmediated understanding of the world is not possible --, but whose labels and analysis will be relied on. Clearly the discourse of development emerged within the Orientalist framework.

That discourse did not include evidence or proof of the First World's developed status as much as it assumed it; most vividly it surfaced in relation to the Post-colonial Other. "It would be the task of the white father to introduce the good but backward Third World people into the temple of progress" (158). Similarly, the change that had to occur required "unprecedented action carefully guided by the experts of the West" (159).

It would be absurd to argue that the First World was not aware of its own imperfections since a large and growing literature focuses on them.

It would be just as absurd to deny that in the discourse of development it was the imperfections, more accurately the pathologies, of exclusively the Third World that were exhaustively displayed, scrutinised, and explained. The contrast with the First World - - sometimes explicit, often implied - - suggested an unmistakable preference for it. In that discourse the implications of unequal exchange among parties surfaced fully, along with large doses of paternalism and condescension.

Not much elaboration is necessary of the frequent images in "devspeak" of the First World as a model for others to follow since we are no strangers to the ethnocentricities of others. These images project the experience of a specific group of people and countries (the First World) as the norm for all the rest, make them the measure of every one else's progress, and lend such change an aura of scientific neutrality. It is from the positionality of both the developing and the developed countries that their names, categories, and hierarchies are derived. Whatever caveats may be offered when questioning whether development equals Westernisation, the indicators and measures of the former are clearly drawn from selective aspects of life in the US and northern Europe; not surprisingly per capita income remains prominent among them while family stability does not. Escobar calls it the hegemonic form of representation.

The prescriptions for moving that First World model, however, changed with time. At one time - - roughly between 1950 to 1980 - -, the emphasis on a cohesive and integrated "attack" on the Third World's problems was strong. With the election of Ronald Reagan as U.S. president, the donor agencies - - from the US AID to the World Bank and the IMF - - began to insist on privatisation, free trade, and smaller government.

Development's Results

The grip of development on our thinking is so strong that I sense the impatience of the reader in wanting answers to questions that have over time become pressing. It is at least naïve, isn't it, to argue that the World Bank, the UN, or the United States "created" poverty in certain parts of the world; wasn't it there to start with? (Perhaps one should pause and take note of that impatience, for that too reflects the power of development). My reading of Escobar suggests that what the primary focus on poverty amounts to is using up most of the space on the canvas with shapes and colours so damaging that there is virtually no space left for different shapes and colours. It does not allow the raising of such questions as, how have the market forces contributed to the spread of poverty? If the major paintings of my features are going to be crafted by those who see only my scars and warts, what would one expect the viewers to think of me? And as I continue to see myself so represented, is there really any serious doubt about what over time my self-perception is likely to become? Other issues are vital as well. "Developmentalisation of the Third World" required that other attributes of the "natives" that interfered with what became the ritual of finding problems with a view to fixing them be largely suppressed; indeed, "culture" entered the discourse of development almost exclusively as an impediment to development. When features that may clutter up the canvas were not being ignored, they were not thought to exist at all. Before development there was nothing; that amounted, for instance, to denying the value in many Third World cultures on bonds of community, labour-intensive productive processes, and care and respect for the old. These considerations, often overlooked, are not expected to deny that

> development might have benefited people at times. It is to emphasise that the work of development institutions has not been an innocent effort on behalf of the poor. Rather, development has been successful to the extent that it has been able to integrate, manage, and control countries and populations in increasingly detailed and encompassing ways. (46-7)

Focus on poverty as the defining characteristic of the Third World is made worse, if that was possible, by conjuring up a monolithic version of it. That the poor distributed over several continents are not homogenous appears not to be fully integrated into the discourse of development. Thus "a squatter in Mexico City, a Nepalese peasant, and a Tuareg nomad become equivalent to each other as poor and underdeveloped" (53). Such sweeping generalisations reminded me of an event that Wa Thiong'o (1986:40) recorded. A "white lady had her nose bloodied by a black actor after she had called him a black bastard. The police came but in the identification parade she could not make out one African face from another."

As one turns to the effects of development, the evidence appears grim. Consider first gender issues. Before the development programmes were introduced, women were in many areas well integrated into work and productive life; work roles merged with family responsibilities; and much of what was produced was for use, not exchange. In those settings, women often participated fully in the economy of the community and household. As much as 50 per cent of the world's food produced for direct consumption was estimated by the Food and Agricultural Organization (FAO) to be the outcome of women's efforts. Development changed all that. The US AID and FAO trained men in agriculture, and women in home economics. Production by more efficient methods (e.g., tractors), and for exchange, reinforced gender segregation since it was men who were selected to drive tractors and grow cash crops. Farmers, in other words, were "replaced by energy- and capital-intensive machinery, and diversified food production for local communities...[was] replaced by export monoculture" (Norberg-Hodge, 1996:19). A recent Pakistani study of rural women confirms these views. Khalid's (1995:65) conclusions are unambiguous: "It seems to us that modernisation, as currently understood and promoted by national and international agencies, tends to increase the burden on women physically, emotionally and psychologically."

The results that development produced over the last half century can be summarised in figures and statistics. Between 1979 and 1982, the food available to poor people fell by 30 per cent; during the same period, more than $30 billion was paid than was received in new lending; tropical forests are being rapidly cut down (212-213). A particularly devastating result of development was the increase in income inequality. Korten relying on United Nations figures showed that

> "20 per cent of the world population who live in the richest countries receive 82.7 per cent of the income." The poorest 20 per cent get 1.4 per cent of world income. The combined incomes of the top 20 per cent are sixty times larger than those of the bottom 20 per cent.
>
> Furthermore, this gap has doubled since 1960, when the top 20 per cent enjoyed only thirty times the income of the bottom 20 per cent. And the gap continues to grow.
>
> The figures actually understate the true inequality in the world because they are based on national income accounts rather than actual individual incomes. If we take into account the very rich people who live in poor countries and the very poor who live in rich countries, the incomes of the richest 20 per cent of the world's people are approximately 140 times those of the poorest 20 per cent. (Korten, 1961:16)

Escobar carefully notes these economic statistical trends but his emphasis is clearly on culture, representation, and influence. The "counting" that he is interested in

> reflects the crafting of subjectivities, the shaping of culture, and the construction of social power – including what these figures say about surplus material and symbolic consumption in those parts of the world that think of themselves as developed. Not the perverse reading, finally, of the International Monetary Fund – insisting on "austerity measures" for the Third World, as if the majority of people in the Third World had known anything but material

> austerity as a fundamental fact of their daily existence -- but a renewed awareness of the suffering of many, of the fact that" [to quote Ashis Nandy] the modern world including the modernised Third World, is built on the suffering and brutalization of millions (213).

Another aspect of this shaping of cultures is explored by Norberg-Hodge (1996:19-20). She too needs to be quoted at length.

> Advertising and media images exert powerful psychological pressures to seek a better, more "civilized" life, based on the urban, Western consumerist model. Individual and cultural self-esteem are eroded by the advertising stereotypes of happy, blond, blue-eyed, clean Western consumers. If you have been a farmer, or are dark-skinned, you are made to feel primitive, backward, inferior. Partly as a consequence, women around the world are now using dangerous chemicals to lighten their skin and hair, and the market is growing for blue contact lenses in such places as Bangkok, Nairobi and Mexico City. Many Asian women who can afford it have had their eyes operated on to make them appear more Western.

Conclusion

This concluding part is divided into two; the first is devoted to Escobar's remedies, and the second to some evaluative comments.

Escobar's remedies flow from his analysis. Since development is destructive, the "need to unmake and unlearn development" (223) is paramount. Instead of alternative development strategies, he argues, we need alternatives to development. Grand, macro-level alternatives that apply to all situations are clearly inappropriate. It is through ethnographic studies of hybrid cultures that take local settings and their meanings seriously that will allow the subaltern to speak. Intellectual work in the future may link popular culture with political struggles, "take up the questions of social justice and of the construction of new social orders from the vantage point of postmodernity"; and "the formulation of the question of cultural identity in nonessentialist ways" (218). These may open up "spaces for destabilizing dominant modes of knowing" (223).

The unqualified denigration of Third World cultures is probably the greatest harm that development inflicts. It does so by viewing them in a monolithic fashion, and finding virtually nothing redeemable about them; on the other hand, the First World is valourised without any hint of its imperfections. Such a verdict is harsh and unwarranted. Others, more willing to look for something positive in the Third World, have found it. Pye (1985:334), for instance, argued that the "most constructive aspect of the psychology of dependency [in Asia] is its potential for building cooperation and strong bonds for teamwork. Acceptance of conformity and commitment to the group makes it easy to suppress egotistical assertiveness and to work smoothly with others."

When economists are sent to an area, we should not be surprised by their conclusion that the problems they are able to identify are economic and the remedy is economic growth. In a broader sense, the First World observers are expected to find those characteristics of the Third World that distinguish it and set it apart; from there the need for massive interventions seem natural. "Development proceeded with creating abnormalities" (41). The fundamental problem of the Third World, it would seem, is that it is the Third, not the First, World.

An attempt to evaluate Escobar's work should probably take into account what existed before the publication of *Encountering Development*. The ideology of development was beyond serious challenge. No one had argued so seriously and impressively that it had inflicted considerable amount of economic damage to the Third World, and that it had gone a long way toward subverting cultural norms and identities. Many Third World students that I came into contact with in the United States, and most of them in Pakistan as well, have learned to disparage, or remain ignorant about, the Third World's cultural heritage. Through their education, media, and films their attraction for the First World, in contrast, continues to grow. "It is the final triumph of a system of domination," writes Wa Thiong'o (1986:20), "when the dominated start singing its virtues."

Escobar's singular achievement is to provide a counter-narrative to such a prevailing orthodoxy. A note of dissent and an antidote to vestigial thinking that was sorely lacking is now available. He minded a variety of disciplines to present an integrated, new perspective on development. He makes a plausible case that development is responsible for damage to the Third World on a vast scale.

I also believe that his understanding of development did not sufficiently include some changes in emphasis over the last fifty years, the period that he explores. He noted the "death and recasting of development economics" (57) in the 1980s. His readers would have benefited from more discussion of how serious were those changes. Greater sensitivity to periodisation and a more nuanced understanding of some changed emphasis would have enriched his work further. Rahim (1998:7), for example, refers to a World Bank study which concluded that "investment has declined after liberalisation in *every* case and had *never* recovered" (emphasis added). Sachs (1998:15) appears to agree: "The problem is that the IMF has become the Typhoid Mary of emergency markets, spreading recession in country after country."

His suspicion of grand narratives and preference for local action is entirely consistent with his findings. They also fit nicely with his grounding in anthropology as well as postmodernism. One size, it is often true, does not fit all. I wish, however, he had given some thoughtful attention to some dangers that lurk in local settings also. The most obvious one, it seems to me, is the prospect of local tyrants being freed from some humane criteria that are often more visible at the national levels (through the constitutions, laws, other norms). It is true that such criteria have often not been applied with any great enthusiasm, but the potential is probably greater there than at local levels. I have argued elsewhere (Shariff, 1995) that a variety of str4uctural incentives run more in the direction of the national government assuming responsibility for income redistribution policies than is likely among smaller sub-national jurisdictions. Similarly, if the multi-national corporations are the menace that he claims, they are more likely to be controlled or regulated at the national level; at the sub-national levels they are quite skilled in inducing such governments to compete with each other in offering them incentives.

All in all, Escobar has made the issue of development more lively and susceptible to diverse meanings. That is an impressive feat.

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Mandatory Rules of Law in International Business Arbitration

S.M. Hyder Razvi

Abstract

Of all mankind's adventures in search of peace and justice, arbitration is amongst the earliest. Long before law was established, or courts were organised, or judges had formulated principles of law, man had resorted to arbitration for the resolution of discord, the adjustment of differences and the settlement of disputes.

One of the recurring themes in International Business Arbitration is the tension between the will of the parties and the ability of states of regulate the conduct of arbitration proceedings. The general trend in international commercial arbitration is to respect, within limits, the will of the parties regarding the choice of law and the procedure for carrying out their arbitration. Thus, party autonomy is recognised as one of the cardinal elements of international business arbitration.

The past decade has witnessed an expansion in the scope of arbitrable matters. Such expansion is exemplified by Mitsubishi Motors Corp. V. Solar 1 Chryster-Ohlymoutt[1] in which the United States Supreme Court held that antitrust disputes arising from international contracts are arbitrable. The court reached this conclusion against the background of a number of U.S. cases which considered antitrust law fundamental to the ideological and economic integrity of the United States.[2] Underlying the Supreme Court's decision in Mitsubishi was the presumption that the arbitrators in the case would respect the imperative provisions of the U.S. Sherman Act (which embodies U.S. antitrust principles), despite the fact that the applicable law in the case was Swiss Law.

It thus seems that the increasing acceptance of international arbitration as a respectable alternative to litigation implies an expectation on the part of States that arbitrators will, like judges, respect the basic notions of justice, and in appropriate cases apply the mandatory provisions of relevant laws. It is one thing to grant parties the power to organise their objectives, but it is a different matter to suggest that parties to an

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[1] 473 U.S.S. 625 (1985) Stamford Ct.

[2] See United States V. Aluminum Co. of America (Alcoa) 148 F.2d 416. Indeed the court in American Safety Equipment Corp. V. J.P. Maguire and Co. 391 F. 2d 821 at 827-828, held that antitrust disputes were non arbitrable in view of "the pervasive public interest in the enforcement of antitrust laws.

international arbitration are entirely free from the demands of public policy and other fundamental provisions of the relevant laws.[3] The integrity of international arbitration and its endurance as a viable alternative to litigation would seem to rest on the arbitrator's continual respect for the public policy of States whose legitimate interests are implicated in arbitration disputes. Arbitrators therefore have to balance their respect for the autonomy of the parties' will with the need to apply mandatory provision of laws which are relevant to the dispute.

Here, I will examine the impact of mandatory rules in resolving the merits of a dispute before international arbitrators. The problem posed by mandatory rules in international arbitration will be put in perspective by contrasting the position of international arbitrators with those of national judges called upon to enforce imperative laws. Therefore, the discussion will focus on the discernible trends in the application of mandatory rules in international arbitration. This is done by examining the treatment of mandatory rules of the *lex contractus* and mandatory rules of laws external to the *lex contractus*. The research concludes with an examination of the role of transnational public policy (which, in a sense, is the mandatory rule of the international legal order) on the determination of the merits of a dispute.

When is an Arbitration International?

The determination of whether an arbitration is international or domestic (national) is often significant because most countries have different legal regimes to govern each type of arbitration. The word international is to distinguish domestic arbitration from those which in some way transcend national boundaries.[4] International arbitrations usually have a foreign element to them, and most countries treat such arbitrations much more liberally than they do arbitrations with purely domestic elements. The liberal treatment of international arbitrations includes greater respect for the expressed intentions of the arbitrating parties, and far less judicial intrusion in the arbitration process than is the case in domestic arbitrations.

There are two main methods used in determining whether an arbitration is international: the identity of the parties and the nature of the dispute.

[3] As A. Bucher and P. Tschanz remind us:
"States that favour international arbitration as a means of resolving international commercial disputes do not by the same token forego compliance with principles and rules which are fundamental for the economic and social system. The fact that arbitral tribunals are allowed to adjudicate disputes instead of courts does not mean that arbitration can enerve the legislative power of States."
International Arbitration in Switzerland (Basle: Helbing & Lichtenhahn, 1989.
[4] A. Redern & M. Mhunter (Settlement of International Business Disputes) at 14.

Identity of the Parties

The method focuses on the identity of the arbitrating parties: their nationality or habitual place of residence, if they are individuals; or their place of incorporation or the seat of their management and control, if they are corporate entities. This approach is exemplified by the European Convention on International Commercial Arbitration which applies to arbitration agreements concluded for the purpose of settling disputes arising from international trade between physical and legal persons having, when concluding the agreement, their habitual place of residence of their seat in different contracting states.

The Swiss Law governing international commercial arbitration incorporates this approach. Article 176(1) of the Swiss Private International Law Act limits the application of the chapter on international arbitration to cases where the seat of arbitration is situated in Switzerland and, at the time the arbitration agreement was concluded, at least one of the parties had neither its domicile nor its habitual residence in Switzerland.[5]

This method of defining international arbitration is very limiting in that it excludes some situations where the dispute being arbitrated has a foreign element. For example, parties resident in the same country may have a dispute about a subject matter located in a foreign country. Focusing on the identity of parties in cases like this obscures the fact that the nature of the subject matter in dispute imports an international element into the dispute an element that may be crucial in the resolution of the dispute. This method also categorises as domestic cases involving a foreign party who has a representative place of business in the country of the other party. For example, a transactional corporation based in the United States may have a representative office in Toronto through which it deals with its Toronto customers. To characterise an arbitration between such a corporation and one of its Toronto customers as domestic fails to reckon with the fact that the dealings between the parties are, as a practical matter, of an international nature.

The Nature of the Dispute

This criterion examines the nature of the dispute between the parties and categorises the arbitration as international if the dispute implicates international commercial interests. The International Chamber of Commerce (ICC) was the first to adopt this criterion. Article 1.1 of the ICC Rules defines the functions of the Court of Arbitration of the ICC as the

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[5] A similar approach is adopted in England, albeit in an indirect manner. See Redfern & Hunter, at 12.

provision of a forum for the “settlement by arbitration of business disputes of an international character”. According to an ICC publication:

The international nature of the arbitration does not mean that the parties must necessarily be of different nationalities. By virtue of its object the contract can nevertheless extend beyond national borders, when for example a contract is concluded between two nationals of the same state for performance in another country, or where it is concluded between a State, and subsidiary of a foreign company doing business in the State.[6]

The test is adopted by French Law. The French Code of Civil procedure provides that “an arbitration is international if it involves international commercial interests”[7], although it does not define what international commercial interests are.

The nature of the dispute test is less artificial than the identity of the parties test because it concentrates on the attributes of the dispute, thereby embracing cases where parties resident in the same country engage in international business transactions.

The Model Law on International Commercial Arbitration sought to harmonise state practice in relation to the definition of international arbitration. It rejected the idea of a single formula, and provides four alternative tests for determining when an arbitration is international:

A dispute is international if:

(a) the parties to an agreement have, at the time of the conclusion of that agreement, their places of business in different states; or

(b) one of the following places is situated outside the State in which the parties have their place of business:-

(i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;

(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject matter of the dispute is most closely connected; or

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[6] The International Solution to International Business Disputes – ICC Arbitration (ICC Publication No. 301, 1977) at 10.
[7] Article – 1492.

(c) the parties have expressly agreed that the subject matter of the agreement relates to more than one country.[8]

The definition adopts both the identity of the parties and the nature of dispute tests, in addition to two other ones: the 'suits test' (the situation of the proceedings outside the place of business of one of the parties) and the 'opt-in test' (the parties expressly agree that the subject matter of the arbitration agreement relates to more than one country). This definition effectively expands the test of internationality, although the opt-in provision may create some difficulties.

The opt-in clause gives the parties the opportunity to internationalise an arbitration with exclusively domestic elements merely by stating that "the subject matter of (their) arbitration agreement relates to more than one country. "This provision is objectionable in that nationals of the same State seeking to escape the mandatory provisions of their country in order to internationalise their proceedings. There is evidence that the drafters of the Model Law were aware of this possibility:

It was understood that the States would be prepared to allow the 'opting-in' only if an element of internationality is present. Such elements should have been that not all of the following places are situated in the same State: place of offer of contract containing the place of settlement clause or of separate arbitration agreement; place of corresponding acceptance; place of performance of contract or of location of subject matter; place of registration incorporation or nationality of each party; place settlement.

However, the final draft of the Model Law fails to incorporate the above requirements, with the result the arbitrating parties could declare an otherwise domestic arbitration to be international. In response to this point, two commentators assert that "domestic arbitration laws tend to provide protection that are not needed by sophisticated parties likely to use the opt-in provision"[9]. This observation misses the point; the issue is not the sophistication of the parties, but their ability to circumvent mandatory rules which are specifically designed to regulate domestic arbitrations – a category in to which their arbitration may otherwise fall. No doubt many countries will find it difficult to accept a situation where parties might internationalise an arbitration which is otherwise purely domestic. It should be noted, however, that under the framework of the Model Law, their exist possible avenues for dealing with parties who abuse the option provision. Under

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[8] Article 14 (ICC-Paris)

[9] H. Holtzmann & J.Neuhaus, A. Guide to the UNCITRAL Model Law on International Commercial Arbitration (The Netherlands: Kluwer Law & Taxation Publishers, 1984) at 43.

Article 8, courts may refuse to refer such cases to arbitration, or exercise the power to set aside or refuse enforcement of any resultant award as being contrary to public policy under Article 34 and 35.

In summary, the identity of the parties and the nature of the dispute are the two main methods of determining when an arbitration is international, although the Model Law introduces additional methods. It is crucial to remember that the answer to the question whether an arbitration is domestic or international is always to be found in the provisions of the relevant national law.

Reasons for the Increasing Use of Arbitration

The post World War II era has witnessed a considerable expansion in the level of international trade and commerce. This process has been tremendously aided by the General Agreement on Tariff barriers to trade. The level of international trade in goods and services continues to increase daily. In relation to developing countries, there is a continuing, if often sporadic, inflow of foreign investment such as capital, joint ventures, turn-key and technology transfer agreements.

Mandatory Rules Defined

Traditional conflict theory postulates that a statute is inapplicable to a contract unless the statute forms a part of the proper law of the contract or is otherwise applicable as part of the procedural laws of a forum court. However, it has long been accepted that this proposition is subject to the qualification that imperative laws of the forum may apply to contract irrespective of the proper law of the contract. Thus, one of the limitations on party autonomy within a national legal system is that overriding Laws of the forum may override the laws chosen by the parties.[10]

It is these rules of law which are capable of overriding the will of parties that are labelled "mandatory rules denote those rules of law that parties cannot derogate from, rules which in appropriate cases supersede the proper law, thereby substituting their provisions for the will of the parties:

[10] As A. Maniruzzaman puts it: Although the parties' freedom of choice (autonomy of will) is a general principle of private international law and is to be respected in principle, it should operate within the limits imposed by such other equally important general principles of law or subject to any restraints of public policy. International arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview (1990) 7:3 J. Int'l Arb.

> [a] mandatory rule is a rule which overrides the normally applicable law (or .. the proper law of the contract) whether that applicable (proper) law is ascertained by reference to an express stipulation or by reference to the closest connection. In short it is a law which applies irrespective of or despite the proper law of a contract."[11]

These rules embody the fundamental public policy of a given State and are therefore applicable by virtue of their imperative nature. They typically regulate matters in which the interest of the State is too important for them to be in competition with foreign laws"[12] or the will of the parties.[13] Thus there is a close relationship between the concept of public policy and that of mandatory rules. Mandatory rules would include those aspects of public policy that lie within the superstructure of a legal system and which, because they reflect the basic social and economic philosophy of a State, are framed in an imperative manner. These include currency and exchange regulations, boycotts and blockades, and environmental protection laws.

Examples of mandatory rules abound in national laws. In Australia, for example, the Consumer Transaction Act applies to a consumer contract involving the delivery of goods in South Australia irrespective of the proper law of the contract. Similar provisions are to be found in the English Employment Protection (Consolidation) Act,[14] the English Uniform contract Terms Act, and the German Regulation of Standard Contract Terms Act.[15]

Treatment of Mandatory Rules in national Courts

Owing to the fact that a national court's allegiance lies with the legal system of its situs, a national court is constrained to apply the fundamental public policy of that system to disputes before it. Thus, a national court would apply the public policy and mandatory rules of its situs regardless of the proper law of the contract involved. The court system is one

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[11] See M. Prylees, "Reflection on the E.E.C. Contractual Obligations Convention – An Australian Perspective" in P. North (ed.) Contract Conflict: The E.E.C. Convention on the law Applicable to contractual Obligations, A Comparative Study (The Netherlands: North-Holland Publishing, 1982).

[12] Y. Derains, "Possible Conflict of Law Rules and the Rules Applicable to the Substance of the Dispute" in P. Sanders (ed.) UNCITRAL's Project for a Model Law of International Commercial Arbitration (Deventer, the Netherlands: Kluwer, 1984) 169 at 179.

[13] Article 3(3) of the EEC Convention on the Law Applicable to Contractual Obligation defines mandatory rules as "rules of law of a country which cannot be derogated from by contract." For a discussion of the convention, see P. North, supra note 5.

[14] See A. Anton and P. Beaumont, Private International Law, 2nd ed. (Edinburgh: W. Green, 1990) at 343.

[15] See V. Tribal, "The Choice of Law in Commercial Relations: A German Perspective" (1988).

of the vehicles through which a society expresses and protects those fundamental values which underlie its social fabric. National courts therefore apply imperative rules which invariably represent the essential values of their societies, even in cases where the forum laws do not govern the contract.

Fundamental public policy has a dual aspect in its impact on judicial proceedings. The first, and perhaps the more common aspect, is that it compels a national court to deny recognition to an applicable foreign law which contravenes the stringent public policy of the forum. Second, it mandates the national court to give effect to those national legislation which, by their provisions, govern all contacts regardless of the proper law of the contract. An example of this kind of legislation is the Australian Consumer Transactions Act cited above.

Under the first aspect, the applicability of foreign governing laws is determined by their conformity with the stringent public policy of the forum.[16] This rule was stated by Lord justice-Clerk Patton in Cannal & Co. V. Loder.

> Everybody knows that the fundamental principle upon which we introduce foreign law as affecting the rights of contracts or otherwise, is only to the effect of introducing such law when it is not in direct contradiction to the principle upon which our law is governed, and according to which the rights of the subjects in this country must be determined.[17]

It is generally accepted that this use of public policy should be highly circumscribed. Specifically, public policy is viewed as disabling the application of otherwise applicable law only in cases where the foreign law offends the forum's essential and basic policy interest. As the court in Loucks V. Standard Oil Co. Put it:

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[16] See Ross V. McMullen (1971) 21 D.L.R. (3d) 228.

[17] Id. At 1110. This principle is contained in Rules 2 of Dicey and Morris conflict of Laws: English courts will not enforce or recognise a right, power, capacity, disability or legal relationship arising under the law of a foreign country, if the enforcement or recognition of such right, power, capacity, disability or legal relationship would be inconsistent with the fundamental public policy of English law.
7th ed. (London: Stevens & Sons, 1987) at 92. Stating the Canadian position on the issue, J. Castel notes that Canadian courts will not recognise or enforce a right or power that is "contrary to the forum's stringent public policy or essential public or moral interest." Canadian Conflict of Laws, 2nd ed. (Toronto: Butterworts, 1986) at 153. In a similar vein, Article 17 of the Swiss Federal Statute of Private International Law provides that "The application of provisions of a foreign law is excluded if the outcome is incompatible with Swiss public policy."

"The courts are not free to refuse a foreign right at the pleasure of the judges, or suit the individual notion of expediency or fairness. They do not close their doors unless help would violate some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal."[18]

Under the second aspect of public policy, in dealing with a contract containing a foreign choice of law, a national court would apply those laws of the forum which by their provisions are designed to apply to all disputes litigated in the forum which fall within their scope. Here the court has no discretion whether or not to apply the mandatory rule because, as a creature of the national legal system, its jurisdiction and powers are regulated by national law. It must therefore apply all imperative laws of its forum. To illustrate, a court in South Australia dealing with a contract for delivery of goods in South Australia must apply the Consumer Transaction Act, whatever the contractual stipulations of the parties or the provision of the proper law chosen by them.

The Particular Position of Arbitrators

Unlike national courts, international arbitral tribunals do not owe allegiance to the laws of the place of arbitration, neither are they constituted by the laws of the arbitral seat. Indeed, they do not have a forum in the same way as national courts do. An arbitral tribunal could decide to conduct the arbitration proceedings in different countries, in which case it is unrealistic to categorise the public policy of any of the fora as applicable to the dispute. Even in case where the proceedings are held in one country, international arbitrators still do not, as a theoretical matter, owe allegiance to the laws of that situs, in the sense that they are not constrained to apply all the imperative rules of the forum in the same way that national courts are.

It is said that an arbitrator's responsibility is to the arbitrants in particular and the international business community in general.[19] This view

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[18] Block Bros. Realty Ltd. V. Mollard (1981) 4 W.W.R. 65. There is a trend towards drawing a distinction between domestic public policy and international public policy in the recognition of foreign law. In this respect, non-recognition of foreign law on grounds of public policy would be based not on the internal rules of public policy in the forum, but on the foreign law's inconsistency with the forum court's view of public policy in international matters.

[19] See J. Lew, Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration awards (New York: Ocean Publications, 1978) at 536. This principle may well be overstated in that an arbitral tribunal still owes a duty to the

originates from the fact that the power and authority of arbitrators are primarily derived from the agreement of the parties. Since their authority is derived from the will of the parties, it is argued that arbitrators have a duty, first, to affirm the will of the parties, and, second, to further the interests of international commerce. This implies that arbitrators have to give primacy to the will of the parties while respecting the basic philosophy and principles of international commerce:

> International commercial arbitrators are the guardians of the international commercial order: they must protect the rights of participants in international trade, give effect to the parties' respective obligations under the contract; imply the presence of commercial *bona fides* in every transaction; respect the customs followed in international trade practice and the rules developed in relevant international treaties; uphold the commonly accepted views of the international commercial community and the policies[20] expressed and adopted by appropriate international organisations; and enforce the fundamental moral and ethical values which underlie every level of commercial activity.

Does this mean that arbitrators are free to ignore the mandatory rules of relevant national laws? While it is true that the jurisdiction of international arbitrators depends on the agreement of the parties, it is also true that arbitration would lose its respect and legitimacy as a dispute resolution system if arbitrators continually ignore the mandatory national laws that are connected with arbitral disputes. States that allow the arbitration of sensitive matters, such as antitrust disputes, do so on the assumption that arbitrators arbitrating antitrust disputes which are substantially connected to their jurisdictions would apply the relevant antitrust laws of these jurisdictions. If arbitrators reject the application of these mandatory laws, there is little doubt that these States would move to make such sensitive matters non-arbitrable.

Mandatory Rules of the *Lex Contractus*

Arbitrators generally apply the law chosen by the parties.[21] Thus, when the parties have made an express choice of law, the arbitrators apply that law together with its mandatory rules. In most awards in which the

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various national legal systems: a duty to ensure that arbitration proceeding conform with basic notions of justice and fairness.

[20] L. Colin

[21] W. Craig, W.l Park and J. Paulsson, International Chamber of Commerce Arbitration, 2nd ed. (New York: Oceana Publications, 1990) at 307-308.

applicability of the mandatory rules of the law chosen by the parties arose, arbitrators applied those rules as a matter of fact.[22]

It is, however, possible to conceive of a situation where an arbitrator need not apply the mandatory rules of the law chosen by the parties. An example would be cases where the underlying purpose and objective of the rule indicate that it is aimed at purely domestic situations as opposed to cases involving international disputes. Additionally, an arbitrator may decline to apply a mandatory rule of a law chosen by the parties in the unlikely event that the rule is contrary to "transnational public policy".[23]

An interesting issue in this area of arbitration is whether arbitrating parties can legitimately exclude the application of agreement. In effect, can the parties slice off unacceptable portions of the governing law of their contract? In theory, it could be argued that since the parties selected the governing law, they could as well determine which parts of the law would govern their agreement; after all they could very well have chosen another law as the governing law. And since the arbitrators are bound to apply the law chosen by parties, they have no choice but to respect the will of the parties.

This theoretical argument however ignores the basic fact that as hackneyed as the concept of party autonomy is, it has its limitations. Maniruzzaman reminds us that:

Although the parties freedom of choice (Autonomy of will) is a general principle of private international law and is to be respected in principle, it should operate within the limits imposed by such equally important general principles of law or subject to any restraint of public policy.[24]

The will of the parties is not sacrosanct. The parties' will prevails so far as it is consistent with relevant public policy. Consequently, since mandatory rules are designed to apply regardless of the parties' choice of governing law, arbitrators may legitimately refuse to recognise the parties' exclusion of mandatory rules of the *lex contractus* in cases where the parties' transaction is very closely connected with the jurisdiction whose law is the *lex contractus* and the mandatory rules were designed to regulate such transactions. For example, if a Canadian company enters into a distribution agreement with a Japanese auto company for the distribution of cars in Ontario (and the parties chose Ontario law as the applicable law), an arbitral tribunal may refuse to apply a

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[22] See, for example, ICC Case No. 1397 (1966) Clunet 878.
[23] The concept of "transnational international public policy" and its effect on the application of mandatory rules of national law is discussed below.
[24] A. Maniruzzaman.

contractual provision excluding Canadian competition laws. To respect the parties' will in such a case would be tantamount to the subjugation of the country's legitimate interest in regulating its business environment to the interest of private contracting parties.

What about cases where the *lex contractus* is chosen by the arbitrators in the absence of an express choice by the parties? Since the conflict rules used in determining the applicable law in the absence of the parties' express choice focuses on the law of the country with which the contract is most closely connected, it would seem that an arbitral tribunal should apply the mandatory rules of the law of such a country. This is because the transaction would invariably have a notable impact on that country. However the arbitrator may have to balance the interests of this country with those of other countries that are equally connected with the transaction.

Mandatory Rules Foreign to the *Lex Contractus*

Mandatory rules foreign to the *lex contractus* are those of jurisdictions other than that whose law governs the merits of a dispute. Thus if New York law governs a dispute, the mandatory rules of jurisdictions other than New York are classified as foreign mandatory rules.

In examining the treatment of mandatory rules foreign to the *lex contractus*, it is useful to draw from the experience of national judicial systems as the issue has more commonly arisen before them. The attitude in most common law jurisdictions is that a mandatory rule shall not be applied unless it is part of the laws of the forum or form part of the governing law of the contract. Stating the law in England, the editors of Dicey and Morris Conflict of Laws note that "Where a mandatory law is neither legislation of the forum nor of the applicable law it has no application in England".[25] This position is the same in Australia,[26] but unclear in Canada. The United States position is somewhat more liberal in its treatment of foreign mandatory rules in that the American Restatement of Conflict of Laws allows for the application of the mandatory rules of a State "which has a materially greater interest than the chosen State in the determination of the particular issue" and which, under the forum's law, would have been the applicable law in the absence of an express choice by the parties. The reluctance of most common law jurisdictions to fully accept the application of foreign mandatory rules is often based on the grounds that recognition of such rules

[25] L. Collins

[26] See E.Sykes and M. Pryles, Australian Private International Law, 2nd ed. (Sydney: The Law Book company, 1987) at 546. See also M. Pryles, supra note 5 at 330.

would cause uncertainty in that the parties would not be able to determine before hand the rules that might affect their transaction.[27]

Civil law jurisdictions, on the other hand, are more receptive to the application of foreign mandatory rules. The civil law approach is exemplified by Article 19 of the Swiss Federal Statute on Private International Law which provides, *inter alia*:

(1) A provision of a law, other than the one designated by this statute, that is meant to be applied mandatorily may be taken into account if interests of a party that are, according to Swiss views, legitimate and clearly overriding so require, and the case is closely connected to that law.[28]

Similarly, Dutch law recognises the possibility of applying the mandatory law of a third State irrespective of the parties choice if "it is in the interest of [the] foreign State that some of its rules be observed outside its territory".[29] German courts also acknowledge the possibility of applying foreign mandatory law. In one case, the German BGH applied a Nigerian mandatory law prohibiting the export of art objects, even though Nigerian law did not govern the contract.[30]

Thus, while civil law jurisdictions are generally receptive to the application of foreign mandatory rules, common law jurisdictions are reluctant to apply such rules. However, it should be noted that even in those countries in which the application of foreign mandatory rules is not fully acknowledged, it is generally accepted that "the mode of performing a contract, as distinct from the substance of the obligation, is governed by the law of the place of performance (the *lex loci* solutions)".

This rule is justified by the assumption that the parties must have "intended to incorporate in their contract those parts of the law of the place of performance which refer to the manner in which the contractual obligations are to be discharged." Thus, where, for example, a Canadian company has a contractual obligation to build an industrial complex in Nigeria, rules would determined the formalities required for the erection of

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[27] See, for example, A. Anton & P. Beaumont.

[28] P. Karrer and K. Arnold, Switzerland's Private International Law Statute, 1987 (Deventer, The Netherlands: Kluwer Law Taxation Publishers 1989) at 44-45.

[29] R. Rooij and M. Polak, Private International Law in the Netherlands (Deventer, the Netherlands: Kluwer Law and Taxation Publishers, 1987)at 129.

[30] See E. Jayme, "The Rome Convention on the Law Applicable to Contractual Obligations (1980)" in P. Sarcevis (ed) International Contracts and Conflict of Laws (London: Graham & Trotman, 1990) at 46-67.

such a complex, and other issues such as building codes and employment standards.

Arbitral practice follows this dichotomy between the civil and common law jurisdictions in regard to the application of foreign mandatory rules. The arbitral practice there is both a hostile and a favourable approach towards the application of foreign mandatory rules, although there is a common acceptance of the role of the *lex loci* solutions in determining the mode of performance. Let us first examine the two divergent approaches to the application of foreign mandatory rules in arbitration proceedings.

The hostile approach is premised on the ground that arbitrators are bound by the will of the parties and are therefore obligated to apply only the law chosen by the parties, or, in the absence of such a choice, the law chosen on their behalf by the arbitrators.[31] Consequently, the advocates of this approach contend that arbitrators are barred from applying laws outside the *lex contractus*. They further suggest that as arbitrators are not custodians of public interests (their obligation is to the parties), they should not apply foreign mandatory rules[32] which reflect the public policy of foreign mandatory rules (a reason which is borrowed from common law jurisprudence) is that their application would lead to uncertainty as the parties would not know before-hand which mandatory rules the arbitrators may decide to apply to their case.

This writer believes that the hostile view gives an overly important weight to the will of the parties. As stated above, the will of the parties is not sacrosanct; it may in appropriate cases give way to the legitimate concerns of those States whose interests are implicated by the dispute. To adopt an earlier example, where Canadian competition policy is central to the determination of a dispute involving the importation of automobiles into Canada, it would be unreasonable for an arbitrator to refuse to apply that policy on the flimsy ground that the governing law of the contract at hand

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[31] This approach is illustrated by some awards. In ICC Award No.1399, the arbitrators, considering the validity of a contract which had the indirect object of circumventing Mexican customs law, held that the proper law of the contract (French Law) could not be displaced by Mexican law, the law of the place where the goods in dispute were to be imported. See J. Lew, supra note 17 at 550-551. Similarly, in an award rendered by the arbitration court of the Chamber of Foreign Trade of the defunct German Democratic republic [(1979) IV Y.Comm., Arb. 197], the arbitrators in determining the validity of a license agreement between firms in the CDR and the Federal Republic of Germany, held that competition laws of the FRG were inapplicable because the contract was governed by the laws of the GDR.

[32] I have designated mandatory rules outside the *lex contractus* as foreign mandatory rules because they are external to the governing law.

say for instance, is Japanese law. The principle of party autonomy ought not to override Canada's cogent public interests in such a case.

One commentator queries whether the principle of party autonomy is "so hallowed that in all cases it would be limited only by the law of the parties' selection?"[33] The answer is certainly no, for "justice is not always to be controlled by the individual as distinct form the community of which the individual is a part."

Furthermore, the application of foreign mandatory rules is not invariably antithetical to the wishes of the parties. As Derains rightly points out, the choice of one law does not necessarily imply an intention to exclude all relevant mandatory rules that are external to the chosen *lex contractus*.[34] It may well be that the parties intended their agreement to conform to the mandatory rules of those countries upon which their transactions have a significant impact. For example, in the above illustration, the parties may have selected Japanese law to govern their agreement on the understanding that despite this selection, Canadian competition laws would be repeated.

More importantly, the will of the parties cannot be used as a ground or refusing to apply the mandatory rules of foreign law as the parties in many cases do not express any view on the applicability of foreign mandatory rules. The choice of a governing law should not be interpreted as implying the exclusion of other relevant laws, unless the parties expressly exclude them. Even then, the parties can legitimately override the public interests of a country whose jurisdiction is substantially connected to the underlying transaction.

Finally, the plea of uncertainty as a justification for non-application of foreign mandatory rules sites a little ill when it is remembered that other principles of law are no less certain. For example, in the absence of an express choice by the parties, arbitrators usually apply the law most closely connected to the contract. Certainly, this process of determining applicable law does not afford certainty of application. More importantly, one wonders why the need for certainty should supersede the necessity of respecting the mandatory rules of foreign laws which are substantially connected to the dispute. The application of foreign mandatory rules should involve a balancing of the public interests of the enacting State with the private interests of contracting parties.

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[33] D. Jackson, "Mandatory Rules and Rules of "Odre Public'" in P. North.

[34] Y. Derains, "Public Policy and the Law Applicable to the Dispute in International Arbitration" in P. Sanders (ed) Comparative Arbitration Practice and Public in Arbitration (The Netherlands: Kluwer Law and Taxation publishers, 1987 at 249.

In contrast, the favourable approach to the application of mandatory rules (to which this writer subscribes) recognises the fact that foreign mandatory rules may be so connected with the dispute as to compel their application, whether or not they are part of the governing law. This approach, acknowledging the fact that the will of the parties has to be reconciled with the interests of those States which are closely connected to the dispute, entertains the possibility of applying foreign mandatory rules in appropriate cases.

The favourable approach is accepted in most of the recent Conventions dealing with contractual relations. An example is Article 7 or the European Convention on the Law Applicable to Contractual Obligations (the Obligation Convention)[35] which provides that:

When applying under this Convention the law of a country, effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract.[36]

A similar approach is also adopted in Article 16 of the Hague Convention on the Law Applicable to Agency:

> In the application of this Convention effect may be given to the mandatory rules of any State with which the situation has significant connection, if and in so far as, under the law of that State, those rules must be applied whatever the law specified by its choice of law rules.

These conventions are of course not directly applicable to arbitration proceedings, but they represent an emerging consensus on the need to respect the imperative rules not only of the proper law but also other laws that are significantly connected to the transaction. O. Lando rightly sees in the obligation convention the embodiment of a reasonable principle that is extendable to international commercial arbitration:

> Article 7(1) of the Obligation Convention is expressive of international solidarity. States should help each other in the

[35] Opened for signature in Rome on June 19, 1980. The Convention does not, however apply to "arbitration agreements": Article 1 (2) (d).

[36] This provision is considered imprecise, vague and controversial by those who favour the English approach of not applying foreign mandatory rules. See-1. Fletcher, conflict of law and European Community Law (Amsterdam: North-Holland Publishing, 1982) at 170. According to Article 22(1) (a) of the Convention, a Contracting State may reserve the right not to apply Article 7(1). Exercising this right, the United Kingdom and Germany excluded Article 7(1).

> enforcement of relevant government policies. The arbitrators should contribute to this solidarity by giving effect to mandatory provisions claiming application, provided that those rules are enacted by a State having a close relationship with the contract and that it is fair and reasonable to give effect to them.[37]

In applying foreign mandatory rules, arbitrators should first weigh the connection of the rules to the dispute, with the aim of determining if the parties' transaction is substantially connected to the country which enacted the mandatory rules. Secondly, they should ascertain that the policy behind the rules demonstrate that the rules are applicable to international commercial transactions. Arbitrators should place particular emphasis on the policy rationale for the rules because in many cases mandatory rules are designed solely for domestic application. The obligation convention endorses this approach by stating that in deciding whether to apply mandatory rules, "regard shall be had to their nature and purpose and to the consequences of their application or non-application."[38] Similarly, Swiss judges applying foreign mandatory rules examine their "policy and consequences for a judgement that is fair according to Swiss views."[39]

The utilisation of the nature and purpose of a mandatory rule as a guide in determining its application would invariably lead to the application for the law of the place of performance. This is because the parties should be presumed to act on the understanding that the contract would be performed in accordance with the rules of the country where performance is required. Arbitrators will doubtless be reluctant to require a party to perform a contract, or pay damages for non-performance, where the mandatory rules of the place of performance makes it impossible to do so.[40]

The attitude of arbitrators to the mandatory rules of the place of performance is illustrated by the award in ICC Case No. 1859 where the tribunal stated:

> Since the contract must be performed in Lebanon, Syria and Jordan, it is a sure fact that the Lebanese importer was obliged to comply with the mandatory rules of the countries of importation and that the Japanese party cannot now claim that those rules cannot be raised against him.

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[37] O. Lando, at 159.
[38] Article 7(1).
[39] Article 19(2) of Switzerland's Private International Law Statute, 1987.
[40] W. Caraig, W. Park & J. Paulsson, at 304.

> Any merchant of a country who attempts to sell his products in another country is bound to respect the mandatory rules of the country of reception and cannot claim to be unaware of or not respect police laws or the regulation governing the importation of its goods, particularly when this law or regulation existed at the time of the performance of the contract.[41]

Also, in ICC Case No. 761[42] one of the parties argued that since the contract was contrary to public interest, therefore it is void according to French law, the law of the place of performance. The tribunal held that in so far as the contract was relevant to the case, it found that the instant contract did not violate French public policy.

However, the case is somewhat more delicate when the foreign mandatory rule involved is not that of the place of performance. Nevertheless, the purpose of the rule and its connection to the dispute are very helpful indicators for the legitimacy of its claim to application. Assume that a Canadian party enters into a contract with a U.S. citizen for the building of a casino in Bermuda. The contract is governed by English law. In proceeding before arbitrators, the Canadian party pleads Ontario's prohibition of gambling as vitiating the contract. In a case like this, the arbitrators should be guided by the nature and purpose of the mandatory rule in question and the extent of its connection to the case. In the instant case, the only connection of Canada to the case is that it is the residence of one of the parties. On the other hand the place of performance and governing law have no connection with Canada. Clearly, Canadian laws do not have any legitimate claim to application in the case. Additionally, a finding that Ontario's prohibition of gambling is aimed at domestic situations would fortify the decision not to apply Ontario law.

The application of foreign mandatory rules is particularly crucial in cases involving sensitive state policy, such as competition laws or environmental laws. Here arbitrators should ensure that arbitration does not become a vehicle for avoiding the application of the mandatory rules of countries significantly connected to the underlying transaction. Nevertheless, the application of foreign mandatory rules should be rejected in cases where they lack a substantial connection with the underlying transaction or where their nature and purpose argue against their application to the international arena. ICC Case No. 4132[43] illustrates the application of this principle. In a dispute between an Italian and a Korean party (governed by Korean law), the

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[41] 1973 Rev. Arb. 122.

[42] Reported in J. Lew, at 542.

[43] S. Jarvin & Y. Derains Collection of ICC Arbitral Awards, 1974-1985 (Deventer, The Netherlands: Kluwer and Taxation Publishers, 1990) at 164.

arbitrators declined to apply European competition law because the contract did not have a significant effect in Europe.

> Since the Agreement is a contract between an Italian and a Korean undertaking and was for a larger part performed in Korea, this Tribunal is not satisfied that the Agreement may affect trade between Member States (of the European Community)......

Similarly, in a 1982 award of the Amsterdam grain Trade Association,[44] the arbitral tribunal noted that the application of a foreign mandatory rule depends on its "nature and extent" and the "consequences of its appellation or inapplication". It held inapplicable the mandatory rule of one of the parties' nationality on the grounds of lack of substantial contact with the agreement. The relevant connecting factors in the case pointed to the Netherlands and Germany, and the party's Austrian nationality was, on it own, insufficient to warrant the application of Austrian mandatory rules.

Also in ICC Case No. 1512,[45] in an action to enforce a guarantee issued by a Pakistani bank in favour of an Indian company, the Pakistani bank pleaded in a defense certain Pakistani decrees making any payment to an Indian, the tribunal held that "Pakistani law, the law of the place of the debtor's residence, should not intervene." The arbitrators focused on the particular issue trained in the case, namely, that of payment under the guarantee. Since that particular element was not connected to Pakistan, the Pakistani prohibition could not effect the performance of the contract in Indian territory.

In conclusion, it could be seen that the major trend in arbitral practice is to apply foreign mandatory rules in appropriate cases. The application of these rules in individual cases depends on their connection with the dispute and their nature and purpose.

The Role of Transnational Public Policy

The preceding discussion has focused on the restriction which mandatory rules of national law (rules which are reflective of the public policy of the enacting states) place on the application of the governing substantive law. However, while mandatory national rules may operate to dislodge the applicable substantive law, there is in international commercial practice a public policy superior to national public policy.

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[44] (1983) 8. Y.Comm. Arb. 158.

[45] (1976) 1 Y. Comm. Arb. 128.

This pre-eminent public policy is sometimes labeled transnational public policy[46] or truly international public policy.[47] Like the concept of public policy in national law, the concept of transnational public policy presupposes the existence of "a certain community and of certain fundamental values." However, unlike national public policy, the relevant community here is not a national community but the international community.

While the public policy of a State embodies the moral and ethical philosophy of the State, transnational public policy performs the same role for the international business community. There is a certain similarity between the two: principles which embody the fundamental and ethical values of a national community would in a majority of cases be equally fundamental in the international community. For example, the requirement of fair hearing and due process is considered a basic element of justice in both the national and the international communities. However, so long as national public policy represents particular and narrow national interests, while transnational public policy represents the values of the world community, the two strands of public policy cannot be identical. For example, while the act of gambling is against public morals in some societies, it can hardly be said that the abhorrence of gambling is part of the fundamental values of the world community.

Transnational public policy represents the fundamental values, the basic ethical standards and enduring moral consensus of the international community. Its principles are ***jus cogens*** in public international law"[48] and the public policy accepted in a generality of nations.[42] These principles, which include the abhorrence of racial, religious and sexual discrimination and the repudiation of corrupt practices, are in a sense the mandatory rules of international commercial relations which must be respected in all arbitrations.

The application of transnational public policy is seen as crucial to the maintenance of minimum standards of conduct and behaviour in international commercial relations. As the court of Appeal of Paris points

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[46] For a very helpful discussion of the role of transnational public policy in international commercial arbitration, see P. Lalive, "Transnational (or Truly International) Public Policy and International Arbitration" in P. Sanders, at 257.

[47] Lew, at 534.

[48] According to J. Robert and T. Carbonneau, transnational public policy incorporates "principles sufficiently general to be recognised by a number of legal systems representing a *bona fide* community of civilised nations." The French Law of Arbitration (New York: Mathew Bender, 1983) at 11:9-11. While the concept of civilised nations as used by the authors is not free from controversy, the general idea is that transnational policy includes the synthesis of the public policy of a representative selection of nations.

out, "The security of international commercial and financial relations requires the recognition of a public policy which is, if not universal, at least common to the various legal systems."[49]

Arbitrators are particularly suited to apply the principles to transnational public policy because they have a responsibility to maintain a certain element of equity and fair play in the international commercial arena and they are not guardians of the public policy of any particular State. This responsibility is partly discharged by their balancing the will of the parties with the legitimate interests of the international community in preserving the basic notions of contractual morality and justice.

Arbitrators, as guardians of the international commercial order, refuse to enforce a contract if it contravenes transnational public policy. This was the result in ICC Case No. 1110.[50] In that case, the claimant claimed some money as commission for his efforts in helping the respondent procure an Argentinean government contract. Having determined that the commission amounted in violation of transnational public policy:

It cannot be contested that there exists a general principle of law recognised by civilised nations that contracts which seriously violate ***bonos mores*** or international public policy are invalid or at least unenforceable and that they cannot be sanctioned by courts or arbitrators. This principle is especially apt for use before international arbitration tribunals that lack a "law of the forum" in the ordinary sense of the term.

The arbitrator declined to proceed with the arbitration, holding that corruption involved in the transaction as "an international evil; it is contrary to good morals and to an international public policy common to the community of nations".

Also in ICC Case No. 2730[51] the tribunal held that an agreement designed to contravene Yugoslav exchange control law was void because the contract was contrary "not only to Yugoslav law but also to morality and ***bonos mores***."

Transnational public policy could also be a ground for an arbitrator's refusal to apply the mandatory rule of a relevant national law. Transnational public policy represents values that are superior to those of particular national systems. Therefore, when a mandatory national rule is in conflict with a transnational policy, the latter prevails, at least in an international

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[49] See P. Lalive, at 278.
[50] Reported by J. Lew, at 553.
[51] (1984) Clunet 914.

arbitral forum.[52] This is because arbitrators owe a paramount duty to the international community. Illustrating this principle, P. Mayer gives as an example certain boycott laws that establish restrictions on the grounds of race and religion. He rightly argues that an arbitrator should in the name of transnational public policy refuse to enforce such mandatory laws because they seek to institute racial or religious discrimination which contravenes transnational public policy.

It is useful to enter a caveat regarding the use of transnational public policy in refusing to apply national mandatory rules. If the use of this doctrine is not placed under careful and continual scrutiny, it may become a ready tool at the hands of Western jurists who wish to utilise this theory in refusing to recognise or apply those national laws which they deem unsuitable to their regional interests. Now and again one hears all sorts of rules being pleaded as part of transnational public policy, rules which at best are thinly disguised attempts to consecrate policies amenable to Western interest and rules of universal validity. For example, the doctrine of *pacta sun servanda* and the principle of good faith are often pleaded in support of an alleged principle of transnational policy which ordains the immutability of State contracts in the absence of a common agreement of the parties to alter the contractual provisions. This argument is made despite clear and readily accessible evidence that State practices in many jurisdictions (for example, State practices in France and those jurisdictions whose legal systems are modelled on the French) adopt the theory of administrative contracts whereby the State in municipal relations has, under certain conditions, extra-contractual powers to alter the provisions of a government contract.[53]

It could then be seen that while the doctrine of transactional public policy is very useful in securing contractual morality in international commercial relations, it could easily become a political tool at the hands of imperial scholars and arbitrators. It is therefore important that third world scholars take particular note of this tendency, and work to ensure that transnational policy is only used to serve its declared and legitimate objective: the enforcement of those policies, standards and principles which truly represent a consensus of the world community, not just a segment, however powerful, of it.

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[52] See P. Mayer, at 291; J. Lew, at 104.

[53] See C. Turpin, "Public Contract" in International Encyclopedia of Comparative Law, Vol. 7 Contracts in General, Chapter 4 (The Hague: Tubingen & Martinus Nijhoff, 1982). See also J. Mitchell, The contracts of Public Authorities: A Comparative study (London: G. Bell & Sons Ltd.)

In sum, the theory of transnational public policy originates from an attempt by arbitrators to enforce those fundamental ethical and moral values which are necessary for the security of international commercial relations. It is the case that the concept of transnational public policy is rarely raised before arbitrators as a ground for invalidating a contractual obligation. Nevertheless, its presence in arbitral practice is a reminder to potential arbitrating parties that the relative process could be used to circumvent the application of basic concepts of morality and justice.

Conclusion

Mandatory rules are one of the ways in which the doctrine of party autonomy is adapted to the legitimate interests of States in ensuring that the arbitral process affirms the basic elements of contractual morality. Of course, arbitrators are not expected to apply each and very mandatory rule that is pleaded as relevant to the case. Their mission in this regard is to examine the nature and purpose of relevant mandatory rules and ascertain whether the enacting State's connection with the parties' transaction warrants the application of such rules. Where the connection is limited or merely speculative, the arbitrator should decline to apply such rules.[54]

Arbitrators should also ensure that disputes before them conform to the requirements of transnational public policy.

The enforcement of appropriate mandatory rules by arbitrators would send a signal to prospective arbitrating parties that the arbitral process is certainly not a device for circumventing imperative laws of States with which their transaction is substantially connected. This attitude would justify the confidence of those States which believe that arbitrators are well suited to adjudicate claims involving sensitive matters of State policy.

[54] J. Enterria, "The Role of Public Policy in International Commercial Arbitration" (1990) 21 Law & Policy Int's Bus 389.

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Punjab Fiscal Resources Review

Shahid Amjad Chaudhry

Abstract

This study raises policy issues arising from the fact that the present tax-expenditure policies and institutional set-up at both the provincial and local government levels of the Province of the Punjab are dated and need revision.

There is now an active awareness within the Punjab Province that substantial changes are necessary. The broad outlines of these required changes which have been identified in this study, as follows:

i) The Provincial Government needs to recognise that the 1997 National Finance Commission (NFC) Award's projected high level of Federal Divisible Pool Revenues are unlikely to materialise in the light of the substantial changes made in tax policies by the post 1997- Award Federal Government as well as by the depressed state of the economy. As a result the historical pattern of Federal Transfers covering more than 85 per cent of consolidated Punjab Provincial and Local Government expenditures is unlikely to be ever repeated. In fact the 1997-98 coverage of 75 per cent is likely to go down even further and this gap needs to be filled by active resource mobilisation and expenditure curtailment measures.

ii) The decline in Federal transfers has meant that the revenue surplus (Federal Transfers plus own resources minus current expenditures) available for funding the Punjab's development expenditures have also declined – from 75 per cent in 1996-97 to an estimated 13 per cent in 1997-98. This gap has been filled (in roughly equal proportions) by a massive increase in Cash Development Loan (CDLs) from the Federal Government, Foreign Debt onlent by the Federal Government, (primarily from the World Bank) and Draw-down of Provincial Reserves. The first carries a market rate of interest (about 17 per cent per annum) while the foreign loans (largely under SAP) carry concessional rates of interest. Here the proposed strategy would be to increase the revenue surplus, phase out the relativvely more expensive CDLs and borrow foreign funds (through the Federal Government) only on concessional IDA terms (i.e. 0.25 per cent interest, 50 years repayment plus foreign exchange risk).

iii) Debt service (on both domestic and foreign debt) to the Federal Government is increasing rapidly (9 per cent of provincial revenues in 1997-98) and needs to be monitored carefully. In addition unfunded pension liabilities of the provincial government to present and future retirees have the potential to create substantial problems. The provincial pension scheme needs to be amalgamated with the provident fund scheme (which is also unfunded since the provincial government has used these employee funds) and turned into a defined contribution scheme i.e. to a fully funded individual pension account scheme. Otherwise pension liabilities which are about 8 per cent of Punjab current expenditures and 35 per cent of Provincial own consolidated revenues in 1997-98 are likely to reach unsubstainable levels in the foreseeable future.

iv) The Tax-Expenditure structure needs to be rationalised between the Provincial Government and the Local Governments. Tax collection heads must be directly linked to expenditure responsibilities. The Provincial Government should only collect and retain the following existing taxes: (a) agricultural income tax, (b) 'land revenue' associated fees - primarily mutation fees - for transfer of agricultural land, (c) stamp duties on urban-property and non-property transactions, (d) motor vehicle taxes, (e) provincial excises and (f) electricity tax. It should also introduce its own Punjab General Services Sales Tax by adding it onto the proposed Federal Sales Tax and have it collected for the Provincial Government by the Federation. The last proposed tax would compensate for the taxes proposed to be transferred to the ULBs/RLBs. All other Provincial Taxes with the exception of the Cotton Fee which is used to fund research should be abolished. All these tax policy changes, together with improvements in the agricultural income tax, provincial excises, electricity tax and non-property related stamp duties will ensure a simple healthy taxation structure at the provincial level.

v) Provincial non-tax revenues can be increased substantially by increased cost recovery and efficiency improvement from the provision of community services and social services – particularly health and education (which show cost recovery percentages of 3 per cent and 5 per cent respectively). The economic services – particularly irrigation – have a cost recovery factor of about 40 per cent instead of providing a substantial surplus (or at least 100 per cent cost recovery) since irrigation water is substantially under-priced (currently about 20 per cent of the cost of tube-well water).

vi) At the Provincial level, substantial efficiency gains are possible in general administration, law and order (particularly the functioning of the courts) and provision of community services including health and education and economic services particularly irrigation. Reducing unnecessary regulations will increase public welfare and reduce administrative costs. The courts need massive productivity improvements through revision of procedures and increasing the costs of litigation which will only be adopted if 'financial autonomy' is given to the Provincial Judiciary. In education, the province should stop expanding its infrastructure and focus on improving the efficiency of its existing schools and colleges and introduce a transferable voucher system (encashable in both public and private institutions). In health it should deal mainly with curative medicine (i.e. hospitals) which should have administrative and financial autonomy. In the economic services increased efficiency through user associations, cost recovery and expropriation of surpluses through taxation in monopoly areas such as irrigation would result in both substantial welfare gains as well as increased revenues.

vii) All taxes relating to the direct functional areas of local bodies ULBs/ RLBs/DAs – should be transferred to these local bodies and collected by them directly. The major taxes here would be on: (i) Property Taxes to be collected by ULBs and RLBs; (ii) Full Cost–Recovery for provision of water supply, sanitation and waste disposal services (iii) A new Local Government Petroleum Tax (to be collected by the petroleum companies) which would fund new roads and related infrastructure (bridges, elevated expressways etc.); and (iv) Octroi/Export Taxes which would be used in part for funding the maintenance of major roads but in large part meeting the needs of the poor for slum and Katchi Abadi up- gradation. The Professional and Calling Tax should be transferred from the Provincial Government to the Local Bodies and be used to fund infrastructure for the use of such professional bodies. The remaining existing local government taxes are minor, save for nuisance value and extracting rents, and should be abolished except when they serve as user fees.

viii) To meet these increased revenue/expenditure responsibilities the ULBs/RLBs/DAs would have to be re-organised. The fundamental administrative change proposed is that all major cities (i.e. Municipal Committee and larger) should comprise a number of Municipal Committees (which should be the effective urban management unit). All areas developed by DAs (either in the past or the future) should be converted into a municipal committee or a number of municipal committees (depending on the size) and these should all be grouped on the pattern of Karachi into a metropolitan corporation with separate mayors for each of the Municipal Committees and a Lord Mayor as envisaged in the recent new Punjab Legislation. Thus all the Punjab's Municipal Corporations will become Metropolitan Corporations. The Municipal Corporation as a tier is being recommended for abolition on the grounds that it is too large and unwieldly as an administrative unit. The WASAs should become an autonomous part of the Metropolitan Corporation (shifting from the DAs). The DAs should be expanded to cover more cities but also be subjected to more financial discipline.

Study Conclusions:

All available qualitative and quantitative indicators point to the fact that Punjab's urban areas have been reduced to vast slums. There is an urgent need for urban renewal. If the measures proposed in this study are implemented, the financial position of both the Provincial Government and the Local Government (particularly the Urban Local Bodies) would be considerably strengthened. In addition to the greater potential for financing own development expenditure by Urban Local Bodies, the policy changes proposed above would make the Provincial Government credit worthy for an additional $ 200 million (Rs. 9 billion) annually of foreign borrowings on concessional IDA terms. This is in addition to its current level of foreign borrowings (through the Federal Government) of about $130 million (Rs.6000) annually. Similarly the ULBs would become cumulatively credit worthy for borrowing upto $ 80 million (Rs.3.5 billion) annually on concessional terms.

The Punjab's Provincial Finances – Existing Situation

1.1 **Introduction**. The Punjab's finances, as in all Provinces of the Federation of Pakistan, are dominated by the constitutional position that all major taxation bases viz. income taxes (except on agriculture), customs duties, all excises except on alcohol and narcotics and sales taxes, are with the Federal Government which distributes 38.5 per cent of it (the so called divisible pool) on a population basis to the provinces after retaining 62.5 per cent for its own federal purposes (primarily defense, communications and debt service on foreign and local borrowing). There proportions are determined every five years by a National Finance Commission and the most recent award was in February 1997. The major taxes available to the provinces are: agricultural income tax, property taxes, taxes on services (a legally undefined area), motor vehicle taxes and a host of minor local taxes. The Provinces use the proceeds from both the Federal Divisible Pool and their own resources to meet their provincial constitutional responsibilities which include virtually everything except defense. The situation is complicated by the fact that Local Governments are not specified in the Pakistan Constitution in terms of structure, taxation and expenditure responsibilities and hence exist only at the legislative and administrative discretion of the Provincial Governments. The Indian Constitution was recently amended to correct a corresponding anomaly.

1.2 The last National Finance Commission Award (February 1997) was pushed through by the care-taker government of Mr. Meraj Khalid and dramatically altered the ratio of division of resources between the Federal and Provincial Governments from 80:20 of all taxes except custom duties, wealth taxes and capital value taxes which were wholly retained by the Federation, to 62.5:37.5 of all taxes. This was primarily intended in order to rescue the faltering financial position of the Federal Government staggering under the burden of overwhelming national and foreign debt and high interest rates. The Provinces accepted this new formula mainly because Federal revenues were projected to grow at extremely high levels and therefore promised even higher absolute resources transfer to the Provinces. The subsequent Federal Government of Mr. Nawaz Sharif dramatically changed policies by lowering Federal tax rates. The parameters of the NFC award have therefore changed and the obvious policy signal is that the Federal Government will lower its tax profile and the Provinces should be raising theirs.

Table: I.1 Punjab Provincial Budget (1997-98) vs. NFC Projections

Rs. Billion Current Prices

	1996/97 (Estimates)	1997-98 (Budget)	1997-98 (NFC)	2001-02 (NFC)	NFC Growth Rate %
Revenue Receipts	85.1	83.2	97.4	186.1	17.6%
Own Revenues	14.3	17.0	14.5	24.0	13.5%
Transfers from Fed Govt.	70.7	66.2	83.0	162.1	18.1%
(Divisible Pool Transfers)	(70.7)	(64.4)	(80.8)	(158.9)	(18.3%)
(Straight Transfers)		(1.8)	(2.2)	(3.3)	(10.7%)
(Special Grants)		(1.0)	(0.0)	(0.0)	
Current Expenditures	75.5	80.7	88.0	163.3	16.8%
Revenue Surplus/Deficit	9.6	2.5	9.5	22.8	
Development Expenditures	13.0	19.7	8.3	15.2	16.3%
Overall Surplus/Deficit)	-3.4	-17.2	1.2	7.6	

Source: Government of Punjab Budget Documents and Report of the National Finance Commission, April 1997.

1.3 As Table I.1 above indicates, Punjab has begun to adjust to the changed situation by raising its own revenues through additional fiscal measures for 1997/98 in order to compensate for the drop in the actual NFC transfers between 1996-97 and 1997-98. However, the increase in current expenditure (in line with inflation) has meant that the Punjab Annual Development Budget is now entirely to be financed by Federal Cash Development Loans, Foreign Loans onlent by the Federal Government and draw down of reserves - all in roughly equal proportions. (See Table I.2).

1.4 A starting point for analysis of the Punjab's finances is to look at its consolidated accounts (Table I.2). Punjab's total revenues for 1997-98 are budgeted at Rs.114.5 billion (including Federal transfers and loans but excluding draw down of the Punjab's own reserves) and total expenditures at Rs.116.3 billion. Of the Rs.31 billion of own revenues generated in the Punjab, Rs.17 billion (55 per cent) accrued to the Provincial Government, Rs.9 billion (29 per cent) to ULBs, Rs.4 billion (13 per cent) to Zila Councils (RLBs) and Rs. 1 billion (3 per cent) to the workers Social Security (Health) Institution and were used almost entirely by these agencies to meet current expenditures. The Provincial Government also used almost all its Federal Transfers for current expenditures. The notable exception were the ULBs which financed

Rs.2 billion of development expenditures from their own resources. On the development side almost 93 per cent of all capital expenditures (or Rs.18.3 billion of a total of Rs.19.7 billion) relating to all public agencies (Provincial Government, ULBs, RLBs, DAs, WASAs etc) were allocated directly through the Provincial ADP and were largely tied to foreign loaned projects – with some flexibility being offered by the drawn down of Rs.6 billion of the Punjab's reserves for its development expenditures. The conclusions from these numbers are fairly obvious. First, the Province of the Punjab needs to raise more revenues, both at the Provincial and Local levels. Second, Local Government Bodies are unnaturally constrained both in raising revenues and in their expenditure decision making which in large part explains the breakdown of infrastructure services in all localities – both urban and rural.

Table: I.2 Punjab Consolidated Fiscal Accounts 1997/98 (Budget)

Rs. Billion

	Resources/Revenues			Expenditure			Surplus/
	Total	(Tax)	(Non Tax)	Total	(Current)	Capital)	Deficit
PUNJAB RESOURCES & EXP.	114.5	82.0	32.5	116.3	90.1	26.2	-1.8
(exc Reserves)							
Prov. Revenues and Current Exp.	83.2	74.4	8.8	80.7	80.7		2.5
(Provincial Revenues)	(17.0)	(10.0)	(7.0)				
(Federal Transfers)	(66.2)	(64.4)	(1.8)				
Provincial Borrowing and Dev. Exp.	17.3		17.3	19.7		19.7	-2.5
(Federal Grants)	(1.0)		(1.0)				
(Cash Dev. Loans).	(6.0)		(6.0)				
(Foreign Loan - Fed.Govt.)	(6.2)		(6.2)				
(Reserves + = decrease)	(5.6)		(5.6)				
(Debt Service to Fed. Govt.)	(-1.5)		(-1.5)				
Metropolitan Corporation Lahore	2.5	1.1	1.5	2.4	2.2	0.2	0.2
(LMC)	(1.2)	(0.9)	(90.5)	(1.2)	(1.0)	(0.2)	(0.0)
(LDA)	(0.5)		(0.5)	(0.4)	(0.4)	(0.6)*	(0.1)
(WASA)	(0.9)	(0.2)	(0.7)	(0.8)	(0.8)	(0.7)*	(0.1)
7 Municipal Corporations	3.4	1.5	1.9	3.7	2.8	0.9	0.3
(MCs)	(2.2)	(1.4)	(0.8)	(2.5)	(1.6)	(0.9)	(0.0)
(DA's)	(0.7)		(0.7)	(0.7)	(0.7)	(0.9)*	(0.0)
(WASAs)	(0.5)	0.1	(0.4)	(0.5)	(0.5)	(0.5)*	(0.0)
78 Municipal Committees	2.5	1.4	1.1	2.6	1.9	0.7	-0.1
140 Town Committees	0.5	0.4	0.1	0.5	0.3	0.2	0.0
34 Zila Councils	4.0	2.4	1.6	5.8	1.5	4.3	-1.8
Social Security (Health) Institution	1.0	0.8	0.2	0.9	0.7	0.2	0.1

Source: Compiled from Government of Punjab Budget Documents. Data for Town Committees relates to actuals for 1996-97. Development expenditures marked with (*) denote financing from Provincial ADPs. Zila Council Development expenditures budgeted for 1997-98 are about Rs.2 Billion more than 1996-97 actuals and these Zila Councils normally run large surpluses on their accounts.

Structure of Revenues and Expenditures – Provincial Level

1.5 **Revenues Shared from the Federation**. Provincial Revenues comprise revenues from three sources: (I) Federal Tax (Divisible Pool) shares and Direct Transfers, (ii) Provincial Tax Revenues, and (iii) Provincial Non-tax Revenues (largely cost recovery). The Federal Divisible Taxes now comprise all Federal Taxes (excluding income tax on renumerations paid by the Federal Government which is retained by the Federal Government). The net distributable share is determined after the deduction of 5 per cent collection charges retained by the Federal Government. The first distribution is between the Federal Government and the Provinces (62.5 per cent: 37.5 per cent) The second distribution is between the provinces on the basis of population under which according to the last published Census (1981) the Punjab gets 58.8 per cent. The rates of the major Federal Taxes are: (I) Income Tax (individuals 15-35 per cent, companies 50-60 per cent); Custom Duties (10-60 per cent); Sales Taxes (8-12 per cent), Excise Taxes (10-80 per cent), Wealth Taxes (2 per cent of assets value) and Capital Value Tax (CVT) (5 per cent of asset value).

Table: I.3 Punjab Share of Federal Divisible Taxes

Rs.Billion

	(1991 NFC) 1996-97 Estimates	(1997 NFC) 1997-98 (Budget)
Income Tax	36.3	19.5
Custom Duty		17.9
Sales Tax	24.6	13.5
Federal Excise Duties	8.0	12.6
Wealth Tax		0.5
Capital Value Tax		0.3
Total	69.0	64.4

Source: Government of Punjab Budget Documents.

Note: The 1997 NFC Award changed the divisible pool by including customs duties, wealth taxes and capital value tax in the pool and changing the portions distributed to the Provinces from 80 per cent to 37.5 per cent. The divisible pool excludes the straight transfer of revenues accruing from petroleum and gas. Electricity profits are transferred outside the NFC and Federal Budget framework directly to the Provinces (largely to NWFP). Direct transfers to the Punjab are budgeted at Rs.1.8 billion for 1997-98 compared to Rs.6 billion and Rs.10 billion each to Balochistan and NWFP for direct transfer of gas revenues and electricity profits respectively.

1.6 **Provincial Taxs Revenues**. As discussed earlier all major tax bases are reserved for Federal collection by the Constitution except for land based taxes. Thus accordingly 60 per cent of Punjab's Provincial revenues (or Rs.6.0 billion of a total of Rs.9.7 billion) come from four land taxes: (i) The recent agricultural income tax (Rs.1.5 billion); (ii) agricultural land transfer taxes – mutation fee (Rs.1.3 billion); (iii) urban land transfer taxes – stamp duties (Rs.2.9 billion); and (iv) urban property taxes (Rs.0.3 billion) retained by the Provincial Government (actual collection is Rs.1 billion and the balance is passed on to the ULBs). Other major taxes are the motor vehicle taxes (Rs. 1 billion); excises on alcohol/spirits (Rs.0.5 billion) and electricity duty (Rs.1 billion - this was the first step towards taxing services). The remaining taxes of Rs.1 billion are minor with the relatively large ones being cotton fees (Rs.0.3 billion) and entertainment taxes (Rs.0.2 billion). The details of the taxes including tax rates and changes suggested are discussed later in Sections II and III of this report.

Table: I.4 Punjab Provincial Tax Receipts

Rs. Billion

		1996-97 Estimates	**1997-98 (Budget)**
1	Agricultural Income Tax	1.3	1.5
2	Agr. Land Transfer Tax (mutation fee)	1.3	1.3
3	Urban Land Transfer Tax (stamp duty)	2.5	2.9
4	Motor Vehicle Tax	1.0	1.1
5	Electricity Duty	0.8	1.0
6	Provincial Excises	0.4	0.5
7	Property Tax *	0.2	0.3
8	Others (Cotton fee, entertainment Tax etc.)	1.0	0.9
	Total	8.7	9.7

Source: Government of Punjab Budget Documents

***Note:** Only 25 per cent of the Property Tax is retained by the Provincial Government which is shown in this Table.

1.7 **Provincial Non-Tax Revenues and Current Expenditures**. It is convenient to look at current expenditures first by internal ratios and then in terms of cost recovery ratios. An examination of the composition of current expenditures indicates that the largest share at 42 per cent (Rs.34 billion out of the total of Rs.80.7 billion in 1997-98) went to social services and particularly education which received Rs.27.6 billion or 34 per cent (excluding public universities which are financed by the Federal Government through an interesting non-constitutional tradition initiated by the then President General Zia ul Haq). This was followed by expenditures on law and order functions of Rs.6.9 billion (9 per cent); Rs.6.2 billion (8 per cent) on pensions; and Rs.4.5 billion (6 per cent) on irrigation. Details of current expenditures and non - tax revenues are given in Table I.5 and Section II of this study.

1.8 Cost recovery percentages are examined in Table I.5 below. Excluding pensions, subsidies and debt service expenditures, interest and dividend income, total cost recovery percentages were 7 per cent in both 1996-97 and 1997-98. Cost recovery for economic services was 40 per cent in 1996-97 and 39 per cent in 1997-98. Cost recovery on community services (largely water supply and sanitation in rural areas) was 27 per cent in 1997-98. The highest expenditure and the lowest cost-recovery percentages were in the social services particularly education (cost recovery percentage of 2.5 per cent) and health (5.0 per cent). While providing social services like education and health and community services such as rural water supply services to the poor justifies low cost recovery, room for efficiency gains in the sector are also explored in Section II. There is much less justification for low cost recovery for economic services particularly irrigation and this is also discussed further in Section II.

Table: I.5 Punjab Current Expenditure and Non Tax Revenues and Cost Recovery Percentages

Rs. Billion, Current Prices		
	1996-97 Estimates	**1997-98 (Budget)**
1. Total Current Expenditure Excluding Pensions, Subsidies and Debt Service	67.8	72.7
2. Total Non Tax Revenues	5.5	5.8
Cost Recovery Percentage	8.0%	8.0%
3. Total Exp. on Gen. Civil Adm.	6.0	4.5
4. Total Receipts from Gen. Civil (Adm.)	0.2	0.2
Cost Recovery Percentage	3.0%	4.0%
5. Total Exp. on Community Services	3.4	4.4
6. Total Receipts from Community Services	1.0	1.2
Cost Recovery Percentage	29.0%	27.0%
7. Total Exp. on Education	24.4	27.6
8. Total Receipts from Education	0.6	0.7
Cost Recovery Percentage	2.0%	2.5%
9. Total Exp. on Health	5.1	5.8
10. Total Receipt from Health	0.2	0.3
Cost Recovery Percentage	4.0%	5.0%
11. Total Exp. on Irrigation	4.3	4.6
Total Receipt from Irrigation	1.7	1.8
Cost Recovery Percentage	40.0%	39.0%

Source: Compiled from data in "Pakistan, Provincial Budgets 1997/8" World Bank, September 25, 1997.

Note: Interest and Dividend payments amounted to Rs.1.4 billion, subsidies to 0.2 billion while interest income was estimated at Rs.0.2 billion in 1997-98. Pensions amounting to Rs.6.2 billion in 1996-97 and estimated at the same levels for 1997-98 are excluded from `General Civil Administration' expenditures.

Un-funded Obligations – Pensions and Provident Fund

1.9 The pension obligations of the Punjab Government were budgeted at Rs.6.2 billion in 1996-97 and are estimated at the same level billion for 1997-98. These pension obligations are likely to mount very quickly for the current Provincial Government establishment of now more than 6,00,000 employees (5,00,000 of them teachers in the Education Department). In addition, the absence of a pension scheme for Local Government Service employees has created on incentive for them to leave the service of the Local Bodies and become Provincial Government Employees. Both these factors necessitate an urgent review of Provincial Pensions. It is recommended that the present unfunded pension scheme be changed to a fully funded defined contribution scheme where individuals make pension contributions as they presently do with their Provident Fund. These are matched by the Government, placed in the individual's interest/profit bearing account and becomes a pension annuity on retirement. Incidently, the present Provident Fund Scheme is also unfunded since the previous governments have used the Provincial Provident Fund contributions to meet current and capital expenditures. The Provident Fund is currently managed on a pay–as–you–go basis with receipts estimated at Rs. 1.3 billion and draw-outs at Rs.1.1 billion budgeted for 1997-98. The total amount of unfunded pension liabilities of existing Provincial Government employees as well as the total unfunded Provident Fund obligations have not yet been made available from the Punjab Government.

Development Expenditures

1.10 The almost negligible revenue surplus left in the Punjab for 1997-98 has meant that if it were not for the fact that Rs.5.6 billion of reserves were drawn down, the Punjab's Annual Development Programme of Rs.19.7 billion would be entirely donor project driven. The IDA/ADB/EUR Social Action Programme (Rs.5.7 billion ADP in 1997-98) which drives 80 per cent of all current and capital expenditure in the Provincial Education, Health and Rural Supply Budgets together with Rs.4.4 billion with other donor funded projects would have meant that Rs. 10.4 billion of Rs. 14.1 billion (72 per cent) available from Federal Foreign Loans for the ADP would be donor driven. In order to free resources for local programmes to reflect the priorities of the new Provincial Government reserves were to be drawn down from Rs.28 billion to Rs.22 billion during 1997/8.

1.11 **The Development Priorities currently are:** (in descending order by resources available) (i) education; (ii) health, (iii) rural water-supply (iv) physical planning and housing (largely urban water supply, sanitation and urban roads and administrative infrastructure); (v) agriculture; (vi) inter-district roads and bridges; (vii) water and power and (viii) rural development. These are summarised in Table I.6 below. In addition, as noted earlier almost all development programmes in urban and rural areas are carried out through the

Annual Development Programme (ADP), Non-ADP Development Programmes for ULBs are budgeted at Rs. 2 billion in 1997-98.

1.12 The two major aspects of concern regarding the way the current Punjab Annual Development Programme is structured are: (i) Foreign donor dependence – particularly since it is in the form of projects with specific project conditionality rather than in Development Funds where there is room for flexibility and innovation; and (ii) Lack of freedom to Local Governments to develop their own investment development programmes.

Table: I.6 Punjab ADP (Development) Expenditures, 1997-98 Budget

Rs. Billion

	Foreign Funded (Aid Donors)	Local Funded (Fed.& Prov.)	Total	%
IDA/ADB/EUR Social Action Prog.	4.5	1.1	5.7	29
(Rural Water Supply)			(2.5)	(13)
(Education)			(2.4)	(12)
(Health)			(0.7)	(4)
Other Foreign Funded Projects	1.8	2.6	4.4	22
Agriculture		1.6	1.6	8
Water and Power		1.1	1.1	6
Roads and Bridges		1.1	1.1	5
Chief Minister's Priority Programmes		1.0	1.0	5
Rural Development		0.6	0.6	3
Physical Planning and Housing		3.0	3.0	15
Others		1.2	1.2	6
Total	6.3	13.4	19.7	100

Source: Government of the Punjab Budget Documents.

Structure of Revenues and Expenditures –Local Levels

1.13 Local Governments raise about Rs.10 billion through their own resources of which they spend Rs.8 billion on current expenditures and Rs.2 billion on capital expenditures (1997-98). They also spend about Rs.2 billion of ADP Funds (1997-98). Within this total, Rural Local Councils (Zila Councils) raise about Rs.4 billion in own resources and usually spend about Rs.1.5 billion on current and Rs.2 billion on development programmes. In 1997-98 they propose to spend Rs.5.8 billion on development but these expanded levels of capital expenditure are unlikely to be realised. Table I.2 (displayed earlier) and Table I.7 below detail these for the Metropolitan

Corporation Lahore, the 7 other Municipal Corporations, the 78 Municipal Committees, the 140 Town Committees and the 34 Zila Councils in the Punjab.

Table: I.7 Punjab Local Council Income and Expenditure, 1997-98

Rs. Billion

	Income			**Expenditure**		
	Octroi/ Export Tax	**Property Tax**	**Total***	**Current**	**Capital**	**Total**
Metropolitan & Municipal Corporations (8)	1.9	0.4	3.4	2.5	1.1	3.6
Municipal Committees (78)	1.0	0.2	2.0	1.5	0.5	2.0
Town Committees (140)	0.3	0.1	0.5	0.3	0.2	0.5
Zila/District Councils (34)	2.3	1.3	4.1	1.5	4.3	5.8
Total:	5.5	2.7	10.0	5.8	6.1	11.9

Source: Government of Punjab, Local Government Department.

Note: Total includes other incomes (tax and non tax) of local bodies.

1.14 The three major sources for the local councils are: (i) Octroi/ Export Taxes (Octrois for ULBs and Export Taxes for RLBs) collected by the LBs through the auction of tax collection with rates set by the Provincial Governments; (ii) Property Taxes (set at 25 per cent of annual rental value with set deductions) collected by the Provincial Excise and Taxation Department and passed on to ULBs/RLBs after deducting 20 per cent and (iii) Property Transfer Fees for ULBs at 5 per cent of the Land/Property value. These account for 90 per cent of their revenues. Other sources of income for ULBs include Fees for bus stands and slaughter houses and some minor local fees/taxes.

1.15 Property Taxes accrue to WASAs in Lahore, Faisalabad, Multan and Rawalpindi in proportion to whether they manage water and sanitation. If they manage both they get the entire 80 per cent, if they manage water only they get 40 per cent (half); and if they manage all the water and half the sewage they get 60 per cent of the total Provincial Property Taxes for the area or three quarters of the distributed amounts.

1.16 Development Authorities realise their income largely from two sources: (i) Commercialisation Fees and (ii) Fines for commercial use of residential zoned property.

1.17 These diffused sources of income and dispersion of expenditure responsibilities across agencies (detailed below in Table I.8) create substantial problems of ownership and management resulting in poor performance. These are discussed further in Section III of this report.

Table: I.8 Punjab Local Bodies Functions and Responsibilities

	Functions	Responsibilities
1.	Curative Health Care	Provinces and ULBs
2.	Land Development	Provinces, ULBs and DAs
3.	Preventitive Health Care	Provinces, ULBs
4.	Primary Education	Provinces, ULBs
5.	Water Supply and Sanitation	Provinces, ULBs, WASAs
6.	Solid Waste Collection	ULBs, WASAs
7.	Street Lighting	ULBs and DAs
8.	Fire Fighting	ULBs and DAs
9.	Parks and Playgrounds	ULBs and DAs
10.	Road Maintenance	Provinces, ULBs and DAs
11.	Building Control	ULBs and DAs

Source: Government of Punjab, Local Government Department.

Authority to Borrow and Structure of Debt

1.18 Borrowing by the Provincial Government is regulated by Article 167 of the Constitution which allows the Provincial Governments to borrow by an Act of the Provincial Assembly. But if these governments have borrowed any amount whatsoever from the Federal Government then they have to obtain its prior permission for any borrowing from any other source. The Punjab floated its last Public Loan in 1994 for Rs.106 million and its total market loan was liability Rs.386 million at the beginning of 1997/1998. The Punjab borrows entirely from the Federal Government either in the form of Cash Development Loans (CDLs) at market rates of interest or obtains foreign (largely concessional loans) through the Federal Government. The total rupee debt outstanding to the Federal Government is Rs.77 billion and foreign exchange debt to the Federal Government is Rs.16 billion. Debt servicing for 1997-98 is estimated at Rs.1.3 billion for rupee loans and Rs.0.1 billion on foreign loans. The entire structure of the debt and the debt service obligations over the next five years have not yet been made available.

1.19 Local Bodies powers to borrow are regulated under Section 133 of the Punjab Local Government Ordinance 1979 which allows them to borrow with the permission of the Provincial Government and also to issue 24 month prommissory notes secured by immovable property or taxes and duties. All Local Bodies and Development Authorities and almost all Statutory Corporations in the Punjab are defaulters to the Federal Government and have not serviced their debt for several years if at all.

Table: I.9 Punjab Government Loans Outstanding to Local Bodies, 1997/98

Rs. Billion

		Principal	Interest	Total
1.	Local Bodies	0.5	1.0	1.5
2.	Development Authority (including WASAs)	9.4	4.6	14.0
3.	Statutory Corporations	6.4	4.4	10.8

Source: Government of Punjab, White Paper on the Budget, 1997-98.

II. The Punjab's Provincial Finances – Proposed Changes

Objectives

2.1 The objectives of a reform of the Punjab's finances should be to: (i) Ensure that the Punjab's finances are healthy enough to bring about accelerated growth in the Punjab and especially the achievement of a range of socially desirable objectives – particularly the provision of education and health facilities; (ii) Make equitable the tax burden across all sections of society and ask consumers of public services to pay for such services if they have the ability to pay; (iii) Transfer to ULB/RLBs/DAs taxation authority for taxes which are intended for them; and (iv) Eliminate taxes which do not raise revenues and only serve as instruments for such collection authorities to extract rent.

Revenue Structure

2.2 The application of the above principles leads to the conclusion that the structure of provincial finances should be confined to the taxes identified in Table II.1 below. The major tax proposed to be added is a tax on services which should be 2 per cent of the final sale value of all goods sold in the Punjab and should be added to the proposed Federal General Sales Tax (probably 8 per cent) to be implemented from July 1999. It could be immediately introduced in all hotels instead of the present occupancy tax. The taxes proposed to be transferred hundred per cent (including collection) to ULBs/RLBs is the Property Tax and the Tax on Professions and Calling Tax. Taxes proposed to be deleted are: (i) Taxes on Hotels (replaced by the 2 per cent Sales Tax proposed above); (ii) Paddy Husking Tax (Rs.55 lakhs in 1997-98); (iii) Education Cess (Rs.45 lakhs in 1997-98); (iv) Tobacco Vending Fee (Rs.13 lakhs in 1997-98); (v) Real Estate Agent Fee (Rs.50 lakhs in 1997-98); and (vi) More than a dozen other taxes each collecting less than Rs.20 lakhs per annum.

Table: II.1 Proposed Punjab Provincial Tax Base

1.	Federally Collected Taxes which are paid by the people of the Punjab Distributed 62.5%: 37.5% between the Federation and the Provinces.	(i)	Income Tax (except on agricultural income)
		(ii)	Customs Duties
		(iii)	Excise Duties (Except on alcohol and Narcotics)
		(iv)	Sales Taxes
		(v)	Capital Value Taxes

2.	Provincially Collected Taxes to be paid by the people of the Punjab	(i) Agricultural Income Tax (ii) Rural Land Transfer Fee (Mutation Fee) (iii) Urban Land Transfer Fee (Stamp Duties) (iv) Excise on alcohol (industrial) (v) Motor Vehicle and Driving Taxes (vi) Electricity Duty (vii) Sale Tax on Services (new)*, including on hotels, restaurants and shops (viii) Cotton Fee

Note: This proposed tax list is exclusive: The proposal is to add only one new tax marked by an asterisk (*) and drop all other taxes from the list of Provincial Taxes.

2.3 The rationalisation and restructuring of the tax structure will lead to a strengthening of the Punjab's financial base. All the taxes which are proposed to be retained or added have historically shown considerable buoyancy. In fact all the above taxes have tax base to GDP coefficients in excess of unity (i..e that tax revenues at existing tax rates will grow at rates faster than the rate of growth of the economy). In addition there is also substantial room in the medium term to expand both the tax rates (i.e. higher taxes) and the tax base (i.e. greater coverage). Thus the Agricultural Income Tax can be moved to assessment of imputed income at Annual Rental Values and taxed at Federal income tax rates. The land transfer fees (both rural and urban) do not presently cover the value of building structures and these can be built into the Land Transfer Taxes. The Motor Vehicle Taxes can be substantially increased for luxury vehicles. The Electricity Duty can be substantially enhanced while the 2 per cent Sale Taxes on Services to be called the General Services Sales Tax can be introduced immediately in the Province starting with hotels as in other countries. As Table II.2 indicates that this would lead to a doubling of the Punjab's tax revenues.

Table: II.2 Financial Implications of Proposed Tax Base and Tax Changes for Provincial Taxes

Rs. Billion

	Tax	Present Base	1997/98 (Budget)	Proposed Base	1997-8 (Impli-cation)
1.	Agricultural Income Tax	Uniform Capacity Tax Rs./acre separate for Irrigated and Non Irrigated and Field Crops and Orchards	1.5	Annual Rental Value	3.0
2.	Land Revenue i.e. Mutation and Other Fees	Value of land	1.3	Value of Land	1.3
3.	Urban Property Transfer-Stamp Duties	Value of Land (Building Societies have own transfer fees)	3.0	Value of land and Building (Building Societies would continue to collect own transfer fees as before)	5.0
4.	Motor Vehicle Related and Driving License Taxes	Engine Capacity	1.1	Value of Vehicle	2.5
5.	Excises on alcohol including industrial alcohol	Sale price for alcohol Nominal for Industrial alcohol	0.5	Sale Price	0.8
6.	Electricity Duty	Unit Charge	1.0	2% of Sale Price including all Federal Taxes and Surcharges	3.0
7.	General Services Sales Tax			2% of Sale Price on all Retail Establish-ments Selling Goods and Services	3.0
8.	(Property Tax)		(0.3)	To be Transferred to ULBs)	(0.0)
9.	Other Taxes		1.3	Other Taxes	(0.0)
		Total:	9.7	Total:	18.6

Revenue Administration

2.4 Revenue administration would be substantially simplified by the adoption of the above changes. The Board of Revenue would be largely unaffected and continue to collect agricultural income tax and 'land revenue' – largely rural land transfer mutation fee – related taxes. It would also collect urban property transfer taxes where applicable but the value of building would now be included according to a set formula. Building Societies and Development Authorities are presently outside the scope of the Board of Revenue and have their own transfer fees. This is only appropriate and should continue. The Excise and Taxation Department would be re-organised and its Property Tax Collection functions transferred to the ULBs and RLBs. It would, however, be given the additional responsibility for the collection of the newly proposed General Services Sales Tax which will be initially on hotels and subsequently added to the Federal Sales Tax when it is introduced.

Expenditure Cost Recovery and Efficiency Gains

2.5 While an effective doubling of provincial taxation proceeds is possible and desirable in the medium term, it must be realised that their ability to finance the Punjab's total current expenditures (currently Rs. 81 billion) will only increase from 13 per cent to 24 per cent. Thus without increasing expenditure cost recovery and realising efficiency gains, no substantial improvement in the overall fiscal situation can be achieved.

2.6 As Table I.3 below indicates overall cost recovery percentages are only 9 per cent for public services directly delivered to consumers excluding general administration and law and order. For Economic Services (Rs. 9 billion in 1997-98) the ratio is 30 per cent; for Social Services (Rs.34 billion in 1997-98) the percentage is 4 per cent, and for Community Services (Rs.4.4 billion in 1997-98) the percentage is 14 per cent.

Table: II.3 Punjab Current Expenditure Cost Recovery Percentages, 1997-98 (Budget)

	Current Expenditure (Rs. Billion)	Receipts from Civil Admn. (Rs. Billion)	Cost Recovery (%)
1. General Administration	10.7	0.2	na
Administration	4.2	0.2	5%
Pensions	6.5		
2. Law and Order	4.4	0.6	14%
3. Community Services	4.4	0.6	14%
Water Supply and Sanitation	0.7		
Others	3.7		
4. Social Services	34.2	1.2	4%
Education	27.6	0.7	3%
Health	5.8	0.3	5%
Others	0.8	0.2	25%
5. Economic Services	9.0	2.7	30%
Irrigation	4.6	1.8	39%
Others	4.4	0.9	20%
Total (excluding Dividend Income and Expenditure, and Pensions)	51.8	5.3	10%
Total (Excluding Gen. Adm and Law and Order, Dividends and Pensions	47.6	4.5	9%

Source: Government of Punjab Budget Documents.

2.7 **General Administration and Law and Order**. The major area here where efficiency and cost recovery factors are directly linked relate to the functioning of the courts. The Judiciary has recently asked for Financial and Administrative Autonomy as is being given to selected Hospitals and Colleges in the Punjab (discussed further below). It is recommended that this be granted. It will lead to more efficient allocation of supporting human resources through ability to 'hire' and 'fire' support staff and services and corresponding efficiency gains in the procurement of material resources (building, infrastructure, equipment, consumables). In addition there will be corresponding increases in Court Fee introduced by the Judiciary itself to meet the costs of litigation and this by increasing transaction costs for the litigants should also help in reducing 'frivolous' or 'non-urgent' litigation and lead to increasing recourse to non-judicial dispute resolution mechanisms which are also desirable in modern civic societies.

2.8 **Economic Services**. The area most amenable to efficiency gains and increased cost recovery is the provision of economic services. This is particularly true of the irrigation sector where cost – recovery factors are 39 per cent of total O & M expenditures of Rs.4.6 billion (1997/98). There is absolutely no justification for this since irrigation water is currently priced at about 20 per cent of alternative tube-well water. These 'rents' are largely expropriated by the Irrigation Department. The creation of Provincial Irrigation Development Authorities (PIDAs) with financial autonomy therefore needs to be expedited. Over all cost-recovery factors for economic services should be in the 80 to 90 per cent range.

2.9 **Education**. The issue of cost recovery in public education in the Punjab which spent Rs.27.6 billion on it in 1997-98 is a sensitive social and political issue. While the cost recovery factor of 3 per cent is low, this is not the relevant issue. The simple fact is that primary education costs the Province of the Punjab Rs.175 per month, secondary education Rs.115 per month and college education Rs.400-450 per month in current expenditure costs alone. If one adds capital costs (depreciation) the costs double. The question that arises is whether the students are getting value for the money that the Government spends on them. Empirical evidence indicates that this is not so. A Survey was conducted last year (1997) by Mr. Shahid Kardar of Systems, Ltd, Lahore involving 6500 Third Grade (Class) students in public schools and private schools charging less than Rs.100 per month. It showed the following results: (i) Public School teachers were paid three times the salaries of private teachers; (ii) A Third Grade level Maths Test administered showed 90 per cent of Private School students passing and only 30 per cent of Public Schools students passing at 33 1/3 per cent Pass Level; and (iii) The same Maths Test administered to the Professors with a 90 per cent Pass Level had 95 per cent of the Private School Teachers passing while only 40 per cent of the Public School Teachers passed. The policy recommendation which follows is obvious. Introduce a Transferable Voucher System at present current cost levels (Rs.175 month for school students, Rs.500 a month for colleges) and allow students to pay with this voucher either at a Public School or College or a Private School or College. While this still meets the subsidy objective it will at least lead to competition, reduce costs and improve efficiency. The reduction in capital expenditures on new educational institutions will be important. However, this will have to be accompanied on the public policy side by making available increased sites for private schools and abolishing the notorious 'commercialisation' fee which is the same whether one constructs a school or a commercial plaza in all urban areas of the Punjab. For the public schools to compete, financial and administrative autonomy will have to be delegated downwards to the institution level. At the college level, there is increased room for cost recovery at elite institutions from rich students. These measures alone should lead to cost-recovery factors increasing to about 10 to 15 per cent in education.

2.10 **Health.** Cost recovery in health (currently at 5 per cent) where the Government spends about Rs.6 billion annually is an equally sensitive issue in the Punjab. Here the Punjab Health Department seems to be taking the right policy decisions by giving financial and administrative autonomy to select Teaching Hospitals. If this is extended gradually to all major public hospitals in the Punjab it will not only lead to greater efficiency but increased cost-recovery, particularly if as planned, hospital doctors can see private patients after hospital hours in hospital premises on the payment of appropriate fees to the hospitals. In the medium term such measures should increase cost-recovery ratios in the health sector from 5 per cent presently to about 20 to 30 per cent in the medium term.

2.11 **Community Services**. This is primarily focussed on the road communication network, government network, government buildings and rural water supply and sanitation. Current cost recovery factors are low at 14 per cent. The use of increased tolls on bridges, etc. and increased cost recovery on rural water supply should lead in the medium term to cost-recovery ratios approaching 30 per cent.

Five Year Financial Forecasts – Surplus Available for Development Expenditure

2.12 It is possible to try to give a quantitative picture to the policy measures proposed above by incorporating these into a Five Year Financial Forecast for the Punjab's Provincial Finances. The proposed policy changes would be phased in over a five year period.

Table: II.4 Punjab Provincial Financial Forecasts, 1997/8 – 2002/3

Rs. Billion
Constant 1997/8 Prices

	No Policy Changes			Proposed Policy Changes	
	1997/8	2002/3	Growth Rate %	2002/3	Growth Rate %
Total Revenues	76.9	79.9	0.7%	84.8	2%
Federal Transfers	66.2	66.2	0%	66.2	0%
Provincial Tax Revenue	9.7	12.4	5%	18.6	13.8%
1997/98 Budget Measures	1.0	1.3	5%		
Net Administration Exp.	73.9	85.7	3%	69.3	-1.3%
Adm. Expenditure	51.8			51.8	
(Education)	(27.6)			(27.6)	
(Health)	(5.8)			(5.8)	
Adm. Income	5.3			9.9	
(Education)	(0.7)			(4.1)	
(Health)	(0.3)			(1.5)	
Debt Service	-1.4	-1.8	5%	-1.8	5%
Provincial & Fed Govt.	0.2				
Interest to Fed Govt.	1.2				
Interest Income	0.3	0.4	5%	0.4	5%
Surplus Available for Develop. Expenditure	-1.9	-7.2		14.1	

2.13 **Implications for Development Expenditures**. The ability to own a current account surplus of about Rs. 14 billion ($ 280 billion) once the proposed policy changes are in place would give substantial flexibility to the Development Planners of the Province of the Punjab. The present scarcity of available resources has meant the adoption of a "triage" policy, i.e. projects at early stages of implementation have been halted in order to finish projects at advanced stages of implementation. The dependence on foreign assistance has also necessitated the provision of excessive counter-part funding as discussed in Section I. With greater availablity of own resources for development, the Punjab will be able to complete all its own projects under various phases of implementation and provide counterpart funding for donor aided projects (but hopefully with more equitable cost sharing arrangements), embark on new projects and also be able to borrow prudently from the Federal Government more foreign concessional loans particularly of the type envisaged for the Municipal Development Fund. Borrowing to set up Funds rather than for specific projects have greater advantage in terms of flexibility of use and the ability to choose the most efficient sub-projects. Given the large volume of development funds tied up in specific programmes (e.g. SAP), it is recommended that future borrowing from foreign donors be restricted to either specific (smaller) projects or for the setting up of Funds, and involvement of foreign donors in 'Province-wide Programmes' should be avoided.

III. The Punjab's Local Body Finances – Proposed Changes

Objectives

3.1 The objectives of reform of local bodies finances are broadly similar to the Provincial level objectives and are intended to: (i) Ensure that the Local Bodies are financially strong and robust so that they can fulfill the responsibilities entrusted to them. These responsibilities for ULBs centre around the development of our urban areas and their maintenance to required standards; (ii) Have equitable distribution of tax burden and cost – recovery for public services particularly water supply and sanitation and maintenance of public roads; (iii) Have Local Bodies achieve control over the administration of taxes linked directly to their responsibilities. This would mean the transfer of 100 per cent of property taxes to the Local Bodies as well as the property tax valuation and collection responsibilities. In addition a new tax on the sale of petroleum products is proposed (1 per cent of price) which would be collected by the petroleum companies through point of sale and transferred to the LBs. This would be earmarked specifically for road maintenance.

3.2 Table III.1 summarises the structure of revenues and expenditures and Table III.2 details the revenue by major source. To recapitulate, the major source of revenues is the Octroi for the ULBs and the Export Tax for the RLBs. The rates for these taxes are fixed on `weight basis' by the Provincial Government (e.g. for wheat at Rs.1.1 per quintal of 100 kgs.) This is followed by the property tax which is collected by the Provincial Government on annual rental value basis and transferred to the ULBs theoretically on population basis after deducting 15 per cent for "collection expenses". In actual fact the property tax is largely expropriated by the WASAs (who take half if they are in the water business and three quarters if they are in the water and sewerage business and who also try to have a separate cost recovery of 100 per cent). Another tax on property is the transfer of property tax which is set at 5 per cent and collected at the time of property transfer in urban areas (a separate stamp duty of 8 per cent and 1 per cent registration fee is also levied by the Provincial Government, and capital value tax of 5 per cent is levied by the Federal Government). There is also a building tax or fee for new construction. Finally there are the water rates or WASA charges and other fees. An interesting aspect of the finances of the Development Authorities which function alongside the MCs and

WASAs is that they get almost 26 per cent of their income from 'commercialisation' charges and 42 per cent of their income from "fines" on properties which are contravening their building usage regulations.

Table: III.1 Punjab Local Body Revenues and Expenditures 1997/98 (Budget)

Rs. Billion

	Resources/Revenues			Expenditure			Surplus
	Total	(Tax)	(Non Tax)	Total	(Current)	(Capital)	Deficit (Rs.Bn)
Total ULBs	9.0	4.4	4.6	9.2	7.2	2.0	-0
Total RLBs	4.0	2.4	1.6	5.8	1.5	4.3	-1.8
Total Local Bodies	13.0	6.8	6.2	15.1	8.7	6.3	-2.0
Metropolitan Corporation Lahore	2.6	1.1	1.5	2.4	2.2	0.2	0.2
(LMC)	(1.2)	(0.9)	(0.3)	1.2	(1.0)	(0.2)	(0.0)
(LDA)	(0.5)		(0.5)	0.4	(0.4)	(0.6)*	(0.1)
(WASA)	(0.9)	(0.2)	(0.7)	0.8	(0.8)	(0.7)*	(0.1)
7 Municipal Corporations	3.4	1.5	1.9	3.7	2.8	0.9	0.3
(MCs)	(2.2)	1.4	(0.8)	(2.5)	(1.6)	(0.9)	(0.0)
(DAs)	(0.7)		(0.7)	(0.7)	(0.7)	(0.9)*	(0.0)
(WASAs)	(0.5)	0.1	(0.4)	(0.5)	(0.5)	(0.5)*	(0.0)
78 Municipal Committees	2.5	1.4	1.1	2.6	1.9	0.7	-0.1
140 Town Committees	0.5	0.4	0.1	0.5	0.3	0.2	0.0
34 Zila Councils	4.0	2.4	1.6	5.8	1.5	4.3	-1.8

Source: Compiled from Government of Punjab Local Government Department and other official Budget Documents. Data for Town Committees relates to actuals for 1996-97. Development expenditures marked with (*) denote financing from Provincial ADPs and amount to Rs.2.7 billion. These are not included in the capital expenditure totals in this table. Including these will increase ULBs capital expenditures to Rs.4.7 billion and total local body capital expenditures to Rs.9 billion. Zila Council Development expenditures budgeted for 1997-98 are about Rs.2 Billion more than 1996-97 actuals and these Zila Councils normally run large surpluses on their accounts.

Table: III.2 Punjab Local Body Revenues, 1997/98 (Budget)

Rs. Million

	Total	Octroi (ULBs) Export Tax (RLB)	Property Tax	Transfer Property Tax	Building Tax	Water Rate	License Fee	Fines	Other
Lahore Metropolitan Corp.	1183	693	95	175	130*	95*	86*		220
Other 7 Metro. Corp.	2709	1237	304	168	129*	95*	85*		1000
78 Munic. Committees	2504	1129	217	208	68	88	245		55
140 Town Committees	510	345	50			28	41		46
Total ULBs	6906	3404	666	551	327	306	447		1321
Lahore Dev. Authority	459						120	195	144
Other Dev. Authorities	700						180*	300*	220
Lahore WASA	863		224			596			43
Other WASAs	500		100			350			50
Total DAs & WASAs	2552		324			946	300	495	457
Total ULBs & Stat Bod.	9458	3404	990	551	327	1252	747	495	1778
34 Zila Councils	4070	2289	1010						771
Total ULBs and RLBs	13528	5693	2000	551	327	1252	747	495	2549

Source: Compiled from Government of the Punjab, Local Development Department and Individual Agency Budget Estimates.

* Numbers marked with asterisks are estimates.

Proposed Changes in Local Government Revenue Structures

3.3 Table III.3 summarises the recommendations of the study. In brief it suggests that: (i) the valuation of properties and collection of property taxes be handed over to the ULBs/RLBs and that the basis of valuation be changed from annual rental value to a value basis and the tax be levied at a very reasonable rate of 0.25 per cent of market value; (ii) the basis of valuation of the new buildings tax also be moved from an arbitrarily determined amount to 0.25 per cent of market value; (iii) water rates be moved so that there is 100 per cent cost recovery of current expenditure plus depreciation; (iv) the professions and callings tax be moved from the Provincial Government to the ULBs/RLBs which should fix the rates and use these proceeds for the welfare of these professions, and (v) that a new tax – the petroleum road users tax-be introduced with a rate of

1 per cent of sales price of petroleum products. This tax would be collected by the petroleum companies and deposited directly into the accounts of the ULBs/RLBs. It's use would be dedicated to the maintenance of urban and rural roads.

Table: III.3 Punjab Local Body Financial Implications of Proposed Tax Changes, 1997/98 (Budget)

Rs. Billion

Tax	Present Base	1997/8 Budget	Proposed Base	1997/98 Implications
Octroi (ULBs)	(Unit Tax Fixed by PG)	3.4	(Unit Tax Fixed by PG)	3.4
Export Taxes (RLBs)	Unit Tax by PG)	2.3	(Unit Tax Fixed by PG)	2.3
Property Tax (ULBs)	Annual Rental Values	1.0	0.25% of Market Value	3.0*
Property Tax (RLBs)	Fixed by RLB	1.0	0.25% of Market Value	3.0*
Transfer of Property (ULBs)	5% of Rated Value	0.6	5% of Rated Value	0.6
Building Tax (ULBs)	Fixed by ULB	0.3	0.25% of Cost	1.0*
Water Rates *(ULBs)	Cost Recovery	1.2	100% of Cost Recovery	2.0*
License Fees (ULBs)	Fixed by ULB	0.8	Fixed by ULB	0.8
Fines (ULBs)	Fixed by DA	0.5	Fixed by DA	0.5
Other, (ULBs)	Fixed by ULB	1.8	Fixed by ULB	1.8
Others (RLBs)	Fixed by RLBs	0.8	Fixed by RLBs	0.8
Transferred from** Provincial Govt.				
Profession & Calling	Fixed by Prov.Govt.	(0.2)	Fixed by ULB/RLB	0.5
New Proposed Tax***				
Petroleum Road User Tax			1% of Sales Price	2.0
	TOTAL ULBs, RLBs	13.1		21.7
	(TOTAL ULBs)	(9.5)		(14.1)
	(TOTAL RLBs)	(4.1)		(7.1)

* Proposed Base Changes in Existing Taxes.
** Transferred from Provincial Government.
*** Proposed New Tax (Revenues of the Petroleum tax are expected to accrue equally to ULBs and RLBs).

Revenue Administration

3.4 It is proposed that the Municipal Corporation as an institution be abolished as an unviable entity (see Section IV), and replaced by Metropolitan Corporations which would now only function as co-ordinating bodies (as in Karachi) and would have within them a number of Municipal Committees (the size of each of which would not exceed 500,000 inhabitants). Also as the Development Authorities develop new areas these would be set up as independent Municipal Committees. Accordingly, the Municipal Committee would now become the prime focus for revenue collection as well as execution of all urban functions except arterial roads and water supply and sewerage (which would be transferred to the Metropolitan Corporation). This would reduce the urban management unit to a manageable size and ensure citizen-local government inter-action. The success of the Cantonment Boards and the Lahore Model Town Society is in great manner due to this size advantage.

3.5 The Municipal Committees (headed by a Mayor) would collect all property taxes including transfer of property taxes and building taxes, license fee and all other minor taxes and fees. The Property Tax staff of the Excise and Taxation Department would be transferred to the ULBs/RLBs (they would, however, retain their status as Provincial Government Employees). These Municipal Committees would have responsibilities for all municipal functions except arterial roads and WASAs (which will lie with the Metropolitan Corporations) and building control (which will lie with the DAs).

3.6 The Metropolitan Corporations (headed by a Lord Mayor) would have under it the WASAs which would function as independent financial entities as is the case with them under the DAs. They would also have responsibility for the maintenance of arterial roads. In addition they will be given the responsibility of preparing and funding special projects for the upgradation of poor areas in their constituent municipalities. To finance these activities they would have control over Octroi receipts which they should collect themselves or auction depending upon their experience with collections.

3.7 The Development Authorities should have responsibility for the development of new housing areas constructed with public funds and their number should be expanded to cover all major towns and municipal committees. While the building control authority should be retained with them it is proposed that their 'dependence' on 'fines' and 'commercialisation fees' be stopped by placing these receipts in a Development Fund for the Authority which should only be used for Development activities and not finance their current budget as presently. They should be financed directly from the Provincial Budget and be placed under the financial control of the Local Government Department.

3.8 As has been pointed out in the first section, the fact that Local Government Service is not attractive has meant that ULB/RLB employees are demoralised. This is particularly so with regard to pensions where Local Government teachers in primary schools are deserting their place of work in droves and there is tremendous pressure to hand over the Primary Schools to the Education Department. It is proposed that all Primary Schools be retained by the Municipal Committees and that all employees of ULB/RLBs have equal employment conditions to Provincial Government employees including the proposed new Pension Scheme.

Expenditure Cost Recovery and Efficiency Gains

3.9 Local Government Institutions world-wide generally try to meet cost recovery targets for direct consumer services rendered—mostly water supply, sewerage and sanitation. For other services (primary schools, health, roads, lighting, parks etc) they generally balance aggregate income against aggregate expenditure (both current and development),. The Punjab Government's Local Government Expenditures on a functional basis are available only for a sample of the Municipal and Town Committees and are reported in Table III.4.

3.10 Water supply and sewerage cost recovery rates on current expenditures for the WASAs range between 80-90 per cent (with the Lahore WASA at 88 per cent and the other WASAs at 80 per cent). However, the Municipal Committees which run their own water supply and sewerage schemes appear to be recovering current costs. Cost-recovery rates for the town committees are poor and average 44 per cent for the 10 town samples. Visits to the sample towns studied indicated that water-rates can be doubled or tripled and in towns where this has been done there has been no significant adverse citizen reaction. It is therefore proposed that cost recovery rates for water supply and sewerage be moved upto 100 per cent including depreciation.

3.11 The best way to get efficiency in local urban services is to involve the citizens and let them deal with local bodies of a size where they can get some attention and satisfaction by virtue of the fact that they are tax payers and voters. Smaller local sized units would also mean greater citizen involvement in local schools, hospitals, roads, lighting and parks. This is the reason for the strong Municipal Committee Level Government proposal for all urban areas.

Table: III.4 Punjab Local Government Expenditure Patterns, 1997/8 (Budget)

Rs. Million

	Municipal Committees		Town Committees	
	10 M.Committee Sample	%	10 Town Sample	%
Revenue Expenditure	285	100	66	100
General Administration	33	12	20	30
Primary Education	71	25	-	-
Sanitation	49	17	15	23
Medical Care	5	2	3	5
Water Supply & Drainage	43	15	8	12
Roads & Street Lights	69	24	5	8
Others	15	5	15	22
Development Expenditure	133	100	24	100
Primary Education	6	5	-	-
Sanitation	14	11	2	8
Medical Care	3	2	-	-
Water Supply & Drainage	23	17	5	21
Roads & Street Lights	41	30	9	38
Others	46	35	8	33

Source: Lahore School of Economics Survey-Sample Municipal Committee and Town Committee Budgets.

Table: III.5 Punjab: Water Supply and Sewerage Cost Recovery Percentages 1997/8

	%
Lahore WASA	88%
Other WASAs	80%
Municipal Committees (all)	117%
Town Committees (sample of 10)	44%

Note: Cost Recovery data above refer to current income and expenditures and exclude depreciation.

Source: Government of Punjab , Local Govt. Department and Agency Budgets

Five Year Financial Forecasts – Surplus Available for Development Expenditures

3.12 A quantitative forecast on the basis of the financial and cost recovery proposals for ULBs/RLBs made in this Section is summarised in Table III.6 below.

Table: III.6 Punjab Local Government Financial Forecasts 1997/8 – 2002/3

Rs. Billion, Constant 1997/8 Prices

	No Policy Changes			With Proposed Policy Changes	
	1997/8	**2002/3**	**Growth Rate**	**2002/3**	**Growth Rate**
Total Revenues	13.6	16.6	5%	21.2	9.3%
1. ULBs	9.5	11.6	5%	14.1	8.2%
2. RLBs	4.1	5.0	5%	7.1	11.6%
Net Administrative Expenditure	8.7	12.7	10%	10.8	4.4%
1. ULBs All Services except Water Supply & Sewerage	5.9	8.6	10%	8.6	10%
2. ULBs Water Supply & Sewerage	1.3	1.9	10%	0.0	
3. RLBs All Services	1.5	2.2	10%	2.2	10%
Surplus Available for Dev. Exp.	4.9	3.9		10.4	
1. ULBs	2.3	1.1		5.5	
2. RLBs	2.6	2.8		4.9	

Implications for Development Expenditures

3.13 The availability of funds for development expenditure will be vastly improved by the proposed policy measures. It is estimated that when these fiscal reforms are implemented the ULBs would have annual surplus available for development of about Rs.8 billion ($ 180 million) per annum while RLBs would have development surplus of about Rs.6 billion ($ 130 million) available annually and these surpluses would be maintainable over the next five years.

3.14 The availability of these surpluses should allow much greater flexibility to ULBs/RLBs to carry out development activities in response to their citizen's requirements. It will also enable the ULBs/RLBs to be credit – worthy to borrow from the Provincial Government and other sources, particularly the proposed Municipal Development Fund.

IV. Governance Issues – Proposed Provincial and Local Body Responsibilities

Background and Issues

4.1 There are two major sets of interlocking issues of governance regarding the Provincial -Local Body relationship. The first relates to the division of fiscal and administrative responsibility between the Provincial and Local Governments and the structure of such Local Governments. The second relates to the management within these Local Governments of various responsibilities such as education, health, sanitation and overall development. The first of these arise largely from the fact that the Pakistan Constitution while recognising the need for 'Local Government' does not spell out the division of responsibilities between the Provincial and Local Governments; nor does it lay down the political, administrative structures relating thereto. In Pakistan, and in the Punjab, the current Local Body structures are primarily established by the Local Government Ordinance 1979 promulgated by the Martial Law Government of the then President General Zia-ul-Haq which modified previous Local Government Legislation. This Ordinance currently governing present local government structures creates and spells out the areas of responsibilities of the four tiers of the ULBs – Town Committees (upto 25,000 inhabitants), Municipal Committees (25,000-5,00,000 inhabitants); Municipal Corporations (5,00,000 – 2,500,000 in habitants) and Metropolitan Corporations (above 2,500,000 inhabitants). Punjab presently has one Metropolitan Corporation (Lahore); seven Municipal Corporations (Faisalabad, Gujranwala, Multan, Rawalpindi, Sialkot, Sahiwal and Sargodha), seventy eight Municipal Committees and 140 Town Committees. The law also specifies the manner in which the rural areas of the administrative districts – the Zilas (of which there are 34 in the Punjab) – come under the preview of the Zila Councils. This Local Government Ordinance 1979 was attempted to be amended during the last government but these amendments were not ratified by the Provincial Assembly. However, last year the present Provincial Government amended the law to allow the creation of mayoral divisions within metropolitan corporations of the Punjab and was an extension of the successful adoption of a system of 'district municipal committees' within the Metropolitan Corporation of Karachi.

4.2 Within the local governments there are a multiplicity of institutions at work. In the ULBs the larger cities have Municipal Bodies (Metropolitan and Municipal Corporations), which run existing infrastructure, Development Authorities which develop new infrastructure and urban areas, and Water and Sanitation Agencies (WASAs) which run these facilities. The smaller cities and towns perform all these functions themselves. Within all the ULBs Provincial Government Departments carry on administrative, taxation and development activities. However, it is in the Zila Council areas that Provincial Government Departments (like the Public Health and Engineering Department responsible for water supply and pollution controls) carry out the dominant functions. The rationalisation of responsibilities between various tiers of Government and between various agencies needs to be addressed.

4.3 A complicating factor regarding governance in urban local bodies relates to the fact that the cities and town have seen a doubling of their population every ten years, particularly in the last three decades as the rural populations (mainly the poor) have streamed into the cities. These new urbanites carry political clout in their voting power and in fact now exercise almost all the crucial swing votes in urban elections, not only in the outlying areas but also in areas under the control of the urban body itself. These new urbanities have different objectives and priorities relating largely to the development of the *Katchi Abadies* and poorer areas which the present system is very poorly positioned to deliver.

Assessment of Existing Institutions

4.4 The existing institutions for the big cities function in a complex manner. The civil jurisdictions lie with the (soon to be) ULBs. The responsibilities for development of new areas is with Development Authorities of which the Chairman is the Chief Minister for Lahore and the Minister of Local Government is the Chairman for the rest. However, once the areas are developed these are passed on to the ULBs excepting the power of building control which remains with the DAs (this is their biggest source of revenue and 'political' power). The water supply and sewerage functions are increasingly with the WASAs which expropriate 50 per cent to 75 per cent of distributed property tax revenues in addition to cost recovery to finance these activities.

4.5 An assessment of performance (both through consumer and control body interviews and by looking at quantitative data) indicates that the Water Supply and Sewerage functions by the WASAs are carried out very poorly. This compares with the comparatively much better (but still poor) solid waste collection performance undertaken directly by the ULBs. The difference in performance relates directly to the fact that WASAs are not accountable – being placed organisationally under the DAs but only nominally – being financially and administratively independent.

4.6 The Development Authorities are by and large doing a good job in developing new areas although, with the increased cost of land and development by private building societies, their scope of activities is relatively restricted. However, their attention is now being focussed instead on new development on building control which has come under intense pressure as commercial activities mount. Both for financial reasons (42 per cent of income of LDA comes from fines on violation of building regulations and 26 per cent from commercialisation) as well as for administrative reasons (the sheer volume of work and the political power and corresponding 'rents' by these policing activities) the DAs have now been reduced largely to 'commercialisation agencies'.

4.7 The ULBs/RLBs themselves also face immense problems of governance. Since these are political bodies, major sources of revenues and expenditure are generally 'sold' to politically influential individuals or benefit the elected (and when these are administrators – the non-elected) managers of the cities, towns and rural bodies. While there are many honest politicians and administrators their ability to serve or be elected in the complex urban environment (with more than 50 per cent of the population being the new poor urbanites as was discussed earlier) is increasingly in doubt. This is particularly so because the smaller unit – the Ward of the ULBs have no financial and administrative power. In the Municipal Corporations it is common practice that at the first meeting of the Corporation the Mayor has a resolution passed that delegates to him all the powers of the elected body. After this first meeting no other meeting is called and all important decisions regarding octrois, development expenditure, etc. are taken by him and a few powerful political associates. When there are no elected bodies the situation is even simpler. Normally a non-civil servant (generally a political appointee representing the choice of the party or individual in power) is appointed to run the Municipality with all the powers concentrated in his person.

The Position of the Citizens and the Taxpayers.

4.8 In this situation the urban citizen and particular the property tax payer is reduced to the role of a helpless onlooker who gets sub-standard or no service for civil amenities which other societies take for granted. This is particularly hurtful to the property tax payer who pays very high taxes and gets nothing in return. In other societies (e.g. Canada) this problem has been addressed by allowing only property tax-payers to vote in local body elections. In the Pakistan context, this proposal would be too extreme (there are only 160,000 property tax payers amongst the more than one million voters in Lahore) and would not meet the social and political requirements of the present situation where the situation calls for empowerment of all sections of society.

Policy Recommedations

4.9 It is recommended that the Pakistan Constitution be amended to provide for the formal third tier (after the Federal and Provincial) of Local Government and specifying its areas of revenue raising and administrative responsibilities. The Indian Constitution which also suffered from not having such a defined structure of Local Government has been recently amended to provide for such a tier. The Punjab Government should examine the Indian Amendment and after improving on it in the light of the Punjab's own experience, pass it on to the Federal Government for discussion between the Federation and all the Provinces and, hopefully, subsequent enactment.

4.10 In the meantime, a Provincial Finance Commission should be established. It should be chaired by the Chief Minister and have representatives of both the Province and Local Bodies. It should meet every five years (like the National Finance Commission) and after reviewing the financial position of the Province and the Local Bodies, allocate both taxes and transfers (including borrowing and grants) between them in the light of expenditure responsibilities.

4.11 The tier of Municipal Corporation should be abolished to bridge the gap between the citizen and the city government. All cities should have one or more Municipal Committees (Municipalities) of sizes of less than 5,00,000 inhabitants. These Municipal Committees should retain all property taxes and all other local taxes and be responsible for all civil amenities except water supply and sewerage (but including solid waste disposal).

4.12 Towns with more than one Municipal Committee should become Metropolitan Corporations. The Metropolitan Corporation would collect Octrois which would be its sole source of income (in smaller cities, i.e. less than 5,00,000, the sole Municipal Committee or Town committee would collect the Octroi). It should be responsible for all arterial infrastructure particularly major roads and water supply and sewerage. All existing and potential WASAs should be transferred to these Metropolitan Corporations. The recent amendments by the present Provincial Government creating a Lord Mayor and allowing for the Metropolitan Corporation to be split into Municipal Areas reflects this aspiration. By abolishing the tier of the Municipal Committee the present legislation may still serve, otherwise it should be amended.

4.13 The Development Authorities are a very useful instrument of development policy and should be introduced in all the big cities. They should perform only development functions. WASAs should move to the Metropolitan bodies as proposed above immediately. In addition they should transfer all new developed areas to a newly created Municipal Committee for that area so that the inhabitants of the newly developed area can function as a civic society. Finally, in order to get rid of their `commercialisation culture', their administrative budgets should not be allowed to use 'fines' on violation of commercialisation rules or 'commercialisation fees' as sources of revenue for administrative expenditure. These should accrue directly to a Special Development Fund for the Development Authority and should be used only for the development of new areas. The administrative cost of the Development Authority should be met from the Provincial Budget and the Local Government Department should be the financial authority for such Development Authorities.

V. Conclusions

5.1 The credit worthiness of the Punjab Government (subject to its undertaking the proposed fiscal reform measures) has been established. It is potentially in a position to generate financial surpluses for development (and the servicing of borrowing) of about Rs.15 billion ($ 330 million) annually, constant 1997/8 prices, from the time when the fiscal reforms are implemented. This will enable it to be in a position to take on and service the external debt of about $ 200 million annually on concessional IDA terms. The exact sequencing of the additional debt and debt service will depend on the pace at which it can undertake the proposed fiscal reforms.

5.2 Similarly, the proposed fiscal reform package for the Punjab ULBs should generate an additional Rs. 5.5 billion ($ 110 million) annually. This will enable them to take on external debt of about Rs. 50 million annually on concessional IDA terms from the time the proposed reforms are in place. The pace of the proposed local body finance reform will, as in the case of the provincial level finances, also determine the exact pace at which these ULBs can take on debt.

Science and Economic Development Conference
Science & Technology to Support Pakistan's Economic Development

The Conference Report

Irfan ul Haque

Introduction

A conference on **Science and Economic Development** was held at Hotel Pearl Continental, Lahore on 1-2 December, 1997. The event was sponsored and organised by the Lahore School of Economics. The World Bank provided a grant to help meet the cost of participant travel and subsistence.

The conference brought together Pakistan's leading businessmen, scientists, engineers, and economists to discuss and develop ideas on how to improve Pakistan's state of science and technology (S&T) capabilities with a view to accelerating the country's pace of economic development, strengthening its competitive position in the global economy, and preparing it for the challenges of the 21^{st} century.

The conference calendar and the list of participants can be found in the Annex.

Background

While the importance of S&T in the long-term development of Pakistan's economy has been widely recognised, there is a general consensus that the current state of the country's S&T capabilities is seriously deficient. Over the years, official reports and articles by Pakistan's leading scientists and other concerned academicians have bemoaned the sad plight of S&T in Pakistan.[1] But there has so far been no palpable improvement.[2]

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[1] Perhaps, no one strove harder than the late Professor Abdus Salam to promote science in Pakistan. An excellent overview of the state of S&T in Pakistan is provided in his *Science and Education in Pakistan*. 1988. The Third World Academy of Sciences. Triest, Italy. It is a reflection of the limited progress that despite the lapse of a decade since its publication, this work still remains highly relevant. The latest in official reports is the *Final Report* of the Prime Minister's High Level Review Committee on Science and Technology, 30 July, 1996, which provides a sobering and painstaking analysis of S&T in Pakistan. A good overview is also given in Ehsan Masood, "Imprisoning the beams of the Sun", *Nature*, the Supplement on Science in Pakistan, 24 August, 1995, Vol. 376.

Among the reasons for the lack of progress, the following three factors seem to have been decisive:

- The promotion of S&T in Pakistan, as in most other developing countries, has been held to be almost exclusively the government's responsibility, even though it has been evident that the government had neither the political will nor the administrative and financial resources to carry out the task on its own.
- The state of S&T has not been recognised as one of the central issues in the discussion and formulation of Pakistan's development plans and economic policies. Pakistan's *Five-Year Plans*, for example, have paid no more than lip service to S&T.
- Pakistan's business community has shown little appreciation of the importance of S&T for economic advancement and international competitiveness, and has not actively participated in the discussion and formulation of the country's S&T policy.[3] This has meant virtual exclusion from policy-making of potentially the principal source of demand for science and technology.

Science through enhancing Man's understanding and command of his physical environment and through conceptualisation of engineering laws and principles, provides the underpinnings for technological progress. If Pakistan is to get on to a path of rapid growth and begin to catch up with the more advanced countries—which seems to be a national aspiration—then there is an urgent need for a fundamental rethinking on the role of S&T in our society and daily lives.

The basis of long term growth and the rise in living standards of a country is technological progress, involving the introduction of new and improved products and more efficient production processes over time. This is as true of agriculture as industry. Feeding a growing population requires continuously raising agricultural productivity. Competing in the world market of manufactures requires producing quality goods at competitive prices, involving continual innovation and improvement in industrial efficiency.

The 50th anniversary of Pakistan's independence from colonial rule provided an opportune time to seek to renew the nation's commitment to

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[2] Defence research has been a significant exception.

[3] A significant exception has been the above-mentioned *Final Report.* A number of Pakistan's business leaders contributed to the deliberations of the Committee charged with the preparation of the report.

the promotion of S&T, and to work on a strategy that indeed could help in turning Pakistan into a dynamic economy, drawing on the experience of the successful Asian economies, and embarking on a path of accelerated long-term sustainable economic growth. With the government's resources severely constrained and policy shifts in favour of the market and the private sector, the new strategy clearly would have to rely heavily on the drive and initiative of Pakistani business.

The conference on **Science and Economic Development**—by bringing together the nation's business leaders, scientists, engineers, and economists—was expected to play the role of a catalyst in forging a new approach to the promotion of S&T in Pakistan. It was seen by its organisers as a forum that would contribute to the definition and development of a business-centred strategy for the promotion of S&T capabilities and capacities in Pakistan. Specifically, the conference sought to engage and involve the business community in shaping a new S&T strategy, as it is ultimately businesses that must become the principal source of demand for scientists and engineers. By bringing in some of the key policy-makers, it was hoped that the issue of S&T development would become central to the definition of a policy-framework for the long-term economic growth of Pakistan. The goal was to arrive at a set of actions that the participants would be expected to pursue to carry out the conclusions reached at the conference.

The Conference Format

The conference had as its participants leading Pakistanis who have, through their work, contributed to the development of our country. The participants—business people, scientists, engineers, and economists—were invited to the conference for their known interest in the promotion of science and technology in Pakistan and for their ability to do something about it. It was understood that their attendance signified that they shared the belief that, despite Pakistan's many problems and handicaps, individuals could make the difference and bring about social and economic change. This spirit is captured quite nicely in the words of Margaret Mead, the renowned anthropologist:

"Never doubt that a small group of thoughtful, committed citizens can change the world; indeed, it's the only thing that ever has."

The conference format was designed to ensure active participation and to draw on the participants' wisdom, knowledge, and experience. With the exception of the opening statements and keynote address, no formal lectures or presentations were organised. Only a limited amount of background reading material was distributed. The participants were, however, encouraged to share their own writings on the promotion of S&T in Pakistan. The heart of the conference, however, was discussions within four small groups, which were constituted on the basis of what were deemed to be the key issues in the development and promotion of S&T in Pakistan. The selected issues were:

- What steps could be taken to foster closer collaboration among businesses, scientists, engineers, and economists in the promotion of S&T
- What steps were required to help Pakistan leapfrog in the achievement of S&T capabilities
- What kinds of S&T capabilities Pakistan needed to promote as it enters the 21st century
- What could be done to improve the number and quality of scientists and engineers in our country

Each Group had a Chairman, a Rapporteur, and three Lead Speakers. The Lead Speakers' task was to initiate the discussion by laying out the principal issues. The goal was for the group to agree on a programme of action as a follow-up to the conference. The participants were urged to concentrate on what the participants themselves could do, rather than making recommendations for the government.

A Summary of Proceedings

Plenary Sessions

The first session of the conference, which was held on the evening of 1 December, 1997, was in the nature of a `warm-up' exercise. After the formal opening, the participants introduced themselves and indicated their expectations from the conference. This session also commemorated the contribution of the late Professor Abdus Salam to the promotion of science and technology in Pakistan. Dr. Abdullah Sadiq, Director General, Centre for Nuclear Studies, Islamabad, paid a tribute to Professor Salam and reminisced about his contacts with the famous physicist. This was followed by similar reminiscences by other participants.

The keynote address was given by Mr. Safi Qureshey, CEO Emeritus, AST Research Inc. Mr. Qureshey underscored the need for spreading educational opportunities in Pakistan and making the population better informed and educated. In today's world knowledge has become a crucially important factor of production. He also exchanged with the participants ideas on how Pakistan might tap the large reservoir of world class scientists and engineers living overseas. He was of the view that a large number of overseas Pakistanis were eager to serve their country, but mechanisms needed to be established to make it possible for them to do so. There was considerable interest in developing information on the availability of such resources. The experience of the successful countries of East Asia in this exercise could provide invaluable insights into what may and what may not work in the context of Pakistan.

Mr. Ahsan Iqbal, Minister of State, etc., spoke next morning on the requirements for science and technology as Pakistan prepares itself for the 21st century. He outlined the Vision 2010, and underscored the need for more widespread education. Mr. Iqbal also returned to preside over the concluding session where the group reports were presented.

Group Discussions[4]

Group 1. Making the Connection

If science and technology are to support Pakistan's economic development, there must be a much closer co-ordination of economic policy, with a focus on the objective of balancing the sources of supply (scientists and engineers) and demand for S&T capabilities (mainly the business sector). The institutional setting of how different agents—businesses, policymakers, researchers—interact to generate and manage technological change has come to be called the *national system of innovation.* This system needs to be defined and developed in Pakistan to support the national aspiration for accelerated economic growth.

The group "Making the Connection" had as its task to identify and develop the means for closer working relationships among Pakistani businesses, scientists, engineers, and economists in the promotion of S&T. The issues that the *Group* discussed included the following:

1. What may be done to promote collaboration between Pakistani businesses and the domestic scientific and engineering community to direct R&D in their spheres of interest?

2. What may be done to improve the consultative mechanisms so that Pakistan's policymakers, in designing economy policy, take account of the implications for the development of S&T capabilities? How can the Pakistani business involvement in the country's national development be fostered?

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[4] The following sections are based on the reports prepared by each of the four groups.

3. What may be done to increase contact/interaction with the community of business persons, scientists, engineers, and economists living outside Pakistan?

4. What is the feasibility of creating a non-governmental network of concerned Pakistani business people, scientists, engineers, and economists who wish to collaborate in the promotion of S&T in Pakistan? Could such a network (let us call it Network to Promote S&T, or Net-POST for short) become influential in redirecting government policy and mobilising resources for the promotion of S&T capabilities?

5. If Net-POST is deemed to be feasible and desirable, what may be its principal tasks and how might it be created?

6. What steps may be taken to reach those businesses, scientists, engineers, and economists who were not present at the conference? How can the awareness of the need for S&T capabilities be fostered among Pakistani businesses?

The *Group* sought to identify the actions or approaches that would facilitate continuing interaction and cooperation between industry and the academic and R&D institutions. It was also deemed important to establish linkages with oversees Pakistani organisations to tap the engineering and scientific resources available abroad. The *Group* underscored the need to obtain a reliable estimate of this resource and to develop approaches for local existing industry to benefit from it.

The *Group* recognised the desirability of establishing **Net-POST**, and proposed the appointment of a small *working group* of experts—drawn from the community of Pakistani businesses, economists, and scientists and engineers—who would be given the task of formulating the Terms of Reference for the proposed network, defining its structure, scope, objectives and the framework of its operations.

The small *working group* was envisaged to undertake the development of an information base on overseas Pakistanis—their skills, education, and qualifications—who are willing and able to contribute to the development of Pakistan. This information could be built up with the help of overseas Pakistani societies or professional organisations. In order to carry out its task, the working group would be expected also to take stock of the available local R&D capacities of the existing government, private, and university research centres. Ultimately, the Net-POST would be expected to facilitate the process of matching the industry's needs for

S&T inputs and the resources available, domestically and abroad, to the country.

Without prejudicing the task of the proposed working group, the *Group* concluded that the Net-POST would be dedicated to promoting the interaction among Pakistani business, education, and industry to ensure demand driven technology development and absorption. It could do so by making known to industry, through seminars, reports, or other means of publicity, the work programme and output of local research institutes. It could also organise seminars and conferences at Pakistani universities, colleges, or even schools to expose them to the needs of business and industry. Equally important would be assistance and advice on how local R&D institutions could market their services to industry. To facilitate interaction and the exchange of information, establishment of a website on the Internet would be indispensable.

The Net-POST could also help in the induction and adoption of new technologies by Pakistani industry, through fostering a business culture that recognises the importance of science and technology. One member of the Group pointed out that the smuggling of appliances and consumer goods was a major reason why private sector investment in domestic R&D was discouraged. The creation of a new culture of S&T in Pakistan would not materialise without building trust between industry, academia and research institutions. There is a need for wider dissemination of the stories of success—such as GIK materials laboratory, HEJ institute, and UET high voltage laboratories—that highlight the benefits of demand driven services and interaction for mutual benefit.

The *Group* felt that the proposed Net-POST should in the end lead to the establishment of a formal, broadly-based association, Pakistan Technology Board, that would provide for linkages and interaction with the government, policy makers and serve as a forum that facilitates the participation of engineers, scientists, economists, academics, business and industry. There was a proposal for the establishment of PTB in 1995, but did not receive the official approval. The Group felt that the Net-POST could provide the foundation for the setting up of the PTB in the private sector.

Group 2. S&T Leapfrogging

Pakistan cannot emerge as a dynamic and internationally competitive economy without considerable investment in building local capabilities to generate and manage technological change, which are at present totally inadequate to meet the challenges of the global economy. The pace of technological change in Pakistan (as, for example, measured by the growth of labour productivity) compares very poorly with the performance of some of its competitors in Asia. This is the principal explanation for Pakistan's slow economic growth and faltering performance in the world market. The traditional approach to building technological and scientific capacity, which relies on spreading education and building R&D institutions, will yield results too slowly, and Pakistan in the meantime will have fallen further behind the more advanced developing countries, not to mention industrial countries. If the country is to catch up with the more advanced developing countries, shortcuts to develop local S&T capabilities and to lay the foundations for a robust national system of innovation will have to be taken to enable the country to leapfrog to the technological demands of the 21st century.

The *Group* was asked to deliberate on the following issues and arrive at recommendations on steps to be taken:

1. Pakistan has not only fewer scientists and engineers per capita than the rapidly growing economies, the available S&T capabilities are of indifferent quality and are being poorly used. What may be done to remedy this situation? What may be done to improve the quality and relevance of our R&D?

2. Since the financial resources for promoting S&T in Pakistan are unlikely to increase significantly in the near future, what criteria may be applied to use the available funds most effectively?

3. What is the scope of using defence research for civilian purposes?

4. How best can we take advantage of the few world class Pakistani scientists and engineers (living in Pakistan or abroad)? Should elitism in S&T be fostered, even as a short-term palliative?

5. One positive aspect of globalisation is that it has increased the opportunities for interaction among the world's scientific and engineering community. What can Pakistan do to derive maximum benefit from this interaction? What is the scope of exploiting such low-cost means of communication as the Internet?

All the members of the *Group* agreed that industrialisation is crucial to Pakistan's economic development. However, industrialisation requires a literate work force, qualified technicians and engineers, and a professional management backed by active research and development institutions. A major reason why the state of science and technology in Pakistan has remained unsatisfactory is that neither the government nor industrialists have been able to create a robust R&D infrastructure. It is difficult to speak of a national system of innovation in Pakistan. But there are a few bright spots in the R&D effort. One example is the laser group in Islamabad (headed by Dr. Shaukat Hameed Khan, one of the *Group's* members), which has successfully developed the expertise, personnel, prototypes and manufacturing facilities for laser devices needed by the defence establishment. Such experiences have lessons for other fields as well.

Various speakers, especially those from industry, pointed out that contrary to popular belief, the Pakistani low-wage does not offer much of a competitive edge to manufacturers over rivals in other developing countries, because of low labour productivity. The main cause of low productivity is the workers' low level of education. The Pakistani education system neither imparts relevant knowledge and appropriate skills nor does it inculcate a professional attitude towards work. It was, therefore, considered imperative that Pakistan's education system be thoroughly overhauled and reconstituted along modern lines. The education system must produce a literate work force, equipped with relevant knowledge, skills and a scientific approach to work.

The *Group* felt that the use of new information technology and multimedia may help to alleviate the shortages of well qualified teachers at college and university level. This will include LAN (Local Area Network), NWN (Nation Wide Network) and Internet; local area television and CD-ROMs. Although, the state will have a crucial role in the promotion of science and education in the short term, the initiatives of the private sector and NGOs could play a far more important role in the long term. The *Group* suggested the setting up of a committee of concerned citizens--comprising educationists, scientists, engineers, entrepreneurs, professionals and leaders of public opinion—that could help to create an awareness among the public of the importance of education in general and of technical and scientific education in particular in Pakistani society.

Group 3. Pakistan in the 21st century

This group was asked to develop ideas on the orientation of the S&T capabilities that Pakistan would require to meet the challenges of the 21st century. A forum, consisting of business leaders, scientists, engineers, and economists, is ideal for examining trends in the global economy and the impact of scientific and technological developments, foreseen or those that have already occurred. This discussion could suggest priorities in the development of S&T capabilities.

Since Pakistan's financial and administrative resources for the promotion of S&T are unlikely to increase significantly in the foreseeable future, priorities in the development of S&T capabilities assume a central place. At the same time, the role of private business in the promotion of S&T is bound to increase over the coming years. This role would be better performed against a perspective of global economic, commercial, and technological trends. In particular, the *Group* was asked to consider the following issues.

1. In what ways does the economic structure need to change if the pace of economic growth in Pakistan is to accelerate? Pakistani economists and politicians have been arguing for the promotion of high value-added lines of production. What does this mean in terms of the industrial orientation of the Pakistani economy?

2. Can such restructuring take place by relying on market mechanisms alone? If government interventions are needed, what options does Pakistan have in the face of WTO regulations?

3. There is hardly a country in the world where economic restructuring has occurred without very close collaboration between the government and private business. What are the prospects of Pakistan Inc. emerging?

4. Economic restructuring would of course necessitate the development of suitable S&T capabilities. What steps may be taken for a better linkage between economic restructuring and the promotion of S&T.

The *Group's* discussions emphasised the differences between the methodologies of science and technology. While science can grow in quantum leaps, technology grows incrementally. Technology is about the application of science, specifically to solve identified problems. The promotion and application of technology entails the development of physical, managerial, and human resources. It needs to address areas of both existing and potential competitive advantage. The development and delivery of technology requires the rationalisation of existing technology institutions in Pakistan, strengthening their links with the universities, and forging close relationships with domestic businesses and industry.

Technology must also address the new challenges arising out of changes in the global market, taking into account the outcome of negotiations/discussions in such world fora as the World Trade Organisation (WTO) and World Intellectual Property Organisation (WIPO).

The *Group* agreed on a programme of action which its members hoped to undertake themselves. This programme was intended to take advantage of the *Group's* composition, that included leaders from Pakistan's leading R&D institutions, academia, and industry. The action programme would consist of:

- Popularising the interest in S&T among the youth of Pakistan.
- Reviewing the existing policies and incentive mechanisms that promote or retard S&T capability and application.
- Supporting the application of scientific management.

Helping to rehabilitate the existing Centres of Higher Learning (notably, the University of Engineering and Technology and the University of the Punjab), including depoliticising them.

Group 4. Science and Engineering Education in Pakistan

No country has developed without an adequate supply of high-level scientists and engineers. While Pakistan is lagging behind in terms of both quantitative and qualitative indicators, there is also the problem of unemployed scientists and engineers. To the extent that this is the result of poor quality or an unsuitable mix of available skills, simply increasing the quantity of science and engineering graduates will not improve the situation. There is, therefore, a need to develop ideas on how educational institutions may respond better to the emerging requirements for scientists and engineers.

This *Group* was assigned the task of developing ideas on what steps might be taken to increase the number and improve the quality of scientists and engineers being produced in Pakistan. In particular, the *Group* was asked to consider the following issues:

1. To what extent has the establishment of private educational institutions helped or worsened the quality of science and engineering education?

2. Low-cost, affordable university education has been the principal means for the children from low-income families to move up the economic ladder. How is private education fulfilling this social goal?

3. Are the best brains of Pakistan still choosing science and engineering fields? Does the growth of business administration schools suggest a shift in market demand conditions?

4. What measures may be taken to increase the number of students going into science or engineering fields? Is the constraint one from the supply-side of educational places or demand-side?

The *Group*, in its discussions, focused on natural sciences, technology, computer sciences, and engineering. Their central recommendation was the establishment of an association of private and public sector academic institutions that would co-ordinate and improve the functioning of the private academic and research institutions. Among its tasks, the association would develop a ranking system or criteria to evaluate the quality of academic institutions and devise a system for allocating endowments, grants, or financial gifts among different institutions and purposes. The *Group* proposed that each university campus should be treated as an individual institution for academic purposes. But a quality assurance system should be developed along the lines of the ISO-9000 system for both private and public sector academic institutions.

In order to make private sector education more widely accessible, the *Group* proposed that at least 10 per cent of the fees should be allocated to qualified, but needy students. No student should ever be refused admission on financial grounds alone. Private institutions should also develop programmes of student loans, on-campus jobs, job placement, and sponsorship of deserving students by the government or private sector. Consideration should also be given to the reorganisation of the Pakistan Banking Corporation's programme of loans--*Qarz-e-hasana*—under the guardianship of the State Bank of Pakistan.

The *Group* expressed concern that the best brains of Pakistan were not choosing science and engineering fields. However, they noted that a shift in market conditions seems to have taken place in favour of managers who are equipped with engineering or scientific expertise. There is evidence of increasing demand for the so-called "Technical Managers", i.e., managers who have a good grasp of S&T. There is also a very rapid increase in the service sector where technological qualifications are required (e.g., computer expertise). In any case, to encourage the young to choose science and technology fields, much greater effort at awareness on science and mathematics needs to be given at an early stage in primary and secondary schools. At the same time, there is a need for redesigning science and engineering courses at the university level that give much greater attention to job market trends.

With respect to measures that may increase the number of students going into science and engineering fields, several ideas were discussed. These included: presenting to young students attractive role models of

Pakistan's leading scientists and engineers; publicising the achievements of scientists and engineers; offering rewards to young scientists; creating scholarship programmes to undertake science and engineering education; introducing credit programmes for science and engineering-based investments; setting up technology parks and laboratory facilities to foster innovation; and providing tax exemption for job creation in technical fields.

The *Group* proposed an action programme that consisted of:

- establishing a professional body of private institutions operating in Pakistan offering programmes in the natural sciences, technology, computer sciences, engineering.
- Initiating a programme for the promotion of "Technical Managers", i.e., managers who have a relatively strong science or engineering background.
- Institutionalising the holding of future Conferences on Science and Economics Development along the lines of the current one.

Afterword

The Conference on Science and Economic Development took place at a time when the Government of Pakistan was in the midst of what was virtually a constitutional crisis. This had two consequences for the conference. First, two of the invited Federal Ministers as well as a few key government officials were unable to attend the conference at the last minute. The result was that the key player in the formulation of S&T policy—the Government—was under-represented at the conference. Two, the political uncertainty combined with the serious financial and economic difficulties the country faced made at least some participants wonder whether any progress on the S&T front can occur in the prevailing circumstances.

The country's economic and financial situation since the conference has continued to deteriorate and no turnaround at the time of writing of this note is in sight. With the Government preoccupied with attempts at managing the evolving financial crisis and businesses uncertain about their investments, it is difficult to be optimistic about the resolution of the fundamental problems of education and S&T in the foreseeable future.

Does this mean that the effort put into the conference on Science and Economic Development was misdirected or wasted? The answer of the Conference Director is an emphatic "No", for the simple reason that the participants—who represented the country's business and academic leadership—still have the freedom, resources, and capability to act on some of the conclusions reached at the conference. These are summarised in the Group reports presented above.

Although the Groups, in view of the severe limitation of time, could not realistically address all the issues that were given to them for consideration, the discussions were serious and purposeful. Even though each Group worked on a different set of issues, their conclusions appear to have some common elements.

First, the need for closer contact and cooperation among the scientific, academic, and business leadership of Pakistan was recognised by everyone. Towards this end, there was a strong endorsement for the proposal to establish a business-led Network to Promote S&T, or Net-POST. This proposal now needs to be translated into action.

Secondly, there was a general recognition that a great deal can be achieved through the better utilisation of Pakistan's existing S&T resources and capabilities. This requires, more than anything else, making scientific and engineering research more relevant to the needs of domestic industry and the greater involvement of Pakistani businesses in research. The proposed Net-POST could help achieve this, but actions at the individual industry or business level would also be necessary. One possibility is to organise, along the lines of this conference, seminars or mini-conferences where industry-specific issues are addressed by participants drawn from business, academic, scientific, and policy-making circles.

Finally, there is a pressing need for popularising S&T in Pakistan. This would involve improving general awareness in the country on S&T issues (through, for example, the mass media), but, more importantly, improving science and engineering education at the primary and secondary school level. The country's `best and brightest' must seek science and engineering as professions of choice. In this area, all the participants can contribute through lectures, media presentations, and articles in Urdu and English language newspapers and magazines.

To conclude, it is important to remember that the Conference could only be a step towards developing a programme for strengthening Pakistan's S&T capabilities and infrastructure. Much will have been achieved by the conference if the participants emerge as a lasting nucleus or a network that helps to bring about the required change in policies and institutions governing the development of science and technology and promote a national environment where scientific methods begin to be applied to the inquiry of social and economic issues.

Appraisal of Higher Education Academic Staff

Rukhsana Zia

Abstract

The Annual Confidential Report is a government document and is used by all government departments. The document is used for all employees of Grade 16 and above. The same document is used for the teaching staff as well. The inefficiency of the document to present an appropriate appraisal of scholarship characteristics of the higher education academic staff is evident. This study will focus on identifying various factors that ought to be assessed to provide information about the performance of the teaching staff and help formulate an effective format to achieve the objectives of appraisal.

Introduction

In Pakistan the teaching staff of government higher education (HE) institutions are annually reviewed by the head of the institution. The appraisal form is called the *Annual Confidential Report*. It has a standard format, and is applicable to all government officers Grade 16 and above. The form lists characteristics such as Personal Qualities (intelligence, confidence, appearance etc.); Attitudes (knowledge and attitude towards Islam, foresight, financial responsibility, judgement etc.); Proficiency on job (power of written and oral expression, knowledge of work, analytical ability, supervision and guidance etc.), which do not focus on the specific tasks related to teaching and learning. This limits the role of assessment and does not introduce the concept of professional development as an intrinsic part of the process. Furthermore, the head of the institution engages in a confidential procedure of assessing the academic faculty. This results in the assessment being regarded as threatening rather than a valuable way of indicating the strengths of the teaching staff. Education personnel are, by and large, critical of the validity of the ACR as an assessment document and demand changes in its format (Zia 1994 p 377). Without a formal appraisal system,

> "...appraisal is covert, secret, liable to be based on impulse or prejudice, incorrect or inadequate information"
>
> (Turner 1981)

Turner criticises it as management failure if a well thought out system of appraisal has not been produced which he believes is the right of every staff member. It is not difficult to translate the above to the system in practice in most HE institutions of Pakistan.

Limitations of the Study

There are many roles at various levels of the service structure that are discharged by the Higher Education Academic Staff (HEAS). In some cases these might pertain to purely management/administration related posts. The appraisal would require different or additional factors for their assessment. This would be true, for example, in the case of a department head or the institutional head. This study focuses on the appraisal of teaching faculty.

The format provided should not be considered as the only way to assess the AS. It will provide a guideline that can be reformulated according to the needs of the individual institutions, or by the employing authority for the institutions.

Different ranks of teachers usually require different standards of competencies/scholarship at different institutions. It is hoped that each institution/employing authority will develop its own criteria for the different ranks which will then have to be reviewed accordingly.

For the sake of this study, words like review, appraisal, evaluation, assessment are considered synonymous. It does not need to be clarified that all can have subtle differences.

Appraisal of the academic faculty will need to be done at various levels for optimal effectiveness. It can be self-appraisal, peer appraisal, appraisal by students, upward appraisal and line appraisal. This study focuses on line appraisal, whereby appraisal of the faculty is done by the “boss”, in this specific case, the head of the institution.

Various factors contribute to and result from a natural progression of assessment procedures as underlined in this study. The discussion of these is beyond the scope of this paper. (e.g. incentives for improvement, rewards for improvement and so on).

Appraisal when stated as areas of responsibility to be assessed, needs to be established as a scheme within a systematic process. This study does not delve into the procedural details of management for the process.

Significance of the Study

As stated earlier, the ACR form does not assess the education personnel, especially teaching faculty, as per the competencies required for teaching in a HE institution. This study will delineate the role of teachers in

HE institutions and thus provide direction to assessment in the required areas of responsibility suited to their job.

The scholarship characteristics delineated in the study will provide a concise picture of excellence in areas of responsibility relevant to the role of the AS and provide a listing of characteristics that will give a valid exposition of their teaching capability.

It will provide a powerful fool for all the teaching faculty in HEAS, who can discover, amongst other things:

What is expected of them

How well they are doing

How they can do better

How they can develop their careers

(Everard 1986)

Feedback on performance is an essential element for attaining and maintaining excellence in scholarship of the HEAS. The guidelines provided in this study will define a feedback criteria which if used systematically, and in an environment of empathy, communication and participation (Kirkpatrick, 1985) will provide a thorough and effective assessment. In fact such a feedback system established on a regular basis is a part of the institution's normal management function and should be introduced at the earliest.

Appraisal, as suggested by this study, over a period of time will motivate the HEAS towards their professional development and to engage in developmental activities in the identified areas of responsibility. James and Newman (1985), identified several main aims of staff appraisal which emphasise the promotion of staff development, communication, assistance in management, motivation, improved efficiency and quality, self-evaluation, reviewing performance to identify strengths and weaknesses, and identifying in-service training needs: All these changes and more is hoped to come about as a result of the introduction of such an appraisal system.

What is Faculty Appraisal?

Faculty appraisal, conventionally speaking, is a system in which the head of the institution or another designated person meets with a member of the faculty to review the staff member's activities during the past year and to exchange views over possible developments for the next year

(Greenaway and Mortimer 1979 pp 57-79). This reflects a two-way discourse and does away with the negative and punitive connotations implicated by the confidentiality of the procedure currently in practice, basically in government education institutions. Faculty appraisal can be and should be seen as a valuable way of providing clarification and feedback to the concerned staff members on the performance of their roles and responsibilities, its three main aims can be stated as:

1. to assess past performance
2. to assess training and development needs
3. to assess future potential

(Baron 1978)

The main objectives of the faculty appraisal scheme, as reflected in the following pages will be to:

- identify the strengths and weaknesses of the staff members
- assess their performance and assist them in the development of their careers,
- create an incentive to improve their performance,
- above all, it will help to identify changes in the operation of the HE institution which would enable the individual faculty to improve their performance.

Responsibilities of the Teaching Faculty in the Institutions

"A community of scholars" is the classic definition of a university (Brown and Thornton 1971 p 44) which can apply to any HE institution. The faculties of colleges and universities, by and large, see themselves as scholars, that is, they conceive that their efforts should be devoted to the extension, through research, of understanding in all areas of knowledge. The scholar feels the responsibility to identify, to recruit and to guide those who will continue research in the future. In fact he/she accepts the education of scholars in his field of study as an integral purpose. Another equally important aspect is the education of the non-specialist, which he/she hopes will provide a trained elite from which the nation's leadership may come. As such the role of a HEAS revolves around "scholarship". Scholarship is the possession of extensive and profound knowledge of a subject along with being up-to-date with developments in that field. HE is being increasingly identified with emphasis in research, translated to HEAS it connotes both teaching and research capability. Thus, scholarship is an umbrella term used for responsibilities imperative for the HE teaching faculty in the following areas:

1. teaching
2. research/creative activities
3. institutional service/administrative, managerial activities.....

   (The Faculty Handbook, Iowa State University, 1998 p 11)

The broad continuum of scholarship is described in Appendix-A. The table describes the parameters to be used for judging the scholarly nature of a faculty member's achievements in appraisal/evaluation reviews. In certain fields journals are the traditional method of documenting scholarship, in others, exhibitions and performances are the appropriate form. In others new technologies will create new media. In certain cases, there might be no documentation by peers, nevertheless, both documented and undocumented scholarship provides a holistic portrayal of the faculty's academic work.

Brown and Thornton (1971 pp 43-52) state the professional responsibilities of the college teacher, which can be translated to all HE teachers, as responsibility to:

1. himself
2. his colleagues
3. his discipline
4. the administration
5. students

All the above is to be placed in an environment of academic freedom with rights, reasonable rewards and so on.

For the sake of this study the areas of responsibility specified in *The Faculty Handbook, Iowa State University* are used as a guideline, with appropriate modifications where necessary.

Areas of Responsibility and the Related Activities/Indicators

This study has identified three areas of responsibility for the faculty of HE institutions. The following pages will try to provide examples of activities that may be documented in each area of faculty responsibility.

Each institution can state additional areas of responsibility in keeping with their mission statement.

I. Teaching

Teaching is a scholarly and dynamic endeavor and covers a broad range of activities. The HEAS have significant teaching responsibilities and quality of teaching is a major concern for their evaluation.

In most countries around the world, the conventional viewpoint holds that the ideal HE teacher holds the terminal/Ph.D. degree in the concerned discipline. But concept of scholarship propounded for HEAS indicates that a "doctorate shows nothing about the teaching ability" (Brown and Thornton 1971 p 42). Understanding, depth of knowledge is an essential quality for a HEAS but it is, by itself, not enough.

Undoubtedly, effectiveness in teaching is essential, HEAS must demonstrate not only a command over their subject matter but show a continuous growth in the subject field and an ability to create and promote an environment that promotes optimal student learning. In other words excellence in teaching is related to efficient student learning. It needs to be realised that different expressions of the term "effective teaching" exist and have to be accepted. Some teachers may exhibit a command over lecture giving, others may promote collaborative learning, while still others may be adept at organised group discussions. Good teaching can mean excellence in different pedagogical skills.

The activities/indicators that exhibit excellence in teaching (for undergraduate and post graduate classes) are:

- command over subject matter including knowledge of recent developments,
- knowledge and use of appropriate teaching techniques and technology,
- presentation of subject matter with conviction,
- presentation of material in a way that promotes the learning process,
- well-written design of syllabi and course planning,
- good relationship with students, that is,

accessibility

ability to enthuse, guide, inspire and involve students

giving feedback to students

concern and respect for students

making students aware of the relationship of the subject to other fields

- excellence in advising, that is,

  interact constructively with advisees

  be informed of current policies and procedures

  aid students in the use of the institution's resources

  assist students in learning to make intelligent choices

  be knowledgeable about curricular and extracurricular activities

- skillful as an examiner, that is, in evaluation/assessment procedures

- significant contributions to professional associations

- overall assessment of ability and attitude as a teacher

- competence in postgraduate supervision (Beard and Hartley pp 261-267)

  ability and willingness to motivate research students

  relationship with research students (helpfulness and quality of feedback)

  ability to identify research projects

  management and supervision of research projects

  completion rate

  relationship with co-operating organisations

  thoroughness as examiner

  overall assessment of ability and attitude as a research supervisor

- ability for other teaching activities such as short courses in the discipline/related areas

  ability to attract sponsors, course members

  ability to design courses and plan programmes

  preparation and planning of course materials

  knowledge and use of appropriate instructional strategies

  overall assessment of ability and attitude in this field

2. Research/creative Activities

It is commonly accepted all over the world, and increasingly being propounded in Pakistan that research is a very significant part of a teacher's role in HE. In fact in the western world, HEAS face the conflict between the demands of teaching and research (Beard et al 1978 p 88). Both are equally important and each institution and each department within the institution will need to identify the desired balance between the two. In an appraisal system, teaching and research activities need to be considered in a manner that the faculty is motivated towards enhanced achievement in both.

HEAS who engage in research/creative activities are expected to make original contributions that are appropriate to their chosen area of specialisation, are respected by peers within and outside the university/ college. The following are some of the indicators for research competence, but it should be realised that all the above may not be equally relevant to all members of staff in different faculties. (In Pakistan the difference may be greater from institution to institution due to lack of resources at the disposal of the staff for research/creative activities):

- Amount of research/creative/artistic activity over the past year
- number of publications
- quality of research and publications
- ability to attract research students
- guidance of research projects of students
- ability to identify original and feasible research issues
- design and management of research projects

- ability to disseminate results of research/creative activity
- peer group evaluation, that is, invitations to conferences and to give papers and so on, respect by peers in and outside the country
- industrial and commercial links
- overall assessment of ability and attitude as researcher and research leader
- awareness of new developments in the area of speciality and related fields
- membership in related professional/scholarly societies and organisations
- other relevant aspects, if applicable

3. Institutional Service/Managerial/Administrative Activities

All HEAS are expected to play a vital role in the functioning of the institution at all levels, by participating in governance and policy formulation or by carrying out administrative responsibilities. this shows the involvement in institutional service and forms an important aspect to be assessed for the faculty member's performance. The listing can include membership on various college/university committees and organisations with clear indication of the staff member's role.

The following criteria need to be considered for appraisal:

- willingness to assume administrative responsibilities
- amount and range of involvement in such activities
- thoroughness and reliability of administrative work, that is, accuracy to meet deadlines
- ability to manage such programmes
- administrative ability, such as innovation, initiative
- communication skills/quality of interpersonal relationships
- supervision of technical/clerical/administrative staff

- overall assessment of ability and attitude as administrator and manager.

Other Relevant Activities

Most of the activities performed by the faculty of HE institutions have been covered in the above paragraphs. There can be other activities, which contribute towards scholarship of the HEAS and need to be considered. These activities are listed below:

- contribution to departmental activities, membership on departmental committees
- contribution to extra-curricular activities, such as contact with students, visitors
- representative duties on behalf of the institution such as, public boards, councils
- unpaid service to local community or local industry
- any other contribution to profession, national bodies, international activities
- other relevant activities
- overall assessment of ability and attitude regarding extra-curricular activities.

Conclusions

The ACR form currently in use in government institutions of HE is deficient in delivering the objectives of appraisal of the AS. In the light of the above documentation it is hoped that it will be modified to meet the scholarship level expected of the teaching faculty. More importantly, the confidential nature of the assessment has to be converted to a two-way discourse and demands immediate attention.

The preceding pages have delineated the role/areas of responsibility for the HEAS and provided a guideline of indicators that can help to assess them efficiently and effectively. As such, the indicators it offers stand valid for most institutions of HE in Pakistan. It will of course, need further research to polish it to the needs of the individual institutions. Detailed attention will also be required to establish an overall scheme with well-planned management procedures.

Appendix-A

The Nature of Scholarship

NATURE OF SCHOLARSHIP	AUDIENCES FOR SCHOLAR-SHIP	MEANS OF COMMUNICA-TION	CRITERIA FOR VALIDATION	MEANS OF DOCUMENTA-TION
Develops and communicates new understanding and insights. Generates, synthesises, interprets, critically analyses, and communicates new knowledge, methods, understanding, technologies, materials, uses, insights, beauty and so forth	Peers, undergradu-ate students, graduate Students, postdoctoral, Associates etc.	Teaching materials and methods, classes, curricula, publications, presentations, exhibitions, performances, copyrights, patents etc.	Originality, significance, accuracy, replicability, scope, applicability, breadth, depth and duration of influence, persistence of influence or use, adoption by peers, impact or public benefit etc.	Present evidence that creative intellectual work was validated by peers; communicated to peers and broader audiences; recognised and accepted, cited, adopted or used by others. In other words, it made a difference.

Source: The Faculty Handbook, Iowa State University, 1998 p 12.

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The Exchange Rate and its Effects
An Overvalued Quantity?

Sikander Rahim

I. Introduction

The Exchange Rate and Competitive Goods

The exchange rate poses an awkward problem; if the same goods are produced by and traded between different countries and if international trade is competitive, the prices of such goods in any country will be the same, regardless of the country of origin. The law of one price must hold within each country; exchange rate movements cannot alter the relative prices in the same country of competing goods according to country of origin. There is, then, no general *a priori* reason why purchasers in a given country should choose the product of one country rather than the competing product of another and the standard argument, that changes in exchange rates alter the volumes of imports and exports through such relative price changes, cannot hold for such goods. The conclusion is that, if most of the imports and exports of a country are goods that have international competition, there is no reason that exchange rate changes will have predictable effects on its balance of trade.

Almost all finished goods and primary products face international competition and they account for much the greater part of international trade. Most trade in finished goods consists of exchanges of similar goods between the developed countries. For example, France, Germany, Italy, Japan, Spain, Sweden and the UK produce motor cars and export them to each other, as well as to the US, which has the biggest motor car industry. The US, Japan, Korea, several European countries, and Taiwan export computers and telecommunications equipment to each other. France, Italy and the US exchange fashion goods and cosmetics, and several countries, notably France, Germany, Switzerland, the UK and the US, exchange pharmaceuticals. The finished goods that developing countries export to developed countries are also produced in the latter. For example, a large part of the exports of developing countries consists of apparel of various kinds, Brazil and Mexico produce motor cars for export and Pakistan sports goods, surgical instruments and carpets.

Similarly, the major primary products are all produced in several countries and their prices are mostly uniform around the world. No one suggests that devaluation is the means for an oil exporting country to increase its exports of oil. The prices of most other major primary products, bananas, coffee, copper, cotton, rice, sugar, wheat, etc., are determined through commodity markets, through contracts between individual producers or countries and buyers, or even through international agreements. Price differences caused by a change in the exchange rate of a single country are short-lived and have little effect.

Primary products that do not face international competition and unfinished goods account for a smaller, though still large part of international trade, but exchange rate changes rarely have effects on them that are predictable *a priori*. Much the largest part of trade in such goods, estimated at over 30 per cent of all trade, consists of intra-firm shipments of unfinished goods produced by foreign subsidiaries of firms to other parts of the firm. In such cases, the firm has made an investment to produce the good, and the price of the good is internal to the firm, normally the outcome of comparisons of the accounting and tax rules of the countries of production and destination. The effects of changes in the exchange rate, then, are determined by how the firm judges future exchange rate changes will affect the profitability of its investment, as well as by tax and accounting rules, and may follow no consistent pattern. Nor do exchange rates have much influence in the few cases in which a country has a monopoly over a primary product, such as jute and vanilla, since pricing is likely to be set to maximise export earnings and will be independent of the exchange rate.

The Exchange Rate, Employment and Production

This paper is a discussion of the standard argument given above and leaves aside the effects exchange rate changes have on production and employment, although the period between the two World Wars showed the problems arising from these effects when countries produce similar goods. Devaluation enabled countries to reduce the underuse of production capacity and unemployment at home at the cost of increasing them abroad. It allowed a country's producers to lower their prices in the markets of other countries and to force competitors to lower their prices too. Competitors who could not cover costs at the new prices and former levels of production, had to reduce or even stop production. Such 'beggar-my-neighbour' policies described by Joan Robinson[1] were common and the consequences were disastrous. The system of fixed exchange rates that prevailed for some time after World War II was adopted to avoid these policies and, while it prevailed, the developed countries grew faster and at lower rates of unemployment than ever before or since.

[1] Joan Robinson.

Full employment will be assumed here. Since economists and organisations like the IMF do not, nowadays, wish to appear to advocate devaluation in one country at the cost of creating unemployment in others, the standard assumption in balance of payments theory is that full employment is maintained by appropriate monetary policies, which fail only if there are economic 'rigidities'. So, in what follows, exchange rate changes are ruled out if they cause unemployment that cannot be removed except by worsening the balance of trade.

II. Three Alternatives

There are three alternatives for escaping the conclusion that changes in exchange rates do not have predictable effects on trade. One is to deny the assumption that countries produce the same or similar goods. They second is to qualify the assumption that international trade is competitive. The third is to postulate some mechanism that leads to the same conclusion regarding the relations between imports and export volumes without assuming relative price movements of imports and local production.

The ensuing discussion of these alternatives is confined to the short run, though occasionally points are made concerning the longer run if they are closely connected to the main argument. Short run means that the capital stock and nominal wages in terms of the local currency do not change. Manufacturing firms are assumed to have stocks of plant, equipment, buildings, land, vehicles, etc., that constitute their productive capacity. Other assumptions are that costs of transport and trade are negligible, there are no multiple exchange rate practices and exchange rates are mutually consistent. When the prices of goods in different countries are compared, they are compared using the going exchange rates.

Alternative One: Specialisation by Country

The first alternative can be dismissed as incompatible with the facts. It is the oldest, but no longer much in favour among economists. Its authoritative exposition is Meade's book on the balance of payments, which assumes that each country produces a different set of goods. The interaction of price and income elasticities then leads to the desired results. When one country devalues, the prices of its goods fall relative to the prices of other goods and, with normal elasticities, he volume of its exports increases. At one point (pp. 75-6) Meade allows for the case in which a country also produces a good that it imports, but he assumes that imports only satisfy the residual demand after all domestic production has been consumed domestically. In other words, consumers choose between goods according to their origins. If this assumption is dropped, domestically produced goods might be exported at the same time as the same goods are imported. The balance of trade would not change, but the volumes of exports and imports would be indeterminate.

Alternative Two: Imperfect Competition

The second alternative is to qualify the assumption of competition. It replaces the perfect competition associated with homogeneous goods by the imperfect competition of brand names and product differentiation. Similar goods are not perfect substitutes; their elasticities of demand are finite and their prices differ. Isard states, "With widespread product diversification, most manufactured goods face finite elasticities of demand and are priced under conditions of imperfect competition."[2] Hence, relative prices of competing goods can change and the exchange rate can change them. Isard's argument is now standard. According to Krugman, "Modern trade imposes less commonality on price-level movements than the trade of 75 years ago."[3]

The argument is also used to explain why prices of similar goods differ between countries. Numerous empirical studies[4] have shown that the differences are too great to be explained by trade barriers and transport costs and qualifying the assumption of competition seems to provide an explanation. Several empirical studies have shown both that prices differ from country to country and that there is no clear tendency to equality. Tests of the theory of purchasing power parity (PPP) have established that it does not hold in its absolute form, according to which the prices of the same or similar goods in different countries tend to equality. Some economists using advanced statistical techniques (cointegration) believe they have evidence for its relative form, which asserts that the prices tend to some relationship that is stable.[5] The periods are long, possibly 70 years.[6]

The argument has the merit of accepting that trade does not equalise the prices of the same goods in different countries, but it attempts to reach two incompatible conclusions. For, if prices do differ in this way, they are not directly related by exchange rates; if the price of a good in an export market is not the same as in its home market, a change in the exchange rate changes the price difference, but does not, *a priori*, lead to the conclusion that a rise or fall of the currency of the producing country will have a similar effect on the good's price in the export market. In the

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[2] Isard. 2. P.60
[3] Krugman. 2. P.8
[4] Isard. 1.; Kravis and Lipsey, and others.
[5] Dornbusch gives a survey.
[6] Breuer.

case of a good whose price was higher in its export market than in its home market, special assumptions are needed to conclude both that devaluation of the home counry's currency will cause its price in the foreign market to fall and that the producers were maximising profit before and after devaluation. In the opposite case, assuming no anti-dumping measures, the assumptions would need to explain why the producers export at lower prices than they get at home.

The imperfect competition of product differentiation and brand names cannot lead to the conclusion that changes in the exchange rate have determinate effects on trade. Nor does it do so. The elasticities Isard refers to may be finite and yet be greater than one. Then, if producers in one country lower the price of a product in a foreign market, their sales in the latter will increase in volume and value. But their competitors cannot be assumed to accept reduced sales passively; even though their products may not be perfect substitutes, competition may be intense and the competitors will lower their prices to match as long as they can cover their costs. They will be cutting their profit margins and, if the producers who originally lowered their prices were enabled to do so by a devaluation, prices may fall enough to leave their competitors no profit margins at their original levels of production. Then, if the competitors have average unit costs that rise with the volume of production, they reduce production; if these costs are constant or fall, they go out of business. Devaluation by one country causes unemployment in others, unless they find some new export possibilities.

The price comparison that matters most here is between the prices of imported and domestic goods in a given country, and empirical studies have shown, at least for the US, that, contrary to what was the standard conclusion of international trade theory, they do not change relative to each other. It means that the exporting country does not necessarily charge the same prices at home and abroad. One study of this kind, by Marston[7], shows that Japanese manufacturing companies try to keep the dollar prices of their exports to the US stable. Since then it has become clear that it is not only Japanese exporters who behave like that. When the dollar was exceptionally high in 1983-85, prices of imported manufactures did not fall correspondingly. Krugman[8] showed that the prices in the US of imported manufactures scarcely changed when the dollar rose by 40 per cent. Yang finds that US prices of simpler goods, such as textiles, apparel, lumber and wood products, and metal products, i.e. goods exported by developing countries, are most affected by exchange rate changes.

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7 Prices of Japanese exporters.

8 Krugman 2.

A specific example discussed by Krugman in 1986 is that of German motor cars, notably BMWs and Mercedes. Someone hoping to buy one of these cars in the US at a price close to that in Germany would have been disappointed. The dollar prices of some models actually rose. The scope for arbitrage was negligible; both BMW and Daimler Benz (the producer of Mercedes) only sold their cars in the US through their authorised US dealers and cars used in the US had to meet specifications different to those of Europe. Someone wanting to import a car at the European price had to go to Europe and buy it there; he might still find that the company would only sell him the car through a US dealer and that dealers would not convert European models to US specifications. Conversion by an unauthorised dealer annulled the manufacturer's guarantee. That this is not peculiar to the US is seen from the recent complaints in the UK that prices of cars there are higher than in many parts of Europe. Sometimes they are as much as 58 per cent higher.[9]

Yet BMW and Mercedes were competing against each other and against other car makers, so why did they not try to increase sales by lowering prices when their production costs had fallen in dollar terms? Ordinary consumer theory using indifference curves does not yield a satisfactory answer. Krugman's discussion examines various alternatives and concludes that the explanation seems to be that purchasers lower their assessment of a brand wen its price fluctuates and that the belief was widespread in 1983-85 that the dollar's rise would soon be reversed. A price fall would soon have been reversed.

An explanation ought not to be limited to consumer goods, for later studies showed that all manufactured imports behaved similarly. Krugman's conclusion can hold for goods other than consumer goods, but it presupposes a type of behaviour that might not be true for another country or at another time. The US is a big and largely self-sufficient economy, so people there are likely to be less aware of the effects of exchange rate fluctuations that people in a small, open economy like Denmark, and this holds for purchasers of engineering goods as much as the ordinary consumer. Hence, a Dane considering buying imported goods might not react to price changes caused by exchange rate changes in the same way as an American. Krugman's explanation also depends on the expectation that the high value of the dollar would be short-lived, the implication being that BMW and Mercedes would have lowered their prices otherwise.

What needs to be explained is why the American prices of imports were stable and there are several ways of doing that. One is that, if BMW

[9] *Financial Times*. 8th December 1998. Car Importers Attached on Prices. John Griffiths.

and Mercedes had lowered their prices, other car makers would have reacted by doing the same. That might have been deterrent enough, but the moment was also particularly dangerous since Chrysler was being helped out of bankruptcy by government loans and Japanese voluntary restraints on their exports of cars to the US (which allowed Japanese car makers to raise prices). Starting a price war then could have provoked curbs on imports of BMWs and Mercedes as well. A second explanation is that neither company wished to increase demand for its cars until it had the production capacity to match and that would have taken a couple of years. Yet another is that these two companies had too small a share of the US market for them to have much effect on prices, in contrast to the Japanese car makers; they were price-takers who could sell all they could produce at those prices.

The example illustrates the limits to the standard arguments that trade equalises prices between countries. One short run argument is that profit maximising firms shift their sales to the market where prices are highest, causing prices to fall there and to rise in other markets. The objection is that, given the size of the American market, the shift would have been large for BMW and Mercedes, even if they had not been producing to capacity, and they would, therefore, have been deterred by the risk that competitors wold take over their foregone European sales. As Krugman points out in his 1989 lectures, the establishment of a brand name in a market and the acquisition of market share often constitute a big sunk cost. Recovering the lost market share later would have been slow, costly, perhaps impossible. Firms would not contemplate such a shift if they were not confident that the dollar would remain permanently strong. There was no such confidence and, even if there had been, it would have been surprising to see European industrial enterprises forsake their home markets for foreign ones.

Price equalisation might have been impossible in the long run too, even if firms had been confident and increased their sales in the US by raising production capacity, rather than by sacrificing the home market, or it might have been accompanied by higher unemployment in the US. Growth of domestic production of BMW and Mercedes cars and exports to the US might have forced American car producers to lower their own prices, but, if not enough labour could have been drawn from among the German unemployed or from other activities, the growth might have stopped before US prices fell to European levels. To the extent that American producers were forced to cut back production and were unable to increase exports other than cars at the higher level of the dollar, the US would have had more unemployment or its balance of trade would have deteriorated. Assuming that the government did not step in, as it had done before to persuade Japanese car makers to restrain their exports, the alternatives might have been the type of 'beggar-my-neighbour' behaviour that was excluded at the outset or more external financing for the US. An alternative to greater domestic production could have been to install capacity in the US. This is not price equalisation through trade, and the high value of the dollar being assumed here would have made it less likely than before.

The other short run argument is that arbitrage will prevent price disparities from persisting. But arbitrage is rare among a wide range of manufactures, which account for the bulk of manufactured imports of developed countries. This is a matter of observation, so there is no need to give more than a rough explanation here. For finished goods arbitrage depends on the buyer being indifferent as to who supplies him and the seller being indifferent as to whom he supplies. For manufactures this often does not hold: buyers want guarantees and service agreements, and they may want adaptation to their specific needs; suppliers want to be sure that the guarantees and service are for their genuine products. Both buyer and manufacturer have, therefore, a motive to deal directly or through authorised agents. Moreover, arbitrage is excluded for a large part of the inputs of the finished goods since a high proportion of trade in manufactures, estimated at over 30 per cent of total world trade, consists of deliveries of unfinished goods produced by foreign subsidiaries of firms to other parts of the firm.

The upshot is that trade does not lead to the equalisation of prices of similar goods in different countries if brand name and product differentiation are important. A separate question is how the prices of goods in one country are affected by a change in the exchange rate of another. In the US prices of imported manufactures remained stable relative to the prices of similar American goods during the period 1983-85, when the dollar was high, and changed relative to the prices in the countries exporting them. In most developing countries, however, prices of manufactures change with the exchange rate. A working hypothesis to reconcile the difference in behaviour is that in large economies imported goods must compete with a local production that is usually greater and sets prices. Smaller economies are price-takers. Thus, the high prices of cars in the UK relative to some other parts of Europe, sometimes 58 per cent higher, which have caused annoyance among the British, are a result of the size of the British car industry. If it did not exist, the British market would not set prices and car prices might be lower. Developing countries are price-takers since the economies of all but the largest of them are small compared to those of the US, Japan and the main Western European countries.

The behaviour of prices of manufactures in developing countries can be explained without assuming 'world prices'. Small economies import large parts of their manufactures from developed countries and have relatively small competing industries. They are also marginal markets for firms in developed countries. Consequently, when a developing country devalues a developed country firm exporting to it can raise its prices in terms of the local currency to keep them at par with its previous prices in terms of its own currency without risk of losing its market to competing local firms. And, even if it risks losing the market, it will be more willing to abandon the market as unprofitable because its sunk cost in acquiring it was small.

Alternative Three: Price Differences Between Tradables and Untradables

The third alternative for arguing that exchange rate movements have determinate effects on the balance of trade is that their price effects shift demand between tradable and untradable goods. Prices of tradables are directly affected by movements in the exchange rate ad those of untradables are not. Hence devaluation causes the domestic prices of tradables to rise relative to the prices of untradables, whose prices are assumed not to rise to the same extent. Domestic demand shifts to the goods with lower prices and the balance of trade improves.

Even accepting the assumptions regarding prices, the argument is obviously wrong. The balance of trade (the balance on goods and non-factor services) is equal to the difference between saving and investment; this is an accounting identity. If the balance of trade improves, either saving increases or investment falls. There is no a priori reason why shifts in demand between tradable and untradable goods should have either effect.

One fallacy is to assume that devaluation reduces the prices of untradable goods relative to the prices of tradable goods. The costs of production, excluding profit, of all goods can be assumed to fall in terms of foreign currency since the nominal wage in the local currency is fixed, the prices of untradables can be assumed not to rise enough to offset the relative fall in the nominal wage and the foreign currency prices of tradable inputs do not change. Profit, then, becomes a bigger part of the price of a tradable. Presumably a competitive system will equalise the rates of profit in different sectors. The local currency prices of untradables will, therefore, rise as well. How they will compare with the prices of tradables depends on whether profit was a larger or smaller part of their prices, i.e. on their capital intensity. The local currency price of an untradable that is more capital intensive than the tradables will rise relative to the prices of tradables, that is to say it will rise in foreign currency terms.

A numerical example illustrates this. Assume that the local currency price of a unit of a tradable good is 100 and that this is the world price at the going exchange rate. Of this 30 is labour cost, 60 is the cost of inputs other than capital, which are assumed tradable, and the rest is profit. After devaluation the local currency price is 125. Since labour costs do not change and the cost of tradable inputs rises to 75, profit goes from 10 to 20. Assuming for simplicity that all the capital goods are tradable (and leaving aside the complications of amortisation), the rate of profit rises by $[20/10]/(5/4) - 1 = 3/5$.

Now assume that electric power is untradable and that it is all generated thermally. Taking the price of a unit as 100, let the labour cost be 20 and the cost of inputs other than capital, which are again all tradable, be 60. Assume again that all capital goods for producing electricity are tradable. Then, to earn the same rate of profit on capital, profit must rise from 20 to 40 and the price of electricity must rise to 135. Therefore the price of electricity rises in terms of foreign currency and relative to the prices of tradables.

One objection is that equalisation of profit rates across sectors is slow and that the present discussion is restricted to the short run. If the profit rate in the production of tradables rises immediately following devaluation but untradables take time to catch up, untradables do become cheaper relative to tradables and demand shifts to them. This may describe how economies actually behave, but it makes the effect of devaluation depend on the persistence of an inconsistency in the economy, which is a market inefficiency that should be taken into account in all other analysis of the economy. The objection is inconsistent with the theories published in support of the original argument, which make the usual assumptions that markets are efficient. Moreover, as the profit rates of untradables approach those of tradables, the effects of devaluation are reversed and, if the former are the more capital intensive, the effect of price changes is ultimately to shift demand to tradables.

The second fallacy in the argument that exchange rate changes affect the balance of trade through shifting demand between tradable and untradable goods is that it ignores income distribution. Demand can be assumed to shift from one set of goods to another when the prices of the former rise relative to those of the latter, provided that changes in the distribution of income are minor. But devaluation causes the share of fixed income groups to decline and the share of incomes that are closely related to prices to rise.

A comparison of car and bus rides illustrates how devaluation may affect prices and trade. Assuming that bus rides are untradable and less capital intensive than tradables produce din the country, devaluation causes their prices to fall relative to the prices of cars, which are tradable. If the market and owners of cars and buses correctly account for all costs, whether or not the cost of a car ride rises relative to the price of a bus ride depends on how the various components of the cost of either maintenance, fuel, amortisation, drivers and administrative overheads in the case of a bus company, possibly a driver in the case of the car are composed of labour, tradable and untradable inputs. If convenience, comfort, independence and other characteristics of car and bus rides do not change and car rides are the more capital intensive, they become more expensive relative to bus rides. Then an individual on a fixed income may switch from car rides to bus rides.

But the import of cars does not necessarily fall. If profit earners had higher incomes than people with fixed incomes before devaluation and rode in their own cars while heir employees mainly rode in buses, they might after devaluation buy more cars or more expensive models, while their employees reduced their use of their own vehicles.

The only ways that a change in the distribution of income can affect the balance of trade is through the saving or investment rates, but there is no *a priori* reason why it should act one way or the other. Devaluation causing a shift in income to the wealthy can increase the saving rate, but it does not necessarily do so. It can also stimulate investment by raising the rate of profit. The two effects work in opposite directions. In practice, however, devaluation is invariably accompanied by measures to restrain inflation, which may not succeed at that but often do succeed in improving the balance of trade by suppressing investment. Almost every time the balance o trade of a developing country improves, it is the result of a decline in investment.

III. Real, Shadow and Equilibrium Exchange Rates

The exchange rate poses a second awkward problem. According to orthodox economic theory the pattern of trade between countries is determined by the real characteristics of the economies, but the exchange rate, as the ratio at which two currencies exchange, is a monetary quantity. Ricardio's theory postulates that the costs of production of each good in a country are given, the Hecksher-Ohlin theory that each country has an endowment of factors, and trade is determined by how these costs or endowments compare between countries. Neither explains the effects of changes in the exchange rate; for instance, whether or not a permanent change in the exchange rate can permanently affect the composition of trade.

No synthesis exists. Instead, there is a dichotomy; the assumptions of the various standard theories purporting to explain the pattern of trade being different to the assumptions of the standard theories purporting to explain the balance of payments. It is apparent in textbooks on international economics which always have two corresponding parts, with no attempt to unite them on a common set of assumptions.

Several attempts have been made to avoid the dichotomy, but each has its own special assumptions. All argue that the exchange rate is not merely a monetary quantity, that there is a real, shadow or equilibrium exchange rate that should determine the nominal exchange rate. Some of these exchange rates and the associated special assumptions are discussed below.

Relative Prices as the Real Exchange Rate (RER)

The simplest and most commonly used is the RER defined as the ratio of the prices of the country in question to 'world prices' or the prices of a set of other countries. It purports to derive from the argument that devaluation allows a country to reduce the prices of its goods relative to the prices of goods from other countries and thereby to increase the volume of its exports and reduce the volume of its imports (and conversely for revaluation). But as it is normally used, it requires special assumptions that are not usually explicitly made.

Special assumptions are needed because, instead of direct comparisons of the individual prices of the country in question with the prices of other countries or with world prices, price indices are used. Direct comparisons are never made for this purpose, presumably because they are slow, costly, complicated and uncertain. The appropriate comparison for this purpose is of the prices of tradables, whereas price indices the consumer price index, the wholesale price index, the GDP deflator relate the general level of prices to the level of a base year. But, unless direct comparisons are made at some point, indices cannot show how prices of two countries compare; they cannot show differences, only relative movement. If, for instance, the prices of two countries had been directly compared at some time, a rough estimate of how their prices differed would be obtained from the movements of the price indices.

Use of the RER, therefore, entails the assumption that, however the prices of a developing country may compare with those of other countries, lowering them further will increase the volume of the country's exports and decrease the volume of its imports. As pointed out earlier, this is not the same as saying that these trade effects will be caused by creating a difference that did not already exist between the prices of the country in question and the prices of others, which had until then been the same.

Disregard for the distinction between RERs using direct price comparisons and those using price indices is common. The IMF always uses indices in its calculations of RERs; it never makes detailed direct comparisons, nor does it ask countries to do so. For developing countries that do not let their exchange rates float and do not have balance of payments problems it advocates constant or gradually depreciating RERs calculated with price indices. For countries with balance of payments problems it insists on devaluation, especially if it estimates that the RER has risen. In this respect the IMF's doctrine is accepted by most economists. A typical example is a standard textbook on international economics by Krugman and Obstfeld, which simply asserts that lowering the RER derived from price indices has the prescribed effects on trade, although a discussion of the purchasing power parity doctrine earlier in the book concludes that prices differ from country to country anyway.

The RER as Shadow Price

A number of definitions of shadow exchange rates were devised in the 1960s and 1970s to show what the exchange rate should be or which should be used in appraising investment projects. These, too, rest on special assumptions. One definition, exemplified by Bruno, has been the dual variable of the balance of trade constraint in an optimisation model of the economy. In principle, this definition is flexible and therefore general; the economy may have no trade barriers or high ones, domestic prices may be determined by world prices or be controlled and wages may be flexible or fixed.

The dual variable of the balance of trade constraint can be assumed to be positive because the constraint is normally binding, but that does not mean it is an exchange rate. World prices may be given in dollars, but there has been no mention yet of a domestic currency. Since the dual variable is the ratio of a change in the optimand's value to a marginal change of the balance of trade constraint when the former is caused by the latter, its interpretation depends on the meaning of the optimand. Bruno brings the domestic currency in by using a linear programming model and putting domestic prices as the weights of the optimand, which makes his dual variable an exchange rate. In general such models do not need a domestic currency to have solutions. They do not, therefore, have exchange rates, even though world prices are given in dollars and the balance of trade constraint is binding. To obtain an exchange rate the domestic currency must be brought in by some expedient such as Bruno's.

But even if money is brought into an optimisation model, the resulting exchange rate is arbitrary. Consequently, its use in project appraisal or exchange rate policy has no justification. The shadow exchange rate has the same drawbacks as any quantity derived from an optimisation model, it is not necessarily applicable when the economy behaves differently to the model" optimum. If, as is usual, the economy's behaviour does not conform to the model's, the optimand is not what households and firms are trying to optimise, but an expression of the opinion of the economists and politicians who chose it. It is in that sense arbitrary.

Thus Bruno's use of domestic prices as the weights of his optimand is arbitrary since the prices are not necessarily optimal. A consequence is that the solution of Bruno's linear programming model is far from the actual economy; it limits net production to one good and the exchange rate is the ratio of that good's price to its world price. The solution rules out most of the existing economy, which continues to exist anyway, and no explanation is given as to why, if the exchange rate does not apply to most of the economy, it applies to new projects.

The arbitrariness of the optimand can be removed by replacing optimisation by general equilibrium, but that removes Bruno's method of bringing in the domestic currency. Instead of a given optimand, economic agents (households and firms) can be assumed to allocate consumption and goods so as to optimise welfare or profits and, with perfect foresight and perfect forward markets, their choices will give an equilibrium. If world prices are not affected by the economy, the prices of tradables within the economy are equal to world prices and the prices of untradables are production costs. Prices in such models are real, i.e. the unit of account is arbitrary. Again, there is no exchange rate.

The foregoing illustrates the point made by some economists that 'real exchange rate' is a contradiction in terms since exchange rates are relations between currencies and cannot be real in the sense of being independent of money. Optimisation and general equilibrium models in which consumption and production decisions are made by allocating goods and labour do not require money for their solution. If money is brought in, it entails some additional assumptions. Bruno's method of bringing in the domestic currency gives an exchange rate, but it is not real in the sense of being determined by the non-monetary features of the economy.

Another notion of the RER, the ratio of the prices of tradables to the prices of untradables, is real but not an exchange rate. It is real since the price ratio is not a monetary quantity, but, as one of its main proponents, Edwards,[10] seems to admit, it is not a exchange rate. He dismisses as irrelevant the point made by some economists that 'real exchange rate' is a contradiction in terms because an exchange rate is a relation between different currencies and cannot, therefore, be real in the sense of being independent of money. In doing so he seems to agree that the term is a misnomer for that notion, though one that has stuck and he considers harmless since it links the nominal exchange rate to prices. However, Williamson, in his discussion of equilibrium exchange rates, believes there is no material difference between this notion of the RER and the other standard notions. The earlier discussion here showed the fallacies in the arguments for these links put forward by the notion's proponents.

One of the same fallacies, namely that demand can be assumed to be determined by prices, without taking income distribution into account, is common to models that reach determinate equilibrium exchange rates.[11] The assumption ensures that, however complicated the equations, domestic and world prices will be related and, therefore, that they will determine an exchange rate. But, if the prices of goods, including capital goods, and of labour are flexible and if world prices are given, the model reverts to the real optimisation or general equilibrium discussed earlier and there is no determinate exchange rate. The difference between this and the equilibrium exchange rate models is that here real incomes are determined by production and real demand by real prices and real incomes. Money prices, then, may move up or down without affecting real prices and, being indeterminate so is the exchange rate.

Williamson[12] quotes a passage by Joan Robinson[13] in which she points out that the equilibrium exchange rate is a 'chimera' since the exchange rate at any time is influenced by interest rates, wage rates and money supply. Attempts to estimate equilibrium exchange rates, especially for the long run, add behaviour equations for these and other quantities to the model. But they thereby become forecasts and as unreliable as any forecasts of exchange rates. Williamson[14] discusses the kinds of assumptions that need to be made, including the budget and trade balances compatible with equilibrium, and compares several models for estimating exchange rates

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[10] Edwards. P.5
[11] See for example Williamson in Introduction to Silliamson, Ed. Estimating Equilibrium Exchange Rates. Also Stern, and Razin and Collins.
[12] Introduction to Williamson Ed.
[13] Robinson 2.
[14] Introduction in Williamson Ed.

along these lines.[15] Their assumptions vary widely and the results correspondingly. His preference is for a model that has yielded so far the best forecasts of the exchange rate of the pound sterling. The question then arises as to what significance the equilibrium exchange rate may have if it is simply a forecast.

Perhaps the best comment on the search for real, shadow and equilibrium exchange rates is that made by Joan Robinson regarding another such exercise in international economics, that it is rather like looking in a dark room for a black cat that one is pretty certain is not there.[16]

IV. Effects of Devaluation on the Domestic Economies of Developing Countries

The effects of devaluation on exports and imports may not be determinate, but the effects on the domestic economy are. Firstly, devaluation shifts real income away from those with fixed nominal incomes. Usually the shift is from lower to higher income groups. Secondly, it alters the relations between financial stocks and flows when the correct or desired amount of the stock or the flow depend on the exchange rate. Thirdly, repeated devaluation creates incentives that hamper economic development.

Income Distribution

When the purpose of devaluation is to lower the prices of the country's domestically produced goods relative to the prices of the competing goods of other countries, it necessarily entails a fall in the real earnings income of some of those receiving fixed nominal incomes, but in practice more incomes fall than need be. Devaluation achieves its purpose by lowering the production costs of tradable goods in terms of foreign exchange. It is indiscriminate in the sense that it lowers all fixed incomes in the same way, whether they enter into the costs of production of tradables or not. Thus, as prices rise because of the devaluation, pensions, salaries of government employees, ranging from highly ranked administrators and judges to simple policemen and bus drivers, salaries of doctors and nurses employed in hospitals and so on all fall in real terms.

Devaluation could be made less indiscriminate by raising, in step with prices, fixed incomes that do not enter into the costs of production of tradables. But economists and the IMF object to this for two reasons. One is that they believe that devaluation must be accompanied by tightening of restraints on domestic expenditure, both to reduce domestic absorption and

[15] Estimating FEERs in Williamson Ed.
[16] Robinson 3.

to prevent, or at least slow, rises in prices and nominal incomes. Hence interest rates must be raised, budget deficits cut and fixed incomes kept from rising. The other is that they believe that markets should determine the structure of incomes, not the authorities.

The first reason is better applicable to developed than to developing countries. In the latter prices of tradables return to their former parties at the new exchange rate and, the more efficient the markets, the quicker the rise. Then the prices of untradables rise too. Hence efforts to prevent price rises only result in reductions in output and unemployment.

Nor does the shift in income distribution caused by devaluation necessarily imply less domestic absorption. It does so, assuming that investment does not rise, when the gainers save more out of the redistributed income than would have done the losers. That may happen, but it is hard to predict for a particular country and the experience of many countries shows that it is not even an approximate rule. A good rule for developing countries is that the improvement in the balance of trade is the result of a fall in investment. An improvement occurs if investment does not rise as much as or falls less than saving, and it always falls after a devaluation accompanied by tightening of expenditure restraints.

The difficulty of predicting the net effect of devaluation on saving is illustrated by salaries of government employees. In principle devaluation increases the government's revenue more than it increases its expenditure if nominal salaries pad out of the budget are not increased. Revenue from import duties and other indirect ***ad valorem*** taxes rises with prices in terms of the domestic currency and so does revenue from direct taxes because of the change in income distribution, provided the thresholds for the various income tax rates are not changed to allow for inflation. Since the bulk of budget expenditure is for salaries, the choice is between improving the budget balance and raising salaries.

Either choice could equally well increase or decrease saving and through that the balance of trade. A smaller budget deficit does not necessarily imply more saving; it is merely a change in the way some of the government's expenditure is financed, e.g. a shift from bonds or seignorage to taxes. Whatever effect that change has on saving must be compared with the effect of raising the salaries of government employees. The government's budget deficit or expenditure may need to be reduced for reasons other than reducing domestic absorption, but then the salaries of its employees are just one of several alternatives that need to be considered. The same type of reasoning applies to pensions and medical insurance, whose financing is similar to taxes.

The objection to raising fixed incomes in step with prices, that it is an interference in the market, assumes that free markets determine income structures optimally. Leaving aside theory, the practice in all developed countries is to interfere or allow interference; they all permit trades unions and nearly all have minimum wages. Moreover, devaluation is also an interference in the market, one that alters the relation between wages, profits and prices.

Financial Stocks and Flows

In a developing country three types of financial stocks are affected by devaluation: external debt, amortisation of capital equipment and savings.

External debt

Devaluation raises the cost, in terms of the domestic currency, of debt denominated in foreign currencies and, even if the volume of domestic sales does not fall, only a rise in prices can prevent the liquidity and profits of non-financial businesses from declining. Well established, profitable firms producing for the domestic market are likely to be able to accommodate the effects of a single, moderate devaluation because their foreign currency debts are likely to be small, and, if they have problems, these firms usually have access to cash reserves or bank loans to tide them through until prices rise. New firms, whose initial financing costs are higher relative to their capital and which may not yet generate much, if any, profit, are more likely to be bankrupted.

Financing obtained from banks in terms of the domestic currency can have the same effects as foreign currency loans if the banks themselves have foreign currency debts. As a simple example, a bank that takes a five year loan at five percent and lends it at ten percent, with repayment in both cases in five equal installments, must raise its lending interest rate to 11¼ per cent to cover the cost of its own borrowing if the devaluation raises the price of foreign currency by 25 per cent. If the bank wishes to recover its margin of five percent to cover its administrative costs, risk and profit, its lending rate is 16¼ per cent.

Since devaluation is accompanied normally by demand restraint intended to keep prices from rising, the effects of the immediate rise in the costs of external debt combined with the slower rise in domestic prices are compounded by a fall in domestic sales. (Further compounding the effects are the rise in the prices of imported inputs.) The greater the devaluation, the greater the compounded effect. If the devaluation is big, firms become unable to stay current on their loans, banks restrict credit because of the spreading of credit problems, and the demand restraint that was meant to restrain price rises turns the external financing into a source of widespread business failures, as has been evident in East Asia.

Amortisation

Since developing countries as a rule import practically all their plant and machinery from developed countries, the amortisation for replacing their existing equipment and the savings for buying new equipment must be adjusted to the exchange rate. But amortisation is rarely, if ever, adjusted in this way, so that the funds a prudently run firm would set aside for the replacement of old equipment become insufficient if devaluation occurs.

Usually equipment is amortised at historic cost in terms of the domestic currency. Then the shortfall for replacing it is equal to the devaluation. Amortising at replacement cost may be difficult or impossible, even if the firm is eager to do it. One reason is that the firm would need to foresee the devaluation several years in advance. In a country that has not devalued for a long time the expectation of devaluation may arise only weeks or months before the event, whereas the equipment may have been bought several years earlier. If a piece of equipment being amortised over five years is four years old and devaluation rises its replacement cost by 25 per cent in terms of the domestic currency, its amortisation in its last year would need to be 45 per cent of its value. If the firm has not placed this amount in its cash reserves, it will have to borrow from a bank or issue new shares.

A second reason that amortisation at replacement cost may be impossible is that the authorities regulate how amortisation may be calculated, both because it affects the taxes paid by the firm and because rules are needed to protect shareholders, creditors and the public. Hence, even if a firm wishes to amortise at replacement cost, it may be prevented by the rules and it will certainly be unable to persuade the authorities that its forecast of a future devaluation should be used for calculating that cost.

Savings

Since devaluation causes inflation, it reduces the real value of savings in the form of cash, bank deposits, fixed interest securities and acquired pension rights, the principal financial savings of lower and middle income groups. If its purpose is to lower the prices of the country's tradables in terms of foreign currencies, this reduction is an unintended redistribution of wealth.

To some extent, it can be compensated by adjusting the nominal value of the savings in step with prices. This is easier with pensions in a state run system, and such an adjustment would apply to workers producing tradables as to any others. Whether or not it will be financially sustainable in the future is a separate question that can only be answered by an independent assessment of the receipts and payments over the long run. But, judging by the diminution in the real values of pensions in most countries that devalue frequently, it seems that wage earners and middle income groups have merely been the losers in the redistribution of wealth caused by devaluation. Nevertheless, adjusting the nominal value of savings to compensate for higher prices may be impractical in most other cases since it would raise the liabilities of the institutions holding them without corresponding gains in their assets.

Alternatively, the real value of savings can be preserved by adjusting interest for inflation. In practice this happens rarely; the interest received by lower and middle income groups in countries that devalue often does not suffice to offset inflation. The economic difficulties that led to and followed from devaluation have their repercussions in the banking system, which protects itself, in effect, by reducing its liabilities to those who cannot negotiate their own terms for depositing with the banks.

Effects on economic incentives

A single, moderate devaluation that is not expected to be repeated in the foreseeable future is unlikely to alter economic behaviour. Firms and households adjust to the new exchange rate and continue as before. But repeated devaluation creates the expectation of more and the resulting differences in economic incentives harm economic development. The following lists a few of the more important differences and their effects.

Holders of wealth make windfall gains in terms of the domestic currency by converting their financial assets into foreign exchange, i.e. capital flight. Exchange controls can limit the outflow, though they may not stop it altogether. This does not mean that they are useless or undesirable; they prevent the sudden large outflows that afflict countries that do not have them and, properly managed, keep them small. Yet, over time, the loss of international reserves from capital flight is greater than the gains expected from devaluation. Estimates of flight capital in the US from Mexico and Brazil are around $100 billion and $150 billion respectively. The estimate for Russian flight capital in Europe is around $50 billion.

If, as with some countries of Latin America, the accumulate flight capital is large, the owners, most of whom have business interests in their home countries, have an incentive to press for devaluation of their home country currency since they are usually able to remove their funds at the right moment. Mexico's budget deficits in the early 1990s were financed in great part by Mexican flight capital at high interest rates, usually over 20 per cent, and short term. This was the capital that moved our first when the crisis began at the end of 1994.

Devaluation gives windfall profits to firms producing tradables, unless trade unions are strong enough to keep real wages from falling. Normally unions in developing countries are not that strong. Firms then have an incentive to press the authorities for more devaluation as a source of profit, rather than to improve efficiency and seek new products and markets. The result is inefficient industries and impoverishment of workers and middle classes.

Since amortisation does not normally suffice for replacement of equipment, firms resort to more bank loans. The greater the rate of devaluation, the more indebted they become.

Inflation becomes permanent and deters holding savings in the form of bank deposits and fixed interest securities, which usually offer yields below the inflation rate. Long run savings, notably pension plans, lose most of their expected value unless they are indexed to inflation, which does not happen in most developing countries.

If trades unions are strong, they have an incentive to press for repeated wage increases to keep pace with inflation. The authorities try to oppose this in the short run by making demand restraint more stringent. The results are higher unemployment and impoverishment of workers who do not belong to strong unions and the middle classes. Over the long run, the authorities try to break the power of the unions and thus enhance the effect of devaluation in making the distribution of income more uneven.

V. Summary and Conclusions

Summary

If countries produce the same or similar goods and markets are competitive the law of one price holds in each market. If a country's producers lower their prices, their competitors do the same. The standard argument, that devaluation enables a country's producers to reduce the prices of their products below the prices of their competitors and thus increase the volume of the counry's exports and decrease the volume of its imports, does not hold.

But devaluation has these trade effects if the lower prices force producers in other countries to reduce or cease production because they cannot cover costs. Then the devaluing country is able to use idle labour and production capacity, with the reverse effects elsewhere.

One way of escape from these conclusions, assuming that countries produce different goods, can be dismissed as incompatible with the facts.

A second way is to deny that markets are competitive. Studies show that the prices of the same goods vary from country to country. But the market of each country may still be competitive, while the mechanisms for equalising prices between countries only work for simple goods with little brand or product differentiation. In larger economies prices of imports of goods for which differentiation is important conform to domestic prices of competing goods. Developing countries, unless they are big, are price-takers.

If prices of the same or competing goods differ between countries but are the same within each country, a country that devalues may alter the difference between its domestic prices and prices in other countries, but not increase any difference between the prices of its goods and the prices of competing goods in its export markets.

A third way is to argue that devaluation causes the prices of tradables to rise relative to the prices of untradables and to result in a shift of demand from the former to the latter. This is supposed to increase the supply of exports and reduce the demand for imports. It is obviously mistaken since the improvement in the balance of trade requires that saving increase or investment fall and there is no reason why this shift in demand should have either effect.

One mistake is to suppose that prices of untradables necessarily fall. Since devaluation causes profits to rise, untradable goods that are relatively capital intensive will rise in price relative to tradable goods. Another mistake is to ignore income distribution; the relation between demand and prices depends on the distribution of income and devaluation shifts income from wages to profits.

Since the exchange rate is a purely monetary quantity, whereas orthodox economic theory holds that the pattern of trade is determined by the real characteristics of economies, some economists have argued that there is an exchange rate that also reflects the real characteristics of the economy and that the nominal exchange rate should be determined by it.

One proposal for such an exchange rte is the ratio of the country's prices to world prices or to the prices of other countries. But, since prices differ between countries in any case, it is not necessarily useful for determining the nominal rate. Moreover, it is never calculated by comparing prices directly, but by following the relative movements of price indices and, therefore, does not, in practice, show how prices actually compare.

The exchange rate defined as the dual variable of the balance of trade constraint in an optimisation model of the economy is not necessarily an exchange rate if the model is real. To make it an exchange rate the domestic currency must be brought in by some expedient, like expressing the optimand in terms of it, though this makes it depend on domestic prices, which are not necessarily optimal. Since the choice of optimand is arbitrary, the exchange rate is arbitrary too. Moreover, it does not necessarily apply to an economy that does not conform to its optimum.

The exchange rate defined as the ratio of the prices of tradables to the prices of untradables is not an exchange rate and, as shown earlier, its link to the nominal exchange rate is ambiguous.

Equilibrium exchange rates are calculated by assuming that demand is a function of prices, without taking account of income distribution. If, instead, demand is determined by incomes, as well as prices, and incomes are determined by production, the equations give a real model, and then the domestic currency must be brought in through more assumptions. Calculations of equilibrium exchange rates also assume relations governing the behaviour of economic quantities such as interest rates, money supply, wages, exports and demand. This makes them merely forecasting models whose results vary according to the assumptions.

Conclusions

Exchange rate changes have no *a priori* determinate effects on the volumes of exports or imports. The only mechanism by which devaluation can be expected to increase the volume of exports is reducing prices to the point where competitors have to reduce or stop production. Then the devaluing country increases its capacity utilisation and reduces its unemployment at the cost of the reverse effects elsewhere.

World prices exist only for goods for which brand and product differentiation are not important. Most manufactures do not have world prices.

Dumping can occur when exporters from developed countries follow their normal practice of pricing their products in the markets of other developed countries according to the price levels of those markets. If the currency of an exporting country appreciates, the country's domestic prices or production costs may rise above the market prices of the importing country.

Overvaluation and undervaluation are usually meaningless terms. No general criterion exists by which they can be judged. A currency may be said to be overvalued if it is obvious that it will be able to increase exports by devaluing and it is desirable to do so. It can be said to be undervalued if it is obvious that it can maintain its exports by revaluing and that it is desirable to do so. No general criterion exists for either.

Floating exchange rates cannot be stable unless expectations make them so. If changes in the exchange rate do not have predictable effects on the balance of trade, there is no 'correct' exchange rate to which the actual exchange rate should move. Unlike markets for goods, where costs of production set limits to prices, the exchange rate of a country may have no identifiable limits to its range of variation. If the market believes that a country's exchange rate is right or if the country has enough reserves to deter speculation, the exchange rate will be stable. Otherwise, it can fluctuate widely and is determined by herd behaviour.

Devaluation has predictable effects on the domestic economy. In all but the very biggest developing countries it is inflationary, because they are price-takers. It shifts income from recipients of fixed incomes, who are usually lower and middle income groups. It also reduces the real value of their wealth, including acquired pension rights. Firms borrow more from banks because their plant and machinery are imported from the developed countries, so that their amortisation of capital equipment according to the usual rules for historic cost and their savings for expansion become inadequate.

Repeated devaluation results in expectations that devaluation will occur again and that inflation will continue for a long time. The resulting incentives hamper economic development. Windfall profits are made from capital flight and, if trades unions are weak, from the rise in prices relative to wages. Firms pay less attention to efficiency and the search for new opportunities. The prospect of permanent inflation deters saving in the form of bank deposits and fixed interest securities.

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Comment:

The State and Civil Society in Pakistan

I. A. Rehman

The state of Pakistan appears to have embarked upon a process of transforming itself. It faces a host of grave socio-political and economic issues which manifestly do not yield to the traditional style of governance. It has also realised that its decayed and outdated administrative system cannot enable it to discharge its social sector obligations even on the limited scale the population has become used to. Thus, on the one hand, it is availing of the opportunities afforded by the rhetoric of globalisation and market economy, and withdrawing from whatever social responsibilities to the people it hitherto recognised - in the areas of education, health, employment, communications, public utilities, etc. On the other hand, it is trying to reinforce its coercive powers through increased reliance on majoritarianism, authoritarian approaches to issues generally reserved for democratic decision-making, and short-circuiting of judicial processes.

This developing phenomenon merits examination from several angles. One important aspect, with which we are concerned in the present essay, concerns the future relationship between the state and the civil society. It is already obvious that the state is gradually abandoning the urban modernists who uphold the universal norm of democracy, rule of law and fundamental rights, which were never totally repudiated in the past. At the same time efforts are being made to redefine the state's ideology once again and to mobilise conservative religious forces to enforce it even at the cost of law. The process is bound not only to drastically alter the democratic structure of the state, it will also reshape its relationship with the individual and with many elements of civil society.

The relationship between civil society and the state in Pakistan has always been a problematic issue. The concept of democracy, as derived from the theory of social contract, did not develop in Pakistan as a result of the changing equation between the rulers and subjects. Pakistan is a state brought into being under a compact its inhabitants had with their colonial rulers and who are supposed to have laid down a framework for state-people is not subject to their mandate. The present constitution does not represent the will of the people, it represents a political contraption devised by a single individual who enjoyed no sanction except that of brute force. That he accommodated in his scheme some features of a consensus document (the 1973 Constitution) does not materially affect the character of the basic law governing the state. This constitution has laid the foundation of confrontation between the state and the people. It leaves quite a few issues of individual's rights, at least of such sections of the population as women and minorities, ethnic communities' aspirations, and unit - federation relationship unanswered and liable to be misconstrued.

By and large Pakistan's civil society has operated within the confines determined by the state. However, the people have had to intervene directly on several occasions to correct its political course. They has given the state's founding fathers a mandate to establish a federation of autonomous units to be governed in accordance with the parliamentary system. They never got what they had asked for. The provincial entities in the western wing were obliterated in 1955. In 1958 the popular mandate was overruled by a martial law administrator who propounded his own theory of controlled democracy. His adventures in the state's transformation were suffered for over a decade and finally rejected. But the people did not get what they had fought for. Another praetorian regime took over. It conceded some of the popular demands but resisted some others with such obduracy that the resultant strife culminated in the state's dismemberment. A new beginning was made to manage the state in accordance with the wishes of the people but before long the state and the people found themselves in their adversarial roles and another military adventurer rose to establish his personal rule. The people rose against him, too. Instead of conceding what the people demanded he foisted on them a political *dhancha* (framework) of his own contrivance. Since his death a decade ago the people have elected their representatives four times. During this period some changes have indeed been made in Ziaul Haq's *siyasi dhancha,* but its essential features have survived and no attempt to erase them is in sight. And now we are witnessing the state's attempts to put only one element of the civil society - the militants mobilised under religious banners - in the driving seat without any regard to the interests and views of the rest of the civil society.

What do we mean by civil society? It is difficult to apply this term to a mass of people who occasionally set themselves a single-point task. They may come together to secure freedom from colonial rule, to replace dictatorship with representative government, or to overthrow an oppressive socio-economic order. But anti-colonial movements, struggles for restoration of democracy, or even revolutions are in the nature of short-term popular fronts. They may succeed or fail or they may partly achieve their objectives, their impact is transitional whereas civil society's role presupposes a degree of permanence and dynamism.

Unfortunately the expression "civil society" has been bandied around in Pakistan somewhat carelessly. We have tended to assume any order in which the military does not openly assume sovereign powers to be not only civilian but also civil, though it may be neither. Off and on, the slogan of civil society's supremacy over military establishment is raised. But you can have a non-military state that is in confrontation with the civil society, that does not acknowledge it.

It could be argued that elements of civil society did contribute to the upheavals referred to above. Politicians, workers, academics, lawyers, journalists contributed to the movement against the Ayub regime or that Mr. Bhutto derived his political slogans from the thesis the radicalised elements of civil society had offered. Gen. Zia too was forced to climb down from the pedestal of a divinely ordained patriarch by the jolts he received from civil society's groups. While all this may be true, it does not give us the picture of a civil society that can productively interact with the state or can mediate between it and the people.

In order to appreciate the essential features of a dynamic civil society we have to take a look at the theory of the democratic state. Such a state has its jurisdiction demarcated by the people. It has no authority to intervene in areas the people have not placed under its jurisdiction, areas in which the people deem themselves free to pursue their interests, individually or in groups. These areas can cover a wide range -- from basic individual rights, to social, cultural and economic rights of communities and groups. But states are by definition expansionist. They tend to over-step their jurisdiction and interfere in matters outside their domain. It is to prevent this, to oblige the state to operate within its legitimate confines, that civil society develops institutional safeguards. In an ideal democracy the state would not only acknowledge the institutions of civil society but also develop an arrangement whereby the state and civil society play complementary roles, thereby reducing the coercive attributes of the state and making governance subject to participatory principles. The problem of civil society's neglect does not arise acutely in mature democracies because there civil society has developed alongside the emergence of democratic institutions. Indeed, institutions of rule have developed under pressure from civil society.

No such arrangement is possible in a totalitarian state. In the models we have seen over the past five decades the functions of civil society have often been assumed by the state directly or indirectly. In our own history we have seen how authoritarian rulers have tried to usurp the functions of civil society. Let us examine the situation of some of the more prominent elements of civil society that could be expected to throw up countervailing forces -- landlords, farmers, business people, industrial workers, media-persons, lawyers, teachers, writers, professional groups such as doctors, engineers, architects, women's groups, youth, and NGOs. Our authoritarian rulers have sought to pursue what Gramsci identifies as hegemonic interests in two ways. First, by making laws that restrict these groups' functioning and, secondly, by imposing state nominees on their associations. The one group that has escaped their attention is that of landlords and that for the obvious reason of their hold over state power. The chambers of commerce and industry are at the sufferance of the Ministry of Commerce vide the law on trade bodies. When Ayub Khan deprived teachers of their rights as an important group in civil society by promulgating University Ordinances and degrading academics to the level of state employees, or when he created the National Press Trust or the Writers' Guild to tell the Press or the writers what their interests were, he was not far from following Mussolini's text on transforming civil society into an appendage of the state system.

Pakistani rulers' desire to control civil society's platforms is insatiable. When government changes the heads of Bar council, media organisations, cultural outfits, science and literary academics also change. But these changes do not alter the relationship between the state and these organisations. The latter continue as agents posted to force the civil society to conform to the interests and policies of the state.

Before we note the extent to which our state has robbed the civil society of the possibilities of developing an institutional framework for interaction, it may be necessary to point out the flaws in the political structure itself. The fact of the matter is that Authority has nearly always been reluctant to accept one of the cardinal principles of constitutionalism -- that of division of power. The executive has consistently declined to treat the legislature and the judiciary as co-equal organs of the state. The biggest casualty has been the legislature. It has become subservient to the executive, which may mean a small coterie or just an individual.

A democratic legislature is supposed to function as a bridge between the state and civil society. In countries that have written constitutions a legislature has to be conscious of the constitutional limits to its authority. If it adheres to the spirit of representative governance it cannot ignore its duty to respect public opinion. A responsible legislature therefore continually seeks guidance from the people or civil society institutions before making laws or framing policies which affect civil society as a whole or some parts of it. We had begun to recognise this imperative of representative rule in the colonial period when the legislature started developing safeguards against the executive's initiatives. What did the system of standing and select committees introduced in our part of the world much before independence mean? It meant the need to get an executive prescription examined by elements outside the government to determine whether it really conformed to the public good as claimed. And there could be occasions when it was found necessary to seek a bill's circulation to elicit the views of the public. Does it not strike as odd that the parliaments we have had for several decades have no time for debate and do not elicit public views on any measure? One would present the discontinuation of the system of referring legislative proposals to the public as legislature's surrender to the executive at the cost of its obligations to civil society.

The setbacks the people of Pakistan have had in their quest for a democratic dispensation, and especially the failure to break the authoritarian mould, have prevented the emergence of active institutions of civil society. At the horizontal level, the unresolved unit-federation confrontation has precluded the rise of civil society's forums on a national scale. Attempts to form national organisations of farmers, workers, teachers, students women, youth et al have more often than not failed and where some notional unity of provincial interests has occasionally been secured, their effectiveness is not visible. Besides, more decisive than the institutional underpinnings of authoritarianism is the culture it fosters. Civil society cannot interact with state institutions if the latter do not accept the principle of interaction itself.

The situation at present is that there are elements in Pakistan that are conscious of their right to interact with the state but there is no formal or informal mechanism for such interaction nor any mutually accepted ground rules. The state takes notice only when a section of civil society displays capacity to disrupt normal life. Today the state's topmost priority seems to be its desire to be on the right side of the religious lobby. The only other elements of civil society that it acknowledges are landlords and businessmen. The landlords do not have to confront the state in the open. They can have their way in legislatures and through their hold over the bureaucracy. Witness the exclusion of land reform from the national agenda and the imbroglio that has been made of the agricultural tax proposal. The businessmen are recognised by virtue of their ability to bring the shutters down. Witness the unending haggle over sales tax. When CBR inspectors raid a business house to catch tax evades, nothing happens to the culprits, the state functionaries are reprimanded. All other elements of civil society are treated with contempt. All the teachers of Pakistan cannot persuade the state to adopt a modern, rational curricula. The entire lawyer community may cry itself hoarse against bad laws, the state will not listen. Women organisations have been agitating against *Hudood* laws and the state stubbornly refuses to budge an inch. Take the latest events in Karachi. Had the state paid heed to civil society's initiatives for a settlement the present ugly turf war might have been avoided.

Statecraft based on the greatest good of the greatest number demands that the state must accept civil society's role in raising the people to a higher stage of moral and material satisfaction. This demands the creation of an environment in which all elements of civil society can be peacefully accommodated. It demands renunciation of force, even of laws bearing the stamp of arbitrariness, and a shift from majoritarian rule to participatory democracy. Unfortunately, the state of Pakistan now seems to be moving in the opposite direction.

The consequences of this drift are not difficult to imagine. Exclusive reliance on denominational elements of society can be extremely dangerous in a situation where these elements deny the very right to existence to nearly all other components of the civil society - the provincial entities, the ethnic communities, the modern academics, the scientists, woman activists, human right defenders, et al. This will not only complete the process of civil society's exclusion from public affairs, it could breed further strife among its different elements.

Book Review:

Biplab Dasgupta. *Structural Adjustment Global Trade and the New Political Economy of Development.* New Delhi. Sage Publications. 1998. Price Indian Rupees 450 (hardback).

The author has written a very topical book the relevance of which cannot be understated. At the core of the book the author discusses the concept of the new political economy of development which forms the theoretical underpinnings that lie behind the structural adjustment/ stabilisation programmes of the international financial institutions such as the World Bank and the International Monetary Fund.

Biplab Dasgupta has very concisely and succinctly analysed the new political economy of development which has, as its centre-piece, a blind faith in the operation of free-market forces. This can be traced back to the Reagan and Thatcher years, which saw a shift away from interventionist policies to allowing the markets to decide.

The implicit assumption behind letting the market decide was that of Pareto-optimality which, in theory, is very intellectually appealing, but, in actual practice, extremely difficult to apply. However, for Pareto-optimality to be achieved a number of very strict conditions have to be met for both commodities as well as factors of production, in the domestic economy as well as when that economy engages in international trade. Once all the conditions have been satisfied the economy is perceived to be operating at maximum efficiency. And it is the conventional wisdom that such efficiency can only be gained by letting the markets operate freely and without hindrance, whether these markets are commodity oriented, labour-oriented or markets for financial capital. The unfettered operation of such markets it is felt, is beneficial for the economy as resources would be allocated efficiently and growth rates enhanced and sustained.

In addition to a free market philosophy a long list of other conditionalities are appended/incorporated in the new political economy of development. These include privatisation of public sector corporations, freely floating exchange rates, low tariff barriers and a periodic raise in fuel charges; e.g. electricity, gas, oil prices etc., to highlight some of the common conditionalities. T put it rather simplistically, these packages usually involve raising tax rates (direct and indirect) on the one hand, and reducing government expenditure on the other. What happens in practice then is that such policies lead to a further decline in the purchasing power of the consumers which, in turn, has a depressing effect on the domestic economy, largely aggravating the macroeconomic indicators. Also, the most likely of government expenditures that are easily axed are those spent for education and health, particularly in developing countries. All in all the new political economy of development is extremely retrogressive and functional only within extremely limited economic parameters.

Some of the specific issues that are discussed in detail by Biplab Dasgupta are those of conditionalities, which form the core of any structural adjustment programme the working of the GATT and the WTO, restrictive trade practices, for example, voluntary export restraints, the Multi-fibre agreement and super 301; the way multinational companies operate and their impact on third world countries and, finally, the emerging relationship between structural adjustment and environmental issues. Case studies of countries in East and South East Asia, Sub-Saharan Africa and Latin America are given. Finally the author presents India as a case study of structural adjustment.

The book, therefore is reasonably global in its coverage of the new political economy of development with its centre-piece of structural adjustment. The irony is that these policies were introduced some twenty years ago as a short-term corrective for the external and internal imbalances of the developing countries. To date their impact has been adverse in the main, particularly on the less advantaged strata of society. On the whole what is needed is an alternative development paradigm that does not rely on economists sitting in The world Bank or the International Monetary Fund for implementation. However, for such a paradigm to develop would require a shift in economic and political power to the less developed countries as in the world of today whoever controls the purse strings also controls the mind and, thus, independent intellectual development. Therefore, as long as the World Bank/IMF have the economic power of the western developed world behind them, they will be controlling the global economy both physically as well as intellectually. Biplab Dasgupta has done well in writing a book on the new political economy of development. His presentation is concise and convincing with a useful select bibliography. To conclude, all economic ills are not necessarily cured by blindly following free-market economies.

PIDE, Islamabad **Mir Annice Mahmood**

Book Review:

International Conference on Islamic Laws and Women in the Modern World, GIANT Forum, 1996, Pp 607.

The particular volume is a compilation of the material presented at the three day international conference on “Islamic Laws and Women in the Modern World”, held in Islamabad in December 1996, and organised by the Global Issues Awareness for National Thrust Forum in collaboration with the Women’s Development Fund CIDA Islamabad. It contains the panel discussions held between members of the nine participating countries, a series of country reports, and several background papers on specific topics.

The underlying theme is how Islamic Laws, both from a historical and more importantly, contemporary perspective, have dealt with the problems of Muslim women, to the extent that the interpretation of such laws has at least in part, engendered these very problems. The introductory background paper provides a useful historical and theoretical background to the concept of Islamic Law, the diversity of approaches ranging from the philosophical and theological to the rational, and traces the development of Islam as a legal system.

The six themes under discussion all have particular relevance to women: age at marriage, polygamy, divorce, evidence, inheritance and *hudud*. The question of marriage prior to attaining the age of majority is discussed only to some extent as a human rights issue, there seems to have been far more deliberation on the omni present issues of morality and female chastity. With regard to the issue of divorce, the two main points discussed deal with the impact of divorce on women without recourse to financial means, and custody of children.

The debate on evidence concludes with the view that the interpretation of Islamic injunctions with regard to the evidence of two women being equal to that of one man, is indeed discriminatory and that given the change in times and the position of women, modifications are necessary. From a theological point of view, it is worth noting the point made, that of the nine verses of the Quran that deal with the question of evidence, eight treat both genders equally.

In dealing with the issue of inheritance, most of the concerns voiced have been by women delegates, and there is seen to be a great deal of diversity in the way local customary laws in each country have tended to co exist alongside the relevant Islamic Laws, often to the disadvantage of women. Finally, there is the contentious issue of *hudud*. The crucial points agreed upon include a criticism of the way in which *hudud* laws are applied in Pakistan, particularly when treated under Criminal law, and unjust police intervention in cases of *Zina*. One conclusion reached is that the suspension of *hudud* laws is justified where there is more harm caused to society by this imposition than good.

The nine participating countries at the Conference were Bangladesh, Egypt, India, Pakistan, Iran, Malaysia, Turkey and Tunisia. A detailed country report for each provides an analysis of the experiences of Muslim countries in interpreting and imposing Islamic law, which is useful because it allows room for comparison. Moreover, in comparing the different approaches ranging from the more orthodox in Iran to the vastly secular in Turkey, what emerges is the inherent diversity of these approaches. There is no one way of establishing right or wrong, and this is as true now as it has been historically, with reference to the many schools of thought within Islam itself.

Although not particularly well written, the book is useful in a number of ways: the inter panel discussion format allowing participants the liberty to brainstorm a little, is fairly involving. Both the various discussions and background papers tend to rely heavily on a considerable vocabulary of analogical and legal terms in the Islamic sense - this is important in expanding the limited range of interpretive approaches that the layperson may be aware of, where for example, it should be preferable to resort to *maslaha* (the principle of public interest) as opposed to *qiyas* (deductive reasoning based on a precedent) when it comes to Muslim women and contemporary problems, when no solid precedent even exists. However, it is the overall thrust of the book with its emphasis on the drastic need for modification and change in laws that have discriminated against women, that is encouraging.

Lahore School of Economics, **Maheen Pracha**
Lahore.

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